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2018
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SCHOOL OF ACCOUNTANCY

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

A research report submitted to the Faculty of Commerce, Law and Management in partial fulfilment of the requirements for the degree of Master of Commerce in the field of Taxation

A comparison of the respective advantages and disadvantages of companies and trusts as vehicles for estate planning

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Degree:	Master of Commerce (Specialising in Taxation)
Date:	18 March 2018

Abstract

Estate planning is often thought of to be for the purposes of minimising estate duty only. This is but one of the intentions of estate planning. Being able to provide capital and income for beneficiaries before and after death is usually the main objective of creating an estate plan. It therefore follows that liquidity after death is an imperative part of the estate plan.

In this research, the formation of a trust or company as an estate planning tool will be discussed. The advantages and disadvantages of both will be explored. There will also be a discussion around methods which can be used to transfer assets into either a trust or a company. The income tax, capital gains tax, donations tax and estate duty considerations will be considered.

Over the years, the fiscus has been closing more and more loopholes for tax planning. It has therefore become imperative to determine whether the above-mentioned tools, being a trust and a company, for estate planning are still relevant in current economic times.

This research therefore seeks to provide a comparative study between using a trust, a company or a combination of both a trust and a company for estate planning purposes.

Keywords:

Trust, company, estate planning, donations tax, income tax, estate duty, capital gains tax, wealth tax, South Africa

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Chapter 1: Introduction

1.1 Context of the research

Stiglingh, Koekemoer, van Zyl, Wilcocks & de Swart (2016:1027) explain that estate planning involves:

> Arranging the financial affairs of an individual i.e. the 'planner' so that he and his heirs can enjoy the maximum benefit of his assets during his lifetime and the heirs can derive the maximum benefit after his death.

Meyerowitz (cited in Davis & Urquhart 1986:1-1) describes estate planning as:

> The arrangement, management and securement and disposition of a person's estate so that he, his family and other beneficiaries may enjoy and continue to enjoy the maximum from his estate and his assets during his lifetime and after his death, no matter when death may occur.

According to Davis and Urquhart (1986:1-1) this definition is comprehensive and four points deserve special mention.

Firstly, the definition implies that it is imperative that the planning occurs timeously and should be well organised.

Secondly, the definition does not make mention of the saving of estate duty. Estate planning is not mainly concerned with minimizing estate duty (as commonly thought of), it is a far wider concept. The estate planning process must therefore always take cognisance of the fact that estate duty, and the basis upon which it is levied, are but one part of the changing environment against which estate planning is performed.

Thirdly, the definition makes the point that the person concerned should still be able to enjoy the maximum from his estate and assets during his lifetime.

Lastly, the definition emphasises that the timing of the death should be immaterial to the successful working of an estate plan.

Some of the objectives of estate planning include amongst others flexibility, the minimisation of estate duty, the provision of liquidity, capital protection from creditors and the provision of capital and income for dependants.

Building flexibility into an estate plan makes provision for changes in the legal environment and changes in the personal and family circumstances of the estate planner (hereafter referred to as the "planner"). There have been serious problems in practice as a result of unduly rigid estate plans which have caused unnecessary hardship and misery for dependants of the

planner. Very rigidly structured trusts are an example of this problem. Problems of this nature cannot be allowed to occur in a properly structured plan.

One of the main reasons for creating an estate plan is to minimise estate duty. Prior to 1 March 2018, the estate duty payable in South Africa was at a rate of 20% of the net asset value of the deceased estate that exceeds the threshold of R3 500 000 (s 4A(1) of the Estate Duty Act 45 of 1955 (Estate Duty Act)). In the Budget Speech presented by the Minister of Finance, Malusi Gigaba on 21 February 2018, he stated that the estate duty rate would increase to 25% on dutiable amounts of estates above R30 million effective 1 March 2018.

The planner can minimise his estate duty by arranging his affairs in such a way that he ensures that the future growth of his assets does not accrue to him. A common way of doing this is by ensuring that assets which have a potential to yield income or capital appreciation are held in a trust or in a company.

This research seeks to determine the advantages and disadvantages of the formation of trusts and companies as vehicles for estate planning.

Stiglingh et al (2016:1029) indicates that:

> An important objective of an estate plan is to avoid liquidity problems on the death of the deceased. As part of estate planning, the planner should estimate the potential CGT liability and estate duty based on the projected value of the assets and liabilities of his estate. If there is a shortfall between the cash available in the estate to cover the above-mentioned taxes and other liabilities of the planner, he could consider purchasing a life insurance plan. The life insurance plan would settle the outstanding liabilities.

Davis and Urquhart (1986:5-5) suggest that 'The need for liquidity following death is often linked to the need to provide both capital and income for dependants both immediately after death and into the future'. The most widespread technique which is applied by people to minimise their estate duty is to donate their assets to an inter vivos trust, in particular those assets which are likely to increase in their value during their lifetime (Davis, Beneke & Jooste, 2015).

Van Dyk & Calitz (2016:1376) make reference to the 2013 Budget Speech in which the Minister of Finance spoke about the way in which people misuse trusts in order to reduce their liability for taxes and announced government's intention to bring in legislative involvement to control the mistreatment of trusts for the avoidance of tax and estate duty. The Davis Tax Committee (DTC) (2015:7) has made numerous recommendations on how the present tax legislation in relation to trusts should be amended and stated that 'Taxpayers must be allowed to make use of trusts when it makes sense to do so in the pursuit of a commercial benefit, as opposed to an estate duty benefit'.

An inter vivos trust is commonly used to reduce the estate duty liability of the founder upon death. A donation is normally involved in the creation of an inter vivos trust. (Stiglingh et al. 2016:843)

Caroll (2016:24) maintains that:

> The trust, and in particular the discretionary inter vivos trust, has in many ways become the hallmark of most modern estate plans. This should not be taken to mean that trusts are indispensable in estate planning, or that every estate plan should be built on this foundation. However, in the case of any large estate the possible use of a trust should always be considered.

Individuals who use trusts to reduce their estate duty liability are under the spotlight from government and the DTC has proposed legislative involvement to diminish the use of trusts for the reduction or for the avoidance of estate duty. One of these recommendations is to have section 25B of the Income Tax Act 58 of 1962 (the ITA) repealed thereby resulting in the trust being taxed even when the income vests in a beneficiary. (Van Dyk & Calitz 2016:1379)

It is vital to note that with the introduction of section 7C of the ITA which became effective on 1 March 2017, interest-free loans advanced to a trust will have donations tax consequences which will have an impact on its suitability as a vehicle for an estate plan. Olivier, Strydom and van der Berg (2017) state that no mention is made of any loans which are made from an existing trust to another trust and, accordingly, such loans would seem to fall outside the scope of these provisions.

Notwithstanding the above, the planner could set up a company and issue ordinary shares to the beneficiaries and preference shares to himself. The growth assets of the planner would be transferred into the company at market value. The purchase consideration would be left outstanding on an interest-free loan account which is repayable on demand. (Davis, Beneke & Jooste 2017)

Alternatively, a planner could transfer his assets to a company which is held by a family trust.

In this research, the use of companies for estate planning will be discussed in detail in Chapter 4 and it will be determined if the above arrangement could result in any donations tax (as occurs in a trust), particularly in the hands of the planner.

1.2 Objectives of the research

1.2.1 Research statement

The purpose of the research is to compare the advantages and disadvantages of using a trust, a company or a combination of both a trust and a company as a vehicle for estate planning.

1.2.2 Sub-problems

The following sub-problems will assist in answering the main research problem detailed above.

1. What are the objectives of estate planning?
2. How should a trust be structured to obtain the maximum benefit for an estate plan and what are the disadvantages that could be encountered?
3. How should a company be structured to obtain the maximum benefit for an estate plan and what are the disadvantages that could be encountered?
4. How do estate duty, income tax, donations tax and capital gains tax feature in the abovementioned options?

1.3 Significance of the study

Although not every South African will be liable for estate duty, estate planning does not only seek to minimise estate duty. A significant part of estate planning is that of providing capital and income for dependants. This is an element that any ordinary person will consider in their life time. It is necessary to assess whether the common estate planning tools that have always been used still provide maximum benefits for planners and beneficiaries in light of the ever-changing tax legislation. What may have been an advantage in previous years may no longer be applicable in current times.

This research therefore seeks to interrogate and compare the use of trusts, companies or a combination of both a trust and company as vehicles for estate planning to determine which of these vehicles are more favourable in current times.

1.4 Research method

This research has been performed using a qualitative approach. It relies extensively on a literature review of available literature on the subject. The study relies on primary and secondary sources of information. The primary source references were obtained from South African legislation. The secondary source references were obtained from books, articles, journals, reports and government publications. The use of different internet sites will be included in the literature review.

1.5 Scope and limitations

The research will consider the inter vivos trust as a vehicle for estate planning. The testamentary trust and bewind trust will be mentioned for definition purposes; however there will be no detailed discussion on these types of trusts as a vehicle for estate planning. The special trust will also not be considered for purposes of this research. A private company will be considered for the research. There will be no discussion on personal service providers or small, medium or micro-sized enterprise.

1.6 Chapter outline

Chapter 1: Introduction

This chapter is an introductory chapter which defines estate planning and its objectives. It looks at the significance of the research, the research problem and sub-problems, the research methodology used and the scope and limitations of this research.

Chapter 2: The Estate Duty Act

This chapter deals with the significant provisions in the Estate Duty Act, as a foundation for an estate planning exercise. It looks at what constitutes an estate and the definition of property for estate duty purposes. This chapter ultimately determines how estate duty is levied and calculated.

Chapter 3: Trusts as a vehicle for estate planning

This chapter looks specifically at the creation of an inter vivos trust as a vehicle for estate planning. It looks at the different methods of a trust acquiring assets. The transfer of assets to a trust may bring into play donations tax and capital gains tax which are discussed in chapter 5. The advantages and disadvantages of using a trust for estate planning purposes are explored.

Chapter 4: Companies as a vehicle for estate planning

This chapter looks specifically at the creation of a company as a vehicle for estate planning. It will discuss the advantages and disadvantages in light of South African legislation.

Chapter 5: Donations tax, capital gains tax (CGT) and anti-avoidance measures

This chapter looks at donations tax and CGT in the context of estate planning. It also looks at the anti-avoidance rules which are contained in the ITA and the knock-on effect on the vehicles for estate planning.

Chapter 6: Conclusion

This chapter will summarise the findings of the research by drawing on the parallels and contrasts noted between the two vehicles for estate planning. This chapter will provide concluding remarks and possible recommendations that have arisen as a result of conducting the research.

Chapter 2: The Estate Duty Act

2.1 Introduction

Stiglingh et al (2016:1002) states that:

> When a person dies, his net estate (after the payment of outstanding liabilities) is distributed to the beneficiaries. The distribution is normally made in terms of the deceased will; however, if there is no will, the net estate is distributed according to the laws of intestate succession.

This chapter will involve a detailed analysis of estate duty as provided for in the Estate Duty Act. It will look at the provisions of the Estate Duty Act, in particular how estate duty is calculated. South Africa's Estate Duty Act replaced the Death Duties Act of 1922 and came into effect on 1 April 1955. (Van Dyk & Calitz 2016:1375)

Roeleveld (cited in Van Dyk & Calitz 2016:1375) states that 'South Africa is one of only a few countries that levies both estate duty and CGT upon the death of a person.' She is of the view that one of these taxes should be formally put to an end. The DTC (2015) contends that 'CGT is a tax on capital income' whilst 'estate duty and donations tax are wealth taxes'.

Paragraph 2(1) of the Estate Duty Act states that persons who die after 1 April 1955 will be liable for estate duty.

Stiglingh et al (2016:1002) maintain that estate duty is a tax on the 'transfer of wealth from the deceased estate to the beneficiaries'. It is usually the estate that is liable for the estate duty; however in some cases, the beneficiaries may be liable for estate duty on the property that they receive.

There may sometimes be confusion as to what will actually constitute an estate for estate duty purposes after a person's death. The common questions are how and on what amount will estate duty be calculated and how quickly after the death must this tax be settled.

Section 3(1) of the Estate Duty Act describes an estate of a person as:

> For the purposes of this Act the estate of any person shall consist of all property of that person as at the date of his death and of all property which in accordance with this Act is deemed to be property of that person at that date.

Ostler (2012:32) describes the basic steps to follow when calculating a deceased person's estate duty liability (in terms of the Estate Duty Act). She mentions that firstly one has to determine the residency of the deceased. For purposes of this research, there will be no discussion on residency as the assumption is that the planner/ the deceased is ordinarily resident in South Africa. Secondly, a calculation of the total value of all property belonging to the deceased including deemed property at the time of death should be determined, thirdly the allowable deductions must be utilised, fourthly the primary abatement must be deducted,

fifthly the estate duty payable is calculated by applying the estate duty rate and lastly any relevant rebates and tax credits should be deducted from the amount of the duty.

Estate duty is only applicable if the net value of a person's estate exceeds R3.5 million because an abatement of R3.5 million may be deducted from the net value of the estate to determine the dutiable amount. The dutiable amount is defined below. From 1 March 2018 estate duty is calculated at a rate of 20 percent of the dutiable amount if the net value of the estate does not exceed R30 million. If the net value of the estate exceeds R30 million, estate duty is payable at a rate of 25 percent of the dutiable amount.

Stiglingh et al (2016:1003) state that the dutiable amount is calculated in the following manner:

1 The gross value of the estate should be determined. The gross value of the estate includes both property as defined in section 3(2) of the Estate Duty Act that was owned by the deceased at the date of his death and property deemed to be property as defined in section 3(3) of the Estate Duty Act.
2 The net value of the estate is calculated by deducting the amounts allowed as deductions from the gross value of the estate.
3 The dutiable amount is calculated by deducting the abatement of R3.5 million from the net value.

The estate duty rate of 20% or 25% is then applied to the dutiable amount in order to calculate the amount of estate duty payable.

2.2 Residency

Estate duty is applicable to people who are ordinarily resident in South Africa at the time of their death or to people who own assets in South Africa even when they are not ordinarily resident in South Africa at the time of their death. People who are ordinarily resident are liable for estate duty on their world-wide assets. (Haupt 2018:864)

2.3 Property

The estate of the deceased is defined as consisting of property. Property is defined in section 3(2) of the Estate Duty At as 'any right in or to property, movable or immovable, corporeal or incorporeal.

This definition is wide and includes fixed property, shares, options (that do not lapse on death) to acquire shares, fixed deposits and other cash investments, goodwill, copyrights and patents. (Stiglingh et al 2016:1004)

Stiglingh et al (2016:1006) explains that the income which is received by the deceased prior to their death will be included as property in his or her estate. This includes for an example, interest income from a savings account up to the date of death. This means that interest income earned after the date of death will not form part of property in the estate.

The definition of property in section 3(2) respectively includes:

> (a) any fiduciary, usufructuary or other like interest in property (including a right to an annuity charged upon property) held by the deceased immediately prior to his death and
> (b) any right to an annuity (other than a right to an annuity charged upon any property) enjoyed by the deceased immediately prior to his death which accrued to some other person on the death of the deceased.

Ostler (2012:35) states that the fiduciary interest mentioned in paragraph (a) of section 3(2) of the Estate Duty Act refers to an interest by which property is vested in a person, known as the fiduciary, subject to the condition that on the fiduciary's death the property will vest in another person, known as the fideicommissary. A fiduciary cannot dispose of the property but is generally entitled to the fruits thereof, for example, in the form of rental income. Should the fideicommissary predecease the fiduciary then the property will vest unconditionally in the fiduciary and he or she may dispose of it.

She further explains that the usufuctuary interest mentioned in paragraph (a) of section 3(2) of the Estate Duty Act refers to the situation where the property is bequeathed or transferred to a person, known as the bare dominium holder, subject to a usufruct or right of use in favour of another person, known as the usufructuary. The usufructuary may use the property and fruits thereof but may not dispose of it. While fideicommissa and usufructs are similar, the main difference between them is that the fiduciary becomes the owner of the property subject to the fideicommissum while the usufructuary never becomes the owner.

Davis & Urquhart (1986:3-6) explain that the obvious comment regarding these inclusions is that the limited interest (fiduciary, usufructuary and like interests) concerned must be 'held by the deceased immediately prior to his death'. Therefore, if the deceased had no vested right to the interest, such as in a discretionary trust situation where the trustees may but are not obliged to pay out income, it cannot be said that the deceased held any limited interest at the date of death. This will apply even where the trustee has in fact consistently and continuously paid out income to the deceased during his or her lifetime.

Davis and Urqhuart (1986:3-6) further explain that the phrase 'other like interest in property' includes lesser limited interests such as *usus, habitatio* and grazing rights. Of more significance, this phrase will include a right to income under a trust ceasing upon death. Therefore, this phrase includes not only real rights but personal rights. From an estate planning perspective this provides a powerful incentive to avoid vested rights to income of this sort.

The definition of property in the Estate Duty Act in section 3(2)(*bA*) also includes:

> So much of the amount of any contribution made by the deceased in consequence of membership or past membership of any pension fund, provident fund, or retirement annuity

> fund as was not allowed as a deduction in terms of section 11(k), section 11(n) or section 11F of the Income Tax Act, 1962 (Act No.58 of 1962), or paragraph 2 of the second Schedule to that Act or, as was not exempt in terms of section 10C of that Act in determining the taxable income as defined in section 1 of that Act, of the deceased.

This provision applies to a person who dies on or after 1 March 2016 and in respect of contributions made on or after 1 March 2015.

The gross value of the estate includes deemed property which is discussed below.

2.4 Deemed property

Deemed property is defined in section 3(3) of the Estate Duty Act. Haupt (2018:868) describes deemed property as 'property which did not exist as real property at the time of death of the deceased or which did not belong to the deceased'. He further explains that deemed property consists of the following as envisaged in the Estate Duty Act:

s3(3)(*a*): Domestic insurance policies on the deceased's life;

s3(3)(*b*): Property that has been previously donated by the deceased which was exempt from donations tax under section 56(1)(*c*) or (*d*) of the ITA at the time that the donation occured;

s3(3)(*cA*): An accrual claim against the surviving spouse in terms of section 3 of the Matrimonial Property Act 88 of 1984;

s3(3)(*d*): Property that the deceased could have been able to dispose of for his own benefit or for the benefit of his estate prior to his death.

The proceeds of domestic policies on the life of the deceased referred to in section 3(3)(*a*) of the Estate Duty Act are included in his or her estate as deemed property. These proceeds include both lump sums and annuities. There are certain exclusions which are found under the same section.

Under section 3(3)(*b*) of the Estate Duty Act above, it must be noted that section 56(1)(*c*) of the ITA exempts a *donatio mortis causa* while in contrast, section 56(1)(*d*) of the ITA exempts a donation where the benefit passes to the donee after the death of the donor.

It can be submitted that the above section seeks to tax on death these donations which otherwise are exempt during the lifetime of the donor.

The retirement fund reform became effective on 1 March 2016 and was introduced as a means to encourage taxpayers to save more for retirement. It is interesting to note that whilst taxpayers can get up to an annual R350 000 deduction on contributions to retirement funds,

under section 3(2)(*bA*) of the Estate Duty Act above, contributions not deducted are included as deemed property in the estate of the deceased.

The accrual claims referred to in section 3(3)(*cA*) of the Estate Duty Act refer to those claims where the deceased spouse's estate was smaller than the survivor's at the date of death. The survivor therefore must pay 'an amount equal to half of the difference between the accrual of the respective estates of the spouses to the deceased estate, which amount is included as deemed property in the estate of the deceased' (Haupt 2018:870).

In terms of section 3(1) of the Matrimonial Property Act where parties are married out of community of property subject to the accrual system the party whose estate has shown the smaller accrual claim has a claim against the other party upon the dissolution of the marriage. Death of one of the parties results in dissolution and therefore the claim arises. (Ostler 2012:37)

Haupt (2018:871) explain that section 3(3)(*d*) of the Estate Duty Act above excludes property which has already been included under the other subsections of the Estate Duty Act. The Act further breaks down the meaning of section 3(3)(*d*) of the Estate Duty Act under section 3(5) of the Estate Duty Act and defines property to include profits which are made from the property and that a person would have been competent to dispose of the property if the following criteria are met:

(i) if he had such power as would have enabled him, if he were *sui juris,* to appropriate or dispose of such property as he saw fit whether exercisable by will, power of appointment or in any other manner; (Section 3(5)(*b*)(i) of the Estate Duty Act)

(ii) if under any deed of donation, settlement, trust or other disposition made by him he retained the power to revoke or vary the provisions thereof relating to such property. (Section 3(5)(*b*)(ii) of the Estate Duty Act)

The expression 'property of which the deceased was immediately prior to his death competent to dispose' does not include property under a marriage in community of property.

Abrie, Graham, Schoeman & Spuy (1993:325) suggest that section 3(3)(*d*) of the Estate Duty Act was included in the Act to ensure that transactions which would have otherwise escaped the net of estate duty are caught. They further suggests that due to the wide definition of the section, it was necessary to make a qualification which prevents it from giving rise to double taxation. Section 3(3)(*d*) of the Estate Duty Act only applies to property which is not dutiable in terms of the Estate Duty Act as has already been alluded to by Haupt above. Meyerowitz (cited in Abrie et al 1993:325) suggests that there can be no property which would not have been included in an estate under one of the other sections of the Act. This is confirmed by an example that Meyerowitz (cited in Ostler 2012) gives where he explains that if the deceased

had no proprietary right in the property at the time of his death but subsequent to his or her death it became his or her property, it will not be included. For an example, rental paid after the date of death in respect of property owned by the deceased.

2.5 Deductions

When all property and deemed property has been valued in the estate, the allowable deductions are taken into account in order to arrive at the net value of the estate. These deductions are found in section 4 of the Estate Duty Act. They are discussed below.

Funeral, tombstone and death-bed expenses: Such expenses include payments to medical practitioners, nursing homes and pharmacies as well as the cost of burial or cremation. It includes the cost of a tombstone and hearse as well as other funeral costs. Section 4(a) of the Estate Duty Act states that as much of these expenses as the Commissioner considers fair and reasonable is allowed as a deduction. (Abrie et al 1993)

Debts due within South Africa: These debts must be due to persons who are ordinarily resident in South Africa. The ITA specifies that this does not include 'any debt which constitutes a claim by such a person to property donated by the deceased in terms of a donation which was exempt from donations tax under section 56(1)(*c*) or (*d*) of the Income tax Act, 1962 (Act No.58 of 1962)'. The tax liability of the deceased for the period up to the date of death also falls within the ambit of this provision. (Ostler 2012:39)

Costs of administration and liquidation: These are the general costs of the winding up of the estate. An example of such administration charges would be the Master's fees. (Abrie et al 1993)

Expenditure necessary to comply with the Act: These are expenses incurred during the administration of an estate which are necessary in order to comply with the requirements of the Master and/ or the Commissioner. An example would be legal costs incurred by the Executor in settling a dispute with SARS. (Abrie et al 1993)

Certain foreign assets held by the deceased: The property must be situated outside the Republic as at the date of death and:

(i) Must have been acquired by the deceased before he or she became ordinarily resident in the Republic for the first time; or

(ii) If he or she acquired it after he or she became ordinarily resident in the Republic for the first time,
(aa) he or she must have acquired it by donation from a non-resident (not a company), or

(bb) he or she must have inherited it from a non-resident; or

(iii) He or she must have acquired it out of the proceeds from the disposal of the property mentioned above or out of any income from such property. (section 4(e) of the Estate Duty Act).

Foreign debt: This includes debts due by the deceased to persons who are not resident in South Africa and deductible if the value of the estate's non-dutiable foreign assets are insufficient to settle such debts. Haupt (2018) explain that such debts of the deceased must first be paid from foreign assets which are not property and then only the excess is deducted under this paragraph. (Haupt 2018)

Usufruct, fiduciary interest or an annuity charged upon property:

(i) Fiduciary or usufructuary interests: If the deceased held such interest by virtue of a donation made to him or her, and, on his or her death, the rights reverts to the original donor, then the value of the limited interest (usufruct, fideicommissum or annuity) is deducted from the value of the estate.

(ii) Annuity charged against property: Where the deceased held such an interest by virtue of a donation and the right reverts to the donor the amount is allowed as a deduction. Haupt (2018:872)

Charitable and other bequests: A deduction is allowed in respect of property which is included in the estate and accrues to certain institutions which carry on activities which are primarily concerned with the furtherance of education, charity and religion. (Abrie et al 1993). This includes amounts accruing to any Public Benefit Organisation (PBO) which is exempt from tax in terms of section 10(1)(*cN*) of the ITA or institutions which are exempt from tax in terms of section 10(1)(*cA*)(i) of the ITA and the State or any Municipality (Ostler 2012:41).

Improvements made to property by the beneficiary: This includes the increase in the value of property included in the estate due to any improvement made to the property by the person who will inherit the property during the lifetime of the deceased i.e. while the deceased was still alive whether he or she had consented or not. (Haupt 2018)

Improvements made to property subject to a right of use: Where the deceased's estate includes a fiduciary interest, usufruct or other similar right and the value of such right was enhanced due to improvements made to the property by the limited rights user, the amount by which the value of the right has been increased is deductible. This provision is similar to the one above but it must be highlighted that it is not the cost of improvements which are deductible but rather the increase in the value of the right. (Haupt 2018)

Claim by surviving spouse in respect of an accrual under the Matrimonial Property Act: This refers to claims in terms of section 3 of the Matrimonial Property Act by the surviving spouse of the deceased. (Haupt 2018)

Usufructuary or like interest, or a right to an annuity charged upon property in terms of section 3(2)(1) of the Estate Duty Act *created by a predeceased spouse of the deceased:* A deduction will be allowed where the property over which the deceased enjoyed such a right formed part of the predeceased spouse's estate and no deduction in respect of the value of such interest was allowable in the determination of the net value of the estate of the predeceased spouse under provisions of paragraph (q) of section 4 of the Estate Duty Act. (Haupt 2018)

Books and works of art lent to the state: The value of such items may be deducted if the items have been lent to the State or local authority for a period of at least thirty years in terms of a notarial deed and the deceased died within that period. There is a requirement that the lending period must commence before the deceased's date of death. (Abrie et al 1993)

Value of deemed property taken into account in valuation of shares: The value of property which is deemed to be property of the deceased in terms of section 3(3) of the Estate Duty Act can be subtracted from the estate if it was taken into account in determining the value of any company shares or member's interest in a close corporation in terms of section 5(1)(f)bis of the Estate Duty Act to prevent double taxation, provided it has not been claimed as a deduction under any other subsection of section 4. (Abrie et al 1993)

Property left to surviving spouse: The value of any property included in the estate which accrues to the surviving spouse is deductible from the deceased estate. It must be noted that property which has been deducted under any other provision in section 4 cannot be deducted under this provision. (Haupt 2018)

The net value of the estate is arrived at after the above-mentioned deductions have been deducted from the gross value of the estate.

2.6 Primary abatement

In 2018 a primary abatement of R3.5 million is deductible from the net value of the estate in terms of section 4A of the Estate Duty Act. In the event that a rebate was not utilised by a deceased spouse, the rebate is rolled over to the surviving spouse. The effect of this is that the surviving spouse may have a rebate of up to R7 million.

2.7 Rate of estate duty

Once the primary abatement has been deducted from the net value of the estate, the figure that remains is the dutiable amount of the estate.

The First Schedule to the Estate Duty Act sets out the rate at which estate duty is to be calculated on the dutiable amount of the estate. From 1 March 2018 the rate is 20 percent for estates which are R30 million and less and 25 percent for estates greater than R30 million.

2.8 Other rebates

Stiglingh et al (2016:1020) state that further to the primary abatement, if the estate qualifies, the following rebates could be deducted from the amount of the estate duty.

- Transfer duty paid
- Foreign death duties and
- Rapid succession rebate

These are discussed below.

2.8.1 Transfer duty

If a beneficiary receives property from an estate and double taxation occurs because they are liable for both estate duty and transfer duty, section 16(a) of the Estate Duty Act provides that a rebate is available for the transfer duty paid. (Stiglingh et al 2016:1020)

Abrie et al (1993:339) explains that this means that if someone acquired property from the deceased or from his estate and paid transfer duty on it, the transfer duty can be deducted from the estate duty payable provided that the person who was liable for the transfer duty is also liable for the estate duty in respect of that property.

Stiglingh et al (2016:1020) explains that there is an exemption under section 9(1)(*e*) of the Transfer Duty Act 40 of 1949 if an heir purchases property from an estate. This means that the deduction for transfer duty is unlikely to be encountered.

2.8.2 Foreign taxes

In terms of section 16(c) where the deceased was ordinarily resident in South Africa at the time of death and his or her executor had to pay death duties in a foreign country in respect of property situated there and owned by the deceased at the time of death, a rebate will be allowed for the amount of death duties paid. However, the amount of the rebate may not exceed the estate duty imposed on the particular property in South Africa. (Stiglingh et al 2016:1020)

Stein (2011) states that the deduction is therefore limited to the lessor of the foreign death duties paid on the property and the South African estate duty attributable to the property. It should be noted that relief in terms of this rebate will not be available where relief has already been provided for in terms of a double taxation agreement.

2.8.3 Rapid succession rebate

Stiglingh et al (2016:1020) states that the First Schedule of the Estate Duty Act further sets out the application of the “quick succession rebate”. This rebate is applied where estate duty

was levied on property that fell into the estate of the first-dying person who died not more than ten years prior to the second-dying person. Where the same property, upon which estate duty was levied, falls into the estate of the second-dying person and estate duty is levied thereon again, the value of such property may be reduced by a percentage according to the following scale:

> If the deceased dies within two years of the death of the first-dying person.....100%
>
> If the deceased dies more than two years, but not more than four years after the death of the first-dying person……80%
>
> If the deceased dies more than four years, but not more than six years after the death of the first-dying person……60%
>
> If the deceased dies more than six years, but not more than eight years after the death of the first-dying person……40%
>
> If the deceased dies more than eight years, but not more than ten years after the death of the first-dying person……20%
>
> The rebate is subject to a maximum reduction equal to so much of the duty previously payable upon the death of the first dying person as is attributable to the value of that movable or immovable property or, as the case may be, to an amount equal to the value determined by reference to the value of that movable or immovable property, and as is proved to the satisfaction of the Commissioner to have been borne by the deceased. (First Schedule to the Estate Duty Act)

The reasoning behind this rebate is that it would be unfair for estate duty to be paid on a particular property, whether movable or immovable, only for it to be paid again on the same property within a few years of the death of the first-dying person.

Valuation of property in the estate

In this chapter, attention has been given to property and deemed property which is included in the estate. The allowable deductions and rebates have also been discussed. An imperative factor in any estate is the value of the property which should be included in the estate. Section 5 of the Estate Duty Act specifies in detail the basis of valuation for all property and deemed property included in the estate.

In terms of section 5(1)(*a*) where property is disposed of by way of bona fide purchase and sale in the course of the liquidation of the estate the price realised by such sale will be the value thereof. Section 5(1)(*b*) addresses the valuation of fiduciary, usufructuary and other like interests which is a rather complex calculation. Section 5(1)(*c*) addresses the valuation of annuities. Section 5(1)(*f*) deals with the value of the bare dominium of property subject to such limited interests. Haupt (2018)

It must be highlighted that fiduciary and usufructuary interests are valued in terms of the life expectancy of the beneficiary. This is in contrast to donations which are valued in terms of the life expectancy of the donor. (Ostler 2012:15)

2.9 Liability for estate duty

Section 12 of the Estate Duty Act, states that the duty is payable by the executor of the estate. Silke & Stein (1984:176) state that other people may be liable for the estate duty attributable to certain property in the estate and that the executor may recover the appropriate amount of duty from them.

Stein (2011) in a different book further sets out several instances in which a person other than the executor is liable for estate duty, namely a donee under a death-bed donation, the person entitled to recover the amount due under a dutiable insurance policy, the person to whom benefits accrue from a fund on the death of the deceased and the person benefiting from the cessation of a limited interest enjoyed by the deceased.

'Estate duty is due within 1 year of date of death or 30 days from date of assessment, if assessment is issued within 1 year of date of death. Currently, interest is levied at 6% p.a. on late payments.' (The South African Revenue Services (SARS) 2018).

2.10 Conclusion

This chapter has looked at the calculation of estate duty. Definitions of property and deemed property were discussed as well as the allowable deductions and rebates were identified in order to get to the net value of the estate and in turn the dutiable amount on which the rate of estate duty is applied.

It can be submitted that it is imperative for the deceased to have kept documentary records of his assets and limited interests in order for the executor to be able to accurately calculate the estate duty liable.

It is also submitted that estate duty seeks to tax items which were not taxable during the life time of the deceased. This is evidenced by the items which are included under deemed property such as domestic insurance policies on the deceased's life as well as property which was previously donated by the deceased and was exempt from donations tax under section 56(1)(*c*) or (*d*) of the ITA. Some of the allowable deductions in the Estate Duty Act follow the same principle in section 11(a) of the ITA. Section 11(a) of the ITA requires that there be expenditure and losses actually incurred in the production of income not of a capital nature. Similarly section 4 of the Estate Duty Act allows for deductions where expenses are incurred in the winding up of the estate.

The use of a trust for estate planning purposes will be discussed in the following chapter (chapter 3) and the use of a company for estate planning purposes will be discussed in chapter 4. The advantages and disadvantages of the above-mentioned vehicles will be identified and discussed.

Chapter 3: Trusts as a vehicle for estate planning

3.1 Introduction

Hollingdrake (2016) states that:

> It is every person's right to arrange one's affairs in such a way so as to legally and honestly reduce a tax or regulatory burden. In this context, trusts are regarded as extremely efficient estate planning tools, creating the complete environment for a smooth and efficient exercise of an estate plan.

The Hague Convention on the Law Applicable to Trusts defines a 'trust' as:

> The legal relationship created inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

Section 1 of the ITA defines a trust as:

> means any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person;

For income tax purposes a 'person' includes a trust. Stiglingh et al (2016:842) explains that even though a trust is regarded as a relationship, it was specifically included in the definition of a 'person' in section 1 of the ITA during 1991 to put it beyond doubt that a trust could be subject to normal taxation.

A trust is also defined in section 1 of the Trust Property Control Act 39 of 1984 as:

> the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed—
>
> (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or
>
> (b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,
>
> but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965.

Parties to a trust

It can be deduced from the above definitions of a trust that there are three parties to a trust namely the founder/donor/settlor, trustees and beneficiaries. The founder/donor/settlor of the trust is the person who forms the trust. The trustees are entrusted to administer the trust and

the beneficiaries are the persons who benefit from the trust. I.e., the founder establishes the trust in order for the beneficiaries to benefit.

Types of trusts

There are three types of trusts in South Africa namely, testamentary trusts, bewind trusts and inter vivos trusts. (Lee Attorneys 2015)

Testamentary Trusts are formed during the winding up of a deceased estate due to a particular requirement in the will of the deceased to say that a trust must be set up. A testamentary trust is more often than not usually created to hold assets on behalf of minor children. In terms of the South African law, in the absence of a trust, assets from the deceased estate left to minor children are sold, and they receive the money only when they reach adulthood. (Lee Attorneys 2015)

A bewind trust is a trust where the founder transfers ownership of the assets to the beneficiaries while the trustees are responsible for the administration of the trust assets. (Cliffe Dekker Hofmeyr 2012)

An inter vivos trust is created during the lifetime of the founder/donor/settlor. There are two types of inter vivos trusts namely discretionary and vested trusts. In a vested trust, the benefits of the beneficiaries are set out in the trust deed. In a discretionary trust, the trustees have full discretion at all times about how much should be distributed to each beneficiary. The donor transfers property to the trustees of the trust who then manage it for the benefit of the beneficiaries, one of whom may be the donor. The donation of property to a trust is popular for estate planning purposes because once the donor transfers it to the trust it cannot form part of the donors dutiable estate for estate duty purposes upon death. (Lee Attorneys 2015). Notwithstanding the above, it should be noted that donations tax may become applicable.

This research paper will consider the inter vivos trust as a vehicle for estate planning purposes.

3.2 Creation of an inter vivos trust

Madeleyn Attorneys (2016) explains that an ‘inter vivos trust is registered at the office of the Master of the High Court in whose area of jurisdiction the main assets of the trust are or will be held.’

In order to create a trust, a valid trust deed is drawn up as the first step. A trust deed can be described as a contract between the founder/ donor of the trust and the trustees. It is for the benefit of the beneficiaries. The trust deed is a binding contract in which the founder/ donor

agrees to transfer certain assets to the trustees of the trust for the benefit of the beneficiaries. The trust deed would indicate the names of the first trustees as well as the beneficiaries of the trust. (Lee Attorneys 2015)

Madelyn Attorneys explains that in most of the time the Master will be firm that at least one independent trustee should be appointed. This is someone who would not be entitled to receive anything from the trust apart from trustee remuneration. The beneficiaries as well as their entitlements must be recorded in the trust deed, i.e. whether the entitlement is in the capital of the trust, the income of the trust assets, or both. (Madelyn Attorneys 2017)

Once the trust deed has been drafted, it must be signed and witnessed and must be submitted to the Master of the High Court. The Acceptance of Trusteeship for all trustees has to be completed and signed. This and certified copies of their identity documents are also submitted to the Master together with the trust deed. The purpose of the Acceptance of Trusteeship is for the trustees to make declarations and it also contains the basic information of the trustees that the Master requires. It must be remembered that the trustees have a duty to act in good faith in terms of the trust deed. The Master may request the trustees to furnish security. The trustees would have to furnish the security to the Master when the trust is registered. Amongst other administrative requirements when setting up a trust, the trustees must complete a Form JM21 where they must stipulate their occupations and professions, their level of experience in the administration of trusts as well as the name and branch of the bank account which will be opened for the trust etcetera. (Madelyn Attorneys 2017)

Once the above-mentioned documents have been completed and handed in to the Master, the Master issues a Letter of Authority to the trustees. Once the Letter of Authority has been issued, the trustees may then begin to act on behalf of the trust according to the trust deed.

3.3 Transfer of assets to a trust

Ostler (2012:74) suggests that when it comes to disposing of assets to a trust, the founder/ donor has three options which give rise to different tax consequences. Firstly, the donor may choose to donate the assets and attract donations tax but estate duty will not be payable because the founder will have totally divested himself or herself of the asset during his or her lifetime. Where assets are donated to a trust by the founder, section 7 of the ITA may be invoked. This section deals with income arising from a donation and in terms of which income is taxed in the hands of the donor. An example would be a donation of property which yields rental income. Section 7(1) of the ITA is essentially an anti-avoidance provision which provides for the taxation, in the hands of the donor, of any income which has resulted from a donation or similar disposition.

Secondly, the donor may sell the assets to a trust on a loan account at an arm's length interest rate. The donor would be taxed on the interest received from the trust and the trust could deduct the interest expenditure to the extent that it is incurred in the production of income. Thirdly, the donor may sell the assets to the trust on a loan account at an interest rate below the arm's length rate or even at an interest-free rate. The third option results in a reduction of estate duty and also resulted in the avoidance of donations tax until section 7C of the ITA was introduced. Section 7C of the ITA is discussed below.

The tax implications of the above-mentioned transfer of assets to a trust are discussed in Chapter 5.

3.4 Interest free loans to a trust

The Taxation Laws Amendment Act 15 of 2016 introduced section 7C with effect from 1 March 2017. The section states that if a loan is advanced to a trust by a person who is a connected person to the trust (for an example, the founder/ donor, trustee or beneficiary) which bears interest at a rate which is lower than the official rate of interest in the 7th Schedule of the ITA (which is currently 7.5%), that loan will be deemed to be a donation on the last day of each tax year the loan remains unpaid.

If the loan to the trust does not bear interest, an amount of interest is calculated at 7.5% (the official rate: "repo rate" + 1%). This amount will be treated as a donation. The donations tax is not calculated on the capital sum. If the rate of interest charged is lower than the official rate of interest, the difference between the interest rate charged and the official rate of 7.5% will be deemed to be a donation. The amount which is deemed to be a donation is equal to the difference in the interest payable on the loan and the official rate of interest.

From 1 March 2018, donations tax rate increases from 20% to 25% on donations of more than R30 million and will be discussed in detail in chapter 5. The annual donations tax exemption of R100 000 for natural persons is still available and may be utilised against the donation (assuming that no other donations are made during the financial year of assessment).

The amount which is to be treated as a donation to a trust is deemed to occur on the last day of the year of assessment of the trust. The provision will apply to new and existing loans which are in existence from 1 March 2017. It is important to note that donations tax must be paid by the end of the month following the month in which the donation takes effect.

There are certain exemptions in terms of which Section 7C which will not be applicable to a loan which is made to:

3.4.1 A trust which is an approved Public Benefit Organisation.

3.4.2 A trust in return for a vested interest held by that person in the receipts, accruals and assets of that trust, subject to certain requirements.

3.4.3 A special trust, which is created for the benefit of persons with a disability, where such disability prevents such person from earning sufficient income for their maintenance, or from managing their own financial affairs.

3.4.4 A trust where the loan was used wholly or partially to fund the acquisition of property which was utilised as the primary residence of the lender or the lender's spouse, throughout the year of assessment.

3.4.5 A trust which is subject to the section 31 of the ITA's transfer pricing provisions. In essence, a loan to an offshore Trust will not be subject to section 7C if it is already subject to the provisions of section 31.

3.4.6 A trust which complies as a Sharia compliant financing arrangement.

3.4.7 A trust which is subject to section 64E(4) of the ITA, i.e. a loan was made to a trust by a company and is deemed to be a dividend by the company to the trust.

3.4.8 A trust created for the purpose of providing share incentive schemes to employees. (Section 7C of the ITA)

Lamprecht (2017) explains that the results of the new regulation could mean that 'it may become far less favourable from a tax perspective to move assets to a trust and extend an interest-free or low-interest loan to the vehicle to finance the transaction.'

The amount which is deemed to be a donation is equal to the difference between the interest payable on the loan and the official rate of interest.

Louis van Vuren cited in Lamprecht (2017), explains that:

> If someone extends an interest free loan to a trust of which he or she or any of his children are beneficiaries, the loan would be deemed to accrue interest at 8% per annum. Thus, if an interest-free loan of R1 million is extended to the trust by such a person, the lender will be deemed to have made a donation to the trust on the last day of the tax year of R80 000 (R1 million × (8% minus 0%)), because no interest was in fact charged or paid. But because the annual donations tax exemption of R100 000 will apply, the lender won't be liable for donations tax unless the loan exceeds R1.25 million (while the official rate remains at 8% per annum), provided the person did not make any other donations during the year. New as well as existing loans are affected.

Van Vuren further states that 'depending on the size of the loan, planners won't be able to reduce the outstanding balance of the loan without paying donations tax.' He gives the following example:

> If a founder of a trust extended an interest-free loan of R2 million to the trust ten years ago and donated R100 000 per annum to the trust to reduce the loan (the loan would have reduced to R1 million by now), from 28 February 2018 the founder will be deemed to have made a donation of R80 000 to the trust on

> the last day of the tax year, leaving only R20 000 of the R100 000 annual donations tax exemption to donate to the trust without having to pay donations tax.

Lamprecht (2017) suspects that the number of trusts which are set up in future may reduce because of this new provision in the ITA.

3.5 Taxation of trust income

In terms of section 25B of the ITA, the income of a trust can be taxed either in the hands of the trust or in the hands of the beneficiaries. Section 25B is subject to section 7. If section 7 applies, some other person other than the trust or beneficiaries may be taxed.

Section 7(1) to section 7(11) of the ITA deeming provisions apply if income has been received by virtue of any 'donation, settlement or gratuitous disposition' which is made by any person. Simply stated, when any income arises as a result of a donation, the person who will be taxed on the income is the person who made the donation and not the person who received the income.

A trust is taxed at the highest marginal rate of 45%.

As already stated, section 7 of the Act is essentially an anti-avoidance provision and will be discussed in Chapter 5.

Botha & Goodall (2018) explain that the Davis Committee might recommend changes to section 25B of the Income Tax Act, and is likely to suggest abolishing the conduit principle. Nevertheless, section 25B is currently still in operation and is described hereunder.

> Generally speaking, section 25B embodies the "conduit principle", and provides that income which is received by, or which is accrued on behalf of a beneficiary, will be taxed in the beneficiary's hands. Moreover, that income will retain its nature. This means, for example, if interest is received by the trust and is paid over to (or is accumulated on behalf of) a beneficiary, the income will retain its nature as interest and be treated as such in the hands of the beneficiary for tax purposes. The only exception to the rule that income retains its nature is when income is paid to a beneficiary as an annuity. In the case of income paid as annuity, the income will lose its nature and will be taxed as an annuity. This is important, because, generally speaking, dividends are received by a beneficiary free of tax. However, if dividend income is paid out to a beneficiary as an annuity, the tax-free nature thereof will be lost.

Stiglingh et al (2016) quote a number of cases which displayed the conduit principle. In *Armstrong v CIR 1938* AD 343 the court held that:

> Income received by a beneficiary from a trust retains its nature. The trust is viewed as a conduit pipe through which the income flows. For an example, it retains its nature as interest income in the hands of the beneficiary.

This is also achieved by the wording in section 25B(1) where an accrual to a trust is deemed to be an amount which has also accrued to a beneficiary in certain circumstances. Consequently, when income which accrues is exempt, it will also be exempt in the hands of

the beneficiary, for an example dividend income. Likewise if the income consists of interest from a South African investment, the beneficiary will be entitled to the interest exemption.

In *SIR v Rosen* 1971 (1) SA 172 (A) the income of a trust which was an annuity vested in a beneficiary. Section 10(2) of the ITA states that the section 10(1)(h) exemption for interest as well as the section 10(1)(k) exemption for dividends does not apply to annuities. Therefore the conduit principle was applicable to this trust income which vested in the beneficiary and the beneficiary could not receive the said exemptions.

> The conduit principle was again confirmed in *Estate Dempers v SIR* where the court held that income accumulated by the trustee retained its identity despite a specific provision in the trust deed that the income would in such case form part of the trust capital. (Marais 2014:19)

Stiglingh et al (2016:848) suggest that careful consideration must be given to the provisions of the trust deed and the ITA in relation to the vesting of rights in order to determine the liability for tax in respect of income received by a trust. A distinction was made between a vested right and a contingent right in ITC 76 (1927) (at 70). It was held that a vested right was something substantial which had a present value and could be measured. A contingent right on the other hand was merely an expectation which might be never realised. It does not have a present value. For income tax purposes, a vested right is an accrued right.

Stiglingh et al (2016:849) explain that section 25B(1) further determines that if beneficiaries do not have a vested right to the income, the income will accrue to the trust. It should be noted that a vested right can be obtained if the trust deed gives the trustees a discretion to distribute to the beneficiaries i.e. vesting will occur when the trustees make a discretionary distribution to beneficiaries.

It can be submitted that if the beneficiaries have a vested right to the capital and income, the estate duty will pass from the founder to them. Haupt (2018:897) suggests that a discretionary trust is preferred for estate planning purposes because the assets do not form part of the estate of the beneficiaries.

3.6 Advantages of a trust

Lee Attorneys (2015) list the potential advantages of creating an inter vivos trust.

Flexibility: A discretionary trust is exceptionally flexible in that it can be administered in such a way that it can cater for changes which may occur over a period of time, it can cater for changes within the family, it can cater for changes in financial circumstances and it can take into account changes in legislative circumstances. Trustees are able to manage the trust's assets in the best interest of the beneficiaries at all times by taking into account the relevant factors at that point in time. This flexibility is able to cater for unforeseen circumstances such

as divorce and insolvency. The flexibility is also able to cater for increase in family size in that beneficiaries can be added to the trust deed at any time. Lewis (2013) refers to ITC *1828* which held that beneficiaries are able to amend the contents of a trust deed if they all consent to doing so. Beneficiaries are also able to make amendments to an existing trust and form a new trust which is different from the old trust. The facts in ITC 1828 were such that 'a new trust had in fact been created in view of the fact that the object and purpose of the old trust (as envisage by the founder) had come to an end'. Lewis (2013) cautions that:

> One should be mindful that if beneficiaries of a trust vary the object and purpose of the trust to such an extent that a different ascertainable object and purpose has been effected, a new trust may come into existence, which may trigger tax implications for the trust and/or its beneficiaries.

Tax planning: If a trust is created and operated by a professional, 'a trust can be administered so as to mitigate taxes such as estate duty, income tax, capital gains tax, donations tax and transfer duty.' The mitigation of the above-mentioned taxed will depend on the relationship between the founder and the beneficiaries and the structuring used. Also, the assets owned by the trust will not be subject to estate duty, capital gains and executor's fees on the death of the founder. It should be noted however that trusts are under a lot of scrutiny and not favoured by SARS. As a result, the introduction of section 7C of the ITA has taken away from tax planning to a certain extent the extension of interest free loans to a trust. (Lee Attorneys 2015)

Estate/ succession planning: A trust is able to create flexible succession arrangements. Furthermore, the assets owned by the trust will not be subjected to onerous and more often than not extended legal procedures after death, as it is with the administration of assets in a personal estate. This is because individual estates are frozen during the administration process. This is not the case with trusts. Trust assets are accessible at all times during the administration process. (Lee Attorneys 2015)

Continuity: 'A trust can provide a certain degree of continuity and control to ensure that the wider affairs of a deceased continue after the death of the founder without interruption and hardship to the family.' (Lee Attorneys 2015)

Family asset management: A trust can be used in structuring effective means of 'making controlled distributions for beneficiaries who are not in a position to manage assets themselves.' (Lee Attorneys 2015) For an example, for minors or disabled beneficiaries. 'A trust can provide for joint ownership of indivisible assets like property.' If the founder were to ever become mentally ill by way of injury or disease, there would be no need to appoint a curator to manage his or her affairs if there is already a trust. This speaks to the continuity above. (Lee Attorneys)

Asset protection: A protective discretionary trust can assist family members to protect their assets from potential creditors. It must be cautioned that transfers of property should not be made in such a way as to prejudice creditors. The method in which assets are transferred is also imperative and relevant to the extent of the protection. For an example, if an asset is transferred on a loan account, the amount of the loan account will remain an asset in the founder/ donor's estate until the trust repays him or her. (Lee Attorneys 2015)

Lee Attorneys 2015 elaborates on the example above:

> This means that the amount of the loan account will not be protected from creditors, only the increase in the value of the asset during the period of the trust's ownership of it. However, over a period of time, as the value of the trust's assets increase and the value of your loan account decreases, so will the benefit of asset protection be established. Also, the ownership of the asset by the trust also means that it will not fall into the beneficiaries' personal estates upon the death of the founder, i.e. the asset will be protected from creditors of your beneficiaries.

In the event that a founder/ donor has businesses, it would be advisable for him or her to form a trust so that he or she can protect his individual assets from creditors. This is can be particularly helpful if his businesses are not doing well thus exposing him financially. (Lee Attorneys 2015)

'Assets held in a trust may be protected from claims arising from matrimonial/ relationship disputes.' (Lee Attorneys 2015).

Professional asset and investment management: The donor can have peace of mind knowing that his or her assets are well taken care of by a professional in the event that he dies.

Tax savings. A trust can potentially provide tax savings. For the founder/ donor, they are able to get away with saving tax on estate duty. The distribution of income in a trust can also provide for a tax saving depending on how the income is distributed. It should be noted however that the beneficiaries could be liable for income of the trust as has already been discussed under paragraph 3.5 above.

Cliff Dekker Hofmeyr (2017) states that 'an inter vivos trust remains one of the most valuable mechanisms to protect and grow assets' and that they are often advisable for saving on estate duty. They further state that although they are recommended for saving on estate duty, they are also necessary to protect assets from creditors or relationship claims, they provide for continuity after death and for the protection of assets if a beneficiary is a minor or is disabled.

Coetsee (2017) lists the seven best uses of a trust in estate planning:

Children from a previous marriage: If a founder remarries and wishes to protect their new spouse and children from a former marriage, a trust can support their spouse during their lifetime, while ensuring that his/her children from a former marriage eventually benefit from or inherit any remaining assets. (Coetsee 2017)

Spouse and/ or children lack financial expertise: If a founder's spouse and/ or children need assistance with money management following the death of the founder, a trust allows qualified trustees to manage the trust assets on behalf of his/her beneficiaries. (Coetsee 2017)

*Spouse or child is disabled***:** If a founder has a disabled spouse or child requiring care, a trust can be used to ensure that they receive an appropriate level of care after the death of the founder. (Coetsee 2017)

Minors to inherit: If a founder wants minors to inherit, a trust can be used to provide income to the minor beneficiaries whilst they are still minors. The planner is able to appoint trustees of his choice to administer the trust for the minors' benefit. In the event that there is no trust set up, any inheritance received by the minor will go to the Guardians fund (which is administered on their behalf by people whom the planner does not know) because in South Africa, minors cannot inherit in their own names. A trust is therefore a crucial inheritance tool for anyone with minor children as beneficiaries. (Coetsee 2017)

Tax planning: Income earned by an inter vivos trust is taxed at the highest marginal rate which is currently 45%, but any trust income that is distributed to beneficiaries will be taxed in the beneficiary's hands. Therefore if the beneficiaries are in a lower tax bracket, the investment income can be taxed at their personal lower rate provided that the income vests in the beneficiary (Coetsee 2017).

Avoid having assets frozen: When a family member dies, their assets are frozen. This means that none of the assets can be withdrawn, transferred or sold. This may be a problem if the family requires money to cover living costs. The issue of frozen assets can be avoided altogether if the assets are owned by the trust. This is because the trust will continue to exist even if any one of the members (whether it is the founder/ donor, beneficiary or trustee) of a trust has died. This means that the beneficiaries will still have access to the assets, through the trustees. (Coetsee 2017)

To bypass probate: **'**Probate is the public court process that verifies the accuracy of wills and distributes people's assets. The proceedings become public record.' (Coetsee 2017) With an inter vivos trust, probate can be bypassed with the added peace of mind that assets are

transferred and distributed in the way intended by the founder/ donor. This also offers greater privacy for trust assets, as probate is a public process of which can be accessed by anyone.

Haupt (2018:897) suggests that the advantages of a trust are that it enables the founder to divest himself of his assets, the beneficiaries do not have to have a vested right to the assets and there is no estate duty problem because a trust is not a living person.

3.7 Disadvantages of an inter vivos trust

Lee Attorneys (2015) explains the disadvantages of using an inter vivos trust.

Loss of ownership: The founder should be prepared to divest himself of ownership and control of the assets which are transferred to the trust because once these assets are transferred to the trust, they can no longer belong to him or her. The trust deed then determines how the assets are used and/ or transferred. The founder loses control of the underlying assets. To set up a valid trust, the founder must intend to and transfer legal ownership of the trust assets to the trustees. (Lee Attorneys 2015)

> The trustees are then responsible for the administration and control of the trust assets. They are legally bound to comply with the terms of the Trust deed and with their fiduciary duties. This means that the trustees may only distribute assets to the beneficiaries as defined in the trust deed and in the manner prescribed in the trust deed. They are also obliged at all times to act in the best interests of the beneficiaries. (Lee Attorneys 2015)

Administration: The establishment of a trust comes with administrative responsibilities. Administrative requirements include:

- Compiling and retaining records of financial statements from the time the trust is established to at least 5 years after the trust has been deregistered.
- Minutes of meetings held by trustees about all dealings pertaining to the trust and resolutions need to be drafted and kept.
- A separate bank account must be maintained for all the cash flows pertaining to the trust
- An asset register must be kept. (Lee Attorneys 2015)

Costs: It may be costly to set up a trust due to the level of professionalism and administration required. Establishing a trust has its complexities.

Trustees: It may not be easy to find independent trustees who are knowledgeable, dedicated and with a high level of experience.

> If the trust is not set up and administered properly, there is a risk that the trust may be regarded as a sham (or as not having been established in the first place), in which case the benefits of asset protection may be lost. (Coetsee 2017)

Tax: There are certain income tax disadvantages for trusts. Trusts do not enjoy rebates like individuals. They pay higher transfer duty and pay income tax at the highest marginal rates. However, these may be immaterial when compared to the amount which could be saved on estate duty. Capital gains tax is payable in the trust at an effective rate of 36%, and there are no abatements. Income retained in a trust is taxed at 45%. The inclusion rate is 80%. The application of the anti-avoidance provisions as well as splitting of income amongst beneficiaries could potentially result in saving of tax rather than additional tax being incurred. (Coetsee 2017)

Piercing the trust veil: SARS may seek to tax the donor by deeming income back to the donor if there is not enough proof that the assets are no longer in control of the donor. A court may look through the trust if there is not sufficient separation of control between the trustees and the trust assets. (Coetsee 2017)

3.8 Conclusion

This chapter looked at different types of trusts and how the trust is formed. The parties to a trust were defined and the benefits and disadvantages of a trust were discussed. It was submitted that a trust offers flexibility and is able to cater for changes over time in family, financial and legislative circumstances. It was also highlighted that one should be wary of the fact that amendments to a trust deed could mean a disposal of the original trust deed which would give rise to CGT implications. CGT is discussed in chapter 5 of this paper. Trusts are able to offer a certain degree of continuity and control as they continue after the death of the founder and are not subject to cumbersome lengthy legal procedures after death as individual estates. A trust is also able to protect assets from potential creditors.

Some of the disadvantages which were highlighted are that the founder must be prepared to divest himself of ownership and control of the assets which are transferred to the trust. It must be noted that if the founder has not diversified himself fully from controlling the trust assets, he may be caught in the net of section 3(3)(*d*) of the Estate Duty Act which provides that if the deceased was competent to dispose of property for his or her own benefit of his or her estate such property will amount to deemed property in his or her estate. An example of where the founder may still have control over the trust assets is when he is the founder and the only trustee or has a controlling vote or even where he retains the right to dismiss trustees and appoint new trustees. (Ostler 2012:73). There are administrative requirements on setting up and maintaining a trust. There are also costs involved. It was highlighted that trusts are not favoured by SARS and that over the years, SARS has introduced laws which make trusts less attractive as an estate plan. From a tax perspective, trusts incur higher transfer duty and income tax rates and do not enjoy the benefit of rebates and exemptions.

Trusts can be subject to donations tax and CGT. The costs incurred in establishing a trust as well as the tax that could be incurred when transferring assets to a trust should be assessed and a determination should be made if these costs could potentially be outweighed in the long run by the benefits that a trust can yield.

Chapter 4: Companies as a vehicle for estate planning

4.1 Introduction

In the previous chapter, the advantages and disadvantages of using a trust as an estate plan were explored. In this chapter, the use of a company as an estate plan will be examined as well as the possibility of structuring both a trust and a company as an estate plan.

A company is defined in section 1 of the Companies Act 71 of 2008 (Companies Act) as:

> a juristic person incorporated in terms of this Act, a domesticated company, or a juristic person that, immediately before the effective date-
>
> was registered in terms of the-
>
> (i) Companies Act, 1973 (Act No. 61 of 1973), other than as an external company as defined in that Act; or
>
> (ii) Close Corporations Act, 1984 (Act No. 69 of 1984), if it has subsequently been converted in terms of Schedule 2;
>
> (b) was in existence and recognised as an „existing company" in terms of the Companies Act, 1973 (Act No. 61 of 1973); or
>
> was deregistered in terms of the Companies Act, 1973 (Act No. 61 of 1973), and has subsequently been re-registered in terms of this Act;

A company is also defined in section 1 of the ITA and includes:

> (a) any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or
>
> (b) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or
> (c) any co-operative; or
>
> (d) any association (not being an association referred to in paragraph (a) or (f)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or
>
> (e) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or
> (f) portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1 (x) of the JSE Limited Listings Requirements; or
>
> (g) a close corporation,
>
> but does not include a foreign partnership.

This chapter will provide an example of how to structure an estate plan using a company.

4.2 Parties to a company

A private company must have at least one shareholder and one director. The owners of the company are its shareholders. Unlike a trust, there is no requirement for a company to have a beneficiary. The shareholders benefit by way of dividends and increase in value of the shares.

4.3 Creation of a company

Davis, Beneke & Jooste (2017) explain that a company is created by following the procedures laid down by the Companies Act. The procedures involve:

- Filing a “notice of incorporation” together with the prescribed fee and a copy of “the Memorandum of Incorporation (MOI)”; with the Companies and Intellectual Property Commission (CIPC).
- The CIPC registers the company and assigns it a registration number. It also delivers a company registration certificate.

The MOI is effectively the “constitution” of the company. It deals with matters relating to the governance of the company and the relationship between the company and its members and between the members themselves. It is a flexible document and may be supplemented by “rules” drawn up by the board of directors of the company. The ownership of shares in a company can be reflected in the share certificate or uncertificated electronic form.

4.4 Separation of management and ownership

A company is represented and managed by directors, who may or may not be members of the company. Membership of a company does not entitle a person to take part in the management of a company or to represent the company. Company law thus adheres to the principle of separation of management and ownership. Ultimate control of the company does, however, vest in the members, in the sense that they have the power, as a body, to appoint and remove the directors.

The directors of a company have various duties which they owe to the company and which are to be found in the common law. They have a duty to act with reasonable care and skill and the so-called “fiduciary duties”, which include, for example, the duty to act in the best interests of the company and the duty to avoid a conflict of interest. The Companies Act also contains numerous provisions restricting directors’ powers and the benefits (e.g. loans, shares, share options) that may flow to directors. In certain instances too (e.g. where

directors have acted fraudulently or recklessly in conducting the business of the company), they may become personally liable for some or all of the debts of the company. Directors are also subject to the King Code on Corporate Governance, which contains a set of rules aimed at securing better governance of companies. The rules do not, however, have the binding force of law.

Generally, any natural person can become a director of a company and no special expertise or qualification is required.

4.5 Types of companies

Haupt (2018:259) state that the main reason for distinguishing between public and private companies, for tax purposes is that public companies are exempt from donations tax (section 56(1)(*n*)).

Davis et al (2017) states that the main differences between a public and private company is that a private company is restricted from transferring its shares to the public. Whereas a public company is not restricted and a public company must make its financial statements available to the public for inspection.

A major advantage that a public company has over a private company is the ability to raise capital from the public by offering its shares to the public. Also the shares can be listed on the Johannesburg Securities Exchange (JSE), which provides a ready market for the shareholder who wishes to dispose of shares.

The private company will be considered for this research paper as the purpose of the company is for estate planning. The formation of this company is to hold the assets of the founder in the company as was done in the trust.

4.6 Shares and share capital

Davis, Beneke & Jooste (2017) explain that shares entitle the shareholder to various rights. The rights are determined by the articles of the company, and it is possible to have different classes of shares with different rights within a single company. The common classes of shares are “ordinary” and “preference” shares. Preference shares have rights which are preferent to those of ordinary shareholders, either in respect of the distribution of dividends or the return of share capital on a winding-up of the company, or both. The preference shareholder enjoys the benefit of having a fixed dividend unless it is a “participating preference share” which is similar to interest. The ordinary shareholder does not have the benefit of a fixed dividend and the dividend that an ordinary shareholder is entitled to is dependent on whether there are any profits available for distribution. A participating

preference share entitles the shareholder to a fixed dividend and, in addition thereto, to participate with ordinary shareholders in the dividend that is distributed to them. A preference shareholder (not a participating preference shareholder) is akin to a creditor of the company but is not a creditor and differs in material respects from a creditor. If a company grows in value, the ordinary and participating preference shares grow in value, but the preference shares do not.

4.7 Structure using a company

Davis et al (2017) provides a working example of how to structure an estate plan using a company. In his example, he makes the assumption that the planner has three children whom he wishes to benefit equally. He states that the integration of a company into an estate plan could be structured along the following lines:

4.7.1. The planner would establish a company (say Newco) which has both ordinary and preference shares. Both the ordinary and preference shares would carry one vote per share and be issued at a nominal price of, for example, R1 per share.

4.7.2. The preference shares would carry a low dividend coupon (non-cumulative) per annum. On any winding up of Newco (whether by way of a liquidation or deregistration) a preference shareholder would only be entitled to share in any surplus of the value of the company's assets over its liabilities to the extent of what was paid for the shares. Any further surplus on a winding up of the Newco would accrue to and be shared amongst the ordinary shareholders only.

4.7.3. The ordinary shares would be issued in equal proportion to each of the three children (e.g. 100 ordinary shares to each of the three children), with the planner being issued with more than 300 preference shares – for instance, 325 preference shares.

All the growth assets (and possibly the non-growth assets) of the planner would be transferred to Newco.

4.7.4. The assets would be transferred at their market values. The purchase consideration would be left outstanding on interest-free loan account repayable on demand. (If the sale of the assets to the company results in a capital loss to the planner, that loss can only be set off for capital gains tax purposes against capital gains made as a result of future disposals by the planner to Newco. Davis et al (2017) maintains that the same applies where a trust is used and also where both a company and a trust are used.

He suggests that the intention with this structure is that on the death of the planner, the only significant assets falling into his estate would be the outstanding balance on the loan

account and the value of the preference shares. The loan account balance would be the initial balance created on the sale of the assets to Newco less any capital repayments plus any interest charged. The value of the preference shares would also be included in the estate, but these are unlikely to be worth more than their par value of R325.

Davis et al (2017) explains that if the planner owns a business, consideration would have to be given to placing the business into a separate company (Opco) to shield the other assets of Newco from any creditors of the business. Opco could be a wholly owned subsidiary of Newco (or its ordinary shares could be held directly by some or all of his children, with the planner in such case holding preference shares in Opco to ensure control). The planner may even identify one of the children as the person who will run the business in the future and accordingly give that child a majority (or all) of the ordinary shares in Opco.

Where the planner holds properties which are not used in an “enterprise” for VAT purposes, it may be advisable to place the properties in separate property owning companies (Propcos). Again all the shares in Propco could be held by Newco, or the ordinary shares could be held by the children with the planner holding preference shares to maintain control. It should be noted that future transfer of shares will attract transfer duty.

Where any properties are used in an enterprise registered for VAT, a future transfer of the properties may be effected without any material transaction tax costs. This is because although the seller would probably have to account for output tax (VAT) on the sale (unless it is sold as a going concern), the purchaser would usually be able to claim any VAT payable as input tax.

Davis et al (2017) stresses that if the shares in any Opco or Propco are not held by Newco, the structure can become fairly complex to administer. Accordingly, the shares in Opco or Propco are usually held by Newco.

As the preference shares (in Newco) are used as a mechanism to allow the planner some control over the structure, the question arises as to what happens to the preference shares on the death of the planner. Davis (2017) suggests that the planner could bequeath the shares to his/her surviving spouse – thereby allowing the surviving spouse to continue to exercise some control over the structure during his or her lifetime, after the death of the surviving spouse, bequeath the shares in equal shares to the ordinary shareholders, or provide that the shares should at that stage be redeemed by Newco. Newco’s MOI would have to provide for redemption in such circumstances.

Davis et al (2017) explains that the planner could in his will provide that on his death the first R3,5 million of the outstanding balance on the loan account be bequeathed to the children in

equal shares. The balance could pass to his surviving spouse, and on her death, the balance could pass to the children in equal shares.

Davis et al (2017) explains that an estate pegging operation is only warranted if the planner has growth assets, but this is not always true. He emphasizes that a cash deposit is also a growth asset because it yields an interest return. Accordingly, the planner could lend his surplus cash interest free to Newco, with Newco earning interest thereon and paying the tax on the interest – the after tax return merely being left in Newco. Not only is the planner preventing his estate increasing by the after tax return on the cash, but there may be an income tax benefit in that Newco only pays tax at the corporate tax rate of 28% on the interest as opposed to the maximum marginal for individuals of 45%.

Davis et al (2017) further challenges that the question that arises is whether section 80A (the general anti-avoidance provision in the ITA known as GAAR) may be applied to subject the planner in such circumstances to income tax on the interest earned by Newco. He maintains that it is doubtful whether Revenue may apply section 80A in such circumstances. He concludes that if Revenue were ever successful in applying section 80A to a structure such as this, it would probably have to be shown that the "interest-free" element of the loan account creates abnormal rights or obligations between the parties.

If the assets had been donated to the trust, the planner would have been liable for donations tax.

4.8 Providing the planner with enough funds

Davis et al (2017) maintains that where a planner transfers all or virtually all his assets to Newco, the planner often needs funds to finance his living expenses. He suggests that the planner could possibly be earning a pension or a retirement annuity, but the need for access to funds (particularly for major expenses such as medical expenditure) is often present. In his example, he obviously assumes that the planner is an elderly person. However, one does not need to have retired in order to start putting one's affairs in order where estate planning is concerned. The planner may well be working and getting a monthly income.

Nevertheless, to overcome the issue of the elderly planner not having sufficient funds to finance his living expenses, Davis (2017) suggests that in theory, the loan account should at least be repayable on demand. Therefore the planner may cause Newco to repay portion of his loan account (created on the transfer of his cash and growth assets to Newco). In theory the planner could continue calling up the loan account until it is exhausted; in practice the planner may wish to commence charging interest on the loan once it reaches a figure with which he feels comfortable.

Davis et al (2017) cautions that if the loan account was initially established when Newco acquired assets which do not generate “income” for income tax purposes, any interest charged would not be deductible for income tax purposes in the hands of Newco. In such a case one is merely “creating” an income tax liability within the structure. This would occur, for example, if the loan account was created on the transfer of listed shares to Newco.

Davis et al (2017) continues to explain that the decision whether to charge interest or not should not be one that the planner has the power to take unilaterally. Thus, if the planner decides not to charge interest (i.e. waives his right to charge interest), the possibility arises as to whether there is a donation by the planner of the interest not charged. The decision as to whether to charge interest or not must require the consent of the debtor (Newco) as well.

Davis et al (2017) suggests that if there is a likelihood of a planner’s loan account not being sufficient over his lifetime to provide for his needs, and assuming that interest should not be charged for the reason noted, the planner could be issued with preference shares (bearing a market-related coupon rate) in settlement of portion of his loan account. Alternatively the planner could be left with portion of the ordinary shares in Newco; thus he would be able to participate in any ordinary dividend declared by Newco and at a later stage sell the ordinary shares to his children to raise further funds. That he retains some ordinary shares does, of course, mean that one has not completely “frozen” the increase in the value of his estate.

4.9 Interest free loans to companies

Davis et al (2017) maintain that in the 2016 Budget it was proposed that interest-free and low-interest loans to a trust should be treated as donations. As a result certain interest-free or low-interest loans do, as from 1 March 2017 as has already been mentioned in the previous chapter, attract donations tax in terms of the provisions of section 7C of the ITA. Accordingly what is set out below relates to those interest-free and low-interest loans not covered by section 7C.

Davis et al (2017) suggest that a planner would usually transfer assets to a company by selling them with the consideration left outstanding on interest-free loan account. It has already been established that where an interest-free loan is advanced to a trust, donations tax is applicable. The question which arises is whether this arrangement can result in any liability for donations tax, particularly in the hands of the planner where the interest free loan is advanced to a company.

Davis et al (2017) suggest that in analysing such an arrangement, there are two aspects which could possibly attract donations tax:

- The sale of the assets to the heirs; and

- Allowing the purchase consideration to remain outstanding on interest-free loan account.

Provided that when the assets are sold they are sold for at least their fair market value at date of sale, it seems doubtful whether the sale of the assets per se can attract donations tax. A sale at full market value is surely not a gratuitous disposal as no element of liberality is present.

The next question which arises is whether by not charging interest and allowing the loan to remain outstanding, this gives rise to a potential liability for donations tax. In particular, regard must be had to the provisions of section 58 of the ITA. This section provides that where any property has been disposed of for a consideration which the Commissioner believes is not sufficient consideration it means that that property has been donated, provided that in the determination of the value of such property a reduction shall be made of an amount equal to the value of the said consideration.

Davis et al (2017) suggest that although the case of *CIR v Berold* dealt only with the provisions of section 7(3) of the ITA, it provides some guidance in this connection. They explain that it is necessary to examine the ratio decidendi of the case in the context of the loan account method of transferring assets. The court held that the taxpayer, so long as he did not charge interest on the purchase price of the assets which had been sold to a company, and for so long as he refrained from claiming payment of the amount due, was making a continuing donation to the company. The donation of shares in the company to a trust allowed the trust to obtain the benefit of the continuing donation by way of the enhanced dividends received on the shares. The court consequently upheld the Commissioner's invocation of section 7(3)) of the ITA.

Davis et al (2017) suggest the following:

> It is necessary to distinguish between a loan where no interest is charged and the lender cannot alter the interest conditions and a loan where no interest is charged but the lender is entitled to charge interest. If the lender can charge interest but refrains from doing so, it is submitted that there may well be a donation, as a donation for donations tax purposes includes any 'gratuitous waiver or renunciation of a right'. It must also follow that if not charging interest constitutes a continuing donation of the interest which could have been charged, no donation of capital has taken place. If, by way of example, the capital value of an asset is R100 000, the seller of that asset would normally expect to receive that amount in cash which could be invested, by agreement with some other party, in a way which generates annual income. The right to this annual income then arises from the contract concerned. However, if the seller elects to receive not cash, but an asset of another sort, namely a loan account, and has no right in terms of the contract to charge interest, this does not in itself mean that some sort of capital donation has taken place.

Davis et al (2017) further suggest that assuming an interest-free loan where the lender has no right to charge interest can in the opinion of the Commissioner be regarded as inadequate consideration for the assets sold, where the loan is repayable on demand, the valuation of the continuing donation is obviously extremely problematic. They conclude that no real problem exists, as the current SARS practice is that a mere provision of an interest-free loan is not regarded as giving rise to a donation for donations tax purposes. The donation, in terms of section 62(1)(*d*) of the ITA, has to be valued at the date when it took effect. If the transaction is a loan repayable on demand, and repayment can be demanded at any time, the value of the donation of interest cannot be valued at the date it took effect because it can be terminated at any time.

Furthermore, it should be noted that if the express object of the company is to save estate duty, there is no anti-avoidance provision in the Estate Duty Act equivalent to sections 80A–80L of the ITA which may be invoked by SARS to set the scheme aside for estate duty purposes.

Davis et al (2017) suggest that it may possibly be argued that when a lender makes a loan of money, they expect to recover the amount of money which has been loaned out in the future. If a repayment date is specified it could be argued that the right on that date has a value that is less than the face value (because of inflation) and accordingly the difference between this 'present' value and the face value would constitute a deemed dividend in terms of section 58 of the ITA. Accordingly, to prevent SARS from raising this argument the loan should be made repayable on demand. At the instance that money is lent, there is no inherent right to interest that arises; therefore by not stipulating for interest in the loan agreement there is no 'waiver or renunciation of a right' within the meaning of the definition of a 'donation' for donations tax purposes.

Davis et al (2017) state that the Katz Commission recommended that no specific anti-avoidance measures be introduced to counter the use of interest-free loans in estate planning.

In order to reduce any risk of donations tax it is recommended that where significant assets are sold in this way as part of an estate plan:

- Independent valuations are obtained of the assets sold;
- Where possible, SARS approval is obtained for the transfer values; and
- The loan must be repayable on demand.

Davis et al (2017) observe that:

> The question then arises as to whether section 62(1)(*d*) is in fact the correct valuation provision to apply to such a loan. On the basis that the borrower, until such time as repayment is demanded or the loan period expires, has all the rights in the loan capital, including the rights to all fruits, is the right to an interest-free loan not in fact another like interest in property" for the purposes of section 62(1)(*a*), which refers to "fiduciary, usufructuary and other like interests in property? If so, then, in terms of that section, the interest-free loan should be valued at an annual value of 12 per cent. A similar argument could conceivably be made that the interest not charged constitutes an annuity for the purposes of section 62(1)(*b*). The value of such an annuity, based on the dictum in *Ovenstone,* would be determined on the basis of what the trust, as borrower, would have paid had it borrowed the funds on normal commercial terms. If either of these approaches were accepted, then the donation– if it is a loan repayable on demand– should be valued over the life expectancy of the donor as per the provisions of the aforementioned sections.

Davis et al (2017) suggests that the question of an interest-free loan should be analysed in light of the decision of the Supreme Court of Appeal (SCA) in *C: SARS v Brummeria Renaissance (Pty) Ltd.*

The facts of the case were as follows: There were three housing companies which developed retirement villages. These companies secured the capital for building the homes by way of acquiring interest-free loans from the investors who were the persons who would stay in the homes. In return for the loans the investors were given life rights. Other than the loans the investors were to contribute monthly and if necessary special levies relating to the running costs of the homes. The loans were secured against the properties. An occupier had the right to end his life right and be repaid his loan. Similarly on death the loan became repayable.

In the Tax Court, evidence was led that the loans were required and used solely for the purpose of establishing the retirement homes. If an occupier had to be repaid his loan the companies would raise loans. The companies were engaged in their business from 1988 and the court believed that they were not the only taxpayers carrying on business in the same manner.

Originally the companies were not taxed in the way which became the subject of the cases in the Tax Court. The original assessments were revised then further revised. In the case of Brummeria the revised years involved were 1996 to 2000; in the case of the other companies the revisions went back before 1996.

SARS claimed in the revised assessments that the right to the interest-free loans had a value which constituted gross income. Its statement in respect of this issue read:

> 11. In the case of a developer conducting a housing scheme for retired persons, the capital of the developer is the property units. The property units are employed in its business by either:
>
> 11.1 Selling the units under sectional title to the purchasers; or

> 11.2 Granting the use (occupation) of the units to the occupiers by way of selling life rights to the occupiers.
>
> 12. The quid pro quo which the developer received in return is, respectively:
>
> 12.1 The selling price obtained from the purchasers, in respect of the disposal of the units under sectional title; or
>
> 12.2 The benefit of the rights to interest free loans obtained from the occupiers, in respect of the disposal of the life rights to occupy the units.
>
> 13. The benefit received in exchange for the provision of occupation rights has an ascertainable money value and accordingly falls within the definition of 'gross income' of the Act.
>
> 14. As income tax is calculated on an annual basis, an annual value is placed on the benefit referred to above. The value of the benefit is determined by applying the weighted prime overdraft rate of banks to the average loan capital over the period for which the developer had the use of the loan capital during that specific year of assessment.
>
> 15. The money value of the benefit of the interest free loans accrues to the developers, and as such fall within 'gross income' as defined in section 1 of the ITA.

The taxpayers objected. The Tax Court found for the taxpayer. On appeal the SCA rejected the finding as there was no amount to be taxed as of right as the moneys loaned could not be turned into gross income.

The reasoning employed by Cloete JA to justify rejection of this approach is simple: A right 'to retain and use loan capital for a period of time, interest-free is a valuable right.' This right is capable of being valued in money. The test for such enquiry is objective: The question is not whether the individual taxpayer is in a position to convert the receipt of cash loan into money. The test is objectively whether the receipt can be so converted.

These steps were then employed to arrive at the following conclusion: The Tax Court held that the money which the companies received was not for the purposes of producing any income, and that the Commissioner had therefore assessed the companies on notional income. If the companies had invested the amounts lent, the income which would have been derived from investing the money would have been included in their gross incomes. However, that was not the point. The Commissioner did not seek to tax the companies on that basis. To the argument about the potential for double taxation, the court said:

> No question of double taxation would arise, as suggested by the companies, if the amounts were to have been invested so as to produce interest – in such case there would be two separate and distinct receipts or accruals, each of which would fall to be included in the companies' gross incomes.

Davis et al (2017) suggests that an important aspect of the case concerned the refusal of the court to consider whether the accrual was of capital nature as this issue had not been raised by the taxpayer in its statement of grounds of appeal. It thus appears to be open to argue in

a future case that an interest-free component of a loan is of a capital nature. Take for example, the case of A, who sells his factory to B, for a loan which is interest-free for 20 years. B can argue that the right to use the money loaned for 20 years constitutes the consideration for the sale of a capital asset.

But that, unfortunately, is not the case in the context of an estate plan where A sells his factory to the trust, leaving the purchase price as an outstanding loan. The question which arises after *Brummeria* is whether the trust will be liable to tax on an imputed amount. By imputing income to the recipient of this kind of transaction, the SCA appeared to find that the failure to charge interest constituted a donation. On this basis, it may be contended that A, in the example, has donated an amount to the trust. The latter cannot then be taxed upon the donation which value stands to be taxed in the hands of the donor. But the donation must be valued as at the date when it took effect as per section 62(1)(*d*) of the ITA. If the transaction is a demand donation, so that the loan can be terminated at any time, the value of the donation of interest cannot be valued at the date it took effect because it can be ended at any time. (Davis et al 2017)

The problem with the judgment in *Brummeria* is that, although the facts concerned a trader, in view of the manner in which the judgment is presented, the principle established does not seem to be confined to taxpayers who trade.

4.10 Advantages of a company

Taking into consideration the example of Newco under paragraph 4.7, Davis et al lists potential benefits of such a structure.

Swapping of growth assets for non-growth assets: The planner has in essence swapped his (usually mainly) growth assets for non-growth assets, namely preference shares in, and a loan to, Newco. The preference shares are “non-growth” assets as any increase in the value of Newco’s assets does not accrue to the preference shareholder, but only to the ordinary shareholders. Any dividend payable on the preference shares is limited to a certain amount and on any winding up of Newco the most a preference shareholder would receive is an amount equal to the original subscription price for the shares. (Davis et al 2017)

Ability to keep in control: However, by utilising voting preference shares, the planner may hold a majority of the votes in any general meeting of shareholders of Newco. This is in contrast to how a trust is structured as in a trust, the founder must divest himself from the control of the assets. Accordingly, he may for instance control the composition of Newco’s board of directors. As a result, although he may have transferred some or all of his assets to Newco (or its subsidiaries) he still has a considerable say in how the assets are used. For

example, he may ensure that he is elected as one of the directors of Newco. (Davis et al 2017)

Limited liability: If there is a business involved, by placing it in a separate company (e.g. Opco), the benefits of limited liability are achieved. (Davis et al 2017)

Less danger of dissipation of asset base: By consolidating all the assets in Newco (or any subsidiaries) there is less danger of the asset base being dissipated in the foreseeable future, as all the assets are held via a company over which the planner has significant control. The assets are not being distributed between several beneficiaries at this stage. Even if the shares in any Opco or Propco are not held by Newco, this advantage is still present provided that the planner has some control over such companies via the holding of voting preference shares. (Davis et al 2017)

Share in assets: There is no need at the stage when the structure is set up for the planner to identify precisely which child will ultimately "inherit" which asset; they would merely by way of their ordinary shareholdings in Newco own an effective undivided share in all the assets. This shows that there is flexibility as in a trust if the structure is not rigid. (Davis et al 2017)

Ease of facilitation: The transfer of the business is generally easier to facilitate if shares (in Opco) are transferred rather than the individual assets and liabilities of the business, which would be the case if it is not owned by a corporate entity. (Davis et al 2017)

Pandey (2017) lists advantages of incorporating a company:

Creates a separate legal entity: This states that a company is independent and separate from its members, and the members cannot be held liable for the acts of the company, even when a particular member owns a majority of shares. (Pandey 2017)

Perpetual succession: This means is that members may come and go, and those involved in the running of the company may come and go, but this will not affect the continued existence of the company. This can also be achieved in a trust. (Pandey 2017)

4.11 Disadvantages of a company

Davis et al (2017) states that the use of a company on its own does, however, hold certain disadvantages. These include:

Ring fencing of capital losses: If the disposal of the assets to the company results in a capital loss for capital gains tax purposes the planner can only set off the loss against capital gains arising on the disposal of assets to that company in the future. The loss cannot be set off against the planner's other capital gains. (Davis t al 2017)

Capital gains tax rate: Companies pay capital gains tax at a higher rate than individuals. It is not possible for a company (as opposed to a trust) to vest capital gains in its shareholders and so lower the rate of capital gains tax. (Davis et al 2017)

Estate duty: By having the children as ordinary shareholders, one may be creating an estate duty problem for them in due course, as they now own growth assets. (Davis et al 2017)

Rigid structure: The structure can be fairly rigid in that one is now giving each child exact shares in Newco. This means that it is more difficult to change this ratio at a later stage. This problem can be overcome if the ordinary shareholders in Newco own an effective undivided share in all the assets. (Davis et al 2017)

No distribution of pre-tax income: There is no income splitting as all the income is earned by Newco and its subsidiaries and taxed at the corporate tax rate of 28%. Accordingly, where there are persons who are financially dependent on the planner (e.g. aged relatives or indigent persons) their maintenance cannot be paid out of the pre-tax income of Newco or its subsidiaries. (Davis et al 2017)

Fragmentation of control: After the death of the settlor and his wife, and assuming that each child then holds a portion of the preference shares as well, differences of opinion between the children may occur as to who acquires ultimate control/ownership of which assets. With no independent arbitrator, this may lead to deadlock between them as to the future direction and control of Newco. Fragmentation of control may take place, and the possibility exists of interference in businesses by children not involved in running them. This is in contrast to a trust where a trustee is appointed to ensure that control is maintained. (Davis et al 2017)

Share dealers: Companies are more readily classed as “share dealers” by SARS. Accordingly from this perspective share portfolios, particularly if they are “borderline”, are better placed in trust or individual ownership (the latter being viewed the more favourably by SARS). (Davis et al 2017)

Piercing the corporate veil: A company is a legal person distinct from its members. This rule is known as the ‘Veil of incorporation’. The effect of this rule is that there is an invisible veil between the company and the members of the company. That is, the company has a corporate personality which is different from its members. In a number of circumstances, the Court will cut through the corporate veil or will ignore the corporate veil to get to the person behind the veil or to reveal the true form and character of the concerned company. The rationale behind this is probably that the law will not allow the corporate form i.e. the structure of the company to be mistreated or abused. In those circumstances in which the Court feels that the corporate form is being mistreated, it will pierce through the corporate

veil and expose its true character and nature. This is similar to the trust where it is referred to as piercing the trust veil. (Pandey 2017)

4.12 The use of both a trust and company in estate planning

The rest of this chapter will look at the advantages and disadvantages of structuring a trust within the company for estate planning purposes. The possibility of this structure will be drawn from what has been learnt in the previous chapter about the formation of an inter vivos trusts as well as the current chapter about the formation of a company.

4.12.1 Advantages of integrating a company into the structure

Interest free loans: A structure of this sort overcomes most of the disadvantages of only using a trust as it appears that section 7C is not applicable to an interest free loan advanced to a company. It must be cautioned that SARS may argue that the loan is made indirectly to the trust. (Davis et al 2017)

Maintaining of control: The planner maintains control of Holdco or any other company held by the trust through the preference shares, but all growth in the value of the ordinary shares and the other assets is taken up in the trust and so is outside his estate. It is not essential for the planner to control the trustees of the trust since he controls the underlying companies and thereby controls both the underlying assets and the income and capital flows up to the trust. The possible section 3(3)(d) problems outlined in chapter 3 can be avoided. He will obviously not have the same degree of control over assets held by the trust directly. (Davis et al 2017)

Access of funds: The planner has various options when it comes to having access to funds for either himself or his spouse. He could call up portion or all of his loan accounts, charge interest thereon and as a potential income and capital beneficiary of the trust, he may be distributed funds via that source as well. (Davis et al 2017)

Anti-avoidance provisions: To the extent that income or capital gains are retained in the company rather than the trust, the attribution rules in section 7(5) of the Income Tax Act and paragraph 70 of the Eighth Schedule of the ITA are not applicable. These will be discussed in the following chapter. (Davis et al 2017)

Shielding from creditors: Individual assets may be owned by separate companies, thereby shielding assets from business creditors and facilitating the future transfer of assets, whilst having one overall structure. (Davis et al 2017)

4.12.2 Disadvantages of integrating a company into the structure

Capital gains tax: Companies, like trusts, pay capital gains tax at a higher rate than normal persons. Where only a trust is used, however, there are means of preventing the payment of tax at the higher rate. (Davis et al 2017)

Capital losses: It is possible that capital losses may be isolated with no capital gains to neutralise and also assessed capital losses may be wasted. In the trust-only situation, this will not happen. (Davis et al 2017)

Administration: With a trust and one or more companies, the overall cost in terms of trustees' fees and accounting and auditing costs can be quite high. Furthermore, a multiplicity of entities creates a compliance burden in terms of income tax returns, VAT returns and financial statements. (Davis et al 2017)

Share dealers: Companies are usually more easily seen as share-dealers than trusts or individuals. (Davis et al 2017)

The planner must always consider the flexibility and viability of the structure once neither he nor his spouse are alive.

4.13 Conclusion

This chapter looked at how a company is formed and how to structure a company for estate planning.

A similar effect to that of the trust can be achieved by transferring assets to a company and making the spouse and children of the planner shareholders. The increase in the value of the assets which belong to the company will be for the benefit of the spouse and children who are the shareholders and will not increase the net value of the estate of the planner. The use of a company moves the liability for estate duty from the planner to his or her spouse and children, because the value of the shares will be included as property in their own estates. (Ostler 2012:77)

The chapter looked at interest free loans advanced to companies and whether they could be caught in the net of section 7C. It was concluded that interest free loans to a company are not classified as a donation.

The chapter also looked at the possibility of structuring a trust within a company; that is having a structure where both a company and trust are used for estate planning purposes. This method yielded advantages which would have been disadvantages if only a trust was used and vice versa.

Chapter 5: Donations Tax, Capital Gains Tax and Anti-avoidance provisions

5.1 Donations tax

5.1.1 Introduction

Donations tax was introduced by way of an amendment to the Income tax Act in March 1955. Davis et al (2012) states that the donation is an obvious method of shifting wealth from one person to another, or from one generation to another, and thereby reducing the dutiable amount of one's estate. In this way estate duty could be minimised or avoided altogether. It is therefore strange that non-residents are not liable for donations tax even in respect of the donation of assets situated in South Africa, whereas such assets would attract estate duty.

The case of *Ogus v SIR* explains why donations tax was introduced in South Africa:

> At the outset it is necessary to draw attention to the fact that donations tax was introduced to make up for loss of revenue by way of income tax and estate duty when certain types of donations are made. The mischief aimed at was the practice by taxpayers of reducing their assets by making donations and thereby reducing their income on which income tax is payable, reducing their assets on which estate duty would be payable at their death, and spreading the assets and the income derived therefrom over several taxpayers. The tax is consequently in terms levied in respect of the gratuitous disposal of property. (Olivier, Strydom and van der Berg 2017)

According to Stiglingh et al (2016:826), donations tax is a tax on the transfer of wealth.

> It imposes a tax on persons who may want to donate their assets in order to avoid normal income tax on the income derived from those assets and/ or estate duty when those assets are excluded from their estates. (Stiglingh et al 2016:826)

The donations tax provisions are contained in sections 54 to 64 of the ITA. Section 55(1) contains a number of definitions, of which a few are discussed in this paper.

A 'donation' is defined as 'any gratuitous disposal of property including any gratuitous waiver or renunciation of a right.' (Section 55(1) of the ITA)

A 'donee' is defined as:

> any beneficiary under a donation and includes, where property has been disposed of under a donation to any trustee to be administered by him for the benefit of any beneficiary, such trustee: provided that donations tax paid or payable by any trustee in his capacity as such may, notwithstanding anything contrary contained in the trust deed concerned, be recovered by him from the assets of the trust. (Section 55(1) of the ITA)

'Property' is defined as 'any right in or to property movable or immovable, corporeal or incorporeal, wherever it is situated.' (Section 55(1) of the ITA)

5.1.2 Donations tax and trusts

Olivier et al (2017) states that property constitutes an essential element of a trust, it is usual practice to create an inter vivos trust with a donation of property to the trustee. Once the disposal of property to the trustee has become a disposal under a donation, it can only follow that such a disposal may be taxable. Donations tax can be levied if the disposal is gratuitous or if it takes place by way of a sale at a consideration which in the opinion of the Commissioner is inadequate.

In ITC 891 the taxpayer created an inter vivos trust and donated R40 000 to the trustee for the benefit of his daughter and her children. While the daughter was alive, she was the sole income beneficiary of the trust. It was contended by the taxpayer that he made two donations, firstly of a usufruct or like interest to his daughter and secondly of the bare dominium to his grandchildren. The court did not hesitate to reject this argument and held that there was a single donation of R40 000 to the trustee. The judgment clearly identified the definition of a donee in section 55(1) of theITA, which clearly identifies a trustee as a donee who can be taxed.

The exemptions applicable for trusts are in paragraph 5.3 below.

5.1.3 Transfer of assets to a trust to fulfil a legal obligation

It has already been established that in terms of the ITA, any gratuitous transfer of ownership or gratuitous renunciation of a right constitutes a ‘donation’.

This gives rise to the question of what exactly constitutes a donation in terms of everyday life. For an example, if a mother gives her minor daughter pocket money, will this be viewed as a donation in terms of the definition of a ‘donation’? The answer is ‘definitely not’. The payment was not a ‘gratuitous transfer’, because, by law, a mother has an obligation to support her daughter, and giving her pocket money is simply a way of doing so.

The question that then arises is if the above-mentioned situation can be distinguished from the one where a parent creates a trust on behalf of a minor, and transfers a large amount for an example R1 million to the trust and the trust deed makes it clear that the purpose of the trust is to pay maintenance to the child. The only difference is that the trust has been used as an intermediary mechanism (between parent and child) to fulfil the duty of support that is owed to the child. The question is; will the transfer of the R1 million to the trust be regarded as a donation on which donations tax will be payable.

In *CSARS v Estate Welch* 2004 the facts of the case were as follows: During the course of divorce proceedings, a couple by the name of Welch signed a settlement agreement which

was made an order of court. In the agreement, Mr Welch acknowledged and accepted that after the divorce he would have a legal duty to maintain his former spouse and their minor child. He agreed to pay Mrs Welch R4 500 per month, and his child R1 500 per month. In the document, it was also stated that Mr Welch had the responsibility of establishing a trust for the sole purpose of paying maintenance and that if at any time the trust was unable to make such payments, Mr Welch would be responsible for making the payments in his personal capacity. Mr Welch, in compliance with the maintenance obligation that had been imposed on him, then established the trust with a donation of assets worth approximately R3,2 million. The beneficiaries of the trust were his ex-wife, minor child, himself and his child from a previous marriage. However, Mr Welch died before the capital could be transferred to the trust. The executors in his estate transferred assets worth R3,2 million to the trust and SARS tried to tax the donation. The courts found in favour of Mr. Welch that that the transfer of the assets to the trust could not be seen as a donation in terms of section 55. The majority judgment was that the transfer of the assets to the trust was not motivated by “pure liberality or disinterested benevolence”. In summary, it may be said that the court’s decision has been able to create a possibility to establish a trust where assets are transferred to the trust with the sole objective of relieving the founder/ donor of his legal duties. However it must be stressed that the trust document will have to be very carefully worded if donations tax is to be avoided.

5.1.4 Donations by a company

Section 57 of the ITA provides that if a person disposes of any property under the name of the company and that disposal would have been treated as a donation if that person had disposed of that property under his individual capacity, then that disposal is deemed to be a donation which was made by that person who disposed of the property.

In the 2017 Comprehensive Guide to Dividends Tax, SARS states that if a company makes a donation to someone, on the instruction of a shareholder, this is a dividend because it is paid on behalf of the shareholder. If the shareholder is not a South African company, the dividend may be subject to dividends tax. If the donation is subject to donations tax, SARS will raise donations tax on the shareholder. (Haupt 2018:846)

5.1.5 Deemed donations

In terms of section 58 of the ITA, the disposal of property for an inadequate consideration is deemed to be a donation, to the extent that the “adequate consideration” exceeds the actual consideration given.

5.1.6 Exemptions from donations tax

The exemptions are set out in section 56 of the ITA. Section 56(1) of the ITA addresses the exemptions in respect of the value of any property which is disposed of under a donation. Section 56(2) of the ITA addresses other disposals. Honiball (2009:260) suggests that the purpose of a successful estate plan is to decrease the value of an estate during the planner's lifetime with the aim of avoiding donations tax and this is often attempted by setting up a trust. There will be a discussion on those exemptions which are relevant for this discussion owing to their connection to trusts, CGT and estate duty. Section 56(1) of the ITA states that donations tax will not be payable when a property is disposed of under a donation under the following circumstances (which are relevant for this discussion):

a) The donation is made under a duly registered antenuptial or post-nuptial contract for the advantage of the donors spouse;
b) The donation is made for the advantage of the spouse where they (the donor and spouse) are not separated under a judicial order or notarial deed of separation;
c) The donation is made by the donor in anticipation of death (*donatio mortis causa*);
d) The donation is made in such a way that the donee will not benefit from the donation until the donor dies;
e) The donation is cancelled within six months from the time it was made

…

l) if such property is disposed of under and in pursuance of a trust.

Paragraphs (a) and (b) above are exempt from both donations tax and CGT. Paragraphs (c), (d) and (e) are exempt from donations tax but not CGT. In other words, any growth in the value of the assets donated will be subject to CGT.

5.1.7 Donatio mortis causa (paragraph (c))

Honiball (2009:265) explains that:

> Even though a trust is not a separate entity under South African common law, assets donated to it will not form part of the deceased estate of the donor. This is the case with inter vivos trusts. Where the trust is a testamentary trust and only comes into existence on the donor's death, the assets donated to such trust will still form part of the deceased estate for estate duty purposes. As these assets will be subject to estate duty, a donatio mortis causa is exempt from donations tax under section 56(1)(*c*) of the ITA.

5.1.8 Donations under which the donee will not obtain any benefit until the death of the donor (paragraph (d))

Section 56(d) of the ITA provides that donations tax will not be payable in respect of the value of any property which is donated in such a way that the donee will not benefit from the

donation until the donor dies. As already mentioned, a ‘donee’ means ‘any beneficiary under a donation and includes a trustee where property has been disposed of’ to a trust. Therefore this exemption applies if property is donated to a trustee of a trust.

5.1.9 Transactions where property is disposed of under, and in pursuance of, any trust (paragraph (l))

In terms of paragraph (l) above, donations tax is not applicable in respect of property which is donated ‘if such property is disposed of under and in pursuance of a trust.’ Olivier et al (2017) explains that this section merely ‘means that any distribution of trust property to the beneficiaries is not regarded as a donation for the purposes of donations tax.’

Marais (2014:37) states that this section ensures that there will be no double taxation. When an amount is distributed or allocated to a beneficiary, section 56(1)(*l*) of the ITA ensures that no further donations tax liability arises. This is because donations tax would have arisen at the initial donation to the trustee. This section ensures that a distribution to a beneficiary does not attract donations tax provided that the distribution is made by trustees in accordance with the terms and conditions of the trust deed.

Section 56(2) of the ITA lists further exemptions which could have a specific application to trusts.

5.1.10 Casual gifts

Section 56(2)(*a*) of the ITA allows for an exemption from donations tax of

> so much of the sum of the values of all casual gifts made by the donor other than a natural person during any year of assessment as does not exceed R10 000 provided that where the year of assessment exceeds or is less than 12 months, the amount in respect of which the tax shall not be payable in terms of this paragraph shall be an amount which bears to R 10 000 the same ratio as that year of assessment bears to twelve months.

Section 56(2)(*b*) of the ITA further allows for an annual exemption from donations tax of R100 000 for natural persons. This means that natural persons can make annual donations of the said amount tax free.

5.1.11 Maintenance

Section 56(2)(*c*) states that bona fide contributions which are made by an individual for the maintenance of someone are exempt from donations tax. The Commissioner exempts the amount which he considers to be reasonable. Honiball (2009) explains that this exemption is available to trusts and not confined to natural persons.

It is not uncommon for estate planners to make small disposals annually so as to avoid donations tax while they are still alive and to minimise the payment of estate duty after their death.

5.1.12 Valuation of donated property

Section 62 of the ITA sets out how donated property should be valued for donations tax purposes. Section 62(1)(*a*) of the ITA deals with fiduciary, usufructuary and like interests, section 62(1)(*b*) of the ITA deals with annuities and section 62(1)(*c*) of the ITA deals with bare dominium rights of ownership in property. Section 62(1)(*d*) of the ITA states that:

> in the case of any other property not dealt with by the above-mentioned subsections, the value thereof shall be the fair market value of such property as at the date upon which the donation takes effect provided that in any case in which as a result of conditions which in the opinion of the Commissioner were imposed by or at the instance of the donor, the value of any property is reduced in consequence of the donation, the value of such property shall be determined as though the conditions in terms of which the value of the said property is reduced in consequence of the donation had not been imposed.

Section 64 of the ITA states that donations tax is levied at 20 percent of the value of property donated. In the Budget Speech presented by the Minister of Finance, Malusi Gigaba on 21 February 2018, he stated that donations tax would be levied at 25% for donations of more than R30 million. This is effective from 1 March 2018.

5.1.13 Calculation of the liability

Stiglingh et al (2016:827) set out the steps to be used when calculating donations tax:

1. Identify the disposal of property by a resident
2. Determine whether the disposal constitutes a 'donation' as defined or if it is deemed a donation in terms of section 58 of the ITA.
3. If the disposal is a donation or is deemed a donation, determine whether it is specifically exempt from donations tax.
4. If it is not specifically exempt, determine the value of the donation. If the donee paid any consideration for the property, the consideration paid must be deducted from the value of the donation.
5. Deduct the balance of the general exemption available to the taxpayer from the value of the taxable donation.
6. Multiply this value by 20 percent or 25 percent to determine the donations tax payable.

5.1.14 Payment of donations tax

The donor is liable for donations tax, however if the donor does not fulfil his obligation to pay the donations tax within the prescribed period (which is the end of the month following the month after the donation occurred), both the donor and donee become liable to pay the donations tax.

5.1.15 Donations tax and death

A *donatio mortis causa* is exempt from donations tax in terms of section 56(1)(*c*). However a *donatio mortis causa* is not exempt for estate duty purposes. This is included in the donor's estate on death as discussed in Chapter 3. There is an annual exemption of R100 000 which is enjoyed by natural persons according to section 56(2)(*b*), for donations tax purposes. It can be expected that from a tax planning perspective, people utilise this exemption by making annual donations of R100 000 to their family trusts in order to minimise the value of their estate upon death and with the result of reducing their estate duty liability.

Davis et al (2012) mentions that a donation is the obvious method of shifting wealth from one person to another, or from one generation to another, and thereby reducing the dutiable amount of one's estate. In this way, estate duty could be minimised or avoided altogether.

5.2 Capital Gains Tax (CGT)

5.2.1 Introduction

CGT came into effect in South Africa on 1 October 2001 by virtue of the addition to the Income Tax Act of the Eighth Schedule (in terms of the Taxation Laws Amendment Act 5 of 2001). Before its introduction any capital gain a person made on the disposal of an asset was not taxable. According to Haupt (2018:660) the basic principle behind CGT is that:

> If a capital asset is sold at a profit, the profit is subject to CGT, and if it is sold at a loss, the capital loss can be set off against other capital profits. If there are no other capital profits in the year, the capital loss is carried forward to the next year.

CGT is not a separate tax but has been incorporated into the Income Tax Act in terms of section 26A and is regarded as tax on income. (Haupt 2018)

The significant and relevant sections of the Eighth Schedule will be discussed in this paper.

5.2.2 Application

The Eighth Schedule applies to a disposal by a South African resident of assets on or after 1 October 2001. For non-residents, only the disposal of certain kinds of assets are taken into account. There will be no further discussion on CGT and non-residents.

Paragraph 1 of the Eighth Schedule defines an 'asset' as:

> Property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and
>
> A right or interest of whatever nature to or in such property

A 'disposal' is defined as:

> An event, act, forbearance or operation of law envisaged in paragraph 11 or an event, act, forbearance or operation of law which is in terms of this Schedule treated as the disposal of an asset, and 'dispose" must be construed accordingly.

Part 3 of the Eighth Schedule deals with the disposal and acquisition of assets. Part 3 paragraph 11 deals specifically with disposals. Subparagraph (1) explains what constitutes a disposal while subparagraph (2) explains what does not constitute a disposal. This paper will look at disposals relevant to the discussion.

In terms of subparagraph (1)(a) a disposal includes the 'sale, donation, expropriation, conversion, grant, cession, exchange or any other alienation or transfer of ownership of an asset.' The fact that a donation is considered to be a disposal for CGT purposes is of significance as this raises a possibility of double taxation, namely the application of both CGT and donations tax. In terms of subparagraph (1)(d) when an interest in a trust asset vests in a beneficiary, this constitutes a disposal. This is of significance as the vesting of interests in trust assets in beneficiaries is a commonly used estate planning method. Similarly, subparagraph (1)(f) which involves 'the granting, renewal, extension or exercise of an option,' is of significance as options may be granted to family members as part of an estate plan.

The disposals set out in subparagraph (2) which are excluded from CGT are not relevant to this discussion as none of them is disposed of under a donation or form part of the estate of a deceased person.

In determining whether a disposal will incur CGT, Stiglingh et al (2016:872) provide the following guidelines:

> In determining whether the disposal of a particular asset will result in a capital gain and therefore be subject to CGT, it is first necessary to determine whether the disposal is revenue in nature by applying the basic principles of income tax. If it is determined that the disposal is revenue in nature the gain or loss will then be subject to normal tax, not CGT. The proceeds that are taken into account for normal tax purposes are specifically excluded from proceeds that are used to calculate a capital gain or loss for CGT purposes (par 35(3)(*a*)). Any expenditure allowed for normal income tax purposes is excluded in a similar way from the base cost that is used to calculate a capital gain or loss for CGT purposes (Par 20(3)(*a*)).

5.2.3 Calculation of the liability

The Comprehensive Guide to Capital gains Tax (2017:64) provides that:

> A person's capital gain for a year of assessment on the disposal of an asset during that year is equal to the amount by which the proceeds received or accrued in respect of the disposal of the asset exceed the base cost thereof.

An annual exclusion of R40 000 is allowed in the 2018 year of assessment. The exclusion is substantially higher if a person dies during the year of assessment. The annual exclusion in the year of death is R300 000 in the 2018 year of assessment. A person's taxable capital gain is 40%. This amount is then added to the taxpayer's taxable income for the year of assessment. Therefore the effective tax rate for an individual who is on the highest income bracket i.e. 45% is 18%. There is also an exclusion to natural persons who dispose of their primary residence. This exclusion is R2 million for the 2018 year of assessment.

The calculation of the CGT liability on the disposal of an asset may be best explained by way of an example. If a taxpayer is paying tax at the maximum marginal rate of 45% and he or she sells a house in November 2017 for R2 million, which house had cost him R1.2 million in 2013 then his or her CGT liability will be calculated as follows:

Proceeds of sale……..R2 million

Base cost……..(R1.2 million)

Capital gain……..R800 000

Annual exclusion…….(R40 000)

Net capital gain……R760 000

Taxable capital gain (40%)……R304 000

Tax at 45%.....R136 800

The above example assumes that the house sold was not a primary residence, there was no capital loss brought forward from the previous tax year and the maximum marginal tax rate is applicable.

5.3 Donations and CGT

A donation is a disposal for CGT purposes. Paragraph 38 of the Eighth Schedule to the ITA states that where an asset is disposed of by way of donation, the donor is deemed to have disposed of the asset for market value and the donee is deemed to have acquired it at the same market value.

Haupt (2018:697) states that when the donor calculates the deduction of the base cost from the deemed proceeds, he may add a portion of the donations tax to the base cost. This is calculated in terms of paragraph 22 of the Eighth Schedule to the ITA. By way of an example, if a person donates fixed property with a market value of R2 million and a base cost of R1 million, and assuming the exemption of R100 000 for donations tax has been used on other donations, the donations tax payable will be R400 000 but only R200 000 will

be added to the base cost for CGT purposes ([R2 million – R1 million] / R2 million × R400 000). The CGT would then be equal to R600 000 ([R2 million – (R1 million + R400 000)]

Davis et al (2012) explain that with regard to donations, if a person donates an asset or sells an asset at a price which cannot be measured or sells an asset to a connected person at an amount which is not at arm's length,

- That person who donated or sold the asset will be treated as if they sold the asset at market related value at the date of disposal and
- The person who bought the asset will be treated as if they bought the asset at a market related price which price is the acquirer's base cost (together with the costs of any improvements to the asset)

This provision is in paragraph 38 of the Eighth Schedule to the ITA.

It should be noted that while donations of cash attract donations tax, they do not attract GCT. An asset consisting of cash forming part of the estate is, however, subject to estate duty.

5.4 Trusts and CGT

Haupt (2018:737) emphasises that a trust, like any other taxpayer, pays tax on a portion of its capital gain and as a non-natural person, 80% of the net capital gain of a trust is included in taxable income unless it is a special trust.

Honiball (2009) suggests that trusts are treated harshly by the Revenue Authorities by virtue of paying capital gains tax at a rate which is twice as much as it is for individuals.

Trusts do not qualify for interest exemptions, the CGT annual exclusion and individual rebates unless they are special trusts which are out of scope for purposes of this discussion. (Honiball 2009)

Capital gains tax will apply to a discretionary trust if there has been a 'real' or 'deemed' disposal by the trust. The assets which are kept under a discretionary trust are the assets of the trust itself for CGT purposes, until such time as the assets have vested unconditionally in a beneficiary. Capital gains will arise for the trust if any disposals of assets are made by the trust until such time that the assets vest in a beneficiary. The vesting of a trust asset in a beneficiary is a disposal for capital gains tax purposes. This event is deemed to be a market value disposal as stated in paragraph 11(1)(*d*) read together with paragraph 38 of the Eighth Schedule to the ITA, because the trust is a connected person in relation to the beneficiaries. (Marias 2014:31)

5.5 Capital gain distributed to a beneficiary

Haupt (2018:737) explains that 'a capital gain is not an economic concept like profit and that the trust deed must specifically give trustees the power to distribute the capital gain or parts of the gain.'

Paragraph 80(1) of the Eighth Schedule provides that gains made by a trust on the disposal of an asset which vest in a resident beneficiary are taxable in the hands of the beneficiary. This provision is subject to paragraph 68, 69, 71 and 72 of the Eighth Schedule to the ITA. It must be noted that the gain must vest in a resident beneficiary in the same tax year in which it arises. If the gain does not vest in the beneficiary in the same tax year, the trust itself will be taxed on the gain. Likewise, if a portion vests in the beneficiary in the tax year, only the portion will be taxed in the beneficiary's hands and the remainder of the gain will be taxed in the trust. The significance of the residency of the beneficiary is that a gain which vests in a non-resident beneficiary will not be taxed in the non-resident beneficiary but rather in the hands of the trust. Likewise if a gain is vested in a tax-exempt public benefit organisation, or tax exempt public benefit organisation, or tax exempt recreational club, or in the Government, or any provincial organisation, the trust will be taxed. The trust will also be taxed if the gain vested in any entity exempt from tax in terms of section 10(1)(*b*), (*cA*), (*cE*), (*d*) or (*e*). (Haupt 2018:738) (Marais 2014:31)

Capital gains retained by the trust

> Paragraph 70 deals with gains retained in the trust and states that where a South African resident makes a donation, settlement, or similar disposition to a trust and the trust makes a capital gain as a result of that donation or disposition, the resident is taxed on that capital gain instead of the trust if the gain is not distributed to or vested in a beneficiary who is a South African resident. (Haupt 2018:740)

Attribution of capital gains distributed by a trust

> Paragraph 71 states that if a capital gain is made to a beneficiary and the creator of a discretionary trust (the donor) has a right to revoke the beneficiary's right to the capital distribution, then the creator is taxed on the gain so distributed (to the extent that it is attributable to the gratuitous disposition made by the creator of the trust). (Haupt 2018:741)

Capital gains attributed to donor

> Paragraph 73 states that where both an amount of income and a capital gain are derived by reason of, or are attributable to a donation, settlement or other disposition, then the capital gain attributed to the 'donor' may be limited to what the trust earned by reason of the fact that the donor did not charge a market related rate of interest. (Haupt 2018:742)

5.6 Companies and CGT

Company distributions are dealt with in Part XI of the Eighth Schedule (paragraphs 74 to 78). Haupt suggests that in a nutshell the following points are important:

- When a company or close corporation distributes an asset as a dividend or a repayment of capital to a shareholder, the company or close corporation will have a capital gain or a capital loss, depending on whether the market value of the asset is higher or lower than the asset's base cost. A distribution of cash has no capital gains tax effect for the company as cash is not an 'asset' for CGT purposes.

- When a shareholder receives a distribution from a company (of cash or assets) the distribution will either be a tax-free dividend to the shareholder, or a return of capital (capital distribution). If it is a return of capital, it will be subject to either normal income tax or the tax on capital gains, depending on whether the shareholder held the share as a revenue asset or a capital asset. A repayment of share capital or share premium, for example, is a capital distribution because it is not a dividend as defined. Under the new dividend definition it is a return of 'contributed tax capital'

Like trusts, the inclusion rate for CGT purposes for companies is 80%. Therefore a company pays CGT at an effective tax rate of 22.4%.

In specie dividend distributions

> Paragraph 75 states that where a company distributes an asset *in specie* to a shareholder, the company must be treated as having disposed of the asset to the shareholder for proceeds equal to its market value on the date of the distribution. The shareholder is deemed to have acquired the asset on the date of the distribution for an expense equal to the market value of the asset. Haupt (2018:743)

5.7 Anti-avoidance provisions

There was a discussion on section 25B of the ITA in chapter 3. In summary, section 25B provides that if any income accrues or is paid to a beneficiary during the year that the income is received by the trust, the beneficiaries will be taxed on the income and for tax purposes even though the income initially accrued to the trust. They will also be deemed to have incurred the expenditure in relation to that income which is now received. It was also briefly mentioned in chapter 3 that section 25B of the ITA is subject to the deeming provisions of section 7(1) - 7(11) of the ITA.

Botha et al (2018) states that 'the deeming provisions will apply if income has been received by virtue of any donation settlement or gratuitous disposition made by any person'.

In *Ovenstone v CIR* the expression 'other disposition' was described as meaning 'any disposal of property made wholly gratuitously out of liberality or generosity'. Gratuitous transactions are thus donations, interest free or low interest loans. Botha (2018) states these interest free loans are common when assets are sold by the founder to the trust for the

avoidance of donations tax, however these interest free or low interest loans as gratuitous dispositions are not free from the provisions of section 7. In *Joss v SIR '*only the interest-free loan in respect of the purchase price of the shares was deemed to be a disposition within the meaning of s 7(3)'. Therefore if a transaction is partly commercial and partly gratuitous an apportionment is possible to include in taxable income only that part of the transaction which is gratuitous. If it is not possible to determine the apportionment, the transaction will be treated as a gratuitous disposition. (Botha et al 2018)

The anti-avoidance provisions as envisaged in the Act are discussed in detail below.

Section 7(2): Deems any income which is received or accrues to a spouse by virtue of a donation from the other spouse to be the income of the spouse who donated the asset.

Honiball (2009) states that there has to be a donation, settlement or other disposition in order for the section to apply. It is obvious that this section seeks to prevent spouses from splitting income between themselves to reduce their combined tax liability.

Section 7(3): Any donation, settlement or other disposition made by a parent, which results in income being received by a minor child, which has been expended for his maintenance, education or benefit or has been accumulated for his benefit, the section deems the income to have been received by or accrued to the parent of the minor child. This section clearly aims to prevent income splitting between the parent and the minor child to prevent the parent from taking advantage of the child's lower tax rate.

Honiball (2009) states that this provision could apply to a trust where a parent has set up a discretionary or vesting trust for the benefit of his minor children. The parent would continue to be taxed on the income and neither the trust nor the children. This is tricky because in *CSARS v Estate Welch*, it was found that the transfer of assets to a trust to fulfil a legal obligation was not deemed a donation. Therefore one would argue that the purpose of transferring assets to a trust is not motivated by "pure liberality or disinterested benevolence" but rather to fulfil a legal obligation in order to avoid being caught by the provisions of this section.

Stiglingh et al (2016) highlight that income from a donation made by a parent to a major child is taxable in the child's hands, unless some other anti-avoidance provision is brought into effect, such as the general anti-avoidance rule contained in section 80A to 80L. The provisions of s 7(3) would thus not apply in respect of income which accrues after the child has attained majority.

Section 7(4): This provision addresses a situation where income accrues to a minor by way of donation, settlement or other disposition made by a third person other than the parent of

the minor child but who is family. The income which accrues or is received by the minor will be deemed to be that of the parent of that child. (Marais 2014:25) This section clearly seeks to prevent parents from introducing a third party to make a donation by avoiding the possibility of being caught in the section 7(3) net.

Section 7(5): This section applies where any person has made any donation, settlement or other disposition which is subject to a condition, which could be imposed by the person who makes the donation or any other person and has the effect that the beneficiaries cannot receive the income until that condition has been lifted or until the happening of a certain event. That income is then deemed to be that of the person who has made the donation until the happening of that event or until death, whichever occurs first. (Marais 2014:26)

Honiball (2009) suggests that section 7(5) is one of the most significant anti-avoidance provision which pertains to trusts and that it applies when both of the above-mentioned conditions are met. I.e. the donation is subject to a condition and the beneficiaries will not receive the income until the happening of a certain event. The amount which would have been received by the beneficiary is included as the donor's income.

Section 7(6): This provision applies where a donor has the right to cancel the right of a beneficiary to receive income. The section stipulates that the donor will be taxed on that income which has accrued or has been received by the donor. The provisions of this section will not apply when the donor no longer has the powers over the rights of the income. (Marais 2014:28)

Section 7(7): This provision applies where investment income has been received by another person as a result of a donation, settlement or other disposition. The donor will be taxed on the investment income if he has retained the right to regain the property in the future. (Marais 2014:28)

5.8 Conclusion

This chapter looked at donations tax and CGT in the context of estate planning. It is submitted that donations tax and CGT are wealth taxes as they are aimed at targeting the wealthy. There is an overlap between donations tax and CGT because a donation is considered to be a disposal for CGT purposes.

Both trusts and companies do not pay donations tax. It should be noted that while donations of cash attract donations tax, they do not attract CGT.

CGT will apply to a discretionary trust if there has been a 'real' or 'deemed' disposal by the trust. Capital gains will arise for the trust if any disposals of assets are made by the trust until

such time that the assets vest in a beneficiary. The vesting of a trust asset to a beneficiary is a disposal for capital gains tax purposes.

There was also a discussion on the anti-avoidance provisions which seeks to tax the person who has made any donation, disposition or settlement to another person in order to avoid paying tax on the income that may accrue to him or her.

Chapter 6: Conclusion

The objectives of estate planning include amongst other things assurance to the planner that he is able to appreciate the income which is yielded from his assets in his estate during his lifetime and after he has passed on. Estate planning does not only involve the minimization of estate duty as often envisaged but rather flexibility and provision of capital and income for the beneficiaries who are left behind. A good estate plan is one which is also able to provide capital protection from creditors to ensure that beneficiaries have peace of mind when the planner has passed on.

The discussion in chapter 2 demonstrated the complexity of the calculation of the estate duty liability. It can be quite confusing as to what should be included in the estate of the deceased. 'Property' was defined for estate duty purposes and it can be submitted that the definition is extremely wide and includes almost everything which could be thought of to be defined as property. It can be submitted that if the deceased has not kept records of all his or her investments as well as documentation of his or her limited interests, it may be difficult to establish what property was owned by the deceased at the time of death. The discussion of wills was out of the scope for this paper, however it can be deduced that it is of utmost importance that the planner keeps a record in writing of all his 'property'. There was also a discussion on deemed property. It is the responsibility of the Executor to scrutinize if the planner could have deemed property included in the estate to ensure that the provisions of the Estate Duty Act are applied. Likewise, the executor must ensure that the allowable deductions are taken into account as well as to claim any available rebates or credits. The Estate Duty Act does not have any anti avoidance provisions expressed in the Act but the very nature of the 'deemed property' which is included in the estate demonstrates the idea of taking away from tax planning from the deceased. For an example, property which was donated and exempt from donations tax under section 56(1)(*c*) or 56(1)(*d*) of the ITA is included as property in the estate of the deceased. Notwithstanding the above, there could still be opportunities for avoidance by the utilization of the allowable deductions. It can be submitted that almost everything which was not taxed while the planner is alive will be taxed when the planner dies.

The discussion in chapter 3 attempted to determine if trusts are still a viable tool or if they still have a role in estate planning. The trust itself pays tax at the highest rate for both taxable income and capital gains tax. The income tax rate is 45% and the effective capital gains tax rate is 36%. A trust is not a natural person therefore it does not qualify for any tax rebates or any capital gains tax exclusions. The use of a company for estate planning was discussed in chapter 4. The company pays tax at a rate of 28% and at an effective capital

gains tax rate of 22.4%. Like a trust, a company is not a natural person and also does not qualify for rebates and capital gains tax exclusions. Without looking at any other factors, it can be seen that from a tax perspective, in contrast to a company, the trust is definitely not favoured by SARS. Companies are viewed as 'share dealers' by SARS whereas trusts are viewed as the means to avoid tax. Over the years, SARS has put measures in place to restrict the perceived tax avoidance associated with trusts. It has been easier to increase the tax rates incurred by trusts as opposed to increasing the tax rates for companies because increasing the tax rates for companies could discourage foreign investment from foreign investors.

Notwithstanding the highest rate at which a trust pays tax, the trust does obtain a tax advantage through the 'conduit' principle. This is achieved when the trust income or capital gain is vested in the beneficiaries in the same year that the income accrues to the trust. In this way, the beneficiaries are taxed on the income and not the trust. The advantage of this is that it may be possible that the beneficiaries are taxed at a lower rate of marginal tax. The beneficiaries who are natural persons can also enjoy rebates and the capital gain annual exclusion will apply. If the DTC's recommendations to repeal section 25B of the ITA for residents were to be ever promulgated, this would be yet another disadvantage to establishment of trusts.

A trust can be used to protect assets from creditors because beneficiaries are able to enjoy the use or benefits of an asset which is held in the trust but not having ownership of the trust. A company as a juristic person offers the same benefit because of its limited liability status.

The manner in which assets are transferred to a trust are of utmost importance because they come with different tax consequences. It was submitted that if assets are donated to the trust, donations tax arises but estate duty is avoided. If the assets are sold on a loan account at an arm's length interest rate, the donor will be taxed on the interest received from the trust. Although a trust offers protection, the amount of the loan account will remain an asset in the founder/ donor's estate until the trust repays the founder/ donor. This means that the amount of the loan account is not protected from creditors. This was one of the disadvantages that could be encountered. If the assets are sold on a loan account at an interest rate below the arm's length rate, section 7 C of the ITA may be invoked. This section states that the difference in the interest payable versus the official rate of interest will be deemed to be a donation. This section has surely closed a tax planning loophole that has been used for years. This problem can be overcome by charging interest at the official rate. It was established that interest free loans advanced to companies do not fall within the ambit

of section 7C. It can be submitted that it is better to advance an interest free loan to a company than to a trust from a tax perspective.

One of the main disadvantages of establishing a trust for estate planning is that the founder must divest himself completely of the ownership and control of the assets.

The parallel advantages of a trust and a company are that the assets owned in both will not be subject to estate duty and executors fees upon the death of the founder. The parallel disadvantages are that of the corporate veil and trust veil and the administration of drafting financial records and submitting annual returns.

If a trust is merely set up for the avoidance of tax, it is doubtful that it will satisfy expectations in the future because of the scrutiny of trusts from Revenue authorities which has resulted in harsh tax laws for trusts.

The possibility of integrating a trust within a company was also discussed. The advantages of this structure were that the founder can still maintain control of the assets through the company and that section 7C does not apply to interest free loans advanced to companies. Furthermore the deeming provision of section 7(5) of the ITA will not apply to capital gains retained in a company. The most significant disadvantage could be the administration of running both a company and trust. This could be too costly as both entities require financial statements and are required to submit returns.

It is submitted that the goals of the research have been met. The objectives of estate planning were established. The advantages and disadvantages of using a trust for estate planning purposes were identified and discussed. The advantages and disadvantages of using a company for estate planning purposes were also identified and discussed. The possibility of structuring a trust within a company was also explored and the advantages and disadvantages were discussed. Lastly, the income tax, donations tax and capital gains tax implications for the above-mentioned options was discussed. The question that remains is which vehicle is ultimately the best for estate planning. It can be submitted that there is no blanket answer. Although the objective of estate planner is similar for individuals, individual's circumstances, family structures and finances are different therefore it is difficult to say which vehicle is the best for everyone. It can be submitted though that trusts are still a great tool to offer protection of assets which is useful in estate planning. Currently as things stand, perhaps it is better to structure a trust within a company in an estate plan to leverage off the advantages and disadvantages of a company and trust, although this option may be costly.

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