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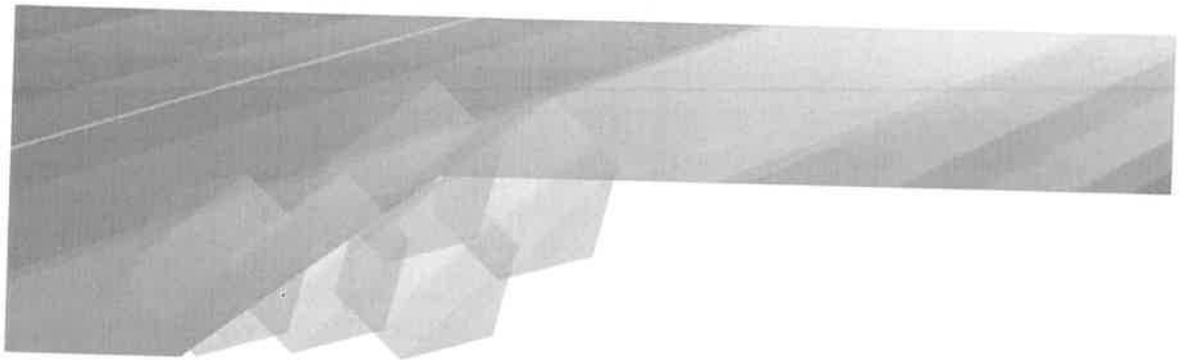
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2019

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Crafford, Carel Pieter,(2019). The feasibility of trust as a generation skipping device based on the amendments to the Income Tax Act and the Davis tax committee's report into wealth taxation as well as the potential effect these may have on trusts, University of the Witwatersrand, https://hdl.handle.net/10539/29690

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UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

University of the Witwatersrand, Johannesburg

The feasibility of trusts as a generation skipping device based on the amendments to the Income Tax Act and the Davis Tax Committee's report into wealth taxation as well as the potential effect these may have on trusts.

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 (specialising in taxation).

Sandton, 2019

Student: Carel Crafford

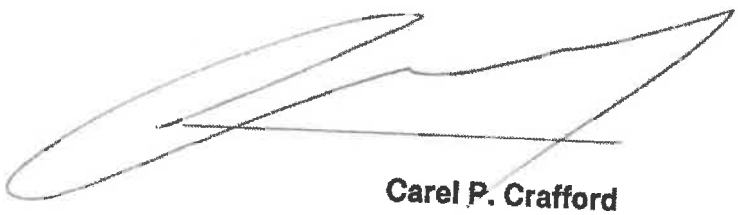
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Declaration

By submitting this research report electronically, I declare that the entirety of the work contained therein is my own original work, that I am the sole author thereof save to the extent explicitly or otherwise stated, that the reproduction and publication thereof by Witwatersrand University will not infringe any third party rights and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

Johannesburg, February 2019.



Carel P. Crafford

Abstract

Trusts are not as desirable as they once were, and every year they seem to become less so. The reason for their increasing undesirability is the heavy tax burden they carry. In addition, wealthy individuals generally choose a trust as the chosen vehicle in which to hold their assets and they have as a result, come under further attack. This study will look at the feasibility of wealth taxes and the taxation of trusts in South Africa. The Davis Tax Committee's recent proposals on trusts and wealth tax (April 2018), the amendments to the Income Tax Act, specifically section 7C, as well as the present and future usefulness of trusts as an estate planning tool, or in the words of the Katz Commission a 'generation skipping device', and the constant intermittent threats of removing the 'conduit pipe principle', will be considered herein.

There seems to be a persistent view, as discussed in the Davis Tax Committee reports, as well as by Thomas Picketty, that trusts are predominantly utilized by high net worth individuals to avoid tax or even to evade tax. The research will also briefly look at taxing trusts in general, and their feasibility in the future.

The focus of this report will essentially be on wealth taxes in trusts, for the purpose of this report, Estate Duty (ED) and Donations Tax (DT). Mention is also made to Securities Transfer Tax (STT), and Transfer Duties (TD), and then the author considers the nature and possibility of implementation of a net wealth tax.

In conclusion, the study will focus on the viability of wealth tax, the implication on trusts, and its future as a vehicle for wealth preservation spanning generations.

Key words

wealth tax, trusts, tax on trusts, high net worth individuals, estate planning, offshore trust structures, transfer pricing.

Acknowledgements

I want to express my gratitude to the people who accompanied and supported me during my journey of completing this research report.

Roy Blumenthal, thank you for your support and guidance through the research process. You not only taught me how to communicate my thoughts comprehensibly but equipped me with invaluable skills for my future academic endeavours.

Lelys Maddock, I thank you for your professional editing of my work and teaching me not to use emotive language, which you know I love to do.

For the University of the Witwatersrand, an excellent place to study, and a special thank you to professor Alwyn De Koker. Your passion for tax law and teaching is evident in the interest you show in your subject, students and your patient with their questions.

To my team at Crafford Attorneys who gave me the opportunity to study while keeping a steady hand on the wheel. I would not have been able to embark on this journey without your encouragement and support, thank you.

Michele, my better half who spent days editing my work and delivering running commentary structuring my thoughts that can sometimes become scattered, to you I owe immense gratitude for your contribution. 'Many women have done excellently but you surpass them all' (Prov.31:29)

To my parents who supported me and passed onto me, not only their intellectual curiosity, but also a natural curiosity about life and the bigger questions out there.

And last but not least I thank my beautiful daughter Lilly who has been my inspiration and served as my motivation to undertake this task. I promise to catch up on play time and hope that I may one day instil in you the same love of learning, for you already have a natural inquisitive mind.

I sincerely thank you all.

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Chapter 1

Introduction

It has always been a popular concept to take from the rich as enshrined in economic doctrines throughout world history, for example, socialism. Recently the popularity of this concept has taken centre stage in South Africa's and throughout the world's tax debate. Wealth tax is not a recent development but, it was only possible for governments in England to tax the aristocracy as their wealth was in plain sight. (Honiball, 2009) Our current complex tax system, on the other hand, imposed tax on almost everyone and everything. The Davis Tax Committee ("DTC") is at pains to point out that there is a difference between a tax imposed on the wealthy, and a wealth tax (Davis Tax Committee, 2018). It is suspected that this "differentiation" is of little comfort to the wealthy, considering that their wealth has now become a target in South Africa. Wealth, however, seems to move seamlessly among countries, asset classes, and evades many tax authorities as is apparent in the leaked Panama papers, exposing wealthy South Africans and enforcing the perception that the wealthy do not intend to be compliant or pay their dues. (Orthofer, 2015)

It is sometimes difficult to differentiate between wealth taxes and other taxes. In its attempt to differentiate between wealth and the wealthy, the DTC states in its report that the income stream *generated* by wealth is taxed through the income tax system. Wealth bestows (an interesting choice of words used by the Commission, since it entirely negates the effort and skill employed in wealth generation), certain benefits over and above the rate of return and wealth is as a result a tax base in its own right. South Africa presently has four types of wealth taxes: Transfer Duty, Estate Duty, Securities Transfer Tax and Donations Tax. (Davis Tax Committee, 2018)

Although wealth may be difficult to define for wealth tax purposes, it is sometimes defined with reference to all forms of accumulated and marketable assets by individuals or households, through savings or the preservation of inherited wealth (Trotman-Dickenson, 1996). The DTC seeks to define a net wealth tax as a tax

imposed on the difference between the sum of all gross assets (gross wealth) and the sum of all liabilities at a point in time. It then further proceeds to differentiate between additive or substitutive tax. An additive wealth tax is a tax paid when an asset of market value is sold, the selling then triggering a tax event, whereas a substitutive wealth tax is a fixed tax payment from either capital or annual income earned by owning an asset (Trotman-Dickenson, 1996).

Trusts are unique vehicles of wealth preservation and make them targets for tax authorities in an attempt to balance the scales of financial inequality. This report will briefly look at the economics of inequality and will analyse the arguments and reasons for wealth taxation, including historical perspectives from classical writers, such as Adam Smith, Thomas Paine and JS Mill, to name but a few.

The DTC points to the fact that SARS's internal reports as at 31 October 2015 reflect that there are currently 333 465 active trusts registered. Many of these registered trusts, however, do not regularly submit tax returns. It was, a result, proposed that SARS and National Treasury investigate the use of trusts (Davis Tax Committee, 2017). DTC proposed an extension of general anti-avoidance regulations (GAAR) to the Estate Duty Act but advised that, when addressing the GAAR applicable to Estate Duty and trusts, it is necessary to examine and consider the actual relationship which exists between donors, beneficiaries and trusts. This is not always readily reflected in the trust deeds and other documentation available to SARS. (See for example, *Zandberg v Van Zyl* (1910) and *CSARS* v *NWK*. (CSARS v NWK). However, the chances of SARS succeeding in such an attack are minimal, particularly in the light of the recent clarification of the *NWK* judgement by the Supreme Court of Appeal in the recent cases of *Roshcon v Anchor Auto Body Builders CC* (2014) and *CSARS v Bosch* (2014).

The DTC also made certain recommendations which resulted in the amendment to the Income Tax Act (ITA) (1962), and the introduction of section 7C which pertains to interest-free loans to trusts and amendments to sections 7(8) and 25B(2A) to the ITA and its impact on foreign trusts with South African resident beneficiaries.

1.1 Research Problem

1.1.1 The research question

The focus of this study will essentially be to enquire whether trusts are still feasible considering recent reports such as the Davis Tax Committee on trusts, and wealth taxes (April 2018), probable future amendments to the conduit principal, and recent major amendments to the Income Tax Act, which have been cornerstones of estate planning and advice pertaining to trusts.

This study will look at the current developments, the current and possible future wealth taxes in trusts – Estate Duty (ED), Donations Tax (DT), Securities Transfer Tax (STT) and Transfer Duties (TD)- and will also look at income tax including sections 7C, 7(8) and 25B(2A), its impact on wealth taxes in broad terms and, finally, a net wealth tax.

1.1.2 The sub-question

To answer the main research question, the following sub-questions will be addressed:

What are wealth taxation and the underlying economic principles, and how should it be understood against the historic principles envisaged in the development of the canons of taxation, according to Adam Smith. (Smith, 1776).

1. What are trusts and why are they being targeted by SARS for, *inter alia*, further net wealth taxes?
2. What is the impact of wealth taxes which already exist such as Estate Duty, Donations Tax, interest free loans and proposed amendments including loans to foreign trusts and distributions made from foreign trusts?

1.2 Research methodology

The research will be qualitative in nature. The primary sources to be analysed will include the various Davis Tax Committee reports on trusts and wealth taxes, OECD material, journal articles and books as these addresses the main objectives of the report. However, an extensive literature review and analysis will be undertaken that includes the following sources –cases, electronic databases, electronic resources – internet, journals, magazine articles, publications and statutes.

The other source material will include the Income Tax Legislation, Estate Duty Act and Transfer Duty Act of South Africa. Country specific legislation will be examined to analyse the definition of wealth taxes in each country.

1.3 Chapter outline

Chapter 1: Introduction

In the influential book *Capital in the Twenty-First Century* (Picketty, 2014), Thomas Picketty reinvigorated the old debate on inequality, and pointed to the fact that the distribution of income and wealth has become more unequal over the past two decades, especially with the marked rise of the share accruing to the 'top one per cent' (Piketty, 2014). It has also influenced policy makers in South Africa and was quoted extensively in the DTC report on wealth taxes.

South Africa presently has wealth taxes in the forms of Transfer Duty (TD), Estate Duty (ED) Donations Tax (DT) and Securities Transfer Tax (STT). These wealth taxes currently raise very small amounts of tax revenue for the fiscus. This report will look at the effects of these wealth taxes on trusts in South Africa, as well as at the economics behind wealth taxation.

Although wealth may be difficult to define for wealth tax purposes, it is sometimes defined with reference to all forms of accumulated and marketable assets by individuals, or households through savings or the preservation of inherited wealth (Trotman-Dickenson, 1996).

Chapter 2: Wealth taxes: economic principles of wealth taxation

This report will consider Picketty's main contribution to research, as well as his suggestion that current inequality is the product of a broken capitalist system which could be resolved by government intervention through taxes. He argues that wealth inequality rests on the relationship between the rate of return on capital (*r)* and the rate of economic growth (*g*). He argues that, in the long run there is a tendency for the rate of return on capital (*r*) to exceed the rate of economic growth significantly (*g*) which suggests that inherited wealth is likely to grow much faster than output and income (Picketty, 2014).

According to the DTC, a net-wealth tax is a tax imposed on the difference between gross assets (gross wealth) and liabilities at a particular point in time. Gross assets may include real assets (such as your home) and financial assets (shares, bank deposits and bonds). Gross liabilities may include home loans, credit cards or overdrafts. The argument seems to be that wealth confers something above and, beyond mere income which can be derived from wealth, and according to the DTC, forms a tax base in its own right. (Davis Tax Committee, 2018)

A net-wealth tax can further be classified as either an additional wealth tax or a substitutive tax. An additive wealth tax is a tax paid only when an asset of market value is sold, whereas a substitutive tax is a fixed tax payment from either capital or annual income earned by owning an asset, which seems to be the one which can be used to target trusts in general. (Trotman-Dickenson, 1996)

The DTC report on wealth taxes admits that tax is not the only device to solve inequality. Economic policy has a role to play in wealth formation. Monetary and fiscal policies can promote savings and investments by keeping inflation rates stable, while progressive taxation can encourage middle-class savings, (Orthofer, 2016), leading to much needed economic growth and lowering wealth inequality.

However, it stands to reason that the most important form of wealth for the middle class is pensions. The proposals by the National Treasury to increase the coverage of occupational pension systems may have the most influential impact yet on the development of a more equitable wealth distribution. If participation rates were to increase and pre-retirement withdrawals be reduced, this will help significantly to foster wealth formation, potentially lowering overall wealth inequality. (Orthofer, Wealth Inequality Striking New Insights , 2016)

Chapter 3: Trusts: introduction and statistical analysis

According to the DTC and SARS there is a clear and substantial discrepancy between the SARS register of trusts and the number of income tax returns received and assessed. The discrepancies have resulted in SARS responding by implementing measures to investigate trusts, but at the same time conceding that this would be a laborious and intricate task which will consume valuable resources. (Davis Tax Committee, 2017)

Chapter 4: Wealth taxes and Trusts

At the time of writing the final DTC report on Estate Duty, it was commented that few would contest the proposition that Estate Duty savings are one of the major incentives to form trusts. This has however dramatically changed with the inception of section 7C of the ITA, so from an Estate Duty point of view, South African taxpayers are no longer at liberty to transfer their assets into trusts to

delay or reduce their Estate Duty liabilities. (Davis Tax Committee, 2017) (Davis Tax Committee, 2015)

The DTC proposed in its final report on Estate Duty (Lester, 2016) that the National Treasury should consider the possibility of extending the provisions of section 3(3)(*d*) of the Estate Duty Act to include deeming provisions which identify "deemed control" of a trust through a loan account between a trust and a "connected person(s)", where the loan is not subject to interest or is subject to interest at below the official rate. In these circumstances the loan provides the lender with *de facto* control over the trust. (Davis Tax Committee, 2015) This situation is now resolved to the extent that section 7C of the ITA has been enacted.

Prior to the enactment of section 7C of the ITA, assets could not simply be donated to a trust as a result of the implications for donations tax provided under section 54 of the ITA. The said implications were then avoided by disposing of assets to the trust at market value on an interest-free loan account. After the enactment of section 7C this form of tax circumvention is no longer available. This chapter will consider the impact on trusts and the possibility of a further wealth tax on its feasibility.

Chapter 5: Foreign trusts arrangements

Prior to the amendments to the ITA, South Africans could set up foreign trusts to diversify asset bases and mitigate jurisdiction and economic and political risk. However, in 2004 taxpayers were offered a generous income tax and exchange control amnesty in respect of assets accumulated abroad in contravention of the Income Tax Act and Exchange Control Regulations. The DTC reports that no less than 42 672 South Africans participated in the amnesty programme, and assets exceeding R68,6 billion were identified and brought within the South African tax system. Exchange control levies totalled R2,9 billion. Sections 7(8) and 25B of

the ITA have been amended to deal specifically with the taxation consequences of offshore trust arrangements of South African donors and beneficiaries. The South African Revenue Service (SARS) has implemented a permanent mechanism for all taxpayers to amend their taxation declarations through the Voluntary Disclosure Programme contained in sections 225 to 233 of the Tax Administration Act, 2011 (Davis Tax Committee, 2015)

In the first report, the DTC recommended (Davis Tax Committee, 2015) that, owing to the difficulties of identifying the components of income distributed to a beneficiary, all distributions from foreign trusts must be taxed as income. This recommendation, if implemented, will discourage offshore trust formation and may be justified on the grounds of the deferral of the tax a beneficiary obtains by using an offshore trust. DTC also identified offshore investment products in South Africa which are promoted under the umbrella of an "offshore retirement fund", commonly using the taxpayer's offshore investment allowance, where after funds are donated to an offshore discretionary trust and, have flagged these to be investigated by SARS.

Chapter 6: High Net Worth Individuals ('HNWI')

A great deal of confusion exists about who falls within the definition of a HNWI, and why these are important to tax authorities. Different countries determine HNWI by means of different standards. Picketty (2014) argues that they are important due to their mobility, and so they need to be identified and better classified to enable tax authorities worldwide to tax them better.

Despite the DTC pointing out (Davis Tax Committee, 2017) that a tax on wealth does not equate to a tax on the wealthy, people generally have a negative view of HNWI. Tax collection agencies throughout the world view these individuals as surrounded by a team of tax experts advising them on tax savings strategies and guiding them through a process to avoid/evade paying their fair share of taxes.

There is a general perception that HNWI even dodge taxes entirely, although the fact of the matter is that HNWI have tax matters which are unique to their financial status. (Weltman, 2019)

According to Elle Sarah Rossato, of the South African Institute of Tax Professionals, ('SAIT') HNWI have various risk areas which require attention by authorities, including offshore structures and bank accounts having become synonymous with them as highlighted in the 'Luxembourg leaks' in 2014, the 'HSBC leaks' in 2015, the 'Panama Papers' which implicated various South African HNWI in 2016 and in the 'Paradise papers'. (Visser, 2017)

Since the DTC reports there has been a renewed focus on HNWI, and SARS has recently upgraded its infrastructure to effectively deal with them. In considering wealth taxes and trusts, it is important to look at what the HNWI means for society and tax authorities alike.

Chapter 7: Selected country overview

This report considers and compares the wealth taxes of two European countries, namely, France and Germany. In France wealth taxes have been in existence for many years and recent debates focus on potential losses in capital investment and emigration of HNWI due to the existence of net wealth taxes, as well as on their feasibility and sustainability. The policies of France are then compared to those of Germany, which also used to have wealth taxes but has phased them out. However, since the financial meltdown the world experienced in 2008, two of Germany's political parties have proposed a different way of introducing a wealth tax.

Finally, this report looks at the case of an emerging economy, India, which also recently abandoned a wealth tax introduced more than 65 years ago and, through

various reforms, was eventually abandoned. The author will look at the characteristics of India's wealth tax and the reasons India discontinued it.

Chapter 8: The South African case for a Wealth Tax and its implication for trusts

This chapter will consider past and potential future wealth taxes and what impact these may have on the usefulness of trusts.

Chapter 9: Conclusion

In conclusion, the study will seek to answer the question on the viability of wealth taxes, trusts, their usefulness for estate planning and as a vehicle for wealth preservation spanning generations. In conclusion, the study will ask whether the focus on avoiding taxes has made some forget the core benefits of a trust, namely, the protection of assets, both for ourselves and for minor children upon one's death and creating continuity and liquidity on death, by means of the generation skipping device.

Seemingly, and despite various recent attempts, the government has not yet succeeded in removing the conduit principle, which creates flexibility and enables trusts to pay lower taxes than individuals. (Honiball, 2009)

Chapter 2

Wealth taxes: Economic principles of wealth taxation

2.1 Introduction

According to international standards and, in particular, the developed world, South Africa is viewed as an extremely divided society. Combined with this fact is the high unemployment rate in the country. (Parkin, 2017) By way of example, in 2012 twenty-five % of working adults in the Western Cape (615 000 people) were unemployed, compared to wealthy suburbs like Constantia, Clifton and Camps Bay where there is factually 0% unemployment. Extreme wealth and extreme poverty exist side by side in the world today and economists are grappling with causes and solutions for the inequality. (Parkin, 2017).

During the first quarter of 2018, the South African working-age population increased by 153 000 or 0,4 % in the first quarter compared to the fourth quarter of 2017. The unemployment rate of 26,7% remained static over the first quarter of 2018 compared to the fourth quarter of 2017. (Statistics South Africa, 2018). By all measures, South Africa has an exceptionally high unemployment rate: to put things into perspective, the unemployment percentage in the United States during the Great Depression was 24% (Bernanke, 2007), thus being 2,7% better than the current situation in South Africa. South Africa's economy is experiencing a highly depressed state in terms of its high unemployment rates and the unequal distribution of wealth within its society. Furthermore, there is a widening gap between what CEO's of listed companies on the Johannesburg Stock Exchange ('JSE') earn, and what employees of those same companies earn (Businesstech, 2018) (PricewaterhouseCoopers, 2018).

One needs to consider what economic inequality means and what measures a government can take in order to alleviate it. The question which needs to be asked is whether the rich are getting richer and the poor are getting poorer and,

if so, to what extent can the government intervene, and is the answer the introduction of wealth taxes as proposed by Picketty and others.

Another important measure for inequality is the Gini coefficient, which is quite simply a measure to check how equal or unequal a country is. A country with a Gini of zero (0) is an equal society and a Gini of 1 is a completely unequal society. South Africa with a Gini coefficient of 0.709 Orthofer, 2015; Orthofer, 2016; (Mbewe, 2016) proposes that wealth inequality is, in fact, much higher than income inequality with a Gini coefficient above 0.9. This is the type of data which are currently reigniting the debate on wealth taxes.

Picketty's major contribution to the debate lies in the association between the rate of return on capital (*r*) and the rate of economic growth (*g*). He contends that, in the long, run there is a propensity for the rate of return on capital (*r*) to exceed the rate of economic growth (*g*) which proposes that inherited wealth is likely to grow much faster than do output and income. He argues that individuals with inherited wealth need only save a portion of their income from capital to see that capital grows more quickly than the economy does. (Piketty, 2014) (Davis Tax Committee, 2018) According to Picketty, it follows that a wider gap between *r* and *g* is likely to lead to convergence of higher levels of wealth concentration in certain groups of society. Under such conditions, inherited wealth will dominate the wealth accumulated from a lifetime's labour and the concentration of capital will attain extremely high levels. (Piketty, T and Zucman, G, 2014)

One of the central views in Picketty's argument is his recommendation that the world's governments should cooperate and introduce a global wealth tax. This may solve most problems associated with tax migration and relax any tax secrecy laws. (Piketty, 2015).

It may then be logically argued that failing such a co-operation among governments, it could be detrimental to a country like South Africa to implement

such a proposed wealth tax prior to co-operation being guaranteed, as Orthofer pointed out, capital can simply be moved to a more desirable place or country (Orthofer, Savings and Wealth in the Context of Extreme inequality, 2017). One should consider that the world's largest economy, the United States of America, is competing to become an aggressive tax haven (Bloomberg, 2017), and will take no prisoners in a global competition without their co-operation, the Picketty proposal may prove futile.

It is further important to note that the design of any tax system should be firmly grounded on sound economic principles, according to the DTC (Davis Tax Committee, 2018). The DTC further explains that, in contrast to income and consumption taxes, the theoretical literature on the design of a wealth tax offers very little consensus and this explains the lack of global agreement on the topic of wealth taxes and why it elicits such emotional responses. (Boadway, 2010) The DTC goes on to explain that it views a net wealth taxation as a tax on the difference between a person's assets (gross assets being the sum of all assets) and liabilities, calculated at a particular point in time. (Davis Tax Committee, 2018)

Broadway (2010) points out that it becomes difficult to achieve tax efficiency when one considers the possibility and, in fact, the result that the introduction of a wealth tax causes various changes in the behaviour of people, some intended consequences and some unintended. It has been shown, for example, that the introduction of wealth taxes in some instances discourages the willingness of people to work and has the potential to change and negatively impact otherwise logical decisions associated with wealth accumulation and disposal of assets, as these decisions are being driven by tax considerations instead of by sound commercial considerations. The cost of administration of wealth taxes due to complications are also significant as wealth can be difficult to measure and easy to conceal. (Boadway, 2010)

2.2 Tax treatment of wealth

The DTC points out that the nature of wealth taxes is, in fact, a supplement to income tax (Davis Tax Committee, 2018): more specifically, they supplement taxes on capital income. Wealth is a form of utility and can be construed as a self-insurance against unforeseen circumstances of 'Black Swans', a term coined by mathematician Nassim Nicholas Taleb in his seminal work *The Black Swan*, he describes, before the discovery of Australia people in the old world were convinced that all swans were white until the discovery of the black swan. His book is then based on black swans as outliers, for they lie outside the realm of regular expectations, the black swan event must carry an extreme impact. (Taleb, 2007)

Furthermore, wealth holds a certain status for the wealthy and provides them with a portable power and influence over people. Because of the mobility of wealth, argues the DTC, the desire to hold it in certain jurisdictions may be greatly diminished as it may be costlier to the holder than the marginal expected benefit derived from its taxes. This will then lead to wealth destruction, potential wealth destruction or hesitance to create wealth in the first place or capital flight to jurisdictions which are more favourable. (Davis Tax Committee, 2018)

Trotman-Dickenson, (1996) points out that the taxation of wealth leads to various challenges in relationship valuations and they identify two asset valuation methods: open market valuation, which depends on the sale or purchase price of an asset and expert valuation of assets.

Open market valuation of assets is fairly straightforward especially when one deals with liquid assets which trade on a daily basis on a stock exchange, such as shares or bonds. These valuations become more problematic when fewer liquid and specialised assets need to be valued as inherited assets or assets which were purchased many years ago with no comparable asset which has

come onto the market recently, such as rare goods or antiques, such as Rembrandt's The storm on the sea of Galilee, of which only one exists. In this regard expert valuations may be required in instances of such rare artworks or unique patents and intellectual property. (Trotman-Dickenson, 1996)

2.3 Principles of taxation (historic overview)

The original principles of taxation were laid down by the father of economic theory (Cantillon, 2011), Adam Smith. There were essentially four canons of taxation, namely: equity, certainty, convenience and economy. Smith argued that all of these are needed to comprise a good tax system. However, since Adam Smith wrote about these, significant developments have occurred, and it was necessary for further principles of taxation to be implemented (Smith, 1776).

Over time, concepts such as the canons of taxation have lost their meaning and effectiveness and so it becomes necessary to compare equality of outcome, and to state what the classical economists understood by the term equality of "taxation". (Vivian, 2006) refers to Nobel Laureate Hayek (Hayek, 1960) noted for the following:

> If old truths are to retain their hold on men's minds, they must be restated in the language and concepts of successive generations. What at one time are their most effective expressions gradually become too worn with use so that they cease to carry a definitive meaning. The underlying ideas may be as valid as ever but the words, even if they refer to problems that are still with us, no longer convey the same conviction; the arguments do not move in a context familiar to us and they rarely give us direct answers to the questions we are asking.

Chapter two of Smith's (1776) work sets out the canons of taxation from which one can derive the framework for the general tax equation, which can be summarised as follows:

> The subjects of every state ought to contribute to the support of the government, as nearly as possible in proportion to their respective abilities, that is, in proportion to revenue which they respectively enjoy under the protection of the state. In the observation or neglect of this maxim consists, what is called the equality or inequality of taxation.

The DTC points out that it can be demonstrated that, even though wealth taxes intend to achieve some degree of equity, they fall short of an efficient, effective and equitable tax system when measured against the various principles of good taxation. (Trotman-Dickenson, 1996)

Considerations laid down by Adam Smith, such as equity considerations of the benefit principle and the ability to pay principle, should be considered when a wealth tax is implemented, although the DTC do not credit these considerations to Smith, equity considerations require an alignment of the taxpayer's willingness to pay and the taxpayer weighing up simultaneously the benefits he will receive.

Smith's canon of equality aimed to provide economic and social justice as he envisioned that every person should pay to the government, depending on his ability to pay. He pointed out that the rich should pay higher taxes because without the protection of government authorities such as the police, army and, importantly, the judicial system, the rich would not be able to enjoy their wealth and income.

When one considers the "ability to pay" principle, it is difficult to arrive at a recommendation for the design of a wealth tax system as pointed out by the DTC. The DTC uses the example of Mr A, who is unemployed and suddenly inherits some shares and bonds. Mr A may rely on dividend and interest or coupon income from his bonds and shares to consume goods and services in the economy. The comparison is made against Mr B who is employed and holds a university degree but has acquired no wealth or savings. (Davis Tax Committee, 2018)

Considering the above, a decision may need to be made as to whether financial assets or human capital (Goldin, 2014) should be taxed, or whether both should be taxed, and, if so, at what respective rates. If wealth taxes are implemented on human capital or only on financial assets both Mr A and Mr B may be unable to sustain their reasonable consumption on the "ability to pay" principle.

2.4 Efficiency under Wealth Taxation

Savings in South Africa are in short supply, and DTC argues that tax on wealth has the ability to depress the culture of savings. Furthermore, depending on what will qualify as a wealth tax, this may also lead to depressed decisions on investment into human capital development. (Ihori, 2001) Investment in human capital development has not yet been defined as a possible tax base and uncertainty remains. If implemented it will lead to depressed investments in tertiary education and skills and training development.

2.5 Certainty of wealth and wealth transfer taxes

Smith's second canon of taxation is certainty. Taxes should not be arbitrary, and the taxpayer should know in advance how much, at what time and in which form taxes should be paid to the government. The DTC points out the factors which need to be considered in the valuation of assets for tax purposes which may impact these valuations. The factors are identified as death, changes in asset demand, such as a market downturn or upswing, the valuation method and the inflation rate. These considerations are not simple as will be pointed out below. (Davis Tax Committee, 2018)

2.6 Simplicity

Legislation which governs wealth transfer taxes is generally complicated because of the above factors, especially concerning valuation of assets, and which assets needs to be valued. The situation is further complicated by the need to close loopholes and so these taxes need to be comprehensive. The necessity for comprehensiveness ultimately results in complicated and lengthy legislation and cumbersome administration, and this does not conform to the principle of simplicity. (Smith, 1776) (Davis Tax Committee, 2017)

2.7 Cost of compliance and collection of taxes

The cost of compliance and collection of taxes is what Smith refers to as the canon of economy. The principal states that the cost of tax collection should be lower than the amount of tax collected. The cost of compliance in the case of wealth taxes may fall short of Smith's canon. As shown above, wealth taxes are generally complicated and are costly to collect. One will also see this later in our country analysis of France, Germany and India, and debates around wealth taxes in those countries.

Tax laws must be comprehensive to avoid exploitation of loopholes and to lead to higher compliance cost and, as DTC points out, this inevitably leads to unequal treatment of taxpayers as wealthy individuals pay more to comply, whereas poorer taxpayers cannot afford to employ experts. Wealthy individuals tend to seek advice from costly tax experts on tax avoidance measures and have the resources to pay these experts. This can then lead to the tax burden falling on the less wealthy or the poor who do not have the resources to employ an army of accountants and attorneys to lessen their tax burden. (Davis Tax Committee, 2018)

Administrative costs dealing with wealth taxation are generally high due to the fact that it must cater for inspection and valuation of assets which is a specialised field of expertise and the market value of such assets may not always be easily ascertainable. (Bach, 2014)

2.8 Convenience to pay

Smith's third canon of taxation dictates that a convenient tax system will encourage people to pay tax, and simultaneously increase tax revenue. In line with this the DTC correctly points out that, in general, taxes on wealth and wealth transfer are more inconvenient than other forms of taxes such as income tax. The reason is that wealth taxes usually entail the sale of an asset in order to achieve the required liquidity to service the tax liability generated by that wealth. (Davis Tax Committee, 2018) However, with regard to the sale of an asset there is some overlap with Capital Gains Tax (CGT).

In 2018 South Africa experienced a technical recession which creates a depressed economic environment as the demand for acquiring assets is low. The servicing of a wealth tax could be made more difficult in these circumstances (Statistics South Africa, 2019). The technical recession in certain circumstances may mean that a taxpayer even incurs debt to finance a tax liability. Without exaggerating this position, it is not inconceivable that failing a loan due to depressed economic circumstances, the Receiver of Revenue may try to attach or liquidate the asset on less than market related terms.

2.9 Wealth

Wealth is an important factor when one wants to measure the long-term economic prospects of a society. A society's ability to absorb different economic seasons is heathier if there is a smaller economic divide between the rich and the poor. Wealth has the ability to generate income through interest, dividends, rental

income through property ownership and capital gains or growth in share portfolios, which may take the form of capital gains, or income, depending on certain factors such as time (Parkin, 2017). Wealth further has the potential to be passed from parents to children, and properly managed can grow to vast sums. If the economic divide between the rich and he poor is too vast, the passing on of wealth from one generation to another can create further inequality. Wealth tends to be more unequally distributed throughout the world than is income and one of the reasons may be the time and skill it takes to accumulate it. (Orthofer, Wealth inequality – striking new insights from tax data, 2016)

In unequal societies such as South Africa, policy makers and government has started to investigate how monetary and taxation polices can be crafted to assist in making the society more equal. (Orthofer, Wealth Inequality Striking New Insights , 2016) It cannot be disputed that an unequal society can become an unstable society and all measures need to be considered, while simultaneously looking at how fiscal and monetary policies have been effective in other jurisdictions. One should at the same time be sceptical about a one-size-fits-all approach and must consider that different policies may need to be crafted to cater for different jurisdictions.

It has always been difficult to ascertain exactly how wealth is distributed, especially because the data are usually collected via surveys, and people are generally not comfortable discussing their wealth and, in some instances, they are simply unaware of exactly how much, or little wealth they have. One way to ascertain wealth and income distribution data, is through investigation of tax records, which in itself is difficult due to privacy limitations. Tax records, however, need to be filed by all residents if they fall within a certain threshold, and these supply invaluable information about income and wealth but they also have limitations, such as the fact that they tell us nothing about that portion of the population whose income is so low that it does not require the filing of a tax return: at this stage this forms 80% of the population. (Orthofer, Wealth inequality – striking new insights from tax data, 2016) Because wealth is presently not taxed

in South Africa, or in most other countries, our tax returns do not provide efficient information on wealth held by residents.

Orthofer (2016) in the research found that after the author processed 1.2 million personal income tax records for the 2010/2011 tax year in South Africa, there is a discrepancy between wealth and income in that the wealthiest 10% of the population own, at least, 90–95% of all *wealth*, whereas the highest-earning 10% receive ('only') 55–60% of *income*. The next 40% of the population — the group often considered to be the middle class — earn approximately 30-35% of all income, but only own 5-10 % of all wealth. And the poorest, which makes 50% of the population, earning about 10% of all income, owns no measurable wealth. Orthofer concludes that compared to income, wealth is much more concentrated in the hands of the few. (Orthofer, Wealth inequality – striking new insights from tax data, 2016)

Net wealth, which is the difference between gross wealth, which includes all assets and total debt, is an important definition when one considers net wealth taxes in this report.

2.10 Wealth taxes

The DTC is at pains to point out that it is important to emphasise that a tax on wealth is not the same thing as a tax on the wealthy (Davis Tax Committee, 2018). The report then explains that the income stream *generated* by wealth is taxed through the income tax system, but that wealth earns certain benefits over and above the rate of return it generates; wealth is a tax base in its own right according to the DTC. The Republic currently has wealth taxes which form a small portion of the tax base, and these are discussed in this research report.

From the below chart it can be observed that wealth and transfer taxes during 2017 formed a mere 1.4% of revenue collected by SARS. This is not unique as

the Organisation for Economic Co-operation and Development ('OECD') countries which are more reliant on wealth taxes, even though some are fast abandoning the concept, are contributing 5.5% to their revenue collection. (OECD, 2017) It is also important to point out that the interest in wealth taxes has systematically decreased over several years. In 1990 there were 12 OECD countries implementing wealth taxes; the figure has declined to only four countries today. (OECD, 2017) Picketty has, all the same, revived discussions surrounding wealth taxation.

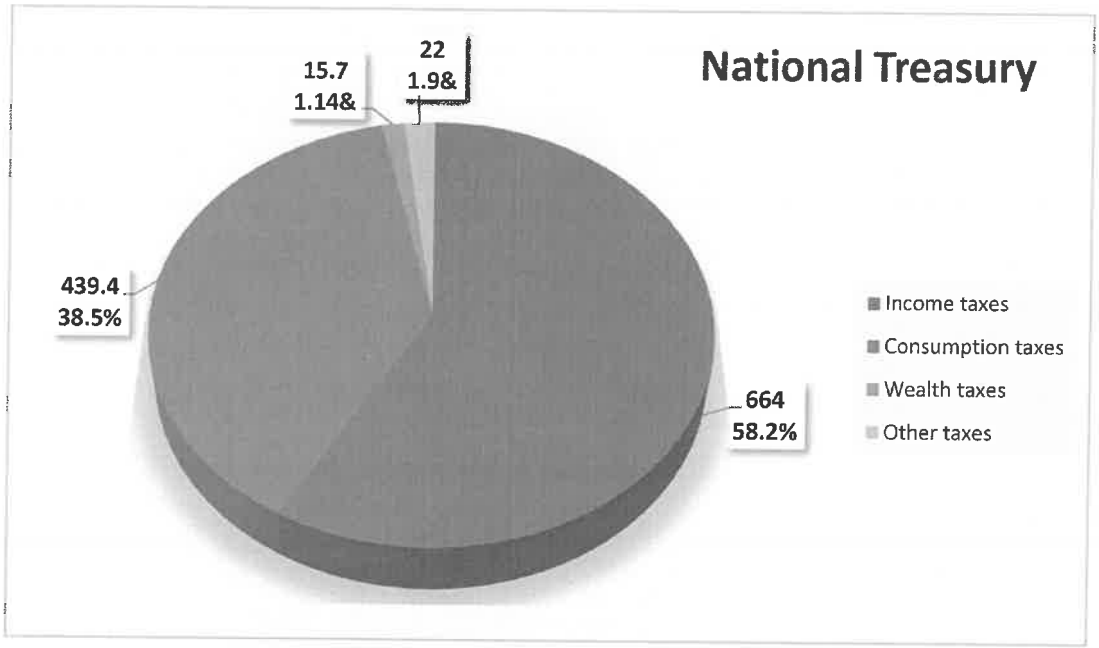


Figure 1: DTC report with information provided by National Treasury and SARS 2017.

Various submissions were made to the DTC and, according to the Committee, these were overwhelmingly negative. The Committee further pointed out that the irony was not lost as the parties who made the submissions seemingly had something to lose. One of the key points was that new wealth taxes may hinder foreign investments and new investments by locals and will, in all probability, not contribute much to the fiscus. This is supported by Orthofer (2015) who stated that:

> given that the wealth-income ratio is so much lower in South Africa than it is in rich countries, capital-related taxes not only have much lower revenue potential than elsewhere but might also undermine the country's simultaneous efforts of encouraging capital formation and lowering the dependency on foreign capital inflows.

Wealth taxes can generally be classified as additional or substitutive taxes which boils down to the timing of when the tax is paid, being at either disposal or simply by holding the asset. In other words, an additional wealth tax is a tax paid only when an asset at market value is sold, whereas a substitutive tax is a fixed tax payment from either capital or annual income earned by owning an asset (Trotman-Dickenson, 1996). It appears that in the case of additional wealth taxes CGT will have to be paid as well.

2.11 Policy considerations

When looking at possible solutions to wealth inequality, the problem can be approached from two angles: one, by redistributing wealth from the top through capital related taxes or, two, from the bottom by building wealth through the promotion of savings and investments among the middle class. Such promotions may include tax-free savings accounts and pension funds. Given South Africa's relatively low level of private wealth and our desperate need for foreign capital investment, policies to create a more equal distribution of wealth should attempt to balance these considerations. (Orthofer, Wealth inequality – striking new insights from tax data, 2016)

With regards to wealth taxation, this research will consider a revenue-neutral shift in tax policy from employment-related to capital-related taxes. Such a shift can benefit the middle class relative to top wealth holders as the middle class is more reliant on employment related income. The bulk of tax revenue is currently collected from employment income (35% of the total tax revenue). In considering wealth taxes one must be cognisant of the fact that, in the 21st century, one must be aware of the mobility of capital.

According to Orthofer and supported by the Davis Tax Committee report, it is imperative to obtain better data on wealth, for instance, by integrating the personal income tax database with other tax databases (such as the Dividend Withholding Tax system, the deeds office, credit bureaus, and the tax files of trusts) and by improving the information that SARS holds on wealthy households.

The Reserve Bank can act, as it effectively does by implementing monetary policy to promote saving and investment by keeping inflation rates stable, while progressive taxation can encourage middle-class saving, by the introduction of tax-free savings and tax deductions for pension fund contributions. (Orthofer, 2016)

It is further pointed out that unlike the wealthier countries, South Africa did not experience a prolonged increase in private wealth, a trend which reflects structural differences between developing and advanced economies (lower savings and higher growth rates) and specific factors surrounding South Africa's political transition in the 1980's and 1990's. The period from 1980 to 1990 was stagnant in South Africa as a developing country, despite the world economy expanding, especially in developed countries in the Western World. (Orthofer, Savings and Wealth in the Context of Extreme inequality, 2017)

During the last decade of the apartheid regime and sanctions reaching their apex, especially after President PW Botha's Rubicon speech, the Rand fell against major currencies and the South African economy shrank. (Louw, 2004) After the dawn of democracy, wealth within South Africa has grown at a more rapid pace than accumulated incomes have. (Orthofer, 2015)

The DTC also commented that, due to declining collections on Estate Duty and donations tax over the past couple of years, with some modifications and following improvement, it may not be necessary to implement new wealth taxes.

This seems to be a more sustainable argument than introducing additional and potentially administratively cumbersome taxes. (Davis Tax Committee, 2015)

The DTC considered the current position of the income streams being taxed on wealth, and how the taxes on income have increased over the past two decades. The current position was considered in conjunction with the implementation of further wealth taxes.

2.12 Cash and savings

Cash and savings earn interest which is taxed in terms of section 24J of the Income Tax Act. A trust is not exempt insofar as a portion of its income on interest is concerned and is liable to pay tax at the maximum rate on all the interest. A trust is not entitled to the interest exemption that an individual enjoys under section 10(1)(*i*) of the ITA. Being cognisant of the fact that a trust is a conduit pipe wherein income retains its nature and interest income to beneficiaries can be distributed if partial interest exemptions have not been used by those individuals. It is further noteworthy that interest rates have declined considerably, as can be seen from the graph below. At present interest rates at most banks and financial institutions trail behind inflation, further reducing these returns when tax is deducted. This is hampering the creation of a savings culture in South Africa, which will lead to further unemployment.

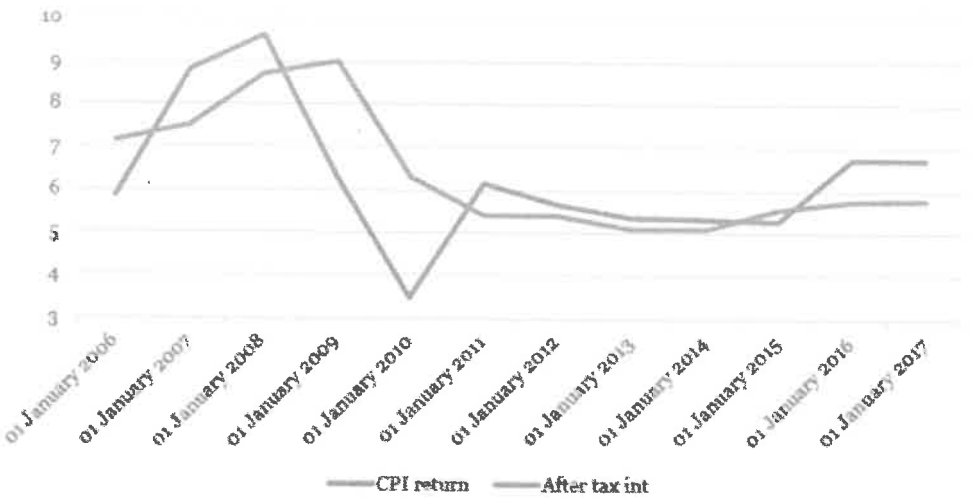


Figure 2: CPI vs after tax interest returns in South Africa 2006 - 2017 (Davis Tax Committee, 2018)

Looking at the above data, it would be unwise to introduce a wealth tax on savings and cash, especially since it would contradict the tax incentives introduced on pension funds and tax-free savings accounts. Admittingly these are not accessible to a trust but individuals who created legitimate trusts may be heavily reliant on the interest portion of the investment as beneficiaries to sustain themselves during old age instead of being reliant on the state.

2.13 Listed investments and collective investment schemes

DTC points out that Capital Gains Tax (CGT) increased substantially since its implementation on 1 October 2001. The inclusion rate for CGT also increased to the point where if one looks at an ordinary trust, it is a staggering 80%. The economist, Dawie Roodt, calls CGT an immoral tax specifically for the reason that it does not account for inflation (Roodt, 2013). DTC also make the point that CGT was increased without the effect of tapering to make provision for inflation, which would have made CGT morally justifiable.

Furthermore, dividends tax was raised to 20% on 1 April 2017, and trusts operate at a maximum effective rate of 45%. In these circumstances DTC correctly points out that the introduction of further wealth taxes on investments will hamper capital formation locally as the government is striving to make the country less reliant on capital inflows or FDI (Foreign Direct Investment). It is clear that excessive taxation on investments, which already seems to be the case, especially when it comes to trusts and their holdings of investments may result in a situation where South African capital is invested abroad, whether legally or illegally.

2.14 Immovable property (including land and taxes)

Any discussion regarding the desirability or feasibility of a recurrent tax on property, such as wealth taxes, needs to take cognizance of the sensitivities around land and ownership in South Africa, according to the DTC. Similarly, when one considers a further wealth tax on property ownership using trusts as a vehicle, it should be considered that property is already overburdened with the, CGT, transfer duty or VAT and municipal property rates levelled by local government. (Davis Tax Committee, 2018).

Land is generally considered an illiquid asset especially considering the tedious administrative process involved in what could easily extend to three months. (Nolan, 2011) In amplification of this constraint the author considers Smith's canon discussed above. The "ability to pay" principal may be particularly strenuous in certain circumstances as it is not feasible to sell a portion of a property to pay the tax liability, according to the DTC; it may also create distortions as it singles out an asset class by taxing one component of wealth and this may lead to a disproportionate effect on the middle class who own more of their wealth in property (primary residence) than wealthy individuals do.

National recurring property taxes may be implemented as alternatives to transfer duty, as transfer duty has the potential to hinder the proper functioning of the

property market as it discourages buying and selling, making the market illiquid. Costly property transfers negatively impact the relocation of the labour market to here labour is demanded which affects growth and employment.

It would at this stage make little sense to propose a wealth tax at this stage on residential property tax, especially since the adverse impact of transfer duty has not been reduced. Although stamp duties on the transfer of assets such as properties and equities raise revenue for government, they also tend to distort behaviour in a commercially and economically costly manner as mutually beneficial transactions are discouraged, and the effective allocation of assets in the economy is negatively impacted. (Mirrlees, 2011)

Transfer duties on properties have increased significantly over the past decade, especially on properties valuated at R10 million and above. The transfer duty rate is currently at 13%, indicating that a large contribution in taxes has already been made by wealthy individuals. (South African Revenue Service, 2019c)

Due to the increases in transfer duties on expensive properties the proportion of transfer duties paid by wealthy individuals has substantially increased, as can be seen from the graph below.

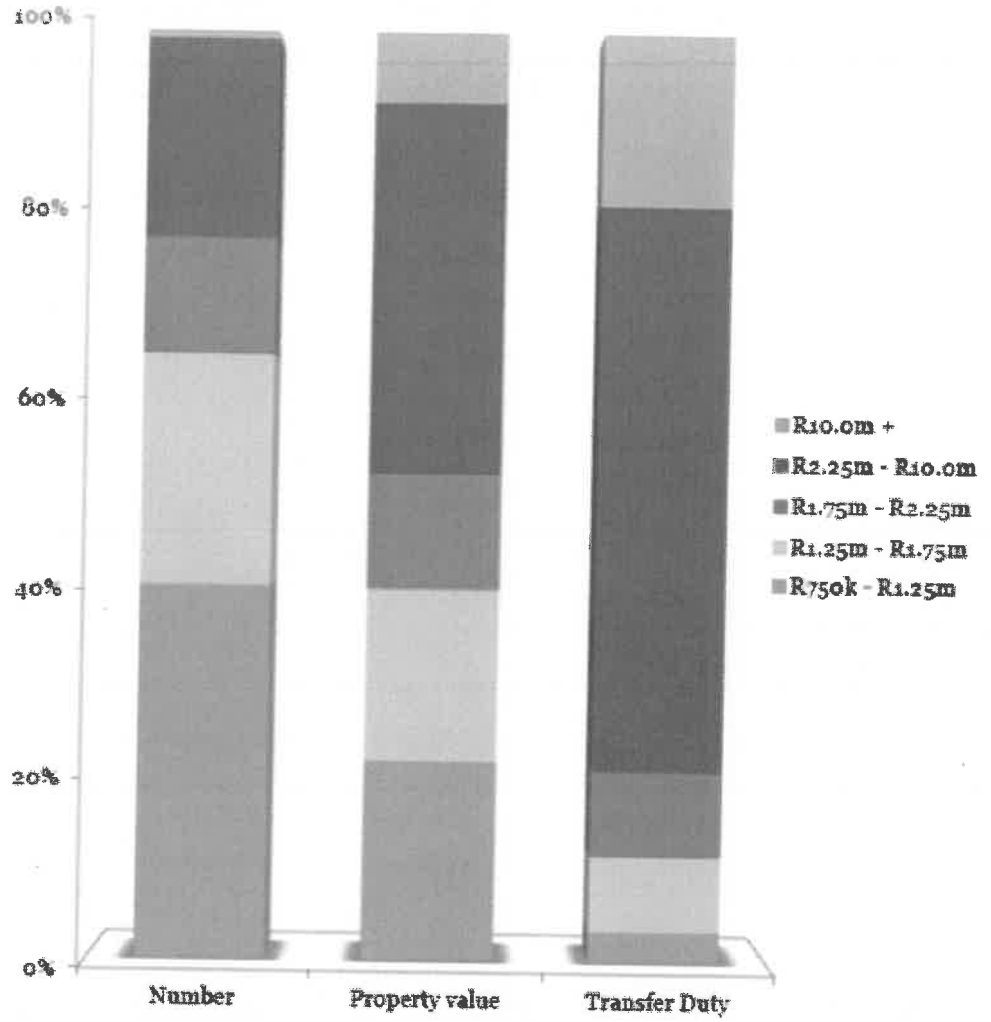


Figure 3: Transfer Duty collections April 2015 – April 2016 (Davis Tax Committee, 2016)

2.15 DTC conclusion

The DTC reaches the conclusion that, before a further recurring tax on land is considered in the form of a wealth tax, the following issues should be addressed:

1. Transfer duty
2. The effect of double taxation at local government and at national level
3. Inconsistency which may arise between local government rating policies and wealth taxation at national level

4. Complexity with regard to business property, farming land and tribal land
5. Basis of valuation
6. The impact of the above on government's existing policies on land redistribution, particularly, the effect upon recipients of a land redistribution programme

When considering the factors surrounding a further recurring tax on land it is concluded that consultation must be convened regarding the above issues and that a further land tax is not ripe to be implemented at this stage.

Chapter 3

Trusts: Introduction and statistical analysis

3.1 Introduction to South African trusts

In South Africa there are primarily three different types of trusts that can be identified: The first is the 'ownership trust' (South African Revenue Service , 2009) where the owner transfers assets to the trustee to be held on behalf of certain beneficiaries. The second is where ownership is transferred from the owner to the beneficiaries but control over this property is given to the trustees. This type of trust is referred to as the '*bewind trust*'. The third is typically where a person is entrusted with the affairs of another, for example a curator being placed in charge of a mentally ill patient or prodigal, or an agent who holds assets on behalf of his or her principal. (*Zinn NO v Westminster Bank* 1936 AD 89 at 97, 1936). These persons are often agents with fiduciary duties bearing office. (Honiball, 2009)

3.2 Statutory definition

Section 1 of the Trust Property Control Act, (57 of 1988) defines a trust as:

> the arrangement through which the ownership of 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;
> 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 do 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 66 of 1965

3.3 Different types of trusts

Trusts are broadly categorised as *inter vivos* and *mortis causa* trusts. An *inter vivos* trust is established during the lifetime of the founder of the trust, whereas a *mortis causa* trust is established after the death of the founder. The main distinction between these is to ask when these trusts take effect. Apart from this distinction, trusts are also categorised as vested or vesting trusts and discretionary trusts. (Honiball, 2009)

From a tax point of view, it should be determined whether income is taxed in the hands of the trust or in the hands of the beneficiaries.

3.3.1 Vested trusts

These are trusts where the beneficiaries have vested rights to trust income or capital, and the trustees do not have discretion to distribute income or capital, but it should be noted that ownership of the trust assets still vest in the trustees and **not** in the beneficiaries. (Van der Merwe, 2000) However, when a beneficiary passes away before the income accrues to him or her, the right to income or capital falls within his estate. (Honiball, 2009)

3.3.2 Discretionary trusts

As opposed to vested trusts, a discretionary trust, as the name suggests, gives discretion to the trustees as to when, how and where the distribution of income and capital to beneficiaries is to be made.

A beneficiary who has a discretionary right, has a right which is a contingent right referred to as a *spes, or hope*. A discretionary beneficiary, as a result, has a right. (see General Jewish Colonial Trust, v Estate Nathan 1940 SA 163 (A)). The beneficiary, however, does not have a right to the ownership of the trust property as is the case with vested trusts. (Honiball, 2009) A vested right is a right to the income and the trustees hold ownership of the assets, but in the case of a discretionary trust, the beneficiary does not have a vested right until the trustee exercises his discretion and vests the property or income in the beneficiary.

3.4 Requirements for a valid South African trust

It is interesting to note that a trust need not be in writing to be valid, but the Trust Property Control Act is only applicable to trusts which have been reduced to writing. It is wise, in order to avoid disputes, for trusts to be in writing. (Honiball, 2009). Although there is consensus about the requirements for a valid trust, and South Africa has over the years developed its own trust laws, there are different views about the requirements of a valid trust. Coertze points out the following (Coertze, 1946):

1. The founder must have the intention to create a trust;
2. This intention must be expressed in a manner appropriate to create a trust;
3. The trust object, property and beneficiaries are indicated with sufficient certainty;
4. The trust object is lawful (Coertze, 1946).

When a founder wishes to create a trust, he must have the intent to hand over to another the control of the property to be administered for the benefit of certain beneficiaries. (Cameron, 2002) The Hague Convention has defined a trust as follows: (Hayton, 2014):

> For the purposes of this Convention, the term "trust" refers to the legal relationships 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.

A trust has the following characteristics:

a) the assets constitute a separate fund and are not a part of the trustee's own estate;

b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;

c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust. The Convention applies only to trusts created voluntarily and evidenced in writing. (Hayton, 2014)

3.5 Income tax principles applicable to trusts

For income tax purposes, a trust is defined in section 1 of the ITA (1962) as:

> 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.

A trust is included in the definition of 'person' and a trust could be subject to normal tax, however, in terms of common law a trust is regarded as a contractual relationship. (Stiglingh, 2018)

3.6 The tax residence of a trust

When one deals with the taxation principles of trust, one must first investigate the tax residence of the trust. One does so by looking at the definition of gross income (defined in section 1 of the Income Tax Act), as the total amount of cash or otherwise received by or accrued to or in favour of such resident. In the case of a non-resident, gross income is defined as the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within South Africa. (Honiball, 2009)

When one then applies the Income Tax Act to trusts, one notes that a resident is defined as any trust which is established or formed in South Africa, or which has its place of effective management in South Africa but, as in the case of other residents, specifically excludes a trust which is deemed to be exclusively resident of another country for purposes of the application of any double taxation agreement. With this exclusion in mind one can conclude that any person including a trust is liable to account for South African tax upon receipt or accrual of any gross income. (Honiball, 2009)

3.7 The Nature of income received and distributed by trusts

Income received by a trust and income received by a trust and then distributed to the beneficiaries is deemed taxable. However, the question is who is held liable for tax? The answer is determined by investigating the nature of the income received by the trust or distributed by the trust to the beneficiary.

It was previously noted that the 'conduit pipe' principle is applicable to trusts where income received by the trust retains its identity in the hands of the trust beneficiaries. It follows that any exemption from tax provided in the Act (1962) which applies to the type of income (such as interest, dividends, capital, etcetera), once identified, will be available to the specific beneficiary. (Stiglingh, 2018)

The above position was supported by South African courts in Armstrong v CIR 1938 AD 343, 10 SACT 1, in that income received by a beneficiary in a trust retains its nature, whether it be capital or otherwise. The term 'conduit pipe' has its genesis in a South African case CIR v Polanski 12 SACT 11, where the court found that the trustees were no more than a conduit pipe and did not have any material interest in the income of the respondent's wife. (Olivier and Van den Berg and Strydom, 1990)

3.8 Income of trusts and beneficiaries of trusts (Persons liable for tax on the income earned by trusts)

Prior to the existence of the 'conduit pipe' principle, trust income was taxed in the hands of the trust when the income did not vest in any trust beneficiaries. The income was taxed in the hands of the beneficiaries if they were vested beneficiaries. The conduit pipe principle was challenged in South African courts in the case of Friedman NO v CIR 1993 (1) SA 353 (A), 53 SATC 166, on the basis that a trust was not a taxable entity and trustees were not representative taxpayers. This argument was upheld by the court *a quo* and confirmed by the Appellate Division. The definition of 'person' in the Income Tax Act was amended to include a trust, so came about the statutory 'conduit pipe' principle in the form of section 25B of the Income Tax Act. (Honiball, 2009)

Section 25B is headed 'Income of trusts and beneficiaries of trusts' and states the following:

Any amount received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.

Section 25B(2) determines that:

Where a beneficiary has acquired a vested right to any amount referred to in subsection (1) in consequence of the exercise by the trustee of a discretion vested in him or her in terms of the relevant deed of trust, agreement or will of a deceased person, that amount shall for the purposes of that subsection be deemed to have been derived for the benefit of that beneficiary.

According to Honiball (2009) the wording of this provision clearly applies to a discretionary trust as opposed to a vesting or bewind trust because no vesting has yet occurred.

Section 25B(2A) is the only provision which applies where a South African resident is a beneficiary of a foreign trust. The provision then determines where during any year of assessment any resident acquires any vested right to any amount representing capital of any trust, that amount must be included in the income of that resident in that year, if—

(a) that capital arose from any receipts and accruals of such trust which would have constituted income if such trust had been a resident, in any previous year of assessment during which that resident had a contingent right to that amount;

(b) that amount has not been subject to tax in the Republic in terms of this Act.

This anti-avoidance provision can also be triggered when an asset of a non-resident trust vests in a resident beneficiary. (Honiball, 2009) In *SIR v Rosen* the court said that income retains its nature only if it accrues to the beneficiaries in

the same year of assessment as it accrued to the trust. Any accumulated income in the trust thus loses its identity. This section is further elaborated upon below in the discussion pertaining to offshore trusts.

In terms of Section 25B(3) any deduction or allowance which may be made under the provisions of this Act in the determination of the taxable income derived by way of any amount referred to in subsection (1), must, to the extent to which that amount is under that subsection deemed to be an amount which has accrued to—

(a) a beneficiary, be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by that beneficiary;

(b) the trust be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by that trust.

Section 25B(4) then states the deduction or allowance contemplated in subsection (3) which is deemed to be made in the determination of the taxable income of a beneficiary during any year of assessment will be limited to so much of the amount deemed to have been received by or accrued to that beneficiary in terms of subsection (1), as is included in the income of that beneficiary during that year of assessment.

Section 25B(5) states the amount by which the sum of the deductions and allowances contemplated in subsection (4) exceeds the amount included in the income of the beneficiary during a year of assessment as contemplated in that subsection—

(a) is deemed to be a deduction or allowance which may be made in the determination of the taxable income of the trust during that year: Provided that the sum of those deductions and allowances shall be limited to the taxable income of that trust during that year of assessment as calculated before allowing any deduction or allowance under this subsection; or

(b) where the trust is not subject to tax in the Republic, must be carried forward and be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by that beneficiary by way of amounts referred to in subsection (1) during the immediately succeeding year of assessment.

Section 25B(6) then determines that the amount by which the sum of the deductions and allowances contemplated in subsection (4) exceeds the sum of the amount included in the income of the beneficiary as contemplated in subsection (4) and the taxable income of the trust as contemplated in subsection (5)(*a*) must be deemed to be a deduction or allowance for purposes of subsection (3), which may be made in the determination of the taxable income derived by that beneficiary by way of any amount referred to in subsection (1) during the immediately succeeding year of assessment.

In terms of section 25B(7) subsections (4), (5) and (6) do not apply in respect of any amount which is deemed to have accrued to any beneficiary in terms of subsection (1) where that beneficiary is not subject to tax in the Republic on that amount.

Chapter 4

Wealth taxes and trusts

4.1 Introduction

At the time of writing the first interim report on Estate Duty, the DTC held the view that in the absence of specific anti-avoidance provisions in the Estate Duty Act, trusts would continuously be used as a vehicle to avoid Estate Duty. It was also pointed out that the provisions of sections 7 and 25B of the Income Tax Act which allow trustees to vest the income in the trust beneficiary after which the income is also taxed in the hands of the beneficiary at his marginal rate benefits high net worth individuals. (Davis Tax Committee, 2015)

The attribution or 'conduit pipe' principle (set out above) allows the trustees of a trust to vest trust income in a natural person who is taxed between 0% and 45% on income, whereas trust income is taxed at 45%. There is also a benefit where the CGT is concerned as trusts pay 36% and individuals pay 18%. This led the DTC to advise that the 'conduit pipe' principle be abolished.

Below is a statistical analysis published by the DTC final report on Estate Duty which gives information on income tax returns for trusts. According to the DTC 333 465 active trusts were on SARS's system in October 2015, but tax returns submitted for the period 1 October 2014 to 30 September 2015 reflected only 100 590, so the conclusion which can be reached is that only about a third of trusts are tax compliant.

Tax year	2011			2012			2013			2014		
Taxable income group	Number of taxpayers	Taxable income (R million)	Tax assessed (R million)	Number of taxpayers	Taxable income (R million)	Tax assessed (R million)	Number of taxpayers	Taxable income (R million)	Tax assessed (R million)	Number of taxpayers	Taxable income (R million)	Tax assessed (R million)
A: < 0	68 400	-23 511	0	64 648	-20 321	4	50 298	-25 880	0	44 845	-20 810	-
B: = 0	147 073	-	3	130 942	-	2	118 911	-	1	79 611	-	4
C: 1 – 20 000	12 816	63	25	11 918	57	23	10 862	53	21	8 313	42	17
D: 20 001 – 30 000	3 438	85	14	1 396	34	14	1 298	32	13	986	25	10
E: 30 001 – 40 000	1 103	38	15	985	35	14	928	32	13	782	27	10
F: 40 001 – 50 000	891	40	16	847	38	15	851	38	14	622	24	9
G: 50 001 – 60 000	661	36	14	614	34	13	544	30	12	470	26	10
H: 60 001 – 70 000	519	34	13	530	34	14	497	32	13	386	24	9
I: 70 001 – 80 000	446	34	13	417	31	12	348	26	10	357	27	11
J: 80 001 – 90 000	383	34	12	297	25	10	326	28	11	269	23	10
K: 90 000 – 100 000	351	34	13	297	29	11	314	30	12	264	24	10
L: 100 001 – 110 000	280	29	11	314	33	13	302	32	13	234	25	10
M: 110 001 – 120 000	291	34	13	220	25	10	287	30	12	213	25	10
N: 120 001 – 130 000	226	28	11	235	29	12	226	28	11	200	25	10
O: 130 001 – 140 000	197	27	11	183	25	10	206	28	11	166	22	9
P: 140 001 – 150 000	204	30	12	182	26	10	186	24	9	185	24	10
Q: 150 001 – 200 000	743	129	51	774	134	53	722	126	49	578	100	38
R: 200 001 – 250 000	555	124	48	536	123	47	507	136	54	526	118	47
S: 250 001 – 300 000	413	114	45	386	106	42	421	115	46	387	98	39
T: 300 001 – 500 000	934	385	145	863	359	147	1 069	413	163	879	342	135
U: 500 001 – 750 000	538	377	131	505	369	147	597	425	169	585	369	144
V: 750 001 – 1 000 000	327	283	115	312	276	111	460	405	162	442	386	156
W: 1 000 001 – 2 000 000	466	655	268	525	729	298	553	783	319	505	713	287
X: 2 000 001 – 5 000 000	282	672	352	308	678	382	327	1 007	417	328	957	369
Y: 5 000 001 +	138	1 782	767	196	2 206	982	192	2 588	1 043	193	3 064	1 230
Total	239 676	-18 364	2 857	218 641	-16 678	2 302	201 348	-19 445	2 594	142 188	-14 388	2 613
<= 0	215 473	-23 511	3	195 590	-20 321	5	179 207	-25 880	1	124 456	-20 810	4
1 – 70 000	17 426	245	97	16 300	232	92	14 938	211	86	11 427	166	68
70 001 – 250 000	5 699	498	196	3 457	478	188	3 476	487	193	2 960	414	164
250 001 – 500 000	1 347	478	190	1 348	474	189	1 490	528	209	1 232	440	174
500 000 +	1 771	3 924	1 571	1 945	4 368	1 827	2 329	5 188	2 105	2 055	5 482	2 205
Total	239 676	-18 364	2 857	218 641	-16 678	2 302	201 348	-19 445	2 594	142 188	-14 388	2 613

Table 1: Analysis of Income Tax assessments raised on trusts 2011-2014 (Davis Tax Committee, 2016)

4.2 Estate Duty on trusts

Estate Duty is considered a wealth tax as it is a tax levied against a person's wealth upon his/her death and where it is transferred to his/her beneficiaries. The distribution is usually made in terms of the deceased's will, failing a will, it will be governed by the laws of intestate succession. (Stiglingh, 2018)

Estate Duty ('ED') is governed by the Estate Duty Act (45 of 1955) and is presently levied at a rate of 20% of the dutiable amount of the deceased estate. (Stiglingh, 2018). Section 3(2) of the ED determines that the deceased had to be ordinarily resident in South Africa at the time of his/her death and the value of all

his/her property, regardless of the jurisdiction in which it is situated, will be included as property in his/her estate. Similarly, and in terms of section 3(2)(*c*) to 3(2)(*h*), a person who was not ordinarily resident in South Africa at the time of his/her death will be liable for Estate Duty only on his/her property situated within South African.

Section 3(3) of the ED Act deals with property deemed to be property of the deceased. Section 3(3)(*d*) specifically deals with property of which the deceased was competent to dispose for his/her own benefit. Such deemed property could include a trust where the deceased was the sole trustee and beneficiary, and which may be seen as a sham trust. (Stiglingh, 2018)

At the time of writing the final report on ED the DTC, interest-free loans were still applicable to trusts. In fact, it was due to the recommendations of the DTC that section 7C of the Income Tax Act was implemented. At the time, Estate Duty savings were one of the major incentives to form trusts.

It is noteworthy that, on a progressive scale, Estate Duty has increased from 20% to 25% on the dutiable amount of estates exceeding R30 million (South African Revenue Service, 2019a). In this way substantially increasing the tax burden on the deceased estates of wealthy individuals and closing the gap with intergenerational wealth transfers and the inequality these may create, except if the wealth is held in a trust.

4.3 Interest free loans to trusts

The DTC observed that Donations Tax can easily be avoided by disposing of assets to a trust at market value and creating an interest free loan account in the trust. This observation then led to recommendations to National Treasury and the Minister of Finance and section 7C was introduced in the Income Tax Act.

4.3.1 Section 7C

This section was introduced by National Treasury into the Income Tax Act on 1 March 2017 and was ratified by parliament and in many respects, it came as a shock to the fiduciary services community and donors, as well as beneficiaries, of trusts. In terms of these provisions certain loans and credit advanced to a trust by a connected person may result in the application of the Donations Tax provisions to such loan or credit.

The provisions of section 7C are not implemented retrospectively and so do not affect tax liabilities of these types of loans which were already in existence on or prior to 1 March 2017 but would affect the loan from 1 March 2017. Therefore, a loan that was in existence in January 2000 would be affected up until 28 February 2017. Section 7C(1) provides that, in order for these provisions to apply, the person advancing the loan must be a connected person in relation to the trust and, must also be a natural person. Section 7C will also be applicable if the lender is a company whom granted the loan on the instance of a natural person who is a connected person in relation to the company or trust.

As from the 19 July 2017 this provision also applies to loans from the lender to a company in which the trust or the beneficiary of the trust holds at least 20% of the equity shares or voting rights. SARS explained its rationale in an explanatory memorandum dated 1 December 2016 regarding loans created by the vesting of awards in the beneficiary without payment of the whole or portion of such award to the beneficiary (Stiglingh, 2018):

> the proposed rules will apply only in respect of loans advanced or provided by a natural person or, at that person's instance, by a connected company. An amount that is vested irrevocably by a trustee in a trust beneficiary and that is used or administered for the benefit of that beneficiary without distributing or paying it to that beneficiary will not qualify as a loan or credit provided by that beneficiary to that trust if:

a. The vested amount may in terms of the trust deed governing that trust not be distributed to that beneficiary, e.g. before that beneficiary reaches a specific age;

b. That trustee has the sole discretion in terms of that trust deed regarding the timing of and the extent of any distribution to that beneficiary of such vested amount.

An amount vested by a trust in a trust beneficiary that is not distributed to that beneficiary will, however, qualify as a loan or credit provided by that beneficiary to that trust if that non-distribution results from an election exercised by that beneficiary or a request by that beneficiary that the amount not be distributed or paid over, e.g. if the beneficiary has reached the age at which a vested amount must be paid over or distributed to him or her and:

a. The trustee accedes to a request by that beneficiary that this not to be done;
b. The beneficiary enters into an agreement with the trustee in terms of which the amount may be retained in the trust.

As has been seen from the DTC reports on Estate Duty, and according to National Treasury, the policy rationale behind section 7C was to move towards preventing the voidance of Donations Tax and Estate Duty through schemes involving trusts and interest free or low interest loans. Section 7C(5) specifically excludes the following from its Donations Tax provisions:

1.1 Special trusts which are created solely for the benefit of minors with a disability;

1.2 Trusts or companies which fall under public benefit organisations or small business funding entities;

1.3 Vesting trusts (in respect of which the vesting rights and contributions of the beneficiaries are clearly established);

1.4 Loans used by a trust or company to fund the acquisition of a primary residence;

1.5 Loans which constitute affected transactions and are subject to transfer pricing provisions (section 31 of the Income Tax Act);

1.6 Loans provided to a trust or company in terms of Sharia–compliant financing arrangement;

1.7 Loans subject to dividends tax (see s 64E(4);

1.8 Loans by a company to a trust created solely to set up a share incentive scheme. The loans may be for the trust to acquire shares in that company or any other company in the same group of companies. This exemption applies if equity instruments (as defined in section 8C) are offered by the trust to full time employees and directors of the company. However, the scheme must not be available to connected persons of the company (natural persons holding 20% or more of the equity or voting rights of the company). (Stiglingh, 2018)

In terms of section 7D, when the amount of interest which would have been charged on a loan is calculated regarding the Income Tax Act any common law principles or provisions in any other Acts which limit the amount of interest charged are disregarded.

4.3.2 Conclusion

Even without any further changes to section 7C, and as stated above, it seems that the Davis Tax Committee has made further proposals and recommendations which may lead to further changes in tax legislation with negative consequences to trusts. One must also not lose sight of seemingly forgotten, and in some views, the draconian section 3(3)(*d*) of the Estate Duty Act of 1955, which deems the property of the deceased for Estate Duty purposes, the assets of the deceased, which he had the power to control. This may obviously include the assets of a trust where the deceased was in effective control of the trust.

4.4 Donations tax

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

Donations Tax is not considered to be an income tax and indeed forms a wealth tax on its own accord. The Donations Tax provisions are contained in section 54 to 64 of the Income Tax Act. Donations Tax is payable on the value of any property disposed of by a South African resident in terms of a donation, whether directly or indirectly (Section 54 of the ITA). Donations tax is presently levied on the value of the property at 20% on the first R30 million of donations made during a tax year and then at the rate of 25% on donations exceeding R30 million, with an annual exemption of up to R100,000 of the value of all donations made during the tax year from 21 February 2018 (Section 64 of the ITA) but it is noteworthy that non-residents are not liable for this tax.

It is possible to argue that the granting of interest free loans may lead to deemed donations, but it is further possible to avoid the donations tax on interest free loans by making them payable on demand. (Stiglingh, 2018) Interest free loans to trusts are, however, now governed by Section 7C of the ITA as discussed above.

One has also seen that as from 21 February 2018, donations tax increased progressively from 20% to 25% on donations exceeding R30 million, affecting larger donations by wealthy individuals. (South African Revenue Service, 2019a)

4.5 Transfer duty ('TD')

Transfer duty ('TD') is one of the simpler forms of tax. It is governed by the Transfer Duty Act 40 of 1949 ('TDA') and is payable by the purchaser upon the

acquisition of immovable property. TD is calculated at 0% to 13% of the value of the property. (Stiglingh, 2018). The rate of TD is determined by section 2(1)(*b*) of the TDA and the below rates as applicable after 1 March 2016 to February 2017 apply to all persons, natural persons, companies and trusts.

Rand Value of Property	**Transfer Duty Rate**
0 – 900 000	0%
900 001- 1 250 000	3% of the value above 900 000
1 250 000 – 1 750 000	R10 500 + 6% of the value above R1 250 000
1 750 001- 2 250 000	R40 500+8% of the value above R1 750 000
2 250 001 – 10 000 000	R 80 500 +11% of the value above R2 250 000
10 000 001 and above	R 933 000+13% of the value above R10 000 000

Table 2: Transfer Duty rates 2019 (South African Revenue Service, 2019c)

It is interesting to note that over the past seven years has seen the top marginal rates on TD increase progressively on high value properties, increasing the financial burden of wealthier individuals. From 2012 to 2015 the top marginal rates of TD remained the same at R37 000+8% of the value of properties above R1 500 000 (South African Revenue Service, 2019c). From 1 March 2015 to 29 February 2016 these increased to R85 000 +11% on the purchase price of properties above R2 250 000. From 1 March 2016 to 28 February 2017 the rate was R933 000 plus 13% of the value of a property above R10 million and from 1 March 2018 to 28 February 2019 this remained the same at a rate of R933 000 + 13% on the value of properties above R10 million. These rates on higher value

properties are shown on the below tables. (South African Revenue Service, 2019d)

TRANSFER DUTY

2019 (1 March 2018 - 28 February 2019) - no changes from last year

Value of the property (R)	Rate
0 – 900 000	0%
900 001 – 1 250 000	3% of the value above R900 000
1 250 001 – 1 750 000	R10 500 + 6% of the value above R 1 250 000
1 750 001 – 2 250 000	R40 500 + 8% of the value above R 1 750 000
2 250 001 – 10 000 000	R80 500 +11% of the value above R2 250 000
10 000 001 and above	R933 000 + 13% of the value above R10 000 000

2018 (1 March 2017 - 28 February 2018) - see changes from the previous year

Value of the property (R)	Rate
0 – 900 000	0%
900 001 – 1 250 000	3% of the value above R900 000
1 250 001 – 1 750 000	R10 500 + 6% of the value above R 1 250 000
1 750 001 – 2 250 000	R40 500 + 8% of the value above R 1 750 000
2 250 001 – 10 000 000	R80 500 +11% of the value above R2 250 000
10 000 001 and above	R933 000 + 13% of the value above R10 000 000

2017 (1 March 2016 - 28 February 2017)

Value of the property (R)	Rate
0 – 750 000	0%
750 001 – 1 250 000	3% of the value above R750 000
1 250 001 – 1 750 000	R15 000 + 6% of the value above R 1 250 000
1 750 001 – 2 250 000	R45 000 + 8% of the value above R 1 750 000
2 250 001 – 10 000 000	R85 000 +11% of the value exceeding R2 250 000
10 000 001 and above	R937 500 +13% of the value exceeding R10 000 000

2016 (1 March 2015 - 29 February 2016)

Value of the property (R)	Rate
0 - 750 000	0%
750 001 - 1 250 000	3% of the value above 750 000
1 250 001 - 1 750 000	15 000 + 6% of the value above 1 250 000
1 750 001 - 2 250 000	45 000 + 8% of the value above 1 750 000
2 250 001 and above	85 000 + 11% of the value above 2 250 000

Please note: The Transfer Duty rates remained unchanged for the 2012 - 2015 tax years.

Value of the property (R)	Rate
0 - 600 000	0%
600 001 - 1 000 000	3% of the value above 600 000
1 000 001 - 1 500 000	12 000 + 5% of the value above 1 000 000
1 500 001 and above	37 000 + 8% of the value above 1 500 000

Table 3: Transfer Duty table (South African Revenue Service, 2019c)

4.6 Securities Transfer Tax ('STT')

The purpose of this study is not to go into a lengthy discussion on STT but to mention that it is also a form of wealth tax which contributes a small and negligible amount to the fiscus every year. STT is governed by the Securities Transfer Tax Act 25 of 2007 ('STT Act') and is imposed on the transfer of shares levied at a rate of 0.25% of the taxable amount of the security which is transferred. (Stiglingh, 2018)

4.7 Capital Transfer Tax ('CTT')

The DTC proposed that CTT could be considered as an alternative to Estate Duty. CTT is an advanced and sophisticated tax which seeks to impose tax periodically instead of only upon death as is the role of Estate Duty. Therefore, CTT seeks to recover 'lost' Estate Duty revenues where assets are transferred to a trust. The DTC, however, stopped short of making a recommendation on CTT because of the complexity and potential burden on the resources of SARS and the taxpayer.

4.8 Net Wealth Taxes ('NWT')

The thinking behind the DTC's Net Wealth Tax is that it is to be periodically applied to taxpayers with surplus wealth, whether they are beneficiaries of trusts or as individuals. However, in the DTC's first report on Estate Duty it was proposed that the focus should be on improving the collections of CGT and Estate Duty, especially pertaining to trusts, instead of focussing on additional complicated CTT or NWT models.

Chapter 5

Foreign trust arrangements

5.1 Introduction

The trust concept was developed in England as part of the English law of equity and, subsequently, spread throughout the world in English law systems via colonialism or what others may refer to as the Empire' in what is today known as the Commonwealth countries. Before the First World War which started in 1914, the concept of a tax haven barely existed. In fact, at that time the direct taxation on income and wealth was only beginning to be implemented and the top marginal tax rates were in the single digits.

Today, Switzerland is known throughout the world as a tax haven and, unsurprisingly, Switzerland pioneered the concept of cross border wealth management during a period today referred to as the roaring 20's. But it was only during the 1980's that other countries throughout the world started offering 'services' through which assets could be 'hidden'. It can only be assumed, as the Panama Papers has shed some light on this fact in recent years, that a significant amount of wealth in these offshore jurisdictions and tax havens are kept in offshore trusts.

5.2 The Hague Convention: sham trusts and considerations for setting up a valid foreign trust

As the trust developed in English law jurisdictions bearing in mind many other legal jurisdictions across the world do not afford for the recognition of trusts, and therefore they either don't recognise trusts or they don't have properly developed trust laws. In order to create more certainty about trusts, the Hague Convention now defines what a trust is. In terms of section 3 of the Convention, the

Convention only applies to and recognises trusts set up in writing. It is worthwhile to mention that paragraph 2 of the Convention broadly outlines what the requirements are for a trust to be recognised as such;

> trust refers to the legal relationships 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.

A trust has the following characteristics –

a) the assets constitute a separate fund and are not a part of the trustee's own estate;

b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;

c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.

In terms of section 6 of the Convention, the founder or settlor has the right to choose the applicable law of jurisdiction to govern the trust deed but, should the founder neglect to choose and stipulate within the trust deed the desired law of jurisdiction, in terms of section 7 of the Convention, the jurisdictional law which will apply is the one that most closely associated or connected to the settlor.

SARS takes a cautious view of trusts, especially foreign trusts, and often views these as sham trusts. In South Africa the test is whether its legal substance differs from its form. The South African test is not the world norm. For example, in the United States, if the form of the agreement coincides with the economic substance of the agreement, the trust has passed the test and is considered to be valid. It cannot safely assume that a trust which is a sham under foreign law

would also be a sham under domestic law and *vice versa*. Whether a trust is a sham or not is often a factual determination, especially in circumstances where the settlor has no real intention of disposing of or giving up control of the trust property.

Upon creating a foreign trust, it is crucial to ensure that the trust is not only a valid trust within the jurisdiction, but that it also complies with all the foreign laws of that jurisdiction so that the trust deed will pass legal muster should the courts in that jurisdiction be called upon to determine or interpret the trust, or in respect of any foreign taxation principles which may apply.

5.3 How offshore trusts are formed

From the above it is clear that guidance is now taken from the Hague Convention, read in conjunction with the relevant jurisdictional legislation, when considering the formation of offshore trusts. The often-quoted case of *Knight v Knight* was the definitive case which outlined the essential requirements for valid trust formation in English law jurisdictions. Three so-called certainties were laid out: *firstly,* the certainty of intention to create a trust; *secondly,* the certainty of subject matter (trust property); *thirdly,* the certainty of objects, including the identity of the beneficiary.

South Africa has developed its own Common Law and legislation in the form of the Trust Property Control Act, which governs the establishment of trusts. In terms of this a trust means the arrangement through which the ownership of property of one person is by virtue of a trust instrument made over or bequeathed to another person, the trustee, in whole or in part. The property is 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. This is to achieve the object stated in the trust instrument. (Honiball, 2009)

The Income Tax Act is a departure from the legal principle that a trust is not a legal person in that it specifically defines a taxpayer in section 1 as a 'person' that includes 'any trust' (De Koker, 2018). Furthermore, a resident means any

(a) ....

(b) Person (other than a natural person) which is incorporated established or formed in the Republic, or has its place of effective management in the Republic, but does not include any person who is deemed to be exclusively resident of another country for purposes of the application of any agreement entered into between the government of the Republic and that other country for the avoidance of double taxation'...

To illustrate the inventiveness of trusts it is useful to discuss a clause such as 'flight or flee' which may be contained in trust instruments, which can lead to re-domiciliation of a trust to another jurisdiction, effectively changing the proper law of the trust in events such as a breakdown of the rule of law, and when property rights are under attack and socialist policies are implemented. The migration of the trust will require it to comply with laws of its new home jurisdiction and may involve amendments to the trust instrument. (De Koker, 2018)

5.4 The role of the protector

The concept of a protector is common in the establishment of offshore trusts. It is generally a third party with contractual obligations and powers recorded in the trust deed.

The protector will often be an attorney or accountant and, although it is not generally a person with fiduciary control over the trust property and, does not interact with third parties, there are some jurisdictions in which the courts decided that protectors have fiduciary duties to the trust (English law jurisdictions). Protectors are given a variety of administrative and discretionary powers in terms of the trust deed.

5.5 Letter of wishes

A letter of wishes is a non-binding document wherein the settlor 'instructs' the trustees on how to proceed with regard to the assets after he has transferred the assets to the trust. The nature of this instrument is to communicate certain wishes which the trustees are to consider when exercising their discretion in respect of handling the trust property. These wishes are however not binding.

The settlor may wish to keep certain issues a secret from the beneficiaries. For example, the existence of an illegitimate child who may be a trust beneficiary but is not named in the trust deed. This is a matter typically dealt with in the letter of wishes.

The issue of confidentiality and disclosure of the content of a letter of wishes to beneficiaries was considered in an English (UK) case *Breakspear and Others v Auckland and Another* [2008] EWHC 220(Ch) where the trustees argued that disclosure of the letter of wishes can cause division and discord within the family and should, as a result, remain undisclosed. The court held that although the letter of wishes is inherently confidential, in that instance the risk of family discord was outweighed by the need for full disclosure. The letter of wishes can also deal with administrative issues and investment decisions pertaining to the trust property which may have to be considered by the trustees.

5.6 Tax consequences of foreign trusts

Sections 7(8) and 25B of the ITA deal with foreign trusts. These sections were amended with effect from 1 March 2019 to make provision for the taxation of offshore trusts in which South African donors or beneficiaries are involved.

The voluntary disclosure program ('VDP") was introduced when the Minister of Finance announced in the 2010 Budget, presented to Parliament on 17 February 2010, that legislation would be introduced to encourage taxpayers to regularise prior transgressions of the tax statutes in South Africa and the Exchange Control Regulations (SAICA, 2010) was a special mechanism to enable taxpayers to amend their tax declarations and disclose previously undisclosed foreign trust arrangements. These provisions are contained in section 225 to 233 of the Tax Administration Act (2011). Since foreign trusts are not registered for tax in South Africa, the DTC's recommendations that the attribution principle should be eliminated in an attempt to curtail lost Estate Duty will be ineffective because as a result of assets being kept in foreign trusts, SARS would have to seek recourse in the provisions of sections 7(8) and 25B(2A). The equivalents to section 25B(2A) for CGT purposes is paragraph 80(3) of the Eighth Schedule of the Income Tax Act, as stated herein above.

By way of example De Koker (De Koker, 2018) points out that section 25B(2A) creates a legal fiction in terms of which it is assumed that a foreign or non-resident trust is a South African tax resident during tax years wherein income is received by the foreign trust: this is factually not the case where a resident had a contingent right to income of a foreign trust for a period of six years, and thereafter obtains a vested interest. The income accumulated in the trust is distributed to the South African beneficiary, then the beneficiary will be liable to income tax, and not Capital Gains Tax on that income. (De Koker, 2018)

5.7 Rules addressing the use of trusts to avoid tax in respect of controlled foreign companies

Prior to 1 March 2019, section 10B(2)(*a*) of the ITA created a participation exemption for trusts in terms of which a resident is not taxed on dividends distributed to him if certain conditions are met. One such condition is that, at least, 10% of the equity shares and voting rights in the foreign company must belong to the resident. De Koker points out that such exemption would also be applicable

if the dividends were received by a foreign trust and distributed to a resident beneficiary during a later tax year. (De Koker, 2018). This has now been amended as of 1 March 2019 by amendments to section 7(8) and paragraph 72 of the Eighth Schedule to the ITA. The contentious amendment which came into effect on 1 March 2019 and at the finalisation of this research report was the closure of a loophole regarding the use of trusts to defer tax or the recharacterization of the nature of the income which the trust receives. (ENS Africa , 2018)

Previously the controlled foreign company ('CFC') rules of the ITA did not apply to foreign companies held by interposed foreign trusts which had South African resident beneficiaries. The amendment to section 7(8) of the ITA expanded the ambit of the donor attribution rules for South African resident donors of a foreign trust. In terms of section 7(8) as amended, the income of a foreign trust may be attributed to a South African resident in the case of the South African resident making donation, settlement or other disposition to the foreign trust. This may include a loan which earns interest below the market rate. (ENS Africa , 2018)

Previously where the income of the foreign trust comprised foreign dividends from a foreign company, in which 10% of the equity shares and voting rights were held by the trust, such foreign dividends would not have been taxed in the hands of the South African beneficiaries because of the participation exemption which existed in the form of section 10B(2)(*a*) of the ITA.

The amendment to section 7(8) now disregards the exemption in determining the amount which would have constituted income had the trust been resident. (National Treasury, 2018)

Although Capital Gains Tax falls outside the ambit of this research report it will briefly mention that, as from 1 March 2018, similar to section 7(8), Section 72 of the Eighth Schedule of the ITA provide for the attribution of a capital gain arising

in a foreign trust to a South African resident who has made a donation, settlement or other disposition to that foreign trust. (Klein, 2018)

5.8 Capital distribution to South African resident beneficiaries

Prior to 1 March 2019 capital of a foreign trust arising from a prior year's foreign dividends derived from the foreign company of which the shares were held in that trust, would have been exempt from tax if the trust had been a resident in terms of section the 10B(2)(*a*), participation exemption.

The amendment to section 25B(2A) which came into effect on 1 March 2019 is that the participation exemption contained in section 10B(2)(*a*) must be disregarded in determining the amount received or accrued to the foreign trust, consisting of a foreign dividend in the case where more than 50% of the total participation rights or voting rights in the foreign company are held or exercisable by the trust or by any one or more connected persons in relation to the trust. (Klein, 2018)

It is therefore concluded that capital distributions by a trust which are derived from such foreign dividends will be taxable in the hands of the South African resident beneficiary, materially altering the status quo.

Previously when gains of a non-resident trust were distributed in the same year of assessment in which they arise, SARS was generally powerless to subject those gains to CGT. The reason for this, according to the DTC, is that paragraph 80(2) is ambiguous in that the section, unlike paragraph 80(3), and refers to a 'capital gain' and not to an amount which would have constituted a capital gain had the non-resident trust been a resident. As a result, it only applies to assets contained in paragraph 2(1)(*b*) of the Eighth Schedule.

The DTC wanted to discourage offshore trust formation, and in its first interim report on Estate Duty advised that, due to the difficulties of identifying the components of income in foreign trusts distributed to the beneficiaries, it be recommended that all distributions be taxed as income. In addition, during June 2014 SARS published a draft public notice (SARS Home, 2019) which lists certain reportable arrangements, involving foreign trusts:

> Any arrangement in terms of which a resident makes contributions or payments to a non-resident trust and acquires a beneficial interest in that trust and the amount of all contributions, payments or the value of the interest exceeds R10 Million excluding any contributions/payments or beneficial interest acquired in any:
>
> (a) Foreign collective investment scheme in securities and bonds;
> (b) Foreign investment entity as defined in section 1(1) of the income tax act.

5.9 DTC recommendations

In its first interim report on ED, the DTC recommended that because of the difficulties experienced in identifying the nature of income distributions from foreign trusts to South African trust beneficiaries, all distributions from foreign trusts should be taxed as income. (Davis Tax Committee, 2015) In the second report on ED the Committee also pointed out that the issue of distributions made by foreign trusts had been addressed, but where no distributions have occurred, or where distributions are still to be made at a future date, these have not yet been considered or addressed. (Davis Tax Committee, 2017) Similarly the ITA is silent on the issue of how to deal with trusts where income or capital distributions have not occurred. It was further proposed by the DTC that the criminal offence provisions in the ITA be extended to taxpayers who fail to disclose their interest in foreign trust.

5.10 Conclusion

Many foreign trusts controlled by South African tax residents and this will bring them within the ambit of section 7(8) of the ITA or paragraph 72 of the Eighth Schedule which will deem the income or capital gains back to the South African resident taxpayer. This is not the case with many other legitimate foreign trusts which were established in a *bona fide* fashion. These trusts have a right to exist as foreign tax residents and to protect the underlying assets and beneficiaries involved, as De Koker points out, trusts are innovative and can flee certain jurisdictions when socialist changes are affecting its assets through populist policies and when the rule of law is no longer sacrosanct or the criminal justice system collapses. (De Koker, 2018). Material amendments to section 7(8) and section 25B(2A) may have the desired effect of discouraging offshore trust formation but, in the longer term, may also mean that more South African taxpayers decide to emigrate or financially emigrate (Businesstech, 2019), which is a formal emigration process changing your status with the South African Reserve Bank (Reserve Bank, n.d.) from resident to non-resident for exchange control and tax purposes. You will not lose your South African citizenship if you emigrate financially.

Chapter 6
High Net Worth Individuals (HNWI)

6.1 Introduction

Although the DTC pointed out (Davis Tax Committee, 2017) that a tax on wealth is not a tax on the wealthy, people generally have a negative view of High Net Worth Individuals (HNWI): tax collection agencies throughout the world envision them as people with a team of tax experts who suggest tax savings strategies to them, guiding them throughout the process to escape their payment of their fair share of taxes. There is a general perception that HNWI even dodge taxes entirely, although the fact of the matter is that HNWI have tax complexities unique to their financial status. (Weltman, 2019)

According to Elle Sarah Rossato, the Vice Chairperson of the Tax Administration Work Group at the South African Institute of Tax Professionals ('SAIT') HNWI have various risk areas which include offshore structures and bank accounts becoming synonymous with them as recently highlighted in the 'Luxembourg leaks' in 2014, the 'HSBC leaks' in 2015, the 'Panama Papers' which implicated various South African HNWI in 2016 and the 'Paradise papers'. (Visser, 2017)

SARS recently appointed a team of 30 people to investigate and focus on wealthy individuals and their tax affairs. The number of HNWI in South Africa at the moment is just more than 37 200 although other sources mention higher numbers, with less than 1% of those individuals (234) being classified as Ultra Rich (individuals with a net worth exceeding $30 million. (Visser, 2017)

The DTC believes that HNWI have a profound impact on tax administration in South Africa and the DTC believed that not enough was being done to deal with HNWI. The OECD states that HNWI are of particular importance and interest to revenue authorities for the following reasons:

1. The segment's tax and private affairs is complex with various entities involved;
2. There is considerable potential tax revenue at stake in this segment;
3. There are various opportunities for aggressive tax planning;
4. HNWI have an impact on the overall integrity of the tax system.

The OECD concluded that it is possible to improve overall compliance by HNWI by doing the following (OECD, 2009):

1. Understanding the broader concerns of HNWI, such as privacy and wealth preservation including passing of wealth to future generations and looking at types of aggressive tax planning (ATP) as well as looking into suppliers of these ATP services.
2. Tax administrations must have appropriate and adequately staffed departments able to deal efficiently and engage with HNWI and their advisors.
3. International co-operation between HNWI units of tax authorities on both strategic and operational levels.
4. Effective legislative frameworks must be developed with focused strategies on HNWI.
5. Development by tax authorities of pre-filing and advanced ruling programs for HNWI.
6. Tax Authorities should be transparent and provide clarity on key issues of concern to taxpayers. (OECD, 2009)

6.2 Definition of HNWI and their importance to revenue authorities

SARS has recently defined the term HNWI in more detail which will be detailed below. It is worthwhile to note that the World Wealth Report (World Wealth Report, 2019) compiled by Merril Lynch/Cap Gemini Ernst and Young (EY)

defines HNWI as individuals who have assets exceeding $1 million. On the SARS register for HNWI there appear approximately 37 299 individuals.

HNWI definition has been expanded by SARS to include the following subsections:

1. Lower affluent individuals: these are individuals who earn R3 million per annum and are generally salaried employees. These make up 54% of the HNWI register, representing 20 303 individuals. (Davis Tax Committee, 2018)

2. Affluent individuals: these are divided into groups of people who earn between R5 and R7 million per annum or have net assets exceeding R16 million. They represent 10 217 individuals or approximately 27% of the HNWI register at SARS. 5 476 of those individuals meet the income criteria for affluent individuals, and 4 449 meet the asset criteria, whereas 301 individuals meet both the asset and income criteria. (Davis Tax Committee, 2018)

3. HNWI: these are individuals whose annual income exceeds R7 million or have net assets exceeding R40 million. There are approximately 6 545 such individuals on the SARS register, representing 18% of individuals on the list. It is noteworthy that 5 824 of these individuals qualify under the income criterion, whereas 557 have assets exceeding R40 million. A mere 164 people meet both the income and asset criteria. (Davis Tax Committee, 2018)

4. Ultra HNWI: South Africa has only 234 of these individuals who are defined as individuals whose assets exceed R75 million. There are no income criteria for this sub-segment. (Davis Tax Committee, 2018)

Recent tax statistics of interest show that 4 061 individuals had taxable incomes exceeding R5 million in 2014, 103720 had taxable incomes exceeding R1 million but below R5 million, and 372 654 had taxable incomes greater than R500 000 but below R1 million. Tax collected from this group amounted to R141 billion in 2014, and of the 16 779 711 taxpayers registered (of which 6 597 244 were expected to submit returns), 4 941 390 were assessed, paying tax of R245.8 billion. From this fact it can be deduced that 9.7% of taxpayers who pay tax 2.86% of registered taxpayers, and 0.9% of the South African population of 54.5 million, pay 57% of the total tax derived from individuals in South Africa. (Davis Tax Committee, 2018)

It is also interesting to note that taxes collected for the 2016/2017 budget review at the time were R1.174 Trillion; taxes collected from individuals amounted to R441 billion or 38% of the total, compared to companies R198 billion or 17% and VAT collections amounted to R301 billion or 26% of the total; the remaining portion came from other forms of taxes. (Davis Tax Committee, 2018)

SARS has recognised that concentrating resources on HNWI will bear fruit for future tax collections, together with its compliance programme launched in 2012 (Honiball, 2009). This programme included seven priority areas for compliance improvement: coincidentally the first item on the list which forms the focus of this research report is 'wealthy South Africans and their trusts' (Honiball, 2009).

6.3 Wealthy South Africans and their trusts

One should not be blind to the contribution HNWI are making to the South African economy and also to their philanthropic efforts (Du Toit, 2019) (Hlongwane, 2013) in our country. The DTC made it clear that authorities now have their sights on trusts but pointed out that this is not to be seen as a witch hunt which prioritises the interests of other South Africans over HNWI. The DTC also suggested (Davis

Tax Committee, 2017) that, in line with international trends, South Africa should adopt a taxpayers bill of rights, which is a welcome development.

Due to the complications of tax law provisions pertaining to trusts, they have become a minefield, even though they remain popular. (Honiball, 2009) Estate planning has always been one of the exceptional qualities of trusts. The Katz Commission which coined the term 'generation skipping device' proposed that a periodic capital tax (Geach W. , 2013) on the market value of net assets of trusts should be implemented (Honiball, 2009) (Geach, 2007). Although this has not yet been pursued, it must be kept in mind for future estate planning and tax purposes.

Chapter 7

Selected country overview

7.1 Introduction

In different countries the debate about wealth taxes take various forms. In the United States the debate about Green Taxes, sustainability and global warming where wealth taxes at a top marginal rate of 70% it was provocatively suggested by Congresswoman Ocasio Cortez, that the programme will require billions of dollars in new taxes to fund. In South Africa, on the other hand, the debate around wealth taxes turns around inequality and wealth redistribution.

The complexities in tax administration and the enforceability of tax laws can make a portion of the tax base highly mobile or easily hidden from tax authorities, and this requires careful policy consideration. (Schnellenbach, 2012)

It is interesting to note that the number of OECD countries with wealth taxes on individuals dropped from twelve in 1990 to only four in 2017. After the world financial crises of 2008 which started with the mortgage crises and subsequent collapse of investment bank Lehman Brothers (Sorkin, 2010).

Spain and Iceland reintroduced net wealth taxation as a temporary measure for fiscal consolidation. (Davis Tax Committee, 2018) France, Norway, Switzerland and Spain are the only countries which presently levy net wealth taxes on individuals.

Net Wealth Taxes raise very little revenue for the fiscus. In these countries in Europe they account for less than 1% of the total taxation in 2015, with the exception of Switzerland where 3.6% of tax revenue was raised through wealth taxes. (OECD, 2017)

This chapter will look at these countries. France has a well-established wealth tax, Germany is discussing the introduction of a wealth tax, and India recently abolished the wealth tax for various reasons. Wealth related taxes raise around 2% of Gross Domestic Product ('GDP') on the EU average. The debate surrounding wealth taxes in the EU gained momentum recently, especially in times of fiscal consolidation and strong macro-economic adjustment needs in exposed or vulnerable countries. (Wohlbier, 2014)

Wealth taxes are widely used in the EU but exclude net wealth taxes (imposed on a person's net wealth meaning assets minus liabilities), and their importance to revenue authorities can be seen from the below graph (Ernst and Young, 2014). These taxes include inheritance tax, gift tax, real estate possession tax, real estate transfer tax, total net worth tax and specific assets taxes. (Wohlbier, 2014)

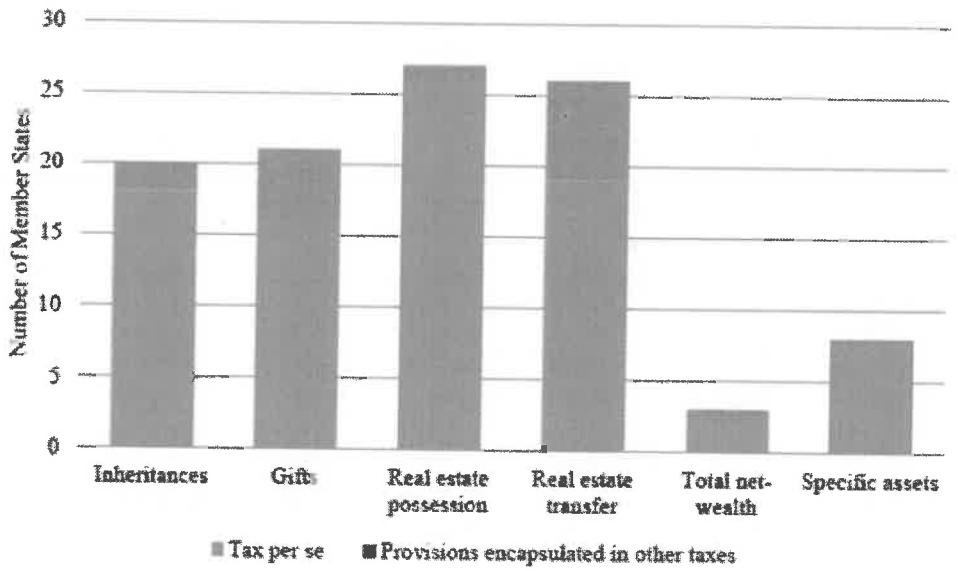


Figure 4: Revenue of wealth taxes collected in European countries (Ernst and Young, 2014)

EU member states raise different types of wealth taxes, but one needs to answer the question how much revenue is raised form these taxes. As can be seen from

the figure below (Ernst and Young, 2014), revenue generated by various wealth taxes varies wildly among member states from more than 3% to below 0.25% of GDP. (Wohlbier, 2014)

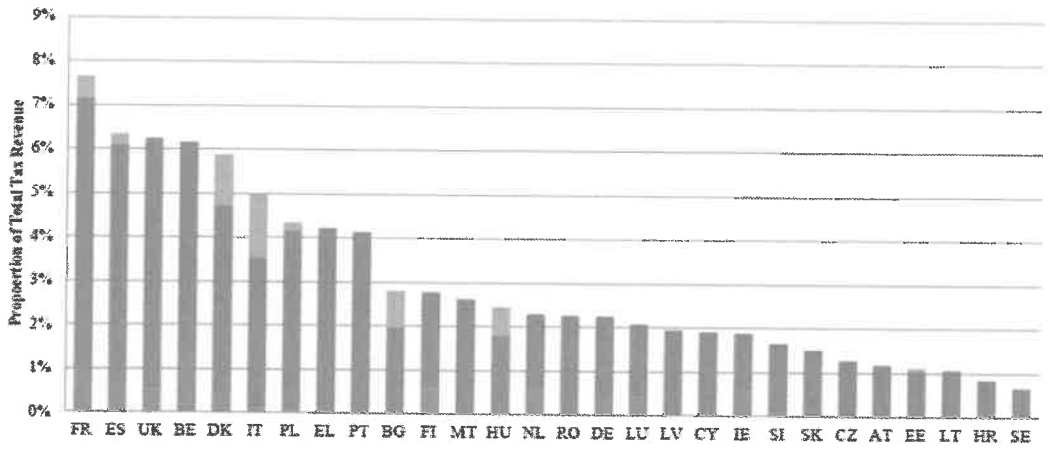


Figure 5: Variants in revenue generated by wealth taxes between EU member states (Ernst and Young, 2014)

7.2 France

France has an extended history of love and hate when it comes to wealth taxes, and to this day it is one of the European countries which still has net wealth taxes, together with other forms of wealth taxes. France has always been reluctant to introduce income taxation, and it was not until the First World War that income taxes were introduced in France. (Astarita, 2014)

France always relied and preferred different forms of wealth taxation in the form of property and, later, in the form of capital and net wealth taxation. (Trannoy, 2014) With the launch of *Impôt sur les grandes fortunes* (Tax on great fortunes) introduced by President Francois Mitterand in 1982 and abolished by President Jacques Chirac from 1987 to 1989 then reintroduced by President Mitterand in 1989 (Astarita, 2014) as *Impôt de solidarité sur la fortune* (ISF, the solidarity tax on wealth). (Trannoy, 2014)

In France the tax base for wealth taxes, similar to South Africa is made up of global wealth, except for countries which have signed an agreement with France. Wealth is calculated by using the test for market value of the assets minus deductible debts. Furthermore, there is allowance for a special deduction of 30% for a primary residence with the following exemptions (Trannoy, 2014):

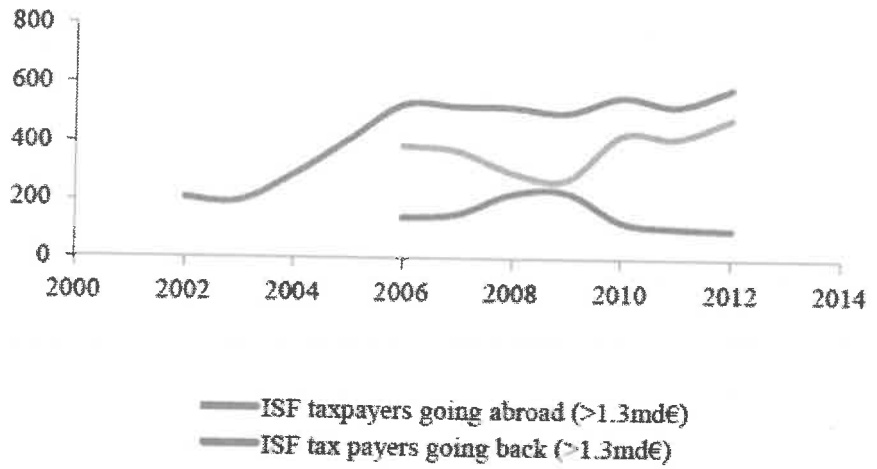
1. Professional goods such as businesses (depending on the % owned);
2. Vintage collectable objects;
3. Artistic literature or industrial rights;
4. Woods and participation in forestry plantations (75% of their value);
5. Capital value of pensions and retirement plans;
6. Capital obtained as compensation for physical injury in accidents or due to illness.

The tax base represents about 10% of the total wealth of French households. It is interesting to note that the amount of ISF revenues only contribute 63 billion Euro, or 0.6% of total net wealth. ISF is among many wealth taxes in France, which include property tax and the rapidly shrinking estate tax revenues. (Trannoy, 2014)

7.2.1 Tax migration in France

It has been said that the wealthy vote with their feet by fleeing with their capital when a country's taxation regime no longer satisfies, until their host country increases wealth taxation under pressure from voters becoming more intolerant of inequality. Migration from France by wealthy individuals presently dominates the debate around ISF taxes. (Trannoy, 2014) That being said, it has been notoriously difficult to assess tax migration figures accurately as a result of ISF tax, as access to fiscal data is scarce.

In the figure below one can see recent information from the French Treasury distinguishing between gross outflows and net outflows, but the information stops short of giving an indication why the outflows take place. One cannot deduce that it is because of ISF; obviously ISF will have some impact but this cannot be accurately measured. (Trannoy, 2014)



Source: parliamentary report by Yann Galut and DGFIP.

Figure 6: Gross outflows and nett outflows of capital from France (Trannoy, 2014)

From the graph below one can see what the average wealth of the taxpayers leaving France for countries like Belgium and Switzerland is. Belgium has no net wealth taxes and Switzerland has lower estate taxes than France. (Trannoy, 2014)

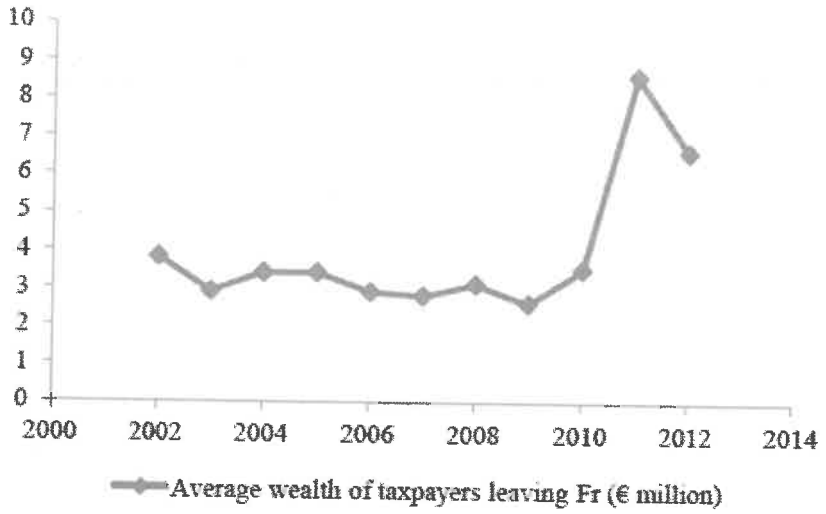


Figure 7: Average wealth of taxpayers leaving France (Trannoy, 2014)

7.2.2 Conclusion

Though it is difficult to estimate the impact of wealth migration empirically as a result of ISF tax, one notes certain particularities such as reports in the media that there are 65 French billionaires, of which one third either lives abroad or has substantial assets in countries like Switzerland and Belgium: before 1981 (when ISF was introduced) few wealthy Frenchman lived in Belgium.

7.3 Germany

Germany has suffered from rising inequality over the past decade. Germany's *Gini* coefficient has increased four percentage points between 1990 and 2005. (Grabka, 2014) (OECD, 2014)

Employment in Germany, on the other hand, has increased, to be briefly interrupted by the financial crises in 2008 to 2009. Progressive tax policies have suffered because of international tax competition. Business and Capital Income Tax have been reduced in conjunction with a reduction in personal Income Tax

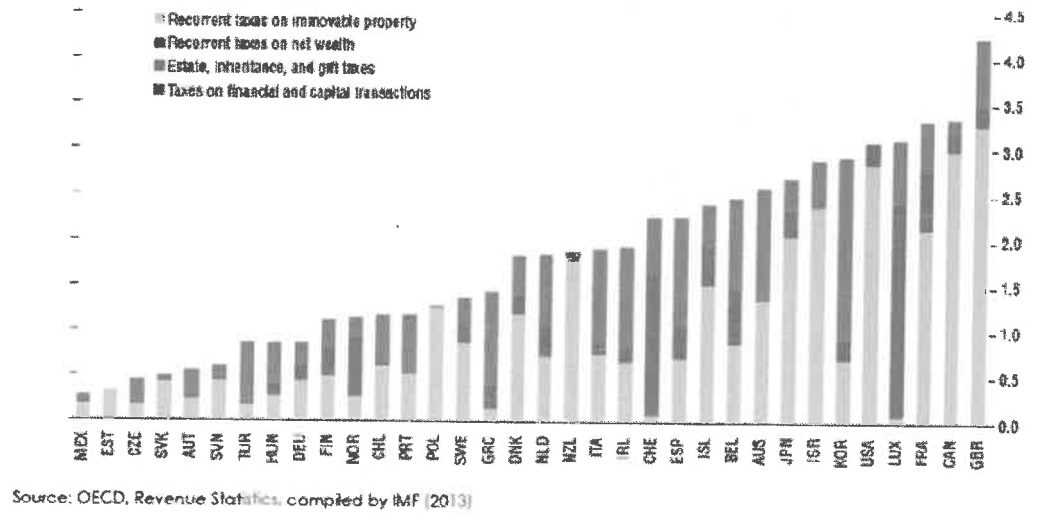
with Inheritance Tax remaining low, and personal wealth taxes have completely been abolished. (Astarita, 2014)

It is against the above developments that left wing parties in Germany ignited the debate around wealth taxes, or as most people view, it higher taxes on 'the rich' with a reintroduction of recurrent wealth taxes, strengthening of inheritance tax, a one-time capital levy to reduce public debt, and increases in property tax, and property transfer tax being proposed. (Bach, 2014)

7.3.1 Property and wealth related taxes in Germany

These taxes do not generate a great deal of revenue for German tax authorities. As in other countries in the world, property and wealth related taxes raise less than 1% of GDP: inheritance taxes and gift taxes raise only 0.2% of GDP. (Astarita, 2014).

Germany has a long history of personal wealth taxation and has in the past raised significant tax revenues from wealth taxation is seen in the below figure. (Bach, 2014).



Source: OECD, Revenue Statistics, compiled by IMF (2013)

Figure 8: Revenue on personal wealth taxes in Germany (Bach, 2014)

Wealth taxes in Germany were increased after the First World War and raised significant revenues as can be seen in the figure below, and capital levies were introduced to fight public debt, which problem was solved by hyperinflation in Germany in 1923, where after a unique tax called a 'mortgage profit' legislation was introduced ('*Hauszinsteuner*') which raised a substantial amount of revenue for the fiscus by absorbing inflation gains of mortgage debtors.

After World War Two, capital levies were introduced in 1952 as a source of 'burden sharing' ('*Lastenausgleich*') wealth tax rates as high as 50% were levied on wealth exceeding a personal allowance with quarterly instalments spread over 30 years, raising revenues of 1% of GDP: these were successful in funding Second World War indemnities, reconstruction of Germany's infrastructure and integration of displaced persons after the war. (Hughes, 1999)

The main reason for the low revenues of wealth taxation are outdated property values ('*Einheitswerte*') of real estate properties which have not been updated since the 1960's. (Bach, 2014)

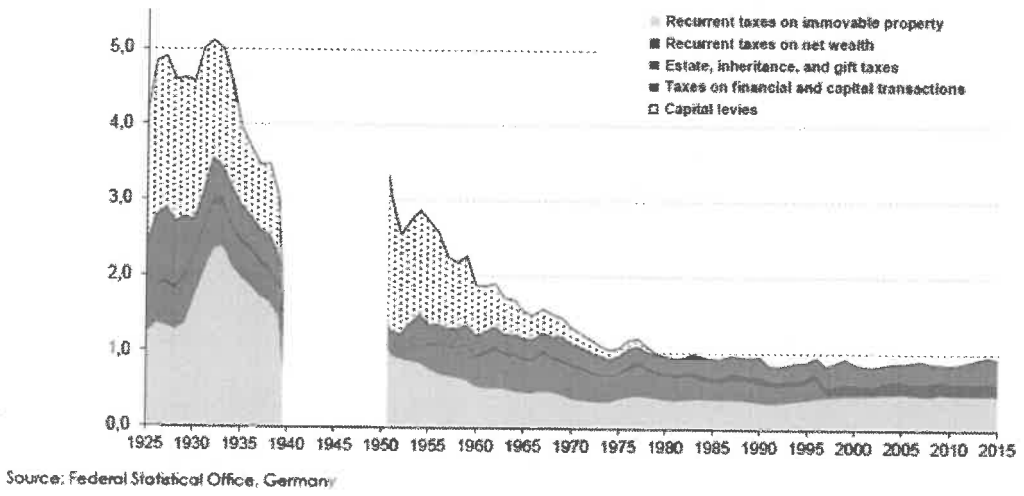


Figure 9: Revenues from wealth taxes in Germany after the first World War (Bach, 2014)

7.3.2 Proposals on personal wealth taxes in Germany

The German Green party endorsed the introduction of a one-off capital levy to raise 100 billion Euro (4% of GDP in 2011) to reduce public debt incurred as a result of the 2008 financial crises. The criterion for the levy would be individuals (companies excluded) with a personal net wealth greater than 1 million Euro, in other words, the levy would focus on the wealthy. (Astarita, 2014)

Similarly, the Social Democrats proposed the reintroduction of a recurrent wealth tax with the aim of raising 10 billion Euro (0.4% of GDP in 2011). Both individuals and corporations would be liable for the wealth tax. The annual tax rate was proposed at 1%, with a personal allowance set at 2 million Euro. (Bach, 2014)

This requires the assessment of taxable assets i.e. real estate properties, business properties, financial assets and some household assets less liabilities. Appraisal methods aim to capture market values as closely as possible although this is an intricate issue when it comes to real estate and the valuation of small firms. (Rudnick, R and Gordon, R, 1996)

7.3.3 Revenue and distribution effect

Regarding the proposals of the Greens (Bach, 2014) is of the view that a personal wealth tax can raise substantial tax revenue. In the case of a 1 million Euro personal allowance, a child allowance of 250 000 Euro, a further allowance on business property of 5 million Euro, the tax base is estimated at 1400 billion Euro or 56% of GDP in 2011. The number of taxpayers affected are minimal at 330 000 or 0.5% of the adult population. (Astarita, 2014)

The conclusion drawn from various studies indicates that a personal wealth tax of 1% can raise 14 billion Euro or 0.6% of GDP (2011). It follows that the target of 100 billion Euro set by the Greens was optimistic, depending on allowances, and to achieve this tax, a rate of 7.1% would need to be implemented. (Bach, 2014)

When consideration is given to the wealth tax proposal by the German Social Democrats, 16.5 billion Euro or 0.64% of GDP could be raised. About 143 000 individual taxpayers would be affected and approximately 164 000 corporations would be liable for the tax. The tax base and tax revenue are approximately equally divided taking into account the half exemption of corporate wealth tax.

Debate pertaining to wealth taxes relates mainly to tax compliance and administrative costs of wealth taxes which are generally high estimated considering various factors in their simulations so that total cost of assessment could be less than 2% of tax revenue which they concede seems to be on the low side. (Steiner, 2014)

7.3.4 Economic effects

One of the negatives of recurrent wealth taxes is their impact or distortion on wealth or per capita accumulation and behavioural changes such as asset and investment allocations, financing decisions and tax avoidance or even tax evasion strategies developed to circumvent these taxes. (Astarita, 2014)

The problems with wealth taxes have pointed out that there is no counterbalance to fluctuations in income or losses even of a capital nature. They affect the liquidity of small and medium enterprises (SME) and tax breaks for SME may create new distortions. (Bach, 2014)

An additional 1% wealth tax will place significant impediment on business and capital income, especially considering the low interest rates following the 2008 economic crises. These additional taxes may even raise Constitutional concerns about over-taxation when considering that returns of as low as 2% on safe investments like government bonds and lower for fixed investments are achieved following the low return environment in Europe post 2008. (Astarita, 2014) The Constitutional debate in Germany at the moment circles around recurrent income and wealth tax burdens systematically exceeding returns on investments. (Bach, 2014)

In contrast to recurrent wealth tax, a one-time capital levy may not have the negative impact of incentivising immediate tax avoidance as a result of the 'element of surprise' as taxpayers may not timeously anticipate the levy, provided that, in the long term, they don't expect the levy to re-occur. (Eichengreen, 1990) has argued that a capital levy may be welfare improving if it is adopted to redress debt problems created by extraordinary circumstances such as the 2008 financial crisis.

These taxes may create a backlash, especially when wealthy individuals feel they are being unfairly targeted by the government and their interests are being neglected. (Bach, 2014) A once-off capital levy could serve as an extraordinary instrument in times of fiscal emergency (IMF, October 2013). This does not seem to be the case with Germany at the moment but other southern Mediterranean countries such as Turkey, Greece and possibly Italy may need to consider this extraordinary instrument. (Astarita, 2014)

7.3.5 Reform of inheritance taxation in Germany

Compared to recurrent taxes on business and capital income, inheritance taxation is preferred by many economists as an economically favourable wealth tax. (Boadway, R and Chamberlain, 2010) (Kopczuk, 2013)

Inheritance tax is the last so-called wealth tax in place in Germany, with personal allowances of 500 000 Euro for spouses and 400 000 Euro for children.

It should be borne in mind that inheritance tax is a major consideration in estate planning and can trigger change of residency with competition from other OECD countries which no longer levy inheritance tax and have abolished net wealth taxes. (Förster, 2014). Inheritance taxes are also unpopular taxes in the German middle class because it impacts the population at large and not only a minority group (Astarita, 2014)

Discussions and debates in Germany mostly pertain to restriction of corporate privileges and the reduction of benefits such as tax exemptions for the family home (primary residence) or tax exemptions for donations. (Bach, 2014).

7.3.6 Conclusions

From the information on Germany one sees considerations for increased top income and capital income taxes, recurrent wealth taxes, one-time capital levy and improving inheritance tax by reducing tax privileges, which is the preferred route for many economists. (Astarita, 2014)

One can also see that there are drawbacks to recurrent wealth taxes such as the incentives they create for taxpayers to avoid or evade the tax burden. Due to the low interest rate on investments in Europe, a 1% annual wealth tax on business, especially SME, and capital income, which is the higher, the lower the rate of return may be unconstitutional. A similar situation presents itself in South Africa because of low economic growth.

A one-off capital levy due to its 'element of surprise', if not anticipated, would give little if no reward for instantaneous tax avoidance provided that the taxpayers do not anticipate this levy to re-occur. This measure should only serve as an extraordinary instrument in cases where a government is heavily indebted for example. (Bach, 2014)

The tax burden on intergenerational transfers known as inheritance taxation promotes a 'meritocracy' and equal opportunities among members of generations, and therefore it is a wealth tax preferred by economists. Proposals have been made to restrict corporate privileges and tax benefits that could be revoked or reduced such as tax exemptions for the primary residence or 'family home' and exemptions for donations. (Astarita, 2014)

There are currently no definite prospects for increased taxes on personal wealth but, increases in top income taxation looks more likely. It would not be difficult to raise an extra 10-15 billion Euro with conventional income taxation (Bach, 2014). It should also be pointed out that, in the long run, improved international coordination among tax authorities will increase opportunities to tax high incomes and wealth more progressively.

Lastly, consideration in the long-term should be given to integrate elements of wealth taxation into current income taxation. Income taxation may also be replaced by or integrated into a recurrent net wealth tax on the market value of assets less liabilities as in the Netherlands. (Cnossen, S and Bovenberg L, 2001)

7.4 India

A recommendation was made in 1956 by the Kaldor Committee to implement a wealth tax in India to broaden the tax base through an introduction of a net wealth tax, a capital gains tax, an expenditure tax, as well as general gift taxes. (Kaldor, 1956)

The Indian Tax Reform Committee in 1991 proposed a distinction between productive and unproductive wealth and, as a result, only unproductive wealth, things like luxury cars and jewellery, were taxed but productive wealth was not taxed to encourage investments in financial assets such as shares, securities, bonds and bank deposits. (Tax Reforms Committee , 1991)

According to (Kaldor, 1956) introducing a wealth tax in India was *firstly* to reduce the possibility of tax evasion, *secondly* , to account for a person's capability to pay and, *lastly*, to promote an egalitarian society using distributive measures which provide no disincentive effects both conceptionally and operationally.

7.4.1 Challenges associated with wealth tax administration in India

The administration of wealth taxes in India faced several challenges: one of the most pressing were that valuation of assets created inequities, mostly due to the exemption of some assets from taxation. Tax authorities also did not account for the indexation of wealth taxation with respect to inflation and, finally, the tax burden of the collective incidence of wealth tax imposed a heavy burden on taxpayers. (Pandey, 2006)

7.4.2 Conclusion

India abolished its wealth tax primarily because the nominal value of revenue it was possible to collect was overshadowed by the administrative burden on the tax authority and compliance cost to the taxpayer was increased. (Pandey, 2006)

The government had a gap to fill in its budget, even though the tax collections from wealth taxes were minimal, new measures had to be put in place. To make up the revenue shortfall, the Indian government introduced a two % surcharge

levied on high income earners. (Batra, 2015) The decision was to tax the income of the rich, rather than taxing the wealthy who seem to evade taxation by employing expensive tax advisers. (Batra, 2015)

Chapter 8

The South African case for a wealth tax and its implication for trusts

8.1 Introduction

In answering the South African proposal for a wealth tax on trusts one must start by considering whether a further wealth tax in necessary. This paper has already identified four wealth taxes applied to trusts being Estate Duty, Transfer Duty, Securities Transfer Tax and Donations Tax, the only other significant tax discussed by the DTC and Katz Commission was Capital Transfer taxes that could be imposed on an annual basis. The question is not whether wealth taxes should be implemented as they already exist but whether additional wealth taxes are necessary and whether the existing wealth taxes should be increased, or efficiencies and collections improved.

Recent emigration statistics by First National Bank (FNB) show that 8% of properties being sold in Gauteng were by sellers indicating that they will be emigrating: figures for Cape town were 9.57% and for eThekwini 10.64%. (Businesstech, 2019)

There is very little information available as Home Affairs do not keep statistics of South Africans leaving the country. (Businesstech, 2019) Pew research found that significant increases in emigration from South Africa has taken place between 2010 and 2017 and that more than 900 000 South Africans live abroad. Below are figures from the Pew research study, indicating to which countries South Africans emigrated. The United Kingdom homes 210 000 South Africans, Australia 190 000 and the United States 100 000. (Pew Global Research, 2019)

Destination	Migrants
United Kingdom	210,000
Australia	190,000
United States	100,000
New Zealand	60,000
Canada	50,000
Angola	40,000
Botswana	40,000
Chile	20,000
Zimbabwe	20,000
Germany	20,000
Netherlands	10,000
Swaziland	10,000
Israel	10,000
Portugal	10,000
Mozambique	<10,000
Ireland	<10,000
Malawi	<10,000
Switzerland	<10,000
Namibia	<10,000

Table 4: Emigration figures from South Africa 2010 – 2017 (Pew Global Research, 2019)

The UK's National Statistics Office reported to City Press that 7 500 people migrated to the United Kingdom from South Africa in 2017 (Peter, 2019) and that a majority of those immigrants were qualified and skilled workers. Their concerns were financial stability, education and violent crime accounted to by City press. (Peter, 2019). There is no clear indication that South Africans are leaving due to rising taxes, although some emigration agencies are claiming South Africans are migrating due to changes in the tax laws, such as those applicable to South Africans working abroad, although these fall outside the ambit of this research report. (Businesstech, 2019).

South Africans have experienced significant increases in pressure when it comes to the tax burden and the above indicates how citizens sometimes vote with their feet when it comes to emigration and taxes, which is something the revenue authorities should consider retaining its tax base.

The issue of a Capital Transfer Tax is complex for both taxpayers and SARS, cast aside in the DTC reports on Estate Duty, they are generally burdensome on tax authorities and they don't yield much return when their administration cost is deducted from their yield. (Astarita, 2014)

Wealth taxes were at the centre of public debate when US congresswoman Ocasio Cortez who expressed the idea of a 70% top marginal tax rate on income over $10 million: which according to her calculations this could generate $72 Billion in taxes per year for government, and this tax would affect less than 1% of the population. Many people in the United States denounced the idea: former Federal Reserve Chairperson, Alan Greenspan, said it was a 'terrible idea' which would crimp economic growth (Klebnikov, 2019). His sentiments can be applied to the current South African situation as it is linked to world economy.

Historically it is interesting to note that the top US tax rate exceeded 90% during the Eisenhower administration, and rates did not fall below 50% until the Reagan administration. Nobel laurate, Paul Krugman, called Cortez's proposal fully in line with serious economic research and pointed out that the United States used to have high tax rates on the rich, and even had high tax rates during the most successful part of its history as can be seen from the below chart. (Klebnikov, 2019) It should be pointed out though that high tax rates don't necessarily lead to growth in the economy, just as low tax rates don't necessarily affect the economy: it is not within the ambit of this report to go into the details of the effect of tax rates on economic growth.



Figure 10: US tax rates vs economic growth rate 1957 - 2017 (Klebnikov, 2019)

The history of South Africa tells a different story from that of the United States. During the dying days of apartheid when the economy shrank in the 1980's, the top marginal income tax rate for individuals was 50%, dropping to 45% in 1987/88 and varied between 45% and 42% until 2002 when it was further dropped to 40%, until 2016 when it was increased to 41% and in 2017 to a whopping 45%. (Musviba, 2019) (tradingeconomics, 2019)

During this period, the highest growth in GDP was achieved between 1995 and 1998 at the dawn of democracy when growth, at certain periods, exceeded 7% and from 2004 to 2006 when growth exceeded 6%. (Statistics South Africa , 2019) Due to other factors such as South Africa's political climate, sanctions and recent corruption at state enterprises, South Africa did not grow as did the US. It is concluded that this fact should be taken into consideration when further wealth taxes are considered.

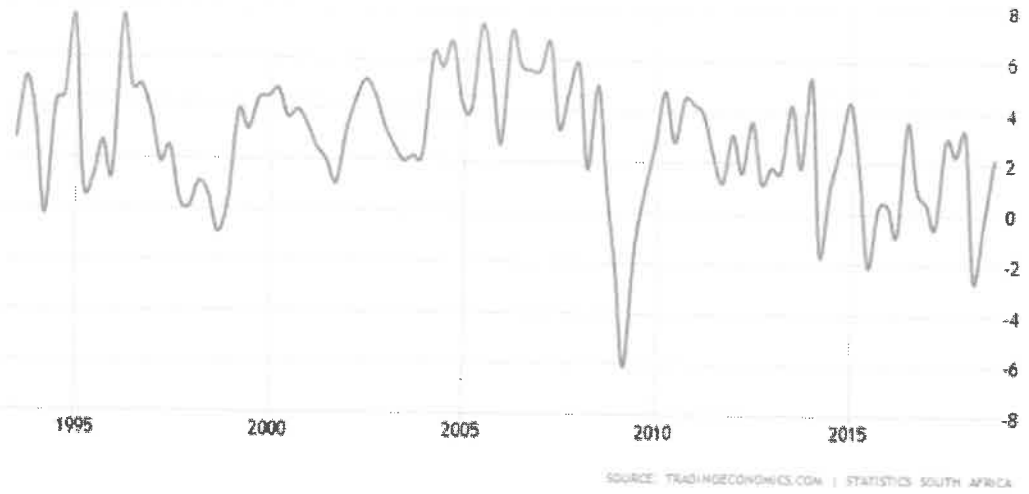


Figure 11: South African economic growth 1995 – 2015 (Statistics South Africa , 2019)

8.2 Estate Duty

The DTC was concerned about tax compliance relating to trusts and suggested the prevalent use of trusts should be investigated by SARS. (Davis Tax Committee, 2017) SARS should focus on the individual trusts and their inner workings, as well as investigate whether they are compliant with the Income Tax Act and Estate Duty Act.

The DTC advised National Treasury to consider extending the provisions of section 3(3)(*d*) of the EDA to include deeming provisions which identify 'deemed control' of a trust through a loan account between a trust and a 'connected person(s)' where the loan is not subject to interest or is subject to interest at below the official rate.

Furthermore, the DTC advised National Treasury that trust structures should be examined upon registration of the trusts, which is currently not done, and upon transfer of assets to trusts.

From the below figure it can clearly be seen that ED has been in decline over the past two decades. This is in line with international trends.

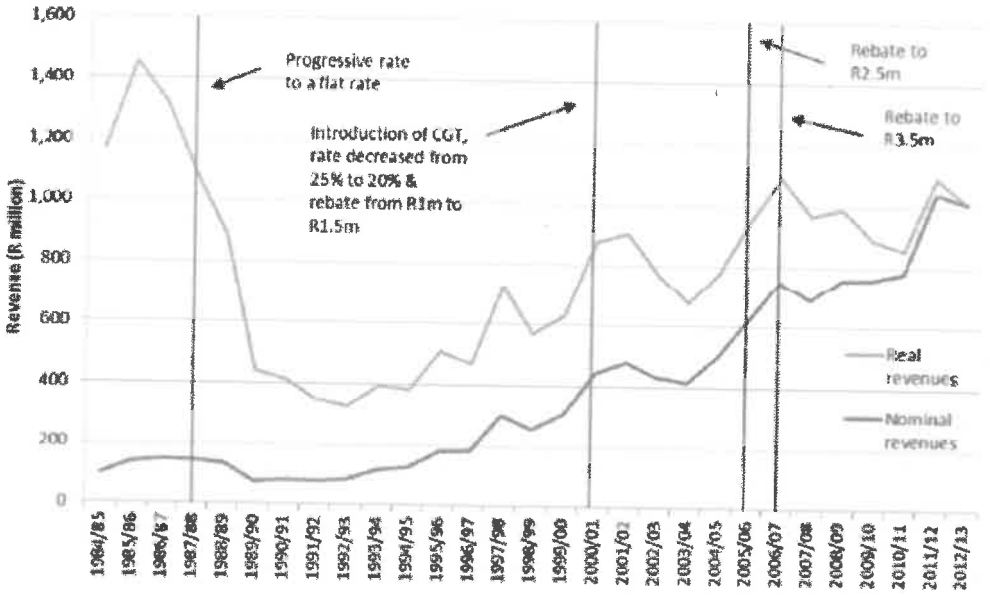


Figure 12: Estate Duty Collections 1985-2013 (National Treasury) (Davis Tax Committee, 2016)

There is no doubt that trusts have a benefit when it comes to ED. The DTC in its final report on ED pointed out that section 80A of the Income Tax Act and judicial precedent do not act as effective deterrents against ED savings mechanisms which exist in trusts today and proposed targeted anti-avoidance rules (Davis Tax Committee, 2016). It was also advised that SARS examine the actual relationship which exists among donors, beneficiaries and trusts as this is not always apparent from the trust deed. As explained above, there are already anti-avoidance mechanisms in the ED Act in section 3(3)(*d*). These investigations are complicated, and conclusions reached by SARS may lead to expensive and lengthy litigation in the courts, as can be seen from the discussion below. (Davis Tax Committee, 2016)

It is trite that a taxpayer may organize his financial affairs in such a way as to pay least the tax permissible. There is, in principle, nothing wrong with arrangements

which are tax effective. Tax payers can make poor judgement calls and as a result deals which make no commercial sense, at least, until recently.

The law on simulated or disguised transactions has been crystallised for more than a century, in what is known as substance over form, as enunciated in the *Zandberg* (*Zandberg v Van Zyl* [1910 AD, 302]) decision discussed below.

This principal was clouded in the SCA decision under discussion, namely, *NWK* case, causing uncertainty and panic for some time, by introducing an additional criterion, namely, 'commercial purpose' which will be discussed below. (*Commissioner for the South African Revenue Service v NWK* [2011 (2) SA 67 SCA] Par 55)

Innes CJ in the Zandberg decision found (par 302):

> Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose) the parties to a transaction endeavour to conceal its true character. They call it by a name or give it a shape, intended not to express but to disguise its true nature. And when a court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be... But the words of the rule indicate its limitations. The court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances that the same subject might have been attained in another way will not necessarily make the arrangement other than what it purports to be.

This position is contrasted with that found in the *NWK* matter. In this case, the SARS Commissioner contended that *NWK* had deliberately disguised its contract to borrow R50m from FNB as a transaction in terms of which it would borrow actually R96 415 776, repayable by the delivery of maize, neither of which, in fact, was ever intended. (par 56) By delivering the unanimous judgement of the Court, Lewis JA said the following:

> In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation. (par 55)

This court has previously held that the mere production of agreements does not prove that the parties genuinely intended them to have the effect they appear to have. In *Erf 3183/1 Ladysmith (Pty) Ltd v CIR Ltd* 1996 3 SA 942 (A) Hefer JA, dealing with a contention that agreements should be given effect in accordance with their tenor (form), said:

> This is plainly not so. That the parties did indeed deliberately cast their arrangement in the form mentioned, must of course be accepted; that, after all, is what they had been advised to do. The real question is, however, whether they actually intended that each agreement would inter partes have effect according to its tenor. If not, effect must be given to what the transaction really is.

According to Wallis JA in *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* (49/13) [2014] ZASCA 40

> Whether a particular transaction is a simulated transaction is therefore a question of its genuineness. If it is genuine the court will give effect to it and, if not, the court will give effect to the underlying transaction that it conceals. And whether it is genuine will depend on a consideration of all the facts and circumstances surrounding the transaction. (Par 27)

And further at par 37:

> For those reasons the notion that *NWK* transforms our law in relation to simulated transactions or requires more of a court faced with a contention that a transaction is simulated than a careful analysis of all matters surrounding the transaction, including its commercial purpose, if any, is incorrect. The position remains that the court examines the transaction as a whole, including all surrounding circumstances, any unusual features of the transaction and the manner in which the parties intend to implement it, before determining in any particular case whether a transaction is simulated.

The criterion in the *Zandberg* case is that of substance over form as summarised in the judgment: the actual ascertainable intention of the parties is paramount, which will naturally differ from the simulated intention.

The additional criterion laid down in the *NWK* case can be summarised in that it requires a consideration of the commercial sense of a transaction. The court found that the test to determine simulation cannot just be whether there is an intention to give effect to a contract (which there was), in accordance with its terms. In this case, *NWK* conclude several transactions which made little commercial sense, and the court found further that where parties structure a transaction to achieve an objective other than the one ostensibly achieved, they will intend to give effect to the transaction on the terms agreed.

It follows that if the transaction is contrived to avoid tax as its sole purpose, it logically follows in terms of case law that it will be a simulation. The mere mechanical signing of these types of agreements will fall foul of the law, as set out in NWK.

A welcome clarification came when the SCA considered a non-tax related matter of *Roshcon*:, the judgment brought clarity for its affirmation that the essence of a simulated transaction is not that it has the effect of avoiding tax, or that it lacks a commercial 'purpose' (as some passages in the *NWK* judgement seems to suggest), but rather that the essence of a simulated transaction is that it is not

genuine and that, conversely, if it is genuine the court will give effect to it. (South African Institute of Tax Professionals, 2019)

The simulation principle still requires an element of dishonesty, disguise or deception. (ENSAfrica, 2019) It therefore seems that the principles as expressed by our courts, specifically in *Zandberg* are still intact but the court has a supplementary means to assist it, this being 'commercial purpose', not as an independent peremptory consideration as all the facts will need to be considered to establish whether a transaction is simulated or not.

The court examines the transaction as a whole, including all relevant circumstances, any unusual features of the transaction and the manner in which the parties intend to implement it. The court will not give effect to mere mechanical recording of agreements which patently show no commercial purpose, and also show dishonesty as it did in NWK.

8.3 Capital Transfer Tax

The DTC summarised the following conclusions in its final report on ED after comparative research undertaken.

1. CTT is generally extremely complex, both for SARS and for the taxpayer;
2. Complexities involved in CTT lead to high cost for tax collections and numerous administration problems;
3. CTT has a low yield when the costs are deducted from the revenue earned by tax authorities;
4. Evidence has suggested that, worldwide, CTT gives rise to an unproductive estate planning industry.

Following the above conclusions, the DTC recommended that many of the objectives of the CTT could, in fact, be achieved with some modification to the

ED system. It was suggested that a periodic charge to ED, in addition to General Anti-avoidance Regulations ('GAAR') be implemented.

8.4 The DTC recommendations

The DTC proposed that three questions need to be answered before South Africa can implement a net wealth tax:

1. Consideration as to the appropriate tax base (which forms of wealth to include within the scope of the tax);
2. Comprehensive data on the pattern of wealth ownership;
3. An evaluation of whether the revenue generated would exceed the administrative and economic burden on taxpayers and the revenue authorities.

Relating to the first question, the DTC proposed that further consultation with treasury, SARS and stakeholders should take place to ascertain, among other considerations, whether pension assets should form part of these assets.

Secondly, it was proposed that all taxpayers including trusts and their beneficiaries must complete in their tax return the market value of all ascertainable wealth held by individuals and in trusts for the 2020 assessment. It follows from the recommendations of the DTC that the introduction of wealth tax is not imminent. Interestingly the DTC points out that, although a wealth tax is legitimate in its own right in spite of it being contentious, it 'not necessarily the best instrument to address inequities of income and wealth'.

Of the 132 submissions received by the DTC regarding the implementation of wealth taxes, only five were in favour of a recurring net wealth taxation.

It has been pointed out by Orthofer (Orthofer, Savings and Wealth in the Context of Extreme inequality, 2017) that South Africa has an extremely low household savings rate and that in central Europe where Picketty's research was conducted, economists were growing worried about the high savings rates which continued after central banks had lowered interest rates to near zero. Household spending remained insufficient to support the financial recovery after the economic crisis and concerns about a secular stagnation became more evident (Baldwin & Teulings, 2014).

In South Africa the opposite has occurred and household saving rates have reached historic lows of close to zero, raising fears that citizens would be vulnerable to unexpected losses or expenses and would struggle to maintain their living standards during retirement. (Orthofer, Savings and Wealth in the Context of Extreme inequality, 2017) The low propensity to save was also thought to increase South Africa's reliance on foreign capital inflows, increasing the vulnerability of the economy to large current account deficits and skewing the market structure in favour of larger companies (National Planning Commission , 2012) Savings-enhancing policy initiatives such as the introduction of tax-free saving and investment accounts in March 2015 were motivated largely by these concerns (Orthofer, Savings and Wealth in the Context of Extreme inequality, 2017).

Even in South Africa, for instance, recent proposals for higher wealth taxation relied more heavily on Picketty's findings on the major advanced economies than on an analysis of domestic data (Davis Tax Committee, 2015). Orthofer points out this is, despite the fact that South Africa was the first developing country to compile its own household sector balance sheets in 2006, and also despite the fact that Piketty's concern about the growing importance of wealth contrasts, at least outwardly, with South Africa's original apprehensions about low saving and scarce capital. (Orthofer 2017).

A significant problem with an annual wealth tax lies in its potential to discourage capital accumulation. One way of circumventing this negative result would be substantial increases in the limits on contributions to tax free savings accounts- cognisant of the fact that pension funds already has large tax benefits, as outlined by the DTC. Perhaps an increase in tax free savings, in line with pensions contributions to R350 000 annually could be considered (DTC, 2017). The world economy is currently experiencing low interest rates and below inflation related returns on investments. Wealth taxes could further reduce wealth, as wealth taxes are not submitted to deductions for inflation. Constitutional concerns in respect of over taxation therefore exists especially where one already has high upper marginal rates and low investment returns. (Astarita, 2014)

The author agrees with Orthofer that a net wealth tax at this stage, with the present facts at hand, will promote tax migration and a loss of capital that South Africa cannot afford to lose. Therefore, the author proposes that a wealth tax at this point would not be beneficial to South Africa and would probably, at worst, have an adverse effect on the economy and at best result in the opposite result it is aimed to achieve, namely tax migration, tax avoidance and tax evasion.

It is acknowledged that our society has notoriously high levels of inequality and a pattern of economic class overlaid with race. To reduce inequality, the author contend that a further wealth tax would diminish the legitimacy of the tax system. The focus should be on further incentives for building wealth for the people at the base of the wealth pyramid as well as the middle class to incentivise a philosophy of saving that is currently extremely low in this country (S Mbewe & Davis, 2019).

Chapter 9

Conclusion

From the above three country overviews, as well as research cited in this study, it seems that South Africa is not ready for implementation of a net wealth tax in the near future and that a substantial number of consultations with various stakeholders still needs to be conducted, especially when the nature of the assets such as pension fund assets which might be affected are considered.

There have also recently been significant increases in wealth taxes in South Africa which need to be considered when a further net wealth tax is contemplated: these include the 2018 increases is Estate Duty for dutiable estates above R30 million, and Donations Tax increases to 25% of donations exceeding R30 million. (South African Revenue Service, 2019b) Similarly, transfer duty on property transfers exceeding R10 million is now 13%. It seems that wealth taxes have been significantly increased recently, not forgetting the introduction of section 7C regarding interest free loans to trusts which significantly altered the benefit trusts held pertaining to Estate Duty savings and Donations Tax savings. Furthermore, and as from 1 March 2019, the amendment to section 7(8) of the ITA and paragraph 72 of the Eighth Schedule to the ITA expanded the ambit of the donor attribution rules for South African resident donors of foreign trusts. Now the income of a foreign trust may be attributed to a South African resident if he or she made a donation, settlement or other disposition, which may include a loan which incurs interest below market rate. The participation exemption in section 10B(2)(*a*) of the ITA also no longer applies to companies where a foreign trust is interposed, and the exemption is disregarded in terms of the amendment. These amendments significantly impact the usefulness of foreign trusts for South African resident beneficiaries.

As can be seen from the above, there have been massive recent tax increases in wealth taxes in South Africa, as well as over the past 20 years. One should be

cognisant of wealth migration and competition from other countries, as well as of the impact wealth taxes can have on savings and SME.

From this study of Germany, it is understood that there is grave concerns insofar as international tax competition is concerned, flight of capital and the impact of wealth taxes on entrepreneurs and SME, opposition from the middle-class citizenry, as well as the wealthy and the possible unconstitutionality of wealth taxes because of over taxation. Similarly high inflation in South Africa of (between 5 and 6 % over the past 5 years) (Statistics South Africa, 2019), combined with the decline in the Johannesburg Stock Exchange all share index ('ALSI') (8.5% in 2018), while 2017 the ALSI saw a 20% gain, 2015 (5%) and 2016 (2.6%) delivered returns below inflation: this equates to returns on the local bourse barely being positive in real terms over the past five years. (Mohr, 2019) there is, as a result, a real chance of negative returns on savings and investments, should a 1% recurring net wealth tax be implemented.

An interesting observation from the German case study was that a onetime capital levy could be introduced in a scenario where a recurrence can be assured not to happen and as an extraordinary measure where the government is heavily indebted.

It seems that the preferred path in Germany and in South Africa is not to implement a recurring net wealth tax but to increase other wealth taxes already in operation as can already be seen with increases in Estate Duty, Transfer Duty, and Donations tax. Furthermore, there has not been sufficient consultation with stakeholders at this stage to implement net wealth taxes, and relevant statistical information of net wealth in South Africa is still lacking. One will have to wait and see whether taxpayers are asked to submit information pertaining to their wealth in their 2020 tax returns as proposed by the DTC.

The DTC conceded that income inequality could be improved following several submissions made to it by improving wasteful and corrupt government expenditure will go some way in improving tax morality and curbing tax avoidance and tax evasion.

This study concurs with Orthofer that economic policy has a role to play in wealth creation. Monetary and fiscal policy can promote saving and investment by keeping inflation rates stable while progressive taxation can encourage middle class savings. (Orthofer, Wealth Inequality Striking New Insights , 2016)

The constitutionality of a further net wealth tax should also be considered in the current economic environment discussed above where citizens may end up paying taxes when their real return on their investments is in decline.

In addition, in the current environment of problems in the European Union with Brexit, and US/China trade wars, it seems unlikely that Picketty's suggestion of global cooperation on wealth tax will happen. There is also the debate which is heating up in the United States over the proposal of a wealth tax of 70% on income that exceeds $10 million, being driven by the Democratic Party's congresswoman Corte.

The debate can go anywhere at this stage but, as in the case of Germany, it does not appear to be going anywhere soon.

The above amendments certainly outline a dim future for trusts in South Africa and foreign trusts with South African resident beneficiaries. Each individual's needs and requirements have to be properly considered before making a decision as to whether a trust is still cost effective in light of these amendments (Brink, An investigation into the future of discretionary trusts in South Africa: An income tax perspective: Part 2, 2017), and potential future net wealth tax considerations.

It is further important to note that a trust cannot simply be terminated because to changes in tax legislation. (Brink and Willemse, 2014) also explain the procedure for the termination of a trust and the tax consequences.

In conclusion this study finds that the trust is unparalleled when it comes to the preservation of inter-generational wealth because it can exist in perpetuity. The amendments to Estate Duty, Donations Tax and the taxes on interest free loans in the Income Tax Act, discussed herein above, already address the issue of wealth taxes, and a further wealth tax on trusts would be inadvisable, and possibly unconstitutional.

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