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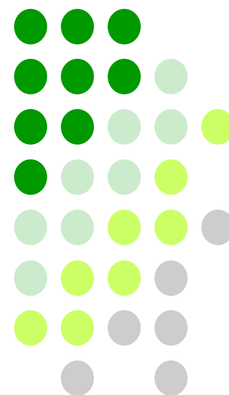

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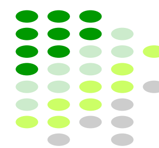

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Contributions and enquires are welcomed and must be sent to:

The Editor

Premiums & Problems

Personal Finance (Legal)

Old Mutual, 6th Floor, L Block

PO Box 66

Cape Town

8000

E-mail : premiums&problems@oldmutual.com

Editors

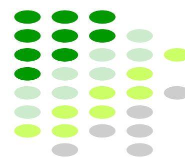
Soré Cloete: CFP® BCom LLB H Dip Tax

Laverne Slater CFP® LLB Adv PG Dip in Fin Plan

Tristan Naidoo: CFP® LLB Adv PG Dip in Fin Plan

Design & Layout

Fazlin Tambay



Contents

General

The impact of the National Credit Act on the transfer of assets into a trust — **A1 – A8**
Karen Van der Poll

Elements to consider when amending a trust inter vivos — **A9 – A18**
Madeleine Britz

A summary of inheritance and claims in respect of minor children — **A19 – A27**
Amanda Moolman

South African inheritance and heirs staying abroad — **A28 – A32**
Suzelle Jooste

Personal Liability of Directors – Risk Planning Considerations — **A33 – A43**
Anél Strampe

Maintenance claims after the death of a domestic partner: A brief summary of developments — **A44 – A51**
Deon van Vuuren

Trust assets could affect your accrual claim — **A52 – A59**
Saudiqa Fakier

Estate Planning

Estate Planning: Finding a Successor: Suggestions for the farmer — **B1 – B7**
Nevetha Maharaj

The risks of selling assets in the course of winding up an estate — **B8 – B17**
Gerald Peter

Renouncing the Accrual Claim on death: An opinion the tax implications — **B18 – B22**
Shakira Bodasing

The impact of the new tax-laws on interest free loan accounts in the context of estate planning — **B23 – B31**
Maryke Marais

Retirement Planning

Is there still rationale for making excess contributions to a retirement fund C1 – C8
Natalie Dillon-van Acker

The Tax Deduction for Contributions to Retirement Funds – The Latest Developments C9 – C32
Carl Muller

Severance Benefits C33 – C41
Keith Peter

Investment Planning

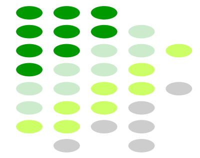
A basic investment comparison in an individual capacity, company or a trust D1 – D9
Jothi Chirkoot

Income Tax

Crossing the Rubicon…A costly change of mind! E1 – E9
Gerald Peter

Capital gains tax & Income tax implications on livestock at death E10 – E16
Louw du Toit

Specific requirements of special trusts E17 – E24
Carla Letchman



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The recipient of the

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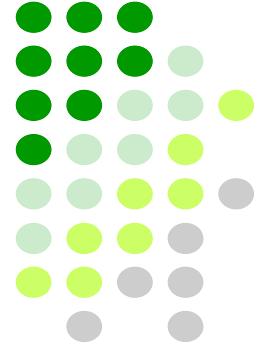
for **2017** is

Carl Muller

For his contribution entitled

The Tax Deduction for Contributions to Retirement Funds –
The Latest Developments

In reaching their decision, the judges have taken into account the technical correctness, how informative the article is, learning potential for the reader, method and effectiveness of transfer of relevant information, originality, practical applicability and potential for marketing opportunities.



General

The impact of the National Credit Act on the transfer of assets into a trust

Karen van der Poll CFP®
LLB, Adv. PG Dip in Fin Plan
Legal Adviser Specialist
PFA: Western Cape

Introduction

It is fairly common practice for a founder of a trust to transfer property into the trust as an estate planning tool.

This transaction can take the form of a donation or a sale. If the transaction takes the form of a donation then there will be donations tax payable on the amount exceeding R100 000 at the rate of 20%. Capital gains tax may also be payable, however, where both donations tax and capital gains tax is payable, the donations tax payable, will form part of the base cost of the asset.[1]

The transaction may also take the form of a sale transaction where the assets are sold to the trust and a loan account is created, which is reduced over time by utilising the annual R100 000 donations tax exemption[2] available to a natural person. In this instance donations tax is not payable. There may also be capital gains tax payable.

The question this article aims to answer, is whether this sale transaction is subject to the National Credit Act 34 of 2005 (hereinafter referred to as "the Act").

Is the sale subject to the National Credit Act?

To answer this question we have to look at various definitions contained in the Act.

Juristic Person:

Includes a partnership, association or other body of persons, corporate or unincorporated, or a trust if-

(a) There are three or more individual trustees; or

(b) The trustee itself is a juristic person[3]

Credit Agreement:

The Act applies to every credit agreement between parties at arm's length and made within, or having an effect within, the Republic except-

(a) A credit agreement in terms of which the consumer is-

  (i) A juristic person whose asset value or annual turnover, together with the combined asset value or annual turnover of all related juristic persons, at the time of the agreement is

[1] Paragraph 22 of the Eighth Schedule to the Income Tax Act
[2] Section 56(2)(b) of the Income Tax Act 58 of 1962
[3] Section 1 of the Act

made, equals or exceeds the threshold value determined by the Minister in terms of section 7(1) (*currently R1 000 000)*[4];

(ii) The state; or

(iii) An organ of state.[5]

(b) A large agreement, as described in section 9(4), in terms of which the consumer is a juristic person whose asset value or annual turnover is, at the time the agreement is made, below the threshold value determined by the Minister in terms of section 7(1).

(c) A credit agreement in terms of which the credit provider is the Reserve Bank of South Africa; or

(d) A credit agreement in respect of which the credit provider is located outside the Republic, approved by the Minister on application by the consumer in the prescribed manner and form.

Credit provider:

A "credit provider" is *inter alia* defined as a party who advances money or credit to another under any credit agreement.

The Act provides that a person must apply to be registered as a credit provider if

(a) That person, alone or in conjunction with any associated person, is the credit provider under at least 100 credit agreements, other than incidental credit agreements; or

(b) The total principal debt owed to that credit provider under all outstanding credit agreements, other than incidental credit agreements, exceeds the threshold prescribed.[6] The threshold is currently R500 000.[7]

Arm's length

In any of the following arrangements, the parties are not dealing at arm's length:

(i) a shareholder loan or other credit agreement between a juristic person, as consumer, and a person who has a controlling interest in that juristic person, as credit provider.[8]

"Controlling interest" is not defined in the Act however, in my opinion, a trustee by the very definition of a trust, has a controlling interest in a trust. A trust as defined in the Trust Property Control Act[9] *"means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed-*

[4] General Notice 713 of 2006, Government Gazette 28893
[5] Section 4(1) of the Act
[6] Section 40(1) of the Act
[7] Supra at footnote 3
[8] Section 4(2)(b)
[9] 57 of 1988

(a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument, but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act[10];"

Further to the above, it is important for the founder to note that a natural person is disqualified from being a credit provider if:

(i) that person is an unrehabilitated insolvent,

(ii) is under the age of 18 years

(iii) as a result of a court order, is listed on the register of excluded persons in terms of section 14 of the National Gambling Act

(iv) is subject to an order of a competent court holding that person to be mentally unfit or disordered.

(v) has ever been removed from an office of trust on account of misconduct relating to fraud or the misappropriation of money, whether in the Republic or elsewhere.

(vi) has ever been a director or a member of a governing body of an entity at the time such entity had been deregistered, brought disrepute to the industry or acted with disregard for consumer rights generally.

(vii) convicted during the previous 10 years of fraud, forgery, perjury, a crime of violence against a natural person, an offence in terms of this Act and imprisoned without a fine.

(viii) subject to an administration order of the Magistrate's court

(ix) subject to debt re-arrangement

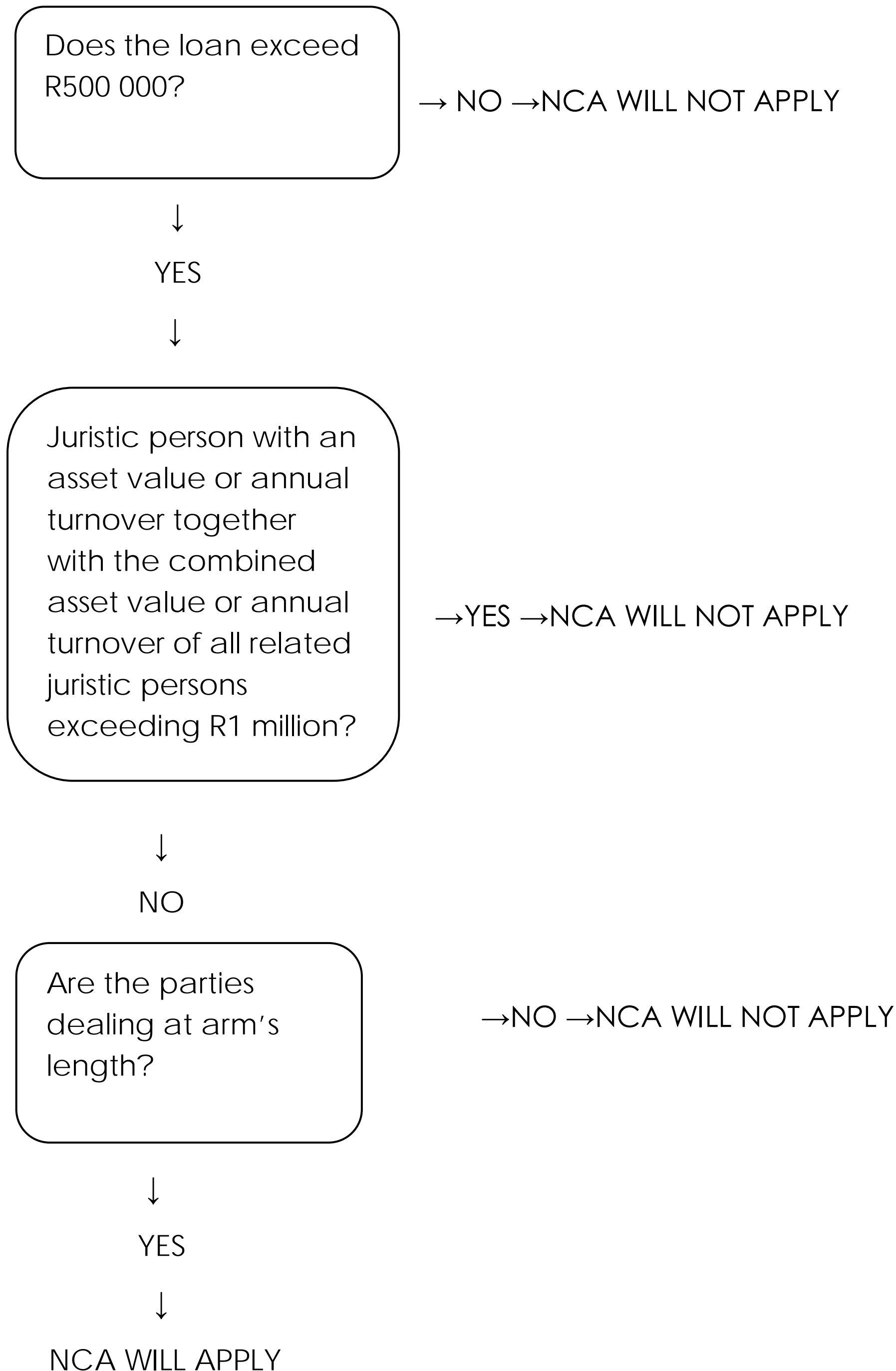
(x) engaged in, employed by or acting as an agent for a person that is engaged in debt collection, the operation of a credit bureau, credit provision, on any other activity that the Minister considers to be inherently conflicting debt counselling

In Van Heerden v Nolte[11] the court held that it is irrelevant whether the loan is a once-off or if the lender doesn't frequently provide credit. If the total principal loan amount exceeds R500 000, registration is required. Therefore the Act's registration requirement does not only apply to those

[10] 66 of 1965
[11] (19428/11) (2014) ZAGPPHC 12; 2014 (4) SA 584 GP

who are in the business of providing credit but applies to anyone who provides credit if the requirements for registration are met.

In summary, where a founder of a trust transfers an asset to the trust by way of a loan account the following questions have to be asked:



The above is illustrated by way of examples:

Example 1:

The founder of the trust is a trustee along with the bookkeeper. The assets of the trust exceeds R1 000 000. The founder transfers a property worth R600 000 to the trust by way of a loan account. Does the founder have to register as a credit provider?

Answer: The parties are not dealing at arm's length as the founder is a trustee, therefore the Act will not apply and the founder will not have to register as a credit provider.

Example 2:

The founder transfers a property of R1 000 000 to the trust by way of loan account. The founder's spouse and son are the sole trustees. The assets of the trust exceeds R1 000 000. Does the founder have to register as a credit provider?

Answer:

They are dealing at arm's length and the loan amount is above R500 000 and the trust is not an excluded juristic person as there are less than 3 trustees therefore the Act will apply and the founder will have to register as a credit provider.

Example 3:

The founder transfers a property worth R1 000 000 to the trust by way of a loan account. The founder's two sons and his attorney are the trustees. The assets of the trust exceeds R1 000 000. Does the founder have to register as a credit provider?

Answer: They are dealing at arm's length and the loan exceeds R500 000 however since the trust is a juristic person with assets worth more than R1 000 000, the Act will not apply and the founder will not have to register as a credit provider.

Consequences of not registering as a credit provider:

A credit agreement entered into by a credit provider who is required to be registered but who is not so registered is an unlawful agreement and void. If however, the credit provider had, at the time of the credit agreement or within 30 days thereof, applied for registration then the agreement would not be unlawful.

Conclusion

It is clear that there is a huge burden on a founder when transferring assets to a trust, to ensure that all legislation is complied with. The National Credit Act is merely one of many Acts which has to be carefully considered when transferring assets to a trust to avoid entering into an unlawful transaction.

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Elements to consider when amending a trust *inter vivos*

Madeleine Britz CFP®
BLC, LLB, Adv. PG Dip in Fin Plan
Legal Adviser Advanced
Broker Distribution: Northern Region

Introduction

When drafting an estate planning report for clients the trust deed of the particular client sometimes forms an integral part of the planning process. The trust is often used as the vehicle for succession planning within a family business or as an estate planning tool. There might be many reasons for amending a trust deed but the amendment of a trust deed is however not as simple and straight forward as one might think.

Hofer and others v Kevitt NO 1998 SCA

A leading case dealing with the amendment of a trust deed is the Supreme Court of Appeal case of Hofer and others v Kevitt NO 1998 SCA.[1] In this case an *inter vivos* trust had been amended by the founder and consented to by the trustees. The amendments prejudiced the appellants (beneficiaries) and their descendants. An important factor in this case was that the beneficiaries had not accepted any benefits under the trust.

The beneficiaries argued that the rights of the trustees to vary the deed were not unfettered and if the amendments were not in the interests of both the founder and the discretionary beneficiaries, then it was the duty of the trustees not to agree thereto. It was argued that the trustees had not even considered the interests of the beneficiaries but acted solely on the instruction of the founder.

Judge Conradie held that the trustee has no fiduciary duty to a potential beneficiary who has not accepted his benefits under the trust and therefore a trustee can agree to the amendment of the trust deed.

The court in the Hofer -case referred to Crookes v Watson[2] in which it was accepted that a trust *inter vivos* is a contract for the benefit of a third person. In the stipulation in favour of a third party, the third party acquires no rights if he has not accepted the benefits stipulated for him. This formula also applies to an *inter vivos* trust and the current position in law is that the beneficiary who has not accepted his benefits has no rights for as long as he does not accept them.[3] Thus the trust *inter vivos* is grounded in the law of contract, and is seen as a contract between the founder and the trustees in favour of the beneficiaries. If the beneficiaries accept their benefits, they are parties to the trust contract and any subsequent amendments must include them as contracting parties. This reflects the present/current legal position.

1 Hofer v Kevitt 1998 (1) SA 382 A).

2 Crookes v Watson 1956(1) SA 277 (A) at 285

3 McCullogh v Fernwood Estates 1920 AD 204;de Wet Ooreenkoms ten behoewe van 'n Derde;Hofer v Kevitt 1996(2) SA 402 (C)

Acceptance of benefits by beneficiaries

The question whether beneficiaries of a trust have accepted benefits is a question of fact.

"A mere mental attitude of approbation does not amount to acceptance. An unequivocal expression of intention to accept is needed."[4]

With reference to Cameron, and the decisions of the courts, acceptance and what it includes may be summarised as follows:

- A person with contractual capacity may himself accept benefits. The guardian of a minor may accept on behalf of the minor. A clear and preferably written acceptance is necessary.[5]
- A beneficiary may even accept his benefits after the death of the founder.[6]
- The mere ratification by a court of the trust deed does not amount to the acceptance by the beneficiaries.[7]
- The trustee's acceptance of the office of trustee does not mean that he accepts the beneficiaries 'benefits on their behalf.[8]
- The court as upper guardian of minors may accept benefits on behalf of minors[9].
- A minor over the age of puberty may also accept benefits without assistance as long as he/she has complete understanding.[10]
- "*Where trustees exercise their discretion and award benefits to the beneficiaries in terms of a discretionary trust, a particular beneficiary's acceptance of a particular award* cannot, *in our view, be seen as an acceptance of the total benefits in terms of the trust*".[11]

The question of what a beneficiary of a discretionary trust is actually accepting when he/she accepts benefits under the trust deed needs more clarification. The opinion expressed by PA Olivier, GPJ Van Den berg and S. Strydom[12] is one of doubt as to whether a beneficiary in a normal discretionary trust can accept a benefit under the trust for the simple reason that, in a discretionary trust, the beneficiary has nothing more than a *spes* or "hope" to eventually receive a benefit from the trust.

4 Cameron et al Honoré's South African Law of Trusts at 499

5 Cameron et al Honoré's South African Law of Trusts at 499

6 Crookes v Watson 1956 (1) SA 277(A) at 299

7 Buttar v Ault NO 1950 (4) SA 229 9(T).Cameron et al Honoré's South African Law of Trusts at 499 questions whether the decision is correct. They prefer the judgement in Exparte Isted 1948(2) SA 71(C) in which it was held that a court order does amount to acceptance.

8 Butar v Ault supra at 239.

9 Cameron et al Honoré's South African Law of Trusts at 498.

10 Buttar v Ault supra at 239

11 Trust Law in Practice by PA Olivier, S. Strydom, GPJ Van Den Berg at 2-41

12 Trust Law in Practice by PA Olivier, S. Strydom, GPJ Van Den Berg at 2-41

However in an unreported Case No 9179/2007[13] the facts were as follows:

- The applicant and respondent were divorced 10 years prior to the decision.
- The applicant was not a trustee of the trust but qualified as a discretionary income and capital beneficiary. At that stage the only asset of the trust was a patent and no income or capital was distributed to any beneficiary.
- Five years subsequent to the finalisation of the divorce the trust deed was amended by way of agreement between the founder and the trustees after it was established that the applicant had not received any benefits from the trust and according to the information provided the applicant also had not accepted any benefits under the trust. The trust deed was amended without the consent of the applicant and at the same time the applicant was removed as a beneficiary of the trust.
- Five years subsequent to the amendment the applicant lodged an application to set the amendment of the trust aside on grounds that it was done without her consent.
- The Judge ruled that the letter by the applicant's attorney during the divorce proceedings as well as her behaviour in this regard constituted acceptance by her of her "hope" to eventually receive something from the trust and that her consent was therefore necessary to amend the trust deed.

Potgieter and Another v Potgieter NO and Others 2012 (1) SA 637 (SCA)[14]

The facts of the case were as follows:

- Mr. & Mrs. Potgieter got divorced in 2003.
- Later in 2003 Mr. Potgieter remarried.
- Mr. Potgieter, the founder of the trust concerned died in 2008.
- The trust was founded in 1999.
- The amendment clause of the trust deed provided that the trustees could amend the trust subject to certain conditions, amongst others that no amendment could take place subsequent to the death of the Founder and, more important, that capital beneficiaries could only be appointed from the ranks of the existing beneficiaries (the client's children from his first marriage) and their descendants or the family of the founder.
- On the 21st of February 2006 the trust was amended by means of agreement between the founder and the trustees therefore not in terms of the amendment clause of the trust deed but in terms of the law of contract.
- These amendments added Mr. Potgieter's second wife and her two children as capital beneficiaries of the trust.

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13 Case 9179/2007(T)-decided on the 7th of November 2007(not reported).

14 (629/2010)[2011]ZASCA 181(30 September 2011)

- The two children from Mr. Potgieter's previous marriage were the applicants and later the appellants in this case.
- The importance of this case for the law of trusts is that it gives clarity regarding what would constitute acceptance by the beneficiaries and also whether beneficiaries in a discretionary trust can accept the benefits under the trust.
- The court found that the beneficiaries (children from the first marriage) accepted their benefits under the trust and therefore should have consented to any amendments of the trust deed. The first reason for this ruling was the wording of the trust deed to the effect that Mr. Potgieter accepted benefits under the trust on behalf of his children as beneficiaries: "whereas the founder desires to create the trust referred to in this deed for and on behalf of named capital beneficiaries, subject to the terms and conditions more fully set out hereafter; And whereas the beneficiaries have indicated their acceptance of the benefit conferred upon them in terms hereof." Secondly that Mr Potgieter included the children as parties to a meeting when, during the divorce, it was decided to distribute a property belonging to the trust to his first wife, thus acknowledging that their consent was necessary.

As stated above, the amendments to the trust deed in the Potgieter-case was done in terms of the law of contract and not in terms of an amendment clause in the trust deed. The amendment clause in the trust deed contained some prohibitory provisions. The trust deed was amended by way of agreement between the founder and trustees on the premises that no beneficiary accepted benefits under the trust and therefore no beneficiaries needed to be parties to the amendment of the trust deed.

Adv. Leon Luke Zazeraj and NO v JH Jordaan and Others[15]

On the 22nd of March 2012 Meer J ruled that amendments of certain trust deeds were invalid. The Potgieter –case was quoted as authority for the ruling. PA Olivier, GPJ Van Den berg and S. Strydom[16] respectfully disagree with this ruling for reasons set out below:

- One of the trusts in question was the Johannes Jordaan Trust (in the ruling referred to as the JJ Trust)Paragraph 5.1 of the trust deed provides as follows:
  - "Hierdie trustakte kan gedurende die leeftyd van die oprigter gewysig word by wyse van skriftelike ooreenkoms tussen die oprigter en al die trustees van die trust van tyd tot tyd"
- The Founder of the trust was Mr. J.H. Jordaan.
- No beneficiary unequivocally accepted benefits under the trust prior to the amendment. Apparently some distributions was made to beneficiaries and credited to loan accounts in favour of the beneficiaries.
- Judge Meer summarized her view regarding amendment of trust deeds in paragraph 22 as follows:

15 (22526/11[2012]ZA WCHC 120(22 March 2012)

16 Trust Law in Practice by PA Olivier, S. Strydom, GPJ Van Den Berg at 2-45

- "With regard to the amendment of trust deeds, it is established law that beneficiaries of discretionary trusts who have received conditional benefits, as have the patient and his sister, have vested rights and the trust deed cannot be changed without their consent."

- The trust deed in the Potgieter–case, contained an amendment clause but the amendments, as envisaged by the founder could not be done in terms of the amendment clause due to the fact that Mr. Potgieter wanted to include his second wife and her children from a previous marriage as capital beneficiaries. Therefore the amendments was done in terms of the law of contract by way of agreement between the founder and the trustees.

- The beneficiaries unequivocally accepted their benefits under the trust deed as their father in essence as guardian accepted the benefits on their behalf when the trust was formed.

- Nowhere in the Potgieter–case is authority found to rule that the moment a beneficiary receives anything from the trust through the exercise of the trustee's discretion in this regard, it automatically means that such beneficiary accepted the benefits as beneficiary of the trust and therefore should be a party of any future amendments of the trust deed. The authors further argues that there is a huge difference between unequivocal acceptance of his/her possible benefits by a beneficiary and the acceptance of a one-time benefit from the trustees. Say for instance an amount of R15 000 is distributed to a beneficiary, the acceptance of the R15 000 or the lack of repudiation of the R15 000 does not constitute acceptance of benefits to such an extent that it necessitates that beneficiary to become a party to any future amendments of the trust deed.

- The view of the authors is that should the Jordaan judgement represent the correct legal position it would lead to the following untenable position: If a charitable trust for example over a period of years make some capital and income distributions to a number of fifty or more charitable institutions, would the consent of all these institutions that received benefits from the trust be needed when amending the trust deed, notwithstanding the fact that the trust deed contains a clause authorizing such an amendment? Surely this cannot be the legal position.

- Although the area of amendment of trusts is still a grey area, the authors are of the opinion that where there is an amendment clause and the amendment is done in terms of the amendment clause, acceptance of benefits by beneficiaries should not play any role. Acceptance should be more than a mere acceptance of a discretionary award from a trust or a mere repudiation of such an award. There was no such acceptance in the Jordaan-case.

PPS Insurance Company Ltd and Others vs Nkabela[17]

The deceased nominated his mother as the beneficiary of a policy on his life. The mother predeceased him and after his death the question arose whether the proceeds of the policy should be paid to his mother's or his estate?

The court accepted that the appointment of a beneficiary under a life policy amounted to a stipulation in favour of a third party but ruled that the acceptance of the benefits by the mother

17 (159/2011)[2011]ZASCA 191(14 November 2011)

prior to the death of the life assured had no legal consequences: *"It is well established that a nominated beneficiary does not require any rights to the proceeds of the policy during the lifetime of the policy owner. It is only on the policy owner's death that the nominated beneficiary is entitled to accept the benefit and the insurer is obligated to pay the proceeds to the beneficiary .Until the death of the policy owner the nominated beneficiary only has a spes (an expectation) of claiming the benefit of the policy –the nominated beneficiary has no vested right to the benefit."*

The insured life reserves the right to at any time cancel or change the beneficiary nomination therefore the nominated beneficiary has no right to claim any benefit under the policy prior to the death of the life assured. The nominee's acceptance becomes nugatory if the life assured chooses another beneficiary thereby revoking the first.

It is clear from the facts of this case that the court is of the opinion, that where the life assured had the right to unilaterally or in conjunction with the insurance company cancel the nomination, acceptance of the benefits by the beneficiary prior to the death of the life assured could not have any legal significance.

If we therefore compare this case with the facts of the Jordaan-case, it is clear that this is exactly what happened. In the Jordaan-case the founder of the trust inserted a provision in the trust deed enabling him and the trustees to amend the trust deed as they saw fit even changing the beneficiaries if need be. Therefore the consent of the beneficiaries is only needed after the death of the founder. The decision in the Jordaan-case results in acceptance of benefits by a beneficiary nullifying certain terms of the contract. The question of whether a beneficiary has anything to accept prior to the death of the founder must on strength of the Nkhabela –case be answered in the negative.

PA Olivier, GPJ Van Den berg and S. Strydom[18] suggest that a trust deed should provide for amendment by way of agreement between the founder and the trustees without the consent of any beneficiaries notwithstanding the fact that a beneficiary might have accepted or received benefits under the trust.

An example of such an amendment clause:

Amendment to the TRUST DEED [19]

- *"The TRUST DEED may be amended by agreement between the FOUNDER and TRUSTEES and, if the FOUNDER is no longer alive, or is declared incapable of managing his own affairs, by agreement between the TRUSTEES and the CAPITAL BENEFICIARIES alive at that stage. The*

18 Trust Law in Practice by PA Olivier, S. Strydom, GPJ Van Den Berg at 2-49

19Extract from a Trust Deed of GPJ Van Den Berg

consent by the guardian of a minor BENEFICIARY will be sufficient to effect a valid amendment of the TRUST DEED.

- *It is the intention of the FOUNDER that, during his lifetime and, provided he is not declared incapable of managing his own affairs, the TRUST DEED may be amended by agreement between the FOUNDER and the TRUSTEES without the consent of any BENEFICIARY, notwithstanding the fact that such BENEFICIARY may have received and/or accepted any benefit from the TRUST in writing or otherwise.*

- *In the event that the TRUST DEED is replaced in toto with a Deed of Amendment such amendment shall not be construed to be a novation of the TRUST."*

It is important to take note of the fact that in the Crookes v Watson, Hofer v Kevitt and the Potgieter–case, the amendments made were made in terms of the law of contract by way of agreement between the founder and trustees. The reason being that the particular trust deeds did not have an amendment clause or the amendment clause contained some prohibitory provisions.

The variation of a trust deed by agreement between the founder and trustees are possible at any time as long as the beneficiaries have not accepted any benefits[20].

The legal position concerning the variation of the trust deed of an inter vivos trust can be summarized as follows:

- If the trust deed contains a provision that authorises amendment, that provision applies. If the beneficiaries have not accepted any benefits, even the provision authorising the amendment can be amended by means of an agreement between the founder and trustees.

- If the trust deed does not contain a provision authorising amendment, the position is as follows:

  - Where the founder is still alive and the beneficiaries have not accepted any benefits, the trust deed may be amended by way of agreement between the founder and the trustees. If the beneficiaries have accepted any benefits, they must be parties to any amendment.
  - After the death of the founder, if there is no provision authorising amendment, it is not legally possible to amend the trust deed.

- Where beneficiaries have vested rights, they can amend the trust deed.

- In certain circumstances the court has the right in terms of the common law and Section 13 of the Trust Property Control Act, to amend the trust deed.

20 Crookes v Watson 1956 (1) SA 277(A) at 285

Conclusion

What then are the lessons learnt from the above?

- If you are a beneficiary of an inter vivos discretionary trust you might want to accept your benefits, making sure that no amendment can be made without your consent or permission. The most secure way of accepting your benefits is to write to the trustees accepting all benefits and rights created for you in the trust deed.

- If you are the founder and wish to reserve the right to amend the trust deed without the consent of the beneficiaries, you can include such a right in the original trust document making it very clear that permission from the beneficiaries need not be obtained prior to amending the trust deed.

- If you are the founder of an existing trust and wish to amend the trust deed, ensure the proper process is followed. If the beneficiaries have not accepted any benefits under the trust, document that fact. Clearly communicate to the trustees the amendments you want to make and why you want to make them. The trustees of the trust must hold a properly constituted meeting discussing the founder's request and the reasons for amending the trust deed. Proper minutes must be kept detailing the discussions the trustees had in arriving at their decision.

- Ensure that all amendments are sent to the Master's office for registration with the original trust document.

- Make use of a trust specialist when amending the trust deed.

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A summary of inheritance and claims in respect of minor children

Amanda Moolman CFP®
LLB LLM (NWU), PG Dip in Fin Plan (UFS)
Legal Adviser Specialist
Broker Distribution: Pretoria

Introduction

There is some uncertainty regarding the inheritance of minor children, or benefits accruing to minor children. This article aims to clarify the position regarding inheritance or benefits accruing to minor children and possible solutions to protect their inheritance or such benefits. Furthermore, this article will also briefly discuss maintenance orders for the benefit of minor children and the position of a minor's inheritance where the divorced parent is the natural guardian of the minor child.

Inheritance of minor children

Common scenarios which occur: parents either do not have a will in place; or they have a will, but have not made provision for a testamentary trust for the benefit of a minor child until they reach a mature age; or assets are bequeathed to minor children without the parents considering the practical implications of the bequest.

If the parents do not have a will in place, or the will or part thereof is invalid, the provisions of the Intestate Succession Act (hereinafter referred to as the "ISA")[1] applies with regard to the distribution of the deceased's estate. In this instance, no provision would have been made to protect and/or preserve the minor child's inheritance. The same consequences regarding property received by minor descendants, as provided for in the Administration of Estates Act (hereinafter referred to as the "AEA")[2] will apply, as will be discussed below.

It also happens that provision is made in a will for a testamentary trust to be formed at the parent's death until the child reaches the age of majority, but the parent often does not consider the level of maturity of the child when he / she reaches the age of majority, at 18 years.[3] The parent fails and/or neglects to consider whether the child will use the inheritance received for valuable investments into his/her future, or whether the inheritance will be squandered.

There are also instances where the parent does not consider the practical implications of bequests, for instance, a farm is bequeathed to a minor child without a testamentary trust being formed in respect of the property for the benefit of the minor child.

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[1] Act 81 of 1987 Applicable in this discussion is s 1(1) of the ISA, which provides that if a person (hereinafter referred to as the "deceased") dies intestate, either wholly or in part, and is survived by a descendant, but not by a spouse, such descendant shall inherit the intestate estate; or if the deceased is survived by a spouse as well as a descendant, then: (i) such spouse shall inherit a child's share of the intestate estate or so much of the intestate estate as does not exceed R250 000 in value, whichever is the greater; and (ii) such descendant shall inherit the residue (if any) of the intestate estate. See http://www.justice.gov.za/master/m_deseased/deceased_intestate.html.

[2] Act 66 of 1965, makes provision for, *inter alia*, the administration of property of minors.

[3] In terms of s 17 of the Children's Act, 38 of 2005 (hereinafter referred to as the "Children's Act"), the age of majority in South Africa is 18 years.

The AEA makes provision for the administration of property, including contingent interests in property of minors.[4]

Immovable property inherited can be registered in a minor child's name.[5]

When a minor child is entitled to a sum of money or movable property – the natural guardian, or nominated tutor, of the minor may be entitled to receive any money or movable property for and on behalf of the minor.[6]

This is, however, subject to the provisions of the deceased's will, if applicable, and whether the deceased specifically stated in his / her will that security need not be provided by the natural guardian, or nominated tutor. If no provision has been made for the discharge of security, then no money or other movable property may be delivered to the guardian, or nominated tutor, unless payment of such sum of money or of the value of such movable property to the minor child, at the time when he / she is to become entitled thereto, has been secured to the satisfaction of the Master of the High Court.[7]

It is also important to note that, failing a natural guardian, a person nominated in the deceased's will, or appointed by the Court, to administer any property which the minor inherits, must first apply to the Master to grant him/her letters of tutorship.[8] No nominated or appointed person may take care of or administer any property belonging to a minor, or carry on any business undertaking of the minor, unless he/she has been authorised to do so under letters of tutorship granted in terms of the AEA.[9]

Due consideration must also be given to instances where there is no natural guardian or nominated tutor, or where a legal guardian has not yet been appointed. In which case any money which accrues in favour of the minor will need to be paid over to the Guardian's Fund until the minor reaches the age of majority.[10] Until such time that the minor reaches the age of majority, the guardian or tutor can apply to the Guardian's Fund to provide funds for the maintenance, education or other benefit of the minor.[11] This process in practice, is however, quite laborious.[12]

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[4] S 1 of the AEA.

[5] The executor must ensure that the immovable property to which an heir is entitled is registered in the name of the heir, subject to any rights and conditions affecting such property (s 39(1) of the AEA). Also see s 79 of the AEA and the Deeds Registries Act, 47 of 1937.

[6] S 43(1) of the AEA.

[7] S 43(2) and s 77 of the AEA.

[8] Id. s 72.

[9] Id. s 71.

[10] S 43(6) of the AEA. Also see ss 86 – 90 of the AEA in respect of the Guardian's Fund.

[11] S 90 of the AEA.

[12] The Master is entitled to pay all accrued interest as well as up to R250 000 from the invested capital for maintenance, like school and university fees, clothes, sporting and computer equipment, medical fees,

Benefits accruing to minor children

Other examples to consider, are benefits accruing to minor children in the following instances:

Maintenance claims

Parents have a responsibility to contribute to the maintenance of their minor child, in accordance with their respective means.[13]

When granting a decree of divorce, the court may make an order with regard to the maintenance of a dependent child of the marriage.[14] However, the obligation to pay maintenance does not terminate at a parent's death.[15] There will also be a duty on the parent, at death, to make provision for the maintenance of his/her minor or dependent children.[16]

Therefore, parents should make provision for maintenance in respect of their children and they also need to ensure that the provision made is safeguarded and applied only in the best interest of their children and their children's needs.

Retirement fund benefits

Section 37C of the Pension Funds Act (hereinafter referred to as the "PFA")[17] regulates the disposition of pension benefits upon the death of a member of a pension fund. In terms of the PFA, any benefit payable by the fund upon the member's death does not form part of the assets in the estate of the deceased member and the benefit will be payable to the deceased member's dependants and/or nominees in such proportions as the board of trustees of the fund may deem equitable.[18] A member, therefore, does not have freedom of

board and lodging and any other needs that can be motivated. Maintenance can be claimed by the guardian, tutor, curator, or person looking after the person of the account holder by way of an application in the form of form J341, supported by quotations and accounts. Payments can be made directly to the service deliverer, like schools, universities, bookshops, etc. See http://www.justice.gov.za/master/guardian.html.

[13] S 18(2)(b) of the Children's Act; and s 15 of the *Maintenance Act*, 99 of 1998. See s 18(2)(b) of the Children's Act, which states that the parental responsibilities and rights that a person may have in respect of a child, include the responsibility and the right to contribute to the maintenance of the child.

[14] S 6(3) of *the Divorce Act*, 70 of 1979. Further, s 15 of the Maintenance Act, 99 of 1998, provides for the duty of parents to support their children. S 15(2) provides that "the duty extends to such support as a child reasonably requires for his or her proper living and upbringing, and includes the provision of food, clothing, accommodation, medical care and education". S 15(3) lists the factors the court will take into consideration when determining the amount to be paid as maintenance in respect of a child.

[15] See *Carelse v Estate de Vries* at 532; Van Heerden *et al Boberg's Law of Persons and the Family* (1999) at 270; Du Bois *Wille's Principles of South African Law* (2007) at 360-361.

[16] See fn. 13 above. Also see S 37D of the *Pension Funds Act*, 24 of 1956, which provides that a fund may deduct amounts due by the member under a maintenance order issued in terms of the Maintenance Act.

[17] The *Pension Funds Act*, 24 of 1956.

[18] See s 37C(1) of the PFA. The distribution is subject to a pledge in accordance with s 19(5)(*b*)(i) and subject to the provisions of ss 37A(3) and 37D of the PFA.

testation in respect of his/her retirement benefits. A member can make nominations, but the discretion remains with trustees after taking into consideration all persons who were dependent on the member.

The fund may make the payment, in respect of and for the benefit of a minor dependant or nominee, to:

- a trustee nominated by the member, or guardian, of the minor dependant or nominee;
- a person recognised in law or appointed by a Court as the person responsible for managing the affairs or meeting the daily care needs of a dependant or nominee; or
- a beneficiary fund.[19]

Once the trustees have determined how to distribute the benefits to the minor dependants and nominees, they need to determine the manner in which payment will be made. The payment options available to the trustees in respect of minors are as follows:

- the fund can pay the benefits in instalments until the minor reaches the age of majority; or
- the benefit can be paid into a beneficiary fund or into a rust selected by the member or beneficiary, or selected by the legal guardian or caregiver of the minor beneficiary.

Living annuities

The remaining value of the assets or amount of a living annuity, pertaining to a member or former member, may be paid to his/her dependants or nominees at his/her death.

It may be paid to his/her dependants or nominees either as an annuity or lump sum or as an annuity and a lump sum.[20]

The benefit, as stated above, will be paid to the natural or legal guardian of the minor beneficiary nominated by the member or former member. The member may, however, also nominate a trust for the benefit of a minor beneficiary.

[19] S 37(2)(a) of the PFA. See further, the definition of 'pension fund organisation' in s 1 of the PFA. A 'beneficiary fund' is a fund established specifically to manage death benefits awarded to beneficiaries of deceased retirement fund members (which entails payments from employer-provided retirement funds and group life policies). It is a fund established with the object of receiving, administering and investing death benefits on behalf of beneficiaries. A beneficiary fund is regulated by the Financial Services Board by virtue of the Financial Services Laws General Amendment 22 of 2008, and is used as an alternative to unregulated Trusts. The accumulated funds for the benefit of a minor beneficiary will be released upon his / her reaching majority. See Goodall *et al The South African Financial Planning Handbook* (2016), at Chp. 36.3.

[20] Goodall *et al The South African Financial Planning Handbook* (2016), at Chp. 38.3.2.

Life policy proceeds

A minor child may be nominated as a beneficiary on a life insurance policy and the insurer is consequently obliged to pay the proceeds to such beneficiary's natural guardian acting on his / her behalf.[21]

In the event that there is no natural guardian, the proceeds will need to be paid to the Guardian's Fund, unless alternative provision has been made by way of a will or unless the Court or the Master otherwise directs.[22]

However, it is important to note that different insurers deal with benefits accruing to minor beneficiaries in different ways. Some insurers are reluctant to pay the proceeds to the guardian and pay the proceeds directly into the bank account of the minor; whilst other insurers do pay to the natural or legal guardian as required; and some insurers insist on paying the proceeds into a trust for the benefit of the minor. It is therefore important for a policyholder to find out how the particular insurer will approach the situation, in order to make adequate provision in accordance with his/her wishes.[23]

Possible means of protecting the inheritance or benefits

The first imperative step is to ensure that there is a properly drafted and valid will, which takes into consideration the implications of certain bequests in respect of minor children, and makes provision for the protection and/or preservation of the minor's inheritance.

Provision can also be made in the will for the security which needs to be provided to the Master in terms of the AEA to be dispensed with, if that is the intention of the testator or testatrix.[24]

In the event that, *inter alia*:

- the natural guardian is not financially responsible to receive or administer benefits on behalf of a minor child as discussed above; or
- the natural guardian might be influenced by other persons to possibly misuse the inheritance or other benefits intended for the minor children; or
- the surviving natural guardian of the minor child and the deceased parent are divorced; or
- there would be no surviving natural guardian to administer and safeguard the minor children's inheritance; or

[21] S 18(3)(a) and (b), read with s 17, of the Children's Act provides that a parent or other person who acts as guardian of a child must: (a) administer and safeguard the child's property and property interests; and (b) assist or represent the child in administrative, contractual and other legal matters.
[22] See s 82 of the AEA.
[23] Ombud.co.za, 2016.
[24] On the one hand the required security will be beneficial to the minor's interests in the instance where the guardian may possibly misuse or irresponsibly diminish the minor child's inheritance to the detriment of the minor; but on the other hand it might not be financially possible for the natural guardian, or nominated tutor, to provide such security and the administration process might be delayed. In the latter instance, if the natural guardian or tutor is unable to provide security, any money will need to be paid into the Guardian's Fund (see ss 43, 44, 77 and 82 of the AEA).

- the parents are divorced and the deceased parent has maintenance obligations toward the minor children,

it is imperative that the parent makes provision for any property bequeathed or accruing to the minor child to be held in trust, whether it is a testamentary trust or an *inter vivos* trust, by the trustees for the benefit of and in the interest of the minor children until they reach a mature age.

A trust, for the benefit of a minor child, can also be nominated as a beneficiary on a life insurance policy or living annuity.

A parent can also make provision for a trust in respect of his / her maintenance obligations toward his / her child.

It is equally important that the trust Instrument be properly drafted and that it is valid and binding. It is, furthermore, essential that qualified persons or a reputable institution who will act with the necessary care, diligence and skill required, be appointed as the trustee(s).

With regard to retirement fund benefits which accrue to a minor dependant or nominee, as discussed above, it is in the discretion of the trustees to determine to whom and the manner in which the benefit will be paid to a dependant or nominee.

However, the member or former member can still make provision in an endeavour to avoid the benefit being paid directly to the natural guardian, or court appointed guardian, on behalf of the dependants or nominees, by nominating a trust prior to his/her death. It is important that the trust nominated for this purpose is a fully vested trust and the dependant or nominee will be the owner of the capital and income.

However, a beneficiary fund will also be suitable where minor dependants or nominees interests need to be safeguarded.[25]

Conclusion

If a parent fails to make adequate provision to protect and preserve his/her minor child's inheritance or other benefits which accrue, it may be used by the surviving natural guardian for purposes other than what was originally intended by the deceased parent, as discussed above.

Or, if the inheritance is to be held in the Guardian's Fund until the minor reaches the age of majority, there will be some hardships due to the onerous processes that need to be followed when applying for maintenance or education needs for example.

[25] *Id.* at Chp. 36.3.

Furthermore, the best possible return on investment is also not sought within the Guardian's Fund;[26] and the balance in the fund is accessible when the minor reaches 18 years of age, which will in all probability, without the necessary guidance, be squandered, depending on the level of financial maturity and independence of the minor at that age.

In consideration of the above, it is imperative that a parent makes adequate provision for the inheritance of minor children and other benefits accruing to minor children at his / her death, and that he/she obtains expert advice in this regard.

[26] The money in the Guardian's Fund is invested with the Public Investment Commission and audited annually. Interest is payable on the amounts paid into the Guardian's Fund and is calculated on a monthly basis at a rate per annum determined from time to time by the Minister of Finance. The interest is compounded monthly and is paid for a period from a month after receipt up to five years after it has become claimable, unless it is legally claimed before such expiration. The current interest rate as from 01 April 2016 is 9%. See "FAQ's on Guardian's Fund" at http://www.justice.gov.za/master/guardian.html.

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South African inheritance and heirs staying abroad

Suzelle Jooste CFP®

Adv Dip in Fin Plan(UOFS), BA LLB (PU for CHE), Adv Certificate in

Trust Law (UP), Dip in Labour Law (UJ), Admitted Attorney

Legal Adviser Manager

Broker Distribution : Johannesburg

Introduction

Financial advisers are bombarded with questions on emigration and what emigrants are able to do and not do. Although it is hard to find accurate figures of the number of people emigrating, it is common knowledge that the number of people emigrating keep on increasing. Sometimes people just pack up their belongings and move abroad, without emigrating. People leave South-Africa, and leave family members and their parents behind, which means that they are still attached to South Africa with an umbilical cord. If it is children that now live abroad, will they be able to inherit from their parents, when the parents pass on? Are there any requirements that they should be aware of? The intention of this article is to make financial advisers aware of the legal position where their clients are South African parents with children (heirs) living abroad. The article can also be used by Wills Consultants and legal advisers, when advising clients, during the wills drafting process.

Don't leave it to chance

From the perspective of the South African authorities[1] if clients are likely to receive an inheritance from a South African resident, careful consideration should be given to their status given the potential impact of exchange control regulations. If left to chance, and no advance planning is done, there is a risk that inheritance payments due to heirs staying abroad cannot be effected without making retrospective application to the South African Reserve Bank.[2] The South African Receiver of Revenue states specifically that there is no guarantee that the necessary approval will be granted, when making these retrospective applications.[3]

Requirements of the South African Reserve Bank[4]

In terms of South African Exchange Control, if an heir lives overseas, and has received an inheritance from a South African estate, the heir will fall into one of three categories, namely:

(1) South African Resident temporarily abroad;

(2) Heir who has already emigrated, and is classified as a non-resident; or

(3) Non-resident heir (who was never a South African citizen before)

Understanding the relevant definitions[5]

In terms of South African Exchange Control Manual[6] the relevant definitions, for purposes of this article, read as follows:

[1] www.sars.gov.za/FAQS
[2] www.sars.gov.za/FAQS
[3] www.sars.gov.za/FAQS
[4] www.youve-earned-it.co.za/finance/inheritance-and-emigration-do-you-and-your-children
[5] www.resbank.co.za/Regulationandsupervision/FinancialSurveillanceandExchangeControl/ExCMan, Section A of Exchange Control Manual, Definitions
[6] www.resbank.co.za/Regulationandsupervision/FinancialSurveillanceandExchangeControl/ExCMan

Resident *is any person who has taken up permanent residence, is domiciled and registered in the Republic.*

Emigrant *means a South African resident who is leaving or has left the Republic to take up permanent residence in any country outside of the CMA.*

CMA *means the Common Monetary Area, which consists of Lesotho, Namibia, South Africa and Swaziland.*

Non-resident *is defined as a person (i.e. a natural person or legal entity) whose normal place of residence, domicile or registration is outside the CMA.*

Category 1: South African Resident temporarily abroad

Many South African residents fall into this category, since there are a lot of South Africans that relocated (sometimes also referred to as informal emigration) to other countries for work and travel purposes. Young people relocate for instance, to gain some invaluable work experience, or to save enough money to kick-start their studies. What is of importance here is that the relocation is on a non-permanent basis and is temporary. Therefore these residents remain South African Residents for tax and exchange control purposes.

Should a South African Resident temporarily abroad inherit from an estate within South Africa, and the heir want to take this inheritance offshore, then in terms of the existing rules, the resident will have to use his/her investment allowance for private individuals, currently R10 million per calendar year. This stays subject to tax clearance from SARS.[7]

Category 2: Heir who has already emigrated (classified as a non-resident)

This category of people concluded their financial affairs when they left South Africa, and have settled permanently in another country (also referred to as *financial emigration*).[8] Their status classification therefore have changed for exchange control purposes from being a resident of South Africa, to being a non-resident of South Africa. This is often referred to as 'formal emigration', which can be used as a synonym for 'financial emigration'.[9] Emigration does not affect the emigrant's birth-right, citizenship or the right to retain a South African passport.[10]

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[7] Premiums and Problems 2016, Edition 113, Exchange Control Guidelines, page F3.
[8] www.cashkows.com Financial emigration
[9] www.cashkows.com What is formal emigration?
[10] www.cashkows.com

Heirs who already emigrated, can have their inheritance transferred offshore provided that they can provide proof of their emigration. Proof of the South African Reserve Bank approval or reference number received when they originally emigrated would be needed. [11]

Category 3: Non-resident heir (who was never a South African citizen before)

These heirs were never residents of South Africa, and would only need to provide evidence of their non-residence status to be able to transfer their inheritance offshore. [12]

Conclusion

Financial advisers can save the heirs living abroad a lot of frustration, by making them aware of the influence of their status on the remittance of their inheritance offshore. It is strongly recommended that parents and children have discussions about estate planning and wills, and the practical implications thereof where children have '*packed for Perth*'. If the children did not formally emigrate from the Republic, then they might be frustrated if they, one day, want to transfer their inheritance abroad. Since a lot of parents are aging in South Africa, whilst their children have emigrated, children also have to take the responsibility to know their status (and be able to proof it) with the South African authorities. This will also address the concern of many parents with children overseas. Parents want to know that their children are taken care of, and that they will be able to receive their inheritance abroad.

[11] www.sars.gov.za/FAQS
[12] www.youve-earned-it.co.za/finance/inheritance-and-emigration-do-you-and-your-children

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Premiums and Problems 2016, Edition 113, Exchange Control Guidelines

Exchange Control Manual

Personal Liability of Directors – Risk Planning Considerations

Anél Strampe CFP®
B.Com, LLB, LLM, PG Dip in Fin Plan [UFS]
Legal Adviser Specialist
Broker Distribution: Western Cape

Introduction

Business contingency cover pays out a lump sum to the business when the person who signed surety as co-principle debtor for the debts of the business, becomes disabled or dies. The fact that the person signed surety contractually binds that person to be liable for any outstanding debt. The person who signs surety is generally a person with a shareholding in the business if the business is a private company, or a member if the business is a close corporation. Life insurance is the perfect solution to provide a payment to the company upon the death or disablement of that person. The Estate Duty Act[1] provides for an exemption provided the requirements of section 3(3)(a)(ii) are met. The Income Tax Act[2] also provides that the premiums are not deductible but that the proceeds will pay out tax-free, thus making the business contingency plan attractive as the perfect solution should the debt become payable at death or disablement of the co-principle debtor. It is a plan that is often recommend to clients to prepare for every business contingency as part of business risk planning.

The Companies Act[3] (hereinafter referred to as the Act) came into force on the 1st of May 2011 and with it a plethora of provisions including a partial codification of the common law fiduciary duties of directors. The Act also establishes grounds for personal liability of company directors for the debts of their companies. Recourse against directors of companies that contravene the Act is consequently on the increase. The global consciousness and focus on greater corporate governance, with South Africa's King III Code and Report on Corporate Governance on the forefront, shines a bright light on the way companies operate. The possibility that this statutory liability might be a profitable insurable liability must not be *prima facie* excluded. Director and Officer Liability Insurance (hereafter "D&O insurance") has become very popular in the US (95 per cent of Fortune 500 companies) and Germany (70 per cent of all companies)[4]. This article serves to critically examine the duties imposed on directors, the consequences of violation thereof and awareness of the possible solutions for personal liability other than business contingency cover for debt liability.

Directors' duties

The directors' fiduciary duties and duties of care and skill are founded in common law principles. At common law a director was subject to the fiduciary duty to act in good faith to the benefit of the company as a whole, to act with care and skill and to avoid the situation where the director's personal interest conflicts with that of the company.

The Companies Act defines a director as *"a member of the board of a company, as contemplated by section 66, or an alternate director of a company and includes any person occupying the position of a director or an alternate director, by whatever name designated"*.

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[1] 45 of 1955.
[2] 58 of 1962.
[3] 71 of 2008.
[4] Peter Egger et al, *Heterogeneous Beliefs and the Demand for D&O Insurance by Listed Companies*: CESIFO 1, 2 (2014).

For the purpose of these statutory duties a "director" includes a prescribed officer[5] and a member of the board committee. Section 66(1) states that the affairs of the company must be managed by the direction of its board, to the extent that the company's Memorandum of Incorporation allow it. The powers and functions of the board may thus be altered by the memorandum. In the case of a private company or a personal liability company the board must comprise of at least one director.[6] The Act requires at least three directors in the case of a public company or a non-profit company.[7] Section 76 introduces a new legal framework in the form of a codified regime of directors' duties, which includes a fiduciary duty and a duty of reasonable care. The provisions governing directors' duties are supplemented by other new provisions addressing conflict of interest,[8] directors' liability,[9] and indemnities and insurance.[10]

Section 76(3)[11] of the Act states:

"Subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director —

(a) in good faith and for a proper purpose;

(b) in the best interests of the company; and

(c) with the degree *of care, skill and diligence that may reasonably be expected of a person —*

- (*i*) *Carrying out the same functions in relation to the company as carried out by that director; and*
- (ii) *having the general knowledge, skill and experience of that director."*

A distinction should be drawn between complete codification and partial codification.

Complete codification entails the use of a body of rigid rules. Complete codification cannot easily accommodate an environment that constantly changes.

Partial codification entails adopting the general principles of law but allows some room for the development of the common law. The provisions in the Act relating to directors' duties are a partial codification of the company law. Section 76 and the common law must therefore co-exist together as the common law will apply to the extent that specific duties are not dealt with in the Act and determine the consequences thereof and this could create confusion.

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[5] "prescribed officer" means a person who, within a company, performs any function that has been designated by the Minister in terms of section 66(10) of the Act. ;

[6] Section 66(2)(a).

[7] Section 66(2)(b).

[8] Section 75.

[9] Section 77.

[10] Section 78.

[11] Subsection (1) includes alternate directors, prescribed officers or a person as a member of a committee of a board of a company.

A director must not use his position as such or awareness of confidential information or information of a sensitive nature to knowingly cause any harm to the company or a subsidiary of the company, or gain advantage for himself or any person other than the company.[12] In the case of *Cyberscene Ltd and Others v i-Kiosk Internet and Information (Pty) Ltd*[13], JP Hlope made it clear that there is a breach of the fiduciary duty if the company's contractual opportunities or confidential information are taken for the director's own advantage.

Section 75(3) to 75(7) deal specifically with a director's personal financial interests, and provides that if a director's personal interests conflict with those of the company, the director should disclose the conflict of interest to the shareholders or the board of directors of the company. A decision by the board or an agreement approved by the board is valid despite any personal financial interest of a director or person related to the director, if it was approved or has been ratified by an ordinary resolution of the shareholders.[14] Any interested person may apply to court for a court order validating a transaction or agreement that was approved by the board, or shareholders, despite the failure of the director to satisfy the disclosure requirements.[15]

A director must communicate to the board any information that comes to his/her attention,[16] unless the director reasonably believes that the information is immaterial to the company, generally available to the public, or known to the other directors. A director is also not compelled to disclose information where a legal or ethical obligation of confidentiality prevents him from disclosing the information.[17] A director of a company must exercise the powers and perform the functions of a director in good faith and in the best interests of the company.[18]

The duty of skill and care provides that the director must exercise that degree care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director.[19] An objective test is applied to determine what the reasonable director would have done in the same situation. The test applied contains subjective elements in that the general knowledge, skill and experience of the particular director in question are taken into account as well as what is expected of this director.[20]

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[12] Section 76(2)(b)(i) and (ii) states that Information that is immaterial, perceived to be generally available to the public or other directors and information that falls under a legal or ethical obligation of confidentiality need not be disclosed.
[13] 2000 (3) SA 806 (C).
[14] Section 75(7).
[15] Section 75(8).
[16] Section 76(2)(b).
[17] Section 76(2)(b)(ii).
[18] Section 76(3).
[19] Section 76(3).
[20] J.J. Du Plessis, *A comparative analysis of director's duty of care, skill and diligence in South Africa and Australia*: Modern Company Law for a Competitive South African Economy, 263, 269 (2010).

Personal liability of directors and the business judgment rule

The personal liability of directors is an important issue. The Act introduced the Anglo-American law inspired business judgement rule into South African company law.[21] Although this section is everything but an example of clarity, it seems that what is intended is that a director will not have committed a breach of his/her fiduciary duties and duties of care and skill, and will have satisfied his/her obligations as director if he/she can prove that he/she has taken reasonably diligent steps to become informed about the matter[22] and either he/she had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter.[23] The Act requires that all three requirements must be met to ensure that the business judgment rule takes effect.

Section 76(4) requires that a director must have taken reasonably diligent steps to become informed about the matter. When analysing "reasonably diligent" a director may rely on information by persons who have been legally delegated the authority to perform one or more of the functions of the board. Financial data prepared by accountants or company employees, or other persons who's services has been professionally obtained by the board or committee of the company also falls within the category of information attained in a reasonable diligent manner.[24]

The particular director will be excused from liability if the director had a rational basis for believing, and did believe that the decision was in the best interests of the company.[25] A director is entitled to rely on:

- the employees of the company whom the director reasonably believes to be reliable and competent in the functions performed;[26]
- the information, opinions, reports or statements provided by legal counsel, accountants, or other professional persons retained by the company;[27]
- the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters within the particular person's professional or expert competence or as to which the particular person merits confidence or a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.[28]

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[21] Section 76(4)(a) and (b).
[22] Section 76(4)(a)(i).
[23] Section 76(4)(a)(ii)(aa).
[24] Available at http://www.companylaw.uct.ac.za/usr/companylaw/downloads/legislation/WLB_2011-05_Cos_Act_liability_EL.pdf
[25] Section 76(4)(a)(iii).
[26] Section 76(5)(a).
[27] Section 76(5)(b).
[28] Section 76(5)(c). N. Bouwman, *An appraisal of the Modification of the Director's Duty of Care and Skill*: South African Mercantile Law Journal 12(1) 509, 514 (2009).

- Included are opinions, recommendations, reports or statements prepared or presented by a person or persons as stated above.

Directors' duties of care and skill are governed by the common law of delict derived from the Roman-Dutch law. Therefore, liability in delict arising from a breach of his/her duty is based on the general action provided by the *Actio Legis Aquiliae* which is a legal action to recover compensation for a financial loss which is wrongfully caused by culpable conduct. Section 77(2)(a) of the Act provides that a director who is in breach of a fiduciary duty may be held liable for damages, costs or any loss suffered by the company as a consequence of any breach of the duties in section 76. The court held in *Fisheries Development Corporation v Jorgensen*[29] (decided under the previous Companies Act of 1973), where the common law duty of care and skill was analysed, that the extent of a director's duty of skill and care largely depends on the nature of the company's business.[30] What is taken into consideration is whether a director is a full-time executive director or a non-executive director. It is not required that a director has to have special business acumen, a certain degree of experience or intelligence and they may assume and trust that officials will perform the duties delegated to them honestly.[31]

According to Kennedy-Good and Coetzee[32] the rule encourages risk-taking activities by directors. Directors do not have to be overly cautious in making business decisions. The authors argue that the business judgment rule will help to persuade competent persons to serve as directors, avoid that shareholders end up managing company affairs instead of directors, and prevent judicial second-guessing.[33] The codification of the business judgment rule will, according

[29] 1980 4 SA 156 (W) 165.

[30] Paragraph 158. Margo J explained, that the duty of care and skill can be paraphrased in three broad propositions:

(a)The extent of a director's duty of care and skill depends to a considerable degree on the nature of the company's business and on any particular obligations assumed by or assigned to him. There is a difference between the full-time or executive director, who participates in the day to day management of the company's affairs and the non-executive director who has not undertaken any special obligation. The latter is not bound to give continuous attention to the affairs of the company. His duties are of an intermittent nature, to be performed at periodical board meetings and at any other meetings which may require his attention. He is not, however, bound to attend all such meetings, though he ought to whenever he is reasonably able to do so.

(b) A director is not required to have special business acumen or expertise, or singular ability or intelligence or even experience in the business of the company. He is, however, expected to exercise the care which can reasonably be expected of a person with his knowledge and experience. A director is not liable for mere errors of judgment.

(c) In respect of all duties that may properly by left to some other official, a director is, in the absence of specific grounds for suspicion, justified in trusting that official to perform such duties honestly. He is entitled to accept and rely on the judgment, information and advice of the management, unless there are proper reasons for questioning such.

[31] Paragraph 158, J.J. Du Plessis, *A comparative analysis of director's duty of care, skill and diligence in South Africa and Australia*: Modern Company Law for a Competitive South African Economy, 263, 264-265 (2010).

[32] S. Kennedy-Good, *The business judgement rule (part 1):* Obiter 27(1) 62, 65 (2006).

[33] S. Kennedy-Good, *The business judgement rule (part 1):* Obiter 27(1) 62, 65-66 (2006).

to Lee, assist the court in applying the accurate business principles of good faith, best interest of the company, reasonableness and rationality.[34]

Bouwman, however, argues that in South Africa competent directors are few and courts generally afford directors the benefit of the doubt and therefore it is not necessary to implement such a principle that provides an extra defence for directors into South African company law.[35] A more rigorous approach for the enforcement of the duty of care and skill is needed rather than a defence for breach of this duty.[36] Havenga is of the opinion that the common law company law and delictual principles already address the issues.[37]

The test to determine whether a director has acted properly in terms of the Act is incorporated in the business judgment rule. If a director is able to show that he or she took reasonably diligent steps to become informed about the matter, if he did not have an interest in the matter being considered, or declared his or her interest as required by section 75[38], or if he or she has made, or supported a decision made by a committee of the board a rational basis of believing, and did believe, that the decision was in the best interest of the company.[39] A director may therefore avoid liability if he or she can prove that they relied on the advice of an expert or professional advisor in making a decision whilst rationally believing that the decision was in the best interests of the company.

Section 22 of the Act prohibits a company from carrying on business recklessly, with gross negligence or with intent to defraud any person or for any fraudulent purpose.[40] Reckless trading is a criminal offence. Negligence includes *dolus*[41], *culpa*[42] and vicarious liability. Gross negligence is a serious form of negligence and includes an omission. When answering the question if a directors conduct constitutes negligence, the test is essentially objective and hypothesizing the reasonable director. The reasonable director must act within the same circumstances as the relevant director would have and therefore the test is also subjective.[43]

A director may be declared delinquent or under probation if he or she acted materially inconsistent with the duties of a director or if he or she grossly abused his or her position as

[34] A. Lee, *Business judgement rule: Should South African corporate law follow the King Report's recommendation*: University of Botswana Law Journal 1, 50, 77 (2005).
[35] N. Bouwman, *An appraisal of the Modification of the Director's Duty of Care and Skill*: South African Mercantile Law Journal 12(1) 509, 533 (2009).
[36] N. Bouwman, An appraisal of the Modification of the Director's Duty of Care and Skill: South African Mercantile Law Journal 21(1) 509, 531 (2009).
[37] M. Havenga, *The business judgement rule: should we follow the Australian example?*: South African Mercantile Law Journal 12(1) 25, 33 (2000).
[38] Regarding director's personal financial interests.
[39] Section 76(4).
[40] Section 22(1).
[41] An intentional wrong.
[42] A negligent wrong.
[43] http://www.companylaw.uct.ac.za/usr/companylaw/downloads/legislation/WLB_2011-05_Cos_Act_liability_EL.pdf

director.[44] The company, a shareholder, a director, a prescribed officer, a registered trade union or other representative of employees may apply to the court to declare a director delinquent.[45]

The legal foundation for Directors & Officers Liability Insurance

It is fundamental to understand what the basis for liability is in order to establish if we might be overlooking other business risks in terms of the Companies Act. Where a company incurs a financial debt, that debt is the liability of the company.

The liability that could occur in terms of Directors & Officers Liability Insurance (hereinafter referred to D&O insurance) is based on the statutory fiduciary duties as explained above. To shift the cost of litigation and liability would be the most obvious method to protect the company.[46] The cover consists of two types, cover that provides protection for the company and cover that provides for the personal property of the director. The policy is company owned and indemnifies directors and officers against costs of suit and would pay directly to a director or officer in certain instances.[47]

Section 78 of the Act specifically deals with directors' indemnities and insurance. It provides that a company may, if in line with the Memorandum of Incorporation,

(a) *"advance expenses to a director to defend litigation in any proceedings arising out of the director's service to the company; and*

(b) *may directly or indirectly indemnify a director for expenses contemplated in paragraph (a), irrespective of whether it has advanced those expenses, if the proceedings –*

 (i) are abandoned or exculpate the director; or

 (ii) arise in respect of any liability for which the company may indemnify the director, in terms of subsection (5) and (6)."

Subsection (5) states that a company may indemnify a director against any liability except for wilful misconduct or wilful breach of trust on the part of the director as well as acts or omissions as contemplated in section 77(3)(a),(b) and (c) of the Act.[48] Subsection (2) clearly prescribes

[44] Section 162.

[45] Section 162(2).

[46] J. Bishop, *New Problems in Indemnifying and Insuring Directors: Protection Against Liability Under the Federal Securities Laws*: Yale Law School Legal Scholarship Repository 1153, 1156 (1972).

[47] Peter Egger et al, *Heterogeneous Beliefs and the Demand for D&O Insurance by Listed Companies*: CESIFO 1, 2 (2014).

[48] Section 77(*3) A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having—*

(a) acted *in the name of the company, signed anything on behalf of the company, or purported to bind the* company *or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so;*

(b) acquiesced *in the carrying on of the company's business despite knowing that it was being conducted in a* manner *prohibited by section 22(1);*

(c) been a party to an act or omission by the company despite knowing that the act or omission was calculated *to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose;*

that any agreement, resolution or rule of the company that aims to relieve a director of his fiduciary duties or liability, or restrict any legal consequences arising from a wilful misconduct or wilful breach of trust will be void.

Critics argue that directors must pay for their actions and that D&O insurance is morally questionable. Therefore there must be resolutive conditions attached by the insurer. Main exclusions on such a policy may include dishonesty and fraud, copyright infringements, illegal profits and even acts such as damage to property or causing bodily harm.[49] Underwriting will be very complex to ensure that the insurance is not misused. Before the insurance contract is concluded the company's corporate governance system will be extensively examined and monitored.[50] An empirical study published in 2014[51] proposes a regime where the D&O insurance forms part of the director or officer's compensation package – based on a complex mathematical formula taking numerous variables and assumptions into account.

The proliferation of lawsuits against companies in the last decade caused an increase in the demand for D&O insurance. D&O insurance is not only for the larger public company but it can be very useful for private companies. The type of claims could range from creditors alleging the company reasonably knew payment could not be made, misappropriation of funds, negligent management decisions to disclosing confidential trade secrets and information.[52]

Conclusion

The Companies Act has changed the business sector substantially by introducing several statutory duties on company directors that could lead to accountability and personal liability. Section 76 sets out duties of directors such as acting with the necessary care and skill, in good faith and for a proper purpose and in the best interests of the company. The Act provides that directors that contravene the standard of directors' conduct can be held personally liable in certain instances. The Act also provides for a statutory defence by importing the business judgment rule into South African company law.

Globally the demand for D&O insurance is growing rapidly. Companies are exposed to an increasing risk as a result of transparency on their corporate governance and various compliance risks. Litigation costs and reputational damage could lead to a company's complete demise.

Section 78 of the Act sets out a statutory framework to ensure that directors may be insured against liabilities within certain bounds. Agreements or resolutions that constitute otherwise will

[49] http://www.iodsa.co.za/?Camargue
[50] Peter Egger et al, *Heterogeneous Beliefs and the Demand for D&O Insurance by Listed Companies*: CESIFO 1, 6 (2014).
[51] Peter Egger et al, *Heterogeneous Beliefs and the Demand for D&O Insurance by Listed Companies*: CESIFO 1, 6-21 (2014).
[52] http://www.iodsa.co.za/?Camargue

be null and void. Those who question D&O insurance on moral and ethical grounds can rest assured that strict criteria will be used to evaluate and establish if the risk is insurable.

As financial advisors deals with clients who are directors of companies regularly, being at least aware of risks other than traditional business contingency can only lead to high quality and comprehensive risk planning. The payment of debt that becomes due at death of the co-principle debtor is very different from the risk covered by means of D&O insurance, but both are legitimate risks and both could lead the downfall of the company. At least being aware of other risks and possible remedies cannot do harm and can increase our value proposition as holistic financial risk planners.

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Maintenance claims after the death of a domestic partner: A brief summary of developments

Deon van Vuuren CFP®
LLB, PG Dip in Fin Plan
Legal Adviser Specialist
Broker Distribution: Western Cape

Introduction

The reciprocal duty of support in domestic partnerships has come under a lot of scrutiny in our Courts in the past. For this reason it is of utmost importance that clients receive the correct advice if they are faced with similar challenges.

This article will provide a brief overview of developments with regard to the maintenance claims of domestic partners in the event of one of the partners passing away and also discuss the possible future of the topic at hand. The situation for civil partners in a same sex relationship has been clarified by the promulgation of the Civil Union Act[1] which will be discussed shortly below. Therefore, the most part of this article will discuss the situation of partners in a heterosexual domestic partnership, where these partners have not entered into a marriage or civil union.

Background

Domestic partnerships are a very common occurrence in the modern era. More and more people elect not to get married for numerous reasons, or live together for longer periods of time before entering into a marriage.

Various court decisions have been made with regard to the existence of maintenance claims for domestic partners.

Two distinctive cases are that of Gory v Kolver[2] (The *Gory v Kolver*-Case) and Volks NO v Robinson[3] (The *Volks v Robinson*-Case). However, since these two cases served before the Constitutional Court, there have been other matters that came before other courts which warranted the Court's scrutiny on domestic partnerships, albeit that the facts and/or the legislation on which the various plaintiffs seeked legal remedies differs somewhat. These cases will be discussed shortly.

The *Gory v Kolver*-Case[4]

The applicant in the matter was a partner to a same-sex domestic partnership. His partner passed away without a will. The executor in the deceased estate regarded the deceased's parents as the only heirs in the estate. The applicant then approached the High Court seeking an order that section 1(1) of the Intestate Succession Act[5] be declared unconstitutional as a result of the fact that a partner to a same-sex domestic partnership did not qualify as a spouse in terms of the Act. The High Court ordered the said clause to be unconstitutional and referred the matter to the Constitutional Court for confirmation. The Constitutional Court upheld the order of the High Court

[1] Act 17 of 2006.
[2] Gory v Kolver NO and Others (Starke and Others intervening) [2006] 4 BPLR 255 (CC).
[3] Volks NO v Robinson and Others 2005 (5) BCLR 446 (CC).
[4] Gory v Kolver NO and Others (Starke and Others intervening) [2006] 4 BPLR 255 (CC).
[5] Act 81 of 1987.

and ordered the reading in after the word spouse: *"or partner in a permanent same-sex life partnership in which the partners have undertaken reciprocal duties of support"*.

The *Volks v Robinson*-Case[6]

In this case the Applicant succeeded in the High Court after the executor denied a claim for maintenance and sought an order that section 1 of the Maintenance of Surviving Spouses Act was unconstitutional and invalid. The Applicant contended in the court *a quo* that the definition of *"survivor"* was unconstitutional in that it did not include partners to a heterosexual domestic partnership. The court *a quo* declared this section unconstitutional and the matter was once again referred to the Constitutional Court.

The Constitutional Court, however, came to a different conclusion and overruled the decision of the High Court. In a majority judgement the court held that the sanctity of marriage must be protected and the mere fact that people who are able to enter into a marriage but elect not to do so cannot be afforded the same protection and legal stance as people who indeed elect to get married. The Court also held that there is no reciprocal duty of support where persons are not married.

This judgement has been discussed by various authors at length and remains the *status quo* with regards to maintenance claims of heterosexual domestic partners.

The Verheem v RAF[7] and Paixão v RAF[8] cases

In both these cases the plaintiff claimed for damages as a result of the loss of support. In both cases the plaintiffs were parties to a heterosexual domestic partnership.

The courts came to the conclusion that the plaintiffs in both instances could claim from the Road Accident Fund for the loss of support as a result of the convictions of the community and the changing times we live in require that their claims be acknowledged. It is important, however, to note that none of these two claims were brought in front of the courts as claims for maintenance, but rather claims founded on the basis that the death of a life partner was caused as a result of the negligence of a third party.

Accordingly, these two cases have little to no effect on maintenance claims for domestic partners, not only due to the fact that it was not founded on maintenance, but also because the *Volks*-case still reigns supreme on the maintenance front.

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[6] Volks NO v Robinson and Others 2005 (5) BCLR 446 (CC)
[7] *Verheem v Road Accident Fund* 2012 2 SA 409 (GNP)
[8] Paixão and another v Road Accident Fund [2012] 4 All SA 262 (SCA)

The legislative framework

The definition of the word *"spouse"* has been amended in various acts to include domestic partners, some of which that have an impact on financial planning will be discovered briefly below. Furthermore, the enactment of the Civil Union Act[9] has given a lot of body to the recognition of same-sex marriages / partnerships in South Africa.

The changing norms of society also led the legislator to introduce the Domestic Partnership Bill in 2008. The worrying factor here being that not much has happened since the Bill was introduced to get it enacted as legislation. The content of the Bill will also be discussed briefly.

Civil Union Act[10]

The Civil Union Act has without a doubt ensured that the recognition of same-sex marriages and civil partnerships promotes equality in South Africa.

A Civil Union is defined in the Act as follows: *"the voluntary union of two persons who are both 18 years of age or older, which is solemnised and registered by way of either a marriage or a civil partnership, in accordance with the procedures prescribed in this Act, to the exclusion, while it lasts, of all others"*

Therefore, the same rights are afforded to parties to a Civil Union as are afforded to spouses who are married in terms of the Marriage Act.[11]

A Civil Union Partner is defined as follows: *"a spouse in a marriage or a partner in a civil partnership, as the case may be, concluded in terms of this Act."*

The important aspect to bear in mind is the fact that the Civil Union between two parties needs to be registered in order to bring about legal consequences. A partner to a heterosexual domestic partnership will therefore not receive any assistance in proving the existence of a civil partnership in terms of this act.

Pension Funds Act[12]

The word *"spouse"* is defined in the Pension Funds Act as: *"a person who is the permanent life partner or spouse or civil union partner of a member in accordance with the Marriage Act, 1961,*

[9] Act 17 of 2006
[10] Act 17 of 2006
[11] Marriage Act 68 of 1961
[12] Pension Funds Act 24 of 1956

the Recognition of Customary Marriages Act, 1998, or the Civil Union Act, 2006, or the tenets of a religion"

From the above it is clear that the Trustees of a Pension Fund are in the position to acknowledge a permanent life partner of a deceased member as a spouse for the purposes of establishing the payment of the deceased member's pension benefits in terms of section 37C of the Pension Funds Act. The trustees will surely require further investigation in cases where it will not be easily ascertainable to what extent the domestic partnership can be regarded as permanent and whether a reciprocal duty to maintain exists.

The payment of pension benefits still, however, does not constitute a claim for maintenance.

Estate Duty Act[13]

In terms of the Estate Duty Act, a spouse is defined as:

In relation to any deceased person, includes a person who at the time of death of such deceased person was the partner of such person:

(a) in a marriage or customary union recognised in terms of the laws of the Republic;

(b) in a union recognised as a marriage in accordance with the tenets of any religion; or

(c) in a same-sex or heterosexual union which the Commissioner is satisfied is intended to be permanent:

Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union without community of property.

The result of the amendment of the definition of *"spouse"* in the Estate Duty Act has the effect that a testator can bequeath assets to a domestic partner and such a bequests will be exempt from estate duty in terms of section 4(q) due to the fact that such a domestic partner qualifies as a spouse for purposes of the Act.

Maintenance of Surviving Spouses Act[14]

The Maintenance of Surviving Spouses Act gives spouses of deceased persons the opportunity to institute a claim for maintenance against the deceased estate in the event where there was not enough provision made for their maintenance and where they were married to the deceased at the time the deceased passed away. It is in terms of section 2(1) of the Maintenance of Surviving Spouses Act that the plaintiff in the *Volks*-case relied on to institute her

[13] Estate Duty Act 45 of 1955
[14] Maintenance of Surviving Spouses Act 27 of 1990

claim. The main reason the court dismissed the claim was that partners to heterosexual domestic partnerships do not fall within the definition of "*survivor*" in terms of the Act.

Survivor is defined in the Maintenance of Surviving Spouses Act as follows:

The surviving spouse in a marriage dissolved by death, and includes a spouse of a customary marriage which was dissolved by a civil marriage contracted by her husband in the customary marriage to another woman on or after 1 January 1929, but before 2 December 1988.

The clear reference to the word marriage in the above definition results in the fact that parties to heterosexual domestic partnerships do not fall within the definition.

Usually, the claim is instituted against the estate and the executor of the deceased estate will either acknowledge or deny the claim. If the claim is denied by the executor, the spouse will have recourse by applying to court.

At present, with the *Volks*-case still being the precedent, heterosexual domestic partners will surely not have many successes in Court, as the lower Courts are bound by the Constitutional Court decision. The result is that the costs that will be involved in litigating to the ends of approaching the Constitutional Court again will not be affordable for most individuals and as such it is unclear if the *Volks* decision will soon be challenged and even if it does happen the Court is unlikely to reach a different decision as strong remarks were made on the protection of certain benefits that spouses to a marriage receive.

The Domestic Partnership Bill, 2008

The Domestic Partnership Bill (hereinafter referred to as the Bill) was published for comment in 2008. The purpose of the Act is to align the treatment of heterosexual domestic partners with the treatment that same-sex civil partners receive, as it is noted in the preamble that there is: "no legal recognition or protection for opposite-sex couples in permanent domestic partnerships".

In the Bill there is a distinction drawn between registered domestic partnerships and unregistered domestic partnerships and the rights flowing from each of these are different in some aspects. It also allows for a registration procedure and maintenance after the termination of the domestic partnership.

Importantly, in section 19, the Bill purports to include a "registered domestic partner" into the reference of spouse in the Maintenance of Surviving Spouses Act and in section 20 to the Intestate Succession Act. Section 21 furthermore determines that registered domestic partners

will be entitled to claim on delictual grounds for the loss of support as a result of the death of a partner.

Section 27 of the Bill stipulates that a partner in an unregistered domestic partnership will have no claim for maintenance as the parties are not liable to maintain each other, but such a party will however be able to approach a Court in order to claim reasonable maintenance from the estate until their death, remarriage or registration of a subsequent domestic partnership, taking into account their own means.

The Domestic Partnership Bill will certainly alleviate a lot of uncertainty for parties to domestic partnerships once it is enacted as legislation. When precisely that will happen is unclear at his stage.

Conclusion

As is clear from the discussion above, a party to a domestic partnership may make provision for his partner in his will. His partner in turn, will not be able to claim for maintenance from the executor as the executor has no legal grounds at present to acknowledge the claim. One remedy will surely be to approach the Court in instances where necessary, but the litigation process will be a costly and timely one.

It is advised that clients be made aware of the various aspects and the implications thereof. The most important of all is that the clients wishes need to be contained in the form of a will and / or beneficiary nomination on pension benefits or life insurance policies.

Should the Domestic Partnership Bill be promulgated as legislation it is once again important that clients' financial plans and wills be revisited to ensure that it complies with the requirements as imposed.

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Trust assets could affect your accrual claim

Saudiqa Fakier CFP®
LLB (UWC) PG Dip Legal Practice (UCT) PG Dip Plan (US)
Legal Adviser Specialist
Broker Distribution: Western Cape

Introduction

In recent years trusts and its taxes are being scrutinised by SARS, so too by the Davis Tax Committee with its recommendation on how trusts are to be dealt with in future. So much is changing on the trust horizon. This article discusses some of the latest developments with regard to trusts in as far as accrual claims at the dissolution of marriage out of community of property are concerned.

There are numerous cases where individuals getting divorced, especially those married out of community of property are asking that the judiciary consider trust assets when determining patrimonial consequences of dissolution. In general this is done in one of two ways:

(1) Requesting that trust assets be added to a spouses' personal estate for purposes of effecting an equitable redistribution agreement[1]; and

(2) Including the value of the trust assets in calculating an equitable accrual claim.[2]

In this article the discussion will be centered around point 2 above.

The Trust Property Control Act [3] is the main piece of legislation which regulates South African trusts. This Act provides all the essential elements that need to be present in order to form a valid trust and also stipulates the way in which trusts are to be administered and controlled.

Section 1 of Trust Property Control Act provides the following definitions:

"Trust"

Means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed-

a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust *instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument, but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965 (Act 66 of 1965);*

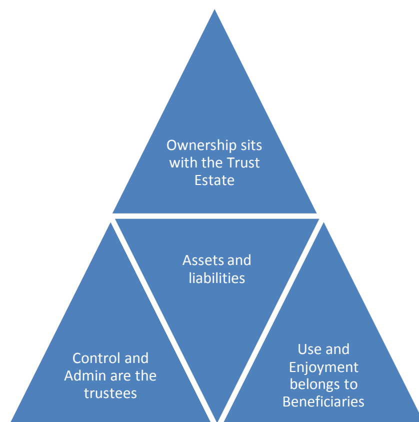
[1] Section 7 (3) of the Divorce Act 70 of 1970
[2] Section 3 of the Matrimonial Property Act 88 of 1984
[3] The Trust Property Control Act 57 of 1988

From this we see that a trust is an entity created via contract for the benefit of a third person; it is a so-called *stipulation alter*[4].

Section 12 of Trust Property Control Act states:

"Trust property shall not form part of the personal estate of the trustee except in so far as he as the trust beneficiary is entitled to the trust property."

Section 12 of the Trust Property Control Act provides for the separateness of trust assets from the personal estate of its trustees unless the trustee is also a beneficiary of the same trust, and in that capacity has a claim against the trust. This provision goes to the very heart of discretionary trusts and it is for this reason that, as a general rule, when a person who is a trustee gets divorced, the trust estate [5] are treated as separate and therefore excluded from any patrimonial consequences of divorce. The landmark case of *Land and Agricultural Bank of South Africa v Parker and Others*[6] asserted the importance of a functional separateness between the ownership of trust assets; the control and administration of a trust; and the ultimate enjoyment of trust owned property on the other hand. The separateness of each function of this "Trust Triangle" is the essence of the purpose of a trust.



What is encountered more frequently is that courts are treating the trust estate and divorcing trustees' personal estate as unanimous for good reason.

The trust as an "alter-ego"

The "alter-ego trust" is an expression used whenever a trustee demonstrates disregard of this separateness by controlling the trust assets with self-interest as though the trust entity itself is in some way an extension of him/herself. The trust is merely the trustees "alter-ego". This undermines

[4] The third party (tertius or alteri) is the intended beneficiary of the contract. The founder of the trust places assets into the care/custodianship of the trustees of the trust for the benefit and enjoyment of and by the theirs party beneficiaries.

[5] Trust owned assets and all its liabilities Perhaps put this part in brackets in the body of the article where you have the footnote reference

[6] (2005 (2) SA 77 (SCA)

the very essence of the purpose of a trust when contrasted with the definition of "trust" as envisioned in Section 1 of the Trust Property Control Act.[7]

A recap of the accrual system in contrast to other marital regimes is provided below.

The Matrimonial Property Act 88 of 1984 and the Civil Union Act 17 of 2006 regulate marriages and registered civil unions in South Africa. For simplicity the term marriage will be used to refer to both marriages and registered civil unions as they are afforded equal protection in South Africa.

A couple has the option to:

(1) Marry or enter into a Civil Union in community of property i.e. default position, where a joint estate is created; or
(2) Marry or enter into a Civil Union out of community of property, where both spouses retain their separate estates, which grow or reduce independently from each other; or
(3) Marry or enter into a Civil Union out of community of property with the accrual.

For all marriages out of community of property, couples must enter into an ante nuptial contract which is notarially registered at the Deeds office within 3 months of the marriage.

Section 3 and section 4 of the Matrimonial Property Act[8] brought about the accrual system. It introduced this system in 1984 as a means of providing a more equitable system to marriages out of community of property in situations where the family adopted a more traditional approach (one spouse is the sole breadwinner and the other the homemaker) and where the homemaker spouse is often left financially prejudiced. In terms of this marital regime, in the ante nuptial contract, the couple must state each spouse's estate value at date of marriage. Should either, or both spouses not own anything then the value to be stated will be zero.

Upon the dissolution by either death or divorce, the value of each estate is calculated and the growth since date of marriage (adjusted by inflation) in each estate is measured. Any legacies, inheritances and donations received by parties during their marriage are excluded from the respective estates for purposes of measuring the accrual. The difference between each party's estate's growth is then determined, and the spouse whose estate has grown the least is entitled to half of the difference in the growth determined above.[9]

[7] 57 of 1988
[8] Act 88 of 1984
[9] S 4 of the Matrimonial Property Act 88 of 1984

Piercing the Trust Veil

"Piercing the trust veil" is similar to piercing the corporate veil in companies and close corporations where courts disregard the limited liability afforded to directors or members of such entities and thereby treat business responsibilities as that personally of its directors and members. This practice has been sanctioned as a remedy to the trustees' abuse of power and disregard of the "Trust Triangle" i.e. the ownership, control, enjoyment relationship and the balance mentioned above.

Typical trustee transgressions that warrant piercing the trust veil include *inter alia*:

(1) The duty to exercise independence of judgment and independent discretion;

(2) The duty to give effect to correct interpretation of the trust deed, the constitution of the trust;

(3) Neglecting the principle that Trustees should act with care, diligence and skill in the performance of their duties and exercising their powers;

(4) Neglecting to adhere to trust deed rules with regard to the quorum of trustees needed to make decisions;

(5) Not jointly making decisions with all required trustees.[10]

It is Important to highlight that the court in Van Zyl v Kaye[11] have also drawn a distinction between a "sham-trust" and an "alter-ego" trust. Simply put, those that can be "pierced" are those which failed to adhere to important principles of trust administration/abuse, this is the "alter-ego" trust. A "sham" trust on the other hand, is one where some or all of the legal requirements of setting up the entity are not adhered to and there is no trust to "pierce".

This being said both these concepts of alter-ego trusts and sham trusts are explained by Dr PA Olivier [12] as not having any real legal standing, and any reference to it is an innovation by people who write newsletters or articles on the topic in the hope of explaining the concepts. These explanations, often in different pieces of literature, tend to overlap, though in practice they share common ground in that both the "sham-trust" and the "alter-ego" trust risk either being set aside and disregarded wholly or at its very least "pierced" by our judiciary.

To reflect how the courts have developed their stance on accrual claims and alter-ego trusts over the recent years the following cases paint a picture:

[10] Marius J. De Waal, The abuse if the Trust as mentioned in Francois Du Toit: Trusts and Patrimonial consequences of Divorce 2015 pg. 665 Journal of Civil Law Studies Vol 8 No 2 of 2015

[11] 2014 (4) SA 452 at paragraph 16- 19

[12] PA Olivier, S Strydom & GPJ Van Den Berg, Trust Law and Practice page 6-18

Badenhorst v Badenhorst[13]

Mr and Mrs Badenhorst were married out of community of property (without accrual). Whilst each had separate estates during their marriage, Mrs Badenhorst helped Mr. Badenhorst in his businesses which were all held in trust. At date of divorce Mrs Badenhorst applied for a redistribution order in terms of S7 (3) of the Divorce Act. The court had to decide whether they could include the inter vivos trusts' assets in determining the redistribution order.

The SCA looked at the following factors (1) how trust assets were controlled by the trustee and (2) how the affairs of the trust are conducted during the marriage. The court found that in response to (1) Mr Badenhorst, the Respondent has full control over all trust assets and in response to (2), he rarely sought the approval of his co trustees when making decisions and also disregarded the difference between trust assets and his own assets. The court therefore found that trust assets could be used when effecting the redistribution order. The court numerous times invoked the well-known case of Jordaan v Jordaan[14] which was one of the first South African cases reported where a court considered the value of trust assets when assessing the value of a spouse's estate.

RP v DP[15]

The above case refers to a recent (2014) case, where a couple married out of community of property with the accrual system, applied for a divorce. When the accrual within each estate was measured the wife (applicant and school teacher) claimed half the net accrual of her husband's estate, which was later counterclaimed by the husband (a practising attorney and respondent) who argued that his estate (smaller growth since date of marriage) enjoyed the claim. This gave rise to a new application by the wife to amend her claim to the effect that the value of the assets of a family trust the R and JP Trust, of which the husband was a trustee, be included in calculating the accrual claims.

She contended that he had control of trust assets; that the trust was his alter ego; that he had abused the trust form to grow his personal wealth; that he did not keep trust assets separate from his personal estate; nor separate from his personal enjoyment, the above all being the grounds on which she brought the application.

The court found that the trust was being used as though it was extension of the trustee-husband and directed that the asset value of the trust should be taken into account in determining the extent of the accrual of a trustee's personal estate and as such granted that the applicant amend her counterclaim against her husband.

[13] 2006 2 All SA 363 (SCA)
[14] 2001 (3) SA 288 (C)
[15] RP v DP and Others (2014) (6) SA 243 (ECP)

Conclusion

One of the common reasons why trusts may possibly be set up may be that it protects assets within the trust against matrimonial claims, but when doing so one needs to be mindful of the very fine print condition that reads- "if all within the trust is above board and receives a clean bill of health".

Just like trusts will no longer be a means to avoid taxes, it is also no longer simply a means to grow an "outside" estate that is capable of avoiding an ex-spouse's patrimonial claims. The duty of a trustee is onerous and needs to be dealt with the utmost skill and diligence if there is to be any benefits from utilising the entity at all.

This is of utmost importance when the trust form is considered in financial planning. Often trustees guilty of using the trust as their alter ego are professionals with the relevant education who should have known and practiced better. This indicates how easy it is to slip up on ones responsibilities as a trustee, and how at risk a lay person, who is a trustee, is of falling into this trap. There is an onus on advice-givers to continuously educate clients with regard to their duties as trustees and to assess how well clients are doing at maintaining the separateness required in exercising control over trusts.

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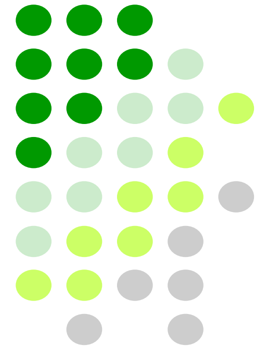

Estate Planning

Estate Planning: Finding a Successor: Suggestions for the farmer

Nevetha Maharaj CFP®
B. Soc. Sc. LLB. B. Com (HONS) (IR), PG Dip in Fin Plan
Legal Adviser Specialist
Broker Distribution: KwaZulu-Natal

Introduction

Succession planning in South Africa, especially amongst the farming community is often taken for granted. There seems to be the assumption that the generation that follows will simply continue with farming as well as maintenance of the outgoing generation. Estate planning becomes all that more important with a family owned operation as there are several factors that require due attention if the family owned farming enterprise is to succeed under the leadership of the subsequent generation. For example, legislative restraints in the form of the Subdivision of Agricultural Land Act[1] which does not allow agricultural land to be owned by more than one person places a restraint on the possible succession to more than one farming heir.

This article will endeavour to highlight potential considerations when planning to hand over the ownership of a farming operation to the next generation.

Identification of a Successor

The identification of the successor is usually the first step and comprises in the main one of the farmers descendants. This is then followed by a decision on how the actual farming enterprise will be handed over i.e. the preparation for the transfer.

Communication is vital in the preparation phase of the transfer as one would need to decide what is expected on transfer i.e. does it entail the mere handing over of the enterprise, or will there be a trial period where one can assess if the decision to hand over control of the enterprise will ensure its continued success, or will there be a period of jointly managing the enterprise to ensure a smooth handover or try a period of parallel farming where the operations are split into separate entities to allow a degree of autonomy to the successor. In the case of the latter the current operator and the successor will rely on each other for consultations on business matters, expertise and advice. Management of the new entity will be the responsibility of the new generation and with time more and more responsibility is transferred to the new entity or potential successor.

Importantly when deciding on how the enterprise will be transferred, one should be in a position to determine if the said decision was correct thus a trial period as contemplated above may be appropriate. [2]

To illustrate by example, the Adams family operates a farming entity, a family owned business run by Mr Adams that produces and distributes nursery seedlings. Five years ago his son Tim joined the business and began to work alongside his father. On Tim's suggestion they extended the farming operation to also include the growing and supply of garden vegetables. Whilst Mr Adams

[1] Section 3 of Act 70 of 1970
[2] Gary A Hatchfield and Others Series 2,2013.

oversaw the farming operation, all the management of the new enterprise was the responsibility of Tim. Over time as the farm required new equipment, vehicles and labour this all became Tim's responsibility. Again over time and with a degree of confidence of having seen how well Tim worked the responsibilities of the seedling enterprise was handed over to him as well. The advantage of this method is that it allows Mr Adams to ease into retirement while ensuring that Tim is not overwhelmed by a sudden onslaught of responsibility.

Once a decision is made on how the farming enterprise will be transferred, the results will equip one to assess the skill of the new generation[3], i.e. determine whether the designated successor has the ability to contribute to the success of the enterprise, is capable of effectively managing the operations and whether the successor and current operator are compatible.

Choices during retirement

A lot of famers still rely on their farming operation as a source of income for their retirement planning, even after they have handed over the reins to their successor. This is an unspoken rule that is often an unspoken term of a farmers succession plan.

In the case where a farmer decides that his retirement income shall be funded by the farming enterprise then it is important that he remain an interested party in the farming operation. This will entail inter alia being part of regular progress meetings on operational activities, possibly ensuring that the enterprise has a formal annual general meeting where finances, goals and resolutions for the year ahead is finalised and the operation of the year that was, is accepted and finalised. In this way all pertinent issues are discussed, documented and finalised. This approach will give the farmer a sense of how the enterprise has progressed. There are very real risks involved in this method.

If the farming operation is not successful, the farmer's retirement income will be compromised and he will have to accept concessions. The farming operation therefore has to be successful so that it can afford to sustain and pay an extra salary over a period of approximately twenty years (the farmers estimated lifespan after retirement) whilst also ensuring that that salary keeps up with inflation over that time.

It is perhaps best that before this method is considered, one evaluates their financial position at retirement. This will entail assessing whether there are enough savings for retirement and whether the income from the farming enterprise is a vital supplement to retirement income.

[3] Id at para 8.

Using the illustrated example, as a retirement option Mr Adams could consider a living buy and sell agreement.[4] Such an agreement will then oblige Tim, the successor to buy out Mr Adams on the occurrence of a particular event, in this case retirement thus ensuring financial independence of the farming operation and on the generation that will follow Mr Adams. A living buy and sell agreement therefore will ensure that Mr Adams does not have to consider the affordability of the incoming generation to keep him on the payroll as well as keep up with the expenses of the farm and creditors as well. The alternative for Mr Adams is having to deal with concessions that often present themselves with little warning which could potentially prompt Mr Adams to consider postponing retirement.

The concept of a living buy and sell agreement will be beneficial if the farmer seeks independence at retirement. Paramount here however is the setting of goals early. These should include individual goals which is what you want, family goals which relates to for example where you want to stay, business goals of succession, and retirement goals of whether you want to be dependant or not, passive income and medical aid etc.

Treating heirs fairly

Another vital consideration is that how one would structure succession as it is usually one child that has taken over the farming operation but one would want to be fair to all other children as well. One has to pay attention to the situation as a farming heir adds value to the business in the form of labour, time and expertise which translates to an improved bottom line for the farming operation.

Suggestions often include that the farming heir pay out his/her siblings upon inheriting, a so called bequest price which effectively is a condition of inheritance. This then begs the question does the heir have enough money to pay out his siblings, or does the farming operation have that amount of liquidity, or can the farming operation generate that amount of liquidity. [5]

This cash flow pressure has the potential to impact on the continuity of the farming operation. Hence the concept to "treat each child fairly is to treat each child equally"[6] must be revisited.

One often does not consider the value that a farming heir adds to a business, apart from adding renewed energy to the farming operation, a value to his hard work and sweat is not given. Thus when Tim joined the Adams farming operation he added a new facet to the operation of growing and selling the table vegetables which added positively to the Adams farming operation's bottom line.

[4] Polly Dobb para 4.
[5] David Goeller para 1.
[6] David Goeller para 6.

While not a proved science, or proof of establishing a valuation, one would suggest that one compares the value of the farming operation before the farming heir became an active part of the operation to the present valuation of the farming operation, taking into consideration:

(1) The increase in value.

(2) The value of the heirs input.

(3) The effect of the heirs input.

(4) The current value of the operation.

This can be illustrated by using Tim as an example. When Tim joined his family business, the Adams farming operation was valued at R1 000 000. Tim is one of 4 siblings but only he is involved in the farming operation. Therefore at face value, if each child was to be treated equally then each of the 4 children would receive R250 000.

However consideration must be given to Tim's input since joining the farming operation 5 years ago which has increased the value of the farm from R1000 000 to R5 000 000. Tim has added value by working the farm and ensuring a greater equity is achieved. Again if all the children are to be treated equally then each child in this scenario would receive R1 250 000 each but now the inequality in the equality trying to be achieved, becomes visible.

Ideally, the net growth of the farming enterprise since the farming heir joined the business was R 4 000 000. The Adams establish that the growth that can be attributed to Tim is 50% and the efforts of Mr Adams is 50%.[7]

Mr Adams' share of the business should ideally be split between his heirs which means that each child would receive ¼ of R3 000 000 (i.e. R2000 000 attributed to Mr Adams's input and the initial R1 000 000 valuation of farm before Tim's involvement. This R3000 000 could be funded by an investment policy or a pure risk policy.

This scenario could be reflected in client's estate plan and recorded in the client's will as follows:

It is recorded that the value of Tim's contribution is 50% of the growth of the Adams' family business since Tim joined. The current value of the Business is R5 000 000. It is further recorded that the value of the Adams Family Business was R1 000 000 on the date that Tim joined the Business

[7] David Groeller para 8.

I therefore bequeath to Tim R2 750 000 made up as follows:

- 50 % of R4 000 000 (R 2 000 00) attributed to Tim's input in the business , and
- 25% of R3 000 000 (R750 000) representing his share of inheritance

Treating unequal's equally could be the most unfair thing that one could do.[8]

Conclusion

This article highlighted the need for early retirement planning, in particular related to a farming enterprise. The implications of relying on the future income of the farming operations can have dire consequences for both the subsequent generations as well as the operation itself.

Whilst not an exhaustive list, this article provided a brief overview of some of the considerations that need to be taken into account when planning for retirement in the case of a farmer.

It is acknowledged that an individual farmer may opt to treat succession differently, but if approached properly and documented well, family relations will remain intact and the family business will pass to the next generation in a planned manner.

[8] David Goeller para 8.

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Subdivision of Agricultural land Act 70 of 1970

The risks of selling assets in the course of winding up an estate

Gerald Peter CFP®
LLB, Adv PG Dip in Fin Plan
Legal Adviser Specialist
PFA : Durban

Introduction

While expediency or even compulsion may sometimes dictate that assets be sold during the process of winding up an estate, this is not always a good option. The process of selling assets during the course of winding up an estate is fraught with many, often unseen, risks which can negatively affect the estate or an heir.

Apart from the obvious economic difficulties associated with selling assets during the winding up of an estate, there are also hidden income tax, capital gains tax (hereinafter referred to as "CGT") and estate duty risks. This article explores some of these risks and explores ways in which these risks could be mitigated.

Some reasons for selling assets during the course of winding an estate

There are many circumstances which may dictate the sale of assets during the course of winding up an estate.

(1) A testator may for example, owing to his peculiar family dynamics (e.g. conflicting family members) direct the sale of all assets in the estate.
(2) In other instances an executor may be compelled to sell assets in the estate to create sufficient liquidity to settle liabilities and pay cash legacies.
(3) A testator who is a specialist in his field (e.g. a medical practitioner) may, due to licencing and other legislative restrictions on succession direct that the assets of his/ her business be sold. The Prevention of Sub- division of Agricultural Land Act for example prohibits the sub-division of agricultural land between multiple heirs.
(4) Assets may also be sold as part of a redistribution agreement between the heirs.
(5) Where a testator dies intestate, an executor may be forced to sell assets to create sufficient liquidity to pay out the intestate heirs.

Risks

Market constraints

Selling assets during the course of winding up an estate is normally a pressured process. Almost invariably, assets sold during this period are not sold for their true worth thereby reducing the value of the estate's distributable residue. In such cases, the conflicting interests of the executor to realise as much capital from the sale and those of the heirs to free up the estate as quickly as possible are not always easy to reconcile. Unlike a normal seller, an executor as seller does not have the luxury of time. This deprivation of time may result in the executor disposing of assets for lower than anticipated returns. Potential buyers, usually speculators, are aware of this dilemma and will always look to take advantage of desperate executors.

Capital Gains Tax

Distribution to heir

Under the newly introduced Section 9HA read with the amended Section 25 of the Income Tax Act[1], a deceased person is treated as having disposed of his or her assets for an amount equal to their market value on the date of death[2]. Section 25 (2) of the Act states that the estate is also deemed to have purchased the assets at that market value (this becomes the estate's base cost).

When the asset is distributed directly to an heir by the executor, the CGT implications will be as follows:

(1) The heir is deemed to have acquired the asset at market value (this becomes the heir's base cost)[3].
(2) The estate is deemed to have disposed of the asset at its base cost (i.e. the market value)[4].

Therefore the deceased estate makes no capital gain or loss on assets which are inherited and passed onto the heirs or legatees.

Mr. Tau dies. He is survived by his son Jimmy who is the sole heir. The only asset in Mr. Tau's estate is a primary residence valued at R3 million. He bought the house in 2005 for R500 000. On his death Mr. Tau will be treated as if he sold the house for R3 million (the market value). His taxable gain will be as follows:

Example

Proceeds	R 3,000,000.00
Less	
Base Cost	R 500,000.00
Capital Gain	**R 2,500,000.00**
Less	
Primary residence exclusion	R 2,000,000.00
	R 500,000.00
Less	

[1] Income Tax Act 58 of 1962, Taxation Laws Amendment Act, 2015 (Act No. 25 of 2015)]
[2] Section 9HA (1)
[3] Section 25 (3)(b) read with Section 9HA (3)
[4] Section 25 (3) (a)

Exclusion (death)	R 300,000.00
Aggregate capital gain	R 200,000.00
Taxable capital gain (40%)	R 80,000.00

The estate is then deemed to have purchased the house at the market value (R3 million). When it transfers the house to Jimmy the estate will be deemed to have disposed of it for the same amount of R3 million.

Proceeds	R 3,000,000.00
Less	
Base Cost	R 3,000,000.00
Capital Gain	**R 0.00**

Distribution to third party

The situation is radically different if the asset is disposed to a person other than an heir or legatee.

Where a deceased estate acquires assets from the deceased and then disposes of the asset to a third party in the course of winding up the estate the following applies:

(1) The deceased estate is deemed to have acquired the asset at market value (from the deceased)[5].

(2) Any gain made on the disposal must be treated in the same manner as if that asset had been disposed of by a natural person[6].

This means that when the estate transfers the asset to a third party, it will not be deemed to have disposed of that asset for an amount equal to its base cost. The estate will be treated as if it disposed of the asset at the actual price realised from the sale. The estate must therefore include 40% of the gain in its taxable income and be taxed at the same tax rate as natural persons. The R40 000 annual exclusion (not the primary residence exclusion) will also be available to the deceased estate.

Example

Mr. Mudau dies on the 1st of August 2016. He is survived by 3 children. The only asset on his death is a primary residence worth R3 million. Due to the strained relationships between the children, he directs the executor (in his will) of the estate to sell the house and distribute the proceeds

[5] Section 9HA (1) read with Section 25 (2)(a)
[6] Section 25(5)

equally amongst his three children. The house is duly sold for R4 000 000. The CGT implications for the estate in this transaction are as follows:

Proceeds	R 4,000,000.00
Less	
Base Cost	R 3,000,000.00
Capital Gain	**R 1,000,000.00**
Less	
Primary residence exclusion	R 0.00
	R 1,000,000.00
Less	
Annual Exclusion (death)	R 40,000.00
Aggregate capital gain	R 960,000.00
Taxable capital gain	R 384,000.00

Primary residence exclusion

Another unforeseen risk is found in Paragraph 48 of the Eighth Schedule. Under para 48(*d*) a primary residence held by a deceased estate is treated as being ordinarily resided in by the deceased person for a maximum period of two years after the date of death. Should the executor take longer than two years to dispose of the residence, the period exceeding two years will not qualify as a primary residence, and the gain or loss must be apportioned (the R2 million exclusion may only be set off against the portion of the gain applicable to the first two years following the date of death).

It is therefore important for the executor to ensure that the house is sold as soon as possible to ensure that the full primary residence exclusion is preserved.

Valuation of Property for Estate Duty

Section 5(1)(a) of the Estate Duty Act states that if property is disposed of by way of a bona fide sale in the course of the liquidation of the estate, such property is valued at the price realised by the sale. Property which is not sold in the course of liquidation of the estate is valued at fair market value at the death of death.

In the case of farming property, fair market value is defined as market value less 30%[7]. However if a farm is sold during the course of the winding up of the estate then the full value realised from the sale will be used in the estate duty calculation.

In the case of Commissioner for SARS V Estate Late HE Streicher[8], SARS tried, albeit unsuccessfully, to impose the provisions of Section 5(1) (a). In this case the beneficiaries of the estate had sold farming property during the winding up of the estate. The executor used the lower Land Bank value in the estate duty calculation. On assessment, a number of years later, SARS levied estate duty on the price realised during the sale. Although SARS lost this case (the court held that the sale was not 'in the course of liquidation' but 'during the liquidation'), this case serves as a warning to executors and testators.

Example

Mr. Moloi dies and is survived by three children. He owned a farm worth R10 million. Since none of his children were interested in farming, Mr. Moloi directed in his will that the farm should be sold and the proceeds distributed equally amongst his children. Due to the profitability of the farm, the executor manages to sell the farm for R12 million.

In terms of Section 5(1) (a), the value which will be included for the estate duty calculation will be the R12 million realised from the sale of the farm. Had the farm not been sold, the value included for the same calculation would have been R7 000 000 (i.e. R10 million less 30%).

Income Tax: Recoupments

In the case where assets of a deceased estate are disposed of by the executor and a depreciation allowance was claimed by the deceased in respect of those assets, an amount equal to the difference between the selling price and the 'tax value'[9] of the asset could be subject to tax in the hands of either the estate or the heirs or legatees (it is a taxable recoupment).

Section 8(4) (a) of the Income Tax Act provides for such recoupments to be included in a taxpayer's income.[10]

Example

Mr. Nzama purchased a mini bus on the 1st of March 2011 to carry his workers to and from work every day. The purchase price of the minibus was R300 000. He claimed a wear and tear

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[7] Paragraph (b) of the definition of 'fair market value' in the Estate Duty Act 45, of 1955
[8] Commissioner for SARS V Estate Late HE Streicher, 66 SATC 282, 2005 (SCA)
[9] The tax value of an asset is the purchase price less any wear and tear or depreciation allowances allowed in respect of that asset.
[10] See also Paragraph (n) of the gross income definition.

allowance at a rate of 20% per annum on the straight line method. On the 1st of March 2015, he sold the minibus for R280 000. The tax value of the minibus is:

Original cost		**R 300,000.00**
Wear and Tear Allowance		
2011/2012	R 60,000.00	
2012/2013	R 60,000.00	
2013/2014	R 60,000.00	
2014/2015	R 60,000.00	
Total allowances claimed		R 240,000.00
Tax value (i.e. 300 000 – 240 000)		**R 60,000.00**

The taxable recoupment for the 2015/2016 is therefore:

Recoupment		
Actual Selling Price	R 280,000.00	
Less		
Tax value	R 60,000.00	
Taxable recoupment	**R 220,000.00**	

The amount of R220 000 will therefore be included in Mr. Nzama's gross income for the 2015/2016 tax year.

Section 25

Section 25 of the Income Tax Act now provides that income which is received by the executor of a deceased estate in his/ her capacity as such will be taxed in the hands of the estate.

If a business asset, for which an allowance was previously allowed in the determination of the taxable income of the deceased person, is disposed of by the executor during the winding up of the estate, a recoupment of such allowance will occur as described above. The executor will therefore be obliged to register the estate for income tax purposes and render returns for the periods until such time as the estate is wound up.

This can result in significant expenses for the estate.

Example

Dr Mathe purchased an ultrasound machine for his medical practice on the 1st of March 2013. The purchase price was R5 million. He dies on the 1st of March 2016. In terms of his will, all the equipment in his practice must be sold and the proceeds paid to his son Mduduzi who is not a medical practitioner. The ultrasound machine has been depreciated annually at 20% on a straight line basis. The executor manages to sell the machine for R3 million.

In this case, an amount of R1 million will be included in the estate's taxable income.

Original cost		**R 5,000,000.00**
Wear and Tear Allowance		
2013/2014	R1,000,000.00	
2014/2015	R1,000,000.00	
2015/2016	R1,000,000.00	
Total allowances claimed		**R 3,000,000.00**
Tax value (i.e. 5m – 3m)		**R 2,000,000.00**
Recoupment		
Selling Price	R3,000,000.00	
Less		
Tax value	R2,000,000.00	
Taxable recoupment	**R1,000,000.00**	

How can these risks be mitigated or avoided?

It goes without saying that proper estate planning is imperative to avoid any complications and ensure that the wishes of a testator are achieved with as little disruption as possible.

(1) The first port of call for any testator must be to ensure that there will be sufficient liquidity in their estate to avoid the forced sale of assets. This is where life insurance cover can be so critical.

(2) Professionals such as medical doctors and quantity surveyors who are constrained in as far as the succession of their businesses are concerned should look at entering into buy and sell

agreements to prevent the sale of assets in the winding up process. Such contracts which are contracted during the life time of the deceased to sell or dispose of property for a set consideration, cannot be regarded as a sale by the executor in the course of liquidation and the property must be valued at its fair market value and not the sale price.

(3) In some instances the use of trusts could negate the need to sell assets during the course of winding up an estate (for example where a farm is bequeathed to more than one heir).

(4) In some cases testators must leave the discretion to sell assets to their heirs and legatees. On the strength of the decision in the SARS V Estate Late HE Streicher case, assets sold by beneficiaries will not be deemed to have been sold in the course of liquidating the estate.

Conclusion

As can be seen, selling of assets during the course of winding up an estate can give rise to several complications. Given these potential risks, it is submitted that the option of selling assets must be a course of last resort.

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Renouncing the Accrual Claim on death: An opinion the tax implications

Shakira Bodasing CFP®
LLB, Adv PG Dip Fin Plan
Legal Adviser Manager
PFA : Johannesburg

Introduction

For Estate Planning purposes and in the process of drafting a Last Will and Testament, it is imperative to understand the legal implications of the marital regime on one's assets.

Since 1 November 1984, anyone entering into an ante nuptial contract (hereinafter referred to as an ANC) that excludes community of property and community of profit and loss is automatically married under the accrual system, unless expressly excluded in the ante nuptial contract.[1] When the accrual is included, the spouse with the smaller accrual will be entitled to share in the growth of the two estates on dissolution of the marriage.[2] Therefore an accrual claim can either be an asset (deemed asset) or a liability in a deceased estate. It is therefore important that provision is made for in the testator's estate plan.

For Estate Planning purposes this article is an opinion on whether the accrual claim can be renounced and the estate implications thereof.

To illustrate the implications of the accrual claim, a basic example is required:

VALUES	H	W
Current Net Asset Value	R35 000 000	R5 000 000
Less: Begin value	R0	R0
Accrual	R35 000 000	R5 000 000

ACCRUAL CLAIM

H's accrual	R35 000 000
W's accrual	R5 000 000
Net Accrual (difference)	R30 000 000
Accrual payable to W (50%)	**R15 000 000**

H and W are married out of community of property subject to the accrual system. They began the marriage with a R0 value. In the event that H and W passes on and they leave their estate to each other, the accrual will be set off against the inheritance. However, if they bequeath to anyone other than the spouse, the following concerns arise:

[1] Section 2 of the Matrimonial Property Act 88 of 1984
[2] Section 3 of the Matrimonial Property Act 88 of 1984

Scenario 1: H is the first dying

H's estate may not have the liquidity to pay the R15,000,000 accrual claim to W. W will get the accrual claim plus any inheritance in terms of the will, which may be more than H intended.

Can W, during the marriage, renounce her right to the accrual claim? Both W and H have a contingent right to a possible accrual claim during the marriage. After dissolution of marriage the contingent right becomes a vested right for one of the spouses. The timing of the renunciation is therefore important. Should W renounce her accrual before the dissolution of the marriage it is submitted that there shall be no donations tax payable as no asset or right to an asset vests in the surviving spouse before dissolution.

In the event that W renounces the right to the accrual claim after dissolution of the marriage, it is possible that donations tax can be payable at a rate of 20%. A donation is defined as *"any gratuitous disposal of a property including any gratuitous waiver or renunciation of a right."*[3]

It is accordingly further submitted that the donations tax exemption, which applies to donations between spouses,[4] would not apply in the case where the right to claim is waived after dissolution of marriage. Further, in answering this question of whether W can renounce her right to the accrual claim, one also needs to ascertain whether this will be enforceable on the executor as the claim is no longer against the deceased spouse but the spouse's estate (a separate legal persona).

The executor's position is a fiduciary one and therefore he must act not only in good faith but also legally. It must be in line with the last will and testament and law. It is accordingly submitted that should W renounce her right to the accrual claim before H's death, the executor will be able to enforce the renunciation provided same is not to the detriment of residual heirs.

Possible solution: A policy on H's life payable to his estate to settle the accrual claim. Bear in mind that the problem with this solution is that the life cover increases H's estate resulting in higher estate duty, executor's fees and increasing W's accrual claim. Policies payable directly to the deceased estate are included in the accrual calculation.[5]

Scenario 2: **W is the first dying**

Can the executor's of W's estate elect not to enforce the accrual claim against H?

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[3] Section 55 of the Income Tax Act 58 of 1962
[4] Section 56(1) of the Income Tax Act 58 of 1962
[5] Old Mutual Premiums and Problems Edition 2016, page E49

Section 3(1) of the Matrimonial Property Act[6] states the spouse whose estate shows no accrual or a smaller accrual than the estate of the other spouse, or his estate if he is deceased, acquires a claim against the other spouse or his estate. As stated above the executor has a fiduciary duty to the residual heirs. If there is no evidence that W renounced her right before the dissolution of the marriage (eg. in her Will) or if it will be to the detriment of the residual heirs, the executor should enforce the accrual claim.

Conclusion

As discussed above, persons married out of community with the accrual system may find themselves in financial positions that were unintended. Therefore it is imperative that financial planners implement sound estate plans and solutions for such clients. These estate plans will enable a smoother winding up of the estate and ensure that the intentions of the clients (testators) are carried out.

[6] Act 88 of 1984

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The impact of the new tax-laws on interest free loan accounts in the context of estate planning

Maryke Marais CFP®
B.Com (Law) LLB, PG Dip in Fin Plan
Legal Adviser Specialist
PFA: Central Region

Introduction

For many years, interest free loan accounts have been used to transfer assets from personal estates to trusts for estate planning purposes.

This article focuses on the tax implications of such loans in the estate planning environment.

The Taxation Laws Amendment Bill (tabled at Parliament on 26 October 2016) and the tax consequences thereof is also discussed. The Taxation Laws Amendment Bill 2016 introduces a new Section 7C, Loan or Credit Advance to a Trust by a Connected Person, in the Income Tax Act, No 58 of 1962 (hereinafter referred to as "the Act").

Background

The Davis Tax Committee has made a number of proposals with the intention to stop tax avoidance through the use of interest free loans to trusts. Until these proposals are signed into law, however, the position regarding CGT and estate duty remains the same.

Currently a person has three options to choose from when transferring assets to a trust.

(1) By way of donation. This option triggers donations tax at 20% of the fair market value of the assets donated as exceeds the R100,000 annual donations tax exemption, in the hands of the donor;

(2) Selling the assets to the trust is the second option. The sale is usually done on loan account at market related interest. The seller will be fully taxed on the interest paid by the trust. The interest exemption as available in section 10(1)(i) of the Act will be available to the seller;

(3) The third option involves the sale of assets to the trust on loan account at an interest rate that is below market rate or interest free. The interest charged will be taxable and once again the interest exemption is available to the seller.

Often, in current practice an asset will be sold to a trust, while the purchase price remains outstanding. This outstanding price may be funded, as mentioned in paragraph 3 above, with a loan account. This loan account is not subject to any interest (or very low interest) and payable on demand. This means that the value of the asset will increase the assets of the trust and the estate of the lender will be decreased with the asset value. The outstanding loan value will create an asset in the estate of the planner and will not increase with interest (or with very little interest) or in value over time, but will only decrease in value with the donations made by the lender to the trust as explained below.

The lender would generally donate the maximum annual donations tax exempt amount (currently R100, 000) per year in accordance with Section 56(2)(b) of the Act to the trust in reduction of the outstanding balance of the loan. This reduces the amount of the loan in the

estate and subsequently minimises estate duty by the tax free reduction of the value of the asset in the deceased estate.

The sale will likely also have capital gains tax (hereinafter referred to as "CGT") implications.

Estate planning analysis and reports usually deal extensively with the capital gains tax and estate duty implications of the transfer of assets to a trust.

In reality, as a result of the costs involved (for example CGT; transfer duty etc.), very few clients have the funds available to transfer an existing asset to a trust funded by a loan account.

Assuming a client does have the available funds, the costs and tax implications of such a transfer is set out below by means of an example.

The current position

Example[1]:

Mr. A[2] (40) owns a property which he bought 10 years ago. The current market value of the property is R5, 000,000 and the base cost is R2, 000,000. He would like to know the cost implications of transferring the property to a trust funded with an interest free loan, as was recommended to him. His marginal rate of tax is 41%.

Transfer of assets to the Trust

Estate planning

- The transfer of the asset by way of the interest free loan account will reduce the value of the estate of Mr. A with R5, 000,000 and increase the asset value of the trust with R5, 000,000.
- The outstanding amount of the loan will now be an asset in the estate of Mr. A. Thus, a R5, 000,000 asset loan account will be formed in Mr. A's estate.
- The loan account could be reduced with annual donations made to the trust by Mr. A with a value of (currently) R100, 000 per annum.
- The value of the asset will increase (grow) in the trust and not in the estate of Mr. A, as it has been doing in the past 10 years of ownership. The loan account will not increase in value, as it is interest free and payable on demand.

[1] Note that for the purposes of simplification, the calculations are done without regard to other forms of income, exemptions, rebates etc. and that simple interest is used throughout.
[2] References to the male gender also include the female and *vice versa*.

Capital Gain Tax payable on transfer

	R
Market value:	5,000,000
Less: Base cost	(2,000,000)
Capital gain	3,000,000
Less: Annual exclusion	(40,000)
Aggregate capital gain	2,960,000
Inclusion rate (40%)	
Taxable capital gain	1,184,000
Tax payable@ marginal tax rate (41%)	**R 485,440**

Transfer cost payable at date of transfer

The costs of transferring a property valued at R5, 000,000 will amount to approximately R45, 000.

Transfer duty payable at date of transfer

The transfer duty on a property of R5, 000,000 will amount to R387, 500.

Thus the total costs for this transaction (assuming there is no bond registered over the property) amounts to approximately R917, 940.

Estate duty payable on death

- In terms of Mr. A's will, the loan account is bequeathed to the beneficiaries of the trust.
- Should the loan account not be bequeathed to the trust, the executor of Mr. A's estate could demand repayment of the loan which could have severe financial implications on the trust; alternatively the loan account will be distributed according to the will and the heir/s will be able to demand repayment thereof.
- Estate duty will be calculated only on the outstanding portion of the loan account owed by the trust to the estate.
- In terms of Paragraph 12 of the Eighth Schedule to the Act, no capital gains tax will be payable on this bequest of the loan account to the trust.
- If no repayments were made and/or no donations were made in reduction of the loan account, the full amount of the loan will attract estate duty at 20%. Thus, disregarding any other influencing factors, estate duty would amount to R5, 000,000 X 20% = R1, 000,000.

To summarise this transaction: At date of transfer the cost to transfer the asset will be R917, 940. The growth in the value of the asset has been transferred to the trust with a subsequent saving in

estate duty over the long term. If donations in the amount of R100, 000 per annum were made to the trust by Mr. A for 5 years in reduction of the loan account, the value of his estate would be decreased with an amount of R500, 000 with a subsequent saving in estate duty of R100, 000. The value of the loan account will not increase as it attracts no interest. If we assume the asset that was transferred has increased in value with 6% per annum, the value of the asset after 5 years will be R6, 691,128. The growth of R1, 691,128 has taken place in the trust causing a saving in estate duty for Mr. A's estate of approximately R338, 226 on the growth value.

The proposed position from 1 March 2017

The Taxation Laws Amendment Bill, 2016 introduces measures to prevent estate duty and donations tax avoidance through transfer of assets to a trust using interest free loans.

The Bill proposes to introduce a new Section 7C to the Act. The effective date for the new Section 7C of the Act to come into operation is on 1 March 2017 and will apply for years of assessment ending after 1 March 2017 and will be applicable in respect of any amount owed by a trust in respect of a loan, advance or credit provided to that trust before, on or after that date[3]. The purpose of Section 7C of the Act is to limit a taxpayer's ability to transfer wealth without being subject to tax and is focused on interest free- or below market related interest rate loans to trusts. It is applicable where a loan is provided by natural person directly or indirectly to the trust connected to that person or where the natural person makes a loan to a trust that is not connected to him or her if someone connected to that person is connected to the trust. It also applies where certain companies makes loans to a trust at the instance of a natural person where the company is connected to that natural person by way of voting rights or shareholding, whether directly or indirectly.

Furthermore, Section 7C(3) of the Act states that an amount equal to the difference between the amount incurred by the trust as interest and the amount that would have been incurred by the trust at the official rate of interest (currently 8%), **must** be treated as a donation made to the trust on the last day of that year of assessment by the lender.

Section 7C(4) provides that where the loan is made by a company at the instance of more than one person connected to the company, then the donation is deemed to be made by the persons in the ratio of their equity shares or votes in the company to each other.

Section 7C(5) provides for exceptions where Section 7C2) and (3) will not be applicable, for instance if the trust is a public benefit organisation as approved by the Commissioner.

[3] Section 12(2) of the Taxation Laws Amendment Bill, 2016.

SUMMARY OF THE PROPOSED INCORPORATION OF SECTION 7C: "Loan or Credit Advance to a Trust by a Connected Person".

When is Section 7C of the Act applicable?

- If a loan is made, directly or indirectly, to a trust by a natural person, or by a company at the instance a person who is a "connected person" to the trust, as defined in terms of paragraph (d)(iv) of the definition of connected person in Section 1 of the Act.
- *Connected person*: A person is connected to the trust if he/she or any relative is a beneficiary of the trust.[4] A company is connected to the trust if any person individually or jointly with another connected person directly or indirectly holds at least 20% of the company's equity share capital or voting rights."[5]
- *Official Rate:* 1% above the repo rate and is currently at 8%.[6]

The implications of Section 7C of the Act

(a) If the trust incurs no interest or interest at a rate lower than the official rate of interest, the difference between the amount incurred by the trust and the amount that would have been incurred at the official rate of interest, must be treated as a donation made to the trust.[7]

(b) Thus, if a loan is made at 0% interest, 8% of the amount of the loan will be deemed a donation in the hands of the lender in that year of assessment and successive years of assessment, on the outstanding amount of the loan.

(c) Section 7C does not specifically exclude using the Section 56(2) of the Act yearly donation exemption to be set off against such deemed donation. It could thus be argued that the yearly donation exemption can be utilised for this purpose.

Application using the same facts as in the example above

CAPITAL GAINS TAX IMPLICATIONS	R
Market value:	5,000,000
Less: Base cost	(2,000,000)
Capital gain	3,000,000
Less: Annual exclusion	(40,000)
Aggregate Capital Gain	2,960,000
Inclusion rate (40%)	
Taxable Capital Gain	1,184,000

[4] Definition of connected person in terms of paragraph (bA) of the Act.
[5] Definition of connected person in terms of paragraph (d)(iv) of the Act.
[6] Johann Jacobs, *The fate of interest free loans?*, Cliffe Dekker Hofmeyr Trusts and Estates Alert, 20 July 2016.
[7] Section 7C(3) of the Taxation Laws Amendment Bill, 2016.

Tax payable@ marginal tax rate (41%)	**R 485,440**
TRANSFER COSTS	
Will remain the same:	R45,000
TRANSFER DUTY	
Will remain the same:	R387,500
DONATIONS TAX IMPLICATIONS	
Amount of loan	R5,000,000
Interest rate actually charged	0%
Current SARS interest rate(official rate)	8%
Amount to be treated as a donation for the tax year	R400,000
Less Section 56(2) donation exemption	R100,000
Taxable amount	R300,000
Donations tax payable @ 20%	**R60,000**

Estate Duty Implications

The seller will no longer be able to donate R100,000 per year in reduction of the outstanding loan account, as it is being utilised to reduce the amount of deemed interest. This means that the loan (asset) in his estate will never, during his lifetime (assuming the trust does not actually make payments towards settling the outstanding capital amount), reduce and estate duty could be payable on the full R5, 000,000 at a rate of 20%. Further growth of the asset will still take place in the trust, resulting in the subsequent estate duty and capital gains tax savings (as usual), but the tax free reduction in the value of the asset (loan) by way of yearly donations will no longer be possible.

Donations Tax Implications

Assuming the trust does not pay interest on the loan, and the value of the outstanding loan is not reduced by donations or repayments, donations tax of R60,000 per year will be payable by the lender.

It is clear that, to avoid paying donations tax in this context, the loan must attract interest of at least the official rate of interest per year and measures must be put in place to ensure that the trust receives enough income per year to actually pay the interest on the loan to the lender annually. The lender may then also utilise the yearly interest exemption and the Section 56(2) yearly donation exemption could still be utilised for purposes of reducing the outstanding amount of the loan account.

What could the possible industry responses to the new Section 7C of the Act be?

Some planners will consider unwinding the trust arrangement, but what they must remember and not lose sight of is the transactional costs and the tax consequences of such termination.[8]

What must also be remembered is that the unwinding of the trust must be a power that was granted by the founder to the trustees in terms of the trust deed and that such winding up must be to the benefit of the beneficiaries of the trust and done in accordance with the fiduciary duties of the trustees.[9]

Others might consider the changes an opportunity to revise current estate planning techniques involving trusts and contemplate ways to minimise the possible negative financial effects of the new legislation.

Conclusion

The proposed new tax changes will have far reaching implications for current estate planning techniques using trusts. Current estate planning techniques involving trusts will have to be revised to determine the sustainability thereof. Transferring assets to trusts will still have advantages, but estate duty savings can definitely no longer be the most important consideration in the decision making process. The particular circumstances of each person must be taken into account to determine whether it will still be an effective estate planning technique in the future.

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[8] Johann Jacobs, *The fate of interest free loans?*, Cliffe Dekker Hofmeyr Trusts and Estates Alert, 20 July 2016.
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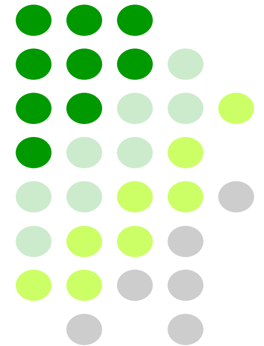

Retirement Planning

Is there still rationale for making excess contributions to a retirement fund

Natalie Dillon-van Acker CFP®
BCom (Law), LLB, Adv PG Dip in Fin Plan
Legal Adviser Advanced
Broker Distribution: Central Region

Introduction

Section 10C of The Income Tax Act[1] provides that previously disallowed contribution to a retirement fund can be offset against income at retirement. This provides an important tool to advisors when preparing a retirement plan for a client.

While Section 10C[2] provides an obvious income tax benefit, it must not be looked at in isolation when advising a client since the amendment to Section 3 (3)(a) of the Estate Duty Act[3] brings certain previously disallowed contributions[4] into the dutiable estate of the deceased member of the fund. This gives rise to tax implications which need to be considered before advising clients that the benefits of Section 10C[5] justify making contributions to a retirement fund that are in excess of the allowable deduction in any specific tax year. The choice of the beneficiary of the deceased's retirement fund will also impact on the tax payable on the funds and should also be considered.

The income tax consequences, both negative and positive, can also not be seen in isolation – the effect of Section 4(q) of the Estate Duty Act[6] must be given consideration and the age old benefits of a retirement fund and the income tax benefits at retirement may well outweigh the potentially negative tax consequences.

What qualifies as a previously disallowed contribution?

In terms of Section 11(k) of the Income Tax Act[7], with effect from 1 March 2016, a taxpayer qualifies for a deduction in respect of all contributions to a retirement fund (pension, provident and retirement annuity fund). The new deduction regime allows for a deduction of 27.5% of the greater of remuneration and taxable income, with the deduction being limited to R350 000 per annum. Contributions in excess of this limit will roll over to the subsequent tax years.

Let us illustrate this by way of an example:

Mrs Smith's taxable income for the 2016/2017 tax year is R1 800 000 and for the 2017/2018 tax year, her taxable income is R2 000 000 (we assume that the taxable income is greater than

[1] Act 58 of 1962
[2] Act 58 of 1962
[3] Act 45 of 1955
[4] Section 3(2) of the Estate Duty Act provides that any contributions made after 1 March 2015 by a person who dies after 1 January 2016, that:
- did not qualify as a deduction under sections 11(n) or (k), or
- was not applied under Section 10C of the Income Tax Act; or
- was not deducted from a taxable lump sum under Paragraph 2 of the Second Schedule of the Income Tax Act,

shall be included in the gross estate of the deceased.
[5] Act 58 of 1962
[6] Act 45 of 1955
[7] Act 58 of 1962

remuneration). She intends making a contribution of 27,5% of her taxable income to a retirement annuity fund.

In the 2016/2017 tax year, she qualifies for a deduction of 27.5% of her taxable income. This amounts to R495 000. Since her deduction is capped at R350 000, she qualifies for a deduction of R350 000 in the current tax year and R145 000 rolls over to the 2017/2018 tax year.

In the 2017/2018 tax year, she qualifies for a deduction of 27.5% of R2 000 000 which amounts to R550 000. Her deduction is capped at R350 000, there is thus R200 000 which is rolled over.

R145 000 has rolled over from the previous year and this will be added to the R200 000.

At the end of the 2017/2018 tax year, Mrs Smith will have previously disallowed contributions of R345 000.

The application of Section 10C

Section 10C of the Income Tax Act[8] provides that any contributions to a retirement fund that do not qualify for a deduction under Section 11(k) (or previously under Section 11 (n) which has subsequently been repealed) and which has also not been set off against a lump sum taken, may be deducted against the income from the compulsory annuity purchased with the fund proceeds at retirement.

Importantly, Section 10C[9] dies with the annuitant – it therefore does not pass to the surviving spouse or any other beneficiary of the annuitant, but will still be applied to the lump sum commutation by a beneficiary of a retirement fund since the taxpayer in such case is the deceased.

This is best illustrated by way of an example:

Let us assume that Mrs Smith, from our example above, continues to contribute to a retirement annuity fund for another 8 years, has accumulated R4 500 000 in her fund, has previously disallowed contributions of R1 800 000 and has taken no previous lump sums.

At retirement, Mrs Smith takes one third of her retirement annuity as a lump sum and purchases an annuity with the remaining two thirds.

- One third amounts to R 1 500 000 from which the R1 800 000 will be deducted

[8] Act 58 of 1962
[9] Act 58 of 1962

- Since the R1 800 000 exceeds the lump sum of R1 500 00, the excess of R 300 000 will be deducted from the income that she receives.
- Assuming that she draws an income of 5%, she will earn an annuity income of R150 000 in her first year of retirement. The R300 000 must be deducted from the R150 000 and will leave R150 000 previously disallowed contributions to roll over to the subsequent tax year.

This fact that Mrs Smith made contributions in excess of what she was allowed to deduct in a specific tax year provides her with a significant tax benefit at retirement.

She did not pay any tax on the R1 500 000 lump sum that she commuted, but this money is now voluntary money and no longer enjoys the benefits of being in a retirement fund. If she did not take a lump sum, the income tax benefit would have been greater as she would have had the full R1 800 000 to deduct against her annuity income.

This can, however, not be seen in isolation and one cannot assume that it is the best advice to a client that creating a tax free income at retirement is sufficient reason to make such excess contributions.

When advising a client, one needs to consider that at death:

(1) the unused previously disallowed contributions will be an asset in the deceased's estate

(2) if the benefit passes to a surviving spouse, the section 4(q)[10] deduction will be allowed but there are other tax consequences that need to be considered

(3) if the beneficiary elects to continue receiving an income, the unused previously disallowed contributions cannot be deducted from the income earned by the beneficiary. The benefit dies with the annuitant;

(4) if the beneficiary elects to commute the benefit due to him/her, it is taxable in the hands of the deceased and any unused previously disallowed contribution will be deducted from the lump sum benefit before applying the retirement tables; the lump sum becomes voluntary money and is subject to estate duty at the beneficiary's death.

The implications of death while still a member of the retirement annuity fund

In terms of Section 3 of the Estate Duty Act[11], any previously disallowed contributions made after 1 March 2015 to a retirement fund will be included in the gross estate of the deceased member of the fund.

[10] Estate Duty act 45 of 1955
[11] Act 45 of 1955

If Mrs Smith, in our example above, dies the day before she retires, the full R1 800 000 will thus be included in her estate and be subject to estate duty.

If we assume, however, that Mrs Smith has a surviving spouse who is the only beneficiary of the retirement annuity fund, the R1 800 000 will be included in her gross estate, but will qualify as a deduction under section 4(q) of the Estate Duty Act[12] and will thus be exempt from Estate Duty.

Consideration, however, also needs to be given to the income tax implications:

The surviving spouse has the option to commute the value of the fund or to purchase an income:

- If an income is elected, the Section 10C[13] benefit does not carry over to the surviving spouse and the income is thus taxed at the surviving spouse's marginal tax rate;
- If the value is commuted, the previously disallowed contributions will be deducted from the lump sum before the lump sum retirement tax tables are applied.

If we assume that Mrs Smith has no surviving spouse, there will be no section 4(q)[14] deduction allowed and the full R1 800 000 will be subject to estate duty of 20% in the deceased member's estate.

The R1 800 000, however, is still a previously disallowed contribution in the tax payer's hands and will thus be deducted from any lump sum commuted by the beneficiary prior to applying the retirement tax tables. In the beneficiary's hands, however, this after tax lump sum amount is now subject to estate duty and no longer enjoys the benefits that are afforded to funds in a retirement fund.

While this gives rise to additional estate duty in the deceased's estate, holistic financial planning for Mrs Smith would have ensure that she had sufficient liquidity in her estate to cover the additional estate duty. One must remember that the purpose of contributing to a retirement fund is not the tax benefit or saving in estate duty, the actual purpose of the accumulation of retirement capital in a tax efficient vehicle. The benefits afforded to funds in a retirement annuity would, in most cases, have justified the additional cost of life cover.

Another point for consideration is that, putting additional funds (i.e. in addition to one's allowable contribution) into a retirement annuity does not create an additional estate duty cost – the money was voluntary money to start off with and, regardless of how the money was invested, it would be subject to estate duty in any case.

[12] Act 45 of 1955
[13] Income Tax Act 58 of 1962
[14] Estate Duty Act 45 of 1955

The benefit under Section 10C does not pass to the beneficiary, so if the beneficiary elects to receive an income, he or she will be taxed at her marginal rate on the annuity income. The benefits of the money being in a retirement fund will continue to be enjoyed by the beneficiary.

The implications of death after retirement from the retirement annuity fund

Continuing with Mrs Smith's example and if we assume that she dies one year into retirement, she will have utilised R1 500 000 of the previously disallowed contributions against the lump sum that she took and she would have used R150 000 of the remaining R300 000. Only R150 000 would thus be included in the dutiable estate of Mrs Smith.

The tax benefit to her would thus have been significant. And, again, since the purpose of a retirement fund is to fund retirement as tax efficiently as possible, is this not what one should be focussing on when planning for retirement.

Conclusion

The reality is that the question of whether there is still rationale for making excess contributions to a retirement fund, will not affect your average corporate employee since their existing contributions to their employer's retirement fund and to their retirement annuity fund will more than likely fall comfortably within the 27,5% deduction limitation and the R350 000 cap.

The question is more significant for very high earners and individuals with significantly high net asset values since their 27.5% of the greater of remuneration or taxable income will generally be much higher than the cap of R350 000.

What this article aims to highlight is that there is no right or wrong answer to the question.

Is taking the risk of paying estate duty on previously disallowed contributions justified by the chance of being able to earn a tax free income from one's retirement capital?

What would the client do with the excess contributions? If they are needed to achieve the capital need at retirement, why would one cap one's contribution at R350 000?

If the money is not needed to achieve the retirement capital, should the client not be considering a trust?

Is enjoying the benefit of the tax free build up, insolvency protection and other benefits of retirement funds a good enough reason for one to contribute the excess to one's retirement fund?

There are more questions than answers and what it boils down to is that it is the responsibility of the financial advisor to understand the purpose and benefits of a retirement fund and be able to match the client's needs in terms of investment objectives, income needs, taxes and liquidity at retirement as well as at death. The clients need to be informed and advised in such way that they are able to make an informed decision.

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The Tax Deduction for Contributions to Retirement Funds – The Latest Developments

Carl Muller CFP®
BLC, LLB, LLM (Tax Law), Adv PG Dip in Fin Plan
Legal Adviser Manager
PFA : Western Cape

Introduction

The South African retirement landscape has undergone significant changes in recent times, with undoubtedly more amendments to follow in future. This article will focus on the tax deduction regime for contributions to retirement funds post 1 March 2016, with specific reference to the 2016 Draft Taxation Laws Amendment Bill.

The tax deduction regime for contributions to retirement funds post 1 March 2016

From 1 March 2016 section 11(k) of the Income Tax Act[1] (hereinafter referred to as "the Act") has been amended to provide that the tax deduction for contributions to a pension, provident or retirement annuity fund by a member of the fund will be limited to the greater of 27.5% of that person's remuneration as defined in the Fourth Schedule to the Act or taxable income as determined before allowing this deduction. Retirement lump sum benefits, retirement fund lump sum withdrawal benefits and severance benefits are expressly excluded from both remuneration and taxable income for purposes of this calculation. The deduction is further limited to a maximum amount of R350 000 per year of assessment. The effect of this amendment is that the tax deduction for members' contributions to pension, provident and retirement annuity funds is now treated in the same fashion. Before 1 March 2016 members' contributions to provident funds were not tax deductible and the tax deduction for members' contributions to pension funds[2] was treated differently to the tax deductions for members' contributions to retirement annuity funds[3].

One of the points of criticism levied against section 11(k) in its current form is that the deduction is only allowed against income from trade[4], and not against passive sources of income such as annuity income or the taxable portion of interest earned. The Draft Taxation Laws Amendment Bill 2016 and Explanatory Memorandum thereto were however published on 8 July 2016, and the Bill was tabled before parliament on 26 October 2016. If this Bill is legislated in its current form, the deduction will also be allowed against passive forms of income[5]. This Bill further proposes that the 27.5% deduction be applied before applying this deduction (in respect of contributions to retirement funds) and before allowing for the section 18A deduction (the deduction for

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[1] Act 58 of 1962, as amended.

[2] Section 11(k) was amended by section 27 (1) (*j*) of Act No. 31 of 2013 and substituted by section 27 (1) (*k*) of Act No. 31 of 2013, as substituted by section 122 (1)(*a*) of Act 43 of 2014) with effect from 1 March, 2016.

[3] Section 11(n) deleted by section 27 (1) (*m*) of Act 31 of 2013 with effect from 1 March, 2016 and applicable in respect of amounts contributed on or after that date. Effective date in section 27(3) of Act 31 of 2013 as substituted by section 122 (1) (*b*) of Act 43 of 2014.

[4] The preamble to section 11(k) provides as follows:" For the purpose of determining the *taxable income derived by any person from carrying on any trade*, there shall be allowed as deductions from the income of such person so derived—"

[5] Section 27(1)(c) of the Draft Taxation Laws Amendment Bill of 2016 proposes to add the following paragraph after paragraph (iv) of section 11(k):

"(v) any deduction in terms of this paragraph must apply for the purpose of determining the total amount of taxable income, before any deduction in terms of section 18A or the inclusion of any taxable capital gain of the person, *whether derived from the carrying on of any trade or otherwise*;".

It is proposed that this section be applicable from 1 March 2016.

donations by the taxpayer to certain organisations)[6]. It thus appears that the calculation of "27.5% of taxable income" would include taxable capital gains and taxable allowances (e.g. the taxable portion of a travel allowance that an employee receives). The deduction itself is however applied before adding taxable capital gains and before allowing for the section 18A deduction[7].

Section 11(k)(ii) further provides that amounts contributed in any previous year of assessment which has been disallowed as a tax deductions solely as a result of it exceeding the amount of the allowable deduction in that year of assessment, will be deemed to be an amount contributed in the current year of assessment, unless

(i) it has already been allowed as a deduction in any year of assessment, or

(ii) it has been allowed as a deduction against retirement lump sums or retirement withdrawal lump sums[8], or

(iii) it has been exempted against compulsory annuity income[9].

The effect of Section 11(k)(ii) is thus that contributions not allowed as a deduction in previous years of assessment because it is higher than the allowable amount of deduction, can be carried forward to following years of assessment and applied in such years, subject to the limits discussed above. The language used in section 11(k)(ii) also indicates that this is also applicable to disallowed contributions made by members before 1 March 2016. The one aspect that however seemed to be uncertain is whether Section 11(k)(ii) applies to disallowed contributions made to all retirement funds prior to 1 March 2016, or only to pension and retirement annuity funds. In this regard it is submitted that the language used in Section 11(k)(ii) [10] is open for 2 possible interpretations:

(i) Only contributions made to pension and retirement annuity funds before 1 March 2016 can be carried forward to following years of assessment for purposes of the Section 11(k) deduction after 1 March 2016, because no deduction was allowed for members'

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[6] Section 26(1)(b) of the Draft Taxation Laws Amendment Bill of 2016 proposes to substitute paragraph (i)*(bb)*of the proviso to paragraph *(k)* for item (B) with the following:

"(B) taxable income (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as determined before allowing any deduction under this paragraph and section 18A;"

[7] Section 26(1)(c) of the Draft Taxation Laws Amendment Bill of 2016 proposes to add the following paragraph after paragraph (iv) of section 11(k):

"(v) any deduction in terms of this paragraph must apply for the purpose of determining the total amount of taxable income, *before any deduction in terms of section 18A or the inclusion of any taxable capital gain of the person*, whether derived from the carrying on of any trade or otherwise;".

[8] In terms of paragraph 5(1)(*a*) or 6(1)(*b*)(i) of the Second Schedule of the Act.

[9] In terms of section 10C of the Act

[10] Section 11(k)(ii) provides as follows:

"(ii) any *amount so contributed in any previous year of assessment* which has been disallowed solely by reason of the fact that it exceeds the amount of the deduction allowable in respect of that year of assessment is deemed to be an amount so contributed in the current year of assessment.."

contributions to provident funds prior to 1 March 2016. To put it differently: contributions made by members to provident funds prior to 1 March 2016 has not "*been disallowed solely by reason of the fact that it exceeds the amount of the deduction allowable in respect of that year of assessment*" as no deduction existed for members contributions to provident funds prior to 1 March 2016.

(ii) Contributions of members to provident funds prior to 1 March 2016 should also be allowed as a deduction under Section 11(k)(ii) as such contributions would have exceeded the allowable deduction prior to 1 March 2016. To put it differently: contributions made by members to provident funds prior to 1 March 2016 has "*been disallowed solely by reason of the fact that it exceeds the amount of the deduction allowable in respect of that year of assessment*" because the allowable deduction for members contributions to provident funds prior to 1 March 2016 was 0, and therefore any contribution made by a member before this date exceeded the allowable deduction.

It would appear that Treasury has taken the view that the position as set out in (i) above is the correct interpretation of Section 11(k)(ii), i.e. that only contributions made to pension and retirement annuity funds prior to 1 March 2016 that exceeded the allowable deduction, will be allowed to be carried over to future years of assessment from 1 March 2016. On page 5 of the Explanatory Memorandum to the Draft Taxation Laws Amendment Bill 2016 the following is stated:

"*The 2016 changes to the legislation relating to the harmonisation of the tax treatment of contributions to retirement funds applies to contributions made after 1 March 2016, and any contributions above the limit to any retirement fund can be rolled over to the following year. However, these legislative changes do not cater for any excess contributions made before 1 March 2016 and previous contributions above the limit to retirement annuity funds can no longer be rolled over. Contributions above the limits to both retirement annuity funds and pension funds made before 1 March 2016 would then not be afforded the rollover treatment and could only be received tax free at retirement.*"

The following *proposal* is then referred to on page 5 of the Explanatory Memorandum:

To continue with the current rollover treatment for retirement annuity funds and align the treatment for excess contributions to pension funds it is proposed that excess contributions to both of these funds before 1 March 2016 should be allowed to be rolled over and deducted in the following tax year. Excess provident fund contributions would not be allowed to be rolled over since there was no requirement for provident funds to purchase an annuity before 1 March 2016.

It is interesting to note that his paragraph appears to indicate that there is a proposed amendment seeking to clarify that only non-deductible contributions made to pension and retirement annuity funds prior to 1 March 2016 will be rolled over and be deductible in the next tax year, and that this concession will not be afforded to non-deductible contributions made to provident funds prior to 1 March 2016. The 2016 Taxation Laws Amendment Bill however does not

propose to amend Section 11(k)(ii), and it is uncertain why this statement was made in the Explanatory Memorandum.

It is however submitted that contributions made to provident funds on or after 1 March 2016 that exceeds the allowable deduction in terms of the regime applicable from this date, will be carried over to the following year of assessment by virtue of the fact that it "*has been disallowed solely by reason of the fact that it exceeds the amount of the deduction allowable in respect of that year of assessment*".

Where the employer of a member of a pension, provident or retirement annuity fund makes a contribution on behalf of the member (employee), this contribution will be a fringe benefit in the hands of the member[11] and it will also be deemed to be a contribution made by the employee for purposes of calculating the deduction under section 11(k)[12]. The value of this fringe benefit in the case of a defined benefit fund is calculated in terms of paragraph 12D of the Seventh Schedule to the Act, but it will not be discussed in this article.

If the proposed amendments to section 11(k) as per the 2016 Taxation Laws Amendment Bill are legislated, it is submitted that the correct methodology to calculate the maximum allowable deduction in this regard will be as follows:

(i) Establish the remuneration of the taxpayer. Here it is important to understand what constitutes remuneration.

Remuneration is defined in paragraph 1 of the Fourth Schedule to the Act and includes salaries, leave pay, wages, overtime pay, bonuses, gratuities, commission, fees, emoluments, pension, superannuation allowances, retiring allowance or stipends, annuities (compulsory or voluntary annuities), restraint of trade payments, taxable proceeds of employer owned policies accruing to an employee, amounts received or accrued in commutation of amounts due under any contract of employment or service, 80% of the travel allowance of an employee (unless the employer is satisfied that at least 80% of the use of the motor vehicle will be for business purposes, in which case remuneration will constitute 20% of the travel allowance), the value of shares received under share incentive schemes under section 8C of the Act, etc.

Remuneration will include the amount of the contribution made by the employer on behalf of the employee, as discussed above.

Remuneration does not include amounts received by independent contractors (i.e. who are not employees) for services rendered, pensions received under the Aged Pensions Act or Blind

[11] Section 11(k)(iii)(aa) of the Act, read with paragraph 2(l) of the Seventh Schedule to the Act
[12] Section 11(k)(iii)(bb) of the Act

Pensions Act, disability grants, children grants, amounts paid to an employee in respect of expenditure incurred by the employee in the course of his employment, or annuities received under a divorce order or decree of judicial separation or any agreement of separation.

Further bear in mind that section 11(k)(i)(bb)(A) expressly excludes retirement lump sum benefits, retirement fund lump sum withdrawal benefits and severance benefits from remuneration for purposes of calculating the deduction.

(ii) Establish the taxable income for calculating the section 11(k) deduction of the taxpayer.

The taxable income of the member would thus be established as follows:

Gross income (this will include the amount of the contribution made by the employer on behalf of the employee, as discussed above).

Minus exemptions

Minus Deductions (excluding the deduction under section 11(k))

Plus taxable allowances (taxable portion of travel allowance etc.)

Plus taxable capital gain

= Taxable income *for purposes of calculating the section 11(k) deduction.*

Section 11(k)(i)(bb)(B) in this instance also expressly excludes retirement lump sum benefits, retirement fund lump sum withdrawal benefits and severance benefits from taxable income for purposes of calculating the deduction.

(iii) Establish which one of the amounts calculated in step (i) or (ii) is higher and multiply the higher amount with 27.5%.

If the answer is less than R350 000, this is *potentially* the deductible amount, if it is R350 000 or higher, R350 000 is *potentially* the deductible amount.

(iv) Calculate the taxable income again as per step (ii) again, but only up to the point before the taxable capital gain is added. Thus:

Gross income

Minus exemptions

Minus Deductions (excluding the deduction under section 11(k))

Plus taxable allowances (taxable portion of travel allowance etc.)

= Amount from which the section 11(k) deduction is deducted.

(v) If the amount in step (iii) is lower than then answer in step (iv) the full amount in step (iii) is deducted, i.e. the amount calculated in step (iii) will be the maximum deduction allowed under section 11(k).

If the amount calculated in step (iv) is smaller than the amount calculated in step (iii), the maximum allowable deduction under section 11(k) will be limited to the amount calculated in step (iv). This situation will only occur in some of the instances where a taxable capital gain is included in the taxable income of the member (as per step (ii)), and the taxable capital gain exceeds the income calculated before adding the taxable capital gain.

(vi) If the amount that the taxpayer contributed to one or more pension, provident or retirement annuity fund is less than the maximum amount calculated in step (v), the taxpayer may of course only deduct the amount that he or she contributed.

If the amount that the member contributed to one or more pension, provident and retirement annuity fund in the year of assessment is bigger than the deduction calculated in step (v), the difference between the amount so contributed and the deduction calculated in step (v) will be carried over to the next year of assessment.

In this regard always bear in mind that the amount contributed by the employer of the member (where applicable) will be a taxable fringe benefit in the hands of the member (employee) but will also be deemed to be a contribution made by the member for purposes of calculating the deduction under section 11(k).

The following are examples of the calculation of the section 11(k) deduction. The calculations are based on the assumption that the amendment of section 11(k) as provided for in the 2016 Taxation Laws Amendment Bill is enacted.

Example 1: Taxpayer earning a salary

Mr John Smith is employed by ABC (Pty) Ltd, and earns a salary of R1 500 000 per annum. In addition to this his employer contributes R150 000 to his pension fund, and Mr Smith also contributes R150 000 to this pension fund. He also contributed R200 000 to a retirement annuity fund in this year of assessment (2016/2017). His total contributions thus amount to R500 000 per annum.

(i) His total remuneration is thus R1 650 000 (R1 500 000 plus the fringe benefit of R150 000).

(ii) In this instance his total taxable income *for purposes of calculating the section 11(k) deduction* will also be:

R1 500 000 plus R150 000 (annual employer contribution to pension fund)

= R1 650 000 (gross income) minus R0 (exemption)

= R1 650 000 minus R0 (deductions other than section 11(k)) plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R1 650 000 (taxable income)

(iii) Remuneration and taxable income is thus the same in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R1 650 000 x 27.5% = R453 750. As this amount exceeds R350 000 the amount *potentially* deductible under section 11(k) is limited to R350 000.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

R1 500 000 plus R150 000 (employer contribution to pension fund)

= R1 650 000 (gross income) minus R0 (exemption)

=R1 650 000 (income) minus R0 (deductions other than section 11(k))

= R1 650 000 (taxable income)

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R350 000 is fully deductible under section 11(k).

(vi) The balance of R150 000 (R500 000 contribution minus R350 000 deduction allowed under section 11(k)) is carried forward to the next year of assessment.

If we thus calculate the taxable income of Mr Smith for the 2016/2017 year of assessment, it will be:

R1 500 000 + R150 000 (employer contribution to the pension fund is a taxable fringe benefit)

= R1 650 000 (taxable income) – R0 (exemptions)

= R1 650 000 (income) – R350 000 (deduction under section 11(k) = R1 300 000 + R0 (taxable allowances) + R0 (taxable capital gain)

= R1 300 000 (taxable income).

Example 2: Taxpayer earning a salary with contributions to retirement funds not allowed as a deduction in the previous year of assessment

In the following year of assessment (2017/2018) Mr Smith (see Example 1) earns R1 600 000. In addition to this his employer makes a contribution of R160 000 to his pension fund. Mr Smith also contributes R160 000 to his pension fund, but makes no contributions to his retirement annuity fund in this year, bringing the total contributions to R320 000. We however have to add the non-deductible contributions brought forward from previous years of assessment and add this to his

contributions in this year of assessment, i.e. R320 000 + R150 000 = R470 000 total deemed contributions made for this year of assessment.

(i) His total remuneration is thus R1 760 000 (R1 600 000 plus the fringe benefit of R160 000).

(ii) In this instance his total taxable income *for purposes of calculating the section 11(k) deduction* will also be:

R1 600 000 plus R160 000

= R1 760 000 (gross income) minus R0 (exemption)

= R1 760 000 (income) minus R0 (deductions other than section 11(k)) plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R1 760 000 (taxable income)

(iii) Remuneration and taxable income is thus the same in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R1 760 000 x 27.5% = R484 000. As this amount exceeds R350 000 the amount *potentially* deductible under section 11(k) is limited to R350 000.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

R1 600 000 plus R160 000

= R1 760 000 (gross income) minus R0 (exemption)

= R1760 000 minus R0 (deductions other than section 11(k))

= R1 760 000 + R0 (taxable allowances)

= R1 760 000 (taxable income)

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R350 000 is fully deductible under section 11(k).

(vi) The balance of R120 000 (R320 000 contribution in 2017/2018 year of assessment plus R150 000 contribution carried over from 2016/2017 year of assessment = R470 000 contribution & deemed contribution minus R350 000 deduction allowed under section 11(k)) is carried forward to the next year of assessment.

If we thus calculate the taxable income of Mr Smith for the 2016/2017 year of assessment, it will be:

R1 600 000 + R160 000 (employer contribution to the pension fund is a taxable fringe benefit)

= R1 760 000 (gross income) – R0 (exemptions)

= R1 760 000 (income) – R350 000 (deduction under section 11(k) = R1 410 000 + R0 (taxable allowances) + R0 (taxable capital gains)

= R1 410 000 (taxable income).

Example 3: Taxpayer is a sole proprietor not earning remuneration

Mr Simon Tshabalala, aged 45, is the sole proprietor of a business. He earned R500 000 in the current year of assessment from his business, and incurred expenses in the amount of R100 000, which expenses are deductible in terms of Section 11(a) of the Income Tax Act. He also earned local interest in the amount of R50 000 from his money market account and R30 000 local dividends from his unit trust portfolio.

Mr Tshabalala wants to know what the maximum allowable deduction he is entitled to in respect of contributions to a retirement annuity fund.

(i) Mr Tshabalala has no remuneration – he is not an employee but a sole proprietor, essentially earning income as an independent contractor. The R50 000 interest and R30 000 dividends earned also do not constitute remuneration.

(ii) In this instance his total taxable income *for purposes of calculating the section 11(k) deduction* will be:

R500 000 (business income) plus R50 000 (interest) + R30 000 (dividends)

= R580 000 (gross income) minus R23 800 (interest exemption for persons younger than age 65) minus R30 000 (exempt local dividends)

= R526 200 (income) minus R100 000 (deduction under section 11(a) for expenses incurred in the production of income)

= R426 200 plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R426 200 (taxable income *for purposes of calculating the section 11(k) deduction).*

(iii) Taxable income is thus higher than remuneration in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R426 200 x 27.5% = R117 205. As this amount is smaller than R350 000 the amount *potentially* deductible under section 11(k) is limited to R117 205.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

R500 000 (business income) plus R50 000 (interest) + R30 000 (dividends)

= R580 000 (gross income) minus R23 800 (interest exemption for persons younger than age 65) minus R30 000 (exempt local dividends)

= R526 200(income) minus R100 000 (deduction under section 11(a) for expenses incurred in the production of income)

= R426 200 plus R0 (taxable allowances)

= R426 200 (taxable income before adding taxable capital gains).

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R117 205 is the maximum amount deductible under section 11(k).

(vi) He is currently not contributing to any fund, so he will not be allowed to deduct any amount under section 11(k).

If Mr Tshabalala however decides to contribute the maximum allowable deduction under section 11(k), taxable income for the year of assessment will be:

R500 000 (business income) plus R50 000 (interest) + R30 000 (dividends)

= R580 000 (gross income) minus R23 800 (interest exemption for persons younger than age 65) minus R30 000 (exempt local dividends)

= R526 200 (income) minus R100 000 (deduction under section 11(a) for expenses incurred in the production of income) – R117 205 (deduction under section 11(k))

= R308 995 plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R308 995 (taxable income).

Example 4: Taxpayer is both an employee and a sole proprietor

Mr Andrew Naidu is employed and earns R400 000 per year. His employer contributes R40 000 to his pension fund and Mr Naidu contributes R40 000 to his pension fund. Mr Naidu is also the sole proprietor of a business. As a result of non-favourable economic circumstances, he only earned R100 000 in the current year of assessment from his business, whilst incurring expenses in the amount of R150 000 (which expenses are deductible in terms of section 11(a) of the Act). The assessed loss of his business is also not ring fenced in terms of section 20A of the Act.

Mr Naidu wishes to supplement his retirement savings and wants know what the maximum allowable tax deduction he is entitled to in respect of contributions to a retirement annuity fund.

(i) Mr Naidu's remuneration is:

R400 000 (salary) plus R40 000 (fringe benefit in respect of contributions by employer)

= R440 000 (remuneration)

(ii) The taxable income *for purposes of calculating the section 11(k) deduction* of Mr Naidu is:

R400 000 (salary) plus R40 000 (fringe benefit in respect of contributions by employer) plus R100 000 (business income)

= R540 000 (gross income) minus R0 (exemptions)

= R540 000 (income) minus R150 000 (expenses incurred in the production of income)

= R390 000 (taxable income) plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R390 000 (taxable income *for purposes of calculating the section 11(k) deduction).*

(iii) His remuneration is thus higher than his taxable income in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R440 000 x 27.5% = R121 000. As this amount is smaller than R350 000 the amount *potentially* deductible under section 11(k) is limited to R121 000.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

R400 000 (salary) plus R40 000 (fringe benefit in respect of contributions by employer) plus R100 000 (business income)

= R540 00 (gross income) minus R0 (exemptions)

= R540 000 (income) minus R150 000 (expenses incurred in the production of income)

= R390 000 (taxable income) plus R0 (taxable allowances)

= R390 000 (taxable income before adding possible capital gains tax).

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R121 000 is the maximum amount deductible under section 11(k).

(vi) He is currently contributing R80 000 (R40 000 own contributions plus R40 000 contributions made by employer and deemed to be made by Mr Naidu) to his pension fund, so he will allowed to deduct the full R80 000 under section 11(k).

Mr Naidu will thus be allowed to contribute a further R41 000 (R121 000 minus R80 000 contributions already made) tax-deductible contributions to a retirement annuity fund. If he does this, his taxable income for the year would be:

R400 000 (salary) plus R40 000 (fringe benefit in respect of contributions by employer) plus R100 000 (business income)

= R540 000 (gross income) minus R0 (exemptions)

= R540 000 (income) minus R150 000 (section 11(a): expenses incurred in the production of income) – R121 000 (section 11(k))

= R269 000 (taxable income) plus R0 (taxable allowances) + R0 (taxable capital gain)

= R269 000 (taxable income).

Example 5: Taxpayer is a retiree earning annuity income

Mr Piet Ferreira has retired from ABC retirement annuity fund and is earning income from a compulsory annuity in the amount of R300 000 per annum. All his contributions to this retirement annuity fund were previously allowed as a deduction for income tax purposes.

In the 2016-2017 year of assessment Mr Ferreira is however still making contributions to the XYZ retirement annuity fund in the amount of R50 000 per annum.

Mr Ferreira wants to know whether he can deduct the premiums of R50 000 under section 11(k).

(i) Mr Ferreira's remuneration is:

R300 000 (annuity)

= R300 000 (remuneration)

(ii) The taxable income *for purposes of calculating the section 11(k) deduction* of Mr Ferreira is:

R300 000 (annuity) = R300 000 (gross income) minus R0 (exemptions)

= R300 000 minus R0 (deductions)

= R300 000 (taxable income) plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R300 000 (taxable income *for purposes of calculating the section 11(k) deduction).*

(iii) His remuneration is thus equal to his taxable income in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R300 000 x 27.5% = R82 500. As this amount is smaller than R350 000 the amount *potentially* deductible under section 11(k) is limited to R82 500.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

R300 000 (annuity = gross income) minus R0 (exemptions)

= R300 000 (income) minus R0 (deductions)

= R300 000 (taxable income) plus R0 (taxable allowances)

= R300 000 (taxable income before adding possible capital gains tax).

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R82 500 is the maximum amount deductible under section 11(k).

(vi) He is currently however contributing R50 000 to the XYZ retirement annuity fund, so he will be allowed to deduct R50 000 under section 11(k).

If we assume that Mr Ferreira is not going to increase his contributions to his retirement annuity fund, his taxable income for the year would be:

R300 000 (annuity = gross income) minus R0 (exemptions)

= R300 000 (income) minus R50 000 (section 11(k) deduction: although he can deduct up to R82 500, he only contributed R50 000 to the XYZ retirement annuity fund.)

= R250 000 (taxable income) plus R0 (taxable allowances) + R0 (taxable capital gains)

= R250 000 (taxable income for the year of assessment).

Example 6: Taxpayer is an employee receiving a travel allowance

Mr John Jacobs is employed and earns R400 000 per year. His employer contributes R40 000 to his pension fund and Mr Jacobs contributes R40 000 to his pension fund. Mr Jacobs also receives a travel allowance of R50 000 per year. His employer is not satisfied that at least 80% of the use of his motor vehicle will be for business purposes. At the end of the tax year the taxable portion of the travel allowance is calculated to be R20 000. Mr Jacobs wants to contribute to a retirement annuity fund and wishes to know what the maximum deduction is that he will be entitled to.

(i) Mr Jacobs' remuneration is:

R400 000 (salary) + R40 000 (employer's contribution to pension fund) + R40 000 (R50 000 travel allowance x 80%: as per the definition of remuneration 80% of his travel allowance will form part of his remuneration unless his employer is satisfied that at least 80% of the use of his motor vehicle will be for business purposes, in which case 20% of the travel allowance will be included as remuneration)

= R480 000 (remuneration)

(ii) The taxable income *for purposes of calculating the section 11(k) deduction* of Mr Jacobs is:

R400 000 (salary) + R40 000 (employers contribution to pension fund)

= R440 000 (gross income) – R0 (exemptions)

= R440 000 (income) – R0 (deductions) + R20 000 (calculated taxable portion of his travel allowance) + R0 (taxable capital gain)

= R460 000 (taxable income for purposes of calculating the section 11(k) deduction)

(iii) His remuneration is thus higher than his taxable income in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R480 000 x 27.5% = R132 000. As this amount is smaller than R350 000 the amount *potentially* deductible under section 11(k) is limited to R132 000.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

R400 000 (salary) + R40 000 (employers contribution to pension fund)

= R440 000 (gross income) – R0 (exemptions)

(v) = R440 000 (income) – R0 (deductions) + R20 000 (calculated taxable portion of his travel allowance)

= R460 000 (taxable income (taxable income before adding possible capital gains tax*)*.

(vi) As the amount calculated in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R132 000 is the maximum amount deductible under section 11(k).

(vii) He is currently however contributing R80 000 to his pension fund (including the contributions made by the employer, deemed to be made by Mr Jacobs), and he will therefore be allowed to deduct R80 000 under section 11(k).

Mr Jacobs will be allowed to contribute a further R52 000 (R132 000 minus R80 000 contributions already made) tax-deductible contributions to a retirement annuity fund. If he does this, his taxable income for the year would be:

His taxable income before allowing for possible taxable capital gains is thus:

R400 000 (salary) + R40 000 (employers contribution to pension fund)

= R440 000 (gross income) – R0 (exemptions)

= R440 000 (income) – R132 000 (section 11(k) deduction) + R20 000 (calculated taxable portion of his travel allowance) + R0 (taxable capital gain)

= R328 000 (taxable income).

If his employer was satisfied that at least 80% of the use of his motor vehicle will be for business purposes and included only 20% of the allowance in his remuneration, his remuneration would be as follows:

R400 000 (salary) + R40 000 (employer's contribution to pension fund) + R10 000 (as per the definition of remuneration 20% of his travel allowance will from part of his remuneration where his employer is satisfied that at least 80% of the use of his motor vehicle will be for business purposes)

= R450 000.

If this was the case in this example his remuneration (R450 000) would be less than his taxable income (R460 000) and we would use the taxable income for calculating the section 11(k) deduction.

Example 7: Taxpayer earning income that is lower than taxable capital gain made

This example is adapted from an example provided in the Explanatory Memorandum to the 2016 Draft Taxation Laws Amendment Bill[13].

Mr Thrift (aged 37) receives remuneration of R75 000 for part-time work over the course of the 2016/17 year of assessment. He also receives R10 000 in interest from a money market account and sells unit trusts to receive a capital gain of R790 000. The value of the taxable capital gain is R300 000 (R790 000 – R40 000 annual exclusion for individuals = R750 000 x 40% inclusion rate for individuals). Before the end of the year he contributes R100 000 to his retirement annuity fund. He wants to know what the maximum deduction is that he will enjoy under section 11(k).

(i) Mr Thrift's remuneration is:

R75 000 (part time work)

(ii) The taxable income *for purposes of calculating the section 11(k) deduction* of Mr Thrift is:

= R75 000 (salary) + R10 000 (interest)

= R85 000 (gross income) – R10 000 (interest exemption limited to R23 800 for persons under age 65)

[13] Page 4 of the Explanatory Memorandum.

= R75 000 (income) – R0 (deductions) + R0 (taxable allowances) + R300 000 (taxable capital gain)

R375 000 (taxable income for purposes of calculating the section 11(k) deduction)

(iii) His taxable income is thus higher than his remuneration in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R375 000 x 27.5% = R103 125.

As this amount is smaller than R350 000 the amount *potentially* deductible under section 11(k) is limited to R103 125.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

= R75 000 (salary) + R10 000 (interest)

= R85 000 (gross income) – R10 000 (interest exemption limited to R23 800 for persons under age 65)

= R75 000 (income) – R0 (deductions) + R0 (taxable allowances)

= R75 000 (taxable income before adding taxable capital gains tax).

(v) As the amount in (iv) is smaller than the answer in (iii), the amount calculated in (iv), i.e. R75 000 is the maximum amount deductible under section 11(k).

(vi) He is currently contributing R100 000 to his retirement annuity fund, but he will only allowed to deduct R75 000 under section 11(k). The balance of the contributions, i.e. R25 000 (R100 000 contributions minus R75 000 section 11(k) deduction) will be carried forward to the following year of assessment.

His taxable income for the year of assessment will thus be:

= R75 000 (salary) + R10 000 (interest)

= R85 000 (gross income) – R10 000 (interest exemption limited to R23 800 for persons under age 65)

= R75 000 (income) – R75 000 (section 11(k) deduction) + R0 (taxable allowances) + R300 000 (taxable capital gain)

= R300 000 (taxable income).

Example 8: Taxpayer earning income that is higher than taxable capital gain made

Mr Extravagance (aged 37) receives remuneration of R500 000 for part-time work over the course of the 2016/17 year of assessment. He also receives R10 000 in interest from a money market account and sells unit trusts to receive a capital gain of R790 000. The value of the taxable capital gain is R300 000 (R790 000 – R40 000 annual exclusion for individuals = R750 000 x 40% inclusion rate for individuals). Before the end of the year he contributes R100 000 to his retirement annuity fund. He wants to know whether he will enjoy a deduction for this contribution of R100 000 under section 11(k).

(i) Mr Extravagance's remuneration is:

R500 000 (part time work)

(ii) The taxable income *for purposes of calculating the section 11(k) deduction* of Mr Extravagance is:

= R500 000 (salary) + R10 000 (interest)

= R510 000 (gross income) – R10 000 (interest exemption limited to R23 800 for persons under age 65)

= R500 000 (income) – R0 (deductions) + R0 (taxable allowances) + R300 000 (taxable capital gain)

= R800 000 (taxable income for purposes of calculating the section 11(k) deduction)

(iii) His taxable income is thus higher than his remuneration in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R800 000 x 27.5% = R220 000.

As this amount is smaller than R350 000 the amount *potentially* deductible under section 11(k) is limited to R220 000.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

= R500 000 (salary) + R10 000 (interest)

= R510 000 (gross income) – R10 000 (interest exemption limited to R23 800 for persons under age 65)

= R500 000 (income) – R0 (deductions) + R0 (taxable allowances)

= R500 000 (taxable income (taxable income before adding possible capital gains tax).

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R220 000 is the maximum amount deductible under section 11(k).

(vi) He is currently however only contributing R100 000 to his retirement annuity fund, and he will therefore only be allowed to deduct R100 000 under section 11(k).

If we assume that he does not increase his contributions to a retirement fund, his taxable income for the year of assessment will thus be:

= R500 000 (salary) + R10 000 (interest)

= R510 000 (gross income) – R10 000 (interest exemption limited to R23 800 for persons under age 65)

= R500 000 (income) – R100 000 (section 11(k) deduction – the maximum allowable deduction is R220 000, but he is only contributing R100 000) + R0 (taxable allowances) + R300 000 (taxable capital gain)

= R700 000 (taxable income).

Example 9: Taxpayer – taxable income consists of taxable capital gain only

Mr Frugal (aged 37) sells unit trusts and makes a capital gain of R790 000. The value of the taxable capital gain is R300 000 (R790 000 – R40 000 annual exclusion for individuals = R750 000 x 40% inclusion rate for individuals). He does not earn any other income in the year of assessment. Before the end of the year he contributes R100 000 to his retirement annuity fund. He wants to know what the maximum deduction is that he will enjoy under section 11(k).

(i) Mr Frugal's remuneration is:

R0 (no remuneration)

(ii) The taxable income *for purposes of calculating the section 11(k) deduction* of Mr Frugal is:

= R0 (gross income) – R0 (exemptions)

= R0 (income) – R0 (deductions) + R0 (taxable allowances) + R300 000 (taxable capital gain)

= R300 000 (taxable income for purposes of calculating the section 11(k) deduction)

(iii) His taxable income is thus higher than his remuneration in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R300 000 x 27.5% = R82 500.

As this amount is smaller than R350 000 the amount *potentially* deductible under section

11(k) is limited to R82 500.

(iv) His taxable income before allowing for possible taxable capital gains is thus:

R0 (gross income) – R0 (exemptions)

= R0 (income) – R0 (deductions) + R0 (taxable allowances)

= R0 (taxable income before adding the taxable capital gain).

(v) As the amount in (iv) is smaller than the answer in (iii), the amount calculated in (iv), i.e. R0 is the maximum amount deductible under section 11(k) – there is therefore no deduction allowed under section 11(k) in this instance.

(vi) He is currently contributing R100 000 to his retirement annuity fund, but he will not be allowed to deduct any amount under section 11(k). The contributions of R100 000 made in the year of assessment will be carried forward to the following year of assessment.

His taxable income for the year of assessment will thus be:

R0 (gross income) – R0 (exemptions)

= R0 (income) – R0 (section 11(k) and other deductions) + R0 (taxable allowances)

+ R300 000

(taxable capital gain)

= R300 000 (taxable income).

Example 10: Taxpayer contributes to a provident fund before and after 1 March 2016

Mrs Cathy Madonsela is employed by XYZ (Pty) Ltd. In the 2016/2017 year of assessment she earns a salary of R1 800 000 per annum. In addition to this her employer contributes R200 000 to her provident fund. Mrs Madonsela also contributes R200 000 to this provident fund in the same year of assessment. Prior to 1 March 2016, Mrs Madonsela made contributions in the amount of R500 000 to her provident fund.

(i) Her total remuneration is thus R2 000 000 (R1 800 000 plus the fringe benefit of R200 000, being the contribution made to the provident fund by her employer).

(ii) In this instance her total taxable income *for purposes of calculating the section 11(k) deduction* will also be:

R1 800 000 plus R200 000 (annual employer contribution to provident fund)

= R2 000 000 (gross income) minus R0 (exemption)

= R2 000 000 minus R0 (deductions other than section 11(k)) plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R2 000 000 (taxable income)

(iii) Remuneration and taxable income is thus the same in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R2 000 000 x 27.5% = R550 000. As this amount exceeds R350 000 the amount *potentially* deductible under section 11(k) is limited to R350 000.

(iv) Her taxable income before allowing for possible taxable capital gains is thus:

R1 800 000 plus R200 000 (employer contribution to provident fund)

= R2 000 000 (gross income) minus R0 (exemption)

=R2 000 000 (income) minus R0 (deductions other than section 11(k))

= R2 000 000 (taxable income)

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R350 000 is fully deductible under section 11(k).

(vi) The balance of R50 000 (R400 000 contribution minus R350 000 deduction allowed under section 11(k)) is carried forward to the next year of assessment. The amount of R500 000, being the contributions to the provident fund by Mrs Madonsela prior to 1 March 2016 will not be carried over to the 2016/2017 or 2017/2018 (or any subsequent) years of assessment for purposes of the section 11(k) deduction[14] .

If we thus calculate the taxable income of Mrs Madonsela for the 2016/2017 year of assessment, it will be:

R1 800 000 + R200 000 (employer contribution to the pension fund is a taxable fringe benefit)

= R2 000 000 (taxable income) – R0 (exemptions)

= R2 000 000 (income) – R350 000 (deduction under section 11(k) = R1 650 000 + R0 (taxable allowances) + R0 (taxable capital gain)

= R1 650 000 (taxable income).

Example 11: Taxpayer contributes to a pension fund before and after 1 March 2016

Mrs Joan Botha is employed by PQR (Pty) Ltd. In the 2016/2017 year of assessment she earns a salary of R1 800 000 per annum. In addition to this her employer contributes R200 000 to her provident fund. Mrs Botha also contributes R200 000 to this provident fund in the same year of assessment. Prior to 1 March 2016, Mrs Botha made contributions in the amount of R500 000 to

[14] In this example the member's (disallowed) contributions to the provident fund prior to 1 March 2016 is thus not carried forward to subsequent years of assessment, as per the interpretation of Section 11(k)(ii) of the Income Tax Act in the Explanatory Memorandum to the 2016 Draft Taxation Laws Amendment Bill, discussed earlier in this article.

her pension fund that were not allowed as a tax deduction, as it exceeded the maximum allowable deduction.

(i) Her total remuneration is thus R2 000 000 (R1 800 000 plus the fringe benefit of R200 000, being the contribution made to the provident fund by her employer).

(ii) In this instance her total taxable income *for purposes of calculating the section 11(k) deduction* will also be:

R1 800 000 plus R200 000 (annual employer contribution to provident fund)

= R2 000 000 (gross income) minus R0 (exemption)

= R2 000 000 minus R0 (deductions other than section 11(k)) plus R0 (taxable allowances) plus R0 (taxable capital gain)

= R2 000 000 (taxable income)

(iii) Remuneration and taxable income is thus the same in this instance. The amount *potentially* deductible under section 11(k) will thus be:

R2 000 000 x 27.5% = R550 000. As this amount exceeds R350 000 the amount *potentially* deductible under section 11(k) is limited to R350 000.

(iv) Her taxable income before allowing for possible taxable capital gains is thus:

R1 800 000 plus R200 000 (employer contribution to provident fund)

= R2 000 000 (gross income) minus R0 (exemption)

=R2 000 000 (income) minus R0 (deductions other than section 11(k))

= R2 000 000 (taxable income)

(v) As the amount in (iii) is smaller than the answer in (iv), the amount calculated in (iii), i.e. R350 000 is fully deductible under section 11(k).

(vi) The balance of R550 000 (R400 000 contribution in 2016/2017 year of assessment minus R350 000 deduction allowed under section 11(k) plus R500 000 contributions to the pension fund prior to 1 March 2016 that were not allowed as a tax deduction as it the contributions exceeded the maximum deduction allowable to the member) is carried forward to the next year of assessment in terms of Section 11(k)(ii).

If we thus calculate the taxable income of Mrs Botha for the 2016/2017 year of assessment, it will be:

R1 800 000 + R200 000 (employer contribution to the pension fund is a taxable fringe benefit)

= R2 000 000 (taxable income) – R0 (exemptions)

= R2 000 000 (income) – R350 000 (deduction under section 11(k) = R1 650 000 + R0 (taxable allowances) + R0 (taxable capital gain)

= R1 650 000 (taxable income).

Conclusion

It is commendable that the Taxation Laws Amendment Bill of 2016 allows for non-trade income as well as taxable capital gains to be included in the calculation for the deduction of contributions under section 11(k), and that the proposal provides for the amendments to be effective from 1 March 2016, being the inception date of the new retirement contribution deduction regime. There however remains the possibility of a different interpretation of Section 11(k)(ii) than the one expressed in the Explanatory Memorandum to the Draft Taxation Laws Amendment Bill relating the deduction of contributions made to provident funds before 1 March 2016. It is hoped that this issue will be clarified in subsequent amendments to the Income Tax Act.

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Severance Benefits

Keith Peter CFP®
B.Soc.Sc, LLB, Adv PG Dip in Fin Plan, Programme in Compliance Management, MBA
Legal Adviser Manager
Broker Distribution and PFA: Durban and Eastern Cape

Introduction

According to Solidarity Retrenchment Report 2016, almost 60 000 workers were retrenched with the mining, information and communication technology and metal and engineering sectors bearing the worst of these retrenchments.[1] According to Gideon du Plessis, secretary general of Solidarity, *"The end result is usually the misallocation of severance package and pension funds, with the result that, generally, their funds run out even before they can find another job."* [2]

People who are retrenched are not necessarily near retirement age and invariably are still in the job market. Retrenchment has both short term and long term effects. In the short term people are looking for new jobs or opportunities to start their own businesses. In the long term the receipt of the retrenchment or severance benefit will affect their retirement fund benefits from a tax perspective.

This article will look at some aspects concerning severance benefits. These include the taxation and possible preservation of such benefits.

Severance Benefits

In terms of the Income Tax Act of 1962 (hereinafter referred to as the ITA), severance benefits include any amount received by or accrued to a person by way of a lump sum from a person's employer as a result of the relinquishment, termination, loss, repudiation, cancellation or variation of that person's office and employment if:[3]

(1) That person has reached the age of 55 years, or

(2) The relinquishment, termination, loss, repudiation, cancellation or variation is due to that person becoming permanently incapable of holding office or employment due to sickness, accident, injury or incapacity through infirmity of mind or body, or

(3) The termination or loss is due to:

  (a) the employer having ceased to carry on or intending to cease carrying on the trade in respect of which he was employed or appointed, or

  (b) the person becoming redundant in consequence of a general reduction of personnel or a reduction in personnel of a particular class by his employer.

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[1] Natasha Odendaal, 26 April 2016, Creamer Media's Engineering News.
[2] Natasha Odendaal, 26 April 2016, Creamer Media's Engineering News.
[3] Income Tax Act No. 58 of 1962 paragraph *(d)(1)*

Calculation of severance benefits

The Basic Conditions of Employment Act (hereinafter referred to as the BCEA)[4] governs the calculation of severance benefits. The retrenched employee is entitled to a severance benefit that is calculated on the basis of one week of pay for each completed and continuous year of service with the same employer.[5] The amount of severance pay may be increased and included in the contract of employment.

In addition, the retrenched employee will be entitled to the following:

(1) Notice pay which is an amount equal to the salary that the employee would have earned if the employee had remained in employment during the notice period. If the person was employed for less than six months the employee is entitled to one week's notice; if employed for more than six months but not more than one year the entitlement is two weeks' notice and if employed for more than a year such four weeks' notice pay is due. By mutual agreement the employee may not be required to work during the notice period.

(2) Accrued leave not yet taken (outstanding leave pay)

(3) Pro-rata bonus (if applicable)

Taxation of severance benefits

(a) Severance benefit

Initially Section 10(1)(x) of the ITA governed the taxation of gratuities received as a consequence of the termination of employment by way of retrenchments. The first R30 000 was exempt from tax (provided one of the afore-mentioned requirements was met). The balance was taxed at the client's average rate of tax and/or marginal rate of tax.[6]

With effect from 1 March 2011, section 10(1)(x) was deleted and as such the R30 000 tax-free amount was no longer applicable to these lump sums. All lump sum benefits received on retrenchment became subject to tax according to the retirement tax tables. The first R500 000 is taxed at 0%. According to the retirement tax tables:[7]

Taxable Amount	Rate of Tax
Between R0 and R500 000	0%
Exceeding R500 000 but not R700 000	18% of the amount exceeding R500 000

[4] Section 41 (2) Basic Conditions of Employment Act No. 75 of 1997
[5] Section 35 & Section 41(2) of Basic Conditions of Employment Act No. 75 of 1997
[6] Income Tax Act No 58 of 1962
[7] Paragraph 2 of the Second Schedule of the Income Tax Act 58 of 1962

Exceeding R700 001 but not R1 050 000	R36 000 + 27% of the amount exceeding R700 000
Exceeding R1 050 001	R130 500 + 36% of the amount exceeding R1 050 000

However, there seems to be some disagreement over the taxation regarding taxpayers receiving Voluntary Separation Packages (hereinafter referred to as a VSP). The question is whether a VSP will be taxed according to the retirement tax tables or the taxpayer's marginal rate of tax.

It has been argued that the Income Tax Act does not define the term redundant and as such it should be interpreted in its ordinary meaning for tax purposes. The argument postulated is from a labour law perspective. According to this argument, a severance benefit structure is as the result of a labour law process that will result in employees becoming redundant and the payment of some amount to that employee.[8]

The VSP process is indicative of the employer's intention to effect a general reduction of employees. When an employee elects to receive the VSP, this indicates an acceptance that he has become redundant. Thus the payment in respect of the VSP would not have been possible had the employee not been affected by the redundancy. This proposition states further that to limit the interpretation of "*redundant*" to a forced retrenchment is too narrow, because the decision to effect a "*general reduction*" in employees is part of a wider process that includes voluntary retrenchment.[9]

The counter argument is that a VSP is not a forced retrenchment but an agreement open to the affected employees to accept or decline the VSP. Therefore the payment resulting from a VSP does not fall within the definition of severance benefit as contemplated by the ITA. The affected employee, in accepting the VSP was not made redundant as a result of operational reasons of the employer, but opted to exit the company on his or her own volition. For the severance benefit to be taxed according to the retirement tax tables, the decision to reduce personnel has to be a unilateral decision made by the employer.[10]

[8] Cliff Dekker Hofmeyr, Alert, 7 August 2016.
[9] Cliff Dekker Hofmeyr, Alert, 7 August 2016
[10] Cliff Dekker Hofmeyr, Alert, 7 August 2016

According to Stiglingh et al, if one of the requirements of the definition of severance benefit is not met (as stated above) it will be taxed according to the marginal rate of tax applicable to the respective individual. If it meets one of the requirements it will be taxed according to the retirement tax tables.[11]

(b) Other payments received – notice pay, leave pay and bonuses

These amounts are taxed according to the taxpayer's marginal rate of tax and not according to the retirement tax tables.

Impact on aggregation of the receipt of lump sum benefits

Severance benefits are aggregated with lump sums received from retirement funds as a consequence of a retirement or a withdrawal from a retirement fund. The following amounts are aggregated:[12]

(a) lump sum benefits received from a retirement fund as a consequence of a retirement after 1/10/2007

(b) lump sum benefits received from a retirement fund as a consequence of a withdrawal after 1/3/2009

(c) other withdrawal benefit amounts included in gross income after 1/3/2009 e.g. divorce awards and deemed accruals for pension to provident fund transfers

(d) severance benefits received after 1/3/2011

The effect of aggregation is that the taxpayer receives the R500 000 only once during his lifetime. If it is utilised against the severance benefit, on retirement from a retirement fund, this "tax-free" amount is may no longer be available or it may be reduced.

This will also be applicable where the taxpayer receives a lump sum as a consequence of a withdrawal from a retirement fund after receiving a severance benefit. According to the aggregation rules, the lump sum received as a consequence of a withdrawal from a retirement fund will be aggregated with the severance benefit and the withdrawal tax tables will be used to calculate the tax payable on the withdrawal amount.

[11] Stiglingh et al, Silke: South African Income Tax, 2013
[12] Paragraph 2(1) of the Second Schedule of the Income Tax Act 58 of 1962

Example (where client receives severance benefit and retires from a retirement fund):

- The taxpayer is a member of a preservation pension fund from which he will retire. The value of the said fund is R2 700 000 (1/3 is R900 000). He received a retrenchment benefit of R600 000 (after 1/3/2011). It is assumed that this meets the definition of severance benefit. When he retires from the preservation pension fund aggregation will apply in respect of this amount and the one received previously.

Calculation:

- Step 1: Add the 1/3 lump sum of R900 000 to the severance benefit of R600 000 and apply the retirement tax tables to the total amount. The tax payable on R1 500 000 will be R130 400 + 36% of the amount above R1 050 000 = R292 500
- Step 2: Apply the retirement tax tables to R600 000 only. The hypothetical tax payable will be R18 000 (18% of the amount above R500 000)
- Step 3: Deduct step 2 from step 1 = R292 500 less R18 000 = R274 500

The above is cause for concern for taxpayers who are not near retirement age. Being forced to receive their severance benefits in cash would result in them invariably utilising the once-off "tax free" exemption of R500 000 against the severance benefit. On retirement from a retirement fund, the lump sum received in cash will be taxed (which could be prejudicial if the lump sums are required for payment of certain debts or for voluntary investment purposes or to create an emergency fund).

The taxpayer has no option but to pay the tax on the severance benefit and invest the after-tax amount in a voluntary investment. However, if the amount is in excess of the R500 000 this option entails paying tax on the amount above R500 000 (notwithstanding the fact that the R500 000 "tax-free" amount is used at this stage).

Preservation of severance benefit

Preservation funds are governed by the Income Tax Act and Practice Note 1/2012. A person is entitled to become a member of a preservation fund if his/her employment was terminated due to resignation, retrenchment, winding up of the occupational sponsored retirement fund or a merger or acquisition of one employer by another in terms of section 197 of the Labour Relations

Act. These events allow the affected person to transfer his/her employer sponsored retirement fund to a preservation fund (pension or provident preservation, as applicable).[13]

Non-member spouses are allowed to transfer their divorce awards (in respect of pension and provident funds) to preservation funds. In addition, unclaimed benefits can also be transferred to preservation funds. Transfers between preservation funds are also permitted.[14]

This begs the question – can a retrenched person transfer his (her) severance benefit to a preservation fund or a similar vehicle in order to not use the R500 000 exemption or part thereof (against the severance benefit) on retrenchment?

Preservation funds are defined by the Income Tax Act as preservation pension or preservation provident funds. By definition, a preservation fund is only able to accept funds that arise from an approved pension or provident fund on the happening of one of the events mentioned above.

A severance benefit by contrast is included in the definition of gross income in terms of paragraph (d)(i)) of the Act in respect of the definition of gross income. It is the payment of income to the taxpayer using the person's salary as basis for the calculation of the severance benefit.

However, it is taxed according to retirement tax tables (if we assume it meets the requirements of section 7A(4A) of the ITA). Therefore it is treated the same way as retirement fund benefits from a tax perspective.

The argument can be put forward that the preservation fund rules as per the Practice Note 1/2012 be extended or amended to accommodate the receipt of severance benefits. However, this may be viewed as impossible due to the fact that severance benefits are not retirement fund benefits, that preservation funds can only accept retirement fund benefits and the definition of a preservation fund would have to be amended in terms of the ITA.

[13]Section 1 of Income Tax Act No. 58 of 1962 & Practice Note 1/2012
[14] Section 1 of Income Tax Act No. 58 of 1962 provide the section & Practice Note 1/2012

If this is the case, severance benefits should be allowed to be invested in another vehicle similar to a preservation fund. This would allow individuals to increase their potential savings for retirement. Further, if possible, this vehicle should accommodate these individuals to draw an income from this vehicle before retirement to tide them over till they find other employment or until they reach retirement age (assuming they have preserved their employer sponsored retirement fund on retrenchment). This would ensure that they do not pay unnecessary taxes on the severance benefit as a lump sum and rather draw it as income (paying tax according to their marginal rates of tax). This will ensure that the R500 000 tax exemption is still available for use on retirement from retirement funds.

Conclusion

One has to be mindful of the tax implications in respect of severance benefits. Aggregation of severance benefits with retirement fund lump sums is usually ignored when people retire from the retirement funds and this can be to their detriment financially. Where taxpayers have received severance benefits this needs to be taken into account when retirement fund lump sums are received. Further, employees need to ensure that their retrenchment or severance benefits are structured correctly so as to enjoy the preferential tax treatment upon receipt that is taxed according to the retirement tax tables.

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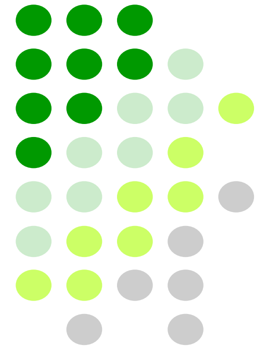

Investment Planning

A basic investment comparison in an individual capacity, company or a trust

Jothi Chirkoot CFP®
BA (LAW) LLB,PG Dip. Risk & Comp,
Adv PG Dip in Fin Plan
Legal Adviser Specialist
PFA : Durban

Introduction

Financial advisors are often approached by clients who would like for an investment to be done but are unsure whether the investment ought to be effected in their individual capacity, in the name of their company or a trust.

This article attempts to briefly set out the tax implications that should be considered when advising a client.

Please note that for the sake of convenience wherever reference is made to a company in this article this would include a close corporation as well.

An important starting point would be to enquire from the client what is the purpose or objective of the investment. Who is to be the ultimate recipient of the proceeds of the policy?

The reason for this is that if for example the investment is in the company's name simply because the company tax rate is 28% but the purpose of the investment is for the proceeds to benefit the individual in his personal capacity, then upon maturity of the investment the proceeds will have to be transferred from the company to the individual and the transfer itself may trigger additional tax implications like dividend withholding tax of 15% if the company declares a dividend. Effectively SARS would receive 43% of tax in total (28% + 15%) in respect of this investment. Whereas if the investment was to be invested the individual's personal capacity the income tax applicable would either be 30% as per the four fund (now five-funds) in a life wrapped investment or at the marginal tax in a lisp wrapped investment.

In many cases clients do not wish to increase the value of their estates as they are fully aware that this could increase the estate duty and capital gains tax liability in their estates on their death. So they prefer to invest in the name of the company in which they have a shareholding. An investment owned by the company will increase the value of the company hence; the value of their shareholding will increase. The value of the shareholding will be included in their estate on death. In other words the increased value of the shareholding as a result of an investment owned by the company will inevitably be included in the estate for estate duty purposes should the shareholder die.

The table below looks at some of the various aspects that should be considered when clients seek advice and guidance:

	Individual	**Company**	**Trust**
1.Tax implications: Income Tax-			
Life wrapped investment	Taxed in the Individual policy holder fund at 30%	Taxed within the Company policy holder fund at 28%	Taxed within the Individual policy holder fund at 30% **IF the** beneficiaries of the Trust are natural persons.
CGT	Taxed within the individual policy holder fund. If investment is in life funds, then CGT will be factored within the investment over its duration in the fund; if investment is in unitised funds, CGT will be triggered only when a CGT event occurs e.g. on disinvestment.	Taxed within the individual policy holder fund. If investment is in life funds, then CGT will be factored within the investment over its duration in the fund; if investment is in unitised funds, CGT will be triggered only when a CGT event occurs e.g. on disinvestment.	Taxed within the individual policy holder fund. If investment is in life funds, then CGT will be factored within the investment over its duration in the fund; if investment is in unitised funds, CGT will be triggered only when a CGT event occurs e.g. on disinvestment.
Lisp wrapped investment	Interest/growth taxed at the marginal tax rate of the individual. Interest exemptions allowed up to certain limits. Dividends withholding tax at 15% in the individuals hands before pay-out.	Interest/growth taxed at marginal tax rate of the company. No interest exemptions available. The company is exempt from paying dividends withholding tax.	Interest/growth taxed at marginal tax rate of the trust i.e.41% if the income/growth is retained in the trust during the tax year. No interest exemptions available. Dividends will attract tax and dividend withholding tax will be imposed.

CGT	On switching funds and disposing of the investment- inclusion rate 40% and effective rate 0-16.4%	On switching funds and disposing of the investment- inclusion rate 80% and effective rate 22.4%	On switching funds and disposing of the investment- inclusive rate 80% and effective rate 32.8%
Estate Duty - on life and Lisp wrapper	The investment will attract estate duty in the estate of the owner of the policy. There will be no executor fees if beneficiaries have been nominated on the life wrapper.	The investment will increase the value of the company; hence the value of the shareholder's shareholding. The latter is an asset in the estate of the shareholder and will attract estate duty. If an employee is the beneficiary to a life wrapped investment, on death of the employee the investment will be dutiable in his/her estate.	The investment will increase the asset value of the trust. Assets owned by the trust do not form part of the beneficiaries estate for estate duty purposes unless the trust is a bewind trust i.e. the beneficiaries have vested rights, in which case the investment will be estate dutiable in the estate of the ascertained beneficiary.
2.Pay-out to Investment Policy Owner: **Life wrapped investment**	Pay-out will be tax free as the taxation would have occurred within the four funds during the investment term. If the funds within the investment are unit trust based, CGT will be applied at the disinvestment stage.	Pay-out tax free as the taxation would have occurred within the four funds during the investment term. If the funds within the investment are unit trust based, CGT will be applied at the disinvestment stage.	Pay-out tax free as the taxation would have occurred within the four funds during the investment term. If the funds within the investment are unit trust based, CGT will be applied at the disinvestment stage.
Lisp wrapped investment	On disinvestment- capital gains tax applicable inclusion rate 40% and effective rate 0-16.4%	On disinvestment- capital gains tax applicable - inclusion rate 80% and effective rate 22.4%	On disinvestment- capital gains tax applicable- inclusion rate 80% and effective rate 32.8%

3.After maturity and pay out of the proceeds of the policy to the owner of the investment policy, what are the tax implications to have the proceeds paid over to an individual person for e.g. a shareholder/member, an employee or beneficiary			Section 25B (1) and (2) of the Income Tax Act are applicable but subject to the provisions of section 7. However financial advisors and investors must be mindful of the outcome of the Davies Tax Committee which is currently reviewing the taxation system pertaining to trusts.
Life wrapped investment:	After receiving the proceeds of the investment tax free, if the owner wants to transfer the proceeds out of his/her personal name to another, the owner will become liable for donations tax unless the donation to the donee falls under the exemptions category e.g. to a spouse.	After receiving the proceeds of the investment, if the company wants to pay-out the proceeds to:- (i) A shareholder/ member, the pay-out will have to be effected through a dividend being declared by the company. There will be 15% dividend's withholding tax imposed in the individual's hands before a dividend is paid to the individual. (ii) An employee – will be a section 11(a)[1] expense deduction for the employer. It will be included in gross income of the employee.	After the trustees receive the proceeds of the investment tax free, if there are beneficiaries with a vested right to such proceeds during such year, it would be deemed to have accrued to the beneficiary and remain tax free in their hands. Otherwise it will accrue to the trust and still remain tax free. This is because the taxation occurred within the individual policy holder fund.

[1] Income Tax Act 58 of 1962

Lisp wrapped investment	If the owner transfers proceeds of this investment out of his/her personal name to another, the owner will be liable for donations tax unless the donee falls under the exemptions category e.g. to a spouse.	After the company receives the proceeds of the investment if the company wants to pay the proceeds over to: (i) A shareholder/ member then a pay-out to the shareholder/individual will have to be effected through a dividend being declared by the company There will be 15% dividend's withholding tax imposed in the individual's hands before a dividend is paid to the individual. (ii) An employee – will be a section 11(a)[2] expense deduction for the employer. It will be included in gross income of the employee.	After the trustees receive the proceeds of the investment, if there are beneficiaries with a vested right to such proceeds during such year, it would be deemed to have accrued to the beneficiary and the CGT triggered as a result of the disinvestment will be taxed in the hands of the beneficiaries. Otherwise it will accrue to the trust and be taxed in the hands of the trust.
4. If an individual is nominated as a beneficiary for proceeds or replacement contracting party/beneficiary for ownership to the policy on a life wrapped investment policy	In terms of an endowment- Proceeds will pay-out tax free directly to the nominated beneficiary on the death of the life assured.	In terms of an endowment- If the company owns the policy and makes the shareholder the beneficiary, then the proceeds on pay-out will be paid over directly to the shareholder on the death of the life assured. If the employee is the beneficiary the proceeds will be paid directly to the employee and will	In terms of an endowment- If the Trust owns the policy and makes the individual the beneficiary, then the proceeds will pay-out tax free to the beneficiary on the death of the life assured.

[2] *Id.* at 6

		form part of gross income to be taxed in terms of paragraph (d) of the definition of gross income in the Income Tax Act.[3]	
	Or in the case of a sinking fund where there is no life assured, on death of the contracting party the replacement contracting party/beneficiary for ownership takes over the policy and on maturity will be entitled to the proceeds.	If the policy is a sinking fund, there is no beneficiary for proceeds appointment. There is provision for a replacement contracting party/beneficiary for ownership. Death does not occur to a company hence the contracting party may never be replaced.	If the policy is a sinking fund, there is no beneficiary for proceeds appointment. There is provision for a replacement contracting party/beneficiary for ownership. Death does not occur to a trust hence the contracting party may never be replaced.
On a Lisp wrapped investment	No provision is made for a beneficiary nomination. Provision may in certain circumstances be available for the nomination of a replacement contracting party. This however depends on the product rule.	No provision is made for a beneficiary nomination. Provision may in certain circumstances be available for the nomination of replacement contracting party. This however depends on the product rule.	No provision is made for a beneficiary nomination. Provision may in certain circumstances be available for the nomination of replacement contracting party. This however depends on the product rule.

Conclusion

It is important for financial advisors to be tax savvy especially when advising clients about where investments should be placed. The objective of the investment will play a vital role. Transferring of proceeds, investments and assets from one entity to another, from individual to an entity or

[3] Income Tax Act 58 of 1962, section1

vice versa more often than not attracts tax implications. In attempting to avoid paying tax, more tax than anticipated may end up being paid.

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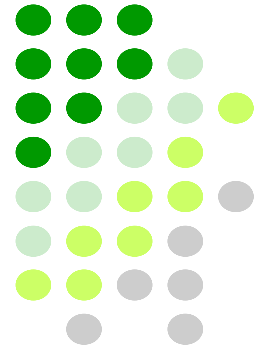

Income Tax

Crossing the Rubicon…A costly change of mind!

Gerald Peter CFP®

LLB, Adv PG Dip in Fin Plan

Legal Adviser Specialist
PFA : Durban

Introduction

Income which is received by or accrues to a person on the disposal of an asset is classified as being either of a capital nature or of a revenue nature. This classification is informed mainly by the intention with which a person acquires, holds and uses a particular asset during the period of ownership. If for example, a person purchases a residential property for his personal domestic use (a capital intention), the proceeds when the property is disposed of will be subject to capital gains tax.[1]

It often happens that a person can change his/ her original intention with regard to the use or purpose of a particular asset. In the above example, the taxpayer's original intention to use the property for domestic purposes may, due to certain intervening factors, change to one of carrying out a scheme of profit making (making the proceeds revenue in nature and subject normal tax).

When an asset is sold, the distinction between capital and revenue receipts is most crucial, primarily because the effective rate of capital gains tax is much lower than that of normal income tax.[2] It is little wonder therefore that invariably many taxpayers prefer their receipts to be classified as capital receipts rather than income receipts.

Over the years South African courts have fashioned the term 'crossing the Rubicon' as a metaphor that refers to the taxpayer crossing the boundary between selling an asset to its best advantage (capital) and embarking on a scheme of profit-making (revenue).

This crossing of the Rubicon is a pivotal moment which can have profound unintended implications for a taxpayer.

This article will examine some of the leading court decisions on this issue with a view to identifying some of the factors which could result in a change of intention being deemed to have occurred. The possible tax implications of crossing the Rubicon will also be explored.

Intention

The most dominant test used by the courts in deciding whether a receipt is income or capital in nature is the intention of the taxpayer. The taxpayer's intention must be investigated:

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[1] Capital receipts and accruals are excluded from the gross income definition in Section 1 of the Income Tax Act (the Act). In addition, the general deduction formula also excludes expenditure and losses of a capital nature from its ambit.

[2] The effective capital gains tax rate for the 2016/17 tax year is 16.4%. The maximum tax rate for individuals is 41% and 28% for companies.

- at the time he acquired the asset
- during the whole period over which he held the asset, as well as
- at the time he disposed of the asset

This three pronged enquiry requires a court to investigate a taxpayer's intention from the time the asset was acquired to the time it is disposed of. The court considers the particular facts of the case to determine whether any intermediating factors are identifiable (from the actions and conduct of the taxpayer) which are indicative of the taxpayer's change of intention in relation to the asset. The burden of proof squarely rests upon the taxpayer's shoulders[3] to convince the court that there has not been a change of intention.

In John Bell and Co (Pty) Ltd v SIR[4] the court had to decide whether the sale of land and buildings which had been held as an investment resulted in gross income. The court held that the mere change of intention to dispose of an asset previously held as capital does not subject the result of profit to tax. Something more is required in order to transform the character of the asset and to render its proceeds gross income. For example, the taxpayer must already be trading in the same or similar kinds of asset and he then and there starts some trade or business or embarks on some scheme for selling such assets for profit, and, in either case, the asset in question is used as his trade-in-stock.

The Court of Appeal of Botswana has on this issue held that a mere sale of a capital asset which had been acquired and held as such for a long time does not by itself constitute a trafficking in that asset. Before that can be said to have taken place there must be something else to show that the sale was in pursuance of a profit-making scheme or of a business of buying and selling in that commodity.[5]

So what is something more that must be done to bring about a change of intention?

In the case of Natal Estates Ltd V Secretary for Inland Revenue[6] the taxpayer, a sugar milling company, held a large piece of land purchased with the intention of sugar cane farming. It was therefore clear that the intention of the taxpayer with respect to the land at the time of acquisition was of a capital nature. Around 1970 the company sold a number of properties in seven areas north of the present-day Durban.

The court found that in the company's conduct, whilst subdividing the land, the planning that went into the project, the large-scale nature of the project, the time taken to complete the

[3] Section 102 of the Tax Administration Act
[4] 1976 4 SA 177 (A)
[5] Tati Company Ltd V Collector of Income Tax, Botswana (Court of Appeal Botswana) (October 1974) 37 SATC 68 at 85
[6] 1975(4) SA 177 (AD)

project as well as the marketing of the company meant that it was clear that the taxpayer had crossed the Rubicon and had entered into a scheme of profit- making.

Therefore the land constituted trading stock (it had ceased to be held as a capital asset) and the receipts from the sale of the land were included in the gross income of the taxpayer.

In Elandsheuwel Farming (Edms) Bpk V SBI[7], the court had to decide whether the sale of land by a company gave rise to a receipt of a capital or revenue nature. The land had been held by the company for a considerable period and had originally been acquired with the intention of holding as a long term investment. Subsequent to a change in the shareholding in the company, the land was sold.

The Commissioner, in assessing the company for tax, treated the proceeds from the sale as a receipt of a revenue nature on the grounds that there had been a change of intention in the company.

The court held that due to the change in shareholding, there had been a change in the policy of the company with respect to the holding of the land. The court held that the new shareholders in the company were property speculators and that their intentions had to be imputed to the company.

Other considerations

Other factors which the courts will consider to determine whether or not there has been a change of intention are as follows:

- What the taxpayer declares as his intention (his *ipse dixit*). This is crucial but not decisive. The court will test this evidence against the surrounding facts and circumstances (in other words, objective factors) in order to establish the taxpayer's true intention.
- The length of time the asset was held. An asset held for a long time will most likely be a capital asset than one held for a shorter period.
- Frequency. If the asset in question is one which the taxpayer regularly buys and sells, the presumption is that it is a revenue asset.
- The nature of the taxpayer's business. For example the income of property speculators will almost invariably be taxed as revenue income.
- A capital asset is one which is acquired as a source of an income stream. However if it is apparent from the facts that the pursuit of an income flow was negligible, the court is likely to conclude that that intention was of a revenue nature.

[7] (1978) 1 SA 101 (A)

- ❑ The shorter the period between acquisition and sale, the higher the likelihood that the income will be revenue.
- ❑ Some assets are by their very nature easily identifiable as either capital or revenue in nature (for example a tractor is clearly a capital asset).[8]

Tax Implications

A change of intention by the tax payer has capital gains tax implications as well as gross income implications. The implications are as follows[9]:

Capital Gains Tax (hereinafter referred to as "CGT"): Deemed disposal

(1) If an asset was previously held as a capital asset and then there is a change of intention to hold it as a revenue asset (or trading stock), the owner is deemed to have realised the asset at market value and then immediately to reacquire it as part of trading stock at the market value at the time of the change of intention.

(2) The effect of this is that, even though there has been no actual disposal, the difference between original cost and market value is subject to CGT.

Income Tax: Profit from sale of asset

(1) Thereafter, for income tax purposes, the cost of the taxpayer's trading stock is deemed to be the market value so that only any profit realised above that value will be subject to normal income tax.

Example

Mr. Zulu bought a block of flats in April 2011 for R5 million with the intention of renting them out (capital intention). Five years later, due to a spike in the demand for residential properties in the area, Mr Zulu realises the huge economic benefits of selling individual units to desperate buyers. In April 2016, he applies for and obtains permission to register a sectional title over the property. At this time the market value of the building is R8 million. He immediately begins selling the individual flats. By June 2016 all the flats have been sold at a combined value of R15 million. From the 1st of March 2016 until the end of June 2016, he collected rental income of R400 000.

His tax situation for the 2016/ 17 tax year will be as follows:

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[8] Philip Haupt, 'Notes on South African Income tax', H&H Publications, 2014
[9] Paragraph 12(1) and 12(2)(c) of the Eighth Schedule of the Income Tax Act, No 58 of 1962

Capital Gain: Deemed Disposal

Market Value @ date of change of intention (April 2016)	R 8,000,000.00
Less	
Base Cost	R 5,000,000.00
Capital Gain	R 3,000,000.00
Less	
Annual exclusion	R 40,000.00
Aggregate Gain	R 2,960,000.00
Taxable Capital Gain @ 40%	**R 1,184,000.00**

Taxable Income arising on sale of building

Gross Income R15 000 000 (proceeds of the sale) R400 000 (rental income collected)	R 15,400,000.00
Less	
Deductions	
Deemed cost of the trading stock (the market value at date of change of intention)	R 8,000,000.00
Taxable Income before capital gain	R 7,400,000.00
Plus	
Taxable Capital Gain	R 1,184,000.00
Taxable Income	**R 8,584,000.00**
Tax payable (after rebates)	**R3,425,371.00**

Had Mr. Zulu had not changed his intention but merely sold the building in June 2016 for R15 million, his tax position would have been as follows:

Proceeds	R 15,000,000.00
Less	
Base Cost	R 5,000,000.00
Capital Gain	R 10,000,000.00
Less	
Annual exclusion	R 40,000.00
Aggregate Gain	R 9,960,000.00
Taxable Capital Gain @ 40%	**R 3,984,000.00**
Gross Income	R 400,000.00
Less	
Deductions	
Deemed cost of the trading stock	R 0.00
Taxable Income	R 0.00
Plus	
Taxable Capital Gain	R 3,984,000.00
Taxable Income	**R 4,384,000.00**
Tax payable (after rebates)	**R 1,703,371.00**

In this example the difference in tax payable between the capital accrual and revenue accrual is R1 722 000.

(2) Conversely, if there is change of intention from holding an asset as trading stock to capital, on the date of change of intention there is a deemed disposal and reacquisition at market value.[10] Thus the difference between the market value and original cost will immediately be subject to normal income tax, and the market value will then be the base cost for CGT purposes so that only a profit in excess of that base cost will be subject to CGT.

Example

Mr. Zulu is a property speculator who buy and sells residential properties as part of his business. Mr Zulu bought a house in 2012 for R2 million, at an auction, with the intention of reselling it at a profit. On the 1st of April 2016, the house had still not been sold so Mr Zulu decided to convert it into an office for his new insurance broking business. He duly applied to have to property rezoned from 'residential to commercial'. The value of the property at this time was R3 million.

In this case a change of intention in respect of the property can be discerned. The implications of this change will be as follows:

(1) He will the deemed to have disposed of the house for an amount equal to its market value (R3 million).

(2) The R1 million (i.e. R3 million – R 2 million) profit from the sale will be subject to normal tax.

(3) The market value of R3 million will be the new base cost for CGT purposes.

Conclusion

The intention of the taxpayer at the time of acquisition and throughout the ownership period is a crucial consideration in classifying the proceeds of an asset when it is disposed of. To prevent any unpleasant surprises, tax payers must ensure that they accurately document and retain records showing their intentions prior to the acquisition of assets (e.g. minutes of meetings) and throughout the holding period. Good record keeping is essential as poorly kept records can contribute to difficulties in proving whether a transaction is capital or revenue and treated correctly for tax purposes. Ultimately, the taxpayer has the burden of proof in demonstrating the true intention with which an asset is held.

[10] Paragraph 12(3) of the Eight Schedule

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Capital gains tax & Income tax implications on livestock at death

Louw du Toit CFP®
BCom (Law), LLB, PG Dip in Fin Plan
Legal Adviser Specialist
Broker Distribution: Central Region

Introduction

When a taxpayer dies, that taxpayer (the "deceased person") is terminated and another taxpayer is created, namely the deceased estate. The executor (the deceased person's "representative taxpayer") of the deceased person is still required to submit a tax return for the deceased person concerning the period of assessment commencing from the 1st of March until the date of death for the deceased person.[1]

It is furthermore important to distinguish between revenue assets and capital assets as each of these assets is taxed accordingly at death. For instance capital assets will be taxed at an individual's inclusion rate of 40%, with an exclusion allowed at death in the amount of R300 000. The taxable capital gain is thereafter included in the deceased's income and taxed according to the deceased's marginal tax rate, being a maximum of 41%.

The consequence is that capital assets will be subject to capital gains tax and revenue assets will be subject to income tax.

The Taxation Laws Amendment Act[2] (hereinafter referred to as the "Amendment Act") was promulgated on the 8th of January 2016. The Amendment Act introduced a new Section 9HA to the Income Tax Act. [3]

This article will discuss the impact of the newly introduced Section 9HA on farmers who held livestock, which includes game, in their personal capacity at date of death. It will specifically look at the tax implication for the "deceased person".

Position before 1 March 2016

In terms of paragraph 40 of the Eighth Schedule[4] a deceased person is deemed to have disposed of his or her assets to the deceased estate for an amount equal to the market value on date of death, which gives rise to a capital gain in the hands of the deceased immediately before his or her death under paragraph 35 of the Eighth Schedule.[5] The reason for capital gains tax being payable is due to the wide definition of "asset"[6] in paragraph 1 of the Eighth Schedule.[7]

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[1] Phillip Haupt, Notes on South African Income Tax 801 (2016)
[2] Act 2 of 2015
[3] Act 58 of 1962
[4] Eighth Schedule of the Income Tax Act 58 of 1962
[5] Phillip Haupt, Notes on South African Income Tax 802 (2016)
[6] Paragraph 1 of the Eighth Schedule of the Income Tax Act 58 of 1962 reads as follow:
"asset" *includes –*
(a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding currency, but including any coin made mainly from gold or platinum; and
(b) a right or interest of whatever nature in such property.
[7] Eighth Schedule of the Income Tax Act 58 of 1962

However, the following exceptions apply to the abovementioned rule:

- Assets transferred to a surviving spouse; [8]
- A long-term insurance policy of the deceased that would have been exempted from capital gains tax in terms of paragraph 55 of the Eighth Schedule if it was disposed of; [9] and
- An interest in a retirement fund (pension fund, provident fund, retirement annuity, and preservation fund) in the Republic or a fund, arrangement or instrument situated outside the Republic which provides similar benefits in terms of paragraph 54 of the Eighth Schedule.[10]

Paragraph 67 of the Eighth Schedule [11] applies when assets are bequeathed to a surviving spouse, who is a resident, which results in a "roll-over". The surviving spouse steps in the deceased's shoes and takes over from the deceased.

A capital gains tax liability therefore only arises where livestock is transferred to an heir or legatee (who is not the surviving spouse) as the deceased is deemed to have disposed of the livestock at a cost equal to the market value as determined at date of death of the deceased person reduced by the standard value of the livestock that was included in for income tax purposes, with the base cost being nil where the acquisition cost was deducted for income tax purposes.

Consider the following simplified example concerning a farmer who passed away **before 1 March 2016** and bequeaths his farm and livestock to an heir or legatee (who is not a surviving spouse).

ASSETS	
Farm (less 30%)	R 7 000 000
Livestock (market value)	R 3 000 000
Farm (base cost)	R 4 000 000
Standard value of Livestock (closing stock at death)	R 5 100
Standard value of Livestock (opening value)	R 2 000

[8] Paragraph 40(1)(a) of the Eighth Schedule of the Income Tax Act 58 of 1962
[9] Paragraph 40(1)(c) of the Eighth Schedule of the Income Tax Act 58 of 1962
[10] Paragraph 40(1)(d) of the Eighth Schedule of the Income Tax Act 58 of 1962
[11] Paragraph 67 of the Eighth Schedule of the Income Tax Act 58 of 1962

CAPITAL GAINS TAX	
Total Capital Gains (R7 000 000 – R4 000 000 + R3 000 000 - R5 100- R0)	R 5 994 900
Less: Exclusion on death	(R 300 000)
	R 5 694 900
X 33.3% (inclusion rate for natural persons who passed away before 1 March 2016)	
Taxable Capital Gain	R 1 896 402
INCOME TAX	
Livestock (R5 100 – R2 000)	R 3 100
Plus Taxable Capital Gain	R 1 896 402
Taxable Income	**R 1 899 502**

Position after 1 March 2016

As from 1 March 2016 the newly introduced section 9HA governs the tax treatment of disposals by a deceased person. Paragraph 40 and 67 of the Eighth Schedule only applies to persons who passed away before 1 March 2016.

Section 9HA(1) of the Income Tax Act [12] deems a person to have disposed of his or her assets for an amount equal to the market value at date of death as contemplated in paragraph 31 of the Eighth Schedule.[13]

The following exclusions are applicable to Section 9HA (1):

- Assets disposed to the deceased's surviving spouse who is a resident in the Republic.[14] It is important to note that there is currently no roll over relief for movable assets transferred to a surviving spouse who is not a resident;
- A long-term insurance policy of the deceased that would have been exempted from capital gains tax in terms of paragraph 55 of the Eighth Schedule if it was disposed of;[15]
- An interest in a pension, pension preservation, provident, provident preservation or retirement annuity fund in the Republic or a fund, arrangement or instrument situated outside the Republic in terms of paragraph 54.[16]

[12] Act 58 of 1962
[13] Eighth Schedule of the Income Tax Act 58 of 1962
[14] Section 9HA(1)(a) of the Income Tax Act 58 of 1962
[15] Section 9HA(1)(b) of the Income Tax Act 58 of 1962
[16] Section 9HA(1)(c) of the Income Tax Act 58 of 1962

Section 9HA (2)[17] governs the situation where the deceased person disposes of his or her assets to his or her surviving spouse through either intestate succession, testamentary succession,[18] as a result of a redistribution agreement between the heirs and legatees of the deceased in the course of liquidation or distribution of the deceased estate[19] or in settlement of a accrual claim under Section 3 of the Matrimonial Property Act, 1984.[20] The assets are deemed to be disposed of by the deceased person for an amount equal to either the expenditure incurred by the deceased in respect of that asset, as allowed in terms of Section 11 (a)[21] or 22[22] as a deduction for purposes of determining that person's taxable income for the year of assessment ending on the date of that person's death[23] or the base cost as determined in terms of paragraph 20 of the Eighth Schedule.

According to Section 9HA (3)[24], where any assets that are disposed of by a deceased person as contemplated in subsection (1) are transferred directly to an heir of legatee of that person, the heir or legatee is treated as having acquired that asset for an amount of expenditure incurred equal to the marked value as at date of death of the deceased as contemplated in paragraph 31 of the Eighth Schedule.

In term of Section 9HA(1)[25], should the deceased person hold any livestock at date of death it is deemed that the deceased disposed of the livestock to heirs or legatees, other than his spouse, at market value with the opening stock of the livestock at the standard value as at date of death being a deduction. The result is that the income tax is payable on the disposal.

Consider the following simplified example concerning a farmer who passed away **after 1 March 2016** and who bequeaths his farm and livestock to an heir or legatee, other than his spouse.

ASSETS	
Farm (less 30%)	R 7 000 000
Livestock (market value)	R 3 000 000
Farm (base cost)	R 4 000 000
Standard value of Livestock (closing stock at date of death)	R 5 100
Standard value of Livestock(opening stock)	R 2 000

[17] Section 9HA(2) of the Income Tax Act 58 of 1962
[18] Section 9HA(2)(a)(i) of the Income Tax Act 58 of 1962
[19] Section 9HA(2)(a)(ii) of the Income Tax Act 58 of 1962
[20] Section 9HA(2)(a)(iii) of the Income Tax Act 58 of 1962
[21] Section 11 (a) of the Income Tax Act 58 of 1962
[22] Section 22 of the Income Tax Act 58 of 1962
[23] Section 9HA (2)(b)(i) of the Income Tax Act 58 of 1962
[24] Section 9HA (2)(b)(i) of the Income Tax Act 58 of 1962
[25] Section 9HA (1) of the Income Tax Act 58 of 1962

CAPITAL GAINS TAX	
Total Capital Gain on Farm(R7 000 000- R4 000 000)	R 3 000 000
LESS: Exclusion on death	(R 300 000)
Capital Gain at death	R 2 700 000
X 40% (inclusion rate for natural persons who passed away after 1 March 2016)	
Taxable Capital Gain	R 1 080 000
INCOME TAX	
Income on disposal of livestock (market value)	R 3 000 000
Less: opening stock at Standard Value	R 2 000
	R 2 998 000
Plus Taxable Capital Gain	R 1 080 000
Taxable Income	R 4 078 000

Conclusion

It is clear from the examples above that the tax liability for a farmer, who farms with livestock, has increased considerably should he pass away after 1 March 2016.

According to the first example, where the farmer passed way before 1 March 2016, the taxable income amounts to R 1 899 502, whereas should the farmer pass away after 1 March 2016, the taxable income would amount to R4 078 000. It is important to note that the abovementioned examples only demonstrate the tax consequence where livestock is bequeathed to heir or legatees, other than the deceased person's surviving spouse. "Roll-over" relief will be applicable where livestock is bequeathed to the surviving spouse on condition that the surviving spouse qualifies as a resident in the Republic.

Some of the key objectives of estate planning is avoiding intestacy, avoiding delays in the winding up of the estate, to insure the wishes in the client's will can be given effect to and to protect the assets in the estate. It is therefore vital to ensure that there is a valid will for the farmer to give effect to his wishes and furthermore that there is enough liquidity available in the estate to settle liabilities and prevent the sale of assets in circumstances where there is a shortfall. Adequate liquidity in the estate will furthermore give effect to the wishes set out in the will.

It is important that farmers revise their estate plans in order to identify any shortfalls and make adequate provisions for the additional income tax liability on livestock at death. In the alternative farmers should consider restructuring their estates accordingly to decrease the income tax payable at death on livestock. It is however important for clients to be informed of any cost implications concerning restructuring of their estate.

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Specific requirements of special trusts

Carla Letchman CFP®
LLB, PG Dip in Fin Plan
Legal Adviser
PFA: Northern Region

Introduction

The concept of a "special trust" was first announced in the Budget review of 1998 and only related to trusts created for the benefit of people with a mental illness or those with a serious physical disability.[1] The definition of a special trust was later expanded, in 2003, to include trusts set up for the benefit of individuals under the age of 21 years. These two types of special trusts are for the benefit of the "vulnerable in our society" and therefore the fiscus sought to provide tax relief for these structures. In order for the tax relief to apply, specific requirements need to be met when setting up special trusts. This article will focus on the specific requirements that need to be met in order to qualify for the tax relief afforded.

Definition of a Special Trust

"Special trust" means a trust created –

(a) *Solely for the benefit of one or more persons who is or are persons with disability as defined in section 6B(1) where such disability incapacitates such person or persons from earning sufficient income for their maintenance, or from managing their own financial affairs : Provided that –*

(aa) *such trust shall be deemed not to be a special trust in respect of years of assessment ending on or* after *the date on which all such persons are deceased; and*

(bb) where *such trust is created for the benefit of more than one person, all persons for whose benefit the trust is created must be relatives in relation to each other; or*

(b) by *or in terms of the will of a deceased person, solely for the benefit of beneficiaries who are relatives in relation to that deceased person and who are alive on the date of death of that deceased person (including any beneficiary who has been conceived but not yet born on that date), where the youngest of those beneficiaries is on the last day of the year of assessment of that trust under the age of 18 years.*[2]

The definition of a special trust now caters for trusts for the benefit of minors as well as for persons with a disability.

" 'Disability' in terms of the Income Tax Act, means a moderate to severe limitation of any person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation –

(a) has lasted or has a prognosis of lasting more than a year; and

(b) is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by the Commissioner."[3]

Therefore, both physical and mental incapability to earn an income or maintain oneself is covered under the definition above. Once it is determined that the set of facts do fall within the

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[1] Legal & Policy SARS Guide to the Taxation of Special Trusts: Issued 17 September 2015
[2] Section 1 (1) of the Income Tax Act 58 of 1962
[3] SARS Guide, Supra Note 1, Ibid section 7 (1) inserted section 6B into the Income Tax Act at page 6

definition of a special trust, it needs to be determined if the further requirements are met and then only will the special provisions apply. The further requirements for two different types of special trusts will be dealt with separately.

A trust for the benefit of a person with disabilities: Requirements

This type of trusts' trust deed needs to specify that it is set up solely for the benefit of individual[s] who are disabled as per the definition above. The trust cannot have any other secondary function. Further to this, the two types of special trusts cannot be dealt with in a single trust deed.

For example:

Mr A is married to Mrs A and they have two minor children. One child will never be able to earn an income and maintain herself due to being born with a genetic disorder. They would like to ensure that their daughter, with special needs, will be taken care of upon their simultaneous death. Further, they would also like to cater for their other daughter should they both pass away whilst she is a minor. They would like to set up a testamentary trust in their wills that provides for what is to happen upon simultaneous death.

In this instance they cannot set up one trust seeing as their children have different needs. Their daughter with special needs will need the trust to continue for her lifetime. The minor daughter will only need the trust to be in place until she reaches the age of majority. Therefore, two separate trusts will need to be set up in the will, one for minor beneficiaries and the other for their daughter with special needs.

The specifics of how the special trust is set up do not affect this requirement. The trust could be a vesting or a discretionary trust.

The person with a disability need not be a relative of the donor for the requirements of this particular special trust to be met. However, if there are multiple beneficiaries with disabilities provided for in a single trust they must be relatives of each other.[4]

A relative is defined as follows:

- the spouse of that person;
- anybody related to that person within the third degree of consanguinity;
- anybody related to the spouse of that person within the third degree of consanguinity; and

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[4] id at page 9

- the spouse of anybody related within the third degree of consanguinity to that person or that person's spouse.[5]

Determining whether or not a person is disabled and unable to earn sufficient income for their maintenance or is incapable of managing their own financial affairs, is a factual enquiry and varies from person to person.[6]

An important requirement that needs to be noted when setting up a special trust, of this nature, is that the beneficiary for whose benefit the trust was set up needs to be alive on the last day of February of the relevant year of assessment of the trust.[7]

Once all of the above requirements have been met the trust can be registered as a special trust for the benefit of a disabled person or persons. Once the trust is registered as such it will qualify for the tax benefits discussed below.

A trust for the benefit of a minor or minors: Requirements

This type of trust can only be created in the will of a testator. Unlike with the first type of special trust, which can be an inter vivos trust, this particular trust will not qualify as a special trust unless it is a testamentary trust.[8]

In this instance the creator of the trust needs to be a relative of the beneficiaries and the beneficiaries do not have to be relatives of each other.

The beneficiaries need to be alive or conceived at the time of death of the testator/creator of the trust. No substitution of beneficiaries is permitted; it would disqualify the trust from being a special trust for the benefit of a minor[s].[9]

The beneficiaries of the trust must be under the age of 18 years on the last day of the relevant year of assessment of the trust.

The trust will remain a special trust until the youngest beneficiary attains the age of 18.[10]

The resident status of the beneficiary is not prescribed by the Act.[11]

[5] id at page 9
[6] id at page 8
[7] id at page 8
[8] id at page 12
[9] id at page 12
[10] id page 12
[11] Section 1 of the Income Tax Act

Tax Consequences of Special Trusts

In terms of income earned and distributed to the beneficiaries of both types of special trusts the conduit principle contained in section 25B (1) will apply.[12] Section 25B is however subject to the deeming provisions of section 7 of the Income Tax Act. Section 25B states the following:

"(1)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.

(2) 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."[13]

Section 25B, in summary, provides that the income can be taxed in the hands of the beneficiary if that beneficiary has a vested right to the income in the particular year of assessment. This is however subject to section 7 of the Income Tax Act. Section 7 provides a list of deeming provisions. The list determines who will be liable for tax based on the relationship and nature of how the funds came to be in the trust amongst other considerations.

Whether the income is retained in the trust for the benefit of the beneficiary or distributed for the benefit of the beneficiary it is taxed in the same manner. Namely the beneficiaries or the trust will be taxed on a sliding scale based on the income that has accrued in the year of assessment. This could be anything from 18% to 41% of the accrued income as opposed to the flat rate of 41% for trusts.

For capital gains tax purposes, a special trust for the benefit of a person with disabilities, will have an inclusion rate for individuals which is 40% as opposed to 80% for normal trusts. Further, the primary residence abatements, of R2 million, will be applicable in addition to the annual exclusion of R40 000. In terms of a trusts for the benefit of a minor; this trust will also qualify for the inclusion rate of 40%, however it does not qualify for the annual exclusion of R40 000 nor the special abatement for the sale of a primary residence.

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[12] M Botha et al "The South African Financial Planning Handbook" 2016 LexisNexis page 841
[13] Income Tax Act, Supra note 11

Example of how the tax is applied:

The deeming provisions and attribution rules will not be considered in these examples.

Ordinary Trust

Sam Smith has set up an inter vivos trust. Sam, his wife and Trust Company A are the trustees. The beneficiaries of the trust are Sam, his wife and their one minor child. The trust property comprises of commercial property which generated income of R100 000 for the 2017 year of assessment. Further, the trustees sold one of the properties for an amount of R1 500 000 in the 2017 year of assessment, the property was purchased by the trust for an amount of R1 000 000 in 2014.

The income will be retained in the trust, further, the proceeds of the sale will also be retained in the trust.

The income tax will be as follows:

R100 000 × 41% = R41 000

The Capital gains tax will be as follows:

R1 500 000 – R1 000 000 = R500 000 [Gain] × 80% (Inclusion rate) = R400 000 × 41% [Flat rate] = R164 000

Special Trust for the benefit of a person with disabilities

Sam Smith and his wife died simultaneously in a motor vehicle collision. They left behind one minor child aged 5 with disabilities and who will never be able to earn an income of their own. They set up a testamentary trust for the benefit of their child with special needs in their wills. The trustees are Trust Company A, the child's guardian and their uncle. The trust generated income of R100 000 in the 2017 year of assessment and further sold a property purchased in 2014 for R1 000 000 for an amount of R1 500 000. The income will be distributed to the minor and the capital gain retained in the trust.

The income tax will be as follows in the hands of the minor:

R100 000 × 18% = R18 000 – R13 500 = R4 500

The Capital Gains Tax will be as follows in the trust:

R1 500 000 – R1 000 000 = R500 000 [Gain] – R40 000 [Annual exclusion] = R460 000 × 40% (Inclusion rate) = R184 000 × 18% [Marginal tax rate] = R33 120

Special trust for the benefit of a minor

Sam Smith and his wife died simultaneously in a motor vehicle collision. They left behind one minor child aged 5. They set up a testamentary trust for the benefit of their child in their wills. The trustees are Trust Company A, the child's guardian and their uncle. The trust generated income of R100 000 in the 2017 year of assessment and further sold a property purchased in 2014 for R1 000 000 for an amount of R1 500 000. The income will be distributed to the minor and the capital gain retained in the trust.

The income tax will be as follows in the hands of the minor:

R100 000 × 18% = R18 000 – R13 500 = R4 500

The Capital Gains Tax will be as follows in the trust:

R1 500 000 – R1 000 000 = R500 000 [Gain] × 40% (Inclusion rate) = R200 000

(R200 000 – R188 000) × 26% [Marginal tax rate] + R33 840 = R36 960

Conclusion

A special trust can play a key role in financial planning where there are dependants with special needs and minors. If implemented correctly it can be very beneficial for the dependants. Further, it gives the creator of the trust piece of mind that his/her dependants will be taken care of by the appointed trustees.

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