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The recipients of the
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Louw Du Toit

For his contribution entitled

Better The Devil You Know – Tax And Other Unknown Estate Expenses At Death On Offshore Investments

and both

Petri Lourens

and

Anel Strampe

For their contribution entitled

Wills to be signed and witnessed using audio-visual links – time to amend the Wills Act 7 of 1953

and

Jothi Chirkoot

For her contribution entitled

A world-wide will versus foreign wills

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.

Contents

Estate Planning

The impact of standing crops on a farmer's estate **A1 – A13**
CJ Le Roux

A world-wide will verses foreign wills **A14 – A21**
Jothi Chirkoot

Massing of estates - A practical overview **A22 – A30**
Madeleine Britz

Retirement Annuity: Still an effective estate planning tool? **A31 – A44**
Maryke Maryke

Inheritance Law: The main differences between common law and civil law systems **A45 – 52**
Stephan Van Zyl

Wills To Be Signed and witnessed using audio-visual links – time to amend the Wills Act 7 of 1953 **A53 – A61**
Petri Lourens and Anel Strampe

Security cession and the accrual claim **A62 – A70**
Carla Letchman

Dissolution of Customary Marriages – The impact on the estate at death and divorce? **A71 – A80**
Lehlohonolo Salemane

Business Assurance Planning

Family businesses: The need for synergy between succession planning and corporate governance **B1 – B15**
Natalie Dillon-van Acker

Income Tax

Income tax options available to farmers during a drought: paragraph 13, 13A and 19 of the first schedule **C1 – C9**
Monica Moodley

Flexible employment and the work from home scenario: Unpacking the immediate impact on income tax **C10 – C23**
Nevetha Maharaj

Special trusts under the magnifying glass **C24 – C37**
Suzelle Jooste

The disposal if immovable property: Which entity to hold property in gives a seller best financial outcome? C38 – C54
Saudiqa Fakier

Investment Planning

Better the devil you know – Tax and other unknown estate expenses at death on offshore investments D1 – D15
Louw du Toit

Retirement Planning

The 'ABC' of Section 37A, B, C & D of the Pension Funds Act 24 of 1956 – Protection measures for pension benefits E1 – E7
Eugene Mpikwane

Members of retirement annuity funds and preservation funds emigrating from South Africa – Changes in terms of the 2020 Taxation Laws Amendment Act E8 – E31
Carl Muller

Montanari V Montanari: Living annuity – Accrual claim on divorce E32 – E41
Carl Muller

The annuitisation regime: Provident and provident preservation funds – The practical implications E42 – E58
Carl Muller

General

Business rescue vs cancelling business assurance policies F1 – F8
Chantel Strauss

The process of retrenchment and the taxation of severance and retirement benefits F9 – F19
Charlotte van der Merwe

When do I need my spouse's consent to transact when married in community of property? F20 – F28
Daleen Harris

Estate planning considerations for 'bloody' estates F29 – F38
Anél Strampe

Using usufructs to save tax during one's lifetime F39 – F46
Keith Peter

An unexpected event: The trigger of transfer duty F47 – F60
Chris Du Plessis

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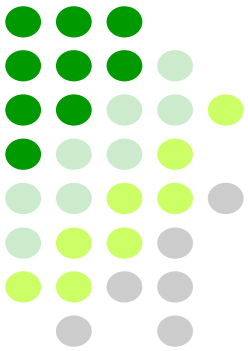

Estate Planning

The Impact of Standing Crops on A Farmer's Estate

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Introduction

The founder of Forbes magazine, B.C. Forbes, once said the following: "*It is only the farmer who faithfully plants seeds in the Spring, who reaps a harvest in the Autumn*". The question in terms of estate planning is if this will still be the case if a farmer passes away and there are unharvested crops on his farm land? Farmers often pass away while there is some form of crops on their farms. Whether these crops have just been sowed or are almost ready to harvest the question stand as to who will be taxed on these crops, who will receive these crops or their proceeds and what will the effect be on the deceased farmer's estate or the farmer's heirs?

One of the important aspects when conducting an estate plan is the liquidity of that person's estate. This has never been more prevalent than in the case of farmers that own farm land and who use production loans or other credit facilities for the purpose of producing crops and produce. This article will delve into the questions above and specifically focus on the effects that standing crops have on a farmer's estate for estate duty and income tax (including capital gains tax) purposes as well as what the possible pitfalls are in a farmer's will that have to be consider while conducting an holistic estate plan.

"Property" in terms of the Estate Duty Act[1]

First of all one has to understand what will be considered to be property and deemed property in a person's estate. The estate of a deceased person consist of both the property of the deceased as at the date of death as well as deemed property[2] considered to be the deceased's as at date of death.[3]

The Estate Duty Act[4] defines property as the following: "*Property means any right in or to* property, *movable or immovable, corporeal or incorporeal*". It is clear that the definition includes all types of properties.[5]

To be property in a person's estate it must have belonged to the person or vested in him at the time of his death. The mere fact that it becomes an asset in his estate after his death does not make it property in his estate, for example dividends or rent that accrue after death.[6] This is an

[1] 45 0f 1955
[2] Section 3 of the Estate Duty Act 45 of 1955
[3] It falls beyond the scope of this article to discuss what will be deemed property in a person's estate.
[4] 45 0f 1955
[5] DM Davis, C Beneke & RD Jooste, Estate Planning at 2-7 (Service Issue 51 2018)
[6] DM Davis, C Beneke & RD Jooste, Estate Planning at 2-8 (Service Issue 51 2018)

important qualification as it would impact the value of the estate for estate duty purposes. Income that accrues after death would not be dutiable.

Farm land owned by a person would therefore be property in that person's estate.

The value of farm land for estate duty purposes

When calculating estate duty, farm land registered in the name of the deceased at the date of his death is property that is included in his estate and is valued in terms of Section 5 of the Estate Duty Act[7].[8] With regards to immovable property on which a *bona fide* farming operation is being carried on, the value to be used is the price that could be obtained from a sale on the open market, less 30%. But what about the crops on the farm land on date of death?

The general rule is that crops accede to the soil in the same way that permanent buildings or improvements do.[9] Seeds planted can result in crops that are incorporated with the soil by a process of nature, and become one with that from which they draw their nourishment.[10] Therefore under common law, growing timber and crops accede to the land *superficies solo cedit* – whatever is attached to the land forms part of it).[11]

Therefore as far as the crops are concerned standing crops[12] (not yet harvested on date of death) form part of the land. If the farm land is not sold[13], the standing crops will be part of the land and valued as such. If the land is sold in the winding up of the estate then the purchase price will be the value.[14] If the crops are harvested before the farm land is sold it is considered that such crops are to be regarded as fruits accruing after death and therefore constitutes income that is not subject to estate duty.[15] It is important to note here that income that accrues

[7] 45 of 1955
[8] Section 5(1) of the Estate Duty Act prescribes the method that must be applied to determine the value of the 'property' or 'property deemed to be property' to be included in the estate for purposes of calculating estate duty.
[9] SARS Interpretation Note no. 79: PRODUCE HELD BY NURSERY OPERATORS and Secretary for Lands & another v Jerome 1922 AD 103
[10] Secretary for Lands & another v Jerome above at 105. See also Macdonald Ltd v Radin NO & the Potchefstroom Dairies & Industries Co Ltd 1915 AD 454 and Gore NO v Parvatas (Pty) Ltd 1992 (3) SA 363 (C).
[11] SARS Capital Gains Tax Guide Issue 7 at 627
[12] Standing crops is crops that has already been sowed but has not yet been harvested or reaped.
[13] The general principle is that property disposed of by the executor of the deceased's estate in the course of the liquidation of the estate shall be included at the value realised by such sale.
[14] DM Davis, C Beneke & RD Jooste, Estate Planning at 2-8 (Service Issue 51 2018)
[15] Meyerowitz supra para 27.25.

after the date of death of a deceased is shown in the income and expenditure account of a liquidation and distribution account.

From the above it is clear that the value of farm land for estate duty purposes will be impacted by any unharvested crops on those farm lands. This is best explained by way of an example:

Example 1:

Farmer McDonald owned a 1 000 hectare sowing farm in the Ottosdal District. The current market value for farm land in that area is R 20 000 per hectare. Farmer McDonald passed away a month before his crops (that he sowed using a production loan) could be harvested. The value of the unharvested crops are R 6 000 000. Farmer McDonald bequeaths his farm to his son in terms of his Will.

The impact of the unharvested crops will be as follows:

- Value of the farm included as property for estate duty with the unharvested crops:
  = (R 20 000 x 1 000) + R 6 000 000
  = R 26 000 000 x 70%
  = R 18 200 000
- Value of the farm included as property for estate duty **without** crops:
  = R 20 000 x 1 000
  = R 20 000 000 x 70%
  = R 14 000 000

The inclusion of the unharvested crops clearly increases the value of the farm to be included in the estate of farmer McDonald by R 4 200 000 and would lead to an increased amount of estate duty payable.

It is further important to note that it is the value of the crops at date of death that is included in the market value of the farm land. It would therefore be of paramount importance that the farm land is valued as soon as possible after the death of a farmer to nullify any increase in the value of the crops.

The effect of unharvested crops on farm land for capital gains tax purposes

Capital Gains Tax (hereafter CGT) applies to all assets of a person disposed of on or after 1 October 2001 regardless of when the asset was acquired by that person.[16]
The death of a person gives rise to a deemed disposal of a person's assets for purposes of CGT and the deceased person is treated as having disposed of his assets to his deceased estate for proceeds equal to the market value of those assets at the date of the person's death.[17]

Immovable property on which *bona fide* farming operations are carried out is valued in terms of Paragraph 31(1)(f) of the Eighth Schedule of the Income Tax Act 58 of 1962.[18]

Farm land that is owned by a farmer would thus be a capital asset that is deemed to be disposed of at date of death of the farmer. The question is then how unharvested crops will affect the value of farm land for CGT purposes.

The answer lies in the First Schedule of the Income Tax Act[19]. Paragraph 14(1) of the First Schedule provides that any amount received by or accrued to a farmer in respect of the disposal of any plantation shall, whether such plantation is disposed of separately or with the land on which it is growing, be deemed not to be a receipt or accrual of a capital nature and shall form part of such farmer's gross income.[20] To fall within the ambit of paragraph 14(1) the deceased must have been a farmer.[21] It is clear from the above that where the deceased was a farmer paragraph 14(1) of the First Schedule deems unharvested crops on land to be revenue of nature (and not capital). Unharvested crops will be treated as income and the value of the unharvested crops should thus be separated from the land and subjected to income tax and not CGT.

Paragraph 14(2) of the First Schedule[22] sets out how the allocation between the unharvested crops (revenue) and farm land (capital) should be made. Paragraph 14(2) determines that an

[16] CGT is levied on the capital gain which is generally speaking the difference between the proceeds and the base cost of the asset. What constitutes the base cost and methods for determining the base cost are prescribed in the Eighth Schedule of the Income Tax Act 58 of 1962 and are beyond the scope of this article.
[17] Section 9HA of the Income Tax Act 58 of 1962
[18] A complete discussion of how farm land is valued for CGT purposes falls beyond the scope of this article and for all further example the full market value of such farm land will be used.
[19] 58 of 1962
[20] SARS Capital Gains Tax Guide Issue 7 at 627
[21] Kluh Investments (Pty) Ltd 2016 (4) SA 580 (SCA), 78 SATC 177. It falls beyond the scope of this article to discuss what constitutes a "farmer" and the reader hereof is referred to the Notes on South African Income Tax (2020) at page 760 onwards for a discussion of the topic.
[22] The Income Tac Act 58 of 1962

executor must, in instances where farm land is disposed of with unharvested crops and there is not an agreement regarding the consideration for the unharvested crops, make an apportionment between the market value of the farm land and the unharvested crops based on the relative market values of the respective assets on the date of death.[23]

An exception to the rule, contained in the First Schedule, is when a farm is bequeathed as a going concern. It is important to understand what constitutes a going concern. Although Draft Interpretation Note 57[24] deals with issues concerning Value Added Tax, it gives a good indication of the meaning of a going concern in relation to a farming enterprise:
"The mere sale of farm land does not constitute the supply of a farming enterprise *and is rather the supply of a capital asset used in a farming enterprise. In order to supply a farming enterprise as a going concern, the seller and purchaser must agree in writing that the income-earning activities of the farm are disposed of together with, amongst others, the crops, livestock, assets and equipment necessary for carrying on these farming activities."*

When a farm property is disposed of on a going-concern basis, there is no requirement to include the value of any growing crops in gross income, except when the sale agreement specifies an amount in respect of those crops.[25] The value of the crops is simply treated as part and parcel of the value of the farm land and is an amount of a capital nature.[26] Upon death of a farmer the same treatment applies and the value of the unharvested crops will be included in the market value of the of the farm land and will therefore form part of the proceeds on disposal of the farm land on date of death.

The following examples illustrates this principle:

Example 2.1:

Farmer Howlett owns as sowing farm in the Lichtenburg District. The farm is 350 hectares big and the current market value is R 25 000 per hectare. There is standing crops on the fields with a value of R 2 000 000. He bequeaths his farm to the Howlett Family Trust.
The value of the farm for CGT purposes will be as follows:

[23] SARS Capital Gains Tax Guide Issue 7 at 628
[24] Issue 2, undated. https://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2017-13%20-%20Draft%20IN%2057%20(Issue%202)%20-%20Disposal%20of%20an%20enterprise%20or%20part%20thereof%20as%20a%20going%20concern.pdf
[25] SARS Capital Gains Tax Guide Issue 7 at 628
[26] Id

❑ = (R 25 000 x 350)[27]

= R 8 750 000The value of the standing crops will be revenue of nature and will not impact the value of the farm land for CGT purposes.

Example 2.2:

Farmer Howlett owns a sowing farm in the Lichtenburg District. The farm is 350 hectares big and the current market value is R 25 000 per hectare. There is standing crops on the fields with a value of R 2 000 000. He bequeaths his farm and all assets related to the farming activity to the Howlett Family Trust **as a going concern**[28].[29]

The value of the farm will be impacted by the standing crops as follows:

❑ Value of the farm, bequeathed as a going concern, for CGT with the unharvested crops:

= (R 25 000 x 350)+ R 2 000 000[30]

= R 10 750 000

The inclusion of the standing crops increases the value of the farm for CGT purposes by R 2 000 000 and would lead to an increased amount of tax payable. This will only be the case where the farm land and the needed income-earning activities of the farm, its equipment, crops and assets necessary for carrying on the farming activities has been bequeathed as a going concern.[31] It is important in the circumstances where a farm is bequeathed as a going concern for the valuation of the farm to be done as soon as possible after the date of death to ensure that any increase in the value of the standing crops is nullified.

Income tax on the crops (who will be liable)

A person ceases to *be* a taxpayer on the date of his death but the normal tax payable on the income derived by the deceased before death is a debt due by his estate.[32] The executor must complete the return of income of the deceased to the date of death and submit the resulting

[27] Please take note that for the purposes of this example I assume that the 70% value of farm land that may be applicable to the CGT calculation is not applicable in this instance. I refer to the article "Under which circumstances does farm land qualify for a 30% deduction in value for purposes of estate duty and CGT?" by Natalie Dillon in the Premiums &Problems Acticle Edition Nr. 118.

[28] It can be accepted here that all the requirements have been met for the bequest of the farm to indeed qualify as a going concern.

[29] SARS Capital Gains Tax Guide Issue 7 at 628

[30] Id footnote 27.

[31] SARS Capital Gains Tax Guide Issue 7 at 628

[32] AD Koekemoer et al, SILKE: South African Income Tax at 898 (2018).

claim for normal tax against the assets of the estate.[33] Section 9HA[34] comes into effect for persons who die after 1 March 2016. Section 9HA(1)[35] deems a person to have disposed of all his assets as at date of death for an amount received or accrued equal to the market value of those assets as defined in paragraph 31 of the Eighth Schedule of the Income Tax Act[36].[37] What is important here is the fact that the deceased will be taxed on all of his income and assets to the date of his death. If crops are unharvested as at date of death the value of the crops will be included in the value of the farm land as discussed earlier.

The question remains who will then be taxed when the crops are harvested? The answer lies in the section of the Income Tax Act[38] that deals with income that accrues or is received after death.

A *person* ceases to be a taxpayer on the date of his death. After that date a new taxpayer, i.e. the deceased estate, is created.[39] Section 25 of the Income Tax Act[40] regulates how any income after death needs to be taxed and in whose hands it will be taxed.

Section 25[41] has been totally revised for persons who die on or after 1 March 2016[42]. The section now states that income received by or accrued to the executor of a deceased estate must be taxed in the hands of *the* deceased estate. This includes amounts which would have been income in the hands of the deceased had it been received during his lifetime.[43] The last sentence is crucial. It makes it clear that the deceased estate will be taxed on any income after death that would have been income in the hands of the deceased for example the income from harvesting crops. The crux of the matter is that the deceased estate of a farmer will be liable for the income tax on the standing crops *on* the farm land when it is eventually harvested. The proceeds of these harvested crops will be income that accrued or is received after death and as mentioned above it will be reflected in the income and expenditure account of the liquidation and distribution account.

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[33] AD Koekemoer et al, SILKE: South African Income Tax at 899 (2018).
[34] Income Tax Act 58 of 1962
[35] Id
[36] Id
[37] Haupt, Phillip, Notes on South African Income Tax (2020) at page 796
[38] Supra 19
[39] AD Koekemoer et al, SILKE: South African Income Tax at 901 (2018).
[40] Supra 19
[41] Id
[42] The previous Section 25 of the Income Tax Act will not be discussed in this article and the focus will be on the revised Section 25 that is applicable to all deaths after 1 March 2016.
[43] Haupt, Phillip, Notes on South African Income Tax (2020) at page 797

Income that accrues after death will be distributed to the heir or legatee who inherits the asset that caused the income to be accrued/earned. For example rental income from a fixed property that is bequeathed to a trust will be distributed to the trust after the deduction of any liabilities against such income. The same will then apply to income earned from the harvesting of crops. It will be distributed to the heir or legatee that inherits the farm. It must be borne in mind that any income earned after the transfer of the asset to the legatee or heir had taken place will be taxed in the hands of the specific legatee or heir.

The following example illustrates this principle:

Example 3:

Farmer Jan passed away leaving standing crops on his farm worth R 10 000 000. He bequeathed his farm to his daughter. Two months after his death the crops are ready for harvesting and is indeed harvested. The proceeds of the harvested crops (before tax) is exactly R 10 000 000.

The R 10 000 000 of proceeds from the harvested crops is income that accrued after death of farmer Jan and in accordance with Section 25(1) of the Income Tax Act[44] *will be taxed in his* deceased *estate as the proceeds accrued to the estate before the farm was distributed/transfer to his daughter. The amount of tax payable and other deductible liabilities on the above-mentioned proceeds is R 2 500 000*[45]*. Therefore the amount of R 7 500 000 will be distributed to farmer Jan's daughter who inherits his farm in terms of his Will.*

The impact on the liquidity of a farmer's estate

Liquidity in a deceased estate is necessary to enable the executor to settle all the estate costs. These costs will include the administration cost, the payment of any claims against the estate for example credit facilities and *bonds*, the *payment* of taxes such as estate duty and income tax (including CGT) *et cetera*.

The question now is what impact standing crops on a farm have on the liquidity of a farmer's *estate?*

First of *all* the value of standing crops will lead to a higher value of the farm land and therefore will in return lead to higher amounts of estate duty payable.[46] With regards to CGT the impact would vary depending on whether the farm was bequeathed as a going concern or not. If the

[44] 58 0f 1962

[45] For the purpose of this example a fictitious amount of R 2 500 000 is used which is not an amount calculated in accordance with any relevant tax tables. It is therefore purely used for illustrative purposes.

[46] None of the possible exemptions or deductions with regards to estate duty or CGT has been taken into account here.

farm was indeed bequeathed as a going concern it could lead to an increased market value of the farm for CGT purposes and therefore an increased amount of CGT payable.

A further burden on the liquidity of a farmer's estate is the executor's fee that will also be higher due to the *increased* value of the farm land caused by the standing crops.

Another *conundrum* that will impact the estate's liquidity is production loans, other credit facilities and input cost that is used by a farmer to finance the input of crops. While still alive the proceeds from the harvested *crops* would normally cover any production loans or other input costs that the farmer is liable for. This will however not always hold true when a farmer passes away. Should a farmer bequeath his farm to a specific heir or legatee it would entail that any proceeds from the harvested crops may be distributed to the relevant heir or legatee and the costs settled from the residue of the estate (assuming the residue, or its proceeds are adequate to cover the said costs). The proceeds in such a case might thus not be used to settle any production loan or input costs. It will remain the responsibility of the estate to settle these outstanding *amounts* and could be detrimental to the liquidity of the farmer's estate and the residual heir.

It should be noted that in certain circumstances the proceeds of harvested crops may be used to settle any of the above-mentioned cost. *This* will for example be true if the proceeds fall to the residual heir and will therefore be available to be used to settle any of the estates financial liabilities.

Example 4:

Farmer Koos passed away and had the following assets and liabilities in his estate:

Assets:

- ❑ Farm Blinkklip
- ❑ Farming implements (including tractors and combine harvesters)
- ❑ Two houses in Cape Town
- ❑ Private vehicles
- ❑ Furniture and household effects

The only liability in his estate is a production loan of R 5 000 000.

Farmer Koos bequeaths his farm Blinkklip, and it is distributed as a going concern, to his son's trust, the two houses to his daughter and the residue of his estate to his wife.

An estate plan was conducted for farmer Koos and determined that the potential estate duty, CGT and administration costs would be approximately R 6 000 000.
Farmer Koos took out a life policy on his life to cover the above in case of his death. He was not concerned about the outstanding production loan as the proceeds from the harvested crops where normally more than enough to cover the payment of the loan and thought that it would be the same should he pass away.

Farmer Koos passed away 5 weeks before the crops on his farm Blinkklip could be harvested. Due to the fact the standing crops form part of the farm Blinkklip the farm and the proceeds of the harvested crops (after the deduction of the relevant income tax and other liabilities) will be distributed to his son's trust who is the heir. The production loan however remains a liability in his estate. The proceeds of the harvested crops will not be used to cover the outstanding production loan and will lead to a liquidity problem in the estate. Furthermore the value or the standing crops increases the value of the farm Blinkklip and would potentially increase the amount of estate duty, CGT and executor's fee payable by the estate.

This could have been very different if farmer Koos passed away 5 weeks after the crops was harvested and the proceeds fell into the residue of the estate.

A farmer's will

After discussing all of the consequences that standing crops can have on a farmer's estate it is evident that the testamentary bequests contained in a farmer's will is essential and their effects needs to be thoroughly investigated. A testator only has the rights to bequeath/distribute assets of which he was the owner as at the date of his death in terms of his Will. The proceeds of crops that was harvested after the date of death of a farmer is income that accrues after death and does not fall within the estate and assets that the farmer may bequeath in his Will. One should therefore, in my opinion, be careful with the wording of a bequest such as "*I bequeath the yield of any crops on lands, after all production costs, production loans and all other related costs have been recovered, to…*". This type of bequest might be an in-executable and unenforceable bequest due to our common law status that the unharvested crops forms part of the farm land.

When drafting the will one could make use of conditions such as a bequest price where you determine that the bequest of the farm to an heir is subject to the heir paying a bequest price

that is equal to the amount of input costs[47] as at the date of death or make the bequest subject to a suspensive or resolutive condition that the heir must take over any input costs[48] as at date of death or use the proceeds of the harvested crops for the payment of any related production loans or other costs. This would ensure that such a bequest will enforceable and the executor will be able to execute it.

Conclusion

It seems as if the saying of B.C. Forbes may not always hold water when a farmer passes away before his crops could have been harvested. Crops could either be detrimental to the estate of a farmer when it increases the value of farm land and the proceeds thereof in return can, depending on the provisions of the will, not be used for liquidity purposes. On the other hand, it could be beneficial if the proceeds can be used for liquidity purposes.

This emphasises the fact that when advisors conduct an estate plan for a farmer there is a definite need for a holistic investigation into what the wish of the farmer truly is when he passes away. In this regard, the amount of liquidity needed to administer the estate should be calculated in order to ensure that there is enough liquidity in the estate without the need for the executor to sell *assets*. The will of the farmer also needs to be perused to establish what adjustments need to be made to address these requirements.

[47] Input costs refers to all cost that a farmer incurred in the production and or sowing of crops and refers any production loans or other credit facilities.
[48] Supra 32

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A World-Wide Will Versus Foreign Wills

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Introduction

There are many South Africans who have investments and/or property in other countries. Although it is possible to have one will which deals with your worldwide assets, it is also possible, subject to section 3*bis* of the Wills Act [1] to have a separate will for each country in which you have assets. The question that is often asked is which of the two is a better option? The answer to this question is not as straight forward as one may think and one answer certainly does not fit all scenarios.

Having one will dealing with worldwide assets is often the preferred choice as this promotes simplicity and certainty in an estate plan[2]. However, it is important to make a decision based on the following:

i. In which jurisdiction(s) the assets are located to understand the legislation in respect of succession and estate planning; and
ii. The type of asset and the value to establish the feasibility of dealing with the asset/ s in one Will or more than one Will; and
iii. What the estate administration formalities would be, to deal with the assets once the testator has passed away.

The following are important considerations:

Forced heirship

In South Africa we have freedom of testation which means a South African person may dispose of his or her assets according to their wishes recorded in their last will and testament. Complications can arise if the testator owns assets in a jurisdiction which implements a forced heirship regime. This requires a certain portion of the assets to be allocated to particular family members. This restricts a testator's ability to bequeath assets freely. Forced heirship is a complex set of rules and if one does not carefully structure their succession plan, forced heirship could become an unexpected and unwanted reality. Many countries in Europe such as France, Spain, Germany and Italy have "forced heirship" rules which can potentially provide statutory or fixed inheritance rules in respect of certain family members and restrict testamentary freedom[3]. The

[1] Wills Act 7 of 1953

[2] Lamprecht, I 31 July 2017. Do you need a separate Will for your off shore assets? Available at https://www.moneyweb.co.za/in-depth/fisa/do-you-need-a-separate-will-for-your-offshore-assets/

[3] Phipps, O August 2017. Multi-jurisdictional estate planning and administration, Fiduciary Institute of Southern Africa. Available at https://www.fisa.net.za/wp-content/uploads/2017/08/Oliver-Lester-Aldridge/FISA-August-2017-Presentation.pdf presentation slide 10

common offshore havens such as Guernsey, Jersey and The Isle of Man do not apply forced heirship rules[4].

The following means to avoid forced heirship may be considered, although due to its accompanied complexities, it is recommended that a professional or specialist with knowledge of these rules is consulted:

- ❑ According to Oliver Phipps, where a South African individual owns assets located in the European Union (apart from the UK, Ireland and Denmark), the European Succession Regulation (also known as Brussels IV) presents a very useful planning opportunity, as an individual can elect for the law of their nationality to apply to the succession of their assets. This can potentially be a convenient way to avoid the forced heirship rules and for a South African national to ensure that South African law applies to the succession of the European assets[5].
- ❑ Trusts have been a dependable method of succession planning and generally protected from forced heirship claims[6].

Bank accounts

In the interest of practicality, a South African will should be able to deal with moveable assets such as simple offshore bank accounts. During the winding up of an estate and upon the request from the South African executor to have the funds from the foreign bank account paid into the estate account, some foreign banks, such as England, have a threshold under which they would release the funds into the South African estate account without delay. However, if above the threshold, the court in the foreign jurisdiction will have to first formally recognise and give effect to the South African letters of executorship. This is referred to as "resealing" the letters of executorship. The entire process can be time consuming, because the letter of executorship has to first be obtained locally from the Master of the High Court in South Africa, and thereafter be resealed by the foreign court before the funds in the foreign bank account are released. There are jurisdictions, like Switzerland, where it is not necessary to have a foreign will in place for assets

[4] Fin24 26 January 2018. Be aware of foreign estate implication of offshore investments- expert. Available at https://m.fin24.com/Money/Wills-and-trusts/be-aware-of-foreign-estate-implications-of-offshore-investments-expert-20180126

[5] *Id* at slide 10

[6] Intertrust group, 16 May 2019. 5 Things you should know about forced heirship and how to avoid it. Available at https://www.intertrustgroup.com/news-and-insights/insight-news/2019/five-things-you-should-know-about-forced-heirship-and-how-to-avoid-it

held in that jurisdiction. This is because a South African executor will be recognised by financial institutions without the need for expensive court applications[7].

The principle of survivorship

The principle of survivorship should also be considered during estate and succession planning for a South African client who jointly owns a foreign bank account or investment account. In some countries, on the death of one joint owner, his/her share may not pass through the estate to a beneficiary of choice, but may pass automatically to the surviving joint owner of the bank account or investment account. Making a special bequest in respect of the owner's portion of the bank account or investment account to a beneficiary in a will, may very well be in conflict with the principle of survivorship if the latter applies in that country. The principle of survivorship operates in the UK, Ireland, Jersey, Guernsey, the Isle of Man and many other countries throughout the world[8].

Foreign investments

If assets consist of foreign investments administered by a South African institution, there is no need to prepare a separate foreign will[9], particularly if the value of the investment is small. The option to have a separate will is however still available in such an instance. An offshore endowment policy issued by a South African insurer may have a beneficiary nominated, in which case the proceeds will pay directly to the beneficiary on the death of the life assured. There is thus no need to cater for succession by means of a will.

Oliver Phipps illustrates the advantage of having a separate will in an example of a share portfolio in Jersey: if there is a will in place to cover the Jersey estate, the advantage is that access to the share portfolio would be quicker for an executor, who would not have to wait or rely on the local South African estate to produce the required document and then await the Jersey grant of probate. In other words, the two separate estates may be wound up simultaneously but separately in the respective jurisdictions[i10].

[7] Snyman J, 4 August 2015. You probably need a foreign Will if you have invested offshore. Available at https://www.fanews.co.za/article/life-insurance/9/estates-wills/1001/you-probably-need-a-foreign-will-if-you-have-invested-offshore/18450 page 2

[8] *Supra* note 3 at slide 11

[9] *Supra* note 6 at page 2

[10] Supra note 3 at slide 7

The type of foreign investment and the value of the investment should however be used as guidelines as to whether a world-wide will or a foreign will would be appropriate from a practical perspective.

Foreign immovable property

If the client owns foreign immovable property, a foreign will is almost always recommended. This is because different countries have different laws that deal with the transfer of property. Having a foreign will in these circumstances will ensure that the provisions and dispositions in a will conform with the law of the specific country. This would avoid conflict which could later lead to delays in the winding up of an estate. If the client chooses to have one world-wide will, it would be important to obtain legal advice from a specialist in the country where the property is situated to ensure conformity with the law.

Estate duty

Having a foreign will does not relieve South Africans from estate duty on their worldwide assets. In terms of the Estate Duty Act[11], property of a person who dies whilst a resident in the Republic includes all property wherever situated[12]. Estate duty may also be payable in the foreign country in accordance with the laws of the such country.

There are double estate duty agreements in force between South Africa and a few other countries. The Estate Duty Act makes provision for the National Executive to enter into such agreements with the Government of another country in order to make arrangements for the prevention, mitigation or discontinuance of the levying of estate duty in respect of the same property[13].

The Estate Duty Act further makes provision for the deduction of foreign death duties levied against estate duty payable on a South African resident's property situated outside South Africa[14]. This deduction may however not exceed the amount of estate duty imposed on such property in terms of the Estate Duty Act. It must also be borne in mind that this deduction is not

[11] Estate Duty Act 45 of 1955, section 3(1); Meyerowitz D, Meyerowitz On Administration Of Estates And Their Taxation, 2010, Chapter 27 at page 27-2
[12] Haupt P, Notes on South African Income Tax, 2020 edition, Chapter 28 at page 871
[13] Estate Duty Act 45 of 1955, section 26(1)
[14] Estate Duty Act 45 of 1955, section 16(c)

applicable where there is a double estate duty agreement in place between South Africa and the country levying the foreign death duty[15].

The Estate Duty Act[16] additionally provides for a deduction of the value of property included in the estate from the gross value of the estate where:

a) such property is situated outside the Republic and was acquired by a deceased person before he first became ordinarily resident in the Republic; or
b) where such property is situated outside the Republic and was acquired by means of a donation or inheritance from a non-resident.

Administration of estates

Having a foreign will to deal with assets outside the Republic may avoid delays in winding up of the estate. Both the foreign estate and the local estate can be wound up at the same time without delay in one estate impacting negatively on the other estate. If a South African resident only has a South African will, the executor of his estate may have to apply to foreign courts to recognise his right to deal with the foreign property. This could result in foreign language problems and additional administration costs[17]

Validity of wills and clarity

Caution needs to be had when it comes to the validity of a South African will in a foreign jurisdiction. The validity requirements may be met in terms of South African law, but it may be in conflict with the validity requirements of foreign law. To avoid this conflict a foreign will in that jurisdiction would be recommended.

If the client has separate wills, each will must be very clear about the assets it is dealing with in the various the jurisdictions i.e. the assets owned in a specific jurisdiction. There should also be a residuary clause to deal with unforeseen contingencies.

[15] Meyerowitz D, Meyerowitz On Administration Of Estates And Their Taxation, 2010, Chapter 30 at page 30-9, Chapter 31 at page 31-1
[16] *Supra* note 9, Estate Duty Act 45 of 1955, section 4(e)
[17] *Supra* note 6, at page 1

Revocation clause

When there are multiple wills, there is risk of unintentionally revoking wills pertaining to other jurisdictions. It is therefore of extreme importance to make sure when revoking a will in one jurisdiction, the revocation clause is specific in that it is revoking the previous wills pertaining to that particular jurisdiction only. In the absence of such a provision, there is a risk that all wills, including those pertaining to other jurisdictions, may be revoked, and the client may only have one will on death which deals with a portion of his assets only.

Conclusion

As exchange control measures are relaxed and the offshore investment allowance increases, many South Africans opt to invest offshore, particularly in times when the value of the Rand slides downwards. As part of an estate and succession plan for a client, the option of having one world-wide will versus a foreign will for foreign assets must be given due consideration. In this regard the feasibility, practicality and necessity factors discussed above for each client's unique set of circumstances must be taken into account.

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Wills Act 7 of 1953

Massing Of Estates - A Practical Overview

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Introduction

Massing is an estate planning technique used by fiduciary specialists and estate planners, most commonly where the spouses are married in community of property. One of the major reasons for using massing as an estate planning tool is the fear that the surviving spouse will not utilize or manage the assets as contemplated by the first-dying spouse and that the children or heirs will not benefit from his/her legacy, or that children will not inherit if the surviving spouse remarries.

There are two forms of massing namely "Statutory massing" which is governed by section 37 of the Administration of Estates Act,66 of 1965[1] and then there is what is referred to as "common law massing".

The purpose of this article is to give a broad and practical overview on massing with particular reference and to focus on the statuary requirements of massing in terms of Section 37 of The Administration of Estates Act. [2]

What is massing?

Massing can be described as an event where two or more parties, in a joint will, consolidate their estates or part of their estates (e.g. a jointly owned house) into one massed estate for joint disposition on the death of the survivor.

Statutory massing

Section 37 of the Administration of Estates Act[3]

Section 37 of the Administration of Estates Act provides as follows:

"If any two or more persons have by their mutual will massed the whole or any specific portion of their joint estate and disposed of the massed estate or of any portion thereof after the death of the survivor or survivors or the happening of any other event after the death of the first-dying, conferring upon the survivor or survivors any limited interest in respect of any property in the massed estate, then upon the death after the commencement of this Act of the first-dying, adiation by the survivor or survivors shall have the effect of conferring upon the persons in whose favour such disposition was made, such rights in respect of any property forming part of the share of the survivor or survivors of the *massed estate as they would by law have possessed under the*

[1] Act No.66 of 1965
[2] The Administration of Estates Act, No.66 of 1965
[3] Act No.66 of 1965

will if that property had belonged to the first-dying; and the executor shall frame his distribution account accordingly."

The requirements for statutory massing in terms of Section 37 are as follows[4]:

- There must be a valid mutual will in place.

  A mutual will is the separate wills of two (or more) persons contained in one document. Before the death of the first-dying either can revoke the will in so far as the estate of the person who revokes is concerned. After the death of the first-dying the survivor can still revoke the will in respect of the survivor's estate except where the estates are massed and the mutual will disposes of the massed estate after the death of the survivor and the survivor has accepted benefits under the will.[5]
- There must be two or more persons that are parties to the mutual will, but they do not need to be married. Massing between parties that do not have any relationship or connection does not occur very often, but is possible in terms of section 37.[6]
- Some or all the property must be consolidated into a single massed estate and must be disposed of by the mutual will. Whether or not a will masses the two estates is a question to be decided on interpretation of the will and the language used. There is a presumption against massing[7], but this presumption is rebutted when the terms of the will make it clear that the testators intended to mass the estates. The wording in the mutual will must make it clear that it is the intention of the parties to mass their entire estate or a portion thereof.

Example clause in mutual will-massing

- "We declare that the estates of the first-dying of us and of the survivor shall be massed and be administered as one estate.

- The survivor must adiate the benefits under the mutual will.

  The survivor's incapacity to make a will, when there has been a massing followed by adiation by the survivor, applies only to the portion of the joint estate which is massed. Thus, when there is a massing of only a portion of the joint estate, the survivor is at liberty to make a will dealing with the portion of the estate which has not been massed. Even if the whole of the joint estate is massed and the survivor has adiated under the joint will but subsequently acquires further

[4] Administration of Estates Act, No.66 of 1965
[5] Oosthuysen v Oosthuysen 1868 Buch 51;
Secretary SA Association v Mostert 1869 Buch 231 and 1873 Buch 31;
Receiver of Revenue v Hancke 1915 AD 64 78
[6] Act No.66 of 1965
[7] Perry v Executors Estate Oats 1941 TPD 91 97

assets after the death of the first dying, he or she will be entitled to dispose of such further assets by a subsequent will.[8]

Where the survivor repudiates the benefits under the mutual will no massing will take place. The survivor will retain his/her own assets but will forfeit any benefits he/she would've received in terms of the mutual will. The ultimate beneficiaries of the mutual will, will be entitled to their benefits immediately except where the will contains a clause to the contrary.

Although there are no formalities prescribed for adiation and repudiation, most Master offices have stringent requirements for both a deed of adiation as well as one for repudiation. The deeds of adiation and repudiation must be in writing, executed before two witnesses and must contain a certificate from an attorney or notary or a person with specific knowledge in this field, confirming that the act of adiation has been explained to the beneficiary and that he/she understands the legal consequences of adiation.[9]

Once an election by the heir or legatee is made either to adiate or repudiate, the decision is final and irrevocable. The only exception to this is where an election is made in ignorance of legal rights, as this will not be a true election. An adiation in such circumstances is thus not a proper adiation and the court will set it aside on application of the person concerned. Where the acceptance of a benefit under the will is however made with full knowledge of rights and obligations, the court will not allow such adiation to be repudiated.[10] In this regard, Meyerowitz states:

"Once the heir or legatee has made his election it is final. Having renounced he cannot thereafter accept and vice versa. But as election involves a surrender of rights to property, it ought not to be lightly inferred and clear proof of some unequivocal act of election will be required, because there can be no intention to surrender the rights involved in making an election unless there is knowledge both of the facts and the legal consequences of such surrender. Thus if a beneficiary were to take benefits in ignorance of the fact that he has to elect or that he was entitled to repudiate, the fact that he has taken a benefit will not preclude him from thereafter repudiating. It will, however, be some proof of his having elected and he would have to show that his ignorance was in the circumstances justus et probabilis. What will

[8] Joubert v Ruddock 1968 1 SA 95 (E)
[9] Davis, Beneke and Jooste, 2020, *Estate Planning*, LexisNexis: Durban: para 9.5A
[10] Weiner *NO v The Master (1)* 1976 2 SA 830 (T)).

be sufficient proof of election depends upon the circumstances of each particular case, the best evidence being, of course, the express acceptance by the beneficiary.

The question *of* election *is usually of importance where spouses have massed their estates and the survivor must elect whether to take her share and forgo the benefits of the joint will or allow her share to be disposed of and enjoy the benefits.This election by the surviving spouse is usually referred to as adiation.. The courts have been slow to infer that a surviving spouse has adiated merely because she has taken some steps from which adiation may be inferred. So, for instance , it has been held that adiation was not established where the surviving spouse took out letters of administration as executor in terms of the will; failed to claim her rights under the community for a considerable period; or remained in possession of the joined estate."*[11]

- The mutual will must give the surviving party a limited interest over the massed estate. A direct bequest of the property of the first-dying which does not form part of the massed estate will not be sufficient. The limited right may be in the form of a usufruct, fiduciary interest, annuity or any other right. Another benefit of bestowing a limited right upon a surviving spouse is the reduction or eradication of estate duty. The bare dominium devolves upon the heirs/legatees of the parties in the joint will. A usufructuary interest is most commonly used in this regard.
- For a detailed explanation of the capital gains tax implications of limited interests created in a will see Premium & Problems Article Edition Nr.110 January 2015. [12]

Examples of limited interests used

Massing with usufruct

Liezel and Tony are married in community of property and stipulate in their joint will that their joint estate will be massed and consolidated as one, and that the massed estate will, on the death of the first-dying go to their son Thomas, subject to the condition that the surviving spouse will have a lifelong usufruct over the massed estate.

Massing with fideicommissum

John and Sue mass their estates and stipulate in their joint will that on the death of the first-dying their massed estate will go to the survivor of them, and on the death of the survivor to their children in equal shares.

[11] *Meyerowitz on Administration of Estates* 2007 at para 18.11. p 18-7.
[12] Muller,2015: B49-B86

Massing with an annuity & trust

Mandla and Thebogo mass their estates and stipulate that on the death of the first-dying, the massed estate must be transferred to a trust subject to the condition that the survivor receives an income/annuity from the trust (income beneficiary with a vested right) for the duration of his/her life. On the death of the survivor the right to income ceases and their children will receive the capital of the trust in equal shares.

Example of adiation certificate[13]

Adiation by surviving spouse under the will of the deceased spouse with waiver of benefits of marriage in community of property:

DEED OF ADIATION

I, the undersigned (*surviving spouse's full names*), do hereby declare:

(1.) Marriage	That I was married to (*deceased*) on (*date of marriage*) in community of property.
(2.) Date of death	That my said husband (*or* wife) died on (*date of death*) at (*place*).
(3.) Massing	That the last will and testament of my said husband (*or* wife) and myself dated (*date*) constituted a massing of our estates.
(4.) Effect thereof	That I understand the meaning, implications and legal effect of a massing which has been fully explained to me.
(5.) Option	That I understand that I have the option either to adiate under, and be bound by the terms of, the said will or to repudiate the same.
(6.) Implications	That the implications both of an adiation and a repudiation have been fully explained to, and are understood by, me.
(7.) Election	That after due consideration I have elected to adiate under the said will and to be bound by the terms thereof and I hereby declare that I have done so.
(8.)	That I fully understand that my decision, hereby declared, is irrevocable.

SIGNED at (*place*) on this (*day, month, year*) in the presence of the subscribing witnesses

Witnesses:

1.

2.

(*Signatures of witnesses*) (*Signature of surviving spouse*)

[13] Davis et al., 2020, *Estate Planning*, LexisNexis: Durban: para 9.

Massing and Insolvency

The effect of section 37[14] is that heirs who inherit the massed estate receive exactly the same rights in respect of the survivor's contribution to the massed estate that would fall to them from the first-dying's contribution. They may therefore claim delivery, cession or registration, depending on the type of property, of all the assets in the total massed estate, including therefore the assets contributed towards the massing by the survivor. Section 37 provides that the executor who administers the estate shall be obliged to frame his liquidation and distribution account accordingly. If the survivor is declared insolvent after the massing, the assets he/she contributed towards the massing will not fall to his/her insolvent estate because they no longer belong to him/her but to the heirs who inherited it in terms of the joint will.[15] If the survivor dies after dies cedit but before he/she made an election either to adiate or repudiate the benefits under the mutual will, his/her right to make an election will form part of his/her estate as this right makes up an integral part of his/her estate.[16] In the case of insolvency of the survivor his/her curator acquires the right to make an election. [17]

Common law massing

Although common law massing shows great resemblance to statutory massing, there are various opposing opinions with regard to common law massing. When two persons mass their separate estates and dispose of the massed estate without granting the survivor a limited interest in the massed assets, and either other assets are bestowed upon the survivor or not, this will not fall within the ambit of Section 37 of the Administration of Estates Act.

Example:

John and Linda who married out of community of property. They stipulate in their mutual will that on the death of the first-dying the survivor inherits the family home, while the residue of the massed estate is bequeathed to the children.

The provisions of section 37 of the Administration of Estate Act is clear that the above construction does not fall within the scope of "statutory massing". The survivor obtains full ownership of the property and not only a limited interest over the property. Writers refer to this type of construction as "common law massing". The survivor will have to elect whether to accept or repudiate the

[14] Administration of Estates Act, No.66 of 1965
[15] Cronje *et al. Workbook for the law of succession,* 2nd edition, Butterworths Durban 1996, 154
[16] Lourens "Boedelsamesmelting as instrument by boedelbeplanning" 2000 *THRHR* 422
[17] Lourens "Boedelsamesmelting as instrument by boedelbeplanning" 2000 *THRHR* 422

provisions of the will. Common law massing could, depending on the provisions of the will, have the effect that the survivor receives nothing from the massed estate.

Election means the choice which is given to an heir or legatee who, in terms of a will, is required to dispose of his/her own property subject to certain conditions. The heir or beneficiary must decide between accepting the testamentary benefits or rejecting it. This decision is known as election or is also referred to as the doctrine of election.

The following issues should be discussed in the case of spouses who wish to mass their entire estates or any portion thereof:

- ❑ The difference between massing and non-massing;
- ❑ The impact of the refusal of the survivor to adiate the benefits under the mutual will. This is particularly important when the parties are married in community of property. The parties should make provision in the will for alternative bequests in the case of the estate of the first dying to cater for the possibility of the survivor refusing to adiate under the mutual will;
- ❑ A mutual will is considered to be the two separate wills of the testators and either party could unilaterally revoke his or her portion;
- ❑ Even if there is massing and the survivor does not accept any benefits in terms of the mutual will, he or she could still revoke his or her portion;
- ❑ The tax consequences of massing, including estate duty, capital gains tax, possible donations tax, transfer duty and value added tax.

Conclusion

Although massing as an estate planning tool is currently less popular than it has been in the past, there are still instances where massing can be used as an effective estate planning tool.[18] The tax implications, including transfer duty, possible donations tax, capital gains tax (especially in the case of two persons who are not spouses), value added tax and estate duty should always be accounted for and explained to clients considering the massing of their estates. [19]

[18] Lourens "Boedelsamesmelting as instrument by boedelbeplanning" 2000 *THRHR* 417
[19] For a comprehensive discussion on The Tax Consequences of massing see Cloete, Premiums & Problems Nr.92 2006 "Massing-The Tax Considerations"

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Retirement Annuity: Still An Effective Estate Planning Tool?

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Introduction

In the past, a retirement annuity fund (RA) has been a useful vehicle to reduce the estate duty payable in an estate, particularly since 1 January 2009 when retirement fund lump sum payments were effectively removed as "property" for estate duty purposes. As a result of this, a person could achieve large estate duty and other savings[1] by investing large sums of money into an RA, especially if the investor has already reached retirement age[2]. The fund value at death of the investor would then be free from estate duty, effectively reducing the value of the estate and so reducing the estate duty liability. From an income tax perspective, the fact that disallowed contributions are deductible against any lump sum received at death made an RA an even more attractive investment vehicle, as large amounts of disallowed contributions can also reduce or even diminish the taxable lump sums on these RA's at death.

As a result of this, section 3(2)(bA) was introduced to the Estate Duty Act to prevent the use of, particularly retirement annuity funds as an estate planning tool whilst tax savings were simultaneously achieved on retirement fund lump sums as a result of the deduction afforded in Paragraph 5(1)(a) of the Second Schedule to the Income Tax Act[3] in respect of contributions not previously allowed as a deduction[4] or exemption[5] for income tax purposes
Section 3(2)(bA) was recently amended via the 2019 Taxation Laws Amendment Act.

This article will look at whether an RA can still be an effective estate planning tool in the light of these current developments.

Disallowed contributions and estate duty before the amendments effected by the 2019 Taxation Laws Amendment Act

Section 3(2)(bA) of the Estate Duty Act[6] was inserted[7] aiming to close the loophole mentioned above by including the balance of disallowed contributions to retirement funds as property in the estate for estate duty purposes.

[1] For example, executor's fees.
[2] Remember there are certain exceptions and cases where the value of a retirement fund could be subject to estate duty.
[3] Act 58 of 1962
[4] In terms of Section 11F, Paragraph 5(1)(a) of the Second Schedule or Paragraph 6(1)(b)(i) of the Second Schedule to the Income Tax Act.
[5] In terms of Section 10C of the Income Tax Act.
[6] 45 of 1955.
[7] By Section 2(1) of Act 25 of 2015.

Shortly, the original section 3(2)(bA)[8] provided that:

(2) "Property means any right in or to property, movable or immovable, corporeal or incorporeal, and includes–

(bA) so much of the amount of any contribution made by that person (the deceased) on or after 1 March 2015, in consequence of membership or past membership of any retirement fund, as was not allowed as a deduction in terms of section 11(k) or (n) of the Income Tax Act, or paragraph 2 of the Second Schedule to that Act, or as was not exempt in terms of section 10C of that Act in determining the taxable income of that person, is included as property in the estate of that person for the purposes of calculating the amount of estate duty for which his estate is liable.

Thus, regardless of whether the deceased's beneficiary/dependent chose to take a lump sum in cash, the contributions not allowed as a deduction or exemption would have been included as "property" in the estates of persons who died between the abovementioned dates

According to various opinions written about the section, it was defective. The original Section 3(2)(bA) applies to persons who died between 1 January 2016 and 30 October 2019 in respect of contributions made to retirement[9] funds on or after 1 March 2015. For purposes of this article, the positions in respect of deaths that occurred between 1 January 2016 and 30 October 2019 will not be discussed.

Disallowed contributions and estate duty after the amendments effected by the 2019 Taxation Laws Amendment Act

Section 3(2)(bA)[10] was amended with effect from 30 October 2019 as follows:

"3. *What constitutes an estate. –*

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

[8] Of the Estate Duty Act 45 of 1955 as amended by Act 25 of 2015.

[9] Specifically, contributions to pension, provident or retirement annuity funds that were not allowed as a deduction under section 11(k), 11(n) or 11F, or the Second Schedule of the Income Tax Act or exempted against a compulsory annuity income in terms of Section 10C of the Income Tax Act 58 of 1962.

[10] Of the Estate Duty Act 45 of 1955.

(2) "Property" means any right *in or to property, movable or immovable, corporeal or incorporeal, and includes –*

(bA) so much of the amount of any contribution made by the deceased in consequence of membership *or past membership of any pension fund, provident fund, or retirement annuity fund, as was allowed as a deduction in terms of paragraph 5 of the Second Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962), to determine the taxable portion of the lump sum benefit that is deemed to have accrued to the deceased immediately prior to his death."*

The amendment came into operation on 30 October 2019 and is applicable to all persons who die on or after that date in respect of any contributions made on or after 1 March 2016[11].

The amendment of Section 3(2)(bA) of the Estate Duty Act is only applicable to the amount "*as was allowed as a* deduction *in terms of paragraph 5 of the Second Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962), to determine the taxable portion of the lump sum benefit that is deemed to have accrued to the deceased immediately prior to his death.*". Thus, should the beneficiary/dependant choose not to take the fund value as a lump sum upon death and rather transfer the fund value to his/her own retirement vehicle or purchase a compulsory annuity, the section will not be applicable because there will be no amount allowed as a deduction in terms of paragraph 5 of the Second Schedule to the Income Tax Act, due to no lump sum benefit being deemed to accrue to the deceased immediately prior to his death. It is submitted that this creates an equitable state of circumstances, as the section 10C[12] exemption in respect of the contributions not previously allowed as a deduction or exemption will not be exempted against annuity income accruing to the beneficiaries/ dependants of the deceased member, whereas such contributions not previously allowed as a deduction or exemption will be allowed as a deduction against a retirement fund lump sum paid to beneficiaries/dependants on death[13].

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[11] For purposes of this article the position if a person died between 1 January 2016 and 30 October 2019 will not be discussed.

[12] Of the Income Tax Act 58 of 1962. Section 10C(2) provides as follows (my emphasis): (2) There shall be exempt from normal tax in respect of the aggregate of qualifying annuities payable to a person an amount equal to so much of the **person's own contributions** to any pension fund, provident fund and retirement annuity fund **that did not rank for a deduction** against the person's income in terms of section 11F as has not previously been—
(*a*) allowed to the person as a deduction in terms of the Second Schedule; or
(*b*) exempted from normal tax in terms of this section, in respect of any prior year of assessment.

[13] Retirement fund lump sums payable on death is, in terms of paragraph 3 of the Second Schedule deemed to have accrued to the deceased member immediately before death and contributions not previously allowed as a deduction or exemptions are consequently allowed as a deduction against such lump sum in terms of paragraph 5(1)(a) of the Second Schedule to the Income Tax Act.

The loophole whereby RA's were used for the sole (or main) purpose of reducing estate duty is thus effectively closed where the plan is for the dependant/beneficiary to take the fund value as a lump sum.

Example 1

Mr Beets invested R1,000,000 in a single premium RA. His disallowed contributions on date of death were R800,000. The fund value at date of death is R1,100,000. He dies before 1 January 2016. No retirement fund lump sum or severance benefit had accrued to Mr Beets before his death.

Result:

The estate is reduced by R1,100,000 – estate duty saving in the amount[14] of R220,000 (R1,100,000 X 20%).

The beneficiaries/dependants will also receive the fund value without any income tax being deducted from it:

R1,100,000 less R800,000 disallowed contributions = R300,000 which will be taxed at 0% in terms of the retirement tax table applicable to the lump sum[15] on death.

Example 2

Mr Beets invested R1,000,000 in a single premium RA after 1 March 2015. His disallowed contributions on date of death were R800,000. The fund value at date of death is R1,100,000. He dies after 1 January 2016, but before 30 October 2019. No retirement fund lump sum or severance benefit had accrued to Mr Beets before his death.

Result:

The estate is reduced by R1,100,000 (RA investment) but increased by R800,000 (deeming provision for balance of disallowed contributions to retirement funds on date of death).

Thus there would be an estate duty saving of R60,000 (R300,000 X 20%)[16].

[14] Viewed in total isolation, without taking into account any other factors/amounts influencing the net estate for calculating estate duty and also assuming a dutiable estate less than R30million and the R3,5million abatement has been utilized fully.

[15] Assuming no previous retirement lump sums received.

[16] Viewed in isolation, without taking into account any other factors/amounts influencing the net estate for calculating estate duty and also assuming a dutiable estate less than R30million and the R3,5million abatement has been utilized fully.

The beneficiaries/dependants will receive the fund value without any income tax being deducted from it:

R1,100,000 less R800,000 disallowed contributions = R300,000 which will be taxed at 0% in terms of the retirement tax table applicable to the lump sum[17] on death.

Example 3

Mr Beets invested R1,000,000 in a single premium RA after 1 March 2016. His disallowed contributions on date of death were R800,000. The fund value at date of death is R1,100,000. No retirement fund lump sum or severance benefit had accrued to Mr Beets before his death.

He dies after 30 October 2019. His only dependant/beneficiary, Betty Opts to receive the full benefit as a lump sum.

The estate is reduced by R1,100,000 (RA investment) but increased by R800,000 (deeming provision for balance of disallowed contributions to retirement funds on date of death).

Thus there would be an estate duty saving of R60,000 (R300,000 X 20%)[18].

Whether Beets dies before or after 30 October 2019, assuming no previous lump sums received from retirement funds[19], the beneficiary/dependants will also receive the fund value free of tax (R1,100,000 less R800,000 disallowed contributions = R300,000 which will be taxed at 0% according to the retirement lump sum tax table).

Based on the facts of the particular examples above you will not that, even after section 3(2)(bA) was promulgated, there is still a reduction in estate duty, even though it is not as much as before the amendment.

The closing of this loophole does thus not necessarily mean that making use of RA's for estate planning purposes, has been rendered useless.

[17] Assuming no previous retirement lump sums received.
[18] Viewed in isolation, without taking into account any other factors/amounts influencing the net estate for calculating estate duty and also assuming a dutiable estate less than R30million and the R3,5million abatement has been utilized fully.
[19] In practice this is rarely the case. Most people would have previous lump sums that have to be taken into account to calculate the tax payable on the lump sum at death.

Example 4

Mr Beets invested R1,000,000 in a single premium RA after 1 March 2016. His disallowed contributions on date of death were R800,000. The fund value at date of death is R1,100,000. He dies after 30 October 2019. His only dependant/beneficiary, Betty Opts to purchase a living annuity with the full fund value of the RA.

In this instance, the estate duty saving will still be R220,000 (R1,100,000 X 20%).

Since Beets died after 30 October 2019, and there is **no lump sum benefit that is deemed to accrue to him, and thus no deduction in terms of paragraph 5 of the Second Schedule to the Income Tax Act applicable**, no amount will be included in his estate as property in terms of Section 3(2)(bA)[20].

Example 5

Mr Beets invested R1,000,000 in a single premium RA. His disallowed contributions on date of death were R800,000. The fund value at date of death is R1,100,000. He dies before 1 January 2016. Mr Beets had during his lifetime[21] taken R1,500,000 in retirement fund lump sums.

If Betty takes the full fund value as a lump sum, the tax payable will be:

Income tax

Current taxable lump sum	R 300,000
Previous lump sums	R1,500,000
Total	R1,800,000

Tax payable applying retirement tax tables: R130,500 + 36% of amount above R1,050,000[22] = R400,500.

Deduct hypothetical tax amount on R1 500 000 (i.e. apply tax table on previous lump sums) = R130,500 + 36% of amount above R1,050,000[23] = R292,500.

[20] Of the Estate Duty Act 45 of 1955.
[21] Assuming all lump sums are taken into account for purposes of the aggregation principle when applying the retirement/death/retrenchment tax table.
[22] R1,800,000 – R1,050,000 = R750,000 X 36% = R270,000
[23] R1,500,000 – R1,050,000 = R450,000 X 36% = R162,000

The total tax payable on the R1,100,000 lump sum would thus be:
R400,500 – R292,500 = R108,000.

Estate duty
As calculated in Example 1 above, no estate duty will be payable, resulting in a saving of R220,000.

The net effect amounts to a tax saving in the amount of:
R220,000 – R108.000 = R112,000.

B) If Betty chose to purchase an annuity with the fund value of the RA:
Estate duty
No estate duty will be payable. The estate duty saving of R220,000, as calculated in Example 1 above, will be applicable.

Income tax
No tax will be payable on a lump sum (as there will be no lump sum to tax). Although income tax may be payable on the annuity, such income tax is payable on the annuity income and not the full lump sum. If a living annuity is chosen, the amount of income received and resultant tax liability could also to a certain extent be controlled[24]. It should further be borne in mind that the income and capital gains within the living annuity (i.e. on the underlying assets of the living annuity not yet paid to the annuitant) are not taxed[25] and growth in this regard will thus occur tax-free.

Note
Betty could also have considered taking an amount of R800 00 as a lump sum in this scenario, as no tax would be payable on that portion of the lump sum, due to the deduction afforded in paragraph 5(1)(a) of the Second Schedule to the Income Tax Act, nor would it attract any estate duty as indicated above.

[24] GN290: Annual income of 2.5% to 17.5% of the value of the underlying assets of the annuity calculated on inception of the living annuity and thereafter on each anniversary date of the living annuity.
[25] Section 29A(4)(a)(iii) of the Income Tax Act.

Example 6

Mr Beets invested R1,000,000 in a single premium RA. His disallowed contributions on date of death were R800,000. The fund value at date of death is R1,100,000. He dies after 1 January 2016, but before 30 October 2019. Mr Beets had during his lifetime[26] taken R1,500,000 in retirement fund lump sums.

A) If Betty takes the full fund value as a lump sum, the tax payable will be:

Income tax

The income tax liability on the lump sum is the same as calculated in Example 5 above, i.e. an amount of R108,000.

Estate duty

The estate is reduced by R1,100,000 (RA investment) but increased by R800,000 (deeming provision for balance of disallowed contributions to retirement funds on date of death).

Thus there would be an estate duty saving of R60,000 (R300,000 X 20%)[27].

The net effect amounts to an increase in tax in the amount of:

R220,000 (estate duty payable on R1 100 000) – R160 000 (R800 000 x 20% estate duty) – R108.000 (tax on lump sum) = - R48 000.

The difference in tax positions between before and after the amendment is therefore substantial, which was no doubt the intention of the amendment.

Note

Betty could also have considered taking an amount of R800 000 as a lump sum in this scenario, as no tax would be payable on that portion of the lump sum, due to the deduction afforded in paragraph 5(1)(a) of the Second Schedule to the Income Tax Act. It would however still attract estate duty in the amount of R160 000 as indicated above, but the total saving would then amount to:

R220 000 (estate duty on R1 100 000) – R160 000 (estate duty on R800 000) = R60 000.

[26] Assuming all lump sums are taken into account for purposes of the aggregation principle when applying the retirement/death/retrenchment tax table.

[27] Viewed in isolation, without taking into account any other factors/amounts influencing the net estate for calculating estate duty and also assuming a dutiable estate less than R30million and the R3,5million abatement has been utilized fully.

If a living annuity is purchased with the balance (R300 000), the amount of income received and resultant tax liability could also to a certain extent be controlled[28]. It should further be borne in mind that the income and capital gains within the living annuity (i.e. on the underlying assets of the living annuity not yet paid to the annuitant) are not taxed[29] and growth in this regard will thus occur tax-free.

Example 7

Mr Beets invested R1,000,000 in a single premium RA after 1 March 2016. His disallowed contributions on date of death were R800,000. The fund value at date of death is R1,100,000. He dies after 30 October 2019. Mr Beets had during his lifetime[30] taken R1,500,000 in retirement fund lump sums.

A) If Betty takes the full fund value as a lump sum, the tax payable will be:

Income tax

The income tax liability on the lump sum is the same as calculated in Example 5 above, i.e. an amount of R108,000.

Estate duty

The provisions of Section 3(2)(bA) will be applicable. The balance of disallowed contributions as mentioned above in the amount of R800,000 will be included as an assed in the estate, giving rise to an estate duty liability in the amount[31] of R160,000[32].

The net effect again amounts to an increase in tax in the amount of:

R220,000 (estate duty payable on R1 100 000) – R160 000 (R800 000 x 20% estate duty) – R108.000 (tax on lump sum) = - R48 000.

B) If Betty chose to purchase an annuity with the fund value of the RA:

Estate duty

[28] GN290: Annual income of 2.5% to 17.5% of the value of the underlying assets of the annuity calculated on inception of the living annuity and thereafter on each anniversary date of the living annuity.
[29] Section 29A(4)(a)(iii) of the Income Tax Act.
[30] Assuming all lump sums are taken into account for purposes of the aggregation principle when applying the retirement/death/retrenchment tax table.
[31] Viewed in total isolation, without taking into account any other factors/amounts influencing the net estate for calculating estate duty and also assuming a dutiable estate less than R30 million.
[32] R800,000 X 20%.

As no lump sum is deemed to accrue to Mr Beets, thus resulting in the tax deduction as provided for in Paragraph 5(1)(a) of the Second Schedule to the income Tax Act not being applied, no amount will be included as property in this regard in the estate for estate duty purposes. An estate duty saving of R220,000 will be thus be applicable, as indicated in Example 1.

Income tax

No tax will be payable on a lump sum (as there will be no lump sum to tax). Although income tax may be payable on the annuity, such income tax is payable on the annuity income and not the full lump sum. If a living annuity is chosen, the amount of income received and resultant tax liability could also to a certain extent be controlled[33]. It should further be borne in mind that the income and capital gains within the living annuity (i.e. on the underlying assets of the living annuity not yet paid to the annuitant) are not taxed[34] and growth in this regard will thus occur tax-free.

The tax position is thus still better than what it was before 1 March 2009. With regards to estate duty it is in fact exactly the same as it was immediately prior to the insertion of Section 3(2)(bA) of the Estate Duty Act[35], if the beneficiary does not op to take the retirement benefit as a cash lump sum.

Unfortunately, if the choice is made not to take the cash lump sum, the disallowed contributions of the deceased as at date of death is forfeited, as the section 10C[36] exemption is not applied against the annuity income of the beneficiary, as the case would be with the original owner[37]. However, if the drawdown rate is kept as low as possible, the tax payable on the income could be kept to a minimum, well below the highest marginal tax rate. One can also argue that this would have been the case even if an income was chosen over a lump sum for reasons other than the saving of estate duty and other tax.

Other considerations

One must not lose sight of the fact that RA's still have other advantages even though their potential in reducing estate duty have, to a certain extent, been negatively impacted since the

[33] GN290: Annual income of 2.5% to 17.5% of the value of the underlying assets of the annuity calculated on inception of the living annuity and thereafter on each anniversary date of the living annuity.
[34] Section 29A(4)(a)(iii) of the Income Tax Act.
[35] 45 of 1955.
[36] Of the Income Tax Act 58 of 1962.
[37] See footnote 10 *supra*

inception of section 3(2)(bA). Also bear in mind that the amount of disallowed contributions could be substantially reduced if the investor lives for a long time after making the investment, via the allowable tax deduction[38] or exemption[39].

Other advantages still applicable to investing in an RA:

- ❑ Protection against creditors;
- ❑ Strict regulatory requirements to protect investors;
- ❑ Contributions deductible to certain limits against yearly taxable income;
- ❑ Investment growth is not subject to income tax or capital gains tax[40];
- ❑ Not subject to executor's fees on death[41].

Other advantages of choosing income over a lump sum:

- ❑ Provides income to the surviving spouse which may in certain instances be transferred to the children upon his/her death, e.g. with a living annuity if the value of the underlying investments is not depleted on the death of such spouse;
- ❑ Can protect the inheritance of children against, for example, financial mismanagement by their guardians;
- ❑ Reduces cash payable to heirs, thus potentially increasing their estates and thus estate duty liability, especially in already large estates;
- ❑ Protection of assets against inexperienced heirs.

Conclusion

The loopholes available to taxpayers to reduce their tax liability via tax avoidance measures are continuously being reduced or closed. The reduction of taxes should thus not be the only or main factor to consider when deciding on investment types and other vehicles to use as tools in estate planning.

In light of the latest amendment to section 3(2)(bA) of the Estate Duty Act, an investment in a retirement annuity fund can still be used as an effective estate planning tool. Whether or not it is the best option it will depend on the specific circumstances applicable to each individual client.

[38] Section 11F of the Income Tax Act; Paragraph 5(1)(a) and 6(1)(b)(i) of the Second Schedule to the Income Tax Act.
[39] Section 10C of the Income Tax Act
[40] Taxed in the hands of the insurer in the untaxed policy holder fund as per Section 29A(3) and (4) of the Income Tax Act.
[41] Unless payable to the estate.

An important consideration is not to dismiss a possible solution to a client's needs purely if an alternative solution will result in the reduction of tax liability. One could, depending on the circumstances, sometimes construct a solution that suites a client better in reaching his/her financial planning goals, despite an alternative solution being more tax-friendly.

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Inheritance Law
The Main Differences between Common Law and Civil Law Systems

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Introduction

Across the world, many countries follow two primary legal systems known as common law and civil law. There are also countries which follow a religion based legal system, like Shariah Law and then some countries which follow a hybrid system. This article will focus on the differences between common law and civil law systems.

The basic differences are well known. Civil law systems derive mostly from a civil code. This is then interpreted by judges according to the facts of each case. The codified statutes are the primary source of legal authority. Decisions by courts does not have the same authority and effect in shaping law as they do in common law systems. The codified statutes are prescriptive with regards to rights and obligations and individual liberties are sometimes more limited. There are often very strict formalities for creating legally-binding documents and individuals normally do not have the freedom to agree to provisions that are inconsistent with legal requirements when contracting. Countries with civil law systems include: Brazil, China, France, Germany, Mexico, Japan, Panama, South Korea, Spain many other Asian, European and South American nations. [1]

Common law systems rely on legal precedents where judges in later cases are bound by decisions of judges in earlier cases, supplemented by legislation. Citizens and non-citizens generally are free to engage in activities and make decisions that not expressly prohibited by law. The freedom to contract is broader than with civil law systems and judicial decisions create the law for future cases. Notable common law countries include: South Africa, Australia, Canada, England, India and the United States of America.[2] As with most legal systems, the South African legal system can in some instances be seen as a hybrid system in that it have certain civil law characteristics as well.

Specific differences between these two systems arise in matters of succession and estate administration. It is important to understand the precise differences in substantive law from jurisdiction to jurisdiction. The terms of a will or other testamentary disposition may be overridden by the applications of domestic or foreign laws in some jurisdictions.

[1] Kim Jiah, 2017, International Estate Planning: Difference Between Common Law and Civil Law Systems, jiahkimlaw.com
[2] Kim Jiah, 2017, International Estate Planning: Difference Between Common Law and Civil Law Systems, jiahkimlaw.com

Estate planning: General differences between common law and civil law systems.

There are many differences between different succession systems. Some fundamental differences are of key importance to cross-border estate planning. When considering the differences, it is perhaps prudent to look at two main differences, namely:

(a) succession rights and estate administration, and
(b) wills and estate documents.

Succession rights and estate administration

1. Forced heirship and protected persons

In common law systems, persons are largely free to distribute their assets as they see fit, as freedom of testation is mostly allowed with very few restrictions. Therefore, a "forced heirship" regime seems foreign to persons that grew up in a common law environment. As long as the will meet the legal requirements for a valid will, it will override the laws in intestate succession and testamentary freedom is mostly guaranteed. There are exceptions to this as some common law countries may have different rules, for example Ireland, where there are considerable restrictions on the freedom of testation.[3] In South Africa and England, the starting point is typically that a person is free to choose who will inherit their net estate and in what portions.

In civil law systems, the opposite is normally true because these systems usually restrict the freedom of testation of a testator and the extent that they may dispose of their assets. Generally, the family of the testator will receive fixed shares of the estate and very often there is no power to override these rules. This is called "forced heirship" and is a lot more common in civil law systems. Where these forced heirship rules apply, a testator may only be able to dispose freely of a small part of their estate and in some cases higher tax rates apply to bequests to non-family members.[4] In many civil law countries, a person's estate will be divided into "indefeasible" and "discretionary" portions – with the indefeasible portion subject to forced heirship and discretionary portion available to bequeath freely. Under forced heirship laws, spouses and children are generally designated as the preferred mandatory heirs. The manner in determining size of the reserved share will vary from jurisdiction to jurisdiction. In some instances, the number of children and a living spouse will play an important role in determining the size of the

[3] Mark Cooney, Succession and Judicial Discretion in Ireland: The Section 117 Cases, 1980, Irish Jurist, Vol 15, No 1, p62
[4] 2020, STEP UK, Advanced Certificate in Cross Border Estates Course Manual

indefeasible portion. [5] Some systems favour the surviving spouse more than children, while in others the children will inherit a fixed share that cannot be overridden. In most civil law systems, forced heirship goes beyond the deceased's estate. It extends to lifetime gifts as well. The forced heirs of the deceased should also inherit a fixed portion of all gifts made by the deceased during lifetime and also at death. If the deceased gave assets away to a non-forced heir before death, the forced heirs can claim against the recipient of lifetime gifts for a portion of such a gift.[6]

In France for example, the French Civil Code provides for a significant portion of the deceased's estate to be reserved for inheritance by close family members. The spouse of the deceased would normally have a reserved share of one-quarter of the estate, if the deceased leaves no children. Should the deceased leave any children, the spouse's reserved share falls away but the spouse will have right to take a usufruct on the whole or part of the disposable portion of the estate, against the spouse's own children. The number of children the deceased leaves will determine their reserved share, for example if the deceased leaves one child, the reserved portion for that child is one-half of the estate. If the deceased leaves two children, every child's reserved portion will be one-third of the estate and if the deceased leaves three children, the reserved portion for each child will be one-quarter of the estate. If there are no surviving spouse or children, there will be no reserved share in the estate.[7]

2. Marital property regimes and joint property

The normal position under common law is that assets brought into the marriage by each spouse and assets acquired by them after the marriage remain the property of the spouse who own them. This being said, it must be noted that different rules apply in some common law jurisdictions with regards to joint property and marital property regimes. In South Africa for example, our common law system allows for different marital property regimes, i.e. in community of property, out of community of property and the accrual system. Most common law jurisdictions have a more favourable tax dispensation when assets are transferred between spouse, either in life or from a deceased estate.[8]

[5] Kim Jiah, 2017, International Estate Planning: Difference Between Common Law and Civil Law Systems, jiahkimlaw.com
[6] 2020, STEP UK, Advanced Certificate in Cross Border Estates Course Manual
[7] French Civil Code, Articles 912 - 917
[8] 2020, STEP UK, Advanced Certificate in Cross Border Estates Course Manual

In civil law jurisdictions, the surviving spouse's rights to marital property is usually defined by law and the usual position is that there is, to some extent, a merging of assets into a single community of property. The specific rules will differ from jurisdiction to jurisdiction. Where a marital property regime exists, the surviving spouse could have additional rights to succession on property in the deceased estate. The law applicable to the marital property regime will determine what each spouse receive as a result of the marital property regime and what they can receive under the inheritance rules. In China for example, half a deceased's estate will transfer to the spouse unless it was agreed otherwise prior to the date of death.[9]

3. The role of executors and administrators

In common law legal systems, the assets of a deceased vests upon death in the executors and administrators of the estate. It is the executor's role to administer the estate according to the deceased's will and estate plan and it falls upon them, as personal representatives of the deceased, to pay any estate debts, taxes or other liabilities before distributing the remaining assets to the beneficiaries of the deceased's will or under the relevant intestacy rules. The beneficiaries do not inherit anything until the administration of the estate is completed. Common law systems allow for a high degree of testamentary freedom which means that there can potentially be a high number of beneficiaries in the estate. The liability of the common law executor for estate debts is mostly limited to the assets in the estate. Once assets in the estate is exhausted when paying of the debt, the creditors of the estate will mostly be unable to pursue the debts any further.[10]

In civil law systems this is often very different. Executors and administrators play a significant smaller role and the assets of the deceased is passed directly to the heirs upon death. The heirs of the deceased play a far greater role in the administration of the estate. The usual position is that the assets of the deceased vests directly in the deceased's heirs. The heirs are then responsible to ascertain what assets is in the estate, determine the debts in the estate and to complete the estate administration. The heirs take personal responsibility for the payment of the deceased's liabilities and estate taxes even if these exceed the value of any assets that they may inherit. There are usually provisions in law for this liability to be limited to the value of the estate, but normally the heirs must make an election on whether to accepts the estate benefits,

[9] Kim Jiah, 2017, International Estate Planning: Difference Between Common Law and Civil Law Systems, jiahkimlaw.com
[10] 2020, STEP UK, Advanced Certificate in Cross Border Estates Course Manual

with the liability for estate debts, or not. The heirs to the estate are sometimes determined by provisions in the civil law as discussed above.[11]

Wills and estate documents

1. Formal validity

The rules with regards to the formal validity differs from common law systems to civil law systems as well as from country to country and in some instances even from state to state, as is the case with the United States of America. Formal validity refers purely to the procedural aspect of the execution of a will. Most systems require a will to be in writing and then impose further requirement with regards to procedure. Formal validity is totally unrelated to the content of the will and the procedural legal validity thereof. In common law systems it is usually required that the will is signed by the testator and that the signature is attested by one or more witnesses. Witnesses normally should be an adult of sound mind. Sometimes there are restrictions however. For example, in the UK and South Africa a witness cannot be a beneficiary under the will.[12]

In civil law systems, the task of concluding a will is normally left to a notary. Wills tend to have a specified form and must be countersigned by a registered notary. It is also sometime required that the will be added to a register of wills. Holographic wills are also allowed in most civil law systems. These are wills that is drafted in the testator's own handwriting. Civil law systems sometimes also refer to "public wills", which are wills that must be executed by a notary and entered into the official records of the notary, as mentioned above.[13]

2. Substantive validity

This refer to everything that is not related to the formalities of executing a will. Typically, this would refer to the capacity to make a will, the clarity of the wording and whether the provisions of the will is in conflict with any law. There are very few distinctions between common law and civil law systems with regards to substantive validity. Every legal system will have certain requirements with regards to a person's capacity to make a will, for example the minimum age etc. The different legal systems will also have rules with regards to the role of courts in determining the rules around substantive validity and the interpretation thereof. Countries will not allow a will to be valid if it is in conflict with the general law of succession in that country. An example of this would be where

[11] 2020, STEP UK, Advanced Certificate in Cross Border Estates Course Manual
[12] 2020, STEP UK, Advanced Certificate in Cross Border Estates Course Manual
[13] 2020, STEP UK, Advanced Certificate in Cross Border Estates Course Manual

a will in a civil law country puts the inheritance to a non-statutory heir in conflict with the applicable forced heirship provisions in that country. Wills that are made in common law countries may also sometimes be in conflict with the mandatory legal position in civil law countries, although they could be substantively valid in the common law country. It is however clear that each system will allow courts to determine what a testator's intention was, from the wording of the will or estate document.[14]

Conclusion

From the above it is clear that estate planners should take note of the differences in inheritance law between common law countries and civil law countries. It would be dangerous to assume that a will drafted in a common law country, will be substantively valid and executable in a civil law country. This is very important in modern times where more and more individuals, who have different nationalities and different domiciles, have assets in various jurisdictions all over the world. It is clear that where individuals have assets in different jurisdictions, they should contact a professional in the specific countries to assist them with drafting wills in those jurisdictions that takes the laws of that jurisdiction into account.

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Wills to be Signed and Witnessed Using Audio-Visual Links – Time to Amend the Wills Act 7 of 1953

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Introduction

The Wills Act was promulgated in January 1954 and has remained in force and mostly unchanged for more than 60 years. The Act sets out provisions with regards to the valid execution of a will, who may benefit under a will, the legal manner in which to sign a valid will, who may be witnesses to a will and the process with regards to the revocation of a will.

The current position in South Africa with regards to the formalities required for the execution of a will requires that the will must be signed at the end thereof by the testator or some other person in his presence and by his direction.[1] The will must be made by the testator, or must be acknowledged by the testator and in the presence of two or more competent witnesses present at the same time. These witnesses must also attest and sign the will in the presence of the testator, and of the person who signs for him, and in the presence of each other. The testator must sign on every page of the will if it consists of more than one page.[2]

With the evolution of technology and the move to a more digital world, it has become clear that South African law needs to be adapted to recognise electronic signatures and audio-visual links to authenticate legal documents such as last wills and testaments. The Covid-19 pandemic amplified this need, since many South Africans were not able to leave home to sign a will and thus may have struggled to do so in front of the witnesses required to ensure the validity of a will. Because electronic signatures, currently regulated by the Electronic Communications and Transactions Act 25 of 2002, and audio-visual links are not recognised to serve the legal requirement for a testator to "sign" a will, a situation may arise that a person passes away without a valid or up-to-date will, because of the current physical restrictions in place. Persons may also not have access to printing facilities, or may be at home in isolation with family members who are also beneficiaries and therefore cannot legally sign the will as a witness. It will also be impractical for persons living alone to execute a will that is compliant with the provisions of the Wills Act.

Other jurisdictions have already implemented temporary laws that provide for digital signatures on wills and the execution of wills via audio-visual links. Good examples of recent legislation are the Epidemic Preparedness (Wills Act 2007 – Signing and Witnessing of Wills) Immediate Modification Order 2020 of New Zealand, the Practice Direction Number 10 of 2020 issued by the

[1] Section 2(3) of the Wills Act 1954.
[2] Section 1(a)(iv) of the Wills Act 1954.

Supreme court of Queensland in Australia and regulations issued by the parliament of the state of Jersey in the United States of America, which are discussed below.

Examples of measures taken in foreign jurisdictions

Epidemic Preparedness (Wills Act 2007 – Signing and Witnessing of Wills) Immediate Modification Order 2020

The Act came into force as part of the Covid-19 legislation when the government realised the need to legally sign wills during the lockdown measures implemented in New Zealand. The lawmakers recognised that the current measures in place (similar to the current legislation in South Africa) may be impossible or impracticable to comply with during an epidemic.[3] The Act modifies the requirement in the Wills Act of 2007 to allow digital signing and witnessing of wills, specifically via audio-visual links. It came into force on the 17th of April 2020 and will be revoked when the Epidemic Preparedness (Covid-19) Notice 2020 expires or is revoked. Section 4 of the act makes provision for wills to be signed and witnessed using audio-visual links.[4] The testator may sign the document legally using audio-visual links or direct another person to sign the document on his or her behalf in his or her presence. Previously witnesses, as is the case in South Africa at present, had to be together in the will-maker's physical presence. The modification allows witnesses to be regarded as being in the will-maker's presence via an audio-visual link from one or more other locations where an epidemic is in force.

It is clear, as provided for in the amended legislation, that it was recognised that being physically present as a requirement for witnessing wills is not always possible for all persons, especially during the Covid-19 pandemic.[5]

Supreme Court of Queensland Practice Direction Number 10 of 2020: Informal Wills/Covid-19

Supreme Court of Queensland Practice Direction Number 10 of 2020 was issued by the Supreme Court under Rule 452(2)(b) of the Uniform Civil Procedure Rules and is restricted in its application, similar to New Zealand, to documents that are executed between 1 March 2020 and 30 September 2020. Section 10 of the Succession Act 1981 provides that a party must be in the physical presence of the testator when witnessing a will. The new rule dispenses the physical presence requirement subject to the production of evidence to the approval of the registrar[6]:

[3] Statement for Reasons, Explanatory note to the Epidemic Preparedness Modification Order 2020.
[4] Section 4(1)(c)(i).
[5] Statement for Reasons, Explanatory note to the Epidemic Preparedness Modification Order 2020.
[6] Practice Direction number 10 of 2020. Supreme Court of Queensland. Informal Wills/Covid-19

"1. that the will was drafted by a solicitor, or a solicitor is one of the witnesses to the will or the person supervising the execution of the will;

2. that the deceased intended the document to take immediate effect as their will, alteration to their will, or full or partial revocation of their will;

3. that the testator executed the document:

a. in the presence of two witnesses being in the presence of the testator by way of video conference but not physically; or

b. in the presence of one witness being in the presence of the testator by way of video conference but not physically;

4. that the witness or witnesses were able to identify the document executed; and

5. that the reason why the testator was unable to execute the will in the physical presence of two witnesses was because of either government enforced or recommended, or self-imposed isolation or quarantine arising from the COVID 19 pandemic."

Similar to the New Zealand legislation, the need to legally set up a will and the difficulty the physical presence requirement posed, was amplified by the Covid-19 pandemic. It is uncertain if these laws will become permanent in the future.

COVID-19 (Signing of Instruments) (Jersey) Regulations 2020

Another jurisdiction that followed suit is the state of Jersey in the United States of America. The Jersey parliament's amendment to the formal requirement for two witnesses to be physically present when a will is signed, was presented on 22 April 2020 and will remain in force until 30 September 2020 unless it is extended. During this period, the witnessing of wills may be done by audio-video communication instead of in person.

This new law will enable people in hospitals, care homes and isolation to execute a new valid will without breaching the social distancing rules. A witness who appears by audio-visual link must, as soon as is reasonably practicable after witnessing the signing of the will, provide the testator (or the testator's advocate or solicitor, where such a person was retained to draft the will in question) with a written declaration. The declaration must state that the witness:

(a) has witnessed the signing of the will in question over audio-visual link; and

(b) positively identified the testator and the method used to do so; and

(c) has seen the testator sign the will; and

(d) is satisfied that the document signed by the testator is the will; and

(e) has heard the will read aloud in its entirety if the will relates to immovable property.[7]

The change was welcomed by the legal fraternity, stating that the common sense introduction of temporary legislation will help provide peace of mind for clients.[8]

Law reform

At present, the Electronic Communications and Transactions Act 25 of 2002 (hereafter the ECA) regulates the types of electronic communications and transactions in South Africa. The ECA makes provision for two types of signatures: an electronic signature and an advanced electronic signature.

The ECA defines an electronic signature in section 1 as "data attached to, incorporated in, or logically associated with other data and which is intended by the user to serve as a signature". An advanced electronic signature is "an electronic signature which results from a process which has been accredited by the authority in section 37. Section 37 of the ECA provides for the accreditation of authentication products and services by The Accreditation Authority set up by the Act. Currently advanced electronic signatures can be used in a suretyship agreement (General Amendment Act, 1956) and signing as a Commissioner of Oaths (Justices of the Peace and Commissioners of Oath Act, 1963).

Documents such as wills and codicils may not be verified by an electronic signature. Section 18(3) of the ECA provides the following: "*Where a law requires or permits a person to provide a certified copy of a* document *and the document exists in paper or other physical form, that requirement is met if an electronic copy of the document is certified to be a true copy thereof and the certification is confirmed by the use of an advanced electronic signature*." This section is similar to the measures put in place in other jurisdictions. The provisions of the ECA does not make provision for the possible signing and witnessing of documents through the means of audio-visual links. It is submitted that the Wills Act of 1953 should make provision for alternative methods of signing and witnessing to ensure practicability of setting up a valid will.

[7] http://www.mondaq.com/jersey/litigation-contracts-and-force-majeure/935682/covid-19-signing-of-wills-in-jersey. Accessed on 26/05/2020.
[8] COVID-19 (Signing of Instruments) (Jersey) Regulations 2020 Comments. Submitted on 20 April 2020 by the Corporate Services Scrutiny Panel.

The current definition of "sign" in the Wills Act of 1953 makes provision for the making of initials and only in the case of a testator, making a mark.[9] It is our view that, similarly to New Zealand's Epidemic Preparedness (Wills Act 2007 – Signing and Witnessing of Wills) Immediate Modification Order 2020, an amendment to the Wills Act of 1953 should be considered to include audio-visual links in the definition of "sign". The testator should be able to sign a copy of the document via an audio-visual link from another place if physical presence is not possible.

Witnesses should thus be able to witness the will and identify the testator via an audio-visual link from one or more places, if they are not able to be in the physical presence of the testator when signing the will. The witnesses should acknowledge that the testator signed the document and that the signature on the document is their own, and was signed in his or her presence, or via an audio-visual link from another place because it was not possible to be in the physical presence of one another. A guideline in this regard is section 4(3) of New Zealand's Epidemic Preparedness (Wills Act 2007 – Signing and Witnessing of Wills) Immediate Modification Order 2020. In terms of this legislation, such a manner of witnessing a will is valid, if at least two witnesses declare the following[10]:

"*(a) that he or she was present with the other witnesses when the will-maker, or that he or she was together with the will-maker and the other witnesses in the will-maker's presence or via an audio-visual link from 1 or more other places because an epidemic notice is in force when the will maker,—*

(i) signed the document; or

(ii) acknowledged that he or she signed the document earlier and that the signature on the document is his or her own; or

(iii) directed another person whose signature appears on the document to sign the document on his or her behalf in his or her presence; or

(iv) acknowledged that another person directed by him or her signed the document earlier on his or her behalf in his or her presence; or

(v) directed another person to do what is specified in sub clause (1)(c)(i), (ii), and (iii); or

(vi) acknowledged that another person directed by him or her complied earlier with each of his or her directions given under sub clause(1)(c)(i), (ii), and (iii); and

(b) that he or she signed the document in the will-maker's presence, or that he or she—

(i) signed a copy of the document before the will-maker via an audio-visual link from another place because an epidemic notice is in force; and

[9] Section 1 of the Wills Act of 1953.
[10] The Epidemic Preparedness (Wills Act 2007 – Signing and Witnessing of Wills) Immediate Modification Order 2020.

(ii) made clear on the copy it is signed in that way; and

(iii) sent a photograph or scan of the signed copy promptly to 1 holder, who is identified by the will-maker, of— (A) the document; and (B) all required photographs or scans of signed copies of it."

Similar legislation should be enacted in South Africa, to distinctly set out the process of signing a will via an audio-visual link. It should be made clear when an audio-visual link used by the testator and witnesses will be allowable. This method should not necessarily replace the requirement of a signature by the testator and witnesses in each other's presence where it is possible to comply with the physical presence requirement. It should be however an allowable method in situations where physical presence is not possible, and not only be limited to circumstances brought about by a pandemic.

Conclusion

The importance of a valid will cannot be overstated. Without a valid will any estate planning strategy will be futile.

It is however evident that the requirement of a testator and witnesses being physically present in the same location, which has been longstanding in many jurisdictions, has under certain circumstances become a hindrance for clients to legally execute their last wishes. A pertinent example of this is the Covid-19 pandemic which resulted in the majority of the world population being, at some point in 2020, under lockdown and thus compelled to adhere to social distancing measures. In South Africa physical presence is still a requirement by law to witness a will. In many instances people would not have been able to comply with this requirement without breaking the laws governing social distancing.

According to the CEO of Capital Legacy, Alex Simeonides, a solution to set up valid wills during the lockdown in South Africa would be to for the testator to provide an additional declaration stating that he/she signed the will either digitally or in the original format, but without the required witnesses due to the special circumstances that do not allow such testator to be in the physical presence of witnesses. The executor will then, after the passing of the testator, be able to petition the High Court to accept the will and allow the executor to still honour the deceased's wishes.[11]

[11] https://www.polity.org.za/article/covid-19-how-to-make-sure-your-clients-wills-are-valid-during-south-africas-lockdown-2020-05-11

This process will however be costly, delay the administration process of finalising the estate and the possibility exists that the court may dismiss the petition.

It is the view of the authors that it is time to revisit the practicability of the Wills Act of 1953 to not only accommodate the measures put in place via other legislation that might have an impact the validity of wills, but to also make provision for instances where physical presence of witnesses and a testator at the same location is not possible. It is submitted that audio-visual links as a method to sign and witness wills should be included in the Wills Act if the requirements of physical presence cannot be adhered to. If the provisions are extended to the Wills Act it will ensure that all persons can practically and legally execute a valid will.

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Wills Act 7 of 1953

Security Cession and the Accrual Claim

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Introduction

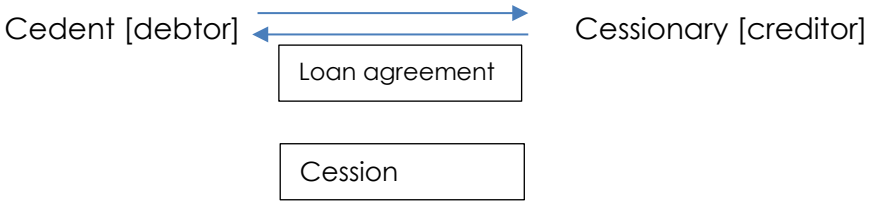
"*If you would know the value of money, go and try to borrow some*". This quote by Benjamin Franklin aptly describes the nature of loaning money. The lender usually has an upper hand and often would provide terms and conditions to the loan. A common condition applied to loans is that the individual to whom the money was loaned [henceforth referred to as the 'debtor'] provide a form of security to cover the debt owed to the loaner in the event of their death. This is often done by the debtor taking out a life insurance policy on their life and then ceding that cover as security to the creditor. This is done to ensure that the debt can be paid upon the death of the debtor.

This article explores the way in which a security session should be treated when doing an accrual calculation upon the dissolution [by death only] of a marriage out of community of property with the inclusion of the accrual.

Cession in securitatem debiti

In the event that the creditor requires security for a loan debt, the debtor could effect a life insurance policy on his/her life and cede it to the creditor as security for the loan debt. It is a cost effective and easy way of securing a debt and is often done to secure a bond for immovable property. If this were to be done the creditor would become the cessionary and the debtor would be the cedent.

Below is a graphic representation of the structure:



There are two different types of cessions that exist; one being an absolute cession and the other being the cession *in securitatem debiti* [henceforth referred to as a 'security cession']. In terms of an absolute cession the cedent, cedes all of their rights and obligations to the cessionary. There is a transfer of ownership that happens and the cessionary becomes the new owner and will continue to pay the premiums in the case of a life insurance policy.[1]

[1] Botha et al, 'The South African Financial Planning Handbook' LexisNexis 2020 paragraph 10.9.1.2

A security cession is different in nature. It is not an absolute or outright cession of all rights and obligations. An absolute cession is when the ownership transfers to the cessionary: an example of this would be when a contracting party cedes a life insurance policy to the original life assured which sometimes happens with business assurance. A security cession has the same consequence as an ordinary pledge[2]: the cedent cedes the life insurance policy to the cessionary until such a time that the loan debt is repaid. The cedent retains the bare dominium or reversionary rights and the cessionary acquires the right of action to enforce the ceded rights. Ownership does not pass from the cedent to cessionary: a personal right is created in favour of the cessionary[3]. The personal right in this instance is the right that the cessionary acquires to receive the policy proceeds, or part thereof in the event of the death of the cedent, if the loan debt is still owed by the cedent to the cessionary. The cedent is under the obligation, whilst the cession is still in place, to make sure that all of the contractual obligations in terms of the life insurance policy are fulfilled, and the cedent may not surrender the policy[4]. There are two different agreements in place between the cedent and cessionary;

- loan agreement and
- the cession.

There may not be a separate cession agreement, however, proof of the transfer of the rights to the cessionary needs to be provided. This is usually done by the cedent providing written proof from the insurer to the cessionary that their right against the life insurance policy has been noted. Once this is done then only does the cessionary(creditor) release the funds. If this were to be explained in terms of the bond example given above: the cedent would inform their insurer that they are ceding their life insurance policy to the bank [cessionary/creditor], and would request the insurer to confirm in writing that the cession has been applied. That written confirmation of the cession needs to be provided to the bank as proof and then only will bond monies be released.

Once the debt has been paid the cessionary (creditor) provides the cedent with a letter that can be sent to his/her insurer to remove the cession on the life insurance product. It is only upon the full payment of the loan debt that the cession expires. It is important for the life assured (cedent) to remember to remove the cession once the loan debt has been paid. Certain insurers

[2] The Law of South Africa (LAWSA), Insurance Part 2: (Volume 12(2) – Second Edition), paragraph 126
[3] id
[4] id

first require proof from the cessionary that the loan debt or an amount thereof is still outstanding before they pay the policy proceeds to cessionary.[5] On the other hand there are insurers that do not request such proof and pay to the cessionary as per the contract.[6] If the policy proceeds are paid to the cessionary and the loan debt has already been paid or the policy proceeds are in excess of the outstanding loan debt, then according to the policy contract they may pay the policy proceeds or the excess amount to the estate or the beneficiary nominated.[7] The insurer should make sure that they do their due diligence and not just pay the policy proceeds to the creditor, if the policy proceeds are paid erroneously to the creditor or an excess amount is paid to them, the insurer may be sued by either the cessionary or beneficiary.[8] This can be a real issue at death seeing as it can delay the benefit being paid to the beneficiary if it is first paid to the insurer and then the beneficiary. A further concern is that if it is paid to the estate, executors fees would be levied on that policy benefit amount and the provisions of the will would then be applied. This could present a further delay in the policy benefits being paid to the beneficiary and would also increase estate administration costs. There is also the possibility that the heir in the will is a different person than the beneficiary nominated on the policy, thus resulting in the beneficiary not receiving the benefit. This article will not go into detail with regards to these practical issues; if you want to read more on the topic please refer to the following 2017 Premiums and Problems article by Deon van Vuuren entitled, '*A practical view on the importance of reviewing security cessions when revisiting a client's estate plan*'.

Accrual system

In South African law we have three [3] marital property regimes, which are as follows:

- Marriage in community of property;
- Marriage out of community of property; and
- Marriage out of community of property with the inclusion of the accrual system.

It is the last marital property regime, i.e. the accrual calculation at death, that will be discussed in this article.

[5] Heidi Vorster, 'Insurance and Tax', Volume 29 December 2014 page 149
[6] id
[7] id
[8] Dissertation by Adv KD Sunkel, 'Cession of Life Insurance Policies in securitem debiti: A practical perspective', University of Pretoria October 2013 at page 48

The accrual system is provided for in section 3 and 4 of the Matrimonial Property Act[9], as quoted below:

"3. Accrual system

(1) At *the dissolution of a marriage subject to the accrual system, by divorce or by the death of one or both of the spouses, 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 for an amount equal to half of the difference between the accrual of the respective estates of the spouses.*

(2) Subject *to the provisions of section 8 (1), a claim in terms of subsection (1) arises at the dissolution of the marriage and the right of a spouse to share in terms of this Act in the accrual of the estate of the other spouse is during the subsistence of the marriage not transferable or liable to attachment, and does not form part of the insolvent estate of a spouse."*

"4. Accrual of estate

(1) (a) The accrual of the estate of a spouse is the amount by which the net value of his estate at the dissolution of his marriage exceeds the net value of his estate at the commencement of that marriage.

(b) In the determination of the accrual of the estate of a spouse –

(i) any amount which accrued to that estate by way of damages, other than damages for patrimonial loss, is left out of account;

(ii) an asset which has been excluded from the accrual system in terms of the antenuptial contract of the spouses, as well as any other asset which he acquired by virtue of his possession or former possession of the first mentioned asset, is not taken into account as part of that estate at the commencement or the dissolution of his marriage;

(iii) the net value of that estate at the commencement of his marriage is calculated with due allowance for any difference which may exist in the value of money at the commencement and dissolution of his marriage, and for that purpose the weighted average of the consumer price index as published from time to time in the Gazette serves as prima facie proof of any change in the value of money.

(2) The accrual *of the estate of a deceased spouse is determined before effect is given to any testamentary disposition, donation mortis causa or succession out of that estate in terms of the law of intestate succession."*

[9] The Matrimonial Property Act 88 of 1984

The death of one or both of the spouses will dissolve the marriage and therefore the accrual calculation would need to be done to ascertain if a spouse has a claim against the other [or their deceased estate] due to him/her having the lesser accrual.

The accrual claim is calculated as follows:

	Spouse 1	**Spouse 2**
Current value of estate		
Less: Liabilities		
Less: Assets excluded from accrual		
Net value of estate		
Less: Inflation adjusted commencement value		
Total [Accrual]		
Deduct the lesser total from the greater total		
Take the answer above and divide it by 2. This answer will provide you with the accrual claim in favour of the spouse with the lesser accrual.		

It is important to note that you work with the net value of the estate at death; that means that the liabilities have already been taken into account; therefore claims by creditors are not affected[10].

There are certain assets that do not form part of the accrual calculation, namely:

- ❑ Damages for non-patrimonial loss;
- ❑ Assets excluded in the anti-nuptial contract;
- ❑ Inheritance or legacy received by a spouse during the subsistence of the marriage, or anything purchased from such inheritance;
- ❑ A donation made to a spouse by somebody other than the spouse or anything purchased from such donation;
- ❑ Donations between spouses.

[10] Botha et al, 'The South African Financial Planning Handbook' LexisNexis 2020 para 31.3.2

We will now explore in more detail how life insurance policies, and in particular life insurance policies that have been ceded as a security cession, are treated when calculating the accrual claim.

A life insurance policy that has been ceded as security and the accrual calculation

If the deceased had a life insurance policy and had a beneficiary nomination on such policy, the proceeds of that policy will not be included in the accrual calculation because it will be paid directly to the beneficiary in terms of the contractual agreement between the deceased, the life insurance company and the beneficiary.

In an instance where the deceased does not nominate a beneficiary and the policy proceeds are paid into the estate, it will form part of the accrual calculation. Further, it should be noted that even if there was a beneficiary nomination on the ceded policy, the beneficiary's rights may be revoked by virtue of the cession if the policy agreement provides for this.[11] In the absence of such a provision, a security cession will not automatically revoke a beneficiary nomination, as the policy still belongs to the cedent's estate and if the cedent would like to revoke the nomination then he/she would need to inform the insurer in accordance with their requirements.[12] In terms of a security cession and the spouse, who has an accrual claim, the creditors rights are greater thus creditors are settled prior to the accrual calculation. There has been some differing opinions as to whether or not it should be taken into consideration when doing the accrual calculation, however, it is more generally accepted that it should be included in the accrual calculations[13].

A security cession life insurance policy at death is not included in the accrual calculation if the policy proceeds are paid directly to the cessionary resulting in the debt of the cedent being paid off. Further, one only works with the net value of the estate when doing the accrual calculation and therefore claims of creditors are not taken into account[14] if no claim is instituted against the estate. There would no longer be a liability deducted from the gross value of the estate when doing the net value calculations seeing as the debt would be paid off; this has the effect of increasing the net value of the estate that will be included in the accrual calculation. The policy proceeds would not form part of the accrual if the value of the outstanding debt is equal to or

[11] Dissertation by Adv KD Sunkel, 'Cession of Life Insurance Policies in securitem debiti: A practical perspective', University of Pretoria October 2013 at page 26
[12] id
[13] Marius Botha and Wessel Oosthuizen, 'Insurance and Tax- Life insurance and accrual system: Policies in or policies out? ', Volume 24 June 2009
[14] Supra note 9

greater than the value of such proceeds, because, as per the contractual agreement created between the life assured, the life assurance company and cessionary, the policy proceeds are to be paid directly to the cessionary therefore it should be treated in the same way one would treat a life insurance policy with a beneficiary nomination. Similarly, where the outstanding debt is less than the policy proceeds and the balance is payable to a nominated beneficiary, the policy proceeds should not form part of the accrual calculation. However, where the outstanding debt is less than the policy proceeds and the balance is payable to the estate of the deceased, such balance should be included as an asset in the accrual calculation, as the deceased estate will have a claim in respect of this amount against the insurance company or cessionary (creditor).

Conclusion

A security cession could, depending on the circumstances, be treated in the same manner as one would treat a life insurance policy with a beneficiary nomination for accrual calculation purposes. Where the loan debt has already been paid via the policy proceeds, such debt would not be taken into consideration when calculating the net value of the estate.

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Dissolution of Customary Marriages – The Impact on the Estate at Death and Divorce?

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Introduction

There is currently a social need in South Africa to develop a culture of its citizens who are married according to customary laws to approach a court of law to dissolve their customary marriage. Although this is required by law, it is a common problem in South Africa that people separate informally without obtaining a decree of divorce and this leads to complications further down the line in respect of their personal estate planning and their retirement planning.

The Recognition of Customary Marriages Act 120 of 1998 (hereinafter referred to as "the Act") brought about fundamental changes to the legal position of a customary marriage in South African law. The Act ensured that a customary marriage is for all purposes of South African law recognised as a valid marriage whether it is registered or not. This article will explore the pitfalls of not obtaining a valid divorce decree if you were married according to customary law as well as the impact on the clients' estates. The article will explore some of the provisions of the Act , as well as the case law on which the system of customary marriages has been moulded.

Customary marriage

Section 3 of the Act provides as follows:

3. *(1) For a customary marriage entered into after- the commencement of this Act to be valid-*

(a) the prospective spouses-

(i) must both be above the age of I8 years; and

(ii) must both consent to be married to each other under customary law: AND

(b) the marriage must be negotiated and entered into or celebrated in accordance with customary law.

For a customary marriage to be valid, the prospective spouses must both be above the age of 18, they must consent to be married to each other under customary law, and the marriage[1] must be negotiated and entered into or celebrated in accordance with customary law'. Lobola is not a necessary requirement for the validity of the customary marriage, however, if it is paid, it proves that the marriage was negotiated in accordance to custom.

Registration of customary marriages

Section 4(3) of the Act provides as follows:

[1] Section 3(1) of the Act

4(3) A customary marriage-

*(a) entered into before the commencement of this Act, and which is not registered in terms of any other law, must be registered within a period of 12 months after that commencement or within such longer period *as the Minister may from time to time prescribe by notice in the Gazette; or*

*(b) entered into after the commencement of this Act, must be registered within a period of three months after the conclusion of the marriage or within such longer period *as the Minister may from time to time prescribe by notice in the Gazette*

Section 4 of the Act requires spouses to ensure that their marriages are registered within a period of three months following the conclusion of the marriage, for marriages entered into after the commencement of the Act[2].

However, Section 4(9)[3] of the Act states that failure to register a customary marriage does not affect the validity of the marriage. A certificate of registration is nonetheless prima facie proof of the existence of the customary marriage. Proving the existence of an unregistered customary marriage is one of the main challenges that spouses face. In the case of Lina Sesi Nhlapo v Lillian Mahlangu[4] the court settled a legal battle between the two wives of a man, Thomas Jack Mahlangu, who both alleged that they were married to him. The deceased passed away on 11 May 2014.

Lina Sesi Nhlapo (the Applicant) went to court to have her customary marriage to the late Thomas Jack Mahlangu declared valid after the Department of Home Affairs refused to register the marriage due to the existence of her husband's civil marriage to another woman, Lillian Mahlangu (the First Respondent). The applicant argued that she is the legal customary spouse of the deceased. Customary marriage negotiations between the deceased's family and the Applicant's family commenced during 1986. On 29 April 2000, the last payment of the *lobola* was made as per the *lobola* agreement. Neither the deceased nor the applicant registered the customary marriage at the Department of Home Affairs.

[2] Customary marriages entered into before the commencement of the Act were required to be registered by the end of November 2009.
[3] Act 120 0f 1998.
[4] Nhlapo v Mahlangu and Others (59900/14) [2015] ZAGPPHC 142 (20 March 2015).

The two families had a handing-over celebration through the ukuvunula ritual in 1986, cows were slaughtered and her family handed her over to her husband's family. She still lived with her mother-in-law. Four children were born of the customary marriage.

The Applicant argued that her husband's civil and customary marriage to the First Respondent was invalid because she had not been aware of the marriage and had not agreed to it in terms of Ndebele customary union laws.

The First Respondent opposed the application, on the basis that her husband had never told her he was already married. The First Respondent stated that she entered into a civil marriage with the deceased on 5 May 2005, and on 12 November 2005, they entered into a Ndebele customary marriage. The first respondent's family requested *lobola* payment in the amount of R6000, 00 from the deceased. An amount of only R2000, 00 was paid by the deceased's brother, Jacob Mahlangu, on behalf of the deceased to the first respondent's uncle but her late husband's family submitted he had no brother named Jacob.

The Applicant stated that her late husband's family had never met the second wife and was not aware of her existence. The First Respondent did not attend the deceased's funeral. The Applicant submitted that she was her husband's only legal customary spouse despite the marriage not being registered.

The court ruled in favour of the Applicant, finding that the failure to register the marriage did not affect its validity and that the marriage had been valid.

The court set aside the second marriage, finding that the deceased's civil marriage to a second woman had contravened the Recognition of Customary Marriages Act, which clearly provided that no spouse in a customary marriage could enter into a marriage under the Marriage Act while the customary marriage still existed.

A valid Ndebele customary marriage could also not be concluded without the active participation of the first wife.

The court stated that the deceased's second customary marriage had not been celebrated in accordance with customary law, the Respondent was not handed over to the deceased's family

through a traditional ceremony and the customary marriage therefore also did not comply with the Act.

The court thus declared that the first wife's customary marriage as valid and declared the second civil marriage null and void.

Impact on the estate – marital regime

A customary marriage in which a spouse is not a partner in any other existing customary marriage, is a marriage in community of property and of profit and loss between the spouses, unless such consequences are specifically excluded by the spouses in an ante nuptial contract which regulates the matrimonial property system of their marriage[5].

It seems that most people are not aware that their customary marriages are by default in community of property and they are entitled to an equal division of the joint estate. Even though that customary marriage has to be registered to serve as proof and in order to reflect the marital status of the couple, failure to register the marriage does not mean the marriage is not valid.

A partner in a customary union is recognized as a spouse for all purposes in terms of the following laws of the Republic :

- Wills Act and Intestate Succession Act[6]
- Maintenance of Surviving Spouse Act[7]
- Pension Fund Act[8]
- Income tax[9] .

Pitfalls in termination of a customary marriage

In terms of the Act[10] a customary marriage may only be dissolved by a Court by a decree of divorce. A customary marriage where parties failed to approach a court to obtain a divorce order remains valid and has consequences at death. Failure to obtain a divorce order means that a spouse will still be entitled to his/her share of the estate at death in an event where parties were the parties did not register an ante nuptial contract. A customary marriage concluded after

[5] Section 7(2) of the Act.
[6] Act 7 of 1953.
[7] Act 27 of 1990.
[8] Act 24 OF 1956.
[9] Act 58 of 1962.
[10] Section 8 of the Act.

the commencement of the Act without an ante nuptial contract, and where neither of the parties is party to another customary marriage, is a marriage in community of property[11] . The safest option is to go to court and file for divorce once the parties have permanently separated.

Retirement fund benefits

In terms of Section 1 of the Pension Funds Act[12] a spouse is defined as a person who is the permanent life partner or spouse or civil union partner of a member in accordance with the Marriage Act[13], the Recognition of Customary Marriages Act[14], or the Civil Union Act[15], or the tenets of a religion.

In the case of a customary marriage, should the board decide to treat a person as a customary spouse for purposes of section 37C of the Pension Funds Act, it needs to establish:
(i) that a customary union was indeed concluded and,
(ii) that the union continued to subsist at the time of the death of the member.

Where there is more than one spouse, the trustees must pay the benefit to the dependants in such proportions as they deem equitable. This means that each spouse may receive a portion of the benefit, or that one of the spouses may receive the entire benefit, but the trustees have the discretion to decide what proportion each spouse will actually receive. They will exercise this discretion after a full investigation into the matter and they must apply their minds to the facts at hand.

There has been case law where courts found that second marriage was invalid because of failure to divorce the first spouse and also because of the requirement that the first spouse must consent to marriage of second spouse.

In the case of Mayelane v Ngwenyama and Another[16] the Constitutional Court handed down judgment in a matter regarding Tsonga customary marriages in which it had to determine the

[11] Section 7(2) of the Act.
[12] Act 24 of 1956.
[13] Act 68 of 1961.
[14] Act 68 of 1997.
[15] Act 17 of 2006.
[16] Mayelane v Ngwenyama and Another (CCT 57/12) [2013] ZACC 14; 2013 (4) SA 415 (CC); 2013 (8) BCLR 918 (CC) (30 May 2013).

extent to which the absence of a first wife's consent to her husband's subsequent polygynous marriages affects the validity of the latter marriages.

The Applicant married her late husband (the deceased) in 1984 in terms of Tsonga customary law. Their marriage was not registered. After his death the Applicant was informed that her husband had purported to conclude a further customary marriage with the First Respondent. The Applicant successfully applied to the High Court for an order declaring her customary marriage valid and the First Respondent's purported customary marriage invalid. On appeal, the Supreme Court of Appeal confirmed the validity of the Applicant's customary marriage, but ruled that the First Respondent had also concluded a valid customary marriage with the deceased.

On appeal to the Constitutional Court, the Applicant argued that the purported second marriage was invalid because she (the Applicant) had not consented to it.
The First Respondent submitted that it would be inappropriate to determine the consent issue raised by the applicant as there was no proper evidence on the applicable customary law regime and further because that the issue had not properly been traversed in the High Court. She asked the Constitutional Court to uphold the decision of the Supreme Court of Appeal.

After the hearing, the Constitutional Court called for further evidence on the content of Tsonga customary law.

In a majority judgment, the Constitutional Court upheld the appeal. The majority held that, at the time of the conclusion of the purported marriage between the first respondent and the deceased, Tsonga customary law required that the first wife be informed of her husband's subsequent customary marriage. The first respondent's marriage was found to be invalid because the applicant had not been informed.

The majority was nevertheless of the opinion that, in accordance with the Court's obligations to develop living customary law in a manner that is consistent with the Constitution, Tsonga customary law had to be developed to include a requirement, to the extent that it does not yet do so, that the consent of the first wife is necessary for the validity of her husband's subsequent customary marriage. This development stems from the fundamental demands of human dignity and equality under the Constitution.

The importance of the judgment is that, from now on, further Tsonga customary marriages must comply with the consent requirement in order to be valid.

If the marriage is not registered, you will have to approach the High Court to apply for a declaratory order to legally confirm whether a party was indeed married under customary law.

The judge will then have to exercise his/her discretion in deciding whether you and your spouse can be declared as being married. In such cases, the courts may also be guided by customary law experts who understand the laws of different cultures. The courts may also need affidavits from family members, stating what actually transpired. Additional evidence, such as photos of the celebration, could also be helpful.

In a recent case of Monyepao v Ledwaba and Others[17], it was decided that in order for the marriage to have been brought to an end prior to the death of the deceased, it would have been necessary for a decree of divorce to have been issued in terms of section 8 of the Act.

Matsatsi Monyepao (the Appellant), who Phago (the deceased) married in 2010 and lived with until his passing, wanted the Supreme Court of Appeal to declare his marriage to Mokgaetji Ledwaba (First Respondent) invalid. The deceased married the First Respondent in 2007 and separated from her in 2008, leaving her in their matrimonial home with their minor child.

The Appellant wanted the house occupied by the First Respondent and her minor child to be awarded to her minor child, and for the court to rule that the marriage between the deceased and the First Respondent was dissolved in 2008 after they went their separate ways. The Appellant argued that the First Respondent's civil marriage to Andrew Kwele in November 2009 invalidated her customary marriage to the deceased.

The First Respondent admitted that she married Kwele but she argued that the marriage "was null and void and did not have the effect of dissolving my customary marriage with the deceased".
The Judge found in the First Respondent's favour on the nullity of her civil marriage, on grounds that it was registered while her customary union to the deceased was undissolved. The judge also shot down the Appellant's argument that her husband's marriage to the First Appellant got

[17] Monyepao v Ledwaba and Others (1368/18) [2020] ZASCA 54 (27 May 2020).

dissolved in 2008. There was no factual basis for finding that the First Respondent's customary marriage to the deceased was terminated and the appellant had no admissible evidence to establish this fact.

Section 8[18] of the Act is instructive in providing that a customary marriage is to be dissolved by a decree of divorce granted by a competent court. As of necessity, this provision means that a customary marriage needs to be dissolved like a civil marriage and that the provisions of the Divorce Act[19] will apply.

Conclusion

Should parties decide to separate and obtain a divorce order, it is advisable to draft a will in the meantime. If of the parties dies, their affairs will be in order. Should one of the parties pass on and their affairs are not in order, the estranged spouse could possibly institute a claim against the estate of the deceased spouse. Cognizance should however be taken of the consequences of a marriage being in community of property that has not been dissolved, where applicable.

An informal separation and the fact that a spouse left the matrimonial property does not mean that the family property only belongs to the other spouse. Spouses are therefore advised to ensure compliance with legal provisions regulating the consequences of the dissolution of customary marriages, especially if they intent claiming a share of the matrimonial property. Customary marriages may only be dissolved by a Court. Financial planners must be aware of this fact when dealing with clients that are married according to customary law.

[18] Recognition of Customary Marriages Act.
[19] 70 of 1979.

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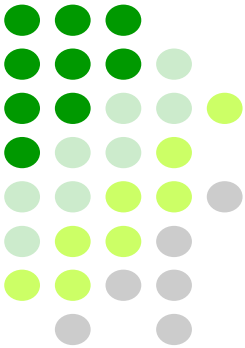

Business Assurance

Family Businesses: The Need For Synergy Between Succession Planning And Corporate Governance

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Introduction

The small and medium enterprises (SMEs) sector of most countries includes a large number of family businesses. There is no legal definition of what is regarded as a 'family business[1][2], but it is, generally speaking, a business where the majority of ownership lies with persons who are related to each other by blood or marriage. For purposes of this article, a business owned by unrelated parties where this ownership is intended to pass to future generations of the current owners, will also be regarded as a family business, since the need for corporate governance and succession planning is the same as the need within a business where the majority of owners are related.

While there is no reliable database of family businesses in South Africa, it is estimated that they are the most common occurring form of business and comprises about 80% of South African businesses. It is also estimated that they account for 50% of our economy's growth.[3]

It is further estimated that 30 -33% of family businesses survive into the second generation, only between 10% and 16% survive to the third generation and only 4% survive to the fourth generation[4]. Since these businesses are seen as major contributors to capitalist societies such as our own, the fragility of the ease of succession of these businesses is a cause for concern.

The primary reason for the lack of longevity of family businesses is seen as the inability to manage the process of management and ownership succession from one generation to the next.[5]

From a financial planning perspective, business succession planning generally provides for the transfer of ownership of the business from a shareholder, member or partner (shareholder for purposes of the article) to another party at the death or disability of a shareholder. It also provides for the personal retirement planning of the business owners.

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[1] According to the Family Business Unit of the Nelson Mandela University, a family owned business (family business) is a business where 51% of the equity in the business is owned by a single family unit, a single family is able to exercise considerable influence, at least two family members are involved in the management and/or operations; the transfer of the management and ownership to the next generation of family members is planned.

[2] FABASA(Family Business Association of South Africa) defines a 'family business' as one where 'the majority of the votes are held by the person who established or acquired the business (or by his or her spouse, parents, children or children's direct heirs; at least one representative of the family is involved in the management or administration of the business and where the company is listed, the person who established or acquired the business (or his or her family) possesses 25% of the voting rights through his or her share capital and at least one family member sits on the board" FABASA

[3] An exploration into family business and SMEs in South Africa

[4] Venter, E 2015 Succession Slides

[5] The Business of the Family Business: Introduction, Nature and Challenges

This transfer of ownership, which we can loosely refer to as 'ownership succession', should, however be regarded as only one of the several pillars in succession planning for businesses. In preparing a holistic succession plan for a family business[6] consideration should also be given to the 'softer' more emotive issues that the business owners need to address. These 'softer' more emotive issues should be dealt with in the corporate governance of the business.

According to the Institute of Directors, South Africa, corporate governance is essentially about effective leadership. It can be used as a mechanism to create applicable processes, systems and controls as well as the appropriate behaviour to ensure sustainability and long term continuity of a business. Corporate governance helps to ensure that decisions are made in the best interests of the business and its stakeholders.[7]

In South Africa, King III is the recognised code of governance, and the principles contained in King III apply to all organisations, irrespective of the nature and size of the business. The corporate governance structures within a business generally have three role players, namely the shareholders, board of directors and management, as far as SME's are concerned. In most family businesses these role players are played by the same person, and the family business owners often need to wear different hats, depending on the issue or situation at hand.

For purposes of this article, only the elements of corporate governance that relate to 'ownership succession' will be discussed and will be lumped together under the heading of corporate governance.

This article aimed to highlight the need for synergy between the corporate governance of the business and 'ownership succession' when providing financial advice in preparing a succession plan for a business.

'Ownership succession'

Ownership succession, for purposes of this article, refers to the transfer of ownership of a business owner's interest in the business to another person or party upon a business owner's exit from the business for a reason other than the sale of his shares or interest on the open market. The exit events covered will thus be the death, permanent disability or retirement of a business owner.

[6] Supra 1 and Supra 2
[7] https://cdn.ymaws.com/www.iodsa.co.za/resource/resmgr/Docs/GovernanceinSMEsGuidelowres.pdf

These three exit events are discussed under separate headings:

- estate planning, i.e. the structuring of assets in the most tax effective way in order to ensure protection and preservation of assets from one generation to the next[8] which encompasses the exit from the business due to death or permanent disability;
- retirement planning i.e. the process of determining retirement income goals and the actions and decisions necessary to achieve those goals[9].

'Ownership succession' for purposes of estate planning

In most instances, 'ownership succession' presents a simple scenario that can easily be addressed from a purely financial planning perspective as part of a client's overall estate plan.

Example:

A and B are siblings and equal shareholders in AB (Pty) Ltd, and neither of them have children. They want their spouses to be paid out for their respective shares in the business in the event of death or disability.

It is common knowledge that we can provide for ownership succession at death or disability by way of a buy-and-sell agreement funded by life and disability cover.

An agreement will be drafted in terms of which the respective party's shares in AB (Pty) Ltd will be bought by the other party in the event of the first party's death or permanent disability. Each party will own a policy on the other's life (the life assured), pay the premiums on that policy and will agree to use the proceeds to buy the shares from the life assured or his estate in the event of his disability or death.

Should A die, we know that in terms of the Estate Duty Act 4 of 1955[10], the value of his 50% share in AB(Pty) Ltd is regarded as property in his deceased estate. If the policy on A's life was taken out by B, B paid all the premiums on the policy, and the policy was taken out for the sole purpose of funding the purchase of A's shares in terms of the buy and sell agreement, the proceeds of the policy will not attract estate duty in his estate as the requirements of section 3(3)(a)[11] are met.

[8] https://www.fisa.net.za/estate-planning/
[9] https://www.investopedia.com/terms/r/retirement-planning.asp
[10] Section 3(2)
[11] Estate Duty Act 45 of 1955

The benefits of the buy and sell agreement include the fact that there is certainty as to what will happen to the deceased party's shares at death. It is important that the client's will is reviewed in order to ensure that the proceeds from the sale of the shares by the executor of the deceased's estate are bequeathed to the deceased's intended heir. If for instance A intends for his spouse to receive the proceeds from the sale of his shares to B, his will should provide for this to ensure that his spouse will receive the cash in lieu of the shares that he owned in AB (Pty) Ltd. From an estate planning perspective, one must note that the policy proceeds will pay into the estate of the deceased, and could possibly be utilised to cover any taxes and other costs that may arise in the deceased's estate before bequests can be given effect to.

The agreement may also provide for the permanent disability of either party with either party's permanent disability giving rise to the sale of the disabled party's shares to the unaffected party. The disabled party will thus receive cash in return for the sale of his shares.

Where no valid or executable succession plan is in place, the continuity of the business can be negatively impacted on, as there may be disruptions to business activities brought about by potential disputes regarding the deceased shareholder's shares. One of these disruptions may be a 'forced partnership' with the deceased's heirs. The heirs, who could be minors or the spouse, who possibly have no knowledge of the workings of the business, inherit the shares and become entitled to dividends in return for no contribution to the profitability of the business. The heir, who will now have voting rights, will be party to critical decisions without the knowledge or business acumen to make informed decisions for the benefit of the company.

Having a valid buy and sell agreement in place has the benefit of creating certainty regarding who the purchasers will be, as well as certainty over the purchase price or at least how the purchase price will be determined.

Depending on the liquidity position in the deceased's estate, the shares, as an asset in the estate of the deceased, may need to be sold under 'forced sale' conditions to generate liquidity. This will in all likelihood result in the shares being sold for a value below its market value, and thus reducing the value that the heirs are able to realise for the shares.

The simplicity of the scenario relating to AB (Pty) Ltd should not mislead one into believing that a buy and sell structure is only available in simple or identical ownership structures, and/or in scenarios where the intentions of the owners is identical to each other or clear cut.

It must be remembered that the agreement can provide for the situation where the shares are not held personally, but in the name of another company or a trust. Further to this it should be noted that the purchaser under the agreement need not even be an owner in the business – it can be an employee or any other external third party who wishes to buy the business owners shares in the event of such owner's death or disability.

In the case of a sole shareholder, a client will often argue that there is no need to identify a successor with whom to enter into a buy and sell agreement, as the business will cease at his death or disability. As advisors, we play a critical role here as the client should consider the impact of his death on the other stakeholders in the business. For example, loyal employees stand to lose their jobs and creditors are at risk of not receiving payment for liabilities owning to them by the business.

A sole shareholder can consider approaching an industry competitor for purposes of a buy and sell agreement. For example: Jeweller A and B are both the only shareholders in their respective businesses and are each other's strongest competitor. Entering into a buy and sell agreement, funded by life cover, will not only ensure that the deceased jewellers' estate and financial dependants are provided with capital from the proceeds of the sale of his shares, but will also benefit Jeweller B, who will now have access to Jeweller A's client base and intellectual capital – a win-win scenario for both parties.

Sole shareholders could also consider identifying a loyal employee to enter into a buy and sell agreement with. Besides providing the estate and financial dependants of the deceased shareholder with capital, entering into a buy and sell agreement with an employee has the added benefit that the employee is incentivised to give of his absolute best in his role as an employee, as he/she knows that they will possibly become the owner of the business at some point into the future.

Even though the sole shareholder scenario will not give rise to the estate duty benefits enjoyed in the example of AB (Pty) Ltd above since all the requirements of Section 3(3)(a) will not be

met[12], there is still a significant benefit from the perspective of the 'ownership succession' of the business.

However, in order to potentially enjoy the estate duty exemption under Section 3(3)(a)[13], the sole shareholder can consider the immediate sale of a nominal interest to the identified employee/competitor – besides the potential saving in estate duty, this will create a vested interest in the business for the identified employee/competitor, which benefit speaks for itself.

The above examples are by no means exhaustive and there are many scenarios where the drafting of the agreement and correct structuring of the policies becomes more complicated and seemingly impossible to execute. These complexities generally arise where the business owners have different intentions regarding the 'ownership succession' of their shares. This is often the case where there are children involved or where the spouse of a business owner is also involved in the business operations.

These are typically the scenarios that highlight the need for the corporate governance structure of the business to deal with 'ownership succession'. This does not necessarily mean that a buy and sell agreement in some or other form is not an option. One must also not lose sight of the fact that the estate duty benefits are not the only motivation behind entering into a buy and sell agreement.

Further financial planning issues relating to 'ownership succession' relate to the protection/preservation of the intrinsic value of the business for the surviving or unaffected shareholders.

Where persons have signed personal surety for debts of the business, contingent liability cover is generally considered by the business owners. Contingent liability cover works as follows: the business takes out life, disability or severe illness cover on the life of the relevant party. For 'ownership succession' the death or disability of the life assured will provide the business with capital to be used to settle business liabilities that the deceased or disabled party signed surety for. In addition to the protection that this offers the deceased or disabled party's estate,

[12] Section 3(3)(a) of the Estate Duty Act 45 of 1955
[13] Estate Duty Act 45 of 1955

protection is also offered to the surviving or unaffected shareholder since the business is not at risk of having to settle the loan by way of liquidation of company assets.

Effecting key-person policies on the lives of shareholders who play a critical role in the management, administration and financial viability of the business, is also a tool that can be used to further enhance the 'ownership succession' of the business. The business insures the life, disability and health of the identified business owner. In the case of the death or disability of an insured business owner, the company receives cash which it uses to protect the financial wellbeing of the business and thus the asset that is subject to the 'ownership succession.'

'Ownership succession' on retirement

A business owner may take on one or two roles in a business. He may either be a 'silent partner' - a shareholder who is not involved in the daily operations of the business, or he may be an owner and an employee of the business.

In our discussion, our focus is on the scenario where the business owner is both a shareholder and an employee.

For the shareholder who is also an employee, one needs to address the financial needs that will arise as a result of his retirement from employment. One also needs to consider whether he will continue in his role as business owner after his retirement, or whether he will want to be bought out by the other business owners.

As an employee of the business, he will need to make provision for his retirement. In other words, he will need to seek financial advice in developing his own personal retirement plan. This will entail determining his capital and income need at retirement and then devising a strategy on how he is going to meet those needs. It will entail proper salary structuring and making effective use of the section 11F deduction allowed in the Income Tax Act[14] that allows him to claim a tax deduction for his contributions to a retirement fund.

The retiring shareholder who is also an employee needs to determine his intentions with regard to the 'ownership succession' of his shares. If he intends to sell his shares at retirement, one needs to determine if the sale will be to his fellow shareholders or if he will be allowed to sell the shares

[14] Income Tax Act 58 od 1962

on the open market. Importantly, one needs to look at the Memorandum of Agreement (MOA) between the shareholders to see what it provides for this in regard, and whether changes need to me made to it to provide for the shareholders' intentions.

If the retiring shareholder intends selling to his fellow shareholders, a formalised arrangement needs to be put in place between them in terms of which a financial strategy is implemented to provide the intended purchasers of his shares with the funds to buy him out.

Where the purchasers have sufficient liquidity/capital to purchase his shares, this exercise is simple. Where there is no or limited capital to pay the purchase price, all relevant parties need to agree on how provision is going to be made. One option is for the purchasers to privately fund the purchase of the retiring shareholder's shares. A further option available to the other shareholders is a share buy-back in terms of which the company buys back the retiring shareholder's shares on terms and conditions agreed on by the parties. The purchasers could also enter into a sale agreement with the retiring shareholder in terms of which the shares are bought on loan account and the terms of the loan are agreed to by the parties. The loan repayments could effectively supplement any retirement income that the retiring shareholder receives and is in effect a way of being compensated for his share in the business by way of monthly repayments over an agreed term. Another option is for the shareholders or company to make provision for the purchase of a retiring shareholders shares by contributing towards a savings vehicle to provide the required capital to purchase the shares. This option is often not a viable solution as the monthly/annual contributions required to accumulate the required capital is more often than not unaffordable.[15]

This issue of 'ownership succession' on retirement is even more critical if the retiring shareholder is reliant on the proceeds from the sale of his shareholding to supplement his retirement capital. Ideally, the personal retirement plan of each business owner should allow him to be financially independent of the sale of his shares in the business. A formal retirement plan, funded by a retirement annuity, is a preferred method to fund retirement because the income stream is not dependant on the financial success of the business as will be the case where the shares are bought by the other shareholders or bought back by the company. Theoretically this is sound advice, but it is unfortunately rarely implemented in practice.

[15] Note that all the income tax implications as well as the provisions of the Companies Act 71 of 2008 relating to these suggested arrangements will need to be discussed in detail with the accountant.

'Corporate Governance'

Family businesses generally lack any specific form of corporate governance relating to 'ownership succession' and this is highlighted as one of the primary reasons for the failure of many family businesses to succeed into subsequent generations. FABASA[16] explains that governance in a family business provides a guideline for balancing the interests of the business with the interests of the family, and that a family business needs a roadmap of values and guidelines to follow in determining how the family conducts itself as a family AND as a business. FABASA suggests that a family business drafts a Family Business Constitution which will essentially help the existing and future generations deal with the benefits and complexities of a family business. This document should be drafted after the family have consulted with each other – often making use of a Family Business Consultant – and agreed on critical issues. From the perspective of 'ownership succession' these critical issues are *inter alia:'*

- The definition of 'family' – does it include blood descendants only or are their spouses also included?
- Leadership and succession – must management also be a shareholder? What is the recruitment process? What happens at death or disability of current shareholders?
- Shareholding – Who is eligible to be a shareholder in the business? How do successive generations take ownership of shares? Do they get given shares or do they have to buy the shares? At what value are they bought?
- Employment policy – eligibility of family members to be employed needs to be detailed and formal job descriptions need to be put in place for all staff, including family members who are employees and shareholders

These critical issues should be addressed in as much detail as possible to avoid as much uncertainty as possible and can include finer details such as:

- What is the minimum entry age for a family member to be employed by the business?
- What is the minimum experience required to run the business?
- Can a position be created for the new family member entering the business?
- What training does the family member to be employed need to undergo?
- Where should a junior start in the business?
- What is the agreed retirement age?
- What is the agreed retirement process?
- What are the rules for exiting the business on retirement?

[16] Family Business Constitution Manual: Old Mutual Legal Advisor Workshop

The above questions are but a few of the emotive questions that arise and need to be addressed in family businesses. These businesses are characterised by complex interactions between family members – both those involved in the daily business operations and the family members who are not.

Most of the complex interactions are driven by emotions and one of the biggest emotional challenges, for example, is the management of the founder's departure, which could be an exit due to retirement or handing over the reins, or exit due to death or disability.

This is just the tip of the iceberg when it comes to the corporate governance structure that may need to be covered by a family business.

Example:

A is the father and patriarch of ABC Engineering (Pty) Ltd. A owns 45% of the shares in the business, B is the older brother and owns 40% of the business, and C the younger brother who owns 15% of the shares in the business.

A is planning on taking things a bit easier from the date of his 70th birthday later in the year.
B has no formal qualification but has worked his way up in the business since he started there 20 years ago. He is married and has two children of his own. His one son is a CA and the other a farmer. The CA has expressed an interest in joining the family business.

C recently joined the business after working as a business analyst at an international company for several years. His wife is an engineer and they have 3 children. His oldest daughter is a CA with vast financial management experience at EXCO level. She is returning to SA from a stint in the UK and has an interest in joining the family business.

Are C's eldest daughter and B's eldest son eligible to be employed?
Are there positions available for them to fill? What if there is only one position available?
Who will take over from A, the patriarch?
What happens to A's shares at death? What happens to B and C's shares at death?

Most family businesses will benefit from implementing corporate governance procedures and this article is in no way advocating a solution or answer to these questions, but rather highlighting

the need for these issue to be addressed as part of the corporate governance structure of the family business.

The interplay between 'ownership succession' and 'corporate governance'

From a financial planning perspective, where the financial goal of the business owner is clearly ascertainable, the advice process is much clearer, since one knows what the client is working towards. In simple business structures, with simple or at least potentially uncomplicated emotive issues, 'ownership succession' can easily be catered for by way of a buy and sell agreement funded by life cover. The consultative and advice process to arrive at the solution for the client, will be relatively easy in such a scenario.

The advice process is significantly more complicated when there are issues, such as those illustrated in the ABC (Pty) Ltd example, that have not been addressed by the respective family members.

This is not to say that a buy and sell agreement funded by life cover will not be possible to facilitate 'ownership succession' at death, or that there is no potentially workable solution. One will need to develop an understanding of the family dynamic, and provide them with creative solutions that suit their needs relating to their unique family structure.

The critical issue is that financial solutions cannot be implemented when the parties have not agreed on the 'softer' matters that are highlighted above.

As mentioned above, there needs to be synergy between the 'ownership succession' and the corporate governance of a family business. The financial solutions that are recommended need to be implemented in such way that they achieve the objectives set out and agreed upon in the Family Business Constitution or other form of formalised corporate governance implemented by the company.

When addressing the 'ownership succession' of a business the following basic checklist should provide a good guideline of what needs to be considered in achieving the abovementioned synergy:

1. Do the current owners have a clear objective in terms of successive ownership of the business at death or disability of a current shareholder? If so, is it documented?

2. Do the current owners have a clear financial exit strategy for retirement? If so, is it documented and is it executable?
3. Does the company have MOA that contains provisions relating to who may own shares and who a shareholder may sell shares to?
4. Is there a written document detailing governance issues pertaining to successive ownership or exit/entry strategies of family members (spouses, children etc.)?
5. Do the documents speak to each other or are they contradictory? A party may have a clear objective, but the governance documents or MOA may not allow for what he intends to happen.

Where the documents speak to each other, the advice process is relatively simple as the intention of all the parties is clear. Where these documents contradict each other or are silent on the issues mentioned above, the advice process is much more challenging as one first needs all the parties to agree to objectives in order to advise on how to achieve them.

Once the objectives are known and agreed on (note that the objectives may differ from party to party in relation to their own shares, but they still need to accept and agree to each other's objectives), financial advice can be given with regard to the mechanisms available to achieve these objectives, as well as the most tax efficient way of structuring them.

Conclusion

Family businesses are key contributors to our economy and the ability for their ownership to successfully pass to successive generations, i.e. by them remaining viable, is critical to the economy and also to the continued financial wellbeing of the successive business owners.

Most family businesses have no, or at best informal, corporate governance structures in place. In achieving a successful transfer of ownership to successive generations, we need to take cognisance of the fact that the advice process will be hampered where there is no formal corporate governance structure in place within a business.

A formal corporate governance structure will provide documented rules and guidelines which will allow the financial objectives of the current business owners (that relate to their ownership in the business) to be clearly determined. Having a clear financial goal or objective to work

towards, allows one to focus on the most tax efficient and practical financial solutions to achieve the desired outcome.

Where there is no, or only informal, corporate governance in place that addresses or regulates the 'ownership succession', we should highlight the risks to the client and encourage them to engage the services of an expert in this field to assist them in putting these corporate governance structures in place.

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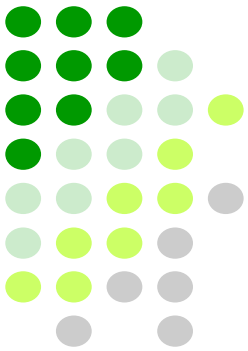

Income Tax

Income Tax Options Available To Farmers during a Drought: Paragraph 13, 13A and 19 of the First Schedule

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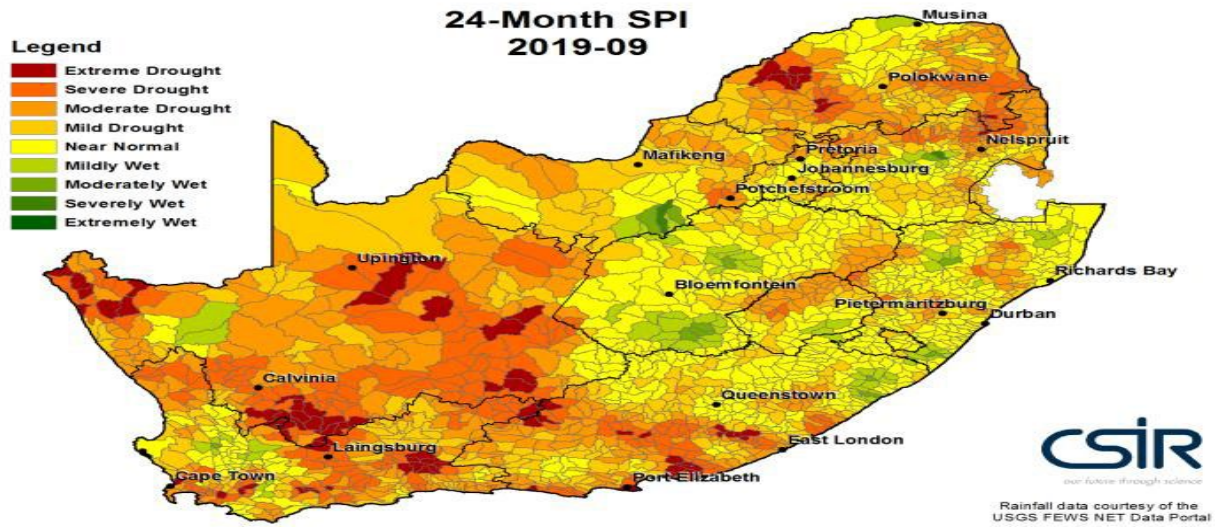
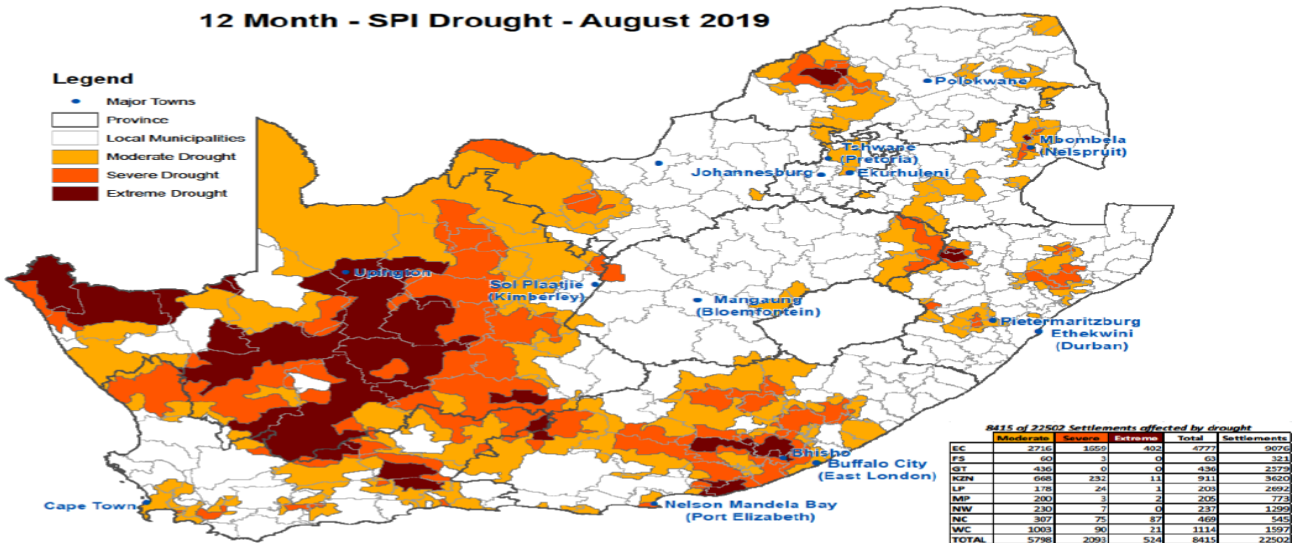
Introduction

South Africa is a country that experiences various climates and rainfall patterns. The rainfall patterns differ from area to area. The current status of our country is that water resources is very limited and the recent drought which was caused by extremely poor rainfall has further placed water resources under pressure.

The drought-affected settlements in South Africa as a 24-month SPI map.[1]



The drought-affected settlements in South Africa as a 12-month SPI map.



8415 of 22502 Settlements affected by drought

	Moderate	Severe	Extreme	Total	Settlements
EC	2716	1559	402	4777	9076
FS	60	3	0	63	321
GT	430	0	0	430	2579
KZN	668	232	11	911	3620
LP	178	24	1	203	2692
MP	200	3	2	205	773
NW	230	7	0	237	1299
NC	307	75	87	469	545
WC	1003	90	21	1114	1597
TOTAL	5798	2093	524	8415	22502

[1] Agricultural Drought Report 2019-2020

The table below illustrates the drought status outlook for the first quarter of 2019

Province	Current Drought Status	Rainfall Status	Runoff Status	Dams Status	Groundwater Status	Drought Outlook [2]
Eastern Cape	Severe	Very low	Very Low	Low	Moderately Low	Critical
Free State	Severe	Very low	Very Low	Low	Moderately Low	Critical
Gauteng	Stable	Normal	Normal	Moderately High	Moderately High	Stable
Kwa Zulu Natal	Below normal	Moderately Low	Low	Moderately Low	Low	Conditions to worsen
Limpopo	Moderate	Moderately Low	Moderate	Moderately Low	Low	Conditions to worsen
Mpumalanga	Moderate	Normal	Normal	Normal	Normal	Stable
Northern Cape	Severe	Very low	Very Low	Low	Very low	Critical
North West	Severe	Very low	Very Low	Moderately Low	Very Low	Critical
Western Cape	Below normal	Low	Very Low	Low	Moderately Low	Conditions to worsen

Settlements affected by drought 2019-2020

Province	Moderate	Severe	Extreme	Total[3]
Eastern Cape	2716	1659	402	4777
Free State	60	3	0	63
Gauteng	436	0	0	436
Kwa Zulu Natal	668	232	11	911
Limpopo	178	24	1	203
Mpumalanga	200	3	2	205
Northern Cape	307	75	87	469
North West	230	7	0	237
Western Cape	1003	90	21	1114
TOTAL	5789	2093	524	8415

[2] Agricultural Drought Report 2018-2019

[3] Agricultural Drought Report 2019-2020

From the above data, it is evident that the changing weather pattern which include the change in rain periods is affecting the agricultural sector in a detrimental manner. The limited availability of water, due to the drought, has placed pressure on farmers, as they rely hugely on this resource for the success of their business.

Many livestock farmers in a drought affected area face serious challenges, in that there is a lack of grazing pastures. This forces them to sell their livestock due to the drought. If a drought does not end before the end of the tax year, the problem of lack of grazing land still exists, thus the farmer would not be able to purchase replacement stock. This in effect would mean that, due to the sale of livestock, the farmer will have a bigger revenue than normal and since he could not purchase the replacement stock, he would not be able to deduct such expense, resulting in the income becoming taxable at a higher rate.

The Income Tax Act, includes provisions that provide relief to farmers that is forced to sell livestock due to a drought.

Paragraph 13 of the First Schedule[4]

a) If it can be proved to the satisfaction of the Commissioner that the farmer has had to sell livestock due to drought*, stock disease, damage to grazing by fire or plague, and that the said livestock have been replaced within 4 years after the end of the year of assessment in which the livestock was sold, the farmer has the option of:*

(i) deducting the cost of the replacement stock from his income in the year of assessment, in which the forced sale took place or

(ii) deducting it from the income, in the year in which the replacement livestock is purchased.

There are certain conditions, but not limited to, for this paragraph to apply:

- *The claim* for *deduction need to be made within 5 years*
- *Full details* of *the livestock sold (forced sale) must be reflected in the tax return in the year of sale*
- *The* replacement *stock must be of the same category sold[5]*

[4] Income Tax Act of 1962
[5] The SA Institute of Tax Professionals: 2017. News and Press: Tax Talk

From the *above* provision, it is clear that the Income Tax Act does provide tax concessions to farmers who have been forced to sell livestock due to a drought. The cost of replacement livestock can be claimed as a deduction against the forced sale income. If a farmer has not purchased replacement livestock in the year of the forced sale, then the farmer must submit his income tax return without taking the deduction into account. When new livestock is purchased he will provide proof of such transaction to the Commissioner. The original assessment will then be reviewed and the farmer may be granted a refund or a credit.

Paragraph 13 A of the First Schedule[6]

If there is a forced sale of livestock, due to a drought, the farmer also has an option to transfer the full proceeds or portion of the proceeds to the Land and Agricultural Bank of South Africa. If such transfer is effected within 3 months of such sale, the proceeds will not be included in his gross income in that year. These proceeds will only incur the applicable tax when the funds are withdrawn. If the farmer elects to withdraw the funds, within 6 months after the end of the year of the sale, he will be taxed, not taking the concession afforded in terms of Paragraph 13A into consideration. If a withdrawal is done after the end of the 6-month period, but before 6 years from the end of the tax year of the sale, the withdrawal will become taxable. If the farmer decides to leave the funds in the Land and Agricultural Bank of South Africa for a period of 6 years or more, it is regarded as his gross income on the last day of the 6-year period.

In order to qualify for this *concession*, the relevant forms must be completed and provided to the Commissioner within the time period prescribed.

Paragraph 19 of the First Schedule[7]

Another option that can be considered by the farmer is paragraph 19. Cognisance must however be taken of the fact that this paragraph is not applicable to legal entities such as a company or close corporation. If the farmer elects to be taxed under the provisions of this formula, then paragraph 13 cannot be applied.

Note must also be taken of the fact that although this provision does not specifically provide relief only during drought situations, it can still be an option that can be considered during periods of drought. This paragraph provides the benefit of equalised rates of tax. In certain instances, it may

[6] Income Tax Act of 1962
[7] Income Tax Act of 1962

be more preferable for the farmer to use the benefit of the equalisation rates instead of utilising the concessions afforded in terms of paragraph 13 and 13A.

It is also important to bear in mind that in terms of the general rating formula, when calculations are done, the tax rate cannot be less than 18%. If the farmer's average farming income is an amount that is higher than his actual income, then tax will be applied on his actual income. Paragraph 19 cannot be taken into consideration if a loss has occurred in the current year of assessment.

Example :[8]

s 5(10): Y = A/ B+D-C X B

Y = Normal tax to be determined before the rebates are deducted

A = Normal tax (before the deduction of any rebate) calculated for taxable income of " B+ D-C".

B = Taxable income for the year (excluding any lump sum benefit, but including non-farming taxable income).

C = is the amount by which the farmer's taxable income from farming for the year exceeds his average taxable income from farming as determined under paragraph 19(2).

Plantation and other farming: is the sum of the "excess plantation profits" and the "excess farming profits" as well as any paragraph17 amounts.

D = Retirement fund current contributions as is allowable as a section 11F deduction, solely by reason of the inclusion in the farmer's income of the excess calculated under "C" above. (The retirement fund contributions include pension, provident, and retirement annuity fund contributions.)

Note: The rate of tax determined using the formula cannot be lower than 18%.

[8] Haupt, P. 2019.Notes on South African Income Tax (pp. 765-766)

Farmer Denaeya has the following farming taxable income:

2016: R80 000

2017: R40 000

2018: (R 160 000) loss

2019: R200 000

2020: R 320 000

2021: R400 000

Other trade income for the 2020 tax year is R320 000

Average taxable income from farming is:

(40 000- 160 000 + 200 000 + 320 000 + 400 000) / 5

= R160 000

In the rating formula (section 5 (10)):

B = Actual taxable income for the year

Farming taxable income:	R 400 000
Other taxable income:	R 320 000
	R 720 000

C = Actual taxable income from farming (current year)	R400 000
Less: Average taxable income from farming	(160 000)
	R240 000

B =	R720 000
C =	(240 000)
D =	nil
	R480 000

D = nil (no contribution to a retirement fund)

A = Tax on B + D – C ie . tax on 480 000 **R117 993**[9]

[9] 445 101 – 584 200 105 429 + 36% of taxable income above 445 100

Calculation

s 5(10): Y = A/ B+D-C X B

117 993 /480 000 X 720 000

176 989

Rebate: Primary (14 958)

Tax payable: R162 031

(D is nil therefore omitted)

Conclusion

Many financial advisors have clients who are farmers that are experiencing financial burdens that can be attributed to the drought. Many are unaware of the tax concessions that are afforded by SARS. This relief that is available under provision 13, 13A and 19 of the First Schedule can prove to be very beneficial to farmers, relieving a portion of their tax burden.

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Flexible Employment and the Work from Home Scenario: Unpacking the Immediate Impact on Income Tax

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Introduction

Up until recently, the idea of working from home as a norm rather than the rule would have seemed far-fetched. However, the current global pandemic has brought into question the need to present oneself in a formal office environment if the same tasks could be efficiently and effectively carried out in a home office environment.

Working from home has advantages from both a social and economic perspective. This article seeks to provide a framework on the benefits that one would qualify for in respect of the tax deductibility of expenses related to a home office environment.

The legislation:

SECTIONS *11(a), 11(d), 23(b) AND 23(m)* of the **Income Tax Act 58 of 1962 ("The ITA")** relate to the deductibility of Home office expenses

The general rule is that ALL the requirements of these sections have to be complied with in order for the deductibility for home office expenditure to apply.

Sections 11(a) and 11(d) provides as follows:

11. General deductions allowed in determination of taxable income. —

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—*

(a) expenditure and losses actually incurred in the production of the income, provided

such expenditure and losses are not of a capital nature;

(b) – (c) . . . . . .

(d) expenditure actually incurred during the year of assessment on repairs of property

occupied for the purpose of trade or in respect of which income is receivable, including any expenditure so incurred on the treatment against attack by beetles of any timber forming part of such property and sums expended for the repair of machinery, implements,utensils and other articles employed by the taxpayer for the purposes of his trade;

Sections 23(b) and 23(m)

23. Deductions not allowed in determination of taxable income.—

No *deductions shall in any case be made in respect of the following matters, namely—*

(a) ……

(b) domestic or private expenses, including the rent of or cost of repairs of or expenses in

connection with any premises not occupied for the purposes of trade or of any dwelling-house or domestic premises except in respect of such part as may be occupied for the purposes of trade: Provided that—

(a) such part shall not be deemed to have been occupied for the purposes of trade, unless such part is specifically equipped for purposes of the taxpayer's trade and regularly and exclusively used for such purposes; and

(b) no deduction shall in any event be granted where the taxpayer's trade constitutes

any employment or office unless—

(i) his income from such employment or office is derived mainly from commission or other variable payments which are based on the taxpayer's work performance and his duties are mainly performed otherwise than in an office which is provided to him by his employer; or

(ii) his duties are mainly performed in such part;

(c) – (l) . . . . .

(m) subject to paragraph (k), any expenditure, loss or allowance, contemplated in section 11, which relates to any employment of, or office held by, any person (other than an agent or representative whose remuneration is normally derived mainly in the form of commissions based on his or her sales or the turnover attributable to him orher) in respect of which he or she derives any remuneration, as defined in paragraph 1 of the Fourth Schedule, other than—

(i) any contributions to a pension or retirement annuity fund as may be deducted from the income of that person in terms of section 11(k) or (n);

(ii) any allowance or expense which may be deducted from the income of that person in terms of section 11(c), (e), (i) or (j);

(iiA) any deduction which is allowable under section 11(nA) or (nB);

(iii) any deduction which is allowable under section 11(a) in respect of any premium paid by that person in terms of an insurance policy, to the extent that—

(aa) it covers that person against the loss of income as a result of illness, injury, disability or unemployment; and

(bb) the amounts payable in terms of that policy as contemplated in item (aa) constitutes or will constitute income as defined; and

(iv) any deduction which is allowable under section 11(a) or (d) in respect of any rent of, cost of repairs of or expenses in connection with any dwelling house

or domestic premises, to the extent that the deduction is not prohibited under paragraph (b);

Application of legislation

What is home office expenditure?

The expenditure contemplated in Section 23(b) will include:[1]

- rent,
- interest on mortgage bond,
- repairs to the premises,
- all other expenses relating to the house.

Other typical home office expenditure may include:

- phones,
- stationery,
- rates and taxes,
- cleaning,
- office equipment, and
- wear-and-tear.

Requirements of Section 11

Home office expenditure falling within the ambit of section 11 is relatively easy to prove, but it should be borne in mind that such expenditure may not be an expense of a capital nature.

Expenditure such as maintenance, rates and taxes and wear-and-tear on office equipment would usually satisfy the requirements of section 11.

Section 11, in so far as it relates to home office expenses, draws no distinction between taxpayers in employment, taxpayers that are holding an office or other taxpayers.[2]

[1] SARS Interpretation Note 28 (Issue 2) 15 March 2011
[2] Income Tax Act 58 of 1962

Requirements of section 23(m) - the limitation on deductibility

The application of Section 23 (m) is illustrated in *Appendix 1*[3]. Section 23(m) is applicable if the taxpayer is in receipt of remuneration derived from employment or the holding of an office, unless the remuneration is derived mainly from commission based on sales or turnover[4].

Deductions available to the taxpayer are limited under section 23(m) to the deductions listed in Section 23. As far as home office expenses are concerned, the taxpayer will only be able to claim rental, repairs and expenses incurred in relation to a dwelling house or domestic premises under Sections 11(*a*)[5] and (*d*)[6] and wear-and-tear allowances under Section 11(*e*).[7]

Requirements of section 23(b)

An expense must still meet the requirements of section 23(b) even though it meets the requirements of section 11 and is allowed under section 23(m).

The requirements of section 23(b) are as follows:

- The part of the home in respect of which a claim is submitted must be occupied for purposes of a "trade",[8]
- The part that is so occupied must be specifically[9] equipped[10] for purposes of the trade:
  - These definitions indicate in order for a part of a private home to be considered "specifically equipped" for the purposes of trade, that part must be fitted with the instruments, tools and equipment required to conduct that trade.
  - As an example, a mechanic that uses his garage for fixing cars, must have that garage equipped and fitted with all the right tool for fixing cars.

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[3] Also see SARS Interpretation Note 28
[4] SARS Interpretation Note 13 (Issue 3), 15 March 2011 on S23(m) of the ITA 58 of 1962
[5] S11(a) - expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;
[6] S11(d) expenditure actually incurred during the year of assessment on repairs of property occupied for the purpose of trade or in respect of which income is receivable, including any expenditure so incurred on the treatment against attack by beetles of any timber forming part of such property and sums expended for the repair of machinery, implements, utensils and other articles employed by the taxpayer for the purposes of his trade;
[7] Section 23 (m)
[8] Definition of "trade" as defined in section 1 of the Income Tax Act is as follows:
"trade" includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act, 1978 (Act No. 57 of 1978), or any design as defined in the Designs Act, 1993 (Act No. 195 of 1993), or any trade mark as defined in the Trade Marks Act, 1993 (Act No. 194 of 1993), or any copyright as defined in the Copyright Act, 1978 (Act No. 98 of 1978), or any other property which is of a similar nature.
[9] The Collins English Dictionary defines "specific" to mean "relating to a specified or particular thing"
[10] The Collins English Dictionary defines "equip" to mean "to furnish with"

- A Doctor may then not treat his patients in his lounge. He would need a separate consulting room with specialised examination room equipment for his trade as a doctor.
- There is a grey area though, where one makes renovations to a home in order to create the home office and to equip the home office, such renovation may not be considered for deduction as it may be considered a capital expense in terms of section 11(a).

The part of the home must be regularly and exclusively used for purposes of the trade.

- The Concise Oxford Dictionary defines "regularly" to mean "done or happening frequently" and "exclusively" to mean "excluding or not admitting other things; excluding all but what is specified".
- A financial planner may not qualify for home office expense if he uses his dining room to consult with clients. There needs to a specific room designated solely for the use of the Financial planning practice.
- It is not possible to define what would be acceptable to SARS as regular usage for the purposes of trade, as each case will have to be judged on its own merits.
- If your home office is an alternate office to your business premises for clients that you cannot consult with during office hours and this is an exception to the norm of doing business at the office, you shall not qualify for home office expense deductions.
- "exclusively for the purpose of trade", requires space used for trade may not be used for any other purpose other than the taxpayer's trade. The financial planner will not qualify for home office expenses the dining room is used as his office by as well as the family room .[11]

If the trade is employment or the holding of an office –

- The income derived from this trade must be mainly (that is, must exceed 50% of total income from employment or office) commission or other variable payments which are based on the taxpayer's work performance, and the taxpayer's duties were not performed mainly in an office provided by his or her employer; or
- The taxpayer's duties must be performed mainly (more than 50%) in that part of the private premises occupied for purposes of trade.
- Employees who do not earn commission but who spend the majority of their time on the road visiting clients perform their duties mainly at their clients' premises and as a result they do not qualify for a deduction under section 23(b).[12]

[11] S23(m)
[12] S23(m)

Practical application of section 23 (b) : What expenses can be deducted?

People who work for themselves[13]

Individuals who have their own businesses (sole proprietors) are entitled to claim actual home offices expenditure under the "Local Business, Trade and Professional Income" section of their ITR12. The same applies to partnerships and independent contractors.[14]

Generally, such taxpayers can claim all actual expenditure incurred with their trade (S11(a)), as well as a portion of overall home expenses which are applicable to their office use.

Persons that are employed

Requirements:[15]

- You must be employed.
- The employer must allow the employee to work from home.
- The employee must spend more than half of their total working hours working from their home office.
- The employee must have an area of their home which is used exclusively for this purpose. For example, employees who meet clients in their dining room at home would not qualify. A separate office, which is used specifically for the employee's work, must be maintained to qualify for the deduction.
- The office must be specifically equipped for the employee's trade, i.e., it must be specially fitted with the relevant instruments, tools and equipment required **for the employee to perform his or her work.**

There are 2 options based on an employee's remuneration structure:

1. The commission earner[16]

This type of employee earns more than 50% of total remuneration either from commission or some other variable form based on work performance.

[13] The Tax Shop Blog , Bernard Schoeman . https://taxshopservices.co.za/when-can-you-deduct-home-office-expenses/
[14] https://www.taxtim.com/za/blog/the-deduction-of-home-office-expenditure
[15] S23(m); https://www.taxtim.com/za/blog/the-deduction-of-home-office-expenditure
[16] S23(m)

This group can claim pro-rated deductions based on[17]:

- rent,
- interest on mortgage bond,
- repairs to the premises,
- all other expenses relating to the house.

- Other typical home office expenditure may include –
- phones;
- stationery;
- rates and taxes;
- cleaning;
- office equipment; and
- wear-and-tear.[18]

2. The salaried employee[19]

In this instance we are dealing with a normal salaried employee with variable payments or commission making up less than 50% of his or her total remuneration.

This group can only claim pro-rated deductions based on rent, interest on mortgage bond, repairs to the premises, rates and taxes, cleaning, wear and tear, and all other expenses relating to their house.[20]

How to calculate the home office deduction[21]

You need to calculate the total square meterage of the home office in relation to the total square meterage of the house as a percentage and apply this percentage to the overall home expenses which are applicable.

You are thus required to know:

a) The total square meterage of your home.
b) The square meterage of your home office room or space.
c) The percentage of your home office space in relation to your whole home

[17] https://www.taxtim.com/za/blog/the-deduction-of-home-office-expenditure
[18] https://www.taxtim.com/za/blog/the-deduction-of-home-office-expenditure
[19] S23(m)
[20] https://www.taxtim.com/za/blog/the-deduction-of-home-office-expenditure
[21] https://www.taxtim.com/za/blog/the-deduction-of-home-office-expenditure

This percentage then needs to be applied to the home office expenditure to calculate the portion that is deductible.[22]

Practically, this means that when you complete your annual tax return (ITR 12) as a taxpayer you will also complete the required portion on the return relating to home office expenses, or the portion that is indicated under other deductions for "Local Business, Trade and Professional Income" section for SARS consideration. This would be the section called "other deductions".

Example 1: Determination of home office expenses for the self-employed individual [23]

Sole Proprietor

Bob runs an advertising agency from his house. He has converted his garage into an office and incurred the following expenses during the tax year:

- Printing costs: R80,000
- Repairs to printers: R3,000
- Depreciation on printers: R4,000 (assume same as for SARS)
- Salaries and wages: R40,000 (he employs one person to help him)
- Cell phone costs: R15,000 (50% is for business use).
- Home expenses:
  - Interest on bond: R20,000
  - Repairs to house: R10,000
  - Electricity and water: R25,000
  - Rates and taxes: R15,000
  - Cleaning: R12,000

His garage is 10m^2 and the total space of his house (including the garage) is 100m2. The percentage space of his garage is therefore 10%. In Bob's ITR12, he would deduct the following expenses under the "Local Business, Trade and Professional Income" section:

- Printing costs: R80,000
- Repairs to printers: R3,000
- Wear and tear: R4,000
- Salaries and wages: R40,000

[22] https://www.taxtim.com/za/blog/the-deduction-of-home-office-expenditure
[23] The tax shop Blog Bernard Schoeman ; https://taxshopservices.co.za/when-can-you-deduct-home-office-expenses/

- Cell phone costs: R7,500 (R15,000 x 50%)
- Home office expenses:
  - Interest on bond: R2,000 (R20,000 x 10%)
  - Repairs to house: R1,000 (R10,000 x 10%)
  - Electricity and water: R2,500 (R25,000 x 10%)
  - Rates and taxes: R1,500 (R15,000 x 10%)
  - Cleaning: R1,200 (R12,000 x 10%)

Example 2: Determination of home office deduction by an employee with income derived mainly from commission[24]

Facts:

X is an employee who is in receipt of commission income of R50 000, a salary of R20 000 and a travel allowance of R3 000 a year. X is obliged in terms of his employment contract to work from home since his employer does not provide him with an office at work. He maintains a home office which he has specifically set up for the purposes of his employment duties. The home office is used regularly and exclusively for the purposes of work. His duties are performed mainly in the home office. The total area (square metres [m^2]) of the home study is 20 m^2 in relation to the total area of his house which is 200 m^2 The percentage area of the home office in relation to the total area of the house is 10% (20/200). He had purchased a computer for R12 000, an office desk for R2 000 and an office chair for R800 for the home office. The interest on his household bond amounts to R25 000 a year. The rates and taxes for the year amount to R2 500. X contributes R5 000 a year to a pension fund and had also incurred commission-related business expenses of R9 000 consisting of cell phone expenses and stationery costs.

Result:

Since more than 50% of X's total income consists of commission, the restrictions imposed by section 23(m) will not apply. Furthermore, he maintains a home office which is regularly and exclusively used for the purposes of earning income. The home office has been specifically equipped for the purposes of his trade and is mainly used by him to perform his duties. X can therefore claim a deduction for the following:

- Pension fund contributions of R5 000, subject to the limits imposed by section 11F.
- Cell phone expenses and stationery expenses of R9 000.

[24] SARS interpretation note 28 (issue 2) 15 March 2011

- Wear-and-tear allowance under section 11(e) for the computer, office desk and office chair.
- Travel deduction.
- Interest on bond of R2 500*.
- Rates and taxes of R250*.

* 10% of the total area of the house relates to the home office. Therefore 10% of the interest on bond and rates and taxes will be allowed as a deduction.

Example 3: Determination of a home office deduction by employee with income NOT derived mainly from commission[25]

Facts:

Y is an employee, who is in receipt of a salary of R50 000, commission of R20 000 and a travel allowance of R3 000 a year. Y is obliged in terms of her employment contract to work from home since her employer does not provide her with an office at work. She maintains a home office which she has specifically set up for the purposes of her employment duties. The home office is used regularly and exclusively for the purposes of work. Her duties are performed mainly in the home office. The total area (square metres) of the home study is 20 m2 in relation to the total area of her house which is 200 m2. The percentage area of the home office in relation to the total area of the house is 10% (20/200). She had purchased a computer for R12 000 and incurred computer repair costs of R2 000, an office desk for R2 000 and an office chair for R800 for the home office. The interest on her household bond amounts to R25 000 a year. The rates and taxes for the year are R2 500. The renovation costs amount to R5 000. Y contributes R5 000 a year to a pension fund and has also incurred commission-related business expenses of R9 000 consisting of cell phone expenses and stationery costs.

Result:

Since more than 50% of Y's total income consists of a salary, the restrictions imposed by section 23(m) will apply. Although she meets the requirements of section 23(b), that is, she maintains a home office which is regularly and exclusively used for the purposes of earning income, the home office has been specifically equipped and is mainly used for the purposes of her trade. Y will be limited under section 23(m) to the following deductions:

- Pension fund contributions of R5 000, subject to the limits imposed by section 11(k).
- Wear-and-tear allowance under section 11(e) for the computer, office desk and office

[25] SARS interpretation note 28 (issue2) 15 March 2011

- chair.
- Travel deduction.
- Interest on bonds of R2 500*.
- Rates and taxes of R250*.
- Renovation costs of R500*.

* 10% of the total area of the house relates to the home office. Therefore, 10% of the interest on bond, rates and taxes and renovation costs will be allowed as a deduction.

The following expenses will be disallowed under section 23(m):

- Cell phone expenses and stationery costs of R9 000.
- Repair costs of computer of R2 000

The importance of supporting documents

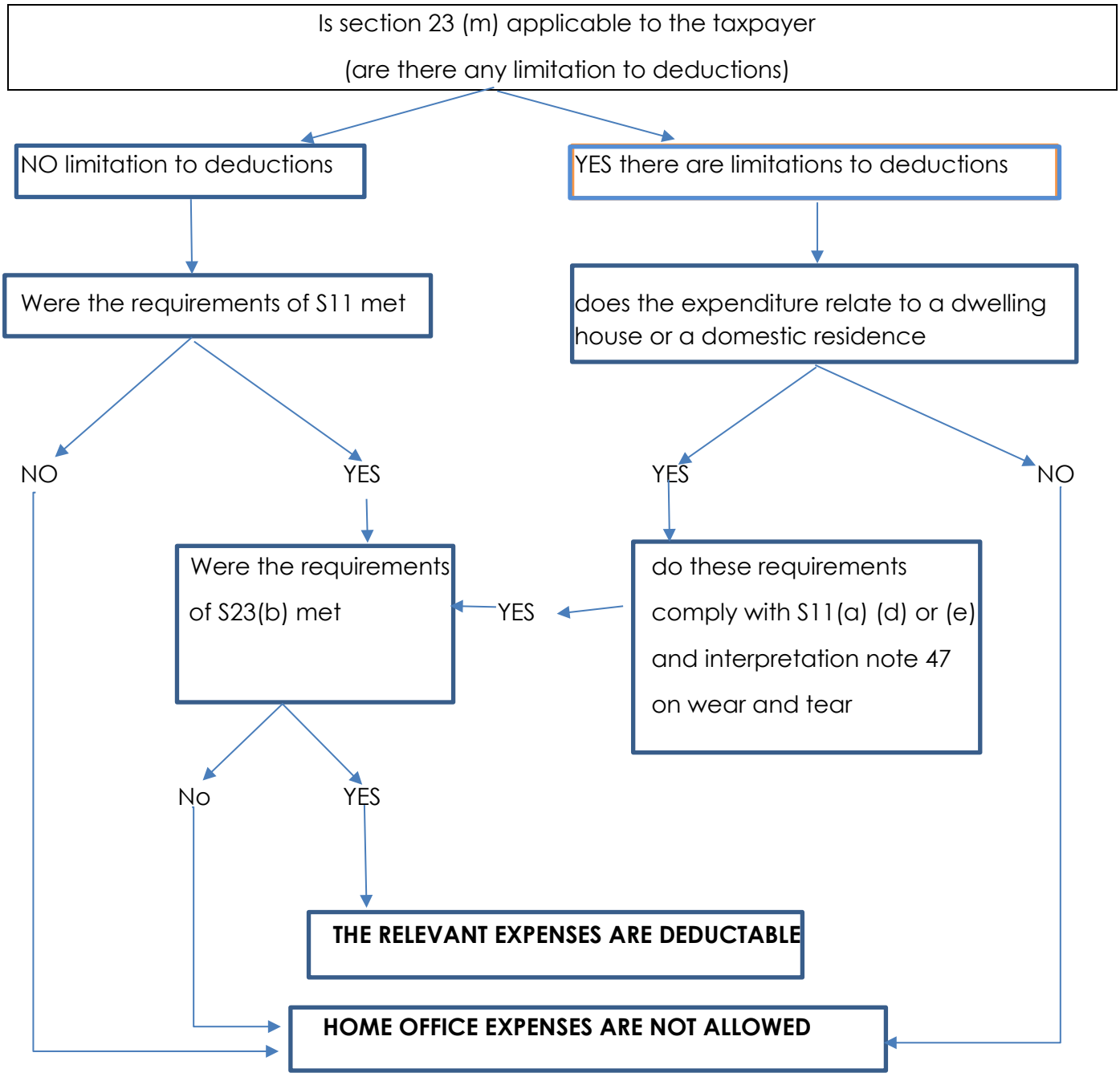
SARS often requests supporting documents from taxpayers to back up their home office deductions. Taxpayers must be aware that they have to submit scanned copies of invoices, as well as all relevant calculations to substantiate the percentage of home office expenses claimed (a spreadsheet or list of expenses will not suffice). They must also ensure that the supporting documents can easily be reconciled with the home office claim on their ITR12. If the backup is unclear or insufficient, SARS will disallow the deduction altogether.

It is clear from the above that employees will generally not be able to claim home office expenses due to the restrictions in section 23(b). Individuals who are not employees will be entitled to claim the deduction so long as the home office is used regularly and exclusively for their trade.

Conclusion

The article outlined the qualifying requirements for home office deduction. It is evident from the legislation that expenditure incurred does not translate into an automatic deduction. It is thus imperative that prior to incurring expenditure relating to the setup of a home office, one if fully acquainted of the requirements of legislation.

Appendix 1: Decision Chart : Home Office expenses[26]



[26] SARS interpretation Note 28 (Issue 2) 15 March 2011.

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Special Trusts Under the Magnifying Glass

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Introduction

The article is aimed at assisting financial advisors on the most pertinent issues surrounding special trusts in the financial planning process. Financial advisors should be giving holistic financial advice. It is therefore important that, where a client has children, a spouse or other family members that qualify for the protection of a special trust, advisers understand the requirements to create a special trust and the tax implications thereof. In this article I will highlight that, although special trusts are more tax-friendly than normal trusts, the devil is really in the detail. Advisers should thus also take cognisance of the disadvantages of special trusts when the tax liability of this structure is compared to that of individuals.

1. Definition of a special trust

Section 1(1) of the Income Tax Act[1] defines a special trust as follows-

"'***Special trust'*** *means a trust created—*

(a) solely for the benefit of one or more persons who is or are persons with a 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. Characteristics of a special trust

A) Special trust for disabled persons (hereinafter referred to as *Type-A* trust)

Paragraph (a) of the definition of a "special trust" in section 1 of the Income Tax Act[2], provides –

[1] Income Tax Act 58 of 1962
[2] Income Tax Act 58 of 1962

"*(a solely for the benefit of one or more persons who is or are persons with a 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:*"

Interestingly the definition does not mention that the Type-A trust should be only a testamentary trust or only an inter vivos trust. *Therefore*, it can be either a testamentary trust or an inter vivos trust, as *long* as the requirements are met.

First requirement: Disability[3]

It is clear that this type of trust is created solely for the benefit of one or more persons who is or are persons with a disability as defined in section 6 B(1)[4]. This definition provides as follows:

"***disability***" *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;"

Interestingly enough section 6B has no definition of "physical impairment". Physical *impairment* would include[5] –

- Bad eyesight
- Hearing problems
- Paralysis of a portion of the body
- Brain dysfunctions such as dyslexia, hyperactivity or lack of concentration

Second requirement: Sole benefit of the disabled person[6]

The special trust must be created *solely* for the benefit of one or more persons with a disability. Therefore, no beneficiaries that do not have a disability may qualify as a beneficiary as long as the person/persons with the disability is/are still alive. This does not mean that the beneficiary with the disability must have a vested right to the income or capital gains in the trust, since then it will be taxed in the beneficiary's hands, and the fact that it is a special trust will have no impact on the taxation of the income or capital gains in the hands of the beneficiary.

[3] SARS Guide to the Taxation of Special Trusts, 2019, p 6
[4] Income Tax Act 58 of 1962
[5] Notes on South African Income Tax, Phillip Haupt, 2020, p 236
[6] SARS Guide to the taxation of Special Trusts, 2019, p 7

Paragraph (a)(aa)of the definition of a special trust contains the following proviso –

"*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…."[7]

The trust deed of a *Type-A* trust may provide that the trust assets are held for the benefit of a *beneficiary* without a disability after the date of the death of the last living beneficiary with a *disability*. The trust will qualify as a *Type-A* trust until the death of the disabled beneficiary, and will subsequently be taxed as a normal trust, from the year of assessment in which the disabled beneficiary has died. [8]

Third requirement: The incapacity of the disabled person[9]

Paragraph (a) of the definition of a "special trust" in the Income Tax Act, also provides the following in respect of the *Type-A* trust –

"……*where such disability incapacitates such person or persons from earning sufficient income for their maintenance, or from managing their own financial affairs:*"

It thus appears that disability of the beneficiaries in itself is not sufficient for a trust to qualify as a special trust. The beneficiaries of a *Type-A* trust must thus be incapacitated to the extent that it prevents them from earning sufficient income for their maintenance or managing their own affairs. The onus will be on the trustees[10] of the *Type-A* trust to prove that the beneficiaries with a disability are incapacitated from earning sufficient income for their maintenance or financially managing their own affairs. This is a factual issue and will depend on the specific circumstances of the beneficiaries of the *Type-A* trust.

Fourth requirement: At least one of the disabled persons must be alive at the end of the year of assessment[11]

At least one of the disabled beneficiaries for whose benefit the trust was created, should be alive at the end of the year of assessment of the trust. If all the disabled beneficiaries are deceased for whose benefit the trust was created, the trust will cease to be a *Type-A* special trust, and will

[7] Income Tax Act 58 of 1962
[8] SARS Guide to the taxation of Special Trusts, 2019, p 9, 4.3.5
[9] SARS Guide to the taxation of Special Trusts, 2019, p 9

[10] Tax Administration Act 28 of 2011, Section 102 (1) (c)
[11] SARS Guide to the taxation of Special Trusts, 2019, p 9

be taxed as a normal trust from the year of assessment in which the last living beneficiary with a disability dies.

Fifth requirement: Disabled beneficiaries must be relatives to each other[12]

The last requirement is that the beneficiaries having a disability must be relatives. The beneficiaries and the founder do not need to be relatives, and their relationship does not impact whether the trust qualifies as a Type-A special trust.

A relative is defined as follows[13]

the spouse of that person;

- anybody related to that person within the third degree of consanguinity; Consanguinity means the degree of relationship by which a person is related to another person. For example, your parents are related to you in the first degree, whilst your grandparents are related to you in the second degree. Family members that will fall within the third degree of consanguinity of a person would include your parents, children (adopted children included) grandparents, siblings, nieces and nephews, uncles and aunts, and grandchildren. Spouses of the aforementioned persons also qualify as relatives. Cousins and their spouses would fall within the third degree of consanguinity, and would therefore not qualify.
- anybody related to the spouse of that person within the third degree of consanguinity; and
- the spouse of anybody related within the third degree of consanguinity to that person or that person's spouse.

Special Trust for minors (hereinafter referred to as *Type-B* trust)

Paragraph (b) of the definition of a "special trust" in section 1 of the Income Tax Act[14], provides –

(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;"*

[12] SARS Guide to the taxation of Special Trusts, 2019, p 10
[13] Section 1(1) of the Income Tax Act, 58 of 1962
[14] Income Tax Act 58 of 1962

First requirement: Only by a will of a deceased

A *Type-B* special trust can only be created through a will of a deceased person. Therefore, only a testamentary trust will qualify as a *Type-B* trust, and not an inter vivos trust.

Second requirement: Solely for beneficiaries who are relatives in relation to the deceased

A *Type-B special* trust is solely created for beneficiaries who are relatives of the deceased, they don't need to be relatives in relation to each other[15].

As alluded to earlier, 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
- the spouse of anybody related within the third degree of consanguinity to that person or that person's spouse.

Third requirement: The beneficiaries (who are relatives in relation to the deceased) must be alive on death of the deceased[16]

The beneficiaries must be *alive* on the death of the deceased. A beneficiary who has been conceived, although not born yet, will qualify. If one of the qualifying beneficiaries of the *Type-B* trust dies, the trust will continue to qualify as a *Type-B* trust if the remaining beneficiaries were alive on the date of the death of the deceased person, if they are relatives in relation to the deceased person, and the youngest beneficiary is under the age of 18 years, in the year of the assessment.

Fourth requirement: The youngest of the beneficiaries must be under the age of 18 years[17]

The youngest beneficiary must be under the age of 18 years. As long as the youngest beneficiary is under the age of 18 years, the other beneficiaries of the *Type-B* trust may be older than 18 years. In this regard, please refer to the Annexure with a flowchart, attached to this article, to establish whether a trust is regarded as a special trust for income tax and capital gains tax purposes.[18]

[15] SARS Guide to the taxation of Special Trusts, 2019, p 11
[16] SARS Guide to the taxation of Special Trusts, 2019, p 12
[17] SARS Guide to the taxation of Special Trusts, 2019, p 12
[18] SARS Guide to the taxation of Special Trusts, 2019, p 50

3. The special trust and income tax provisions

The income tax rate applicable to a special trust is not the single (45%) rate applicable to normal trusts, but rather the sliding scale applicable to natural persons. For the 2021 year of assessment the rate, depending on the taxable income, vary between 18 % and 45 %.

3.1 Exemption of the capital amount of voluntary purchase annuities for certain *Type-A* special trusts (section 10A)[19]

The capital element of a voluntary purchase annuity is exempt from tax in the hands of the purchaser or his spouse, surviving spouse, deceased/insolvent estate. One of the requirements that must be met before this exemption applies, is that there must be an agreement between an insurer and a purchaser. The definition of "purchaser"[20], includes, amongst other persons, a trust created solely for the benefit of a natural person if the High Court –

- Declared such person to be of unsound mind and incapable of managing his/her own affairs, and
- Ordered the creation of such a trust.

A trust established by an order of the High Court where such Court also ordered the creation of the trust, would qualify as a *Type-A* special trust, assuming that the rest of the requirements as set out above have been met. It is important to note that not all *Type-A* special trusts will qualify for the exemption of the capital portion of voluntary annuities provided for in section 10A(2). For instance, where a beneficiary is capable of managing his/her own affairs, or where the trust is not established under a High Court order, the requirements of Section 10A are not met the trust will thus not qualify for the exemption. Advisers should therefore establish whether these requirements have been met where they are considering a voluntary purchase annuity for a *Type-A* special trust.

It should also be noted that the section 10A exemption will not be applicable to special trusts created for minors (*Type-B* special trusts).

[19] SARS Guide to the taxation of Special Trusts, 2019, p 20
[20] Section 10A (1) of the Income Tax Act 58 of 1962

3.2 Income Tax rebates and exemptions

The assumption is often made that because a special trust is taxed at the rates of normal tax applicable to a natural person, that special trusts also qualify for the rebates and exemptions that natural persons qualify for. This is an incorrect assumption. A special trust is not a natural person, and does not qualify for rebates or exemptions that applies only to natural persons, for example the primary, secondary and tertiary rebates[21], medical tax credits[22] and the interest exemption[23]. The impact hereof should not be underestimated, and one should apply one's mind to establish whether a special trust makes sense for a beneficiary, if such beneficiary then loses out on the tax rebates and exemptions that he/she will qualify for as an individual taxpayer. Before a special trust is suggested advisers should familiarise themselves with all the rebates and exemptions that a special trust does not qualify for, to ensure what advice would be in the best interest of the client.

3.2.1 Primary, secondary and tertiary rebates:

Personal rebates are fixed amounts deductible by a natural person (not by a special trust) from the tax calculated per the tax table, to arrive at the normal tax due for the year of assessment. The rebates for the year of assessment ended 28 February 2021 are as follows:

- Primary rebate – R14 958
- Secondary rebate – R8 199
- Tertiary rebate – R 2 736

The secondary rebate would be claimable if a taxpayer is 65 years or older on the last day of the 2021 year of assessment. A person who is 65 years or older therefor qualifies for a rebate of R23 157 (this would include the primary rebate of R14 958 plus the secondary rebate of R8 199).

The tertiary rebate would be claimable if a taxpayer is 75 years or older on the last day of the 2021 year of assessment. A person who is 75 years or older therefore qualifies for a rebate of R25 893 (this would include the primary rebate of R14 958 plus the secondary rebate of R8 199 plus the tertiary rebate of R 2 736).

[21] Section 6 of the Income Tax Act
[22] Section 6A and 6B of the Income Tax Act
[23] Section 10(1)(i) of the Income Tax Act

If a special trust is created for a person, it is important to also take note that these rebates will be lost, especially if there are limited funds available to take care of the person.

3.2.2 Medical tax credits:

Medical expenses for individuals fall into two categories, namely:

- Contributions to a medical aid scheme[24]
- Out-of-pocket medical expenses (these expenses are not covered by medical aid schemes, and it is referred to as 'qualifying medical expenses'). There is also a category of *non-medical expenses* that are incurred *in consequence of* the physical impairment or disability of the taxpayer or his dependants. These are *necessary expenses*, as determined by SARS[25].

A rebate (known as a medical scheme fees tax credit) may be claimed by a natural person who makes a contribution to a registered South African or (similarly registered) foreign medical scheme. The amount of the tax credit that the person making the contribution can deduct from his normal tax for the 2021 year of assessment is R3 828 (R319 x 12 – assuming that the person does not have any other dependants on his/her medical aid scheme). A special trust does not qualify for a section 6A medical tax credit as this rebate may only be claimed by natural persons.

Qualifying medical expenses

The additional medical expenses tax credit in terms of section 6B is a rebate in addition to the section 6A rebate. A natural person who pays qualifying medical expenses can deduct this rebate from the tax payable by himself. This is only applicable to qualifying medical expenses that are actually paid during the year of assessment.

Section 6(B) gives a definition of qualifying expenses –

(a) "payments …… (excluding recoverable amounts) to registered doctors, dentists… for services or medicines…. to nursing homes, hospitals, nurses in respect of illness or confinement, to pharmacists for medicines on prescription.

(b) ……

Expenditure as prescribed by the Commissioner (excluding amounts recoverable by the taxpayer or spouse) in consequence of any physical impairment or disability of the taxpayer or dependants, necessarily incurred and paid during the year of assessment.

[24] Section 6A of the Income Tax Act
[25] Notes on South African Income Tax, Phillip Haupt, 2020, p 233

In my opinion the fact that a special trust does not qualify for the section 6A and section 6B rebates is an issue that should be revisited by the legislature. People with disabilities will usually have considerable medical expenses that are not recoverable from their medical aid. This might also be one of the reasons why a family that needs a special trust as a vehicle to care for a special needs person, makes a choice against the formation a special trust, thus defeating its purpose. It is my view that the legislature should seriously consider extending the benefit of the section 6A and section 6B tax rebates to special trusts as well, since the vulnerable beneficiaries of special trusts are disadvantaged by the current position.

4. The special trust and capital gains tax provisions

A *Type-A* special trust is entitled to specified exclusions that is also applicable to natural persons, for example the personal-use asset exclusion, the primary residence exclusion and the annual exclusion whereas the *Type-B* special trust does not qualify for the same exclusions[26]. It is not clear why this differentiation is made between the two types of special trusts in relation to capital gains tax. In my view *Type-B* trusts are unduly prejudiced in this regard, and this issue should also be reconsidered by the legislature.

4.1 Inclusion rate of a net capital gain[27]

The inclusion rate applicable to the capital gains tax calculation for a *Type-A* and a *Type-B* special trust is 40 %[28], compared to the inclusion rate of a normal trust of 80 % for a normal trust.

4.2 Annual exclusion[29]

The annual capital gains tax exclusion that a *Type-A* special trust qualifies for is currently R40 000. A *Type-B* special trust does not qualify for any exclusion in this regard.

[26] The definition of a "special trust" in paragraph 1 of the Eighth Schedule to the Income Tax Act only includes paragraph (a) of the definition of a special trust as defined in section 1 of the Income Tax Act.
[27] Income Tax Act 58 of 1962, Eighth Schedule, Part II, Paragraph 10(a)
[28] The reason why a *Type B* special trust qualified for the lower inclusion rate of 40%, is that paragraph 10(a) of the Eighth Schedule to the Income Tax Act provides that the 40% inclusion rate applies to a "special trust" as defined in section 1 of the Act. This is thus an indication that for purposes of paragraph 10(a), the limitation of the definition of a special trust as provided for in paragraph 1 of the Eighth Schedule is not applicable.
[29] Income Tax Act 58 of 1962, Eighth Schedule, Part II, Paragraph 5

4.3 The primary residence exclusion[30]

Only the *Type-A* special trust will qualify for the primary residence exclusion.

4.4 Personal-use asset exclusion[31]

The personal-use asset exclusion is also applicable only to a *Type-A* special trust. Typical examples of personal-use assets include artwork, jewellery, furniture, veteran cars, private motor vehicles, stamp and coin collections. This exclude gold and platinum coins of which the value is derived from the metal content. To qualify as a personal-use asset, the asset must be used more than fifty percent for purposes other than the carrying on of a trade.

4.5 Compensation for personal injury, illness or defamation[32]

A *Type-A* special trust must disregard a capital gain or loss on the disposal of a claim that resulted in the special trust receiving compensation for personal injury, illness or defamation of the trust beneficiary. The compensation is received to restore the person who suffered harm, to the position that the person was in before the harm was suffered.

4.6 Preserving the status of a *Type-A* special trust for purposes of CGT[33]

Paragraph 82 preserves the status of a trust as a special trust for purposes of capital gains tax after the death of the beneficiary for whose sole benefit the trust was created, until the earlier of the disposal of all the assets held by the trust or two years after the date of death of that beneficiary. All the CGT exclusions applicable to a special trust will still apply, including the annual exclusion. The inclusion rate will also remain at 40 % for a *Type-A* special trust. However, the marginal tax rate at which the taxable gain will be taxed, will be the single rate that applies to trusts generally. The sliding scale applicable to natural persons can only be applied to the special trust for the year of assessment during which the beneficiary of the *Type-A* special trust was still alive.

[30] Income Tax Act 58 of 1962, Eighth Schedule, Part II, Paragraph 45. The exclusion on the capital gain on disposal of a primary residence is currently R2 000 000.
[31] Income Tax Act 58 of 1962, Eighth Schedule, Part VII, Paragraph 53
[32] Income Tax Act 58 of 1962, Eighth Schedule, Part VII, Paragraph 59
[33] SARS Guide to the taxation of Special Trusts, 2019, p 35

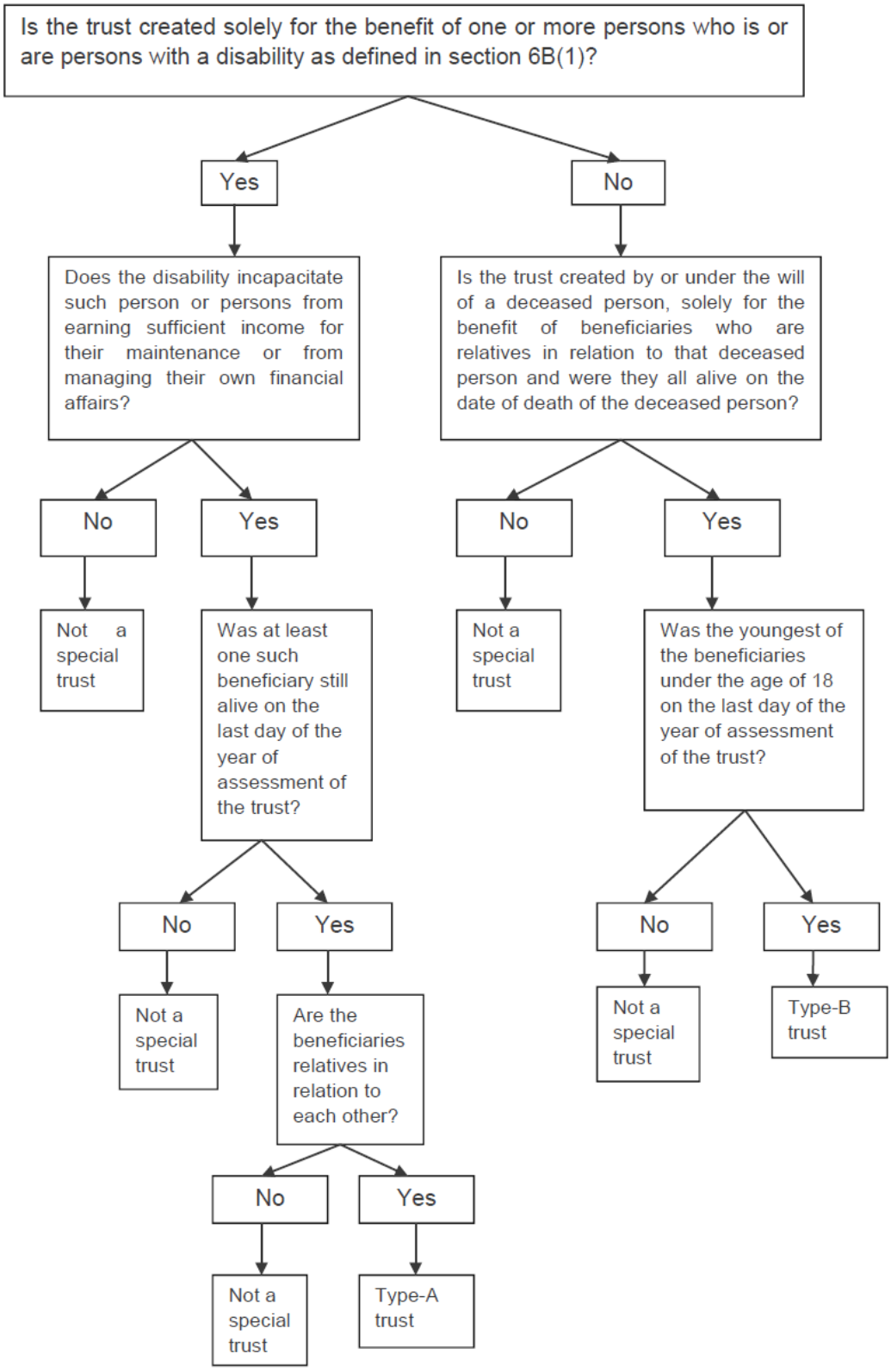
Conclusion

Although a special trust is taxed on the same sliding scale applicable to natural persons, the Income Tax Act makes provision for two types of special trusts, which are not treated the same throughout the legislation. It seems as if the *Type-B* special trust is almost treated as the "stepchild", since the "favourite child" (the *Type-A* special trust) qualifies for more exemptions and exclusions. One should really take care to ensure the tax implications including the exemptions and exclusions that the specific special trust qualifies for, are understood by clients when advice is rendered.

It should also be made clear to clients that, although a special trust is taxed at the same income tax rates as a natural person, it does not necessarily qualify for all the income tax benefits afforded to a natural person. The fact that both types of special trusts do not qualify for the section 6A and section 6B medical tax credits is a huge disadvantage. Since medical expenses are an unfortunate reality for persons suffering from disabilities, the fact that special trusts do not qualify for both the medical schemes tax credit and the additional medical expenses tax credit is a disconnect in legislation that should be addressed earlier rather than later.

It is an unfortunate reality that a lot of persons with disabilities are at the mercy of people, whilst they could have been properly protected via a special trust. However, because of the tax treatment of special trusts, decisions could potentially be taken not to follow the route of setting up such a trust. This is in my view a regrettable state of events.

Annexure – Whether a trust is regarded as a special trust for income tax and CGT purposes [definition of "special trust" in section 1(1)]



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The Disposal if Immovable Property: Which Entity to Hold Property in Gives a Seller Best Financial Outcome?

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Introduction

There are different ways in which to hold ownership in immovable property, especially if people are looking to grow their wealth and build a property investment portfolio. Each different entity in which property may be owned have different tax consequences. Often people find themselves already invested via entities with adverse consequences and it could possibly be too late to change without incurring unnecessary costs. This article investigates the outcomes on disposal of a property held in different entities and also proposes some options in certain instances if already invested via a specific entity.

Transfer duty is the tax levied on the purchase of immovable property and is applied to all persons purchasing in the same manner regardless of the type of entity[1]. Transfer duty not be discussed in this article. The capital gains tax outcomes per legal person however differ greatly and will thus be the main focus[2].

Capital gains tax: the basic calculation

Capital Gains tax (CGT) is the tax on the growth of capital assets, since its acquisition i.e. the how much the asset has increased in value since the asset was acquired by the tax payer. [3]

Although CGT came into effect 1 October 2001, it is applicable on the disposal of all capital assets, even the ones acquired before 1 October 2001.

The basic calculation for a capital gain is

Proceeds from sale of capital asset	R
Less: base cost	R
Equals: Capital gain	R
Less: any exclusions	R
Multiplied by the inclusion rate	%
Multiplied by the marginal income tax rate	%

[1] There are exemptions to the payment of transfer duty, but it is not relevant for purposes of this article.
[2] The 4 different types of property ownership in South Africa Jan 17, 2018: https://www.privateproperty.co.za/advice/property/articles/the-4-different-types-of-property-ownership-in-south-africa/6144
[3] Capital Gains Tax- Notes on South African Income Tax 2020: Phillip Haupt. H & H Publications pg 648

A capital gain thus exists when the proceeds or deemed proceeds from a sale or disposal of capital asset exceeds its base cost. [4]

This tax on the growth/gain, is triggered by the disposal and deemed disposal of the asset. Disposal in this sense is far wider than just a sale, and includes a donation, any alienation or transfer of asset, even vesting of an asset in an asset of a trust in a beneficiary.

Capital gains tax exclusions

After the capital gain is determined, any relevant capital gains tax exclusions may be applied. A general principle is that capital gains, or losses which may be subject to any exclusion must be disregarded when calculating their aggregate capital gain or loss for the tax year. This list only mentions the most relevant and common CGT exclusions. If a person is not aware of a particular exclusion, one may miss the opportunity to use it.

Annual exclusion:

An annual exclusion of R40,000 is available to special trusts and natural persons. Another way of putting it is that in any fiscal year only capital gains in excess of R40,000 is subject to capital gains tax. [5]

Death exclusion in the year of death:

This exclusion is available to deceased natural persons and special trusts in the event of the beneficiary of the special trust dying. Death is regarded as a deemed disposal of capital assets but in this event the annual exclusion is increased to R300,000.[6]

Primary residence exclusion

A primary residence[7] is defined as,

a. A residence
b. In which natural person or special trust holds an interest
c. Which that person or the beneficiary of that special trust
d. Ordinarily resides or resided in as their main residence

[4] Paragraph 3 Eighth Schedule Income tax act
[5] Paragraph 5 (1) Eighth Schedule Income Tax Act
[6] Paragraph 5 (2) Eighth Schedule Income Tax Act
[7] Paragraph 44 Eighth Schedule Income Tax Act

e. And uses it mainly for domestic purposes

When a person disposes his primary residence the first R2,000,000 of the capital gain may be disregarded. [8]

This exclusion is available to natural persons and special trusts. The exclusion is available on the property, hence if two or more natural personal jointly own the property, the exclusion is apportioned in relation to the interest the person had in the property, and on condition that it is in fact the primary residence of that individual. [9]

Special trusts may also utilise this exclusion if the property was used by the beneficiary of the special trust as his or her primary residence.

Small business exclusion

If a natural person disposes of an active business asset of a small business, capital gains up to R1,800,000 may be disregarded, when calculating the capital gains tax liability. [10] The total amount of this exclusion may not exceed R1,800,000 over that tax payer's life.

a) The first criteria to claim this exclusion is that the interest being sold should be a small business. A business qualifies as being a small business if the market value of all its assets at date of disposal is R10,000,000 or less. Also if the person owns numerous businesses, the combined market value of such assets may not exceed R10,000,000.
b) At the time of disposal the natural person is to have held the asset for at least 5 continuous years; **and**
c) have been actively and substantively involved in the operations of the small business; **and**
d) The person must be 55 years or older or, the disposal should be as consequence of ill-health, superannuation, infirmity or death.

Capital gains tax and income tax

A portion of a tax payer's capital gain is included in the taxpayer's taxable income, at which point it is thus subject to income tax. Capital gains tax therefore refers to the effective income tax which is payable on a capital gain made by the taxpayer.

[8] Paragraph 45 Eighth Schedule Income Tax
[9] Capital Gains Tax- Notes on South African Income Tax 2020: Phillip Haupt. H & H Publications pg 714
[10] Para 57 (1) of the Eighth Schedule of the Income Tax Act

Type of Taxpayer	Inclusion Rate	Statutory Tax Rate	Effective Tax Rate
Individuals	40%	0 - 45%	0 – 18%
Trusts	80%	45%	36%
Companies/CC	80%	28%	22,4%

The inclusion rate is 40% for natural persons and 80% for companies, close corporations and trusts. This multiplied by the person's or entity's marginal tax rate gives us the effective tax rate.

Options in relation the ownership of property

In South Africa, there are four main ways in which a property may be purchased. These are

1) as a natural person; or

2) in the name of a trust; or

3) in the name of a company; or

4) in the name of a close corporation.

Company and Close corporations are taxed in similar way so this will be grouped together.

1. Property owned by natural person

This is the most direct way in which people buy property. A natural person is a living, breathing individual and property will thus be registered in that persons own name.

Capital gains tax inclusion rate to an individual is 40%. With individuals an income tax marginal rate can be anything from 0% for individuals who earn no taxable income to a maximum marginal tax rate of 45%. The effective tax rate thus ranges from 0% to 18%, as is evident from the table above.

Example 1

Eva Bailey (aged 55) owns a home worth R5,000,000. The property was purchased by her for R2,000,000 after 1 October 2001 and it is not her primary residence. No other improvements have been made. Her taxable income is taxed at the maximum marginal tax rate.

CGT

Proceeds	R5 000 000
Less base cost	R2 000 000
Capital Gain	R3 000 000

Less annual exclusion	R40,000
Net capital gain	R2,960,000
X40% CGT inclusion rate	R1,184,000
x 45% marginal tax rate	
Total CGT liable	R532,800

Her CGT liability is R532,800 on the R5,000,000 sale, and the net proceeds after sale in the seller's pocket is thus R4,467,200.

As a natural person, some of the exclusions one should look out for is

1) the R40,000 annual exclusion available to her as she is a natural person, and
2) if the property sold qualifies with the definition of primary residence as provided above she may claim an additional R2,000,000 exclusion from her capital gains. If we apply the primary residence exclusion it reduces the overall capital gains tax liability to R172,800 as seen in the example below:

Example 2

Assume that the facts are the same as in example 1, but the property is Eva's primary residence:

Proceeds	R5 000 000
Less base cost	R2 000 000
Capital Gain	R3 000 000
Less primary residence exclusion	R2,000,000
Less annual exclusion	R 40,000
Net capital gain	R 960,000
X40% CGT inclusion rate	
x 45% marginal tax rate (i.e. effective rate of 18%)	
Total CGT liable	R 172,800

Bear in mind that if it doesn't qualify as a primary residence, because it is, for example, an investment property or a property used mainly for trade purposes, the seller would not be able to claim this exclusion, and the CGT liability would be R532,800. The annual exclusion would still be available to the taxpayer if such seller is a natural person.

A natural person should also consider his/her marginal tax rate. The lower the marginal tax rate, bearing in mind that the taxable capital gain will form part of the taxable income of the taxpayer, the lower your effective CGT rate will be. The examples used reflect 45% being highest marginal tax rate to provide a worst case scenario.

2. Property owned by a trust

As an introduction, I am first going to discuss some background issues pertaining to trusts.

Section 1 of Trust Property Control Act[11] 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);*

A trust is an agreement between a founder and the appointed trustees to administer assets for the benefit of a third party, i.e. the trust beneficiaries.[12] This is known in Latin as a *stipulatio alteri*.

Section 12 of Trust Property Control Act provides:

"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."

[11] S1 Trust Property Control Act 57 of 1988

[12] 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 third party beneficiaries.

A property held in a discretionary trust will not form a part of an individual's estate when they die, which means that the estate will benefit from estate duty and executor's fees savings. Another benefit is that, since the trust is a separate legal entity, the property held in the trust is protected from being attached by creditors of the beneficiaries.

The drawback to owning property in a trust is that a trust has a CGT inclusion rate of 80% and a marginal tax rate of 45%. The effective CGT rate of a trust is thus 36%, double that of the maximum effective CGT rate applicable to a natural person.

The founder of a trust also does not have any control of trust assets. A discretionary trust gives trustees of that trust the discretion to make full decisions in respect of trust assets. Only at distribution of trust assets, the trustees ultimately decide who gets what, when and how. A beneficiary only gains rights of ownership over those distributed assets once the trustees pass a resolution to distribute it to such beneficiary. It is then said that the asset vests in the beneficiary.

Example 3

The Eva Bailey Family Trust, a discretionary trust, sells a property it holds for an amount of R5,000,000. The property was purchased after October 2001 for R2,000,000.

Eva Bailey and her 2 children are the capital and income beneficiaries of the trust. None of the proceeds from the sale of the property are distributed to any of the beneficiaries in the year of assessment that the gain is made.

Market value of property	R5,000,000
Less base cost	R2,000,000
Capital gain	R3,000,000
Less: exclusion	no exclusion
Net capital gain thus	R3,000,000
x inclusion rate for trusts 80%	
x marginal tax rate for trusts 45% (i.e. effective CGT rate for trusts being 36%)	
Total capital gains tax liability	R1,080,000

The net proceeds after tax for the trust in this example is thus R3,920,000.
This is a very simplistic way of looking at the calculation, however it need not stop here.

If the net gains remain in the trust at the close of the financial year that the disposal by the trust took place, the tax liability of the trust in respect of the disposal is R1,080,000.

The R40,000 annual exclusion is not available to the trust as it is not a natural person. Each of the trusts beneficiaries who are natural persons are however entitled to the R40,000 annual exclusion.

The provisions of a trust deed could reduce the capital gains tax liability if a trust disposes of property. If the trust deed makes provisions for distributing capital gains to the beneficiaries, the capital gain could be payable by applying the inclusion rate and marginal tax rate applicable to the such beneficiaries[13]. This will only occur if the gains are distributed to the beneficiaries in the same year of assessment as when the disposal is made, instead of retaining the gains in the trust. This is known as the conduit principle. The capital gains flow through to the beneficiaries as though they are the beneficiaries and not the trusts capital gains.

Example 4

A discretionary trust sells a property and makes the following capital gain:

Market value of property	R5,000,000
Less base cost	R2,000,000
Net capital gain	R3,000,000

The trustees distribute these gains in equal portions to the beneficiaries. There are three beneficiaries.

a) The first and second beneficiary do not earn any other taxable income and are Eva's minor children[14].
b) The third is Eva and has a marginal tax rate of 45% (hence an effective rate of 40% x 45% = 18%)

Beneficiary one and two tax is as follows

R1,000,000 – R40,000

= R960,000

x 40%

= R384,000

[13] Paragraph 80(1) of the Eighth Schedule to the Income Tax Act.
[14] For purposes of this example it is assumed that Paragraph 69 of the Eighth Schedule to the Income Tax Act is not applicable.

This amount is added to their taxable income.

Taxable income (R)[15]	Rates of tax (R)
1 – 205 900	18% of taxable income
205 901 – 321 600	37 062 + 26% of taxable income above 205 900
321 601 – 445 100	67 144 + 31% of taxable income above 321 600
445 101 – 584 200	105 429 + 36% of taxable income above 445 100
584 201 – 744 800	155 505 + 39% of taxable income above 584 200
744 801 – 1 577 300	218 139 + 41% of taxable income above 744 800
1 577 301 and above	559 464 + 45% of taxable income above 1 577 300

R384,000 = R67,144 +31% (R384,000-R321,000)

= R129,544

Less primary rebate for person under 65 years

-R14 958

= R114,585 tax payable each by beneficiary one and two

Beneficiary three pays R1000,000 less R40,000 (x 18%) = R172,800

Total tax paid by beneficiaries thus equal R401,970

The after tax proceeds are thus R5,000,000 – R401,970 = R4,598,030

Even if the trustees were to have decided to distribute all gains to Eva, i.e. R3,000,000 (less R40,000) * (18%) = R532,800; it would have an after tax proceeds of R4,467,200. The CGT liability would thus be the same than if she had she sold it herself, and still less than if the trust were to settle its own capital gains tax liability without a distribution.

For many trusts that were set up before 1 October 2001 the distribution of capital gains would obviously not be included in the deed as the levying of CGT only became effective on this date. In these cases, it should be seriously considered to amend the trust deed to make provision for this.

If the deed makes provision for the distribution of CGT to beneficiaries if gains are vested in beneficiaries, the marginal tax rates of beneficiaries at time of disposal is an important consideration: the lower the marginal tax rate (taking into consideration the effect that the

[15] 2021 tax year (1 March 2020 - 28 February 2021)

taxable capital gain may have on such marginal rate), the less the capital gains tax liability will be.

3. Property owned by a company or close corporation

Companies and Close Corporations have a CGT inclusion rate of 80% and an income tax rate of 28%. This amounts to an effective rate of 22,4%.

Example 5

Eva Meiring holds 100% shareholding in Property Developers (Pty) Ltd. It holds a property which is valued at and is to be sold at R5,000,000. It was purchased at R2,000,000 for rental purposes 10 years ago.

Should the company sell the property the following taxes will be applicable:

CGT

Proceeds	R5,000,000
Less base cost	R2,000,000
Capital Gain	R3,000,000
Less exclusion	no exclusion
Net capital gain	R3,000,000

x 80% inclusion rate

x 28% company and close corporation marginal tax rate (i.e. 22.4% effective rate)

Total CGT liability	R 672,000
Net proceeds after sale is thus	R4,328,000.

Further to this, if the business intends on distributing the proceeds to the shareholder, Eva, the transaction will trigger dividend withholding tax.

Dividends Tax

Dividend Tax replaced Secondary Tax on Companies from 1 April 2012. Dividends Tax is currently levied at a rate of 20% on dividends paid by South African company to a shareholder[16], but the tax is withheld by that company and paid on behalf of the shareholder receiving the dividend.

[16] There are exemptions provided for dividends in Section 64F of the Income Tax Act, but it is not relevant

20% x R4,328,000 = R865,600
This brings the total tax bill to R1,537,600 resulting in the final proceeds of the sale after tax being R3,462,400

Another option in respect of property held by a company or close corporation could also be considered.

Assuming that a company has no other assets but for a property and does not trade, we can reasonably assume that the value of the shares in the company is equal to the value of the property. The shares in the business holding the sole asset, being the property, could be sold instead.

Base cost in this case would be the cost at which the business was acquired by the shareholder, not the cost as which the property was acquired by the company. If the shareholder acquired the share by means of a capital investment then that capital investment is part of the base cost[17].

If the shareholding is acquired by way of a loan account to the company, which is to be repaid to the shareholder, or if for whatever reason no value was paid for acquiring shareholding or membership interest in the company then the base cost of the interest in the business is zero.

Assuming that the shareholder is a natural person, the seller would therefore also be a natural person, in this instance the capital asset disposed of is the shares in the business. The effective rate for CGT is therefore 0-18%.

Example 6

Eva Meiring holds 100% shareholding in Property Developers (Pty) Ltd. It holds a property which is valued at and is to be sold at R5,000,000. The company had obtained a loan from a financial institution to purchase the property and Eva thus invested no capital in the company.

Market value of the business	R5,000,000 (the company only holds the one property)
Less base cost	R 0
Capital gain	R5,000,000
Less annual exclusion	R 40,000
Net capital gains	R4,960,000

[17] Paragraph 20(1)(a) Eighth Schedule Income Tax Act

x 40% CGT inclusion rate to natural persons
x 45% marginal tax rate (i.e. 18% effective rate)
Total capital gains tax payable R 892,800

After tax proceeds available to seller is thus R4,107,200 if she sells the business which holds the property. Still a better outcome than selling the property out of the business.

This option is only truly comparable with the other scenarios if the company has no other assets but for the property.

To further improve upon this last scenario, business owners should see if the requirements for utilising the small business exclusion of R1,800,000 as provided above are met.

Example 7

If the facts are the same in Example 6 and assuming the requirements[18] for the small business exclusion are met the CGT calculation will look as follows:

Market value of the business	R5,000,000
Less base cost	R 0
Capital gain	R5,000,000
Less small business exclusion	1,800,000
Less annual exclusion	R 40,000
Net capital gains	R3,160,000

x 40% CGT inclusion rate to natural persons
x 45% marginal tax rate (i.e. 18% effective rate)
Total CGT Payable is now reduced to R568,800. This leaves the seller with after tax proceeds of R4,431,200

[18] If the property was used mainly rental purposes, the exclusion would not be applicable as the definition of "*active business asset*" in paragraph 57 of the Eight Schedule to the Income Tax Act excludes an asset held in the course of carrying on a business mainly to derive income in the form of rental income.

Summary of after tax proceeds, based on the facts provided in the examples

ENTITY INVESTED VIA	AFTERTAX PROCEEDS	RANKING
Natural person investment property	R4,460,000	3rd
Natural person primary residence	R4,827,200	1st
Trust	R3,920,000	6th
Trust if trustees distributes to beneficiaries	R4,598,030	2nd
Company sells property and retains proceeds	R4,328,00	4th
Company sells property and distributes proceeds	R3,462,400	7th
Shareholder/member sells company/CC holding property	R4,107,200	5th

Conclusion

Where property is owned by an individual could have the most favourable outcome form a capital gains tax perspective, especially where such property qualifies as a primary residence. It must further be borne in mind that a special trust, set up for one or more persons who suffer from a disability[19], also be entitled to the annual exclusion and primary residence exclusion applicable to natural persons. Where there is more than one disabled beneficiary of such a special trust, all beneficiaries must be relatives[20] in relation to each other.

[19] The definition of a "*special trust*" in paragraph 1 of the Eighth Schedule to the Income Tax Act provides that a special trust means a trust contemplated in paragraph (a) of the definition of a special trust in section 1. Paragraph (a) of the definition of a "special trust" in section only pertains to a trust set up for a person or persons suffering from a disability (as defined in section 6B(1)) and not to a special trust set up in the will of a person for the benefit of relatives under the age of 18 years.

[20] As provided for in paragraph (a)(aa) of the definition of "*special trust*" in section 1 of the Income Tax Act. The term "relative" is defined in section 1 of the Income Tax Act as a person's spouse, or anyone that is related to such person or spouse within the third degree of consanguinity or any spouse of a person so related. An adopted child will be deemed to be related to an adoptive parent within the first degree of consanguinity.

A trust has the highest effective CGT rate of 36% and thus finds itself placed close the bottom of the ranking at 6th place, should the trust not vest the proceeds in beneficiaries in the tax year of the disposal.

The conduit principle applicable to trusts, when applied wisely, does however change this position, especially in the case of beneficiaries with lower marginal tax rates. Being able to utilise the annual exclusion, the lower inclusion rate and possible lower marginal tax rate of a natural person who is a beneficiary of a trust, could make this a very appealing option to use.

Based solely on the examples above, it is evident that, where a company disposes of property and distributes the funds to its shareholder in the form of a dividend, will have the worst outcome from a tax point of view. Despite it not having the highest effective CGT or marginal tax rate, the impact of dividend tax makes a notable difference to the final outcome. If the company refrains from distributing to the shareholder and uses the proceeds within the business, it is placed it in the 4th ranked position.

This indicates that it is not only the disposal alone which affects the financial outcome, but also what the entity plans to do with the funds thereafter. A dividend distribution to the shareholders of a company thus has an adverse effect from a tax perspective in these circumstances. In the case of a trust distributing its capital gains to one or more beneficiaries, such distribution has a positive financial effect from a CGT perspective.

The financial outcome form a CGT perspective however only represents one of many needs and criteria that must be considered in choosing which entity to utilise for property ownership. Protection of assets from creditors and marital regimes, the effect on a deceased estate and other relevant factors should also be taken into consideration. Although owning property in personal capacity could be more favourable from a CGT perspective, it would be thus prudent to also consider the financial consequences in a deceased estate and the lack of protection against creditors.

A trust could provide good flexibility for the ownership of property if the trust deed is drafted astutely and the trust is administered effectively via the appointment of knowledgeable trustees. Utilising the conduit principle to distribute capital gains to natural beneficiaries. whilst at the same time affording the protection provided by a trust structure and the saving of costs and taxes associated to deceased estates, may provide the "best of both worlds" approach in this regard. All relevant tax[21] and other factors should however be considered in deciding on which approach to follow.

[21] An example of an important tax consideration to take into account is the provisions of section 7C of the Income Tax Act. The section would in this regard be applicable where property is transferred to a trust via a loan account by a connected person in relation to the trust or where such a connected person makes a loan to the trust in order to purchase the property.

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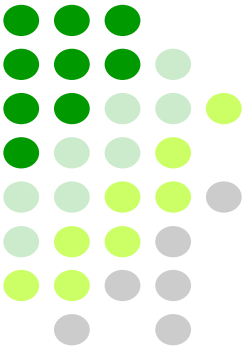

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Introduction

Before 1995, South Africans were not allowed to invest capital in offshore markets. South Africans only access to foreign currency income was through rand hedge shares and tank containers[1]. With the dawn of Democracy, South African institutional investors were given permission to access offshore markets and therefore, in the past decade, offshore investments have been seen as an opportunity to provide investors with flexibility, diversity and transparency.

However, the access to offshore markets places a duty on financial advisors to provide investors with all the relevant tax and administrative consequences should such an investor pass away with offshore investments in his estate. More than often financial advisors neglect to consider the potential "extra" estate duty (situs tax) and other estate administrative complications at death. This article will briefly look at the difference between direct offshore investments (specifically in the United Kingdom and the United States of America) and indirect offshore investments, by comparing the taxes (CGT and Estate Duty) and other estate expenses associated with the type investment on death.

Exchange control

Before we look at the different types of offshore investments, we need to understand how much capital an investor can transfer out of the country. The South African Reserve Bank is in charge of regulating exchange control through banks that are authorised foreign exchange dealers. The Reserve Bank is there to protect South Africa's foreign currency reserves, which largely consists of gold bullion, currency balances and amounts owed to South African banks by banks abroad[2].

In protecting South Africa's reserves, the South Africa Reserve Bank has exchange controls in place, which prevents a person from taking money out of South Africa without its permission.

The South African Reserve Bank has pre-approved certain transactions into which a resident is permitted to enter. For example:

- Each individual of 18 years and older may take up to R 10 million rand per calendar year out of South Africa, provided that they obtain a tax clearance certificate from SARS[3]. This amount

[1] Fundamentals of Financial Planning, 2018, *M Botha, L du Preez, W Geach, B Goodall, J Palframan, L Rossini & P Rebenowitz*, p 434
[2] Fundamentals of Financial Planning, 2018, *M Botha, L du Preez, W Geach, B Goodall, J Palframan, L Rossini & P Rebenowitz*, p 435
[3] Premium & Problems Article Edition 110, 2015, *M Marias*, p F4

is furthermore capped at R 20 million per family, after all local liabilities have been accounted for[4]. This is known as the 'foreign investment allowance' or 'foreign capital allowance'.

- Additional to the foreign investment allowance, an annual 'discretionary allowance' of R 1 million may be used by persons of 18 years and older for legal purposes abroad. These funds may be transferred out of South Africa, whether a person travels overseas or not. No tax clearance from SARS is required[5].
- A 'travel allowance' in the amount of R 200 000 is available for persons under the age of 18[6].

Available offshore investment vehicles

An investor's choice of an offshore investment vehicle will mainly be influenced by the source of the funds that are to be invested. The funds can either be sourced from South Africa under the exchange control allowance or may already be legitimately held outside South Africa from external sources, for example an inheritance from a non-resident[7]. In broad terms foreign investments can be classified in two categories, namely investments available in respect of funds which have to remain under exchange control, which includes "indirect offshore" or "asset swap" investments, and direct offshore investments of funds held or transferable offshore.

Indirect offshore investments or "asset swap": A number of offshore investment options were introduced with the relaxation of exchange control, such as "asset swap" investments. An "asset swap" is essentially an arrangement whereby certain types of local institutions were allowed to take a percentage of their assets under management offshore in exchange for securing a reciprocal investment into South Africa[8].

In 2001 the "asset swap" mechanism was replaced by rules governing portfolio investments by South African institutional investors. Since then Institutions are allowed to invest client funds outside South Africa, subject to certain "prudential foreign exposure limits". The current exposure limits are 30% of total assets for pension funds and life assurer' underwritten policies, and 40% for

[4] Premium & Problems Article Edition 110, 2015, *M Marias*, p F5
[5] Notes on South African Income Tax (2020), *P Haupt*, p 15
[6] Notes on South African Income Tax (2020), *P Haupt*, p 15
[7] Premiums & Problems, Edition119, 2019, *Editors: S. Cloete, C. Muller, S. Starling, G. Peter, M. Britz & L. du Toit,* p B58
[8] Premiums & Problems, Edition119, 2019, *Editors: S. Cloete, C. Muller, S. Starling, G. Peter, M. Britz & L. du Toit,* p B59

collective investment schemes, investment managers and investment-linked business of long-term insurers[9].

When institutions reach the limits imposed, it will have the consequence that they cannot accept further investments, or if the value of their local assets under management decreases, the offshore portion may exceed the limit. In these circumstances, the managers of these institutions may be forced to sell foreign securities, and acquire local assets usually so-called "rand hedged" shares on the JSE[10].

These investments are mostly rand-denominated offshore unit trusts offered by a local manager.

Direct offshore investments: South African citizens have two categories of assets which may legitimately be held outside of South Africa, and which may be invested directly into offshore investment vehicles:

a) South African citizens can firstly export amounts under the exchange control investment allowance, as discussed above under "Exchange Control".

b) Secondly, South African citizens may also legitimately hold certain foreign-sourced assets. This includes for example, immigrants' foreign-held funds, foreign income and inheritances from non-South African residents. This also includes assets or funds in respect of which amnesty was granted, or which was regularised during the 2003 exchange control and tax amnesty process in 2011 Voluntary Disclosure Programme (which ran from 1 October 2016 to 31 August 2017)[11].

It is important to note that these investments are mostly denominated in foreign currency.

South African tax system

A country's method of taxation may be categorized into two broad types of tax:

- Residence based tax: This tax system taxes the resident of the country on their worldwide income having no regard to the source of the income;

[9] Premiums & Problems, Edition119, 2019, *Editors: S. Cloete, C. Muller, S. Starling, G. Peter, M. Britz & L. du Toit,* p B59
[10] Premiums & Problems, Edition119, 2019, *Editors: S. Cloete, C. Muller, S. Starling, G. Peter, M. Britz & L. du Toit,* p B59
[11] Premiums & Problems, Edition119, 2019, *Editors: S. Cloete, C. Muller, S. Starling, G. Peter, M. Britz & L. du Toit,* p B60

- Source based tax: Is a tax system where a country imposes tax on all the income which has its source in that country and the residential status of the taxpayer is irrelevant.

South Africa has a "residence" basis of tax system. A 'resident' is defined in section 1 of the Income Tax Act[12] as either:

- A person who is "ordinarily resident" in South Africa. Which in plain language would mean South Africa is his or her true home[13]; or
- A non-resident who has spent a certain number of days in South Africa, i.e.[14].
  - More than 91 days in total in each of the current and previous five tax years; and
  - More than 915 days in total during the previous five tax years.

The result is that South African residents are taxed on their worldwide income, while non-residents remained only taxable on their South African source income[15].

In South Africa the Estate Duty Act[16] applies to the estate of any person who dies ordinarily resident in the Republic or leaves assets connected by situation or enforcement of rights in South Africa[17]. However, unlike the Income Tax Act[18], the Estate Duty Act [19] does not have a definition of "resident"[20], and it is therefore up to our courts for interpretation thereof[21]. The position is succinctly summarised in the Income Tax Interpretation Note No. 3 (4 February 2002) as follows:

"Although the Act does not define 'ordinarily resident', the courts have interpreted the concept to mean country to which a person would naturally and as a matter of course return from his/her wanderings. It might therefore be called a person's usual or principle residence and it would be described more aptly, in comparison to other countries as the person's real home"[22]

[12] Act 58 0f 1962
[13] Notes on South African Income Tax (2020), *P Haupt*, p 25
[14] Notes on South African Income Tax (2020), *P Haupt*, p 25
[15] Notes on South African Income Tax (2020), *P Haupt*, p 551
[16] Act 45 of 1955
[17] Meyerowitz On Administration Of Estate And Their Taxation, 2010 Edition, *D Meyerowitz*, par 27.1
[18] Act 58 of 1962
[19] Act 45 of 1955
[20] Phillip 863
[21] Estate Planning, *DM Davis, C Benek & RD Jooste*, p 2-16(1)
[22] Estate Planning, *DM Davis, C Benek & RD Jooste*, p 2-16(1)

In interpreting 'ordinarily resident', the above approach was followed in the case of Cohen v CIR[23] and confirmed in the case CIR v Kettle[24].

Estate duty and double death duty agreements

In terms of section 3 of the Estate Duty Act[25], "the estate of any person shall consist of all property of that person as at the date of his death and of all property which is deemed property of that person at that date". It is therefore clear that estate duty has an impact on offshore assets, with certain exclusions specified under section 4(e) of the Estate Duty Act[26], as well as assets situated within South Africa. For purposes of this article, it is assumed that all the exclusions under section 4(e) are not applicable to the property. In terms of section 4(e), property situated outside South Africa which is in resident's personal name, will attract estate unless the property was acquired before the deceased became ordinarily resident in South Africa for the first time, or the property was acquired by donation or inheritance from a non-resident after becoming a South African resident for the first time[27]. Therefore, if offshore property in the deceased's estate is not excluded in terms of section 4(e), then such property will be subject to estate duty in terms of section 3 of the Estate Duty Act[28].

It is important to note that the mere fact that asset of a deceased is 'property' under the Estate Duty Act[29], and therefore dutiable for estate duty in South Africa, does not prevent another state from charging duty thereon and *vice versa*[30]. It might be possible that the same asset may be subject to tax in both the countries where broadly similar taxes are involved. Section 16 of the Estate Duty Act[31] makes provision for the deduction of foreign death duties imposed on property situated outside South Africa and included, for estate duty purposes, in the estate of any person ordinarily resident to South Africa on his or her date of death[32].

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[23] 13 SATC 362
[24] 54 SATC 298
[25] Act 45 of 1955
[26] Act 45 of 1955
[27] Estate Planning: The impact of estate duty and capital gains tax on offshore assets (2010), *C Bornman*, p 3
[28] Act 45 of 1955
[29] Act 45 of 1955
[30] Meyerowitz On Administration Of Estate And Their Taxation, 2010 Edition, *D Meyerowitz*, par 31.1
[31] Act 45 of 1955
[32] Meyerowitz On Administration Of Estate And Their Taxation, 2010 Edition, *D Meyerowitz*, par 31.1

As required by section 26 of the Estate Duty Act[33], South Africa concluded double death duty agreements with Canada, Lesotho, Botswana, Switzerland, Mauritius, the United Kingdom (UK), the United States of America (USA) and Zimbabwe. Double death duty agreements effectively allocate the primary right to tax in the country where asset is located at death and grant relief in the resident country by either exempting the income or crediting foreign tax paid against the South African tax charge[34]. It is, for purposes of this article, only important to note that South Africa have concluded agreements with the UK and the USA[35].

The double death duty agreement between South Africa and UK determines that:

- immovable property (article 6);
- business property of a permanent establishment and assets pertaining to a fixed base used for performance of independent personal services (article 7); and
- ships and aircraft, shares, debentures and unit trust holdings (article 9)

may be taxed in the state in which it is situated, or if the assets pertain to shares or rights in unit trusts, the place where the company is incorporated or where the register of unit holders is kept[36].

Example:

A South African dies owning property in shares in a company registered in the UK. The shares are subject to Estate Duty in South Africa and Capital Transfer Tax (the "death duty" payable in the UK) in the UK. The South African tax attributable to the property is R 3 000, whilst the UK tax attributable to the property is R 5 000. Due to the fact that the property is situated in the UK, and the deceased estate is liable for capital transfer tax in the UK, the South African government must allow a credit of R 3000 against its tax. The property will therefore only be taxed in the UK. If the tax attributable were reversed, for example R 5000 in South Africa and R 3 000 in the UK, then South Africa must allow a credit of R 3 000 against its tax[37].

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[33] Act45 of 1955
Section 26 of the Estate Duty Act 45 of 1955 provides:
"Prevention of, or relief from double taxation. (1) the Nation Executive may enter may enter into an agreement with the Government of any other country, whereby arrangements are made with such Government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of estate duty in respect of the same property or to the rendering of reciprocal assistance in the administration of, and in collection of estate duty under the laws relating to estate duty in force in the Republic and in such other country."

[34] Estate Planning: The impact of estate duty and capital gains tax on offshore assets (2010), *C Bornman*, p 32

[35] Estate Planning, *DM Davis, C Benek & RD Jooste*, p 2-16(5)

[36] Meyerowitz On Administration Of Estate And Their Taxation, 2010 Edition, *D Meyerowitz*, par 31.18 to 31.21

[37] Meyerowitz On Administration Of Estate And Their Taxation, 2010 Edition, *D Meyerowitz*, par

The double death duty agreement between South Africa and the USA determines that the place (or *situs* in Latin) where property is located determines the imposition of tax or duty, and for credits and refund in the case where tax or duty in imposed by both governments[38]. The rules of situs apply where a person was at the time of his or her death domiciled in the USA or ordinarily resident in South Africa.

Capital (income) gains and double tax agreements (DTA's)

In terms of section 9HA of the Income Tax Act[39] a deceased person is, subject to certain exclusions, deemed to have disposed of all of his or her assets (which includes capital assets and revenue assets[40]) at the date of death for an amount received or accrued equal to the market value, which could give rise to a capital or an income gain in the hands of the deceased. When dealing in with assets acquired or disposed of in foreign currency, it is necessary to determine the capital gain or loss in Rands as dealt with in paragraph 43 of the Eighth Schedule. It states that the capital gain or capital loss is determined in that foreign currency and then converted to Rands.

Capital gains and losses are determined as follows in term so f paragraph 43(1) of the Eight Schedule[41]:

- Firstly, determine the capital gain or loss in the foreign currency; and
- Secondly, convert the foreign currency capital gain or loss into Rands at the date of disposal by applying the average exchange rate for the year of assessment in which the asset was disposed of (or deemed to be disposed of), or by applying the spot rate at the date of the disposal or deemed disposal.

The following example is provided in the South African Notes on Income Tax[42]:

31.23

[38] Meyerowitz On Administration Of Estate And Their Taxation, 2010 Edition, *D Meyerowitz*, par 31.28

[39] Act 58 of 1962

[40] Notes on South African Income Tax (2020), *P Haupt*, p 796

[41] Notes on South African Income Tax (2020), *P Haupt*, p 750

[42] Notes on South African Income Tax (2020), *P Haupt*, p 750

Proceeds from foreign currency	$40 000
Base Cost in that same currency	($28 000)
Capital gain on disposal of asset	$12 000
Translate into local currency either at the average rate	
for the year or at the spot rate on the date of disposal: $12 000 x R14,50….	R174 000

Paragraph 43(1A) of the Eight Schedule deals with the situation where the expenditure incurred and the proceeds are in different currencies[43].

As previously mentioned, South Africa has a residence based tax systems which means that South African residents are taxable on their worldwide income[44]. It is however important to note that the Income Tax Act[45] contains certain sections which either exclude or exempt foreign income from tax in South Africa[46], and in many instances double tax treaties, entered into with other countries, determine the incidence of tax[47]. The rebate can either be equal to the amount of the foreign tax or a portion thereof[48].

Section 6*quat*(1) of the income Tax Act[49] states that foreign tax paid on income or capital gains that are taxable in South Africa may be deducted from the South African tax on that income or capital gain, if the taxpayer is a South African resident[50]. The section 6*quat* foreign tax rebate, is a rebate that is deducted from the South African tax payable on foreign income, provided that the foreign income that is taxed is also taxed in South Africa[51]. Section 6*quat*(1) is however subject to section 6quat(2), which provides that the rebate shall not be granted in addition to any relief provided under a double tax treaty or DTA[52].

Section 108 of the Income Tax Act[53] provides that the National Executive of South Africa may enter into an agreement with the government of any other country to regulate the taxation of

[43] Notes on South African Income Tax (2020), *P Haupt*, p 751
[44] Notes on South African Income Tax (2020), *P Haupt*, p 551
[45] Act 58 of 1962
[46] Notes on South African Income Tax (2020), *P Haupt*, p 551
[47] Notes on South African Income Tax (2020), *P Haupt*, p 551
[48] Notes on South African Income Tax (2020), *P Haupt*, p 562
[49] Act 58 of 1962
[50] Notes on South African Income Tax (2020), *P Haupt*, p 562
[51] Notes on South African Income Tax (2020), *P Haupt*, p 562
[52] Notes on South African Income Tax (2020), *P Haupt*, p 569
[53] Act 58 of 1962

income, profits, gains and donations which may be taxable in both countries[54]. These agreements are usually referred to as double taxation agreements or DTA's in short. DTA's usually have an 'elimination of double taxation' article that states for example that one country (Country A) must allow foreign tax paid on the income arising in a foreign country (Country B) as a credit against the tax on that income in Country A[55]. In South Africa where the credit is not made subject to South African law, the tax payer has a choice between using section 6*quat* of just claiming a tax credit in terms of the DTA[56]. For example, it could be more preferable for a tax payer to choose a treaty relief if the foreign tax is at a rate lower than the domestic rate and the treaty provides that foreign income shall be exempt[57].

The taxes payable on death in the United Kingdom (UK)

The UK law mainly operates a common law system which combines the passing of legislation and precedents through case law[58]. The Inheritance Act, 1984, manages and controls the imposition of Inheritance Tax (IHT)[59] (Known as Estate Duty in South Africa). IHT applies to the value of an individual's estate when he or she dies in which case it is deemed that the deceased transferred his or her whole estate immediately before such time. The tax applies on the basis of the loss of value to the donor's estate that arises by reason of the transfer of value[60].

IHT is charges at a zero rate on the first GBP325,000 for the tax year 2018-19 and fixed until 2020-2021, which is also known as the nil-rate. IHT charged on transfers at death is charged at 40% on the amount over and above the nil-rate threshold[61]. In terms of section 4 of the Inheritance Tax Act of 1984, transfers between spouses are exempt from IHT, even if both spouses are non-UK-domiciled.

The rate of Capital Gains Tax in the UK depends on your tax band. If you fall within the basic rate tax band, you be liable for Capital Gains Tax at a rate of 18%, but if you are in the higher tax band the Capital Gains Tax Rate is 28%[62]. The capital gains tax allowance in 2020-21 is £12,300.

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[54] Notes on South African Income Tax (2020), *P Haupt*, p 633
[55] Notes on South African Income Tax (2020), *P Haupt*, p 562
[56] Notes on South African Income Tax (2020), *P Haupt*, p 634
[57] Notes on South African Income Tax (2020), *P Haupt*, p 569
[58] Estate Planning: The impact of estate duty and capital gains tax on offshore assets (2010), *C Bornman*, p 52
[59] Estate Planning: The impact of estate duty and capital gains tax on offshore assets (2010), *C* Bornman, p 52
[60] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 397
[61] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 404
[62] Available at Experts for Expats website Capital Gain Tax for Non-UK Residents (18 March

The taxes payable on death in the United States of America (USA)

In 2017 President Trump signed into law the Tax Cuts and Jobs Act, which made significant changes to US federal tax law. The US imposes an Estate Tax on the transfer of a deceased person's taxable estate at death. The estate tax rate is levied at a rate of 40% (for both residents and non-residents) and US citizens are entitled to an estate tax exemption of USD11.4 million, whilst non-residents are entitled to a tax exemption of USD60 000[63]. The US law however prohibits a marital deduction for a transfer to a non-US citizen spouse, even if the deceased is a US citizen[64].

For CGT purposes the US distinguishes between long-term capital (capital assets held for longer than 12 months and short-term capital (assets held for shorter than 12 months) and on current transactions, the long-term capital gains tax rate is the same as the tax rates applicable to ordinary income, 21% being the maximum rate (Excluding the additional phase-out rates) [65].

Probate of will and other administrative elements

Where a deceased only had a South African will that deals with his or her worldwide assets, it may delay the administration of the estate and may in some instances cause uncertainty due to most jurisdictions not sharing the same legal terminology.

For example, the UK will accept the formal validity of a will drawn up under the laws of the deceased's domicile, nationality or place of residence at the time of making the will or at death[66]. However, in instances where the will is drawn up in a language other than English, for example Afrikaans, English translation is required and the UK courts usually prescribes certain requirements for the translator and the format in which it must be provided[67].

If an individual domiciled in South Africa passes away, leaving assets registered in England, it is regularly the case that the letter of executorship issued by the Master of the High Court will not be recognised by the English asset holder[68]. For example, of a person, who is domiciled in South Africa, passes away leaving a bank account or house in registered in England, the South African

2020): https://www.expertsforexpats.com/expat-tax/capital-gains-tax-for-british- expats/capital-gains-tax-for-non-uk-residents/

[63] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 414

[64] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 422

[65] Available at PWC Wordwide Tax Summaries website: https://taxsummaries.pwc.com/united- states/corporate/income-determination

[66] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 409

[67] English Estates – what is "resealing", *O Phipps*

[68] English Estates – what is "resealing", *O Phipps*

letter of executorship may not be recognised by the bank and will also not be recognised by the English Land Registry.

Resealing is a way to obtain recognition of the letter of executorship by the English court, which will then enable the executor or their attorney to gain access to the assets registered in England[69]. The documents that are required by the English Courts is a court sealed copy of the will, as the original will is usually retained by the Master in South Africa, and the original or court sealed copy of the letters of executorship[70]. If an English solicitor is instructed to apply for the reseal on behalf of the South African executor, the solicitor will prepare the letter of authority However, where the English solicitor is also instructed to continue and administer the assets in the UK, the solicitor will also prepare a power of attorney[71]. It is important to note that a fee of £155 is payable for the resealing where the net estate exceeds £5,000. Although resealing appears straight forward, the following examples provide reasons why professional legal assistance, for example a UK solicitor, is usually required[72]:

- In England and Wales, a certain form IHT400 must be used to deliver an account of the deceased's taxable estate to the HM Revenue & Customs Capital Office within 12 months of the end of the month of death. Any inheritance tax due must also be paid within 6 months after the end of the month in which the deceased died[73]. If a foreign executor attempts to submit an English Inheritance Tax Return and it is completed incorrectly, they may be committing a criminal offence.
- If a foreign executor obtains a reseal in England, they may have difficulty when dealing with certain assets, which are registered in England.
- Although resealing is a common exercise in the UK, it is worth noting that resealing is only possible in England and Wales. It not possible to reseal in Scotland, Northern Ireland, Republic of Ireland, Jersey, Guernsey or the Isle of Man.

Unlike the UK, the USA does not follow a civil law system. The Uniform Probate Code provides a model of provisions that states consider when drafting their legislations. The Uniform Probate Code has been adopted by certain states in the USA and modified by other. Some states in the

[69] English Estates – what is "reseaing", *O Phipps*
[70] English Estates – what is "reseaing", *O Phipps*
[71] English Estates – what is "reseaing", *O Phipps*
[72] English Estates – what is "reseaing", *O Phipps*
[73] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 405

USA has not adopted the Uniform Probate Code. The probate system may therefore differentiate from state to state in the USA.

US courts will usually not accept jurisdiction over the estates of non-domiciliaries. However, a court may accept jurisdiction in the context of an ancillary probate proceeding where the decedent died leaving realty in the subject jurisdiction. In such circumstances, the courts will generally accept the validity of a foreign will if it was successfully probated without being contested in the deceased's country of residence. In the event that the court is unsatisfied with the validity of the probate proceedings in the domicile jurisdiction, it may assume original jurisdiction and in such in instance conduct its own analysis regarding the validity of the foreign will. It is therefore recommended that US non-resident aliens holding realty in the United States execute a will valid in the jurisdiction where the property is located[74].

In the USA the deceased's estate is a separate legal entity and tax payer, which comes into existence at the date of death and continues until the estate if finalised and all the property is distributed[75]. They estate may therefore have US income tax filing obligations during the period between date of death and date of finalisation. A non-resident must appoint a qualified US personal representative in his will, if not, every person in possession of the deceased's property are required to file an estate tax return. For non-residents, a form 706-NA must be filed with the Internal Revenue Service Centre within nine months following the date of death. An estate can request an extension of an additional six months to file the return. The tax however must be paid by the original date to avoid any interest and penalties[76].

Taking the above into consideration, it might be advisable for a client to rather have an offshore will for assets situated in foreign countries, as some foreign states might require the original will. This will resolve the delays caused in obtaining sealed copies from the Master of the High Court[77].

Conclusion

As highlighted above, the possible higher returns on a direct offshore investment might not compensate for additional costs, and taxes payable as a result of incorrect structuring. It is

[74] Available on Cadwalader Wickersham & Taft LLP website: https://www.lexology.com/library/detail.aspx?g=809b0f26- a9cc-4a8d-af4c-02bcb91b446e
[75] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 422
[76] Worldwide Estate & Inheritance Tax Guide 2019, *Ernest & Young*, p 423
[77] Estate Planning: The impact of estate duty and capital gains tax on offshore assets (2010), *C Bornman*, p 52

important that careful consideration should be given to all relevant facts when advising a client on investing offshore. In circumstances where offshore assets form part of a client's estate, the necessary steps must be taken to ensure that the administration of the estate is not delayed. An advisor must take into account the burden of the additional tax and the possible complication of estate administration which a direct offshore investment might create on the death of an investor.

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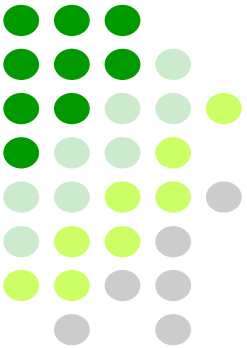

Retirement Planning

The 'ABC' of Section 37A, B, C & D of the Pension Funds Act 24 of 1956 – Protection Measures for Pension Benefits

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Introduction

Pension benefits are intended for the advantage of members and their dependants, and should therefore not be eroded unnecessarily.[1]

The Pension Funds Act[2] (hereafter "the Act") aims to protect the pension benefits of members by through the provisions of sections 37A-37D. Over time members have turned to the courts and other forums (such as the Pension Funds Adjudicator) to interpret these provisions. This article looks at the four ways in which of the Act sets out to protect a member's pension benefits and how they have been interpreted by the courts and adjudicators.

Whilst there is no explicit definition provided for the term "pension benefit", the Act does define a "benefit" as follows: "in relation to a fund means any amount payable to a member or beneficiary in terms of the rules that fund".[3]

Section 37A – Pension benefits not reducible, transferable or executable

The first and probably most direct measure is section 37A, which establishes a general rule protecting pension fund benefits from attachment and execution. It provides that any benefit or right to any benefit provided for in the rules of a registered fund is protected from attachment or any form of execution against a judgment in satisfaction of a debt[4]. Its objective is to protect pensioners against losing their source of pension. Pension benefits may also not be reduced, transferred, ceded or pledged by a fund or member, except to extent permitted by this Act[5], the Income Tax Act[6] and the Maintenance Act[7].

A further exception to this rule allows a non-member spouses to be awarded a portion of the pension benefits of a member spouse upon divorce, if it qualifies as a "pension interest" as provided in terms of section 7(7) and (8) of the Divorce Act[8]. Once a divorce order complies with the above provisions of the Divorce Act, it is binding on the pension fund and the fund will have to pay the amount over to the non-member spouse. Parties must take note though that a

[1] Marumoagae (2016).
[2] 24 of 1956.
[3] Section 1.
[4] S37A(1).
[5] Discussed in greater detail below under discussion of section 37D.
[6] 58 of 1962.
[7] 99 of 1998.
[8] Read with the definition of a "pension interest" in section 1 of the Divorce Act, and section 37D(1)(d)(i), (3), (4), (5) & (6) of the Pension Funds Act.

defective order cannot be amended by agreement only and it will have to amended through a court application.

Section 37B – Disposition of pension benefits upon insolvency

Where a member is insolvent, the only asset that they have left is often their retirement funds. Section 37B of the Act seeks to protect the retirement funds of a member from creditors.

The sequestration of an insolvent's estate is dealt with in terms of the provisions of the Insolvency Act[9]. The purpose of the process is to distribute the proceeds of the debtor's assets through an orderly equitable process where all of his creditors cannot be paid in full. All movable and immovable property of the debtor forms part of his insolvent estate, but section 37B specifically provides that pension benefits do not form part of a member's insolvent estate[10] and the full amount is protected against creditors.

In the recent matter of *Moreau and Another v Murray and Others*[11] the court had to consider whether or not this protection from creditors extended to benefits which were paid out to an insolvent before his estate was sequestrated. The court considered the case of *Absa Bank vs Burrmeister*[12], where it was held that the money "loses" its character once in the hands of the member and ceases to be a benefit and the member is free to do with it as he pleases. Similarly, the money becomes available to the creditors of the member to satisfy outstanding debts. The court further found that the member's benefits only enjoys the protection of section 37B while the funds are held in the fund.

Section 37C – Disposition of pension benefits upon death of a member

The introduction of section 37C was primarily done to regulate the payment of death benefits in accordance with the object of the Act. According to the section, death benefits do no form part of the deceased member's estate[13] and as a result they are not dealt with under the provisions of the Administration of Deceased Estates Act[14]. It effectively serves as a statutory limitation in

[9] 24 of 1936.
[10] This is however subject to a pledge in accordance with section 19(5)(*b*)(i) and subject to the provisions of sections 37A(3) and 37D of the Pension Funds Act.
[11] [2020] ZASCA 86.
[12] 2004 (5) 595 (SCA); (2005) 3 All SA 409 (SCA) paragraph 9 where the court considered section 37D(1)(b) of the Act
[13] This is however subject to a pledge in accordance with section 19(5)(*b*)(i) and subject to the provisions of sections 37A(3) and 37D of the Pension Funds Act.
[14] 66 of 1965.

respect of beneficiary nominations in that the fund has the obligation, where a beneficiary is nominated but the deceased member also had one or more dependants, to pay the benefit to the dependant(s) or beneficiary in such proportions as the board may deem equitable.

Section 37C determines how the lump sum benefits of members of pension funds, provident funds, preservation funds and retirement annuity funds should be distributed and paid upon the death of the member. These death benefits enjoy the same protection that other pension benefits do under section 37A of the Act.

Although the deceased member can nominate beneficiaries to receive the benefit, the trustees of the fund have a duty to:

(a) Identify the dependants and nominees of the deceased member

The Pension Funds Amendment Act[15] identifies three classes of dependants based on the duty of support that the deceased member might have towards them:

- A person in respect of whom the member is legally liable for maintenance such as a spouse[16], minor child, adult child still studying, a grandchild, parent or grandparents[17].
- Dependants which the member was not legally liable for maintenance, if such person was in fact dependent on the member for maintenance, is the spouse or child of the member (this assumes that we are dealing with a spouse or major child who is self-sufficient and does not require the maintenance of the member).
- Future dependants, who are dependants whom the deceased member was not legally liable to maintain at the time of his death, but would have become liable were it not for their death. The Adjudicator in *Malinga v Ejoburg Retirement Fund and Another*[18] accepted that the child is a dependant even if the member did not know about or acknowledged his existence.

  The trustees of the fund have to, within twelve months, identify and trace the possible dependants of the member. If the twelve months have lapsed, the trustees may extend it with a reasonable period to allow for further investigation[19]. The onus is on the fund to

[15] 11 of 2007.
[16] Section 1 Pension Funds Act defines a "spouse" as a person who is the permanent life partner or spouse or civil union partner of a member in accordance with the Marriage Act, the Recognition of Customary Marriages Act, or the Civil Union Act or the tenets of a religion.
[17] The obligation for maintenance could arise due to legal obligation, common law or statute.
[18] (2016) BPLR PFA.
[19] Dobie NO v National Technikon Retirement Pension Fund (1999) 9 BPLR 29 (PFA).

trace and identify the dependants and it should take all reasonable steps to do so and reasonable steps will differ from case to case. There is no duty on a dependant to come forward and prove that his or her dependency[20]. If the trustees do not become aware of or cannot trace any dependant of the member within the twelve month period, the benefit needs to be paid to the beneficiary[21]. In this regard it must be born in mind that if the value of the debt in the estate of the deceased member exceeds the value of the assets, an amount equal to the difference in value between the debt and assets must be paid into the estate, and the beneficiary will then be entitled to the difference. If the fund is not able to trance, or does not become aware of any dependents or beneficiaries within the twelve-month period, the benefit must be paid into the estate of the deceased.

(b) Effect an equitable distribution of the benefit among the beneficiaries

It is important to keep in mind that the distribution of benefits has to be equitable. In *Malinga* matter mentioned above, the Adjudicator held that the test in law is to determine whether or not the trustees acted rationally and arrived at a proper and lawful decision and not what is fair or generous.

(c) Determine an appropriate mode of payment[22].

Section 37D – Fund may make certain deductions from pension benefits

Despite the general rule against deductions from pension benefits, certain claims against funds are permitted provided that strict requirements are met. The most common deductions include:

(i) Amounts owed to the South African Revenue Services (SARS) in accordance with the provisions of the Income Tax Act.

(ii) Amounts due in respect of housing loans, granted by the fund/employer or for which the fund/employer agreed to stand surety.[23]

(iii) Pension interests awarded to former spouse in terms of an order for divorce.[24]

[20] Mthiyane v Fedsure Life Assurance Ltd and Others (2002) 5 BPLR 3460 (PFA).
[21] S37C(1)(b).
[22] 37C(2), (3) and (4).
[23] S37(D)(1)(i)(aa) and (bb)
[24] S37D(1)(d)(i).

(iv) Maintenance claims awarded against the member and the fund.[25]

(v) Damages due to an employer caused by a member's misconduct.[26] The employee has to admit liability in writing and that he consents to the deduction of the amount upon his exit from employment[27] or the employer must produce a judgment in his favour[28] against the employee.

The interpretation of section 37D(1)(b)(ii)(bb) has been subject of a number of court cases and disputes until the Supreme Court of Appeal in *Highveld Steel and Vanadium Corporation Ltd v Oosthuizen*[29] gave some certainty in this regard. The court held that a pension fund has the discretion to (under section 37D) to withhold payment of pension benefits due to a member at the termination of his employment, pending finalisation of a claim for damages which the employer allegedly suffered due to the employee's misconduct.[30] The court cautioned that pension funds have to exercise this discretion with care and in the process balance the competing interests with due regard to the strength of the employer's claim. This warning was echoed by the Appeal Board of the Financial Services Tribunal in *Tleane v The Pension Fund Adjudicator and Others*.

The *Highveld* decision was later reverberated by the Pension Funds Adjudicator in *Coka and Another v Old* Mutual *Superfund Pension Fund and Others*[31] where it was ruled that legal cost may be recovered against the benefits of a member if it relates to the recovery of financial damages caused by the misconduct of the employee.

Conclusion

Through this discussion the writer aimed to provide a better understanding of the provisions of sections 37A-37D by showing the practical application thereof through a selection of applicable case law. It is important to remember that the law is not static and that it evolves with time.

[25] S37D(1)(d)(iA).
[26] Rowan v Standard Bank Staff Retirement Fund and Another (1) [2001] 2 BPLR 1643 - The member's alleged misconduct must be shown to have actually caused the employer loss.
[27] S37D(1)(b)(ii)(aa).
[28] S37D(1)(b)(ii)(bb).
[29] 2008 ZASCA 164.
[30] At paragraph 19.
[31] 2013 JOL 30751 PFA.

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Old Mutual Life Assurance Company (SA) Ltd and Sanlam Life Insurance Ltd v Swemmer (2004) 4 BPLR 5581 SCA.

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Members of Retirement Annuity Funds and Preservation Funds Emigrating from South Africa – Changes in Terms of the 2020 Taxation Laws Amendment Act

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Introduction

Annexure E (Financial Sector Update)[1] to the 2020 Full Budget Review, published with the 2020 Budget Speech by the Minister of Finance, contained the following statement:

"*The concept of emigration as recognised by the Reserve Bank will be phased out, to be replaced by a verification process based on the requirements above. Tax residency for individuals will continue to be determined by the ordinarily resident and physically present tests as set out in the Income Tax Act (1962)*."

It was, at that stage, uncertain how this budget proposal would affect members of retirement annuity funds and preservation funds emigrating from South Africa. The 2020 Draft Taxation Laws Amendment Bill[2], Draft Explanatory Memorandum on the 2020 Draft Taxation Laws Amendment Bill[3], the Draft Response Document on the 2020 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2020 Draft Taxation Laws Amendment Bill and 2020 Draft Tax Administration Laws Amendment Bill (Based on hearings by the Standing Committee on Finance in Parliament)[4] and the 2020 Taxation Laws Amendment Act provide more details of the amendment in this regard,

Position prior to 1 March 2021

Currently, a member of a retirement annuity fund or preservation fund may, prior to his/her retirement date, withdraw from such a fund (and thus receive the retirement interest as a lump sum) if such a member[5]:

a) is or was a resident who emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control; or

b) departed from the Republic at the expiry of a visa obtained for work or visiting purposes.

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[1] http://www.treasury.gov.za/documents/national%20budget/2020/review/Annexure%20E.pdf , p154

[2] http://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20Taxation%20Laws%20Amendment%20Bill%20-%2031%20July%202020.pdf , published 31 July 2020.

[3] http://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20%20Explanatory%20Memorandum%20on%20the%202020%20Draft%20TLAB%20-%2031%20July%202020.pdf , published 31 July 2020, p8-9

[4] http://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20Response%20Document%20on%20the%202020%20Draft%20Tax%20Bills%20-13%20October.pdf . published 13 October 2020, p26-28

[5] Paragraph (c)(ii) of the definition of a pension preservation fund, paragraph (c)(ii) of the definition of a provident preservation fund and paragraph (b)(x)(dd) of the definition of a retirement annuity fund in section 1 of the Income Tax Act, 58 of 1962.

It is important to note that, in the case of a preservation fund, the withdrawal on emigration is allowed even if the member had already taken the once-off withdrawal allowed as provided for in the definition of a pension preservation and provident preservation fund in section 1 of the Income Tax Act.

The discussion of the relevant provisions of the Income Tax Act and operational requirements pertaining to these provisions are set out in the SARS External Guide, Tax Directive: Emigration and Cessation of Visas[6].

Draft Taxation Laws Amendment Bill and Draft Explanatory Memorandum thereto

The Draft Explanatory Memorandum to the 2020 Draft Taxation Laws Amendment Act reiterate the sentiments expressed in Annexure E to 2020 Full Budget review and provides the following reasons for change:

"*As outlined in Annexure E of the 2020 Budget Review, Government will be modernising the foreign exchange control system. As a result, a new capital flow management system will be put in place. This new system will move from a "negative list" system to one where all foreign-currency transactions, other than those contained on the risk-based list of capital flow measures, being allowed.*

In *respect of individuals, one of the changes to be implemented during modernisation of the foreign exchange* control *system is the phasing out of the concept of "emigration" for exchange control purposes. The phasing out of this concept will have a direct impact on the application of the tax rules as the tax legislation makes provision for a payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes*."

The proposed change is then summarised as follows:

"*In order to ensure efficient application of the tax legislation, it is proposed that the definitions of "pension preservation fund", provident preservation fund and "retirement annuity fund" in section 1 of the Act be amended to remove the reference to payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes. As such, a new test should be inserted which will make provision for*

[6] https://www.sars.gov.za/AllDocs/OpsDocs/Guides/IT-AE-33-G01%20-%20Tax%20Directive%20for%20Emigration%20and%20cessation%20of%20visas%20-%20External%20Guide.pdf

the payment of lump sum benefits when a member ceases to be a South African tax resident (as defined in the Act), and such member has remained non-tax resident for at least three consecutive years or longer."

To this extent, the Draft 2020 Taxation Laws Amendment Bill proposed to substitute the requirement of "emigration from South Africa recognised by the South African Reserve Bank" on order to commute a retirement interest in a preservation fund or retirement annuity fund with the following prerequisite[7]:
"*is a person who is not a resident for an uninterrupted period of three years or longer;*".

The proposal thus, in short, entailed replacing the current requirement of "formal emigration" in order to have an interest in retirement annuity and preservation funds commuted and paid to a member as a lump sum, with the requirement that such member must be non-resident in South Africa for a period of at least 3 years.

The proposed effective date for the amendment was 1 March 2021.

Draft Response Document on the 2020 Draft Rates and Monetary Amounts and Amendment of Revenue Law Bill, 2020 Draft Taxation Laws Amendment Bill and 2020 Draft Tax Administration Laws Amendment Bill

The Draft Response Document deals with public comments received in response to the various proposals of the relevant Draft Tax Bills. The comments and replies in relation to the proposed amendment discussed above are as follows:

Comment:
The 3-year waiting period places a financial burden on the individual as the amounts received from the retirement funds are often used to cover settling in costs in the new country. It also adds additional requirements (which includes administrative requirements) for fund members, SARS and fund administrators to meet. SARS will also be subject to a cash-flow delay while waiting for the 3-year period to lapse. Many commentators suggest that the withdrawal should be allowed immediately.

[7] By an amendment to the definition of "pension preservation fund" through section 2(1)(h) of the Draft Taxation Laws Amendment Bill, an amendment to the definition of "provident preservation fund" through section 2(1)(k) of the Draft Taxation Laws Amendment Bill and an amendment to the definition of "retirement annuity fund" through section 2(1)(m) of the 2020 Draft Taxation Laws Amendment Bill

Response:

Not accepted. The 3-year rule is a mechanism to ensure that there is a sufficient lapse of time for all emigration processes to have been completed with certainty, without affecting such workers whose residence status changes for reasons other than emigration. The current system of financial emigration imposes a lot of strictures, not least its requirement that individuals close bank accounts and credit cards and repatriate funds that are taken out above the limits if return to the country before 5 years has elapsed. The envisaged system as a whole will have much lower compliance burdens overall for those looking to move abroad, and therefore it is not useful to focus on the 3-year requirement in isolation of the overall policy change.

One of the main objectives of the reform is to modernise the capital flow oversight system in a manner that balances the benefits and risks of more mobile people, financial flows and cross-border transactions. Now there is recognition that people's working lives may well include a unique combination of periods spent in South Africa and abroad. One possibility is emigration, with a multitude of possibilities on the continuum between emigration and a short business trip abroad. Policy design has to take all of these options into account, while the most vocal comments have focussed on only emigration.

When individuals contribute to pensions (tax-free), the understanding is that tax is deferred until benefits are received upon retirement. Government did not intend to provide a tax incentive for funds to be used for emigration. Our attempt is to reconcile the choice to emigrate and electing to withdraw a retirement lump sum with the design principle of deferred taxation upon retirement. This also illustrates a horizontal equity point: tax residents who decide not to emigrate have to wait until retirement for withdrawals from retirement annuity funds.

Comment:

There is uncertainty as to whether the requirement to be a non-resident for 3 years refers to the physical presence test or ordinarily resident test. The 3-year test conflicts with other existing residency tests (e.g. section 9H). There is also uncertainty whether the 3 years refers to tax or calendar years. Clarity is also sought with regard to the interaction between Double Tax Agreements (DTA) and the new proposal. Many commentators recommended ceasing residence in terms of the ordinary residence test as a more appropriate measure.

Response:

Not accepted. The 3-year rule applies if an individual has ceased to be tax resident in South Africa, irrespective of the particular test under which that tax residency is determined. Therefore, the 3-year rule does not focus on the ordinarily resident test alone.

Comment:
Clarity is required with regards to how cases where the emigration process commenced before 1 March 2021, but have not yet been finalised when the effective date kicks in, will be dealt with.

Response:
Accepted. All complete applications received by the SARB before 1 March 2021 will be finalised through the existing process, provided that they are approved by the SARB (even if the approval should occur after 1 March 2021). The amended provision will apply to all cases that meet the requirements on or after 1 March 2021 including individuals that did not receive formal approval to emigrate from SARB. In most cases, a change in tax residence, triggers capital gains tax on the deemed disposal of assets. National Treasury and SARS encourage taxpayers to weigh their options carefully and not be swayed by superficial advice, often at exorbitant fees.

Comment: Uncertainty with regard to cases where funds are in a preservation fund before 1 March 2021 and emigration process commences after 1 March 2021.

Response:
Noted. In applying these provisions, the rules of each preservation fund will be honoured.

Comment:
The 3-year period may cause administration issues as there have been cases where SARS has deregistered individuals as soon as they ceased residency.

Response:
Noted. Although this is not routinely the case as SARS deregisters taxpayers upon request by those particular taxpayers, however, SARS will monitor this.

Comment:
Using tax residency as a criterion creates timing uncertainty as the ordinarily residence test is a subjective test – difficult to determine with certainty the point at which intention changes.

Response:
Not accepted. The residency rules apply as they have in all other cases, guided through Interpretation Note 3.

2020 Taxation Laws Amendment Act

The Minister of Finance tabled the 2020 Taxation Laws Amendment Bill in parliament on 28 October 2020 and the 2020 Taxation Laws Amendment Act[8] was promulgated on 20 January 2021. The provisions related to the commutation of an interest in a retirement annuity or provident fund if a person has ceased to be a South African resident for three consecutive years as contained in the 2020 Draft Taxation Laws Amendment Bill (published in July 2020) has been amended to a certain extent. The amendment of the definitions of a pension preservation fund, provident preservation fund and retirement annuity fund now provides for commutation of the interest in such a fund if the member:

(a) is a person who is or was a resident who emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control in respect of applications for that recognition received on or before 28 February 2021 and approved by the South African Reserve Bank or an authorised dealer in foreign exchange for the delivery of currency on or before 28 February 2022; or;

(b) is a person who is not a resident for an uninterrupted period of three years or longer on or after 1 March 2021;

It would thus appear that, in terms of the amendment, a person would be allowed to commute his/her interest in a preservation fund or retirement annuity fund if:

(i) such person *has* "formally" emigrated from South Africa if:
   a) the application for *recognition* of emigration was received on or before 28 February 2021; and
   b) the said application was approved by the South African Reserve Bank or an authorised dealer in foreign exchange for the delivery of currency on or before 28 February 2022; or

(ii) the person has not been a South African resident for an interrupted period of at least three *years* on or after 1 March 2021.

The above amendment is effective form 1 March 2021.

[8] Act No. 23 of 2020

Residence: Legislation, case law & SARS Interpretation Notes

In order to ascertain when a person ceases to be a resident for purposes of the Income Tax Act, we first need to look at the definition of "resident" in relation to a natural person in section 1 of the Income Tax Act:

"resident" means any—

(a) natural person who is—

(i) ordinarily resident in the Republic; or

(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic—

(aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and

(bb) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment, in which case that person will be a resident with effect from the first day of that relevant year of assessment: Provided that—

(A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a "port of entry" as contemplated in section 9 (1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act; and

(B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic;

The definition of resident the goes further to provide that a resident "*does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation*" and further "*that where any person that is a resident ceases to be a resident during a year of assessment, that person must be regarded as not being a resident from the day on which that person ceases to be a resident*."

The relevant provisions in the definition of "resident" can thus be summarised as follows:

a) A natural person will either qualify as a resident based on the fact that the person is "ordinarily resident" in South Africa, but if a person is not "ordinarily resident", such person may still qualify as being a resident based on the "physical presence" test; but
b) A person will not be a South African resident if that person, in terms of the double tax agreement between South African and another country, is deemed to be a resident of such other country; and
c) Where a person ceases to be a resident in a tax year, the person is not regarded as a resident on the day the person ceases to be a resident.

To establish when the three-year period commences in the case of a natural person who ceases to be "ordinarily resident" in South Africa, one would have to look at the facts of each matter. The term "ordinarily resident" is not defined in the Income Tax Act and relevant case law thus provide guidance in this regard. The following are a few examples of case law giving guidelines to this effect[9]:

a) Hardy v Hardy[10] (non-South African case): The place that the person's lifestyle is centered and to which the person regularly returns if his/her presence is not continuous.
b) Cohen v CIR[11]: A person does not need to be physically present in the country in the year to be ordinarily resident. It would be the country to which a person would naturally and as a matter of course return from his wanderings, i.e. his real home.
c) CIR v Kuttel[12]: Where a person sets up his principal home in another country, he is not a resident
d) ITC 1770: The taxpayer retained his house in South Africa and rented it out for the exact period of his assignment overseas. The taxpayer's wife and two children accompanied him but his parents remained in South Africa, his permanent employment was in South Africa and he had bank accounts in South Africa. Although he entertained the possibility of remaining overseas, there was no definite decision in this regard and no other country was regarded as his ordinary residence.

SARS Interpretation Note 3 (Resident: Definition In Relation To A Natural Person – Ordinarily Resident)[13] is also important with regards to establishing whether a person is deemed to be

[9] Notes on South African Income Tax, P Haupt, 2020, H & H Publications
[10] (1969) 7 DLR (3d) 307 (OHC)
[11] 13 SATC 262, 1946 AD 174
[12] [54 SATC 298] 1992 (3) SA 242 (A)
[13] https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-03%20-%20Resident%20definition%20natural%20person%20ordinarily%20resident.pdf Issue 2, dated 20 June 2018

ordinarily *resident* in South Africa. The following is stated on page 5 of this document (my own emphasis in bold font):

When assessing whether a natural person is ordinarily resident in the Republic, the following factors will be taken into consideration:

- *An intention to be ordinarily resident in the Republic*
- *The natural person's most fixed and settled place of residence*
- *The natural person's habitual abode, that is, the place where that person stays most often, and his or her present habits and mode of life*
- *The place of business and personal interests of the natural person and his or her family*
- *Employment and economic factors*
- *The status of the individual in the Republic and in other countries, for example, whether he or she is an immigrant and what the work permit periods and conditions are*
- *The location of the natural person's personal belongings*
- *The natural person's nationality*
- *Family and social relations (for example, schools, places of worship and sports or social clubs)*
- *Political, cultural or other activities*
- *That natural person's application for permanent residence or citizenship*
- *Periods abroad, purpose and nature of visits*
- *Frequency of and reasons for visits*

The above list is not intended to be exhaustive and is merely a guideline.

Interpretation Note 3 further provides the following guidelines with respect to when a person ceases to be a South African resident (my own emphasis in bold font):

A natural person who ceases to be ordinarily resident in the Republic will not be "resident" in South Africa from the day that person ceased to be ordinarily resident in the Republic. A natural person cannot be resident *under the physical presence test in the year that person ceases to be ordinarily resident because paragraph (a)(ii) of the definition of "resident" in section 1(1) provides that it applies only to a natural person who is not at any time during the year of assessment ordinarily resident in the Republic. Whether the physical presence test is met in subsequent years of assessment will depend on the facts of the case. However, often when a natural person ceases to be ordinarily resident in the Republic, that person leaves the country and does not return and spend periods of time in the Republic which meet the requirements of the physical presence test.*

*Generally, **if a natural person emigrates from the Republic to another country, that person ceases to be a resident of the Republic from the date that person emigrates**.*

In this regard it is also important to note that where a person who was ordinarily resident in SA, leaves without the intention to return, he/she becomes a non-resident on the day that he/she leaves. Section 9H(2)(b) deems the person's year of assessment to have ended the previous day.

The interaction between the Income Tax Act and tax treaties (double tax agreements) between South Africa and the effect thereof as far as the determination of residence is concerned, is also discussed in Interpretation Note 3 (my own emphasis in bold font):

***A person who is exclusively a resident of a country other than South Africa for purposes of the application of a tax treaty is not a resident of the Republic under the Act**. This position is achieved for two reasons.*

Firstly, once approved by Parliament *and published in the Government Gazette, tax treaties have effect as if enacted in the Act. The tax treaty's provisions and those of the Act should therefore, if at all possible, be reconciled and read as one coherent whole. In the context of the definition of "resident", if there is conflict between the general definition of that term in section 1(1) and a more specific definition in a tax treaty, the maxim generalia specialibus non derogant. applies and the more specific definition in the tax treaty takes precedence.*

Secondly, the precedence of a more specific tax treaty definition has been included in the definition of "resident" *in section 1(1), which excludes a person deemed to be exclusively a resident of another country for purposes of applying any tax treaty. Therefore, if a natural person is held to be a resident of another country and not to be a resident of South Africa for purposes of any tax treaty, such person is excluded from the definition of "resident" in section 1(1).*

***A natural person who meets the ordinary residence test or the physical presence test will therefore not be a resident of South Africa if, notwithstanding having met those tests, that person is held to be exclusively a resident of a country other than South Africa for purposes of the application of any tax treaty**. For example, the tax treaty might include a core definition of "resident" which differs from the definition in section 1(1) or the application of the tie-breaker rules might result in the natural person being exclusively a resident of the other country.*

This portion of Interpretation Note 3 is consistent with the definition of resident in section 1 of the Income Tax Act insofar it provides that a resident "*does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation*". Here it is important to note that the provisions of a tax treaty will take preference I irrespective of whether a person qualifies as a South African resident based on the principles of "ordinarily residence" or the "physical presence test" (as per the discussion below).

As alluded to above, a person who is not "ordinarily resident" in South Africa may still qualify as a resident based on the physical presence test. SARS Interpretation Note 4 (Resident: Definition In Relation To A Natural Person – Physical Presence Test)[14] deals with the physical presence test.

The practical application of the "physical presence" test is summarised in Interpretation Note 4 as follows:

These requirements are that the person must be physically present in the Republic for a period or periods exceeding -

(i) 91 days in aggregate during the year of assessment under consideration;

(ii) 91 days in aggregate during each of the five years of assessment preceding the year of assessment under consideration; and

(iii) 915 days in aggregate during the five preceding years of assessment.

A natural person who complies with all the requirements referred to above is a resident of the Republic, for tax purposes, for the year under consideration.

Interpretation Note 4 also deals with the issue of when a person, qualifying as a resident based on the "physical presence" test will cease to be a resident:

A natural person, who is resident by virtue of the physical presence test, ceases to be a resident when that person is physically outside the Republic for a continuous period of at least 330 full days. Residence will cease from the day that the person left the Republic.

The continuous period of 330 full days cannot be observed over a single year of assessment, because the person must have been physically present in South Africa for at least 92 days during

[14] https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-04%20-%20Resident%20definition%20natural%20person%20physical%20presence.pdf Issue 5, dated 3 August 2018

that year in order to qualify as a resident during that year of assessment. The continuous period of at least 330 full days will therefore always extend over two years of assessment.

Interpretation Note 4 provides the following example to illustrate this principle:

Example 4 – When a person ceases to be a resident

Facts:

Z, a citizen of Argentina employed by a South African company, never visited South Africa before 29 June 2011 and is ordinarily resident in Argentina. Z was physically present in the South Africa for the following periods:

Year of assessment	***Period in the Republic***	***Number of days in the Republic***
2012	*29/06/2011 – 29/02/2012*	*246*
2013	*01/06/2012 – 31/08/2012*	*92*
2014	*01/09/2013 – 28/02/2014*	*181*
2015	*01/03/2014 – 21/05/2014*	*82*
	08/11/2014 – 28/02/2015	*113*
2016	*01/07/2015 – 29/02/2016*	*244*
2017	*29/06/2016 – 15/07/2016*	
	17 29/08/2016 – 30/11/2016	*94*
2018	*01/11/2017 – 30/11/2017*	*30*

Result:

(i) Z was physically present in South Africa in the 2017 year of assessment for a period exceeding 91 days (17 + 94 = 111 days).

(ii) Z was physically present for more than 91 days in each of the five prior years of assessment (246 days in 2012; 92 days in 2013; 181 days in 2014; 195 days (82 + 113) in 2015; and 244 days in 2016).

Z was physically present for more than 915 days in aggregate during those five preceding years of assessment (246 + 92 + 181 + 195 + 244 = 958 days).

All the requirements were therefore met for the 2017 year of assessment. Z was resident in South Africa under the physical presence test from the beginning of the 2017 year of assessment, that is, 1 March 2016.

Z was physically absent from the Republic from 1 December 2016 to 31 October 2017, which is a continuous period of 335 full days. This meets the 330-day rule. Z thus ceases to be a resident from the day of the original departure from the Republic, 30 November 2016. Z is therefore not resident in the Republic from 30 November 2016.

Discussion of amendment

1. From the above it is clear that the question on whether a member of a retirement annuity/preservation fund is ordinarily resident in South Africa, or ceases to be ordinarily resident in South Africa, depends on various factors and will differ from matter to matter. The concern is that this may lead to a factual dispute as to whether such a member ceased to be a resident, and if it is accepted that such a member ceased to be a resident, as to when the member ceased to be a resident.

   The reply in respect of this issue in the Draft Response Document on the 2020 Draft Taxation Laws Amendment Bill, as discussed above, is that this comment is not accepted because: "*The residency rules apply as they have in all other cases, guided through Interpretation Note 3*". It is however, with respect, my view that this response does not provide clarity on the matter. From Interpretation Note 3 it is clear, that, whilst some guidelines are given, the factors in deciding whether a person is ordinarily resident in South Africa as mentioned in the document are not exhaustive and merely a guideline. It is also clear from case law on this issue that the facts of each matter are different and that the decision on where a person is ordinarily resident is dependent on the specific circumstances.

2. It appears that the onus of proving that residence ceased will be on the member of a retirement annuity/preservation fund to show that he/she ceased to be ordinarily resident in SA. If such a member has provided the necessary proof to show that he/she ceased to be ordinarily resident in South Africa, it is unclear why he/she would have to wait a further three years to withdraw the interest in the retirement annuity/preservation fund.

   Although the reply in respect of this issue in the Draft Response Document on the 2020 Draft Taxation Laws Amendment Bill focuses on the comment that the three-year period will place a financial burden on the individuals as the amounts received from retirement funds are often used to cover settling in costs in a new country, there are some salient points in the response that I would like to focus on:

a) *"The 3-year rule is a mechanism to ensure that there is a sufficient lapse of time for all emigration processes to have been completed with certainty, without affecting such workers whose residence status changes for reasons other than emigration."*

The first question that comes to minds in respect of this response is why the time spent on the completion of the emigration process should be a consideration at all, in light of the intention to replace the requirement of "formal emigration" with the requirement of "non-residence". If the answer to this question is that emigration is merely one of the mechanisms to prove the termination of residence, the question remains as to the purpose of the three-year period if emigration is finalised in a period shorter than 3 years. It is further not clear what the requirements for proving emigration would be if the test of "*emigration recognised by the South African Reserve Bank for purposes of exchange control*" is not applied anymore.

The second question in this regard would be what the purpose of the three-year period would be for persons whose residence status changes or terminates for reasons other than emigration.

a) *When individuals contribute to pensions (tax-free), the understanding is that tax is deferred until benefits are received upon retirement. Government did not intend to provide a tax incentive for funds to be used for emigration. Our attempt is to reconcile the choice to emigrate and electing to withdraw a retirement lump sum with the design principle of deferred taxation upon retirement. This also illustrates a horizontal equity point: tax residents who decide not to emigrate have to wait until retirement for withdrawals from retirement annuity funds.*

The above paragraph still does not explain the purpose of the three-year waiting period where the particular person has provided proof of the termination of South African residence (though emigration or otherwise). If a person is allowed to withdraw the interest in a retirement annuity fund or preservation fund due to termination of residence, and thus opts not to preserve retirement savings until eventual retirement, the rationale of a three-year waiting period is not evident.

3. Where a member of a retirement annuity or preservation fund ceases to be a resident based on the physical presence test (i.e. where such a person is not ordinarily resident in South Africa

but qualifies as a resident based on the physical presence test), it is clear that, although the person has to be absent from South Africa for 330 days to be viewed as not being a resident of South Africa, such person will be deemed to have ceased being a resident on the day that he/she ceased to be physically present in SA. The three-year period should thus in such an instance commence on the day that he/she has left South Africa.

If a member of a retirement annuity or preservation fund who enjoyed SA residence purely based on the physical presence test has not been physically present in South Africa for 330 continuous days, it is again unclear why he/she would have to wait three years from date that he/she ceased to be physically present in SA to withdraw the interest in the retirement annuity or preservation fund. It is understandable that there should be a waiting period of 330 days in order to comply with the physical presence test as a measure to show that residence is terminated and that the absence from South Africa is not merely temporary, but the reason for the three-year period is uncertain.

4. If a member of a retirement annuity or preservation fund who enjoyed South African residence was also the holder of a visa for work or visiting purposes, it poses the question on whether such person will have to wait 3 years after residence ceases to have interest in a retirement annuity or preservation fund paid to him/her, or whether payment can be effected upon leaving South Africa on expiry of such visa. As per the amended legislation, the relevant portions of the definitions of "pension preservation fund", provident preservation fund" and "retirement annuity fund" in section 1 of the Income Tax Act now provides as follows (own emphasis in bold font):

"*a* member *shall, prior to his or her retirement date, be entitled to the payment of a lump sum benefit contemplated in paragraph 2 (1) (b) (ii) of the Second Schedule where a member—*

(aa) (a) is a person who is or was a resident who emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control in respect of applications for that recognition received on or before 28 February 2021 and approved by the South African Reserve Bank or an authorised dealer in foreign exchange for the delivery of currency on or before 28 February 2022; or;

(b) is a person who is not a resident for an uninterrupted period of three years or longer on or after 1 March 2021; ***or***

(bb) departed from the Republic at the expiry of a visa obtained for the purposes of—

(A) working as contemplated in paragraph (i) of the definition of "visa" in section 1 of the Immigration Act, 2002 (Act No. 13 of 2002); or

(B) a visit as contemplated in paragraph (b) of the definition of "visa" in section 1 of the Immigration Act, 2002 (Act No. 13 of 2002), issued in terms of paragraph (b) of the proviso to section 11 of that Act by the Director General, as defined in that Act;"

From the language used, it thus appears that if either event occurs, commutation will be allowable. It is therefore my view that a member of a member of a retirement annuity fund or preservation fund who enjoyed South African residence was also the holder of a visa for work or visiting purposes, commutation will be possible on the occurrence of the earlier of such events. Where a person holding a work or visiting visa thus leaves South Africa on expiry of such a visa, it is evident that the three-year waiting period will not apply, even if such a person qualified as a South African resident.

5. If a person is, in terms of the legislation of South Africa and another country, deemed to be a resident of both countries, and the residence has to be decided in terms of a double tax agreement, one would have to peruse the terms of such agreement to establish the "tiebreaker" rules to determine residence. Factors taken into account for these tiebreaker rules contained in double tax agreements/tax treaties to establish where a person is deemed to be resident usually include:
   (i) Where the person has a permanent home;
   (ii) Where the individual's personal and economic relations are closer (centre of vital interests);
   (iii) The country in which the individual has a habitual abode;
   (iv) The country of which the individual is a national;
   (v) If no other tiebreaker is applicable the agreements often provide that competent authorities of the contracting countries must settle the issue by mutual agreement.

   Some of these factors are again dependent on each situation and the interpretation thereof, which could lead to disputes over which country the person is a resident of. If it is established that, in terms of the provisions of the double tax agreement/tax treaty, the person is not a resident of South Africa, a dispute could then arise on when the relevant factor establishing residence in the other country first occurred (i.e. when the person ceased being a SA resident

and started being a residence of such other country in order to establish when the three-year period commences).

As alluded to earlier in this article: the definition of "resident" in section 1 of the Income Tax Act provides that a resident "does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation". This is confirmed in SARS Practice Notes 3 and 4 where it is stated that:
"*A person who is exclusively a resident of a country other than South Africa for purposes of the application of a tax treaty is not a resident of the Republic under the Act.*"; and
"*A natural person who meets the ordinary residence test or the physical presence test will therefore not be a resident of South Africa if, notwithstanding having met those tests, that person is held to be exclusively a resident of a country other than South Africa for purposes of the application of any tax treaty. For example, the tax treaty might include a core definition of "resident" which differs from the definition in section 1(1) or the application of the tie-breaker rules might result in the natural person being exclusively a resident of the other country.*"

This could also result in anomalies, as illustrated in the following examples:

Example 1 – Residence and Double Tax Agreement
Jack, a South African resident, is employed on a ten-year contract in Dubai, where after he will retire in South Africa. He does not have a permanent home in South Africa, and also does not have a wife and children or other close family members in South Africa. He rents a house in Dubai. He rarely visits South Africa during his employment in Dubai.

For purposes of this example, let us assume that he has also met the requirements to be regarded as a resident of Dubai.

Article 4(2) of the double tax agreement between South Africa and the United Arab Emirates[15], contains the following "tiebreaker" rules in respect of residence:
2. *Where by reason of the* provisions *of paragraph 1 of this Article an individual is a resident of both Contracting States, then that individual's status shall be determined as follows:*

[15] https://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2016-04%20-%20DTA%20United%20Arab%20Emirates%20GG%2040496.pdf Publication Date 15 December 2016; Date of Entry into Force 23 November 2016

(a) the individual shall be deemed to be a resident only of the State in which a permanent home is available *to the individual; if a permanent home is available to the individual in both States, the individual shall be deemed to be a resident only of the State with which the individual's personal and economic relations are closer (centre of vital interests);*
(b) if the State in which the individual has a centre of vital interests cannot be determined, or if the individual has not a permanent home available in either State, the individual shall be deemed *to be a resident only of the State in which the individual has an habitual abode;*
(c) if the individual has an habitual abode in both States or in neither of them, the individual shall be deemed *to be a resident only of the State of which the individual is a national;*
(d) if the individual is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

In this example, it could be argued that Jack's permanent home is in Dubai, or alternatively that his centre of vital interest is in Dubai, or further that his habitual abode (the place where he spends most time) is in Dubai. Effectively, although he is a South African resident in terms of the general portion of the definition of resident in Section 1 of the Income Tax Act, in the sense that he remains ordinarily resident in South Africa (his plan is to return to South Africa after his contract in Dubai expires), the provisions of the double tax agreement will effectively take preference.

If one looks at the definition of residence in Section 1 of the Income Tax Act in that it provides that a resident "*does not* include *any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation*", this should then mean that in this example Jack is, and remained to not be a South African resident for more than three years.

If this conclusion is correct, it would technically mean that Jack would be able to withdraw his interest in a South African retirement annuity fund or preservation fund three years after he ceased to be a South African resident and became a resident of Dubai, despite him planning to return to and retire in South Africa.

The example above raises the question: Is this outcome compatible with the intention of the legislature in this regard? It is in my view doubtful whether this result would be in harmony with

the spirit of the Income Tax Act in that it generally does not allow access to retirement savings before retirement (except where expressly provided to the contrary).

Example 2 – Residence and No Double Tax Agreement

John, a South African resident, is employed on a ten-year contract in the Isle of Man, where after he will retire in South Africa. He does not have a permanent home is South Africa, and also does not have a wife and children or other close family members in South Africa. He rents a house in Isle of Man. He rarely visits South Africa during his employment in Isle of Man.

For purposes of this example, let us assume that he has also met the requirements to be regarded as a resident of the Isle of Man. There is no double tax agreement between South Africa and Isle of Man.

John is a South African resident in terms of the general portion of the definition of resident in the sense that he remains ordinarily resident in South Africa (his plan is to return to South Africa after his contract in Isle of Man expires). In this example there is no double tax agreement that will change, or deem to change his residence.

This would mean that he will <u>not</u> be able to withdraw his interest in a South African retirement annuity or preservation fund.

Save for the existence of a double tax agreement in Example 1, the facts surrounding Jack's and John's circumstances are exactly the same. If we assume that Jack will be allowed to commute his interest in a retirement annuity fund or preservation fund as he ceased to be a South African resident for a continuous period of three years, but John will not be allowed to do the same, it creates an anomaly. It is my view that this could not be in line with the intention of the legislature.

6. The 2020 Taxation Laws Amendment Act contains some provisions allowing for commutation of the interest in a retirement annuity fund or provident fund that were not contained in the 2020 Draft Taxation Laws Amendment Bill. The amendment can be summarised as follows:
   (a) A person who has emigrated from South Africa and the emigration is recognised by the South African Reserve Bank for purposes of exchange control will still be able to commute the interest in a preservation fund or retirement annuity fund if:

(i) The application for recognition (of emigration) was received on or before 28 February 2021; and

(ii) The application by for recognition was approved by the Reserve Bank or an authorised dealer in foreign exchange for the delivery of currency on or before 28 February 2022; or

(b) A person who is not a South African resident for an uninterrupted period of 3 years on or after 1 March 2021.

In this regard it is encouraging to note that the amendment makes provision for an effective extension of the existing emigration requirement in respect of applications for emigration received before or on 28 February 2021. The fear in relation to the previous proposal, that essentially provided that the emigration requirement be replaced with the non-residence for an uninterrupted period of three-year requirement, was that persons who had already emigrated or were in the process of finalising emigration procedures may withdraw their interest in preservation funds and retirement annuity funds before 1 March 2021 for the sole reason to avoid being subjected to a three year waiting period before being able to access these funds. In terms of the amendment it thus appears that persons complying with the requirements set out in (a) above will be able to withdraw their interest in a preservation or retirement annuity fund, whether such application for withdrawal occurs before or on/after 1 March 2021.

The only issue that may lead to an unjust result, is where a member of a preservation fund submits a complete application for emigration before 1 March 2021, but the emigration is, due to no fault on the side of such member, not approved by the Reserve Bank or an authorised dealer in foreign exchange for the delivery of currency on or before 28 February 2022. In such an instance, the amendment appears to have the consequence that a member will have to comply with the "non-residence for an uninterrupted period of three-year" requirement. In this regard the amendment differs from the reply provided in the Draft Response Document on the 2020 Draft Taxation Laws Amendment Bill, which indicated that (my own emphasis in bold font):

"***All complete applications received*** *by the SARB* ***before 1 March 2021 will be finalised through the existing process****, provided that they are* ***approved by the SARB (even if the approval should occur after 1 March 2021****)."*

The amendment also does not indicate that it is a requirement the application received by 1 March 2021 should be a complete application. It would thus appear that it would be sufficient if the application process had commenced on or before 28 February 2021, irrespective of whether the application contains all the required documentation and information.

If a person applies for a commutation in a preservation or retirement annuity fund in terms of the "non-residence for an uninterrupted period of three-year" requirement discussed in (b) above, it is a prerequisite that the person should qualify as not being resident for 3 years or more either at 1 March 2021 or anytime thereafter. The practical consequence of the amendment is thus that a person applying for commutation on this basis from 1 March 2021 onwards will have to show that he or she has been a non-resident for at least 3 uninterrupted years.

7. The last issue that I want to discuss relates to the following statement and response in the Draft Response Document on the 2020 Draft Taxation Laws Amendment Bill:

Comment: Uncertainty with regard to cases where funds are in a preservation fund before 1 March 2021 and emigration process commences after 1 March 2021.

Response:
Noted. In applying these provisions, the rules of each preservation fund will be honoured.

It is not clear what the *comment* and response is alluding to. If the response is providing that a person who is a member of a preservation fund before 1 March 2021 but only commences with the application for emigration after 1 March 2021, will still be allowed to commute the interest in the fund as a lump sum in terms of the emigration requirement because the fund rules had not yet been amended to provide for commutation in terms of the "non-residence for an uninterrupted period of three-year" requirement, it appears to be in conflict with the provisions of the amendment as discussed in 6 above, as the amended legislation does not make any exception to this effect.

Conclusion

It is my view that *there* are uncertainties and anomalies contained in the legislative amendments discussed in this article. It would be in my view be prudent if these issues are rectified and clarified via legislative amendments and/or interpretation notes.

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[20] http://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20Response%20Document%20on%20the%202020%20Draft%20Tax%20Bills%20-13%20October.pdf . published 13 October 2020, p26-28

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Montanari V Montanari: Living Annuity – Accrual Claim on Divorce

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Introduction

The issue of the effect of a living annuity in cases where the annuitant is married out of community of property with inclusion of the accrual claim or in community of property has been a contentious issue over the last few years.

In the matter of SC v CT[1], the Supreme Court of Appeal had previously found that the capital value of a living annuity does not form part of an annuitant's estate for purposes of the accrual calculation.

The judgement of the Supreme Court of Appeal in Montanari v Montanari[2] was delivered on 5 May 2020.

Facts

The parties were married in out of community of property and subject to the accrual system in 1999. In 2008, 2012 and 2015 the respondent purchased living annuities. In 2014 the respondent instituted divorce proceedings against the applicant. The respondent sought a declaratory order that the living annuities were not assets in his estate and were consequently not subject to the applicant's accrual claim. The full court of the Gauteng Division of the High Court had previously affirmed the trial court's decision that the respondent's living annuities do not form part of his estate for purposes of calculating an accrual.

Judgement by the Supreme Court of Appeal

The SCA found the following:

1. Living annuity proceeds or annuity income does not fall within the definition of "pension interest as defined in the Divorce Act, and therefore an annuitant cannot give part or all of the living annuities to an ex-spouse in terms of a divorce order, or agree to split the annuity income with an ex-spouse.
2. The Court disagreed with the applicant's contention that the underlying assets of the living annuity constitutes trust property as envisaged with the Financial Institutions Act, as the Court held that the underlying capital is owned by the insurer and is accordingly reflected in the insurer's balance sheet. The annuitant is entitled only to the annuity income, and it is the annuity that would be reflected in the annuitant's balance sheet. The Court also held that

[1] [2018] ZASCA 73; [2018] 3 All SA 408 (SCA); 2018 (5) SA 479 (SCA)
[2] [2020] ZASCA 48

there is no indication in legislation[3] and the insurer's contracts concluded between the parties, that a living annuity should be regarded as 'trust property'. It was further found that there is no indication of a fiduciary relationship between the parties in respect of living annuities.

3. The Court however made reference to the following judgments:
   (a) *De Kock v Jacobson*[4] in which the court found that where persons are married in community of property, a spouse's accrued right to monthly income pension payments was part of the community of property existing between the parties prior to the divorce.
   (b) *Clark v Clark*[5] in which the court accepted that a spouse's interest in a pension which had not yet accrued did indeed form part of the community estate, as did a pension right which had accrued.
   (c) *Commissioner for Inland Revenue v Nolan's Estate*[6], which reaffirmed that the right to a *pension* is a right which vests in the parties to a marriage in community of property in undivided shares.
4. As a result, the Court found:
   (a) It agreed with the reasoning of the judgments cited above and found no reason why it could not extend to the current matter, as the respondent (annuitant) has a right to the investment returns yielded by his capital investment in the living annuity in the form of future annuity income – this income is an asset which can be valued (as testified by the actuary who acted for the applicant).
   (b) The trial court had erred by finding that the annuity income is only relevant for purposes of a *maintenance* claim.
   (c) The Court referred the matter back to the trial court for purposes of valuing the respondent's right to receive future payments in respect of the living annuities.

Comments

The practical implications of the judgment can be summarised as follows:

1. The underlying capital value of a living annuity is not taken into account for purposes of the accrual calculation on divorce[7], nor may the annuity income be split on divorce, because:
   (a) It does not constitute a "pension interest" as defined in the Divorce Act; and

[3] Section 37A and 37B of the Pension Funds Act, the definition of "living annuity" in section 1 of the Income Tax Act and the Financial Institutions Act.
[4] 1999 (4) SA 345 (W)
[5] 1949(3) SA 226 (D)
[6] 1962 (1) SA 785 (A)
[7] This aspect was previously confirmed by the SCA in the matter of *SC v CT* [2018] ZASCA 73; [2018] 3 All SA 408 (SCA); 2018 (5) SA 479 (SCA)

(b) The underlying capital is owned by the insurer and not the annuitant.

This would mean that the ex-spouse of the recipient of a living annuity would not be able to enforce the payment of an accrual claim against the administrator of a living annuity. The situation thus differs from a claim in respect of a pension interest in a pension, provident, retirement annuity or preservation fund that will be enforceable against such a fund, as provided for in the Divorce Act[8] and Pension Funds Act[9].

This however raises the question on how an annuitant will be able to settle an accrual claim in a situation where such annuitant has no other property (or property with little value), with the result that the largest portion of the accrual claim emanates from the calculated value of the future annuity income. This aspect was alluded to in paragraph 109 of the judgment in SC v CT[10] where the court stated:
"If the supposed capital value of the Glacier contract were included in the appellant's accrual, one would have the anomalous outcome that he would be obliged to pay half its value to the respondent in circumstances where he has no right to claim half the capital from Sanlam. He would have to satisfy this part of an accrual award from other assets. While in the present case the appellant may have other assets from which to make payment, the question is one of principle. If the Glacier contract is to be included in the appellant's accrual, it would have to be included in the accrual of any spouse with a comparable annuity contract, even though the contract were such spouse's only 'asset'."

2. The right of an annuitant to receive the annuity income in future, however, forms part of the estate of such annuitant and is thus taken into account for purposes of the accrual calculation. An actuarial calculation would be needed to calculate the current capital value of such future payments. It is not clear how the capital value of future payments to the annuitant are to be valued in the case of a living annuity, where the income stream may vary between 2.5% and 17.5% of the capital. This issue was discussed in paragraph 110 of the judgment in SC v CT[11], which may be an indication of factors to take into consideration:
"The value of the conditional right would be affected by the appellant's life expectancy and the rate at which he has in the past, and is likely in the future, to draw down his annuity."

[8] 70 of 1979
[9] 24 of 1956
[10] [2018] ZASCA 73; [2018] 3 All SA 408 (SCA); 2018 (5) SA 479 (SCA)
[11] [2018] ZASCA 73; [2018] 3 All SA 408 (SCA); 2018 (5) SA 479 (SCA)

3. The Court makes reference to the protection of benefits (including annuities) as provided for in section 37A of the Pensions Fund Act[12], in that the Court acknowledges that it is applicable to living annuities. The judgment however does not go into detail on whether the protection of this section extends to the right of the annuitant to receive the future annuity payments against the accrual claim of the ex-spouse on divorce. Section 37A(1) of the Pension Funds Act provides as follows:

37A. Pension benefits not reducible, transferable or executable.

(1) Save to the extent permitted by this Act, the Income Tax Act, 1962 (Act No. 58 of 1962), and the Maintenance Act, 1998, ***no benefit*** *provided for in the rules of a registered fund (****including an annuity purchased or to be purchased by the said fund from an insurer for a member****),* ***or right to such benefit****, or right in respect of contributions made by or on behalf of a member, shall, notwithstanding anything to the contrary contained in the rules of such a fund, be* ***capable of being reduced, transferred or otherwise ceded, or of being pledged or hypothecated, or be liable to be attached or subjected to any form of execution under a judgment or order of a court of law****, or to the extent of not more than three thousand rand per annum, be capable of being taken into account in a determination of a judgment debtor's financial position in terms of section 65 of the Magistrates' Courts Act, 1944 (Act No. 32 of 1944), and in the event of the member or beneficiary concerned attempting to transfer or otherwise cede, or to pledge or hypothecate, such benefit or right, the fund concerned may withhold or suspend payment thereof: Provided that the fund may pay any such benefit or any benefit in pursuance of such contributions, or part thereof, to any one or more of the dependants of the member or beneficiary or to a guardian or trustee for the benefit of such dependant or dependants during such period as it may determine.*

It is in my *view* doubtful that section 37A will be applicable in this instance, as the Montanari *judgment* will not have the consequence of the living annuity being reduced, transferred, ceded, pledged or subjected to any form of execution. However, in paragraph 110 of the judgment in SC v CT[13], the SCA appeared to indicate that there is at least a possibility that section 37A may be applicable in respect of the value of the future annuity stream when dealing with an accrual claim: *"It might be argued that the appellant's conditional right to future annuity payments is an asset which can be* valued. *However,* ***and even if this were an***

[12] 24 of 1956
[13] [2018] ZASCA 73; [2018] 3 All SA 408 (SCA); 2018 (5) SA 479 (SCA)

***asset which did not enjoy the protection of s 37A and could notionally be included in a spouse's accrual (on which it is unnecessary to express an opinion)**, the respondent did not adduce evidence to establish the value of the conditional right*."

4. Another issue that needs to be discussed is whether the annuity payments will still be taken into account for purposes of the maintenance claim that the ex-spouse may have against the annuitant, if the current value of the future annuity payments is taken into account for purposes of valuing the accrual claim.

   Paragraph 38 of the Montanari judgment, where the Court refers to the trial court, appears to indicate that it should be taken into account for both the accrual claim as well as for future maintenance:
   "*But* then *it erroneously considered the annuity income relevant **only** for purposes of a maintenance claim*".

   A claim for maintenance is subject to various considerations, such as whether a duty of maintenance exists, the maintenance need of the dependent and the financial ability of the person against whom maintenance is claimed to pay the maintenance. The accrual claim per se will thus not necessarily have an effect of the maintenance claim. It may however be argued that it would be unjust to take the annuity payments into account both as a capital value for calculating the accrual claim, and again thereafter as an income stream for purposes of maintenance.

5. It would further appear that the future right of an annuitant to receive living or conventional annuity income would also be taken into account in divorce proceedings of persons married in community of property.

6. It is also prudent to look at the provisions of section 37D(1)(d)(i) of the Pension Funds Act[14], that provides as follows:
   37D. Fund may make certain deductions from pension benefits.
   (1) A registered fund may—

[14] 24 of 1956

(d) deduct from a member's or deferred pensioner's benefit, member's interest or minimum individual reserve, ***or the capital value of a pensioner's pension after retirement****, as the case may be—*

(i) any amount assigned from such benefit or individual reserve to a non-member spouse in terms of a decree granted under ***section 7 (8) (a) of the Divorce Act****, 1979 (Act No. 70 of 1979) or in terms of any order made by a court in respect of the division of assets of a marriage under Islamic law pursuant to its dissolution;*

The *practical* execution of this section with regards to post retirement annuities has not taken place, as the capital value of a pension (annuity) after retirement does not form part of a person's "pension interest", as defined in section 1 of the Divorce Act. It has thus generally been accepted that an amendment to the definition of "pension interest" is required to give proper effect to this section. The section does not define the term "capital value", but it is assumed that this refers to the value of the underlying assets in a living annuity as at date of divorce.

It is submitted that if the definition of "pension interest" is amended to include the value of the underlying capital in a living annuity as part of the "pension interest" of a person, the legislation would preferably, in light of the Montanari judgment, specifically have to exclude the value of future annuity payments from the matrimonial consequences of a marriage, as it would not be just to include both the capital value of the annuity as well as the value of future annuity payments flowing from the investment for purposes of divorce proceedings when calculating the accrual claim or the value of a joint estate.

7. Based on the argument followed in the Montanari judgment, i.e. that it is the right of the annuitant to receive future annuity income (and not the capital value of the living annuity) that is calculated for purposes of the accrual claim, it would appear that the right to receive future income from a guaranteed/conventional annuity could likewise be taken into account for purposes of the accrual calculation or the value of a joint estate.

8. It is further my view that the principles of the Montanari judgement will not be applicable where a marriage is terminated as a result of the death of one of the spouses, for the following reasons:
   (a) The value of the right in the annuity has to be calculated in relation to the right of the annuitant to receive future annuity income. Where an annuitant dies, there is no annuity payable to such annuitant from date of death, and the value of future annuity income in this regard will thus be nil.
   (b) Where there is a beneficiary nominated on a GN18 living annuity, such beneficiary will on acceptance of the benefit, in my view be the only person entitled to the benefit, based on the principles of a *stipulatio alteri* entered into between the long term insurer and the annuitant[15]. Where we are dealing with a fund-owned living annuity, the benefits of the living annuity will be dealt with in terms of provisions of section 37C of the Pension Funds Act[16].
   (c) Where there is no nominated beneficiary, and the proceeds of the living annuity is paid to the estate of the deceased, such capital payment will however be taken into account in respect of the matrimonial consequences of the marriage,

Conclusion

The SCA judgment of the Montanari matter has certainly brought about a change in the way that the value of an accrual claim is calculated where parties are married out of community of property with the accrual calculation. As alluded to in this article, the reasoning in the judgement also appears to extend to the value of a joint estate where parties are married in community of property.

It is my view that legislative intervention is still required to iron out some of the anomalies discussed in this article. Such amendments should be carefully drafted and take cognizance of the rights and responsibilities of the parties involved in divorce proceedings, as well as the practical execution of such amendments.

Subsequent to the Montanari judgment, in the matter of GR v SR[17], the Gauteng Local Division of the High Court made the following order in a divorce matter on 14 October 2020:

[15] In this regard see Pieterse v Shrosbree and Others, Shrosbree v Love and Others [2004] ZASCA 129; [2006] 3 All SA 343 (SCA). Although this matter dealt with life insurance policies, the principle remains the same.
[16] 24 of 1956
[17] High Court, Gauteng Local Division, Case No A3108/2018, date of judgment 14 October 2020

"d) It is declared that the defendant is entitled to an amount equal to fifty per cent of the plaintiff's net pension interest in the Sanlam Glacier Living Annuity / Pension Fund calculated as at the 7th of May 2018.

e) Sanlam is ordered to endorse the Living Annuity to the effect that the appellant is entitled to fifty per cent of the value of the annuity as and at the 7th of May 2018."

The judgement itself however did not deal with the issue pertaining the effect of a marital regime (in this matter the parties were married in community of property) on living annuities on divorce.

It is my view that this order is, as far as it pertains to the living annuity, not enforceable against the administrator of the living annuity for the following reasons:

(i) The right to the annuitant to the living annuity income does not constitute a pension interest as defined in the Divorce Act or Pension Funds Act. This was confirmed by the Supreme Court of Appeal in both the Montanari judgement as well as in SC v CT.

(ii) The living annuity benefits are protected in terms of Section 37A of the Pension Funds Act, as discussed above.

(iii) The long-term insurer owns the underlying capital of the living annuity, as confirmed by the Supreme Court of Appeal in the Montanari judgement.

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Divorce Act 70 of 1979, as amended

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Montanari v Montanari [2020] ZASCA 48

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SC v CT [2018] ZASCA 73; [2018] 3 All SA 408 (SCA); 2018 (5) SA 479 (SCA)

The Annuitisation Regime: Provident and Provident Preservation Funds – The Practical Implications

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Introduction

The application of the annuitisation regime insofar as provident and provident preservation funds are concerned has been on the table since the publication of the 2013 Taxation Laws Amendment Bill. The implementation date of the annuitisation regime has however been postponed on more than one occasion, but is now finally set to become effective from 1 March 2021.

The practical implications of the amendments pertaining to the annuitisation regime for provident and provident preservation funds are discussed in this article.

The position before 1 March 2021

Where a member of a provident or provident preservation fund retired before 1 March 2021, such a member was entitled to take the full retirement interest in the fund as a lump sum[1].

If a member withdrew from a provident fund (e.g. on resignation, dismissal or retrenchment from employment) or from a provident preservation fund, and transferred the retirement interest to another provident or provident preservation fund prior to 1 March 2021, and such member retired from the subsequent provident or preservation fund before 1 March 2021, the member would be entitled to take the full interest in the provident or provident preservation fund as a lump sum. If such a transfer was made to a pension, pension preservation fund or retirement annuity fund before 1 March 2021, and the member retired from such pension, pension preservation fund or retirement annuity fund prior to 1 March 2021, the member would only be able to take a maximum of one third of the retirement interest in such a fund as a lump sum on retirement, unless the retirement interest in the fund was equal to or less than the prescribed *de minimis* amount (currently R247 500).

[1] The definition of "provident fund" and "provident preservation fund" in section 1 of the Income Tax Act, prior to the 1 March 2021 amendments, does not require the annuitisation of any portion of the retirement interest in such a fund upon retirement.

As far as the tax-free transfers[2] between different types of funds are concerned, the following transfers were allowable before 1 March 2021:

From	To
Pension Fund Pension Preservation Fund	Pension Fund Pension Preservation Fund Retirement Annuity Fund
Provident Fund Provident Preservation Fund	Provident Fund Provident Preservation Fund Pension Fund Pension Preservation Fund Retirement Annuity Fund
Retirement Annuity Fund	Retirement Annuity Fund

The position from 1 March 2021

The following changes were implemented with effect from 1 March 2021:

Persons who are members of provident funds and provident preservation funds on 1 March 2021, and retire from the same fund after 1 March 2021

The definition of a provident fund in section 1 of the Income Tax Act is amended in this regard by the inclusion of proviso (ii)(dd).

The effect of this amendment in respect of provident funds can be summarised as follows:

1. In the case of a person who is 55 years or older and is a member of a provident fund on 1 March 2021, both the amounts contributed before and after 1 March 2021 (and any other amounts credited to the member) as well as growth thereon will **not** form part of the retirement interest for purposes of annuitisation. In plain language: such a person will, on retirement be able to take the full interest in the fund as a lump sum, **provided that the person remains a member of the same fund until retirement**. The scenario where such a member transfers to another fund after 1 March 2021 and subsequently retires from such a fund is discussed below.
2. In the case of a person who is younger than 55 years and is a member of a provident fund on 1 March 2021, the amounts contributed before 1 March 2021 (and any other amounts

[2] Paragraph 6(1)(a) of the Second Schedule to the Income Tax Act, prior to the 1 March 2021 amendments.

credited to the member before 1 march 2021) as well as growth thereon will **not** form part of the retirement interest for purposes of annuitisation. Any amounts contributed by such a person on/after 1 March 2021 (and any other amounts credited to the member after 1 March 2021) as well as growth thereon will however form part of the retirement interest for purposes of annuitisation. In plain language: such a person will, on retirement from such provident fund:

(a) be able to take an amount equal to contributions and other amounts credited to the member **before** 1 March 2021 as well as subsequent growth thereon as a lump sum; but

(b) the portion of the fund value on retirement representing all contributions made and other amounts credited to the member **on/after** 1 March 2021 plus growth thereon will be subjected to the annuitisation regime: the member will only be entitled to a maximum of one third of this amount as a lump sum, and the balance will have to be used to purchase a compulsory annuity. The only exception to this is if the value of this post-1 March 2021 portion is equal to or below the *de minimis* amount of R247 500, in which case this portion may also be taken as a lump sum. The scenario where such a member transfers to another fund after 1 March 2021 and subsequently retires from such a fund is discussed below.

Example 1: Member of provident fund is 55 years of age or older on 1 March 2021

Joe is 58 year of age on 1 March 2021. He is a member of the ABC Provident Fund and his interest in the fund on 1 March 2021 is R2 000 000. Joe keeps on contributing to the ABC Provident Fund and retires from this fund on 1 February 2028. On 1 February 2028 the full value of his interest in the ABC Provident Funds is R5 000 000.

Result: Joe may take the full value of R5 000 000 in the provident fund as a lump sum (subject to the deduction of tax from the lump sum).

Example 2: Member of provident fund is younger than 55 years of age on 1 March 2021

Jack is 53 year of age on 1 March 2021. He is a member of the DEF Provident Fund and his interest in the fund on 1 March 2021 is R2 000 000. Joe keeps on contributing to the DEF Provident Fund and retires from this fund on 1 February 2028. On 1 February 2028 the full value of his interest in the ABC Provident Funds is R5 000 000. Of this R5 000 000:

(a) an amount of R3 500 000 represents contributions made before 1 March 2021 plus growth thereon till date of retirement; and

(b) an amount of R1 500 000 represents contributions made after 1 March 2021 plus growth thereon till date of retirement

Result: Jack may take:

(a) the amount of R3 500 000 as a lump sum; plus

(b) R500 000 (one third of R1 500 000) as a lump sum and will be compelled to use the balance of R1 000 000 to purchase a compulsory annuity.

Jack will thus be allowed to take a maximum of R4 000 000 (R3 500 000 + R500 000) as a lump sum (subject to the deduction of tax from the lump sum).

Note: If the value of the contributions made after 1 March 2021 plus growth thereon (R1 500 000 in the example) was R247 500 or less, Jack would be allowed to also take this full amount as a lump sum if he wanted to.

Paragraph (e) of the definition of a provident preservation fund has also been amended. In the case of a person who was a member of a provident preservation fund **before** 1 March 2021, it would mean that, due to the nature of a provident preservation fund, no contributions would be possible from date of transfer. As no contributions would have been made on or after 1 March 2021, the full interest in the fund as at 1 March 2021 plus growth and any other amounts credited to the member would be "vested", i.e. the member would be able to take the full amount as a lump sum on retirement, irrespective of whether the member was 55 years or older on 1 March 2021 or not. If such member however, after 1 March 2021, makes an additional transfer into the provident preservation fund, such transfer may, depending on the situation, consist of only a fully vested interest, or a partially vested and partially non-vested interest or only of a fully non-vested interest. Therefore, the interest in the fund **in respect of such subsequent transfer** may, depending on the situation, be treated differently. In this regard, please see the discussion regarding transfers post 1-March 2021 below.

Example 3: Person is a member of provident preservation fund on 1 March 2021

Jabu is 50 year of age on 1 March 2021. He is a member of the GHI Provident Preservation Fund and his interest in the fund on 1 March 2021 is R2 000 000. Jabu made no other transfers to the GHI Provident Preservation Fund. Jabu retires from this fund on 1 February 2035. On 1 February 2035 the full value of his interest in the GHI Provident is R5 000 000.

Result:

Jabu may take the full value of R5 000 000 in the provident fund as a lump sum (subject to the deduction of tax from the lump sum).

Persons who become members of provident funds and provident preservation funds on or after 1 March 2021

In the case of persons who become members of provident funds on/after 1 March 2021, the effect will be that all contributions plus growth thereon and other amounts credited to the member will be subjected to the annuitisation regime. The member will only be entitled to a maximum of one third of this amount as a lump sum and the balance will have to be used to purchase a compulsory annuity. This will be the case irrespective of whether the member was 55 years of age or older on 1 March 2021 or not. This will not change if the member subsequently transfers to another fund (another provident fund, pension fund, provident preservation, pension preservation or retirement annuity fund. The only exception to this rule is where the value of the retirement interest in the fund is equal to or below the *de minimis* amount of R247 500, in which case the full interest may be taken as a lump sum.

Where a transfer from another fund however occurs in respect of a person who becomes member of a provident fund after 1 March 2021, and the transfer contains a vested portion in respect of pre-1 March 2021 membership of a provident or provident preservation fund, this vested portion and growth thereon will be available as a lump sum on retirement. Subsequent contributions to the "new" provident fund post-1 March 2021as well as any non-vested portion that may have been transferred from the other fund to the "new" provident fund will however be subject to the annuitisation regime. In this regard, please see the discussion on the effect of the annuitisation regime on transfers from provident and provident preservation fund post-1 March 2021 below.

Tax-free transfers between funds after 1 March 2021

The following tax-free transfers[3] between funds will be allowable from 1 March 2021:

From	To
Pension Fund Pension Preservation Fund Provident Fund Provident Preservation Fund	Pension Fund Pension Preservation Fund Provident Fund Provident Preservation Fund Retirement Annuity Fund
Retirement Annuity Fund	Retirement Annuity Fund

The effect of transfers from provident and provident preservation funds post 1 March 2021 on the annuitisation regime

The annuitisation regime also provides for the preservation of the vested portion (the portion that would not be subject to the annuitisation regime) of the interest in in a provident or provident preservation fund, where a person **who is a member of a provident or provident preservation fund on 1 March 2021**, transfers the interest therein, or a portion thereof, to another provident or provident preservation fund, or a pension or pension preservation fund or a retirement annuity fund **after 1 March 2021**. The definitions of provident fund[4], provident preservation fund[5], pension fund[6], pension preservation[7] fund and retirement annuity fund[8] in Section 1 of the Income Tax Act have been amended to this effect.

These amendments can be explained as follows:

1. In the case of a member of a **provident fund** who is **55 years or older <u>on</u> 1 March 2021**, and transfers the interest therein to another fund **<u>after</u> 1 March 2021**, both the amounts contributed before and after 1 March 2021 to such provident fund (and any other amounts credited to the member) **up to the date of transfer** as well as growth thereon and subsequent growth in the fund transferred to, will **not** form part of the retirement interest for purposes of annuitisation. In other words: such a person will, on retirement

[3] Paragraph 6(1)(a) of the Second Schedule to the Income Tax Act, prior to the 1 March 2021 amendments.
[4] Paragraph (b)(ii)(dd) of the definition of "provident fund" in Section 1 of the Income Tax Act.
[5] Paragraph (e) of the definition of "provident preservation fund" in Section 1 of the Income Tax Act.
[6] Paragraph (d)(ii)(dd) of the definition of "pension fund" in Section 1 of the Income Tax Act.
[7] Paragraph (e) of the definition of "pension preservation fund" in Section 1 of the Income Tax Act.
[8] Paragraph (b) of the definition of "retirement annuity fund" in Section 1 of the Income Tax Act.

(a) be able to take the **full transfer value from the provident fund, plus growth thereon in the fund to which the amount was transferred to,** as a lump sum on retirement from this fund (another provident fund, a provident preservation fund, a pension fund, a pension preservation fund or retirement annuity fund), but

(b) in the case of a transfer to another provident fund, a pension fund or a retirement annuity fund, all contributions made to such fund after date of transfer plus growth thereon (and other amount credited to the member) will be subject to the annuitisation regime, unless this amount is less than the *de minimis* amount (currently R247 500) on retirement. In the case of a transfer to a provident preservation or pension preservation fund, further contributions are not allowable, and the amount so transferred, plus growth thereon will thus not be subject to the annuitisation regime (i.e. the member will be able to take the full amount as a lump sum on retirement).

2. In the case of a member of a **provident fund** who is **younger than 55 years or of age <u>on</u> 1 March 2021**, who transfers the interest therein to another fund **<u>after</u> 1 March 2021**, the amounts contributed to such provident fund (and any other amounts credited to the member) **before 1 March 2021** and growth thereon, as well as subsequent growth in the fund transferred to, will <u>not</u> form part of the retirement interest for purposes of annuitisation. In other words:

   (a) such a person will, on retirement, be able to take an amount equal to the **contributions made to the provident fund (and other amounts credited to the member) before 1 March 2021 plus growth thereon in the provident fund plus growth in the fund to which the transfer was made,** as a lump sum on retirement from this fund (another provident fund, a provident preservation fund, a pension fund, a pension preservation fund or retirement annuity fund); but

   (b) all contributions made to the provident fund **<u>on/after</u> 1 March 2021** plus (in the case of a transfer to another provident fund, pension fund or retirement annuity fund) all contributions made to such fund after date of transfer plus growth thereon (and other amounts credited to the member) will be subject to the annuitisation regime, unless this amount is less than the de minimis amount (currently R247 500) on retirement.

3. In the case of a persons (irrespective of whether they are 55 years of age or older, or younger than 55 **on** 1 March 2021) who is a member of a **provident preservation fund <u>on</u> 1 March 2021**, and transfers the interest therein to another fund **<u>after</u> 1 March 2021**, the transfer value (and any other amounts credited to the member), as well as growth thereon and subsequent growth in the fund transferred to, will <u>not</u> form part of the retirement interest for purposes of annuitisation. If there are however further amount credited to the interest in respect of this

transfer (e.g. a surplus payment) after 1 March 2021, such amount plus growth thereon will be subject to annuitisation on retirement, unless it (plus any other "non-vested" transfers made to the fund) is equal to or less than the de minimis amount (currently R247 500). In other words: such a person will, on retirement

(a) be able to take the **full transfer value from the provident preservation fund plus growth thereon in the fund to which the amount was transferred to** as a lump sum on retirement from this fund (another provident fund, a provident preservation fund, a pension fund, a pension preservation fund or retirement annuity fund), but

(b) in the case of a transfer to a provident fund, pension fund or retirement annuity fund, all contributions made to such fund after date of transfer plus growth thereon (and other amount credited to the member) will be subject to the annuitisation regime, unless this portion is less than the de minimis amount (currently R247 500) on retirement. In the case of a transfer to a provident preservation or pension preservation fund, further contributions are not allowable, and the amount so transferred, plus growth thereon will thus not be subject to the annuitisation regime (i.e. the member will be able to take the full amount as a lump sum on retirement).

The "vested" portion (the portion not subject to annuitisation) of the interest in a fund plus subsequent growth thereon will remain "vested" upon subsequent further transfers to other funds post 1 March 2021.

Example 4: Member of provident fund is 55 years of age or older on 1 March 2021 and transfers the interest in the provident fund to another fund after 1 March 2021

Joe is 58 year of age on 1 March 2021. He is a member of the ABC Provident Fund and his interest in the fund on 1 March 2021 is R2 000 000. Joe keeps on contributing to the ABC Provident Fund and transfers his interest in the ABC Provident Fund on resignation from employment to the DEF Retirement Annuity Fund on 1 February 2025. On 1 February 2025 the full value of his interest in the ABC Provident Fund is R5 000 000 and this amount is transferred to the DEF Retirement Annuity Fund. He makes contributions to the DEF Retirement Annuity Fund from February 2025 and retires from the DEF Retirement Annuity Fund in April 2028.

Result:

(a) Joe may take the full value of R5 000 000 (transfer value) **plus subsequent growth thereon** in the DEF Retirement Annuity Fund as a lump sum (subject to the deduction of tax from the lump sum).

(b) The contributions made to the DEF Retirement Annuity Fund from February 2025 until his retirement on April 2028, plus subsequent growth thereon, will be subject to the annuitisation regime (i.e. he will only be able to take a maximum of one third of this amount as a lump sum, and the balance will have to be used to purchase a compulsory annuity). However, if this portion (contributions to the DEF Retirement Annuity Fund from February 2025 plus any growth thereon till date of retirement) is equal to or less than the *de minimis* amount (currently R247 500), on date of retirement, Joe will also be able to also take this as a lump sum.

Example 5: Member of provident fund is younger than 55 years of age on 1 March 2021 and transfers the interest in the provident fund to another fund after 1 March 2021

Jack is 53 years of age on 1 March 2021. He is a member of the ABC Provident Fund and his interest in the fund on 1 March 2021 is R2 000 000. Jack keeps on contributing to the ABC Provident Fund and transfers his interest in the ABC Provident Fund on resignation from employment to the DEF Provident Fund on 1 February 2025. On 1 February 2025 the full value of his interest in the ABC Provident Fund is R5 000 000 and this amount is transferred to the DEF Provident Fund. He makes contributions to the DEF Provident Fund from February 2025 and retires from the DEF Provident Fund in April 2028.

Result:

(a) Jack may take the amount of R2 000 000 (value in the ABC Provident Fund on 1 March 2021) **plus subsequent growth thereon** in both the ABC Provident Fund and the DEF Provident Fund as a lump sum (subject to the deduction of tax from the lump sum).

(b) The contributions made to the ABC Provident Fund from 1 March 2021 and to the DEF Provident Fund from February 2025 until his retirement on April 2028, plus subsequent growth thereon, will be subject to the annuitisation regime (i.e. he will only be able to take a maximum of one third of this amount as a lump sum, and the balance will have to be used to purchase a compulsory annuity). If this portion (contributions to the ABC Provident Fund from 1 March 2021, plus contributions made to the DEF Provident Fund from February 2025, plus any growth thereon till date of retirement) is equal to or less than the *de minimis* amount (currently R247 500), on date of retirement, Jack will also be able to take this as a lump sum.

Example 6: Person is a member of provident preservation fund on 1 March 2021 and transfers the interest in the provident preservation fund to another fund after 1 March 2021

Jabu is 50 year of age on 1 March 2021. He is a member of the GHI Provident Preservation Fund and his interest in the fund on 1 March 2021 is R2 000 000. On 1 February 2025 the full value of his interest in the GHI Provident Preservation Fund is R2 500 000 and this amount is transferred to the JKL Pension Fund. He makes contributions to the JKL Pension Fund from February 2025 and retires from the JKL Pension Fund in April 2028.

Result:

(a) Jabu may take the full value of R2 500 000 (transfer value) **plus subsequent growth thereon** in the JKL Pension Fund as a lump sum (subject to the deduction of tax from the lump sum).

(b) The contributions made to the JKL Pension Fund from 1 February 2025 till his retirement on April 2028, plus subsequent growth thereon will be subject to the annuitisation regime (i.e. he will only be able to take a maximum of one this of this amount as a lump sum, and the balance will have to be used to purchase a compulsory annuity). However, if this portion (contributions to the JKL Pension Fund from February 2025 plus any growth thereon until date of retirement) is equal to or less than the *de minimis* amount (currently R247 500) on date of retirement, Jabu will also be able to take this as a lump sum.

The effect of deductions from member's minimum individual reserve post 1 March 2021 on the annuitisation of provident funds

The definitions of a provident fund[9], provident preservation fund[10], pension fund[11], pension preservation[12] fund and retirement annuity fund[13] in Section 1 of the Income Tax Act have been amended to provide for the proportionate reduction of the "vested" portion of a member's interest in a provident or provident preservation fund, in the event of deductions from the minimum individual reserve in such fund, whether such deduction occurs before, on, or after 1 March 2021.

Section 37D of the Pension Funds Act provides for instances where it will be allowable to make a deduction from retirement funds. The most common deduction in this regard is the deduction from a member's interest or individual reserve, is where a pension interest in a fund is awarded to

[9] Paragraph (b)(ii)(dd) of the definition of "provident fund" in Section 1 of the Income Tax Act.
[10] Paragraph (e) of the definition of "provident preservation fund" in Section 1 of the Income Tax Act.
[11] Paragraph (d)(ii)(dd) of the definition of "pension fund" in Section 1 of the Income Tax Act.
[12] Paragraph (e) of the definition of "pension preservation fund" in Section 1 of the Income Tax Act.
[13] Paragraph (b) of the definition of "retirement annuity fund" in Section 1 of the Income Tax Act.

the spouse of the member in divorce proceedings. The following example illustrates the effect of this provision:

Example 7: Deduction of divorce award in favour of spouse of member

Thandi is a member of the MNO Provident Fund. On 1 March 2021 she was 40 years of age. Thandi's final divorce order dated 3 April 2025 provides that her ex-husband, Thabo (aged 43 on 1 March 2021), is entitled to 50% of here pension interest in the MNO Provident Fund. On date of divorce her interest in the fund is R10 000 000, of which R8 000 000 represents the vested portion (contributions before 1 March 2021 and growth thereon) and R2 000 000 represents the non-vested portion (contributions on and after 1 March 2021 and growth thereon).

Therefore her vested and non-vested portions will be proportionately reduced:

a) Vested portion: R8 000 000 x 50% (awarded to her ex-spouse in the divorce) = R4 000 000.

b) Non-vested portion: R2 000 000 x 50% (awarded to her ex-spouse in the divorce) = R1 000 000.

Result:

a) When Thandi eventually retires, she will thus be able to take the R4 000 000 plus growth thereon from date of divorce to date of retirement as a lump sum. The balance in the fund on retirement will be subject to the annuitisation regime.

b) If Thabo opts to transfer the award to any other retirement fund (including a provident or provident preservation fund), the full amount awarded plus growth thereon will, in my view, be subject to the annuitisation regime on his retirement from such fund. The reason for this is that this transfer would not constitute an amount contributed by Thabo (or his employer) to a provident fund, or transferred by Thabo to a provident preservation fund prior to 1 March 2021, as contemplated in the legislation.

Note: If Thabo was aged 55 or older on 1 March 2021 and was also a member of a provident or provident preservation fund on this date, it could be argued that, in the event of the divorce award subsequently being transferred to such provident or provident preservation fund, the amount transferred is fully "vested", as it would constitute an amount transferred, or credited to his interest in the fund as contemplated the definition of provident[14] and provident preservation[15] fund in Section 1 of the Income Tax Act. The result of such a scenario would be that on retirement from such fund, Thabo would be entitled to take the full interest in the fund as a lump sum. It is however not certain whether this is the way that it will be applied in practice.

[14] Proviso (ii)(dd)(a)(AA) and (BB) of the definition of "provident fund".
[15] Paragraph (e)(a)(i) and (ii) of the definition of "provident preservation fund".

It however appears that the amendments referred to above (pertaining to the proportionate reduction of the "vested" portion of a member's interest) only allude to the provident fund and/or provident preservation fund that the person was a member of on 1 March 2021, and not to other retirement funds that the member may have subsequently transferred to. I can only assume that this was an oversight by the legislature and that legislative amendments to rectify this should be effected in the future. The understanding his however that in practice, the fund that the transfer was made to will attend to proportional reductions as a result of section 37D deductions form such funds.

The effect of partial withdrawals from funds post 1 March 2021 on the annuitisation regime

It was expected that the same principle of the proportionate reduction of the "vested" portion of a member's interest in a retirement fund would also be provided for, where there is a partial withdrawal from the fund by the member. i.e.

(a) where a member, after 1 March 2021, resigns from a pension or provident fund that contains a vested and non-vested portion and opts to take a portion of the benefit in cash and transfer the balance to another fund; and

(b) where a member takes the one allowable withdrawal from a pension preservation or provident preservation fund after 1 March 2021, and the member's interest in the fund consists of a "vested" and "non-vested" portion.

The following example illustrates this principle:

Example 8: Member's interests consists of a "vested" and "non-vested" portion and a partial withdrawal is made

Jan's interest in the QRS Provident Fund in respect of contributions made before 1 March 2021, plus growth thereon (all growth, before and after 1 March 2021), is R6 000 000 (vested portion) and in respect of contributions made on/after 1 March 2021 is R4 000 000 (non-vested portion) on the date that he resigns from employment. He transfers the full benefit to the TUV Provident Preservation Fund. The vested and non-vested portions are invested in the same underlying investments, and the growth thereon is thus proportionately the same.

Jan thereafter makes a once-off withdrawal of R2 000 000. In this regard, his vested amount will be reduced by R1 200 000 (60% times R2 000 000) and his non-vested amount would be reduced by R800 000 (40% times R2 000 000). Therefore after the once-off withdrawal payment of

R2 000 000 is made, Jan's interest in the fund would comprise of R4 800 000 vested (R6 000 000 – R1 200 000) and R3 200 000 non-vested (R4 000 000 – R800 000).

When the Jan eventually retires from the TUV Provident Preservation Fund 15 years later, the fund value is R15 000 000. At this point, the above-mentioned vested and non-vested portions should have grown to R9 000 000 and R6 000 000 respectively.

Result (the same apportionment is applied):
Growth from the time of the once-off withdrawal to the date of retirement is R7 000 000 (R15 000 000 – R8 000 000)

(a) Vested portion: R4 800 000 + R4 200 000 (R7 000 000 x 60%) = R9 000 000 – this amount may be taken as a lump sum if Jan chooses to do so; and
(b) Non-vested portion: R3 200 000 + R2 800 000 (R7 000 000 x 40%) = R6 000 000. In respect of the non-vested portion of R6 0000 000, a maximum amount of R2 000 000 (one third) may thus be taken as a lump sum and R4 000 000 has to be used to purchase a compulsory annuity (if this value was below R247 500, Jan would have been able to take this as a lump sum too).

It however appears that provisions in the legislation to make provision for such a reduction in the case of a partial withdrawal were erroneously omitted. The result is that the legislation does not provide for such proportionate reduction in respect of the vested portion. This issue is problematic, as fund administrators had expected the change to be legislated and thus implemented system changes to cater for this. At the time of writing this article, industry organisations were awaiting feedback from SARS/Treasury on guidelines for the practical application in such instances, in light of the omission in the legislation.

The effect of the annuitisation regime on approved permanent disability cover

Approved permanent disability cover is provided directly by retirement fund (usually by an employer fund, i.e. a pension or provident fund).

The definition of "retirement interest" in section 1 of the Income Tax Act provides as follows:
"retirement interest" means a ***member's share of the value of a*** *pension fund, pension preservation fund,* ***provident fund****, provident preservation fund or retirement annuity fund as determined in terms of the rules of the fund* ***on the date on which he or she elects to retire*** *or transfer to a pension preservation fund, provident preservation fund or retirement annuity fund;*

The definition of normal retirement age in section 1 of the Income Tax Act includes the instance where a person becomes permanently incapable of carrying with an occupation *due to sickness, accident, injury or incapacity through infirmity of mind or body*.

A consequence of this is that where a person retires as a result of disability, and approved disability cover becomes payable, such approved disability cover will form part of his/her retirement interest.

The effect of the annuitisation regime for provident funds post 1-March 2021 on approved permanent disability cover is the following:

(a) Where a member of a provident fund is 55 years of age or older on 1 March 2021 and becomes disabled after 1 March 2021, resulting in approved permanent disability cover being paid, the full disability benefit essentially constitutes a "vested" interest in these circumstances. The member may thus take the full interest (fund value plus disability benefit) as a lump sum.

(b) Where a member of a provident fund is however younger than 55 on 1 March 2021, and becomes disabled after 1 March 2021, resulting in approved permanent disability cover being payable, such disability benefit will form part of his/her retirement interest. As this benefit will constitute an amount credited to the member's individual account or minimum individual reserve after 1 March 2021, it will be subject to the annuitisation regime if the total "non-vested" value of the total interest (disability payment plus post 1-March 2021 contributions and growth thereon) exceeds R247 500.

It is doubtful that this state of affairs, pertaining to approved disability cover of provident fund members who were younger than 55 on 1 March 2021, was an intended consequence of the legislation. The purpose of disability cover is often to provide members with lump sum payments to cater for lifestyle changes brought about by disability. It is my view that legislative intervention is required to amend this consequence.

A possible solution would be for employers to, where applicable, convert approved disability cover (i.e. provided by a provident fund) to unapproved disability cover (i.e. so-called loose standing disability cover provided by a long-term insurer) to ensure that the disability cover is payable as a lump sum to employees. The only drawback of such a solution is that the premiums paid will constitute a taxable fringe benefit in the hands of the employee, whilst it will not be

deductible under section 11F of the Income Tax Act (as the case would be with a premium paid to the provident fund in respect of approved disability cover). Unapproved disability cover does however enjoy the benefit that the proceeds will pay out tax-free,

Conclusion

The shift to the compulsory annuitisation of provident fund and provident preservation fund benefits on retirement of a member is, in my opinion, a positive step in the preservation of retirement savings of members after retirement. However, as indicated in this article, there are teething problems in respect of the amendments. These issues will hopefully be swiftly clarified or rectified via legislative amendments or appropriated guidelines form SARS and/or National Treasury.

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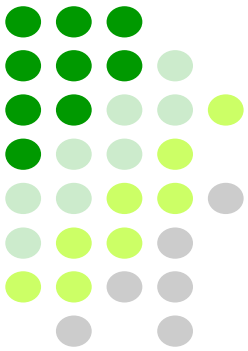

General

Business Rescue vs Cancelling Business Assurance Policies

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Introduction

The effect of the Covid-19 pandemic hit South Africa in March 2020 when a national lockdown came into place from 27 March 2020. During the initial lockdown period most businesses had to close their doors and could not generate any cash flow or generated very little cash flow while they still had to pay certain expenses.

For most businesses to survive, business owners had to cut down on cost and expenditure. This included measures such as staff retrenchments, salary cuts, expense reduction like cancelling business assurance policies, and the list goes on and on. Business rescue is one survival tool overlooked by many businesses. The reasons for this could include the incorrect perception that a business under business rescue has already failed or because business owners do not understand this tool and the relief it provides businesses.

Businesses[1] could have buy-and-sell policies, key person policies, business contingency policies or other forms of business insurance in place, as recommended by their financial advisors. Premiums may have been paid on these policies for many years and now, with businesses struggling financially, insurance policies premiums are often one of the first expenses a business owner stops paying. This begs the question whether this is the correct decision, or whether other tools such as business rescue should be considered.

Defining business rescue

Section 128(1)(b) of the Companies Act 71 of 2008 ("the Act") provides as follows:

''business rescue'' means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for—

(i) the temporary supervision of the company, and of the management of its affairs, business and property;

(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and

(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the

[1] Businesses refer to companies, close corporations and partnerships.

company's creditors or shareholders than would result from the immediate liquidation of the company;

In practical terms this means that when a company is financially in distress, a business rescue practitioner[2] ("the practitioner") will be appointed to temporarily supervise the company, pause the rights of the creditors or claimants against the company and also develop and implement a rescue plan for the company.

Section 128 (f) of the Act provides the following:

''financially distressed'', with reference to a particular company at any particular means that—

(i) it appears to be reasonably unlikely that the company will be able to pay all of its debts *as they fall due and payable within the* **immediately ensuing six months***; or*

(ii) it appears to be **reasonably likely** *that the company will* **become insolvent** *within the immediately ensuing* **six months.**

The appointment of a practitioner

A person may be appointed as the practitioner of a company only if the person:

(i) is a *member* in good standing of a legal, accounting or business management profession *accredited* by the Companies and Intellectual Property Commission[3];

(ii) has *been* licensed as such by the Commission[4]

(iii) is not subject to an order of probation in terms of section 162(7)[5];

(iv) would not be disqualified from acting as a director of the company in terms of section 69(8)[6];

(v) does *not* have any other relationship with the company such as would lead a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that person is compromised by that relationship[7]; and

(vi) is *not* related to a person who has a compromised relationship with the company[8].

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[2] Section 128(1)(d) of the Companies Act defines a business practitioner as follows: ''*business rescue practitioner'' means a person appointed, or two or more persons appointed jointly, in terms of this Chapter to oversee a company during business rescue proceedings and 'practitioner' has a corresponding meaning;*

[3] Section 138 (1)(a) of the Companies Act 71 of 2008;

[4] Section 138 (1)(b) of the Companies Act 71 of 2008;

[5] Section 138 (1)(c) of the Companies Act 71 of 2008;

[6] Section 138 (1)(d) of the Companies Act 71 of 2008;

[7] Section 138 (1)(e) of the Companies Act 71 of 2008;

[8] Section 138 (1)(f) of the Companies Act 71 of 2008; Although this section provides the requirement that it is a requirement that a person appointed as a practitioner "*is not related to a person who has a relationship* contemplated *in paragraph (d)*" it is assumed that this is a mistake and that the reference should be to paragraph (e).

Procedural aspects of business rescue

The process to be followed, for a business to be placed under business rescue, is set out in Section 129[9]:

(1) Subject to subsection (2)(a), The board of a company may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that—

(a) the company is financially distressed; and

(b) there appears to be a reasonable prospect of rescuing the company.

(2) A resolution contemplated in subsection (1)—

(a) may not be adopted if liquidation proceedings have been initiated by or against the company; and

(b) has no force or effect until it has been filed.

(3) Within five business days after a company has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Commission, on application by the company, may allow, the company must—

(a) publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and

(b) appoint a business rescue practitioner who satisfies the requirements[10] of section 138, and who has consented in writing to accept the appointment.

(4) After appointing a practitioner as required by subsection (3)(b), a company must—

(a) file a notice of the appointment of a practitioner within two business days after making the appointment; and

(b) publish a copy of the notice of appointment to each affected person within five business days after the notice was filed.

(5) If a company fails to comply with any provision of subsection (3) or (4)—

(a) its resolution to begin business rescue proceedings and place the company under supervision lapses and is a nullity; and

(b) the company may not file a further resolution contemplated in subsection (1) for a period of three months after the date on which the lapsed resolution was adopted, unless a court, on good cause shown on an ex parte application, approves the company filing a further resolution.

[9] Of the Companies Act 71 of 2008;

[10] Section 138 of the Act defines the requirements for a practitioner as follows:

(6) A company that has adopted a resolution contemplated in this section may not adopt a resolution to begin liquidation proceedings, unless the resolution has lapsed in terms of subsection (5), or until the business rescue proceedings have ended as determined in accordance with section 132(2).

(7) If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in section 128(1)(f) that are applicable to the company, and its reasons for not adopting a resolution contemplated in this section.

Payment of policy premiums: Policyholder protection rules

The next question that needs to be answered, is what happens if a business that is financially in distress stops paying the premiums of business assurance policies because it needs to go into survival mode and save money.

Rule 15A of the Policyholder Protection Rules[11] of the Long-Term Insurance Act[12] ("the PPR") contains the following provisions:

(i) If a premium under a policy, other than a fund policy, has not been paid on its due date, the insurer must notify the policyholder of the non-payment within 15 days after the payment was due, and the policy and the cover must, notwithstanding anything therein to the contrary, in the case of a policy under which there are to be two or more premium payments at intervals of-
   (a) one month or less, remain in force for a period of 15 days after that due date; or
   (b) longer than one month, remain in force for a period of one month after that due date, or for such longer period as may be determined by agreement between the parties.[13]

(ii) If the overdue premium in respect of a policy referred to in above mentioned rule, is not paid by the end of any such period, the policy must be dealt with in accordance with following rule discussed in the following bullet.[14]

(iii) The remaining value of a policy, as mentioned above, after the satisfaction of any claim of the insurer which is secured solely by the policy benefits to be provided under the policy, is greater than half of the aggregate amount of the premium payments due thereunder during

[11] Issued in terms of section 62 of the Long Term Insurance Act No.52 of 1998
[12] Act 52 of 1998
[13] Rule 15A.1 of the Policyholder Protection Rules (Long-Term Insurance), 2017
[14] Rule 15A.2 of the Policyholder Protection Rules (Long-term Insurance), 2017

the period of 12 months commencing on the due date of the unpaid premium, the insurer must-

(a) inform the policyholder of the amount of that remaining value and notify him or her that the policy will remain in force, in accordance with the documented procedure of the insurer, until-

- ❑ the policy no longer has any such remaining value, whereupon it will lapse;
- ❑ the payment of premiums is resumed;
- ❑ the provisions of the policy are amended, in accordance with the rules of the insurer, so that it becomes a policy which is fully paid-up; or
- ❑ if the policyholder so requests, the policy is surrendered, in accordance with the rules of the insurer, and so much of the remaining value as then remains is, subject to section 54, paid to the policyholder; and

(b) deal with the policy accordingly.[15]

(iv) An insurer must have documented procedures which to the satisfaction of its statutory actuary prescribe a sound basis on which, and the methods by which, a policy is to be valued and otherwise dealt with for the purposes of rule described above.[16]

Conclusion

If the business of your client is under financial distress, a business plan needs to be developed to help them in difficult times. Business rescue is a good tool to consider under these circumstances.

This is effected by placing the business under business rescue and appointing a business rescue practitioner who will temporarily supervise the company, pause the rights of the creditors or claimants against the company and also develop and implement a rescue plan for the company.

As indicated in the discussion of the legislative provisions above, a resolution to place the business under business rescue may not be adopted if liquidation proceedings have been initiated by or against the business. There must be a reasonable prospect that this business can be saved if it is placed under business rescue.

[15] Rule 15A.3 of the Policyholder Protection Rules (Long-term Insurance), 2017
[16] Rule 15A.4 of the Policyholder Protection Rules (Long-term Insurance), 2017

If the business plan is to stop paying their business assurance policies, these policies will in terms of Rule 15 of the PPR lapse on expiration of the prescribed periods and new policies should be issued. New policies may be more expensive and also not even approved by the insurance company on application. Careful consideration should thus be given before a decision is made to cease paying policy premiums, even in a scenario where a business is placed under business rescue.

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The Process of Retrenchment and the Taxation of Severance and Retirement Benefits

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Introduction

Retrenchment is a form of dismissal due to no fault of the employee. It is a process whereby the employer reviews its business needs in order to increase profits or limit losses, which leads to reducing its employees. The Labour Relations Act[1] permits employers to dismiss employees for operational requirements. Operational requirements are requirements based on the economic, technological, structural or similar needs of an employer.

Employers are subject to the process set out in section 189[2] and section 189A[3] of the Labour Relations Act, which sets out the procedural and substantive obligations placed on the employer to maintain a fair retrenchment process.

This article focuses on the process set out in section 189 as well as the taxation of retrenchment benefits.

Prescribed retrenchment process in terms of Section 189

Retrenchment must be procedurally and substantively fair. In order to determine whether or not the decision to retrench was fair, the court will look at the real reason for the retrenchment and whether it was unavoidable.

Before retrenching any employees, employers must consult any person whom the employer is required to consult in terms of any collective agreement that may be in force before retrenching any employee[4]. If the employer does not have a collective agreement that requires consultation, the employer must consult a workplace forum[5] and any registered trade union whose members are likely to be affected by the proposed dismissals[6]. Where there are no such trade union, the employers must consult with the employees likely to be affected by the proposed dismissals or their representatives nominated for that purpose[7].

The consulting parties must attempt to reach consensus on the following matters[8]:

[1] Act 66 of 1995
[2] Applicable to all employers.
[3] Applicable to employers with more than 50 employees.
[4] Section 189 (1)(a) Labour Relations Act 66 of 1995
[5] If the employees likely to be affected by the proposed dismissals are employed in a workplace in respect of which there is a workplace forum.
[6] Section 189(1)(b) and section 189(1)(c) Labour Relations Act 66 of 1995
[7] Section 189 (1)(d) Labour Relations Act 66 of 1995
[8] Section 189 (2) Labour Relations Act 66 of 1995

- The possibility of avoiding the dismissal for example, adjusting working hours, eliminating temporary labour, eliminating overtime, offering early retirement;
- Appropriate measures to minimize the dismissals;
- Measures to change the timing of the dismissals;
- Appropriate measures to mitigate the effects of retrenchment;
- The method for selecting the employees to be dismissed; and
- Severance Pay.

In terms of section 189 (3) of the Act, the employer is required to disclose, in writing, to employers or their unions, all relevant information, including but not limited to:

- The reasons for retrenchment;
- Alternatives considered and why they were rejected;
- The number of employees likely to be affected and their job categories;
- Proposed method of selection;
- Time when, or period during which dismissals will take place;
- Severance pay proposed;
- Assistance that the employer will be offering;
- The possibility of future re-employment;
- The number of employees employed by the employer; and
- The number of employees dismissed by the employer in the last 12 months in respect of operational requirements.

The employer must give the other consulting party an opportunity to make presentations in relation to the proposed retrenchment, that must be considered and be responded to[9].

Once the consulting parties agree upon the criteria for retrenchment, the employer may then select employees to be retrenched according to such criteria[10]. If no agreement is reached on the criteria for selection, the selection must be fair and objective. The "last-in-first-out" principle is often applied in this instance.

[9] Section 189 (5) Labour Relations Act 66 of 1995
[10] Section 189 (7) Labour Relations Act 66 of 1995

The following payments must be made to a retrenched employee:

- Severance pay[11];
- Any outstanding leave due (up to date of dismissal);
- Notice pay; and
- Other. Depending on the employment contract and whether the employee is a member of a pension/provident fund, the following may be relevant — pro rata payment of bonus, pension and provident fund benefits (options in this regards are discussed later in the article).

Leave pay, bonus, and notice pay fall within the ambit of the definition of gross income in section 1 of the Income Tax Act[12] and are therefore taxed as normal income according to the tax payers marginal tax rate. The taxation of severance benefits and retirement fund lump sums are discussed below.

The taxation of severance benefits and lump sums from retirement funds

Employees are entitled to receive severance pay where they have been retrenched for operational requirements. Section 41(2) of the Basic Conditions of Employment Act prescribes that the severance pay is equal to at least one week's remuneration for each completed year of continuous service with that employer, calculated in accordance with section 35 of the Act.

A severance benefit is defined[13] as any lump sum amount received by or accrued to a person by the person's employer in respect of the relinquishment, termination, loss, repudiation, cancellation or variation of a person's employment, only if:

- The person is 55 years or older; or
- The relinquishment or termination is due to the person being permanently incapable of holding his employment or office due to sickness, accident, injury or incapacity through infirmity of mind or body; or
- Such termination or loss is due to:
  - the person's employer having ceased to carry on the trade in respect of which the person was appointed, or
  - the person is retrenched due to a reduction in personnel;

[11] The calculation for severance pay is set out in The Basic Condition of Employment Act which will be discussed later in the article
[12] 58 of 1962
[13] Section 1 of the Income Tax Act 58 of 1962

- except where the person being retrenched holds more than 5% of the shareholding of the company.

If the amount that the person receives qualifies as a severance benefit as per the above definition, the lump sum will be taxed according to the tax table applicable to retirement lump sum benefits:

Taxable Income	Rate of Tax (R)
R0 – R500 000	0% of taxable income
R500 001 – R700 000	18% of taxable income above R500 000
R700 001 – R1 050 000	R36 000 plus 27% of taxable income above R700 000
R1 050 001 and above	R130 500 plus 36% of taxable income above R1 050 000

If the amount that the person receives does not qualify as a severance benefit as per the above definition, the lump sum will be taxed as normal income according to the employee's marginal tax rate.

It is important to note that the Income Tax Act does not distinguish between voluntary and involuntary retrenchments. Where an employer offers a retrenchment package to employees who then opt to be retrenchment it is regarded as voluntary retrenchment. On the other hand, where the employer selects the employees who will be retrenched it is regarded as an involuntary retrenchment. In both these instance the amounts paid to these employees that qualify as a severance benefit will be taxed in terms of the tax table applicable to retirement fund lump sum benefits at retirement and or death, provided that such benefit qualifies as a severance benefit as per the definition discussed above.

If the amount that a person receives from an employer does not qualify as a severance benefit as per the definition discussed above, such amount will be taxed as normal income at his/her marginal tax rate. Examples of such amounts include salary, bonuses and outstanding leave pay.

Options at retrenchment: Pension and provident fund benefits

The retrenched person may:

- receive the full pension or provident fund in cash; or
- elect to receive part in cash and transfer part to an approved fund; or
- transfer the full fund value to an approved fund which transfer will be free of tax.

The following tax-free transfers in respect of pension and provident funds are allowed in this regard[14]:

Fund Transferred From	**Fund Transferred To**
Pension Fund	Pension Fund Pension Preservation Fund Retirement Annuity Fund
Provident Fund	Provident Fund Provident Preservation Fund Pension Fund Pension Preservation Fund Retirement Annuity Fund

From 1 March 2021, when the annuitisation regime becomes applicable to provident and provident preservation funds, the allowable tax-free transfers will be amended as follows:

Fund Transferred From	**Fund Transferred To**
Pension Fund	Pension Fund Pension Preservation Fund Provident Fund Provident Preservation Fund Retirement Annuity Fund
Provident Fund	Provident Fund Provident Preservation Fund Pension Fund Pension Preservation Fund Retirement Annuity Fund

[14] Paragraph 6(1)(a)(aa) and paragraph 6(1)(a)(cc) of the Second Schedule to the Income Tax Act.

Severance benefits and any amounts taken from a pension or provident fund in cash, are taxed according to the retirement tax tables (as per the table above), subject to the aggregation principle where the following earlier lump sums received must be taken into account:

- Taxable lump sums received from retirement funds upon retirement (as from 1 Oct 2007); plus
- Taxable lump sums received from retirement funds upon withdrawal (as from 1 March 2009); plus
- Severance payments (as from 1 March 2011).

If the retrenched person elects to transfer any part of the pension or provident fund benefits to a preservation fund and thereafter makes a withdrawal from the preservation fund, this withdrawal will be taxed according to the tax tables applicable to retirement fund lump sum withdrawal benefits and not the tax table applicable to retirement fund lump sum benefits (i.e. the table provided above). The retirement tax concession is only available at the point of retrenchment. It is important to note that the aggregation principle will also be applicable on this withdrawal.

The table that will be applied on such withdrawal from a preservation fund looks as follows:

Taxable Income	Rate of Tax (R)
R0 – R25 000	0% of taxable income
R25 001 – R660 000	18% of taxable income above R25 000
R660 001 – R990 000	R114 300 plus 27% of taxable income above R660 000
R990 001 and above	R203 400 plus 36% of taxable income above R990 000

Practical example

Nick Black, a 53-year-old factory worker was retrenched in March 2020. Nick's employer had to reduce the personnel due to the Covid-19 pandemic that hit South Africa and Nick met the criteria that was agreed upon for retrenchment. Nick received a retrenchment package (severance benefit) of R600 000, leave pay of R15 000, pro rata bonus of R20 000 and a final salary of R30 000. He also decided to take R300 000 from his pension fund and wants to transfer the balance to a pension preservation fund. Nick needs advice on the taxes that he would need to pay. Assume that Nick pays tax on normal income at a marginal tax rate of 31%.

Retirement fund lump sum benefit and severance benefit

Step 1:

Advise Nick that his leave pay, bonus and salary will be taxed as gross income at his marginal tax rate.

Step 2:

Identify if Nick's retrenchment package qualifies as a severance benefit by establishing if one of the requirements is met as per the definition of severance benefits in section 1 of the Income tax act. Nick was retrenched due to a reduction of personnel which meets one of the requirements for severance benefits.

Step 3:

Calculate the tax payable. It is important to remember that the South African Revenue Service applies the aggregation of lump sum principle and therefore the severance benefit and the lump sum from the pension fund has to be added together before calculating the total tax payable. Therefore:

R600 000 + R300 000 = R900 000

Tax payable = R36 000 + 27% of taxable income above R700 000

= (R900 000 – R700 000) x 27% + R36 000

= R200 000 x 27% + R36 000

= R54 000 + R36 000

= R90 000

Nick will receive an after tax payment of R810 000 (R900 000 – R90 000).

Tax on salary, leave pay and bonus

R30 000 (salary) + R20 000 (bonus) + R15 000 (outstanding leave pay)

= R65 000 x 31% (marginal tax rate as indicated above)

= R20 150

Aggregation (applicable to retirement fund lump sum benefits, retirement fund lump sum withdrawal benefits and severance benefits) – Previous lump sums taken

It is important to note that the retirement tax table is cumulative over your life and any of the benefits received (as discussed above) prior to current retirement fund lump sum or severance benefit may have an influence on current tax payable.

Using the same example, but here Nick informs you that he resigned from a previous employer on 1 April 2010 and he took his full pension fund in cash to the value of R400 000. In this instance Step 3 will look as follows:

- **Step 3.1: Calculate the taxable lump sum amount of the current retirement lump sum and or severance benefit:**
  R600 000 (severance pay) + R300 000 (lump sum form pension fund) = R900 000
- **Step 3.2: Identify and add previous amounts received:**
  R400 000 (previous withdrawal from pension fund)
- **Step 3.3: Add the taxable amounts in 3.1 and 3.2:**
  R900 00 + R400 000 = R1 300 000
- **Step 3.4: Calculate the tax payable on the total amount calculated in 3.3 by applying the retirement tax table:**
  Tax payable = R130 500 + 36% of the taxable income above R1 050 000
  = (R1 300 000 – R1 050 000) x 36% + R130 500
  = R250 000 x 36% + R130 500
  = R90 000 + R130 500
  = R220 500
- **Step 3.5: Calculate the "hypothetical" tax payable on the previously taxable withdrawal as calculated in step 3.2. Apply the retirement tax table:**
  Taxed at 0% therefore the "hypothetical" tax payable on the previous withdrawal is R0
- **Step 3.6: Calculate the tax payable by deducted the amount in step 3.5 from the amount step 3.5:**
  R220 500 – R0 = R220 500

Nick will receive an after tax amount of R679 500 (R900 000 – R220 500).

Comparison: Retirement fund lump sum benefits, retirement fund lump sum withdrawal benefits and severance benefits

	Total tax payable	**After tax amount paid to Nick**
Scenario 1: No previous withdrawal	R90 000	R810 000
Scenario 2: Previous withdrawal	R220 500	R679 500

Conclusion

Advisers must note that not all benefits received from an employer on retrenchment may qualify as severance benefits. It is very important to always refer back to the definition of a severance benefit before giving advice to clients.

Further to the above, clients must be advised that severance benefits cannot be transferred tax-free to a retirement fund. The only option is to take the severance benefit in cash. The receipt of a severance benefit will therefore always impact the client's tax payable on future lump sum benefits, future retirement lump sum withdrawal benefits and future severance benefits due to the principle of aggregation.

Advisers should further make mention of the fact that once the client transfers the retirement fund benefits to a preservation fund, and a withdrawal is made from the preservation fund, such withdrawal will be taxed according to the tax table applicable to retirement fund lump sum withdrawal benefits and not the tax table applicable to retirement fund lump sum benefits.

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When do I Need My Spouse's Consent to Transact When Married in Community of Property?

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Introduction

Helen Mirren is quoted as saying: "*The great marriages are partnerships. It can't be a great marriage without being a partnership*".

Marital regimes are governed by The Matrimonial Property Act 88 of 1984 (hereafter referred to as the Act). Marriages in community of property are still the most popular marital regime, mainly due to the fact that clients often do not seek proper advice before getting married and secondly, because the drafting and registration of an ante-nuptial contract can be an expensive exercise.

The concept of marriages in community of property is that spouses are in a "universal economic" partnership and that all their assets and liabilities are combined in a joint estate in which they hold undivided equal shares.[1]

The focus of the article will be on marriages in community of property and the types of consent which can be given by one spouse to the other during the marriage.

Powers of spouses

Spouses in a community of property marriage have the same powers with regards to the disposal of assets and in the joint administration of the estate.[2] Section 15 of the Act however provides that the consent of the other spouse is needed for certain transactions. There are different types of consent and in certain instances it can be given informally. There are however certain acts that can only be performed with the written consent of both the spouses, for example:[3]

- The alienation or burdening of assets in the joint estate, which are kept mainly for investment purposes, such as jewellery or coins;
- The alienation, ceding or burdening of any insurance policies, mortgage bonds, shares or any of the other spouse's investments without their consent;
- Withdrawing money from any account held in the name of the other spouse.

Section 15(4) of the Act[4] confirms that consent can also be given by way of ratification within a reasonable time after such an act has occurred.[5]

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[1] Hogan Lovells What's yours is mine and what's mine is mine. Insurance Law Newsflash 20 September 2018.
[2] Section 14 of The Matrimonial Property Act 88 of 1984.
[33] Section 15(2)
[4] The Matrimonial Property Act 88 of 1984
[5] There is no specific definition in law as to what a reasonable time is, but section 7(1) of the Promotions of Administration Justice Act 3 of 2000 even though not applicable in this case suggest 180 days.

The question however is, what type of consent is needed where one spouse alienates/ donates assets to a third party and what are the implications should there be no consent from the other spouse? Can one also expect a third party to know that consent is needed and, if so, what will be the implication thereof?

Permission needed by spouse for alienation/donation of assets

Section 15(3)(c) of the Act stipulates:

"*A spouse shall not without the consent of the other spouse donate to another person any asset of the joint estate or alienate such an asset without value, excluding an asset of which the donation or alienation does not and probably will not unreasonably prejudice the interest of the other spouse in the joint estate, ……..*".

In determining whether such a donation or alienation will unreasonably prejudice the interest of the other spouse, the court will consider the value of the asset, the reason for the donation/alienation, the financial and social standing of the spouses, as well as their standard of living.[6]

Section 15(9) of the Act provides that any such transaction entered into without the necessary consent is void and unenforceable, unless the third party to the transaction did not know or could not reasonably have known that the transaction was contrary to section 15(2) or (3) of the Act.[7] The purpose of this section is to balance the interests of third parties and the non-consenting spouse.

In Broodie No v Maposa (née Ledwaba) and Others [2018] JOL 39536 (WCC) the facts were as follows:

- The applicant was married in community of property to Mr Broodie since 1967. Mr Broodie died intestate on 4 December 2016. The single biggest asset in the joint estate at the time would have been 100% membership in a close Corporation, Seepunt Eiendomme CC, with a value of approximately R20 million.
- Mr Broodie had a longstanding extramarital relationship with the third respondent, Ms Ledwaba since 1986, and two children were born from this relationship. It is common

[6] Section 15(8) of the Matrimonial Property Act.

[7] L Steyn When a third party 'cannot reasonably know' that a spouse's consent to a contract is lacking. South African Law Journal 119 (2002) p253. In such an instance the contrary to the provisions, it is deemed that the transaction concerned has been entered into with the necessary consent.

knowledge that the customary marriage they entered into was invalid by virtue of his pre-existing civil marriage to the applicant.

- Mr Broodie (deceased) had, during May 2014, transferred a 25% share of the Close Corporation to each of the first, second and third respondents respectively.
- The purpose of the application was to have the registration of the transfer of 75% of the member's interest to the respondents set aside based on various arguments, the most important one for the purposes of this article being that it occurred without the consent of the applicant, thus contravening sub-sections 15(2) and/or (3) of the Matrimonial Property Act.
- The respondents argued before the court that the onus was on the applicant to prove that she did not consent to the transaction, and even if she succeeded in proving this, furthermore had to prove that the respondent was aware that the deceased and the applicant were married in community of property. The argument is objective and needs to be determined with reference to the knowledge that a reasonable person in the position of the respondents would have been expected to have or obtained.
- The respondents further argued that the applicant became aware of the transfer of the shares approximately 6 months before Mr Broodie passed away, and the fact that she did not contest the legality, can be regarded as tacitly consenting to, or ratifying of the donation.
- The court *a quo* ruled in favour of the respondents and based the ruling on the fact that it was not incumbent on the third respondent to investigate the legal character of the deceased's marriage before she accepted the donation. The court also ruled that the respondents' position is protected in terms of section 15(9)(a) of the Matrimonial Property Act, and it is deemed that the donation was made with the consent required in terms of section 15(3).

The case was taken on appeal and before judgement was delivered, Mrs Broodie passed away and was substituted in the proceedings by the executors in her estate.

On appeal, in the matter of Marais N.O. and Another v Maposa and Others [2020] ZASCA 23, the following transpired:

- The Court found that the central issue in this matter is section 15(9)(a) of the Act.
- The third respondent claimed that she did not know that Mr Broodie was married in community of property, nor did she make any enquires into his marital regime. The Judge

referred to Distillers Corporation Ltd v Modise[8] where the statement was made that it is a general principle that the party who asserts a particular state of affairs, has the burden of proof. The Judge further stated that the standard is an objective one, and must be established with reference to the standard of the reasonable person. The Court referred to B van Heerden, A Cockrell and R Keightley, Boberg's Law of Persons and the Family (2 ed) (1999) on p 191, where the following is stated:

"Lack of actual knowledge on the part of the third party is a straight forward enough stipulation and capable of determination. But "cannot reasonably know" is more problematic. It must simply imply that the third party is under some sort of obligation to enquire about the status of the person whom he or she is contracting."

- The respondent's council conceded that she did not enquire about his marital regime.
- The Appeal was upheld as the Judges found that the respondent, whilst knowing that Mr Broodie was married, made no enquires regarding his marital status as a reasonable person would have done. The result was that the member's interest in Seepunt reverted to the joint estate of Mr and Mrs Broodie.

Section 15 of the Matrimonial Property Act and the insurance industry

Section 15(2) of the Act provides that there needs to be written consent to alienate, cede of pledge an insurance policy. The definition of insurance is outlined in Lake v Reinsurance Corporation Ltd[9], in which it is described as "*a contract between an insurer and an insured, in terms of which the insurer undertakes to render to the insured a sum of money, or its equivalent, on the occurrence of a specified event in which the insured has some interest, in return for the payment of a premium*".

The issue of third party beneficiary nominations on life policies where spouses are married in community of property has come up quite often in recent years. As far back as 2011, the Ombudsman in Case CR298[10] had to decide if there was an onus on insurance companies to investigate whether a client, on signing a beneficiary nomination form, was married in or out of community of property. The Ombudsman considered the facts and based his determination thereon that when a policy owner changes a beneficiary nomination, he has to sign a form, and in this matter there was a section where the spouse of a person married in community of property

[8] Distillers Corporation v Modise 2001 (4) SA 1071 (O) par 4.
[9] 1967 (3) SA 124 (W).
[10] CR298 Beneficiary nominations March 2011 www.ombudsman.co.za/topics-cases/beneficiary nominations/insured married in community of property.

had to consent to the change, which was not completed nor signed. It was therefore concluded that under the circumstances the insurer could not have known that the document being signed is in breach of section 15(2)(c) of the Act and it must be deemed that it was completed with the necessary consent.

The Court recently, in Naidoo v Discovery Life and Others (202/2017) ZASCA 88, had to decide on two issues:

(i) Was a life insurance policy considered an asset of the policyholder during his lifetime and, by default then, an asset of the joint estate? and

(ii) Was the nomination of a beneficiary an alienation that required prior written consent of the spouse in terms of section 15(2)(c) of the Act?

The facts of the case were as follows:

- Mr and Mrs Naidoo were married in community of property in 1996. Mr Naidoo effected a life policy on his life and nominated his spouse as the beneficiary for the proceeds upon his death.
- Unbeknown to his spouse in October 2011 he instructed Discovery Life to change the beneficiary nomination from his spouse to reflect his parents, brother and sister. He committed suicide in March 2012.
- Discovery Life paid the proceeds of the policy as per the beneficiary nomination and Mrs Naidoo challenged the validity in terms of section 15(2)(c), as the substitution of beneficiary was done without her prior knowledge or written consent.
- The applicant argued that the rights and obligations under the policy vested in the joint estate, which included the right to nominate a beneficiary, receive payment of benefits and revoke a nominated beneficiary.
- The Court a quo focussed on the contract of life insurance, with the nomination of a beneficiary to the proceeds, being a *stipulation alteri*[11] The court referred to the unreported judgement in PPS Insurance Limited v Mkhabela[12] where it was found that a beneficiary's entitlement to the proceeds of a policy is merely a *spes* until the actual death of the insured, and based on this the policy was not an asset and therefore not an asset in the joint estate.

[11] Contract for the benefit of a third party.
[12] (159/200) [2011] ZASCA 191 (14 November 2011)

- The court went further to characterise the nomination and substitution of beneficiaries as a personal right, and that the substitution would not constitute an alienation of property that requires the spouse's prior written consent.
- The court unanimously held that the nomination of the third party did not constitute an alienation of the policy.
- The case was taken on appeal and once again the applicant failed, based on the same arguments. Both courts came to the same conclusion that upon the death of the insured, the proceeds of an insurance policy owned by the deceased do not fall into either the deceased estate or the joint estate, but go directly to the nominated beneficiaries prior to winding up of the estate.
- The court in this instance held that the wording "*insurance policies*" as found in section 15(2)(c) cannot be read in isolation and must be interpreted with the other financial instruments listed in the section. The court found that there is a clear distinction between insurance policies, which have a current value such as an endowment and retirement annuity that can be surrendered or made paid up, and a pure risk policy such as a life policy. Their conclusion is that a risk-only policy would not constitute an "insurance policy" in terms of section 15(2)c) as it is a contract for the provision of an indemnity in the event of a future risk occurring.

There are different views on the interpretation of the Court in this regard. Harry Joffe[13] welcomes the judgement and supports this on the basis that, when an estate duty calculation is done for a marriage in community of property, pure risk policies are not considered part of the joint estate, unless there is no beneficiary nomination and it is payable to the estate. A policy with a beneficiary nomination is treated as deemed property in the deceased's share of the joint estate only.

Jerome Veldsman and Roxanne Ker feel that the court should have interpreted section 15 as was intended, i.e. to protect a spouse against the alienation of property forming part of the joint estate by the other spouse, without the knowledge or consent of the first mentioned spouse. Their view is that the definition of assets by the Court in the Naidoo judgment as "*property that could be applied to the payment of debts*", is a narrow definition that is inconsistent with South African law in general. They further referred to the definition of "*asset*" in section 1 of the Tax

[13] Insurance & Tax, Volume 33, 3 September 2018.

Administration Act[14], which includes a right or interest of whatever nature to or in property. In this regard they also argued that property in terms of section 1 of the Prevention of Organised Crime Act[15] takes account of "*money or any other movable, immovable, corporeal or incorporeal thing and includes any rights, privileges, claims, any interest therein and all proceeds thereof*". Based on this argument, their opinion is that even if it is correct that Mr Naidoo had a personal right or interest in the policy, such right or interest forms part of their joint estate. Their perception is that interrogation of the future consequences of a particular interpretation of a statue is not part of our judicial tradition.[16]

Conclusion

Apart from understanding the advantages and disadvantages of being married in community of property, clients also need to comprehend what transactions are allowed to be performed without the consent of the other spouse, and in which instances consent is necessary.

Clients need to seek proper advice on the various marital regimes before they get married and decide on one that will suit their specific situation. In this regard it is also important for them to understand the patrimonial consequences of the marital regime that they opt for.

[14] 28 of 2011.
[15] 121 of 1998
[16] J Veldsman and R Ker De Rebus Joint estates: Clarification on the alienation of assets www.derebus.org.za/joint-estates-clarification-on-the-alienation-of-assets

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Estate Planning Considerations for 'Bloody' Estates

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Introduction

A recent increase in family murder cases has gained scores of attention in the media. These murders have implications on the estate of the deceased victims as the offenders were closely related to the victims and the Roman Dutch common law principle of "*de bloedige hand neemt geen erfenis*" would apply. The question that arises is what the implications are for the administration of the estate of the deceased victim(s).

The principle of "*de bloedige hand neemt geen erfenis*"(hereafter 'the bloody hand-principle') is based on the principle that a person who has caused the death of the testator cannot benefit under his will.[1] Even in the case where the beneficiary for example caused the death of the testator indirectly, e.g. by encouraging him to drink to death, the principle will apply.

It is important to note that the offender (beneficiary) must be blameworthy. In *Gaffin v Kavin*[2] a husband who killed his wife and children was not disqualified by the court to inherit from the estate of his wife as he was mentally ill at the time of the killings. Similarly, a son who shot his father while mentally disturbed was entitled to inherit from the father.[3] The bloody hand principle is meant to protect the 'victim' by ruling that the unworthy offender is incompetent to inherit or to take any other benefit of the deceased's estate[4]. What about policies and pension funds where the offender was nominated as beneficiary? What is the position if the offender is a beneficiary of a trust? Does the common law rule include all possible direct or indirect inheritances? This article aims to examine the legislation and case law and find answers as to the scope of the bloody hand-principle.

Pension funds – Section 37C of the Pension Funds Act 24 of 1956

Section 37C of the Pension Funds Act regulates the payment of death benefits. The board of trustees of a retirement fund must ensure that those persons who were dependents of the deceased member are not left destitute, irrespective of whether or not such dependents instituted a claim against the fund,. The primary objectives of the board as set out in Section 37C is to identify and trace "dependents" and those persons nominated by the deceased. This is in order to make benefit allocations based on the principles of fairness and equality, and to determine an appropriate mode of payment of the death benefit in question. What will happen

[1] Meyerowitz 4-10.
[2] 1980 (3) SA 1104 (W).
[3] Ex parte Meier 1980 (3) SA 154 (T).

when a dependent murdered the deceased? Will the bloody hand-principle apply? Is a guilty conviction by a competent court a requirement before trustees can make a decision?

Section 37C(1)(a) & (b) provides as follows:

(1) Notwithstanding anything to the contrary contained in any law or in the rules of a registered fund, any benefit (other than a benefit payable as a pension to the spouse or child of the member in terms of the rules of a registered fund, which must be dealt with in terms of such rules) payable by such a fund upon the death of a member, shall, subject to a pledge in accordance with section 19 (5) (b) (i) and subject to the provisions of sections 37A (3) and 37D, not form part of the assets in the estate of such a member, but shall be dealt with in the following manner:

(a) If the fund within twelve months of the death of the member becomes aware of or traces a dependant or dependants of the member, the benefit shall be paid to such dependant or, as may be deemed equitable by the fund, to one of such dependants or in proportions to some of or all such dependants.

(b) If the fund does not become aware of or cannot trace any dependant of the member within twelve months of the death of the member, and the member has designated in writing to the fund a nominee who is not a dependant of the member, to receive the benefit or such portion of the benefit as is specified by the member in writing to the fund, the benefit or such portion of the benefit shall be paid to such nominee: Provided that where the aggregate amount of the debts in the estate of the member exceeds the aggregate amount of the assets in his estate, so much of the benefit as is equal to the difference between such aggregate amount of debts and such aggregate amount of assets shall be paid into the estate and the balance of such benefit or the balance of such portion of the benefit as specified by the member in writing to the fund shall be paid to the nominee.

Section 37C subsection (1) thus clearly sets out that all death benefits payable by a fund upon the death of a member shall not form part of the assets in the estate of the deceased member, but must be dealt with in terms of section 37C, irrespective of provisions of any other law, including common law, and notwithstanding any rule of a fund that is registered. The wording of the section undoubtedly states that other laws including the common law (where the bloody hand-principle originates) is not to be taken into account when deciding how death benefits should be dealt with. The effect of section 37C can be summarized as follows:

(i) death benefits do not form part of the deceased estate of the member (other than in the limited exceptions set out in the section);
(ii) the member's freedom of nomination of a beneficiary is limited t a certain extent, as it is subject to the provisions of Section 37C;
(iii) the law of intestate succession does not apply;
(iv) death benefits are not subject to the law applicable to marriages; and
(v) the common law does not apply either.

The bloody hand-principle was dealt with in the matter of *Makhanya v Minister of Finance and Others*[5] where the deceased was a member of the government pension fund, a fund which is not regulated by section 37C. The deceased was killed by his wife who was also due to inherit his death benefit according to the specific fund rules. The court stated that the bloody-hand principle "is one of public policy that precludes a person who has unlawfully killed another form acquiring a benefit in consequence of the killing". The Makhanya-case extended the bloody hand-principle to pension benefits and explained that he could "think of no cogent reason why this should be limited to benefits accruing directly from the estate of the victim".

Since the Makhanya-case did not deal with section 37C but with a public sector fund, the following questions remain unanswered: Does section 37C override the bloody-hand common law principle and enable the dependent who wrongfully caused the death of the member to still possibly obtain the deceased's death benefits? Or may the trustees exclude the dependent on the basis of the common law principle? When purely examining the wording of section 37C, as stated above, it is clear that the common law is excluded. It is however submitted that the extension of the bloody hand-principle to include public sector funds in the Makhanya-case is an indication that it could possibly be applied in private sector funds regulated by section 37C on the same basis of reasoning stated by the court, i.e. that there is no reason why the principle should be limited to benefits accruing directly from the estate to the victim.

Assuming that the bloody hand-principle could apply to section 37C, the next question is whether there should be a conviction of the dependent by a competent court or may the trustees declare the dependent unworthy based on other evidence? In *Ferreira v The Master of the High Court*[6] the Master upheld an objection raised with regards to the benefit of an asset to an alleged

[5] 2004 3 BPLR 5514 (D).
[6] 2001 3 SA 365 (O).

unworthy heir, a husband accused of killing his wife. The application was contested by the children of the husband the husband on the basis that there was no guilty conviction or prima facie evidence to prove the husband wrongfully killed the deceased. The court, after examining the powers of the Master[7], held that the Master did not have the authority to make a finding on a question of fact and that the Master therefor did not have the authority to decide whether a heir is unworthy to inherit without the interference of a competent court. It is submitted that if the Master of the High Court may not make such a decision, the board of trustees of retirement fund would, most likely, also not be able to decide that a person is unworthy to inherit because that person wrongfully caused the death of the member, unless a competent court convicted that person. This could mean that the trustees may have to wait for the court to make their decision before the benefits could accrue to someone, which may take many years. The above questions remains unanswered and the issue is, most possibly, going to remain unanswered until new precedents from the courts is set. In my view the offender should not be entitled to obtain benefits from pension funds and the trustees should examine the facts of each case and make a decision on the merits thereof given the powers bestowed on them in terms of section 37C.

Life policy benefits

The position with regards to the payout of life insurance where the beneficiary wrongfully caused the death of the life assured is more certain.

In the case of *Danielz NO v De Wet and others*[8] the wife of the deceased was the sole nominated beneficiary under four life insurance policies on the life of her late husband. The wife had hired and paid two men to assault her husband. The two men then violently assaulted her husband resulting in his death. After the wife had been convicted on the criminal charges against her, she preceded to issue a claim under the life insurance policies from the insurer. The applicant applied for a declaratory order that the wife of the deceased was not entitled to the proceeds of the life insurance policies. The court agreed and the application for a declaratory order to stop the claim on the life insurance policies was enforced.[9] The court made the following statement in paragraph 43 of the judgement:

"It is only after the death of the deceased that the rights in respect of the death benefits arise. The joint estate will therefore not have a claim to an asset that arose after the joint estate had been terminated by the death of the deceased."

[7] In terms of section 35 of the Administration of Estates Act 66 of 1965.
[8] 2008 4 All SA 549 (C)
[9] 2009 (6) SA 42 (C)

The bloody-hand principle was thus extended to life policies where the beneficiary nominated caused the death of the life assured. The policy proceeds will most probably form part of the estate of the deceased that will be dealt with according to their last will and testament.

Matrimonial property – in community of property marriages

In terms of the Matrimonial Property Act 91 of 1986, persons who are married in community of property share all the assets and debts from before the marriage in a joint estate between both spouses. Any assets, debts and liabilities acquired by either spouse after their marriage will then also be added to this joint estate[10]. The spouses are tied co-owners of the joint estate and thus each receives half when the marriage ends. Can the bloody-hand principle be applied to exclude the wrongdoer of his or her share?

In the matter of *Nell v Nell*[11] a wife murdered her husband, to whom she was married in community of property. The husband did not have a valid will and passed away intestate. The question the court had to decide on was whether the wife would be entitled to her half share of the estate by virtue of their marriage in community of property given the fact that she was responsible for the death of the deceased husband. In the decision it was held by the court that there should be a causal link between the crime committed and the benefit and since the murderer does not receive the benefit from the estate of the deceased but from the virtue of their marriage in community of property and her half of the joint estate. The court deemed the wife entitled to benefit from her half of the joint estate but not the life policies where she was nominated as beneficiary.

This decision was later challenged in *Leeb v Leeb*[12]. Judge Thirion respectfully disagreed with the decision in *Nell v Nell* and held that one cannot put the offending spouse in a better position that she was especially in the case of murder than they would have in a divorce. The court confirmed the principle that a person is not allowed to benefit from their own wrongful conduct. Furthermore, the court stated that this is a principle that was based on public policy. It is important to note that the benefits the surviving spouse would forfeit as a result of his or her conduct is the benefits he or she would have received as a result of the death of the other spouse.[13] The court ruled that where one spouse murdered the other in a marriage in community

[10] Chapter III, Martimonial Property Act 91 of 1986.
[11] 1990 (3) SA 889 (T)

[12] 1991 2 All SA 88 (N).
[13] Paragraph E-F.

of property, the court has the power to order the forfeiture of the benefits that the guilty party would have received if they had not murdered the other.[14] Factors that the court will take into account includes fairness, reasonableness and public policy.

Both the *Nell*-case and the *Leeb*-case received criticism from legal writers. Hahlo[15] agreed with the *Leeb*-judgment and granted that there is a causal link between the benefit of the half share and the murder of the deceased. Sonnekus[16], however, believes that the courts should not dilute long standing practices in our law to fit public policy. Du Toit[17] calls for the amendment of the Matrimonial Property Act to include forfeiture provisions similar to those in section 9(1)[18] of the Divorce Act 70 of 1979. It is submitted that an amendment to the Matrimonial Property Act would ensure legal certainty on the basis of fairness, reasonableness and public policy.

Executorship

The Master of the High Court has the sole authority to appoint an executor.[19] There are two kinds of executors namely testamentary and dative. The first is nominated as executor in the will of the deceased and the second is appointed by the Master in the event that no executor was nominated by the deceased. An executor is a beneficiary of an estate despite not directly inheriting from the deceased[20]. The nominated executor may be unworthy to act in such capacity due to the provisions of the Administration of Estates Act[21] or due to an alleged criminal act against the deceased or the will of the deceased. The Master of the High Court may refuse the application or remove an executor once an interested party lodges an objection to the appointment of the particular person as a nominated executor.

In *Marais NO v Botha*[22] the wife of a deceased husband was in the process of being indicted on a charge of conspiracy to murder her deceased husband. The wife bought an application before the court for the condonation of a joint will between herself and the deceased in which

[14] Paragraph H-I.
[15] Hahlo 1976: 376.
[16] Sonnekus 2010: TSAR 1831184.
[17] Du Toit 2012: 147.
[18] When a decree of divorce is granted on the grounds of the irretrievable breakdown of the marriage the Court, under section 9(1) , may make an order that the patrimonial benefits of the marriage be forfeited by one party in favour of the other, either wholly or in part. The court will make a forfeiture order if, having regard to the duration of the marriage, the circumstances which gave rise to the breakdown, and any substantial misconduct on the part of either of the parties, it is satisfied that, if an order for forfeiture is not made, the one party will in relation to the other be unduly benefited.
[19] Section 14, Administration of Estates Act 66 of 1965.
[20] Section 4A(3) of the Wills Act 7 of 1953.
[21] Sections 14 , 22 and 54 of the Administration of Estates Act 66 of 1965.
[22] 2008 ZAWCHC 111.

she was named executor and the sole heir of the joint estate. The learned judge held that it would be against the principle of the bloody hand if the application was to succeed. The judge stated that it would be against public policy for a person to hold office as an executor of a person they stand accused of killing or killed that person[23]. The accused wife was not granted appointment of executorship despite not being convicted at the time the decision. It is therefore submitted that a conviction by a competent court is not necessary to disallow the appointment of an executor.

Trust beneficiaries

A situation may arise where a person who wrongfully caused the death of the deceased, is a beneficiary to a trust that the deceased bequeathed his assets to. A trust is set up for the benefit of the beneficiaries with trustees responsible for managing the trust assets for the beneficiaries' benefit.

Example:

A is the only son of B and C and according to the joint will of B and C, A is the sole beneficiary. Failing him, their entire estate is bequeathed to B's father's inter vivos trust, the XYZ Trust. A was found guilty of the murder of his parents, B and C, and is thus not entitled to inherit according to application of the bloody-hand principle. According to the wishes of B and C the benefits of their estate falls in the hands of the XYZ Trust (B's father and mother are the only trustees). A is one of the beneficiaries of the trust. A's grandparents do not believe that A could have murdered his parents, and as the trustees they have no problem in vesting assets and income in him. Will A in such an instance be entitled to benefit from the trust?

The principle that a person is not allowed to benefit from their own wrongful conduct in causing the death of another can arguably be applied in trusts as well. If a wrongdoer who caused the death of a person does not inherit directly from such person's estate, but is a beneficiary of a trust with vested rights or rights that vest as a result of the discretion exercised by the trustees, it goes against public policy, if such a person benefits indirectly from the estate of the deceased. It is submitted that the if bloody-hand principle is applied to pension funds, life policy nominated beneficiaries, in community estates and the appointment of executorship, it should in a relevant scenario be applicable to trust beneficiaries as well.

[23] PU and others v Ranchod NO and Another 2005 JOL 15767 (ZA).

Conclusion

The bloody hand principle has been adapted and applied from the common law in many instances via legal precedents over the years. There however remains legal uncertainty in respect of certain issues surrounding this principle. Even though the *Makhanya*-case gave rise to legal certainty as to the handling of death benefits in the relevant public sector fund where the dependent murdered the fund member, the answer to the question whether the principle is applicable to section 37 of the Pension Fund Act is not definite.

The basic principle is that a person is unworthy to inherit when their wrongful and blameworthy conduct resulted in the death of the person they are to receive benefits from. The possibility that forfeiture provisions in the Matrimonial Property Act, in respect of the half share in marriages in community of property and the accrual claim in marriages out of community of property with inclusion of the accrual system, should be investigated by taking into account fairness, reasonableness and public policy. This will give clarity as to whether a wrongdoer will forfeit a matrimonial benefit under these circumstances. Clarity on this issue should also be provided for in the Pension Funds Act. It is submitted that legal certainty will assist in preventing unnecessary delays in finalizing the estate of a deceased and the payment of pension benefits. It would also assist in avoiding unnecessary costs that place an additional a burden on families that are already dealing with the murder of a loved one.

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Using Usufructs to Save Tax During One's Lifetime

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Introduction

The use of a usufruct is often used in respect of farm property to ensure the retention of such property in the family beyond generations. Usufructs are also frequently used to provide the right of occupation for a surviving spouse, whilst the bare dominium would usually vest in a major child. One of the reasons for the creation of a usufruct in favour of a surviving spouse is to minimise estate duty on the death of the first dying spouse.

However, usufructs can prove to be a valuable tool in estate planning during a person's life time. This article will explore the proposal of transferring a property to a family trust subject to a usufruct in favour of the transferor (seller).

What is usufruct?

A usufruct is a limited right over the property (asset) of one person given to another subject to bare ownership vesting in a third party. The person granted this limited right is referred to as the usufructuary and the owner of the property (asset) is referred to as the bare dominium holder. The usufructuary has the right to use the property and enjoy the fruits of the property. The usufructuary does not own the property and cannot dispose of the property. The bare dominium holder does not have unfettered ownership and if he/she disposes of the property, the sale will be subject to usufruct and the rights of the usufructuary.

Use of a usufruct on death

Usufructs are often used as a tool to reduce the liability for estate duty. This often occurs where the one spouse bequeaths an immovable property to a major child or trust, subject to right of use in favour of the surviving spouse. This value of the usufruct, in favour of the surviving spouse, will qualify as a deduction in terms of section 4(q) of the Estate Duty Act. The value of the usufruct, and subsequently the section 4(q) deduction, is usually greater than the value of the bare dominium itself, but is dependent on the period that the usufruct is granted for, or if it is a lifelong usufruct, the age of the surviving spouse at death of the first dying spouse.

On the death of the surviving spouse, the property itself does not form part of the surviving spouse's estate, but the value of the usufruct at that stage will constitute property in such spouse's estate. This ensures that there is a limitation of executor's fees and estate duty, as the value of the usufruct in the estate of the surviving spouse will be less than the value of the property.

Let's look at an example: (For the purposes of our example, the effect of capital gains tax will be ignored)

A leaves property worth R5 000 000 to his son C subject to a life-long usufruct in favour of his spouse (a female) 65, age next birthday (a.n.b.).

On the death of A:

Annual value of property: 12% x R5 000 000	= R600 000
Present value of R1 per annum for B's life	= 6,84161
4(q) deduction in A estate's	= R4 104 966

On the death of B:

B dies 10 years later. The value at that stage is R9 000 000. C was 45 when B died.

Annual value of the property: 12% x R9 000 000	= R1 080 000
Present value of R1 per annum for C's life (a.n.b. 46)	= 7,81924
Present value of R1 080 000 per annum for life	= R8 444 779

Value of bare dominium when originally acquired:

R5 000 000 less R4 104 966	= R895 034

Difference between present value and bare dominium when first acquired:

R9 000 000 less R895 034	= R8 104 966

For estate duty purposes the lesser of R8 444 779 or R8 104 966 is used. Therefore, the value of ceasing usufruct is R8 104 966. This is less than the current market value of R9 000 000.

Use of usufruct during lifetime

One way of reducing estate duty is to sell property (assets) to a family trust. The sale of the asset to the trust via a loan account will be subject to section 7C of the Income Tax Act. In terms of section 7C, if the sale is subject to an interest-free or low interest loan (less than the official rate of interest[1]), the difference between the interest charged (if any) and the interest that should be charged at the official rate of interest will be seen as a donation on the part of the seller. Further, the sale will be subject to transfer duty, capital gains tax and conveyancing fees. The value of

[1] As defined in section 1 of the Income Tax Act, 58 of 1962

the outstanding loan account will remain an asset in the seller's estate. The loan account is the sale price being R5 000 000. The seller can donate up to R100 000 the interest and/or capital per annum to the trust.

Example:

A sells his property valued at R5 000 000 to the A Family Trust. This property is not his primary residence. The base cost of the property is R1 000 000. A's marginal rate of tax is 41%. A is 45 years old age next birthday.

The transfer duty will be calculated according to the following table:

Value of the property (R)	Rate
1 – 1000 000	0%
1 000 001 – 1 375 000	3% of the value above R1 000 000
1 375 001 – 1 925 000	R11 250 + 6% of the value above R 1 375 000
1 925 001 – 2 475 000	R44 250 + 8% of the value above R 1 925 000
2 475 001 – 11 000 000	R88 250 +11% of the value above R2 475 000
11 000 001 and above	R1 026 000 + 13% of the value exceeding R11 000 000

The transfer duty payable will be:

= R88 250 + 11% of (R5 000 000 less R2 475 000)

= R366 000

The capital gains tax will be calculated as follows:

= Market value/sale price less base cost

= Less annual exclusion of R40 000

= x 40% inclusion rate

= x marginal rate of tax

The CGT payable will be:

= R5 000 000 – R1 000 000

= R4 000 000 – R40 000

= R3 960 000 x 40%

= R1 584 000

= R1 584 000 x 41%

= R649 440

The conveyancing fees will be about **R62 610.**[2]

One way of reducing this transfer duty and capital gains tax is to sell the property subject to a usufruct in favour of the seller for a limited period of time. This will be usually based on the life expectancy of the seller/usufructuary e.g. if the seller's age next birthday is 45 years old, his life expectancy will be another 25.38 years[3], therefore the usufruct should be less than 25.38 years.

Using the same example above:
A sells his property valued at R5 000 000 to the A Family Trust, subject to a usufruct in favour of A himself.

Annual value of the property: R5 000 000 x 12%	= R600 000
Present value of R1 per annum for A's life (a.n.b. 45)	= 7,863.80
Value of usufruct:	= R4 718 280
Value of bare dominium: R5 000 000 less R 4 718 280	= R281 720

The value of the bare dominium will be used to calculate the transfer duty and it will be **R0** because it is less than R1 000 000 (one only pays transfer duty on the amount above R1 000 000).

The CGT payable will be as follows:

Capital gain on property as a whole: R5 000 000 less R1 000 000	= R4 000 000
Portion of capital gain relating to bare dominium	
[(R281 720/R5 000 000) x R4 000 000)]	= R225 376
Less annual exclusion:	= R40 000
Net Gain	= R185 376
X inclusion rate of 40%	= R74 150
X marginal rate of 41%	**= R30 402**

The cost savings are as follows:

1. Transfer duty – R366 000 (R366 000 less R0)
2. CGT – R619 038 (R649 440 less R30 402)

[2] Law Society of South Africa: Table of Transfer Costs 2020-2021
[3] Section 29 of the Estate Duty Act No 45 of 1955

3. The sale price will be R281 720 (meaning that the loan account is based on this amount). This can be reduced by the seller donating R100 000 each year to the purchaser (also taking the effect of Section 7C into account in this regard).

Conclusion

The sale of a property (asset) to a family trust subject to usufruct in favour of the seller can result in savings in respect of transfer duty, as opposed to a direct sale to a trust. It also results in a reduction in the value of the estate of the seller thereby saving on executor's fees, estate duty, CGT and transfer fees on death of the seller. Where a person who enjoyed a usufruct dies, there is disposal without any value. The usufructuary would suffer a capital loss (no CGT payable). This capital loss may however not be set off against any other capital gains in the estate, unless the property was used for trade purposes (e.g. rental of property instead of personal use).[4] The seller however loses control of the asset.

Further, the disposal of such an asset by the trust will result in a higher CGT liability due to the higher inclusion rate for trusts. The capital gain will be bigger as the base cost in the hands of the trust will be the base cost of the bare dominium when the asset was transferred to the trust (i.e. the base cost will be low).

On termination of the period, the usufruct will cease and the trust will become the owner of the property without any restrictions or limitations. If the usufructuary dies before the termination of the usufruct, the value of the usufruct, calculated over a period of 50 years, will be an asset in the usufructuary's estate. If the usufructuary outlives the period, there will be no value in the usufruct's estate, because the usufructuary ceased to own the limited interest once the period expired.

In addition, the sale of the bare dominium to the trust via a loan account will be subject to section 7C of the Income Tax Act. In terms of section 7C, if the sale is subject to an interest-free or low interest loan (less than the official rate of interest[5]), the difference between the interest charged (if any) and the interest that should be charged at the official rate of interest will be seen as a donation on the part of the seller.[6]

[4] Paragraph 11(1)(b) of the Eight Schedule of the Income Tax Act No 58 of 1962
[5] As defined in section 1 of the Income Tax Act, 58 of 1962
[6] Section 7C of the Income Tax Act No 58 of 1962

One must be mindful of section 5(1)(b) of the Estate Duty Act, if the usufructuary dies before the termination of the usufruct. If the usufructuary dies before the termination of the usufruct, then, for estate duty purposes in respect of the usufructuary's estate the following needs to be adhered to[7]:

(i) The annual value of the usufruct must be ascertained;

(ii) The extent to which the person who becomes entitled to the usufruct (i.e. the bare dominium holder) to the right must be capitalised over the expectation of such person's life (i.e. in the case of a trust over 50 years);

(iii) The capitalised value must be reduced by the amount equal to the consideration paid by the bare dominium holder (i.e. the amount by which the bare dominium was sold to the trust in the example above) plus 6% interest thereon from date of payment to date of death of the deceased;

(iv) The amount ascertained in (iii) must not exceed the difference between full ownership and the value of the bare dominium in the property when such bare dominium was first acquired.

Before implementing this structure, one needs to ensure that the use of the fixed property, age of the proposed the usufructuary and CGT is taken into account. The period selected for the term of the usufruct is also important and should be less than the life expectancy of the seller/usufructuary.

[7] Section 5(1)(b) of the Estate Duty Act No. 45 of 1955

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An Unexpected Event: The Trigger of Transfer Duty

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Introduction

In the words of Margaret Mitchell: "Death, taxes and childbirth! There's never any convenient time for any of them"[1]. One of the taxes mostly overlooked when buying a "first home" is the transfer duty payable on such property. One usually needs to make additional provision for the transfer duty, over and above the conveyancing fees and bond registration fees payable to the transferring attorney.

In this article we will shorty discuss the circumstances in which transfer duty is payable and when an exemption is applicable.

What is transfer duty?

Transfer duty is an indirect tax, payable by the purchaser on the acquisition of **fixed property** situated in South Africa.[2] It is levied in terms of the Transfer Duty Act[3] (hereinafter referred to as "the Act") by the South African government and is paid to the National Revenue Fund.
Section 2 of the Act imposes transfer duty on the **value** of any property **acquired** by a person by way of a **transaction,** or in any other manner. It is based on the value as discussed below. Transfer duty also applies where the value of immovable property is increased because:

- another person renounces an interest in the property; or
- a restriction on the use or disposal of a fixed property is renounced by another person.

The rate of transfer duty is set out in section 2 of the Act, and the rates apply to both natural persons and legal entities. There is therefore no difference in transfer duty payable whether a natural person, company or trust acquires fixed property.

Transfer duty has to be paid within 6 months of the date of acquisition of the property. It is not the actual transfer of the property which is the transaction, once an agreement has been entered into, a transaction has taken place the transfer duty is payable.

[1] Movie: Gone with the Wind, directed by Victor Flemming
[2] Notes on South African Income Tax 36th Edition, Phillip Haupt at page 970
[3] Act No. 40 of 1949

The current transfer duty rates, for the 2020/2021 tax year is as set our below:

VALUE OF PROPERTY	TRANSFER DUTY TAX RATE
R 0 – R 1 000 000	0%
R 1 000 001 – R 1 375 000	3% of the value above R 1 000 000
R 1 375 001 – R 1 925 000	R 11 250 plus 6% of the value above R 1 375 000
R 1 925 001 – R 2 475 000	R 44 250 plus 8% of the value above R 1 925 000
R 2 475 001 – R 11 000 000	R 88 250 plus 11% of the value above R 2 475 000
R 11 000 001 and above	R 1 026 000 + 13% of the value above R 11 000 000

Property

As previously mentioned, transfer duty is payable by the purchaser on the **acquisition** on the **value** of **fixed property** situated in South Africa. Firstly, we need confirm whether a "**property"** falls within the definition of property for purposes of the transfer duty. Property is defined in Section 1 of the Act, which means land in the Republic of South Africa and any fixtures thereon, and includes:

(a) any real right in land excluding a mortgage bond or a lease of property other than those mentioned in (c);

(c) any right to minerals and a lease or sub-lease of such right;

(d) a share or member's interest in a residential property company;

(e) a share or member's interest in a holding company if that company and all its subsidiary companies qualify as residential property companies; and

(f) a contingent right to residential property or the above-mentioned share or member's interest held by a discretionary trust. This category only applies if the acquisition of the contingent right is

(i) a consequence of, or attendant upon, the conclusion of any agreement for consideration with regard to property held by a trust;

(ii) accompanied by the substitution or variation of that trust's loan creditors, or by the substitution or addition of any mortgage bond or mortgage bond creditor; or

(iii) accompanied by the change of any trustee of that trust

Below are practical examples of when transfer duty will be payable, on various types of property as defined in section 1 of the Act:

Example 1 – Real right

Mr. Joshua died on 1 July 2018. In his will he bequeathed his holiday home in Cape Town, valued at R 7 000 000, to his son James subject to a usufruct in favour of his wife, Joslin. James wants to buy a farm but needs to provide security for the purchase price. His mother, Joslin, decided to donate her usufruct in the holiday home in Cape Town to her son James so that he can obtain unencumbered ownership of the property, which will enable him to use the holiday home as security. The value of the property at the date of donation was R 7 800 000 and the value of her usufruct is calculated at R 5 934 631.

Transfer duty will be payable by James on the transfer of the usufruct, which is valued at R 5 934 631, at the rate set out in section 2 of the Act.

It is therefore important to note that, for transfer duty purposes, the definition of property includes any real right in property. This means that transfer duty is payable on the transfer of a usufruct in fixed property, or on the transfer of a bare dominium in fixed property. According to SARS, even the transfer of a *'usus'* (meaning the right to use) or *'habitatio'* in fixed property (meaning the right to occupy fixed property) is subject to transfer duty[4].

Example 2 – Residential property company

Peter and Steven started a partnership, Do It Your Self Hardware, in 2009 which is mainly a business selling hardware products. They are equal partners in the business. In 2011 they each bought a 50% share in a private company, P & S (Pty) Ltd. The only assets in P & S (Pty) Ltd was a business building from which the hardware shop was operating. In 2017 P & S (Pty) Ltd bought an apartment on the beachfront of Durban. The company is not conducting an enterprise for VAT purposes and the apartment is used exclusively for the leisure of the shareholders. Steven wants to retire and decided to sell his share in Do it Your Self Hardware partnership and his 50% shares in P & S (Pty) Ltd to Peter. The only assets in P & S (Pty) Ltd is the business building with a fair value of R 5 000 000 and the holiday apartment with a fair value of R 8 000 000. There are no liabilities in P & S (Pty) Ltd except a shareholder's loan of R 3 000 000 owed to Steven.

[4] Notes on South African Income Tax 36th Edition, Phillip Haupt

Firstly, it must be determined what constitutes **"residential property"** as defined in section 1 of the Act. The definition of **"residential property"** in the Act is as follows:

"residential property" means any dwelling-house, holiday home, apartment or similar abode, improved or unimproved land zoned for residential use in the Republic, other than –

(a) an apartment complex, hotel, guesthouse or similar structure consisting of five or more units held by a person which has been used for renting to five or more persons, who are not connected persons, in relation to that person; or

(b) any "fixed property" of a "vendor" forming part of an "enterprise" all as defined in section 1 of the Value-Added Tax Act[5].

According to the definition above, only the holiday apartment will constitute residential property for purposes of transfer duty.

Secondly, it must be determined whether P & S (Pty) Ltd, which owns a business property to the value of R 5 000 000 and a residential property to the value of R 8 000 000, falls under the ambles of a "**residential property company"** as defined in section 1 of the Act.

In the Act, **"residential property company"** is defined as:

"any company that holds property that constitutes residential property or a contingent right contemplated in paragraph (f) of the definition of property, and where the fair value of that property or contingent right comprises more than 50% of the market value of all assets (other than financial instruments or any coin made mainly from gold or platinum), held by that company on the date of acquisition of an interest in that company."

In terms of the above example, P & S (Pty) Ltd will fall under the ambles of a "residential property company as residential property constitutes more than 50% of the value of property owned by the company. Transfer duty will therefore be payable on the fair value of all residential properties of the P & S (Pty) Ltd, ignoring any loan obligations. The fair value of the residential property in P & S (Pty) Ltd is R 8 000 000. Peter is therefore liable for transfer duty equal to 50% of the value of the transfer duty on R 8 000 000, at rate set out in section 2 of the Act if he buys Steven's 50% shareholding in P & S (Pty) Ltd.

[5] Act No. 89 of 1991

It is therefore concluded that the purchase of a share or interest in a company or close corporation is subject to transfer duty, if the company or close corporation is a residential property company as defined in the Transfer Duty Act.

Example 3 – A contingent right to residential property held by a discretionary trust[6]

Mr and Mrs S are the trustees of a discretionary trust known as S Family Trust, which owns a residential property. On 1 May 2019, Mr and Mrs S enter into a contract with Mr and Mrs T in terms of which-

- Mr and Mrs S will resign as trustees of S Trust and will be replaced by Mr and Mrs T;
- Mr and Mrs T will acquire the loan account due by the trust, being R 5 000 000; and
- Mr and Mrs T will pay R 4 000 000 for the appointment of their three children as beneficiaries of the trust.

Firstly, we need confirm whether a contingent right falls under the definition of "**property"** in Section 1 of the Act. Section 1(f) of the Act reads as follows:

"*1(f) a contingent right to residential property or the above-mentioned share or member's interest held by a discretionary trust. This category only applies if the acquisition of the contingent right is*

i. a consequence of, or attendant upon, the conclusion of any agreement for consideration with regard to property held by a trust;

ii. accompanied by the substitution or variation of that trust's loan creditors, or by the substitution or addition of any mortgage bond or mortgage bond creditor; or

iii. accompanied by the change of any trustee of that trust"

It is therefore clear from the definition above that a consideration for the contingent rights in a trust falls within the definition of "property" in section 1 of the Act. However, the consideration (which is R 4 000 000) payable to the beneficiaries for the contingent rights in the trust is less than the fair value of contingent right on the trust property, which includes the acquiring the loan account of R 5 000 000 and the R 4 000 000 consideration payable to the beneficiaries. In terms of the definition above, the transfer duty is payable on the "fair value" of the property, ignoring any loan liabilities.

[6] Notes on South African Income Tax 36th Edition, Phillip Haupt

Each beneficiary (three children of Mr and Mrs T) must each based on the above pay transfer duty equal to 1/3rd of the transfer duty calculated on R 9 000 000 at the rate set out in section 2 of the Transfer Duty Act.

Value

The next element that needs to be discussed is the term **"value"**. As transfer duty is payable on the higher of the following values in respect of the acquisition of "property":

- The amount of the consideration payable;
- The "declare value"
- The "fair value" (fair market value)[7]

If the commissioner is of the opinion that the consideration payable, or the declared value, is less than the fair value of the property in question, the Commissioner may determine the fair value of that property. The duty payable must then be calculated on the greater of the fair value as so determined or the consideration payable or the declared value as at date of acquisition.

If the fair value of property as determined by the Commissioner exceeds the amount of consideration payable or the declared value in respect of that property by more than one-third, then the valuation costs (as payable to the valuator or other person appointed by the Commissioner) paid to determine such fair value must be paid by the person liable for the payment of the duty, otherwise it must be borne by the state.[8]

The following amounts are required to be added to the consideration paid for property:[9]

a) Any commission or fees paid or payable in respect of the property by the person who acquired the property.
b) If the property has been acquired by the exercise of an option to purchase or a right of pre-emption, any consideration paid or payable by the person who has acquired the property to any person in respect of the said option or right of pre-emption.
c) Any consideration which the person who has acquired the property has paid or agreed to pay to any person whatsoever in respect of or in connection with the acquisition of the property, over and above the consideration payable to the person from whom the property

[7] Section 5 of the Transfer Duty Act
[8] South African Financial Planning Handbook 2018, M Botha, L Rossini, W Geach, B Goodall, L du Preez & P Rabenowitzi
[9] Section 6 of the Transfer Duty Act

was acquired, other than any rent payable under a lease or sub-lease by the cessionary thereof.

Example 4 – What constitutes fair value?

Mr D bought a holiday apartment in 2013 for R 3 500 000. After his retirement and on advice of his estate planner he decided to sell the property to his only child Peter. In terms of the purchase agreement the amount of the consideration payable (purchase price) for the property was the amount of R 2 500 000. The commissioner was of the opinion that the consideration payable was less than the fair value of the property. The fair value of the property as determined by the person that was appointed by the Commissioner was R 4 100 000.

Although the consideration payable by Peter is R 2 500 000 the transfer duty payable is based on the higher of the amount of the consideration payable or the fair value. Peter will therefore be liable for the transfer duty on R 4 100 000 at the rate set out in section 2 of the Act. Peter will furthermore be liable for the valuation costs on valuation of the property due to the fact that the value of property, as determined by the Commissioner, exceeds the amount of consideration payable in respect of the property by more than one-third.

Acquired

There is no definition of **"acquire"** in the Transfer Duty Act. We are therefore reliant on to legal precedents in the form of case-law to provide us with an interpretation, for example[10]:

- In *CIR v Freddies Consolidated Mines Ltd.*[11] it was held that the word "acquired" meant the acquisition of 'a right to acquire the ownership of property'. It is not the transfer of the property which gives rise to the duty. It is the acquisition of the personal right by the purchaser against the seller which gives rise to the transfer duty obligation.
- In *SIR v Hartzenberg*[12] Botha JA confirms this view. He says that transfer duty becomes payable upon the acquisition by a person of a personal right to obtain dominium in immovable property.

[10] Notes on South African Income Tax 36th Edition, Phillip Haupt
[11] 1957 (1) SA 306 (A)
[12] 1966 (1) SA 405 (A)

The date of acquisition in the case of the acquisition of property by way of a transaction is the date on which the transaction was entered into, irrespective of whether the transaction was conditional or not.[13] In other words, it is the date that the last contracting party signed the agreement. As mentioned above, transfer duty has to be paid within 6 months of the date of acquisition of the property.

Example 5 – Payment of transfer duty

If a conditional agreement to purchase property is entered into on 1 Jan 2019, the transfer duty has to be paid by 30 June 2019, even if the condition has not been met by that date. Assume that the condition is only met by 30 November 2019 and transfer takes place on 15 January 2020, at which date the transfer duty is paid.

Even though the condition is only met by 30 November, penalty interest runs from 30 June 2019. The interest is payable at a rate equal to 10 per cent per annum, calculated in respect of each completed month in the period from the date it should have been paid to the date of payment[14].

Successive transactions

If the purchaser of a property, before taking transfer cedes its rights to take transfer of property to a third party, then section 14 of the Deeds Registry Act[15] requires that the transfers follow the sequence of transactions.

In the case of *Ex Parte Brucken*[16] *it was said:*

"Section 14 of Act 47 of 1937 (The Deeds Registry Act) provides that transfers of land shall follow the sequence of the successive transactions in per pursuance of which they are made and it shall not be lawful to depart from such requirements in recording in any deeds registry any change of ownership in such land".

The fixed property would therefore need to be transferred to the first purchaser and then to the third party purchaser. Both transactions from the original seller to the first purchaser and from the

[13] As per the definition of "date of acquisition" contained in Section 1 of the Transfer Duty Act
[14] Section 4(1A) of the Transfer Duty Act
[15] Act 47 of 1937
[16] 18 SATC 176 - 1952

first purchaser to the third party purchaser would be subject to transfer duty. If there was an agreement for the acquisition of property, the payment of transfer duty must be made whether or not the property was transferred into the name of the purchaser[17].

Example 6 – Double transfer[18]

Mr E buys a business building from Mrs H for R 6 000 000. Before taking transfer of the property, Mr E's accounted says that he should have put the building into his Family Trust. Mr E therefore cedes his right to take transfer of the property to the E Family Trust for an amount of R 200 000. He tells Mrs H he has ceded his right to take transfer to the E Family Trust, so the trust pays Mrs H R 6 000 000 directly, and pays Mr E R 200 000

Mr E must pay transfer duty on R 6 000 000 at the rate set out in section 2 of the Transfer Duty Act.

Transfer duty is also payable by The E Family trust on R 6 200 000 at the rate set out in section 2 of the Transfer Duty Act.

Transfer duty is therefore payable by both Mr E and the E Family Trust, because there is effectively a double transfer.

Cancelled transactions

No transfer duty is payable if the sale to the first purchaser is cancelled, provided that the seller is then free to sell the property to anyone and the first purchaser does not receive any compensation for the cancellation and it is as if no transaction has been entered into. If the first purchaser receives any payment for the cancellation, then the sale to that purchaser is not cancelled *ab initio* and the cancellation is effectively a 'transfer" by the first purchaser back to the seller. Section 5(2) of the Transfer Duty Act does not set a time period within which the sale must be cancelled. It must merely be cancelled before registration of the acquisition in the deeds registry.

[17] Wildrice Investments (Pty) Ltd v CIR 48 SATC 145 at 152, 1986 (T)
[18] Notes on South African Income Tax 36th Edition, Phillip Haupt

Exemptions from transfer duty

Below are some of the exemptions applicable to transfer duty:

- There is a total exemption from transfer duty on property acquired by an heir or legatee on the death of the owner of that property. It is important to note that this exemption extends to the redistribution of the assets[19].

Example:

B bequeaths his holiday house in Mossel Bay to the value of R 2 500 000 and a cash amount of R 2 500 000 to his son, C, and his daughter, D. C and D enters into a redistribution agreement, whereby C will inherit the fixed property and D will inherit the cash amount. There will therefore, due to section 9(1)(e), of the Act be no transfer duty payable on the transfer of the fixed property to C.

- No transfer duty is payable with regards to fixed property acquired by a company in terms of a corporate restructuring as envisaged in section 42 (so called assets-for-shares transactions), 43, 44, 45, or 47 of the Income Tax Act[20].

Example:

XYZ (Pty) Ltd is owned by ABC Trust. ABC Trust also owns a fixed property to the value of R 5 000 000. ABC Trust and XYZ (Pty) Ltd enters into a section 42 transaction, whereby the fixed property is to transferred to the Trust in exchange for shares. There will be no transfer duty payable on the transaction if it complies with all the requirements as set out in section 9(1)(l) of the Act.

- There is a total exemption from transfer duty when property is acquired from a spouse as a result of dissolution of the marriage (divorce), regardless of the marriage regime (including civil unions or same-sex partnerships).
- There is a total exemption from transfer duty when spouses get married in community of property.
- If a sale of fixed property is subject to VAT[21], even if the sale is zero-rate for VAT purposes, it is exempt from transfer duty.

[19] Notes on South African Income Tax 36th Edition, Phillip Haupt
[20] Act 58 of 1962
[21] Section 9(15) 9(15)

- Trust property transferred by the administrator of a trust to persons entitled thereto under the will or other written instrument (which implies to be the "Trust Deed") is exempt from transfer duty if[22]:

  (i) The trust is a testamentary trust and the property is going to the person who is entitled to it under the will (in terms of which the trust was set up); or

  (ii) The trust is an *inter vivos* trust and the property is being transferred to a relative of the person who founded (set up or created) the trust (provided that the relative is a beneficiary of the trust). This exemption is only applicable if the relative pays no consideration (directly or indirectly) to acquire the property.

Example 1:
D bequeaths his residential property to his son F, who is 10 years of age. The will specifies that if his son is younger than 21 years of age on his date of death, that the inheritance for F, must be held in trust until he reaches the age of 21. If D passes away today, there will be no transfer duty payable on the transfer of the property to the trust in terms of section 9(1)(e) of the Act (inheritance), and there will furthermore be no transfer duty payable in terms of section 9(4)(b) of the Act on the transfer of the property from the trust to F, when he reaches the age of 21 (property vesting from a testamentary trust).

Example 2:
D created a trust *inter vivos* with his children as the beneficiaries. The trust owns various fixed residential properties which is currently being occupied by his children. The trustees of the trust, decides to vest the residential properties as occupied by a child in such a child. There will be no transfer duty payable in terms of section 9(4)(b) of the act, as the children are related to the creator of the trust, they are beneficiaries to the trust, and they did not pay any consideration to acquire the property.

It is important to note that the exemption as mentioned above are only a few of the exemptions provided for in the Act.

[22] Notes on South African Income Tax 36th Edition, Phillip Haupt

Conclusion

It is therefore clear from the above that transfer duty can sometimes be payable in the most unexpected instances, whether the client is a first-time home owner, a son buying a property from his father or a business partner buying shares in a company owning fixed property. It is important for financial advisors to take into consideration the technicalities which might lead or not lead to transfer duty being payable.

Financial Advisors should always bring to their clients' attention the possibility of extra costs in transfer duty associated with transfer of property, shares and/or any other right as defined in the Transfer Duty Act[23] when advising them during the estate planning process. This is of importance if such advice entails the transfer of certain assets from one entity or individual to another, which might require additional liquidity to settle the possible transfer duty.

If uncertain, clients can always consult their conveyancer to confirm whether transfer duty is payable on the acquisition or transfer of assets. This will enable their client to make sufficient provisions so that the transfer duty can be settled within the time frames as specified, to ensure that no penalties are incurred due to late payment.

[23] Act No. 40 of 1949

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