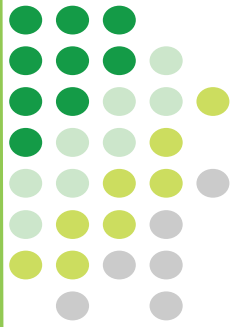




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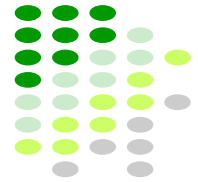
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Heartfelt gratitude is extended to Juta and Company (Pty) Ltd for their sponsorship towards the Literary Award prizes.

Premiums & Problems Literary Award



The recipient of the
Premiums & Problems Article Edition
Literary Award for 2024 is

Stephan Van Zyl

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For the contribution titled

Does a Sinking Fund Policy Form Part of a Deceased Estate For Accrual Purposes?

In reaching their decision, the judges have considered 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.



Premiums & Problems Rising Star Literary Award

The recipient of the
Premiums & Problems Article Edition
Rising Star Literary Award for 2024 is

Nadine Braaf

Legal Advisor: Personal Finance Cape Region



For the contribution titled

The Influence of the Beneficiary When Amending a Trust Deed

The Rising Star Award is awarded to a debutant legal advisor author, who despite being a newcomer to our dynamic industry, has taken the bold step to make a positive and enlightening contribution to the financial services industry. The judging criteria included legal accuracy and research, relevance to our industry and advice givers, and the originality of the article topic. We wish to commend and acknowledge all our Rising Star Contributors for 2023/2024.



Contents

General

The Independent Trustee: Mandatory or Optional? M. Rifaat Jarodien	A1 – A13
Security Cessions: Death of Cessionary Tarryn Miles	A14 – A20
The Responsibility of Being a Trustee of a Trust Madeleine Britz	A21 – A32
The Influence of the Beneficiary When Amending a Trust Deed Nadine Braaf	A33 – A40

Estate Planning

Antenuptial Contract: Marriages Subject to the Accrual Daleen Harris	B1 – B10
Mindful Planning: Practical Considerations for Mental Incapacity In Estate Planning Eugene Mpikwane	B11 – B19
The Feasibility of Using a Trust as a Tax and Estate Planning Mechanism Jothi Chirkoot	B20 – B29
The Section 4(b) Deduction and Sureties Petri Lourens	B30 – B34
The Impact of Divorce on the Provisions of a Will: A Guide for Estate Planning Ndumiso Ntshangase	B35 – B43
The Global Family: Estate Planning Consideration Nevetha Maharaj	B44 – B54

Retirement Planning

Retirement Annuity Funds <i>De Minimis</i> Thresholds – A Summary Charlotte Malan	C1 – C5
Nominating a Trust as a Beneficiary on a Living Annuity Carl Muller	C6 – C11

Disallowed Contributions: Pro's, Cons, and Considerations C12 – C18
Nitasha Raga

Retirement Fund Death Claims in Unregistered Customary Marriages C19 – C27
Siziphiwe Yuze

Income Tax

**Taxation of a South African Tax Resident Earning Foreign Employment
Income and Contributing into a South African Retirement Fund** D1 – D15
Godwin Magosha

Investment Planning

Foreign Pension Trusts: Important Considerations BCR 080 E1 – E6
Monica Moodley

**Does a Sinking Fund Policy Form Part of a Deceased Estate for
Accrual Purposes?** E7 – E13
Stephan Van Zyl

Business Assurance

**Comparisons of Different Taxes Applicable Between a Traditional
Buy-and-Sell Agreement and a Share Buy-Back Agreement** F1 – F16
Chris Du Plessis

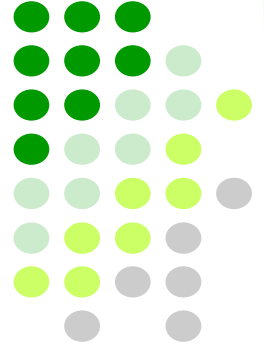
Revision of Buy-And-Sells: Considerations for the Financial Planner F17 – F27
Suzelle Jooste

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General

The Independent Trustee: Mandatory or Optional?



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Introduction

The trust, especially the discretionary inter vivos trust, has gained much popularity as an effective protection vehicle against the claims of creditors, a divorcing spouse, and or a prodigal loved one. The many advantages that a trust ostensibly holds to both the trust founder and trust beneficiaries cannot be denied provided the trust is correctly administered and trust property correctly managed.

Case law abounds with examples where estate planners misunderstood the functioning of the trust and where trustees were neglectful or oblivious to their responsibilities to both the trust assets and the trust beneficiaries. While the blurred line between legal ownership and management by the trust founder and or trustees eventually led to the proposition for an independent trustee it remains debatable whether this "new requirement" is firstly new and, secondly, whether such independent appointment will prevent the abuse of the trust form.

While various types of trusts can be established the focus of this article will seek to show that the independent decision-making of a trustee, as part of its fiduciary responsibility towards the trust and all trust beneficiaries, was always mandatory if one reviews the role and office that a trustee occupies.

The law on trusts

The law on trusts in South Africa is still in the process of development and cannot be found in one Act or statute but in various pieces of legislation, as well as our common law.¹

The Trust Property Control Act² (hereinafter the "Act"), while often considered the primary statute on the law of trusts, seeks, in terms of its preamble, only to regulate the control of trust assets and to provide for matters connected thereto.

In terms of section 1 of the Act, a "trust" is

"the arrangement by 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 a 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,

¹ Pace and Van der Westhuizen. 2022: B2

² Act 57 of 1988.

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 No 66 of 1965)."

Section 1 of the Act defines the word "trust instrument" as "a written agreement or a testamentary writing or a court order" for the establishment of a trust.

The word "trust" is further explained by the Income Tax Act³ as follows:

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

A "trust", in essence, is, therefore, an arrangement or agreement in writing between the trust founder and trustees, or in terms of a court order, whereby one person's property is transferred (whether in terms of a sale agreement or in terms of a donation) or bequeathed in terms of a Will to a trustee(s) or to a beneficiary(ies) but such property is to be controlled and managed by the trustee(s) for the benefit of the identified (or identifiable) trust beneficiaries.

The position of a trustee

The Act makes it clear that a trust is a written agreement characterised by the legal transfer and control of assets, whether by way of a sale or donation, to one or more trustees for the benefit of identified or identifiable beneficiaries in terms of a trust instrument; such instrument includes a trust deed in the case of a living (inter vivos) trust, in terms of a testamentary provision in a Will, or in terms of a court order.

The Act⁴ defines a "trustee" as follows:

"Trustee" means any person (including the founder of a trust) who acts as trustee by virtue of an authorization under section 6 and includes any person whose appointment is already of force and effect at the commencement of this Act."

Section 9(1) of the Act explains the responsibility of a trustee in the following lines:

"A trustee shall in the performance of his duties and the exercise of his powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another."

While the office of trustee is governed by the Act and by the Income Tax Act, our courts⁵ has explained in great detail that a trustee occupies a fiduciary position in relation to the trust property and the trust beneficiary. This fiduciary position requires a trustee, in terms of legislation, to exercise his duties with the utmost care, diligence and skill as can be expected from any reasonable person who manages the affairs of another. This care, diligence and skill is expected to be of a much higher standard if such trustee is a professional person who

³ Section 1 of Act 58 of 1962

⁴ Section 1 of the Act

⁵ Pace and Van der Westhuizen. 2022: 6.2

presents himself as having the requisite knowledge and experience in law and financial matters.⁶

The court in *Griessel v De Kock*⁷ reiterated this important fiduciary relationship between the trustees and trust beneficiaries when it remarked:

"The role of a trustee in administering a trust calls for the exercise of a fiduciary duty owed to all the beneficiaries of a trust, irrespective of whether they have vested rights or are contingent beneficiaries whose rights to the trust income or capital will only vest on the happening of some uncertain future event."

Not only does the Act seek to establish control over trustees but it also seeks to protect third parties in their dealings with representative trustees, as evidenced in the *Land and Agricultural Bank of South Africa v Parker & Others*.⁸

Land and Agricultural Bank of South Africa v Parker

The *Land and Agricultural Bank* case concerned, in essence, the question of whether the actions of a sub-minimum of trustees can bind a trust. In instant case, the trust deed provided that there should always be a minimum of three trustees. While only two trustees were in office, the trustees bound the trust as surety for purposes of a loan from a bank. Failing to honour the terms of the loan agreement, the bank acted upon their surety agreement and obtained a provisional sequestration order against the trust. The trust, in turn, raised the defence that the two trustees had no authority to enter into a loan agreement or to bind the trust as the minimum number of trustees was not in office to enter into such agreement.

Judgment, as delivered by Cameron JA, not only confirmed that a trust must be administered as prescribed in the trust deed but also confirmed that where there are fewer than the prescribed trustees in office, any action on behalf of the trust is invalid. Cameron JA further reiterated that the potential for the abuse of the trust form exists where the trustees are also the trust beneficiaries as no functional separation of ownership and enjoyment of trust property exists.

In the words of Cameron JA in para 20:

"The core idea of the trust is the separation of ownership (or control) from enjoyment. Though a trustee can also be a beneficiary, the central notion is that the person entrusted with control exercises it on behalf of and in the interest of another."

Cameron JA further explained in para 22:

"...enjoyment and control should be functionally separate. The duties imposed on trustees, and the standard of care exacted of them, derive from this principle. And it is separation that serves to secure diligence on the part of the trustee...The same separation tends to ensure independence of judgment on the part of the trustee – an indispensable requisite of office ..."

⁶ *Durr v ABSA Bank Ltd* [1997] 3 All SA 1 (SCA) at page 63

⁷ 2019 ZASCA 19 at para 19

⁸ 2005 (2) SA 77 (SCA)

So while a trustee can be a trust beneficiary, such trustee should not be the only trust beneficiary as it is the “separation of control and enjoyment” that secures the diligence and independence of a trustee in dealing with trust property.

But as so often happens in the case in family trusts, the respondents in this matter were the trustees and also the trust beneficiaries. So, in order to curb future abuses Cameron JA made the following suggestion in para 35:

“The debasement of the trust form evidenced in this and other cases, and the consequent breaches of trust this entails, suggest that the Master should in carrying out his statutory functions ensure that an adequate separation of control from enjoyment is maintained in every trust. This can be achieved by insisting on the appointment of an independent outsider as trustee in which (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another.” (Highlighted emphasis my own).

The call for the independent trustee

The objective independence of every trustee is not new to the law on trusts. However, owing to the failure of some trustees to comprehend the import of section 9(1) of the Act in light of prior court decisions on the duty of every trustee, an implementation change was needed.

This “implementation change”, as suggested by Cameron JA in *Land and Agricultural Bank of South Africa v Parker & Others*⁹, was for the appointment of an “independent outsider” as trustee.

Following the above suggestion of Cameron JA, the Chief Master of the High Court issued a Directive in March 2017 for the appointment of an independent trustee.¹⁰ Thus the notion of an independent trustee came about.

Chief Master’s Directive 2 of 2017

Under point 3.8 of the Directive, the Master of the High Court (“the Master”) must consider appointing an independent trustee when the trust is registered for the first time and the trust deed reflects that it is a “family business trust”.

Whereas the Act does not provide for prescribed qualifications to be held to be a trustee, the Directive provides that an “independent trustee” should hold the following qualities:

- a) Must be an independent outsider who fully understands the responsibilities placed on trustees.
- b) Such an outsider need not be a professional person but he/she must be knowledgeable about the law of trusts.
- c) Must be competent to scrutinise and check the conduct of his/her fellow trustees.

⁹ 2005 (2) SA 77 (SCA) at para 35

¹⁰ https://www.justice.gov.za/master/m_docs/2017-02_CHM-directive.pdf [accessed 23 May 2023].

- d) Would not have any interest in the trust property as a beneficiary.
- e) Has no family relation or connection, blood or other, to any of the existing or proposed trustees, beneficiaries, or founders of the trust.
- f) Is not disqualified under the Trust Property Control Act from acting as a trustee.
- g) Has knowledge and experience in the field of business in which the trust operates.
- h) Must be aware that failure to observe the duties of an independent trustee exposes him/her to personal action for breach of trust, and such an individual accepts such risk.

From the above Directive we learn that the requirement of an “independent outsider as trustee” is only applicable to a trust which is registered after 6 March 2017 (being the date of the Directive) and that such trust must be a “family business trust”.

A “family business trust” is defined by the Directive as follows:

- a) a trust where the trustees have the power to contract with third parties,
- b) trustees are beneficiaries of the trust, and
- c) the beneficiaries are related to each other.

The above Directive further provides that an independent trustee is not mandatory in all trusts all the time, as the requirement for an “independent outsider” can be dispensed with by the Master under the following circumstances:

- a) Where the founder shows good cause to dispense with the appointment of an independent trustee;
- b) Where security to the satisfaction of the Master is provided; or
- c) Where the trust financials are to be audited annually and the auditor must inform the Master should any potential harm to any creditor be likely.

Despite the above Directive, it must be noted that the Master may remove an existing trustee as well as to appoint a trustee to an existing trust.

The role of the Master of the High Court in the appointment of trustees

There is currently no limit on the number of trustees that may be appointed to oversee, control and manage trust assets on behalf of trust beneficiaries.¹¹ While the Master has no common law power to assign trustees, section 7 of the Act does empower the Master to make such further appointments.¹²

Section 7(2) of the Act provides as follows:

“When the Master considers it desirable, he may, notwithstanding the provisions of the trust instrument, appoint as co-trustee of any serving trustee any person whom he deems fit.”

¹¹ Pace and Van der Westhuizen. 2022: 6.2.1

¹² Pace and Van der Westhuizen. 2022: 6.2.3

The Chief Master's Directive of 2017¹³ also provides that where no provision is made for the appointment of an independent trustee, and the Master deems it necessary for such appointment, the Master should consult the founder, existing trustees, and beneficiaries with vested rights to the trust assets for nominating such independent trustee.

Such nominations by the founder, trustees, and beneficiaries are, however, not absolute and the Master can, in exceptional circumstances, dispense with such nomination and appoint another person deemed more suitable as an independent trustee.

As held by *Wiid & Others v Wiid & Others*¹⁴, a trustee can validly be removed from office where there is a clear conflict of interest and where trustees fail to act independently.

*Price and Another v Kaplan and Others*¹⁵ reiterated the fiduciary responsibility owed by each trustee and their independent decision-making, by stating the following:

"...a trustee must always exercise an independent discretion..."

Failure on the part of trustees in upholding their fiduciary duty led Navsa JA in *Fikiswa Fesi and Another v The trustees elect of the Ndabeni Communal Property Trust* to provide the following reminder¹⁶:

"...the Master is empowered in terms of the Act to launch investigations into the trustee's administration and disposal of trust property. In appropriate circumstances, the Master may apply for a court order to direct trustees to comply with a request by the Master or with any duty or for the removal of a trustee."

The *Fikiswa Fesi* case¹⁷ also serves as evidence that the Master can refuse to appoint a trustee should valid reasons for such refusal to appoint exist.

The way forward

The call for an independent trustee by Cameron JA, while welcomed as a reiteration of the responsibility of every trustee, is however not new.

In *Colonial Banking and Trust Co. Ltd. v Estate Hughes and Others*¹⁸, Wessels ACJ provided the following warning:

"If the trustee is also a beneficiary and he acts in such a way as to benefit himself at the expense of the other beneficiaries, his acts will be narrowly scrutinised..."

In *Harris v Fisher*¹⁹, Thompson JA remarked as follows:

¹³ https://www.justice.gov.za/master/m_docs/2017-02_CHM-directive.pdf [accessed 23 May 2023]

¹⁴ 2012 ZANHC 9 at para 18

¹⁵ 2022 SA 44 at para 44

¹⁶ 2018 ZASCA 33 at para 57

¹⁷ 2018 ZASCA 33 at para 69

¹⁸ 1932 A.D 1 at page 16

¹⁹ 1960 (4) SA 437 (A) at page 443

"It is a well-established rule of our law that a party occupying a fiduciary position must not engage in a transaction by which he will personally acquire an interest adverse to his duty."

Following the suggestion for an independent trustee in the Land and Agricultural bank case and the Chief Master's Directive of 2017, Gilbert AJ in *BRR v MBJ*²⁰ provides the following observation; although being from a lower court:

"The suggestion by the Supreme Court of Appeal in Parker above at paragraphs 35 and 36 that there be an appointment of an independent outsider as a trustee to every trust in which the other trustees may lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the trust deed presupposes that those other trustees may be lacking in independence. It does not follow that those trustees are to be removed because of their relationship with the beneficiaries, and more so where the trustees enjoy no direct or indirect financial benefit as a beneficiary."

Gilbert AJ continues at para 66:

"It is unrealistic to expect trustees to be totally impartial at all times. While it may be that professional trustees who are appointed as independent trustees can perhaps be expected to be impartial, in many trusts, including testamentary trusts, the majority if not all the trustees may be family members or other persons who have a close connection to the beneficiaries. Although it is desirable for there to be what has been termed an independent trustee or even to have a majority of independent trustees, it does not follow that every trustee must be so detached from the beneficiaries that they are totally impartial."

Further at para 70, Gilbert AJ explains as follows:

"What is required of a trustee is not total impartiality or no connection to the beneficiaries, but rather that he or she is capable of bringing the necessary independent mind to bear on the business of the trust and of deciding what is in the interests of the trust and its beneficiaries."

Case law also serves as evidence that the mere existence of an "independent trustee" is no guarantee that the trust form will not be abused. One such example is *V.Z. Diane Windsor Morrell v V.Z. Demo and Others*²¹ where an "independent trustee" was in office but the Court questioned this independence given how the trust was administered. At para 23, Gautschi AJ held that the trust was, in fact, the alter ego of the applicant as he had de facto control over "trust property" and ordered that this "trust property" was to be included in the redistribution agreement between the parties.

It must further be noted that the independence of all trustees, or lack thereof, can in most instances not be objectively seen. Independence of thought, decision, and action can only be determined in hindsight given the circumstances when action or a decision on the part of a trustee was required.²² But while independence may be determined later, it should

²⁰ 2021 (4) SA 383 para 69

²¹ 2011/5122

²² Pace and Van der Westhuizen. 2022: 15.1.7

nonetheless be remembered that failure on the part of any trustee to act independently and to fulfil their fiduciary responsibility may result in them being removed as trustees²³ and potentially be exposed to a hefty fine and or imprisonment.²⁴

To assist current trustees, and/or those who plan to accept the onerous responsibilities of being a trustee, the following guidelines may assist in maintaining one's independence and hopefully prevent accusations of being biased, conflicted, or being a puppet²⁵:

- a) Impartially follow the trust instrument.
- b) Independently consider what is in the best interest of all beneficiaries, irrespective if they have contingent or vested rights, without fear or favour.
- c) Independently seek to protect and increase the value of trust property.
- d) Check and scrutinise the actions and decisions of fellow trustees in good faith in terms of current legislation and our common law.
- e) Personal enrichment, whether financial or otherwise, is to be avoided subject to an agreed-to remuneration for services rendered.

After accepting to act as trustee, that trustee has to be officially authorised by the Master, which authority takes the form of a Letter of Authority as issued by the Master before he/she can validly act as a trustee.²⁶

A trustee is further required to complete the following documents²⁷ before he/she will be issued a Letter of Authority to act as trustee:

²³ Section 20 of the Act.

²⁴ Section 19 of the Act.

²⁵ https://www.law.cornell.edu/wex/independent_trustee [accessed 23 May 2023].

²⁶ *Simplex (Pty) Ltd v Van der Merwe* 1996(1) SA 111 (W) at para 112.

²⁷ These forms are available at the Masters' Office or downloadable at the following website:
<https://www.justice.gov.za/master/forms.html>



REPUBLIC OF SOUTH AFRICA

J417

**ACCEPTANCE OF TRUSTEESHIP BY TRUSTEE
(Inter-Vivos Trust)**

I (Full names and surname)

ID / Passport No:

Representative of Organisation (If Applicable)

Registration Number (If Applicable)

Hereby apply for authority in terms of Section 6(1) of the Trust Property Control Act, 1988 (Act 57 of 1988) to act as trustee of the Trust known as:

I choose the following address for the purposes of Section 5 of the Trust Property Control Act, 1988 (Act 57 of 1988):

Domicillium Citandi et executandi (physical address)

Postal Address

.....
.....
.....
.....

.....
.....
.....
.....

Tel:

Cell:

E-mail:

- 1. Is this a family business trust? Yes No
(If, yes an independent trustee must be appointed. If no independent trustee is appointed furnish us with a motivation for non-appointment of an independent trustee)
- 2. I am an Independent Trustee? (If, yes complete attached sworn Affidavit) Yes No
- 3. Is trustee also the beneficiary? Yes No
- 4. Is trustee related to any beneficiary or trustee? Yes No
- 5. Are all the beneficiaries related to one another? Yes No

Profession and or business occupation of the trustee:

Previous practical experience in trust administration: Mention any specific cases.
.....
.....
.....
.....

Will exercise direct special personal control to maintain accurate trust records? Yes No

J417

DECLARATION BY TRUSTEE

I am qualified to act as trustee and do not find myself in any of the circumstances mentioned in Section 20(2) of the Trust Property Control Act, 1988 (Act 57 of 1988), which will justify my removal and undertake to inform the Master immediately should any such circumstances arise.

Thus I declare the following:

- Trustee ever been convicted of any offence of dishonesty or sentenced to prison without a fine option? Yes No
- Trustee ever been declared insolvent? Yes No
- Trustee ever been removed from office in respect to any appointment as a Trustee? Yes No
- Trustee ever been declared mentally ill / incapacitated? Yes No

Provide reason if any of the above was answered YES:

.....

.....

- Trustee has knowledge and understands the law of trust? Yes No
- Trustee is aware of the fiduciary duties and responsibilities? Yes No
- By accepting the position of trustee, you are exposing yourself to civil and criminal actions in terms of section 9 of the Trust Property Control Act, 1988 (Act 57 of 1988) Yes No
- By accepting the position of trustee, you are exposing yourself to removal action by the Master for failure to comply with any lawful request of the Master including a request to account in terms of section 16 of the Trust Property Control Act, 1988 (Act 57 Act of 1988) Yes No
- Trustee will exercise direct special personal control to maintain accurate trust records Yes No

Provide reason if any of the above was answered NO:

.....

.....

UNDERTAKING

I undertake to inform the Master should there be any changes in the capital/income beneficiaries in this Trust

I undertake to instruct the Auditor to furnish The Master, when requested to do so, with any information which the Master may require in connection with the affairs of the Trust.

Signed at on the day Month Year

.....
Signature of Trustee

I certify that on the day Month Year at and in my presence the deponent signed the Acceptance Of Trusteeship by Trustee and declared that she knows and understand the contents hereof, has no objection to taking this oath and considers the oath to be binding on her conscience, and I further certify that the requirements of Regulation GN R1258 of 21 July 1972, amended by GN R1648 of 19 August 1977, and as further amended by GN R1428 of 11 July 1980, and as further amended by GN R774 of 23 April 1982 in terms of Section 10 of the Justices of the Peace and Commissioners of Oaths Act, Act 16 of 1963 have been complied with in all respects.

.....
Commissioner of Oath

* Each Trustee must submit a separate Acceptance of Trusteeship by Trustee form
** Please attach an original certified copy of your ID Document not older than three months.



SWORN AFFIDAVIT BY INDEPENDENT TRUSTEE

I (Full names and surname)

ID / Passport No:

Representative of Organisation (If Applicable)

Registration Number (If Applicable)

As independent trustee I declare and undertake the following:

1. I am qualified to act as trustee and do not find myself in any of the circumstances mentioned in Section 20(2) of the Trust Property Control Act, 1988 (Act 57 of 1988), which will justify my removal and undertake to inform the Master immediately should any such circumstances arise.
2. I undertake to inform the Master should there be any changes in the capital/income beneficiaries in this Trust.
3. I undertake to furnish the Master, when requested to do so, with any information which the Master may require in connection with the affairs of the Trust.
4. That I have no family relation or connection, blood or other, to any of the existing or proposed Trustees, beneficiaries or founder of the trust.
5. That I am competent to scrutinize and check the conduct of the other appointed trustees who lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the Trust instrument.
6. I have no reason to conclude or approve transactions that may prove to be invalid, because I am knowledgeable in the law of trusts.
7. That I do not have any interest in the Trust as a beneficiary.
8. That I was never disqualified by the Trust Property Control Act, 1988 from acting as a Trustee

Signed at on the day Month Year.

TRUSTEE

I certify that on theday.....Month.....Year and in my presence the deponent signed the Affidavit and declared that he/she knows and understand the contents hereof, has no objection to taking this oath and considers the oath to be binding on his/her conscience, and I further certify that the requirements of Regulation GN R1258 of 21 July 1972, amended by GN R1648 of 19 August 1977, and as further amended by GN R1428 of 11 July 1980, and as further amended by GN R774 of 23 April 1982 in terms of Section 10 of the Justices of the Peace and Commissioners of Oaths Act, Act 16 of 1963 have been complied with in all respects.

COMMISSIONER OF OATH

Conclusion

The quest for an independent and impartial trustee is not something new in the law on trusts. While the Master may appoint an independent trustee, it must be remembered that all trustees individually owe a fiduciary responsibility to the trust and to trust beneficiaries; irrespective of whether the beneficiaries have only contingent rights or vested rights, and irrespective of whether the beneficiaries are current or potential future beneficiaries.

All trustees need to apply their minds independently, without fear or intimidation, on how best to control and manage trust property before any action (or inaction) is decided upon. A trustee's responsibility of duty and care is owed not only to trust beneficiaries but also to the trust objective. This responsibility further extends to third parties when dealing with trust property. The trust deed will determine whether any trust decision should be taken on a unanimous vote or whether a majority decision will apply but one trustee cannot hide behind another trustee (even if such trustee is also the trust founder) or behind the majority of trustees as each trustee can individually be held liable for breach of their fiduciary duty.

While an "independent outsider as trustee" may not be required in all trusts all the time, it should nonetheless be remembered that failure on the part of any trustee to act independently and to fulfil their fiduciary responsibility towards the trust and to all its beneficiaries may result in a trustee being removed and face a possible fine and or imprisonment.

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Trust Property Control Act 57 of 1988

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Security Cessions: Death of Cessionary



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Introduction

Life insurance policies are often ceded as security by a policyholder to secure a loan made to a policyholder. If the debt is not repaid the policyholder obtains the right to the proceeds of the policy to the extent of and in settlement of the debt. Conversely, the policy can revert to the policyholder once the loan has been repaid. The question then arises, what happens when the cedent dies. There seems to be uncertainty, in the event of the death of the cedent but the security cession is still on the books, especially in the case where a beneficiary has been nominated to receive the proceeds of the policy.

This article aims to look into the question of what happens to a beneficiary nomination when a policy is ceded as security for a debt and the life assured dies before the loan has been settled.

Cessions

There are two types of cessions, an outright cession and a security cession. Before we establish the difference between the two it is important to look at the definition of a cession and determine which statutes regulates a cession.

A cession is an agreement where one party, also known as the cedent, transfers their rights and obligations to another person, also known as the cessionary.¹ There are two elements to a cession. Firstly, the agreement between the cedent and cessionary and secondly the cession as a transfer. The law of cession thus has its basis in contract law and insurance law.

Insurance Law

In South Africa, insurance contract law is based on common law and law of contract. It is the contract between an insurer and an insured that sets out the conditions of claim and cover.² A contract of insurance has been defined in the case of *Lake v Reinsurance Corporation Ltd*,³ 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 uncertain event in which the insured has some interest, in return for the payment of a premium."*⁴

An insurance contract thus has two parties, namely the insured and the insurer. The contract may in certain circumstances, also include a third party, by way of beneficiary nomination of the policy. A third party may also acquire rights under the insurance contract through a cession, which may be by way of an absolute or security cession. The agreements, therefore, can include clauses providing benefits in favour of third parties and some cases impose obligations on parties who are not signatories to the agreements in question. These clauses

¹ M Botha et al, The South African Financial Planning Handbook at 273 (2023)

² M Botha et al, The South African Financial Planning Handbook at

³ [1967] 3 All SA 225 (W); 1967 (3) SA 124 (W)

⁴ <https://lawguide.co.za/south-african-insurance-law/>

are commonly referred to as *stipulatio alteri*. *Stipulatio alteri* may be used in providing beneficiaries of life insurance policies with direct claims against insurers.⁵

An important source for insurance law is the Long-Term Insurance Act.⁶ Long-term insurance policies include policies that offer benefits against death, disability, funeral costs and severe illness. The conduct of the insurer is also regulated by the Act⁷.

Outright Cession

In an outright cession, ownership of the policy passes on to the cessionary. The cedent therefore permanently cedes all the rights and obligations to the cessionary. As the new owner, the cessionary can nominate a new beneficiary and take responsibility for paying the premium.⁸

Security Cession

A cession to secure a debt takes place when the cession of a policy is affected as security for a debt. As security for the loan repayment, the policyholder cedes the right to the payment of the benefit of the policy, to the bank. The ceded rights arise from the contract between the cedent and the debtor and are known as the principal debt. The obligation that arises from the contract between the cedent and the cessionary is the repayment of the loan. In this way, the debt becomes a secured debt as security is provided for the debt. Once the debt has been repaid, the right reverts to the cedent. The cessionary will only become entitled to realise the proceeds of the policy if the secured debt remains unpaid. The purpose of the security cession is thus to make sure that the secured debt is paid. Whatever is left of the proceeds will be paid to the cedent.

Security cessions and the workings thereof have been well contested.⁹ There are two main views:¹⁰

- (1) Firstly, a security cession is an outright cession of rights and the cessionary will restore the rights to the cedent once the secured debt has been repaid.
- (2) The second view is that the cedent's rights are "pledged" to the cessionary, and ownership remains with the cedent, despite the cession in place.

In the case of *Grobler v Oosthuizen*,¹¹ it was recognised that the pledge theory is accepted as the default position¹² unless the intentions of the parties are different.¹³ Therefore parties can structure the security cessions either way and if the intention is not clear, the pledge theory will be accepted.

⁵ <https://www.propertytime.co.za/news/clauses-for-the-benefit-of-third-parties-stipulatio-alteri/>

⁶ 52 of 1998

⁷ 52 of 1998

⁸ M Botha et al, *The South African Financial Planning Handbook* at 273 (2023)

⁹ <https://www.golegal.co.za/security-cession-debt/>

¹⁰ <https://www.golegal.co.za/security-cession-debt/>

¹¹ [2009] 5 SA 500 (SCA)

¹² *Grobler v Oosthuizen* [2009] 5 SA 500 (SCA), at para 24

¹³ *Grobler v Oosthuizen* [2009] 5 SA 500 (SCA)

Beneficiary Appointments and Security Cessions

What are the cessionary's rights and duties, particularly when a beneficiary has been nominated? The case of *Mulaudzi v Firstrand Bank Ltd*¹⁴ gives perspective on the issues, where the policyholder/contract owner ceded a life policy on his life to the bank as security for a debt, for which he also stood surety, by way of an overdrawn bank account owed by a close corporation of which his son was the sole member of, to the bank. The bank was the defendant and cessionary. The insured appointed his customary law wife, who is also the plaintiff, as the beneficiary. When the life assured died, the insurer paid the proceeds of the policy amounting to R258 000, over to the bank. The bank used the full amount to credit the son's bank account. At the time of the life assured's death, the outstanding amount owing was R142 000, leaving a balance of R116 000. The bank did not pay the balance of the proceeds to the deceased or back to the insurer but left the balance in the bank account of the son of the life assured. The life assured's son used up the balance, which originates from the full policy proceeds, which the bank initially paid into the son's bank account to diminish the overdrawn amount. When the beneficiary realised that there was a surplus, she claimed the amount from the bank. The wife alleged that the bank as the cessionary, had the obligation to pay her, the beneficiary, the balance of the ceded policy proceeds because the bank was aware that she was the beneficiary. The bank acted in breach of its obligation to protect her interest, by allowing the son of the deceased to withdraw the balance. The bank was therefore liable to pay her the amount in question.

The bank conceded that there was a suretyship in its favour and that the plaintiff was the nominated beneficiary for policy proceeds. The bank did, however, deny that it owed the plaintiff any legal duty as the beneficiary, to pay over the balance to the beneficiary.

The court found the cession of the policy to the bank to be a security cession. The bank was entitled to claim the proceeds of the policy, as the cessionary, from the insurer. The full proceeds were paid into the overdrawn bank account of the debtor and that it had paid up the overdraft and left a credit balance. The bank was aware of the numerous payments that were paid from the debtor's bank account with the assistance the bank. In addition the bank also had a copy of the life policy and was aware that the plaintiff was the beneficiary and was entitled to the balance of the policy proceed.

The notion advanced by the bank that the matter could be decided only with reference to the deed of suretyship and the cession of the policy was regulated by the terms of the suretyship, was rejected by the court. The suretyship enables the bank to pay off the principal debt. The bank was entitled to use the proceeds of the policy to pay off the secured debt because the indebtedness of the deceased as surety did not come to an end when he died. Although the bank was permitted to receive the proceeds of the policy as the cessionary and entitled to use the proceeds to extinguish the principal debt, it was not entitled to keep the balance.

On receipt of the R258 000, the principal debt was paid up and a credit balance remained of R116 000. The court failed to see any reason for which the bank could claim any right to

¹⁴ 2006 JDR1048(T)

that amount or a portion thereof. The beneficiary was entitled to judgement against the bank for the amount of the claim plus costs.

Another matter dealing with a cession and the rights of the beneficiary is the Ombudsman ruling: *Cession- effect of cession on rights of nominated beneficiary*.¹⁵ In this matter, the life assured who was also the policyholder and premium payer, nominated his business partner as beneficiary. The policy was also ceded to the business partner, "as sekuriteit vir finansiële hulp aan die versekerde lewe." The provision in the policy provided: "Wanneer 'n polis gesedeer is, sal die regte van die persoon aan wie die polis gesedeer is, terwyl sodanige sessie van krag is, voorkeur geniet bo enige regte wat 'n genomineerde Begunstigde mag verkry."¹⁶

The policy was ceded back to the policyholder, when the debt for which security was given, was repaid. The nomination was not retracted or changed. The policyholder died and the proceeds of the policy were paid into his estate by the insurer. This payment into the estate was challenged by the beneficiary. The insurer supported its decision to pay the proceeds into the estate on the basis that on the recession of the policy, the policyholder became a new cessionary whose rights had prevalence over those of the beneficiary. The Ombudsman expressed its doubts over this position. Upon repaying the secured debt, the policyholder was entitled to a right to the reversion of the ceded rights. His position could thus not be compared to that of a subsequent cessionary. The other view is that the policy provision meant that the rights of the beneficiary were merely suspended during the duration of the initial cession; the implication being that upon payment of the debt for which the cession was given, the rights of the beneficiary revived in full. The ruling was that the insurer was encouraged to look into a settlement between the beneficiary, itself and the estate over which the office in any event had no jurisdiction.

It is important to note that the security cession to the bank does not extinguish the rights of a beneficiary.¹⁷ "The rights that the bank acquired by virtue of the cession do not terminate the rights of the beneficiary i.e. the daughter. The bank has a duty to restore the excess over the amount of the debt and in our opinion they must pay this amount directly to the beneficiary and not into the estate of the cedent."¹⁸

In the industry the general rule is that the insurance company pay the full amount of the policy ceded as security over to the cessionary, this is irrespective of the actual outstanding debt.¹⁹ If this is the case, what happens to the amount that exceeds the outstanding debt, that is paid to the creditor. We have viewed a ruling from case law as well as rulings from matters decided by the ombudsman. In answering the question, it is imperative to look at the insurance contract governing the policy in question. Not all contracts have the same view, so it is important that we explore what some contracts entail.

¹⁵ CR4-Cession effect of cession on rights of nominated beneficiary

¹⁶ CR4- Cession effect of cession on right of nominated beneficiary

¹⁷ CR2 Cession – security cession to bank does not extinguish the rights of a beneficiary

¹⁸ CR2 Cession – security cession to bank does not extinguish the rights of a beneficiary

¹⁹. Vorster, H The cession of financial products, Lexis Nexis

Different contracts from an Insurer: Rights of Beneficiary on Death of Cedent

Some contracts stipulate that the rights of the cessionary take precedence over any rights that may be acquired by nominated Beneficiaries or Replacement Contracting Parties, as long as the cession is noted in the insurer's records. The beneficiary nomination revives as soon as the cession is cancelled.

In this instance if the policy is ceded to the creditor, e.g. the bank, the bank will pay any balance to the deceased estate because, while the cession is in force, the beneficiary nomination is not operative.

The disadvantage to this contract is that in the case of the surviving spouse being the beneficiary of the policy the spouse will only have access to the money once the deceased estate is finalised. There will be executors fees payable on the amount paid into the estate. This contract is not in the best interest of the beneficiary.

There are contracts that make it possible to cede a death benefit without ceding the rest of the benefits in the contract. Therefore, the "unceded" benefits will be paid to the nominated beneficiary while the balance of a ceded benefit will be payable by the security cessionary to the deceased estate. This will put the beneficiary in a better position than the previous contract.

Other contracts state that the claims received while the cover is ceded as security will be paid in full to the cessionary. The cessionary will return any overpaid proceeds back to the insurer and then the insurer will pay the beneficiaries or estate. In this instance if a beneficiary is nominated, the proceeds will be paid directly to the beneficiary and no executors fees will be paid. The beneficiary will also not have to wait for the money until the deceased estate is finalised.

When ceding a policy, it is important for clients to exercise due diligence in scrutinising any potential restrictions or limitations inherent to the specific insurance product in question. Ensuring a comprehensive understanding of these terms is essential, as it empowers clients to make informed decisions regarding the cession of their policy, safeguarding against unforeseen complications or pitfalls that may arise during the process.

Conclusion

Giving advice on beneficiary nominations within security cessions demands a careful examination of the policy document to ensure comprehensive understanding of its terms and implications. This foundational understanding is important for giving informed advice. Alternatively, the strategic inclusion of provisions in the deed of surety, specifying the allocation of proceeds in case of an insufficient loan repayment, not only expedites disbursement, particularly beneficial for surviving spouses, but also establishes clarity and minimises the potential for legal interventions during the process of winding up of the estate.

Furthermore, taking a proactive stance in aligning beneficiary designations and surety deeds with individual circumstances becomes an integral aspect of effective long-term financial planning. This approach not only streamlines financial processes but also strengthens financial security, facilitating a seamless transition of assets while simplifying matters after someone dies. In essence, the synergy between a meticulous understanding of policy nuances and strategic legal provisions can be a powerful combination, optimising the effectiveness of security cessions and safeguarding the interests of both policyholders and beneficiaries in the ever-evolving landscape of financial planning.

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The Responsibilities of being a Trustee of a Trust



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Introduction

The role of a trustee in a trust is significant, as they must manage the trust's assets in a fiduciary capacity and have to act in the best interest of the trust and its beneficiaries. They must manage the trust in line with the law and must have a broad understanding of their statutory and common law duties thus making sure their decision-making is sustained by the fundamentals of South African trust law.

The most important principle is that a trustee should act with due diligence, skill and care which can reasonably be expected from a person who manages the affairs of another.¹ The following duties rest on trustees under the Trust Property Control Act² ("TPCA") and the common law.

For purposes of this article a trust instrument, constitution, or trust deed will be referred to as a trust deed.

Common law duties

Always act in good faith and jointly

Trustees must always act jointly in transactions with third parties and contractual powers must be exercised by all the trustees acting together, save where the trust instruments stipulate differently.³ A trust's "capacity defining clause" contains the minimum and maximum number of trustees that must be in office and must be always adhered to. If the minimum number of trustees as required are not in office all transactions entered into by the trust will be invalid.⁴ The Constitutional Court in *Burger NO and Others v Bester NO and Others*⁵ made it clear that for one or all trustees to bind the trust, they must act together or jointly:

"However, the law relating to the operation of a trust is well-settled. The powers of a trustee to act on behalf of the trust are located within the four corners of the trust deed. They provide for the circumstances in which the actions of trustees may bind a trust. Thus, a trustee acting outside the parameters of the powers conferred on her will be found not to have acted on behalf of the trust."

A trustee must observe the trust deed

Very few trustees can honestly say that they've observed and acquainted themselves with the contents of the trust deed. The trust deed is the constitution of the trust containing the provisions to which trustees should adhere. This is part of the free golden rules for good trust administration.⁶ Failure to observe and give effect to the trust instrument can be a ground for the removal of a trustee.⁷ It is therefore of utmost importance that a trustee read and interpret

¹ Section 9(1) of the Trust Property Control Act, No 57 of 1988

² Trust Property Control Act 57 of 1988

³ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) 85A–C

⁴ *Land and Agricultural Development Bank of SA v Parker* [2004] ZASCA 56; 2005 (2) SA 77 (SCA) (at [11])

⁵ *Burger NO and Others v Bester NO and Others* [2021] ZACC 48

⁶ Cameron (6th ed 305 et seq)

⁷ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) at par 10

the trust deed. The rules of the law of contract apply in the case of an inter vivos trust and in the case of a testamentary trust the rules for the interpretation of wills will apply.

Trustees should take possession of the trust property.

The core role of a trustee is to manage and control trust assets for the benefit of the trust's beneficiaries. Therefore, a trustee should acquaint themselves with the nature and extent of the trust assets and take possession thereof so that it comes under their control.⁸ One of the essential elements of a trust is the existence of trust assets. If trust assets cannot be determined with reasonable certainty, no trust is created. An inter vivos trust will only come into being once the trustee takes possession of the donated trust asset. The trustees of a testamentary trust will take control over the rights acquired in terms of the will once the Master has approved the will. A proper description clause of assets in an inter vivos trust is as follows:

*"The FOUNDER donated to the TRUSTEES an amount of R100.00 (ONE HUNDRED RAND) which donation was made and accepted by the TRUSTEES for the TRUST, and which donation formed the initial capital of the TRUST. Any subsequent additions to the TRUST CAPITAL, irrespective of the source from which such additions are derived, shall, if they are accepted by the TRUSTEES, vest in the TRUSTEES in their capacity as such and form part of the TRUST CAPITAL and be held and administered by the TRUSTEES subject to the terms contained in the TRUST DEED."*⁹

The trustee must make the trust assets more productive.

In essence, this means a trustee must be proactive when dealing with trust assets. Instead of awaiting information about the state of trust assets or the need for investment and securing a good return, they should proactively seek it. The independence of a trustee plays a fundamental role. If the trustee limits decision-making to the dominant/"main" trustee it can be a ground for the removal of the trustee.¹⁰ It is the duty of the trustee to ensure that a reasonable return is obtained on the capital belonging to the trust.¹¹ From a practical perspective, this means a trustee must take control of the trust assets, making sure the trust assets is managed and positioned to produce something be it an income or the appreciation of trust capital or both. Having the assets grow and producing an income is one of the basic requirements for any trustee. Fortunately, the trustees need not have the skills or ability themselves but have the right to hire professionals who can advise them on decisions on what to do with trust assets. For example, where the trust has cash assets the trustees can hire a professional (such as a Certified Financial Planner®) to advise them on investing in a proper investment portfolio. Where the trust has invested in asset classes that are not performing well, the trustees have the responsibility to restructure or sell such assets and invest in a better portfolio or asset class. Where trustees rent out trust assets below market-related rent, it is

⁸ Cameron 6th ed 321

⁹ Trust Deed Delpport Van Den Berg Estate and Trust Services (Pty)Ltd

¹⁰ Tijnstra NO v Blunt-Mackenzie NO 2002 1 SA 459 (TPD) 472A/B-C

¹¹ Tijnstra NO v Blunt-Mackenzie NO 2002 1 SA 459 (T)

considered to be a break of trust.¹² This duty was dealt with in *Administrators in the Estate of the late John Herbert Richards v Nichol and Another*¹³ Scott JA remarked as follows:

“An investment considered prudent in earlier times may rightfully be regarded as quite imprudent in the context of modern conditions. The ongoing and rapid decline in the value of money brought about by inflation, which has become a feature of our economy over the past few decades, may well result in a sharp decline in the value of monetary security within a relatively short time. To preserve the capital of the trust in real terms and so ensure the continued production of income, particularly in the case of a trust intended to be of long duration like the present, a trustee in such circumstances is of necessity obliged to invest in real assets with potential for capital growth. Such an investment, namely one where the capital is not fixed, necessarily involves some element of risk; but the risk may be unavoidable if the capital of the trust is to be preserved in real terms. The acceptance of this element of risk as being unavoidable if the trust is to serve its purpose has inevitably led in more recent times to a change in investment thinking which involves a movement away from the more conservative approach developed in an age when inflation was either non-existent or of little consequence.

*In principle, therefore, I can see no justification at this stage for a hard and fast rule which precludes the investment of trust funds in quoted shares or licensed unit trusts; nor do I understand the ratio in *Sackville West v Nourse and Another*, supra, as imposing such a limitation on the investment of trust property. (The same may be said of s 9 of the Trust Property Control Act 57 of 1988 in terms of which a trustee is required to act ‘with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another’.)”*

Keeping the trust assets separate

Misuse of trust assets comes in many forms ranging from exercising excessive control to blending personal assets with trust assets. When trust assets become blended with personal assets, a trustee can be removed.¹⁴ Trust assets must always be held in a manner that will be identifiable as trust assets. This Common Law principle is reinforced by section 12 of the TPCA which places a general duty on a trustee to separate their personal property from the trust property. This duty goes together with a trustee's duty to act impartial and independent and without exercising excessive control over trust assets. Where an individual trustee manages, controls, and abuses the trust assets the trust becomes his alter ego.¹⁵ In *Badenhorst v Badenhorst*,¹⁶ the court had to decide whether the assets of an inter vivos trust could be considered during a divorce. The court made a clear distinction between *de facto*¹⁷ control and *de jure* control.¹⁸ The trust deed often gives the impression of *de jure* control by the

¹² Cameron 6th ed 357

¹³ (620/96) [1998] ZASCA 82, 1999 1 SA 551 (SCA), [1998] 4 All SA 555 (A) (25 September 1998)

¹⁴ *Tijmstra NO v Blunt-Mackenzie NO* 2002 1 SA 459 (T) 468B–C and E–H)

¹⁵ *Badenhorst v Badenhorst* 2006 2 SA 255 (SCA)

¹⁶ 2006 2 SA 255 (SCA)

¹⁷ What actually happens in practice?

¹⁸ “Concerning the law”

trustees but more often than not, the founder or settlor controls the trust *de facto*. To determine control by the settlor, one must first observe the trust deed and then determine from the evidence how the trust assets and affairs are conducted.

From the trust deed (*de jure*) in the *Badenhorst* case, it appeared that

- Mr Badenhorst's father was the founder of the trust Mr. Badenhorst and his children were the capital beneficiaries of the trust and Mrs. Badenhorst an income beneficiary. The only trustees of the trust were Mr. Badenhorst and his brother. The right to income and capital of the trust vested on a future date to be determined by the trustees in their sole discretion making the trust a discretionary trust. Mr. Badenhorst had the right to "hire" and "fire" trustees as he saw fit. Mr. Badenhorst had to give his consent for the amendment of the trust deed during his lifetime and after his death, his children had to give their consent for amendment of the trust deed. The trustees had the unfettered discretion to deal with the trust assets as they in their sole discretion deem fit. Mr. Badenhorst had the right to ask a fee for acting as trustee of the trust, which ensured an income stream for him.

From the evidence (*de facto*) of Mrs Badenhorst:

- Mr. Badenhorst seldom consulted with his co-trustees for approval when decisions had to be made.
- He was in full control of the trust.
- There was no clear distinction between the trust assets and Mr. Badenhorst's assets. In applying for credit to a co-op, he listed the trust assets as his own.
- He also insured the beach cottage in his name.
- One of his private properties was financed by the trust.
- He received an income of R 50 000 per month from the Seeff Agency Franchise belonging to the trust

The Court held that it was clear from both the facts and the trust deed that Mr Badenhorst had *de facto* control over the trust assets and that the assets were in his hands alone. He never consulted his co-trustees when making decisions concerning trust assets and often blurred the distinction between his assets and the trust assets. The court found that the trust was his alter ego. The value of the trust assets had to be considered when assessing the net value of the estate of Mr Badenhorst and must be considered in the redistribution order.

Duty to be impartial and independent

A trustee must as far as it is possible, avoid the position where private interest conflicts with their duty as trustee. Where the trustees are also a beneficiary of the trust their acts will be narrowly scrutinised, especially where they act in a way that benefits them at the expense of

the other beneficiaries.¹⁹ In *Tijmstra NO v Blunt-Mackenzie NO*,²⁰ the dispute revolved around the administration of the trust by the trustees. The court decided to remove all the trustees due to the lack of proper administration by the trustees. One of the grounds the court based its decision on was the fact that some of the trustees did not act independently but merely accepted the decisions of more senior trustees.

Duty of active supervision and inquiry

A trustee must act in the best interest of the beneficiaries and cannot passively await information on the state of trust assets or wait for opportunities to secure a better return on investment capital but must take active steps to become acquainted with the situation. A trustee will be considered to be negligent when they do not know what they ought to know. In the case of *Wiid & Others v Wiid & Others*,²¹ the court found the trustees' failure to act and decide independently from the founder caused their neglect and liability for losses. The failure to question the acts of co-trustees, especially the founder also acting as a trustee, also made them negligent and resulted in them being removed as trustees.

Duty to preserve the trust property

The principle here involves a balance between productive growth of assets on the one hand, and prudent preservation on the other. Where income beneficiaries and capital beneficiaries are different individuals, they might have conflicted and opposing interests. The income beneficiaries might not necessarily be interested in capital growth or preservation but on the other hand, the capital beneficiaries might want to preserve the capital and not put the capital at risk, especially where they are not immediately entitled to it. The trustees will have to strike a balance between the interests of the two groups of beneficiaries.²²

Duty of account

A trustee must keep a record and correct account of the trust assets and funds administered. A beneficiary has the right to request an account of the investments of the trust or trust assets and in particular information regarding the beneficiaries share of it.²³ In this regard, the financial statements will be an important source of information to be made available to beneficiaries. The accounting duty of trustees relates to the entire spectrum of trustee's activities, it can include any activity from the sale of an asset, investment of trust funds, running a farming business, managing a property portfolio etc. Where the trust is the 100% shareholder of a company the trustees have a direct interest in the financial well-being and accounting of the company for the benefit of the beneficiaries. Therefore, the beneficiaries are entitled to the same form of accountability from the trustees, as are the shareholders of the company.

¹⁹ *Harris v Fisher NO* 1960 4 SA 855 (A) 862

²⁰ *Tijmstra NO v Blunt-Mackenzie NO* 2002 1 SA 459 (T)A

²¹ Unreported Northern Cape High Court case no. 1571/2006

²² *Administrators Estate Richards v Nichol* [1998] 4 All SA 555 (A) at 558H-I

²³ *Cameron* 6th ed 391/2

Duty to transfer income and capital to the beneficiaries

Somewhere in the timeline of administering the trust assets the trustees must pay income and distribute or transfer capital to the beneficiaries who are entitled to it. The trust deed must contain a clause setting out how trustees need to utilize the capital and income of the trust.

Statutory duties

Now we move away from what the Common law says to focus on what the newly amended TPCA contains. There is a focus on duties and obligations of South African trustees and that it applies to any trust deed which means a written agreement between the founder or settlor and the trustees of an inter vivos trust, a testamentary writing or a trust created in terms of a court order. Some other statutes such as the Financial Intelligence Act²⁴ ("FICA") also determine the duties and obligations of the trustees. The following duties and obligations are determined by the TPCA:²⁵

Lodge the trust instrument with the Master of the High Court (Section 4(1) & (2))²⁶

The trustees must lodge with the Master the trust deed and any amendments to the trust deed. The Master's office where the trust deed is to be lodged must have the necessary jurisdiction over the matter, in terms of section 3 of the TPCA. The deciding factor in determining if the Master has jurisdiction will be where the greater or the greatest portion of the trust asset is situated. The property referred to is normally the property of the trust on the date of lodging, which means it is normally the original donation and where is held or where the bank account of the trust is to be opened.

It is important to note that the legality of an inter vivos trust or any variation to it when lodged, is not determined by the Master or any other state authority. Contrary to what is often believed, there is no obligation on the State or the Master to censor the trust objects and it is therefore left to the interested parties to make sure the trust is not invalid or unlawful.²⁷

Furnish their address to the Master (Section 5)²⁸

A trustee must provide the Master with an address for purposes of serving notices and processes and shall notify the Master by registered post within 14 days of any address change.

²⁴ Financial Intelligence Act 38 of 2001

²⁵ Trust Property Control Act, No. 57 of 1988

²⁶ Trust Property Control Act, No. 57 of 1988

²⁷ Pace, RP & Van der Westhuizen, W M. [Wills and Administration of Estates 2022] is Cameron 5th ed 176 & Oosthuizen 605 and B 8.5

²⁸ Trust Property Control Act, No. 57 of 1988

Give security to the Master unless exempted (Section 6(2))²⁹

Trustees must make sure that they are exempted from furnishing the Master with security in terms of the trust deed. A trustee may also be exempt in terms of a court order or by the Master.

Obtain from the Master the authority to act (Section 6(1))³⁰

Trustees cannot transact or act on behalf of the trust if not formally authorised to do so by the Master. The authorization takes place in the form of a letter of authority issued by the Master after the Master is satisfied that the stipulations of the TPCA³¹ have been complied with. Any agreement concluded by a trustee in the capacity as trustee before being authorised to do so by the Master, is invalid. The court confirmed in *Joubert and Others v Joubert and Others*³² that acts performed by trustees without the written authority of the Master were indeed invalid and could not be rectified retrospectively by the trustees themselves after receiving authorisation from the Master.

Trustees must act with care, diligence and skill in the affairs of the trust (Section 9)³³

One of the three golden rules of trust administration and also a common law duty is the duty that trustees must act with care, diligence and skill. In terms of section 9(1), a trustee has a fiduciary duty that arises from or is equivalent to his duty of care to manage the assets of the trust to the benefit of the trust beneficiaries. In *Sackville West v Nourse & Another*³⁴, Kotze JA in a unanimous judgement stated the position of the fiduciary duties or duties of care as follows:

"The effect of this authority is that a tutor must invest the property of his ward with diligence and safety. It is also said that a tutor must observe greater care in dealing with his ward's money than he does with his own, for, while a man may act as he pleases with his own property, he is not at liberty to do so with that of his ward. The standard of care to be observed is accordingly not that which an ordinary man generally observes in the management of his own affairs, but that of the prudent and careful man; Or, to use the technical expression of the Roman law, that of the bonus et diligens paterfamilias . . ."

Section 9(2) of the TPCA confirms the trustee's common law fiduciary duty and imposes a statutory duty of care on the trustees when accepting their appointment/duties as trustees. Where a clause in a trust deed provides that a trustee will not be held accountable where he fails to act with the degree of care, diligence and skill required, that clause will be void.

²⁹ Trust Property Control Act, No. 57 of 1988

³⁰ Trust Property Control Act, No. 57 of 1988

³¹ Trust Property Control Act, No. 57 of 1988

³² 2019 (6) SA 51 (WCC)

³³ Trust Property Control Act, No. 57 of 1988

³⁴ *Sackville West v Nourse & Another* 1925 AD 516 at 534

Open a bank account (Section 10(1))³⁵

A trustee must deposit any money that they receive in a separate trust account at a banking or financial institution. A practical problem caused by this section is that when the initial donation with which most trusts are created is received by the trustees, they cannot open a bank account because they do not have the letter of authority yet. It is therefore important that the initial donation be reflected in the first financial statements of the trust.

Duty to register and identify trust property (Section 11(1))³⁶

In terms of section 11(1), a trustee must indicate clearly in their recordkeeping that the property is held in their capacity as a trustee. If applicable, they must register such trust assets in a manner that it is clear that it is indeed trust assets. A trustee must also make any investment or account at a financial institution identifiable as a trust investment or trust account and make trust assets identifiable as such in the best possible manner. Lastly, they must record the prescribed details of the accountable institutions which the trustees use as agents to perform any of the trustees' functions relating to trust assets.

Account to the Master if called upon to do so by the Master (Section 16)³⁷

A trustee shall, at the written request of the Master account to his satisfaction and requirements for his disposal and administration of the trust assets, deliver to the Master any book, record, account or document relating to his administration or disposal of trust and answer honestly and truthfully any question put to them by the Master in connection with the administration and disposal of trust assets.

The Master may at any time if he deems it necessary, investigate to be carried out by some fit and proper person into the trustees' administration and disposal of trust assets.

Save custody and control of documents (Section 17)

A trustee shall not destroy any documents which serve as proof of an investment, safe custody, control, administration, alienation, or distribution of trust assets before the expiry of a period of 5 years from the termination of the trust, except where the Master gives his written consent.

Background and some history on the amended Regulations³⁸ and amended TPCA³⁹

Due to the risk of being grey listed in February 2023, the National Treasury published the General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Bill 22 of 2022 to demonstrate that government has introduced measures to improve the shortcomings identified by the Financial Action Task Force (FATF). The Bill was signed into law

³⁵ Trust Property Control Act, No. 57 of 1988

³⁶ Trust Property Control Act, No. 57 of 1988

³⁸ Regulations under the Trust Property Control Act 57 of 1988

³⁹ Trust Property Control Act, No. 57 of 1988

on the 22nd of December 2022. Amendments to the following legislation have been made through the General Laws Amendment Act ⁴⁰:Financial Intelligence Centre Act, the Non-profit Organisation Act, Trust Property Control Act, the Companies Act and the Financial Sector Regulations Act.

The Department of Justice issued a Regulation Gazette⁴¹ after hours on the night of the 31st of March 2023 which provided that all the provisions of the amended TPCA⁴² and all the amended Regulations stipulating what was required from trustees in terms of the amended Trust Property Control Act came into effect on 1 April 2023.

The following amendments were made:

- New section 1 definitions of “beneficial owner “and “accountable institution” (Effective date 1 April 2023)
- New Section 6(1A) introduces the grounds for disqualification from acting as trustee, bringing it more in line with Section 20 (Removal Criteria) and more measures were added. (Effective 1 April 2023)
- Amended Section 8-Foreign trustees may only act once authorised by the Master in writing. (Effective 1 April 2023)
- New section 10(2)-requires a trustee to disclose and to make known to any accountable institution their position as trustee and that the trustee engages with the accountable institution in that capacity. (Effective 1 April 2023)
- New section 11(1) (Section 11 deals with registration and identification of trust assets)- Trustees are to provide details of accountable institutions which trustees use as agents to perform trustee functions and who provide any service to trustees. More information and clarifications is needed to understand what is meant by this requirement. (Effective 1 April 2023)
- New Section 11 A-information must be kept by the trustees in relation to beneficial owners, this includes direct/indirect individual beneficiaries of bewind trusts, founders, beneficiaries, trustees and any individual who exercises effective control over the administration of the trust:
 - trustees have to lodge and keep up-to-date records of the beneficial ownership of the trust. (Effective 1 April 2023).
 - trustees have to lodge a register of the prescribed information on the beneficial owners (as defined) with the Master. (No effective date yet).
 - the Master must keep a register in the prescribed form containing prescribed information about the beneficial ownership of trusts (no effective date yet).

⁴⁰ Act 22 of 2022

⁴¹ GN R3240 in GG 48351 of 31 March 2023

⁴² Trust Property Control Act, No. 57 of 1988

- trustees and the Master must make the information contained in the register available to any person as prescribed after consultation with the Minister of Finance and the Financial Intelligence Centre (no effective date).
- Amended section 19 (Section 19 deals with failure by a trustee to account or perform duties) The Master or any person having an interest in trust assets may apply to court to direct the trustee to comply with the Master's request or to perform a duty imposed upon the trustee by the TPCA, trust deed or any other law. It should be noted that the Master may only remove a trustee in terms of Section 20 if they do not comply with the TPCA.
- New Section 19(2)-If the trustee fails to comply with the sections above, they will commit an offense and on conviction will be liable to a fine not exceeding R 10 million or imprisonment of 5 years or both.
- Amended Section 20(Section 20 deals with removal of trustee)-it was added that the Master may remove a trustee if they become disqualified to act as trustee in terms of the new Section 6(1A) ;it was also expanded that the trustee may be removed if they do not comply with the requirements of the TPCA(over and above the requirements to comply with any duty imposed upon them on terms of the TPCA.

Although the above measures were introduced to strengthen South Africa's anti-money laundering and terrorist financing legislation, few trustees and even trust service providers know what is expected of them and how it directly impacts them. Most are unaware of the massive penalties of non-compliance -a fine not exceeding R 10 million or imprisonment not exceeding 5 years or both. Overnight the landscape of trust as we know it has changed, placing a huge compliance responsibility on *all* trustees not only the independent trustee as the amendments equally apply to all trustees.

What is expected of trustees?

Firstly, trustees are expected to keep up-to-date register of "beneficial owners" to the trust. The FATF⁴³ uses this term to identify "warm bodies" who financially benefit from a transaction. A "beneficial owner" "is an individual who gets to enjoy ownership benefits although the assets is in the name of another individual. It also means an individual or group of individuals that has the ability or power to vote or influence the transaction decisions regarding a specific security such as shares in a company. In the specific context of a trust," beneficial owners" include the founder(s), trustee(s) and the named beneficiaries of the trust deed as stipulated in the amended TPCA.

Secondly, trustees are also required to disclose their position as trustees to any "accountable institution" "with which the trustee engages in that capacity. There are an expanded list of accountable institutions and trustees must know it is not only banks that are seen as accountable institution anymore. The list includes -legal practitioners (inclusive of trust advocates), trust and/or company service providers, high-value good dealers, money or

⁴³ The Financial Action Task Force

value transfer service providers, crypto asset service providers, credit providers and precious metals and stone dealers (such as jewellers) to name but a few.

Thirdly trustees are obliged to keep a register of accountable institutions that they use as agents to perform trustee functions and who provide any services to them.

Lastly, trustees will have to review and amend their trust deeds to cater for legislative changes, relating to matters that would disqualify a person from acting as a trustee and the removal of a trustee.

Conclusion

Trustees will have to comply with both long existing Common Law requirements as well as the new statutory requirements. If they fail to do so, they will be imprisoned for 5 years or fined R10 million or both. Financial planners must inform their clients who are trustees of family trusts to seek professional assistance to comply with these additional obligations. Trustees can no longer assume that their accountant or trust service provider will keep them out of trouble. Considering the hefty penalties, deadlines and onerous duties, trustees are well-advised to seek professional assistance to ensure compliance.

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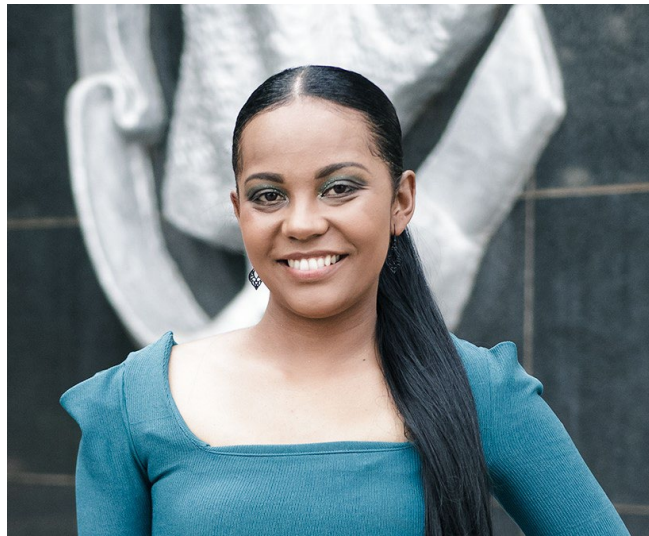
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The Influence of the Beneficiary When Amending a Trust Deed



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Introduction

An *inter vivos* trust remains one of the most valuable mechanisms of financial planning. *Inter vivos* trusts are often effectively used by the founder to protect assets for the beneficiaries, limit estate duty, plan of succession of assets, or protect assets from creditors. An *inter vivos* trust is an arrangement that comes into existence during a person's (founder) lifetime, through which trust property is held and managed by trustees for the benefit of a trust beneficiary.

In most instances, trusts in South Africa are discretionary *inter vivos* trusts. This means that the trustees can make income and/or capital distributions at their discretion to the beneficiaries. Generally, beneficiaries of a discretionary *inter vivos* trust have a contingent right. A contingent right means that the beneficiaries are not entitled to any income or capital unless the trustees decide to make a distribution to the beneficiaries. It is important to note that trust deeds need to be amended from time to time due to e.g., new legislation or change of the founder, trustees, or beneficiaries' circumstances.

The beneficiaries only have an expectation (*merely a spes*) to receive a benefit from the trust, but does this mean that a beneficiary who accepted benefits from the trust does now form part of this contract and must agree to amendments to the trust deed?

Can a trust deed be seen as a contract?

In terms of South African law of contracts, a contract can be defined as an agreement entered by two or more persons, that aims to create a legally binding commitment or commitments. A contract involves promises or undertakings on one or both sides of the relationship. The undertaking may be to deliver a certain performance, immediately or at a date in the future; to give something (*dare*); to do something (*facere*); or to refrain from doing something (*non facere*). The Trust Property Control Act (TCPA)¹ defines a trust as:

"An arrangement through which the ownership in property of one person is by virtue of a trust deed made over or bequeathed".

The Supreme Court of Appeal accepted that an *inter vivos* trust should be regarded as a contract for the benefit of a third party ("*stipulatio alteri*").² The *stipulatio alteri* is a contract in favour of a third party or by virtue or under the terms of an express provision in the trust deed. The use of the *stipulatio alteri* is to accommodate the trust *inter vivos* in South African trusts law.

It has been accepted that an *inter vivos* trust deed may be amended in terms of common law, which rules are derived from *stipulatio alteri*.

Upon acceptance, the beneficiary becomes a party to the trust agreement, which promises the beneficiary a right to benefits, but at the same time, it entails that the beneficiary also accepts any specified requirements related to the promised benefit. The arrangement of an *inter vivos* trust and the intended rights of trust beneficiaries will affect the possible amendments to the trust deed.

¹ Trust Property Control Act 57 of 1998.

² Loggenberg NO v Maree (286/17) [2018] ZASCA 24 (23 March 2018): 22.

Historically, financial planners or specialists could only amend a trust deed by the provisions in the trust deed, however, the power of amendment in a trust deed is now commonly drafted. Financial planners and the parties to a trust deed must be aware of the drafting, decisions, and planning of the amendments to the trust deed. Should a beneficiary accept benefits and be unaware of the amendment, this could lead to a void deed of amendments.

Amending a trust deed in terms of common law principles

Should a trust deed not have a variation clause, advisors can follow common law principles. In *Hofer v Kevitt*³, common law permits the courts to authorise an amendment of a trust deed. If no power of amendments is provided for by the trust deed, the trustees may apply to the High Court by utilising the statutory powers afforded to them by section 13.⁴

In South African trust law, a trust deed can be amended, subject to what the court's powers are in terms of current legislation, and common law rules, together with what the trust deed stipulates. In most circumstances, there is no clarity or relevant basic principle documentation to support any documentary or proof verifying if any of the beneficiaries already received or accepted benefits.⁵ The acceptance of benefits by beneficiaries is undoubtedly authoritative when the validity of the amendments to trust deeds is considered from a common law perspective, which is also a requirement of a contract, in terms of contract law. The creation, acquisition of rights by the beneficiaries, amendments, and revocation of the trust deed are all issues that are governed by contractual principles.

The common law permits the parties to *inter vivos* trust to vary the provisions of trust in certain circumstances,⁶ where an amendment of the trust deed is considered, the trustees must first determine whether the deed should be amended in line with the express amendment clause, or whether the common law principles of a *stipulatio alteri* should be followed.⁷ Secondly, did the beneficiaries of the trust accept their benefits in terms of the trust⁸ and if they indeed accepted the benefits stipulated for them, how significant is that acceptance of benefits in the context of the amendment of the trust deed?

The Chief Master's Directive 2 of 2017 Circular 13 of 2017⁹, sets out the principles of amending a trust deed based on common law principles. Common law principles are based on the law of contracts, where parties to the original contract may amend the original agreement as they please, provided that the formalities for the amendment of such contract are complied with. Only then, are the parties to a contract free to amend their agreement. This means that all the parties to the original contract may amend the contract provided that, the correct steps are followed.⁹ However, if the original contract contains a clause that prohibits the agreement from being amended, the parties must first agree to amend the prohibition clause

³ *Hofer v Kevitt* 1998 (1) SA 382 (SCA); South African Constitution of 1996.

⁴ Section 13 of the Trust Property Control Act 57 of 1988.

⁵ *Potgieter v Potgieter NO and Others* (629/2010) [2011] ZASCA 181; 2012 (1) SA 637 (SCA) (30 September 2011).

⁶ Chief Master's Directive 2 of 2017:2.

⁷ De Jure Law Journal 2018: 1.

⁸ De Jure Law Journal 2018: 1.

⁹ 2 of 2017 Circular 13 of 2017 7 http://www.justice.gov.za/master/m_docs/2017-02_CHM-directive.pdf.

and then amend the contract. Section 13 of the *Trust Property Control Act* contains both subjective and objective criteria.¹⁰ The subjective criterion is the founder's lack of foresight or contemplation. The objective criterion is the hampering of the trust object, prejudice to the interest of beneficiaries, or conflict with the public interest.¹¹

To avoid an invalid amendment in a trust deed, it is recommended that drafters follow a checklist when amending a trust deed given to the common law approach.¹² Where there are clear views on this matter, it seems many of the commentators agree that the trust deed should first be examined when amending and this is also good financial planning.¹³

Amending a trust deed in terms of an amendment clause

Generally, discretionary trust provides more flexibility to vary the trust deed to deal with changes in the legislation.¹⁴ When amending a trust deed, the trustees need to ensure that the powers within the trust deed are broad enough to enable change; that any power of amendment is exercised properly, and that the procedures within the trust deed are followed.¹⁵ In terms of section 4(2) of the TCPA any amendments to a trust deed must be lodged with the Master of the High Court and failure to comply with this provision will not affect the validity of an amendment.

When a deed of amendments is submitted to the High Court by the trustees, it is the Master of the High Court's duty to ensure that the provisions are filed and before the Master accepts the amendments of the trust deed, it is necessary to see whether the power of amendment allows amendments of all provisions in the trust deed; if there are any limitations; who has the power to make the changes; the procedures of amendment; whether it is necessary to obtain the consent of any party such as the founder; and whether there are any specific restrictions on the power of amendment. In the case of *Hanekom v Voight*¹⁶, the consensual amendment to a trust deed was accepted by the Master of the High Court but it triggered an investigation into an *inter alia* and the power of the Master of the High Court in authorising persons to act as trustees in terms of the TCPA.

In the case of *Ferreira and Another v Van der Merwe N.O and Others*¹⁷, the Johannes van der Merwe Trust was originally formed with only one trustee, T. T's was the mother as the founder (F) of the trust and died in 1994. T's four children were the capital beneficiaries since the trust was created. T's relationship with the applications deteriorated over the years and T attempted on more than one occasion to get the applications to sign settlements that would effectively be prejudicial to their rights under the trust. The applicant, however, accepted the benefits under the trust and on certain occasions received benefits from the trust. In 2010, the trustees in the office passed a resolution to amend the trust deed by replacing it with a new deed.

¹⁰ Section 13 of the Trust Property Control Act 57 of 1988.

¹¹ Honore and Cameron 2002: 517.

¹² Pace and Van der Westhuizen 2015: B18.2

¹³ De Jure Journal 2018:4.

¹⁴ Du Toit 2002:40.

¹⁵ Du Toit 2002:40.

¹⁶ *Hanekom v Voight* 2016 (1) SA 416 (WCC).

¹⁷ [2019] ZAECPEHC 39.

A failure to comply with the requirements in terms of the trust deed may result in the amendment being ineffective or void.¹⁸ Therefore, the principles which apply to the amendment of a contract would also apply to the necessary changes of the amendment of the trust deed. The general rule is that all the parties (founder, trustees, and beneficiaries) must consent to the amendment of such trust deed. Therefore, it is important to establish whether a beneficiary has accepted benefits or not.

The intention to amend a trust deed by the founder and trustees.

It must be the founder and/ or trustees' intention to amend the trust deed. The intentions can be based on alignment for the founder's proper estate planning or change or circumstances whichever the case must be.

A trust is created by a trust founder who must reveal the express and definite intention of doing so. The key element of the transfer of ownership and the control of the trust assets from the founder to one or more of the trustees, who hold the trust assets to benefit the trust beneficiaries. Once the trust has been formed, the founder has no further jurisdiction over the trust, unless a specific power has been specifically reserved for the founder in the trust deed.

Where the founder is alive, a trust deed can be amended through derived powers given to the trustees in terms of the trust deed or in terms of the law of contract, through a later agreement between the founder and the trustees. *Hofer v Kevitt*¹⁹, the Supreme Court of Appeal appears to have accepted the fact that the founder may reserve the right to amend the trust deed:

"No provision was made in the trust deed for the amendment of its terms nor was there any reservation of a unilateral right of revocation for the donor."

Administration elements of the trust deed may be amended whilst the class of the beneficiaries may not.

In the case of *Groeschke v Trustee, Groeschke Family Trust*²⁰, the trust deed stipulated that while the founder was alive, the founder would have the right to "alter" the trust deed. Then, years later, the trust founder disowned his son and decided to remove him as the sole capital beneficiary. This was lodged with the Master of the High Court by way of resolution. The son contested the validity of the resolution after the founder's death. The court held that the trust deed had been properly amended because the deceased had the unilaterally right to amend the deed and, in this sense, a formal contract was not required.

The power to amend or revoke a trust deed can be exercised if the trust deed authorises to do so and if no authorisation clause to amend, the trustees must first add a clause to provide them to exercise amendment. Thereafter, trustees may affect amendments to the trust deed either unilaterally or by agreement with beneficiaries. Certain authors²¹ opinions are that a trustee should not agree to amendments unless the amendments are advantageous to the

¹⁸ 2 of 2017 Circular 13 of 2017 7 http://www.justice.gov.za/master/m_docs/2017-02_CHM-directive.pdf.

¹⁹ *Hofer v Kevitt* 1998 (1) SA 382 (SCA).

²⁰ *Groeschke v Trustee for the time being of the Groeschke Family Trust and Others* Unreported judgement. the South Gauteng High Court, Johannesburg cas no 44105/2011 [18].

²¹ Such as Olivier 1990:44.

trust beneficiary. Thus, it is suggested that should the amendments not be to the beneficiary's advantage, a breach of the trustee's fiduciary duty would have been committed and the amendment may be ineffective.

Conclusion

It can be stated that the creation, amendment revocation, and acquisition of rights in the trust *inter vivos* are governed by the law of contract. However, circumstances change, and the trust deed does not make adequate provision for the changed circumstances or badly drafted clauses need to be corrected and more clarification is needed. This acceptance of the beneficiary is unquestionably important when the validity of the amendments to a trust deed from a common law perspective. However, does the acceptance of the benefits have the same implication, where the amendment clause in the trust deed clearly expresses trust beneficiaries with vested rights will not be required, provided that such amendment which is made falls within any condition which is set for amendments by the trustees?

Although the role of the Master of the High Court is to regulate the amendments made to the trust deed, its viewpoint on these amendments is utterly important. The Master also has placed emphasis on the provisions of the trust deed; determining the methodology amending the trust deed, should it "overrule" the common law requirements. Several court cases illustrate that a trust deed should first be examined where a trust amendment is contemplated.

Acceptance by the beneficiary is not a requirement for a trust to be valid. The trustees assume their fiduciary duty, but the beneficiary would have no way to enforce these duties until he or she has accepted.

After all the various court discussions above, one can see that the role of a beneficiary is quite wide. It stretches from the duties of the trustees to the TCPA and affects how trustees must apply their duties when making decisions. The amendments must be in the best interest of the actual beneficiaries, but also, potential beneficiaries, who have not yet accepted the benefits. The *Potgieter* case leaves the existing legal position when amending an *inter vivos* trust unchanged, it needs to be taken into consideration the nature of the benefit being accepted as the mere acceptance of a *spes* and would not entitle the beneficiary to protection against amendments. Uncertain as the precise nature of this "right" prevails, the trust beneficiary can, before his or her acceptance be deprived of his or her right by agreement.

The conclusion that is reached above, is that a beneficiary seeking to challenge the validity of proposed amendments to a trust deed might approach a court to set aside these amendments depending on the drafting of the underlying amendment clause or the failure to obtain the consent of the beneficiaries in these circumstances may be justifiable from the perspective of the trustees.

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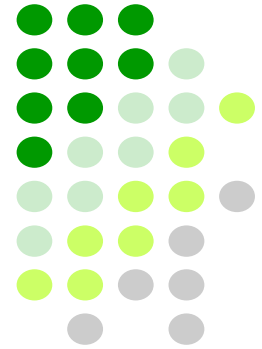
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Introduction

When clients get married the reality is that not enough time is spent on obtaining the right advice in terms of marital regimes and antenuptial contracts. Often the contract is too simplistic a document while the client may be faced with complicated estate structures and in need of specialised advice and antenuptial contact.

This article will focus on important factors that need to be considered when entering into an antenuptial contract, with a specific reference to marriages out of community of property with the inclusion of the accrual system, addressing the influence of the accrual system on divorce, insolvency, or death of one of the spouses.

Antenuptial Contract

An antenuptial contract is an agreement entered into by couples getting married who want to retain their separate estates during the marriage. This is commonly used where parties have accumulated assets before marriage and want to protect them. The contract will also dictate the financial future of the parties after the dissolution of the marriage through either divorce or death.

One of the main benefits of an antenuptial contract is that it can protect a spouse from past and future debts of the other spouse and is also designed to ensure fair arrangements for both parties during the marriage.¹

Once the antenuptial contract is registered it cannot be altered between the parties unless they bring a High Court application in terms of section 21 of the Matrimonial Property Act.² The Court will consider the validity of the parties' reasons for the amendment making sure that creditors and other third parties are protected. Reasons can include that the parties were married out of community of property without the inclusion of the accrual system and then later decide to make it applicable or it could be that one party is involved in a business and they want to exclude the business interest from any future accrual calculation.

There are certain requirements to bring this application:

- An advert needs to be placed in the local newspaper and the Government Gazette to inform all concerned parties of the intended amendments;
- Both spouses must consent to the modification of the antenuptial contract;
- Neither spouse may be insolvent or have sequestration proceedings against them;
- Neither spouse may have any judgements against them.

From this, amending the contract can become a very costly and time-consuming exercise, therefore spouses must ensure that it is in line with their expectations and understand the contents thereof when entering into an antenuptial contract.

¹ <http://www.chmlegal.co.za> /don't overlook importance of an antenuptial contract when planning your wedding [accessed 15 August 2023] Cowan-Harper-Madikizela Attorneys.

² Act 88 of 1984

Perfect Wedding Gift

The median age of bridegrooms in 2021 was 35 years old, whereas that for brides was 32 years³. The relevance of this in the estate planning context is that at this age individuals are still relatively young and likely to be insurable.

Before marriage, it is possible that couples are not fully aware that there are certain tax benefits like saving estate duty, which a well-drafted antenuptial contract can provide them with. Section 3(3)(a) of the Estate Duty Act⁴ states that amounts due and recoverable under life insurance policies, including endowment policies, on the life of the deceased, will be deemed property for estate duty purposes. The exception to this rule⁵ is found in Section 3(3)(a)(i) of the Act,⁶ which states:

“the amount due under such policy is recoverable by the surviving spouse or child of the deceased under a duly registered antenuptial or postnuptial contract.”

As all bequests to a spouse currently qualify for a deduction in terms of section 4(q) of the Act,⁷ this will be more relevant in respect of a child⁸ rather than a spouse.⁹

In practice, a client enters into an antenuptial contract with his fiancée and stipulates in the contract that a specific policy either already in existence or a new policy that will be taken out will be for the benefit of a child/children. This concept works not only for future children born from that marriage but also for children from previous marriages. Policy information does not need to be specified and a general clause in the contract is sufficient. Generally, everything that the children will inherit either via the estate or direct nomination on life policies has the potential to attract estate duty if the amount is more than R3,5 million.

An example:

Mr X was previously married and has 2 major children from that marriage. Mr X is now engaged and will enter into an antenuptial contract with his new spouse. Mr X has an estate of approximately R15 million and he wants to leave the estate in equal shares to his new spouse and his children from his previous marriage. Part of the assets of Mr X is a life policy at Old Mutual Policy Number 12345 of R5 million. Should Mr X as part of the antenuptial contract state that this Old Mutual Policy 12345 will go to his children from the previous marriage, this policy will not form part of deemed assets when calculating estate duty due to the exception of the rule under section 3(3)(a)(ii) of the Estate Duty Act. Therefore, this R5 million will not attract any estate duty in the estate of Mr X which will create a possible saving of approximately R1 000 000.

³ <http://www.statssa.gov.za/publications/P0307/P030721> p17

⁴ Act 45 of 1955

⁵ Premiums and Problems article edition 102 S Jooste 2011 D27

⁶ Act 45 of 1955

⁷ Estate Duty Act 45 of 1955

⁸ Section 1 of the Estate Duty Act 45 of 1955 defines a “child” in relation to any person, includes any person adopted by him. Stepchildren are however excluded.

⁹ Momentum Leverage April 2016 C Weyer, Legal Adviser: Financial Planning A perfect wedding gift. Have you considered the real cost of not including the provisions of Section 3(3)(a)(i) of the Estate Duty Act in an ante-nuptial contract

Suggested wording for such a clause could be:

*“the parties hereby record their intention to take out a policy(ies) for the benefit of their children and that the proceeds of such policy(ies) will be recovered in terms of this antenuptial contract by their children, as provided for in terms of Section 3(3)(a)(i) of the Estate Duty Act 45 of 1955, as amended. The Appearers further declared that they have respectively promised and agreed to solemnise their contemplated marriage upon the above-mentioned conditions and respectively to act up to the tenor of these presents under obligation of their persons and property according to law”.*¹⁰

This clause can assist wealthy clients to create a legacy for future generations and save on estate duty. Once this opportunity is missed it can be very expensive to rectify and therefore generally not done as a postnuptial agreement can cost more than R20 000.¹¹

The above exception is available to clients married out of community of property with or without the inclusion of the accrual system.

If structured correctly it will be the perfect wedding gift that parents can give their children who would be the recipients of the policy proceeds.

Antenuptial contract where clients are married out of community of property with the inclusion of the accrual

The accrual system was created based on the idea that on the dissolution of the marriage, either through divorce or death, spouses must share in the growth that their respective estates have shown during their marriage.¹² Clients need to record the commencement values of their respective estates as well as any assets or income sources that should be excluded when calculating the accrual at the dissolution of the marriage. As an antenuptial contract is considered in the same regard as other contracts the parties can draft the document to suit their specific needs. The default position, in terms of section 3 of the Matrimonial Property Act,¹³ is that the spouse whose estate showed no accrual or the smallest accrual in value during the existence of the marriage will have a claim for 50% of the combined accrual. However, parties can determine a different division in their antenuptial contract, for example, stating that the husband will be entitled to 30% while the wife will be entitled to a 70% share of the accrual.¹⁴ This will be to the advantage of the spouse who is not employed and has no opportunity to create and build his/her own estate. On death or divorce, this spouse will then be entitled to a bigger percentage of the accrual as opposed to the default 50%.

¹⁰ Ibid 10

¹¹ Ibid 11

¹² <http://www.moneyweb.co.za/financial-adviser-views/the-accrual-system-is-why-estate-planning-is-so-important>
Devon Card 22 April 2021

¹³ Act 88 of 1984.

¹⁴ <http://www.snymans.com/advice/what-can-be-considered-when-entering-into-an-antenuptial-contract>.

Suggested wording for such a clause could be:

“On the dissolution of the marriage by divorce or by the death of either or both of the parties, and Mrs X's estate shows no accrual or a smaller accrual than the estate of Mr X, Mrs X or her executor, shall have a claim against the other party or his estate for an amount equal to seventy percent of the difference between the accruals of the respective estates of the parties;”

As mentioned above the accrual sharing takes place at the dissolution of the marriage which will either by divorce or death.

The Accrual Claim at Divorce

The Divorce Act¹⁵ stipulates that it deems a party's “*pension interest*” part of the relevant spouse's assets when establishing the accrual claim on divorce. Pension interest is defined as the benefit to which the member would have been entitled in terms of the rules of the fund if the member terminated service as a result of their resignation.¹⁶

The question from planners about whether living annuities that are regulated by the Long Term Insurance Act¹⁷ fall under this definition of “*pension interest*”, came under the spotlight in *Montanari vs Montanari*,¹⁸ where the court had to determine whether or not a party's living annuity formed part of the estate when calculating the accrual claim. The High Court held, that the capital of a living annuity does not form part of that party's estate when calculating the claim.¹⁹ The non-member spouse took the decision on appeal, however before it was heard, judgement was handed down in *ST v CT*²⁰ where it was found, that the annuity belonged to the insurer and not the annuitant. The court also determined that the annuitant only has a right to the income of the living annuity during his/her lifetime and has no right to capital. The court further remarked that the income for the living annuity can be considered for maintenance purposes, however, the payments were to be made by the ex-spouse as the responsibility does not lay with the insurer.²¹ The court in this case refrained from determining whether the conditional right of the annuitant to future annuity payments was an asset in the estate.²²

The Supreme Court of Appeal in the *Montanari* case (supra) affirmed the decision of *ST v CT* (supra) however held that the value of the annuitant's right to future annuity payments in his/her living annuity policies was an asset in his/her estate.

In *CM v EM*²³ the Supreme Court of Appeal had the opportunity to determine where the ownership of capital invested in the form of a living annuity vests, as well as whether the value

¹⁵ Section 7(7)(a) of the Divorce Act 70 of 1990

¹⁶ Section 7(7)(a) of the Divorce Act 70 of 1990

¹⁷ Sections 37 of the Long Term Insurance Act 52 of 1988

¹⁸ 2020 ZASCA 48 on 5 May 2020

¹⁹ S Jooste Living Annuities: A summary of the Status Quo Premiums and Problems Article Editions 120 January 2020 E49

²⁰ *ST v CT* (1224/16) [2018] ZASCA 73 (30 May 2018)

²¹ *Ibid* 20 E65

²² *Ibid* 18 737

²³ *CM v EM* (1086/2018) [2020] ZASCA 48; [2020] 3 All SA 1 (SCA); 2020 (5) SA 49(SCA) (5 May 2020)

of an annuitant spouse's right to future annuity payments is an asset in calculating the accrual claim. The court determined that the relationship between the insurer and the annuitant is "purely contractual in nature" and therefore no fiduciary relationship exists between the parties. The court agreed with the judgement in *ST v CT (supra)* that the capital of the living annuity belonged to the insurer and that the insurer's obligation is limited to the payment of the stipulated annuity. The court further confirmed that there is a "clear right" to investment returns yielded by the capital invested in an annuity product that would give the client an income in the future and that is "evidently an asset that can be valued". The result of this case is that future annuity payments can be considered when calculating the accrual claim on divorce. The ground-breaking decision considers the annuity not only as a factor in maintenance claims but also as an integral part of the annuitant's estate. This shift will contribute to a more equitable distribution of assets in situations involving divorce or even death.

How the value of this right to receive the annuity is to be determined was not decided, but one can assume that it will be determined based on the annuitant's life expectancy, the expected investment return, and the rate of past and future drawdowns from the annuity.²⁴ In many divorce cases, where clients are older, it can be that the biggest "asset" in the estate might be a living annuity that provides a monthly income.

Although most of the reported matters in this area dealt with divorce, the case of termination of marriage by death is equally important. Fiduciary advisers and financial planners must take note of this decision as it can have an impact on a client's estate planning. The further reality is that parties cannot hide their liquid sums by purchasing a living annuity and then claiming, based on the law, that it does not form part of the accrual calculation.²⁵

Impact of the accrual claim at death

The accrual system is intended primarily to protect and provide for spouses who spend much of their working lives, looking after children and the home. Estate planning for these couples is a very important exercise and careful consideration of the impact of the accrual system on their respective wills needs to be considered.²⁶ Too often, estate duty and liquidity analyses are performed without giving thought to the accrual claim.

Scenario 1 – The deceased spouse's estate is larger

Should a client leave the bulk of the assets to a family trust or their children it will trigger an accrual claim from the surviving spouse. This claim will take precedence over any bequests

²⁴ A Mothibi, H Joubert Legal Update 9 of 2020: Case law on divorce in respect of living annuities Momentum Moment of Trust June 2020

²⁵ <http://www.divorcelaws.co.za/living-annuity-and-divorce> B Preller, MP Wiesenber

²⁶ R Green Accrual can imperil inheritance De Rebus Volume 2008, Issue 481

made in the client's will and the executor will first have to settle the accrual claim before any distributions are made to beneficiaries.²⁷

A question that arises is, how to settle the accrual claim. This claim can be settled by using existing assets, cash, or a combination of the two.²⁸ An additional option available is to make use of the proceeds of a life policy to settle the claim. When the accrual is calculated it is imperative to have certainty when the proceeds of the life policy will be included and when not.²⁹ Where a beneficiary is recorded on a life policy, the proceeds will not be included in the accrual calculation. Where the nominated beneficiary is the surviving spouse, the proceeds received will not form part of the assets for calculation of the accrual and will not be considered in settling the claim.³⁰

Should the client decide to settle the claim with a life cover policy the beneficiary cannot be the deceased estate as this will increase the accrual claim and will not solve the problem.³¹

A simple solution is to make the spouse the contracting party and beneficiary on the life of the client as the proceeds will become payable to the policyholder on death. The proceeds will form part of the calculation of the accrual in the hands of the spouse and possibly solve any liquidity problems the accrual claim can create.

A spouse that has an accrual claim must be very careful when deciding not to instigate the claim, as the waiver may be seen as a deemed disposal in terms of section 55 of the Income Tax Act³² and attract donations tax.

Scenario 2 – The deceased spouse's estate is the smaller

In this instance the will of the deceased client is important. When creating an estate plan, one must consider the implications of the client with the smaller estate bequeathing the assets to children or a family trust. This can trigger an accrual claim against the surviving spouse and create a liquidity problem, especially where the survivor's wealth is held in retirement funds and/or business interests. Consequently, the survivor may be forced to realise certain assets to settle the claim.³³

An executor should also be vigilant about instituting the accrual claim against the surviving spouse, if applicable, in terms of section 3(2) of the Matrimonial Property Act³⁴ as the claim will prescribe within three years after it becomes due.³⁵ In the case of *Reynolds N.O v Smith*³⁶ the executor was gathering information from the surviving spouse to be able to establish and possibly calculate the accrual claim and this continued for a period of six years. When the executor eventually launched an application to compel the surviving spouse to supply better

²⁷ <http://www.moneyweb.co.za> D Card The accrual system: This is why estate planning is so important.

²⁸ Should existing assets be used or sold to settle the claim the capital gains tax implications should not be overlooked in the planning process.

²⁹ M Lotter Estate planning: The inclusion of the proceeds of a life policy when the accrual is calculated 2013 Journal for Juridical Science 38-57

³⁰ N Dillon The Accrual Claim at Death vs Divorce Premiums and Problems Edition 120 January 2020 F10

³¹ Premiums and Problems Edition 125, page E58

³² Income Tax Act 58 of 1962

³³ Ibid 28

³⁴ Act 88 of 1984

³⁵ D Meyerowitz, PH Cilliers The Law and Practice of Administration of Estates and their taxation, 2023 Edition p246

³⁶ *Reynolds N.O v Smith* [2021] ZAWCHC87

information, the spouse argued that the claim has prescribed after three years and the court held that pre-litigation discovery does not stop prescription.

Another important clause that can be considered when drafting the antenuptial contract:

“On the dissolution of the marriage by death and the deceased estate has shown the smaller accrual, his or her executor shall have no accrual claim against the surviving spouse's estate.”

Insolvency and the effect on marriages subject to the accrual system

Where spouses are married out of community of property subject to the accrual system, no claim arises in the insolvent estate of a spouse.³⁷ The problem however arises that should the marriage dissolve after one spouse has been declared insolvent, the insolvent spouse or the executor of the deceased insolvent spouse will not be able to repudiate the claim. In terms of section 26 of the Insolvency Act,³⁸ it will be seen as a disposition without value and may be set aside.

In practice one often finds that where one spouse is insolvent, the solvent spouse purchases the assets in their name. It however will increase the value of the accrual in the insolvent's estate on dissolution of the marriage. It might be sound financial planning advice for the solvent spouse to purchase any new assets in the name of a family trust. Should the trust not be able to purchase the property, the solvent spouse can fund the purchase price via an outstanding loan account which will form part of the estate at the dissolution of the marriage at death. It is important that the impact of section 7(c) of the Income Tax Act³⁹ not be overlooked and should form part of the advice to the client.

The trust can settle any accrual claim by effecting a life policy on the life of the solvent spouse and utilising the proceeds which can be used to settle the loan account.⁴⁰

When drafting the antenuptial contract with the inclusion of the accrual it might also be important to consider the following clause:

“Should either party be an unrehabilitated insolvent on the dissolution of the marriage, then the accrual system as set out will not apply and on the dissolution of the marriage each party shall be entitled to his or her own estate and effects only.”

Conclusion

Each marital regime presents its own set of benefits and drawbacks, and it is important to thoroughly evaluate the rules associated with each regime before entering into a marriage.

The accrual system is intended primarily to protect and provide for spouses who spend much of their working lives looking after children and the home, however, it can also have a very negative impact if proper financial planning is not done.

In summary an antenuptial contract:

³⁷ Section 3(2) Matrimonial Property Act 88 of 1984

³⁸ Insolvency Act 24 of 1936

³⁹ Act 58 of 1962

⁴⁰ Accrual and Insolvency Premiums and Problems article January 2008 B7

- Protects assets that spouses had before entering into the marriage;
- Protect a spouse during the course of the marriage from past and future debts from the other spouse
- On termination it will provide the spouse whose estate showed the least accrual with a claim against the spouse whose estate has grown the most
- If done correctly the contract can also be used as an estate duty saving tool

It is therefore important that spouses get professional advice before entering into an antenuptial contract as there are so many different clauses as seen throughout this article that can added to the contract to make a personalised tailormade one for each situation and not just a general document applicable to every marriage.

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Mindful Planning: Practical Consideration for Mental Incapacity in Estate Planning



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Introduction

Mental illness is not always clear cut, not always detected nor predicted timeously, and if left too late can significantly impact an individual's ability to manage their financial affairs effectively. Without proper planning in place, individuals facing these incapacities may lose control over their financial affairs. This can lead to mismanagement of assets, missed bill payments, and financial vulnerability. A lack of planning can also place the individual at an increased risk of financial exploitation by unscrupulous individuals. Inadequate planning may expose them to scams, fraud, or undue influence, leading to significant financial losses.

The absence of clear directives or legal arrangements could lead to family disputes and legal challenges over the management and distribution of assets. The legal issues in turn result in lengthy and costly court proceedings, further exacerbating the emotional and financial strain on all parties involved.

This article explores some factors to consider when addressing mental incapacity in estate planning, the relevant legislation and regulations, the role of life insurance policies, and the potential pitfalls and consequences of not preparing adequately for such circumstances.¹

Definition of mental incapacity

There is no definition for "mental incapacity" found in either South African law or medical research, but it is generally understood to refer to the mental state of an individual who is suffering from a mental illness. According to the Mental Health Care Act,² a 'mental illness' is defined as a '*positive diagnosis of a mental health-related illness in terms of accepted diagnostic criteria made by a mental health care practitioner authorised to make such diagnosis*'. This definition sets out clear criteria for the diagnosis of a mental illness and an individual can only be classified as having a mental illness if their diagnosis meets this criteria.

"Mental illness" can take many forms but can be distinguished from "intellectual disability" in that the mental illness can usually be treated and recovery may be possible, although not in all circumstances.³

In this article, all references to "mental illness" shall refer to an already confirmed diagnosis, without referring to any specific type of condition.

The legal position in South Africa

A person with a mental illness may find it difficult to carry out juristic acts, take part in legal proceedings, enter into financial transactions, or be fully responsible for certain actions. However, not all persons with mental illness are automatically excluded from performing legal acts or giving valid consent for contractual transactions. The assessment of their legal

¹Throughout the article reference to "mental incapacity" shall also refer to "physical disability", unless the contrary is clear from the context.

²17 of 2002.

³Department of Justice and Constitutional Development Justice College. *Legal Position of Persons Incapable Of Managing Their Own Affairs*. Found at <https://www.justice.gov.za/juscol/docs/note-moh01.pdf> [accessed on 19/07/2023].

capacity depends on the severity of their mental illness at the time they are involved in legal matters. The decision regarding their capability to enter into contracts, litigate, or provide informed consent for medical treatment is based on their intellectual and intentional capacities.

Common law position

It is an essential element of the South African laws of contract that any person who enters into a legal transaction must have the mental capacity to do so. The failure to appreciate the nature, purpose, and consequences of one's actions can render a transaction invalid.⁴ The general rule is that major persons are presumed mentally and legally competent to manage their affairs until the contrary is proven. The onus of proving that a transaction is invalid for lack of mental capacity normally rests on the party who is alleging it.⁵ However, the fact that a person has been declared mentally ill does not mean that they lose all capacity to act. In *Pienaar vs Pienaar's Curator*,⁶ it was held that a person's capacity may vary from day to day and that the purpose of the appointment of a curator is to "assist the person in question in performing legal acts". This means that a person suffering from mental incapacity may execute a valid will during a moment of lucidity.⁷

Legislative position

In South Africa, several key legislations play a crucial role in protecting the rights and interests of persons with mental incapacity. Among these, the Mental Health Care Act,⁸ the Promotion of Access to Information Act,⁹ the Administration of Estates Act,¹⁰ and the Trust Property Control Act¹¹ are of particular significance:

- The Mental Health Care Act establishes procedures for assessing mental capacity, ensuring proper care, and protecting the rights of individuals with mental illnesses. It outlines the rights to information, treatment, and consent for persons with mental incapacity.
- The Promotion of Access to Information Act empowers individuals to access information about their financial affairs, medical records, and other essential information, thereby promoting transparency and informed decision-making.
- The Administration of Estates Act governs the administration of estates, including those of persons with mental incapacity. It provides mechanisms for appointing administrators or curators to manage the financial affairs of individuals who lack mental capacity.

⁴Cronjé & Heaton, 109.

⁵*International Journal of Mental Health*, 5(3), 14–21.

⁶1930 OPD 171 at 174-175 1930.

⁷*Spies v Smith* 1957 (1) SA 539 (A).

⁸17 of 2002.

⁹2 of 2000.

¹⁰66 of 1965.

¹¹57 of 1988.

- The Trust Property Control Act regulates the management and control of trust property, offering a framework for creating trusts to protect and manage assets for the benefit of persons with mental incapacity.

Together, this collection of legislation forms a comprehensive legal framework that safeguards the rights and financial interests of individuals facing incapacity. Depending on the specific circumstances of the affected person, there might be other legislation that can be added to these, such as the Children's Act¹² in the case of the individual being under the age of 18 or the Insolvency Act¹³ when dealing with an insolvent. The Divorce Act¹⁴ can also come into play since an incurable mental illness is a ground for divorce.¹⁵

Preparing for incapacity

When facing the possibility of mental incapacity, there are a few solutions available to ensure that your interests are protected and decisions are made on your behalf, when you are no longer able to do so.

Power of attorney

One such solution is the establishment of a power of attorney (POA), granting a trusted individual or legal representative the authority to act on your behalf in financial and legal matters. The person granting the authority to act is referred to as the principal and the person who is acting on the principal's behalf is referred to as an agent. This is a legal document and can be tailored to suit your specific needs and can be limited or general, depending on your specific needs. For a limited POA could be that the principal grants the agent the authority to perform a specific act like selling a property, after which the authority and POA fall away. The alternative is a general POA where a general authority is given to the agent to contract on the principal's behalf thereby binding the principal.

The benefits of a POA include ensuring decision-making continuity, personal choice in selecting the agent, and avoiding costly guardianship proceedings where children are concerned. However, possible drawbacks included the risk of abuse by the agent, limited oversight over the agent's actions, reliance on the agent's judgment, and potential family conflicts. It is crucial to carefully consider the choice of agent, define the scope of authority, and regularly review and update the POA as needed to ensure it continues to align with the principal's preferences and values. An important thing to remember is that in South Africa, a POA also lapses when the person who granted it is no longer mentally able to make their own decisions and does not have contractual capacity.¹⁶ This solution therefore only works for a limited time.

¹²38 of 2005.

¹³24 of 1936.

¹⁴70 of 1979.

¹⁵Section 3(b).

¹⁶*Pheasant v Warne* 1922 AD 481; *Tucker's Fresh Meat Supply (Pty) Ltd v Echakowitz* 1957 (4) SA 354 (W) confirmed on appeal in 1958 (1) SA 505 (A).

Living will

A living will or advanced healthcare directive is a declaration that allows you to express your wishes regarding medical treatment and end-of-life care, ensuring that your healthcare decisions align with your wish for your life to end.¹⁷ It is crucial to address these aspects in financial planning, as medical expenses can significantly impact an individual's financial well-being. The legal position concerning living wills in South Africa, however, remains uncertain¹⁸ as they are not recognised, either in common law nor legislation, and are therefore not legally enforceable¹⁹ but the Constitution of the Republic of South Africa²⁰ recognises each person's right to accept or refuse medical treatment.²¹ Doctors are recommended to seek guidance from the South African Medical Association (SAMA) if they find it necessary when dealing with a patient who has a living will.²²

This offers several benefits, including the assurance that one's wishes will be honoured, relief for family members who might otherwise face emotionally challenging decisions, and clear guidance for healthcare professionals. Some criticisms of living wills include that they might not represent the patient's true and current wishes, they are automatically interpreted as a "do not resuscitate" order, or they are not always readily available, especially in an emergency.²³ To make the most of a living will, individuals should have a comprehensive document drafted by professionals, communicate its existence to family and healthcare providers, and periodically update it to ensure it accurately reflects their current wishes.

Life insurance

Life insurance policies can play a crucial role in estate planning for mental incapacity since they can provide financial security and support for individuals and their families. An important advantage of life insurance policies, especially terminal illness and disability insurance is that no income tax is payable on the proceeds. However, if the contracting party is not also the insured life then the proceeds fall outside the scope of section 3(3) as there is no amount due and recoverable under any policy of insurance, which is a domestic policy, upon the life of the deceased on the date of death.²⁴ In the case of estate duty, a terminal illness benefit will be deemed property in the estate of the insured life at death, if the contracting party and the insured life are the same person.²⁵ It will however form part of the client's estate should the life assured pass away, which will result in estate duty and higher executor's fees.²⁶

It is important to ensure that your life insurance policy provides sufficient coverage to meet the financial needs of your dependents or yourself and cover any outstanding debts in the event of mental incapacity. It is also important to consider ownership and beneficiaries

¹⁷Mcquoid-Mason 2005:25.

¹⁸Jacobs 2012:62.

¹⁹Grové 2020:271, 275.

²⁰108 of 1996.

²¹Chapter 2.

²²South African Medical Association *Living Wills and Advance Directive* 2017.

²³Bull & Mash 2012:508 and Grové 2020:270.

²⁴Section 10(1)(g).

²⁵Louw du Toit, *The Practical Implications of Terminal Illness Benefits*, A30.

²⁶Section 3(2) of the Estate Duty Act 45 of 1955.

carefully, especially in case of mental incapacity. Having a trusted person, like a spouse, family member, or friend, as the owner or primary beneficiary can ensure proper financial management. If you can't manage the policy, assign it to a trusted individual, such as a family member or trustee, for ongoing coverage and premium payments. Regularly review your policies to match your changing personal and financial situation.

Some solutions that can be considered include:

- Disability insurance is defined as a contract in terms of which an insurer undertakes to provide policy benefits to a person in the event of an impairment of the functional ability of the mind or body of a person, in return for the payment of premiums.²⁷ Ideally, this benefit pays out in the form of regular income to replace lost income but can also be in the form of a cash lump sum.²⁸ The disability insurance policy typically pays benefits when the mentally incapacitated person meets the policy's criteria for disability. These criteria may vary among policies but usually involve demonstrating a level of disability that prevents the person from performing their job or daily activities. The policy will outline the specific terms and conditions under which benefits are payable, such as the waiting period (the time before benefits kick in) and the definition of disability. This type of policy should be taken before the onset of the incapacity. It's important to carefully review the terms and conditions of the disability insurance policy, consult with a financial planner, and ensure that the trigger event and the definition of disability are clearly understood.
- Critical illness insurance can be taken as a standalone benefit or as an accelerated benefit on a death or disability policy. It pays out a lump sum if the insured person is diagnosed with a covered critical illness. The list of covered illnesses can vary between policies, but it usually includes major conditions like cancer, heart disease, stroke, and others defined in the policy. The payout can be used to cover medical treatments, lifestyle adjustments, or any other financial needs. Critical illness insurance offers distinct advantages and disadvantages. On the positive side, it provides much-needed financial security, delivering a lump-sum benefit upon the diagnosis of covered critical illnesses. This flexibility allows policyholders to use the funds as they see fit, whether for medical expenses, specialised care, or lifestyle adjustments. Furthermore, it offers peace of mind by alleviating financial stress during a health crisis. However, they could potentially have high premium costs, limitations on covered illnesses, waiting periods before benefits are payable, and potential gaps in coverage for ongoing treatment. The complexity of policy terms and the risk of claim denials due to non-disclosure of pre-existing conditions should also be considered.
- Some life insurance policies offer life insurance with living benefits or accelerated death benefits that allow the policyholder to access a portion of the death benefit while still alive if they are diagnosed with a terminal illness or critical condition, which can include

²⁷Section 1(1) of the Long Term Insurance Act, 52 of 1998.

²⁸Reinecke, paragraph 26.44-46.

certain mental health issues. This could provide much needed liquidity that could assist with living and medical expenses.

- A popular, yet often excluded, option is funeral insurance. The benefit that is payable on the death of the insured life can be either a cash amount, a provision of service (e.g. a funeral), or both.²⁹ Funeral insurance can cover the expenses associated with funerals and provide a predetermined payout, easing the financial burden on the family. This is helpful when decision-making is challenging for those with mental incapacity. Funeral insurance typically doesn't require a medical exam, which all but guarantees acceptance for individuals in this situation. However, it's important to weigh the cost of premiums and understand policy terms, including waiting periods or coverage limitations. When done right, funeral insurance provides a practical and supportive solution for individuals with mental incapacity and their families, ensuring a dignified farewell without added financial stress.
- A terminal illness benefit is a contractual arrangement between an insurance company and the contracting party, where the insurance company pays the contracting party a lump sum equal to the life assured sum of a life insurance policy if the life assured is diagnosed with a terminal illness (as defined in the life insurance contract).³⁰ Though not often associated with mental illness, diseases such as dementia (including Alzheimer's disease) could be fatal and a terminal illness benefit claim could arise. This sum can be used practically to cover specific needs, such as medical treatments, specialised care, or adjustments to the living environment to accommodate the patient's condition. The immediate financial support from the insurance policy alleviates the financial burden and allows the family to prioritise the patient's well-being without concerns about the high costs of medical care. In essence, terminal illness insurance provides practical assistance and financial stability to ensure the best possible care for the individual with mental incapacity during their final stages of life.
- Lastly, medical insurance and/or medical schemes are essential for individuals with mental incapacity or disability to cover medical expenses related to mental health treatments, therapies, medications, and hospitalisation. The primary distinction between medical schemes and medical insurance lies in their governance and operational principles. Medical schemes are non-profit organisations regulated by the Medical Schemes Act³¹ and guarantee acceptance for applicants, paying actual medical costs. In contrast, medical insurance is for-profit and governed by the Long-Term Insurance Act.³² It offers predetermined daily cash-back or event-based payments for hospitalisation and day-to-day benefits, unrelated to actual medical expenses. Medical insurance premiums, on the other hand, vary based on factors like pre-existing conditions and age. While medical schemes offer comprehensive coverage and charge the same premium to all members, medical insurance provides financial support during hospitalization and other expenses. Combining both can ensure comprehensive medical coverage, covering both medical needs and

²⁹Reinecke at par.26.14.

³⁰Louw du Toit, *The Practical Implications of Terminal Illness Benefits*, A27.

³¹131 of 1998.

³²52 of 1998.

providing financial support during illness. Having either or a combination of the two options can ensure comprehensive medical coverage, guaranteeing access to necessary healthcare and providing financial support during illness, thus offering peace of mind to individuals and their families in managing their healthcare needs.

Protection during incapacity

When mental incapacity takes hold, individuals find themselves no longer able to influence the direction of their lives and must depend on the provisions that they made for their future well-being. In addition to the preparations made, or in the absence of any preparations, the following measures can be taken to ensure that the individual is protected and their needs are taken care of:

Appointment of a curator

Under Rule 57 of the Uniform Rules of Court in South Africa, three types of curators can be appointed: Curator ad litem for legal representation, Curator bonis for financial affairs, and Curator ad personam for personal matters. These curators are appointed by the court to protect and manage the interests and well-being of individuals who are unable to do so themselves, depending on their specific needs and circumstances. The process of appointment typically involves an application to the court by an interested party,³³ supported by two medical reports, one usually by a general medical practitioner, and the other by a neurologist or psychiatrist. The court then reviews the evidence and, if satisfied, appoints a curator to act in the best interests of the incapacitated person. Benefits of curatorship include the legal protection it provides for the incapacitated person, ensuring their well-being and financial interests are safeguarded. It prevents exploitation and abuse, offers a clear legal framework for decision-making, and holds curators accountable for their actions. Curators are held to high standards of fiduciary duty and are typically required to report to the court on their decisions.

Curatorship does come with disadvantages, such as the possible loss of personal autonomy as decisions are made on the individual's behalf. The process can be both time-consuming and costly, often entailing emotionally challenging legal proceedings for family members and the importance of selecting a reliable curator to cater to the individual's specific circumstances.

Special Trusts

Trusts are advisable for individuals suffering from mental incapacity due to the many advantages they offer. They can safeguard financial assets and ensure that they are

³³In terms of Rule 57 of the Uniform Rules of the Supreme Courts Act 10 of 2013.

managed in the best interest of the incapacitated person, providing for their long-term financial security and avoiding the need for guardianship proceedings.

An *inter vivos* trust is generally used for broader estate planning and asset management purposes, making it more appropriate for individuals looking to manage and distribute assets to a wider range of beneficiaries during their lifetime. In contrast, a special trust is typically used when a person wishes to create a trust specifically for the benefit of someone with a disability or a severe medical condition, ensuring that the trust assets are used exclusively for their care and support. The concept of a 'special trust' was introduced in 2001 by the Income Tax Act.³⁴ It is defined³⁵ as "*a trust created solely for the benefit of one or more persons who is or are persons with a disability as defined in section 6B(1)*³⁶ where such disability incapacitates such person or persons from earning sufficient income for their maintenance or from managing their own financial affairs". A special trust is considered to be a more appropriate vehicle for persons with mental incapacity, as opposed to a normal (*inter vivos* or testamentary) trust. One advantage is that special trusts are taxed in the same manner as natural persons (i.e. at the marginal tax rate of the person) and not on the higher, flat rate that normal trusts are subjected to. They are also exempt from the section 7C anti-avoidance provision,³⁷ as well as donations tax.³⁸ This type of trust may only be for the benefit of the mentally incapacitated person, during their lifetime. If, at any time during the lifetime of the person, this is not the case, then the trust will cease to be a special trust.

Conclusion

Mental incapacity is a critical consideration in estate planning to ensure the protection of individuals' assets and well-being. Incorporating life insurance policies into your estate planning can provide valuable protection during times of mental incapacity. By ensuring adequate coverage, thoughtful ownership, and beneficiary nominations, exploring living benefits or accelerated death benefits, considering policy assignments, and seeking professional advice, you can effectively leverage life insurance as a crucial component of your overall financial strategy. The appointment of a third party to manage your affairs can also ensure that your interests are taken care of when you can no longer do it yourself.

While there are various options available, each case needs to be assessed against its own merits and care should be taken to not take a "one-size-fits-all" approach. By understanding the relevant legislation, establishing legal arrangements as discussed in this article and communicating your wishes throughout your lifetime, you can mitigate the potential pitfalls and consequences of inadequate preparation.

Seeking professional advice from financial planners and estate planning experts can further enhance the effectiveness of one's financial planning strategies.

³⁴58 of 1962.

³⁵Paragraph (a) of the definition of "special trust" in section 1 of the Income Tax Act.

³⁶Section 6B(1) defines a disability as: "Disability means a moderate to severe limitation of any person's ability to function or perform daily activities because of physical, sensory, communication, intellectual or mental impairment, if the limitation has last or has a prognosis of lasting more than a year, and is diagnosed by a duly registered medical practitioner in accordance with the criteria prescribed by the commission."

³⁷Section 7C(5)(c) of the Income Tax Act.

³⁸South African Revenue Services' (SARS) binding private ruling, BPR306, dated 28 June 2018.

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The Feasibility of Using a Trust as a Tax and Estate Planning Mechanism



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Introduction

Trusts are undoubtedly complex structures. Despite this, clients have numerous requests for the creation of trusts. It is therefore of paramount importance that the parties to a trust understand not only how a trust works, the tax implications related to trusts, and the true and essential purpose of a trust, but also the conduct and management of trusts and what frustrates the legal system.

The use and purpose of trusts have in many instances, over the years, been misunderstood and/or intentionally abused by many founders, trustees and beneficiaries. As will be seen in this article, this has resulted in legislative changes taking place to close loopholes and bring trusts under the 'SARS radar'.

Many founders have created trusts to meet their various estate planning objectives. Among them are some founders who have created the so-called sham trusts or alter ego trusts with the deliberate intention of utilising the trust in an exploitative manner with under-handed objectives such as tax evasion. In some cases, there appears to be a misconception that creating a trust and transferring assets into a trust is a means of saving on taxes. The improper use of trusts can also result in more punitive legislative changes, almost like a "tactical game" between SARS and the taxpayer.

What then is the purpose of trusts in their purest form and is there a place for trusts in tax and estate planning?

This article aims to highlight all of the above, with a focus on *inter vivos trusts* and what should and should not be done as a founder, trustee and/or beneficiary

Definition of a trust

First and foremost, section 1 of the Trust Property Control Act¹ defines a trust as "an 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, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of person 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 or for the achievement of the object stated in the trust instrument."

¹ 57 of 1988.

Historical development of trusts

Trusts originated during the 12th and 13th centuries when many landowners left England to fight in the Crusades.² The landowners (true owners) entrusted the management of their lands to another person during their absence, by passing ownership to them (legal owners).³ When the Crusaders returned the legal owner would return the land to the true owner. Hence, the underlying principle of "asset protection" within a trust-like system was created which is the true purpose of trusts.

Trusts as a tax planning tool

To establish whether or not a trust is a practical and workable tax-planning tool, the tax implications on trusts will be considered below together with the reasoning for changes in the legislation that took place. The latter is often indicative of the improper use of trusts.

i. Transferring assets into a trust

The founder or estate planner initially encounters taxes on the transfer of assets from his or her name into the trust. Transferring assets into an inter vivos trust may occur through-

- a) A sale.⁴ A sale in exchange for an asset's market value, or if the trust has no funds of its own for the purchase of the assets resulting in the creation of a loan account i.e. via a loan account to the trust;
- b) A donation⁵ or
- c) By inheritance through a deceased person's will.⁶

The sale or the donation of assets is regarded as a disposal and is subject to capital gains tax (CGT), donation tax, and transfer duty for immovable property, respectively.

If there is a loan account created through a sale of assets to the trust, the loan account will be included in the lender's estate as an asset for estate duty purposes until the loan account is settled. Until such time, estate duty will be payable on the loan account in a dutiable estate. Many estate planners may be under the misconception that by transferring assets into a trust, their estate will instantly be exempt from paying estate duty on those assets. Depending on how long it takes to pay off the loan account, there may be a long-term gain rather than an immediate estate duty benefit from not paying estate duty.

ii. Tax on income generated in trust

Once assets are placed in trust, any income generated or capital gain is taxed in the hands of the trust, the donor, or the beneficiaries.⁷ The income tax rules are mostly contained in

² P Van Der Spuy *Demystifying Trusts in South Africa* 2 ed (2021) 4-5.

³ *Ibid* 4.

⁴ Van der Spuy *op cit* note 2 at 268.

⁵ *Ibid* 261.

⁶ *Ibid* 287 and 288.

⁷ Botha et al *South African Financial Planning Handbook* 17 ed (2019) at 855.

section 25B of the Income Tax Act but are subject to section 7.⁸ The latter is an anti-avoidance tax provision, which shifts tax liability for trust income from the trust to a natural person. In terms of this provision, a donation by a person to a trust makes the donor liable for tax on trust income at his or her marginal tax rate which could be lower than the trust. Section 7 is discussed in more detail further in the article.

Section 25B makes provision for tax liability to be extended to the hands of the beneficiaries should income or capital gains vest in a beneficiary in the tax year it was received by the trust. The income or capital gains flow through the trust to the beneficiary in this instance. This is referred to as the *conduit pipe principle*. This is where a trust can be described as a “conduit” or “channel” through which income and gains flow to trust beneficiaries.⁹

Paragraph 80 of the Eighth Schedule¹⁰ follows the same principle as in section 25B and the *conduit pipe principle* but applies to capital gains.

This form of income-splitting is beneficial to the taxpayer in that the vesting of income or capital gains in beneficiaries with low tax rates, such as children, results in there being savings on the amount of tax payable to SARS.

However, there should be some restraint in the way the latter is implemented. Phia Van der Spuy says very aptly in her article,¹¹ “In practice often trustees disregard the purpose for which the trust was set up, as reflected in its objective in the trust instrument, and blindly allocate all income and capital gains to beneficiaries (without making payment to them) in an attempt to avoid or save tax. Little do they realise that they are slowly undoing the purpose of the trust. The tax tail should never wag the estate plan dog”.

The Minister of Finance in the 2013 Budget Speech¹² as well as the first report of the Davis Tax Committee “threatened” the removal of the *conduit pipe principle* and the possible repeal of section 25B and paragraph 80 of the Eighth Schedule “to protect the tax base and limit the scope for tax leakage and avoidance”¹³.

Application of section 7¹⁴ was introduced to keep income-splitting under some control. In terms of Section 7, income that is received or that has accrued to one person is deemed to have been received by or accrued to another.

Where income or capital gains are retained in the trust over a tax year of assessment and where section 7 is not applicable, the income is taxed in the trust at a flat rate of 45%, and capital gains are taxed at a 36% effective rate. The question may be asked why trusts are taxed at a flat rate and at the highest rate. There was a time, between 1999 and 2002, when “trusts were taxed at a dual rate of tax”:¹⁵ The first R100 000 income was taxed at 35% and the

⁸ P Haupt *Notes on South African Income Tax* 40 ed (2021) at 804

⁹ Botha et al op cite note 7 at 852.

¹⁰ Income Tax Act schedule 8 paragraph 80

¹¹ Van der Spuy Trust- to-Trust: Making distribution to beneficiaries to save tax (14 July 2021) available at <https://trusteeze.co.za/article/making-distributions-to-trust-beneficiaries-to-save-tax-at-all-costs>, accessed on 14 June 2023

¹² SM Brink ‘An investigation into the future of discretionary trusts in South Africa: An income tax perspective: Part 2’ (2017) *South African Journal of Economic and Management Sciences* 20(1) a1789 available at <https://doi.org/10.4102/sajems.v20i1.1789>, accessed on the 14 June 2023

¹³ Ibid at 2

¹⁴ Income Tax Act section 7

¹⁵ Davies Tax Committee Final Report on Estate Duty at 35

income above that was taxed at the maximum marginal tax rate at the time. Taxpayers started to have multiple trusts; in fact, it encouraged this activity to continue and use “pour-over”¹⁶ trusts so that taxpayers would pay tax at a lower rate. Each trust confined its income to R100 000 per annum only and any income over R100 000 was “poured over” into another trust beneficiary. This was a loophole in the tax system which taxpayers took advantage of although this activity was not the intention of the legislature. Hence, in 2003 the legislature decided to tax trusts at a flat rate¹⁷ i.e., at the maximum marginal tax rate of individual taxpayers, which continues to this day. In this way, the abusive use of multiple trusts was put an end to.

iii. Section 7 anti-avoidance tax ‘deeming’ provisions

Anti-avoidance provisions in the Income Tax Act, more specifically section 7, were introduced as a means to avoid income splitting. Income splitting is a tax reduction strategy used to reduce gross tax rates¹⁸

Section 7 seeks to ensure that if an amount accrues to a trust or beneficiary as a result of some donation or gratuitous disposition, the person who receives that amount or to whom that amount accrues will not be taxed on that receipt or accrual, but rather, another person will be taxed on that amount.¹⁹

The following example illustrates the application of section 7, more specifically subsection (5):

“Mr. X donates an amount of R300 000 to a trust. The trust earns interest of R28 000 on this amount. The trust has five beneficiaries, and the trustees have the discretion whether, and to whom any income distributions should be made. The trustees decide to accumulate the income in the trust and not to make any distributions. Who will be taxed? In terms of section 25B and in the absence of any deeming provision, the amount will be taxed in the hands of the trust. However, the section 7 anti-avoidance provisions override section 25B. A donor (Mr. X) donated money to a trust. The trust has earned interest from this donation. The direct cause of the interest income was therefore a donation made by Mr X. The income is accumulated in the trust/retained in the trust and will be only distributed upon the happening of an event, namely the exercise by the trustees of their discretion. The R28 000 is deemed to be taxable in Mr. X's hands in terms of section 7(5)”.²⁰

Previously, assets were sold through interest-free loans or low-interest loans, and these loans were eventually bequeathed to the trust upon death. This allowed many estate planners to reduce their estates through the disguise of a loan to avoid estate duty or donations tax.

¹⁶ Ibid at 35.

¹⁷ Ibid at 35.

¹⁸ J. Kagan ‘Income Splitting’ 30 November 2020 available at <https://www.investopedia.com/terms/i/incomesplitting.asp#:~:text=Income%20splitting%20is%20a%20tax, taxes%20that%20they%20otherwise%20would>, accessed on 29 September 2023

¹⁹ W Geach with J Yeats *Trusts Law and Practice* 1 ed (2007) at 241

²⁰ M Botha...op cit note 7 at 859

As a result, section 7C of the Income Tax Act was introduced and came into effect on the 1st of March 2017.²¹ In terms of section 7C, an interest-free or low-interest loan i.e., below the current official rate of interest, will attract donations in the hands of the lender. The donations tax is calculated on the difference between the official rate of interest, at the time when the loan is granted, and the actual rate of interest that is being charged on the loan. In terms of section 7C(1) this applies to any loan, advance or credit made by a natural person or by a company at the instance of that natural person, to a trust, and such person or company is a connected person to the trust.²²

Taxpayers devised a scheme to circumvent section 7C(1) in that interest-free loans were advanced to companies whose shares were held in trust.²³ In this way, section 7C was circumvented because it only applied to interest-free or low-interest loans, advances, or credit made at the instance of a natural person to a trust.²⁴ To close this gap in the legislation, section 7C(1) was amended in 2017 to strengthen these rules. These changes incorporated a natural person as well as a company (at the instance of a natural and connected person²⁵) in section 7C(1)(ii).²⁶

These changes were yet again circumvented as they only “applied in respect of loans, advance or credit made available to a company that is owned by a trust that is a connected person in relation to the natural person advancing”.²⁷

Van der Spuy briefly explains how this new scheme worked,

“Estate planners typically replaced their loans to trusts, or companies held by trusts, with preference shares through the application of section 42 of the Income Tax Act (corporate rules allowing asset-for-share transactions) as part of a scheme, by moving trust assets, funded with interest-free, or low-interest loans, to a new company held by the trust. The preference shares (at a zero or low-dividend rate) were issued to the estate planner by the new company. Preference shares were used to circumvent the provisions of section 7C, as they are usually non-participating in the profits of the company and their value will therefore not increase, similar to those of ordinary shares. Whereas the increase in the value of the ordinary shares will normally be included in the estate of the estate planner, the value of the preference shares will remain at the original subscription value, which results in the saving of estate duty. Through this scheme, the growth in the value of the assets still took place in the trust (indirectly), as the shares in the new company (holding the assets) were held by the trust and the estate planner effectively “swopped” their loan to the trust (to which section 7C applies) for preference shares. The introduction of this anti-avoidance provision therefore undid the effect of the ‘section 42 transfers’.”²⁸

21 Taxation Laws Amendment Act 15 of 2016

22 Income Tax Act 58 of 1962 Section 7C.

23 Explanatory Memorandum to the Taxation Laws Amendment Bill 2020 11.

24 Ibid 11.

25 Income Tax Act 58 of 1962 Section 1 definition of “connected person”

26 Income Tax Act 58 of 1962 Section 7(1) (ii)

27 Explanatory Memorandum to the Taxation laws Amendment Bill 2020 12.

28 P Van der Spuy 'Preference share and trust structure loophole closed by SARS' 8 September 2021 available at <https://www.iol.co.za/business-report/opinion/trust-to-trust-preference-share-and-trust-structure-loophole-closed-by-sars-06903045-d541-429b-80ae-bb682e87b955>, accessed on 12 June 2023

Once again amendments to the legislation were made to attempt to close this loophole. Additionally, the Taxation Laws Amendment Bill of 2020 proposed changes which came into operation on the 1st of January 2021²⁹ through section 7C(1B). This new section regards the subscription price of preference shares used, to be deemed as a loan advanced. In addition, any dividends or foreign dividends in respect of the preference shares are deemed to be interest in respect of the deemed loan.³⁰

Alter Ego Trust

If a founder or planner has the intention to create a trust but deals with the trust assets as if they were his or her assets, this type of trust is referred to as an 'alter ego trust' indicative of the trust being an extension of oneself.³¹ The Trust Property Control Act states³² that "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". However, there have been many instances where founders and/or trustees of a trust conduct the affairs of a trust as if it is their estates, blatantly disregarding the separation of ownership. The leading example of an alter ego trust is the case of *Parker*,³³ where Cameron JA in his judgement pointed out the following:

- a) The importance of ensuring that the specified minimum number of trustees are always in office. Mr. and Mrs. Parker concluded transactions with a sub-minimum number of trustees and completely disregarded the terms of the trust deed
- b) Trustees must act jointly at all times. Mr and Mrs Parker failed to do so even after a third trustee was appointed. They bound the trust without consultation with the third trustee. This was a complete disregard of their trustee obligation.³⁴
- c) The fact that the trust was controlled by the beneficiaries who were also the trustees completely removed the division between control and enjoyment resulting in abuse due to the lack of independence on the part of the trustees. This is likely to occur when the control of the trust resides entirely with trustees-cum-beneficiaries.³⁵
- d) As part of the Master's statutory functions, the Master should ensure that there is a proper separation between control and enjoyment in the administration of trusts. This can avoid the violation of the use of trusts as is evident from *Parker* and other cases. The Master should insist on the appointment of an independent outsider trustee to every trust in which (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another.³⁶

One of the key issues that a founder or planner often experiences is relinquishing control of assets transferred to a trust and allowing the trustees the right to manage the assets strictly

²⁹ Explanatory Memorandum to the Taxation laws Amendment Bill 2020 at 12.

³⁰ Ibid at 12

³¹ Van der Spuy op cite note 2 at 552.

³² Trust Property Control Act Section 12.

³³ *Parker NO & others v Land and Agricultural Bank of SA* [2003] JOL 10468 (T) 3.

³⁴ *Land and Agricultural Bank of South Africa 2004 All SA 261 (SCA)*, judgement para 15.

³⁵ Ibid at para 29.

³⁶ Ibid para 35.

in a fiduciary capacity. There are times when the courts 'pierce the veil' of a trust. This is similar to the well-established principle of '*piercing the corporate veil*' of companies where directors can be held to be owners of property actually owned by the company, or for the directors to be *personally liable* for the companies debts or liabilities.³⁷ With an alter ego trust, the trust exists but the court will 'look through' the trust by disregarding the trust ('pierce the veil' or veneer, of the trust) resulting in the value of the trust being included in the estate of such person.³⁸ Two common situations that may lead to the piercing of the veil or veneer of a trust is divorce or insolvency. In both instances, a trust may be created amidst a forthcoming divorce or insolvency and used to 'hide assets' in the former case from an aggrieved spouse or in the latter case from frustrated creditors.

Sham Trusts

A 'sham trust' is a trust created when a founder or planner does not have the intention to create a 'genuine' trust.³⁹ A 'sham trust' exists when there is a clear intention to form something other than a trust or when there is an intentional or unintentional omission of one or more of the essential elements required for the formation of a valid trust.⁴⁰ Transacting with a sham trust leads to those transactions being void as the trust does not exist.⁴¹ When a trust is a sham trust, it is void from inception (or void *ab initio*) and it does not exist.⁴² The veil may be pierced when the persons who control the trust do so with a deliberate intention to gain an unfair advantage.⁴³

The true and essential purpose of a trust

A shadow is cast over trusts when aspects such as the tax implications related to trusts are considered or when schemes to abuse the proper use of a trust are devised. Despite this, trusts are still able to perform their core function and there are many legitimate reasons for a planner to have a trust. The purpose or objective of the trust is what sets the tone of how the trust will be administered and managed.

Benefits of having a trust

- a) Asset protection and preservation. One of the most important reasons to consider a trust as an asset protection vehicle is because it will assist in keeping one's assets separate, such as property investments, debt from business, interest, and/or other financial needs.⁴⁴ Trust assets are also not subject to the marital regime of beneficiaries and will not be hauled into the divorce arena.

³⁷ Van der Spuy op cite note 2 at 554.

³⁸ Ibid at 553.

³⁹ Ibid at 549.

⁴⁰ Ibid at 549.

⁴¹ Van der Spuy op cite note 552.

⁴² Ibid at 552.

⁴³ Ibid 554.

⁴⁴ Van der Spuy op cite note 2 at 78.

- b) A discretionary trust is extremely flexible and caters for various uncertainties such as an increase in family size and fortune, divorce, and re-marriage for a second or third time with children from previous marriages.⁴⁵ An example of the latter situation is where a founder or planner has entered a second marriage but has children from his or her previous marriage. Should the founder or planner bequeath his or her estate to the new spouse, there is a possibility that the new spouse may disinherit the founder's or estate planner's children from the previous marriage. A solution would be to create a trust to resolve this concern where the spouse and the children may be income and/or capital beneficiaries of the trust. The trustees will manage and control the trust assets thereby avoiding prejudice to any beneficiary.⁴⁶
- c) Perpetual and efficient succession and preservation of wealth for future generations. A well-managed trust allows succeeding generations to participate in, and benefit from, the wealth created by one generation.⁴⁷
- d) Estate freezing or 'pegging' of the estate is a benefit that brings some tax relief. This entails the sale or donation of growth assets to the trust at market value. Any increase in the value of these assets from the date of transfer will then take place in the trust and not in the client's estate. In this way, estate duty is reduced on the growth portion of the asset. The only amount that will appear in the client's dutiable estate will be the amount that the assets were sold to the trust for plus interest and NOT the growth that took place after transfer to the trust, effectively 'freezing' or 'pegging' the estate at this lower value.⁴⁸
- e) A trust can also provide for joint ownership of indivisible assets, such as holiday homes and farms. It is not possible to subdivide farms, as there are laws that prevent the subdivision of agricultural land⁴⁹. A trust, however, can be used to provide for several beneficiaries who could have different rights of use and enjoyment over various parts of the farm.⁵⁰
- f) Medical health issues often accompany aging. A trust can play an important role for planners who become affected by a mental health issue such as Alzheimer's disease or dementia. Transferring assets before the onset of any mental illness allows his or her financial affairs to continue as before, with the trustees being entrusted to manage the trust assets in the interest of the affected beneficiary.⁵¹

Conclusion

Creating a trust to save on taxes is not the true purpose served by a trust. It was never the intention when trusts came about to have this institution created to save or avoid taxes. If this does happen, it should be purely incidental in the circumstances and not the primary focus.

⁴⁵ Ibid at 91.

⁴⁶ Ibid at 91.

⁴⁷ Ibid at 98.

⁴⁸ Trust Law (unpublished lecture notes, Milpark, 2018) at 214-215

⁴⁹ Subdivision of Agricultural Land Act 70 of 1970, section 3

⁵⁰ Ibid at 227

⁵¹ Ibid at 93

The discussion on the tax implications in this article is indicative that SARS and the courts do not tolerate tax schemes being devised to circumvent the system. Legislation is strengthened each time a scheme is devised as is seen with section 7C for example.

However, trusts are certainly an estate planning mechanism that can be used to meet various legitimate objectives as discussed under the benefits of a trust. This list of benefits is not exhaustive.

In this article much has been said about what should not be done when using a trust, but ultimately the administration and management of the trust in line with trust legislation and the deed of trust is key. Trustees must therefore be chosen wisely and prudently as their tasks require diligence and skill. A founder or planner must do the necessary research before deciding whether a trust is an appropriate tool to meet their tax and/or estate planning objectives. Having a sound, proper, and honourable objective or purpose for the trust is the starting point. It must be clear and lawful.

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The Section 4(b) Deduction and Sureties



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Introduction

Consider: In the world of estate planning, the careful management of assets and taxation considerations can significantly impact the legacy that we leave behind. One pivotal aspect of this process is understanding the deductions of the Estate Duty Act,¹ which can play a crucial role in minimising tax burdens on the estate. Section 4(b) of the Act is one such provision in the Act and offers a deduction of all debts from the total value of the property in the estate of the deceased persons who were resident in South Africa at the time of their death, provided that the Commissioner of SARS is satisfied that the debts have been discharged from property included in the deceased estate.

One notable challenge arises when a client during his/her lifetime binds himself/herself as surety and co-principal debtor for debts. In most of these instances, the financial institution registers a security cession on a life assurance policy of the client, so that in the event of the client passing away before the debt is repaid, the proceeds of the life assurance policy settle the debt on behalf of the estate.

This article will attempt to provide financial planners with important insights into the application of Section 4(b), focusing on key factors to consider. Additionally, it will also address the pertinent question surrounding the treatment of executor's fees and ceded policies.

By exploring these topics, financial planners can enhance their understanding and make informed decisions to optimise estate management and ensure a smooth wealth transfer of their client's estates.

Section 4(b) of the Estate Duty Act 45 of 1955

"The net value of any estate shall be determined by making the following deductions from the total value of all property included therein in accordance with section 3, that is to say—

*(b) all debts due by the deceased to persons ordinarily resident within the Republic (other than any debt which constitutes a claim by such a person to property donated by the deceased in terms of a donation which was exempt from donations tax under section 56 (1) (c) or (d) of the Income Tax Act, 1962 (Act No. 58 of 1962)), which it is proved to the satisfaction of the Commissioner have been discharged from property included in the estate."*²

The wording of Section 4(b) sets out that certain conditions must be met before the Commissioner of SARS will allow this deduction. These conditions are:

- (i) The debt must be due by the deceased.
- (ii) It must be due to a person or persons ordinarily resident in South Africa; and
- (iii) It must be discharged from property in the estate of the deceased.³

¹ Section 4(b) of the Estate Duty Act 45 of 1955

² Section 4(b) of the Estate Duty Act 45 of 1955

³ Meyerowitz on Administration of Estates and Estate Duty p.28.3 (2007 Edition)

With reference to (i) above, it is paramount for financial planners to understand what is meant by "debt due" in this context. It has an impact on the Section 4(b) deduction and specifically as it affects the deceased binding him/herself as surety and co-principal debtor for debts.

Illustrative example

Mr Bond is a director and shareholder of a company, Corporation (Pty) Ltd. Corporation (Pty) Ltd has debts to the bank in the amount of R5,000,000. Corporation (Pty) Ltd is the debtor and Mr Bond has bound himself as surety to the company's debts. Mr Bond however is not obligated to service this debt from his own estate. The bank took surety (by way of security cession) of a personal life policy of Mr Bond. On date of Mr Bond's death, the proceed of the said life policy was paid to the bank.

Can the repayment of the debt of R5,000,000 as a result of this suretyship be construed as a Section 4 (b) deduction in the estate of Mr Bond?

The answer to this question will be found in academic discussions, the Estate Duty Act and relevant court cases.

In Meyerowitz on the Administration of Estates and Estate Duty, the author stated the following:

"It is submitted that where the deceased has bound himself to make payments for a period or until due notice such as rent under a lease or on a loan, the liability of the estate to make these payments constitutes debts due by the deceased since they were incurred by him and not his executor in the course of administration".⁴

This means that only debts which were incumbent on the estate while the deceased was alive and not which only become incumbent on the deceased estate after the death of the surety or co-principal debtor.

In the judgment of Kuper J in *Myer NO v CIR (21 SATC 31)* the following was stated:

"It is in my view, clear from the wording of the section that before any debt can be deducted from the gross estate of a deceased person, that debt must have been due by the deceased and in this regard a distinction must be drawn between the deceased and the executor of a deceased estate...if the deceased had a contingent liability, which only became payable after death, such a liability could be deducted because it arose from an obligation of the deceased incurred during his lifetime. The fact that a debt is not due and payable at the moment of death is irrelevant as long as the debt when due was not incurred by the executor in the liquidation and administration of the estate but arose because of some action taken or obligation assumed by the deceased."⁵

In the court case of ITC 1773 (66 SATC 251) the court agreed with both Meyerowitz and Kuper J, but the court applied some conditions that need to be met before a surety can be claimed from the deceased estate as set out in Section 4(b).

⁴ Meyerowitz on Administration of Estates and Estate Duty p.28.4 (2007 Edition)

⁵ March 2005 Issue 67 SAIPA Estate Duty 1270. A surety is not a debt due

What are these conditions?

ITC 1773 (66 SATC 251)⁶

In this court case, the court was confronted with the question whether the payment to a Bank for an amount owing to the Bank, for which the deceased signed surety, qualifies as a deductible liability in terms of Section 4(b) of the Estate Duty Act?

The court concluded that SARS was correct to disallow the deduction under Section 4(b) of the Act. The court arrived at this decision on the following conditions:

- (i) the deceased was only liable to the financial institution as surety and the liability was contingent upon the principal debt being due; and
- (ii) that there was no evidence that the financial institution claimed the principal debt from the estate.⁷

To answer the question above, the following "steps" can be utilised by financial planners to decide whether a surety can be included as a deduction under Section 4(b) of the Estate Duty Act:

- (1) the financial planner will have to determine whether the financial institution will elect to claim the surety from the estate on the death of the client.
- (2) then the financial planner will have to determine whether the executor will claim the debt from the main creditor i.e., the trust, close corporation, or company on whose behalf the client bind himself/herself as surety and - co-principal debtor for debts.
- (3) then the financial planner should determine whether the main creditor will be able to repay the claim of the estate.

Can executor fees be charged on life assurance policies ceded to a financial institution as per the facts discussed above?

Executor fees can also be deducted from an estate when calculating estate duty. The general position is – if the policy proceeds are payable to the deceased estate, then the full proceeds must be reflected in the liquidation and distribution account. Life assurance policies ceded to financial institutions as surety for debts, must be dealt with in the same manner. In practice, the proceeds will be reflected as assets and creditors will claim them as a liability.

⁶ Surety and Contingent Liability – Ryno Van Niekerk, *Glacier* by Sanlam 30 April 2014

⁷ March 2005 Issue 67 SAIPA Estate Duty 1270. A surety is not a debt due

Conclusion

The financial advisor should pay close attention and apply the conditions provided above to determine whether a debt was due and incumbent upon the estate of the deceased. If this is not the case, the Section 4(b) deduction cannot apply and payment to settle the debtor's estate cannot be deducted for estate duty purposes. Erroneous calculations in the estate planning process can easily lead to inaccurately underestimating estate liquidity shortfalls and financial advice risk to the advisor.

In the calculation of the estate liquidity, the executor fees payable on personal policies ceded as security to a creditor must be included in the calculation, because as per the discussion above, the executor can claim executor's fees on such policies.

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Introduction

Life events such as divorce can significantly impact the provisions of a will. This article aims to shed light on the legal considerations and changes in the law that influence financial advice in the context of estate planning, particularly focusing on the effect of the dissolution of marriage on the provisions of a will.

Last Will and Testament

A last will and testament, commonly known as a will, can be defined as a written document in which a testator or testatrix ("testator") voluntarily sets out their instructions as to how their assets are to devolve upon their death.¹ According to the definition in section 1 of the Wills Act², a will includes a codicil and any other testamentary writing.³ This definition does not indicate the essence of a will, rather it prescribes certain legal requirements that a valid will must conform to. These requirements relate specifically to the signing and witnessing of the will in the physical presence of two competent witnesses, amongst other requirements. In terms of section 4 of the Wills Act, a person who is 16 years and older is considered to have testamentary capacity, and is competent to make a will, if they are mentally capable of appreciating the effect of what they are doing.⁴

A testator must have an up-to-date and valid will as this will affect the testator's ability to choose their heirs, beneficiaries, the trustees in a testamentary trust, and the executor of their deceased estate. Further, the testator may want to include special instructions and directions in their will. A carefully structured will assists the testator in reducing estate duty liability and achieving the efficient administration of their deceased estate. If there is no valid will, the rules of intestate succession will apply, and the testator's estate could be inherited by individuals whom the testator would never have wished to benefit on their death.⁵

Freedom of Testation

A fundamental principle of the law of succession is the freedom of testation. This refers to the freedom of a person to make any provision they want to make in a valid will and to the right to have their estate divided in whatever manner they wish.⁶ A testator can determine who will receive their property, money, or other possessions upon their death. The principle of freedom of testation allows the testator to have complete discretion over the beneficiaries of their estate. The Court, in *Harvey NO and Others v Crawford NO and Others*,⁷ referred to this principle as follows:

"The right of ownership permits an owner to do with her thing as she pleases, provided that it is permitted by the law. The right to dispose of the thing is central to the concept

¹ Pace & Van der Westhuizen

² Wills Act 7 of 1953

³ Act No. 7 of 1953

⁴ Act No. 7 of 1953

⁵ M Botha et al, *The South African Financial Planning Handbook* (2023) at 890

⁶ In *Re BOE Trust Ltd and Others* NNO 2013 (3) SA 236 (SCA), para 26

⁷ *Harvey NO and Others v Crawford NO and Others* 2019 (2) SA 153 (SCA)

of ownership and is a deeply entrenched principle of our common law. Disposing of one's property by means of executing a will or trust deed are manifestations of the right of ownership. The same holds true under the Constitution."

There are a few limits to freedom of testation, such as a provision in a will that is against the law or contrary to public policy. A provision is contrary to public policy if it is designed to achieve some objective which is regarded as harmful or unethical by the community. Further, a provision which requires the beneficiary to commit a crime, to divorce their spouse, or to change their religion will be held to be contrary to public policy.⁸

Effect of Divorce or Annulment of Marriage on a Will

It is important to note that the change of status of a testator, such as getting married, divorced, or having children does not automatically result in the revocation of an existing will. However, there may be circumstances where there is tacit revocation of a provision in a will through the operation of section 2B of the Wills Act ("Section 2B").

Section 2B provides the following:

"If any person dies within three months after his marriage was dissolved by a divorce or annulment by a competent court and that person executed a will before the date of such dissolution, that will shall be implemented in the same manner as it would have been implemented if his previous spouse had died before the date of the dissolution concerned, unless it appears from the will that the testator intended to benefit his previous spouse notwithstanding the dissolution of his marriage."⁹

Section 2B was inserted into the Wills Act by section 4 of the Law of Succession Amendment Act 43 of 1992.¹⁰ The insertion of section 2B into the Wills Act emanates from the South African Law Commission ("the Commission") Report of June 1991, after extensive research into the position in several other countries and/or jurisdictions. The rationale is that in such inevitably stressful and sometimes traumatic experiences such as divorce, redrafting a will is often the last thing on a person's mind. However, the Commission recommended that three months was long enough time for a person newly divorced to take stock of their new situation and take remedial action.¹¹

The Three-Month Window

The practical application of section 2B, is that there is a three-month window or grace period following the divorce or annulment of marriage, during which the will is read as if the former spouse had died before the date of divorce.

This means that if the testator dies within three months from the date of divorce and the deceased's will bequeathed any assets to a former spouse, the deceased testator's former spouse will not inherit from the deceased estate, as it will be treated as though the former

⁸ Wills and Succession, Administration of Deceased Estates and Trusts, para 318

⁹ Act No. 7 of 1953

¹⁰ Act No. 43 of 1992

¹¹ SA Law Commission, Project 22, Review of the Law of Succession, 1991

spouse had passed away prior to the dissolution of marriage. By deeming the former spouse predeceased, section 2B ensures that the former spouse does not inherit, despite being named as a beneficiary, while the rest of the deceased testator's will remains intact.¹²

The three-month window following a divorce or annulment of marriage provides an opportunity for individuals to amend their wills and to reflect on their new circumstances. If a testator does not amend the will within this period, and the testator passes away, more than three months after their divorce, the law assumes that the testator had the opportunity to change their will but chose not to. Therefore, any provisions in the testator's will that favours their former spouse will remain valid despite the dissolution of the marriage.¹³

There are a few exceptions to this rule, where the provision in the will that benefits the former spouse will not be revoked by the divorce or annulment of marriage, for example:

- ❑ if the will was made in contemplation of the divorce, and a provision in the will specifically states that it is intended to remain in effect even if the testator gets divorced;
- ❑ if it can be inferred from the provisions of the will that the deceased intended for their former spouse to inherit despite being divorced; and
- ❑ if the testator's former spouse was named as a beneficiary of a life insurance policy or retirement fund, these benefits would typically not be affected by a divorce unless the testator changes their beneficiary designation.

Beneficiary Nominations

A beneficiary nomination is a person nominated in the policy to claim the proceeds of the life insurance policy or retirement fund. This is known as nomination for proceeds. This caters for the situation where the life insured dies or the maturity date has occurred when the policy proceeds are to be distributed in the normal course of business.¹⁴ If no beneficiary is designated, the proceeds will be paid to the policyholder's estate. This could potentially lead to unintended consequences if, for example, a former spouse is the beneficiary of the estate. The former spouse could inherit the proceeds, even if that wasn't the intention of the policyholder. Therefore, it is crucial for policyholders to designate beneficiaries and review these designations regularly, especially after significant life events like a divorce or birth of a child. This helps to ensure that policyholder's assets are distributed according to their current wishes.¹⁵

Scenario – Mr (A), Ms (B) and Ms (C)

Consider the following scenario, where Mr (A) following the dissolution of his marriage with Ms (B) through divorce, remarries, drafts a new will wherein he bequeathed his assets to "my wife"

¹² Act No. 7 of 1953

¹³ Wills and Succession, Administration of Deceased Estates and Trusts, para 299

¹⁴ M Botha et al, The South African Financial Planning Handbook (2023) at 268

¹⁵ M Botha et al, The South African Financial Planning Handbook (2023) at 269

and then dies within three (3) months from the date of dissolution of his initial marriage. Who will inherit from Mr (A)'s estate, Ms (B) the former spouse or Ms (C) the current spouse?

It is my view or opinion that:

- ❑ the law does not provide explicit guidance on whether Ms (C) the current spouse or Ms (B) the former spouse would inherit in the given scenario, however, considering the intention of section 2B provided above, it is likely that Ms (C) the current spouse would inherit, as the law aims to prevent the unintentional inheritance by a former spouse Ms (B); and
- ❑ further, Ms (C) the current spouse would likely be the one to inherit, because at the time of drafting the new will, the term "my wife" would refer to the person they are currently married to because the intention of the testator is a crucial factor in interpreting will.

The courts over time have evolved several presumptions when interpreting wills, such as if the language used in the will is ambiguous or doubtful, that the meaning ought to be given to the will which is in accord with the general wishes of the testator to be gathered from the provisions of a will.¹⁶

Preventing Ambiguity in a Will

❑ **Louw NO v Kock and Another [2017] JOL 38057 (WCC)**

The case of first impression with regards to section 2B is the judgement of *Louw NO v Kock*.¹⁷ The first respondent was a surviving former spouse of the deceased. The deceased and the first respondent had executed a joint will in 2004 in which they each nominated the survivor of them as the sole heir. The first respondent and the deceased were married for twenty-nine (29) years. They divorced on 17 October 2014 and the deceased passed away on 7 January 2015, a mere ten (10) days short of the expiry of the three-month period. The deceased did not make a new will in the period between the divorce and his death.¹⁸

The existing will provided that, should the surviving spouse pass away without making a further valid will, the immovable assets would go to the deceased's father and should he predecease the testator, to the Society for the Prevention of Cruelty to Animals (SPCA). Under such circumstances, the residue of the estate was also bequeathed to the SPCA. Applying section 2B, the Master refused to give effect to the clause of the will instituting the first respondent as heir. As the deceased's father predeceased him, the SPCA then stood to inherit the entire estate.¹⁹

The court held that based on an interpretation of the will, it was clear and unambiguous that section 2B, excluded the first respondent from inheriting. Further, the court held that section 2B must be interpreted strictly and that a divorced spouse can only inherit under a will

¹⁶ *Verseput and Others v De Guchy, NO and Another [1977] 4 All SA 339 (W)*, para 342

¹⁷ *Louw NO v Kock and Another [2017] JOL 38057 (WCC)*

¹⁸ para 2 - 5

¹⁹ para 7

executed before the divorce if it appears from the will that the deceased intended the divorced spouse to benefit notwithstanding the divorce.²⁰

In the present case, the court found that it did not appear from the will that the deceased intended the first respondent to inherit notwithstanding the divorce. The will simply provided that the longest-living spouse would be the sole heir of the first dying spouse. The court agreed with the applicant that if the deceased had intended the first respondent to inherit after divorce, he would have explicitly stated so in the will or he would have made a new will indicating as such.²¹

The court in *Louw NO v Kock* interpreted the provisions of the will strictly. This is a landmark decision, as it guides how to interpret section 2B. This means that it is likely that a divorced spouse will only be able to inherit under a will executed before the divorce if there is unambiguous evidence in the will that the deceased intended the divorced spouse to benefit notwithstanding the divorce.

It is advisable and highly recommended for a testator to review their will regularly, especially at the commencement of divorce proceedings or whenever there is a change in status, for example through marriage, death, divorce, birth, cohabitation, or adoption. If a testator has a will or a joint will with their spouse that was executed before their divorce, they should consider amending it to ensure that their former spouse is not able to inherit from their estate, unless they specifically intend them to do so.

Testamentary Trusts

A testator may also want to consider setting up a trust to protect their assets and to ensure that their assets are distributed according to their wishes upon death. Trusts are legal entities that can be used to hold and manage assets. Trusts are very useful estate planning tools because a trust can be used to separate ownership and control assets. A testamentary trust is a type of trust which is formed on the death of a person through their will, this can be used by the trustee to pass benefits to heirs and legatees rather than give full ownership of the inherited assets directly to them trust in accordance with the terms of the trust deed.²² This is a key advantage, as the trust can be used in estate planning to minimise estate duty liability and Capital Gains Tax that can arise on death. Further, future generations can be protected by ensuring that the assets are held in trust and not in the personal names of a testator's descendants. Lastly, the assets are protected, because they are not available to be divided between former spouses in the event of a divorce.²³

²⁰ para 19 - 22

²¹ para 24 - 26

²² M Botha et al, *The South African Financial Planning Handbook (2023)* at 903

²³ M Botha et al, *The South African Financial Planning Handbook (2023)* at 904

Constitutionality of Section 2B

❑ JW v Williams-Ashman NO and Others [2020] JOL 48042 (WCC)

The legal question before the Court in the case of *JW v Williams-Ashman NO*²⁴ was whether section 2B was unconstitutional and contrary to public policy.²⁵ The applicant, a divorced husband, launched a constitutional challenge against section 2B.

The applicant argued that section 2B infringed his right to property under section 25(1) of the Constitution of the Republic of South Africa, 1996 ("the Constitution")²⁶, because it arbitrarily deprived him of his right to inherit from his former spouse, even though she had intended to leave her estate to him.²⁷ Further, the applicant argued that section 2B limited his right to access the courts, in breach of section 34 of the Constitution.²⁸

Section 25(1) of the Constitution reads as follows:

"No one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property."²⁹

Section 34 of the Constitution reads as follows:

"Everyone has the right to have any dispute that can be resolved by the application of law decided in a fair public hearing before a court or, where appropriate, another independent and impartial tribunal or forum."³⁰

The applicant and his former spouse were married in community of property with the accrual system on 11 June 2011. The deceased had executed a will four (4) days before her marriage, leaving her entire estate to the applicant and nominated the first respondent, her attorney as her executor.³¹ She reiterated this testamentary wish to her former bridesmaid before her death.³² Their marriage broke down irretrievably and the final decree of divorce was issued on 24 October 2016,³³ incorporating a consent paper recording their agreement in relation to the proprietary consequences of their assets on divorce.³⁴

The deceased emailed the applicant a week before the divorce to enquire whether he had changed his will or whether their agreement to leave their assets to each other upon their respective deaths, still applied. The applicant did not reply to the email but had instead telephonically advised the deceased that their wills remain the same on divorce.³⁵ However, the applicant had instead drafted a valid will wherein he bequeathed his estate to the children of a former marriage. The deceased committed suicide and her date of death was recorded as 8 December 2016 on her death certificate. As a result, section 2B became applicable and under the relevant provisions of the Intestate Succession Act,³⁶ her parents

²⁴ *JW v Williams-Ashman NO and Others [2020] JOL 48042*

²⁵ para 26

²⁶ Constitution of the Republic of South Africa, 1996

²⁷ para 51 - 52

²⁸ para 129 - 130

²⁹ Constitution of the Republic of South Africa, 1996

³⁰ Constitution of the Republic of South Africa, 1996

³¹ para 5

³² para 14

³³ para 12

³⁴ para 7

³⁵ para 11 - 13

³⁶ Act 81 of 1987

would inherit her estate in equal shares, as there were no children born of the marriage. The applicant was advised that he did not qualify as a beneficiary of the deceased estate in terms of section 2B.³⁷

The Supreme Court of Appeal (SCA) dismissed the appeal. The court held that section 2B serves a legitimate and compelling social purpose, namely, to protect the interests of divorced spouses and their families. The court found that the deprivation of property that section 2B affects is not arbitrary, as it is reasonably necessary to achieve this social purpose. The court also held that the provision is not procedurally unfair, as it does not prevent the testator from expressing their real intention in their will. The fact that the testator did not give any indication in their will that they wanted to continue to benefit their divorced spouse is the only indication of their real intention that can be considered.³⁸

The decision of the SCA in *JW v Williams-Ashman*, is significant in that it upholds the constitutionality of section 2B. The court's decision is likely to be welcomed by divorced spouses and their families. Section 2B provides a degree of certainty and stability in the event of a divorce, by ensuring that divorced spouses are not inadvertently disinherited. It is important to note that the SCA has emphasised that section 2B does not prevent testators from expressing their real intention in their will. However, Section 2B does place some restrictions on the freedom of testation. Overall, the decision of the SCA strikes a fair balance between the interests of testators and the interests of divorced spouses and their families.

Conclusion

Having considered how the courts have treated section 2B, what are some of the practical implications of divorce on the provisions of a will and what are some of the strategies that a testator may potentially adopt to mitigate the consequences of divorce, in the context of estate planning.

A recently divorced person has a three-month window or grace period to revoke and/or amend their will where their former spouse was named as the beneficiary. Any provisions in the existing will that favour the former spouse will remain valid despite the dissolution of the marriage if the will is not amended the three-month window or grace period. Therefore, a testator should consider the impact of Section 2B when drafting and/or updating a will especially if they are in the process of getting divorced.

When drafting a will, a testator may insert a "counter" clause, which will address the tacit revocation of a provision in a will through the operation of section 2B. A relevant "counter" clause would be a provision in a will that specifically states that the testator intends for their former spouse not to inherit from their estate in the event of the dissolution of the marriage by divorce or annulment.

It is advisable for a testator to have an open discussion with their family about their estate planning wishes, by scheduling a meeting with all their close family members whom they want to include in the discussion i.e., a spouse or partner, children, parents and/or siblings. This is a

³⁷ para 18

³⁸ para 155 - 157

great opportunity for the testator to explain their estate planning goals and objectives ensuring that everyone understands the testator's wishes and that there are no surprises on death. Once the testator has reviewed their estate plan considering their family's feedback and concerns, the testator should consult with a financial advisor or legal practitioner to draft a will that reflects their wishes considering section 2B. Consulting with a financial advisor or legal practitioner may assist in drafting a will that is clear, concise, and easy to understand.

Further, the testator can be advised on how to structure the will to minimise the impact of section 2B. Thus, creating an estate plan that meets the testator's specific needs while protect the interest of their loved ones.

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The Global Family: Estate Planning Considerations



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Introduction- The world is your oyster

“The world is your oyster” is a phrase that speaks volumes to those who seek exciting opportunities beyond South Africa's borders. Taking such bold steps is often fuelled by work opportunities, family safety, and a first-world lifestyle, often summed up as a better quality of life. The ripple effects of taking these bold steps are often not fully explored especially if you have responsibilities of dependants and possibly a potential inheritance in South Africa. You also need to be very aware of the impact on an estate and a financial plan when you live and work abroad.

This article will explore the estate considerations of a South African living and working abroad.

Taking the first step...Leaving behind more than memories and family

While leaving loved ones behind to move overseas is challenging, it is essential to weigh the practicality of the decision and understand its consequences.

Working in a foreign country may result in you acquiring assets in such foreign jurisdiction. For example, a bank account or an immovable property. These acquisitions then have an impact on your estate planning. You will have to consider the consequences and impact of your death on these assets, to avoid unnecessary delays in the administration process.

When you are resident in a foreign jurisdiction, it is important to receive expert advice in respect of any asset that is owned in that jurisdiction. This will ensure, on death you have the right structures in place, allowing for ease of administration. Such structures would include a foreign valid will, especially where the laws of a foreign country are different to South Africa.

Also, consider that if you were to inherit from parents or other family members in South Africa, and the impact that may have on moving such inheritance offshore to your new domain. As a beneficiary of a South African Will, your residential/emigrant status in terms of exchange control regulation at the time of inheritance will be important.

In terms of South African exchange control regulation a beneficiary (inherits from) of a South African estate, living overseas may utilise their inheritance allowance of R10 million per annum if they fall within the following category: ¹

- The beneficiary must never have been a South African Resident – you always lived overseas, such a case your inheritance will be remitted offshore
- The Beneficiary is a non-tax resident - broken tax status with South Africa and no longer consider South Africa your permanent home – provided SARS requirements are met, monies may be remitted offshore
- The Beneficiary is a South African living abroad – exchange control requirements will have to be considered before monies are remitted alternatively, a non-tax resident status will have to be considered.

¹ <https://www.sars.gov.za/faq/faq-i-live-overseas-and-im-the-heir-of-my-parents-estate-is-there-anything-i-must-know-on-how-to-go-about-receiving-the-inheritance/>

Where a South African living abroad is a beneficiary to a South African estate, the estate planner will have to ensure that they consider the legislative requirements such as

- Ensuring that beneficiaries will have to be properly vetted and identified per the requirements set out by the Financial Intelligence Centre Act (FICA).² All documents that are received from an offshore beneficiary would have to be authenticated as it would be a document signed outside of the Republic of South Africa for use within the borders of South Africa.³ This is added paperwork and can be time-consuming and onerous.⁴
- The foreign exchange rate of the Rand with a foreign stronger currency means that the beneficiary can receive a smaller inheritance when the monies are converted and sent offshore.
- A very valid consideration is checking if your new host country has a double taxation agreement with South Africa. South Africa's double taxation agreements and their current status is listed on the SARS website and is easily accessible.⁵ The purpose of a Double Taxation agreement between two countries is to ensure that a taxpayer does not pay taxes both in their host countries and in South Africa (or any two participating countries).
- The impact of other legislation on an inheritance received in the host jurisdiction. The Foreign Account Tax Compliance Act (FACTA) is an apt example.⁶

Documenting your wealth

A valid and comprehensive will that addresses both South African assets and/or offshore assets that you have accumulated is vital to ensure that your family is taken care of in South Africa and wherever they may be in the world and is therefore an important document to have

² Financial Intelligence Centre Act 38 of 2001.

³ Rule 63 of The Rules of the High Court of South Africa regulates the requirements for authentication where documents are signed/executed outside South Africa for use within South Africa. **Rule 63(2)(e) Procedure includes** The documents can be signed in the presence of a Notary Public if signed in the following countries: Botswana, the United Kingdom of Great Britain and Northern Ireland (England or Ireland), Lesotho, Swaziland and Zimbabwe

Authentication may also take place The Hague Convention of 5 October 1961. According to the convention procedure Both countries must be members of the Hague Convention. Therefore, the country in which the document is being signed as well as the country in which the document is to be used must be members of the Convention.

The signed documents must

- Be signed by the signatories;
- Be authenticated, by either placing an Apostille certificate on the document or attaching it thereto;
- The Apostille must conform to the prescribed format – as set out in the Convention; and
- Must be issued and signed by, and bear the seal of office of, the competent authority of that country.

⁴ <https://www.macrobobert.co.za/insights/posts/authentication-of-documents-signed-outside-south-africa>

⁵ <https://www.sars.gov.za/wp-content/uploads/Legal/Agreements/LAPD-InfA-DTA-2013-01-Status-Overview-of-All-DTAs-and-Protocols.pdf> accessed on 10 August 2023.

⁶ Foreign Account Tax Compliance Act of 2010, is US federal law. This requires foreign financial institutions and certain non-financial institutions to report on foreign assets held by US tax taxpayers

A South African estate, on death, is valued on all of your assets worldwide. It is important to establish whether a South African living abroad will require a worldwide will or a foreign will. A worldwide will⁷ is usually appropriate where there are assets located offshore but are not impacted by specific inheritance rules in the offshore jurisdiction and do not require formal transfer and re-registration on death.⁸ Cash and cash-like financial instruments held in a foreign jurisdiction will be an appropriate example

A foreign will on the other hand will ensure assets that are governed by unique inheritance and transfer rules are adequately dealt with in terms of such rules.⁹

Trust Structures

In South Africa, a common estate planning strategy is to leave the residue of your estate to an *inter vivos* trust. In this way, prospective beneficiary estates are not inflated, which in turn means that the future estate of such beneficiary will have reduced estate costs and taxes to be paid on their death because they are not owned by the beneficiary themselves, they are owned by the *inter vivos* trust.

This is an excellent estate planning strategy for a South African beneficiary. For a beneficiary living abroad, this may prove to be a challenge.

One of the tax advantages of a trust is the application of the "conduit principle"¹⁰ which allows income as well as capital gains to be taxed in the hands of a beneficiary.

Any amount received by or accrued to or in favour of any person during any year of assessment in their capacity as the trustee of a trust, shall,

- subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year,
- be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.¹¹

In the recent judgement of *CSARS v Thistle Trust*¹² In paragraphs 8 to 10 of the judgment, the concept, more especially the interpretation of 25B, was highlighted. The Supreme Court of Appeal (SCA overturned the tax court's decision and confirmed that capital gains cannot flow through multiple discretionary trusts. More so the court held it is apparent that the legislature intended that s 25B of the ITA be applied to the taxation of income that accrues to a trust or its beneficiaries. In contrast, the Eighth Schedule is to be applied to the taxation of

⁷ Unless otherwise specified, your South African will covers your world-side assets. That said, the nature, location and value of any assets that are not located in this country may require that you draft a separate will that deals with these assets, and this is known as a foreign will (<https://www.moneyweb.co.za/financial-advisor/eric-jordaan/>)

⁸ Jothi Chirkoot, " Worldwide wills versus Foreign Wills " Premiums and Problems Article edition 122. 2021 at page A16

⁹ Jothi Chirkoot, " Worldwide wills versus Foreign Wills " Premiums and Problems Article edition 122. 2021 at page A15-A18

¹⁰ Section 25B of the income Tax Act 58 of 1962

¹¹ Christine Bornman : "Legacy Planning for offshore beneficiaries." Estate planning for offshore beneficiaries at <https://sanlamprivatewealth.sanlam.com/resources/fiduciary-tax/legacy-planning-for-offshore-beneficiaries/>

¹² (516/2021) ZASCA 153(7 November 2022).

capital gains that accrue to trusts or their beneficiaries. The tax court therefore erred in finding that s 25B applied in this instance.¹³

If a beneficiary or a beneficiary's trust is domiciled in a foreign jurisdiction, the estate planner would have to consider the added tax implications of not having S25B available as a tax advantage.

Foreign Trust structures may be partially or wholly different to trusts in South Africa. The foreign structure will have to be vetted to determine if such structure suits an estate planner's strategy and plans for the next generation.

It is also important to note, that the Trust Property Control Act¹⁴ in South Africa allows for the active participation of trustees¹⁵ while trusts in foreign jurisdictions may have different requirements which may not align with the wishes of the estate planner.

Further, South African exchange control regulations do not allow a South African trust to directly own foreign assets, without the permission of SARB.¹⁶ This could prove to be a challenge especially when you have managed to acquire assets in a foreign jurisdiction and are trying to incorporate such assets in your current estate plan.

Decisions made, and bags packed but have all the ripple effects been considered?

Life insurance is a means to ensure that your dependents¹⁷ are in the same position that they were in before you passed away. Life insurance from the beneficiary's perspective can be seen as compensation for the loss of income suffered because of one's death and ensures that obligations that existed during your lifetime are taken care of. This would include but is not limited to, education, maintenance, and day-to-day expenses.

Sound financial planning advice includes that you review your life insurance portfolio whenever you experience major life events. Leaving South Africa qualifies as one such event, especially if you are leaving loved ones, who are also financially dependent on you, behind.

Always make sure that your policy will remain valid if you should move abroad. Ensuring that your life insurance remains valid should be a priority mainly because at the inception of your policy various factors are considered including your age, health, occupation, and place of residence before a policy and the premiums are approved. Therefore, moving overseas to an area, that may be considered more dangerous than where you currently live or changing your occupation in your new host country may influence your policy, premiums, or both. Not disclosing your visiting, living or emigration from the country to your Insurer, could then potentially be the reason that your policy is declared *null in void*- resulting in the policy not paying out to its beneficiaries.

¹³ (516/2021) ZASCA 153(7 November 2022). At paragraph 27 to 29

¹⁴ Act 57 of 1988

¹⁵ Section 6 read with section 7 allows for the appointment of the trustee. It includes natural persons and corporates

¹⁶ Regulation 7 read with the definition of affected person in The exchange control regulations, 1961

¹⁷ Dependents would include children, persons that fit the definition of a spouse, and possibly elderly parents.

A further, potentially more important reason to revisit your life insurance policy or reassess it is to ensure that there are sufficient funds to pay for estate expenses especially if you intend to acquire assets that would be subject to taxes and administration costs on your death in your new host country. Administration costs could be more onerous in certain jurisdictions, which in turn would mean a greater liquidity need in your estate.

Seeking financial advice in your new country would be a wise decision to ensure that you are in a position to optimise your estate plan and ensure you are armed with the correct information to make the correct decision regarding a revised and improved estate plan

The other aspects of your financial plan should not be ignored. Seek to preserve your retirement savings if possible. The funds in your retirement savings, especially those with your South African employer, have the potential to be readily available when you resign. Most people will use it to get settled in abroad. This could prove detrimental considering that the taxes on withdrawals are more onerous and you could pay approximately 36% on such withdrawals.

Choosing to continue to contribute to a South African retirement planning vehicle could mean that in the event of you passing away while you were employed abroad, your funds in such vehicle will be distributed to beneficiaries when the trustees of such funds exercise their discretion. While your beneficiary nominations in such situations have persuasive value, the court in *Swart N.O and others v Lukhaimane N.O and others*¹⁸ the court held that trustees may not ignore such beneficiary nominations.

Therefore, ensuring that all wishes in respect of dependants are known to your trustees via the beneficiary forms will ensure the correct and effective distribution of funds

Turning the tables on maintenance

As an adult child, you may be responsible for the maintenance of aging parents. The Maintenance Act¹⁹ entrenches the view that parents and children have a reciprocal duty of support and that a child may be responsible for a parent's maintenance when a parent is struggling to make ends meet and requires assistance or simply as an awareness to respect and care for your parents.²⁰

A maintenance claim by a parent will have to be proved. It is a subjective test on two levels:

- A parent will have to show dependence, in that their circumstances they will require additional maintenance to survive and
- The adult child must have the financial ability to support such a parent.²¹

¹⁸ (2021) JOL 49952 (GP)

¹⁹ 99 of 1998

²⁰ Du Toits Law Blog , Maintenance : Not Only for Children <https://dtslaw.co.za/2015/07/28/maintenance-not-only-for-children/>

²¹ Du Toits Law Blog , Maintenance : Not Only for Children <https://dtslaw.co.za/2015/07/28/maintenance-not-only-for-children/>.

When a child supports such a parent or lives at home, and then leaves to work overseas, the duty to maintain such a parent does not cease.²²

Seeking greener pastures usually means, in most cases, greater income and often better work security, which then cements a case for that particular child being in a better position to maintain an ageing parent. The case of an indigent parent will always be stronger and a consideration that the courts will consider strongly when considering whether a child owes an ageing parent a duty of support.

The test being subjective, the South African Appeal court in *Oosthuisen v Stanley*²³ and *Van Vuuren v Sam Rabie*²⁴ indicated that the quality and condition of the life of the person that has to be supported is vital. The Appeal court stressed that the maintenance of a parent must be confined to necessities of food, clothing, shelter, medicine, and care in times of illness, but such criteria should not be narrowly interpreted. For a parent who enjoyed a comfortable life, maintenance, if it can be afforded should be considered in such light, but primarily the parents' lifestyle and quality of life at the time of claiming maintenance should be upheld.

Maintenance claims do not stop even with death but are rather a preferent claim in one's estate after the debt is paid.

Marrying outside South Africa's borders-destination weddings

Foreign marriage or international marriages have become commonplace as South Africans emigrate to explore the world. It is therefore important to understand the consequences of marrying outside of South Africa's borders.

*Lex loci celebrationis*²⁵ is a phrase derived from Latin and applied in international private law²⁶ specifically when there is a conflict of laws. The *lex loci celebrationis* dictates that the validity of the marriage is determined by the law of the place where the marriage is solemnised. Therefore, when a South African marries a person domiciled elsewhere in the world the question that will be asked, should a conflict in the marriage or death arise, is which country's laws are applicable.

We can illustrate this by way of the following example:

Jack is domiciled in South Africa and Jill is a person habitually resident in Mauritius. Both being of the Hindu faith, go through a Hindu marriage ceremony in India where their respective families originate. This ceremony is registered with the Indian authorities and the couple continues to live in India for a year after their wedding to do voluntary work.

²² In the case of *Smith v Mutual and Federal Co Ltd* 1998 4 SA at 626 (C) the court emphasized that, to prove need, a stringent criterion of need must be established. For the claimants to succeed, they are required to prove not only that the deceased had provided support, but also their own indigence and inability to support themselves. Indigence is defined as extreme need or lack of the basic necessities of life.

²³ 1938 AD 322

²⁴ 1972 2 SA 633 (A) 642

²⁵ Latin: "law of the place of performance"

²⁶ 1972 2 SA 633 (A) 642

After a year Jack and Jill return to South Africa. For immigration and other purposes, whether they are now husband and wife would be referred to the law of India. If the ceremony was sufficient to create a valid marriage under Indian, law they will be treated as validly married.

What will be the proprietary consequence of such a marriage?

The country where the marriage was solemnised does not necessarily govern the proprietary consequences of the marriage. The above example is referenced once again on death or divorce. On these trigger, it is paramount to first establish the marital regime that governs the patrimonial consequences of such marriage.

The formal validity of a marriage is determined by the law of the place where the marriage was solemnised. The challenge arises in South Africa when Jack and Jill have to establish the proprietary consequences of their marriage. The current legal position indicates that the domicile of a husband at the time of marriage will determine the proprietary consequences of such marriage, which in practical terms means that if Jack considered South Africa as his permanent place of residence and did not enter into a validly executed antenuptial contract before the conclusion of the marriage, such marriage, by default, will be a marriage in a community of property.²⁷

Therefore, the law of the land where the marriage was concluded will determine the formal validity of the marriage, but the consequences are determined by a husband's domicile at the time of the marriage.²⁸ The foregoing was a consequence of common law principles that a wife will follow her husband wherever he goes.

On review, this discriminatory view of the domicile foreign marriage following the domicile of the husband is unlikely to withstand the test of a constitutional challenge.

This stance then also begs the question how the principles can, as established in the Domicile Act²⁹ and in the cases of *Frankels Estate and another v the Master and another*³⁰ and *Esterhuisen v Esterhuisen*³¹ be reconciled with a same-sex marriage that was concluded, in terms of the Civil Union Act³² or a same-sex marriage that was concluded in a foreign jurisdiction. The new framework for marriages per the Marriages Bill will be in conflict of with the principle of following the domicile of the husband. Though the law has not yet been challenged, current legislation will need to be amended to keep up with the proposed Marriages Bill when it becomes effective.

The Hague Convention of 14 March 1978 on the celebration and recognition of the validity of marriage does provide a potential solution to the dilemma of merely following the husband's domicile to establish proprietary consequences of a marriage concluded outside of South Africa's borders.

²⁷ *Frankels Estate and another v the Master and another* (1950) ALL SA 347 A

²⁸ The Domicile Act 3 of 1992 and *Esterhuisen v Esterhuisen* 1999(1) SA. 492 C

²⁹ Act 3 of 1999

³⁰ (1950) ALL SA 347 A

³¹ 1999(1) SA 492 C

³² 17 of 2006

According to this convention, the legal system to apply to the couple's marriage may be selected by the parties before their ceremony and is based on:

- the law of the state to which either party is a national at the time of the marriage, or
- the law of the state to which either spouse has a habitual residence at the marriage, or
- the law of the first state where one of the spouses established a new habitual residence after marriage.

This convention indicates, if the spouses of a marriage have not predetermined their matrimonial property regime, the internal law of the state where the spouses establish their first habitual residence after marriage shall determine their matrimonial property regime.³³

Let us apply this to Jack and Jill (as referenced above).

If Jack and Jill did not agree on the marital property regime the law of India would apply and their place of the lived immediately after their marriage, being India.

It has to be stressed that the provision of this convention can be relied on in countries that have signed such a convention. South Africa has not signed this convention. The conclusion, therefore, is that the Hague Convention of 1978 only has the force of a persuasive policy document and is not legally binding in South Africa.

Looking forward, 2024/2025 shall see a new Marriage Act conclude its journey to parliament and hopefully be signed into law, such legislation will create a framework within which all marriages in South Africa will find recognition. The proposals in the current white paper include the solemnisation and registration of marriages that involve foreign nationals.³⁴ A welcome approach in aligning the marriage of a South African living and or working overseas and entering into a marriage in a foreign land.

When marriages do not last

Children born of a marriage, that was concluded with a foreign national, while living and working overseas, end in divorce often bear the biggest brunt. Apart from having to establish the proprietary consequences of such marriage, there is often a maintenance order that has been obtained in respect of minor children. If the person responsible for the payment of maintenance is domiciled in South Africa, the foreign court order would have to be accepted by our courts on application and only orders by courts in specified jurisdiction³⁵ will find application in South Africa.³⁶ The [Reciprocal Enforcement of Maintenance Orders Act](#)³⁷ regulates foreign maintenance processes.

³³ www.ghostdigest.com/articles/vaidty-of-foriegn-marriages/54167

³⁴ The Marriage Bill 2022, as published in the Government Gazette 7 July 2023 Vol 697 no 48914

³⁵ South Africa has entered into reciprocal agreement where the parties enforce maintenance orders from these jurisdictions

³⁶ <https://www.burnett-law.co.za/enforcing-foreign-maintenance-orders>

³⁷ Act 8- of 1963

A further hurdle is the Prescription Act.³⁸ If one requires a foreign maintenance or divorce order to be enforced in South Africa, it will have to be accepted by our courts within the period as prescribed by the Prescription Act. The claim for maintenance practically has three years to be recognised by a South African court to be enforceable in South Africa. If prescription has run its course, the foreign order shall have no application in South Africa. This will apply equally to the enforcement of a foreign-obtained divorce order, which is also a foreign debt.³⁹

This position was reiterated and confirmed in the case of *Society of Lloyd's v Price*⁴⁰. The judgment we must note is still enforceable in the country where such an order was obtained. For a South African Court to enforce a foreign legal judgement, a certified copy of the judgment will have to be made available in South Africa.⁴¹ Generally, if a judgement is in a foreign language, a certified translation will have to be supplied⁴² and thereafter there is a further hurdle of a monetary limit.

The enforcement of Foreign Civil Judgments⁴³ Act applies to foreign civil judgments up to an amount of R300 000.00 to be dealt with at the magistrate's court level, while any claims in excess of such amount will have to be considered by the High Court of South Africa.⁴⁴

On return to South Africa, access to children who live with their primary caregiver in a foreign jurisdiction will also have to be a critical factor in estate and financial planning. Access to children shall be costly and will require planning and predetermined savings.

Maintenance orders exist in a state of fluidity, in that such an order, although simply indicating that one person must pay an amount of money to another, is often varied during the course of implementation. This is the case because the circumstances of the person paying or the person receiving such funds change.

Conclusion

When moving overseas, it is so important to have an anchor back home. An adviser that you continue to communicate with in respect of your financial planning affairs. Major life decisions should at least warrant a discussion on the impact on your finances and the ripple effects of such a decision to ensure that an informed decision is made.

Responsibilities in South Africa must be planned for especially if you plan to return to South Africa after your wanderings overseas. The accumulation of worldwide assets will require a specialised estate plan and advice that shall consider all the options available and often this will include having a team of experts at your disposal.

³⁸ Act 68 of 1969

³⁹ S11 of the prescription Act indicates that a normal judgment debt prescribes after 30 years, after which it is no longer enforceable. However, this only applies to judgments in South African Court and not a foreign judgment debt. Foreign Judgment debt will be dealt with in terms of S11(d): "save where an Act of Parliament provides otherwise, three years in respect of any other debt"

⁴⁰ 2005(3) SA 549 (T) At paragraph 9

⁴¹ <https://www.bartermckellar.law/litigation-explained/enforcement-of-foreign-judgments-and-court-orders-in-south-africa-a-comprehensive-guide>.

⁴² Generally, an individual that wishes to submit a foreign language document to court will have to have a court certified translator execute the translation of the document. www.Apostile.co.za

⁴³ Act 32 of 1988

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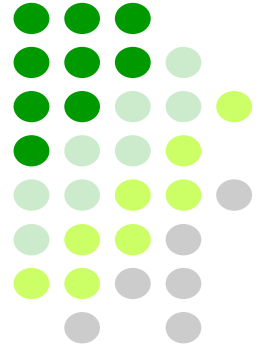
⁴⁵ Act 8- of 1963

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Retirement Annuity Funds *De Minimis* Thresholds – A summary



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Introduction

Section 1 of the Income Tax Act¹ defines a retirement annuity fund as a fund, other than a pension or provident fund, which is approved by the Commissioner and registered in terms of the Pension Funds Act². Members to a retirement annuity fund can make financial contributions to the fund and may be members to more than one retirement annuity fund. The Income Tax Act allows for transfers of one retirement annuity to another.³ These transfers are however subject to certain restrictions, specifically restrictions pertaining to the *de minimis* amount. Similarly, there are also restrictions that apply when a member wants to make a withdrawal from a retirement annuity fund or commute their retirement interest in a retirement annuity fund. The purpose of this article is to set out the different *de minimis* thresholds that applies to retirement annuity funds.

What does *De minimis* mean? In relation to the law, the term '*de minimis*' is taken from the extended latin phrase '*de minimis non curat lex*', which translates to 'the law cares not for small things'. *De minimis* is a legal principle which allows for matters that are small scale or of insufficient importance to be exempted from a rule or requirement.⁴

Transfer between retirement annuity funds – *de minimis*: R371 250

A member of a retirement annuity fund may transfer the member's interest in any approved retirement annuity fund into another approved retirement fund, provided that the value of each individual contract being transferred must exceed R371 250: Provided further that –

- a) in the case where the total member's interest in any approved retirement annuity fund is not transferred into another approved retirement annuity fund, the value of the member's remaining interest after the transfer must exceed R371 250⁵; and
- b) the provisions of the first proviso and paragraph (a) of the further proviso shall not apply in the case where the member's total interest in any approved retirement annuity fund is transferred into another approved retirement fund⁶.

Practical example: Monica has the following three contracts in a retirement annuity fund: Contract A – R350 000; Contract B – R450 000; Contract C – R150 000.

Monica will only be able to transfer Contract B to another retirement as a partial transfer as the transfer exceeds the *de minimis* amount of R371 250 and the remaining interest in the retirement annuity fund exceeds the *de minimis* value of R371 250. If Monica transfers all her contracts from the one retirement annuity fund to another retirement annuity fund, the value of the individual contracts is irrelevant and no *de minimis* applies in this instance.

¹ No. 58 of 1962

² No. 24 of 1956

³ Paragraph 6(1)(a)(ii) of the Second Schedule to the Income Tax Act No. 58 of 1962

⁴ LexisNexis EU, 2023

⁵ Paragraph (b)(xii)(bb)(a) of the definition of retirement annuity fund in section 1(1) of the Income Tax Act No. 58 of 1962

⁶ Paragraph (b)(xii)(bb)(b) of the definition of retirement annuity fund in section 1(1) of the Income Tax Act No. 58 of 1962

Retirement annuity fund withdrawals – *de minimis*: R15 000

A member of a retirement annuity fund may not make any withdrawals prior to retirement or death, except where contributions are discontinued prematurely and –

- i. The member's interest in the fund is less than R15 000⁷; or
- ii. The member has "formally" emigrated from South Africa where such application was made by 28 February 2021 and approved by 28 February 2022⁸; or
- iii. The member has not been a South African resident for an interrupted period of at least three years on or after 1 March 2021⁹.
- iv. The member departs from South Africa upon the expiry of a work or visitor's visa¹⁰.

Retirement annuity commutation at retirement – *de minimis*: R247 500

Not more than one-third of the total value of the retirement interest may be commuted for a single payment, and the remainder must be paid in the form of an annuity except where two-thirds of the total value does not exceed R165 000 or where the member is deceased¹¹. In other words, a member of a retirement annuity fund may in retirement commute the full interest in their retirement annuity fund if the value of the member's retirement interest in the fund is less than R247 500.

Taxation of retirement fund benefits

The transfer of the retirement benefit from one retirement annuity fund to another retirement annuity fund is free of tax.

The retirement annuity fund withdrawals will be taxed according to the tax table applicable to retirement fund lump sum withdrawal benefit (on withdrawal before retirement, but excluding retrenchment):

TAXABLE AMOUNT	RATE OF TAX
R0 – R27 500	0% of taxable income
R27 501 – R726 000	18% of taxable income above R27 500
R726 001 – R1 089 000	R125 730 + 27% of taxable income above R726 000

⁷ Paragraph (b)(x)(cc) of the definition of retirement annuity fund in section 1(1) of the Income Tax Act No. 58 of 1962

⁸ Paragraph (b)(x)(dd)(A)(AA) of the definition of retirement annuity fund in section 1(1) of the Income Tax Act No. 58 of 1962

⁹ Paragraph (b)(x)(dd)(A)(BB) of the definition of retirement annuity fund in section 1(1) of the Income Tax Act No. 58 of 1962

¹⁰ Paragraph (b)(x)(dd)(B) of the definition of retirement annuity fund in section 1(1) of the Income Tax Act No. 58 of 1962

¹¹ Paragraph (b)(ii) of the definition of retirement annuity fund in section 1(1) of the Income Tax Act No. 58 of 1962

R1 089 001 and above	R223 740 + 36% of taxable income above R1 089 000
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The lump sum from a retirement annuity commutation at retirement is taxed according to the tax table applicable to retirement fund lump sum benefit (on retirement, death and retrenchment):

TAXABLE AMOUNT	RATE OF TAX
R0 – R550 000	0% of taxable income
R550 001 – R770 000	18% of taxable income above R550 000
R770 001 – R1 155 000	R39 600 + 27% of taxable income above R770 000
R1 155 001 and above	R143 550 + 36% of taxable income above R1 155 000

The tax tables are cumulative over the lifetime of the taxpayer, and the following amounts received or accrued will thus influence the amount of tax payable:¹²

- a) all lump sum benefits received from any retirement fund (pension/provident/preservation/retirement annuity fund) as a consequence of retirement after 1 October 2007;
- b) all taxable lump sums received on withdrawal (prior to retirement) from any retirement fund (pension/provident/preservation/retirement annuity fund) after 1 March 2009 including:
 - i. divorce awards that were taken as a lump sum; and
 - ii. deemed accruals for pension to provident fund transfers;
- c) any severance benefits received from an employer after 1 March 2011.

The possible impact of the proposed two-pot system on the commutation of a retirement annuity fund (excluding legacy retirement annuity funds¹³) at retirement:

National Treasury is proposing a new two-pot system for retirement savings with the intention of allowing members of all types of retirement funds access to a portion of their interest in

¹² Paragraph 12(a)(i) of Schedule 1 of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2022

¹³ As per the 2023 Draft Revenue Laws Amendment Bill: Section 1(1) of the Income Tax Act, 1962 to be amended to include the definition of Legacy Retirement Annuity Fund:

"legacy retirement annuity funds" means any policy that was entered into before 1 January 2022, is held with a retirement annuity fund and the terms of the policy provide that:

(a) a member of the policy must purchase the sum insured and share investment returns at portfolio level through reversionary bonuses, with no concept of a fund value; and
 (b) on termination of the policy, the member will be subject to early termination charges and claw back provisions.

these funds prior to resignation, retirement or death.¹⁴ Practically the two-pot system will consist out of three components. One-third of a member's future retirement contributions will be saved in the "savings component" and will be accessible before retirement. Two-thirds of a member's contributions will be saved in the "retirement component" which will only be accessible at retirement, death or retrenchment.¹⁵ The third pot is the "vested component" where a member's existing retirement savings as at the effective date (currently, 1 March 2024) will be held and grow until retirement, death or retrenchment.¹⁶

In the case of a member of a retirement annuity fund in respect of whom multiple policies or contracts are held in the fund, the "retirement interest" of the member is the total value of all the policies under the fund on any particular "retirement date".¹⁷ With the two-pot system allowing members of a retirement annuity fund to access a portion of their retirement interest held in the "savings component", when the member applies for a full commutation, all the previous lump sums taken from that same fund will also be taken into consideration when calculating the *de minimis* amount.

Conclusion

When financial planners are advising clients in respect of retirement annuity funds, it is important to make clients aware of the current *de minimis* thresholds and include same in the client advice record. Retirement annuity funds may be the most restrictive of the retirement funds, but it remains an excellent, tax-efficient retirement savings vehicle.

¹⁴ Draft Revenue Laws Amendment Bill

¹⁵ Refer to the *de minimis* value for the retirement annuity commutation at retirement.

¹⁶ Old Mutual Two-Pot System infographic

¹⁷ Cloete *et al*, 2022, p.C54

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Nominating a Trust as a Beneficiary on a Living Annuity



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Introduction

Living annuities are, from a financial planning perspective, often only taken into consideration from a retirement planning point of view, and the importance thereof in relation to estate planning is often overlooked.

The nomination of a trust as beneficiary on a living annuity contract, in particular, could under the right circumstances, be a very useful estate planning tool. The following examples illustrate this point:

- i. A previously divorced client is married to a second spouse. The client has children from his first marriage. The client wants to make provision for an income stream for the benefit of his spouse but wants the remaining benefit of the living annuity to vest in his children from his first marriage on the death of his spouse. If the client nominates his spouse as the beneficiary on the living annuity, he has no guarantee that the remaining benefit will vest in his children on the death of his spouse, as the spouse will then have the right to nominate beneficiaries, which beneficiaries will be entitled to the benefits on her death. By nominating a trust as the beneficiary on the living annuity, with his spouse as the primary trust beneficiary and his children as the secondary trust beneficiaries, this problem is solved.
- ii. The spouse of a client is not capable of managing his finances prudently. The client is concerned that if she nominates her spouse as beneficiary on her living annuity contract, he will select the maximum drawdown rate and deplete the capital, leaving him destitute. By nominating a trust as beneficiary on the living annuity contract, the trustees will have the right to elect the drawdown rate and the frequency of annuity payments, thus solving this conundrum. On the death of the spouse, the benefit could then also evolve on the secondary or capital trust beneficiaries.
- iii. A divorced client has minor children. He does not want to nominate his children as beneficiaries on his living annuity because he does not want his ex-spouse to be in control of the living annuity. By nominating a trust as beneficiary on the living annuity contract, he ensures that the trustees make the required decisions in relation to the living annuity.

In the past, the consequences of the nomination of a trust as a beneficiary on a living annuity was a contentious issue. Before the definition of "living annuity" in the Income Tax Act¹ was amended from 1 March 2021², SARS made certain allowances in this regard. This article will highlight the difference in the approach before, and from 1 March 2021, and provide practical financial planning guidelines in this regard.

¹ Act 58 of 1962

² Via section 2(1)(f) of the 2020 Taxation Laws Amendment Act 23 of 2020.

Before 1 March 2021

Before 1 March 2021, the Income Tax Act³ did not make provision for the consequences flowing from the termination of a trust that was the contracting party on a living annuity. SARS however made a concession to allow for nominated beneficiaries (nominated on the living annuity beneficiary nomination form by the trust) to elect a lump sum benefit or an annuity or a combination of a lump sum and an annuity when the trust was terminated. The choices available to nominated beneficiaries were thus the same as on the death of an annuitant who was a natural person⁴.

Where a nominated beneficiary opted to receive a lump sum on termination of a trust, it was however taxed at the marginal rate of the beneficiary and not as a retirement fund lump sum benefit. Where the nominated beneficiary chose an annuity, it was taxed as normal income in the hands of the beneficiary at his/her marginal rate of tax.

If no beneficiary was nominated on the living annuity contract, the full remaining living annuity benefit was paid as a lump sum on termination of the trust and taxed at the marginal rate of the trust, i.e., at 45%⁵.

From 1 March 2021

From 1 March 2021, the definition of "living annuity" in the Income Tax Act was amended⁶. In terms of the amendment, where a trust holding a living annuity is in the process of being terminated, such living annuity must be paid to the trust as a lump sum pursuant to the termination⁷. This amendment does not make provision for a party nominated as beneficiary by a trust on the living annuity contract to opt for an annuity, or a combination of an annuity and a lump sum.

A further amendment to the Second Schedule to the Income Tax Act from 1 March 2021 dictates that a lump sum will be taxed as a retirement fund lump sum benefit in the hands of the trust in these circumstances⁸, and not at the marginal rate of the trust. Because the trust is the taxpayer, previous lump sums that may have accrued to the person who nominated the trust as the living annuity beneficiary, will not be taken into account in the calculation of the tax liability on the lump sum benefit.

³ Footnote 1 *supra*

⁴ Paragraph (e) of the definition of "living annuity" in section 1 of the Income Tax Act.

⁵ Investec Legal Update: Investec Living Annuity – Options for beneficiaries, March 2018.

⁶ Footnote 2 *supra*

⁷ Paragraph (eA) of the definition of "living annuity" in section 1 of the Income Tax Act.

⁸ Paragraph 3B of the Second Schedule to the Income Tax Act.

Practical Financial Planning Considerations

The following points are important considerations when a client is contemplating the nomination of a trust as beneficiary on a living annuity:

- i. Because current legislation does not allow for parties, nominated as beneficiaries on a living annuity, to opt for an annuity where a trust holding a living annuity is in the process of being terminated, this would result in the benefit being paid to the trust as a retirement fund lump sum benefit. This means that such retirement fund lump sum benefit will be taxed in terms of the following tax table⁹:

Taxable income from lump sum benefits	Rate of tax
Not exceeding R550 000	0 per cent of taxable income
Exceeding R550 000 but not exceeding R770 000	18 per cent of amount by which taxable income exceeds R550 000
Exceeding R770 000 but not exceeding R1 155 000	R39 600 plus 27 per cent of amount by which taxable income exceeds R770 000
Exceeding R1 155 000	R143 550 plus 36 per cent of amount by which taxable income exceeds R1 155 000

This could thus result in a tax rate of up to 36% being levied against the capital paid out. If a client wants to avoid this, a possible solution would be to make provision in the trust deed (or in the will of the client if it is a testamentary trust) that, if the primary trust beneficiary dies, the trust is not terminated, and that the annuity income will continue for the benefit of the secondary (and possibly subsequent) trust beneficiaries. The only drawback of this solution is that the secondary beneficiaries will not have the option of a lump sum payment (unless the value of the underlying assets of the living annuity decline to a value below R125 000) due to the trust not being terminated. This problem could however be solved by giving the trustees the discretion to decide on the termination date of the trust.

- i. Where living annuity income is paid to the trust, it will be taxed in the hands of the trust (other than a special trust) at 45%. The tax will be deducted via PAYE by the living annuity administrator before it is paid to the trust. However – if the trust distributes the annuity income to the trust beneficiary in the tax year in which the income is received, the trust could register for PAYE (thus placing the duty on the trustees to deduct PAYE in respect of the income accruing to the trust beneficiaries) with the trustees requesting a tax directive from SARS in writing. The directive will then provide the rate (if any) at which the living annuity administrator must deduct PAYE. Here it is important to communicate with the living annuity administrator to establish the necessary requirements.

⁹ Paragraph 9(b) of the First Schedule to the 2023 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill

The process to follow to obtain a tax directive from SARS is summarised as follows by Ninety One¹⁰:

- “The trust must register for PAYE if not yet registered.
 - Once the trust has been registered for PAYE, the trustees must request a tax directive from SARS in writing. The letter must contain the following information:
 - *Trust details must be provided (the name of the trust, income tax reference number and the trust's PAYE number);*
 - *The name of the insurer/fund paying the annuity, postal address for the directive and the email address to enable SARS to email the directive directly to the insurer/fund;*
 - *The beneficiaries' details must be provided (surname, initials, ID number and tax reference number)*
 - *The application for the directive must be submitted at a SARS branch office or emailed to contactus@sars.gov.za. The request must specify that a directive in terms of paragraph 10 read with paragraph 11(a) of the Fourth Schedule to the Income Tax Act is required.*
 - *The subject of the email should be "Trust owner of living annuity – directive required for (insert name of trust)."*
 - *The trustees will have an obligation to withhold PAYE from the income distributed to beneficiaries and to issue the applicable tax certificate (IRP5/IT3(a))."*
- i. Before advising a client on nominating a trust as beneficiary of a living annuity, it is also important to take note of the rules of the specific product. Some products, for example, allow for a trust to be nominated as a beneficiary on a living annuity, but the living annuity benefits may only be paid to the trust as a lump sum on the death on the annuitant, which would result in the benefit being taxed as a retirement lump sum benefit prior to being paid to the trust.
- ii. In the event of a living annuity being an in-fund or fund-owned living annuity (as opposed to a member-owned living annuity), the payment of benefits will be subject to the discretion of the trustees of the retirement fund providing the living annuity, within the ambit of Section 37C of the Pension Funds Act¹¹. There is thus a significant chance that the benefits may not be paid to the trust on the death of the annuitant.

Conclusion

The formalisation of the treatment of living annuities held by trusts in the Income Tax Act was a positive step in removing uncertainties surrounding this subject, especially with regards to

¹⁰ Ninety One Living Annuity – options for beneficiaries, August 2023

¹¹ Act 24 of 1956

the tax treatment on commutation of a living annuity in anticipation of the termination of a trust. It is however my view that a further amendment is required to allow for beneficiaries of living annuities nominated (on the living annuity contract) by the trustees of a trust to have a choice between a lump sum, an annuity or a combination of a lump sum and an annuity on the termination of a trust.

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Disallowed Contributions: Pros, Cons and Considerations



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Introduction

The number of South Africans who can afford to retire financially independent has remained a dismal 6 percent for many years.¹ In an attempt to encourage a retirement savings culture, the South African government has implemented various strategies such as reducing the taxation in retirement funds to 0%,² imposing punitive tax at withdrawal,³ allowing overcontributions to retirement funds to be carried over to the next year of assessment and/or if unused can be used to offset at retirement to increase the tax-free portion of the lump sum or reduce one's income tax liability at retirement.⁴

This article aims to accentuate the advantages of utilising disallowed contributions as well as caution members of retirement funds to the potential negative tax implications if not structured correctly.

Disallowed contributions – explained

Section 11F of the Income Tax Act⁵ stipulates that a taxpayer will be entitled to an income tax deduction of contributions to any approved pension fund, provident fund, or retirement annuity fund. The contributions that qualify as a deduction in the current year of assessment are limited to the lesser of:⁶

- (i) R350 000;
- (ii) 27,5% of the higher of the person's
 - Remuneration⁷ or
 - Taxable income⁸ or
- (iii) Taxable income before
 - The section 11F deduction and
 - The inclusion of any capital gain⁹

Contributions that are disallowed under Section 11F¹⁰ will be carried forward in the ensuing tax years. The application of this can be demonstrated using an example:

¹ Desai N, 2023, 'Retirement Planning-How to be part of the 6%', IOL, viewed 07 September 2023, <<https://www.iol.co.za/business-report/budget/retirement-planning-how-to-be-part-of-the-6-b8002393-59ef-4781-99d2-72f32ccb8c84>>

² As of 1 March 2007

³ The tax free amount at withdrawal is R27 500 which is significantly less than the tax-free amount at retirement which is R550 000. The hypothetical tax formula also negatively impacts the R550 000 tax-free amount, resulting in a lesser tax-free amount.

⁴ Section 10C of the Income Tax Act 58 of 1962

⁵ Act 58 of 1962

⁶ Section 11F(2) of the Income Tax Act 58 of 1962

⁷ The remuneration referred to is remuneration for employees' tax purposes, but it excludes severance benefits and lump sums from retirement funds.

⁸ Taxable income excludes severance benefits and lump sums from retirement funds. It is the taxable income before the section 11F deduction, qualifying foreign tax credits [section 6quat(1C)] and the section 18A deduction.

⁹ The 27,5% of taxable income calculation includes the taxable capital gain, but the taxable income limit excludes the capital gain.

¹⁰ Income Tax Act 58 of 1962

Mrs X's taxable income for the 2020/2021 tax year is R1 500 000 and for the 2021/2022 year is R1 700 000. In the 2020/2021 tax year, Mrs X contributed 27,5% of her taxable income to her retirement annuity fund. This amounted to R412 500, but the deduction is limited to R350 000. The balance of R62 500 is carried forward to the next tax year. In the 2021/2022 tax year Mrs X has reduced her contributions to her retirement annuity fund as she has invested money into her business. Her retirement annuity contributions for the year are R200 000. She qualifies to contribute R467 500 which would be limited to R350 000. In the 2021/2022 tax year Ms X can deduct R262 500¹¹ from her taxable income.

Taxpayers can continue to enjoy the tax deduction in the year of assessment or subsequent years while saving towards their golden years, ensuring a healthier financial outcome at retirement.

Section 10 C¹² - compulsory annuities

Section 10 C¹³ became effective on 1 March 2014. The essence of this section is that it provides for the exemption of member contributions, to an approved pension fund, provident fund, or retirement annuity fund, that did not qualify for an income tax deduction under Section 11F¹⁴ against a "qualifying annuity" and which has not been deducted against a lump sum previously. A qualifying annuity is defined as the amount of retirement interest that is payable in the form of an annuity and it includes a living annuity and life annuity. The calculation is cumulative, and the exemption cannot be claimed more than once.¹⁵

The Section 10C¹⁶ exemption is only available to the member of the fund who made the contributions. Therefore, it is not available to beneficiaries of the annuitant upon the death of the original annuitant. The application of this exemption is expounded in the example below:

Mr Y has R250 000 disallowed contributions accumulated when he retires from his pension fund. He opts not to take a lump sum and purchases a guaranteed life annuity with the R1 500 000 retirement interest. The first R250 000 received from the life annuity will be exempt from income tax.

Assume that Mr Y receives an annuity of R200 000:

Gross Income:	R200 000
Section 10C exemption, R250 000 but limited to R200 000	(R200 000)
Balance carried forward	(R50 000)
Income	R0

¹¹ R200 000 + R62 500 (previously disallowed contributions)

¹² Income Tax Act 58 of 1962

¹³ *Id*

¹⁴ *Id*

¹⁵ Haupt P Notes on South African Income Tax 2018: p100

¹⁶ *Supra* note 11

One should be mindful of the application of this exemption. It may be advantageous to the member, in certain circumstances to claim the disallowed contributions as a deduction against the lump sum as the rate of tax on the lump sum may be higher than the rate of tax that the member will pay on the annuity after retirement. This can be demonstrated through the following example:

Mr Y has R250 000 disallowed contributions accumulated when he retires from his pension fund. He opts not to take a lump sum and purchases a guaranteed life annuity with the R8 000 000 retirement interest. The first R250 000 received from the life annuity will be exempt from income tax.

Assume that Mr Y receives an annuity of R1 000 000:

Gross Income:	R1 000 000
Section 10C exemption, R250 000	(R250 000)
Income	R750 000

An income of R750 000 falls in the 39% marginal tax rate bracket. This is higher than the highest tax rate for tax on lump sums which is 36%. In this instance, it would be prudent for the member to take a lump sum and annuitise the balance.

Estate duty implications

Another attractive feature of retirement vehicles is that lump sums from approved pension, provident, preservation, and retirement annuity funds are not subject to estate duty. They are exempted in terms of section 3(2)(i) of the Estate Duty Act¹⁷ which excludes '*so much of any benefit which is due and payable by, or in consequence of membership or past membership of, any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity as defined in the Income Tax Act, on or as a result of the death of the deceased.*'

Therefore, investing in one of these funds is an effective way to peg the growth in one's estate and thereby minimise the impact of estate duty. National Treasury became aware that some investors were utilising this estate planning mechanism as a tax avoidance strategy by making excessive contributions to their retirement annuity funds. This loophole was addressed by amending the Estate Duty Act¹⁸ by the enactment of Section 3(2)(bA), which stipulates as follows:

(2) "Property" means any right in or to property, moveable 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 not allowed as a deduction

¹⁷ Act 45 of 1955

¹⁸ Supra

in terms of paragraph 5 of the Second Schedule to the Income Tax Act 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 effect of this amendment is that overcontributions are considered a deemed asset in the deceased estate, barring the instances where the beneficiaries of the deceased elect to take the benefit as an annuity and not as a lump sum.

In the event of the member's death, the beneficiaries may opt to take the death benefit as either a lump sum or as an annuity. Should they elect to take it as a lump sum, then the disallowed contributions will be available as a deduction to reduce the taxable lump sum.¹⁹ The lump sum is taxed in the hands of the deceased as if it was received the day before death. The disallowed contributions will be included in the deceased estate for estate duty purposes.²⁰

Example – Beneficiary opts for the lump sum

Mr Z invested R1 200 000 in a retirement annuity fund after 1 March 2016. He died in December 2021. The fund value at death is R1 500 000. His contributions that did not rank for deduction at the date of death amounted to R1 000 000. He had not taken any lump sums previously. His beneficiary elects to receive the death benefit as a lump sum. Mr Z's estate is reduced by R1 500 000, however, his disallowed contributions of R1 000 000 will be included in his estate for estate duty purposes. Assuming, Mr Z has not taken any previous lump sums:

R1 500 000 – R1 000 000 (disallowed contributions) = R500 000 lump sum which will be tax-free as the first R550 000 is taxed at 0% according to the retirement lump sum tax table. In this case, there would be an estate duty saving of R100 000 (R500 000 x 20%).

Should the beneficiaries opt to take a living annuity then the disallowed contributions will be lost as it is only available to the member who made the contributions. The transfer to the living annuity will be tax-free and there will not be an estate duty inclusion.

Example- Beneficiary opts to take a living annuity

Assume the same facts as the example above. The beneficiary elects to purchase a living annuity. No amount is included in Mr Z's estate for estate duty purposes as no lump sum benefit is deemed to accrue to him, and no deduction is applicable.²¹ The estate duty saving will be R300 000 (R1 500 000 x 20%). This example clearly illustrates the benefit of opting for an annuity as opposed to a lump sum for the deceased estate.

¹⁹ Paragraph 5 of the Second Schedule to the Income Tax Act 58 of 1962

²⁰ Section 3(2)(bA) of the Estate Duty Act 45 Of 1955

²¹ Paragraph 5 of the Second Schedule to the Income Tax Act 58 of 1962

Section 4q of the Estate Duty Act²²

The value of all property, included in the deceased's estate, which accrues to the surviving spouse, can be deducted from the gross value of the estate. Section 3(2) (bA)²³ provides that it is only the disallowed contributions that are to be included as property in the deceased's estate and not the entire fund amount. The amount would therefore be included as property for estate duty purposes but will qualify as a deduction under section 4q of the Estate Duty Act and be exempt from estate duty. This can be demonstrated by way of an example:

Mr A has a retirement annuity with a fund value of R3 000 000. At the time of his death, he had R1 000 000 that did not rank for deduction under section 11F of the Income Tax Act.²⁴ As Mrs A is the only financial dependant,²⁵ the board of trustees of the retirement annuity fund has awarded the full benefit to the surviving spouse. According to Section 3(2)(bA)²⁶ of the Estate Duty Act, it is only the disallowed contributions that are included as property in Mr A's deceased estate. However, as the benefit is bequeathed to the surviving spouse it qualifies as a deduction under section 4q of the Estate Duty Act. In this instance, the intention of section 3(2)(bA) of the Estate Duty Act is rendered ineffective by the provisions of section 4q of the Estate Duty Act.

Emigration

The Pension Funds Act²⁷ governs the rules on retirement funds in South Africa and it also determines when one can have access to those retirement funds. Ordinarily, one may access your retirement annuity funds only at the age of 55. Should your total investment be less than the de minimus amount which is R247 500 then you can commute the full amount as a lump sum. If the amount exceeds R247 500 then one is entitled to encash a third as a lump sum and the balance of two-thirds must be annuitized.

The exodus of South Africans to other countries has necessitated a more effective manner of dealing with retirement funds. From 1 March 2021, if you have not formally emigrated, you will only be able to access your retirement annuity fund or preservation fund benefits if you have not been a South African tax resident for an uninterrupted period of 3 years. The withdrawal tax tables will apply should you opt to withdraw your funds.²⁸

It is further submitted that if the expatriate does not withdraw his/her retirement funds but opts to retire from the fund, then the disallowed contributions can be utilised to increase the tax-free portion of the lump sum. The withdrawal tax tables are punitive in that only R27 500 is allowed as the tax-free portion of the lump sum. The aim is to discourage withdrawal and encourage the preservation of retirement funds until retirement age. However, the disallowed

²² Act 45 of 1955

²³ *Id*

²⁴ 58 of 1962

²⁵ S37C of the Pensions Fund Act 24 of 1956

²⁶ Act 45 of 1955

²⁷ 24 of 1956

²⁸ Second Schedule to the Income Tax Act 58 of 1962

contributions will be deducted from the lump sum amount to determine the taxable portion of the lump sum.²⁹

The process of liquidating your retirement annuity or preservation fund to move it abroad can be lengthy and convoluted. It is submitted that the expatriate should weigh up the benefits and drawbacks of retiring from the fund in South Africa as opposed to withdrawing from the fund.

Conclusion

Financial planning is not an exact science. It allows financial planners to explore scenarios and probabilities that may deviate from the initial calculations as the variables are dynamic and the timing of events such as death cannot be predicted. It does, however, provide a ballpark indication of one's financial health and regular reviews ensure the best possible outcome in the face of certain eventualities.

Investing in retirement vehicles can be an effective estate planning tool. The introduction of section 3(2)(bA)³⁰ has slightly curtailed the efficacy of this strategy but contributing to retirement vehicles continues to provide estate duty relief. Section 10C³¹ facilitates the provision of tax-free income from qualifying annuities until the disallowed contributions are expunged.

Holistic financial planning entails evaluating the client's needs by addressing the issues that are preventing the client from achieving his/ her financial goals. The reduction of tax liability may not be the client's primary concern and it is imperative that each client be assessed on their requirements and are in a position to make informed decisions.

²⁹ Paragraph 5 of the Second Schedule to the Income Tax Act 58 of 1962

³⁰ Ibid

³¹ Income Tax Act 58 of 1962

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Retirement Fund Death Claims in Unregistered Customary Marriages



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Introduction

South Africa is a diverse country with different cultures and traditions, and it is that diversity that has led the legislature to embrace customary marriages. The Recognition of Customary Marriages Act¹ (hereinafter referred to as the RCMA) recognises customary marriages. Section 3 of RCMA deals with the requirements of a valid customary marriage. The Act recognises both registered and unregistered customary marriages. On the other hand, retirement funds are governed by the Pension Funds Act², and its purpose is to provide for the registration, incorporation, regulation, and dissolution of pension funds and matters related thereto.³ When spouses are married in terms of customary law, and one spouse dies (who is a member of a retirement fund), the non-member spouse has the right to claim death benefits against the retirement fund of the member spouse. This article will explore death claims against retirement funds by spouses of unregistered customary marriages, and the duty of trustees of retirement funds to honour such claims.

Legislative position

In the past and especially pre-democracy, South African women had no rights to perform legal acts without the assistance of a male guardian. Marriage laws made this worse by putting women under the power of their husbands and making husbands the sole owners and controllers of property in the marriage.⁴ The Recognition of Customary Marriages⁵ is a law of Parliament that came into force on 15 November 2000. This law attempts to correct the past discrimination against African women by, amongst other things, providing for the equal status and capacity of spouses in customary marriages.⁶ This means that women in customary law marriages have the same status and protection as women in civil marriages. The Act also confirms equal status and capacity between husband and wife in the customary marriage.⁷ Both monogamous and polygynous customary marriages are recognised as legal under the Act.⁸

The RCMA defines a customary marriage as a marriage concluded in terms of customary law. It then defines customary law as the customs and usages traditionally observed among the indigenous African people of South Africa and which form part of the culture of those people.⁹ The RCMA recognises valid customary marriages that were in existence at the commencement of the Act and those that came after the commencement of the Act. Section 9 of the RCMA states that failure to register a customary marriage does not affect the validity of the marriage.

¹ Act 120 of 1998

² Act 24 of 1956

³ Pension Funds Act 24 of 1956

⁴ UCT Law, Race and Gender Research Unit "The Recognition of Customary Marriages in South Africa: Law, Policy and Practice" 2012, page 1.

⁵ Act 120 of 1998

⁶ Preamble of Recognition of Customary Marriages Act.

⁷ Section 6 Recognition of Customary Marriages Act 120 of 1998

⁸ UCT Law, Race and Gender Research Unit "The Recognition of Customary Marriages in South Africa: Law, Policy and Practice" 2012, page 1.

⁹ Recognition of Customary Marriages Act 120 of 1998. Definitions clause.

There is usually a lot of contention and argument as to what constitutes a valid customary marriage. Section 3 of the RCMA details the requirements of a valid customary marriage. Section 3 of the RCMA¹⁰ provides the following as the requirements of a valid customary marriage:

1. Both spouses must be above the age of 18 years. If either the man or the woman is below the age of 18 years, their parents or legal guardian must give their consent to the marriage for it to be valid.
2. Both spouses must agree to be married to each other under customary law.
3. The marriage must be negotiated and entered into or celebrated under customary law.

The first and the second requirements listed above are not usually a problem and I will not discuss them further. The third requirement is usually under contention and many cases have been referred to the High Court for it to confirm whether or not a customary marriage exists where the marriage was not registered. More problems arise when a spouse in a customary marriage dies and there are assets that stand to be inherited be they movable, immovable, or even a retirement fund. With retirement funds, the surviving spouse submits a claim, and such a claim may or may not be approved by funds because there must be prima facie proof of the existence of a valid customary marriage.

The requirements of customary marriages as applied in decided cases

Tsambo v Sengadi

In the case of *Tsambo v Sengadi*¹¹ (popularly known as the HHP case) dealt extensively with section 3(3)(1) of the RCMA. The validity of a customary marriage came into question specifically with regard to whether or not the "handing over of the bride" had occurred. This custom was especially significant in the Setswana custom. In this case the Tsambo (groom's) family and the Sengadi (bride's) family met at the home of the Sengadi family to negotiate lobola. In 2016 the two families negotiated lobola, reached an agreement and a lobola agreement was concluded, reduced to writing and signed. The families agreed on an amount of R45 000, where R30 000 was to be paid on the day and the remainder to be paid in the future in instalments. After negotiations were concluded, the families shared a meal, the women took the bride, Ms Sengadi to the room, and she was given an attire to wear which matched the groom's, Mr Tsambo's, and she was told that this was her wedding attire. Ms Sengadi was introduced to members of the groom's family who were present on the day and the two families celebrated. The couple then went on to live together however the customary marriage was never registered with the Department of Home Affairs.

The parties lived together until they faced marital problems, after which the parties separated. They later reconciled but never lived together again. Mr Tsambo, a famous South African Hip

¹⁰ Recognition of Customary Marriages Act 21 of 1998.

¹¹ (244/19) [2020] ZASCA 46 (30 April 2020)

hop star, and went by the stage name HHP, died in October 2018 due to suicide. After his death, Ms Sengadi moved back to their once-shared home to mourn his death. She was then informed by his father that they did not acknowledge her as the customary wife and barred her from making funeral arrangements. The family also denied her access to their shared home by changing door locks.

Ms Sengadi then approached the High Court seeking relief that she formally be recognised as the customary wife of the deceased, and that the customary marriage entered into between the parties be declared as a valid customary marriage. Mr Tsambo's father opposed the application arguing that the applicant has no right to the relief she sought as no customary marriage was concluded between the parties in 2016. He argued that the necessary customs, rituals and procedures required for the conclusion of a customary marriage may have commenced but were not completed hence there was no valid marriage. The deceased's father claimed that the meeting that took place on 28 February 2016 was confined to lobola negotiations and what happened thereafter merely constituted a celebration of the successful conclusion of the lobola negotiations. He asserted that it was clear from the terms of the lobola agreement that the families intended to have a further meeting thereafter. The deceased's father further argues that the two families were to still discuss the formalities of handing over the bride to Mr Tsambo's family, and that the ritual or slaughtering a sheep or goat to signify the marriage has not occurred.

The High Court found that the handing over was not a strict requirement for a valid customary marriage and could be waived. It found that there was a tacit waiver of the custom of the handing over of the bride because a symbolic handing over of the bride to the deceased's (groom) family had occurred after the conclusion of the customary marriage. It rejected the deceased father's contention that the most crucial part of a customary marriage is the handing over of the bride and that the absence thereof would result in no valid customary marriage coming into existence. The Supreme Court of Appeal confirmed this view by stating that customary law by its nature is a constantly evolving system, strict compliance with rituals has been waived in the past, customs have never been static, and they change and develop along with the society in which they are practised.

Validity of a marriage certificate of a customary marriage

Mgenge v Mokoena

In the case of *Mgenge v Mokoena and Another*¹² the applicant (mother of the deceased) sought an order cancelling the marriage certificate recording that her son (the deceased, Mr Siphwe Mgenge) and the first respondent (Ms Maleshoane Rose Mokoena, the bride) had entered a customary marriage. She stated that as mother of the deceased, she had not consented to his marriage, and was unaware of the existence thereof. She averred that in terms of customary law, she, as the mother of the deceased, was required to have

¹² [2023] 2 All SA 513 (GJ)

participated in any pre-marriage negotiations between the families of the first respondent and the deceased. The applicant agreed that a “meeting” took place, but it was only to introduce the families to each other and not to negotiate lobola.

The court explained the requirements for the conclusion of a valid customary marriage as contained in section 3 of the RCMA. The parties must both be older than 18; they must both consent to be married to each other under customary law; and the marriage must be negotiated and entered into or celebrated under customary law. In countering the applicant’s argument that no marriage had come about, the first respondent referred to the customary negotiations between the two families and produced a copy of the lobola agreement that was concluded. The argument raised by the applicant that the lobola document did not indicate the successful negotiation of a customary marriage was rejected due to the wording of the agreement and the part-payment of the agreed lobola.

The court addressed the matter of the integration of the bride into the groom’s family (the ‘handing over’ of the bride). The court made no determination that the slaughter of a sheep, at the time when the lobola was concluded, sufficed to signify the conclusion of the marriage between the families of the First Respondent and the deceased. The requirement of the handing over of the bride was decided by the court on a more general consideration.

The court further stated that a marriage certificate stands as prima facie proof of the marriage. The applicant’s contentions did not suffice to cast any doubt on the validity of the marriage certificate. The court confirmed that the marriage certificate correctly recognised the existence of a marriage between the parties during the lifetime of the deceased. The application was dismissed with costs.

Customary marriage and claims against retirement funds.

PN and Others v eJoburg Retirement Fund

In the case of PN and Others v eJoburg Retirement Fund and Others,¹³ the applicant (the deceased’s wife through civil marriage) sought an order restraining the first and second respondents (the retirement fund and fund administrators) from processing any payment of the pension benefits of the late Johann Motsioa (the deceased husband who died on the 30th of July 2020. Secondly, she sought an order that the first and second respondents be prevented from transferring and or paying any portion of the pension benefits arising from the death of the deceased to the third respondent (the spouse of the deceased at the time of death). She also sought an order that the customary marriage allegedly concluded on 24 February 2018 between the deceased and the third Respondent be declared void ab initio. Lastly, the first and second Respondents have to be directed to revise the distribution percentages of the pension benefits of the deceased and exclude the third respondent.

¹³ (43479/20) [2022] ZAGPJHC 454.

To give brief facts of the above-mentioned case, the deceased husband had a retirement annuity. In 2019, he completed a nomination form where he nominated his two children born of the marriage with the first applicant and his brother. After the deceased husband passed away, he had a total death benefit of R8 311 422. The applicant stood to receive R1 246 000 and was not informed of how the rest of the funds would be allocated. When she queried this with the fund, she was informed by the fund that she had received this allocation because she was legally married to the deceased, she was employed and not financially dependent on him, and they had been separated for years. The fund further stated that the civil wife was not on the deceased nomination form and that the deceased also had a customary wife with whom he had a relationship and who supported him from the commencement of their relationship. The case was referred to the Pension Funds Adjudicator, and then to the High Court, which declared the customary marriage between the deceased husband and the third respondent (customary wife) invalid. The court then had to deal with the allocation of the funds and who was entitled to the funds, it should be noted that the applicant did not want the remaining funds to go to her but rather to her two children born of the marriage with the deceased.

The High Court then focused on section 37C of the Pension Funds Act.¹⁴ Section 37C governs the distribution and payment of the lump sum benefits payable on the death of a member of a pension fund, provident fund, pension and provident preservation fund, and retirement annuity funds. It intends to protect dependants. In a nutshell, Section 37C¹⁵ states that any benefit payable by a fund upon the death of a member shall not form part of the assets of that member's deceased estate and shall be dealt with as prescribed in the section. The fund must within twelve months trace the dependants of the member, and the benefit will be paid to the dependants in a manner that is deemed equitable by the fund. If the fund does not find any dependants within the twelve months, and the member nominates a beneficiary in writing, then the benefit shall be paid to such nominated beneficiary. If the member has a dependant and has nominated a beneficiary in writing, the fund will within twelve months pay to such nominee or beneficiary as the board may deem equitable. If the fund cannot trace any dependants within twelve months, and there are no nominated beneficiaries by the member, the benefit shall be paid to the estate of the member.

Section 1 of the Pension Funds Act defines "dependants" as spouses, children and anyone proven to have been legally financially dependent on the member at the time of the member's death or anyone who may in future have become financially dependent on the member for example a child conceived before the death but born after the death of the member. I will draw your attention to a dependant being a spouse of an unregistered customary marriage.

¹⁴ 24 of 1956 as amended.

¹⁵ Pension Funds Act 24 of 1956

The court further emphasised that the duty that is entrusted to the Board of Trustees with deciding as to a proper distribution of the fund is normally directed first by the deceased member's nomination secondly by marital status and lastly dependency. The court further explained that the central and core intention of the Act as stipulated in Section 37C is to protect dependants. The Act serves as a social function striving to ensure that no one who was financially dependent on the member is left without support.

Death benefits and Section 37C of the Pension Funds Act.

Now turning to the Pension Funds Act and the duty bestowed upon trustees to correctly allocate funds from deceased members. Section 37C of the Pension Funds Act deals with benefits colloquially known as "death benefits". They do not form part of the assets in a deceased member's estate. Instead, section 37C places a duty on the trustees of the fund to allocate and pay the benefit in a manner that it deems fair and equitable and only in three exceptional circumstances, may the benefit be paid to the estate. This duty has three important functions, it requires that the trustees identify the dependants and nominees of the deceased member, effect an equitable distribution of the benefit amongst the said dependants and nominees, consider relevant factors, and select an appropriate mode of payment for the benefit.¹⁶

Section 37C limits the freedom of testation of a member in that the member is not able to dispose of his death benefit as he wishes like he would with the other assets in his estate. Even though the member usually completes a nomination form, such nomination is not binding on the trustees, as the benefit must be distributed strictly in terms of section 37C. This limitation on the common law right to testamentary freedom is justified if one considers the important socio-economic purpose underpinning section 37C.¹⁷

It is important to understand that for purposes of distributing death benefits, there is a difference between a dependant and a nominee. The Pension Funds Act defines dependants as spouses, children, anyone proven to have been financially dependent on the member at the time of their death, anyone entitled to maintenance, as well as anyone who may in the future have become financially dependent on the member. A nominee on the other hand is any party (natural person, trust or legal entity) whose details the member provided to the retirement fund in writing indicating that they should be considered by the trustees for a possible allocation of the death benefit. Examples would be one or more dependants, or a person who is not a dependant, such as a friend of the member.¹⁸ Trustees have the power to allocate death benefits to whomever they deem fit, even if such a person is not nominated by the member on the nomination form.

¹⁶ Momentum legal updates No. 10 of 2016: Section 37 C- Distribution of retirement fund lump sum death benefits by Natasha Marhye & Hettie Joubert.

¹⁷ Momentum legal updates No. 10 of 2016: Section 37 C- Distribution of retirement fund lump sum death benefits by Natasha Marhye & Hettie Joubert.

¹⁸ Allan Gray: Understanding the death claims process of retirement funds.

The plight of customary spouses compared to civil spouses.

Spouses married in terms of civil law do not have to jump many hurdles to prove that they are married to the deceased. It is however not that simple for customary spouses of unregistered customary marriages. The process of entering into a customary marriage is not a simple one, especially ensuring that the requirements of the RCMA are met. It is mostly difficult to prove the third requirement that the marriage must be negotiated, entered into and celebrated under customary law. Due to each family's customs, this usually lands many spouses at the High Court to prove the validity or invalidity of their unregistered customary marriage.

Different families have different traditions and what they regard as a "recognised customary marriage". I will give an example of how some Xhosa families go about this. After lobola negotiations are concluded, meaning the full agreed lobola amount has been paid, the bride's family hands her over to the groom's family, and a goat or sheep is slaughtered for this purpose. The bride is then taken to the groom's home where she is welcomed by the family slaughtering a sheep or goat and the bile of that animal is smeared on her head. She is then introduced to the groom's ancestors and given a new name.

While many families do not recognise the parties as married until this whole process has been concluded, Courts however have proven in case law that they do not apply a strict or one approach to these varied cultural requirements, because of how diverse customs in South Africa are, and how they continuously evolve.

The duty of Trustees to correctly allocate death benefits

Trustees of approved pension funds play a very significant role in making sure that death benefits are distributed in a just and fair way to those who are meant to benefit. While the beneficiary nomination form by the deceased member is there is a guide as to whom the deceased would like to benefit, this does not guarantee that the Trustees will distribute the death benefits as per the nomination form. Section 37C places an onus on the Trustees to conduct proper investigations in determining all the dependants of the deceased member. It is not enough that the member elected members on their beneficiary nomination form, trustees need to go further than this in identifying people who fall within the definition of dependants of the deceased member¹⁹. It might be easy to identify children of the deceased, however, it might not always be as easy to identify a spouse of an unregistered customary marriage.

The Pension Funds Act requires the Trustees to conduct an enquiry into the circle of dependants of the deceased member at the time of their death. The Act grants the trustees at least 12 months to search for dependants, but the time frame for allocating the benefit depends on the completeness of the information provided, as well as the response time of the dependants and nominees²⁰. There are certain factors that Trustees consider when

¹⁹ Glacier by Sanlam: Section 37 C and settlement agreements, by Lize de la Harpe

²⁰ Allan Gray article : Understanding the death claims process of retirement funds

deciding how to allocate death benefits like the financial position of the person, the age of the person, how much money that person needs, the value of the member's benefit, and how that person was related to the member²¹. Time and resources must therefore be spent on this process by retirement funds to make sure that investigations are done thoroughly and that everyone who stands to benefit, benefits especially spouses of unregistered customary marriages. Trustees however do not always get this right and cases end up going to the Pension Funds Adjudicator and then the High Court.

Conclusion

There is no doubt that the existence of unregistered customary marriages does not make the job of trustees of retirement funds any simpler. It would be easy to encourage all spouses married in terms of customary law to register their marriages, but understanding the society we live in and our history, it is not as simple and easy as that. How then can trustees ensure that spouses of unregistered customary marriages are recognised and protected? There is no simple answer to this question, however, they can ensure that thorough investigations are done to find dependants of the deceased member and that more practical but secure methods are used to ensure that the correct spouse is awarded because not all of them can afford to approach courts.

Retirement funds can also educate member's and their spouses of their rights to claim from each other's death benefits upon death, this way knowledge is spread during their lifetime. Prospective spouses of customary marriages should also be encouraged to make sure that while adhering to their customs the lobola agreement is drafted, dated and signed as proof that lobola negotiations took place, this way members stand a better chance in proving their unregistered customary marriages to retirement funds when the time comes. People who assist members in completing retirement fund forms should be encouraged to educate members more of their rights and responsibilities in this regard, that way we can avoid litigation.

²¹ Allan Gray article: Understanding the death claims process of retirement funds

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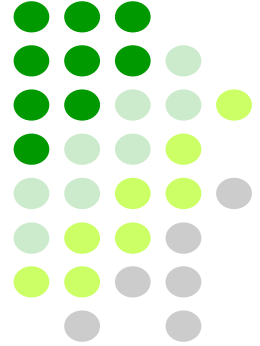
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Income Tax

Taxation of a South African Tax Resident Earning Foreign Employment Income and Contributing into a South African Retirement Fund



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Introduction

In recent years the number of South Africans living abroad has increased. This means that a financial planner who once had clients who were all South African tax residents, may find him or herself required to answer technical questions that involve some aspects of international tax law. The questions range from access to retirement savings to cross-border divorce orders among others.

This article focuses on the deductibility of retirement fund contributions made by a South African tax resident earning foreign employment income. The article will discuss, the deductibility of retirement fund contributions, in the case where a tax resident's remuneration is from an employment contract in a foreign jurisdiction and that tax resident contributed to a South African retirement annuity, and

- the foreign employment income is less than R 1 250 000;
- the foreign employment income exceeds R 1 250 000; and
- the tax resident has both domestic and foreign employment income, with foreign employment income exceeding R 1 250 000.¹

The Law Applicable to A Tax Resident with Foreign Employment Income

The South African tax system can be described as a residence-based tax system supplemented with income source rules governing the taxation of tax non-residence. A person is a South African tax resident if that person is ordinarily resident in the Republic.² The phrase "ordinarily resident" is not defined in the Income Tax Act and has been subject to litigation. The court held that a person is ordinarily resident if that person considers South Africa his or her home and will return to South Africa despite a long period of absence.³ In addition, a person who is not ordinarily resident in South Africa can become a South African tax resident if that person meets the physical presence test.⁴

A person may be found to be a tax resident of South Africa and another tax jurisdiction, due to the wide span of the definition. In this case, provisions of a double taxation agreement between South Africa and that other tax jurisdiction may be applied to allocate taxing rights to one of the countries. If it is found on the grounds of the double taxation agreement that a person is a tax resident of another tax jurisdiction (other than South Africa), that person will no longer be considered a South African tax resident.⁵

A South African tax resident is required to include in his or her gross income the total amount, in cash or otherwise, received by or accrued to or in favour of such resident, which is not capital in nature – despite the source from which the receipts came.⁶ By contrast, a non-resident is required to include in his or her gross income the total amount, in cash or otherwise,

1 Section 10(1)(o)(ii) read with section 11F of the Income Tax Act 58 of 1962.

2 Section 1 of the Income Tax Act 58 of 1962, definition of a resident, paragraph a(i).

3 *Cohen V Commissioner for Inland Revenue* 13 SATC 362; Emslie et al, *Income Tax Cases and Material* 2001, pages 102-103.

4 Section 1 of the Income Tax Act 58 of 1962, definition of a resident, paragraph a(ii).

5 Section 1 of the Income Tax Act 58 of 1962, definition of a resident.

6 Section 1 of the Income Tax Act 58 of 1962, definition of gross income, paragraph (i).

received by or accrued to or in favour of such person from a source within the Republic, which are not capital in nature.⁷ The implication of this is that for a resident taxpayer, remuneration will be included in the gross income irrespective of where the contract was signed or where the actual work was performed.

Exemptions

Section 10(1)(o) provides full and partial exemption from normal tax on receipts of any remuneration under the following circumstances:

An officer or crew member of a ship

- Where remuneration is derived by any person as an officer or crew member of a ship engaged in international transportation for reward of passengers or goods.⁸
- Where remuneration is derived by any person as an officer or crew member of a ship engaged in the prospecting, exploration, or mining (including surveys and other work of a similar nature) for, or production of, any minerals (including natural oils) from the seabed outside the Republic, where such officer or crew member is employed on board such ship solely for purposes of the "passage" of such ship, as defined in the Marine Traffic Act, 1981.⁹
- In both cases above, such person must have been outside the Republic for a period or periods exceeding 183 full days in aggregate during the year of assessment.¹⁰

An officer or crew member of a South African ship

Where remuneration is derived by any person as an officer or crew member of a South African ship mainly engaged in international shipping or fishing outside the Republic as defined in section 12Q (1) of the Income Tax Act.¹¹

Employment Income earned from a foreign jurisdiction

Any form of remuneration is exempt from normal income tax if the following requirements are met:

- To the extent to which that remuneration does not exceed R 1 250 000 which is received by or accrues to any employee during any year of assessment;¹² and
- The remuneration took the form of salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, or allowance, including any amount referred to

⁷ Section 1 of the Income Tax Act 58 of 1962, definition of gross income, paragraph (ii).

⁸ Section 10(1)(o)(i)(aa) of the Income Tax Act 58 of 1962.

⁹ Section 10(1)(o)(i)(bb) of the Income Tax Act 58 of 1962.

¹⁰ Section 10(1)(o)(i) of the Income Tax Act 58 of 1962.

¹¹ Section 10(1)(o)(iA) of the Income Tax Act 58 of 1962.

¹² Section 10(1)(o)(ii) of the Income Tax Act 58 of 1962.

in paragraph (i) of the definition of gross income in section 1 or an amount referred to in section 8, 8B or 8C of the Income Tax Act;¹³ and

- The remuneration was paid in respect of services rendered outside the Republic by that employee for or on behalf of any employer.¹⁴
- Provided that the employee was outside the Republic:
 - For a period or periods exceeding 183 full days in aggregate during any period of 12 months.¹⁵
 - For a period or periods exceeding 117 full days in aggregate during any period of 12 months in respect of any year of assessment ending on or after 29 February 2020 but on or before 28 February 2021,¹⁶
 - For a continuous period exceeding 60 full days during that period of 12 months, and those services were rendered during that period or periods.¹⁷

This exemption does not apply to remuneration received or that accrued to a taxpayer due to:

- the holding of a public office to which that person has been appointed or is deemed to have been appointed in terms of an Act of Parliament;¹⁸
- services rendered to or work or labour performed for or on behalf of any employer in the national, provincial, or local sphere of government of the Republic;¹⁹ or
- services rendered to or work or labour performed for or on behalf of any employer that is a constitutional institution listed in Schedule 1 to the Public Finance Management Act.²⁰

Deductions

The Income Tax Act²¹ provides for deductions and allowances that a taxpayer may deduct from the income in the process of determining a taxable income for a specific tax year. The focus of this article is section 11F, which regulates the deductibility of retirement fund contributions. The relevant provisions are reproduced below:

Section 11F of the Income Tax Act

- (1) *For the purposes of determining the taxable income of a natural person in respect of any year of assessment there must be allowed as a deduction from the income of that person any amount contributed during a year of assessment to any pension fund, provident*

¹³ Section 10(1)(o)(ii) of the Income Tax Act 58 of 1962.

¹⁴ Section 10(1)(o)(iii) of the Income Tax Act 58 of 1962.

¹⁵ Section 10(1)(o)(ii)(aa)(a) of the Income Tax Act 58 of 1962.

¹⁶ Section 10(1)(o)(ii)(aa)(b) of the Income Tax Act 58 of 1962.

¹⁷ Section 10(1)(o)(ii)(bb) of the Income Tax Act 58 of 1962.

¹⁸ Section 10(1)(o)(ii)(B) of the Income Tax Act 58 of 1962.

¹⁹ Section 10(1)(o)(ii)(B) of the Income Tax Act 58 of 1962.

²⁰ Section 10(1)(o)(ii)(B) of the Income Tax Act 58 of 1962.

²¹ Income Tax Act 58 of 1962 as amended.

fund or retirement annuity fund in terms of the rules of that fund by a person that is a member of that fund.

- (2) *The total deduction allowed in terms of subsection (1) must not in a year of assessment exceed the lesser of—*
- (a) *R 350 000;*
 - (b) *27,5 per cent of the higher of the person's—*
 - (i) *remuneration (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as defined in paragraph 1 of the Fourth Schedule; or*
 - (ii) *taxable income (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as determined before allowing any deduction under this section and sections 6quat (1C) and 18A; or*
 - (c) *the taxable income (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) of that person before—*
 - (i) *allowing any deduction under this section and sections 6quat (1C) and 18A; and*
 - (ii) *the inclusion of any taxable capital gain.*

Section 11F makes it mandatory to deduct retirement fund contributions made during the year of assessment from the taxpayer's income. The contributions must have been made to either of the three specific funds, namely pension fund, provident fund, and retirement annuity fund in terms of the rules of the funds.²²

The retirement fund contribution is deducted from the income. The term income should not be confused with gross income, it is defined in the Act. Income means the amount remaining of the gross income of any person for any year or period of assessment after deducting any amounts exempt from normal tax.²³ This definition will become useful later, since a person earning foreign employment income may have a significant gross income, but still have little or no income.

Not all retirement savings contributions are deductible, but only those made to the funds mentioned. This aspect may sound trivial, but it may be relevant where a taxpayer has contributed to a foreign pension or retirement annuity fund, or something similar. In this case, the question is whether the retirement fund to which a contribution was made, is a pension, provident, or retirement annuity fund as contemplated under section 11F(1) and read with the definitions under section 1 of the Act. It is my submission that the answer to whether foreign retirement funds are retirement funds contemplated in the Act may be found by examining the administrative requirements of establishing these funds under South African law. The fund needs to be approved by the South African Revenue Service and the Registrar of Pension Funds.²⁴ Since foreign retirement funds will not have been approved by the SARS or the

²² Section 11F(1) of the Income Tax Act 58 of 1962.

²³ Section 1 of the Income Tax Act 58 of 1962, definition of Income.

²⁴ Section 4 of the Pension Funds Act 24 of 1957 read with the definitions of pension, provident and retirement annuity fund under section 1 of the Income Tax Act 58 of 1962.

Registrar of Pension Funds, contributions to foreign retirement funds would not be deductible. In addition, the analysis of the definition of pension, provident, and retirement annuity fund does not mention a fund registered or established in terms of foreign law.²⁵

Section 11F(2) limits the amount deductible under section 11F(1). It is worth noting that section 11F(2) does not place a cap on the amount that a person can contribute to a retirement fund. If a person has not been saving for retirement, and such a person wishes to accelerate the accumulation of retirement savings, contributions above the maximum deductible contributions may be acceptable, even though not all the contributions will be deductible in that tax year. For example, if the taxpayer's remuneration is R 1 500 000, and that taxpayer contributes 27,5% to an RA. The total contribution shall be R 412 500. However, the contribution exceeds the monetary cap of R 350 000. Thus, that taxpayer's deduction in that tax year shall be limited to R 350 000 and R 62 500 shall be a non-deductible contribution in that year of assessment.

Section 11F(2)(a) provides that the retirement contributions that are deductible may not exceed a monetary amount of R 350 000. For an employed taxpayer (with no other income such as rental or interest income), the R 350 000 limit is equivalent to 27.5% of R 1 272 272,27 remuneration (being $R\ 350\ 000 \div 27,5\% = R\ 1\ 272\ 272,27$). Thus, where a taxpayer's remuneration exceeds R 1 272 272,27, and that taxpayer contributes 27.5% to a retirement annuity fund, the contributions will exceed the maximum deductible contribution under section 11F(2).

The allowable deduction is further limited under section 11F(2)(c) to the taxable income **before** the inclusion of taxable capital gains and before the deduction of retirement fund contributions, donations deductible under section 18A, foreign taxes paid, and deductible by-election under section 6quat (1C).²⁶ The following example may work well to illustrate the point:

Suppose a taxpayer has R 340 000 in remuneration, and R 1 000 000 in taxable capital gains in a tax year. The taxpayer contributes R 368 500 to a retirement annuity fund. What will be the allowable deduction in that tax year?

Three amounts must be considered to apply section 11F. They are:

- ❑ The monetary limit of R 350 000 under section 11F(2)(a);
- ❑ 27,5% of the greater of **remuneration** and **the taxpayer's taxable income including taxable capital gains** but before the section 11F deduction, under section 11F(2)(b); and

²⁵ The definitions of pension, provident and retirement annuity fund under section 1 of the Income Tax Act 58 of 1962.

²⁶ SARS Interpretation Note 18 (Issue 5) 2022 at page 48 for support to the idea that taxable capital gain is included in the calculation of the 27,5% of the taxable income – but taxable capital gain is excluded under section 11F(2)(c).

- ❑ The taxpayer's **taxable income excluding taxable capital gains but before the section 11F deduction**, under section 11F(2)(c).

The smallest of the three amounts is the deductible amount, provided that, it is smaller than the actual contributions made to a retirement fund. However, if actual contributions are smaller than the amount determined in the step above, actual contributions will be deductible.

In this example, the three amounts are as follows:

The monetary limit of R 350 000 under section 11F(2)(a);	R 350 000
27,5% of the greater of: <ul style="list-style-type: none"> • Remuneration: R 340 000 • Taxable income including taxable capital gain – excluding listed deductions: R 1 340 000 $R\ 1\ 340\ 000 \times 27,5\% = R\ 368\ 500$	R 368 500
Taxable income excluding taxable capital gain and before the listed deductions.	R 340 000

Since taxable income including taxable capital gains is greater than the remuneration; 27.5% is applied on the taxable income including taxable capital gains – and the resultant amount is R 368 500. At first, one may think that the deductible contribution will be limited to R 350 000. However, the limit under section 11F(2)(c) must also be applied. It limits the deduction to the taxable income excluding taxable capital gains which works out to R 340 000. So, there are three amounts (R 350 000; R 368 000; and R 340 000) from which the least is preferred, which means R 340 000 is the deductible amount.

In this case, where a taxpayer receives remuneration and has no other income like interest income, business income, or rental income and has no business expenses to deduct, the taxable income excluding taxable capital gains works out to be equal to that person's remuneration. In this way, the deductible retirement fund contribution is limited to the remuneration amount, provided that the remuneration is less than R 350 000.

The limitation to the deductible retirement contribution will become useful when dealing with the impact of foreign employment income exemption on the deductibility of retirement annuity contributions.

Double Taxation Relief under the South African Income Tax Act

Section 6quat (1)(a) applies when determining the normal tax payable by a tax resident during a year of assessment, if the taxable income of a tax resident includes any income received by or accrued to such resident from any source outside the Republic. It provides that in determining the normal tax payable in respect of that taxable income a rebate must be deducted which is determined in terms of section 6quat.

This provision is meant to provide relief from the double taxation that may arise due to overlapping tax claims by two tax jurisdictions. The relief granted under this provision is unilateral and does not depend on the double taxation agreement that may exist between South Africa and a foreign jurisdiction.²⁷

Double taxation may arise where a South African tax resident is employed in a foreign tax jurisdiction. That foreign tax jurisdiction may tax the remuneration received by the South African tax resident because the remuneration originates within its jurisdiction. At the same time, South Africa will exercise its taxing rights over the remuneration received by the taxpayer because the person is a South African tax resident.²⁸ Section 6 quater(1B) provides a limit to the rebate that a South African tax resident may claim for foreign taxes paid. A rebate is available to the extent that the foreign income, on which foreign tax has been paid, is also taxable in South Africa.²⁹ If the foreign income is not taxable in South Africa because it is exempt from South African normal tax, then no foreign tax rebate is available.

For a tax resident earning foreign employment income, section 6 quater(1A) reads:

*[T]he rebate shall be **an amount equal to the sum of any taxes on income** proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person by such resident in respect of any income received by or accrued to such resident from any source outside the Republic, **which is so included in that resident's taxable income**.*³⁰

For a foreign-employed tax resident earning R 1 500 000 per year, and paying R 300 000 in foreign taxes, that tax resident cannot claim R 300 000 as a foreign tax rebate, because foreign tax rebate is available to the extent that the foreign income has been included in that tax resident's taxable income.

Since R 1 250 000 of foreign employment income is exempt from South African normal tax, only R 250 000 shall be the income that is included in the tax resident's taxable income. Thus, the tax resident can only claim a foreign tax rebate that represents foreign tax paid on the R 250 000. To get to the amount of foreign taxes paid that qualify for a foreign tax rebate under the South African Income Tax Act, the taxpayer will need to:

Determine total foreign remuneration	R 1 500 000
Determine total tax paid on foreign remuneration (to foreign authorities)	R 300 000
Determine taxable foreign remuneration (R 1 500 000 – R 1 250 000)	R 250 000
Express Taxable foreign remuneration as a ratio of Total Foreign Remuneration (R 250 000 ÷ R 1 500 000)	16,67%
Apply ratio to total tax paid to foreign authorities (16,67% X R 300 000)	R 50 000

²⁷ SARS Interpretation Note 18 (Issue 5) 2022 at page 4 -5.

²⁸ Ibid.

²⁹ SARS Interpretation Note 18 (Issue 5) 2022 at page 10.

³⁰ Section 6 quater(1A) of the Income Tax Act 58 of 1962.

Section 6quat(1B) further limits the amount that a tax resident who is receiving foreign remuneration can claim as a foreign rebate.³¹ The provision caters for a scenario where a taxpayer has both foreign and South African-sourced income, but it also works where the taxpayer has foreign income only as shall be shown in the example later. It provides that the foreign tax rebate shall not exceed the South African normal tax that is attributable to the foreign remuneration that has been included in that resident's total taxable income.³²

Suppose the tax resident in the preceding example, had in addition to the R 250 000 taxable foreign remuneration, R 500 000 remuneration from a South African source. The steps that may be followed to apply section 6quat(1B) are as follows:

Determine taxable income from a foreign source;	R 250 000
Determine taxable income from South African sources;	R 500 000
Add the foreign and the South African sourced taxable incomes to get worldwide taxable income;	R 750 000
Determine South African normal tax payable on a resident's worldwide taxable income – before rebates: R 179 147 + 39% X 27 000	189 677
Express foreign-sourced taxable income as a percentage of the worldwide taxable income: $250\,000 \div 750\,000$	33,33%
Apply the ratio of foreign taxable income to worldwide taxable income to the normal tax payable. This will be the upper limit to the foreign tax rebate that a tax resident can claim as a tax rebate for foreign taxes paid. $33,33\% \times R\ 189\,677$	R 62 225.7
The rebate that the taxpayer qualifies for is limited to the lesser of the foreign taxes paid (R 50 000) and the normal tax attributable to the foreign remuneration (R 62 225.7)³³	

In the preceding examples, taxable foreign remuneration was determined as foreign remuneration less section 10(1)(o)(ii) exemption without considering any retirement fund contributions made by the taxpayer.

Section 6quat(1B)(i) governs the deductibility of retirement fund contributions made by a tax resident with foreign remuneration. It provides that in determining the amount of the taxable income that is attributable to that income (foreign remuneration after deduction of section 10(1)(o)(ii)):

³¹ Section 6quat(1B) of the Income Tax Act 58 of 1962.

³² SARS Interpretation Note 18 (Issue 5) 2022 at page 10.

³³ SARS Interpretation Note 18 (Issue 5) 2022 at page 41.

- ❑ any allowable deductions contemplated in sections 11F and 18A must be **deemed to have been incurred proportionately in respect of taxable income derived from sources within and outside the Republic**;³⁴
- ❑ **the deduction under section 11F must be allocated in relation to the taxable income from sources within and outside the Republic** before considering any deduction in terms of that section, subsection (1C), and section 18A.³⁵

Suppose that the taxpayer contributed R 180 000 to a South African retirement annuity in a tax year. The taxpayer has R 250 000 in foreign taxable income; and a further R 500 000 taxable income from South African property rented out, both taxable incomes are before the deduction of retirement fund contributions under section 11F.

The taxpayer can do the following:

Determine taxable income from a foreign source before the section 11F deduction	R 250 000
Determine taxable income from South African sources before the section 11F deduction	R 500 000
Add the foreign and the South African sourced taxable incomes	R 750 000
Express Foreign Taxable Income as a percentage of total taxable income – before section 11F deduction $250\ 000 \div 750\ 000$	33,33%
Apply the percentage to retirement fund contribution. 33,33% X 180 000	R 60 000

In this example, the taxpayer shall deduct R 60 000 from the foreign taxable income to arrive at taxable income after the section 11F deduction. Note that the allocation of deductible retirement fund contributions is based on taxable income before the section 11F deduction and not gross income.³⁶

Integrated Examples

In the preceding sections, various examples were used to illustrate the workings of specific provisions. This example attempts to put all the provisions together demonstrating how a person with both domestic and foreign income, would go about determining the section 11F deduction, the foreign tax that will qualify for a rebate under section 6quat, and the limit that applies to the amount of foreign tax that may be claimed as a foreign tax rebate.

The following steps are suggested:

³⁴ Section 6quat(1B)(i) of the Income Tax Act 58 of 1962.

³⁵ Ibid.

³⁶ SARS Interpretation Note 18 (Issue 5) 2022 at page 48.

- ❑ Calculate foreign income before section 11F deduction by applying section 10(1)(o)(ii).
- ❑ Add the foreign and domestic income before the section 11F deduction to obtain a taxpayer's worldwide income.
- ❑ Express foreign income before section 11F as a percentage of the taxpayer's worldwide income.
- ❑ Apply section 11F to retirement fund contributions to determine deductible contributions for that tax year.
- ❑ Use the ratio above to determine retirement contributions that are deductible from the foreign and domestic income.
- ❑ Deduct section 11F contributions from the foreign and domestic income respectively, resulting in the taxpayer's worldwide taxable income.
- ❑ Apply the South African personal income tax table to the worldwide taxable income (before deduction of any rebates).
- ❑ Express foreign taxable income as a percentage of the taxpayer's worldwide taxable income after section 11F deductions.
- ❑ Apply the ratio to the South African tax on worldwide income to get the South African tax attributable to foreign income.
- ❑ Express foreign taxable income as a percentage of the taxpayer's foreign employment gross income.
- ❑ Apply the ratio to total non-recoverable foreign taxes paid to get foreign taxes recoverable under section 6quat.

Note that the foreign tax rebate is given for foreign income that is included in that taxpayer's taxable income. Thus, it is not sufficient that the taxpayer's gross foreign income exceeds the exempt amount of R 1 250 000. The income above the exempt amount must be included in the taxpayer's taxable income. Thus, if the foreign income is equal to the retirement fund contribution deduction under section 11F, then no foreign tax rebate shall be available to that taxpayer.

Put differently, if the ratio of foreign taxable income to the taxpayer's worldwide taxable income is zero, then zero multiplied by the South African income tax payable shall result in zero. The amount of foreign tax recoverable is limited to the South African tax that is attributable to the foreign taxable income.

Suppose a resident taxpayer (45) employed in a foreign jurisdiction received R 1 550 000 in foreign remuneration, paid R 360 000 in foreign tax, and contributed R 300 000 into a South African retirement annuity fund during the 2023 tax year. The tax resident has no South African income.

Applying the steps above will result in the following:

Calculate foreign income before section 11F deduction by applying section 10(1)(o)(ii) $1\,550\,000 - 1\,250\,000$	R 300 000
Add the foreign and domestic income before the section 11F deduction to obtain a taxpayer's worldwide income. Foreign income (R 300 000) + domestic income (R 0)	R 300 000
Express foreign income before section 11F as a percentage of the taxpayer's worldwide income $R\,300\,000 \div R\,300\,000$	100%
Apply section 11F to retirement fund contributions to determine deductible contributions for that tax year <ul style="list-style-type: none"> R 350 000 27,5% of remuneration ($27,5\% \times R\,1\,550\,000$) = R 426 250 Taxable income excluding taxable capital gains: R 300 000 R 350 000 is the lesser of the three amounts. However, the deduction is limited to the actual contribution (R 300 000).	R 300 000
Use the ratio of foreign income to worldwide income before the section 11F deduction above to determine retirement contributions that are deductible from foreign and domestic income. $100\% \times R\,300\,000$	R 300 000
Deduct section 11F contributions from the foreign and domestic income respectively, resulting in the taxpayer's worldwide taxable income. Taxable income before section 11F deduction (R 300 000) Less Section 11F deduction (R 300 000)	R 0

Since the overall taxable income is zero, the taxpayer shall not qualify for the foreign tax rebate, because the amount of foreign income included in the taxpayer's taxable income is zero.

The same logic will apply to a taxpayer whose gross foreign income from employment is less or equal to R 1 250 000 because foreign income included in that taxpayer's taxable income is zero. Since a foreign tax rebate is available for foreign income included in the taxpayer's taxable income, no foreign tax rebate may be claimed.

Now suppose a resident taxpayer (44) employed in a foreign jurisdiction received R 1 750 000 in foreign remuneration, paid R 360 000 in foreign tax, and contributed R 300 000 into a South African retirement annuity fund during the 2023 tax year. In addition, his rental income from properties located in South Africa, after deduction of expenses came to R 500 000. The application of the steps above could look like this:

	Foreign	Domestic	Total
Foreign remuneration	1 750 000		1 750 000
Less Section 10(1)(o)(ii) exemption	1 250 000		1 250 000
South African Rental Income		500 000	500 000
Worldwide Income	500 000	500 000	1 000 000
Ratio	50%	50%	100
Section 11F deduction Deduct actual contribution limited to the Lesser of: <ul style="list-style-type: none"> • R 350 000 • 27.5 % of remuneration (R 481 250) • Taxable income before s11F deduction (R 1 000 000) The lesser of the above is R 350 000. The actual contribution of R 300 000 is less than R 350 000 – so the deduction allowed shall be R 300 000. The retirement fund contribution is allocated proportionally between the domestic and the foreign taxable income before the section 11F deduction. <ul style="list-style-type: none"> • $50\% \times 300\,000 = R\,135\,000$ 			
Taxable income	350 000	350 000	700 000
Ratio	50%	50%	100
Determine South African tax payable on the taxable income before the deduction of rebates: <ul style="list-style-type: none"> • Tax on R 673 000: R 179 147 • Tax on R 27 000: R 10 530 • Total Tax: R 189 677 			
Determine South African Tax attributable to foreign taxable income: $50\% \times R\,189\,677 = R\,94\,838,5$	94 838,5	94 838,5	189 677
Domestic Normal Rebate		(17 235)	(17 235)
Determine the amount of foreign tax that qualifies for the rebate. <ul style="list-style-type: none"> • Foreign income ÷ Total foreign income × Foreign tax paid • $500\,000 \div 1\,750\,000 \times 360\,000 = 102\,857$ Only R 94 838,5 is the amount of foreign tax that is recoverable under the foreign tax rebate provision – because it is limited to South African tax attributable to foreign income. The foreign rebate is limited to the lesser of actual foreign tax paid (R 75 086) and normal tax attributable to foreign taxable income (R 104 334) Foreign tax rebate limited to R 75 086	(94 838,5)		(94 838,5)
TOTAL TAX PAYABLE	0	77 603,5	77 603,5

This example demonstrates the steps suggested above. The following is noteworthy about the steps above:

- Retirement fund contributions are allocated proportionally between foreign and domestic income, using worldwide income before the section 11F deduction. What is noteworthy is that the retirement contribution is not allocated using gross income. If the allocation was based on gross income, a significant portion of retirement contributions would have been allocated to foreign income.

- ❑ When applying section 11F to determine is R 300 000 contribution made to a South African retirement fund, it is assumed that foreign remuneration before the application section 10(1)(o)(ii) is remuneration as defined. This is significant because, if remuneration refers to foreign remuneration over R 1 250 000, the calculation would have been different. Remuneration would have been R 500 000, and taxable income including taxable capital gains but before section 11F deduction would have been R 1 000 000. In that case, 27.5% would have been applied on R 1 000 000, being the greater of the two amounts, resulting in R 275 000 allowable deduction. Thus, not all of the R 300 000 would have been deductible.
- ❑ The deductible retirement contribution is allocated proportionately between the foreign and domestic income, using taxable income before the section 11F deduction.
- ❑ Worldwide taxable income is calculated, and taxed under the South African tax provision, by applying the personal income tax table – but before the deduction of any rebates.
- ❑ The foreign taxable income that is part of the worldwide taxable income is expressed as a percentage. This percentage is applied to South African tax calculated, to arrive at South African tax attributable to foreign taxable income. This tax attributable to foreign taxable income is the upper limit of the foreign tax rebate – in that the rebate available cannot exceed this amount. In the example above, R 94 838,50 is attributable to foreign income included in the taxpayer's income. The foreign tax paid, attributable to the foreign income tax in South Africa, is R 102 857. In this case, only R 94 838,50 can be claimed as a foreign tax rebate and the balance is carried over to the next year of assessment.
- ❑ The foreign taxable income is divided by the gross foreign income to arrive at a percentage of foreign taxes paid that qualify for foreign tax rebate. The foreign tax rebate is deductible in the process of determining the net tax amount payable to the South African tax authority. The use of taxable foreign income means a smaller percentage of foreign taxes paid are recoverable through the foreign tax rebate mechanism. This is because foreign taxable income is arrived at after the deduction of the R 1 250 000 exemption and a portion of the section 11F deduction, resulting in a significantly lower amount of taxable income relative to the total foreign remuneration.

Conclusion

When working with a tax resident with foreign employment income, the two important questions are how much tax will be paid in South Africa on the foreign income, and whether a retirement fund contribution can help reduce the tax burden. The second question is often followed by how much contribution should be made into a retirement annuity fund, to reduce the South African tax.

In summation, the advice that is given depends on several factors, some of which are beyond the scope of this article. However, the amount of foreign employment income received plays a significant role.

- ❑ If the gross amount of foreign employment income is less than R 1 250 000, then there is no need for the taxpayer to worry about South African tax. The use of retirement fund contributions is optional because the contributions will be non-deductible, except if the taxpayer also has domestic income against which the retirement fund contributions can be claimed. It does not mean that the taxpayer cannot contribute to a South African retirement annuity if the taxpayer only has foreign employment income. The taxpayer may still make contributions, notwithstanding that the contributions will be non-deductible because tax saving is not the main reason for retirement contribution, but for retirement goal.
- ❑ If the gross foreign employment exceeds R 1 250 000, then the taxpayer, working with a financial planner, will have to consider what is the most optimal outcome, after calculating the tax that will be payable in South Africa if the taxpayer makes no contribution to a retirement fund versus tax payable if there the taxpayer makes a retirement fund contribution. You will notice that the approach is not straightforward, it is dependent on several factors and scenario planning. The reason for this is that financial planning involves the balancing of competing financial needs, and financial planning is about assisting a client to come to the most optimal outcome, after a proper analysis of all the factors.
- ❑ It was shown under the integrated example that if the taxpayer receives foreign employment income, that taxpayer has no domestic income, and the deductible contribution equals or exceeds the taxable foreign income before deduction of section 11F contributions, then no South African tax will be payable. However, the example assumed that the gross foreign remuneration would be used to calculate 27.5% of the greater of remuneration and taxable income including taxable capital gain. If this assumption does not hold, the taxpayer may end with non-deductible contributions, which may not be desirable, depending on other financial considerations of the taxpayers.

The last example, under the integrated examples section, illustrates how the tax will be determined for a taxpayer receiving foreign employment income, domestic rental income, and contributing to a retirement annuity fund. The example is explained in full and shall not be repeated here.

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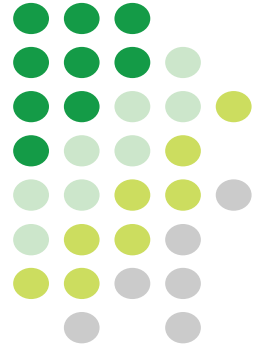
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Introduction

In South Africa, many investors have low confidence in the local markets due to the volatility of the rand and unstable political situations. Regulation 28¹, which is a provision within the Pension Funds Act has limitations on the amount that retirement funds can invest offshore. Many are seeking exposure to international markets, and because there is a limitation in terms of access to offshore markets in terms of retirement funds, foreign pension products have become popular. Thus, individuals who want this exposure often seek foreign pension trusts as a solution. Just like a regular pension plan, the aim of a foreign pension trust is to provide retirement benefits to those individuals that participate in it. Whilst a pension fund in South Africa is governed and regulated by South African law, a foreign pension trust is established in a foreign jurisdiction, and as such, is governed by that country's relevant laws.

This article aims to provide an overview of the important considerations that must be considered when investing in foreign pension trusts². Apart from the reasons stated above, there are further factors that encourage South Africans to invest in an offshore pension trust.

Diversification:³

When a resident invests in a foreign pension trust, they are allowed to diversify their retirement investment portfolio geographically. Such diversification allows them to have investments across different markets, thus reducing their exposure to any one economy or currency. By investing in such a manner, risk is mitigated, and investment returns are enhanced.

Access to global markets:⁴

Since a resident investor can be restricted in their domestic market, investing in an offshore pension provides an individual with access to global investment markets. Thus, they will have access to sectors, industries, and asset classes that they generally do not have access to.

Currency Hedging:

⁵If an individual invests in an offshore pension, they will be in a position to hedge against currency risk. Since the South African rand is so volatile, investing in different currencies can

1 Regulation 28-Section 36(1)(bB) of the Pension Funds Act 24 of 1956

2 Offshore pension refers to the jurisdiction where the pension fund is held. This includes various different structures, one of them, being a trust. An offshore pension trust, therefore is a pension plan that is structured as a trust in a foreign jurisdiction.

3 Investing offshore: A diversification strategy- Available at <https://www.moneyweb.co.za/financial-advisor-views/investing-offshore-a-diversification-strategy/> 23 March 2023

4 Investing offshore: A diversification strategy- Available at <https://www.moneyweb.co.za/financial-advisor-views/investing-offshore-a-diversification-strategy/> 23 March 2023

5 Investing offshore: A diversification strategy- Available at <https://www.moneyweb.co.za/financial-advisor-views/investing-offshore-a-diversification-strategy/> 23 March 2023

provide a hedge against the potential depreciation of the South African rand. This can result in stability in the overall investment position.

Political and Economic Stability:⁶

By diversifying the portfolio, an individual can reduce exposure to risk associated with local political events, policy changes, or economic downturns.

Access to Specialist Investment Managers:⁷

A local domiciled investor may be restricted in terms of fund options. By investing in an offshore pension product, the investor will have access to a variety of investment managers who may have the necessary, specialised skill, knowledge, and expertise. Their expertise may range from certain sectors, regions, or investment strategies. The investment could therefore result in an overall balanced and superior investment performance.

International Retirement Planning:⁸

Due to the current political and economic instability in South Africa, many residents have or are considering relocating to other countries. To align their investments with their future plans, investing in an offshore pension could be viewed as part of their retirement planning.

Global Investment Trends:⁹

A South African investor may be subjected to a limited range of financial products by only being invested domestically. By investing in an offshore pension product, an individual has exposure to global investment trends and a wide range of financial products, that may not be available in South Africa. The investor will have exposure to emerging industries, technologies, and various investment strategies.

Previously, offshore pensions were marketed for their tax benefits. Due to the ever-changing environment of tax legislation, these tax concessions that may have been applied in the past, may not be applicable under the new tax law. One such concession, is the availability of tax deferral¹⁰ on investment gains. When an individual participated in an offshore pension plan, they had the option to invest in a variety of assets. The gains that were generated such as capital gains, interest and dividends were not subject to taxation immediately but was

⁶ Investing Offshore- SAICA – Available at <http://magazine.accountancysa.org.za/articles/investing-offshore-your-questions-answered>
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⁷ Investing offshore – Available at <https://ninetyone.com/en/south-africa/investment-platform/our-product-solutions/offshore-investing>

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¹⁰ Tax implications of resident beneficiaries of a foreign pension trust – Available at <https://fincor.co.za/tax-implications-for-resident-beneficiaries-of-a-foreign-pension-trust/>

deferred to the time when the participant accessed the funds from the pension, which generally would be on retirement.

With recent changes in tax laws, some countries have eliminated the tax deferral benefit and annual taxation has been introduced. Thus, a participant is liable for any taxes that may arise on an ongoing basis rather than deferring the liability until retirement.

Tax Consequences

Estate Duty:

It is important to note that South African Revenue Services (SARS) recognises *certain* foreign pensions as “approved pension funds” for estate duty purposes. Thus, the concessions afforded to approved pension funds do become applicable.

Income Tax:

Cognisance must be taken of the fact that a residence-based tax system is followed in South Africa. This in effect means that a resident is taxed on their worldwide income, irrespective of the jurisdictional source of their income.¹¹

Thus, when distributions are received from a foreign pension trust, there are income tax implications for a resident beneficiary. Income tax will be influenced by various factors. The nature of the income, residency status, the Double Taxation Agreement (DTA) between South Africa and the country where the foreign pension product was established, are important considerations. The aim of the DTA, is to prevent double taxation, by allowing for a credit or exemption in certain circumstances.

Capital Gains Tax:

In relation to a foreign pension trust, capital gains tax will become applicable when assets are disposed of or when the beneficiary receives a distribution that involves a capital gain component. Capital gains tax will be influenced by various factors such as the residency status of the beneficiary, the type of assets being disposed of, and the relevant DTA.

A recent binding class ruling (BCR 080) by SARS has highlighted the importance of understanding the product and its rules and the potential tax implications.” This ruling determines the income tax, capital gains tax, and estate duty implications for resident beneficiaries of a foreign pension trust”.¹²

Note must be taken of the fact that the ruling was based on a specific pension trust deed and does not necessarily apply to all foreign pension trusts.

¹¹ Tax and exchange control considerations for South African tax residents taking up employment in the UAE. Available at <https://www.cliffedekkerhofmeyr.com/en/news/publications/2021/Tax/Tax-Alert-11-February-2021-Tax-and-exchange-control-considerations-for-South-African-tax-residents-taking-up-employment-in-the-UAE.html>
¹² SARS BINDING CLASS RULING: BCR 080 Available at <https://www.sars.gov.za>

“In BCR 080, the applicant is a South African company and founder of the foreign pension trust. The FPT is a non-resident pension scheme established under trust and constituted by way of a trust deed. The FPT has scheme rules. The class of persons to whom the BCR applies are the resident investors who will make contributions and become the beneficiaries of the foreign pension trust.

The FPT was established in a foreign jurisdiction where its beneficiaries are potentially exempt from income tax on any annuities or lump sums paid pursuant to its pension scheme, provided that the individual to whom the annuity or lump sum is payable is not resident for income tax purposes in that jurisdiction. The applicant intends to offer a financial product which will be housed in the FPT which is intended to be a pension scheme which will offer SA resident investors access to offshore hard currency retirement investment options with estate and succession planning benefits.

The ruling made is as follows:

- a) *The FPT is not a “pension fund”, “provident fund” or “retirement annuity fund” as defined in section 1 (1).*
- b) *Section 11F will not apply in respect of contributions made by Investors to the FPT.*
- c) *A contribution made by an Investor will not constitute a “donation” as defined in section 55. Sections 54 and 58(1) will not apply to Investors in respect of contributions made to the FPT.*
- d) *An investor will, upon becoming a beneficiary/member of the FPT, acquire a personal right against the trustees of the FPT to administer the trust appropriately, and a vested personal right to the income and capital of the FPT, subject to the time-based restrictions stipulated in the scheme rules.*
- e) *An Investor's personal right to the income and capital of the FPT will have a base cost in accordance with paragraph 20(1) of the Eighth Schedule equal to the contribution made by the Investor. Paragraph 81 of the Eight Schedule will not apply in respect of the personal right of an Investor mentioned in this paragraph as the right is not a contingent right but a vested right.*
- f) *Section 7(1) will apply to the Investors of the FPT.*
- g) *When an Investor dies prior to the normal retirement date, the vested personal right will constitute “property” in terms of section 3 of the Estate Duty Act. The right will form part of the deceased Investor's dutiable estate.*
- h) *When an Investor dies prior to the normal retirement date, he or she will be deemed to have disposed of his or her vested personal right before his or her death for market value in terms of Section 9HA(1). Where the requirements of paragraph 54(b) of the Eighth Schedule are not satisfied, the market value of the right will be treated as proceeds for purposes of paragraph 35(1) of the Eighth Schedule.*
- i) *When an Investor reaches normal retirement date as stipulated in the scheme rules, any annuity paid by the FPT to the Investor will constitute an annuity for purposes of the*

Act which must be included in the gross income of the Investor in terms of paragraph (a) of the definition of "gross income" in section 1 (1).

- j) On the death of an Investor after normal retirement date, the right to an annuity will constitute "property" as defined in paragraph (b) of the definition of "property" in section 3 of the Estate Duty Act. The right to an annuity will fall within the dutiable estate of the deceased investor.

On the death of an Investor after normal retirement date, the Investor will be deemed to have disposed of the right to an annuity for market value in terms of section 9HA(1). The Investor will also be deemed to have disposed of his or her right to lump sum benefits for market value where the requirements of paragraph 54(b) of the Eighth Schedule are not satisfied.

No ruling is made on the application of section 25B of the Act and paragraph 80 of the Eighth Schedule to the Investors."¹³

Conclusion

Based on the above ruling, it is evident that not all foreign pension trusts enjoy the same tax benefits as local retirement funds. It is of vital importance that when deciding to invest in an offshore pension, cognisance must be taken of the fact that there are complexities involved such as tax implications, regulatory compliance, and potential currency and market risks.

Before an individual invests in such a financial product, they must understand the structure and tax implications involved. This includes Income Tax, Capital gains tax, and Estate duty.

In the past, these offshore products were marketed for the tax benefits that they enjoyed. As the taxation legislation has changed over the years, the investor needs to understand such changes before deciding to invest offshore solely for tax benefits.

Cognisance must also be taken of the fact that the investor has the onus to declare their worldwide income to SARS. This includes income from a foreign pension trust. Non-disclosure can lead to penalties and legal consequences. Thus, it is of vital importance that resident beneficiaries ensure full and accurate reporting of all income received so that there is compliance with tax legislation.

13

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Does a Sinking Fund Policy Form Part of a Deceased Estate for Accrual Purposes?



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Introduction

A question that sometimes arises is whether a sinking fund policy forms part of a deceased person's estate when an accrual calculation is done. The reason why there is some uncertainty around this is that there is no life assured on a sinking fund policy. This leads to the question of whether the value of the sinking fund must be included or excluded as an asset or deemed asset in the estate of the owner of the policy.

It is also important to understand the impact of the inclusion of an asset for accrual purposes in the estate of a person and inclusion in the liquidation and distribution account as an estate asset or deemed asset to calculate estate duty.

The definition of a Sinking Fund is discussed first and then the accrual claim and how it is calculated will be examined before the question of whether policies must be included or not is discussed.

What is a Sinking Fund?

The Long Term Insurance Act¹ defines a sinking fund policy as a contract, other than a life policy, in terms of which a person, in return for a premium, undertakes to provide one or more sums of money, on a fixed or determinable future date, as policy benefits.² According to Reinecke *et al*, although sinking fund policies are treated as long-term insurance policies in the Act, they are not a true form of insurance because they lack the element of uncertainty, which is the hallmark of insurance. What it does have in common with other insurance products is that it is an investment made with a registered long-term insurer.

A sinking fund policy does not have a life insured and is therefore not contingent on a life event. If the policyholder dies before maturity of the policy, the benefit will be payable to his or her estate.³ The policyholder may appoint a nominee for ownership of the policy.⁴ If the policyholder dies before the end of the policy term, the nominee for ownership, on acceptance, becomes the new policyholder.

Where the policyholder has nominated a beneficiary for proceeds, the policy benefit will be payable, provided that it is not revoked by the policyholder and if it is duly accepted by the beneficiary, to the beneficiary. If there is no beneficiary for proceeds or ownership nominated, the proceeds will be payable to the estate of the policyholder.⁵

To summarise then, a sinking fund policy is an investment policy that is regulated by the Long Term Insurance Act,⁶ that does not have a life assured on it, only a policyholder (owner) who can appoint a beneficiary for ownership to take over ownership of the policy should the policyholder die before the end of the policy term.

¹ Act 52 of 1998

² Section 1(1) of Act 52 of 1998

³ Reinecke (et al), *The Law of South Africa [LAWSA], Insurance Part 2, Volume 12(2), Second Edition at 319.*

⁴ Reinecke (et al), *The Law of South Africa [LAWSA], Insurance Part 2, Volume 12(2), Second Edition at 104.*

⁵ Reinecke (et al), *The Law of South Africa [LAWSA], Insurance Part 2, Volume 12(2), Second Edition at 319.*

⁶ Act 52 of 1998.

Accrual - Matrimonial Property Act

According to the Matrimonial Property Act,⁷ at the dissolution of a marriage that is subject to the accrual system, either by death or divorce 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/her estate if they are deceased, acquires a claim against the other spouse or his/her estate for an amount equal to half of the difference between the accrual of the respective estates of the spouses.⁸ The spouses only have contingent rights to claim any benefit before the dissolution of the marriage and not vested rights. The rights only become vested when the marriage ends, either by death or divorce.⁹

The Act in section 4, however, excludes the following assets when determining the accrual of the estate of a spouse:

- Any amount which accrued to the estate by way of damages, other than damages for patrimonial loss;¹⁰
- Any asset which has been excluded from the accrual in an antenuptial contract, or assets acquired by virtue of the possession of such an asset;¹¹
- Any inheritance, legacy, or donation received by a spouse during the marriage as well as any other assets acquired by virtue of the possession of such an asset;¹² and
- Donations between spouses.¹³

Example

It is best to illustrate the workings of the accrual calculation by way of an example and calculation. Let's assume the following facts:

- Jack and Jill were married out of community of property with the inclusion of the accrual system on 15 October 2005;
- In their antenuptial contract (ANC) the beginning values of their respective estates were recorded as follows: Jack – R500 000 and Jill – R250 000;
- Assets excluded in their ANC: Jack - R250 000 and Jill - R0;
- Jill owns a life policy on Jack's life of which the life cover is R750 000
- The current value of their respective estates were as follows: Jack - R10 000 000 and Jill – R5 000 000
- Liabilities in their respective estates: Jack - R1 000 000 and Jill – R500 000
- Jack died in a car crash on 26 November 2022

⁷ Act 88 of 1984

⁸ Section 3(1).

⁹ Joubert (et al), The Law of South Africa [LAWSA], Vol 28(2), 3rd Edition at 106.

¹⁰ Section 4(1)(b)(i).

¹¹ Section 4.

¹² Section 5.

¹³ Section 5.

The calculation will be done as follows:¹⁴

	Jack	Jill
Current gross value of each spouse's assets	R10 000 000	R5 000 000
Plus: Life assurance policies of which the other spouse is the owner (contracting party) (See note 3 below)		R750 000
Less: Liabilities in each spouse's estate:	R1 200 000	R500 000
Less: Assets excluded from estates in ANC (See note 2 below)	R250 000	R 0
Current value of their respective estates	R8 550 000	R5 250 000
Less: Nett value at commencement of marriage revalued @ CPI (rounded for this example) (See note 1 below)	R1 200 000	R600 000
Accrual in each spouse's estate	R7 350 000	R4 650 000
Greatest Accrual (Jack)	R7 350 000	
Less: Smallest Accrual (Jill)	R4 650 000	
Divisible accrual:	R2 700 000	
Divide divisible accrual by two: Portion that spouse with the smallest accrual will receive from the other spouse (Jill will receive from Jack's Estate)	R1 350 000	

Note1:

Section 6(1) of the Matrimonial Property Act determines that a spouse must declare the commencement value of their estate in the antenuptial contract or by a notarised statement within 6 months after the commencement of the marriage. The commencement value must be adjusted for inflation affecting the monetary value of the estates between commencement and termination by making use of the weighted average of the Consumer Price Index (CPI) that is published by Stats SA.¹⁵ The exception to this is if the commencement value of the estates has been declared as nil or if it is deemed to be nil.¹⁶

¹⁴ Calculation template of the accrual worksheet, Premiums and Problems, Edition 125, 2022, at E56.

¹⁵ Section 4(1)(b)(iii) of Act 88 of 1984.

¹⁶ Wiechers and Vorster, Administration of Estates, Issue 23, at 12-4.

Note 2:

The Matrimonial Property Act contains no reference to the indexation of assets excluded from the accrual or assets that were acquired with the proceeds of excluded assets. It is not clear whether the value of such assets should be CPI adjusted as with the commencement value of the estate. It is however suggested that the value of cash legacies and cash donations received by a spouse during the marriage should be indexed when calculating the accrual.¹⁷

Note 3:

It is important to note that where a deceased person's spouse is the contracting party on a life policy on the life of the deceased and the proceeds of this policy are paid to the surviving spouse, the proceeds of the life policy will be included in the accrual of the surviving spouse.¹⁸ In our example above Jill will have a vested accrual claim against Jack's estate for the amount of R1 350 000. Before Jack's death, Jill only had a contingent claim which only realised after Jack's death.

Pure risk life policies and accrual

A question that arises is whether life policies on the life of the deceased are to be included in the accrual of the deceased's estate. To answer this, it is important to look at when die proceeds of a life policy vest in the estate of a deceased. The moment of death is very important to establish any claims in terms of the applicable matrimonial property law. In terms of the law of contract, the right to claim the proceeds of a life policy already vests on the conclusion of the contract but it only becomes payable on death. The moment of death is seen as a suspensive time clause which is incorporated into the life insurance contract. The obligation to pay in terms of the contract comes into existence at the conclusion of the contract but the obligation to pay is suspended until the future event happens, in this case when the life assured dies.¹⁹

In *CIR v Estate Hersov*²⁰ the court held that a person who is the insured on a life policy that is payable to his estate has proprietary rights in such a policy, which vests during his lifetime. Such a policy will be regarded to belong to the deceased at the time of his death and should be reflected as property of the deceased estate. The proceeds of this policy should be included in the liquidation and distribution account of the deceased of the insured.²¹

Should there be a beneficiary for proceeds on the life policy, the proceeds will be paid to the beneficiary on acceptance of the benefit. This has the effect that the estate of the deceased does not have the right to claim the proceeds of the policy and therefore the proceeds cannot be included in the estate as an asset and consequently not in the calculation of the

¹⁷ Wiechers and Vorster, Administration of Estates, Issue 22, at 12-6.

¹⁸ Premiums and Problems, Edition 125 (2022), page E57.

¹⁹ E Muller, "The treatment of life insurance policies in deceased estate with perspective on the calculation of estate duty", 2006 (69) THRHR 250 – 270.

²⁰ 1954 (4) SA 559 (A) 264

²¹ Marius Botha, Accrual claim and life insurance, Insurance and Tax No2, May 2015

accrual of the deceased's estate either.²² Such a policy will however be included in the estate as a deemed asset for estate duty purposes.²³

(See note 3 above for life policies that are owned by a spouse on the life of the other spouse.)

Policies with a cash value and the accrual.

If the same reasoning as discussed above with life policies is applied to investment policies (endowment policies) and some life policies with a cash value, the logical outcome would be that the surrender or cash values of these policies will form part of the assets of the deceased estate and must be taken into consideration when determining the accrual of the estate.²⁴ In these cases, the policy will have a value before the day of death.

In the case of an investment policy, the value will be the surrender value and in the case of some old-generation life insurance policies, it will be a cash value. The deceased have vested rights to the benefits in these policies even if the benefits are to be paid to someone else.

The Supreme Court of Appeal, in the case of *CM v EM*²⁵, a divorce matter, found that a right to income that flows from a living annuity is an asset in a person's estate and is subject to accrual. The reason for this is that the person has a clear right to the income and the future income stream, and the value can be calculated and capitalised. The principle on which the Court based its decision can also be used to argue that the same applies to policies with a cash or surrender value.²⁶

Conclusion

From the above, it is then concluded that a sinking fund policy will be included in a person's estate when determining the accrual of that person.

Where there is no beneficiary for ownership or proceeds nominated on the sinking fund policy, the owner's estate has a vested right to proceeds (surrender value) of the policy and the proceeds will be payable to the estate of the owner. The surrender value will therefore be seen as an asset in the estate of the owner for purposes of calculating the accrual and will be included in the liquidation and distribution account of the deceased. It will also be seen as an asset for purposes of calculating estate duty.

Where a beneficiary for ownership or a beneficiary for proceeds is nominated on the sinking fund policy, the surrender value will also be included in the estate of the owner for accrual purposes. The policy will then be seen as deemed an asset in the owner's estate to calculate estate duty.

²² Natalie Dillon, *The Accrual Claim at death v Divorce, Premiums and Problems*, Article Edition Nr. 120, January 2020 at F14

²³ Section 3(3)(a) of Estate Duty Act 45 of 1995

²⁴ Marius Botha, *Accrual claim and life insurance*, Insurance and Tax No2, May 2015

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²⁶ Danie Gouws and Nerissa Naidoo, *Legal Note on Calculation of Surrender Value of a Sinking Fund policy where a beneficiary is nominated*, 5 October 2022

The fact that a sinking fund policy does not have a life assured does not exclude it from the owner's estate when calculating the accrual of that estate. The owner has vested rights to the proceeds of the policy and these right makes the proceeds of the policy subject to the accrual.

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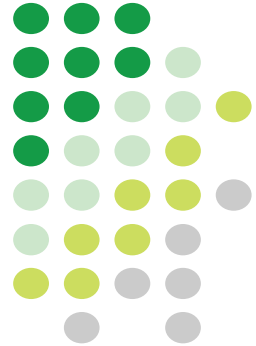
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Comparison of different taxes applicable between a Traditional Buy- and-Sell Agreement and a Share Buy- Back Agreement



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Introduction

Business owners often have a crucial concern regarding the continuity and secure disposition of their business interests in the face of unfortunate events like the death or disability of a co-owner. They would like to make provision for the business to remain exclusive to the owners, ensuring that no external parties will get involved and allowing the remaining owners to continue operating without any disruptions. Several risks can arise, including the risk of the remaining owners not having sufficient funds to purchase the deceased co-owner's business interest, a lack of security for heirs regarding fair compensation, potential ownership disputes, and potential depletion of the business capital resources while funding the purchase. Buy-and-sell or share buyback arrangements are often used as solutions to address these concerns.

It is however important to ask the question: "*Which of these two agreements will be more favourable for the business owner, taking into account his circumstances?*". The tax implications of each agreement will play an integral role in this decision.

This article delves into the tax implications of both buy-and-sell and share buy-back arrangements by comparing various scenarios where the shareholders of a company can either be individuals, trusts, or companies.

Different business structures

Selecting the correct business structure is crucial when starting a new business. Different structures, such as sole proprietorships, partnerships, close corporations, incorporated companies, limited liability companies, and trusts come with distinct advantages and disadvantages. Making an informed decision based on factors like funding sources, personal liability, taxes, and regulatory compliance is essential for long-term success.

In terms of the Company Act 71 of 2008 ("the Act") a distinction is made between various types of companies in South Africa. For purposes of this article when referring to a company the term will refer to a private company.

The importance of buy-and-sell and share buy-back agreements

Given the uncertainty surrounding the timing of death, it would be impractical to save specifically to acquire a co-owner's interest. A practical and relatively affordable approach to financing the purchase price is through life insurance. This arrangement offers several benefits for both the heirs of the deceased co-owner and the remaining co-owners. Other benefits include the following:

- i. Clarity is established regarding the designated buyers for the business interest, which will assure the departing or deceased co-owner that the value of their business interest can be realised in the event of unfortunate circumstances such as death or disability, providing financial security for their family.
- ii. A mutually agreed-upon and fair purchase price is determined, safeguarding the full value of the deceased co-owner's interest for inheritance by their heirs.

- iii. The continuity of the business is preserved as the remaining co-owners can proceed without the disruption caused by disputes over the deceased co-owner's interest or interference from individuals or entities who may lack the same vision and dedication to the company.
- iv. Funding the purchase price through policy proceeds proves to be a cost-effective method.
- v. Dividend payments to inactive co-owners (i.e., heirs who receive the interest) are avoided.
- vi. The agreement prevents the unintended formation of partnerships with the heirs, avoiding an involuntary association.
- vii. The agreement provides certainty for all stakeholders, as it instils confidence in employees, creditors, and other stakeholders that there is a well-structured exit plan in place, increasing the likelihood of business continuity after the passing or disability of one of the business owners.

The agreement can also incorporate provisions for the sale of the business interest in the event of a co-owner's permanent disability.

Buy-and-sell agreement

A buy-and-sell agreement is a contractual arrangement entered into between business owners, binding them to sell their business interest to the surviving co-owners at a predetermined price in the event of their death or disability.¹ This agreement outlines that in the event of a co-owner's death, the remaining co-owners are obligated to also buy the business interest from the deceased co-owner's estate. The purchase price is then paid to the estate and distributed as directed in the deceased co-owners will. Co-owners insure each other's lives, and the policy proceeds are utilised to finance the acquisition of the deceased co-owner's shares.

In situations where the obligation to purchase a deceased co-owner's interest is not reciprocal, a unilateral buy-and-sell agreement may be established. Examples of unilateral agreements include arrangements between a sole shareholder and an employee or instances where the owner of a similar business intends to purchase the shareholder's shares upon their demise.

Share buy-back agreement.

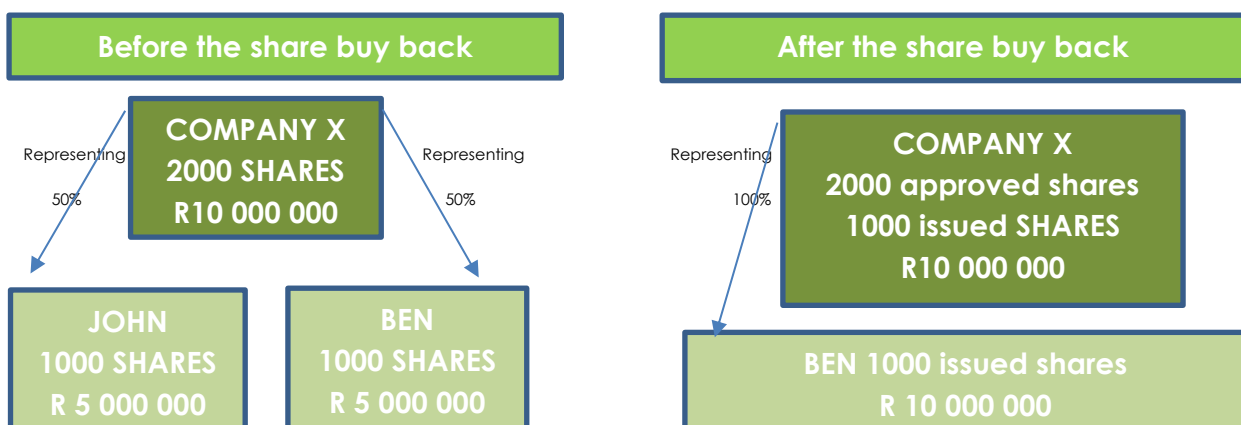
If the shareholder sells shares to the company that issued the shares, the transaction is a share buy-back (also referred to as a share repurchase transaction).² Share buy-back agreements serve as an alternative to the previously mentioned buy-and-sell arrangements where the business entity is a company. In a share buy-back, the mechanics of the structure is different in that the company repurchases its shares from a shareholder. The company enters into an agreement between itself (represented by the directors) and the shareholders who effect the

¹ Premiums and Problems, Edition 125, Page D40.

² SILKE: South African Income Tax AD Koekemoer et al, LexisNexis 2021. P 759.

sale at the occurrence of a certain or uncertain event occurring at an uncertain time in the future like for instance death or disability of a shareholder or his nominated insured life. The life insurance policies covering each shareholder will be owned by the company and the company will pay the premiums. Consequently, upon the death or disability of the shareholder or the nominated insured life of the shareholder, the company will receive the proceeds and fulfil its contractual obligation to repurchase the shares. It's important to note that the company does not become the legal owner of the shares. The company reduces its total issued shares by the number of shares it repurchases.

For example, company X initially had 2 000 approved and issued shares, with John holding 1 000 shares (representing 50% ownership) and Ben holding 1 000 shares (also representing 50% ownership). If John passes away, the sale agreement is activated, and the company repurchases the 1 000 shares originally issued to John from his estate. As a result, the company cancels these 1 000 shares, leaving the company with 2 000 approved shares and only 1 000 shares issued to Ben. The 1 000 issued shares now represent 100% of the total issued shares in the company, making Ben the sole shareholder.



Estate duty on policy proceeds

Under the provisions of the Estate Duty Act,³ all policy proceeds of a “domestic policy” on the life of the deceased are considered as deemed assets in their estate. However, there is a potential exemption under section 3(3)(a)(iA) of the Estate Duty Act that may apply to policies established to fund buy-and-sell agreements. To qualify for this exemption and prevent the policy from being considered part of the deceased's estate, the following conditions must be met:

- i. The policy must be taken out or acquired by a person who was a partner of the deceased at the time of their death, or who held a share or similar interest in a company where the deceased also held a share or similar interest.

³ Section 3(3)(a) of the Estate Duty Act 45 of 1955

- ii. The policy must be taken to acquire the deceased's interest in the partnership or a portion of their share or similar interest in the company, along with any claim the deceased had against the business.
- iii. The deceased must not have paid or borne any premium for the policy.

Where a company owns a policy on the life of an employee or director, section 3(3)(a)(ii) of the Estate Duty Act can also be relevant to provide for an estate duty exemption. This section provides for an exemption if the following requirements are met:

- i. The policy was not effected at the instance of the deceased.
- ii. No premium was paid by the deceased in respect of the policy on their own life;
- iii. No amount due under the policy will be payable to the estate of the deceased; and
- iv. No amount will be paid or utilised for the benefit of:
 - any relative of the deceased, or
 - any person who is dependent on the deceased, or
 - any company that is a family company in relation to the deceased

A "family company", as defined in the Estate Duty Act, means any company other than a quoted company which at any relevant time was controlled or capable of being controlled directly or indirectly, by way of a majority holding of shares or any other manner by the deceased, or by the deceased and one or more of his/her relatives.

Estate duty is calculated at a rate of 20% for the first R30 000 000 of an individual's estate, and 25% for the value above R30 000 000. In terms of the Estate Duty Act, the executor is entitled to claim the proportionate estate duty from the recipient of the policy proceeds, if any estate duty is payable by the deceased estate. It is crucial to determine whether a specific scenario will attract estate duty. If it does attract estate duty, it is important to ensure that the policy proceeds include an additional amount to cover the estate duty.

As a general guideline, this can be achieved by applying the following formula:

Net sum insured / 0.8 (for policy amount up to R 30 000 000)

Net sum insured / 0.75 (for policy amount over R 30 000 000)

a) Estate duty on policy proceeds of a buy-and-sell agreement

The proceeds from the policy shall be exempt from estate duty at the death of the deceased co-owner if the policy adhered to the requirements of section 3(3)(iA) of the Estate Duty Act and the shareholders are natural persons. The exemption may be applicable when a trust or a company, that is a shareholder, takes out a policy on the life of the other shareholder if the other shareholder is a natural person. However, if a natural person (who is also a shareholder of the business) takes out a policy on the life of a trustee of a trust (which is a shareholder) or

the life of a director of a company (which is a shareholder), the exemption will not be granted for estate duty.

In terms of section 3(3)(a)(iA) of the Estate Duty Act, it is required that the person who took out the policy, as well as the insured life, must both be shareholders in the company. This requirement will not be met if the shares are held in the name of a trust or a company.

Policy proceeds considered a deemed asset and subject to estate duty	
Shareholders are natural persons. The policy is taken out by one shareholder on the life of another shareholder.	NO - exempt if it meets the requirements of section 3(3)(a)(iA) of the Estate Duty Act.
Shareholder is a trust or company. The policy is taken out on the life of other shareholders if the other shareholder is a natural person.	NO - exempt if it meets the requirements of section 3(3)(a)(iA) of the Estate Duty Act.
Shareholder is a natural person. The Policy is taken out on the life of the nominated insured life if the other shareholder is a trust or a company.	YES – do not meet the requirements of the exemption in terms of section 3(3)(a)(iA) of the Estate Duty Act.
Shareholder is a trust or company. The policy is taken out on the life of the nominated insured life if the other shareholder is a trust or a company.	YES – do not meet the requirements of the exemption in terms of section 3(3)(a)(iA) of the Estate Duty Act.

b) Estate duty on policy proceeds of a share buy-back agreement

In terms of section 3(3)(a)(iA) of the Estate Duty Act, it is required that the person who took out the policy, as well as the insured life, must both be shareholders in the company to qualify for the exemption. Since the company will own the policy on the life of the shareholder, the policy for a share buy-back arrangement will not qualify for the exemption in terms of section 3(3)(a)(iA).

In terms of section 3(3)(a)(ii) of the Estate Duty Act it is required that no amount due under the policy will be payable to the estate of the deceased and no amount will be paid or utilised for the benefit of any company that is a family company in relation to the deceased. The third and fourth requirements of section 3(3)(a)(ii) will not be met and the policies for a share buy-back arrangement will not qualify for the exemption.

Policies taken out by a company on the life of a shareholder, or the nominated insured life, of a shareholder to fund a share buy-back arrangement will always be considered as deemed assets in the estate of the insured life and the company will be liable for the proportionate estate duty if any estate duty is payable by the deceased estate.

Policy proceeds considered a deemed asset and subject to estate duty	
The policy is taken out by the company on the life of the shareholder or the nominated insured life of the shareholder to fund a share buy-back.	YES – do not meet the requirements of the exemptions in terms of section 3(3)(a)(iA) or section 3(3)(a)(ii) of the Estate Duty Act.

If the policy proceeds are included in the estate as a deemed asset, the amount included in the estate will be reduced by an amount equal to premiums plus 6% compound interest per annum. The premiums must be paid by a third party that was entitled to the proceeds payable from the policy. It is important to note that the premium payer and the person entitled to the proceeds must be the same person for this deduction to apply.⁴

Capital gains tax (CGT)

Capital gains are determined and then a portion thereof is included in the taxable income of a taxpayer. Capital gains are therefore included in the determination of normal tax and incorporated as part of the Income Tax Act. A capital gain is the proceeds (or deemed proceeds) from the disposal (or deemed disposal) of an asset less the base cost.⁵

For CGT purposes, an “asset” is defined as:⁶

- i. Property of whatever nature (movable or immovable);
- ii. Including tangible and intangible assets (corporeal and incorporeal);
- iii. Including rights or interests of whatever nature to or in such property;
- iv. Excluding any currency (other than coins made mainly from gold or platinum).

To calculate the CGT liability, the base cost will be subtracted from the market value and this amount is then multiplied by the inclusion rate, after applying all applicable exclusions.

It is also necessary to consider whether the taxpayer qualifies for the capital gain concession granted on the disposal of an interest in a small business.

If a gain arises from the disposal of a long-term life policy the gain can be disregarded if it is a pure risk policy (i.e. the policy has no cash/surrender value). Even if ownership of a pure risk policy is changed no CGT will be payable.⁷

⁴ Section 3(3)(a) of the Estate Duty Act 45 of 1955

⁵ Premiums and Problems. Edition 125, Page A44

⁶ Act 58 of 1962; Paragraph 1 of the Eight Schedule

⁷ Act 58 of 1962; Paragraph 55(1)(e) of the Eight Schedule

a) CGT implications on the sale of a share in terms of a buy-and-sell agreement

The sale of a business interest will be regarded as a deemed disposal for CGT purposes. Where the business interest is sold due to death or disability, it is treated as a deemed disposal for CGT purposes. Income tax will be payable on any taxable capital gain made on the disposal if a gain is realised due to the sale of a business interest. The shareholder or estate of the shareholder will be liable for CGT.

CGT payable on the sale of shares in terms of a buy-and-sell agreement			
Taxpayer	Inclusion rate	Statutory tax rate	Effective tax rate
Individuals/natural persons	40%	0-45%	0-18%
Trusts	80%	45%	36%
Companies	80%	28%	22.4%

b) CGT implications on the sale of a share in terms of a share buy-back agreement

When a share buy-back takes place, the consideration paid to the shareholder is by default defined as a dividend for income tax purposes and no capital gains tax (CGT) is applicable. However, to the extent that the directors of the company elect that payment to a shareholder be paid out of the contributed tax capital (hereafter referred to as 'CTC') of the company, this amount is not a dividend and can be subject to capital gains tax. The Taxation Laws Amendment Act⁸ amended the definition of CTC. In terms of this amendment, an amount transferred would not constitute CTC unless all of the shareholders, in that class of shares to which the CTC relates, participate in the transfer "in the same manner and are allocated an amount of CTC based on their proportional shareholding within that class". The effect of the amendment is that when a share buy-back takes place, the consideration paid to the shareholder would not constitute CTC but would represent a dividend since all the shareholders do not participate in the transfer. Where a share buy-back takes place the general conclusion is that there will be no capital gains tax (CGT) applicable since the consideration paid is a dividend. Exempt extraordinary dividends are the exception.

The Anti-Stripping provision in terms of Paragraph 43A of the Eighth Schedule of the ITA states: "where a company disposes of shares in another company and the shares were held by the disposing company as a capital asset, not as trading stock, and the disposing company held a qualifying interest⁹ in the company being disposed of whether the qualifying interest was

⁸ Act No. 20 of 2021

⁹ Qualifying interest is a 'direct interest held by a company in another company, that is at least 50% of the equity shares or voting rights in the other company or 20% of the equity shares or voting rights in the other company, if no other person holds the majority of the equity shares or voting rights in the company.

held at the time of the disposal or at any time in the period of 18 months before the disposal any exempt extraordinary dividend must be treated as part of the proceeds from the disposal of the shares. This exempt extraordinary dividend will be included in the income of the disposing company. The exempt extraordinary dividend will be subject to capital gains tax. Exempt extraordinary dividends are defined as those dividends (accruing within the period of 18 months prior or part of the disposal) to the extent that they exceed 15% of the proceeds received or accrued from the disposal of the share. The whole dividend is not an exempt extraordinary dividend, only the portion of the total exempt dividend received on the shares which exceeds 15% of the proceeds from the sale of the shares is treated as extraordinary.¹⁰

Example: CGT on exempt extraordinary dividends (the Anti-Stripping provision in terms of Paragraph 43A of the Eighth Schedule of the ITA)

Company A holds 50% of Company B. There are 100 Company B shares in issue. Both Companies are South African companies. Company A paid R100 000 for these shares in 2007. The shares were acquired as a capital investment. The shares of Company B are worth R4 million, and this value has been unchanged for the last two years. The other 50% of the shares in Company B are held by Mr. C. These shares cost Mr. C R50 000 in 2005. Company B effected life policies on the life of Mr. D (company A's nominated assured life) and on the life of Mr. C to fund a share buy-back from the shareholders at the date of death of a shareholder or the nominated life assured of a shareholder. Company B is the owner of the life policies and pays the premiums on these life policies.

What are the capital gains tax implications for the shareholders if one of the lives assured dies?

Company A:

1. Company A's shareholding in Company B is a 'qualifying interest' because it is not less than 50% of the shares in issue.
2. There is no dividend tax because the dividend accrues to a company as a shareholder, and because it is a local dividend, it is also not subject to normal tax – therefore it is an 'exempt dividend' in terms of paragraph 43A.
3. The dividend is received within 18 months of the sale to Mr. C.
4. The dividend exceeds 15% of the market value of the shares at the date of disposal (R2 000 000 being the market value) as well as exceeding 15% of the market value of the shares at the beginning of the 18 months (R2 000 000 being the market value for past 2 years).

The dividend is therefore an exempt extraordinary dividend to the extent of R2 000 000 – 15% of R2 000 000 = R1 700,000. The portion that relates to the shares disposed of (the provision uses the words 'in respect of the shares disposed of') is R 1 700 000.

¹⁰ P Haupt, Notes on South African Income Tax, 40th Edition, H & H Publications, p 730

The result is that R1 700 000 of the dividend is treated as proceeds on the disposal of shares by Company A.

Therefore, Company A has a capital gain as follows:

<input type="checkbox"/>	Tainted dividend (in respect of shares disposed of).....	R1 700 000
<input type="checkbox"/>	Cost of shares disposed of.....	(R 100 000)
<input type="checkbox"/>	Capital gain.....	R1 600 000

Capital gains tax payable by company A is $R\ 1\ 600\ 000 \times 80\% \times 28\% = R\ 358\ 400$.

Mr. C

Mr. C has paid a dividend tax of 20% on the dividend therefore no capital gains tax is applicable. Paragraph 43A does not apply to Mr. C, because the dividend that he receives is not exempt from dividends tax.

CGT payable on the sale of shares in terms of a share buy-back agreement	
Shareholders are natural persons	No: CGT
Shareholder is a trust	No: CGT
Shareholder is a company (does not hold a 'qualifying interest')	No: CGT
Shareholder is a company (holds a 'qualifying interest')	Yes: CGT (on the portion which exceeds 15% of the proceeds (dividend) from the sale of the shares)

Dividend tax

Under section 64D of the Income Tax Act a dividend is defined, for the purpose of "dividend tax", as follows:

- i. It refers to a dividend paid by a South African resident company, or
- ii. It includes a dividend paid by a non-resident company if the share in relation to which the foreign dividend is paid meets the definition of a "listed share" in section 1 of the ITA and does not involve the distribution of an asset in kind.

The definition of "dividends" in section 1 of the Income Tax Act explicitly includes the repurchase of a company's shares, except when this repurchase leads to a reduction in contributed tax capital.¹¹ Contributed tax capital is defined in section 1 of the Income Tax

¹¹ Paragraph (b)(i) of the definition of dividend in section 1 of the Income Tax Act;

Act, and in this article, we will focus on resident companies. We will not address non-resident companies in this discussion.

For a resident company, contributed tax capital can be summarised as follows:¹² It comprises the untainted share capital and share premium (or stated capital) of the company before 1 January 2011 (if applicable), along with the consideration received for the issuance of shares on or after that date. The contributed tax capital of a company is reduced by any portion transferred for the benefit of a shareholder holding shares in the company after 1 January 2011.

Section 64F of the ITA applies to dividends paid in cash and dividends credited to the shareholder's loan account. This section addresses exemptions applicable to dividend tax. In the case where a South African resident company is the beneficial owner of shares in another company and a dividend is declared by the company of which the South African resident company is the beneficial owner of shares, such dividend will be exempt from dividend tax in terms of section 64F(1)(a) of the ITA for "dividend tax" purposes.

a) Dividend tax on proceeds of a buy-and-sell agreement

When the shares are sold, the transaction will be treated as a "disposal of assets." It will not be considered a dividend received from the company because the company is not purchasing the shares. Instead, the remaining parties involved in the agreement will act as the buyers, which means no dividend tax will be payable.

b) Dividend tax on proceeds of a share buy-back agreement

The definition of "dividends" in section 1 of the Income Tax Act explicitly includes the repurchase of a company's shares, except when this repurchase leads to a reduction in contributed tax capital. Therefore, if the company's board decides to repurchase its shares, and all the requirements specified in the Companies Act¹³ are fulfilled, this transaction will be treated as a dividend. As a result, a dividend tax will be payable on the declared dividend. In such cases, the company is required to withhold dividend withholding tax (DWT), which is currently set at 20% of the declared dividend. It is important to note that DWT is a liability imposed on the shareholder, not the company. The company acts as a facilitator by withholding and remitting the tax to the South African Revenue Service (SARS). Consequently, the shareholder receives the purchase price net of DWT. This also applies to close corporations (CCs).

¹² P Haupt, Notes on South African Income Tax, 40th Edition, H & H Publications, p 424; Paragraph (b) of the definition of 'contributed tax capital' in section 1 of the Income Tax Act.

¹³ Act No. 71 of 2008

Dividend tax payable on the sale of shares in terms of a share buy-back agreement	
Shareholders are natural persons	Yes: dividend tax
Shareholders are a Trust	Yes: dividend tax
Shareholders are a Company	No: exempt from dividend tax in terms of section 64F of the ITA

Income tax

Section 11(w)(ii) of the ITA permits the deduction of premiums on specific employer-owned policies if the following conditions are met:

- i. The policy covers loss resulting from death, disability, severe illness, or is based on the life of a director or employee.
- ii. The policy is a pure risk policy without any cash or surrender value.
- iii. The policy is owned by the employer at the time the premium is paid, and transferring security rights does not alter its ownership status.
- iv. If the policy was initiated after 1 March 2012, the selected status must be specified in the Policy Agreement.
- v. If the policy was initiated after 1 March 2012, the client had to make a selection on or before 31 August 2012. Failure to make a selection resulted in the premiums being non-deductible.

a) Income tax on policies for a buy-and-sell agreement

The policies are not company-owned policies and premiums paid may not be deducted from income tax in terms of section 11(w) of the ITA. However, this means that the policy proceeds will be exempt from income tax when a death benefit is paid out.

b) Income tax on policies for a share buy-back agreement

The company cannot claim a deduction for the premiums paid in terms of section 11(w) of the ITA. The purpose of this policy is to provide coverage for potential capital expenditure rather than compensating for a loss as defined in section 11(w)(ii)(aa) of the Income Tax Act. The proceeds will be exempt from income tax when a death benefit is paid out.

A practical example to compare different taxes applicable between a traditional buy-and-sell agreement and a share buy-back agreement:

Company XYZ (Pty) Ltd was registered on 1 November 2003 with 1 000 issued shares of R1 each. The shareholders were and still are as follows:

Mr. A – 240 shares (24% shareholding),

Company B (Pty) Ltd (a South African company) – 240 shares (24% shareholding), and

The trustees of C Trust – 520 shares (52% shareholding).

The value of Company XYZ (Pty) Ltd is currently R 30 000 000. The shareholders want to enter into a buy-and-sell agreement or a share buy-back agreement and asked for a comparison between the different taxes that will be applicable between the two different agreements. For purposes of this example:

- i. it is assumed that the share buy-back agreement provides that the policy proceeds are not taken into account for purposes of valuing the shares on death, and
- ii. it is assumed that the dutiable estate of the deceased is less than R 30 000 000.
- iii. Other costs and deductions that may be applicable in the estate have not been taken into account.

Shareholder 1: Mr. A's 24% shares in personal capacity are valued at R 7 200 000, which is (R 30 000 000 X 24%)

Tax	Buy-and-sell agreement	Share buy-back agreement
Estate Duty on policies	R 0 ¹⁴	R 7 200 000 x 20% = <u>R 1 440 000</u> ¹⁵
Capital gains tax on the shares¹⁶	Proceeds R 7 200 000 Less base cost (R 240) Capital gain R 7 199 760 Less abatement (R 300 000) Net capital gain R 6 899 760 Taxable capital gain (40% inclusion rate) R 2 759 904 Capital gains tax (45% assumed marginal tax rate) <u>R 1 241 956</u>	R 0
Dividend tax¹⁷	R 0	R 7 200 000 x 20% = <u>R 1 440 000</u>
Income tax¹⁸	R 0	R 0
TOTAL TAX	R 1 241 956	R 2 880 000

¹⁴ Section 3(3)(a)(iA) of the Estate Duty Act 45 of 1955

¹⁵ The exclusion provided for in section 3(3)(a)(iA) is not applicable in this instance, as the life assured will not be a shareholder in the company.

¹⁶ Act 58 of 1962; Paragraph 35(3)(a) of the Eight Schedule;

¹⁷ Section 1 of the Income Tax Act 58 of 1962;

¹⁸ Section 1 of the Income Tax Act 58 of 1962

Shareholder 2: Company B (Pty) Ltd's 24% shares are valued at R 7 200 000, which is (R 30 000 000 X 24%)

Tax	Buy-and-sell agreement	Share buy-back agreement
Estate duty on policies	R 7 200 000 x 20% = <u>R 1 440 000</u> ¹⁹	R 7 200 000 x 20% = <u>R 1 440 000</u> ²⁰
Capital gains tax on the shares ²¹	Proceeds R 7 200 000 Less base cost (R 240) Capital gain R 7 199 760 Taxable capital gain (x 80% inclusion rate) R 5 759 808 Capital gains tax (x 28% marginal tax rate) <u>R 1 612 746</u>	R 0 ²²
Dividend tax	R 0	R 0 ²³
Income tax	R 0	R 0
TOTAL TAX	R 3 052 746	R 1 440 000

¹⁹ The exclusion provided for in section 3(3)(a)(iA) is not applicable in this instance, as the life assured will not be a shareholder in the company.

²⁰ The exclusion provided for in section 3(3)(a)(iA) is not applicable in this instance, as the life assured will not be a shareholder in the company.

²¹ Act 58 of 1962; Paragraph 35(3)(a) of the Eighth Schedule;

²² The Anti-Stripping provision in terms of Paragraph 43A of the Eighth Schedule of the ITA is not applicable because company B do not hold a 'qualifying interest'.

²³ Section 64F(a) of the Income Tax Act. The dividend is exempt, as we are dealing with one South African company paying a dividend to another South African Company.

Shareholder 3: The trustees of C Trust's 52% shares are valued at R 15 600 000 (R 30 000 000 X 52%)

Tax	Buy-and-sell agreement	Share buy-back agreement
Estate duty on policies	R15 600 000 x 20% = <u>R 3 120 000</u>	R15 600 000 x 20% = <u>R 3 120 000</u>
Capital gains tax on the shares	Proceeds R 15 600 000 Less base cost (R 520) Capital gain R 15 599 480 Taxable capital gain (80% inclusion rate) R 12 479 584 Capital gains tax (45% marginal tax rate) <u>R 5 615 812</u>	R 0
Dividend tax	R 0	R15 600 000 x 20% = <u>R 3 120 000</u>
Income tax	R 0	R 0
TOTAL TAX	R 8 735 812	R 6 240 000

Conclusion

Where the business entity is a company, and a share buy-back agreement can be considered as an alternative to a traditional buy-and-sell agreement, it is important to ask the question: *"Which of these two agreements will be more favourable for the business owners?"*.

One of the factors that must be considered is the tax implications of each of the arrangements. As illustrated in the example above, a share-buy-back agreement, can, in certain instances be much more favourable from a tax perspective, than a buy-and-sell agreement, especially where the shareholder is a trust or a company.

Business owners should be made aware of all available options as well as the consequences of each of these options, to enable them to make an informed decision.

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Revision of Buy-and-Sells: Considerations for the Financial Planner



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Introduction

It is a well-known fact that financial planners must do revisions of their clients' financial portfolios, and the revision of their client's buy-and-sell contracts and policies is therefore nothing new. There is quite a lot to remember to give the client the best possible advice. This article will attempt to address some of the considerations when reviewing buy-and-sell agreements with business assurance clients. The article is aimed at financial planners, and the list of considerations is not exhaustive, therefore only some points are highlighted.

What is a buy-and-sell agreement?¹

A buy-and-sell agreement contains the following essential elements:

It is an agreement between the parties that obligates all the parties involved to sell their shareholding to the surviving parties, at the happening of a certain event like death or disability and the surviving parties simultaneously commit to purchase the deceased party's shareholding. The parties further agree in the agreement on a valuation method and a payment terms.

Copy of the signed buy-and-sell agreement.

When doing a review consultation with a client start by gathering the correct documentation. This means a copy of the existing signed buy-and-sell agreement (with annexures if applicable) and any amendments to the original contract. Make sure that there is indeed a signed agreement in place. This means that it should be signed by the shareholders as well as the witnesses and that the agreement should be dated. If the agreement is not signed and/or dated, this could become problematic if one of the parties to the agreement does not want to honour the agreement by not wanting to buy or sell. Under these circumstances, the parties that want to enforce the agreement will have to approach the court, and each party will have to prove whether there was an agreement between the parties or not. The court will give a final decision.² The fact that there is no signed agreement in place can lead to unnecessary litigation that can be costly for all the parties involved. The South African Revenue Services may also go as far as disallowing the estate duty exemption on the buy-and-sell policies as there is no enforceable contract that backs and provides evidential proof of the whole buy-and-sell arrangement³. The lack of agreement will make it challenging to prove the estate duty exemption requirement that the life insurance policy should be taken out to acquire the shares of the deceased shareholder.⁴ A signed buy-and-sell agreement is the foundation for a successful buy-and-sell transaction, and it also protects shareholders through

¹ M Botha et al, South African Financial Planning Handbook ,2023: Chapter 40 Business insurance, Paragraph 40.9 Buy-and-sell arrangements.

² The Momentum Business Assurance Manual prepared by Legal Advisers: Financial Planning Version 3,2019/20, Updated 8 March 2019, page 2:13

³ Swanepoel Martin, Technical issues and common (and not so common) mistakes in buy-and-sell agreements, Insurance and Tax, Volume 36 of 2021, No 1 March 2021.

⁴ Starling Samantha, The importance of a correctly structured Buy and sell agreement, Premiums and Problems Article Edition 118, 2019.

the clause that is normally included in the agreement that if a buy-and-sell agreement is cancelled for whatever reason, the shareholders must cede the policies that they hold on their co-shareholders life's back to the shareholder.⁵

Copy of the MOI document (Memorandum of Incorporation)

What is a Memorandum of Incorporation document?⁶

Before we discuss why the Memorandum of Incorporation document should be asked for by the financial planner, it is important to understand what a Memorandum of Incorporation document is, to understand its importance when reviewing buy-and-sell agreements with clients. It is mandatory for every company registered in South Africa and every incorporated company to have a Memorandum of Incorporation document (it will further be referred to as MOI in this article) in terms of the Companies Act.⁷ The MOI is a vital public document that is registered with the Companies and Intellectual Property Commission (CIPC) and this document replaced the Articles of Association which was used under the previous Act.⁸ The MOI outlines the company's internal rules and procedures. The document further sets out the rights, responsibilities, and duties of shareholders and directors in the company. It regulates the company's relationship with its shareholders and sets out voting rights and procedures.

It is of utmost importance to establish if there are buy-and-sell provisions in a company's MOI and whether the MOI allows for a separate buy-and-sell agreement or not. Companies are allowed to include buy-and-sell provisions in the MOI document, but practically it makes sense to have a separate buy-and-sell agreement which can be updated if need be. If the MOI incorporates buy-and-sell provisions and the buy-and-sell provisions need to change, the amended MOI will have to be submitted to the Companies and Intellectual Property Commission (CIPC) every time a need arises to amend the buy-and-sell provisions.⁹

In terms of the Companies Act,¹⁰ a buy-and-sell agreement with provisions that conflict with the company's MOI or are inconsistent with the Act shall be void.¹¹ As a result, financial planners should make sure that the revised buy-and-sell agreements that they use contain a clause that the provisions of the MOI will have precedence in the event of conflict between the provisions of the agreement. A suggested example of such a clause could be:

“Should there be any conflict between the provisions of this AGREEMENT and the provisions of any Shareholders agreement or any other agreement between the PARTIES, the provisions of this AGREEMENT shall take precedence; provided that should there be a conflict with the provisions of the Memorandum of Incorporation the provisions Memorandum of Incorporation will take precedence.”

⁵ Ibid

⁶ Barter Heidi, www.bartermckellar.law/corporate-law-explained “Understanding the Memorandum of Incorporation in South Africa”

⁷ Ibid

⁸ Companies Act 61 of 1973.

⁹ Daffue Hein, Buy-and-sells from 1 May 2011 under the new Companies Act Insurance and Tax, Volume 26 of 2011, September 2011, page 28

¹⁰ Companies Act 71 of 2008

¹¹ Companies Act 71 of 2008, Section 15 (7)

Financial planners must make sure that a buy-and-sell agreement is enforceable and that it is in line with the MOI document and not in conflict with the Companies Act¹² when it is time to review your existing client's buy-and-sell agreement.

Copy of the shareholder agreement

What is a shareholder agreement?¹³

Shareholder agreements are also part of the documentation that a financial planner should ask for when revisiting the client's buy-and-sell agreement. Shareholder agreements are not mandatory in South Africa, but it is highly recommended that companies with more than one shareholder have a shareholder's agreement in place. A shareholder agreement regulates the relationship between shareholders in a company. It provides a framework for corporate governance and ensures that the company is managed effectively. Although shareholder agreements are optional, they play an important role in providing shareholders and directors guidance with respect to their rights, duties, and obligations. While a MOI document is a public document, a shareholder agreement is confidential and is only viewable by the shareholders in a company unless it is for example shared by the shareholders with a financial planner for planning purposes¹⁴. A shareholder agreement does not have to be registered with the CIPC.

The financial planner must read the shareholders agreement especially as it pertains to the sale of shares to other shareholders. In terms of section 39 of the Act shareholders of private companies are obliged to first offer their shares to the remaining shareholders before they can sell their shares to a non-shareholder third party.¹⁵ This is known as a shareholder's pre-emptive right. The shareholder agreement could also provide the financial planner with information on any restrictions on share transfer. This information is relevant and important when advice is given on buy-and-sell agreements.

Parties to the agreement

When reviewing the agreement, confirm who would be party to the agreement, who are the existing shareholders, and whether the existing buy-and-sell agreement correctly includes all the relevant parties to the agreement. Also make sure that the parties included in the existing buy-and-sell agreement have not left the company, if so, the agreement must be reviewed and amended. One will also have to review the life assurance policies that are linked to the buy-and-sell agreement.

Ensure that parties to an existing buy-and-sell agreement are still the owners of the shares in the business. Often parties have drafted a buy-and-sell agreement years ago when they started their company, and the growth in the business has resulted in them doing estate

¹² Companies Act 71 of 2008

¹³ Barter Heidi, www.bartermckellar.law/corporate-law-explained "Understanding Shareholder agreements in South Africa"

¹⁴ Barter Heidi, www.bartermckellar.law/corporate-law-explained "Understanding the Memorandum of Incorporation in South Africa"

¹⁵ Barter Heidi, www.bartermckellar.law/corporate-law-explained "Understanding Shareholder agreements in South Africa"

planning to protect their wealth. It could be that they have sold their respective shares, which are growth assets, to an inter vivos trust since then. This means that the trust is the shareholder and not the individual any longer. The trust therefore will need to be the new party to the buy-and-sell agreement. This in turn creates the need for the review of the buy-and-sell agreement as well as the restructuring of the buy-and-sell policies. Technically the trustees should be the owners of the respective policies on the life of the other inter vivos trust's nominated assured, and vice versa. If the trusts are the owners of the buy-and-sell policies, the policies will not be exempt from estate duty.¹⁶

These are just a few practical examples of scenarios that can come to light on the revision of an existing buy-and-sell agreement. It is therefore critically important that the shareholders are correctly cited in the buy-and-sell agreement.¹⁷

Marital regimes of the parties to the agreement

A further consideration that is often overlooked by financial planners is the marital regimes of the parties to the buy-and-sell agreement. Financial planners should ensure beforehand that parties who are married in community of property have the necessary written consent from their spouse to sell the shares because the shares form part of their joint estate.¹⁸ In terms of section 15(6) of the Matrimonial Property Act,¹⁹ a business owner who is married in community of property can perform certain acts without the consent of their spouse, if such acts are in the ordinary course of their profession, trade, or business. However, business owners married in community of property are not empowered to alienate shares without the consent of the spouse. A spousal consent is often drafted as part of the free service insurance companies offer their clients along with the drafting of the buy-and-sell agreement.

Where parties are not married, it can be valuable to advise business partners to incorporate a provision into their MOI document and shareholders agreement that determines that unmarried shareholders must provide the company with a copy of their antenuptial contract before they get married.²⁰ The benefit to the unmarried shareholder could be that this will highlight the importance of financial planning to the shareholder before he/she ties the knot – the impact of his/her marital regime on his/her shareholding will be of the essence.

If an existing shareholder intends to make the accrual system applicable to their marriage, it can also be recommended that the shareholding in the business be excluded from the accrual on death or divorce. This can protect the business and the remaining shareholders against a change in the personal circumstances of shareholders, for example a divorce where the shareholder that divorce must pay out an accrual claim to his/her spouse. If the shareholder does not have the means to pay out an accrual claim in cash, the ex-spouse can also claim shareholding as an alternative. This can have unexpected implications for the shareholder going through a divorce. The impact on the co-shareholders could be that they

¹⁶ SARS External Guide, Estate Duty Implications on Buy-and-sell arrangements where shares are held in Trusts, pages 7 - 8.

¹⁷ Swanepoel Martin, Technical issues and common (and not so common) mistakes in buy-and-sell agreements, Insurance and Tax, Volume 36 of 2021, No 1 March 2021.

¹⁸ <https://www.schliemann-attorneys.co.za/matrimonial-property-regimes/>

¹⁹ Matrimonial Property Act 88 of 1984

²⁰ Van den Ende Isabel, <https://bamardinc.co.za/2020/12/04/protect-your-business-in-divorce>.

will get an unwanted co-shareholder. This can change the dynamics of the business totally and is often unforeseen. The financial planner can add tremendous value by pointing this out to shareholders timeously.

Shareholding of the parties to the agreement

Financial planners in the review process, must confirm whether there was any change to the shareholding in the company due to parties leaving, passing away, or retiring. If the shareholding has changed from what is reflected in the buy-and-sell agreement, or if there is any discrepancy between the shareholding in the buy-and-sell agreement, MOI, and/or shareholder agreement this must be pointed out to the client and this is an indication that the buy-and-sell agreement and policies need to be reviewed and amended.

Recordal

Financial planners must familiarise themselves with the recordal of the buy-and-sell agreement if the agreement has one. The recordal typically sets out the intention of the parties regarding the buy-and-sell agreement. It sets out who the shareholders of the company are, and their shareholding is confirmed. The parties will clearly state the event, which can be death and/or disability, that will trigger the sale and purchase of the shares.

Often the recordal states whether the deceased or disabled party will sell their shares and loan account in the company in terms of the buy-and-sell agreement. Financial planners should be aware of the fact that the loan account owed by the company and due to the shareholder can be included in the buy-and-sell agreement. Alternatively, the loan account can be excluded from the buy-and-sell agreement, and only the shareholding can be sold on a specific event. The loan account can then be covered through a loan account protection strategy if it is not part of the buy-and-sell agreement.²¹ If any existing shareholder is not a party to the buy-and-sell agreement it can be mentioned under the recordal of the buy-and-sell agreement.

Triggering events

In the context of Long-Term Insurance, life events that trigger the sale and purchase of shares are typically the death and/or disability of shareholders since the triggering events are connected to the means of financing the buyout of shareholding with life insurance policies. At death or disability, the policy pays out to fund the purchase of the shares. Financial planners should make sure they know what the client's intention is. Do they want to sell their shareholding upon death and disability, or only upon death or only upon disability?

It is important to remember that clients' situations differ and that their intentions and personal circumstances should be taken into consideration. It might for instance be that a client wants to leave their shares to their major child who is already working in the company, instead of

²¹ The Momentum Business Assurance Manual prepared by Legal Advisers: Financial Planning Version 3,2019/20, Updated 8 March 2019, page 2:11.

selling it off. Financial planners are however reminded that there is not a once-size-fits-all solution and that financial planners must read the MOI,²² existing buy-and-sell agreement, and shareholders agreement and make sure that there is no conflict between the documents and the client's intentions.

The risks if the buy-and-sell agreement does not make provision for disability should be pointed out to the client during the consultation by the financial adviser.²³By way of an example: if one of the shareholders becomes disabled, and no disability cover was provided, this will mean that the remaining shareholders will have to carry the disabled shareholder by taking over their responsibilities and workload, while the disabled shareholder might not be able to contribute anything to the company like before. If the agreement does not make provision for a buyout on disability, this will mean that the disabled shareholder will remain a shareholder until his death, at the financial expense of his co-shareholders.

Financial planners must be cautious when disability is a triggering event for the buy-and-sell agreement to take effect. It is important that a thorough definition of disability is included in the agreement, and that there is no conflict between the MOI, existing buy-and-sell agreement, and shareholders agreement in terms of the definition of disability. It is further advisable that a buy-and-sell is only triggered upon permanent disability, and in this regard a definition similar to the following can be incorporated into the buy-and-sell agreement to ensure that there is also no discrepancy between the definition of disability in the policies of assurance and the buy-and-sell agreement:

"Permanent disability means any incapacity defined as permanent disability by the Insurer in the policy of assurance and permanent disabled shall have a similar meaning".²⁴

Financial planners should also steer away from using physical impairment²⁵ cover in a buy-and-sell situation since physical impairment cover is severity-based. This means that clients will not be guaranteed a hundred percent payout, which can have a severe impact on the buy-and-sell for the seller as well as for the purchaser/s. This can also mean that a client for example must sell shareholding in case of a heart attack, while this was not the client's intention in the first place.

Valuation of shareholding

Valuation of shareholding can be a potential minefield, but financial advisers should focus on advising their clients that the shareholding (and loan account, if applicable) should be valued by an independent auditor on the date of the triggering event, such as the death of the selling shareholder.

The valuation of the business should be reviewed when the buy-and-sell agreement is reviewed, and the financial planner should make sure that the policies correspond with the valuation of the business. Financial planners should review their buy-and-sell clients regularly

²² Abbreviation for Memorandum of Incorporation

²³ Starling Samantha, The importance of a correctly structured Buy and sell agreement, Premiums and Problems Article Edition 118, 2019, page B22

²⁴ Definition quoted from Old Mutual buy & sell agreement.

²⁵ Impairment in a person's body structure or function, or mental functioning; examples include loss of a limb, loss of vision or memory loss. Activity limitation such as difficult seeing, hearing, walking or problem solving.

especially where it is a fast-growing business,²⁶ to make sure that the policy values keep up with the valuation of the business. This will be beneficial to the buying shareholders as well as the selling shareholders. It is important for the financial planner to advise the clients that the market value or real value will be applied in the estate of a deceased shareholder for estate duty purposes as well as for capital gains tax purposes.

When reviewing an existing buy-and-sell agreement financial planners should never assume what the agreement stipulates or that all buy-and-sell agreements have the same contents. Instead, always read the agreement to advise clients accordingly. Clauses in agreements may differ vastly from one agreement to another. An agreement could place a responsibility on the shareholders to review the value of the business annually, with an annexure to the agreement where the parties must manually write the newly agreed valuation, and where all the parties have to sign next to it. Clients seldom keep up with this responsibility to review their valuation, and it can have devastating implications should a triggering event happen. Financial planners must take the responsibility to diligently review their clients with buy-and-sell agreements, and make sure that should there be such a responsibility in terms of the existing buy-and-sell on the shareholders, it is adhered to or else that an amended buy-and-sell agreement be put in place whereby the independent auditor must do a valuation on the happening of a trigger event. The financial planner must then do a regular review to make sure that the policies and the value of the shareholding are intact. This will be advantageous to all the shareholders involved.

Where clients/shareholders/parties to the agreement agree on the value of the business in their buy-and-sell agreement, the financial planner must make sure that they understand the possible tax implications, and that the necessary disclaimers are in place to protect the financial planner, where the clients/shareholders/parties to the agreement confirm that the tax implications of this decision were discussed with them. Here it is advised that the buy-and-sell agreement refers to the fact that the purchase price is the greater of the net policy proceeds of the policy of insurance or the value of the selling shareholder's shareholding as determined upon the triggering event.

The financial adviser should point out to the client that if the value of the shareholding is less than the purchase price, it can result in the purchaser being liable for donations tax on the difference between the value of the agreed purchase price and the market value of the shareholding. On the other hand, if the policy proceeds are worth more than the market value of the shareholding in the business, there can also be an argument that the purpose of the buy-and-sell policy was not to acquire the deceased's shareholding in the business and that the policy should thus be deemed property in the estate for estate duty purposes. Although this may seem too cautious an approach, it is important to advise clients on the possible tax implications. In the end, the final say on the tax implications lies with the South African Revenue Services, but financial planners and clients should rather be safe than sorry.

The executor in the estate of the shareholder might be faced with additional costs in the winding up of the estate where the shareholders agreed on a valuation that is more than the

²⁶ Swanepoel Martin, Technical issues and common (and not so common) mistakes in buy-and-sell agreements, Insurance and Tax, Volume 36 of 2021, No 1 March 2021.

market value since the correct valuation would be needed for capital gains tax and estate duty purposes, and clients should tread with caution since this can delay the winding-up of the estate.²⁷

Other considerations

Are the wills of shareholders consistent with the terms of the buy-and-sell, MOI and the shareholder agreement?

Financial planners should remember that reviews cannot be done in isolation. When a business owner's portfolio and business assurance is reviewed, it is an opportunity to review that client's will too. It is an opportunity to ensure that the will is not in conflict with the contents of the MOI, the shareholder agreement, or the buy-and-sell agreement. Ensure that these documents are aligned with one another and accurately reflect the wishes of the client. It is recommended to place the fact that the client has entered into a buy-and-sell agreement on record in the client's will for the knowledge of the executor.

Time limit for disposal of assets

If the net proceeds of the policy are insufficient to pay for the deceased shareholder's shares, the buy-and-sell agreement could make provision for a term during which the buyer/s can buy the shareholding and pay off the balance. While the terms given may differ, some contracts make provision for 12 months and sometimes longer than 24 months. Pay attention to the term, since this could impact the small business capital gains tax exclusion in the estate of the deceased. The Income Tax Act²⁸ provides that all qualifying capital gains must be realised within 24 months of the date of the first disposal²⁹. If the time limit in the buy-and-sell contract is therefore longer than 24 months, the small business exclusion will be lost to the client.³⁰

A "small business" means a business of which the market value of all its assets at the date of the disposal of the asset (triggering event for the buy-and-sell) does not exceed R10 million.³¹

To qualify for the exclusion the person must have held, before disposal for his benefit, that shareholding in the company for a continuous period of at least 5 years before disposal and must have been substantially involved in the operations of that small business during that period. The person must have reached the age of 55 years, or the disposal must be in consequence of ill-health, other infirmity, superannuation, or death.³²

²⁷ Ibid

²⁸ 58 of 1962

²⁹ Van der Poll Karen, CGT: Small Business Exclusion, Premiums and Problems 2016 Article Edition 112, page E16.

³⁰ Paragraph 57(4) of the Eight Schedule to the Income Tax Act 58 of 1962

³¹ Paragraph 57(1) of the Eight Schedule to the Income Tax Act 58 of 1962

³² Premiums and Problems, Edition 127, 2023, Income Tax, Dividends Withholding Tax & Capital Gains Tax Section page A49.

Conclusion

The buy-and-sell agreement review process requires that financial planners take the contents of all the relevant documents into consideration. The financial planner should know the tax implications of certain clauses in buy-and-sell agreements. Many financial planners seek the assistance of legal advisers in this regard who are specifically skilled to point out any financial risks a client is faced with in these agreements. Consider utilising the legal resources in the financial services industry especially if there is any uncertainty regarding aspects of the agreement during the consultation process. Even the effects of the client's will cannot be ignored when the buy-and-sell agreement is reviewed, since it can be the client's intention not to sell all his shareholding in the buy-and-sell agreement, but to bequeath some shareholding in his will to his heirs for instance. The importance of the MOI and the shareholder agreement was also referred to.

Business assurance and especially buy-and-sell agreements can be very rewarding for financial planners that wish to specialise in business assurance to be able to add value to his/her clients through specialised knowledge and experience.

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