

DO GREAT THINGS



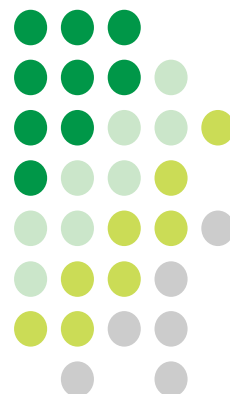
**OLDMUTUAL**

Licensed Financial Services Provider

# Premiums & Problems

**Article Edition No. 112**

**January 2016**





Premiums & Problems Article Edition is published by the Old Mutual Personal Finance Division. The publication provides an information service and a forum for the discussion of problems and new developments in financial planning.

While all reasonable care has been taken to ensure that the information provided in this publication is correct, the articles only touch on broad principles, and as such do not constitute advice. Neither the writers of the articles nor the editors will bear responsibility for any actions taken on the strength of the information contained in this publication. We recommend that before you make any decisions based on information contained in this publication, you contact a professional financial adviser.

**Copyright reserved.**

Contributions and enquires are welcomed and must be sent to:

The Editor  
Premiums & Problems  
Personal Finance (Legal)  
Old Mutual, Sixth Floor, L Block  
PO Box 66  
Cape Town  
8000

**Editors**

Soré Cloete: CFP® BCom LLB H Dip Tax  
Laverne Slater: CFP® LLB Adv PG Dip in Fin Plan  
Tristan Naidoo: CFP® LLB Adv PG Dip in Fin Plan

**Design & Layout**

Fazlin Tambay



# Contents

## General

<b>The impact of insolvency on the administration of a deceased estate</b> Stephan van Zyl and Amanda Moolman	<b>A1 – A9</b>
<b>The proposed changes to the taxation of trusts in South Africa</b> Madelein Marais	<b>A10 – A17</b>
<b>May a trust mortis causa be amended?</b> Madeleine Britz	<b>A18 – A25</b>
<b>Legal implications: When “I do” turns into “I don’t”</b> Shakira Bodasing	<b>A26 – A31</b>
<b>Family business and succession planning thereof</b> Ingrid Sout	<b>A32 – A36</b>
<b>The division of pension interest in respect of Islamic marriages</b> Keith Peter	<b>A37 – A44</b>
<b>FICA Amendment Bill 2015 – An overview</b> Roslynn Petersen	<b>A45 – A51</b>
<b>Practical application of Section 54 of the Long Term Insurance Act</b> Lohu Makgamatha	<b>A52 – A57</b>

## Estate planning

<b>The provision of maintenance for a surviving spouse</b> Natalie Dillon	<b>B1 – B6</b>
<b>The validity of a Pactum Successorium contained in an Antenuptial Contract</b> Deborah Escott-Watson	<b>B7 – B14</b>
<b>Intestate Succession: Potential challenges</b> Gerald Peter	<b>B15 – B22</b>
<b>Capital gains tax on death: spouses married in community of property</b> Carl Muller	<b>B23 – B39</b>
<b>Shariah Compliant Wills - A practical perspective</b> Saudiqa Fakier	<b>B40 – B46</b>

## **Retirement Planning**

### **Comparison of TFSA vs RA for retirement purposes**

**C1 – C8**

Suzelle Jooste

## **Investment Planning**

### **What offshore vehicle do I use for investments?**

**D1 – D7**

Daleen Harris

## **Tax**

### **Tax Implications on Foreign Pensions**

**E1 – E6**

Jothi Chirkoot

### **The implications of converting par value shares to no par value shares**

**E7 – E12**

Deon van Vuuren

### **CGT: Small Business Exclusion**

**E13 – E20**

Karen van der Poll



## Premium & Problems Literary Award

The recipients of the  
Premiums & Problems Article Edition Literary Award  
for **2016** is

**Daleen Harris**



**For her contribution entitled**

**What offshore vehicle do I use for investments?**

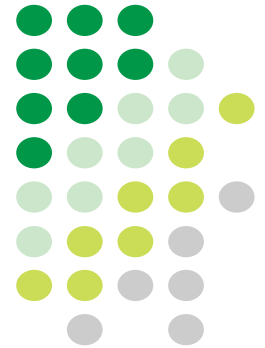
In reaching their decision, the judges have taken into account the technical correctness, how informative the article is, learning potential for the reader, method and effectiveness of transfer of relevant information, originality, practical applicability and potential for marketing opportunities.

DO GREAT THINGS



**OLDMUTUAL**

Licensed Financial Services Provider



# General

# The impact of insolvency on the administration of a deceased estate



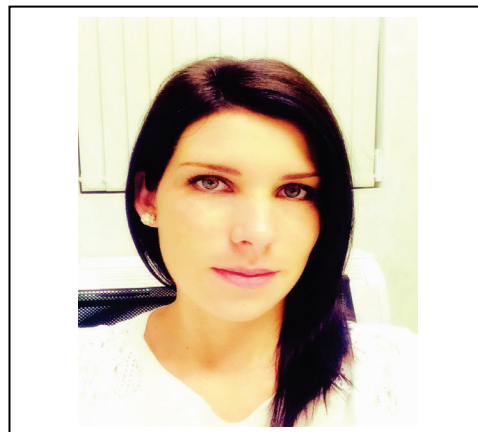
**Stephan van Zyl CFP®**

B Proc, Adv PG Dip in Fin Plan, LLM (UNISA), LLM (UFS)

Legal Adviser Manager

Broker Distribution : Pretoria Region

**and**



**Amanda Moolman**

LLB LLM (NWU), PG Dip in Fin Plan (UFS)

Legal Adviser Specialist

Broker Distribution : Pretoria Region

## Introduction

This article serves to elucidate the process of administering a deceased estate once the executor has established that the deceased estate is in fact insolvent.

Further, the impact of insolvency on the deceased's estate assets will be considered in respect of sequestration before death and in respect of insolvency being determined by the executor after death.

## The insolvent deceased estate

During the administration process and after the expiration of the notice period afforded to any creditors or claimants of a deceased estate in terms of section 29 of the Administration of Estates Act,<sup>1</sup> the executor will be enabled to determine the solvency of the estate.<sup>2</sup>

Section 34(1) of the Estates Act prescribes that in the instance where the executor finds the estate to be insolvent, he is required to, either immediately or at any time before the distribution of the estate, lodge a written notice to all creditors informing them of the position and allowing the majority in number and value of all the creditors an opportunity to provide written instruction, within a specified period of time, to surrender the estate under the Insolvency Act.<sup>3</sup>

Should the period lapse for the submission of the aforesaid written instruction from the majority in number and value of all the creditors, the executor may, after notifying the creditors accordingly, liquidate the assets in the estate in accordance with section 34(2) of the Estates Act.

A creditor may, however, still object to the sale of assets before the sale thereof and the Master will then need to make an order, after due consideration of the particular circumstances, whether the executor may continue with the sale or whether any conditions will be attached to the sale.<sup>4</sup>

From the above it is evident that the decision regarding the process of administration and the ultimate manner of distribution of the estate assets in an insolvent deceased estate rests with the creditors.<sup>5</sup>

---

<sup>1</sup> Administration of Estates Act 66 of 1965 (hereinafter referred to as "the Estates Act").

<sup>2</sup> Section 34(1) of the Estates Act.

<sup>3</sup> 24 of 1936 (hereinafter referred to as "the Insolvency Act").

<sup>4</sup> Sections 34(3) and 34(4) of the Estates Act.

<sup>5</sup> APJ Bouwer, Die beredderingsproses van Bestorwe Boedels 135 (1978).

## ❑ Sequestration under the Insolvency Act

The process under the Insolvency Act will be followed and the executor will have to allow the appointed trustee to continue with the sequestration of the estate in the following two instances:

### ○ The creditors provide written instruction in terms of section 34(1) of the Act

The majority in number and value of all creditors accordingly provide written instruction to the executor to surrender the estate under the Insolvency Act and a voluntary surrender in terms of the provisions of the Insolvency Act follows.<sup>6</sup>

### ○ Petition by the creditors for sequestration of the estate

One or more creditors who meet the prerequisites as prescribed in section 9 of the Insolvency Act may apply to the court for the sequestration of the estate.<sup>7</sup> Section 34(13) of the Estates Act allows for such petition by providing that *"the provisions of this section shall not prevent the sequestration of any estate in terms of the Insolvency Act, 1936"*.

The court may then make an order sequestrating the estate provisionally if it is satisfied that the petitioning creditor has an established claim, that the estate is insolvent and that it will be to the advantage of creditors.<sup>8</sup>

The trustee will be obliged to follow all the prerequisites in terms of the Insolvency Act and even though it is a deceased insolvent estate, the trustee will not be able to allocate any surplus funds in the insolvent estate to the deceased's testate or intestate beneficiaries as the surplus must be paid into the Guardian's Fund until the rehabilitation of the insolvent.<sup>9</sup> The surplus will only be paid to the executor for distribution to the beneficiaries once it has been established that the deceased estate is rehabilitated.<sup>10</sup>

## ❑ Administration under the Administration of Estates Act

In the instance where the creditors omit to provide written instruction to the executor to surrender the estate under the Insolvency Act, the executor may continue to administer the insolvent deceased estate according to the Estates Act, particularly in accordance with section 34. The executor is required to provide, in his liquidation and distribution account, for

---

<sup>6</sup> Section 34(1) of the Estates Act; and sections 3 and 6 of the Insolvency Act.

<sup>7</sup> Section 9 of the Insolvency Act.

<sup>8</sup> Section 10 of the Insolvency Act.

<sup>9</sup> Section 116 of the Insolvency Act; APJ Bouwer, *Die beredderingsproses van Bestorwe Boedels* 135 (1978).

<sup>10</sup> Sections 116 and 124 of the Insolvency Act; APJ Bouwer, *Die beredderingsproses van Bestorwe Boedels* 136 (1978).

the distribution of the proceeds in the order of preference prescribed under the Insolvency Act.<sup>11</sup>

After the account has laid open for inspection<sup>12</sup> and the Master has confirmed the account,<sup>13</sup> the executor must pay the creditors in the order of preference as indicated in the confirmed account and thereafter distribute the estate among the heirs, if any.<sup>14</sup>

### **The impact of insolvency on the administration and distribution of the estate assets**

In terms of section 20(1)(a) of the Insolvency Act the insolvent is divested of his estate upon sequestration, whereupon it is vested in the Master until a trustee is appointed. Once a trustee has been appointed the insolvent estate will vest in him.<sup>15</sup>

The insolvent's estate includes all property of the insolvent at the date of the sequestration, which includes property or the proceeds thereof which are in the hands of a sheriff or a messenger under writ of attachment.<sup>16</sup> The insolvent's estate also includes all property which the insolvent may attain or which may accrue to him during the sequestration, subject to certain exceptions and / or exclusions.<sup>17</sup>

Certain property is excluded from an insolvent estate in terms of the law of insolvency and other legislation as will be indicated below. The excluded property will therefore not vest in the trustee.

### **Property which will be excluded, inter alia, comprises:**

#### **(i) The principle of ownership**

Property which the insolvent was merely in possession of, or which was merely under his control, at the date of sequestration of his estate will be excluded from the insolvent estate.<sup>18</sup>

#### **(ii) Foreign property**

Property, both movable or immovable, which is situate outside of South Africa and which is owned by the insolvent at the date of sequestration of his estate, or attained by him after he is sequestrated but during the sequestration. However, movable property situated in a foreign

---

<sup>11</sup> Section 34(7)(b) of the Estates Act.

<sup>12</sup> Section 34(9) of the Estates Act.

<sup>13</sup> Section 34(10) of the Estates Act.

<sup>14</sup> Section 34(11) of the Estates Act.

<sup>15</sup> Section 20(1)(a) of the Insolvency Act; *Meskin et al Insolvency Law* at 5.2.

<sup>16</sup> Section 20(2)(a) of the Insolvency Act.

<sup>17</sup> Section 20(2)(b) of the Insolvency Act. Also see sections 23 and 24 of the Insolvency Act.

<sup>18</sup> *Meskin et al Insolvency Law* at 5.2; *Evans Legislative exclusions or exemptions of property from the Insolvent Estate* (2011), at 40/240.

jurisdiction may vest in the trustee if the insolvent is domiciled within the area of jurisdiction of the sequestrating Court.<sup>19</sup>

### **(iii) Trust property**

Where the trustee is the insolvent, the trust property will be excluded from his personal insolvent estate, unless he has a vested right to such property as a trust beneficiary.<sup>20</sup>

### **(iv) Insurance policies**

#### *Insurance payments in respect of a third party*

Any indemnified amount in respect of a liability incurred by the insured person towards a third party will be excluded from the insured's insolvent estate, and can be recovered by the third party directly from the insurer.<sup>21</sup>

### **Protection of certain policy benefits**

In terms of section 63(1) of the Long Term Insurance Act<sup>22</sup> certain policies<sup>23</sup> are excluded from the insolvent estate during the insolvent's lifetime or upon his death if he is survived by a spouse, child, step-child or parent. The policy benefits, and assets acquired exclusively with such policy benefits, will be excluded from the insolvent estate for a period of five years from the date on which the policy benefits were provided.<sup>24</sup>

Policy benefits will be protected as indicated above, unless it can be shown that the policy in question was taken out with the intention to defraud creditors.<sup>25</sup>

It is important to note that section 63 will not be applicable in the instance where the policyholder's estate has been sequestrated and beneficiaries have been nominated in the policy, since such benefits will not fall into the deceased estate unless the nominated beneficiaries renounces the benefit.<sup>26</sup>

---

<sup>19</sup> Meskin *et al* *Insolvency Law* at 5.2

<sup>20</sup> Section 12 of the Trust Property Control Act 57 of 1988; Meskin *et al* *Insolvency Law* at 5.3; Evans *Legislative exclusions or exemptions of property from the Insolvent Estate* (2011), at 42/240.

<sup>21</sup> Section 156 of the Insolvency Act; Meskin *et al* *Insolvency Law* at 5.3.2.2; Evans *Legislative exclusions or exemptions of property from the Insolvent Estate* (2011), at 41/240.

<sup>22</sup> Act 52 of 1988 (hereinafter referred to as the "Long Term Insurance Act").

<sup>23</sup> That is, other than policies for a debt secured, policies which have been in force for at least three years, and which are assistance, life, disability or health policies in which the insolvent or the spouse of the insolvent is the life insured.

<sup>24</sup> Section 63(2) of the Long Term Insurance Act.

<sup>25</sup> Section 63(4) of the Long Term Insurance Act.

<sup>26</sup> Botha *et al* *The South African Financial Planning Handbook* (2014), at 232; Meskin *et al* *Insolvency Law* at 5.3.2.1; Pieterse *v Shrosbree and Others*; *Shrosbree NO v Love and Others* [2004] 11 BPLR 6187 (SCA).

### **(v) Retirement fund benefits**

A member's benefit in a retirement fund, including an annuity purchased by the said fund from an insurer for the member, will be protected from appropriation by the trustee of the insolvent estate.<sup>27</sup> However, this protection is only available to the member until such time as the benefit accrues to him. Therefore, any proceeds from a retirement fund which is not preserved will form part of the insolvent estate.<sup>28</sup>

At death of the member, as retirement benefits do not form part of the assets of the member's estate, the Board of Trustees (hereinafter "the Trustees") determines the manner in which benefits will be paid and the Trustees are required to pay monies to the financially and legally dependant persons.<sup>29</sup>

It is only in the instance where the deceased is not survived by any dependants and the estate is insolvent, then the Trustees will be obliged to first make payment to the estate before payment may be made to nominated beneficiaries (who are not dependants), or if the deceased member did not make any beneficiary nominations, the Trustees must pay any benefits to the member's estate.<sup>30</sup>

### **(vi) Proceeds and assets protected under the Friendly Societies Act<sup>31</sup>**

Proceeds which are due in terms of the rules of a friendly society on the retirement of a member of the society, who was a member of the society for at least three years, will not form part of the member's insolvent estate. Assets obtained with such benefits will also be excluded from the insolvent estate.<sup>32</sup>

### **(vii) Accrual claim**

In the instance where a spouse's estate is sequestrated during the subsistence of the marriage, such spouse's right to accrual is excluded from the insolvent estate, as such right only arises on the date of dissolution of the marriage.<sup>33</sup> However, should the marriage be dissolved during the sequestration of the estate, the claim will become part of the insolvent estate and will vest in the trustee.<sup>34</sup>

---

<sup>27</sup> Section 37B of the Pension Funds Act 24 of 1956 (hereinafter referred to as "the PFA").

<sup>28</sup> Botha *et al* *The South African Financial Planning Handbook* (2014), at 911.

<sup>29</sup> Section 37C of the PFA; Botha *et al* *The South African Financial Planning Handbook* (2014), at 911 – 912

<sup>30</sup> Section 37C of the PFA; Botha *et al* *The South African Financial Planning Handbook* (2014), at 913

<sup>31</sup> Act 25 of 1956.

<sup>32</sup> Meskin *et al* *Insolvency Law* at 5.3.

<sup>33</sup> Sections 3(1) and 3(2) of the Matrimonial Property Act, 88 of 1984; Meskin *et al* *Insolvency Law* at 5.3.6

<sup>34</sup> Sections 20(1)(1) and 20(2)(b) of the Insolvency Act; Meskin *et al* *Insolvency Law* at 5.3.6

### **(viii) Other exclusions**

The insolvent's essential means of subsistence,<sup>35</sup> compensation payable to the insolvent under the Workmen's Compensation Act,<sup>36</sup> unemployment insurance benefits available to the employee as at the date of sequestration<sup>37</sup> and compensation for loss or damage by reason of defamation or personal injury.<sup>38</sup>

#### **□ Sequestration before death and the effect on beneficiary nominations**

Prior to composition or rehabilitation and whilst assets still vest in the trustee, the insolvent will not be able to bequeath the attached assets.<sup>39</sup> However, the excluded assets are not affected by the sequestration and may accordingly be bequeathed to the insolvent's beneficiaries or be distributed intestate.

#### **□ Insolvency determined after death and the effect on surviving heirs**

Excluded assets will not be affected by the sequestration and may accordingly be distributed amongst the insolvent's beneficiaries or be distributed intestate. Whilst, all other property not specifically excluded from the insolvent estate should be dealt with either in terms of the provisions of section 34 of the Estates Act or in terms of the provisions of the Insolvency Act, dependant on the actions of the creditors, as indicated above.

---

<sup>35</sup> Section 82(6) of the Insolvency Act; Meskin *et al* *Insolvency Law* at 5.3.7

<sup>36</sup> Act 30 of 1941 – which was repealed by the Compensation for Occupational Injuries and Diseases Act 130 of 1993 with effect from 1 March 1994. Such compensation is excluded since it constitutes compensation for personal injury within the meaning of s 23(8) of the Insolvency Act; Meskin *et al* *Insolvency Law* at 5.3.8

<sup>37</sup> Meskin *et al* *Insolvency Law* at 5.3.9; Section 33(1)(b) of the Unemployment Insurance Act, 63 of 2001, provides that the benefits payable may not be attached by an order of court, unless it relates to maintenance claims of dependants, including a former spouse.

<sup>38</sup> Section 23(8) of the Insolvency Act; Meskin *et al* *Insolvency Law* at 5.3.10

<sup>39</sup> Sections 20 and 25 of the Insolvency Act.

## Conclusion

From the discussion above it emerges that the process of administering a deceased estate, once the executor has established that the deceased estate is in fact insolvent, ultimately rests in the hands of the creditors of the insolvent estate and the course they select to implement.

Further, from the discussion above it is clear that the insolvent is unable to deal freely with assets which vest in the trustee of the insolvent estate and the insolvent may only deal freely with assets which are specifically excluded by legislation. Therefore, assets specifically excluded at sequestration and before the death of the insolvent may be bequeathed freely to beneficiaries of the insolvent.

Should insolvency be determined during the administration of the deceased estate, certain property shall be excluded from the insolvent deceased estate, whilst the remaining property shall be dealt with either in terms of the provisions of section 34 of the Estates Act or in terms of the provisions of the Insolvency Act.

## **Bibliography**

### **Books & Journals**

Botha *et al*, *The South African Financial Planning Handbook* (2014).

APJ Boucher, *Die beredderingsproses van Bestorwe Boedels* (1978).

RG Evans *Legislative Exclusions or Exemptions of Property from the Insolvent Estate* PER 2011 Vol 14 No 5.

PM Meskin *et al Insolvency Law at Chapter 5* (LexisNexis 2014).

### **Case law**

*Pieterse v Shrosbree and Others; Shrosbree NO v Love and Others* [2004] 11 BPLR 6187 (SCA).

### **Legislation**

Administration of Estates Act 66 of 1965.

Friendly Societies Act 25 of 1956.

Insolvency Act 24 of 1936.

Long Term Insurance Act 52 of 1998.

Matrimonial Property Act 88 of 1984.

Pension Funds Act 24 of 1956.

Trust Property Control Act 57 of 1988.

Unemployment Insurance Act 63 of 2001.

# The proposed changes to the taxation of trusts in South Africa



**Madelein Marais CFP®**

LLB, Adv PG Dip Fin Plan, H Dip Tax

Legal Adviser Specialist

Broker Distribution : Cape Town

## Introduction

For many years the formatting of a trust has been a very popular financial planning tool. Trusts are commonly used for "estate freezing" where a person does not want his assets to form part of his deceased estate. By transferring assets to the trust any further growth in the value of the assets will accrue to the trust and not the person, effectively reducing estate duty liability over time. Another reason for the use of a trust is to limit the deceased's capital gains tax ("CGT") on death, as a person is deemed to dispose of all his assets for proceeds equal to the market value of the asset at the date of his death.<sup>1</sup>

In the National Budget, tabled in Parliament on 27 February 2013, the Minister of Finance, Pravin Gordhan indicated that government was proposing several legislative measures regarding trusts to curtail perceived tax avoidance associated with trusts. A concern regarding the use of trusts to avoid estate duty was also indicated by the Treasury.<sup>2</sup> The Davis Tax Committee released its first interim report on estate duty in South Africa on 13 July 2015 recommending that the deeming provisions of section 7 and 25B should be repealed, insofar as they apply to South African resident trusts.<sup>3</sup> Comments on the abovementioned report are to be submitted by 30 September 2015 and it is the recommendation of the committee that any changes should only be implemented in the next tax year.

## Current income tax treatment of trusts in South Africa

A trust is a person for tax purposes as referred to in Section 1 of the Income Tax Act.<sup>4</sup> Even though a trust is defined as a person for tax purposes it is treated differently from corporate persons such as a company or close corporation.<sup>5</sup> Income received by or that accrued to a trust is not always taxed in the hands of a trust and can be taxed in the hands of the beneficiary, founder or someone who has made a disposition to the trust depending on the circumstances.<sup>6</sup>

Trusts are taxed at a flat rate of 41% and do not qualify for the interest exemption or personal rebates.<sup>7</sup> Section 25B of the Income Tax Act is the principal taxing section relating to trusts.<sup>8</sup> This section provides that the income of a trust is taxed either in the trust or in the hands of beneficiaries.<sup>9</sup> Section 25B is however subject to Section 7 of the Income Tax Act<sup>10</sup> and if section 7 applies some other person instead of the trust or beneficiaries may be taxed.<sup>11</sup>

---

<sup>1</sup> Brink and L Willems: An investigation into the future of discretionary trusts in South Africa- an income tax perspective 798 (2014)

<sup>2</sup> Id.

<sup>3</sup> Davis Tax Committee: First interim report on Estate Duty for the Minister of Finance 7 (2015)

<sup>4</sup> 58 of 1962

<sup>5</sup> WD Geach, J Yeats, Trust Law and Practice 233 (2007)

<sup>6</sup> DM Davis, C Beneke, RD Jooste, Estate Planning 6-3 (Service Issue 36)

<sup>7</sup> Phillip Haupt, Notes on South African Income Tax 795(2013)

<sup>8</sup> Phillip Haupt, Notes on South African Income Tax 796(2013)

<sup>9</sup> Id.

Section 25B embodies the “conduit principle”, and provides that income which is received by, or which accrued on behalf of a beneficiary, who has a vested right to such amount during such year, shall be deemed to be an amount which has accrued to the beneficiary and will be taxed in the hands of the beneficiary. In *Armstrong v CIR 1938 (AD)* the court held that income received by a beneficiary from a trust retains its nature.<sup>12</sup> The trust is viewed as a conduit pipe through which the income flows. For example, it retains its nature as interest income in the hands of the beneficiary.<sup>13</sup>

Section 25B is therefore not an anti-avoidance provision but rather a regulatory provision in the sense that it determines who will be taxed on trust income, and when.<sup>14</sup>

Various anti-avoidance provisions are contained in Section 7 of the Income Tax Act.<sup>15</sup> These provisions determine certain circumstances when income is deemed to have accrued or to have been received by persons who never actually received the income nor did it accrue to them.<sup>16</sup>

The section 7 deeming provisions rules will apply if income has been received by virtue of any “donation, settlement or gratuitous disposition” made by any person.<sup>17</sup> Any income arising from such donation, settlement or disposition will, generally speaking, be taxed in the hands of the person who made the donation.<sup>18</sup>

With regards to capital gains tax a trust is a non-natural person and will be taxed on its undistributed capital gains.<sup>19</sup> When a capital gain is realised within a trust, 66.6% of that gain has to be included for income tax purposes, unless it is a special trust.<sup>20</sup> The tax rate of which is double that of the tax rate which applies to individuals is an example of how trusts have been singled out for harsher tax treatment.<sup>21</sup> Trusts which are not special trusts do not qualify for the interest exemption, CGT annual exclusion, or any of the rebates individuals qualify for.<sup>22</sup> A special trust is a trust either created solely for the benefit of one or more persons who is or are persons with a ‘disability’ (as defined in s18(3) of the Act, where that disability incapacitates the person or persons from earning sufficient income for their maintenance or from managing their

---

<sup>10</sup> 58 of 1962

<sup>11</sup> Phillip Haupt, Notes on South African Income Tax 796(2013)

<sup>12</sup> M Honiball, L Olivier, *The Taxation of Trusts in South Africa* 72 (2009)

<sup>13</sup> DM Davis, C Beneke, RD Jooste, *Estate Planning* 6-6(SERVICE ISSUE 36)

<sup>14</sup> M Honiball, L Olivier, *The Taxation of Trusts in South Africa* 73 (2009)

<sup>15</sup> M Honiball, L Olivier, *The Taxation of Trusts in South Africa* 84 (2009)

<sup>16</sup> Id.

<sup>17</sup> M Botha, L Rosinni, W Geach, B Goodall, L Du Preez, *The South African Financial Planning Handbook* 831 (2013)

<sup>18</sup> Id.

<sup>19</sup> Phillip Haupt, Notes on South African Income Tax 911(2013)

<sup>20</sup> Id.

<sup>21</sup> M Honiball, L Olivier, *The Taxation of Trusts in South Africa* 123(2009)

<sup>22</sup> Id.

own financial affairs or a testamentary or will trust created solely for the benefit of beneficiaries who are relatives of the deceased person and who are alive on the date of death of the deceased person (including a beneficiary who has been conceived but not yet born on that date). The trust will qualify as a special trust only if the youngest of the beneficiaries is on the last day of the trust's year of assessment under the age of 18 years.

Paragraph 80 of the Eighth Schedule provides that if a trust distributed an asset to a beneficiary (who is a South African resident), the gain made by the trust on the disposal of that asset is taxable in the beneficiaries hands and not in the trusts hands.<sup>23</sup> Paragraph 80 is however subject to the anti-avoidance provisions in paragraph 68 to 73 of the Eight Schedule where the capital gains tax is attributed back to donor.

If the trust sells an asset and makes a capital gain, the trust will not be taxed on the gain if it vests the gain in a South African beneficiary as provided in paragraph 80.<sup>24</sup> It is important to note that the gain must be vested in the same tax year that it arises, if only a portion of the capital gain is vested in a beneficiary, he or she will only be taxed on that portion and the rest will be taxed in the trust.<sup>25</sup>

### **Proposed changes recommended by the Davis Tax Committee**

- The deeming provisions of section 7 and 25B should be repealed, insofar as they apply to RSA resident trust arrangements.<sup>26</sup>
- The deeming provisions of section 7 and 25B should be retained, insofar as they apply to non-residential trust arrangements.<sup>27</sup>
- Trusts should be taxed as separate tax payers.<sup>28</sup>
- The only relief to the rule should be the "special trust definition" contained in section 1 of the Income Tax Act.<sup>29</sup>

The attribution rules in section 7 were originally intended as an anti-avoidance mechanism to prevent a trust from being used as an income splitting device.<sup>30</sup> In the past trusts had a much more favourable tax rate and the need for the deeming provisions of section 7 was appreciated due to the extremely high individual tax rates.<sup>31</sup>

<sup>23</sup>Phillip Haupt, Notes on South African Income Tax 220(2013)

<sup>24</sup> Id.

<sup>25</sup> Id.

<sup>26</sup>Davis Tax Committee: First interim report on Estate Duty for the Minister of Finance 7 (2015)

<sup>27</sup> Id.

<sup>28</sup> Id.

<sup>29</sup> Id.

<sup>30</sup> Davis Tax Committee: First interim report on Estate Duty for the Minister of Finance 37 (2015)

<sup>31</sup> Id.

With the current flat rate of tax of 41% and the effective capital gains tax of 27.3% for trusts the attribution rules no longer serve as an anti-avoidance provision, but is rather used for the benefit of high net worth individuals as it provides a concession which is exactly the opposite of its intended purpose.<sup>32</sup> For capital gains tax purposes the attribution rules currently hold a definite benefit with capital gains only being taxed between 0% and 13.7% as opposed to the 27.3% within trust.<sup>33</sup>

### Example:

MAC Trust is a discretionary trust. The trust has one beneficiary who is a natural person, under the age of 65 and a South African resident. The trust received the following amounts during the 2016 year of assessment.

- |  |                                 |
|--|---------------------------------|
| <input type="checkbox"/> Proceeds from the sale of a property      | R2 000 000 (base cost R500 000) |
| <input type="checkbox"/> Interest received from a local investment | R100 000                        |

### Scenario 1:

Calculation of the income tax liability of the trust and the beneficiary if the trustees of the trust decide to distribute all the receipts and accruals in the trust to the beneficiary during the 2016 year of assessment.

### Income tax of the trust:

Taxable income R-

(No taxable income as all receipts and accruals vest in the beneficiary in the same year of assessment.)

---

<sup>32</sup> Id.

<sup>33</sup> Id.

**Income tax of the beneficiary:**

Gross income		R100 000
Interest	<u>R100 000</u>	
Less: exemptions:		R 23 800
Interest exemption	<u>R 23 800</u>	
Income		R 76 200
Add: Taxable capital gain <sup>34</sup>		<u>R489 510</u>
Taxable income <sup>35</sup>		R565 710
Tax per scale		R155 707
Less: primary rebate		<u>R 13 257</u>
Income tax payable to SARS:		R142 450

**Scenario 2:**

Income tax calculation in terms of the proposed changes:

**Income tax of the trust:**

Gross income		R 100 000
Interest	<u>R 100 000</u>	
Less: exemptions:		R -
Income		R 100 000
Add: Taxable capital gain <sup>36</sup>		<u>R 999 000</u>
Taxable income <sup>37</sup>		R1 099 000
Tax at flat rate of 41%		R 450 590
Income tax payable to SARS:		R 450 590

<sup>34</sup>  $[(R2\ 000\ 000 - R500\ 000) - R30\ 000] \times 33.3\% = R489\ 510.00$

<sup>35</sup> Assume no other receipts or accruals for the 2016 year of assessment.

<sup>36</sup>  $(R2\ 000\ 000 - R500\ 000) \times 66.6\% = R999\ 000$

<sup>37</sup> Assume no other receipts or accruals for the 2016 year of assessment.

## Conclusion

The recommendations of the Davis Tax Committee to repeal the attribution provisions will have far reaching effects to the taxation of trusts as we currently know it. It is clear that there is a movement that the nuts and bolts will be tightened with regards to the taxation of trusts and that trusts should be carefully considered in future and only used when it makes sound financial planning sense and not merely for tax benefits.<sup>38</sup>

---

<sup>38</sup> Davis Tax Committee: First interim report on Estate Duty for the Minister of Finance 7 (2015)

## **Bibliography**

Income Tax Act 58 of 1962

Phillip Haupt, Notes on South African Income Tax (2013)

M Honiball, L Olivier, The Taxation of Trusts in South Africa (2009)

DM Davis, C Beneke, RD Jooste, Estate Planning (Service Issue 36)

WD Geach, J Yeats, Trust Law and Practice (2007)

M Botha, L Rosinni, W Geach, B Goodall, L Du Preez, The South African Financial Planning Handbook (2013)

S Brink and L Willemse: An investigation into the future of discretionary trusts in South Africa- an income tax perspective (April 2014)

Davis Tax Committee: First interim report on Estate Duty for the Minister of Finance (January 2015)

# May a trust mortis causa be amended?



**Madeleine Britz CFP®**

BLC, LLB, Adv. PG Dip in Fin Plan  
Legal Adviser Advanced  
Broker Distribution: Inland Region

## Introduction

It is a reality that certain things in life will change. Therefore a testator might have a certain outcome in mind at the time of drafting his will but taking into account the possibility of changing circumstances and legislation, it becomes clear that even the best-framed trust deed may need variation in the future. When consulting with clients on the matter of wills and the creation of a testamentary trust it is important to know what elements should be taken into account in order to give the correct advice.

As a practical example of a situation in which the question of the variation of a testamentary trust may arise, consider the following set of facts:

Suppose that in 1982 a testator created a testamentary trust which was to continue until the year 2002. In 1982 the trust property comprised of an investment amount of R 150 000. The testator in his will specified that the funds may only be invested at a certain financial institution. Further assume that the maximum rate of return obtainable from this institution is 6% and the inflation rate is 8%. This amounts to a 2% decrease in value of the investment each year. This means that in real terms the R 150 000 investment will be worth nothing at the end of the 20 year term. If the beneficiary wants to acquire property in the year 2002 the value of the original investment in the trust would have depleted so much that it would not be possible to buy property as property values generally increases at an annual rate which at least keeps pace with inflation.

It is clear from the above set of facts that if the status quo is maintained and the trust is not amended, it will be to the detriment of the beneficiaries.

The question that needs answering is when a trust mortis causa may be amended and whether the mere fact that the beneficiaries of the trust are being or will be prejudiced is on its own sufficient reason for the variation of the trust.

## Important points to take into account when variation of a testamentary trust deed is considered:

- What does the common law say with regard to the nature of the trust mortis causa?
- The implications of Sec 13 of the Act 57 of 1988.<sup>1</sup>

The variation of trust deeds in South African law has not been clearly defined as in the case of the American law. When a trust has been created it is final and cannot be amended, unless variations of the trust provisions have been authorised.

---

<sup>1</sup> Section 13 of the Trust Property Control Act 57 of 1988

Many problems relating to the technical interpretation of the variation of a trust deed could have been eliminated if the person setting up the trust made proper provision by including a properly drafted amendment clause in the trust deed. Such provisions are commonly found in the inter vivos trust deeds but there is no consensus on whether such a provision may be included in a testamentary trust or not.

## **Amendment of the testamentary trust**

### **Common law**

The general rule is that the court is not allowed to amend the provisions of a will.<sup>2</sup> When it comes to the interpretation of a will the general rule *voluntas testatoris servanda est*<sup>3</sup> applies. This means that effect must be given to the testator's wishes as recorded in the will.

Roman- Dutch law recognizes, as a matter of public interest, transcending the private interests of beneficiaries, that effect should be given to the wishes of the testator. The latter principle that has been confirmed in a long list of court decisions is also applied to testamentary trusts.

"Acting in accordance with this general approach, the court has refused to authorize departures from the terms of a testamentary trust relating to a testator's directions, express or implied, as to (i) how the trust is to be administered, how and when assets should be realized, what investments should be made, etc. and (ii) the testator's scheme for the provision of benefits to the beneficiaries and the devolution of the trust estate."<sup>4</sup>

Because testamentary trusts are derived from a will, the applicability of the rule *voluntas testatoris servanda est* has been made equally applicable to such trusts. Testamentary trusts are therefore, with reference to the rules regulating variations, treated on the same level as wills.

Corbett<sup>5</sup> refers to a number of instances where the court will indeed allow variations or amendments. No consistent rule may be deduced from these cases. He gives a couple of examples that must be viewed as exceptions to the general view of the courts that they have no inherent jurisdiction to authorise variations. The following two examples amongst others are mentioned by Corbett<sup>6</sup>:

---

<sup>2</sup> Ex parte Naudé 1956 OPD 1; Ex parte Estate Loewenthal 1939 WLD 78

<sup>3</sup> Robertson v Robertson's executors 1914 AD 503 at 507

<sup>4</sup> Corbett et al The Law of Succession (2001) at 423

<sup>5</sup> Corbett et al The Law of Succession (1980) at 436-439 and (2001) at 423-426

<sup>6</sup> Corbett et al The Law of Succession (1980) at 436-439 and (2001) at 423-426

- ❑ If the trust is a charitable trust, it can be amended because of changed circumstances if the cy prés doctrine is applicable.<sup>7</sup>
- ❑ The courts can authorise the variation of a trust deed where circumstances unforeseen by the testator have changed to such an extent it makes compliance with his instructions impracticable or difficult (the ob causim necessarium doctrine).<sup>8</sup> There have been some cases where the court has intervened to give beneficiaries a better income due to changed circumstances. That being said, in the case of *Jewish Colonial Trust v Estate Nathan*<sup>9</sup>, the court denied the existence of a general rule that changed circumstances justifies the variation of the provisions in a will. The interests of the beneficiaries must yield to the intention of the testator as a general rule.

The promulgation of Act 57 of 1988<sup>10</sup> makes it possible that all the scenarios which Corbett mentions are being taken care of under Section 13 of Act.<sup>11</sup>

### **Section 13 of Act 57 of 1988**

If a trust instrument contains any provision which brings about consequences which in the opinion of the court the founder of a trust did not contemplate or foresee and which –

- (a) hampers the achievement of the objects of the founder; or
- (b) prejudices the interests of the beneficiaries; or
- (c) is in conflict of the public interest,

the court may, on application of the trustee or any person who in the opinion of the court has sufficient interest in the trust property, delete or vary any such provision or make in respect thereof any order which such court deems just, including an order whereby particular trust property is substituted for particular other property, or an order terminating the trust.

### **Amendment of a testamentary trust in light of discriminatory provisions**

Recently applications have been made to vary a testamentary trust based on the fact that originally when the trust was created it was created for the purpose of benefitting the broader public but due to the wording used it resulted in unfair discrimination. These trusts were initially created to help students who seek to enrol for tertiary studies but did not have sufficient funding to obtain such education. Some of the provisions contained in the testamentary trusts clearly go against the provisions of section 9 of the Constitution. The applicants approached the court in light of section 13 of the Trust Property Control Act in order to amend the discriminatory provisions.

<sup>7</sup> Corbett et al *The Law of Succession* (2001) at 425 The cy prés doctrine refers to cases where the original goals for which the trust was created have become impossible to achieve or impracticable.

<sup>8</sup> Corbett et al *The Law of Succession* (2001) at 424; *Ex parte Gowans NO; In re Estate Saunders Employees Trust* 1977(3) SA 486 (D) ; *Ex Parte Insel* 1952(1) SA 71 (T)

<sup>9</sup> 1967 (4) SA 397 (N) at 409

<sup>10</sup> Section 13 of the Trust Property Control Act 57 of 1988

<sup>11</sup> Section 13 of the Trust Property Control Act 57 of 1988

## **Board of Executors v Benjamin Godlieb Heydenrych Testamentary Trust and Others (9688/08)[2011]ZAWCHC**

The Godlieb Heydenrych testamentary trust was created for a very specific purpose- 'providing for the education of *European* boys of good character of the *Protestant faith* to enable them to qualify for the civil service of the Union or as a Pharmaceutical Chemist.'

The court was concerned whether it was in fact entitled to intervene and to amend and scrap the discriminatory provisions contained in the testamentary trust. The court relied on the provisions contained in Section 13 of the Act.<sup>12</sup> On deciding whether the court could intervene there were two requirements they took into account:

- Were there any provisions in the trust deed that brought about consequences which in the opinion of the court the founder did not(or could not) foresee or contemplate ; AND
- Will the relevant provision hamper the object which the testator or founder had in mind, OR will such provisions prejudice the interests of the beneficiaries OR will such a provision be in conflict with public policy.

After considering the abovementioned, the court identified three main issues which needed to be addressed namely:

- Was there discrimination on the basis of race?
- Was there discrimination on the basis of sex and/or gender
- Whether the jurisdictional facts allowed for the court to intervene in terms of section 13.

The court referred to the case of 'Minister of Education and Another v Syfrets Trust Ltd NO and Another' which confirmed the common law principle that the court may delete offending provisions and quoted the following:

*"The principle that the courts will refuse to give effect to a testator's directions which are contrary to public policy is a well-recognized common law ground, limiting the freedom of testation."*

The court was of the opinion that the circumstances surrounding the relevant case entitled it to intervene and amend the testamentary provisions in terms of section 13 of the Act and remove the discriminatory provisions.

The testamentary trusts were created long before South Africa became a democracy and there is no way that the testator could foresee the implementation of the Constitution. The

---

<sup>12</sup> Section 13 of the Trust Property Control Act 57 of 1988

court therefore had a solid foundation to bring an application in terms of section 13 of the Act.<sup>13</sup>

### **BoE Trust Ltd NO & Others (VN)(846/11)[2012] ZASCA**

The widow of the late Jean Pierre De Villiers left various special bequests to her siblings, nieces, nephews and godchildren. The residue of her estate was left to the Jean Pierre De Villiers testamentary trust. The funds within the testamentary trust had to be applied for the provision of "small bursaries to assist white South African students who has completed an MSc degree in Organic Chemistry at a South African University and were planning to complete their studies with a doctorate degree at a University in Europe or in Britain."

The applicants in this case (the trustees of the testamentary trust) being mindful of the fact that the provisions in the will could be deemed unconstitutional proceeded to correspond with the Registrars of various universities to see whether they would participate in giving effect to these bursaries subject to the conditions contained in the will. All the relevant universities declined.

The applicants proceeded to approach the High Court in order to have the testamentary provisions amended, specifically to have the word "white" removed from the will. The court found that the bequest was rendered impossible because of the stance adopted by the various universities in respect of the bursaries. The court found that the will of the testatrix made provision for circumstances where the bequest was rendered impossible (the universities were unable to use the funds for the goal she originally envisioned) and in the alternative the testatrix nominated charity organizations who could receive the trust income should these unforeseen circumstances arise. The court found that the amendments in terms of Section 13 of the Act would not be possible.

The applicants renewed their application for leave to appeal based on the *Curators, Emma Smith Educational Fund v University of Kwazulu –Natal and Others 2010 (6)SA 518 (SCA)*. The leave to appeal was denied by Mitchell AJ on the grounds that the Emma Smith case would have no effect on the current application.

The Supreme Court of Appeal however did grant leave to appeal and the applicants argued that the court had the power, on the basis of *Minister of Education and Another v Syfrets Trust Ltd NO and Another* to delete the word "white" from the will.

Erasmus AJ decided there was a clear distinction between the current case and the cases the applicants relied on. The will in this case contained provisions for substitution of beneficiaries

---

<sup>13</sup> Section 13 of the Trust Property Control Act 57 of 1988

should any of the bequests be rendered impossible. The court had a look at Section 25 of the Constitution and found that freedom of testation should be respected. The testatrix envisioned bringing back skilled individuals to the country. She also clearly provided for her bequests not to be contentious and in order to ensure that no conflict could render her bequests invalid she provided for charitable organizations to act as substitute beneficiaries. Therefore the court found it was not possible to use the provisions of Section 13 of the Act to amend the provisions of the will. The court refused to delete the word "white". The court dismissed the appeal and found that the bequest to the charitable organization should be enforced.

When drafting testamentary trusts it is important and advisable that clear provision be made for alternative or substitute beneficiaries in the will should the original purpose for the testamentary trust become impossible or untenable especially where the testator or the testatrix wishes to benefit a certain group of people, lest they run the risk that the intended purpose can be subverted in any event by an application in terms of Section 13 of the Act.

## **Conclusion**

As far as testamentary trusts are concerned the authors of *Trust Law in Practice*<sup>14</sup> recommend the trustees be authorised to extend their powers in the testamentary trusts, provided that any variation contemplated does not prejudice the interests of the beneficiaries.

In certain circumstances, the court has the right in terms of both the common law and in terms of section 13 of the Act to vary the trust deed.

Although it is not possible to foresee and exclude all problems, many unnecessary arguments and uncertainties can be avoided if provision is made to vary the trust deed.

---

<sup>14</sup> *Trust Law in Practice* by PA Olivier, S. Strydom, GPJ Van Den Berg

**Bibliography****Legislation**

Trust Property Control Act No 57 of 1988

**Books**

Trust Law in Practice by PA Olivier, S. Strydom, GPJ Van Den Berg

The Law of Succession by M.M. Corbett

**Case Law**

Ex parte Naudé 1956 OPD 1 Robertson v Robertson's executors 1914 AD 503 at 507

# Legal implications: When “I do” turns into “I don’t”



**Shakira Bodasing CFP®**

LLB, Adv PG Dip Fin Plan

Legal Adviser Manager

PFA : Johannesburg

## Introduction

An engagement between partners brings with it a romantic and celebratory affair. Love-struck partners rarely consider the legal implications of an engagement or the legal implications of the termination thereof. South African common law previously recognised the principle that should an engagement be terminated the aggrieved party may have a claim of breach of promise. This article addresses the legal implications.

As stated above our common law previously recognised the principle that the aggrieved party has a claim for breach of promise. The claim comprised of two parts:

- (a) The delictual claim which the aggrieved party would have under the action injuriarum for contumelia (damages for the humiliation caused as a result of the break-up of the relationship); and
- (b) The contractual claim for the actual financial loss suffered by the aggrieved party as a result of the break-up of the relationship of the parties

Recent Case law regarding the Breach of Promise to Marry

### **Van Jaarsveld v Bridges<sup>1</sup>**

In this appeal case, the Supreme Court found that South African law would only recognise a claim for actual monetary loss incurred in the planning and preparation of the marriage. Judge Harms DP stated that he is unable to accept that parties, when promising to marry each other, at that stage of their relationship, would contemplate that a breach of their engagement would have financial consequences as if they had in fact married. It is the assumption of the two parties that their marital regime will be determined when they marry. Harms DP concluded that in his view an engagement is more of an unenforceable pactum de contrahendo (a contract or agreement between two or more parties) providing a spatium deliberandi: "a time to get to know each other better and in which they would decide whether or not to formally get married".

### **ES Cloete v A Maritz<sup>2</sup>**

Ms. Cloete (Plaintiff) and Mr. Maritz (Defendant) made an oral agreement in 1998 to marry within a reasonable time period. They got engaged in 1999. Ten years later in 2009, Mr Maritz breached that promise and had also started seeing someone else. Ms. Cloete decided to sue for breach of promise.

---

<sup>1</sup> (344/09)[2010] ZASCA 76; 2010 (4) SA 558 (SCA); [2010] 4 All SA 389 (SCA) (27 May 2010)

<sup>2</sup> (6222/2010) [2013] ZAWCHC 69 (24<sup>th</sup> April 2103)

**Plaintiff's claim:**

- (i) Repayment of money that she had donated to the defendant in 1994 and 1996 for his business.
- (ii) Loss of financial benefits that she would have enjoyed had they concluded the marriage. In this regard she claimed firstly the right of enjoyment of an immovable property of a value commensurate with the standard of living enjoyed and maintained by the parties at the time and secondly, maintenance for a period of 25 years.
- (iii) Damages for breach of promise to marry; impairment to her personal dignity and her reputation.

**Defendant's claim:**

He denied the allegations and stated that the plaintiff had in fact called off the wedding and further denied that a breach of promise was still a valid cause of action in South African law. The defendant argued that having regard for the Constitution of the Republic of South Africa 1996 and the current mores as recognised by the community at large, it is not a valid action. Breach of promise is moreover an unenforceable pactum de contrahendo which merely allows for a spatium deliberandi and therefore does not constitute a valid cause of action". This was based on the Supreme Court of Appeal's judgement in *Van Jaarsveld v Bridges*.<sup>3</sup>

In *Van Jaarsveld v Bridges*<sup>4</sup>, Judge Robert Henney discussed two causes of action that a breach of promise gave rise to, the one would be delictual in nature based on the action iniuriarum, where the innocent party would be entitled to sentimental damages if the repudiation was contumelious (scornful and insulting). In such case it was required that the "guilty party", acted wrongly in the delictual sense and animus iniuriandi (acted with malice and without probable cause) when ending the engagement. It did not matter whether or not the repudiation was justified. The mere fact that the feelings of the "innocent" party were hurt or that she or he felt jilted was not enough. The manner in which the engagement was brought to an end was what needed to be considered. The second cause of action was for breach of contract and in considering this cause of action two aspects needed to be considered. The first was that engagement contract might be cancelled without any financial consideration if there was a just cause for cancellation. The second aspect that had to be considered in the context of contractual damages was the justification for placing an engagement on a "rigid contractual footing".

According to the Plaintiff, the Supreme Court of Appeal in the *Van Jaarsveld v Bridges*<sup>5</sup> judgement did not state that the cause of action based on breach of promise was no longer

---

<sup>3</sup> (344/09)[2010] ZASCA 76; 2010 (4) SA 558 (SCA); [2010] 4 All SA 389 (SCA) (27 May 2010)

<sup>4</sup> (344/09)[2010] ZASCA 76; 2010 (4) SA 558 (SCA); [2010] 4 All SA 389 (SCA) (27 May 2010)

<sup>5</sup> (344/09)[2010] ZASCA 76; 2010 (4) SA 558 (SCA); [2010] 4 All SA 389 (SCA) (27 May 2010)

part of our law, but merely said that our Courts should reassess the law relating to breach of promise. Reassessment therefore does not amount to abolishment.

The Court found that the current approach to engagements did not reflect the current *boni mores* or public policy considerations based on the values of our Constitution which was to see a party's failure to honour his/her original promise to marry purely within the context of contractual damages. Clearly to hold a party accountable on a rigid contractual footing where such a party failed to abide to a promise did not reflect the changed *mores* or public interest. The court applied the reasoning and guidelines as set out in the *Van Jaarsveld v Bridges*<sup>6</sup> judgement where it was held that the base claim for prospective losses arising from a breach of promise to marry on a rigid contractual footing was not a valid cause of action. Consequently the position in respect of when a party could successfully claim prospective losses on the basis of breach of contract no longer formed part of our law.

The judge also said: "As pointed out by Sinclair, *The Law Of Marriage Volume 1 (1996)*, to hold a party liable for contractual damages for breach of promise to marry may in fact lead parties to enter into marriages they do not in good conscience want to enter into, purely due to the fear of being faced with such a claim. This is an untenable situation".

Points to ponder on when partners commit to a long term relationship.

Regular and open discussions are vital for a healthy financial relationship. Ideally these discussions should begin as soon as a couple commits to a long-term relationship. There is a general assumption that partners who have been living together for several years would be recognised as a common-law partnership by the law. Common-law marriage is not recognised in South Africa.

There are currently legal channels that one can utilise to spell out or financially safe guard a relationship that turns sour.

A cohabitation agreement is a legal contract drawn up between partners which, similarly to an ante nuptial contract dictates what happens to the assets on dissolution of the relationship. The law views a cohabitation agreement as a business partnership. These agreements have no binding power towards a third party e.g. a creditor. It also does not establish immediate rights of intestate inheritance. A valid will is necessary to establish rights of inheritance.

Although unmarried partners without a cohabitation agreement cannot expect automatic legal protection some have had success in convincing the courts to acknowledge the

---

<sup>6</sup> (344/09)[2010] ZASCA 76; 2010 (4) SA 558 (SCA); [2010] 4 All SA 389 (SCA) (27 May 2010)

existence of a “universal partnership”, whereby each partner contributed to and benefitted from the relationship. A universal partnership is a concept in common law and is essentially a business agreement that may be tacit or expressed.

The requirements for a universal partnership set out in the judgement of *Ponelat v Schrepfer*<sup>7</sup> were confirmed in a Supreme Court of Appeal judgement in March 2012, in the case of *Butters v Mncora*.<sup>8</sup> In that case, the parties were not married but lived together as husband and wife for almost 20 years. The requirements, which may prove difficult to satisfy, are:

- (i) Each party contributes to the relationship (in the form of money, labour or skill)
- (ii) The partnership is carried out for the joint benefit of the parties
- (iii) The objective of the partnership must be to make a profit
- (iv) The contract should be a legitimate one

Once the court has established that such a relationship existed, it may order redistribution of assets, though not necessarily on a 50-50 basis.

The Domestic Partnership Bill (hereinafter referred to as the Bill) was promulgated in 2008. The Bill was promulgated to deal with the legal grey area faced by unmarried cohabitants. In essence, the purpose of the Bill is to afford the domestic partnership the same rights and duties which would flow from a formal traditional marriage. Partners can choose to register their domestic partnership, but the Bill does accord rights to those in unregistered partnerships. The Bill states that the court must have regard to all the circumstances of the relationship, including factors such as its duration and nature, the degree of financial independence, and the degree of mutual commitment to a shared life. Under the Bill, unregistered partners are not liable to maintain each other, and neither party is entitled to claim maintenance except where the court finds that it is just and equitable that maintenance be paid.

## Conclusion

The Bill is yet to be enacted into law. This places the cohabitating couple who intend their relationship to be permanent in an extremely precarious position, as there is uncertainty in the law as to the status of the relationship. It is thus imperative for cohabitating partners to ensure that their rights are protected by regulating their financial affairs and making provision for contingencies.

---

<sup>7</sup> 2011 ZASCA 167

<sup>8</sup> (181/2011) [2012] ZASCA 29

## **Bibliography**

Van Jaarsveld v Bridges (344/09)[2010] ZASCA 76; 2010 (4) SA 558 (SCA); [2010] 4 All SA 389 (SCA) (27 May 2010)

ES Cloete v A Maritz (6222/2010) [2013] ZAWCHC 69 (24<sup>th</sup> April 2103)

Ponelat v Schrepfer 2011 ZASCA 167

Butters v Mncora (181/2011) [2012] ZASCA 29

Did You Know No. 5/2012 Deborah Escott – Watson

Living together Glacier by Sanlam 27 May 2014 Cathy Lammas

Financial implications of living together Fourth quarter of 2013 edition of Personal Finance magazine Martin Hesse

# Family business and succession planning thereof



**Ingrid Sout**

LLB

Legal Adviser

PFA : Johannesburg

## Introduction

A family business is a commercial organization which is influenced by generations of families related by blood or marriage. It also has the challenge of aligning family interests with the interests of the business. If both interests are not managed properly, then a conflict of interest is likely to arise. Retirement and letting go of ownership and/or management or control of the family business by senior generation can be problematic, if not properly planned and addressed. Their reservations for letting go can be based on *inter alia* a lack of personal financial security and independence- in other words they may be dependent on the next generation to run the family business successfully and fund their retirement years. A further problem is that the senior generations may have provided personal financial securities to banks and other institutions.

Another challenge is that some of these family members find it hard to retire because they sadly know no life outside of the family business and there is an emotional attachment to the business that they so successfully built. They can't simply let go of the entity that has defined them for many years.

The key aspects to address include planning in advance for the orderly and efficient transfer of assets, financial security for senior generation, and the provision of adequate liquidity to fund estate duty. Tax laws have changed and rates have increased to such an extent that family businesses have had to be sold so that the family could raise the funds to pay estate duty. Succession planning is a process to ensure that a strategic plan is in place to manage a smooth transition of management and ownership of the family business and ensures that the business can survive through successive generations.

There are three phases in life that renders succession planning as a necessity: Death, disability or retirement. In doing a succession plan, you need to accommodate each family member bearing in mind that one family member's goals for the business might not be the same as that of another family member. So the owner/ founder/ manager would have to address the goals of siblings within the business.

If we look at an example where a man successfully created a family business and brought in one of his children, but not his wife or other children. His desire was to reward the child who was in the business to the exclusion of the others by leaving the business to the one child, but leaving his wife and other children equivalent assets.

Often there are not enough assets to divide the estate or assets in the desired manner. In this scenario the lawyer for the business had the business recapitalized to give the wife and other children notes and/or preferred stock so that the increase in value of the business will go to the

child who is in the business, but requiring him to pay off his mother and siblings through the notes and preferred stock.<sup>1</sup>

Another example would be where one sibling had worked in the family business from the start and only gets remunerated in later years. However other siblings join the business and start earning remuneration from the beginning. There are no shares given to any of the siblings or any assets.<sup>2</sup> The one sibling who had worked in the family business from the start could end up not feeling appreciated and feel a sense of unfairness.

This is where the family/owners of the business need to set systems in place to be followed by the siblings in dealing with remuneration and shares. They need a governance structure and a succession plan in the event that something might happen to the owners of the business.

In any family business there needs to be a successor identified. Once that is done methods of transferring the business to the successor can be implemented. This can be done through a use of a will<sup>3</sup> where the testator bequeaths his assets to his identified successors. Wills should be based on the family's continuity plan and future vision, and must be drafted by a competent lawyer. The common practice in the industry of standard wills being drafted, often free of charge, by financial institutions is not recommended as certain institutions insert themselves as executors and may not have taken into account all the issues and dynamics prevalent in families in business. The executor of the will should preferably be a family member and a professional advisor, such as an accountant or attorney who knows and has the family interests at heart. The advantage of having a will drafted is that there will not be any transfer duty<sup>4</sup> on death but the disadvantage is that there will be Capital Gains Tax<sup>5</sup> as well as Estate duty<sup>6</sup> payable on death. Capital gains tax and Estate duty are payable with or without a will being drafted.

Another option to look at would be to transfer ownership through the use of different structures e.g. a trust, company or partnership. The method of a trust offers possible protection from creditors. There is no estate duty for a trust and the successor has certainty as to the date of ownership transfer. However, there will be cost implications, CGT and transfer duty payable. In relation to trusts, the founder and family members should ensure that they retain assets under their control. Trusts still have a role in our economy, for example they protect assets such as shares in the family business from third parties, peg the value of the business and ensure continuity of ownership, particularly where the family have a long-term orientation.

---

<sup>1</sup> A case study from Stan Henlee, CPA: [www.myownbusiness.org/succession](http://www.myownbusiness.org/succession).

<sup>2</sup> A case study from Business Assurance: Business Entities Pre- work learning material, pg 112.

<sup>3</sup> Wills Act 7 of 1953

<sup>4</sup> Transfer Duty Act 40 of 1949

<sup>5</sup> 8<sup>th</sup> schedule of Income Tax Act 58 of 1962

<sup>6</sup> Estate Duty Act 45 of 1955

The final option would be the transfer of ownership through the use of a buy and sell agreement.<sup>7</sup> The senior member can ensure the identified successor has immediate funds available on death or disability to purchase his interests in the business. In order for there not to be any estate duty payable, the identified successor would need to own shares in the business and in taking out a policy on the life of the owner, he would not pay the premiums on his own life. Thus if the agreement is structured correctly there would not be any estate duty. This would be a one sided buy and sell agreement. This agreement gives certainty regarding a succession plan to the planner and successor.

A properly funded buy and sell agreement where life cover is used not only ensures that there is money available for the successor to purchase the business but it also provides the spouse with proceeds of the policy on the sale of the deceased's interest in the business.

## Conclusion

Having a good succession plan in place benefits the successor to the family business. Adequate capital to sustain the family business is important. There are a number of internal and external solutions, including reinvestment of capital, shares, bank overdraft, private equity funds and sale of assets. Care must be taken to ensure that securities provided to banks and other lenders are appropriate to the current and future ownership, management and borrowing circumstances. A good succession plan ensures that there is money left for the spouse and other children. The employees continue with their employment and there are no job losses.

---

<sup>7</sup> An agreement concluded in terms of which members agree that on death or disability the remaining members will purchase the deceased's interest in the business and life assurance policies are used to fund the purchase.

**Bibliography**

[www.myownbusiness.org/succession](http://www.myownbusiness.org/succession)

Business Entities Pre- work learning material.

Wills Act 7 of 1953

Transfer Duty Act 40 of 1949

8<sup>th</sup> Schedule of Income Tax Act 58 of 1962

Estate Duty Act 45 of 1955

# The division of pension interest in respect of Islamic marriages



**Keith Peter CFP®**

B.Soc.Sc, LLB, Adv PG Dip in Fin Plan, Programme in  
Compliance Management, MBA  
Legal Adviser Manager  
Broker Distribution: Durban

## Introduction

Marriages solemnised in terms of the Islamic religion did not enjoy the same legal status as civil marriages registered in terms of the Marriage Act of 1961 (the Marriage Act).<sup>1</sup> This prejudiced the rights of spouses and children born out of these marriages. Examples of such prejudice included the inability to claim maintenance in terms of the Maintenance of Surviving Spouses Act<sup>2</sup>; to inherit in terms of the Intestate Succession Act or to share in pension benefits on divorce in terms of the Divorce Act<sup>3</sup>, without resorting to high court applications.<sup>4</sup>

There have now been changes to the recognition of Islamic marriages and the Pensions Fund Act of 1956 (the "Pensions Fund Act").<sup>5</sup> However, not all the Acts have been amended to recognise Muslim marriages.

Two cases brought before the Pensions Fund Adjudicator - one before and the other after the recognition of Muslim marriage and the amendments to the Pension Funds Act, highlight this discrepancy. These cases dealt with the refusal of employers and retirement fund administrators to pay non-member spouses (married in terms of the Islamic religion) the agreed amount as per divorced orders granted by the High Courts, based on the Divorce Act. This article will examine these cases in light of the division of pension interest in respect of Muslim marriages.

## Recent Changes

On 30 April 2014, over 100 Imams (Muslim clerics) were officially appointed as marriage officers in terms of the Marriage Act. Islamic marriages officiated by these Imams will be legally recognised.

Section 37D(1)(d)(i) of the Pensions Fund Act was amended by Financial Services General Amendment Act, 2013. According to the amendment, a registered fund:<sup>6</sup>

*"(d) may deduct from a member's or deferred pensioner's benefit, a member's interest or minimum individual reserve or the capital value of a pensioner's pension after retirement, as the case may be-*

- (i) Any amount assigned from such benefit or individual reserve to a non-member spouse in terms of a decree of divorce granted under section 7(8)(a) of the Divorce Act, 1979 (Act No. 70 of 1979) or in terms of any order made by a court in respect of the division of assets of a marriage under Islamic law pursuant to its dissolution..."*

---

<sup>1</sup> Marriage Act No. 25 of 1961

<sup>2</sup> Maintenance of Surviving Spouses Act 27 of 1990

<sup>3</sup> Divorce Act 70 of 1979

<sup>4</sup> Meegan Henkeman, 13 June 2014, inNews

<sup>5</sup> Pensions Fund Act No. 24 of 1956

<sup>6</sup> Financial Services Laws General Amendment Act No 45, 2013

### **T Y Tyron v Nedgroup Defined Contribution Pension and Provident Funds and Old Mutual Life Assurance Company (S.A.) Limited**

The marriage between T Y Tyron (Tyron) and her former spouse M S Wade was dissolved on 21 September 2007 in terms of the tenets of the Islamic religion. The dissolution of marriage and the settlement agreement between the parties was made an order of the High Court on 21 September 2011.<sup>7</sup>

M S Wade was a member of the Nedgroup Defined Contribution Pension and Provident Funds. The agreement stated that Tyron was entitled to 50% of the value of the fund calculated from the date of inception to the date of divorce being the date of fasakh (the date on which the marriage was dissolved in terms of the tenets of Islamic religion).<sup>8</sup>

### **Z Paulse v Sanlam Staff Umbrella Pension Fund and Sanlam Life Assurance Limited**

Z Paulse ("Paulse") was married to C Paulse who was a member of the Sanlam Staff Umbrella Pension Fund. The marriage between the Paulses' was dissolved on the 20 February 2013 in terms of the tenets of the Islamic religion. The dissolution of the marriage and the settlement agreement was made an order of the High Court on 25 February 2014.<sup>9</sup>

One of the terms of the settlement agreement was that Z Paulse was entitled to 50% of the pension interest in the Sanlam Staff Umbrella Pension Fund (of which C Paulse was a member). Z Paulse submitted that the respondents refused to pay the pension interest payable in accordance with the settlement agreement.<sup>10</sup>

### **Respondents' submissions**

In Tyron's case, the respondents submitted that the divorce order did not constitute a divorce order in terms of section 7(8)(a) of the Divorce Act and section 37D(1) of the Pensions Fund Act 24 of 1956 (the "Pensions Fund Act"). This prevented it from giving effect to the divorce order and settlement agreement insofar as it pertained to the division of pension interest.<sup>11</sup>

<sup>7</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): T Y Tyron ("complainant") v Nedgroup Defined Contribution Pension and Provident Funds ("first respondent") and Old Mutual Life Assurance Company (S.A) Ltd ("second respondent"), paragraph 2.1

<sup>8</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): T Y Tyron ("complainant") v Nedgroup Defined Contribution Pension and Provident Funds ("first respondent") and Old Mutual Life Assurance Company (S.A) Ltd ("second respondent"), paragraph 2.2

<sup>9</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Paulse ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 2.1

<sup>10</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Paulse ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 2.1

<sup>11</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): T Y Tyron ("complainant") v Nedgroup Defined Contribution Pension and Provident Funds ("first respondent") and Old Mutual Life Assurance Company (S.A) Ltd ("second respondent"), paragraph 4.1.2

Similarly, in Pause's case the respondents submitted that it could not give effect to the court order because there was no divorce as contemplated in terms of section 7(8)(a) of the Divorce Act. The parties were not married in terms of the Marriage Act (i.e. civil marriage), the Recognition of Customary Marriages Act of 1998 or the Civil Union Act of 2006 (Civil Union Act) but in terms of the Islamic religion. As such, the Divorce Act was not applicable to the dissolution of this marriage because it had to be dissolved in terms of the tenets of the Islamic religion. A decree of divorce as contemplated in terms of the Divorce Act was not possible since there was no marriage as contemplated in terms of the Divorce Act.<sup>12</sup>

Further, it was submitted in Pause's case that Section 37A of the Pensions Fund Act prohibits the reduction, transfer and cession of retirement funds except under certain circumstances described in section 37D of the Pensions Fund Act e.g. a valid section 7(8) order. It was averred that section 37D(4) of the Pensions Fund Act did not apply to the dissolution of Islamic marriages as this section only applies to section 7(8) orders.<sup>13</sup>

The respondents submitted in Tyron's case that the member's accumulated credit the fund was not an asset in his estate during his membership of the retirement fund. It becomes an asset in his estate when he exits the fund because at that stage he is due a benefit. This was substantiated by reference to section 7 of the Divorce Act which states that a member's pension interest will only form part of the member's assets in the marriage if the parties were married in community of property or married out of community of property with or without the application of the accrual system. It was submitted by the respondents that Tyron and Wade were not married in terms of any of these regimes and as such the pension interest was not part of Wade's estate. It was further submitted that no date of divorce could be ascertained for the calculation of the value of pension interest.<sup>14</sup>

In Pause's case the respondents submitted that there was a shortcoming in legislation in that the Financial Services General Laws Amendment Act 2013 only amended section 37D(1)(d)(i) of the Pensions Fund Act while there were many provisions in the Pensions Fund Act, Income Tax Act of 1962 and Divorce Act which required amendment before orders following the dissolution of Islamic marriages could be accepted.<sup>15</sup>

---

<sup>12</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Pause ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 4.3

<sup>13</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Pause ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 4.4

<sup>14</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): T Y Tyron ("complainant") v Nedgroup Defined Contribution Pension and Provident Funds ("first respondent") and Old Mutual Life Assurance Company (S.A) Ltd ("second respondent") paragraph 4.1.3

<sup>15</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Pause ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 4.8

### Tribunal's responses:

The issue in both cases was whether the respondents were justified in their refusal to pay the pension interest in terms of the court order following the dissolution of a marriage in terms of the tenets of Islamic religion and if this refusal to was sanctioned by the law.

Reference was made to *Amod v Multifateral Motor Vehicle Accidents Fund [1999]*<sup>16</sup> ("Amod") and *Daniels v Campbell NO and Other [2004]*<sup>17</sup> ("Daniels"). The court held in Amod's case the question was not whether the customary marriage was lawful but whether there was a legal obligation for the deceased to support the appellant during the marriage and if this required protection. The court held in Daniels' case that the issue was not the legality of the marriage but if the protection which the Acts intended widows to enjoy should be withheld from Muslim widows. The court held that in terms of the Constitution, common sense and justice, the objectives of the Divorce Act would be best served by including a Muslim spouse in the protection provided.<sup>18</sup>

The tribunal referred to the definition of pension interest. Pension interest in terms of section 1 of the Divorce Act and section 37D(4) of Pensions Fund Act is the benefit that the member would have been entitled to had he withdrawn from the fund on the date of divorce.<sup>19</sup> The tribunal relied on the amendment to Section 37D(1)(d)(i) of the Pensions Fund Act as amended. This amendment according, to the tribunal, allowed a registered fund to make deductions to satisfy a court order in respect of the division of pension interests where the parties were married under Islamic law.<sup>20</sup>

The tribunal did acknowledge the shortcomings of the Financial Services General Amendment Act, 2013 and the need for amendments to other Acts to give full effect to section 37D(1)(d)(i). However, the tribunal stated that the intention of the legislature was to provide equal treatment to spouses married in terms of Islamic law as accorded to spouses married in terms of civil and customary marriages when dealing with the division of patrimonial assets on the dissolution of such marriage.<sup>21</sup>

<sup>16</sup> *Amod v Multifateral Motor Vehicle Accidents Fund [1999]* (4) SA 1319 (SCA)

<sup>17</sup> *Daniels v Campbell NO and Other [2004]* (5) SA 331 (CC)

<sup>18</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): T Y Tyron ("complainant") v Nedgroup Defined Contribution Pension and Provident Funds ("first respondent") and Old Mutual Life Assurance Company (S.A) Ltd ("second respondent"), paragraph 5.3

<sup>18</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Pause ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 5.3

<sup>19</sup> Pensions Fund Act No. 24 of 1956

<sup>20</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Pause ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent") paragraph 5.5

<sup>21</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Pause ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 5.7

Insofar as the date of dissolution of the marriage being undeterminable, the tribunal held that the date of divorce could be determined by reference to fasakh (i.e. the date of divorce in terms of the Islamic religion). Thus the member's fund value could be easily calculated. Therefore the agreements were in line with the definition of pension interest as contained in the Divorce Act.<sup>22</sup>

## Review of the submissions

Marriages concluded under the Marriage Act are dissolved either by way of death of one of the spouses or by a divorce action initiated under Divorce Act. In terms of section 7 of the Divorce Act, a court is allowed to grant a divorce in respect of a marriage in community of property and a marriage out of community of property whether subject to accrual system or not. In terms of the Recognition of Customary Marriages Act 120 of 1998<sup>23</sup>, the Divorce Act applies to the dissolution of customary marriages.<sup>24</sup>

The Civil Union Act does not contain any provisions that govern the dissolution of civil unions. According to Gamble J in *Steyn v Steyn* [2010]<sup>25</sup>, "the legislature intended that section 13(2)(a) of the Civil Union Act should incorporate the relevant provisions of the Divorce Act as the applicable statute for the dissolution of civil unions. Section 13(2)(a) of the Act specifically incorporated a reference to the word marriage "in any other law" as being a reference also to a "civil union".

The judge stated that the Divorce Act is regarded as "other law" for the purposes of the application of the section 13(2)(a) of the Civil Union Act. As such reference in the Divorce Act to "marriage" will apply to civil marriage and a civil union. It was concluded that the Divorce Act was applicable to the dissolution of civil unions.

It is clear that the Divorce Act does not govern the dissolution of marriages conducted according to the tenets of the Islamic religion. However, the recognition and accreditation of 100 Imams as marriage officers allows parties married according to the Islamic religion to have their marriages registered in terms of the Marriage Act and thus the Divorce Act will be applicable to the dissolution of such marriages.

---

<sup>22</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"); T Y Tyron ("complainant") v Nedgroup Defined Contribution Pension and Provident Funds ("first respondent") and Old Mutual Life Assurance Company (S.A) Ltd ("second respondent"), paragraph 5.8

<sup>23</sup> Section 8(3) of the Recognition of Customary Marriages Act 120 of 1998

<sup>24</sup> Section 6 of the Divorce Act 70 of 1979

<sup>25</sup> *Steyn v Steyn* [2010] ZAWCHC 224

The tribunal's response took into consideration the Constitutional Court case of Daniels where Sachs J stated that the word "spouse" included parties to a Muslim marriage.<sup>26</sup> The tribunal has a human rights slant in its response as it was stated that to wait for amendments to the relevant Acts would result in injustice and discrimination continuing against parties married and divorced in terms of Islamic tenets. It was the tribunal's view that the legislature intended for spouses married in terms of Islamic tenets to be accorded the same and equal treatment as given to civil and customary marriages.<sup>27</sup>

## Conclusion

Although the Divorce Act has not being amended to govern the dissolution of marriages performed in terms of the Islamic religion (unless solemnised by an accredited Imam), parties will still have recourse for patrimonial benefits flowing from the dissolution of such marriages. This is in light of the above-mentioned two cases decided by the Pensions Fund Adjudicator. However, the relevant Acts have to be amended to provide security for spouses in these marriages. The amendment to section 37D(4)(1)(i) is a step in the right direction but can be viewed as minimal in the absence of corresponding changes to other linked pieces of legislation. If these changes are not attended to spouses in these marriages would be forced to resort to relevant tribunals to obtain satisfaction or worse still be deprived of benefits rightfully due to them.

---

<sup>26</sup> Daniels v Campbell NO and Other [2004] (5) SA 331 (CC)

<sup>27</sup> Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Pause ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent"), paragraph 5.7

## Bibliography

Amod v Multilateral Motor Vehicle Accidents Fund [1999] (4) SA 1319 (SCA)

Daniels v Campbell NO and Other [2004] (5) SA 331 (CC)

Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): T Y Tyron ("complainant") v Nedgroup Defined Contribution Pension and Provident Funds ("first respondent") and Old Mutual Life Assurance Company (S.A) Ltd ("second respondent")

Determination in terms of Section 30M of the Pensions Fund Act, 24 of 1956 ("the Act"): Z Paulse ("complainant") v Sanlam Staff Umbrella Pension Fund ("first respondent") and Sanlam Life Assurance Limited ("second respondent")

Divorce Act No. 70 of 1979

Financial Services Laws General Amendment Act No 45, 2013

Henkeman, Meegan, Muslim marriages in South Africa get long deserving full recognition, 13 June 2014, inNews

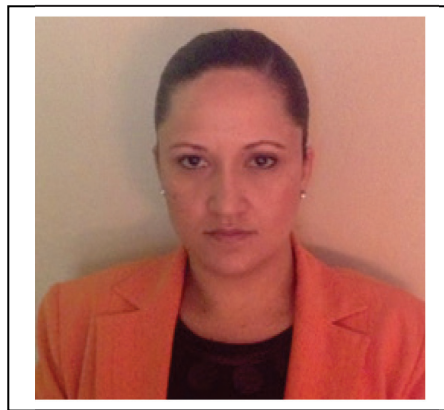
Marriage Act No. 25 of 1961

Pensions Fund Act 24 of 1956

Recognition of Customary Marriages Act 120 of 1998

Steyn v Steyn [2010] ZAWCHC 224

# FICA Amendment Bill 2015 – An overview



**Roslynn Petersen**

LLB

Legal Adviser

PFA : Pretoria

## Introduction

Money laundering, in a nutshell, can be described as the process or means of disguising proceeds from an illegal activity/source with proceeds from a legal source. As financial planners/advisers we deal with transactions on a daily basis and thus need to be aware of the types of transactions that we are concluding with clients and more so these transactions need to be concluded within the prescripts of the laws of South Africa.

There are generally three recognised steps to identify the process of money laundering<sup>1</sup>:

- (1) The stage wherein proceeds enter the financial system is known as Placement;
- (2) The next stage is Layering, this is where the proceeds are separated from their criminal source by blurring the trail of the source; and
- (3) The last stage, is where transactions are designed to make the money available to the criminal again, this is known as Integration.

There are two types of indicators of money laundering, if one is familiar with these indicators, it is easier to identify possible money laundering activities<sup>2</sup>:

### (1) Transaction indicators

- Large once-off cash transactions
- Overseas business from higher-risk jurisdictions
- Client's lack of concern for expensive charges or other costs
- Stated purpose for transacting is inconsistent with the nature of the transaction
- Payments for products or services made by parties other than the customer or client
- Multiple sources of funds to pay for products or services
- Overpayment for product or services, in order to claim a refund
- Unusual and unexplained transactional patterns
- Over-invoicing or under-invoicing for goods and services
- Multiple invoicing for goods and services

---

<sup>1</sup> Botha M & Others (131:2015).

<sup>2</sup> *Id.* at 134.

## (2) Client indicators

- Use of false information
- Use of complex structures
- Transactions inconsistent with the customer or client profile
- Customer or client is a known criminal, or is related to, or associates with, a known criminal
- Erratic or unusual behaviour by the customer or client
- Significant and unjustifiable geographic distance between customer and client or institution
- Undue interest in the early-termination or early-withdrawal options when money has been invested for a fixed period
- Refusal or reluctance to indicate the source of funds or the nature of the business conducted
- Extraordinary concern for secrecy
- Attempts to avoid ordinary record-keeping or reporting
- Apparent lack of knowledge or understanding of the transaction or industry
- Use of bearer shares
- Use of nominees and trustees

The indicators listed above are just a few, there are others and one should not take comfort in the notion that these are the only indicators.

The aim of this article is to give the reader basic insight into the objectives behind the Financial Intelligence Centre Amendment Bill 2015.

### **Financial Intelligence Centre Act<sup>3</sup> (hereinafter referred to as “FICA”)**

The purpose of FICA is to keep money laundering activities and terrorist financing under control, through prescribing a legislative framework that defines the requirements and procedures in the form of “control measures” that must be followed by “accountable institutions” and members of the public to assist in the detection of money laundering activities and terrorist financing under control.<sup>4</sup>

FICA is the Act that enables the Financial Intelligence Centre (“FIC”) to oversee and take action where necessary for all matters concerning the laundering of money in South Africa and

---

<sup>3</sup> 38 of 2001

<sup>4</sup> Botha, *supra* note 1, at 140.

plays an important role in developing policy and efforts to counter money laundering activities.<sup>5</sup>

There are also two Acts that work hand-in-hand with FICA; these are the Prevention of Organised Crime Act<sup>6</sup> ("POCA") and the Protection of Constitutional Democracy against Terrorist and Related Activities Act<sup>7</sup> ("POCDATARA"). POCA prescribes the offences that relate to money laundering and POCDATARA prescribes offences related to terrorism and terrorist activities including the financing thereof.

### **Background of South Africa's relationship with the World**

South Africa (hereinafter referred to as "SA") has a long-standing commitment to combating money laundering and the financing of terrorism. In 2003 SA joined the multi-lateral Financial Action Task Force (hereinafter the referred to as the "FATF") and accepted the United Nations Convention Against Corruption in 2004.

The FATF is an inter-governmental body which sets standards and develops and promotes policies to: combat money laundering, the financing of terrorism and the proliferation of weapons of mass destruction. These standards are used as benchmarks in formal peer review and evaluation processes to test the robustness of a country's measures against these illicit activities, and the integrity of its financial systems.<sup>8</sup>

The 2009 FATF evaluation of the SA anti-money laundering ("AML") and combating of financing terrorism ("CTF") regime, included a review of the relevant AML and CTF laws and regulations, and the supervisory and regulatory systems in place to deter money laundering and terrorism financing. The FATF's evaluation is considered in order to identify issues that require review.<sup>9</sup>

South Africa has adopted the results of the 2009 FATF evaluation and has since then been reporting to the FATF on a regular basis, on steps taken to improve its system.

### **The FICA Amendment Bill 2015 ("the Bill")**

"The Bill seeks to enhance SA's ability to combat financial crimes and has proposed measures to address threats to the stability of SA's financial system posed by money laundering and terrorism financing. It also addresses gap's identified from the 2009 FATF Mutual Evaluation and the 2014 IMF SA Financial Sector Assessment Programme Technical Note on AML/CFT".<sup>10</sup>

---

<sup>5</sup> *Id.* at 142

<sup>6</sup> 121 of 1998

<sup>7</sup> 33 of 2004

<sup>8</sup> Draft Bill, para.1.1.

<sup>9</sup> *Id.* para.1.2.

<sup>10</sup> Media Statement, para.6.

The primary objective of the Bill is to establish a stronger AML and CTF regulatory framework by, amongst other things:

- (1) Introducing the concept of beneficial ownership, ongoing due diligence and foreign and domestic influential persons;
- (2) Enhancing customer due diligence requirements;
- (3) Providing for the adoption of a risk based approach in the identification and assessments of AML & CTF risks;
- (4) Providing for the implementation of the United Nations Security Council Resolutions relating to the freezing of assets;
- (5) Dissolving the Counter-Money Laundering Advisory Council;
- (6) Extending the functions of the FIC in relation to suspicious transactions;
- (7) Enhancing the supervisory powers of accountable institutions; and
- (8) Enhancing certain administrative and enforcement mechanisms.

## **Highlights of the Bill:**

### **(1) Enhancing customer due diligence**

Over and above the normal client identification and verification processes. The Bill introduces two new concepts under customer due diligence requirements: the on-going due diligence of the customers transaction records; and the enhanced measures for persons entrusted with prominent public or private sector functions, whenever accountable institutions establish business relationships with customers.

### **(2) Providing for the adoption of a risk based approach in the identification and assessments of AML & CTF risks**

The implementation and adoption of this approach is largely dependent on the financial institutions AML and CFT Risk and Management programme. The financial institution will be responsible to develop, document, maintain and implement the AML and CFT risk and management programme. The responsibility for ensuring that a financial institution is compliant with this is placed on the board of directors and senior management of the accountable institution. The adoption of this approach will simplify the current complex and rules-based system, by providing financial institutions with the flexibility on how they verify and identify their clients.

### **(3) Providing for the implementation of the United Nations Security Council ("UNSC") Resolutions relating to the freezing of assets**

The UNSC passed a resolution which requires accountable institutions to freeze assets of individuals that appear on the UNSC sanctions list. The Bill empowers the FIC to administer the measures adopted by the UNSC resolutions. The concept of Prominent Influential Persons

("PIPS") is also introduced here and directions are given as to how the assets of PIPS are to be handled should they appear on the sanctions list.

#### **(4) Extending functions of FIC in relation to suspicious transactions**

The functions of the Financial Intelligence Centre are extended to allow them where appropriate, to initiate the analysis of suspicious transactions based on information in its possession or information received from a source other than from information disclosed to it by accountable institutions. The Bill also mandates the FIC to provide information and guidance to accountable institutions, which will assist the FIC to meet the requirements to freeze property and transactions pursuant to the sanctions list.

#### **(5) Enhancing supervisory powers of accountable institutions**

The Bill also brings about amendments to place an obligation on accountable institutions to ensure that their employees are trained to comply with the FIC Act, as well as their respective Risk Management and Compliance Programmes. The FIC is empowered to issue directives, after consultation with the relevant supervisory body, in instances of general application of the Act, or in specific instances set out in the Bill.

### **Conclusion**

"Proposed amendments to the Financial Intelligence Centre Act will clamp down even more severely on money laundering and corruption, enhancing the supervisory powers of the Financial Intelligence Centre and introducing the concept of Prominent Influential Persons".<sup>11</sup>

Essentially the amendments will make it tougher for individuals to "get away" with money laundering activities because of the tighter measures that need to be implemented by companies.

---

<sup>11</sup> Barry, para.1.

## **Bibliography**

Botha M & Others. (2015). The South African Financial Planning Handbook 2015. LEXISNEXIS Durban

MEMORANDUM ON THE OBJECTS OF FINANCIAL INTELLIGENCE CENTRE AMENDMENT BILL, 2015 – DRAFT

MEDIA STATEMENT – REQUEST FOR PUBLIC COMMENTS ON THE DRAFT FINANCIAL CENTRE AMENDMENT BILL, 2015

Hanna Barry. *FICA set to gain more clout*. Moneyweb.

Available from

<http://www.moneyweb.co.za/news/south-africa/fica-set-to-gain-more-clout/>

# Practical application of Section 54 of the Long Term Insurance Act



**Lohu Makgamatha**

LLB

Legal Adviser

Broker Distribution: Johannesburg

## Introduction

Section 54 of the Long Term Insurance Act<sup>1</sup> is a piece of legislation which is often misinterpreted, and some find it difficult to apply. This article looks at the simplified practical application of the restrictions embodied by Section 54 and the Regulations.

## Background

Section 54 refers to the Regulations to the Act that imposes certain restrictions on certain policies. The broad principles of the restrictions laid down by section 54 and the Regulations, state that life insurers may not:

- ❑ Pay an endowment type benefit within 5 years of a policy's commencement date;
- ❑ Pay annuities over less than 5 years or vary them by more than 20% from year to year;
- ❑ Pay more than a loan or surrender that exceeds all premiums plus 5% compound interest within 5 years of policy commencement; and
- ❑ Increase premiums by more than 20% of the higher of the total premiums paid in any one of preceding two years unless the restrictions above are applied again.

## What is the purpose of this section?

The purpose of the restrictions imposed by section 54 on long term policies is to ensure that long term insurance companies do not compete with banking products and that they remain true to their long term insurance license conditions. It limits the tax advantages to be gained by the injection of large amounts into a policy shortly prior to maturity (the pay-out date).<sup>2</sup>

## When does section 54 apply?

This section applies to endowment policies, which can be described as a life insurance contract designed to pay a lump sum after a specified term or on death. Alternatively, the policy could be open ended.<sup>3</sup> Section 54 does not apply to retirement annuities, pension and provident funds. It also does not apply to friendly societies. Legislation allows single and recurring premiums, however with regards to recurring premiums; the intervals may not be longer than 12 months.<sup>4</sup>

---

<sup>1</sup> 52 of 1998

<sup>2</sup> See Marius Botha, Corporate and Personal Financial Planning Chapter 8, 8.1, 2015 Edition

<sup>3</sup> Premiums and Problems Article Edition 100, January 2010, Tax and Legal Implications on Wrapper by Jothi Chirkoot C15

<sup>4</sup> See Old Mutual Premiums and Problems Edition 109 (2014) F9

## Application of the Section

### Facts:

John Smith took out a ten year endowment policy on 01 January 2015 and he pays a recurring monthly premium of R250 [R3 000 per year]. The policy includes a 10% annual premium increase.

### What is a 'restriction period'?

The section restricts access to the funds within an insurance policy for a certain time. This period is called the 'restriction period'. The restriction period starts when the first premium period begins, or during a premium period after the first, on the first day of the month in which an excess premium is received by the insurer.<sup>5</sup>

### Example:

Between 01 January 2015 and 31 December 2019 Mr Smith's policy is restricted.

### Is the restriction period always applicable?

The restriction period is not applicable during certain events, for example:-

- at the death of a policyholder;
- curatorship or sequestration of an estate of the policyholder who is a natural person; and
- at the winding-up, liquidation, curatorship or judicial management, upon a court order of a juristic person.<sup>6</sup>

### What is allowed within the restriction period?

The policyholder is allowed only one loan and one surrender against the policy during this period. Once the restriction period has passed the policyholder may make as many loans and surrenders against the policy as the policy value allows.

### Example:

Between 01 January 2015 and 31 December 2019 Mr Smith is allowed one loan, and one surrender against his policy. The maximum amount that can be taken by Mr Smith via a loan or surrender during the restricted period is premiums paid plus interest at 5% compounded annually.

---

<sup>5</sup> *Id* at F10

<sup>6</sup> Premiums and Problems *Supra* note 4 F11

**What is the 20% rule?**

According to Section 54, premiums may not be increased by more than 20% of the higher of the premiums paid in the immediately preceding two premium periods in the restricted period. This rule applies throughout the existence of the policy, not only during the restriction period.

Should a premium payer wish to make a large lump sum payment into the policy after the expiry of the term, the policy will start with a new restriction period, starting from the anniversary date of the year in question.

**Example:**

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
R3 000	R3 300	R4 125							

20% of R3 300 is R660 and R660 plus R3 300 is R3 960. Therefore the maximum premium allowed in 2017 to not contravene the 20% rule is R3 960. And the R4 125 is a contravention of the rule. The premium payer breaches the 20% rule if he misses a premium and is double debited. Also, if the premium payer just invests a lump sum amount in 2015, nothing in 2016 and nothing in 2017, adding even 1 cent in year 2018 will extend the restriction period as no contributions were made in the immediate previous 2 years.

**What happens if a premium payer breaches the 20%?**

Another restriction period commences at the moment the breach/ contravention is made. If the policy is still within the first restriction period, the new restriction period will run concurrently with the first restriction period; and this is known as an 'extended restriction period'.

**Example:**

Mr Smith, by paying the R4 125 in 2017 enters an extended restriction period.

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
R3 000	R3 300	R4 125							

Mr Smith enters into an extended restriction period which runs concurrently with the initial restriction period, and instead of the restriction period ceasing at the end of year 2019, the extended restriction period will now run until the end of year 2021.

If Mr Smith has already made his one loan, and one surrender in 2016, he cannot make another loan or surrender within the extended restriction period.

### **What is the 5% rule?**

This is also known as a 'restricted amount'; and it means an amount equal to the aggregate of the 'free surrender value' plus the total value of premiums in an extended restriction period plus 5% compound interest per annum, less the aggregate of all payments already made by the insurer in respect of the policy in the extended restriction period, plus 5% compound interest per annum.<sup>7</sup> The restricted amount only applies to surrenders and loans, and does not apply at the policyholder's death.

### **What is the 'free surrender value'?**

It means the value of the consideration which the insurer would provide if the policy is surrendered on the day preceding the date of commencement of an extended restriction period.<sup>8</sup>

### **What would the difference be if it was an annuity instead of a life policy?**

The payments by the insurer to the insured must be made at intervals not exceeding twelve months. At least one of the payments that is to be made to the insured must be made after the commencement of the period of 31 days preceding the expiry of the extended restriction period concerned.<sup>9</sup>

No loans are allowed against annuities. Only one surrender or part-surrender is allowed against an annuity during an extended restriction period.

### **Conclusion**

It is clear from the above that careful consideration should be given to the interpretation and application of the section when advising clients. The restrictions, if not properly understood by an advisor can lead to frustrations and unhappy clients.

---

<sup>7</sup> Premiums and Problems *Supra* note 4 at F10

<sup>8</sup> Premiums and Problems *Supra* note 4 at F9

<sup>9</sup> Premiums and Problems *Supra* note 4 at F11

**Bibliography**

Corporate and Personal Financial Planning 2015 Edition, Marius Botha

Long Term Insurance Act 52 of 1998 and Part 4 of the Regulations

Old Mutual Premiums and Problems Edition 109 (2014)

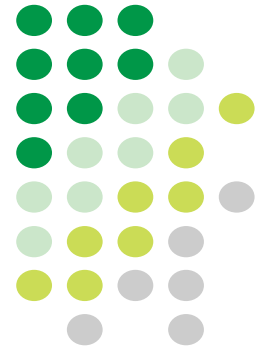
Premiums and Problems Article Edition 100, Tax and Legal Implications on Wrapper by Jothi Chirkoot

DO GREAT THINGS



**OLDMUTUAL**

Licensed Financial Services Provider



# Estate Planning

# The provision of maintenance for a surviving spouse



**Natalie Dillon CFP®**

BCom (Law), LLB, Adv PG Dip in Fin Plan

Legal Adviser Advanced

Broker Distribution : Western Cape and East Coast Regions

## Introduction

The principle of the freedom of testation is recognised under South African law. However, there are instances where this freedom is limited – *inter alia* a bequest must not be illegal or against public policy. Another such exception is a claim under the Maintenance of Surviving Spouses Act<sup>1</sup> (the Act) which came into law on 1 July 1990.

Prior to the enactment of the Act, a surviving spouse did not have a right to claim maintenance from the estate of the deceased spouse.<sup>2</sup> In terms of the Act, the surviving spouse shall have a claim for 'reasonable maintenance'<sup>3</sup> from the estate of the deceased spouse. Should such claim arise, a financial obligation is placed on the deceased spouse's estate - this potential claim is often overlooked and the failure to make provision for the maintenance of a surviving spouse, could have far reaching consequences for the estate of the deceased and intended heirs of such estate.

## Who qualifies as a spouse?

The claim for maintenance is in favour of the 'survivor'<sup>4</sup> which means:

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

The Act contains no definition of 'marriage', but the decision handed down in *Daniels v Campbell*<sup>5</sup> confirms that the surviving spouse of a marriage by religious rites or by a customary union will also qualify as a marriage under the Act. The survivor of a civil union is also included under the Act since the legal consequences of a marriage contemplated under the Marriage Act<sup>6</sup> extend to a civil union under the Civil Union Act.<sup>7</sup>

In terms of the Constitutional Court decision handed down in *Volks NO v Robinson & another*<sup>8</sup>, partners in a permanent life partnership are not provided for under the Act.

## What is a qualifying spouse entitled to claim?

The claim that arises is one for the 'reasonable maintenance'<sup>9</sup> needs of the surviving spouse until that spouse's death or remarriage and is limited in so far as he/she is not able to provide such maintenance from his/her own means and earnings.

---

<sup>1</sup> Act 27 of 1990

<sup>2</sup> Law and Estate Planning Easiguide 2004/2005 Ronald King and Brian Victor

<sup>3</sup> Section 2(1) of Act 27 of 1990

<sup>4</sup> Section 1 of Act 27 of 1990

<sup>5</sup> *Daniels v Campbell* NO 2004 (5) SA 331 (CC)

<sup>6</sup> Act 25 of 1961

<sup>7</sup> Act 17 of 2006

<sup>8</sup> *Volks NO v Robinson & another* (CC) Case No CCT12/04

<sup>9</sup> Section 2 (1) of Act 27 of 1990

In terms of the Act, 'reasonable maintenance' is determined by taking the following factors into account:

- (a) The amount in the estate of the deceased spouse available for distribution to heirs and legatees;
- (b) The existing and expected means, earning capacity, financial needs and obligations of the survivor and the subsistence of the marriage; and
- (c) The standard of living of the survivor during the subsistence of the marriage and his (or her) age at the death of the deceased spouse

Any additional factors which should be taken into account will also be considered.

Of interest is the fact that, when considering what an amount of 'reasonable maintenance' is, acts of generosity by third parties (for example monthly payments to a mother by her children from a previous marriage after the death of her current husband, as was the case in the Oshry case<sup>10</sup>) are not taken into account when determining the maintenance requirements of the surviving spouse.

Since the survivors' claim does not extend beyond his own 'reasonable maintenance needs', one must consider the definition of 'own means' in terms of the Act<sup>11</sup>:

'own means' includes any money or property or other financial benefit accruing to the survivor in terms of the matrimonial property law or the law of succession or otherwise at the death of the deceased spouse.

It is thus clear that any benefit that the surviving spouse receives from the dissolution of the marriage under Matrimonial Property Law (accrual claim, for example), or from the estate of the deceased will be taken into account in determining the amount of the claim. Policy proceeds, cash, income generating properties etc. received by the spouse will thus be considered as assets from which maintenance can be generated for the survivor.

Under Section 2(3)(d) of the Act, the executor has the power to enter into an agreement with the survivor and heirs and legatees of the estate. This provision provides flexibility for the manner in which provision is made for the survivor's claim for maintenance and to facilitate a settlement between the parties.

### **How does the claim rank in respect of creditors?**

The claim that is instituted enjoys the same preference in respect of other claims against the estate as a claim for maintenance of a dependant child of the deceased - i.e. it does not compete with the claims of any creditors, but is satisfied before any assets are distributed in

---

<sup>10</sup> Oshry and Another NNO v Feldman 2010 (6) SA 19 (SC)

<sup>11</sup> Section 1 of Act 27 of 1990

terms of the deceased's last will and testament. If these claims should compete, they will be reduced proportionately.<sup>12</sup>

### **When must the claim be instituted?**

Proof of the claim, and disposal thereof, is dealt with in accordance with the Administration of Estates Act<sup>13</sup> in terms of which the surviving spouse's claim should be lodged before the expiry of the notice given by the executor calling for claims to be lodged. A later claim is, however, not expressly excluded.

The claim can thus be instituted against the estate at any time but it must be noted that if the executor has paid out, delivered or transferred any assets of the deceased's estate to any heir or legatee under the deceased's will, the survivor shall have no claim or right of recourse against such recipient of a benefit.<sup>14</sup>

### **The impact on estate planning**

The claim against the estate will rank as a debt that is due and payable by the estate and will thus qualify for a deduction under section 4 of the Estate Duty Act<sup>15</sup> even if this was not the case, it is a benefit that is due to the surviving spouse and would qualify for a deduction under section 4(q).<sup>16</sup>

The effect of this is that the claim reduces the dutiable estate of the deceased where it is settled from assets that form part of the deceased estate. Where a life policy is taken out to provide for the maintenance of the surviving spouse, the policy will not increase the dutiable estate of the deceased as the proceeds will qualify for the deduction under section 4(q).

Since the testator's freedom of testation is limited by the Act, careful attention must be paid to the provisions thereof and their impact on the testamentary wishes of the testator.

This is of particular relevance where a testator bequeaths the residue of his estate to a third party and the surviving spouse is not provided for in terms of 'reasonable maintenance'.

For example – a farmer married out of community of property bequeaths the residue of his estate (which includes farm land, livestock and implements) to a family trust and intends for the trustees to continue the farming operation. There is no usufruct created in favour of the surviving spouse and no life policies that pay to her. At the farmer's death, the surviving spouse

---

<sup>12</sup> Section 2(3)(b) of Act 27 of 1990

<sup>13</sup> Section (29) (1)

<sup>14</sup> Section 2(2) of Act 27 of 1990

<sup>15</sup> Estate Duty Act 45 of 1955

<sup>16</sup> Estate Duty Act 45 of 1955

can institute a claim under the Act. There is thus a risk that the farmer's bequest will not be effected and/or that assets of the estate will either need to be distributed to the surviving spouse or sold by the executor to settle the claim for 'reasonable maintenance'.

An alternative is for the parties to enter into an agreement as envisaged in section 2(3)(d) of the Act<sup>17</sup> – for example a bequest to an heir is honoured subject to the condition that an amount of maintenance is paid to the surviving spouse by the heir. As explained by Meyerowitz<sup>18</sup>, this could have negative tax consequences for both the heir and the surviving spouse.

A life policy on the farmer's life, on which his spouse is the beneficiary, is a very effective solution for this problem as the policy proceeds will be regarded as part of the surviving spouse's 'own means' from which maintenance can be generated. It is a benefit that accrues to the surviving spouse at the death of the farmer and it will be regarded as either a deduction under section 4(q) or the claim will qualify as a deduction as it will rank as a debt that is due and payable by the estate.

## Conclusion

The limitation on the freedom of testation that arises as a result of the provisions of the Act cannot be overlooked when drafting a will for a client. It is clear from the above that a bequest of assets to a third party (i.e. other than a surviving spouse) will not be given effect until a claim for maintenance by the surviving spouse has been settled by the estate.

It is imperative that clients are advised to plan properly by making provision for the maintenance of their surviving spouse. This can effectively be done by way of bequests to the spouse, or by way of a beneficiary nomination on a life policy.

Failure to make provision for the maintenance of the surviving spouse could give rise to a claim against the deceased's estate which would not only delay the winding up of the estate but could also prevent the intentions of the testator being given effect to.

---

<sup>17</sup> Act 27 of 1990

<sup>18</sup> Meyerowitz on Administration of Estates and Estate planning, 15.79A

## **Bibliography**

Law & Estate Planning Easiguide 2005/2006, R King, B Victor

Meyerowitz on Administration of Estates and Estate Duty 2007, D Meyerowitz

The South African Financial Planning Handbook 2013, M Botha, L Rossini, W Geach, B Goodall, L du Preez & P Rabinowitz

Maintenance of Surviving Spouses Act 27 of 1990

Estate Duty Act 45 of 1955

Administration of Estates Act 66 of 1965

Marriage Act 25 1961

Civil Union Act 17 of 2006

## **Case Law**

Daniels v Campbell NO 2004 (5) SA 331 (CC)

Volks NO v Robinson & another (CC) Case No CCT12/04

Oshry and Another NNO v Feldman 2010 (6) SA 19 (SC)

# The validity of a Pactum Successorium contained in an Antenuptial Contract



**Deborah Escott-Watson CFP®**

BA LLB, Adv PG Dip in Fin Plan

Legal Adviser Manager

PFA : Durban

## Introduction

The most important question that a financial advisor must ask married clients is which matrimonial property regime governs their marriage. The answer will affect every aspect of their financial planning. In the context of estate planning, knowing whether or not a hefty accrual claim could scupper the best laid plans of mice and men is crucial for the effective operation of the plan. However, an Antenuptial Contract (ANC) might contain another surprise for the unwary financial advisor that could cause difficulties for the surviving family if not dealt with appropriately in a Will. Some people use their ANC as a form of will, by incorporating a pactum successorium into the ANC.

This article will highlight the importance for financial advisors of proper examination of a client's ANC when involved in estate planning, and understanding what the implications are for the ultimate devolution of a client's estate if a pactum successorium is overlooked, or not understood.

## Pacta Successoria explained

The freedom of testation is a fundamental principle of our law. A person is entitled to do whatever he or she wishes to do with their property on their death, provided it is not in conflict with socially accepted norms or public policy. This disposition of estate on death is done by means of a will, with required execution formalities that must be adhered to.<sup>1</sup> If the required formalities are not adhered to, then the will is prima facie invalid, with an application to Court necessary to have the will accepted.

However, sometimes people enter into a contract with another person where it is agreed how property must be dealt with on death. These types of agreements are called pacta successoria. They are for the most part invalid in our law and unenforceable as they function to limit the freedom of testation and are seen as an evasion of the execution formalities required in respect of testamentary instruments.<sup>2</sup>

## Pacta Successoria contained in an Ante Nuptial Contract

However a pactum successorium contained in an ANC is not invalid, and is enforceable.

Pacta successoria contained in an ANC are seen as part of the matrimonial property agreement between spouses<sup>3</sup> and therefore valid. Such a disposition of property is not seen as a testamentary act, and so does not need to comply with the formalities laid out in the Wills

---

<sup>1</sup> The Wills Act 7 of 1953

<sup>2</sup> *McAlpine v McAlpine* NO 1997 (1) SA 376 (A)

<sup>3</sup> *Ladies Christian Home v SA Association* 1915 CPD 467 471 - 472

Act.<sup>4</sup> As long as the execution and registration of the ANC complies with the relevant formalities laid out in the Deeds Registry Act<sup>5</sup>, then such clauses are valid.

As the ANC is a contract signed by both parties, the disposition in the ANC which will take effect on death, cannot be changed by only one party in a later will as both parties will have to consent to the change. It is possible to amend the ANC during the subsistence of the marriage and revoke the pactum successorium, or alternatively, a joint will of both parties would be sufficient to revoke the pactum successorium.<sup>6</sup>

Let us consider the example of Daisy, who was married to Donald out of community of property in 1997. The ANC entered into between Daisy and Donald made the accrual system applicable to their marriage and also contained the following clause:

“And the parties further declared that in the event of Daisy surviving Donald she shall be entitled by way of a Pactum Successorium to the following assets of Donald:

- 14 Park Avenue, Durban
- Any motor vehicle belonging to Donald at the date of death
- Half of the balance of the Estate of Donald”

In 2012, Donald executed his Will with the assistance of a financial advisor, who did not ask to see the ANC, and the bequest clauses were as follows:

I bequeath:

- My motor vehicle to my son, Hewey
- The proceeds of my ABC Bank current account to Hewey
- The proceeds of my XYZ Bank account to my two minor grandchildren, Dewey and Louie
- The residue of my estate to my wife, Daisy. If this bequest fails, then the residue to my son Hewey.

Hewey was not Daisy's son and they did not have a good relationship. Donald died in 2014 and on his death, he owned the following property:

- 50% share of 1 Homestead Road (the matrimonial home with the other 50% owned by Daisy). Donald's half share was worth R350,000. There was a bond over this property.
- The ABC Bank Account worth R160,000

---

<sup>4</sup> Act 7 of 1953

<sup>5</sup> Section 87(1) Act 47 of 1937

<sup>6</sup> This is debateable. Ex Parte Executors Estate Everard 1938 TPD 190

- ❑ The XYZ Bank Account worth R40,000
- ❑ A BMW worth R50,000
- ❑ There was not sufficient cash in the estate to pay estate liabilities (executor's fees, Donald's half share of the bond and an accrual claim in favour of Daisy) of R90,000.

When Daisy read Donald's will, and after taking the provisions of the ANC into account, she was of the opinion that the car belonged to her. She was also of the opinion that she was entitled to half the money in the bank accounts. The house would pass to her in terms of the residue and the estate liabilities would be paid from the remainder of the money in the accounts. Daisy did not have any readily accessible cash to pay into the estate, should it be required.

Hewey, on the other hand, once the Will was a matter of public record, called the executor and stated that he expected to receive the car as well as the entire proceeds of the bank accounts for himself and his minor sons, as this was what his father intended.

A fracas ensued.

It was clear that the two documents were in conflict with each other, and the question that had to be answered was how these two documents could be reconciled, and how the estate was to be administered.

It was accepted that Donald's later will did not revoke the pactum successorium in the ANC. In the case *Ex Parte Executors Estate Everard*<sup>7</sup>, it was held that the first dying is unable to revoke his undertaking to the survivor by means of a will. The judge quoted the following words by Voet as authority:

"For if it has been agreed that the surviving spouse shall succeed the first dying in whole or in part, or shall have a certain sum or amount owing out of the property of the first dying, the one spouse cannot make a disposition by last will to prejudice of the other without the latter's consent and knowledge, for it is clear law that what one of two contracting parties have acquired by virtue of the contract, cannot be taken away from him by the other because the latter regrets his bargain or alters his mind".<sup>8</sup>

The judge went on to confirm that in the case where an ANC and a will are in conflict with each other, the surviving spouse must elect which benefit she accepts: either the benefit in terms of the ANC or the alternative benefit in terms of the will. She is not able to accept both. The judge held as follows:

---

<sup>7</sup> *Ex Parte Executors Estate Everard* Supra

<sup>8</sup> *Ex Parte Executors Estate Everard* Supra 195

"If she [the surviving spouse] desires the advantages conferred upon her under the will, she must take them with the disadvantages attaching thereto, in other words, she must surrender the benefits conferred upon her by the antenuptial contract, which are inconsistent with those under the will".<sup>9</sup>

The facts of the Everard case were very similar to our scenario. An ANC entered into between H and W provided that "the said H hereby nominated and appoints the said W to be the sole heiress of one half of his estate, moveable and immoveable, wherever situate, at the time of his death". By his last will, H effected a disposition of his estate in conflict with the above provision, bequeathing his estate to trust. W was the income beneficiary of the trust during her lifetime, with the capital going to other beneficiaries on her death.

Therefore the consequence of the advisor and will drafter not taking proper instructions when drafting Donald's will, and by this it is meant not having sight of the ANC, let alone not assisting him with the obvious liquidity issue created by his bequests, meant that Donald's property might not be administered in terms of his will as he intended, depending on the decision made by Daisy. There was also additional family friction at an already difficult time. It could not be disputed that it was the testator's intention to benefit not only his wife but also his son and grandchildren, which intention could be thwarted by Daisy.

The decision Daisy had to make was therefore to decide whether she wanted to accept the benefits under the ANC or inherit in terms of the will. If Daisy accepted the benefit in terms of the ANC, she is entitled to receive the car and half of the balance of the estate. The "balance" means the balance of the estate available for distribution, that is, after estate debts have been paid but before the award of any specific legacies. Daisy would then renounce her right to the residue of the Estate. This would not give rise to a donations tax liability for her.<sup>10</sup> This option would mean inheriting a larger value. However, the problem would be that she would only be entitled to a further quarter share, that is half the deceased's half share. The remaining quarter share would fall into the residue, which in terms of the will would then pass to the son, as substitutionary residuary beneficiary, who would be responsible for the cash shortfall.

---

<sup>9</sup> Ex Parte Executors Estate Everard Supra 199 - 200

<sup>10</sup> SARS BPR 151

The following calculations show how the estate is distributed depending on Daisy's election:

<b><u>Daisy accepts the ANC and repudiates the will</u></b>	
<b>Assets</b>	
1/2 share property	R350,000.00
Car	R 50,000.00
XYZ Bank	R 40,000.00
ABC Bank	R160,000.00
	<b>R600,000.00</b>
<b>Liabilities</b>	
	(R90,000.00)
<b>Claim in terms of ANC</b>	
Car	(R 50,000.00)
<b>Therefore balance for distribution</b>	<b>R 230,000.00</b>
This balance made up of:	
<b>Dewey and Louie</b>	
XYZ	R 40,000.00
<b>Hewey</b>	
ABC	R 160,000.00
Property	R 175,000.00
Less cash shortfall	(R145,000.00)
	<b>R 230,000.00</b>
<b>Daisy</b>	
Claim in terms of ANC	230,000.00
Car	50,000
	<b>R280,000.00</b>

<b><u>Daisy accepts Will and repudiates the ANC</u></b>	
<b>Assets</b>	
1/2 share property	R 350,000.00
Car	R 50,000.00
XYZ Bank	R 40,000.00
ABC Bank	R 160,000.00
	<b>R 600,000.00</b>
<b>Liabilities</b>	
	(R 90,000.00)
<b>Therefore balance for distribution</b>	<b>R 510,000.00</b>
This balance made up of:	
<b>Dewey and Louie</b>	
XYZ	R 40,000.00
<b>Hewey</b>	
Car	R 50,000.00
ABC	R 160,000.00
<b>Daisy</b>	
House	R 350,000.00
Less cash shortfall	(R 90,000.00)
	<b>R 510,000.00</b>

Daisy had to make her election in writing, by virtue of a certificate of adiation, to the executor, and once made, her decision was irrevocable.

If there was no conflict between the two documents, it is submitted that the property due to the surviving spouse in terms of the ANC will be claimed by her and paid as a claim against the estate (similar to the accrual claim) and then she will take whatever she is entitled to in terms of the will.

It must be noted that a recent judgement in the case of *Radebe v Sosibo NO*<sup>11</sup> dealt with the issue of a pactum successorium being contained in an ANC. The judge made the following remark:

"While an antenuptial contract may certainly contain a succession clause, and such clause would have to comply with the formalities prescribed for wills."

It is accepted that this remark was obiter dicta and not binding precedent. A pactum successorium contained in an ANC is valid if the ANC is executed and registered in terms of the Deeds Registry Act, and does not need to confirm with the formalities contained in the Wills Act.

## Conclusion

Having sight of a client's ANC is of utmost importance when assisting a client with financial planning. The ANC can contain various provisions which can derail any estate plan if an advisor is not aware of them, or does not understand how they will operate when read in conjunction with the client's will. The dangers of not taking into account the possibility of a large accrual claim by the surviving spouse when the marriage is terminated by death, are well documented. Often though, the devil is in the detail, and not being aware of the existence of a pacta successorium in a client's will could have negative consequences for the family, and be the cause of an unnecessary additional headache for the Executor when the times comes to administer the will.

---

<sup>11</sup> 2011 (5) SA 51 GSJ para 33

## **Bibliography**

### **Article:**

"The Requirements for a Valid Pactum Successorium in an Ante Nuptial Contract: The Curious Case of Radebe v Sosibo" Christa Rautenbach and Anton van der Linde The South African Law Journal (2012) 129

### **Cases:**

McAlpine v McAlpine NO 1997 (1) SA 376 (A)

Ex Parte Executors Estate Everard 1938 TPD 190

Ladies Christian Home v SA Association 1915 CPD 467 471 – 472

Radebe v Sosibo NO 2011 (5) SA 51 GSJ

### **Legislation:**

Deeds Registry Act 37 of 1947

Wills Act 7 of 1953

SARS Binding Private Ruling 151

# Intestate Succession: Potential challenges



**Gerald Peter CFP®**

LLB, Adv PG Dip in Fin Plan

Legal Adviser Specialist

PFA : Durban

## Introduction

Whenever a deceased person leaves property which has not been disposed of by a valid will it must be distributed according to the relevant laws of intestate succession (if it is solvent). Intestate succession is governed by the Intestate Succession Act 81 of 1987 (hereinafter referred to as the Act). The Act will also apply where it is impossible to carry out the testamentary wishes of the deceased.<sup>1</sup>

The law of intestate succession can, in certain instances, be very unsympathetic to a deceased person's surviving spouse and dependents. This article highlights some real life examples of the complications which could arise if a person dies without a will. These examples are drawn from the writer's experiences in practice as well as from case law.

## Case study 1

The deceased (Mr. Xulu)<sup>2</sup> died without a will. He was married in community of property. Mr Xulu had previously been married and had two children from that marriage. Although it was common cause that he was the father of the two children, Mr Xulu had never formally acknowledged paternity and was completely estranged from them. Mrs. Xulu also had one from a previous marriage.

The value of Mr. Xulu's estate on his date of death was R800 000 which was made up exclusively of his unencumbered primary residence.

Owing to the fact that Mr Xulu died intestate, his estate had to devolve in terms of the Act. Sections 1(1)(c)(i) and (ii) of the Act state that if a deceased is survived by a spouse and descendants such spouse shall inherit a child's share of the intestate estate or so much of the intestate estate as does not exceed R250 000 whichever is the greater. The descendant/s shall inherit the residue (if any) of the intestate estate.

According to Section 4(f) of the Act a child's portion, in relation to the intestate estate of the deceased, shall be calculated by dividing the monetary value of the estate by a number equal to the number of children of the deceased who have either survived him or have died before him but are survived by their descendants, plus one.

---

<sup>1</sup> For example if the nominated beneficiaries do not wish to inherit or have predeceased the testator.

<sup>2</sup> Fictional names have been used to protect the identities of the clients.

Mr Xulu's intestate estate therefore had to devolve as follows:

- (1) Mrs Xulu was entitled to R400 000, being her share of the joint estate.
- (2) The child's share was R133 333 (R400 000/ the two sons plus one).
- (3) Mrs Xulu was therefore entitled to receive R250 000 (which is greater than the child's share).

Mr. Xulu's two children were entitled to the residue of the intestate estate (R150 000) (Each was entitled to R75 000 each).

Being unemployed and with no hope of raising the residue amount of R150 000, Mrs. Xulu found herself in a dilemma. To compound matters the two children refused to repudiate their share electing instead to vociferously enforce their claims. Left with no bargaining chips, Mrs. Xulu had no option but to sell the primary residence. This case illustrates the unintended complications which intestacy can cause a surviving spouse (even to the smallest estate). Mr. Xulu (and indeed his financial planner) could have averted the crisis had the deceased simply drawn up a will. To purchase another home Mrs. Xulu will have to use a significant portion of her share of the intestate estate to pay costs such as conveyancing and estate agency fees.

The case also highlights the problems which could arise if the intestate heirs do not see eye to eye and cannot reach a compromise regarding the distribution of the estate. Assets may have to be sold, often at ridiculously reduced prices due to the urgency of the sale.

The problem could have been worse if the couple were married in terms of the accrual system. This is because the rules of intestate succession apply in respect of the net estate after the accrual claim has been paid. An accrual claim in favour of the deceased estate could therefore have placed an added burden on Mrs. Xulu as she would have had to pay money into the estate prior to the distribution.

### **Minor Children**

One of the benefits of drafting a will is that a person can nominate an executor of his/her choice. If the person dies intestate, the Master of the High Court will have to nominate an executor, which could lead to a delay in winding up the estate. Where a person nominates an executor through a will, an agreement could possibly be reached on a reduced executor's fee, where this would obviously not be the case if the person dies intestate.

Where the deceased has minor children (or even in other circumstances) there may be a need to make provision for testamentary trusts (and the nomination of trustees in this regard), nomination of guardians etc. If there is no valid will regulating these aspects it could lead to practical problems.

## Case study 2

The deceased was a single mother of two minor children. At the time of her death she had taken out two Greenlight life policies, which were payable to the children. She died intestate. In line with tradition, the children were placed under the care of their aunt (the deceased's sister Mrs. Lukhele<sup>3</sup>), who is unemployed and also a single mother.

Old Mutual could not pay the subsequent claims submitted by Mrs. Lukhele because she had no legal standing to submit the claim forms on the children's stead. A duly appointed executor was required to facilitate the payments of the policies. There was also no nominated guardian or trust set up to accept the policy proceeds on behalf of the children.

Mrs. Lukhele was subsequently appointed by the Master to act as the executor of the estate (fortunately, the Master did not request Mrs. Lukhele to furnish security as a condition of her appointment). However due to the size and complexity of the estate, the Master insisted that a firm of attorneys be appointed to assist her with the process. This means the estate will incur further costs in the form of executor's fees.

Once appointed as executor, Mrs. Lukhele was advised that she also needed to approach the High Court<sup>4</sup> in order to be nominated as the children's guardian. This is an expensive and tedious process.

In the meantime while all these processes were unfolding, the deceased's children have had to change schools and were living in abject poverty.

These delays could have been minimised had the deceased left a will. In the will she could have nominated her sister as the executor of her estate and a trustee of the testamentary trust created for the maintenance of her children. These provisions would have saved a lot of valuable time and spared the children the indignity which they are now going through.

## The wrong people could inherit

If the deceased leaves no spouse, no descendants or parents, but is survived by descendants of his predeceased parents, one-half of the estate will devolve upon the descendants of the mother and the other half upon the descendants of the father.<sup>5</sup>

---

<sup>3</sup> Not her real name.

<sup>4</sup> Only the High Court can appoint a person, other than the natural guardian of a minor, as the legal guardian of a minor.

<sup>5</sup> Sections 1(1)(e) and (f) of the Act

If the deceased is survived only by descendants of a predeceased parent who are related to him only through that predeceased parent, those descendants inherit the intestate estate. This provision brings a deceased person's half brothers and sisters into the picture and entitles them to a share of the intestate estate.

### **Example**

Mr. Baloyi dies intestate. He is not survived by either of his two parents. Mr. Baloyi was not married and had no children. He is survived by his brother, Baya (born from the marriage between his two parents) and a half-brother, Stompie, who was born from his father's first marriage.

The estate will be divided in two equal parts so that one-half will be divided between the descendants of his father and the other half between the descendants of his mother.

One-half (his father's) will be divided equally between Baya and Stompie (one-quarter each). The remaining one-half will go to Baya. In total, Baya gets three-quarters and Stompie one-quarter.

The scary bit in this scenario is that if Mr. Baloyi had only been survived by his half-brother Stompie, then he (Stompie) would have inherited the entire intestate estate. This is regardless of the nature of the relationship between Mr. Baloyi and Stompie (or whether they actually knew each other or not) at the time of his death.

### **Death prior to finalisation of divorce proceedings**

Complications could also arise if a person dies intestate when divorce proceedings are pending or yet to be finalised.

In the case of *Makgwale v Khwinana and another* [2001] JOL 8727 (T) the deceased and his customary law wife started living together as husband and wife in 1994. He died on 9 July 2000.

During the subsistence of the marriage some problems arose which necessitated the wife to temporarily leave their common home.

It was contended on behalf of the applicants that the marriage between the deceased and his wife had been dissolved prior to his death. The deceased's wife denied having left the common home permanently, maintaining that at no stage did she or her late husband terminate the marriage.

The court held that there was no evidence of the union between the first respondent and the deceased ever having been terminated. The court further held that as the deceased died intestate, the laws of intestate succession applied.

This case also highlights the importance of leaving a will. Although the court in this case found no evidence that the marriage had been formally dissolved (according to customary law), it may well be that the relationship between the parties had irretrievably broken down to such an extent that the deceased did not consider his wife as a potential heir. However, since the marriage had not been formally dissolved, the wife was still regarded as a spouse for all intents and purposes. The fact that she may have been a spouse only in title and not one in substance did not disqualify her from enjoying the privileges of a spouse under the Act.

### **Agricultural land**

Many owners of farms in South Africa are not aware that the subdivision of their land is not permitted without the consent of the Minister of Agriculture in terms of the Subdivision of Agricultural Land Act.<sup>6</sup>

This can give rise to serious problems if a farmer dies without a will and has more than one intestate heir (especially heirs who do not see eye to eye).

As mentioned above, in terms of the Act, an application to subdivide agricultural land must be made to the Minister of Agriculture. The application will be approved if the Minister is satisfied that the proposed subdivision will not compromise the viability of the farming property.

If the Minister does not consent to the subdivision of any particular agricultural land as determined in terms of the rules of intestate succession and no agreement is reached as to a subdivision the executor of the estate concerned shall realise the land or undivided share concerned, as the case may be, and dispose of the nett proceeds thereof in accordance with the proportions calculated in terms of the said intestate succession.<sup>7</sup>

Such a forced and unintended sale of a profitable family farm may be financially devastating to the heirs, especially if the sale occurs at a time when markets are depressed.

---

<sup>6</sup> Act 70 of 1970

<sup>7</sup> Section 5 of the Subdivision of Agricultural Land Act

## Conclusion

Having a will is an imperative. Financial planners should ensure that all their clients have validly executed wills. The examples discussed above highlight that complications occasioned by intestate succession affect both small and huge estates. The importance of drafting a will and estate planning cannot be stressed more in contemporary South Africa where the number of estate litigation matters are high and on the rise. Leaving behind a valid will ensures that an estate does not get bogged down in the murky waters of intestate succession and will protect the interests of vulnerable dependants such as minor children.

## **Bibliography**

T. Singh: Schoeman Attorneys: Short Notes of the Importance of Drafting Wills, 2013

Margaret Meyer, Masters Training: Justice College: An Overview on the Distribution of An Estate of A Person Dying Without or with a Will", March 2011

Meyerowitz on Administration of Estates, Sixth Edition, June 1998

Intestate Succession Act 81 of 1987

Subdivision of Agricultural Land Act 70 of 1970

Makgwale v Khwinana and another [2001] JOL 8727 (T)

# Capital gains tax on death: spouses married in community of property



**Carl Muller CFP®**

BLC, LLB, LLM (Tax Law), Adv PG Dip In Fin Plan

Legal Adviser Manager

PFA : Western Cape

## Introduction

The calculation of capital gains tax in deceased estates is often a complex issue. The problems facing executors of estates in this regard are exacerbated when dealing with deceased estates of persons married in community of property. The purpose of this article is to focus on certain interpretational difficulties, with the focus on two specific areas:

- (1) The correct method of calculating capital gains tax in terms of the Eighth Schedule to the Income Tax Act<sup>1</sup> (hereinafter referred to as "the Act") where persons are married in community of property;
- (2) The correct application of the deduction for capital gains tax liability afforded to deceased estates in terms of section 4(b) of the Estate Duty Act<sup>2</sup> where persons are married in community of property.

## The calculation of capital gains tax where a person married in community of property dies

Before the correct method in calculating capital gains tax on the death of a person married in community of property is discussed, it is necessary to analyse the effect of the relevant paragraphs in the Eighth Schedule to the Act.

Paragraph 14 of the Eighth Schedule to the Act provides:

### 14. Disposal by spouse married in community of property

*For the purposes of this Schedule, in the case of spouses married in community of property, where any asset is disposed of by one of the spouses and that asset—*

- (a) falls within the joint estate of the spouses, that disposal is treated as having been made in equal shares by each spouse; and*
- (b) was excluded from the joint estate of the spouses, that disposal is treated as having been made solely by the spouse making the disposal.*

The effect of paragraph 14(a) is that where a spouse married in community of property disposes of an asset that falls within the joint estate, such disposal will be deemed to be a disposal made in equal shares between the spouses. The effect of this will be that 50% of the proceeds will be attributed to each spouse, and that 50% of the base cost of the asset will be attributed to each spouse. Each spouse will be entitled to the full annual exclusion, but the primary residence exclusion will be apportioned between the spouses.<sup>3</sup>

---

<sup>1</sup> Act 58 of 1962

<sup>2</sup> Act 45 of 1955

<sup>3</sup> South African Revenue Services Guide to Capital Gains Tax, 2015 (Draft), p 153; Paragraph 5 and 45(2) of the Eighth Schedule to the Income Tax Act

Paragraph 40(1)(a) of Eighth Schedule to the Act provides:

40. *Disposal to and from deceased estate.*

(1) *A deceased person must be treated as having disposed of his or her assets, other than—*

(a) *assets transferred to the surviving spouse of that deceased person as contemplated in paragraph 67 (2) (a);*

*for an amount received or accrued equal to the market value of those assets at the date of that person's death.*

Paragraph 67(1)(a) and 67(2)(a) of Eighth Schedule to the Act however stipulates:

67. *Transfer of asset between spouses.*

(1) (a) *Subject to subparagraph (3)<sup>4</sup>, a person (hereinafter referred to as "the transferor") must disregard any capital gain or capital loss determined in respect of the disposal of an asset to his or her spouse (hereinafter referred to as "the transferee").*

(2) *For the purposes of subparagraph (1)—*

(a) *a deceased person must be treated as having disposed of an asset to his or her surviving spouse, if ownership of that asset is acquired by that surviving spouse by ab intestato or testamentary succession or as a result of a re-distribution agreement between the heirs and legatees of that deceased person in the course of liquidation or distribution of the deceased estate of that deceased person;*

In terms of the above provisions a person is thus deemed to have disposed of all his/her assets on death for an amount equal to the market value of such asset, unless the ownership of the asset is transferred to the deceased person's spouse as a result of a bequest, the law of intestate succession or a re-distribution agreement entered into between heirs and legatees of the estate, in which case the capital gain or loss must be ignored (commonly referred to as a rollover for capital gains tax purposes).<sup>5</sup>

Where a person married in community of property dies, and assets that do not form part of the joint estate<sup>6</sup> are bequeathed to a person other than the spouse, it is clear from the provisions of Paragraph 14(b) of the Eighth Schedule to the Act, that it will be treated as having been disposed solely by the spouse making the disposal. In this regard there is thus no discrepancy

---

<sup>4</sup> Subparagraph 3 relates to an exception where the spouse is not a South African resident

<sup>5</sup> Other exceptions to the deemed disposal in paragraph 40(1)(a) will be assets bequeathed to a public benefit organisation approved by the Commissioner of inland Revenue where the proceeds of a long term insurance policy is disregarded in terms of paragraph 55 of the Eighth Schedule to the Act. In this regard see the South African Revenue Services Guide to Capital Gains Tax, 2015 (Draft), p 73

<sup>6</sup> An example would be an asset that was inherited by the deceased spouse where the bequest to the deceased spouse was made subject to the condition that it will not form part of the joint estate of the deceased spouse

between the provisions of this paragraph and those of Paragraph 40(1)(a) of the Eighth Schedule.

However, where a person married in community of property dies and his/her share of one or more assets in the joint estate that are subject to capital gains tax are transferred to someone other than the surviving spouse, there are two possible interpretations of the provisions of paragraph 40(1)(a), when read with paragraph 14(a) of the Eighth Schedule to the Act.

The first interpretation is that the deceased's 50% share of joint assets transferred to persons other than the spouse will be dealt with in terms of paragraph 14(a) of the Eighth Schedule to the Act. This would effectively mean that where a person married in community of property bequeaths his or her 50% share of an asset in the joint estate to a person (hereinafter referred to as "the third person") other than the surviving spouse, that the deceased is deemed to dispose of 25% of the asset to the third person in terms of paragraph 40(1) to the Act, whilst the surviving spouse is regarded as having disposed of the other 25% of such asset in terms of paragraph 14(a) of the Act. This principle can be best illustrated through the following example:

#### **Example 1:**

Mr. Jack Johnson is married in community of property to Mrs. Jane Johnson. Mr. Johnson dies on the 5<sup>th</sup> of September 2015. His will provides as follows:

- (i) His 50% share of the primary residence (an asset in the joint estate) is bequeathed to his son, Mr. Peter Johnson. The market value of the house is R8,000,000, and the base cost of the house is R4,000,000.
- (ii) His holiday home is bequeathed to the Johnson Family Trust, a discretionary *inter vivos* trust. The holiday house was inherited from his late father, Mr. Andrew Johnson. The will of the late Andrew provided that the house will not form part of the joint estate of Jack. The value of the holiday house is R4,000,000, and the base cost of the house is R3,000,000.
- (iii) His 50% of the unit trusts in the joint estate is bequeathed to his daughter, Maria Johnson. The total value of the unit trust investment on date of death is R1,000,000 and the base cost is R400,000.
- (iv) His 50% share in the rental property (an asset in the joint estate) is bequeathed to Jane. The total value of the rental property is R3,000,000 and the base cost is R2,000,000.

The assumption is made that Jack and Jane pay income tax at a marginal rate of 41%. In terms of the first interpretation discussed above, the capital gains tax of Jack will be calculated as follows:

<b>CAPITAL GAINS TAX CALCULATION<sup>(i)</sup></b>			
<b>ASSET</b>	<b>MARKET VALUE</b>	<b>BASE COST</b>	<b>CAPITAL GAIN</b>
<b>1. Primary residence</b>	R 2,000,000.00 <sup>(ii)</sup>	R 1,000,000.00 <sup>(iii)</sup>	R 1,000,000.00
<b>Less: Exemption (25%)</b>			R 500,000.00 <sup>(iv)</sup>
			R 500,000.00
<b>2. Holiday Home</b>	R 4,000,000.00 <sup>(v)</sup>	R 3,000,000.00 <sup>(v)</sup>	R 1,000,000.00
<b>3. Unit Trust Investment</b>	R 250,000.00 <sup>(vi)</sup>	R 100,000.00 <sup>(vii)</sup>	R 150,000.00
<b>Total Capital Gain</b>			R 1,650,000.00
<b>Less: Rebate on Death</b>			R 300,000.00
<b>Net capital gain</b>			R 1,350,000.00
<b>CGT payable:</b>			R 184,315.50 <sup>(viii)</sup>
<b>Inclusion rate:</b>	33.30%		
<b>Assumption:</b>			
<b>Income tax rate:</b>	41.00%		

- (i) As the rental property is bequeathed to the surviving spouse, no capital gains tax will be payable on the value of the 50% of the property in the Estate of Jack, as it constitutes a "rollover" as contemplated in paragraph 67(1)(a) and 67(2)(a) of the Eighth Schedule to the Act.
- (ii) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the Eighth Schedule to the Act:  $R8,000,000 \times 25\% = R2,000,000$ .
- (iii) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the of the Eighth Schedule to the Act. The base cost thus has to be apportioned accordingly:  $R4,000,000 \times 25\% = R1,000,000$ .
- (iv) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of such asset in terms of paragraph 14(a) of the of the Eighth Schedule to the Act. The primary residence exclusion thus has to be apportioned accordingly:  $R2,000,000 \times 25\% = R500,000$ .<sup>7</sup>

<sup>7</sup> Paragraph 45(2) of the Eighth Schedule to the Act. The following is further stated in the South African Revenue Service, Comprehensive Guide to Capital Gains Tax (Draft Issue 5) on p380: *The underlying principle is that a person's primary residence exclusion should not exceed R2 million for a single physical structure. Thus if a person decides to embark on a piecemeal disposal of a residence the person's exclusion should not exceed R2 million for the sum of the parts. Unlike the annual exclusion, the primary residence exclusion is not available annually and is tied to the physical structure. This view is supported by para 45(2), which requires that when more than one natural person or special trust jointly holds an interest in a primary residence at the same time (a natural consequence of a part-disposal), the R2 million exclusion must be apportioned in relation to each interest so held.*

- (v) This holiday home is excluded from the joint estate and therefore Jack is deemed to have disposed of 100% of the asset in terms of paragraph 14(b) of the Eighth Schedule to the Act.
- (vi) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the unit trust investment at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the Eighth Schedule to the Act:  $R1,000,000 \times 25\% = R250,000$ .
- (vii) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the unit trust investment at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the Eighth Schedule to the Act. The base cost thus has to be apportioned accordingly:  $R400,000 \times 25\% = R100,000$ .
- (viii)  $R1,350,000 \times 33.3\%$  (capital gains tax inclusion rate for individuals)  $\times 41\%$  (marginal tax rate of Jack).

In terms of this interpretation the capital gains tax of Jane will be calculated as follows:

<b>CAPITAL GAINS TAX CALCULATION</b>			
<b>ASSET</b>	<b>MARKET VALUE</b>	<b>BASE COST</b>	<b>CAPITAL GAIN</b>
<b>1. Primary residence</b>	R 2,000,000.00 (i)	R 1,000,000.00 <sup>(ii)</sup>	R 1,000,000.00
<b>Less: Exemption (25%)</b>			R 500,000.00 <sup>(iii)</sup>
			R 500,000.00
<b>2. Unit Trust Investment</b>	R 250,000.00 <sup>(iv)</sup>	R 100,000.00 <sup>(v)</sup>	R 150,000.00
<b>Total Capital Gain</b>			R 650,000.00
<b>Less: Annual Rebate</b>			R 30,000.00
<b>Net capital gain</b>			R 620,000.00
<b>CGT payable:</b>			R 84,648.60 <sup>(vi)</sup>
<b>Inclusion rate:</b>	33.30%		
<b>Assumption:</b>			
<b>Income tax rate:</b>	41.00%		

- (i) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the Eighth Schedule to the Act:  $R8,000,000 \times 25\% = R2,000,000$ .
- (ii) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the Eighth Schedule to the Act. The base cost thus has to be apportioned accordingly:  $R4,000,000 \times 25\% = R1,000,000$ .

- (iii) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the primary residence at death in terms of paragraph 40(1) to the Act to Peter, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the Eighth Schedule to the Act. The primary residence exclusion thus has to be apportioned accordingly:  $R2,000,000 \times 25\% = R500,000$ .<sup>8</sup>
- (iv) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the unit trust investment at death in terms of paragraph 40(1) of the Act, whilst the Jane is regarded as having disposed of the other 25% of such asset in terms of paragraph 14(a) of the Eighth Schedule to the Act:  $R1,000,000 \times 25\% = R250,000$ .
- (v) Jack is regarded, in terms of the above interpretation, to have disposed of his 25% of the unit trust investment at death in terms of paragraph 40(1) of the Eighth Schedule to the Act, whilst Jane is regarded as having disposed of the other 25% of this asset in terms of paragraph 14(a) of the Eighth Schedule to the Act. The base cost thus has to be apportioned accordingly:  $R400\ 000 \times 25\% = R100,000$ .
- (vi)  $R620,000 \times 33.3\%$  (capital gains tax inclusion rate for individuals)  $\times 41\%$  (marginal tax rate of Jane).

The second interpretation is that the deceased's 50% share of joint assets transferred to persons other than the spouse will be dealt with solely in terms of paragraph 40(1) of the Eighth Schedule to the Act, and that paragraph 14(a) of the Eighth Schedule to the Act is not applicable on the death of a person married in community of property. This would effectively mean that where a person married in community of property bequeaths his/her 50% share of an asset in the joint estate to a person (hereinafter referred to as "the third person") other than the surviving spouse, that the deceased is deemed to have disposed of 50% of the asset. This principle is illustrated in the following example:

---

<sup>8</sup> See footnote 7 *supra*

**Example 2:**

The facts and assumptions are exactly the same as in Example 1. Based on the second interpretation discussed above, the calculations will look as follows:

<b>CAPITAL GAINS TAX CALCULATION<sup>(i)</sup></b>			
<b>ASSET</b>	<b>MARKET VALUE</b>	<b>BASE COST</b>	<b>CAPITAL GAIN</b>
<b>1. Primary residence</b>	R 4,000,000.00 <sup>(ii)</sup>	R 2,000,000.00 <sup>(iii)</sup>	R 2,000,000.00
<b>Less: Exemption (50%)</b>			R 1,000,000.00 <sup>(iv)</sup>
			R 1,000,000.00
<b>2. Holiday Home</b>	R 4,000,000.00 <sup>(v)</sup>	R 3,000,000.00 <sup>(v)</sup>	R 1,000,000.00
<b>3. Unit Trust Investment</b>	R 500,000.00 <sup>(vi)</sup>	R 200,000.00 <sup>(vii)</sup>	R 300,000.00
<b>Total Capital Gain</b>			R 2,300,000.00
<b>Less: Rebate on Death</b>			R 300,000.00
<b>Net capital gain</b>			R 2,000,000.00
<b>CGT payable:</b>			R 273,060.00 <sup>(viii)</sup>
<b>Inclusion rate:</b>	33.30%		
<b>Assumption:</b>			
<b>Income tax rate:</b>	41.00%		

- (i) As the rental property is bequeathed to the surviving spouse, no capital gains tax will be payable in respect of 50% of the value of this property in the Estate of Jack, as it constitutes a "rollover" as contemplated in paragraph 67(1)(a) and 67(2)(a) of the Eighth Schedule to the Act.
- (ii) Jack is regarded, in terms of the above interpretation, to have disposed of his 50% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act:  $R8,000,000 \times 50\% = R4,000,000$ .
- (iii) Jack is regarded, in terms of the above interpretation, to have disposed of his 50% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act. The base cost thus has to be apportioned accordingly:  $R4\ 000,000 \times 50\% = R2,000,000$ .
- (iv) Jack is regarded, in terms of the above interpretation, to have disposed of his 50% of the primary residence at death in terms of paragraph 40(1) of the Eighth Schedule to the Act. The primary residence exclusion thus has to be apportioned accordingly:  $R2,000,000 \times 50\% = R1,000,000$ .<sup>9</sup>
- (v) This holiday home is excluded from the joint estate and therefor Jack is deemed to have disposed of 100% of the asset in terms of paragraph 14(b) of the Eighth Schedule to the Act.
- (vi) Jack is regarded, in terms of the above interpretation, to have disposed of his 50% of the unit trust investment at death in terms of paragraph 40(1) of the Eighth Schedule to the Act:  $R1,000,000 \times 50\% = R500,000$ .

<sup>9</sup> See footnote 7 *supra*

- (vii) Jack is regarded, in terms of the above interpretation, to have disposed of his 50% of the unit trust investment at death in terms of paragraph 40(1) of the Eighth Schedule to the Act. The base cost thus has to be apportioned accordingly:  $R400\,000 \times 50\% = R200\,000$ .
- (viii)  $R2\,000\,000 \times 33.3\%$  (capital gains tax inclusion rate for individuals)  $\times 41\%$  (marginal tax rate of Jack).

As paragraph 14(a) of the Eighth Schedule to the Act is not applicable on the death of a person married in community of property in terms of the second interpretation, Jane will in this example not be deemed to have disposed of any assets on the death of Jack, and she will thus not incur any capital gains tax liability.

It is my opinion that the approach followed in the second interpretation, as illustrated in Example 2 above, is the correct one for the following reasons:

- (1) Paragraph 40(1) provides that a "*deceased person must be treated as having disposed of his or her assets*" on death. It is my opinion that if the legislature had intended to provide that the surviving spouse in a marriage in community of property was deemed to dispose of 50% of the assets that the deceased spouse is deemed to have disposed of on death, paragraph 40(1) of the Eighth Schedule would have been drafted to make specific provision for this.
- (2) Paragraph 40(1) is specific to the situation where a person dies, whilst paragraph 14(a) is applicable to living persons married in community of property that dispose of assets, or part thereof, in the joint estate. When applying the rules applicable to the interpretation of statutes, paragraph 40(1) should thus take preference over paragraph 14(a).
- (3) When paragraph 14(a) is applied where persons married in community of property dispose of a portion of an asset in the joint estate, the disposal of such portion will be deemed to be a disposal in equal shares, and the portion of the asset remaining in the joint estate will be owned in equal shares by the spouses. For example – if Jack and Jane had sold 50% of the rental property during their lifetime, Jack and Jane would each have been deemed to dispose of 25% of the property, and the 50% portion of the property remaining in the joint estate would be owned by them in equal shares (25% each). Should Jack and Jane thereafter (before death) dispose of the remaining 50%, they would again be deemed to have disposed of this 50% in equal shares (25% each). However, if the first interpretation is followed in a scenario where a person married in community of property dies, the survivor remains 50% owner of the asset. It will thus have the effect that the surviving spouse, on death or disposal of the asset after death of the first dying spouse, dispose (or be deemed to have disposed) of the remaining 50% interest in the asset. The surviving spouse will thus effectively have disposed of 75% interest in the asset: 25% interest on the death of the first dying spouse, and 50% interest on death of the surviving spouse (or on disposal of the said interest in the asset by the surviving spouse before death). The first dying spouse will then only be deemed to have disposed of a 25% interest in the asset in the joint estate on death. It is my view that this could not have been the intention of the legislature. Where one of two equal co-owners of property dies in any other situation, (including spouses married out of community of property who are equal co-owners of an asset), that deceased will be deemed to have disposed of the 50% interest in such asset on death where it is not

bequeathed to a surviving spouse. From a capital gains tax point of view, there is no reason why a person married in community of property should be treated any differently merely as a result of his or her marital regime.

### **The deduction for capital gains tax liability in terms of section 4(b) of the Estate Duty Act<sup>10</sup> where a person married in community of property dies**

Section 4 of the Estate Duty Act provides as follows:

#### *4. Net value of an estate*

*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;*

Liability for income tax up to the date of death of the deceased will constitute debt as contemplated in this section.<sup>11</sup>

Where we are dealing with capital gains tax payable as a result of a deemed disposal of assets on death by a person married in community of property, there are three possible ways of applying the deduction afforded in terms of Section 4(b).

The first interpretation is that the capital gains tax liability is that of the deceased spouse only, and that the amount of liability should therefore be deducted in full (i.e. 100%), irrespective of whether the asset formed part of the joint estate or not, when calculating estate duty.

This can again be illustrated via an example.

---

<sup>10</sup> See footnote 2

<sup>11</sup> Estate Duty, Principles and Planning, Second Edition, 1998, ML Stein, p85

**Example 3:**

Assume that the facts are the same as in Example 1 and 2 above, and that the capital gains tax liability has been calculated as per Example 2 above. Also note that for purposes of this example other costs (funeral expenses, administration costs executor fees, transfer costs and other debt) have been ignored.

<b>Estate duty analysis in community of property</b>		
<b>Joint estate:</b>		
<b>Residential property</b>		R11,000,000.00
Primary residence	R8,000,000.00	
Rental property	R3,000,000.00	
<b>Investments:</b>		R1,000,000.00
Unit trusts	R 1,000,000.00	
<b>Gross joint estate</b>		R 12,000,000.00
<b>Less: Spouse's half share (50%)</b>		R 6,000,000.00
Client's half share of the joint estate (50%)		R 6,000,000.00
<b>Plus: Assets excluded from the joint estate</b>		R 4,000,000.00
Holiday home inherited	R 4,000,000.00	
<b>Total estate</b>		R 10,000,000.00
<b>Less: Deductions (50%)</b>		<b>R0.00</b>
<b>Less: Deductions (100%)</b>		R 273,060.00
<b>Less: Capital gains tax</b>	R 273,060.00	
		R 9,726,940.00
<b>Less: Section 4(q) (bequests to surviving spouse)</b>		<b>R1,500,000.00</b>
Rental property (50%)	R1,500,000.00	
<b>Net estate</b>		<b>R8,226,940.00</b>
<b>Less: Section 4A abatement</b>		<b>R3,500,000.00</b>
<b>Dutiable estate</b>		<b>R4,726,940.00</b>
<b>Estate duty payable @ 20%</b>		<b>R945,388.00</b>

The second interpretation is that capital gains tax incurred as a result of a deemed disposal of the deceased's share of an asset in the joint estate must be deducted as a liability from the joint estate (i.e. thus effectively only allowing 50% of the deduction), but that the deemed disposal of assets falling outside the joint estate must be allowed in full (i.e. 100%). An example of how this calculation will look is the following:

**Example 4:**

Assume that the facts are the same as in Example 1 and 2 above, and that the capital gains tax liability has been calculated as per Example 2 above. Also note that for purposes of this example other costs (funeral expenses, administration costs executor fees, transfer costs and other debt) have been ignored.

In terms of this calculation a deduction in respect of 50% of the capital gains tax applicable to the primary residence, rental property and unit trust investment will be allowed, whereas a 100% deduction in respect of the holiday home will be allowed. The problem in this regard is however that the capital gains tax calculation is one calculation, i.e. it is not split between assets within the joint estate and assets not forming part of the joint estate.

One would thus have to do an apportionment of the capital gains tax liability as follows:

(i) Capital gains tax liability to be deducted from the joint estate (50% deduction):

$R1,000,000$  (capital gain of primary residence after the primary residence exclusion is taken into account) +  $R300,000$  (capital gain of unit trust investment) =  $R1,300,000$  (total capital gain of assets falling in joint estate) ÷  $R2,300,000$  (total capital gain before  $R300,000$  abatement) x  $R273,060$  (total capital gains tax payable) =  $R154,338.26$

(ii) Capital gains tax liability to be deducted from the separate estate of the deceased (100% deduction):

$R1,000,000$  (capital gain of holiday home falling outside the joint estate) =  $R1,000,000$  ÷  $R2,300,000$  (total capital gain before  $R300,000$  abatement) x  $R273,060$  (total capital gains tax payable) =  $R118,721.74$

<b>Estate duty analysis in community of property</b>		
<b>Joint estate:</b>		
<b>Residential property</b>		R11,000,000.00
Primary residence	R8,000,000.00	
Rental property	R3,000,000.00	
<b>Investments:</b>		R1,000,000.00
Unit trusts	R 1,000,000.00	
<b>Gross joint estate</b>		R 12,000,000.00
<b>Less:</b> Spouse's half share (50%)		R 6,000,000.00
Client's half share of the joint estate		R 6,000,000.00
<b>Plus: Assets excluded from the joint estate</b>		R 4,000,000.00
Holiday home inherited	R 4,000,000.00	
<b>Total estate</b>		R 10,000,000.00
<b>Less: Deductions (50%)</b>		<b>R77,169.13</b>
<b>Capital gains tax on assets in joint estate</b>	<b>R 154,338.26</b>	
<b>Total</b>	<b>R 154,338.26</b>	
<b>Less: Deductions (100%)</b>		<b>R 118,721.74</b>
<b>Capital gains tax on asset outside joint estate</b>	<b>R 118,721.74</b>	
		R 9,804,109.13
<b>Less: Section 4(q) (bequests to surviving spouse)</b>		<b>R1,500,000.00</b>
Rental property (50%)	R1,500,000.00	
<b>Net estate</b>		<b>R8,304,109.13</b>
<b>Less: Section 4A abatement</b>		<b>R3,500,000.00</b>
<b>Dutiable estate</b>		<b>R4,804,109.13</b>
<b>Estate duty payable @ 20%</b>		<b>R960,821.83</b>

The third interpretation is that the capital gains tax liability is that of the joint estate, thus effectively only allowing 50% of the deduction, irrespective of whether the asset formed part of the joint estate or not, when calculating estate duty. An example of this interpretation is as follows:

**Example 5:**

Assume that the facts are the same as in Example 1 and 2 above, and that the capital gains tax liability has been calculated as per Example 2 above. Also note that for purposes of this example other costs (funeral expenses, administration costs executor fees, transfer costs and other debt) have been ignored.

<b>Estate duty analysis in community of property</b>		
<b>Joint estate:</b>		
<b>Residential property</b>		R11,000,000.00
Primary residence	R8,000,000.00	
Rental property	R3,000,000.00	
<b>Investments:</b>		R1,000,000.00
Unit trusts	R 1,000,000.00	
<b>Gross joint estate</b>		R 12,000,000.00
<b>Less: Spouse's half share (50%)</b>		R 6,000,000.00
Client's half share of the joint estate		R 6,000,000.00
<b>Plus: Assets excluded from the joint estate</b>		R 4,000,000.00
Holiday home inherited	R 4,000,000.00	
<b>Total estate</b>		R 10,000,000.00
<b>Less: Deductions (50%)</b>		<b>R136,530.00</b>
<b>Capital gains tax</b>	<b>R 273,060.00</b>	
<b>Total</b>	<b>R 273,060.00</b>	
<b>Less: Deductions (100%)</b>		<b>R 0.00</b>
		R 9,863,470.00
<b>Less: Section 4(q) (bequests to surviving spouse)</b>		<b>R1,500,000.00</b>
Rental property (50%)	R1,500,000.00	
<b>Net estate</b>		<b>R8,363,470.00</b>
<b>Less: Section 4A abatement</b>		<b>R3,500,000.00</b>
<b>Dutiable estate</b>		<b>R4,863,470.00</b>
<b>Estate duty payable @ 20%</b>		<b>R972,694.00</b>

It is my opinion that that the approach followed in the third interpretation, as illustrated in Example 5 above, is the correct one for the following reasons:

- (1) Where people are married in community of property, all their respective assets (excluding assets not forming part of the joint estate) and liabilities essentially become their joint assets and liabilities in equal undivided shares, irrespective whether the asset or liability was

obtained or incurred before or during the marriage.<sup>12</sup> Where a person married in community of property dies, the executor must discharge the joint liabilities and it is only half of the net balance of the joint estate which vests with in the surviving spouse.<sup>13</sup> A provision in an ante-nuptial agreement that there will be a marriage in community of property as far as assets are concerned, but not as far as debt is concerned will be void.<sup>14</sup>

- (2) Expenses incurred after the death, for example funeral costs of the deceased spouse, are not regarded as a liability of the joint estate, as the community ceases at death and these expenses are incurred thereafter.<sup>15</sup> These expenses are thus deducted in full (i.e. not only 50% thereof). Paragraph 40(1)(a) of the Eighth Schedule to the Act however provides that a person is deemed to have disposed of his or her assets "at date of death". In my opinion capital gains tax liability by a deceased person as a result of a deemed disposal on death will thus be incurred on date of death and not thereafter, and where a deceased was married in community of property this liability will thus form part of the joint debt of the estate.
- (3) Where a deceased person owned property that did not form part of the joint estate, all expenses of administration and liquidation relating to such property are deductible in full (i.e. not only half thereof).<sup>16</sup> The Act further specifically provides for the taxation of spouses married in community of property<sup>17</sup> and that each spouse will be assessed separately for tax purposes. It must however be borne in mind that the tax liability in these instances still falls on the joint estate and that the Commissioner's claim for tax should thus be lodged with the executor of the first dying's estate and be paid out of assets of the joint estate.<sup>18</sup> The capital gains tax liability of the deceased as a result of a deemed disposal on death will form part of this tax liability against the joint estate, irrespective of whether an asset formed part of the joint estate or constituted separate property of the deceased.

## Conclusion

When dealing with the capital gains tax implications and corresponding estate duty deduction of deceased persons who were married in community of property, there is more than one possible interpretation of the relevant provisions of the Income Tax Act and the Estate Duty Act.

It is also clear that the application of principles applicable to the calculation of capital gains tax in this regard differ in certain respects from the treatment of the resultant deduction for estate duty purposes: the fact that a capital gain may be taxable in the hands of one of the spouses (in this instance in the hands of the deceased spouse) does not mean that it is fully

---

<sup>12</sup> Estate Duty, Principles and Planning, Second Edition, 1998, *ML Stein*, p139

<sup>13</sup> Meyerowitz On Administration Of Estates And Their Taxation, 2010 Edition, *D Meyerowitz*, p16-9

<sup>14</sup> Die Suid-Afrikaanse Persone- en Familiereg, Second Edition, 1990, *DSP Cronje*, p249

<sup>15</sup> Footnote 11 *supra*; Meyerowitz On Administration Of Estates And Their Taxation, 2010 Edition, *D Meyerowitz*, p15-35

<sup>16</sup> Estate Duty, Principles and Planning, Second Edition, 1998, *ML Stein*, p140

<sup>17</sup> Section 7(2)(A) of the Act and Paragraph 14 of the Eighth Schedule to the Act

<sup>18</sup> Meyerowitz On Administration Of Estates And Their Taxation, 2010 Edition, *D Meyerowitz*, p15-37

deductible for estate duty purposes, as only half of it will effectively be deductible due to the marriage in community of property.

It is submitted that the correct calculation methodology in respect of assets bequeathed to persons other than a surviving spouse where a deceased person was married in community of property is as follows:

- (1) From a capital gains tax point of view the deceased will be deemed to have disposed of half of the relevant assets that form part of the joint estate and all assets that are the sole property of the deceased;
- (2) From an estate duty perspective the deduction for the capital gains tax liability will be applied against the joint estate, thus resulting in half of this liability being applied as a deduction, irrespective of whether an asset forms part of the joint estate or constitutes separate property of the deceased.

**Bibliography**

Die Suid-Afrikaanse Persone- en Familiereg, Second Edition, 1990, *DSP Cronje*

Estate Duty Act 45 of 1955.

Estate Duty, Principles and Planning, Second Edition, 1997, *ML Stein*

Income Tax Act 58 of 1962.

Meyerowitz On Administration Of Estates And Their Taxation, 2010 Edition, *D Meyerowitz*.

South African Revenue Service, Comprehensive Guide to Capital Gains Tax (Issue 4).

# Shariah Compliant Wills- A practical perspective



**Saudiqa Fakier CFP®**

LLB (UWC) PG Dip Legal Practice (UCT) PG Dip Plan (US)

Legal Adviser Specialist

Broker Distribution : Western Cape

## Introduction

It is estimated that approximately 1.5% of South Africa's 51 770 560 population are Muslim citizens. There is a great need that Muslim clients receive financial advice and Shariah compliant estate planning but what we find is that there exists a gap between Islamic law and South African law. This so called gap also represents a gap in the financial services market that is somewhat still under-addressed. This article serves to explain Islamic succession planning and its significance to Islamic estate planning all being applied in the environment of a South African legal system thereby attempting to close the gap.

Probably the most important component of Islamic succession planning is an Islamically compliant will, also referred to as a "Shariah-Compliant will". The word "Shariah" is an Arabic word which means "Divine Law" law as it applies to Muslims worldwide. The main source of "Shariah" is the Holy Qur'an and it is interesting to note that the instrument of a last will and testament is referred to eight times in the Qur'an.

The 'will' is mentioned in the Qur'an eight times. To mention one example:

*"It is prescribed, when death approaches any of you, if he leaves any goods, that he makes bequest to parents and next of kin, according to reasonable usage; this is due from those mindful of God."*<sup>1</sup> In this verse, leaving a will before death was made obligatory on all Muslims who owned anything.

Being able to provide a client with a Shariah compliant will not only helps him or her fulfill this religious obligation, but also gives a financial planner the opportunity to assess the client's entire portfolio for estate, investment and retirement planning purposes.

## Overview of Islamic Inheritance

Islamic Jurists worldwide agree that duties of a deceased estate rank in the following order:

To pay:

- (1) Funeral Expenses
- (2) Debts, e.g. Creditors, but also Islamic debts/duties
- (3) Execution of the will i.e. "Wasiyyah" (maximum of 1/3 of estate)
- (4) Distribution of remaining estate amongst Islamic heirs in terms of Islamic law

It is advisable that provision be made for the execution of these duties in the deceased's will.

---

<sup>1</sup> The Holy Qur'an Chapter 2 verse 80

## (1) Payment of Funeral Costs

Payment of funeral expenses pertains to the payment of burial costs so too any costs related to the actual funeral. This not only is an Islamic duty but also important to the calculation of the deceased's estate duty in terms of South African law. The full cost of the Islamic funeral and related costs should be noted and proof thereof kept by the executors as these costs are also estate deductions in terms of S 4(a) of the Estate Duty Act.<sup>2</sup>

## (2) Payment of debts in estate

It is of utmost importance that a financial planner be made aware of any liabilities in the testator's estate so that provision can be made for the payment thereof after death. Interesting to note in this regard is that debt in this regard includes payment to all creditors so too Islamic duties.

A liability which is specific to Muslims can include any Dowry that may still be due to the wife of a deceased testator. It is compulsory for a Muslim male at his marriage to pay a dowry of her choosing to his wife, which dowry may by agreement between them be deferred as a long term personal liability. If any amount is outstanding then this must be settled from his estate.<sup>3</sup> The same duty is not encumbered on women. This is a liability in its common understanding and is also an estate duty deduction.<sup>4</sup>

Provision can also be made in the will for the fulfillment of certain Islamic responsibilities of a personal nature that the deceased was unable to fulfill during his or her life. Common examples are:

- ❑ The payment of "Zakaah" (pronounce Zah-Kah), which is the annual compulsory payment of a percentage of your wealth to the poor and needy. Also known as the third pillar of Islam. Compare this to tithing or other wealth tax but payable to the poor as almsgiving for the relief of the poor and not to the State as is done with taxes.<sup>5</sup> If record is kept of how much Zakaah is still due by the deceased this will affect the liquidity in the estate.
- ❑ Performance of the Pilgrimage to Mecca. This is also known as "Hajj" (pronounced Khahj) and is the fifth pillar of Islam. Someone else can perform it on your behalf if you were not able to do so during your life and if the financial provision was made for it by the deceased. As it is incumbent on all Muslims to perform this duty it is an opportunity for a financial advisor to discuss an investment geared toward fulfilling this duty.
- ❑ Take special note that the payment of a Dowry constitutes an actual liability and is an estate duty deduction whereas the latter two examples of payment of "Zakaah" and Pilgrimage are not liabilities but rather forms of personal religious duties and therefore not estate deductions.

<sup>2</sup> Section 4(a) of the Estate Duty Act 45 of 1955

<sup>3</sup> Trusts and Estate Planning- An Islamic Perspective M.A. E Bulbulia 1984

<sup>4</sup> S4 (a) Estate Duty Act 45 of 1955

<sup>5</sup> <http://dictionary.reference.com/browse/zakah>

Understanding exactly which debts and which responsibilities are due by the client, allows a financial planner to factor it into client's needs analysis and recommend ways in which to make provision for the payment thereof, and it also is a necessary component when calculating estate deductions in terms of S4(b) of the Estate Duty Act.

### **(3) Execution of the will (Wasiyyah)**

A Muslim's estate is divided into three parts. Up to a maximum of 1/3 of the estate (after expenses) can be bequeathed as legacies in a will. This legacy is known as the "Wasiyyah".

The purpose of this one-third provision, or Wasiyyah, is that any individual that is not an eligible Islamic blood related heir may be noted as a beneficiary of the testator's estate. This includes but is not limited to public benefit organisations, educational institutions, non-blood relatives and friends. If a testator makes any bequest to charities or public benefit organisations then it should form part of the Wasiyyah. It is important to take cognisance of this as the bequest may qualify as an estate deduction in terms of S 4 (h) (i).<sup>6</sup>

This one-third provision can be used to take care of poor relatives who are not blood related heirs. It is however recommended that smaller estates refrain from utilizing the one-third Wasiyyah so as to leave a bigger percentage of the estate to immediate blood relatives.

### **(4) Distribution of remaining estate amongst Islamic heirs in terms of Islamic law**

The other 2/3<sup>rd</sup>s, or the whole of the estate, (if no Wasiyyah is left) is the inheritance to which a set formula is to be applied. When the formula is applied, it identifies who is eligible to inherit from the testator, and the percentage that each heir is to receive from the deceased estate. I will refer to these individuals as the "Islamic Heirs" for purposes of the article. This formula is based on several Qur'anic verses. Eligibility depends on who the surviving blood relatives of the deceased are immediately after the testator's death.

A user friendly Islamic Inheritance calculator can be found at <http://inheritance.ilmsummit.org> where the said formula is applied by plotting in existing relatives.<sup>7</sup>

In Muslim countries inheritance is automatically applied in terms of Islamic law even if no will is made, and if a will is made, then it will only apply to the 1/3 portion of the estate.

The fact that a client is Muslim does not automatically mean that any of these rules will apply to him or her if domiciled in South Africa. The testator has the prerogative to bequeath their estate

---

<sup>6</sup> S 4(h) (i) Estate Duty Act 45 of 1955

<sup>7</sup> <http://inheritance.ilmsummit.org/projects/inheritance/home.aspx>

as they wish in line with the doctrine of Freedom of Testation. If however it is the wish of the testator to have his or her estate devolve in terms of Islamic law this must clearly be stated in the will. The will should conform with all formalities of a South African will as provided for in the Wills Act<sup>8</sup> the failing of which will result in the estate devolving entirely or partially intestate.

It is a requirement that "Islamic heirs" are blood relatives who are alive on date of death of the deceased. No heir may inherit by representation per stirpes. For this reason it is important not to mention who the Islamic heirs are in the will as it will result in the testament not devolving strictly in terms of Islamic law. For this reason wills often rely on a Islamic Judicial institution to identify and issue a certificate of who are eligible heirs and the respective percentage inheritance each will receive based on who is alive at the time of the deceased's death. This certificate is then read with the will of the deceased.

### **Some practical planning techniques**

- ❑ Encourage testator to keep proper records of all transactions, debt creating agreements e.g. dowry and spouse's contribution toward the purchasing of assets.
- ❑ When consulting with a client make a note of all surviving blood relatives so that you may advise them on who the potential Islamic heirs are and how much each heir would potentially receive. This will merely be for illustrative purposes to the client and may not be the heirs at client's time of death.
- ❑ Similarly the size of the distributable estate is needed so that a S4(q) deduction may be calculated for the estate duty tax return. Understanding the percentage that a surviving spouse will receive is a requisite for calculating this deduction and for calculating capital gains tax liability of the testator.
- ❑ It is common for a husband to grant his wife additional dowries after they are married e.g. more money, investments, property etc. These dowries can also be deferred and increase the estate liability whilst protecting the surviving wife's financial position at her husband's death. It is prudent of the couple to keep record of these dowry contracts for estate duty calculations.
- ❑ Similar to the above, creating a loan account in favour of a wife and allocating monetary amounts per month/annually to it which has the effect of increasing the estate liability and the wife's share of the husband's estate.
- ❑ Consider the benefits of using an inter vivos trust for the benefit of the surviving spouse and children. As one divests of ownership during one's life the rules of inheritance is not applicable. The inter vivos trust can also be used to acquire so called "growth assets" like investments, property and businesses. The trust deed should be utilized for dealing with the trust assets, whilst the Shariah compliant will be used for dealing with the estate.
- ❑ Utilise the donations tax annual exemption (currently R100 000) either for the benefit of the inter vivos family trust or children directly.

---

<sup>8</sup> The Wills Act 7 of 1953

- ❑ Any bequests made to any public benefit organisations are also estate deductions if it complies with provisions of S4(h) of Estate Duty Act.
- ❑ Utilise Buy and Sell Agreements to provide for succession planning of business interests. The sale of the shares in the business takes place at death of the business owner. The transaction is funded using life assurance policy which is paid to the executor of the deceased client's estate in exchange for the shares in the business. With the policy proceeds being paid to the estate this adds liquidity to the estate and makes it much easier to distribute cash percentages to heirs.

## Conclusion

When an individual wishes to have a Shariah compliant will it is imperative that they fully understand the estate and tax implications thereof. The only way for a professional providing legal and/or financial advice to a client on this area of expertise, would be for them to understand at least the basics of Islamic inheritance so as to correctly advise on how the client's estate will devolve. Inheritance law is only applicable at death hence a client's estate can be restructured during his life in a way that puts all surviving family on a stronger financial footing. Clients should understand that during their life they are free to allocate freely to whomsoever they wish and in any proportion.

If a client wishes to have his or her estate devolve in terms of Shariah law it must be spelt out clearly in his or her will. Only the Wasiyah provisions will differ from client to client, whilst the rest of the testament will for the most part be similar from client to client. This similarity of clients' wills does not however detract from the many financial advice opportunities in the client's estate.

**Bibliography**

The Holy Qur'an Chapter 2 verse 80

Estate Duty Act 45 of 1955

<http://dictionary.reference.com/browse/zakah>

The Islamic law of succession-a comparative analysis Gerald Peter Premiums and Problem Article Edition 98 published December 2008

Trusts and Estate Planning- An Islamic Perspective- M. A. E. Bulbulia September 1984

The Wills Act 7 of 1953

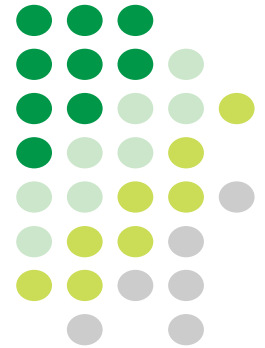
<http://inheritance.ilmsummit.org/projects/inheritance/home.aspx>

DO GREAT THINGS



**OLDMUTUAL**

Licensed Financial Services Provider



# Retirement Planning

# Comparison of TFSA vs RA for retirement purposes



**Suzelle Jooste CFP®**

Adv Dip in Fin Plan(UOFS), BA LLB (PU for CHE), Adv Certificate in Trust Law (UP), Dip in Labour Law (UJ), Admitted Attorney

Legal Adviser Manager

Broker Distribution : Johannesburg

## Introduction

Tax-free savings accounts (hereinafter referred to as TFSA) were introduced by National Treasury on 1 March 2015<sup>1</sup>, as a way to encourage South Africans to save. It is part of the government's drive to reform non-retirement savings, and is therefore not specifically intended as a retirement vehicle. The question is, can it be used as a vehicle to save for retirement, and how does it compare with the well-known retirement annuity?

After Tax-free savings accounts were introduced, Professor Matthew Lester wrote that he would rather save his money for retirement in a retirement annuity than putting it into a tax-free savings account.<sup>2</sup> According to Professor Lester many investors don't have tax exposure now anyway.<sup>3</sup> Fact is that financial advisers are bombarded with information, and in the end they are advising clients. The focus of this article is to enable financial advisers to make an informed decision on retirement vehicles when they are faced with the choice between the tax-free savings account on the one hand and a retirement annuity on the other.

### Differences between a TFSA and a retirement annuity:

#### (1) Access/Liquidity:

In the TFSA you have access to your money at any time to make a withdrawal. This is not ideal, if you want to use the TFSA for retirement purposes, as retirement savings in the TFSA will then most probably be used in the event of a crisis. Once a withdrawal is made from the TFSA, the contributions made, will forever be counted under the R500 000 lifetime limit.

In a retirement annuity you do not have access to the retirement annuity until maturity age (prior to age 55), unless you become disabled. On emigration, your retirement annuity can be commuted, and if the retirement annuity is paid-up, and the value is under R7000, then the retirement annuity can also be accessed.

#### (2) Withdrawals:

Any withdrawals from the TFSA will be tax-free, whereas in the case of a retirement annuity, after the age of 55, where the client retired, the lump sum taken will be taxed according to the retirement tax tables. Where an annuity was purchased by a client, after retirement, with his 2/3 rds, then the annuity income will be taxable at the client's marginal tax rate.

---

<sup>1</sup> Section 12T Income Tax Act 58 of 1962

<sup>2</sup> Biznews.com "Matthew Lester: I'm not putting my money into tax-free savings accounts" 16 March 2015

<sup>3</sup> Ibid

**(3) Pre-tax and post-tax for investment purposes:**

Investors generally use pre-tax money to invest in a retirement annuity, and investments into a TFSA are made with post-tax money. This is an important factor that should be taken into consideration when comparing investment into the two different vehicles.

**(4) Tax Deduction on the contributions:**

A huge advantage of contributing to a retirement annuity is that there is a tax deduction on the contribution, whilst there is no tax deduction on the contribution to the TFSA.

In terms of Sec 11(n)(aa) of the Income Tax Act, the formula for the tax deduction of the contribution to the retirement annuity is still deductible with the maximum of the greater of:

15 % of non-retirement funding taxable income, or

R3 500 – allowable pension fund contributions, or

R1750

The Taxation Laws Amendment Act, 2013 (as read with the Taxation Laws Amendment Act, 2014) introduced changes (effective 1 March 2016) with regards to the deduction regime to retirement funds.

All members of retirement funds will be given a deduction for contributions to retirement funds of 27.5% of the greater of their remuneration or taxable income, subject to an annual maximum amount of R350 000.

**(5) Estate Duty:**

The TFSA will form part of the client's estate for estate duty purposes, whilst currently the retirement annuity will fall outside of the estate for estate duty purposes.

Currently the Estate Duty Act provides that benefits payable in respect of deceased members of approved retirement funds do not form part of the deceased's dutiable estate for estate duty purposes. Therefore currently retirement annuities do not form part of the deceased member's estate for purposes of calculating estate duty.

In the 2015 Budget speech, Treasury shared their concern that clients were injecting large lump sums into retirement annuities for the purpose of avoiding estate duty. To stop this practise, the Draft Taxation Laws Amendment Bill (2015)<sup>4</sup> provides that an amount equal to all un-deducted

---

<sup>4</sup> Hotline 13 of 2015

contributions made by a deceased person will be included in their dutiable estate for estate duty purposes. This advantage for retirement annuities will therefore soon fall away, and the TFSA and retirement annuities will be on equal ground.

#### **(6) Attachment by creditors:**

The TFSA can be attached by creditors. Where the TFSA is however in a life wrapper the protection as per Section 63 of the Long Term Insurance Act<sup>5</sup> will apply. This protection will however not apply for a TFSA in a life wrapper, where the policy was taken out with the intention to defraud creditors.<sup>6</sup> A retirement annuity is protected, and cannot be attached by creditors.

#### **(7) Limitations on amounts and time periods :**

The annual investment limit for the TFSA is currently R30 000, and there is a life-time limit of R500 000 as well.<sup>7</sup> Although no time period is mentioned for a TFSA, if one calculates the annual investment limit, and keep the life-time limit of R500 000 in mind, then it is common knowledge, that the investment period is maximum 16 years and 8 months, to get to the life-time limit of R500 000.

There are no limitations to the amounts that can be contributed to retirement funds, although the tax benefit would be capped<sup>8</sup> (see the tax-deduction discussion under point 4 above). There is also currently no limitation on the time period that one can contribute to a retirement annuity.

#### **(8) Retirement vehicle or not:**

Whilst retirement annuities are known as vehicles for retirement purposes, TFSA is not explicitly intended by government as a retirement vehicle<sup>9</sup>, but is an effort by government to reform non-retirement savings. TFSA investments can however be used to supplement retirement provision.

Let's look at a calculation in order to compare the two options: <sup>10</sup>

---

<sup>5</sup> Act 52 of 1998

<sup>6</sup> Did you know no 5 of 2015 by Wyno Strydom

<sup>7</sup> Section 12 T, Income Tax Act, 1962

<sup>8</sup> Draft Taxation Laws Amendment Bill, 2015

<sup>9</sup> Tax-free savings account vs retirement plan, Money web article dated 10 February 2015

<sup>10</sup> [www.radirect.co.za](http://www.radirect.co.za) TFSA v RA Calculator is used

**Example 1:**

Taxable income per month R40 000

Age currently: 43

Premium per month: R2 500

Term: 16 years 8 Months

Return % received: 6%

If you invest an after tax contribution of R2 500 per month in TFSA, it means you have already paid tax of R1 406 before contributing R2 500. With RA contribution you will be allowed a tax deduction. In order to compare apples with apples, and to make a fair comparison of the two vehicles, the tax saving of R1 406 must be added to the RA contribution of R2 500, thus the amount of R3 906 must be worked on.

**Comparison:<sup>11</sup>****TFSA:**

Payment per month R2 500

Term 16 years and 8 months

Total return @ 6 % : R860 037

Draw income of 6 % per annum: R51 602

Less Tax: NIL

Net income: R51 602

Total income: R51 602

**RA:**

Payment per month R3 906

Term 16 years and 8 months

Total return @ 6 % : R1 343 808

1/3 rd lump sum: R447 936

Less Tax: R0

Nett: R447 936

6 % interest per annum : R26 876

Less Tax: R1 107

Net Interest per annum: R25 769

---

<sup>11</sup> [www.radiirect.co.za](http://www.radiirect.co.za) TFSA v RA Calculator is used

2/3rds Annuity amount: R895 872

6 % Annuity income per annum: R53 752

Less Income Tax: R19 351

Net Income per annum: R34 401

Total income per annum: R25 769 + R34 401 = R60 170.

Therefore the Retirement annuity is the better retirement vehicle for giving the better income at retirement in this scenario.

**Assumptions:<sup>12</sup>**

- 2015/2016 Tax Tables is used
- Marginal tax rate 36 %
- Net return on investment 6 %
- RA contribution tax deduction of R2 500 is available
- Tax-free amount of R500 000 at retirement is not yet utilised
- Income of 6 % per annum drawn from TFSA at maturity
- Interest of 6 % per annum drawn from RA lump sum at retirement
- Draw annuity income of 6 % on compulsory 2/3<sup>rd</sup> RA amount at retirement

**Similarities between a TFSA and a retirement annuity:**

- (1) Growth, which includes capital gains, dividends and interest, in the fund (in the case of a retirement annuity) or in the account (in the case of a TFSA<sup>13</sup>) will be tax-free.
- (2) Retirement annuities and the TFSA cannot be ceded as security.

---

<sup>12</sup> [www.radirect.co.za](http://www.radirect.co.za) TFSA v RA Calculator is used

<sup>13</sup> Did You Know 1 of 2015

## Conclusion

I tend to agree with the learned Professor Matthew Lester, 'it is a matter of horses for courses'.<sup>14</sup> For purposes of this article, as a retirement vehicle, the better of the two is definitely the retirement annuity, as the calculation has shown. However, if your client has enough disposable income, and can invest in both retirement vehicles, then the TFSA can be used to supplement your client's retirement provision. As shown, there are calculators<sup>15</sup> available on the internet, to compare the two retirement vehicles, specifically for your client's circumstances, so use the tools available to advise your client in his/her unique circumstances.

---

<sup>14</sup> Biznews.com "Matthew Lester: I'm not putting my money into tax-free savings accounts" 16 March 2015

<sup>15</sup> [www.radirect.co.za](http://www.radirect.co.za) – see TFSA vs RA calculator

## **Bibliography**

Hotline 13 of 2015: Draft Taxation Laws Amendment Bill, 2015

Did You Know 1 of 2015: The new Tax-free savings investment instruments: Issue of Notices and regulations

Did You Know 5 of 2015: Individual Investment Options: What should be the considerations ?

Biznews.com Matthew Lester: I'm not putting my money into tax-free savings accounts, 16 March 2016

Tax-free savings account vs retirement plan, Moneyweb article, 10 February 2015

[www.sataxguide.co.za](http://www.sataxguide.co.za) – "Tax-free savings: Give it time" by Maarten Mittner (Financial Mail), 4 August 2015

[www.radirect.co.za](http://www.radirect.co.za) – TFSA vs RA Calculator

Income Tax Act 58 of 1962

Long Term Insurance Act 52 of 1998

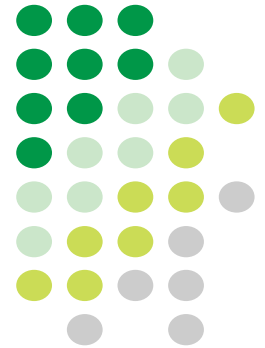
Taxation Laws Amendment Bill 2015

DO GREAT THINGS



**OLDMUTUAL**

Licensed Financial Services Provider



# Investment Planning

# What offshore vehicle do I use for investments?



**Daleen Harris CFP®**

B.lur, LLB, Adv. PG Dip in Fin. Plan, LLM, Dip Insolvency,  
Fiduciary Practitioner  
Legal Adviser Specialist  
Broker Distribution : Johannesburg

## Introduction

The Budget Speech of 2015 created new opportunities for offshore investments by increasing the annual limit for foreign investment from R4 million to R10 million per individual annually with a family limit of R20 million.<sup>1</sup> As South Africa is becoming a more open economy, more people are diversifying their assets internationally.<sup>2</sup>

The question is however, in what vehicle should these funds be invested? Should you do so in your personal capacity, through an offshore trust, a foundation or a company?

This article will look at these four vehicles, their advantages, disadvantages and the costs involved in using these vehicles.

### (1) Investments in Individual Capacity

South African residents are taxed on their worldwide income and must include all income accrued from their foreign investments in their annual tax return. Should there be taxes levied in the foreign jurisdiction, there will be tax relief should there be a Double Tax Treaty in place with that foreign jurisdiction. Should the local resident dispose of a foreign asset there might also be capital gains tax applicable.<sup>3</sup>

When investing offshore in an individual capacity it becomes important considering whether you should have one worldwide will dealing with all your assets, or separate wills for the various jurisdictions. This decision is not as simple as it may sound, as one would need to take into account which countries have statutory rights of forced heirships, such as Switzerland and Italy, where certain family members are entitled to inherit, regardless of the stipulations in the will, or in Jersey, where a will is not accepted unless the formalities of reading the will out loud and having it witnessed by a notary public were complied with.<sup>4</sup>

A worldwide will is normally used where the assets consist of cash, investments or insurance policy proceeds. The general cash threshold of England banks is approximately £10 000, thereafter they will require formal English authority.<sup>5</sup> In such a case the South African executor will have to apply to the Master of the High Court to "reseat" the Letters of Executorship for overseas use as most institutions outside of South Africa do not recognise our letters of executorship and will insist on a local probate. This means that there might be a slight delay in the administration of the local and foreign estate as it can take some time to obtain these

---

<sup>1</sup> South African Reservebank [www.reservebank.co.za](http://www.reservebank.co.za)

<sup>2</sup> Mastermind article by Anton Maskowitz

<sup>3</sup> Albert Vorster, Structuring offshore investments – the devil is in the detail, Money Marketing 31 December (2014) 6

<sup>4</sup> Oliver Charles Phipps, Where there's a Will, Personal Finance 1 January (2014) 30

<sup>5</sup> The nominated person will have to apply for a probate, under which they have to administer the estate, place adverts, settle debt and distribute the assets.

“resealed” documents.<sup>6</sup> A South-African will intended to be used offshore, should preferably be written in English as it is more acceptable and lessens the chances of it having to be translated at a cost of approximately R3 000. It is however important to remember that “resealing” of Letters of Executorship are not accepted in all jurisdictions, therefore it is vital that you investigate the requirements of the country that you intend investing in.<sup>7</sup>

People planning on purchasing immovable property abroad do not always fully understand the tax implications such as capital gains tax or inheritance tax in the country in which they wish to own such property.

Capital gains tax can vary for instance between 19% in France, to 40% in the United Kingdom and there are different sets of rules as to what relief will apply, therefore the nature and term of the investment should be investigated very carefully.

Inheritance tax is also payable in most countries and in continental Europe it can be as high as 60% of asset value on death. Furthermore in countries such as Spain, Portugal and France there are also wealth taxes that are levied annually on the market value of the property, which may exceed 3% of the value.<sup>8</sup> It is also important to note that all offshore assets in your personal name will still form part of the dutiable South African estate but, some relief will be given where countries have Double Taxation Agreements with us.

## **(2) Offshore trusts**

This type of trust continues to be widely used in various jurisdictions especially those where British Common Law is the foundation of its legal system and is still regarded as an excellent vehicle for asset protection and estate planning.

One of the greatest advantages of this offshore trust is wealth preservation and the provision of protection from political, economic and family uncertainty as well in certain countries anonymity. A further advantage is that it allows you to transfer your wealth in a tax efficient manner, avoid forced heirship in certain countries and gives you the opportunity to consolidate the ownership of all your foreign assets in one location.<sup>9</sup>

Recent statistics however show that there is a definite decline in these trusts being established due to enhanced transparency, increasing regulatory requirements, and changes in tax

---

<sup>6</sup> Oliver Charles Phipps, *English Estates - what is resealing?* Money Marketing 30 June (2015) 7

<sup>7</sup> Scotland, Jersey, Gurnsey, Ilse of Man and Ireland

<sup>8</sup> Ocra Worldwide [www.ocra.com](http://www.ocra.com)

<sup>9</sup> Shakira Bodasing, *Considerations for an offshore trust*, Premiums and Problems Article Edition 110 (2015) B103

legislation as well as the perceived exorbitant trustee fees.<sup>10</sup> The establishment fee of an offshore trust is approximately £1 000, thereafter an annual trustee responsibility fee, based on the value of the assets in the trust ranging from £1 500 upwards will be charged. These professional trustees also charge an hourly rate for administration and consultation fees which start from £120 per hour depending on the seniority of the professional trustee.<sup>11</sup>

It is furthermore also important to note that South African residents are normally not appointed as trustees because, if the trust is seen to be controlled from South Africa, it will be deemed a South African taxpayer.<sup>12</sup> To overcome this problem, the trust deed is generally supplemented with an informal confidential letter from the settlor giving his guidance and wishes to trustees and although not binding by law it is generally respected and acted upon.

One of the disadvantages is the transfer pricing provisions that became effective 1 March 2013 which closed the loophole for interest free loans. Should an offshore trust be funded by a loan from a South African resident the Receiver of Revenue (hereafter referred to as SARS) has clearly stated that a market related interest will be charged.<sup>13</sup>

Another disadvantage is that a trust is not a concept recognised across the world. For instance Greece does not recognise any form of trust as a legal entity and should an immovable property in Greece be placed in a foreign trust, that property will be locked into an impenetrable non-existent entity, which can take years to unwind and most probably be a costly exercise.

### **(3) Foundations**

Due to the fact that trusts are not recognised in all countries one can consider establishing a foundation which is an independent self-governing legal entity, without members or shareholders, where the wishes of the founder are reflected in the Foundation's Charter and Regulations. A foundation can be registered for a fixed or indefinite period in countries which recognise such a vehicle, such as the Netherlands, Bahamas, Panama and the Isle of Man, and is established to hold family assets and shares in offshore commercial companies, but may not carry out any commercial activities itself.<sup>14</sup>

One of the main advantages of a foundation is that it is generally found in nil tax havens so there will be no taxes paid on income generated in the foundation and taxes are generally deferred until such time it is paid to a beneficiary.

---

<sup>10</sup> Anton Maskowitz, Are Offshore trusts becoming rare? Mastermind Sanlam Private Investments

<sup>11</sup> Stenham Trustee Fees Schedule

<sup>12</sup> Bodasing "supra"

<sup>13</sup> Section 31 of the Income Tax Act 58/1962

<sup>14</sup> Sterling Offshore *Private Foundations vs Offshore Trusts* [www.sterlingoffshore.com](http://www.sterlingoffshore.com)

#### **(4) Off-shore Companies**

Some clients might decide to hold their offshore assets in a foreign company which can be very efficient especially in countries where forced heirship can be problematic. The assets owned by the company is unaffected by the death of the shareholder, but the shareholding itself will be subject to the inheritance taxes and succession laws of the country where the company is situated. This gives one the opportunity to consolidate foreign assets owned in multiple jurisdictions under one umbrella which can be dealt with under either a worldwide will or a separate offshore will.

Important to remember that shares in an offshore company will not be subject to dividend withholding tax but will be included in the gross income of the South African resident and taxed at marginal tax rates. In order to align tax paid on local dividends and offshore dividends a formula needs to be applied to exempt a certain portion of the offshore dividend from tax.<sup>15</sup>

Currently the Seychelles Business Company is the most popular and versatile to use. This company is not subject to any tax or duty on income and profits, nor is the shareholder of such a company subject to any tax on his income derived therefrom in the Seychelles. The only requirement is that the company will not pursue business within the territory of Seychelles, or own any real estate there. Thus far Seychelles has avoided any information sharing agreements with foreign countries but there are unfortunately no guarantees that it will stay that way.

#### **The Foreign Account Tax Compliant Act (FATCA)**

This legislation came into effect on 1 July 2014 and the main objective is to reduce tax evasion by United States citizens. In South Africa however SARS has advised that there is a broader goal which is to obtain financial information on all persons and entities that might have tax liabilities onshore and offshore. The intention is to report the information to treaty partners under an automatic exchange of information policy. Countries such as Mauritius, Isle of Man, Cayman Islands, British Virgin Islands, Malta and South Africa have indicated they are willing to be part of such an arrangement.<sup>16</sup>

FATCA will place a burden on certain financial institutions such as banks, insurance companies, investment managers and entities, for example professional trustees, companies or any entity managed by a financial institution to provide financial information.

Compliance with the legislation will cause Foreign Financial Institutions and their clients to incur increased operational costs and risk.

---

<sup>15</sup> Section 10B(3) of the Income Tax Act 58/1962

<sup>16</sup> Ann Klein, *The Foreign Account Tax Compliance Act money Marketing*, Money Marketing 31 January (2014)

## Conclusion

It is clear from the above that investing overseas is not as simple as what we might think. It is important to consult with a reputable fiduciary service provider as well as a tax consultant who specialise in the country where you are planning to invest. There are various vehicles to choose from and it is important to get the best possible advice on which vehicle will best serve the purpose for your investment.

When considering foreign vehicles all factors needs to be weighed up, such as the high costs of setting up and running of an offshore trust. It is also important to make sure should you draft a will in a country where either trusts are not recognised or where forced heirship is law, that it complies with such laws, otherwise it can take a long time and be very costly to unravel offshore vehicles, administer a deceased estate or pay taxes not catered for.<sup>17</sup>

---

<sup>17</sup> Lesley Mamman, *Trusts not recognised in some countries*, The Financial Planner, 1 September (2014) 58

**Bibliography**

The Financial Planner, 1 September 2014, Lesley Maman

Money Marketing, 31 January 2014, Ann Klein

Money Marketing, 31 December 2014, Albert Vorster

Money Marketing 30 June 2015, Oliver Phipps

Personal Finance, 1 January 2014, Oliver Phipps

Premiums & Problems Article Edition 110, Shakira Bodasing

Mastermind Sanlam Private Investments, Anton Maskowitz

Ocra Worldwide [www.ocra.com](http://www.ocra.com)

South African Reserve Bank [www.reservebank.co.za](http://www.reservebank.co.za)

[www.sterlingoffshore.com](http://www.sterlingoffshore.com)

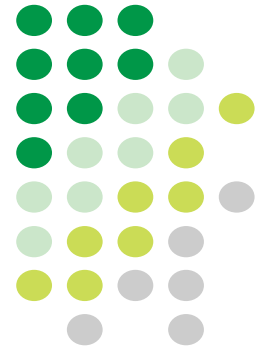
Income Tax Act 58/1962

DO GREAT THINGS



**OLDMUTUAL**

Licensed Financial Services Provider



# TAX

# Tax Implications on Foreign Pensions



**Jothi Chirkoot CFP®**

BA (LAW) LLB, ADV CFP

Legal Adviser Specialist

PFA : Durban

## Introduction

Not all South Africans spend their working life within the borders of South Africa. Some work partly in South Africa and partly outside South Africa while others may work their entire life outside South Africa. However as long as they regard themselves as ordinary residents of South Africa and have the intention to return to South Africa, their world-wide income will be part of their gross income and taxed in South Africa. They may however qualify for certain available income tax exemptions.

South Africans who contribute to an occupational pension fund whilst working abroad often question how and where will their pension be taxed, if at all? Does it depend on where the pension fund is situated or whether the employer is South African or foreign?

In terms of the Income Tax Act 58 of 1962, section 10 (1) (gC) - exempts from normal tax:

- Any amount received by or accrued to any resident under the social security system of any other country; or
- Any pension received or accrued to any resident from a source outside the Republic, which is not deemed to be from a source in the Republic in terms of section 9(1)(g) or section (9)(2)(i) of the Income Tax Act.<sup>1</sup>

The term "source outside the Republic" came under scrutiny. Clarity was required as to whether this should be interpreted to mean either the originating cause which gave rise to that pension i.e. the foreign services rendered or the where the pension fund is situated.

South African Revenue Services (SARS) made a ruling that the term "source outside the Republic," for purposes of section 10 (1) (gC) (ii) refers to the originating cause which gives rise to the pension income, namely, where the services have been rendered.<sup>2</sup>

Where South African residents have worked abroad as well as within South Africa, the Income Tax Act applies specific statutory source rules to establish how much of their pension benefit is from a foreign source or a source within South Africa in order to apportion the tax exempt amount from the taxable amount.

### **The apportionment rule as it applied up until December 2011:**

Section 9 (1) (g)<sup>3</sup> provided that a portion of the pension granted to an individual would be deemed to be from a source within South Africa, if the services were rendered in South Africa for at least 2 years during the 10 years immediately preceding the date on which the pension

---

<sup>1</sup> Phillip Haupt, Notes on South African Income Tax (33rd ed 2014) at 86

<sup>2</sup> SARS, Binding General Rule No. 25, 14 November 2014 at 1

<sup>3</sup> Income Tax Act 58 of 1962

first became due<sup>4</sup> (The 2/10 rule). This effectively means that a resident who worked outside South Africa for more than 2 out of the 10 years prior to his/her retirement would be able to apply the apportionment rule and exempt all or part of his pension benefit. This section applied to both annuities and lump sum benefits from pension, provident and retirement annuity funds.<sup>5</sup>

The apportionment rule<sup>6</sup> is applied as follows:-

$$\frac{\text{Total Amount X} \quad \text{Years of Service in the Republic}}{\text{Total years of service}}$$

Where less than 2 years of service in the 10 years preceding the first pension payment was rendered in South Africa, no part of the pension will be taxable in South Africa even if the tax payer might have rendered many years of service in South Africa prior to the 10 year period.

#### Example:

Mr Smit belonged to the XYZ Pension Fund. His full period of service was from 1 December 1980 to 31 May 2010. The period of his continuous service in the United Kingdom was from 1 July 2000 to 31 May 2010. Of the 10 years preceding his retirement on the 31 May 2010 one month was served in South Africa and 9 years and 11 months was served in the United Kingdom. In applying the 2/10 rule, the client would have qualified for the tax exemption on his full pension annuity.

#### The apportionment Rule as it applies since January 2012:

Section 9 was amended with effect from 1 January 2012. Section 9(1) (g) fell away and was replaced by Section 9(2)(i).<sup>7</sup> In terms of the latter provision where services were rendered partly within and partly outside South Africa, an apportionment must be applied in respect of services rendered outside and within the Republic of South Africa but, the 2/10 Rule is no longer applied. The total period during which services was rendered in South Africa is taken into account, irrespective of whether it was during the preceding 10 years of retirement or any time prior to that.

#### Example:

Mr Smit belonged to the XYZ Pension Fund. His full period of service was from 1 December 1980 to 31 May 2012. The period of his continuous service in the United Kingdom was from 1 July 2002 to 31 May 2012. Mr Smit will receive an annuity of R30 000 pm. In terms of section 9 (2) (i) of the

<sup>4</sup> [www.thesait.org.za/news//118311/Retirement-fund](http://www.thesait.org.za/news//118311/Retirement-fund), News and Press: Individuals Tax, Benefits for employees who worked abroad: The apportionment rules

<sup>5</sup> Keith Huxham, Phillip Haupt, Notes on South African Income Tax (30th ed. 2011), at 36 and 37

<sup>6</sup> Id at 36

<sup>7</sup> Phillip Haupt, Supra note 1 at 86

Income Tax Act, Mr Smit will now be liable to pay tax in South Africa based on the period he rendered services within South Africa.

SARS applies the following formula to calculate the portion of a pension that will be exempt due to services rendered outside the Republic<sup>8</sup>:

$$\frac{\text{Foreign services rendered}}{\text{Total services rendered}} \times \text{Total Pension}$$

Mr Smit's period of foreign service: 1 July 2002 to 31 May 2012 = 9 years and 10 months (118 months)

Mr Smit's total period of service: 1 December 1980 to 31 May 2012 = 32 years and 5 months (389 months)

$$\frac{118}{389} \times R30\,000$$

**R9 100**

The amount of R9 100 of Mr Smit's annuity is exempt from being taxed as this amount is considered to be foreign sourced, hence the portion of the annuity which will be taxable is R30 000 less R9 100 = R20 900.

On Mr Smit's death, his widow or beneficiaries will be entitled to claim the tax exemption on the foreign portion of the pension in terms of Section 10(1) (gC)(ii) whilst the taxable portion will be taxed in their hands.

When section 9(2)(i) was implemented in January 2012, SARS only applied the apportionment rule to annuity payments and not to the lump sum component of retirement fund payments.<sup>9</sup> Clearly this unfairly prejudiced members of retirement funds particularly those who belonged to provident funds. This concern was addressed by National Treasury and SARS. Subsequently this situation was resolved and both section 9 (2) (i) and section 10(1) (gC) of the Income Tax Act as discussed above, was amended by the Taxation Laws Amendment Act 2014 to apply to any lump sum benefits paid out to members, effective from 1 March 2015.<sup>10</sup>

<sup>8</sup> SARS, Supra note 2 at 2

<sup>9</sup> [www.thesait.org.za/news//118311/Retirement-fund](http://www.thesait.org.za/news//118311/Retirement-fund), Hanneke Farrand, News and Press: Individuals Tax, Benefits for employees who worked abroad: The apportionment rules

<sup>10</sup> Hotline No 2/2015, at 6

SARS does not apply the exemption to retirement annuity funds (RAs). South Africans who have to make their own retirement funding arrangement while working abroad should take this into consideration, contributions to an RA could be subject to tax.<sup>11</sup> Furthermore it can be argued that since both section 9 (2) (i) and section 10(1) (gC) of the Income Tax Act implies and/ or makes reference to annuities and lump sum benefits in relation to "services rendered", annuities and lump sum benefits derived from RA's are not related to "services rendered".

## **Conclusion**

The amendment of the source rule and SARS Binding General Rule 25 has simplified and clarified for individuals working abroad and financial advisors giving advice, how foreign pension benefits will be taxed. It should also make clear to financial advisors why perhaps some of their clients may have been exempt from paying any tax on their pension benefits prior to 1 January 2012 whilst those retiring after 1 January 2012 are exempt on a portion of the pension benefits and liable for tax in South Africa on the balance.

It is also important to note that Double Tax Agreements which may exist between South Africa and foreign countries will ensure that the taxpayer is not subject to tax both in South Africa and the foreign country.

---

<sup>11</sup> Mark Bechard, Personal Finance SARS clarifies tax exemptions on foreign pensions

## **Bibliography**

Phillip Haupt, Notes on South African Income Tax, 33<sup>rd</sup> Edition, 2014

SARS Binding General Rule No. 25

Income Tax Act 58 of 1962

[www.thesait.org.za/news/118311/Retirement-fund](http://www.thesait.org.za/news/118311/Retirement-fund), Hanneke Farrand, News and Press: Individuals Tax, Benefits for employees who worked abroad: The apportionment rules

Keith Huxham, Phillip Haupt, Notes on South African Income Tax, 30<sup>th</sup> Edition, 2011

Hotline No 2/2015

Mark Bechard, Personal Finance, SARS clarifies tax exemptions on foreign pensions

# The implications of converting par value shares to no par value shares



**Deon van Vuuren CFP®**

LLB, PG Dip in Fin Plan

Legal Adviser Specialist

Broker Distribution : Inland

## Introduction

The new Companies Act<sup>1</sup> (hereinafter referred to as "the Act") brought along various changes in the law governing business entities. One of these was the fact that a company may not issue new shares with a par value. A grace period has also been given for existing companies to convert par value shares into shares with no par value. This article will focus on the capital gains tax ("CGT") implications as a result of the conversion to no par value shares.

## Applicable legislation

Section 35(2) of the Act<sup>2</sup> stipulates that: "A share does not have a nominal or par value". This brings about that companies will not be allowed to issue new par value shares. When first reading this section one will definitely wonder what the legislature's seeing is with regards to existing par value shares.

Section 35(6)<sup>3</sup>, however, stipulates that a share owned by a shareholder before the effective date of the Act, will continue to have the same rights associated to it as it did before the effective date of the Act, being 1 May 2011. This in plain language means that shareholders who own par value shares can continue being owners of such shares, but to what extent?

Regulation 31 of the regulations to the Act<sup>4</sup> specifically deals with the conversion of par value shares to shares with no par value. Regulation 31(2) states that a pre-existing company may not authorise new par value shares after the effective date of the Act. This, in essence gives effect to section 35(2)<sup>5</sup> as stated above. Regulation 31(3) states that a company which authorised shares of a specific class, which had a par value, of which no shares have been issued, may not issue such shares after the effective date of the Act if such shares have not been converted to shares of no par value in the prescribed format. Regulation 31(5) stipulates that if a company has any outstanding issued par value shares, it may not increase the number of authorised par value shares. Furthermore, it may continue to issue shares of this class, until a proposal for conversion has been lodged.

At first glance it seems that a company might be able to keep its share capital as is and shareholders can continue being owners of shares with a par value. The draft regulations to the new Act proposed a "grace period" of five years in which a Company must convert existing par value shares into shares with no par value.<sup>6</sup> The final regulations however, made no specific mention to a prescribed "grace period". In an explanatory note issued by the Companies and Intellectual Property Commission, however it is stated that a "transition period" of two years is

---

<sup>1</sup> Companies Act 71 of 2008

<sup>2</sup> Act 71 of 2008

<sup>3</sup> Act 71 of 2008

<sup>4</sup> Companies Act Regulations 2011

<sup>5</sup> Act 71 of 2008.

<sup>6</sup> De Jager, N. 2010

given to companies during which all par value shares need to be converted. This explanatory note was issued to clarify the working of Form CoR 31, the form which is used when applying for the conversion of par value shares. The form states that no fee will be payable for the conversion if done during the two year period as mentioned above, but no mention is made that the conversion needs to happen within a specific time.

It is thus evident that existing companies will have to convert par value shares to no par value shares if it wishes to have new shares authorised. Companies that came into existence after the effective date of the Act will not be able to authorise par value shares.

The question that may then be asked is what exactly is the effect of the conversion? In the event of par value shares being converted into no par value shares it is of utmost importance from a tax perspective, that shareholders are informed of the material implications of such conversion. In certain instances such a conversion may trigger possible CGT.

### **Capital Gains Tax implications**

SARS<sup>7</sup> state that: "a share is a bundle of rights", referring to the judgement in *Standard Bank of South Africa Ltd & another v Ocean Commodities Inc & others*.<sup>8</sup> As such, they state that no disposal will take place, for CGT purposes, if a shareholder's rights remain unchanged after his/her shares have been converted from par value shares to shares of no par value. If some of the rights are lost or diminished, SARS is of the view that this will amount to a disposal or a part-disposal. They go on to say that: "Whether the reduction in rights will trigger a full or part disposal is a question of degree and will depend on the facts of the particular case."<sup>9</sup>

When a shareholder is adversely affected by a conversion and receives compensation, such compensation will in all probability be seen as proceeds for the disposal. This will be the case where some shareholders own shares with no par value and the par value shares are converted to shares of no par value.

### **Example where shares are owned in a private company**

A and B are shareholders of XYZ (Pty) Ltd. A owns 100 shares with a market value of R 100 000.00 and B owns 100 shares at a par value of R 100.

XYZ (Pty) Ltd passes a resolution where all existing par value shares will be converted to no par value shares. B will thus own 100 shares which must be assigned a fair market value. XYZ (Pty) Ltd will accordingly have 200 issued ordinary shares. The fair market value of A's shares will now

---

<sup>7</sup> SARS Comprehensive guide to Capital Gains Tax (Issue 4) 68

<sup>8</sup> *Standard Bank of South Africa Ltd & another v Ocean Commodities Inc & others* 1983 (1) SA 276 (A)

<sup>9</sup> SARS Comprehensive guide to Capital Gains Tax (Issue 4) 68

only be R 50 000.00. He was thus adversely affected as his 100 ordinary shares in effect are now worth half of what they were before the conversion. The value of the shares transferred to B (R 50 000.00) will be regarded as a disposal for CGT purposes by A provided he received compensation.

The question now also arises what will happen when B (in the example above) in future decides to sell his shares in XYZ (Pty) Ltd. He acquired the shares at par value of R 100. These shares were valued at R 50 000.00 after the conversion. When B decides to sell his shares, they are valued at R 100 000.00. His base cost, however, will be the value pre-conversion shares. Thus he will have a base cost of R 100. The reason being that the conversion of the par value shares required no monetary consideration from B and the gain made at the conversion stage is seen as a roll over for CGT purposes.

In the event of B passing away the value of his shares also form part of his estate. If the shares were par value shares at the date of his passing, they will merely be an asset to the value of R 100 in his estate. After the conversion to ordinary shares their value has increased significantly. Assume at the date of B's passing his shares are valued at R 5 000 000.00. For CGT purposes the base cost will still be R 100. However, this is only part of the problem as B now has an asset of R 5 000 000.00 in his estate which only carried a value of R 100 before being converted to ordinary shares.

### **Shares are owned in a public company**

On 2 November 2012 SARS issued a binding class ruling<sup>10</sup> which specifically deals with the implications of converting par value shares to no par value shares in a public company.

The proposed transaction entailed the conversion of par value shares. SARS detailed the process which needs to be taken by the company. What is of importance in this ruling is that all the par value shares will be converted. The result of this being that no shareholder will be prejudiced in any manner, as there was no distinction made between different types of shareholders. The shareholder's rights with regards to voting and participation, as well as profit and capital sharing, were also going to remain the same after conversion. Lastly, all shareholders were to be treated equally during and after the conversion and no compensation was to be paid to any of the shareholders.

SARS ruled that the above terms had the effect that no disposal took place and therefore could not trigger any CGT.

---

<sup>10</sup> SARS Binding Class Ruling: BCR 035. 2012

## Conclusion

It is unclear from the legislation governing the conversion of par value shares what the result will be where shareholders refuse to convert current par value shares to no par value shares. However, it is advised that planners who consult clients who recently had par value shares converted, or are in the process of doing so, give due regard to the particular circumstances in order to ensure that the client's needs are met from a tax planning, as well as an estate planning perspective.

## **Bibliography**

De Jager, N. *A practical guide to the implications of the new Companies Act*. December 2010. De Rebus. 47.

Explanatory Note: Notice of Board Resolution to convert par value shares – COR 31.

SARS Comprehensive Guide to Capital Gains Tax (Issue 4)

Stiglingh, M et al, 2015. *Silke: South African Income Tax 2015*. Lexis Nexis. Durban.

SARS Practice Manual

SARS Tax Guide for Share Owners Issue 4

Eighth Schedule to the Income Tax Act 58 of 1962

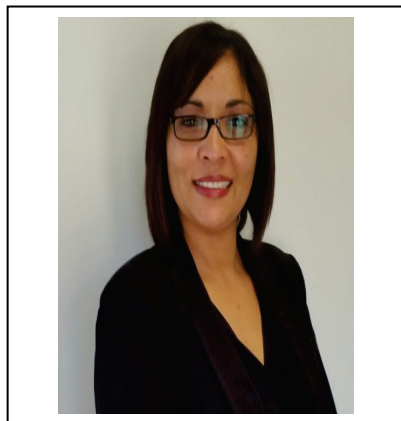
Companies Act 71 of 2008

Companies Act Regulations, 2011

SARS Binding Class Ruling: BCR 035. 2012.

Standard Bank of South Africa Ltd & another v Ocean Commodities Inc & others 1983 (1) SA 276 (A)

# CGT: Small Business Exclusion



**Karen van der Poll CFP®**

LLB, PG Dip in Fin Plan  
Legal Adviser Specialist  
PFA : Western Cape

## Introduction

The disposal of a business gives rise to capital gains tax consequences. This article will look at the relief provided to small business owners in terms of paragraph 57 of the 8<sup>th</sup> Schedule to the Income Tax Act.<sup>1</sup>

Paragraph 57 states that a natural person must disregard a capital gain in respect of the disposal of an active business asset of a small business owned by such natural person if that asset or interest in a partnership or company has been held for a continuous period of at least 5 years before the disposal; that natural person had been substantially involved in the operations of the business of that small business during that period, and that natural person had attained the age of 55 years or the disposal was in consequence of ill-health, other infirmity, superannuation or death.

## Definitions

### Active business asset

An "active business asset" is defined as:

- an asset which constitutes immovable property, to the extent that it is used for business purposes; or
- an asset (other than immovable property) used or held wholly and exclusively for business purposes

but excludes

- a financial instrument; and
- an asset held in the course of carrying on a business mainly to derive any income in the form of an annuity, rental income, a foreign exchange gain or royalty or any income of a similar nature.<sup>2</sup>

### Financial Instrument

A financial instrument is defined as:

- (a) a loan, advance, debt, stock, debenture, bill, share, promissory note, banker's acceptance, negotiable certificate of deposit, deposit with a financial institution, a participatory interest in a portfolio of a collective investment scheme, or a similar instrument;
- (b) any repurchase or resale agreement, forward purchase arrangement, forward sale arrangement, futures contract, option contract or swap contract;

---

<sup>1</sup> Act 58 of 1962

<sup>2</sup> Paragraph 57(1) of the Eight Schedule

- (c) any other contractual right or obligation the value of which is determined directly or indirectly with reference to
  - (i) a debt security of equity;
  - (ii) any commodity as quoted on an exchange; or
  - (iii) a rate index or specific index;
- (d) any interest-bearing arrangement; and
- (e) any financial arrangement based on or determined with reference to the time value of money or cash flow or the exchange or transfer of an asset<sup>3</sup>;

### **Small Business**

A "small business" is defined as:

A business of which the market value of all its assets, as at date of the disposal of the asset or interest contemplated in paragraph 57(2), does not exceed R10 million.<sup>4</sup>

The operation of the exemption can be seen through various examples set out below.

#### **Example:**

Immovable property not utilised 100% for business purposes

Mrs Jolie owns a building and utilises 50% of the building for a supermarket which she owns and the other 50% she lets to tenants who operate a Laundromat from the premises.

Mrs Jolie sells her interest in the supermarket as well as the building. Assume that Mrs Jolie is older than 55 years, has held the interest in the business for more than 5 years and has been substantially involved in the business. How much of the immovable property will constitute an active business asset?

#### **Answer:**

The 50% utilised for the supermarket will constitute an active business asset but the 50% which is let will not be considered an active business asset as it produces rental income, which is specifically excluded from the definition of an active business asset.

#### **Example:**

Movable assets not used wholly for business purposes

Miss Swift, aged 64, has a catering business which she operates from her kitchen at home. After 14 years of being involved in the business on a full time basis, Miss Swift decides to retire and

---

<sup>3</sup> Paragraph 57(1) of the Eight Schedule

<sup>4</sup> Paragraph 57(1) of the Eight Schedule

sells her small business which includes her catering equipment. Miss Swift also utilised the equipment for preparation of her meals. Will the equipment constitute active business assets?

**Answer:**

No, the equipment will not be considered active business assets as the requirement is that an asset (other than immovable property) has to be used or held wholly or exclusively for business purposes.

**Example:**

Differentiating between active and passive assets

Mr Clooney (60 years) is the sole member of XYZ Close Corporation and was substantially involved with the business for 6 years. The business is valued at R3 300 000, consisting of equipment to the value of R2 000 000, money market investments to the value of R800 000 and goodwill valued at R500 000. He sells his member's interest and realises a capital gain of R750 000. What is the gain in respect of active business assets?

**Answer:**

- The active business assets consist of equipment valued at R2 000 000 + goodwill valued at R500 000 = R2 500 000
- Thus the percentage of active business assets in relation to the total assets:  $R2\,500\,000 / R3\,300\,000 = 75.75\%$
- The gain in respect of active business assets is 75.75% of R750 000 i.e. R568 125.

**Time limit for disposal of assets**

Paragraph 57(4) provides that all qualifying capital gains must be realised within 24 months from the date of the first disposal.

**Example:**

Ms. Berry (55 years) was the sole member of Stitches Close Corporation. She operated a small sewing business and she was substantially involved in the business. Ms Berry decided to retire and on 1 April 2013 she sold her member's interest in the CC to her daughter, who was employed in the business. Her daughter did not however buy all of the sewing machines and 3 machines remained. Ms Berry then advertised and sold the sewing machines individually to various buyers. In December 2013 one machine was sold, in March 2015 another machine was sold and in July 2015, Ms Berry sold the last sewing machine. Ms Berry realised a capital gain on the sale of all 3 machines. Will the sewing machines qualify as active business assets?

**Answer:**

The capital gain in respect of the sewing machines sold in December 2013 and March 2015 will qualify as it was realised within 24 months of the first disposal, however the gain on the sale of the last machine, realised in July 2015, will not qualify.

**Partial disposal of an interest or active business asset**

Paragraph 57(2) makes provision for 3 types of disposal:

- An active business asset of a small business owned by a natural person as a sole proprietor
- An interest in each of the active business assets of a business, which qualifies as a small business, owned by a partnership, upon that natural person's withdrawal from a partnership to the extent of his or her interest in that partnership
- An entire direct interest in a company (which consists of at least 10 percent of the equity of that company), to the extent that the interest relates to active business assets of the business of that company.

A business owner would thus have to dispose of his entire interest in the business, whether it be the active business assets of a sole proprietorship, partnership or a company to qualify for the exclusion.

**Disposal of multiple small businesses**

Paragraph 57(5) provides that a natural person may include the disposal of multiple small businesses in the calculation of the capital gain which has to be disregarded.

Paragraph 57(6) stipulates that where a natural person disposes of multiple small businesses, the total market value of all those businesses together may not exceed R10 million.

**Example:**

Mr. Tatum is an accountant and has an accounting practice in which he has been substantially involved for the past 28 years. Mr Tatum (60 years) wishes to retire and sell his business. The business is valued at R1 200 000 consisting of goodwill which has a nil base cost. Mr Tatum also has a 50% shareholding, valued at R4.5 million, in a company which owns a nightclub. The company consists of a building and equipment to the value of R5 000 000, bank investments to the value of R3 500 000, goodwill to the value of R500 000. Mr Tatum has been substantially involved in the business for more than 5 years. The capital gain on the sale of the company is R4 million. Can Mr Tatum disregard the capital gain on the disposal of both businesses?

**Answer:**

No, the disposals will not qualify for the exclusion as the value of the two businesses exceeds R10 million.

## Disposal of a small business by persons married in community of property

Paragraph 14 deals with the disposal of an asset by a spouse in community of property and provides that where an asset falls within the joint estate, the disposal will be treated as having been made in equal shares by each spouse.

The Act<sup>5</sup> is silent on whether the paragraph 57 exclusion has to be apportioned between the spouses, however, since the Act is quite specific on the apportionment of other exclusions e.g., primary residence exclusion, it is my submission that the legislature did not intend for the exclusion to be apportioned between spouses thus where the asset falls within the joint estate, the capital gain will be split between the spouses and each spouse will be entitled to the exclusion provided they each meet the necessary requirements.

### Example:

Mary and Tom are married in community of property. They own a small printing business, which they started 10 years ago. Tom is also the general manager of the business and Mary is responsible for the bookkeeping of the business. Tom (52 years) passes away and Mary is his sole heir. Mary (56 years) decides that she wants to retire from the business and move to her daughter overseas. Mary and the executor sell the business valued at R9 million and realise a capital gain of R5 million. All the assets sold qualify as active business assets. How will the capital gain be treated?

### Answer:

The gain will be split between the spouses and the gain in Tom's estate will be R2 500 000. Tom was substantially involved in the business, which he owned for more than 5 years and the disposal arose as a result of his death. Thus R1 800 000 of the capital gain will be disregarded. Mary was also substantially involved in the business and had a share in the business for longer than 5 years, and Mary has attained the age of 55 years, thus R1 800 000 of the capital gain in Mary's hands will be disregarded.

## Disposal of small business assets upon death

If a natural person has not utilised the full R1.8 million exclusion during his or her lifetime, the deceased estate of that person will be entitled to the unused portion of the exclusion if the executor disposes of any active business assets.<sup>6</sup>

This can be seen by the following example:

Mr. Legend sold his small business in 2012 and realised a capital gain of R1 300 000. He utilised his R900 000 exclusion (the exclusion as at 2012). Mr Legend died in 2015 and his executor disposes of his two small businesses. Mr Legend was substantially involved in both businesses

---

<sup>5</sup> Income Tax Act 58 of 1962

<sup>6</sup> Comprehensive Guide to Capital Gains Tax (Issue 5)

and held the interest in both businesses for longer than 5 years. Business A is a company specialising in manufacturing of furniture. The assets of the company are R6 million but the company is severely in debt and has liabilities to the value of R5 500 000. Company B is a recording company which consists of a studio valued at R3 000 000 and goodwill valued at R1 500 000. The capital gain realised on the sale of both companies amounts to R2 300 000. How much of the capital gain will be disregarded?

**Answer:**

Mr. Legend would have R900 000 available as a small business exclusion, should the disposal qualify. In this instance the value of the two businesses exceed R10 million (Company A valued at R6 million and Company B valued at R4 500 000) and thus the deceased estate would not be able to utilise the exclusion at all.

### **Disposal of assets of a micro business**

In terms of paragraph 57A a registered micro business must disregard any capital loss or gain upon the disposal of any asset which is part of the micro business. An asset is only considered part of the micro business if such asset is used mainly for such business purpose. The word mainly means more than 50%.

Financial instruments held on capital account will not qualify as being used for business purposes and will thus not qualify for the exclusion.<sup>7</sup>

Paragraph 57A must be read in conjunction with paragraph 3 of the Sixth Schedule which provides that a person will not qualify as a micro business if the receipts from the sale of qualifying assets exceed R1 500 000 over a period of 3 years or less but the capital gain will still be disregarded as it is only in the month thereafter that the business will be deregistered as a micro business.

### **Conclusion**

It is thus clear that where the assets of a small business are disposed of, such disposal has to be carefully scrutinised to ensure that all the requirements are met.

---

<sup>7</sup> Comprehensive Guide to Capital Gains Tax (Issue 5)

**Bibliography**

Notes on South African Income Tax, 2015, P Haupt

SARS Comprehensive Guide to Capital Gains Tax (Issue 5)

Income Tax Act 58 of 1962

The South African Planning Handbook 2015, M Botha, L Rossini, W Geach, B Goodall, L Du Preez, P Rabenowitz