the standard approach which looks at intention at the first and only stage of the inquiry, a court could have found against NWK. That is exactly what Hefer JA did in *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* 1996 (3) SA 942 (A), in which, in one clear inquiry, the Court examined the real intention of the parties. Arguably that is what Lewis JA did in *NWK*, but that observation is, for the reasons advanced, open to debate. What is now clear, thanks to Wallis JA, is that if SARS wishes to rely on *NWK*, it must show that the parties intended to evade tax. And that is enough to prevent an overly enthusiastic invocation of *NWK* going forward.

When Beneficiaries Die Out Of Turn – Evaluating The Use Of Successive Usufructs As An Estate Planning Tool – Part I

By Franscois van Gijsen[1]

As an estate planning tool it is sometimes suggested to the estate owner that he bequeath property subject to two successive usufructs. It is proposed here that the scheme offers no real tax benefit and merely transfers the tax liability to the recipient of the bare *dominium* while exposing the contingent beneficiary to considerable tax risk should she die prior to her usufructuary right lapsing. It is further proposed that, should the bare *dominium* holder die prior to both of the proposed usufructuaries, the life expectancy of the first usufructuary, as the person entitled to such interest, should be used to calculate the value of the usufruct and, consequently, the value of the bare *dominium* in the bare *dominium* holder's estate.

There is a well-known practice among estate planners whereby the estate owner is advised to bequeath the bare *dominium* in a property to the heir or legatee in his estate subject to one or more successive usufructs. The idea behind such a bequest is an attempt to save estate duty in the estates of the estate owner and the first usufructuary. Should the scheme work as planned, this saving of estate duty will be achieved without an increased liability for estate duty in the estate of the succeeding usufructuary. The prevalence of this scheme is such that the erstwhile Minister of Finance, Trevor Manuel, announced in the *Budget Review* of 2009 that Treasury would be introducing legislative changes to close the scheme.[2]

The scheme is possible because the value of a usufruct or other limited interest is, for estate duty purposes, tied to the period that the immediate successor to the right is entitled to the enjoyment thereof – the longer the period for which the recipient receives the right, the higher the value thereof. This artificial tie to the period for which the recipient receives the right creates the opportunity to introduce a successor to the right for a short period of time, thereby reducing the value of the right in the hands of the original usufructuary.[3] While variants of the scheme are possible in its traditional form, as it is described in Annexure C to the *Budget Review 2009*,[4] the first usufructuary would receive the usufruct for life, while the succeeding, or contingent, usufructuary would receive the usufruct for a limited period only,

[1] BProc (Unisa); LLM (Tax) (UCT); Diploma Legal Practice (UCT); Post Graduate Diploma Financial Planning (UFS); Advanced Post Graduate Diploma Financial Planning (UFS); Certified Financial Planner®; Fiduciary Practitioner SA®; Attorney and Conveyancer of the High Court of South Africa; Director, Legal Services, Finlac Risk and Legal Management.

[2] *Budget Review*, 2009, Annexure C: Summary of additional tax proposals for 2009/10, p 185.

[3] Section 5(1)(*b*) and (*f*), Estate Duty Act, 45 of 1955.

[4] Footnote 2.

eg for a one- or two-year period.[5] The recipient of the bare *dominium* is usually a family trust or a child of the estate owner, while the first usufructuary is the estate owner's spouse and the succeeding usufructuary is a child or some other descendant of the estate owner. The saving in the estate owner's estate, if it is to be found, is the result of the deduction allowed for bequests to spouses contained in section 4(*q*) of the Estate Duty Act, 45 of 1955, as amended, ('the Act'). The proposed saving in respect of the first usufructuary results from the fact that the value of the usufruct to be included in his or her estate is to be calculated, in terms of section 5(1)(*b*) of the Act, on the lesser period of time for which the right of enjoyment is received by the succeeding usufructuary. The succeeding usufructuary, if events unfold as the estate owner envisaged, will no longer be entitled to the usufruct at the time of her death and, as such, there will be no 'fiduciary, usufructuary or other like interest in property' that can be included in her estate for the purposes of section 5(1)(*b*) of the Act.[6]

Not much has been written on the scheme, but Davis,[7] on the strength of the pronouncement in *Bassett v Commissioner for Inland Revenue*,[8] is of the opinion that the scheme should be effective as a means of saving estate duty. In addition Albertse, in his dissertation 'Die Boedelbelastingimplikasies van die aanwending van opeenvolgende beperkte regte', considers the scheme to be workable.[9] Certainly Treasury, in proposing amendments to section 5(1)*(b)* of the Act,[10] appears to have conceded that the scheme, as it stands, is within the allowable bounds of the law.[11]

The facts in the case of *Bassett v Commissioner for Inland Revenue*[12] were, briefly, as follows. A father, during his lifetime, was entitled to the trust income from a trust created by himself. Further, the trust deed provided in clause 1(*c*) thereof that upon the father's death the trust income would be distributed to his only child. This distribution would continue until the child reached the age of thirty, at which time the trust capital would be distributed to the child in terms of clause 1(*d*) of the trust deed. Revenue sought to levy duty on the value of the usufruct, which value they calculated over the life expectancy of the child. On the other hand, it was argued on behalf of the taxpayer that the period to be used in determining the value of the usufruct was from the date of death of the father until the child reached the age of thirty. As can be expected, the difference in the estate duty leviable was substantial. The Court, *per* Warner AJ, held against revenue on the following basis:

> 'Because he is the only child he is entitled, on reaching the age of 30, to receive from the trustees the capital of the trust. Thereafter the trust has no capital in which he can have a "usufructuary or other like interest", and, therefore, the interest given to him in terms of clause 1(*c*) must cease when he reaches the age of 30 years. It is true that thereafter he has all the income which the assets which previously represented the capital of the trust may bring in, but he then receives it *qua* owner of those assets, and not as a person holding a "usufructuary or other like interest" in those assets.'[13]

The efficacy of the scheme at reducing the overall tax liability

As the scheme involves four different parties who, at various stages, hold an interest in the property, it

[5] D Davis, *Estate Planning*, Service Issue 37 (2013), para 12-3.

[6] Sections 4(*q*) and 5(1)(*b*), Act 45 of 1955.

[7] D Davis (fn 5) para 12-3.

[8] *Bassett v Commissioner for Inland Revenue* 1961 (4) SA 769 (D).

[9] *Die boedelbelastingimplikasies van die aanwending van opeenvolgende vruggebruike* (unpublished LLM Thesis, Potchefstroom University for Christian Higher Education, 2003), p 33.

[10] Footnote 3.

[11] Para 6(*a*), Draft Taxation Laws Amendment Bill, 2009.

[12] Footnote 8.

[13] *Bassett v Commissioner of Inland Revenue supra* at 772.

needs to be considered whether or not it is successful as a method of reducing the overall tax liability in respect of the specific property. The efficacy of the plan should be measured not just in terms of the estate duty saving in the estates of the original estate owner and the first usufructuary, but should be measured instead by taking into account the combined estate duty liability and capital gains tax ('CGT') liability calculated over the whole of the period spanning the property's disposal in the estate of the original estate owner until the whole of the *dominium* therein is once again disposed of by the recipient of the bare *dominium*. In other words: if the scheme works as planned, it should in fact reduce the overall tax liability from one disposal of all the rights of ownership in the property – the bequests from the estate owner – to the next disposal of all the rights of ownership in the property, ie after the lapsing of the usufructs in favour of the recipient of the bare *dominium*.

The scheme occasions an interesting interplay between estate duty and CGT in respect of the burdened property, whereby the bequest of the property subject to the usufructs reduces the property's base cost in the hands of the bare *dominium* holder. The property's base cost in the hands of the bare *dominium* holder is the value of the bare *dominium* at the time he receives it from the estate owner's estate. This is the result of the application of paragraphs 33(1)(*a*) and 40(2)(*a*) and (*b*) of the Eighth Schedule.[14] However, while the property will, presumably, steadily increase in value as time passes and the usufructs lapse, the bare *dominium* holder's base cost in respect of the property will not likewise increase. This, in turn, leads to an increased liability for CGT the next time the property, or a part thereof, is disposed of. In fact, a significant portion, if not all, of the estate duty savings which may have been obtained through the use of the scheme is likely to be recouped by the *fiscus* in the form of increased CGT payable the next time the property is disposed of.

The scheme, as a result of the lowered base cost and the increased exposure to CGT:

- only postpones the moment at which the tax is collected, and
- in effect transfers the postponed portion of the estate owner / parent's tax liability to the child who receives the bare *dominium* in the property, and
- could in addition, in certain circumstances, readily increase the overall liability for tax in respect of the second usufructuary.

Treasury has since decided not to proceed with the changes proposed in the Draft Taxation Laws Amendment Bill, 2009, as the proposal would unfairly penalise all usufructs, many of which fulfil important estate planning functions unrelated to estate duty. It was also remarked that the proposal could still be abused through the use of public benefit organisations to artificially reduce the estate. The Standing Committee on Finance did, however, conclude that 'one-year schemes remain of concern and still warrant an appropriate remedy'.[15] It is however suggested that the increased liability for CGT resulting from the scheme, and the effective recoupment of lost revenue in that manner, is a sufficient reason for Treasury to no longer bother with changes to the Act aimed at closing the scheme. The increase of the inclusion rate for CGT from 25 to 33,3 per cent – for individuals – is probably sufficient to negate any estate duty benefit obtained through implementation of the scheme.[16]

A further aspect to consider is the risk, inherent in the scheme, that one or more of the parties involved may die at a time not in keeping with the sequence of death envisaged by the estate owner when deciding to implement the plan. This possibility raises two issues for consideration: first, how to value the property should the bare *dominium* holder die prior to both the first usufructuary and the contingent usufructuary; and secondly, the effect should the second usufructuary die prior to the lapsing of the usufruct granted over the property.

[14] Paras 33(1)(*a*) and 40(2)(*a*) and (*b*), Eighth Schedule, Income Tax Act, 58 of 1962.

[15] Standing Committee on Finance: Report-back Hearings (25 August 2009), Taxation Laws Amendments Bills, 2009, Final Response Document at 2.6.2; see also D Davis (fn 4) at 12.3.

[16] Para 10, Eighth Schedule, Income Tax Act, 58 of 1962; amended s 9(1)(*a*) and (*b*) of Rates and Monetary Amounts and Amendment of Revenue Laws Act, 13 of 2012.