DECEASED ESTATES

INCOME TAX AND VAT

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Deceased Estate

- After the date of death a new taxpayer is created, the deceased estate.
- The executor must complete the return of income derived by the estate and submit the resulting claim for normal tax against the assets of the estate.
- Register for tax as a category “a” special trust
- In an assessment of the deceased estate, the deceased estate is taxed at the same rate of tax as a natural person, however the deceased estate does not qualify for personal rebates in terms of section 6.
- The taxation of income which is received by or which accrues to the deceased estate is governed by section 25

Deceased Estate Section 25

- *Liability of heir or legatee*

Section 25(1) provides that any income received by or accruing to the executor, including any amount so received or accrued, which *would have been* income in the hands of the deceased (had it been received or accrued to the deceased during their lifetime) shall:

- if such income or an amount has been derived for the immediate or future benefit of any ascertained heir or legatee, be deemed to be income of such heir or legatee, and,
- if not, be deemed to be income of the deceased estate.

In order for an heir or legatee to be an ascertained heir or legatee, a vested right to the income is required. The income to which the heir or legatee has a vested right shall retain its identity in their hands.

Deceased Estate Section 25 deductions

Deductions and allowances

- Section 25(2) provides that any deduction or allowance which relates to any income of an heir or legatee in terms of section 25(1) shall be deemed to be a deduction or allowance of such heir or legatee.
- Similarly, the estate is entitled to the deductions or allowances relating to the income taxed in its hands.
- If the expenditure relating to income deemed to be the income of an heir or legatee in terms of section 25(1) exceeds that income it appears that the heir or legatee may set off the loss against other income. The deductions and allowances are not “ring-fenced” as they are in the case of trusts.

TLAB 2015 first draft

EM TLAB 2015 first draft (22 July 2015, page 7)

- New section 9HA
- "In principle, gains and losses of whatever nature will, in terms of the unified rules, be triggered on a person's death with the current exceptions being preserved"
- "Subsequently, income received by or accrued to the deceased estate will be taxed in the hands of the deceased estate and roll-over relief will be provided in respect of transfers from the deceased estate to any heir or legatee."
- Effective date
  - The proposed amendments will come into operation on 1 January 2016 and apply in respect of a person who dies on or after that date.

Deceased Estate CGT

- Para 40 (8th Schedule)
- Deemed disposal on death
  - Subject to limited exclusions (eg surviving spouse) when a person dies he or she is treated as having disposed of all his or her assets for proceeds equal to the market value of the assets at the date of death.
  - Effect of the deemed disposal on death is that capital gains tax is imposed on the growth in the deceased's estate.
  - Potential impact on the liquidity of the deceased estate
- Executor of deceased estate
  - Distribution of assets, or
  - Disposal of assets

Deceased Estate CGT

- Distribution of assets
  - No capital gains tax arises
  - The disposal must be treated as a disposal for proceeds equal to the deceased estate's base cost of the assets
  - The heir, legatee or trustee is treated as having a base cost equal to the base cost of the deceased estate
- Disposal of assets
  - The disposal is to be treated in the same manner as if the asset had been disposed of by the deceased eg: R3000 annual exclusion and 33,3% inclusion rate
- Capital gains arising from the *disposal* of assets by the executor of a deceased estate are taxed in the hands of the deceased estate. No flow through to heir or legatee

Deceased Estate and VAT

- "VAT 413 Guide for Estates" SARS guide dated 27 March 2015
- The term "**enterprise**" is one of the most important concepts in the VAT Act, because –
  - a person that does not conduct an enterprise cannot register for VAT; and
  - only supplies made in the course or furtherance of carrying on an enterprise (referred to as taxable supplies) are subject to VAT.
- The definition of "enterprise" specifically excludes, amongst others, activities that involve the making of exempt supplies, for example, the letting of a dwelling and any activity carried on by a natural person as a private or recreational pursuit or hobby.

Deceased Estate and VAT

- When a person dies, one of the following scenarios may apply:
  - The deceased person was registered as a vendor at date of death (eg sole trader);
  - The deceased person was not registered as a vendor at date of death but was liable to be registered as a vendor while still alive ; or
  - The deceased person was neither registered nor liable to be registered as a vendor at the date of death and the estate is not liable to register for VAT (eg shareholder in a company).
- Anything done as part of the termination of an enterprise is deemed to be done in the course of that enterprise, eg winding down the enterprise of a deceased person.

Deceased Estate and VAT

- Representative vendor

A representative vendor (also known as the representative taxpayer) represents the estate and has to ensure that the estate complies with the VAT and Tax Administration Acts.

- An *executor* that acts on behalf of deceased persons and their estates is regarded as a representative vendor.
- As such, the executor is responsible for performing all the duties of the enterprise previously carried on by the deceased person.
- The Commissioner has the same remedies against the property controlled by the executor, in a fiduciary capacity as the remedies previously available against the deceased person

Deceased Estate and VAT: Duties of executor

- **Duty to register for VAT**

The administrator of an estate has a duty to register the estate as a vendor if the deceased person was liable to register for VAT but failed to do so before date of death.

- **Duty to issue tax invoices**

The administrator is required to issue tax invoices in respect of taxable supplies of goods or services made by the estate.

- **Duty to submit VAT returns and pay tax**

VAT returns outstanding before date of death

The administrator must complete and submit VAT returns outstanding in respect of the tax periods before the deceased person died. Failure to do so may result in the Commissioner issuing estimated assessments.

Deceased Estate and VAT Duties of executor

- *VAT returns due after date of death*

The administrator must also complete and submit VAT returns in respect of the estate for tax periods after the deceased person's death.

- *Calculating VAT*

VAT due to SARS is calculated by deducting permissible input tax from output tax levied on supplies made by the estate.

- *Payment of VAT*

The administrator has to submit a VAT201 return and pay any VAT due timeously.

- The estate will use the VAT number of the deceased vendor

Deceased Estate and VAT Duties of executor

- Once the administrator has established that the estate is a vendor, the VAT treatment of the various transactions needs to be considered.
- During the course of administering an estate the administrator will collect and pay claims, as well as realise (sell) and distribute estate assets whilst acting as the representative of the estate.
- It is important to consider the estate's VAT status as soon as possible as the liability to register (if applicable) and account for VAT will have a direct effect on the administration of the estate.
- The administrator must distinguish between taxable supplies of the enterprise and non taxable supplies
- It is important to note that the transfer of goods or services from the deceased person to that person's estate is not regarded as a supply as they are deemed to be one and the same person.

Deceased Estate: Non-taxable supplies

- Examples include the sale or disposal of the following:
  - The deceased's dwelling, holiday home, time-share interests;
  - Household furniture and appliances and assets acquired in pursuance of a hobby;
  - Financial instruments and private investments such as life policies, participation mortgage bonds, shares in companies, interests in close corporations and nominee holdings;
  - Assets in respect of which an input tax deduction was denied under section 17(2) of the VAT Act (for example motor cars and entertainment assets).
- The administrator should not account for any VAT in respect of goods and services which did not form part of the deceased person’s enterprise.

Deceased Estate: Taxable Supplies and output VAT

- Examples include
  - Continuing the deceased vendor’s enterprise temporarily
  - Realisation of assets of the enterprise used for the making, wholly or partially, of taxable supplies
  - Cessation of the enterprise
- VAT must be charged irrespective of whether the sale is made by auction or by other means
- The VAT so charged will constitute output tax in the hands of the estate and must be accounted for on the estate’s VAT returns
- There are, however, some exceptions where VAT need not be charged, for example, the supply of a motor car will not be a taxable supply unless the deceased person traded in motor cars or was otherwise entitled to deduct input tax on the acquisition of the motor car

Deceased Estate: Taxable Supplies and input VAT

- The executor may also deduct input tax in respect of costs incurred *to make taxable supplies* during the course of winding up the estate.
- The following are examples of claims which may arise from exempt supplies and the estate will therefore not be entitled to deduct input tax in respect thereof as no VAT would have been charged on these supplies:
  - Loans of money made to the deceased person, including loans secured by mortgage bonds;
  - Life insurance policies (unpaid premiums), pension provident or retirement annuity fund contributions (unpaid contributions);
  - Unpaid medical aid contributions;
  - Outstanding rental in respect of the deceased person's dwelling.

Deceased Estate: Distribution of enterprise assets

- **Distributions to heirs and legatees**
- The executor will become personally liable for outstanding tax if any assets of the estate are distributed to beneficiaries while the estate's tax remains unpaid.
- The distribution of any asset in the form of a bequest or legacy is a supply of goods or services, except in the case of a monetary distribution as "money" is specifically excluded from the definitions of "goods" and "services" in section 1(1) of the VAT Act.
- The executor should classify the various assets of the estate into one of the following categories:
  - Assets which formed part of the deceased's enterprise (wholly or partially);
  - Assets which did not form part of the deceased's enterprise

Deceased Estate: Distribution of enterprise assets

- It is necessary to determine the relationship between the beneficiary and the deceased to establish whether the parties are regarded as "connected persons"
- The term "connected persons" is important as supplies between certain persons falling within the ambit of the definition of "connected persons" in section 1(1) of the VAT Act will most likely occur in the course of winding up the estate of a person.
- As a result, the application of special time and value of supply rules may need to be considered by an administrator when determining the VAT treatment of certain supplies made in that process.

Deceased Estate: Connected persons

- *Natural persons*

A natural person is considered to be a connected person in relation to –

- any relative of that natural person, or
- any trust fund in which the natural person or relative is, or may be a beneficiary.

- The terms “natural person” and “relative” include the deceased or insolvent estate of that natural person or relative.
- A relative, in relation to any person, means:
  - The spouse of that person;
  - Anyone related to that person or his/her spouse within the third degree of consanguinity, or
  - Any spouse of the relative.

Deceased Estate: Consideration

- The estate is liable to account for VAT on the distribution of goods and services that formed part of the deceased's enterprise.
- Output tax is calculated by applying the relevant tax fraction to the *consideration* charged, which, in most cases, will be nil where assets are bequeathed to a legatee or heir without a bequest price. In this case the output VAT is nil
- However, if the special value of supply rule for "connected persons" in section 10(4) applies, VAT must be accounted for on the open market value of the goods, notwithstanding the fact that no consideration was payable.
- The bequest of a limited interest (eg ususfruct and/or bare dominium) must also be considered for VAT purposes

Deceased Estate: Consideration

- Section 10(4) of the VAT Act
- Where a vendor (the estate) supplies goods to a connected person (eg relative of the deceased) for
  - No consideration, *or*
  - A consideration that is less than the open market value (OMV) *and*
  - Had the connected person recipient paid an OMV consideration, the connected person recipient would not have been able to claim a *full* input VAT (eg non vendor, vendor making partially non-taxable supplies)
- The consideration of the supply is deemed to be its OMV
- Estate must account for output VAT: OMW x 14/114

Deceased Estate: Consideration

- Example (VAT Guide page 25)

Scenario

G, a vendor, was the owner of Z Catering. G bequeathed a delivery vehicle (single cab bakkie) which was used in his business to his son (a non vendor student). The rest of the business assets were bequeathed to Z Catering's employees who are not related to G. All G's private assets were bequeathed to G's spouse.

The open market values of the assets were as follows:

- Delivery vehicle – R25 000
- Other business assets – R50 000
- Private assets – R1.5 million

Question

What is the VAT effect on G's estate?

Deceased Estate: Consideration

Solution

- G's son is a connected person who will not be using the delivery vehicle to make taxable supplies, therefore section 10(4) applies and the estate is liable to account for VAT on the open market value of the vehicle. Output tax due in respect of the vehicle is R25 000 × 14 / 114 = R3 070.18.
- The employees of Z Catering are not connected persons in relation to G and therefore the general valuation rule applies. The value of these supplies is nil as the employees are not required to pay any consideration to acquire the assets. Output tax in respect of these assets is therefore nil.
- G's private assets did not form part of G's enterprise and the distribution thereof to G's spouse is not subject to VAT.

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