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FIDUCIARY MATTERS

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Repeal of the interspousal estate duty deduction

The Davis Tax Committee (DTC) was mandated to investigate, amongst other matters, the progressivity of the tax system and the role and continued relevance of estate duty. During July 2015, the DTC's Interim Report was released for public comment. The publication of this interim report has led to widespread speculation and discussions relating to the continued benefits associated with family trusts.

The report made recommendations on measures which may be instituted to increase fiscal revenues. One recommendation relates to scrapping the roll-over relief on death of a spouse. Current legislation dictates that should the first dying spouse bequeath their entire estate to their surviving spouse, there would be neither estate duty nor capital gains tax payable in their estate. The value of the first dying spouse's estate at death would 'roll over' into the surviving spouse's estate, which at death of the surviving spouse may become subject to both estate duty and capital gains tax. In this instance, the first dying spouse does not utilise the primary abatement (currently R3.5 million) and therefore the surviving spouse would now have a deduction of R7 million (R3.5 million plus R3.5 million) before the estate of the last dying spouse would become dutiable. In recommending the scrapping of the roll-over relief on the death of a spouse, the DTC proposes instead that each spouse should pay estate duty on their own estate at death and that the primary abatement be increased from R3.5 million to R6 million.

Example
Current situation:

The first dying spouse ('John') passes away with a net estate value of R10 million, whilst the surviving spouse ('Mary') has a net estate worth R7 million. In terms of current legislation, neither estate duty nor capital gains tax would be levied on John's estate should he bequeath his entire estate to Mary.
On Mary's death (assuming nil growth) estate duty of R2 million would be payable (R10 million inherited from John plus her own estate of R7 million, resulting in a net estate value of R17 million, less the R7 million abatement, resulting in a taxable balance of R10 million at a rate of 20%).
The total estate duty payable for John and Mary is thus R2 million.

If the DTC's recommendations are implemented the effect would be as follows:

On John's death, estate duty of R800 000 would be payable in his estate (net estate of R10 million less the abatement of R6 million at a rate of 20%). Should he proceed to bequeath his entire estate to Mary, she would receive R9.2 million from his estate. On Mary's death (assuming nil growth) her net estate value would be R16.2 million and estate duty of R2.04 million would be payable (R16.2 million less the abatement of R6 million at a rate of 20%). The total estate duty payable for John and Mary is thus R2.84 million.

The net impact of the DTC's recommendation for the scrapping of the roll-over relief on the death of a spouse would be an additional R840 000 (a 42% increase) in estate duty payable by John and Mary.

If the DTC's recommendation to scrap the roll-over relief on death of a spouse is implemented, a family trust becomes a viable option to reduce estate duty, as demonstrated by the example below:

Should John upon death bequeath his net estate (R10 million) to a trust, his estate duty would remain the same (R800 000 - net estate of R10 million less R6 million abatement at a rate of 20%) as if he had bequeathed the assets to Mary. As Mary derives no benefit from John's estate upon his passing, estate duty payable on her net estate at death would be R200 000 (net estate of R7 million less R6 million abatement at a rate of 20%). The total estate duty payable for John and Mary is thus R1 million.

If the DTC's recommendation to scrap the roll-over relief on death of a spouse is implemented, a family trust becomes a viable option to reduce estate duty

Use of a family trust would thus reduce the total estate duty payable from R2.84 to R1 million – an estate duty saving of R1.84 million.

Should the DTC's roll-over relief recommendations be implemented, the benefit derived from a family trust to reduce estate duty and preserve wealth is abundantly clear. As such, trusts will remain useful estate planning tools. Remember, however, that the specific individual's circumstances, assets and needs have to be taken into careful consideration before a trust structure is recommended.

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