



## **Summary of FISA’s commentary on the 1<sup>st</sup> Interim Report on Estate Duty by the Davis Tax Committee (“DTC”)**

In September 2015 FISA formally lodged a document containing its commentary on the 1<sup>st</sup> Interim Report issued by the DTC. In this Interim Report the DTC formalised its recommendations and proposals regarding the current status of wealth taxes and trusts in South Africa. The Interim Report was carefully perused by the FISA Council and after many deliberations formal feedback was lodged to the DTC. This document contains a summary of the most significant comments made by FISA.

### **1. GENERAL:**

- 1.1 The driving principle behind vertical equity in tax law is the notion that those who are more able to pay taxes should contribute more than those who are not. Although FISA acknowledges that this underlying pillar is a fundamental requirement in a country like South Africa where glaring disparities between the rich and the poor exist, FISA cautions that the progressivity of the tax system should not be such as to hurt the middle class and future high net worth individuals.
- 1.2 Some of the suggestions made by the DTC regarding the application of taxes upon death are perceived to be very harsh and could, if implemented, prejudice surviving spouses, especially those who may be vulnerable from a cash flow point of view despite having substantial value locked up in illiquid assets.
- 1.3 FISA concluded its commentary by recommending that further research was desperately needed in some areas before final decisions are taken.

### **2. TRUSTS:**

- 1.1 The conduit principle lies at the heart of the nature of a trust as legal construct and, as such, FISA suggests that it should be retained.
- 1.2 The finding by the DTC that the use of trusts leads to substantial loss of estate duty is questioned and is suggested to be probably substantially overstated. The argument that property transferred to a trust is lost to the estate duty regime and therefore to wealth tax revenue, loses sight of the following:

2.1.1 Upon transfer to a trust, the collection of capital gains tax is accelerated;

2.1.2 The tax leakage due to the so-called perpetual nature of family trusts is also overstated, as the typical “family trust” very rarely lasts longer than the second generation. Necessity, and the desire to own assets individually, usually lead to an undoing of the majority of these structures every second generation.

1.3 The generic proposal that the conduit principle should be abolished to solve “tax leakage” ignores the fact that many a trust structure is set up with a non-tax purpose in mind. In fact, asset protection has probably become the dominant reason for the setting up of trusts.

1.4 It is suggested that the current flaw in practice is that income and/or capital gains flowing through a trust to beneficiaries is not always reflected as such in the hands of those beneficiaries. The answer in countering this is submitted to reside in the proper enforcement and disclosure of income and capital gains vested in beneficiaries. This problem would be greatly reduced with the new framework adopted in the new tax returns for trusts (ITR12).

1.5 As an alternative, it is suggested that the conduit principle be retained but that definitions of typical tax avoidance trusts are refined, similar to what was done with the notion of “personal service providers”. A multi-factor test as with the capital gains exclusion for small business owners upon retirement could also be utilised, or the cases of abuse of trusts could be identified by way of a test based on the fundamentals of trust law, for example as formulated in the Parker case.

### **3. REPEAL OF ANTI AVOIDANCE PROVISIONS: SECTION 7 AND PAR 68 – 72**

1.6 The generic concern about the use of section 7 and paras 68 – 72 of the 8th Schedule, to deem income and or capital gains of the trust to be that of a donor and prevent it from being taxed in the hands of the trust, is probably misplaced.

1.7 Although FISA agrees with the merits in the DTC wanting to abolish section 7(5) and paragraph 70, it is submitted that the other deeming provisions of section 7 and the corresponding paragraphs in the 8th Schedule be retained.

### **4. FOREIGN TRUSTS:**

1.8 The proposal by the DTC to tax all distributions from foreign trusts as income seems harsh and can not be justified on the basis that it is difficult to ascertain the nature of the distribution. A rebuttable presumption to be implemented in this regard is suggested by FISA.

**5. INTER-SPOUSAL BEQUESTS:**

- 1.9 It is submitted that the current deduction for inter-spousal bequests simply recognises the fact that most South Africans who died have been in a relationship at the time of death. The view by the DTC that there are no pragmatic reasons for retaining this, while at the same time proposing that the standard abatement of the survivor can be used at the death of the first-dying “spouse”, seems to be based on flawed logic.
- 1.10 It is submitted that the inter-spousal bequest forms a cornerstone of providing for the survivor’s financial stability and a deduction of such bequest for estate duty purposes should be retained.
- 1.11 As an alternative the deduction could be capped at a level which will refine the attempt to levy estate duty on high net worth individuals, without prejudice to surviving spouses in the middle class.

**6. INTER-SPOUSAL DONATIONS:**

- 1.12 The proposed limitation of inter-spousal donations exemptions to exclude fixed property and shares is perceived not to take cognisance of the reasonable use of such donations for reasons of fairness between spouses.

**7. SECTION 56 OF THE ITA:**

- 1.13 The concern about the exemptions from donations tax in sections 56(1)(c) and 56(1)(d) of the Income Tax Act is misplaced.

**8. RATES:**

- 1.14 The recommendation that the 20% flat rate for estate duty and donations tax be retained is welcomed.

**9. CGT AT DEATH IS A WEALTH TAX:**

- 1.15 It is submitted that the authority used for the view that capital gains tax at death is not a wealth tax, is inappropriate.

*The above summary of the FISA Council subcommittee submission to the Davis Tax Committee was compiled by Dr Stefan Strydom (SBRO).*