

IS TREASURY PULLING THE WOOL OVER OUR EYES?

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In his Budget Speech earlier this year, the Finance Minister announced a higher estate duty tax rate of 25% for estates greater than R30 million. The Budget Review 2018 states that this increase is “in line with Davis Tax Committee recommendations” and that “To limit the staggering of donations to avoid the higher estate duty rate, any donations above R30 million in one tax year will also be taxed at 25 per cent.”

But this is not quite what the Davis Tax Committee (DTC) proposed. In its Second and Final Report on Estate Duty, the DTC pointed out that the primary estate duty abatement of R3,5 million has not been increased in nine years (now 11 years). This lack of adjustment of the abatement has resulted in a substantial amount of fiscal drag in the system.

The DTC also pointed out that the inter-spouse deduction contained in s4q of the Estate Duty Act was discriminatory as it excluded a substantial number of families from the relief offered by s4q - such as single parent families, families supported by grandparents, families supported by children and families supported by relatives or friends. The DTC showed that of 1 445 estates reported in the 2014/2015 fiscal year 1 310, or 90%, were valued at less than R15 million. Of the remaining 135 estates, 87 were valued at above R20 million.

The DTC's recommendations aimed to address potential financial hardship resulting from the estate duty regime, whilst at the same time dealing with the discrimination of the inter-spouse deduction. It suggested that the estate duty abatement, presently at R3,5 million, should be increased to R15 million for all taxpayers, irrespective of their marital status. At the same time the inter-spouse deduction contained in s4q of the Estate Duty Act should be withdrawn. The R15 million estate duty exemption, which the DTC proposed, was calculated to be sufficient to cover a home and personal effects to the value of R5 million, as well as investments and cash to the value of R10 million which the Committee deemed sufficient to provide a sustainable pre-tax income stream of R40 000 to R50 000 per month.

The proposals were also intended to exclude the middle class from estate duty liability, and sought to target those who have large estates. The DTC stated that the owners of larger estates “must, in the interests of the future of the country, be obliged to bear a larger burden without, in any material way, detracting from their lifestyle or family security.”

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To my mind, Treasury has bastardised the DTC's suggestion of increasing the estate duty rate to 25% on the dutiable portion of estates that exceed R30 million, by robbing it of all its defining concomitant suggestions. But by not implementing the whole of the DTC's suggestion it has also provided the taxpayer the means to undermine Treasury in its search for more revenue. With the s4q inter-spouse deduction still in place, it is easy for the taxpayer, by bequeathing assets to a spouse, to reduce the value of the estate to less than the R30 million required to trigger the higher estate duty rate.

Furthermore, increasing donations tax to 25% on that portion of donations that exceed R30 million fails to achieve Treasury's stated objective of limiting

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the staggering of donations to avoid the higher estate duty rate. You do not have to donate R30 million or more in order to avoid paying the higher estate duty rate. You only need to donate, over the course of your life, sufficient assets so your estate not exceed R30 million at the time of your death.

What is more, by reducing your dutiable estate to less than R30 million by means of donations (not exceeding R30 million at a time), you have managed to benefit your estate and deprived the fiscus by much more than the additional 5% estate duty that it wished to levy. While 5% does not sound like a huge amount, it is in fact an increase of 25% on the 20% estate duty that you would otherwise have paid.

Nevertheless, the method of calculation of the two taxes provides a tax saving of at least 25% for those who can afford to donate assets prior to their death

and to pay the donations tax. Let us assume a tax rate of 20% in respect of both taxes and ignore for the moment the R3,5 million estate duty abatement and the R100 000 donations tax exemption. Estate duty is calculated on your estate and what is left after the tax has been paid is divided among your heirs. Therefore, in order for an heir to inherit R1 million you need an estate of R1,25 million (20% of R1 250 000 = R250 000). However, donations tax is calculated on the amount that you donated. Therefore, if you donate R1 million to an heir, your tax is calculated on the amount donated (20% of R1 000 000 = R200 000). The total amount needed to donate a million rand is thus R50 000 less than that needed to bequeath a million rand - a saving in tax, when donating, of 25%.

Now, if you had a R50 million estate, your estate duty liability using the new rates and taking into account the R3,5 million abatement, would be R10 125 000, leaving you with R39 875 000 to be distributed to your heirs.

However, if you did the same exercise, but you donated a once off amount of R20 000 000 prior to death then, using the R100 000 annual donations tax exemption, you would pay R3 980 000 donations tax. That would leave you with an estate on death of R26 020 000. Using the new rates and, taking into account the R3,5 million abatement, your estate duty on the R22 520 000, dutiable estate will be R4 504 000. The combined donations tax and estate duty liability now is R8 484 000. The total assets distributed to heirs in this scenario is R41 516 000.

It should also be borne in mind that this saving increases the larger the amount you donate and also if your donations are spread over more than one tax year so that you get the benefit of the R100 000 donations tax exemption in each year. This benefit would double if both you and your spouse make annual donations, so have a combined R200 000 saving in respect of the annual exemption.

It is ironic, however, that this ability to manipulate tax liability is one that is essentially only available to the wealthy. Middle class taxpayers, those people whom the DTC was trying to benefit, cannot afford to donate large amounts of money in order to reduce an overall tax liability - more so because a large amount of their eventual estates will be the result of life insurance that only becomes available to their estates on death.

A further irony is that the wealthier taxpayer at whom the higher estate duty rates are aimed, and those who are better able to manipulate their estate values by means of donations, are also to a large extent the ones at whom the new s7C (which levies donations tax on deemed donations in respect of interest-free/low-interest loans) is aimed. The dual benefit of reducing overall tax and the annual obligation in respect of s7C would be a great incentive for those people with such loans to donate the loans to the trust that owes it to them. In doing so, they will avoid the annual donations tax in respect of the deemed donation to the trust, while also reducing their eventual estate duty liability.

Considering the comparative ease with which the effect of the increased estate duty and donations tax rates can be avoided, provided that you have the cash flow to do so, one has to wonder whether Treasury truly worries about "the staggering of donations to avoid the higher estate duty rate". I suggest not. The reduced estate duty that results from such donations is for Treasury somewhere in a vague and distant future. The benefits to a cash-strapped government of increased donations tax receipts are much more immediate. The only people who seem not to benefit are those in the low and middle income brackets. ●

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