OLDMUTUAL

FISA PRESENTATION: ESTATE PLANNING

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DO GREAT THINGS

Agenda

- **FISA Agenda- Session 2:**
  - ✓ Limited rights and CGT
  - ✓ Farm property: Estate Duty & CGT
  - ✓ Section 4p deduction and the apportionment of estate duty
  - ✓ Crypto-currency and estate planning

Limited Rights and CGT

- Where a usufruct is granted via the will of a deceased, there will be a part disposal of the asset if the usufruct is granted to the surviving spouse of such deceased person and the bare dominium is bequeathed to another person (for example a child or an *inter vivos* trust). This will essentially amount to a disposal of the bare dominium to another person under Paragraph 40(1) of the 8th Schedule to the Act, whilst there would be a roll-over in respect of the usufruct granted to the surviving spouse. In this regard it will be necessary to segregate the base cost of the asset in relation to the deceased by allocating a portion of the base cost of the asset to the usufruct and the balance of the base cost to the bare dominium. Where a usufruct in respect of the asset is granted to the surviving spouse, whilst the bare dominium is bequeathed to another person, the bare dominium portion of the base cost will be utilised in determining the capital gain (or loss) in the hands of the deceased, whilst the surviving spouse will take over the balance of the base cost (i.e. the portion of the base cost allocated to the usufruct) to determine the capital loss on expiry of the usufruct. Here it must just be borne in mind that the surviving spouse will in this instance only be able to claim a capital loss on expiry of the usufruct, if the spouse had employed the asset for purposes of trade.
- Where a usufruct is granted via the will of a deceased and neither the usufructuary or the holder of the bare dominium is the spouse of the deceased, there will be a full disposal of the asset by the deceased: there will be a disposal of the usufruct to the usufructuary and a disposal of the bare dominium to the holder of the bare dominium. The value of the asset minus the base cost of the asset will thus be used to determine the capital gain (or loss) in the hands of the deceased. In this regard it will however still be necessary to segregate the base cost of the asset in relation to the deceased by allocating a portion of the base cost of the asset to the usufruct and the balance of the base cost to the bare dominium. The base cost of the usufruct will be used to determine the capital loss on the death of the usufructuary where the asset was used for purposes of trade. The base cost allocated to the holder of the bare dominium will essentially be the difference between the base cost of the asset and the base cost of the usufruct on date of death of the person who created the usufruct.
- In a situation where the will of a deceased person provides that the usufruct is granted to a third person, whilst the bare dominium vests in the surviving spouse, there will be a disposal of the usufruct, whilst there will be a roll-over in respect of the usufruct.

Limited Rights and CGT

- <u>Example 1: Usufruct Created in Favour of Surviving Spouse</u>
- This example is taken from the SARS Comprehensive Guide to Capital Gains Tax.
- On 31 July John Brown died and bequeathed his holiday home that he acquired in 2002 to his family trust subject to a usufruct in favour of his spouse over her remaining life. At the time of his death, John's spouse was 72 years old. The base cost of the property in John's hands is R400 000 and the market value of the property at date of death is R1 000 000.
- After 10 years John's wife passes away. The trust thereafter disposes of the property for R1 000 000 (assume the prices remained unchanged from date of John's death until the date of disposal by the trust). What are the capital gains tax implications for:
- John
- John's deceased estate
- John's wife, and
- The John Brown Family Trust
- Example obtained from South African Revenue Service, Comprehensive Guide to Capital Gains Tax (Issue 4), p 649.

Limited Rights and CGT

- Result:
- John (the deceased)
- John’s spouse will turn 73 at her next birthday. According to Table A she has a life expectancy of 10.24 years, and the present value of R1 a year over her remaining life is 5,72222.
- The property is allocated between it’s different parts as follows:

Market Value (full ownership)	R1 000 000
Usufruct (R1 000 000 x 12% x 5.72222)	R686 666
Bare Dominium	R313 334

Limited Rights and CGT

- There will be a deemed disposal of the bare dominium in John's hands at market value at date of death under Paragraph 40(1). Since the usufruct has been left to his spouse there is a rollover in respect of that asset under Paragraph 40(1)(a) read with Paragraph 67(2)(a). The capital gain on the bear *dominium* will be as follows:

Proceeds (Bare Dominium)	R313 334
Less base cost: R400 000 x R313 334/R1 000 000	(R125 334)
Bare Dominium	R188 000

The base cost is apportioned under the part-disposal rule in paragraph 33. John will be entitled to the R300 000 annual exclusion under paragraph 5(2).

Limited Rights and CGT

- John’s deceased estate
- Under Paragraph 40(1) John’s deceased estate will acquire the bare dominium at a market value of R313 334.
- The heir (trust in this case) will in turn acquire the bare dominium at its base cost to the deceased estate (R313 334). There is therefore no gain or loss in the deceased estate.

Limited Rights and CGT

- John’s wife
- John’s Spouse (the usufructuary) acquired the base cost of the usufruct at a rolled over base cost of R274 666 (R400 000, i.e. the base cost of the asset minus R125 334, i.e. the base cost of the bare dominium; alternatively R400 000 x R686 666, i.e. the value of the usufruct ÷ R1 000 000, i.e. the value of the asset).
- When she passes away there is a disposal under paragraph 11(1)(b) (an expiry or termination) of the usufruct without any proceeds:

Proceeds (Usufruct Expiring)	0
Less Base Cost:	(R274 666)
Capital Loss:	(R274 666)

She cannot however claim the capital loss of R274 666 if she used the property for non-trade purposes [paragraph 15(c) read with paragraph 53(3)(f)]. Assuming she let the property, she would be entitled to the loss on the grounds that the asset was used for the purpose of carrying on a trade.

Limited Rights and CGT

- The John Brown Family Trust
- The base cost of the property in the hands of the trust is R313 334 – the market value of the bare dominium at date of death (John's death). Assuming that property values remain constant, the property the property will grow in value each year as the usufruct heads towards expiry. On expiry the property will have regained its full value in the hands of the trust. When the trust subsequently disposes of the holiday home for R1 million it will therefore have a capital gain of R686 666:

Proceeds:	**R1 000 000**
Less Base Cost (base cost of bare dominium of John's death):	(R313 334)
Capital Gain:	R686 666

The base cost remains unchanged at R313 334 and is not affected by the expiry of the usufruct.

Farm Property: Estate Duty and CGT

- Section 5 of the Estate Duty Act prescribes the method that must be applied to determine the value of the 'property' or 'property deemed to be property' to be included in the estate for purposes of calculating estate duty. The general principle is that property disposed of by the executor of the deceased's estate in the course of the winding up of the estate shall be included at the value realised by such sale, and most other property is to be included at the fair market value.
- Fair market value is defined in Section 1(1) of the Estate Duty Act as the price that could be obtained if the property was sold on the open market under an arm's length transaction between a willing buyer and seller. It further states that in relation to immovable property on which a *bona fide* farming operation is being carried on, the value to be used is the price that could be obtained from a sale on the open market, less 30% ('the paragraph (b) value').
- Farm land on which a *bona fide* farming operation is run is thus included at 70% of the fair market value for purposes of determining the dutiable estate of the deceased.
- It must be noted that SARS has confirmed that where the nature of trade of the deceased prior to date of death compromises the letting of the farm, the farm land will not qualify for the paragraph (b) value in the estate of the deceased – the deceased himself needs to have been carrying out the *bona fide* farming operation.

Farm Property: Estate Duty and CGT

- Section 5(1()(a) of the Estate Duty Act states that if the property is sold 'in the course of the liquidation of the estate' the value to be included is the price realised by such sale.
- In C: SARS v Estate Late HE Streicher the Supreme Court of Appeal confirmed that 'during' the liquidation of the estate is not synonymous with 'in the course of the liquidation' of the estate and it is only when it is necessary for the executor to sell the farm that it will be seen as 'in the course of the liquidation of the estate'.
- In this matter, the deceased bequeathed *bona fide* farm land to her two sons. The sons had no intention of farming and instructed the executor to sell the farm land which he did for full market value. SARS argued that the full market value should be included as property in the deceased's estate. The court, however, allowed the executor to use paragraph (b) value, and not the value realises from the sale of the farm, as the value to be included in the deceased's estate. The court held that since the sale was not necessary for any purpose of the estate, it would not be regarded as a sale 'in the course of the liquidation' of the estate.
- We can thus conclude that where the executor is forced to sell the farm land to provide for a liquidity shortfall in the estate, the price realised by such sale will be the value included in the estate since this will be a sale 'in the course of the liquidation of the estate'.

Farm Property: Estate Duty and CGT

- What value is used if farm property is held in a company?
- Section 5(1)(f)*bis* states that, subject to certain condition that fall beyond the scope of this article, shares in a company that are not quoted on a stock exchange are to be included at the value of such shares in the hands of the deceased at his date of death.
- Section 5(1A), however, states that where the company referred to in section 5(1)(f)*bis* owns immovable property on which bona fide farming operations are carried on, the value of such shares shall be determined in the manner defined under 'fair market value'. In other words, for purposes of valuing a company that owns farm land on which bona fide farming operations are carried out, the value of the farm to be included in the company's assets will be the market value less 30%.
- It is thus clear that shares in a company that only owns *bona fide* farm land will be valued at the fair market value less 30% for purposes of the value of property to be included in the deceased's estate, It is important to note that the 30% deduction in value will only apply to the farmland and not any other assets owned by the company.

Farm Property: Estate Duty and CGT

- How is CGT dealt with on death in respect of farm property?
- Paragraph 31(1)(f) prescribes that immovable property on which *bona fide* farming operations are carried out may be valued at either the value contemplated in paragraph (b) of the definition of 'fair market value' in section 1 of the Estate Duty Act, or the price which could have been obtained upon the sale of the asset between a willing buyer and seller in an arm's length transaction on the open market. As we know, 'fair market value' in relation to *bona fide* farm land, as defined in the Estate Duty Act is the price that could have been realised on the open market less 30%.
- The use of the paragraph (b) value for purposes of CGT is, however, limited by paragraph 31(4) in certain circumstances and depends on the valuation method adopted when the farm land was acquired by the deceased. In terms of this paragraph, the paragraph (b) value may not be used where the farming property is disposed of by death, donation or non-arm's length transaction unless:
- For farming property owned prior to 1 October 2001, the valuation date value is determined by using the reduced value prescribed by paragraph (b) of the definition of fair market value, or
- For property acquired on or after 1 October 2001 by way of inheritance, donation or non-arm's length transaction, the property was acquired at the value prescribed by paragraph(b)
- A distinction is drawn between 'pre-valuation date' assets and 'post-valuation date' in determining when the paragraph (b) value can be used.
- For farm land acquired before valuation date (1 October 2001) and disposed of by death, donation or non-arm's length transaction, the paragraph (b) method for determining the proceeds can only be used if the Land Bank value was used to determine the value at valuation date.
- In respect of farm land acquired after valuation that is disposed of by death, donation or non-arm's length transaction, 31(4)(b) provides that the paragraph (b) method may be used to determine the proceeds if the farm land was acquired at the paragraph (b) value (or Land Bank value if acquired before 1 February 2006).

Farm Property: Estate Duty and CGT

- **What if the farmland on which *bona fide* farming operations take place is held in a company**?
- Shares in a company that owns *bona fide* farmland is not afforded the same treatment for purposes of CGT as it for purpose of estate duty.
- The Eighth Schedule of the Income Tax Act does not contain a provision similar to section 5(1A) and as such shares in a company that operates a *bona fide* operation that qualify for the paragraph (b) valuation under the Estate Duty Act are valued under paragraph 31(1)(g), read with paragraph (31)(3) of the Eighth Schedule i.e. the price based on willing buyer, willing seller at arm's length in an open market and not the reduced paragraph(b) value.

Farm Property: Estate Duty and CGT

- **Example 1 – farm land acquired prior to 1 October 2001**
- Farmer Brown inherited a farm (*bona fide* farm land) from his father in 1980. The Land Bank value on 1 October 2001 was R1 000 000 and the market value was R1 300 000. Farmer Brown died on 1 August 2016 and the property had a market value of R1 500 000.
- CGT
- In order for the executor of Farmer Brown's deceased estate to use the paragraph (b) method for valuation of the proceeds for purposes CGT, the Land Bank value must be used as the base cost.

Proceeds	R1 500 000 – R450 000 (30%)	R1 050 000
Base Cost	Land Bank Value	R1 000 000
Capital Gain		R50 000

- Note that for purposes of estate duty, the *bona fide* agricultural land will be included as property in the deceased's estate at the paragraph (b) valuation of R1 050 000

Farm Property: Estate Duty and CGT

- **Example 2 – Farm land inherited after 1 October 2001, paragraph (b) method used on acquisition**
- If Farmer Brown inherited the same farm from his father in 2008 and the executor of his dad's estate used the paragraph (b) valuation for determining the value of the proceeds of R1 000 000 on the deemed disposal of the farm to the deceased estate. At Farmer Brown's death in August 2016, the paragraph (b) method may be used to determine the proceeds for purposes of CGT since the same method was used to determine the base cost when it was acquired:
- Proceeds R1 500 000 – R450 000 (30%) R1 050 000
- Base Cost paragraph (b) valuation method R1 000 000
- Capital Gain R50 000

- Note that for purposes of estate duty, the *bona fide* agricultural land will be included as property in the deceased's estate at the paragraph (b) valuation of R1 050 000

Farm Property: Estate Duty and CGT

- **Example 3 – Farm land inherited after 1 October 2001, market value used at date of acquisition**
- If the executor of Farmer Brown's father used the market value (R1 300 000) to determine the proceeds for calculating the CGT in the deceased estate, Farmer Brown's executor would not be permitted to use the paragraph (b) method for determining the, but would have to use the current market value:
- Proceeds Market Value R1 500 000
- Base Cost Market value (2008) R1 300 000
- Capital Gain R200 000

- Note that for purposes of estate duty, the *bona fide* agricultural land will be included as property in the deceased's estate at the paragraph (b) valuation of R1 050 000.

Farm Property: Estate Duty and CGT

- **Example 4 – Shares in company that owns farmland inherited by deceased**
- Farmer Brown inherits shares in Farmland (Pty) Ltd from his father in 2005. The company owns land on which *bona fide* farming operations take place. The value of the shares at date of his father's death was R1 300 000 and the value included in his estate for purposes of estate duty was R910 000. At Farmer Brown's death the shares in the company are worth R1 500 000.
- At Farmer Brown's death, the value of the shares to be included as property in his estate for estate duty purposes is:
- Market Value R1 500 000
- Less 30% R 450 000
- Value of shares in deceased estate R1 050 000

- The capital gain at Farmer Brown's death is calculated as follows:
- Proceeds Market Value R1 500 000
- Base Cost Market value (2005) R1 300 000
- Capital Gain R200 000
- The paragraph (b) value may not be used for purposes of calculating the capital gain.

Section 4p deduction and the apportionment of estate duty

- Section 4(p) of the Estate Duty Act (hereinafter referred to as "the Act") is aimed preventing the imposition of double estate duty where the proceeds of a policy have been taken into consideration in determining the value of the deceased's shareholding in a company and the policy proceeds have also been included as deemed property in the deceased's estate.
- The section provides for the following deduction from the total value of all property of the deceased: " so much of the value of any property deemed to be property of the deceased by virtue of the provisions of section 3(3) as has not been deducted under any of the other provisions of this section and as the Commissioner is satisfied has been taken into account under the provisions of section 5(1)(f)bis in the determination of the value of any company shares or a member's interest in a close corporation included as property in the estate."

Section 4p deduction and the apportionment of estate duty

- <u>Example 1</u>
- The deceased held 50% shareholding in a company and the company took out a policy on the life of the deceased in the amount of R1 million. If the policy proceeds increase the value of the company by R1 million and section 4(p) did not exist, the deceased's estate would increase by R500,000 as a result of the increased business valuation and R1 million as a result of the deeming provisions which includes the policy in his estate. This will amount to double duty being imposed. As a result of section 4(p) an amount of R500,000 will be allowed as a deduction in the calculation of estate duty as it was included in the value of the deceased's shareholding in the business and also in the value of the policy.

Section 4p deduction and the apportionment of estate duty

- **Who is liable for the estate duty?**
- Section 11 of the Act provides as follows:
- ***11. Person liable for duty.****— The person liable for the duty shall be-*

(a) Where duty is levied on property of the deceased which falls under subsection (2) of section three-

(i) As to any property referred to in paragraph (a) or (b) of that subsection, the person to whom any advantage accrues by the death of the deceased; (this subsection refers to any fiduciary, usufructuary or other like interest, including a right to any annuity charged upon any property, held by the deceased immediately prior to his death).

(ii)As to any other property, the executor;

(b) where duty is levied upon property which, in accordance with subsection (3) of section three, is deemed to be property of the deceased-

(i) as to property referred to in paragraph (a) of that subsection, the executor: Provided that where the amount due under the policy is recoverable by any person other than the executor, the person liable for duty shall be the person entitled to recover the amount due under the policy;(Author's note: this subsection refers to a domestic policy upon the life of the deceased excluding any premiums paid by any other person who is entitled to the proceeds of the policy plus 6% interest per annum thereon; or excluding a policy recoverable by the surviving spouse or child of the deceased under a duly registered ante-nuptial or post-nuptial contract; or a policy acquired for purposes of a buy-and-sell agreement and which meets the requirements for exemption, or a policy not effected by or at the instance of the deceased which will not be paid to the deceased or his relatives or dependents or a family company in relation to the deceased)

(ii) as to any property referred to in paragraph (b) of that subsection, the donee; (Author's note: this subsection refers to property which was donated by the deceased which was exempt from donations tax and not included as property of the deceased for estate duty purposes).

(ii) as to any property referred to in paragraph (CA) or (d) of that subsection, the executor. (Author's note: this subsection refers to an accrual claim in favour of the deceased or property which the deceased was immediately prior to his death competent to dispose of.)"

Section 4p deduction and the apportionment of estate duty

- From the above, it is clear that the executor would be liable for payment of any estate duty levied on any property of the deceased which would include the shareholding in the company and the person entitled to receiving the policy proceeds would be liable for payment of the estate duty levied on the policy.
- This beckons the question: is it the shareholding in the company which attracts the estate duty, thus making the executor liable for the estate duty or is it the policy which attracts the estate duty, thus placing the liability in the hands of the company (policyholder)?

Section 4p deduction and the apportionment of estate duty

- **What does the legislation say?**
- If we have a closer look at the legislation, section 4(p) states that "*The net value of an estate shall be determined by making the following deductions from the total value of all property including therein…so much of the value of any property deemed to be property of the deceased… and has been taken into account… in the determination of the value of any company shares or a member's interest in a closed corporation included as property in the estate*"
- It is thus clear that the answer is not clearly defined, as the deduction is from the total value of all property which shall include property and deemed property. The net value of the estate is determined by adding property and deemed property less allowable deductions but before deducting the abatement of R3.5 million. The legislation is thus not specific as to whether the deduction is applied to the policy or to the shareholding in the company. The question of who is liable for the payment of the estate duty thus remains unanswered.
- Section 13(3) of the Act provides for the calculation of the apportioned estate duty "*whenever duty is in terms of section 11(b)(i) payable by more than one person on the value of any property referred to in section 3(3)(a), the amount of duty payable by each such person shall be such proportion of the total duty attributable to the total value of the said property, as bears to the said total duty the same ratio as so much of the amount which such person is entitled to recover under any policy as is included in the estate under section (3)(3)(a), bears to the total value of the said property*".

Section 4p deduction and the apportionment of estate duty

- This matter of liability for estate duty where the section 4p deduction has been applied can thus clearly be interpreted in two ways.
- It is the view of Karen Van Der Poll (Legal Advisor Manager, Old Mutual Personal Finance) that the purpose of section 4(p) is merely to avoid estate duty being imposed twice in respect of the same amount. It is submitted that it was not the intention of the legislator to absolve the person receiving the policy benefits from being liable for the estate duty brought about by the proceeds, and that the executor should thus be able to recover the proportionate duty from the company.
- In her opinion there is no rational argument to treat the company different than any other person receiving the proceeds of a policy on the life of the deceased. If it was another party benefitting from the proceeds as a contracting party or beneficiary (without the proceeds affecting the value of the company) resulting in an increase of estate duty, such party would be liable for the proportionate duty. This beckons the question: Why would one treat the company different in these circumstances? It is after all the company and not the estate that enjoys the benefit of the proceeds.
- Another argument in support of this view is that if the proceeds of a company owned policy does not increase the value of the shares due to the valuation method used, the company, and not the estate, would be liable for the estate duty resulting from the proceeds.
- This issue will, however, in all probability only be clarified via a legislative amendment or a finding by a Court. Until then, clients and financial planners should be aware that there is potentially more than one viable interpretation of section 4(p) and plan accordingly.

Crypto-currency and estate planning

- SARS is of the opinion that although "currency" is not defined in the Act, crypto-currencies are not a South African tender or wide medium of payment or exchange. In this regard crypto-currencies are not regarded by SARS as a currency for income tax purposes or capital gains tax (CGT). SARS regards crypto-currencies as an asset of an intangible nature.
- The definition of "financial instrument" in section 1 of the Act was amended via section 1(1)(c) of the 2018 Taxation Laws Amendment Act to include any crypto-currency. Financial Instruments means any interest-bearing arrangement or financial arrangement based on or determined with reference to a specified rate of interest or time value of money.
- According to a media release from SARS on 6 April 2018, "SARS will continue to apply normal income tax rules to crypto-currencies received. Any gains or losses made when you sold your crypto-currency will form part of your taxable income as Capital Gains Tax ("CGT"). The onus is on the taxpayer to declare all crypto-currency related taxable income in the tax year of assessment in which it is received or accrued.

Crypto-currency and estate planning

- In terms of the Estate Duty Act 45 of 1955 (“the Act”) an estate consists of all property and deemed property of a person at the date of death.
- Property is defined as:
  - ✓ any right in or to property,
  - ✓ movable or immovable,
  - ✓ corporeal or incorporeal.
- Whether the assets is tangible or intangible.
- It includes ownership and any other interest in or right in property, such as the right to use or occupation.
- SARS regards a Bitcoin or any other crypto-currency as an asset of an intangible nature and for this reason Bitcoin will be defined as property for estate duty purposes.
- When creating a wallet you will be required to create a “private key” to gain access to your wallet’s content. If you should lose this private key no access can be gained to the wallet. If a person dies without giving his private key to someone else, all your Bitcoins will be lost.

Crypto-currency and estate planning

- The value of the wallet as at date of death should be included in a person's estate in terms of Section 3(2) of the Act for estate duty calculation as this is property in his/her estate.
- If the executor does not have access to the private key of the deceased and nobody can give him/her the private key he/she will have no access to the content of the wallet. Because Bitcoin is property in the estate of the deceased it must be included as property.
- The value in terms of Section 5 of the Act the fair market value must be included in the estate for estate duty purposes. The fair "market value" of property is defined in section 1 of the Estate Duty Act as the price which would be obtained upon the sale of the property between a willing buyer and a willing seller dealing at arm's length in an open market. If the executor has no access to this private key he/she will not be able to determine the value as at date of death, and nobody will be willing to buy this asset. The Master of the Free State High Court discussed this issue during a session at the University of the Free State in 2018 with fiduciary specialists, and according to the Master the value that must be included is R0 for Bitcoin without a private key.
- If the executor knows who has the "private key" he will be obligated to request this information from this person. In terms of the Estate Duty Act estate duty must be calculated and is payable by the executor of the estate. A person will in terms of our law be obligated to provide the executor with the private key.
- According to SARS the onus is on the taxpayer to declare these bitcoins. As an executor of the estate the onus will be on the executor to declare Bitcoins.

Questions