Capital gains tax and the accrual claim upon death

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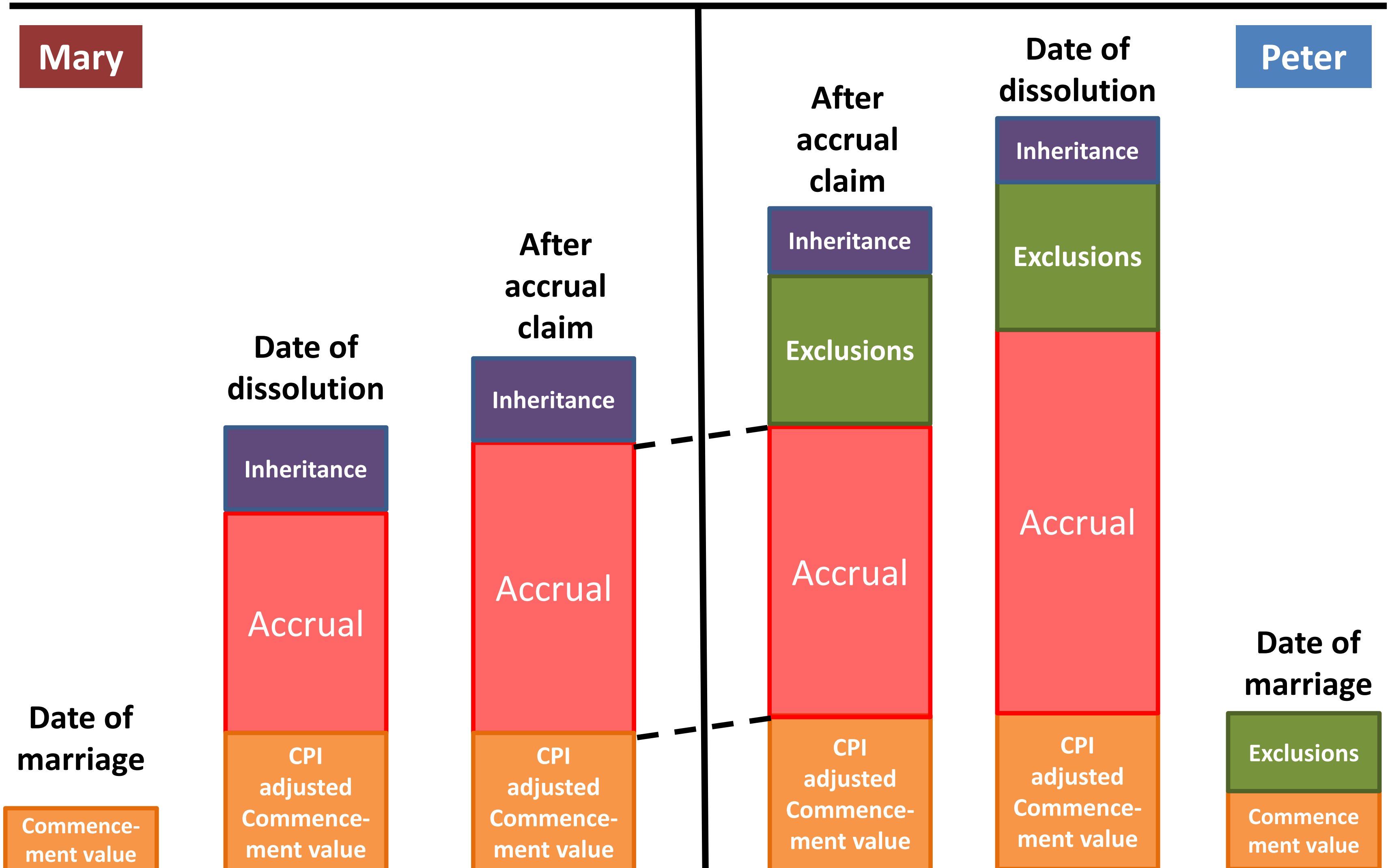
Agenda

- A recap of what the accrual claim does
- Basics of the accrual claim calculation
- Arguments for and against including CGT as a liability
- The tax angle
  - CGT and estate duty without CGT as a liability in accrual calc
  - CGT and estate duty with CGT as a liability in accrual calc
- Questions

What does the accrual claim do?

- The accrual claim is an equalisation of the increase in wealth of the spouses during the subsistence of the marriage
- Once complete, the accrual calculation and claim will theoretically ensure that each spouse's estate will end up with one half of the aggregate net increase in wealth of both spouses during the subsistence of the marriage

What does the accrual claim do?



Basics of the accrual calculation

Accrual Claim Calculation

CPI value at date of marriage	43.2
CPI value at dissolution of the marriage	107.1

NAME OF SPOUSE		Peter	Mary
Assets before the marriage (as shown in the ante-nuptial contract ("ANC"))		15,000	10,000
Current value of each spouse's assets		15,000,000	7,500,000
Less: Liabilities		400,000	250,000
Less: Assets excluded i.t.o. ANC (Beach cottage)		4,000,000	0
CURRENT VALUE OF EACH ESTATE		10,600,000	7,250,000
Less: Original assets revalued @ CPI		37,187	24,792
ACCRUAL		10,562,813	7,225,208
GREATEST ACCRUAL		10,562,813	
Less: Smallest accrual		7,225,208	
DIVISABLE ACCRUAL		3,337,605	
ACCRUAL CLAIM IN FAVOUR OF	Mary	1,668,802	

Basics of the accrual calculation (2)

- Remember, commencement values and exclusions are not the same
- Exclusions must be used in the calculation at their value on date of dissolution
- Income produced by an excluded asset and invested in another asset or investment will not be part of the excluded asset's value
- Commencement values are adjusted for inflation by dividing the commencement value by the CPI value in the month of the wedding, and multiplying by the CPI value in the month of dissolution

CGT upon death

9HA. Disposal by deceased person.—

(1) A deceased person must be treated as having disposed of his or her assets, other than—

- (a) assets disposed of for the benefit of his or her surviving spouse as contemplated in subsection (2);
- (b) a long-term insurance policy of the deceased, … ; or
- (c) an interest of the deceased in—
  - (i) a pension, …; or
  - (ii) a fund, arrangement or instrument situated outside the Republic …,

  if any capital gain or capital loss … would have been disregarded in terms of paragraph 54 of the Eighth Schedule,

at the date of that person's death for an amount received or accrued equal to the market value, as defined in paragraph 1 of the Eighth Schedule, **of those assets as at that date.**

Is CGT a liability for accrual upon death?

- There are two different views on whether CGT payable upon death is a liability for purposes of the accrual calculation upon death
  - No, because the liability only arises after death
  - Yes, because the liability is going to arise upon death and is potentially there at all times, but can only be quantified upon death
- However, the liability cannot be avoided – it can only be postponed and passed on
- There is also a tax (estate duty) angle to this
  - If CGT is not taken into account, the CGT can be deducted more than once in the estate duty calculation

Is CGT a liability for accrual upon death? (2)

- CGT payable upon death is a liability which can be deducted in the estate duty calculation (sec 4(b))
- If the CGT payable is not taken into consideration in the calculation of the accrual claim, the claim will be higher
- This will result in:
  - Higher total deductions if the accrual claim is against the deceased estate (sec 4(lA) of the EDA)
  - Lower gross value of the estate if the claim is in favour of the estate (sec 3(3)(cA) of the EDA)

If CGT is a liability, why not estate duty?

- Did an estate duty liability exist on the date of death?
  - Costs incurred after the date of death are deductible in the estate duty calculation, e.g. funeral expenses, executor's fees , etc.
  - These costs, as well as claims which may arise after the date of death, e.g. a claim under the Maintenance of Surviving Spouses Act, may result in no estate duty being payable
- However, a CGT liability always exists in the year of death – it is just not quantifiable until the date of death is known
- If everything is rolled over, the liability as it existed on date of death is just passed on to the surviving spouse

Assumptions

- Claim is against Peter's deceased estate
- Peter's marginal tax rate – 45%
- Executor's fees – R603,750
- Funeral expenses, valuation fees, final tax liability (excl. CGT), etc. – R200,000
- Capital gain on the excluded asset – R1.6m
- Peter bequeaths the excluded asset to his children
- Peter leaves legacies totalling R7m to Mary, including the primary residence of R4.5m (base cost R2.5m), and cash of R1m
- Peter leaves the residue (all cash) to his children
- Peter does not have any policies on his life on which Mary is not a beneficiary

CGT Calculation

Asset	Market value	Base cost	Exclusion	Capital gain
Primary residence	4,500,000	2,500,000	2,000,000	0
Legacies to Mary	1,500,000	Irrelevant	Roll over	0
Beach cottage	4,000,000	2,400,000	None	1,600,000
Total				**1,600,000**
Year of death exclusion				300,000
Net capital gain				**1,300,000**
Included at 40%				520,000
Tax @ 45%				**234,000**

Estate duty calculation without CGT in the accrual

Description	Value	Value
Property & Deemed property		15,000,000
Deductions		
Funeral expenses etc (sec 4(a))	200,000	
Liabilities (including CGT) (sec 4(b))	634,000	
Executor's fee & Master's fee (sec 4 (c))	610,750	
Accrual claim (sec 4(lA))	1,668,802	
Legacies to Mary (sec 4(q))	7,000,000	
Total	**10,113,552**	
Net estate		**4,886,448**
Sec 4A	**3,500,000**	
Dutiable estate		**1,386,448**
Estate duty @ 20%		**277,290**

Accrual calculation with CGT as liability

Accrual Claim Calculation

CPI value at date of marriage	43.2
CPI value at dissolution of the marriage	107.1

NAME OF SPOUSE	Peter	Mary
Assets before the marriage (as shown in the ante-nuptial contract ("ANC"))	15,000	10,000
Current value of each spouse's assets	15,000,000	7,500,000
Less: Liabilities	634,000	250,000
Less: Assets excluded i.t.o. ANC (Beach cottage)	4,000,000	0
CURRENT VALUE OF EACH ESTATE	10,366,000	7,250,000
Less: Original assets revalued @ CPI	37,187	24,792
ACCRUAL	10,328,813	7,225,208
GREATEST ACCRUAL	10,328,813	
Less: Smallest accrual	7,225,208	
DIVISABLE ACCRUAL	3,103,605	
ACCRUAL CLAIM IN FAVOUR OF Mary	1,551,802	

Estate duty calculation with CGT in the accrual

Description	Value	Value
Property & Deemed property		15,000,000
Deductions		
Funeral expenses etc (sec 4(a))	200,000	
Liabilities (including CGT) (sec 4(b))	634,000	
Executor's fee & Master's fee (sec 4 (c))	610,750	
Accrual claim (sec 4(lA))	1,551,802	
Legacies to Mary (sec 4(q))	7,000,000	
Total	**9,996,552**	
Net estate		**5,003,448**
Sec 4A	**3,500,000**	
Dutiable estate		**1,503,448**
Estate duty @ 20%		**300,690**

Keep the following in mind

- Not taking the CGT liability into consideration will only have an effect on Peter's estate duty liability if:
  - Mary does not inherit the residue
  - The accrual claim is paid in cash and not by way of awarding the beach cottage to Mary
- If Mary inherits the residue, the beach cottage will be the only property left in the net estate, regardless of whether the CGT was included as a liability in the accrual calculation or not

Keep the following in mind (2)

- If the beach cottage is awarded to Mary (alone or as co-owner with the children) all or part of the asset will roll over for CGT purposes and reduce or extinguish the amount of CGT payable as a result
- The effect of the provisions of sec 9HA(1) is to avoid PAYING the CGT liability upon death – it does not remove the liability
- Settling the accrual claim with an award of an asset reduces the CGT payable, and increases the amount of the accrual claim if the CGT payable is taken as a liability for the calculation of the accrual claim

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