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- Donations Tax
- Introduction
 - Donations tax is levied in terms of section 54-64
 - Tax(s 54 is the charging section and the most NB for donation tax), on the transfer of capital by a resident 'section 1'. The donor of a done (definition in section 55) at a rate of 20% (pre October 2001 at the rate as it was then of 25%). The reason for the reduction was because of the introduction of the capital gains tax act. The estate duty was also reduced to 20 %
 - It is to make administration easier as it is in all one act. An all the difinitions in setion 1 apply to donations tax.
 - Why donations tax?
 - Avoiding normal tax, ie to stop people from transferring income producing assets, and wealthy person will split their income to lower their tax
 - Avoiding estate duty, thus stoping a person from donating all his assets and then no estate duty will be payable but this is illegal.
- What is a donation?
 - Gratuitous disposal of property-including any gratuitous waiver or renunciation of a right (s 55). But be free of any conditions then it will be a gratuititious.
 - Where compensation is inadequate – deemed a donation in terms of section 58, is considered to be whatever the price is paid for the object.
 - All donations in terms of common law will be donations for the purpose of the act.
 - Effective date of donation by way of: because it must be within three months after the dontation is made then there is donations tax payable in terms of section 60. The rate of donations tax is in section 64
 - Oral agreement = the date of delivery, BUT if the property is not delivered, then the contract must be in writing as per the General Law amendment act section 50.
 - Written contract = the date 'donee' accepts the contract, NB: immovable property must be donated by way of a written contract

- Property means any right in or to property moveable or immovable, corporeal or incorporeal wheresoever it is situated as per section 55.
- Who is held liable?
 - The donor is liable
 - If the donor fails to pay tax within three months, the donor and the donee shall be jointly and severally liable for the tax as per section 59 and 60
- What is the rate of donations tax?
 - 20% from the 1 October 2001 section 64.
 - 25% on gifts made after 14 March to 30 September 2001
 - Gifts pre 14 March 1996 it was 15 %
 - Pre 16 March 1988 it was a cumulative scale.
- Donations made by a body corporate at the instance of any person [1] Section 57
 - Where the donation by a body corporate at the instance of any person
 - The gift is deemed to be disposed of under a donation by that person.
 - Person is liable for the payment of donations tax (as it is deemed as if he himself made such a payment) but then he or she will;
 - Have a right of recourse against the body corporate for the tax incurred via section 57(1). This is removed in the concept legislation as per the concept legislation.
 - All donations of a public company are exempt as per section 56(1)(m).
 - When does this provision apply?
 - If the commissioner is of the opinion that it was not made in the ordinary course of the normal income earnings of the body corporate
 - If the selection of the donee was made at the instance of the person section 57(2).
 - He has a discretion as to how to apply this discretion.
 - Draft legislation as of JUNE 2011: substitution of section 57

- Proposed new wording of section 57
 - If any (a)property is disposed of by any company at the instance of any person; and
 - (b) that disposal would have been treated as a donation had that disposal been made by that person,
 - That property must for the purposes of this part be deemed to be disposed of under a donation by that person.

- Exemptions section 56(1)
 - Section 56(1)(a)
 - To the spouse of the donor in terms of an ANC;
 - When matrimonial property system changes from out of com prop to in com prop as per section 21 of the Matrimonial Property act.

 - Section 56(1)(b) – to or for the benefit of the spouse of the donor who is not separated from him under judicial order or notarial deed of separation. **KNOW THE DIFFERENCE!**
 - NB: the definition of spouse in section 1, in relation to any person means a person who is a partner-
 - In customary marriage of the laws of RSA
 - Any religious marriage recognised therein in terms of that religion
 - In a same sex marriage or heterosexual union which the commissioner is satisfied is permanent.

 - Section 56(1)(c) by way of a donatio mortis causa. As a result of the death of the donor, it must also fulfil all the requirements of a valid will.
 - Section 56(1)(d) ito which the donee will not obtain any benefit until death of the donor.
 - Section 56(1)(e) cancelled within six month from the date upon which the donation took effect. If they take too long such as one year he will have to pay a second donation tax levied

- Section 56(1)(g) if the property consists of any right in property situated outside the RSA and was acquired by the donor:
 - (i) before the donor became a resident of the RSA
 - (ii) by inheritance from a person who at the date of death was not ordinarily resident in RSA

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Lecture 2

- Section 56(1)(h) by or to any person (including any government) referred to in section 10(1)(a), (b) (cA), (cE), (cO), (d) or (e)
- Section 56(1)(k) as a voluntary award to be included in the gross income of the donee in terms of the definition of gross income per para c and here such an amount will be exempt as it is already taxed. You get a performance bonus, there may be an exception as it is already included in the donee's gross income.
- Section 56(1)(l) if such property is disposed of under and in pursuance of any trust; there are two beneficiaries and the trustees and they in terms of the trust deed decide to donate this house to one of the beneficiaries. This is exempt from taxation as there is already tax paid by the person who gave the house to the trust thus one need not pay tax again. The golden rule is that the value will be the market value.
- Section 56(1)(m) if such property consists of a right, (other than a fiduciary or usufructuary or other like interest). A has a farm, and has a daughter H and pays R 10 per month, will this be taxed? She is a child of A, and it is a property where there are bona fide farming activities take place and this is no or not adequate consideration thus the value of that right to use or occupy the property is exempt from tax. The reasons for this is one that it is difficult to administer and the second reason was that in the old gov many of the ministers had this exact same situation.
 - To the use or occupation of property used for farming purposes
 - For no/ not adequate consideration
 - And the donee is a child of the donor

- 56(1)(n) by a public company in terms of section 38 in terms of the company act is exempt
- 56(1)(o) where property is donated to the beneficiary in terms of the land reform program
- 56(1)(r) a donation to any other company that is a member of the same group of companies as the company making that donation.

- Section 56(2)(a) the first R 10 k (pre 1 March 2002 was R 5K) casual gifts by a donor other than a natural person

- 56(2)(b) where property donated by a natural person does not exceed R 100K (R 50K pre 1 march 2007, R 30K pre march 1 2006 and R 25K pre march 1 2002) per year and will thus be exempt.

- 56(2)(c) any bona fide contribution made by the donor towards the maintenance of any person as the commissioner considers reasonable.

- Order in which donations are made
 - To more than one beneficiary on the same date -
 - Donor select order
 - If the donor fails to make an election – then the commissioner may select per section 60
 - Person liable for donations tax shall be the donor, but the donee may also be liable in terms of section 59.
 - Why is this important? As if the donor does not pay the tax then the donees must pay. He must show that he paid one person first and then that person will be exempt from paying tax.

- Value of property per section 62
 - Section 62 important with regard to the value of donated property
 - In fixing fair market value section 62(5) – commissioner shall have regard to
 - Municipal or divisional council valuations of the property
 - Any sworn valuation furnished by or on behalf of the donor or donee

- Any valuation by any competent and disinterested person appointed by the commissioner.
- Fair market value per section 55
 - Section 55 means that:
 - At arms length price in an open market
 - On exception to this is immovable property on which a bona fide farming undertaking is carried out –
 - The fair market value
 - Or
 - The fair market value reduced by 30%
- The valuation of property disposed per section 62
 - Valuations of limited rights such as usufruct, fiduciary right and right to annuity. The com will use a table and states that if one has a yearly value, then one must keep in mind how old the person is then you take the value of the thing at the next birthday, such as the child is 1 then take the value from the second birthday. If one is 100 years old then use the 90 year age percentile.
 - Capitalised at 12%, the annual value of the right over the expected life of the donor. Why 12 % because it sits in the act section 62(2), this is THE DEFAULT OPTION.
 - Or where the limited right of enjoyment is for a lesser period than the life of a donor, over such lesser period per section 62(3), and that the commissioner must be persuaded
- The value of limited rights per s 62
 - How do you determine life expectancy?
 - Of the donor or
 - The donee
 - And the capitalised value thereof? (Table A) – in the regulations to the estate duty act
 - Or the capitalised value of shorter period (table b)
 - Life expectancy table and examples

- Must use the smaller period as the tax will be less and we always take the specific period or the life expectancy of the person receiving the donation.

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Lecture 3

- Example 1
 - Grandpa ape (male) turns 85 on his next birthday, thus he is currently 84 at this period
 - He donates the usufruct of his cabin to BiBi (Female) his grandchild, she turns 25 years old. Thus she is 24
 - The cabins fair market value is R 1 000 000
 - STEP 1
 - Fair market value of property is R 1 million or section 55
 - Step 2 – fair market value of the poerpty is R 1 million x 12% to determine the annual yield of the property (s 62(2)) = R 120 000. As does 62(1) als oreferes to this amount
 - Step 3 – how long will the donee use the property (usufructry)?
 - Table A BIBI turns 25 – her estimated life expectancy is then 49, 63 years
 - Step 4 - determine the donor's life expecentcy. Grnadpa turns 85 his life expectancy is 4, 72 years
 - Step 5 – take the shortest period of step 3 and 4 and find the value of R 1 capitalised over that period (shortest). GP has a life expectancy of 4, 72 therefore the shortest period to live – present value R 1 is 3, 45232 based on his life expectancy.
 - Step 6 – multiply the current value of R 1 to the annual value of step 2:
 - $3,45232 \times R 120\ 000 = R 414\ 278$
 - Therefore donations tax available
 - $R 414\ 278 - R 100\ 000$ (56(2)(b))
 - = R 314 278
 - $R 318\ 278 \times 20\%$ (s 64)

○ =R 62 855

• Example 2

- Bibi donates the usufruct to GP A
 - The answer remains the same as example 1, as we work with the shortest time period.

• **Example 3 [1]**

- Grandpa Abe donates the usufruct of the cabin with a fair market value of R1 000 000 to Bibi for two years
- Grandpa Abe's life expectancy is = 4,72 yrs
- Bibi's life expectancy = 49,63yrs
- Specific time period = 2yrs
- Specific time period of 2 yrs = shortest time period of (a), (b) and (c)

• **Example 3 [2]**

- To determine the current value of R1 for 2 yrs, see Table B = 1,6900
- Annual value of property = fair market value of R1 000 000 x 12% = R120 000 (s 62(2))
- Take annual value of R120 000 x 1,6900 (current value for 2 yrs) = **R202 800**

• **Example 3 [3]**

• **Donations tax payable by grandpa Abe:**

• R202 800 – R100 000 (s 56(2)(b))

• = R102 800

• R102 800 x 20% (s 64)

• = **R20 560**

• **Example 4 [1]**

- Grandma Cici, who turns 65 on her next birthday, donates
- To her brother Didi, who will turn 70 soon
- The usufruct of an annuity to the value of R50 000 pa

• **Example 4 [2]**

- Annual value of the annuity = R50 000

- Donor's life expectancy = 15,18yrs (Table A)
- Donee's life expectancy = 9,37yrs (Table A)
- Donee Didi's life expectancy is the shortest
- Current value of R1 iro Didi's life expectancy= 5,45165 (Table A)
- Annual value R50 000 x 5,45165 = **R272 582**
- **Example 4 [3]**
- **Donations tax payable by grandma Cici**
- R272 582 – R100 000 (s 56(2)(b))
- = R172 582
- R172 582 x 20% (s 64)
- = **R34 516**

- **Example 5 [1]**

- Grandma **Hanna** will turn 135 yrs soon.
- **Donates the usufruct of her farm** with an open market value R1 428 590 and a s 55 fair value par (b) of R1 000 000, is the land bank value which is 30% less. Thus use the land bank valuation!
- To her great grandchild **Mattie** who will turn 30 in a month, if she donates the farm and not the usufruct the donations tax will be more as we use the life expectancy of Grandma
- And the *bare dominium* to her great granddaughter **Betty** who turns 5 shortly
- The *annual yield* of the farm is **5%** (s 62(2)(a)) can convince the commissioner that the annual yield is less than 12%.

- **Example 5 [2]**

- **Value of the usufruct**

- Annual value is R1 000 000 x 5% = R50 000
- Grandma Hanna (**donor's**) se life expectancy
= 3,92yrs
- Mattie (**usufructory**) life expectancy
= 38,48yrs
- Current value-factor based of R1 based on Grandma Hanna's life expectancy
= 2,98912

- Value is $R50\,000 \times 2,98912 = \mathbf{R149\,456}$

- **Example 5 [3]**

- **Value of bare dominium, MUST NOT USE THE VALUE OF THE DONOR!!!!**
- Annual value = R50 000
- Current value-factor **based** on **Mattie's (usufructary) age** = 8,22694
- Value of usufructary enjoyed by Mattie = $8,22694 \times R50\,000 = R411\,347$
- Value of bare dominium = agricultural land value - **minus** value of usufructary:
- $R1\,000\,000 - R411\,347 = \mathbf{R588\,653}$
- **Value for purposes of donations tax:**
- $R149\,456$ (value of the usufruct) + $R588\,653$ (BARE DOM) = **R738 109**

- **Example 5 [4]**

- **Donations tax:**

- $R738\,109 - R100\,000$ (s 56(2)(b))
= $R638\,109 \times 20\%$ (s 64) = **R127 621**

Instance if the farm was donated to Betty:

- $R1\,000\,000 - R100\,000$ (s 56(2)(b))
= R 900 000
- $R900\,000 \times 20\%$ (s 64) = **R180 000**
- **Saving** in donations tax where the usufruct + bare dominium is donated:
- $R180\,000 - R127\,621 = \mathbf{R52\,379}$

- **Example 6 [1]**

- Rob and Sue are married in community of property
 - They are the owners of a beach house in Strandfontein. The beach house has a fair market value of R600 000
 - Rob turns 75 on his next birthday

- Sue turns 30
 - They donate the usufruct of the house to Mark who will turn 50 soon
 - Determine the donations tax payable by Rob and Sue
- **Example 6 [2]**
 - **Determine Rob's liability for donations tax:**
 - Step 1 – fair market value of property = R600 000
 - Step 2 – annual value is R600 000 x 12%
= R72 000, but **only ½ belongs to Rob**, hence R72 000 x 50% = **R36 000**
 - Step 3 – Donor Rob's life expectancy = 7,41
 - Step 4 – Donee Mark's life expectancy = 21,47
- **Example 6 [3]**
 - **Determine Rob's liability for donations tax: (continue)**
 - Step 5 – donor's life expectancy is the shortest
 - Step 6 – multiply the current value of R1 with the annual value of Step 2:
4,73490 x R 36 000 = R170 456
 - **Donations tax payable by Rob**
 - R170 456 – R100 000 (s 56(2)(b))
= R70 456
 - R70 456 x 20% (s 64) = **R14 091**
- **Example 6 [4]**
 - **Determine Sue's liability for donations tax:**
 - Step 1 – fair market value of property = R600 000
 - Step 2 – annual value is R600 000 x 12% = R72 000, but only ½ belongs to Sue, hence R72 000 x 50% = **R36 000**
 - Step 3 – Donor Sue's life expectancy = 44,86
 - Step 4 – Donee Mark's life expectancy = 21,47
- **Example 6 [5]**
 - **Determine Sue's liability for donations tax (continue)**
 - Step 5 – Donee Mark has the shortest life expectancy

- Step 6 – multiply the current value of R1 with the annual value of Step 2:
- $7,60201 \times R\ 36\ 000 = \mathbf{R273\ 672}$
- **Donations tax payable by Sue**
- $R273\ 672 - R100\ 000$ (s 56(2)(b))
- $= R173\ 672$
- $R173\ 672 \times 20\%$ (s 64) = **R34 734**

- **Example 6 [6]**
- Total donations tax payable by Rob and Sue, for the donation of the usufruct of their beach house to Mark:
- $R14\ 091 + R34\ 734 = \mathbf{R48\ 825}$
- Use 62(3) is authority for the use of table b and the age of 50 years when it comes to calculating the tax on a usufruct donated from a company.

27/07/2011

Law of Taxation

Lecture 4

ESTATE DUTY

Introduction [1]

- Estate duty (ED) is a direct tax on wealth, can also be a person who is a non-resident and that has property in SA and even if outside the country
- Why charge estate duty and why do we still have such a tax? The reason is that one can transfer the property over to another; its also because the capital is transferred over to others. Because he is a SA citizen and used SA to make money.
- Example ▶ ▶ ▶ charging of estate duty in RSA

• **Introduction [2]**

- Charged in terms of the provisions in ss 1 - 32 of the *Estate Duty Act, No 45 of 1955* read with
- *First - and Second Schedule and Regulations to the Act*

Property – s 3(2)	5 500 000
Deemed property – s 3(3) (donatio mortis causa is deemed property, had an exemption in terms of section 56(1)(c)), non domestic policy is not deemed property	<u>4 000 000</u>

GROSS VALUE OF PROPERTY	9 500 000
- <i>minus</i> Allowable deductions ito s 4(a)-(q)	<u>2 000 000</u>
NETT VALUE OF THE ESTATE	7 500 000
- <i>minus</i> Primary deduction – s 4A (Persons who died since 1 March 2007) (NB: 2009 amendment:- transfer of deceased spouse’s primary abatement)	<u>3 500 000</u>
DUTIABLE AMOUNT OF THE ESTATE	<u>4 000 000</u>
4 000 000 x 20% (ED rate – First Schedule of the Estates Duty Act) = R800 000	

- **Introduction [3]**

- ❑ **Definitions (s 1)**

- “Fair market value” similar to the section 55 in the Income tax act, there are differing definitions in terms of the act.
 - “Domestic policy” it is a domestic policy in terms of the act, and is also a foreign policy that is specifically payable in SA. If it is a foreign policy then it will not form part of the persons deemed property
 - “Relative”
 - “Child” also an adopted child
 - “Spouse” is also very wide as in the income tax

Liability [1]

- ❑ **When is estate duty payable ?**

- Charging section (s 2)
 - A tax charged upon the dutiable amount of the estate “*of every person who dies on or after 1st April, 1955*”

- Levied at the **rate** set out in the **First Schedule (currently 20%** - pre 1st Oct 2001 – **25%)** years ago it was even higher closer to 30%.

- **Liability [2]**

- ☐ **Who is liable for the payment of estate duty?**

- Executor – not exceeding the available assets in the estate (ss 11 & 12), has a right of recovery from the person or the estate if he has to pay.
 - Person to whom usufructuary / fiduciary interest in property accrues by death of the deceased – where duty is levied on such interest (s 11). Abe gives the usufruct of his farm to B (has donations tax payable) for the rest of her life, but when he makes the donation he places a provision that upon B's death the usufruct goes to C. B dies and it goes to C (must calculate the value of the usufruct by referring to the life expectancy of C) the value is 500 000 and C must pay the 100 000 for estate duty on the usufruct.
 - A donatio mortis causa, on A's death in terms of this mortis, you will receive the car. What must be paid? No donations tax, it will be deemed property in A's estate and the donee will have to pay the tax on the car.
 - Executor has a right of recovery from the person who is liable in terms of s 11 for estate duty - if the executor has paid the estate duty (s 13).
 - The estate (s 2)

What constitutes an estate ? [1]

- All **property** of that person as **at the date of his / her death**
- and
- All **property** which in accordance with this Act is **deemed** to be **property** of that person at that date (s 3(1)) also 3(3)

- **What constitutes an estate? [2]**

- S 3(2) -) **“property”** means any right in or to property, **movable** or **immovable**, corporeal or incorporeal, and includes – is the definition of the property
- **S 3(2)(a)** - any **fiduciary, usufructuary** or **other like interest in property**
 - **including a right to an annuity** charged upon property

- held by the **deceased immediately prior to his death**
- **What constitutes an estate? [3]**
- **S 3(2)(b) - any right to an annuity**
 - **enjoyed by the deceased immediately prior to his / her death**
 - which **accrued to some other person** on the death of the deceased

What is excluded from “property” ? [1]

- **S 3(2)(c) - (h)** in the case of a **deceased** who was **not ordinarily resident** in the **RSA** at the date of his / her death. The Kettel Case is prescribed for this section

his / her

- **movable and immovable property, debt, right of action not enforceable in the Courts of the RSA, goodwill, licence, patent, design, trade mark, copyright or other similar right not registered or enforceable in the RSA, stocks or shares and proceeds derived from it – situate outside the RSA**
- **What is excluded from “property” ? [2]**
- **S 3(2)(i) - any benefit** which is due and payable by or in consequence of membership of
 - **any pension fund**
 - **pension preservation fund**
 - **provident fund**
 - **provident preservation fund; or**
 - **retirement annuity fund** as defined in the Income Tax Act
 - on or as a result of the **death** of the **deceased**

Deemed “property” [1] - s 3(3)

- **S 3(3)(a)** – an amount due and recoverable under any “**domestic policy**” upon the life of the deceased

minus

- the **premiums** & **6% compound interest** per annum on the premiums can be excluded from the value of the policy
- if the premiums has been paid by any person who is entitled to the amount due under the policy

Daisy purchased a **domestic policy** 5 years ago, upon the life of her late husband Tom. She paid in advance the 5 annual premiums of 10 000 each. The policy paid out an amount of 5 000 000.

Year	Capital + annual premium	Compound interest @ 6%	Total Premiums + compound interest
1	10 000	600	10 600
2	10 600 + 10 000	1 236	21 836
3	21 836 + 10 000	1 910	33 746
4	33 746 + 10 000	2 625	46 371
5	46 371 + 10 000	3 382	59 753
	Total	9 753	

$5\,000\,000 - (50\,000 + 9\,753) = 4\,940\,247$

[‘Deemed property’ ito s 3(3)(a)]

Another exception in terms of section 11 who is liable for estate duty if any from the policy? It is daisy, she must pay the duty. If he paid the premiums the the estate duty must come from his estate.

- **Deemed “property” [2] – s 3(3)**
 - **this paragraph shall not apply in respect of any:**
 - ✓ policy recoverable by the surviving spouse or child of the deceased, under a duly registered ante-nuptial or post-nuptial contract s 3(3)(a)(i).
 - ✓ policy taken out and paid by a person, who on the date of death of the deceased, was a partner or company to acquire the deceased’s interest s

3(3)(a)(iA). Thus can be seen in the case of any partnership or company and purchase the partnership interest or shares after they die.

- ✓ policy taken out and paid by a person, who on the date of death of the deceased, was a non-relative of the deceased s (3)(a)(ii). A key person policy on a very NB person who if dies could harm the company as it could be without him and thus this will form part of the companies gross income.

02/08/2011

Law of Taxation 441

lecture 5

Deemed “property” [3] – s 3(3)

- S 3(3)(b) –
 - ✓ **property** donated by the deceased as a *donatio mortis causa*
 - ✓ and **property** donated by the deceased, in terms of which the donee will **not obtain any benefit** until the death of the donor. The Donee will be liable to pay the amount as per section 11
 - ✓ (Remember s 56(1)(c) & s 56(1)(d) exemptions in the Income Tax Act)
- S 3(3)(cA) - the **amount** of any **claim acquired by the estate** of the **deceased** under s 3 of the Matrimonial Property Act, 1984, against the deceased’s spouse or the estate of his deceased spouse, in respect of any **accrual** contemplated in that section – see example at s 4(1A). The Claim or its value is considered deemed property, but if there is a claim against your estate then there is a deduction form... See example 4(A1)

• Deemed “property” [4] – s 3(3)

- S 3(3)(d) – property of which the deceased was **immediately prior to his death** competent to dispose for his **own benefit** or for the **benefit** of his **estate**.
 - ✓ refer to s 3(5) read it along with 3(5)
 - ✓ important provision – especially in estate planning !!! the reason for this is that one person has so much deemed property but the commissar can add more deemed property to the estate.
 - ✓ why?

• Deemed “property” [5] – s 3(3)

- ☐ When you apply **s 3(3)(d)**
- The term “**property**” shall be deemed to include the **profits of any property**

- **A person shall be deemed to have been competent to dispose of any property –**
 - ✓ if he had **such power** as would have enabled him, to **appropriate or dispose of such property** as he saw fit, whether exercisable by **will, power of appointment** or in **any other manner**
 - ✓ if under any deed of **donation, settlement, trust** or **other disposition** made by him, he **retained the power to revoke** or **vary the provisions** thereof relating to such property
 - ✓ If the deceased created a trust, and in the trust deed that A may in his will name the beneficiaries, it is also possible that A the sole trustee as the trust may allocate assets to himself as beneficiary.

Net value of an estate

- S 4 - the **net value** of any **estate**
 - shall be determined by making the following s 4 **deductions** from the **total value of all property** included therein in accordance with s 3...

S 4 deductions [1]

- S 4(a) – **Firstly the funeral, tombstone and death-bed expenses** of the deceased which the **Commissioner considers** to be **fair and reasonable**
 - **S 4(b) - all debts** due by the deceased **to persons ordinarily resident within the Republic.** 4(f) deals with creditors in or are not ordinarily resident.
 - S 4(c) - **all costs** which have been allowed by the Master in the **administration and liquidation** of the estate
 - other than expenses** incurred in the **management and control** of any **income** accruing to the estate **after the date of death**
 - S 4(d) -**all expenditure** incurred in carrying out the **requirements** of the **Master** or the **Commissioner**

• S 4 deductions [3]

- **S 4(e)** - the value of any right in or to **all property** situate **outside the Republic** **acquired by the deceased –**
 - ✓ before he became ordinarily resident in the RSA for the first time **or**

- ✓ after he became ordinarily resident in the Republic for the first time, by a donation or inheritance from a person who at the date of the donation or his death, was not ordinarily resident in the RSA
 - ✓ 65(1g) of the Income tax act on his donations and is he a citizen of RSA, but he was not ordinarily resident he acquired the property but it may be deducted vi 4(e) but it must be still included per section 3(2)
 - ✓ A 5 Million house but there is a deduction in terms of 4(e) and it cancels out the house.
 - ✓ **What of a foreign policy?** It will be seen as a domestic policy if paid out in RSA, but if paid out in overseas then it will be **specifically excluded**. But a domestic policy is deemed... 3(3)(a)
 - In section **3(2)(c)-(h)**
- **S 4 deductions [4]**
 - S **4(f)** - **any debts due** by the **deceased to persons** ordinarily **resident outside the RSA**;
 - ✓ which have been discharged from property **included in the estate to the extent that the amount of such debts exceed the value of any assets of the deceased outside** the RSA and not so included.
 - ✓ EG: A is the deceased, the debt is 2 million (outside the RSA) and there is 5 million in the estate and there is a foreign policy for 1 million. So uses the policy to remove the debt and the balance of the debt is then a deduction against your estate.
 - ✓ EG is the policy is 3 million and the debt is 2 million... then the amount is more than the debt and the 1 million must remain and cannot be deducted.

03/08/2011

Law of Taxation

Lecture 5

- **S 4 deductions [5]**
 - S 4(g) - the **value** of any interest included as **property** of the deceased (eg. usufruct) under
 - s **3(2)(a)**
 - ✓ where such **interest** was held by the **deceased** by virtue of a **donation** to him

- ✓ **by the person to whom the right** of enjoyment of the property (eg. usufruct) in which the deceased held the interest, **accrues**
- ✓ or, **where** the interest consists of a **right to an annuity** charged upon property, by **the person** who is the **owner** of that **property**.

Example - s 4(g) [1]

- Anna donates the usufruct of her house to Koos
- Koos enjoys the usufruct till his death
- The usufruct falls back to Anna on Koos' death
- The value of the usufruct is "property" in Koos' estate in terms of s 3(2)(a) and valued in terms of s 5 – with Anna's life expectancy in mind ▶ ▶ ▶ Must calculate the value of the usufruct on Ks death and is property in his estate...

□ How does s 4(g) work ?

- Because the usufruct is regained by Anna - the original donor - the value in terms of s 4(g) will be deductible from "property" in Koos' estate
- With the result that s 3(2)(a) "property" is first included and then deducted in terms of s 4(g)

• S 4 deductions [6]

- S 4(h) - the value of any **property** included in the estate which accrues to:
 - ✓ any **public benefit organisation** which is exempt from tax in terms of s 10 (1) (cN) & 10(1)(cA)(i) of the Income Tax Act
 - ✓ the **State** or any **municipality** in the **RSA**
 - ✓ first it is included as property and then a deduction is available per this section.

• S 4 deductions [7]

- S 4(i) - the amount by which the **value** of any **property** included in the estate has been **enhanced** by any **improvements** made to the property concerned
 - ✓ at the **expense** of the **person** to whom such **property accrues** on the death of the deceased; **and**
 - ✓ during the **lifetime** of the **deceased** and with **his consent**

- Study the example ▶ ▶ ▶

Example - s 4(i) [1]

- Mr Abe who dies in 2010 bequeathed his house with an open market value of R2 500 000 to his son Bobby
- During Abe's lifetime and with his consent, Bobby made improvements of R100 000 to the house at his (Bobby's) cost
- By estimation, the improvements have increased the value of the house with R500 000 on Abe's death ▶ ▶ ▶ it is against the ideal of estate duty. And there is now a deduction of R 500 000...it must be built with the permission of the true owner! It will reduce abes estate it will not be R 2million as it is at date of death.
- It has the following effect on the calculation of Abe's estate duty:

- **S 4 deductions [8]**

- S 4(j) -the **amount** by which the **value** of any **fiduciary, usufructuary or other like interest** which **ceased** upon the **death** of the **deceased** has been **enhanced** by any **improvements** made to the property concerned
 - ✓ at the **expense** of the **person to whom** the **benefit arising** by reason of the **cessation** of **such interest** upon the **death of the deceased, accrues; and**
 - ✓ **during** the **lifetime** of the **deceased** and with **his consent**

- Study the example ▶ ▶ ▶

Example - s 4(j) [1]

- Abe donates a usufruct of his house to Bobo and on Bobo's death the usufruct accrues to Jim
- During the lifetime of Bobo and with his consent, Jim effected improvements of R1 000 000 on the house. The improvements on the house increased the value of the house from R4 000 000 to R5 000 000.
- On Bobo's death the value of the usufruct is included as "property" in his estate in terms of s 3(2)(a) and s 5. The value of the usufruct is determined on the market value of R5 000 000 ▶ ▶ ▶ is calculated on J's next birthday we also first work out the value of the property
- A s 4(j) deduction is allowable on the difference between the value of the usufruct calculated on

R 5 000 000 (the “property” value) and the value excluding the value of the improvements – that is R4 000 000

- Jim (male) is 49 years old on Bobo’s death
- What is the deduction in terms of s 4(j) ? ▶ ▶ ▶

• **Example - s 4(j)** [3]

Property (in Bobo’s estate)		Property!
1) Annual value: R5 000 000 x 12% = R600 000		
2) Jim turns 50: R600 000 x 7,602 01		4 561 206 B’s value or property
Deduction i t o s 4(j) (in Bobo’s estate)		
Value of the usufruct on R5 000 000	4 561 206	
<i>Minus</i> Value of the usufruct on R4 000 000 (R4 000 000 x 12% x 7,602 01)	<u>3 648 965</u>	
Deduction in terms of 4(j). no need to tax the persons capital who is the beneficiary of the usufruct.		

Question: A owns a house, its value is R 5 million, he then dies, in his will he creates a usufruct first for b and on b’s death c will then have it. One need only include then the value of the house as property in his estate... not a usufruct.

If B dies, calculate the value of the usufruct with reference to C and his age.

This is **important because if one for example and**: he actually creates a usufruct for his wife with the bare dominium holder is his son S. because in terms of section 4(q) everything that is bequeathed to one’s spouse is deducted. Then for the 4(q) one need only work the usufruct value out.

• **S 4 deductions [9]**

- S 4(1A) - the **amount** of any **claim against the estate** acquired under s 3 of the **Matrimonial Property Act, 1984** (Act No. 88 of 1984)
 - ✓ by the **surviving spouse** of the deceased
 - ✓ or by the **estate** of his **deceased spouse**, in respect of an accrual contemplated in that section
- Study the example ▶ ▶ ▶

Example - s 4(1A) [1]

	John	Sue
Total value of all their assets on John's death [including (ab) – down below]	<u>5 000 000</u>	<u>4 000 000</u>
(aa) Starting value of assets at the beginning of the marriage	10 000 shares	400 000 Apartment
(ab) Adjusted starting values – use the consumer price index and take this value at death.	(25 000)	(1 000 000)

• **Example - s 4(1A) [2]**

Each spouse's own property – excluded from the accrual system and from the calculations		
	John	Sue
Compensation for damages	(100 000)	
Specifically excluded in their ANC		(200 000)
Inheritances & donations	(100 000)	(300 000)
Assets donated by John to Sue		(100 000)
Assets donated by Sue to John	(50 000)	

Total	(250 000)	(600 000)
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- **Example - s 4(1A)** [3]

	John	Sue
Total value of their assets at John's death	5 000 000	4 000 000
Minus Assets excluded from accrual	(250 000)	(600 000)
Minus Adjusted starting values	(25 000)	(1 000 000)
Total accrual	4 725 000	2 400 000
Difference between the two accruals	4 725 000 – 2 400 000=2 325 000	
Divide the difference by 2	2 325 000 / 2 = 1 162 500	

Thus SUE can claim R 1 162 500 from Johns estate and john has this amount as a deduction from his estate.

- **Example - s 4(1A)** [4]

- Sue has an accrual claim against John's estate for an amount of R1 162 500
- There is thus a s 4 (1A) deduction of
R1 162 500 in John's estate
- **NB** : Should Sue die first, her estate will have a claim of R1 162 500 against John and it will be *deemed property* in her estate in terms of s 3(3)(cA)

- **S 4 deductions [10]**

- S 4(o) - the **value of books, pictures, statuary or other objects of art** or so much of the value of any shares in a body corporate as is attributable to such objects of art and if it
- **has been lent under a notarial deed** to the State **or any local authority within the RSA** for a period of not less than thirty years and

- **the deceased died during such period.** Then a section 4(o) will be available to the estate.
 - There are no liquid assets in ones estate and are sold to make a profit... thus they are to be included into the property of the estate and yet there is a possibility of a full deduction in terms of section 4(o)... must be or follow the requirements.
 - If a painting is a personal use asset, then there is an exemption in terms of the 8th schedule of the income tax act in paragraph 53 of the 8th schedule is an exemption from capital gains tax if it is a personal use asset.

S 4 deductions [11] NB!

- **S 4(q)** - the **value of any property included** in the estate which
 - has **not been allowed as a deduction** under the foregoing provisions of this section
 - as **accrues** to the **surviving spouse** of the **deceased**
 - **NB: s 4(q) – Proviso:**
 - ✓ **the deduction** allowable under the provisions of this paragraph shall be **reduced** by so much of any amount as the **surviving spouse** is **required** in terms of the will of the deceased to dispose of to any **other person** or **trust**
 - ✓ **no deduction** shall be allowed under the provisions of this paragraph in respect of any property which accrues to a **trust** established by the deceased for the benefit of the surviving spouse, **if**
 - ✓ **the trustee** of such trust has a **discretion** to allocate such property or any income thereof to **any person** other than the surviving spouse

S 4A Primary abatement

- S 4A - the **dutiable amount** of any estate shall **be determined**
 - by **deducting** from the **net value of the estate**, as determined **in accordance** with s 4
 - an amount of **R3,5 million**

(NB: 2009 amendment:- transfer of deceased spouse's primary abatement – it has the effect that the surviving spouse's estate may have up to **R7 million** primary abatement)

- ✓ More than one spouse? (s 4A(3)(b))
- ✓ When spouses die simultaneously? (s 4A (6))

A and B are partners...A dies... and his estate is worth 0 on his spouses death she has R 10 million... and 4(q) and 4A's deduction is transferred to B's estate. Thus allowing her R 7 million deduction.

B's estate has a net value of R 10 million but A dies and his estate is worth 1, 5 million, thus only 1, 5 million of the abatement is used for his abatement. Thus meaning that B now has R 5,5 million abatement.

A dies uses only R 500000 leaving R 3 million for B,C & D who have 10 million, 5 million and 10 million..

If A and B dies simultaneously then section 4A(6) then he who has the smallest estate has died first according to the estate.

10/08/2011

Law of taxation

lecture 6

S 5(1)(a) valuation of property

- **Property realized** of by a *bona fide* purchase and sale
 - ✓ in the course of the **liquidation** of the estate
 - ✓ is the **price realized** by such sale a market related price for the estate.
- **NB:** The Commissioner must be satisfied that it was indeed a *bona fide* transaction
- **S 5(1)(b) valuation of property**
- The value of a usufructuary or fiduciary
 - ✓ included as “property” in terms of s 3(2)(a) in the estate of the deceased
 - ✓ is the **capitalised value at twelve per cent per year over the life expectancy** of the **beneficiary of the usufruct**
- Calculation otherwise similar to donations tax calculations of limited interests in property

S 5(1)(b) (cont.)

- ❑ **First Proviso Know how to calculate!**
- Where the beneficiary of the limited interest
 - ✓ originally paid any consideration for the *bare dominion*; and then acquires the usufruct thus the full property, this proviso will take into account that you have already paid for the bare dominion

- ✓ the value of the usufruct as calculated in terms of s 5(1)(b), must be reduced by the consideration + 6% compound interest
- ✓ calculated from the date of payment to the date of the deceased's death

➤ Study the example ▶ ▶ ▶

Example: First Proviso [1]

- **Grandpa Abe:**
- **Sold the bare dominion** of his farm to Boeta for R100 000 (the bare dominion right to the land) and; (and leaves the example)
- **Donated the usufruct** of the farm to Carin
- Carin dies 10 years later from influenza. At that stage the agricultural land value of the farm is R1 million
- Boeta is 59 years old on Carin's death
- The value of the property in Carin's estate which accrues to Boeta is calculated as follows ▶ ▶ ▶

Annual value = R1 000 000 x 12% = 120 000

- Age next birthday of Boeta = 60 yrs (Table A)
- Boeta's life expectancy = 14,61 (Table A)
- Present value of R1 per year over Boeta's life expectancy = 6,74206 (Table A)
- Value of the usufruct:
 - ✓ R120 000 x 6,74206 = **R809 047** ▶ ▶ ▶

• **Example: First Proviso [3]**

Limited in terms of the First Proviso	
Boeta purchased the <i>bare dominion</i> for	100 000
<i>Plus 6% compound interest (10 years on 100 000)</i>	<u>79 085</u>
Total	<u>179 085</u>
Value of the usufruct	809 047

Minus First Proviso	<u>179 085</u>
Value of usufruct in Carin's estate	<u>629 962</u>

- **S 5(1)(b) (cont.)**

Second Proviso

- Where the **holder** of the *bare dominium* obtains the full ownership in that property from the **deceased**
- The value of the advantage so accruing by reason of the cessation of the interest held by the deceased
- Shall **not exceed**
 - ✓ the **difference** between the **fair market value** of that property as at the date of such cessation
 - ✓ and the **value** of the *bare dominium* as at the date when such *bare dominium* was **first acquired** under the disposition creating the said interest held by the deceased ▶ ▶ ▶
- **NB:** the *bare dominium* must be acquired under the same transaction that resulted in the deceased holding the usufruct
- Study the example ▶ ▶ ▶
- **Example: Second Proviso [1]**
- **Grandpa Abe:**
- **Donated** the **usufruct** of his farm in year 1 to Boetie. The agricultural land value of the farm is R 1 million in year 1. Boetie's age is 59 at that stage.
- **Donated** the *bare dominium* of his farm in year 1 to Corrie.
- Boetie dies 10 years later from fever and Corrie obtains the full ownership of the farm. The agricultural land value of the farm is now R 2 million and Corrie is 39 years old ▶ ▶ ▶
- **Example: Second Proviso [2] ANSWER!**
- Annual value = R2 000 000 x 12% = 240 000
- Age next birthday of Corrie = 40 yrs (Table A)
- Corrie's life expectancy = 35,48 (Table A)

➤ Present value of R1 per year over Corrie's life expectancy = 8,18386 (Table A)

➤ Value of the usufruct : R240 000 x 8,18386

= **R1 964 126** ▶ ▶

- **Example: Second Proviso [3]** one can either take the smaller amount or the full value of the property at that moment less the value of the bare dominion when it was first acquired... thus calculate the value in Year one and deduct it. Look at the note 1.

Limited by the Second Proviso	
Agricultural land value	2 000 000
<i>Minus value of bare dominium when it was first acquired See Note 1</i> ▶ ▶ ▶	<u>190 953</u>
	<u>1 809 047</u>

- **Example: Second Proviso [4]**

➤ **Note 1:**

✓ Value of **usufruct** in year 1 = R1 million x 12% x 6,74206 (Boetie's age on his next birthday = 60)

= **R809 047**

✓ Value of *bare dominium* in year 1

= R 1 million – R809 047 = **R190 953**

➤ **See Note 2:** ▶ ▶ ▶

- **Example: Second Proviso [5]**

➤ **Note 2:**

✓ The value of the usufruct on Boetie's death is the **smaller**

✓ of **R1 964 126**

or **R1 809 047** thus with the choice one would choose this.

- **S 5(1)(b) (cont.)**

Third Proviso

- Where it is not possible
 - ✓ to ascertain the person who will become entitled to the right of enjoyment of the property until some future date
 - ✓ a life expectancy of fifty years should be used for that person (or use table B)
 - **NB:** the executor & Commissioner may agree, having regard to the circumstances of the case, to adopt a lesser period – on reasonable grounds!

S 5(1)(c)

- **A right to any annuity** included as property in terms of s 3(2)(a):
- An amount equal to the value of the annuity capitalized at twelve per cent
- Where the right **accrues** to some **other person** on the death of the deceased, over the life expectancy of the person to whom the said right accrues on the death of the deceased – **Table A**
- or (to be deleted by a tax amendment) **if it is to be held for a lesser period than the life of such person, over such lesser period... then use table B to do one's calculation.**

A right to any annuity included as property in terms of s 3(2)(a):

- Where the **annuity** does **not accrue** to some other person – then the **value is calculated** over the life expectancy of the person who on the death of the deceased, is the **owner** of the property upon which such annuity was charged.
- Study the example ▶ ▶ ▶

S 5(1)(c) Example [1]

- Ms **Anne** is the **owner** of holiday apartments
- She derives an annual rental income of R100 000
- She is obliged to pay an annuity of R50 000 to her sister **Betty** from the rental income
- **Betty** dies when **Anne** is 49 years old. **Anne** has no obligation to pay the annuity to **Betty** or her descendants
- ❑ What is the **value** of the **annuity** to be included in terms of s 3(2)(a) as “**property**” in **Betty's** estate? ▶ ▶ ▶

- **S 5(1)(c) Example** [2] ANSWER

- Annual value of the annuity = R50 000.
- Age next birthday of Anne = 50 yrs (Table A)
- Anne's life expectancy = 26,71 (Table A)
- Present value of R1 per year over Anne's life expectancy = 7,92950 (Table A)
- Value of the annuity to be included as "property" in **Betty's** estate
- $R50\ 000 \times 7,92950 = \mathbf{R396\ 475}$

S 5(1)(d)

- Right to any annuity referred to in s 3(2)(b) as property:
 - ✓ is normally purchased from an insurance company
 - ✓ where it **ceases** – it is thus not included in property
 - ✓ where it **accrues** to another person – the value is capitalised at twelve percent over the life expectancy of the person to whom it accrues.

S 5(1)(d)bis

- When the right to any annuity in terms of ss 3(3)(a) and 3(3)(a)bis is included as deemed property, e.g. the payments of a "domestic insurance policy":
 - ✓ the value is capitalised at twelve percent over the life expectancy of the person to whom it accrues
 - ✓ or (to be deleted by a tax amendment) **if it is to be held for a lesser period - over such lesser period**

- **NB:** Proviso: ▶ ▶ ▶

- **S 5(1)(d)bis (cont.)**

- **Proviso:**

- If the **annuity** ceases to be payable **within five years after the death** of the **deceased** because

(i) of the **death** of the annuitant within that period or

(ii) **re-marriage** of the annuitant within that period

then the **value** of the **annuity** shall be **deemed** to be an amount equal to the **lesser** of

- (i) the aggregate of the amounts which accrued to the annuitant in respect of the annuity or
- (ii) the **capitalized value** of the **annuity**

➤ Study the example ▶ ▶ ▶

- **S 5(1)(d)bis (cont.) Example [1]**

➤ **Amanda** dies in 2007 of a broken heart and her right to an annuity of R15 000 per annum, accrues to her spouse **Brutus**

➤ The capitalized value of the annuity, included as “property” in **Amanda’s** estate, is R225 000

➤ **Brutus** re-marries in 2010 (within 5 years) to Ms SA, **Bella Floret**, after he received R45 000 as annuity. The annuity ceases on his re-marriage. He further receives a lump-sum payment of R30 000 on cancellation of the annuity payments ▶ ▶ ▶

- **S 5(1)(d)bis (cont.) Example [2]**

➤ The value of the annuity in terms of

s 5(1)(d)bis is limited to

$$R45\ 000 + R30\ 000 = R75\ 000$$

➤ in the **estate** of the **deceased spouse Amanda as deemed property**.

➤ The Commissioner may **recalculate Amanda’s** estate duty in terms of **s 5(1)(d)bis** and reduce it to only **R75 000** and not the **R225 000** as ‘deemed property’.

S 5(1)(e)

➤ Donation in terms of s 3(3)(b) - *donatio mortis causa* = included as deemed property

➤ **NB:** value is capitalized in terms of s 62 of the Income Tax Act BUT;

➤ Where the donee has for instance already received the donation of a usufruct before the death of the donor (like a flock of sheep), then the value is calculated in terms of s 62 – on the shorter time of the life expectancy of the donor, donee or a specific period.

➤ Where the donation of the usufruct only accrues to the donee on the death of the donor – then the usufruct is calculated on the life expectancy of the donee or a lesser period (example: usufruct of a diamond ring)

S 5(1)(f)

- When the **bare dominium** of any movable or immovable property:
 - ✓ which is subject to a usufructuary or other like interest
 - ✓ is determined

take the fair market value of the property XXX

minus value of the usufruct (XXX)

= **bare dominium** XXX

- **S 5(1)(f)bis**

Unlisted shares or a member's **interest** in a close-corporation

- ✓ must be valued by an **independent person (sworn valuer)** on date of death
- ✓ the valuer must **disregard** any **restriction** that may **reduce** the **value** of the shares or interest – for example, like restricting the transferability of the shares to family members only.
- ✓ But, if the deceased was entitled to a larger *pro rata* share on liquidation - it must be taken into account when the shares are valued then if they can make the shares worth more then it must be added!

S 5(1)(g)

- **Any property** which is not sold: requirements
 - ✓ **fair market value** is included as “property”
 - ✓ must be valued by **independent sworn valuer**
 - ✓ **conditions** imposed that could reduce the value of property on or after death must be **disregarded** unless the Commissioner otherwise directs
 - ✓ **executor** has a choice to use the “agricultural land value” or “**fair market value**” – *bona fide* farming activities, if “agricultural land value” is used

S 5(2)

- Annual value is equal to 12% per annum exactly the same as section 62 of the income tax act

but

- ✓ **Commissioner** may decide to use a different percentage like 5% (karoo farm)
- When we work with specific objects then the Annual value of **books, pictures & other art objects** in determination of the value of limited interests = average net receipts derived from such items – **three years prior to date of death**. The value is the bare dominion of the object is one cannot determine the usufructs value.

S 5(3)

- **Life expectancy of a legal person**

to determine the value of usufructuary, fiduciary or other like interests = **50 years (TABLE B)**. Note Table B

S 16

- The following rebates can be deducted from **estate duty**:
 - ✓ any **transfer duty** payable by a person in respect of property included in the estate and acquired from it – by the person liable for the estate duty on that property. Is rubbish there is an exemption in section 9(1)(e) of the transfer duty act and gives an exemption in terms of property which you inherit and you will not pay transfer duty!
 - ✓ any amount of **foreign death duties** paid in respect of foreign property included in the estate of the deceased
 - ✓ **deceased** must have been **ordinarily resident** in RSA at date of death
 - ✓ the **deduction** for foreign death duties may not **exceed** the **estate duty** payable in terms of the Estate Duty Act, No 45 of 1955
 - ✓ There is a house in London and the man was in SA when he dies, and in the UK there is estate duty on the house and he purchased the house as a SA citizen thus he pays the duty in UK and has a deduction in SA for the UK amount.
 - ✓ On this house there is R 500000 for the house for the duty, but R 1 million is paid in the UK thus one can only get a deduction for the R 500K.

- **Rapid succession - First Schedule relief** [1]

- If **estate duty** was payable on the property of the deceased

and

- ✓ the **heir** of that property **dies** within **10 years** after the death of the first-dying person

and

- ✓ the heir's estate is again **subject** to estate duty on **that property** then
- ✓ A dies and he gives B a house (it is a legacy) and B must pay R 100k estate duty and gives it to C. In Bs estate there is estate duty thus use the first schedule and one can see that B's estate need not pay again he gets a full rebate of the amount.

- ✓ *First Schedule relief* is available ▶ ▶ ▶

- **Rapid succession - First Schedule relief** [2]

If the heir dies within the following periods, then the estate duty payable on that same property is reduced as follows:	
0-2 years	100%
2-4 years	80%
4-6 years	60%
6-8 years	40%
8-10 years	20%
NB: the rebate is limited to the amount of estate duty paid on property in the estate of the first deceased	

Estate Planning

What is estate planning?

- ❑ **Meyerowitz** defines estate planning as:

“The arrangement, management and securement and disposition of a person’s estate so that he, his family and other beneficiaries may enjoy and continue to enjoy the maximum

from his estate and his assets during his lifetime and after his death, no matter when death may occur.”

Important objectives for estate planning (1)

- Facilitate the estate owner’s (planner) wishes
- Reduce tax liability
- Keep measure of control over assets
- Planner must not be dependent of beneficiaries – capital & income provided for retirement
- Provision of liquidity in estate – also to pay for estate duty

Important objectives for estate planning (2)

- Simplify the speedy administration of the estate
- Exercising good business principles
- Protection of business interests
- Protection against insolvency of spouses or beneficiaries
- Be practical

Important objectives for estate planning (3)

- Fit in the needs of involved parties
- Provision of income & capital for dependents - spouse, descendents, grandparents
- Maintain peace, prohibits prejudice
- Future growth in assets need not be limited
- Flexibility in respect of changing circumstances

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How can estate duty be avoided ? (1)

- Spend income & capital
- Sell growth assets to an *inter vivos* discretionary trust & live of the returns of the interest-free loan account

- A gives a Property to a Trust and sells it to the trust, its value is R 10 million and it is no longer in A's hands and not part of his assets but he now has R 10 m to live off and there is no interest on the money and thus no need money. And the future value of the farm is in the hands of the trust.
- Use s 7(5) of the Income Tax Act - to minimise the estate of the planner
- Donate assets - use s 56(2)(b) of the Income Tax Act - R100 000 exemption per annum

How can estate duty be avoided ? (2)

- Donate R100 000 per annum to a discretionary trust reduces A's estate but can also have A as an income beneficiary of the trust.
- The trust can use the donation later to settle the loan account
- Elder person donates the usufruct & bare dominium of agricultural land @ "farming land value." Why do this? There will be less tax on the payment but there can be transfer duty payable on the property. If those getting the property are vendors in terms of VAT then there is there is a zero rated supply in terms of 11(1)(e).
- Make *bona fide* maintenance contributions – use s 56(2)(c) exemption
- Marry or remain "spouses" in a permanent union – use s 4(q) deduction of the Estate Duty Act and there is an exemption in the donations tax. And beware of dates!!!

How can estate duty be avoided? (3)

- Donate assets to "spouse" - use s 56(1)(b) of the Income Tax Act exemption
- If spouse dies he/she can make use of the s 4A primary deduction - Estate Duty Act. NB: S 4A transfer of deceased spouse's primary abatement make sure that there is enough left over to transfer...such as the remaining R 3,5 million or the remaining out of that can be transferred over to the living spouses estates.
- Purchase a farm as a going concern, especially if buyer & seller are both "vendors" into the VAT Act – zero rated supply into s 11(1) (e) of the Act and the purchaser is also a vendor and if it is thus sold as such then it may be zero rated and no tax is payable..
 - A buys a farm at market value of R 10 m and sells the farm at agri rates to the family trust to R 7 million and thus a loss is greater than his asset. All parties involved must be registered vendors for it to be a zero rated supply... there were no transfer payable as per section 9(15). In VAT a zero rated supply is still taxable but at a 0% rate.
 - If it is not a running concern...then do not do this.

- Farm is purchased at market value, but then donated or bequeathed at farming land value - debt is greater than value of the asset in estate – however be careful.

Trusts & estate planning (1)

- ❑ **Where do trusts come from ?**
- Creation of English law - 1820 Settlers to SA
- Feudal period in England - *William the Conqueror* 1066 AD
- Trust figure – refined - imported into many legal systems

Trusts & estate planning (2)

- ❑ **Does a trust have its own separate legal personality?**
- *CIR v MacNellie's Estate* 1961 (3) SA 833 (A) HR Steyn - trust does **not possess its own legal personality** that the assets and liabilities of the trust vest in the trustees and they manage the trust for the beneficiaries of the trust. It can be a juristic person under the income tax act but not under the Estate duty act.
- Trust / estate of deceased person / estate of insolvent person = “person” ito s 1 of the Income Tax and VAT Act

- **Classification of trusts (1)**

Testamentary trusts

- ❑ **Testamentary trust** – by way of a will
- The testator must determine the following in his will:
 - ✓ what are the assets ?
 - ✓ who are the beneficiaries ?
 - ✓ who are the trustees ?
 - ✓ what are the powers of the trustees ?
 - ✓ manner in which the trust income & capital are divided?

- **Classification of trusts (2)**

Testamentary trusts

❑ **Why are testamentary trusts set up?**

- Incapacity of beneficiaries
- Specific asset by way of succession falls in the family
- Changed circumstances
- Division difficult or impossible...subdivision of agricultural land act 70 of 1970 forbids the division of such land without the permission of the Minister.

• **Classification of trusts (3)**

Inter vivos trusts

- ❑ During life of the planner by way of a contract (trust deed) set up - to the advantage of third parties – beneficiaries

Reasons for creating:

- ✓ transferring assets from the person from his estate especially growth assets to peg the value and ensure that his estate does not grow anymore but that it should grow in a trust.
- ✓ protection & management of assets, such as minors, use a trustful trustee that can manage the trust.
- ✓ use & control of assets kept separate, the use of the assets and the income but the management in the hands of others.
- ✓ division of income and peg the value in their estates and there should be growth in the estate in the trust. Is important when dividing the income for other tax reasons and that the person for whom you are doing it for.
- ✓ reservation of rights, the person that you advise will want to have certain rights and he has waived the rights to the capital but he will want to have the income for the rest of his rights and should be placed in the trust deed.

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• **Classification of trusts (4)**

Further distinction in trusts

❑ **Bewind Trust**

- Beneficiaries have real rights of ownership to trust assets,

- For example there are three trustees in a trust and the asset and the beneficiary and there is real rights between the trust and the beneficiary and the only function of the trustees is to exercise control over the property. The trustee is likely to have a set of instructions to control the asset and this is not a true estate plan as the asset is still part of the beneficiary's estate.
- Not a useful tool to save estate duty

- **Classification of trusts (5)**
Further distinction in trusts

- **Vested Trust**

- Beneficiaries have only personal rights in respect of trust assets;
 - The property belongs to the trust and the beneficiary has only personal rights, an example of such is the assets are placed in trust and the B will be entitled to the property on the age of 35. The moment the B becomes owner then he will have estate duty problems.
 - If B dies before 35 then the property will not form part of his estate and will transfer to the next in line or to any organ stated in the trust deed.
- Beneficiaries can claim trust asset in the advent of a specific event e.g. 25th birthday
- Limited use – only achieves estate duty savings for the planner and not the beneficiary

- **Classification of trusts (6)**
Further distinction in trusts

- **Discretionary Trust NB!**

- **Most important trust in estate planning**
- Ownership & control of trust assets vest in the trustees and the beneficiary has only a spes or a hope and the trustees control the assets and keep the income in trust and never pay it over. The Trustees must be set by the trust deed, and there must be rules with regards to powers.
- Beneficiaries have no vested right in respect of trust assets
- Planning can span over generations

Factors considered in establishing an *inter vivos* trust, and now the running costs of the trust:

- Determine the establishing costs
- Estimate possible increase in value of the growth assets would it be a good idea and is there a possibility to set the property in a trust or not. Can set shares in a trust rather than putting property in the trust
- Calculate estate duty if planning is not implemented
- Subtract establishing costs from estate duty savings
- Personal circumstances of the client and it should be flexible.

Example 1: Use of s 4A

Gross value of the estate (total of “property” & “deemed property”)	<u>12 000 000</u>
Deductions!!!!	
<i>Minus: s 4(a)-(p) deductions</i>	(1 000 000)
<i>Minus: s 4(q) (bequeath to spouse)</i>	<u>(7 500 000)</u>
Total	<u>(8 500 000)</u>
Net value of the estate which goes to the children	3 500 000
<i>Minus: Primary deduction s 4A thus the taxable value is...</i>	<u>(3 500 000)</u>
Taxable value of the estate	<u>Nil</u>

Example 2 (1)

A is (65) widower has two children B (15) and C (20)	
Property:	
Listed shares ABC Ltd	3 500 000

{ Expected growth of shares in 7 yrs }	{ 9 500 000 }
Farm – FLV	6 500 000
(Farm’s market value = 9 mil)	
{ Expected FLV growth in 7yrs }	{ 10 500 000 }
Cash	2 000 000
S4(a)-(p) deductions	3 000 000

A has two children B and C and B is a minor and property in shares and a farm where there is farming. The shares value at the moment is R 3,5 million and the farm land value is R 6.5 million and the expected growth of the farm is R 10.5 in 7 years and the shares 9.5 million in 7 years time.

A has R 2 million in cash and thus her total estate currently. There are deductions available and if A dies today the total amount is R 12

- **Example 2 (2)**
A dies today

Gross value (property)	12 000 000
<i>Minus</i> s 4(a)-(p) deductions	<u>3 000 000</u>
Net value of the estate	9 000 000
<i>Minus</i> s 4A primary deduction	<u>3 500 000</u>
Taxable value of the estate	5 500 000
Estate duty: 20% x 5 500 000 = 1 100 000, there is liquidity as there is R 2 million in cash	

- **Example 2 (3)**
A dies in seven years; and now what?

Property	22 000 000
-----------------	------------

<i>Minus</i> s 4(a)-(p) deductions	<u>3 000 000</u>
Net value of estate	19 000 000
<i>Minus</i> s 4A primary deduction	<u>3 500 000</u>
Taxable value of the estate	15 500 000
Estate duty: 20% x 15 500 000 = 3 100 000	

Example 2 (4)

- Create an *inter vivos*, discretionary trust to answer the issue. A's mom is the founder H, it is possible that
- B and C capital & income beneficiaries in terms of the trust deed.
- A = only income beneficiary and no capital assets to prevent section 3(3)(d) and 3(5) Estate Duty act that there is any possibility that the section can be used and to stop it being part of her estate.
- Sell shares & farm to trust @ market value & farming land value= R10 000 000. The trust owes or has loaned R 10 m to A and the costs for the transfer of the shares is the 0.75% tax on the shares and the trust might have to pay 8% on the market value of the Farm and the transfer duty act does not provide for farming land value there is no choice. BUT!
 - If A & trust = "vendors" s i to VAT Act, sells farm as going-concern - then zero rated supply [s11(1)(e) of VAT Act] and it is still taxable but at a 0% rate otherwise if the trust is not a vendor and A is the n there is 14% VAT payable.

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Example 2 (5)

- Interest-free loan account, owing by trust to A - R10 000 000, why to make section 7(5) applicable of the income tax,
- Interest-free so that:
 - ✓ A's estate does not grow any further (still has R2 000 000 cash to live on)
 - ✓ S 7(5) of the Income Tax Act can be applicable: can deem the trust income to be the donors and yet A has sold the assets and because he makes an interest

free loan to the trust there is a interest free donation and this can cause the the CSAR to apply 7(5).

- ✓ The trust is the owner of the assets and the farm makes a profit of R 1 million in YOA and the trustees decide not to dispose of the profits to the beneficiaries and then here CSAR may apply the 7(5) and deem the R 1 million to be A's income and the trust will not pay any tax and then A can recoup the tax paid from the trust but he has the right also not to.
 - The reason is that he is charged at his normal tax rate of 40% ... thus R 400k of the R 1 million and his estate is thus reduced every year and there is no increase in the value of A's estate but there is an increase in the Trust assets.

Example 2 (6)

☐ S 7(5):

- ✓ Where a person has made a donation, settlement or other disposition
- ✓ **subject to a stipulation or a condition**
- ✓ that the beneficiaries thereof shall not receive the income until the happening of that event or death of that person
- ✓ **the income or any part thereof shall be deemed to be the income of that person** ▶ ▶ ▶

Example 2 (7)

☐ S 7(5)(continue):

• Example 2 (8)

☐ Discussion:

- Estate duty is still the same on commencement of the scheme
- After 7 yrs it will be quite different -growing assets will not form part of A's estate anymore – because it forms part of the trust's assets;
- Trust's income can be deemed to be A's ito s 7(5) - advantage is that the gross value of A's estate, which is currently R12 000 000, will annually decrease with the "trust's income tax liability" ▶ ▶ ▶

Example 2 (9)

- A may further make donations of R100 000 annually to the trust – **exempted from donations tax (s 56(2)(b) Income Tax Act-)** – to decrease his estate even more over and above his tax payment.
 - **A must never write the debt off of** the trust and let the trust make payments on the loan account, the reason for this is para 12(5) of the 8th Schedule has a section that if one writes off any debts then the debtor (the trust here) then there is a deemed disposal for the amount you have written off.
 - **If A dies then what happens to the debt, then the executor can claim it from the trust, yet A can place it in the testament that the trust can inherit money but never write off existing debts.**
- A receives payment of capital on his loan to the trust - hence has money to live on
- If A needs money in future, he can still receive income from the trust

Example 3 (1)

- The planner may be willing to transfer growth assets to a trust – but still wants to maintain control over such assets: can cause issues with regards to income and tax
 - **Danger** exists that s 3(3)(d) read with s 3(5) of the Estate Duty Act may come into force: if the case of full control is maintained

Example 3 (2)

- S 3(3):
 - ✓ Property that is **deemed** to be the property of the **deceased**:-
 - ✓ (s 3(3)(d)) – **property ... of which the deceased was immediately prior to his death competent to dispose for his own benefit or for the benefit of his estate** ▶ ▶ ▶

Example 3 (3)

- ☐ **NB: S 3(5) & s 3(3)(d) must be read together**
- S 3(5):-
 - ✓ **Person** shall be **deemed** to have been **competent to dispose** of any **property**
 - ✓ if he had such power as would have enabled him to appropriate or dispose of such property as he saw fit whether exercisable by will, power of appointment or in any other manner

There must be a condition in the trust deed that A will be able to receive any Capital from the trust. The trustees cannot give out capital only income if any is received.

Example 3 (4)

- ❑ The question is how to keep control, without being caught by the provisions contained in s 3(3)(d) read with s 3(5)?
- Proposed structure to reconcile s 3(3)(d) and the need to control ▶ ▶ ▶
- Trustees
A X Z

Example 3 (5)

- ❑ **How does the plan work?**
- ❑ A is one of the trustees but not beneficiary and only for income, yet X and Z are income and capital>>>
- Founder H (A's father) donates a nominal amount of R1 000 to the *inter vivos*, discretionary trust
- A may only receive income from the trust – other beneficiaries may receive capital & income
- Trust has at least 3 trustees of which A is one – other trustees is in the majority – cannot enforce his own will on the trust and cannot have any of the capital assets to A either
- Trust & A create a company
- Trust subscribes to 100% of the ordinary shares - 1 000 shares in this case ▶ ▶ ▶ is both capital and profits and the trust is entitled to the capital. A gets 1200 ordinary shares and he is only permitted 5% of the profit to be paid out, and he may not share in any capital at liquidation. Thus A has the majority vote in the company and the trust only 1000 shares and that A is in control of the company although not entitled to any of the assets of the company

Example 3 (6)

- A sells his farm to the company at farming land value; A zero-rated supply to the VAT Act, will limit the costs of the plan
- A makes an interest-free loan to the trust for the balance of the purchase price and the trust makes a loan to the company thus Trust lends the purchase price to the company, at market related interest at say 12% and the company pays for the farm.
- Trust receives interest & dividends of the company (which is now the owner of the business)

- Thus Company has a s 11(a) of the Income Act, deduction for interest expenditure in terms of the Income Tax Act ▶ ▶ ▶
- A has a loan to the trust which is his asset.

Example 3 (7)

- A enrolls for 100% of the 5% preference shares in the company - 1 200
- The shares each have voting rights attached to it - Important that A has a small majority of votes -

reason for this:

- ✓ A may not be able to change the company's Memorandum of Incorporation, by way of a special resolution in terms of s 16 of the Companies Act, thus if the Special resolution is successful and to convert the preferent shares then section 3(3)(d) and 3(5) and he will be able to gain the capital and be liable for tax.
- ✓ A may therefore not be able to convert his 5% preference shares, directly or indirectly, into ordinary shares

Example 3 (8)

- ✓ A will be able to **exercise control over the assets** of the company by way of his majority of votes, but the assets of the company will not on his death, be included as deemed property in his estate, in terms of s 3(3)(d)
- ✓ A can thus retain control of the farm – while there is no growth in his estate ▶ ▶ ▶

Example 3 (9)

- ✓ A may not share in the company's capital on liquidation as per Memorandum of Incorporation
- ✓ A is **not entitled to any assets** of the company, trust owns 100% share capital of the company
- ✓ A may receive income from the trust, if needed in future

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Law of Taxation

Lecture 11

VAT

- Introduction (1)

❑ History of VAT in the RSA it is the most important form of indirect taxation in the developed world today. It is levied by a supplier who is a registered vendor and is always a registered vendor and it also includes a person who is supposed to be registered.

❑ If a non vendor may not levy vat. And the supplier is the person to add it on to the purchase. It is a regressive tax and everyone pays exactly the same rate for good or service.

➤ Introduced Sept 1991

➤ Politically controversial

➤ Replaced GST or called general sales tax

➤ GST introduced in 1978 @ 4%

➤ But, VAT would have been introduced @ a rate of 12% and there was a issue with this. And it excludes fraud. Because of pressure from several quarters, introduced @ 10% rate - currently 14%. But there are different amounts, such as 0% but it is a zero rate but it is still a taxable rate... such as fruit and vegetables are not technically taxed.

➤ VAT – levied on more goods & services than GST. Since 27 Apr 1994 - generally accepted

• **Introduction (2)**

❑ **Reasons for introduction of VAT = Inherent deficiencies of GST**

➤ GST – single phase collecting system - loss is greater when fraud is committed

✓ VAT – collected throughout the whole production & distribution system – losses from fraud are limited. Thus difficult to commit fraud in this system. And if there is some fraud in the system then at least there will be some form of tax in the line.

➤ GST – often a tax on tax if one buys a machine one will pay GST but will not be able to claim the GST back as you are the end user and thus cannot claim the GST back.

- ✓ VAT - only paid by the end user and is self controlling and if one is a vendor one will want to claim back your vat thus you need an invoice before you can claim back your vat.

- **Introduction (3)**

- **Reasons for introduction of VAT = Inherent deficiencies of GST(cont.)**

- GST – narrow tax base while VAT has a broad tax base
 - GST leaves a limited “paper trail”, while VAT leaves an enormous one in order to combat tax fraud (also other taxes). And it is possible to combat other forms of tax evasion using ones VAT returns.
 - VAT – most important form of indirect tax worldwide
 - ✓ VAT in other countries
 - ✓ our VAT is predominantly based on that of New Zealand and the USA still does not have VAT system but in DUBAI there is no tax at all except on alcohol and tourist things. And if there is no authority in SA then refer to New Zealand cases and authority to assist us. In new Zealand one will pay GST (not the same as our gst but is called goods and services tax) and is like our own VAT

Country	VAT	Country	VAT
Belgium	21% (6%)	Netherlands	19% (6%, 0%)
Cyprus	15% (5% or 0%)	Norway	25% (foodstuffs 14%)
Denmark	25%	Poland	23% (8% or 5%)
Finland	23% (13%, 9%)	Portugal	23% (13%, 6%)

France	19.6% (2.1% drugs, newspapers, theatres), (5.5% raw food, books)	Russia	18% (10%, 0%)
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Country	VAT	Country	VAT
Germany	19% (7% on selected goods and services)	Sweden	25% (12%, 6%)
Greece	23% (11%)	Switzerland	8% , 3.8% (hotel sector) and 2.5% (consumer goods)
Iceland	25.5% (7%)	Ukraine	20% (0%)
Ireland	21% goods, (13.5%, services, 0% food)	United Kingdom	20%, 5% and 0%

- In Sweden has a higher rate but it is variable depending upon what you make

- **Introduction (4)**

- Levied into the Value-Added Tax Act, *No 89 of 1991*, read with
- First, Second and Third Schedules; The Regulations; Practice Notes & Interpretation Notes to the Act. It is not necessary to know the whole act!

Payment of VAT (1)

Charging section - s 7(1)(a)

- Levied on the **supply** by (*IS NB AND MSUT KNOW!*)
 - ✓ **any vendor** of **goods** or **services supplied** by him in the course or furtherance of any **enterprise** carried on by him. **NB:** Also levied on imported **goods & services** (s 7(1) (b) & (c)) **SEE ALL CASE LAW ON THIS!**
- @ Standard rate of 14% and zero rate of 0%

- **Payment of VAT (2)**

"Vendor" (s 1)

- Any 'person' who

- ✓ is **registered** under this Act; or
- ✓ who is or is **required to be registered**

❖ **Proviso**

- ✓ Commissioner may, under s **23** or s **50A**, determine the date from which a person is a vendor

- **Payment of VAT (3)**

"Supply" (s 1)

- Performance in terms of
- A sale, rental agreement, installment credit agreement
- And all other forms of supply
- Whether voluntary, compulsory or by operation of law

- **Payment of VAT (4)**

☐ **"Supply" (s 1) (cont.)**

- Irrespective of where the supply is effected
- Any derivative of **"supply"** - construed accordingly
- "Supply" can only be effected if there is a "supplier" and a "recipient" involved with the "supply"
- Amendment of the definition of supply in 1999 - even expropriation is included

- **Payment of VAT (5)**

"Goods" (s 1)

- Corporeal movable things; and

- **“Fixed property”**; and
- Any real right in any such thing or fixed property
- **Payment of VAT (6)**
- ☐ **“Goods” (s 1) (cont.)**

“Fixed property” (s 1):

- ✓ land + improvements affixed thereto
- ✓ sectional title unit
- ✓ share in a share block company
- ✓ right or interest in a time-sharing scheme
- ✓ any real right like a servitude or usufruct
- **Payment of VAT (7)**
- ☐ **“Goods” (s 1) (cont.)**
- ❖ **But excluding:**
 - ✓ money
 - ✓ any right under a mortgage bond or pledge of any such thing or fixed property
 - ✓ any stamp, form or card which has a money value and has been sold or issued by the State

except when: subsequent to its original sale or issue it is disposed of or imported as a **collector’s piece** or **investment article**

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Payment of VAT (8)

- ☐ **“Goods” (s 1) (cont.)**

“Money” (s 1)

- ✓ coins (other than coins made from a precious metal other than silver)
- ✓ that is a legal tender in the RSA

- ✓ foreign notes or coins used as currency (other than coins made from a precious metal)
- ✓ any bill of exchange, promissory note, bank draft, postal order or money order

- **Payment of VAT (9)**

- ☐ **“Goods” (s 1) (cont.)**

- **“Money” (s 1) (cont.)**

NB: Kruger Rands are **“goods”** because:

- it is made of a precious metal

BUT is a zero-rated supply (s 11(1)(k))

NB: Items that are sold or imported as collector’s pieces are “goods” on which VAT is payable (e.g. coins and stamps)

- **Payment of VAT (10)**

“Services” (s 1)

- Anything done or to be done
- Including the granting, assignment, cession or surrender of any right
- Or the making available of any facility or advantage
- ❖ **Exception:** a supply of goods, money or any stamp, form or card contemplated in paragraph (c) of the definition of “goods”

NB: Distinction between “goods” and “services” not important with respect to VAT. It does not matter if a vendor makes a taxable supply of goods and services.

A rugby player loses his teeth in NZ and goes to the Dentist and the D gives him a service and a taxable supply of goods and it could be important if there was an exempt supply but the services are not. So long as it is a taxable supply! Then VAT can be levied.!

- **Payment of VAT (11)**

“Person”

- Vendor must be a person
- Business is not a person
- **What is a person ?**
 - ✓ natural person
 - ✓ sole proprietor
 - ✓ **NB:** partnership although not a legal person it is in terms of the definition.
 - company
 - co-operative
- “Charitable Organisation” (Welfare ~) to enable them to claim all input tax but all output tax is not payable. In delivering a taxable service or goods.
- Association
- Club
- Trust fund
- Deceased or insolvent estate
- “Municipality”
- “Public authority” like government departments and is specifically registered.
- Anybody of persons (corporate or unincorporated)

Payment of VAT (13) NB!

“Enterprise”

- Any enterprise or activity which is carried on by any person,
 - ✓ continuously or regularly
 - ✓ in the RSA or partly in the RSA

✓ and “ in the course or furtherance of which “goods” or “services” are “supplied”

✓ to any other person for a “consideration” whether for profit or not.

➤ Not necessary to make a profit, but so long as it is a taxable act.

➤ Includes any activity that can be carried on by a person (cont.)

✓ for “consideration” as defined (s 1) - can include a donation of “goods”, or rendering of free services **by** a “charitable organisation”, or “an association not for gain”

✓ **reason** - can claim input tax back, even though no output tax is levied

➤ **Specific inclusions:**

✓ commercial, financial, industrial, mining, farming, fishing or professional concern

✓ association or club

✓ certain public authorities

✓ “welfare organisations”

✓ share block companies

“Enterprise” (cont.)

➤ **Important specific exclusions:**

✓ services of employees (i.e. **not** independent contractors)

✓ activities that are essentially hobbies /private pursuits can have time limits that the CSAR can look at.

✓ any activity which involves the making of exempt supplies. For example in section 12 an example is the transport of passengers and the teaching at a university.

How does VAT work? (1)

Tax fraction (s 1)

- Prices are deemed to include VAT (s 64) that is the price one sees is deemed to include the VAT.
- How do you determine the VAT that is **included** in a price? Of the Projector is R 100

“Tax fraction” (s 1)

- How do you determine the VAT that is included in a price?

$$\frac{\text{Price}}{100 + r} \times \text{Price} \qquad \frac{14}{100 + 14} \times 100 = 12,28$$

[r = s7(1) rate which is currently 14%]

“Tax fraction” (s 1)

- Therefore the price of the camera **without** VAT is R87,72
- **R87,72 x 14% = 12,28**
- **And R87,72 + 12,28 = R100**

Standard-rated supplies					
Vendor	Purchase Price	Input tax	Sales Price	Output tax	To SARS
Firestone B Manufacturer	No purchase of materials	-	228	28	28
Makro B Wholesaler	228	28	342	42 deduct your input tax from	14

				your output	
Tiger B Wheels Retailer	342	42	570	70	28
Total received by SARS					<u>70</u>

Zero-rated supplies – Maize					
Vendor	Purchase Price	Input tax	Sales Price	Output tax	To SARS
Mielie farmer M Marais	-	-	100	-	-
Sasko Mills M	100	-	200	-	-
Super Maize M Shop	200	-	250	-	-
Total received by SARS					=

Zero-rated supply Combination					
Vendor	Purchase Price	Input tax	Sales Price	Output tax	To SARS
Mielie M Marais	-	-	100	-	-
Firestone B	-	-	228	28	28
Sasko M Mills	100	-	200	-	-

Tiger B Wheels	228	28	342	42	14
Super M Maize B	Maize 200 Tyres 342	- 42	250 -	- -	- (42)
Total received by SARS					=

Zero-rated supply - Exporter					
Vendor	Purchase Price	Input tax	Sales Price	Output tax	To SARS
Firestone B Manufacturer	-	-	228	28	28
Makro B Wholesaler	228	28	342	42	14
CL B Exporters (Pty) Ltd	342	42	500	-	(42)
Total received by SARS					=

Exempt Supply					
Vendor	Purchase Price	Input tax	Sales Price	Output tax	To SARS
Firestone B Manufacturer	-	-	228	28	28
Makro B	228	28	342	42	14

Wholesaler					
Solomon's V L	342	-	7500	-	-
Taxis	(Tyre)		(Trips)		
Total received by SARS					<u>42</u>

Registration (1)

❑ Who has to register as a “vendor” (s 23)

- Every “person” that carries on an “enterprise”
- Turnover of more than R1 000 000 p.a.
- “Vendor” = any person who **is or is required to be registered** under this Act (s 1)

Registration (2)

❑ Who must register as a “vendor” (s 23) (cont.) the REQUIREMENTS!

- “Vendor” **must levy output tax** on all taxable supplies
- “Vendor” **entitled to claim input tax with respect to VAT** paid by him for purposes of making taxable supplies
- **Non-vendor may not levy output tax or claim back input tax** from the Receiver

Registration (3)

❑ Who has to register as a “vendor” (s 23) (cont.)

- **Exclusions** despite a R1 000 000, 00 turnover:
 - ✓ cessation of enterprise
 - ✓ substantial and permanent reduction in the size

- ✓ replacement of any plant or other capital asset
- ✓ abnormal circumstances of a temporary nature

Registration (4)

- ❑ **Separate persons carrying on same enterprise under certain circumstances deemed to be one person (s 50A)**
 - Commissioner **has power to deem separate persons** who carry on the same enterprise to be a **single person** it is basically an anti-avoidance provision to prevent splitting of business! Three bros A B C they are each locksmiths and shares all the assets of each business and thus can be deemed to be the same enterprise. Each has individually R 400 000, 00 thus need not register but if taken all together then they must register!
 - Anti-avoidance provision prevents artificial splitting (separation) of business activities in order not to register
 - Persons that are deemed to be one “person” - jointly and severally liable for any VAT owing by that “person”

Registration (5)

- ❑ **Bodies of persons, corporate or unincorporated (other than companies) (s 51)**
 - Such body deemed to carry on such enterprise as a separate person (from its members) for VAT purposes
 - Where partnership dissolves due to retirement / withdrawal of member, or by admission of new members, the old and new partnership are deemed to be one and the same “enterprise” (partnership) (s 51(2))
 - EG: A B C are all in a law partnership and sec 51(2) so long as one of the old partners remains it will be seen as a single entity and the registration remains and B who has died his estate is liable as is C who has left to start another firm. The members are jointly and solidarily liable.
 - At least one member of the old partnership must be a member of the new partnership

- Members are jointly and severally liable with respect of VAT obligations
- Persons married in community and carrying on an “enterprise” – also deemed to be such a body of persons

Registration (6)

❑ Failure to register (s 23(4)(b))

- “Vendor” = any person who is or should be registered in terms of the Act (s 1)
- Still liable for VAT as though that person is registered – from date on which that person became liable
- Usually can’t claim / recover VAT from clients after conclusion of contract
- Can also be liable for interest and fines
- NB: Commissioner can determine later date for liability - if he considers it equitable
- But see: s 67 & *Die Trustees van die Santinia Trust v Beukes en ‘n Ander* (TPD-2001), 65 SATC 177
 - In the S trust case it rents farm land to B and the contract is concluded the contract S was a non-vendr and the agreement is concluded in 31/3/98 and it is a 5 year contract for R 11 000 a month. Then a month later S registers as an enterprise and levies R 1540 for VAT and it done via the trust in terms of 67(1) and it applies where there is an increase in the rate of vat after the conclusion of the contract. The Vendor may then add the additional rate on to the price of the deliveries.
 - But the trust was not a vendor when it was concluded and the court had to decide if this is allowed
 - B argued that 67(1) did not apply as the agreement constituted the whole contract between them. No new can be added later.
 - The aquo decides in favour of the B and S takes on appeal and wins as the agreement had to expressly require that the trust can reclaim the

VAT and he should have protected himself against this and that that Trust would have to pay.

Registration (7)

❑ Voluntary registration (s 23(3))

- Any person can apply to be registered – even if his / its turnover is less than
- R1 000 000, 00 pa
- Must have a turnover of more than R50 000 pa
- ❖ **Advantages: the reasons for voluntary registration...**
 - ✓ more input than output tax (exporter) thus similar to the wholesaler.
 - ✓ mainly makes zero-rated supplies – sells milk, eggs, maize and vegetables
 - ✓ mainly supplies goods or services to “vendors” – can claim inputs back - customers too
- ❖ a time when it is not a good idea to register as a Vendor is when you have a hair salon at your house another reason is that it far more difficult to track for tax evasion purposes if they are not registered.

Registration (8)

❑ Voluntary registration (a 23(3))(cont.)

- **Commissioner can refuse voluntary registration (s 23(7)):**
 - ✓ e.g. no fixed place of abode or business
 - ✓ does not keep proper accounting records
 - ✓ has not opened a bank account for purposes of business
 - ✓ was previously registered – but failed to perform duties

Registration (9)

❑ Separate registration of enterprises, branches and divisions (s 50)

- Application to **register separate enterprises**, branches or divisions:

- ✓ where an independent accounting system is maintained
- ✓ can be separately identified with respect of operations / activities and location

Cancelled:

- ✓ on application of vendor
- ✓ duties not complied with

Cancellation of registration (1)

❑ Cancellation of registration (s 24)

➤ Registration cancelled:

- ✓ on application by vendor where it is clear at the beginning of the tax period, that taxable supplies will not exceed

R1 000 000 p a

- ✓ vendor ceases business
- ✓ Commissioner convinced that vendor is not carrying on an “enterprise”

Cancellation of registration (2)

❑ Cancellation (s 24) (cont.)

➤ Follow procedure in s 24 on cancellation the person is still interms of section 26 laible to any VAT that he had prior to cancelation.

- Commissioner obliged to cancel registration, unless grounds exist that person will carry on an enterprise, that should be registered within 12 months – right to objection and appeal (s 24(6))
- Person still liable to comply with VAT obligations after cancellation of registration (s 26)

Tax period

- Six categories A, B, C, D, E & F section 27
- Tax period can be 10 days before or after end of the month instead of last day of a calander month

(s 27(6)(ii))

- **A and B** – every 2 months VAT returns have to be submitted – only difference is that A is for January, March, May, July, ... and B is for February, April ... Receiver determines whether A or B
- Category **C** - monthly basis, for big companies with a income of R 30 million or more a month.
- Category **D** – six monthly – February & August, mainly agricultural and not more than R 1,5 million
- Category **E** – “year of assessment” - def in s1 ITA companies or trusts letting property or managing companies.
- Category **F** – quarterly – June, October & February

Time of supply (s 9) (1)

- ❑ Study chapter 32 of prescribed book

Time of supply

- Time of supply is important – determine when VAT is to be paid over
- **S 9** – general rule – time of supply = earliest: time at which invoice is issued for the supply **or** payment of consideration is received by the supplier ►►►
- **Exception:** the accounting basis in section 15 the normal action is that most vendors work on an invoice basis the earliest time then VAT is payable but a proviso but natural persons, municipalities and state departments may account for the vat on payment by the person cannot be more than 2,5 million a month. Thus make out the invoice and not be liable for VAT till the money is received.

Time of supply (s 9) (2)

- ❑ **Exceptions:**
- Connected persons (s 9(2)):

- ✓ supplies occur when goods are removed or made available or services are rendered
- Rental Agreements (s 9(3)(a)):
 - ✓ supply = earliest of date on which payment becomes due or is received and if you make supply to a connected person then delivery and VAT will be liable.
- Fringe benefits (s 9(7)):
 - ✓ deemed supply (s 18(3)) – time is the same as when fringe benefit must be taken into consideration with respect of employees tax ito ITA

Value of supply (s 10)

- ❑ Study chapter 32 of **prescribed** book
- ❑ **Value of supply**
- **S 10(3)** - general rule – value of supply = consideration in *money* received, or *open market value of goods* received as consideration

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- ❑ **Special rules:**
- Connected persons
 - ✓ value = open market value if value of supply < than open market value
- **Deemed supply ito s 8(2) - when person ceases to be a vendor - (s 10(5))**
- Section 10(10) if a person is a vendor is the making of supplies is commercial accommodation ie a hotel and you give your visitors domestic goods and services, such as a TV.
 - ✓ If you are 28 days and less VAT is leviable, such as tourist for a week; but if a person stays longer than 28 days then that is only payable on 60% of the amount.

- ✓ The reason is to be fair to those who live in the hotel as the rent is an exempt supply from TAX. There is also a retroactive application to this and also applies to a hostel.
- ✓ If a person rents residential property, there is no VAT applicable, and thus a person who stays for a long time in a Hotel then the legislature sees it as a means of residential.
- ✓ **consideration** = least **of costs for vendor** or **open market value**

Deemed supplies (s 8 & s 18) (1)

- VAT levied on real (*werklike*) and deemed supplies
- Fringe benefits (s 18(3)), such as goods bought and gives it to an employer and the income tax, and VAT and output tax must be levied on the goods.
- Supplies to branches outside RSA s 8(9) such as delivering goods to other countries but still part of the same group, will be a zero % per section 11 as exports are exempt.
- Indemnity payments (s 8(8))
 - V buys a fridge for tax purposes and it is burnt and it is destroyed and the insurer pays to insure the fridge. V supplies a fridge and the insurer pays for this fridge and even though there is no delivery it is a deemed delivery. Thus output tax must be paid.

Deemed supplies (2)

- Repossession of a debtor's "goods" (s 8(10))
- Cease to be a "vendor" (s 8(2))
- Goods subsequently applied for making non-taxable supplies (s18(1))
- Disposal of an enterprise as a going concern (s 8(7), s 11(1)(e) & **VAT PN 14**)

Zero-rated supplies (s 11) (1)

- Explanation – zero-rated supplies of "goods" & "services"

- “Goods” and “services” that are **exported** or are **supplied** in an “export country” (ss 11(1)(a), (b), (c) (d) & 11(2)). If sold as a going concern.
- Small shop with profits less than R 100 000,00 buy R 1140 000,00 in ciggarets and sent to Botswana and what van V claim back? It is R 114 000, 00. Can claim back input tax but not output tax is payable. But it is not sold in Botswana and instead sold in Joburg. Later they do not send it to Botswana and they forge the import and export stamps thus continued selling ciggarets.

➤ **C:SARS v British Airways PLC (SCA), 67 SATC 167**

- Dealt with B Airways and it was a) % tax, but to ensure service is done is that there are two services the transport and then a passenger service charge (goes t oACSA) and the CSAR and he looks a 8(15) that states that a single supply of goods or services where there are made up of two one at a 0% and a normal rate then there must be a split of each amount into its own components. It was thus chargeable against British Airways, it paid this to ACSA and got it back from the Passengers. It was decided that a deal would be made
- SCA decided that the ACSA delivered the services and all that the airway was to get the money from the passengers and thus ACSA must levy the output tax on its services. Thus AIRWAYS wins and need not pay the tax because British airways did not supply the passenger services.

Zero-rated supplies (2)

- Supply of an “enterprise” or part of it as a going concern (s 11(1)(e) read with s 8(7) & VAT PN 14 gives the formal requirements for this
- **Study Milner Street Properties (Pty) Ltd v Eckstein Properties (Pty) Ltd 2001 (4) SA 1315 (SCA), 64 SATC 60**
- **Facts:** E Properties and M Properties are both vendors, they sell on 3 January 1995 and if a going concern was sold then 11
 - **It must be a written agreement,**
 - **the seller and the purchaser must be both vendors,**
 - **Must both state that a going concern is sold as an income earning service**

- **Must also agree it is a 0% supply**
- When they concluded their agreement, they did not know of these requirements but they had the intention to do this. The M street props auditors and it could claim R 429000, 00.
- HC and SCA the courts allow them to rectify the agreement so as to meet the requirements of the act.

Zero-rated supplies (3)

- Supply of gold to the SA Reserve Bank, SA Mint and registered banks (s 11(1)(f)) and South African gold coins (s 11(1)(k))
- Supply of “goods” consisting fuel levy goods & petroleum oil (s 11(1)(h) and 11(1)(hA)) he can claim back input tax but most of the tax is for delivery. As there is already a fuel levy on this.

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Zero-rated supplies (4)

- Supply of “goods” for farming purposes - Part A of Schedule 2 (s 11(1)(g))
 - ✓ **Part A Schedule 2 - Items 1-6:**
 - ✓ Animal feed, animal remedy, fertilizer, pesticide, plants & seed

Zero-rated supplies (5)

- “Goods” consisting of foodstuffs set out in Part B of Schedule 2 (s 11(1)(j))
 - ✓ **Part B Schedule 2 – Par 1 - Items 1- 19:** NBNBNB
 - ✓ Practice note 2 SARS ruling 4 (“State”) brown bread; maize meal; samp; mealie rice; dried mealies (not popcorn); dried beans; lentils; pilchards/sardines; milk powder; dairy powder blend; rice; (unprocessed) vegetables ►►►

Zero-rated supplies (6)

- (unprocessed) fruit; vegetable oil (not olive oil); milk (from cattle, sheep or goats - not concentrated, condensed or evaporated); cultured milk; pure brown

wheaten meal; eggs and egg pulp of species *gallus domesticus* or house chickens; edible legumes and pulses

NB: Par 2 – above items are not zero-rated supplies, if they are supplied, in processed form, for immediate use, in a restaurant or shop.

Exempt supplies (s 12) (1)

- Explanation - Exempt supplies
- “Financial services” as defined in s 2 -(s 12(a)) – that are not zero-rated supplies ito s 11
- Supply of board and / or lodging by employer to his / her employee as a benefit of service (s 12(c))

Exempt supplies (s 12) (2)

- Transport services by road or rail (s12(g)) – that are not zero-rated supplies ito s11(2)(a)
- Certain educational services (s12(h)) such as university, but what of private institutions as per setion 12(h)(i) may apply as registration asa higher institutions as per the higher education act.
- Crèche or an after-school care centre (s12(j))

Input tax (s 1) (1) NBNBNB Must Know!

- **Study** the definition of “input tax” (s1) and it will be amended in this tax year and the proviso in the definition as per paragraph b and proviso 1 and 2 will be deleted!!!
- Apportionment of input tax (s17(1)) if you purchase something to make taxable supplies then you may claim back the input tax.
- Non-deductible input tax (s17(2)) thus may not claim back the input tax.
 - ✓ entertainment (s17(2)(a)) such as taking a client for a dinner because the act says so.

NB exceptions

- ✓ Having a restaurant is an exception in terms of 17(2)(a)
- ✓ club subscriptions (s17(2)(b))
- ✓ “motor car” (s17(2)(c)) it has a wide definition and gaming viewing vehicles are not motor cars.

Input tax (s 1) (2)

- Explanation – **notional “input tax”**
- A is a non-vendor and B is a vendor and A delivers to B a Bulldozer (not a motor car). B wants to make a taxable supply with the bulldozer. The price of the thing is R 1140 000 and B if wants to make a deduction in terms of input tax... it must be used to make taxable goods and it must be a second hand good then he can claim the tax fraction... then he will only pay R 140 000
 - ✓ Definition of **“input tax”** (b) in s1
 - NB** – limitation on notional input tax in respect of “fixed property”
 - ✓ Definition of **“second-hand goods”** goods that have previously been owned and used **with the exception of:** animals, SA gold coins defined in terms of **s 11(1)(k)**, prospecting rights etc.
 - ✓ What of fraud here?
 - ✓ If B buys the 2nd hand thing and he does not have to register as it is not used on the roads and he claims a higher price, then paint the bulldozer another colour and sold again and again to vendors from non-vendors.
 - ✓ The definition was changed to stop this!
 - ✓ If A makes a delivery of fixed property and he is a non-vender, and B can claim the tax fraction. But if the Non-vendor delivers and now B is limited to the lesser of any consideration in money or the open-market value or if it is second hand goods then the notional input tax is limited to any transfer duty paid. Since 25 November 1994. But this is being done away with this and even though you paid transfer duty you can still claim the market value or the lesser of any consideration. But today one is limited till the amendment one can only claim the transfer duty.

General (1) SELF STUDY! Not detailed questions going to be asked!

- Assessments, objection & appeal (ss 31-37)
- Refunds (ss 44-45)
- Records (s 55)
- Offences (ss 58-63)
- Reporting unprofessional conduct (s 63)
- VAT money is trust money and is brought in for the Fiscus and never to be used for anything else.

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General (2)

- Prices, advertisements & tax rates (ss 64-67A)

NB Study s 64 and *Strydom v Duvenhage No en 'n Ander* 1998 (4) All SA 492, 61 SATC 6

The executrix of the state D sold 3 farms to S and he his a vendor and if a vedore purchases. And if you purchase from a non-vendor then he pays transfer dty, and that in the agreement S must pay the transfer duty and the conveying costs. He was S going to make taxable supplies and he claimed back the tax fraction on the amount paid. But the CSAR realises that the D estate was a vendor. S claims the tax fraction for the same amount and he wants his invoice to include the price as it is deemed to include vat. D does not agree and wants to add VAT on farms. And according to the agreement it is applied that he will pay the extra vat

In Aquo the court allowed rectification by D to change transfer duty to VAT.

Appeal if the rate is higher then you cannot see it as implied that he would pay tax at a higher rate and that the rectification was refused. Thus D must supply the invoice for S.

General (3)

- Tax avoidance (s 73)
- If VAT is payable on property and transfer duty is payable there in as well then no transfer duty will be payable.

✓ see *ITC 1828*, 70 SATC 91 in this regard

- Exemption of transfer duty (ss 79-80)

Transfer Duty

- **Introduction (1) EASY MARKS!!! IN THE EXAM!**

- Oldest tax in the RSA
- Relatively small contribution to the *fiscus* (compared to Income Tax and VAT)
- Cheap to administer
- “Old tax = good tax”
- Old Dutch tax – so-called “veertigste penning”

- **Introduction (2)**

- Levies on the transfer of property was a common occurrence in the feudal era
- Many of these levies were in connection with the transfer of immovable property
- Government levy at first only instituted in the provinces of West-Friesland and Holland in 1598
- Known as the "veertigste penning" – in other words a levy of 2^{1/2}% on the greatest of the consideration or market value of the property that was alienated

- **Introduction (3)**

- Transfer duty introduced in the Cape on 16 Jan 1686 and also known as the “veertigste penning”
- In a resolution of 14 April 1729 the term “Veertigste Penning of andere Heeren Gerechtigheyd” was used
- The name “veertigste penning” disappeared eventually and the English term currently is “transfer duty”
- Afrikaans term is “hereregte”

- **Introduction(4)**

- Later, transfer duty was levied in all the provinces of SA into separate legislation
- Commissioner was responsible for collecting transfer duty of the provinces
- Provinces were entitled to the income from transfer duty levied in the different provinces till 31 Dec 1949
- Since 1 Jan 1950 - a consolidated act, namely the *Transfer Duty Act, No 40 of 1949* in force
- Since then - only one act - all TD goes to the treasury or *fiscus*

The charging section

- ❑ *Transfer Duty Act, No 40 of 1949*
- Charging section is **section 2**:
- levied on the **value** of any **property**
- **acquired** by **any person**
- by way of a **transaction** or in any other manner
- or on the amount by which the value of any property is enhanced by the **renunciation**
- **of an interest in** or **restriction upon** the **use or disposal of that property** (e.g. *usufruct*)

How is transfer duty levied ? (1)

- Rate on which transfer duty of **persons other than natural persons** are levied (e.g. companies, CCs & trusts)– s **2(1)(a)**:

[NB: S 2(1)(a) will be deleted in 2011]
- 8 % of the **value** or **amount**

E.g.: ABC Ltd buys property for R2 million; transfer duty is 2 000 000, 00 x 8% = R **160 000**

Will become the same as that for natural persons below!

How is transfer duty levied? (2)

- ❑ Rate of **natural persons** – s 2(1)(b) (since 1 March 2006)
 - **0%** : value/amount not more than **500 000**
 - **5%** : between **500 000** and **1 000 000**
 - **8%** : value/amount **more than 1 000 000**

How is transfer duty levied? (3)

E.g. 1 natural persons:

- Sue buys property for R2 million

0% of **500 000** = 0,00

5% of **500 000** = 25 000,00

(between 500 000 and 1 000 000)

8% of **1 000 000** = 80 000,00

(more than 1 000 000)

Transfer duty payable = **105 000,00**

- **How is transfer duty levied? (4)**

E.g. 2 natural persons:

- Sue buys 10 separate properties that cost R500 000 each, but the total amount is R5 million.
- What is the amount of transfer duty payable? One has to take it all together as there is only one price given. The word property does not only mean a unit of land in the deeds office but land under separate titles as well!
- See *CIR v Freddie's Consolidated Mines Ltd* 1957 (1) SA 306 (AD), 21 SATC 132

- **How is transfer duty levied? (5)**

Partnership

- If partners are natural persons – rate in s 2(1)(b)

- Partners other than natural persons – then use the rate in s 2(1)(a)
- **Note that:** Exemption from transfer duty when partners divide their undivided shares in the partnership property when the partnership comes to an end **(s 9(1)(g))**
- Formula for division of undivided share is in s 2(5)
- A partnership has 2 properties and the partnership divides in half the two properties.

2011 Proposed amendment

- ❑ **NB: New proposed rates (2011 Budget) for both non-natural & natural persons:**

- **Any person** buys property for R2 million

0% of 600 000 = 0,00

3% of 400 000 = 12 000,00

5% of 500 000 = 25 000,00

(between R1 m and R1,5 m)

8% of 500 000 = 40 000,00

(between R1,5 m and R2 m)

Transfer duty payable = **77 000,00**

“Property” (1) (Tax object)

- ❑ “Property” is defined in s 1

- Is **land** in the RSA and **any fixtures thereon**

- ❑ **Land =**

- Demarcated piece of land + geological substance & everything connected to it in a natural manner e.g. plants
- Also sectional title units in terms of s 3(4) of the *Sectional Titles Act, No 95 of 1986*
- A share in a share block company as defined in the *Share Blocks Control Act, No 59 of 1980*

“Property” (2)

- ❑ Phrase “**and any fixtures thereon**”
 - Implies that everything that is built or erected on the land, becomes part of the land
 - **Rules of property law** apply to determine the nature of the attachment
- ❑ **3 Factors are important**
 - Nature and purpose of the attached property
 - Manner and degree of attachment
 - Intention of the owner - is the attachment intended to be permanent?

“Property” (3)

- ❖ “**Property**” also **includes “any real right in land”**

Fideicommissum

- Acquisition of the fideicommissary property by both the *fidiciarius* and the *fideicommissarius* in the case of a *fideicommissum*, taxable *inter vivos*
- Acquisition of “property” in terms of a *fideicommissum mortis causa* or by way of a *fideicommissum* at **bequest or inheritance of property is exempt from transfer duty ito s 9(1)(e)(i).**

“Property” (4)

Usufruct

- Is a personal servitude
- Transfer duty payable at the vesting & renunciation thereof by the usufructuary to the benefit of the owner. The Son will gain the property, use the life expectancy tables to work out the usufruct.
- **Reason:** Property is acquired

“Property” (5)***Right to use (usus) and the right to habitation (habitatio)***

- In principle transfer duty is payable at the vesting & renunciation thereof. One calculates the value on the house not on the entire property. Has the right to live there for life but renounces it then the person gaining the full ownership will pay transfer duty.

Servitudes

- Transfer duty is payable at the acquisition or renunciation of *praedial* servitudes
- Property rights principles apply to determine what a *praedial* servitude is

“Property” (6)***Quitrent***

- Is a real right that gives the right to use land that belongs to someone else, at the payment of an annual farm rent. There will just be freehold and potential quitrent, thus one can use another’s land for a monthly rent.
- Acquisition of quitrent is, in principle, subject to transfer duty

“Property” (7)***Leasehold***

- In principle - subject to transfer duty at acquisition of the lessee!
- Normally in the form of a perpetual lease (e.g. a 99-year leasehold).
- This system of land-tenure has mostly disappeared because of legislation. In the Apartheid years it was used to allow persons who could not purchase land in white areas to work in white areas. Thus you never got full ownership rights.

“Property” (8)***Mineral rights***

- Acquisition of mineral rights is subject to transfer duty
- **Reason:** meets the requirements of the definition of “property”
- ❑ **Mining rights:** Transfer duty is payable at the acquisition of mining rights

- BUT there is a number of specific exemptions
- Transfer duty can be paid on land that is not registered.

“Property” (9)

Unregistered real rights

- Transfer duty can also be payable on the acquisition thereof
- E.g. the right to conduct electricity over a certain property
- See *Victoria Falls Power Co Ltd v Colonial Treasurer* 1909 TS 140 on 144-145 in this regard. Not registered in the deeds office and indeed it was property that was acquired.

“Property” (10)

Shares or member’s interest in a residential property company

- ❑ **Shares or member’s interest in a holding company of a residential property company/companies**
 - This was inserted by s 2 (1) (b) of *Act 74 of 2002*
 - **Reason:** Included to prevent the avoidance of transfer duty – where residential property is owned by company or CC, and only shares are being sold.
 - **EG:** a residential company the assets are mostly residential property and they buy 3 beach houses and is placed in a company. If the property is sold to C then transfer duty would be paid; but to get around this they could just sell the share holding at a ¼ duty. But
 - **Now if:** one sells the shares in the residential company there will be transfer duty payable and it can be achieved in a discretionary trust to escape the transfer duty.

“Property” (11)

A conditional right in any residential property or share or member’s interest held

by a discretionary trust

of which the acquisition:

- is the result of any **agreement** for **consideration** with regard to **property** that is **held** by that **trust** along with the **replacement** or **variation** of the **trust’s creditors**

- or by **replacement or addition** of any **bond** or **bond creditor** along with a **variation** of any **trustee** of that **trust**
- The above was inserted by s 2 (1)(b) of *Act 74 of 2002*.
- **Trust:** a trust and the founder has a discretionary trust and it is a discretionary right B1 has a discretionary right to buy the property as the trustees can refuse this. Use the above example but instead of a company it is a trust and A1 and A 2 are trustees.
- **The legislature:** was developed to escape duty and it is in a company property is a small asset but in residential company the property is huge and is the main assets. If there is a shop and a single house then it will not be a property company.

“Property” (12)

Specific exclusions

- **Rights under a mortgage bond and lease of property** are excluded to **par (a)** of the definition of “property” in s 1
- The lease of a house will be exempt from VAT
- Thus: no transfer duty is payable at the acquisition of rights under a mortgage bond or lease of property

except

when it is (for example) the acquisition of a leasehold

Acquisition of “property” (1) (Tax base)

❑ What is “acquisition”?

- Term “acquire” or acquisition - not defined by the legislator
- Look at the interpretation of the courts
- Most important definition: Centlivres CJ, in *CIR v Freddie's Consolidated Mines Ltd* 1957 (1) SA 306 (AD) on 311C, 21 SATC 132 ▶ ▶ ▶
 - “(t)he word ‘acquired’ in the charging section (s 2) must therefore be construed as meaning the acquisition of a right to acquire the ownership of

property. It has been said to be a misnomer to call the duty a transfer duty: it is in fact a duty imposed, *inter alia*, on the consideration given by a purchaser of property for the right conferred on him to acquire the ownership of property.”

- The hartsenberg case
- Although the ordinary legal meaning of acquire means the acquisition of dominium in its wider meaning it means the right of use and transfer duty therefore becomes payable upon the acquisition by a person of a personal right to obtain use in the personal right... us in personam (personal right) to gain the property. Thus the charging section of section 2.
- But if there is a resolute condition and the contract dissolves the nthe liability for transfer duty is removed and thus non need be paid before registration

Acquisition of “property” (3)

- **Important** - ownership or limited real rights
 - ✓ doesn’t automatically pass at the conclusion of the contract
 - ✓ BUT only at registration at the Deed’s Office - right vests in the acquirer
- Distinguish between the obligation-creating-agreement and the real agreement

Acquisition of “property” (4)

- Liability for the payment of transfer duty arises at the parties reaching an “obligation-creating agreement” – i.e. at the conclusion of the contract
- Liability for the transfer duty arises at the moment when the person who acquires the property, vests a *ius in personam ad rem acquirendam* w.r.t. the “property”

Acquisition - “transaction” (1)

- **Definition of “transaction”** is very broad
- Besides specifically mentioned agreements like purchase, exchange and cession - also an agreement in terms whereof “property” is renounced in any other manner

Acquisition - “transaction” (2)

- ☐ **Purchase**

- If the formalities for the contract concerned are not complied with (e.g. **when it has to be in writing**) = null and void & no liability for transfer duty
- **Liability arises on the date the transaction was entered into “irrespective of whether the transaction was conditional or not”** the date of the transaction is that date of when the 6 months for a person to pay transfer duty will run.
 - If there is a suspensive condition in that I will sell you my house if you get a loan. Must wait for the
 - A resolutive condition the contract comes to force immediately, I sell my farm to you in terms of you getting financing. 2 years later gains financing, thus the date of the transaction is 2 years ago ths the buyer will payer the transfer duty.
- Where a condition is not fulfilled later, the basis of transfer duty liability disappears
- Transfer duty is then repayable
- *CIR v Viljoen and Others* 1995 (4) SA 476 (ECD), 57 SATC 335
- Was in terms of an unfulfilled suspensive condition, the Q was was transfer duty to be paid. M stated that on a proper construction of the act the word acquired does not included the sale of the property under the unfulfilled condition of a suspensive condition and thus there was not contract and transfer duty was not to be paid.
- So one can claim the transfer duty back if paid.
- Par (a) of the definition of **“date of acquisition”**: options and rights of pre-emption, the “date of acquisition” is the date on which it was exercised. That the property of or the value of the property at the date that you have received the option even though your date of acquisition is a time later.

Acquisition - “transaction” (4)

Barter (“exchange”)

- Intention of the parties - of whether it is a contract of sale or exchange - is decisive
- Dispute in *Roodt v SBI* 1974 (1) SA 525 (AD), 36 SATC 1 over the legal nature of the transaction concerned.

- Two person bartered their farms with each other. They wanted to evade tax, they gave each a 100 share in each other farms and then bartered and then transferred the shares over. Court saw it as a barter transaction.
- If A and B are co-owners of two farms, then they decide to give each other the farms and there is an exception in 9(1)(g) for the transfer duty as you are not getting any more than what you owned half of. But if it they are not the same amount and B is impoverished thus the person who is enriched should pay transfer duty but he is exempt and it is bellow the R 600 000 exemption and he is a natural person.
- A and R buy 100shares in each farms and the nthey barter and will pay the transfer duty on the chunks but now as it is a barter then there is not a real transaction
- Study the case

E.g.: of a barter transaction

- ✓ **James** exchanges his farm **Alexkraal** with 'n declared value of **R2 000 000** for
 - ✓ **Nerina's** farm **Erasmusfontein** with a declared value of **R1 600 000**
 - ✓ **Nerina** must also pay a further amount of **R600 000** to **James**
 - ✓ Ito **s 5(4)(b)(i)**, **Nerina** must pay transfer duty on the **greatest** of R2 000 000 or R1 600 000 + R600 000 (=R2 200 000)
 - ✓ **James** must, ito **s 5(4)(b)(ii)** pay transfer duty on the **greatest** of R1 600 000 or R2 000 000 - R600 000 (=R1 400 000) ∴ on **R1 600 000**
- the resolutive condition is concluded on 1/3/11 and if it is not paid by 10/12/11, but transfer duty must be paid by the 2/9/11...
- by the 10/12 there was no wall built and there was a right to acquire... thus the right is removed and thus one may claim back the transfer duty back via 5(2)(a) of the Transfer Duty act.
- In the second case we have a suspensive clause there must be bond from a bank and if it is not paid by 10/12 then the contract. If on the 10/12 and the contract is perfecta thus the date of acquisition is the 1/3/11. Transfer duty was to be paid by 2/9/... if not

then pay interest and penalties. Pay the transfer duty even though not liable as there is no fulfilment and if there is no contract then claim the money back.

28/09/2011

Law of taxation

Lecture 16

Acquisition - "transaction" (7)

Nomination contracts

- Principal and agent agree that the agent will buy property on behalf of the principal
- Must comply with the provisions of s 16
 - ✓ Agent must be in possession of a power of attorney and furnish it to the seller
 - ✓ Name and address of the principal must be disclosed on the same day the offer is accepted (auction) or, upon conclusion of the agreement of sale

Danger:

- ✓ Successive purchases - transfer duty will be payable twice
- ✓ Thus the B and C is or are liable to pay

Acquisition - "transaction" (8)

Tripartite agreements

- Are succeeding contracts that are cancelled so that a single new contract between the seller and the eventual buyer comes into existence
- If it is phrased (worded) well - transfer duty will only be payable by the eventual buyer
- **Danger**

Look at the narrow interpretation of the court of the term "cancellation" in *SIR v Hartzenberg* 1966 (1) SA 405 (AD), 28 SATC 94

- H bought property and when he bought the t duty was reduced and he tried to cancel the first agreement and then just a little later he wanted to pay t duty at a lower duty.
- If one cancels agreemtn in terms of secton 5(1)(2)(a) prior to transfer in the deeds offer one will get the money back.

- It did not give the seller his rights back and the money back to the buyer and it was seen as a substitution of a new contract and thus the duty has been paid. It was not a cancellation in terms of the subsection.

Acquisition - "transaction" (9)

Innominate contract

- As mentioned already, the definition of "transaction" is very broad
- If there is acquisition of "property" - transfer duty will also be payable in these circumstances if it is the acquisition of property in terms of the act.

Acquisition - "transaction" (10)

Re-distribution of assets agreement

- Is an agreement between co-owners of property
- In terms of which they agree in what manner the property will be physically divided among them
- **S 9(1)(g)** and **s 9(1)(h)** exemptions as applicable
- Transfer duty only payable on the difference in value between the tax payer's share of the "property" *after* distribution and *before* distribution of the "property"

Acquisition - "transaction" (11)

Option, right of pre-emption & prospecting agreement

- Transfer duty is only payable if an option and right of pre-emption is exercised
- Prospecting agreement that only confers the right to prospect for minerals and not to mine as well - no right to acquire "property" vests – therefore no transfer duty is payable

Acquisition - "transaction" (12)

Cancellation agreement

- Where a contract is cancelled before registration of transfer was effected
- transfer duty only payable on for example consideration that is kept after cancellation, like a forfeited deposit – **s 5(2)(a)**

- *SIR v Hartzenberg* 1966 (1) SA 405 (AD), 28 SATC 94

Acquisition - "transaction" (13)

Diverse agreements

Contracting a marriage in community of property

- "Property" acquired by contracting a marriage in community of property is exempt from payment of transfer duty ito s 9(1)(k)
- **BUT**: "Property" must have been acquired by the other spouse before the contracting of the marriage

Acquisition - "transaction" (14)

Diverse agreements (cont.)

Out of community of property (ANC)

- Transfer duty is payable at the acquisition of "property" i.t.o. an ANC (ante-nuptial contract)
- Transfer duty is also payable at change of the matrimonial property system

Acquisition - "transaction" (15)

Residential property company or holding company of a residential company/companies

- It must have more than 50% of its assets must be residential property, if not then not a company. Agreement where one party agrees to dispose of the **shares** or **member's interest** in a **residential property company** in favour of someone else
- by way of any conduct where any person waives a right to, or limitation in his or her privilege on the use of, or disposing of any such share or member's interest

Acquisition - "transaction" (16)

Discretionary trust

- Replacement or adding of one or more beneficiaries with a conditional right in any property of that trust
- that constitutes "**residential property**", or shares or member's interest in a residential property company, or holding company of a residential property company/companies

Acquisition in a manner other than a transaction (1)

Prescription

- Transfer duty is payable at the acquisition of “property” by way of prescription
- “Date of acquisition” is the date on which the court order is given, in terms of which registration can be effected

- **Acquisition in a manner other than a transaction (2)**

Expropriation

- Persons and authorities that have the capacity to expropriate is exempt from transfer duty ito s 9(1). Can be placed in certain municipal properties or councils that can have exemptions.

Bequest

- “Property” acquired by bequest as well as by ‘n redistribution of the assets of a deceased estate is exempt ito s 9(1)(e)

Massing of estates (PN 34: 28/10/94)

- **No exemption** of transfer duty in the case where an **acquisition** of the **survivor’s** “property”
- is allocated to the heirs by way of massing of estates .
- A and B are married out of com prop... they die and they states become massed at the death of either of the parites or both parties and the one party will be the usufructry of the property in the estate and the bare dom holder will be the children or child. The amount that C gets from the death is excempt but not the bare dominium will be transfer liable. The amount not inherited will be liable for T duty.

Taxable value (1)

Consideration

- Includes consideration - s 5(1)(a)
- As well as commission - s 6(1)(a), if the buyer pays the agents commission then in the past the the commission paid that is more than 5% is part of the amount that must be paid in terms of the T duty

- Could then pay less for the property as come to an agreement and pay less and save on the transfer duty.
- Consideration iro an option or right of pre-emption - s 6(1)(b)
- Consideration payable to a third party– s 6(1)(c)
- **Taxable value (2)**

“Declared value”

- Where no consideration is paid, the “declared value” is used – s 5(1)(b), “declared value” in s 1, s 14

Fair (market) value

- If the Commissioner is of opinion that consideration payable or the declared value is less than the fair value then he/she can use the **greatest** of fair value, fair consideration or fair declared value - s 5(6)

Problem Areas (1)

Nature of property

- This question arises when the Commissioner doesn’t want to accept the declared value, because there is uncertainty about what is *movable* and what is *immovable* property

- **Problem Areas (2)**

Separate properties, global price

- Problem arises where there are different rates, like the rate for natural persons, that increases progressively up to a value of

R1 000 000

- See again: *CIR v Freddie’s Consolidated Mines Ltd* 1957 (1) SA 306 (AD), 21 SATC 132 in this regard
- Must specify each property with separate prices as property also includes property held under different deeds.

Problem Areas (3)**Object of sale consists out of more than just “property”**

- Problem arises where the object of sale also consists out of e.g. movable property, but only a global price was paid for everything
- *Receiver of Revenue (Cape) v Cavanagh* 1912 AD 459
- The Grand hotel in Muizenburg, C bought it all lock stock, the CSAR,
- Good will is not part of property and neither is the liquor license but it may enhance the property value
- NB!!! COULD BE CASE

- **Problem Areas (4)**

Quotas and licences

- Question is whether for example a sugar quota or liquor licence forms part of “property” as defined in the Act, and if so, what influence it will have on the fair market value of the “property”
- *Receiver of Revenue (Cape) v Cavanagh* 1912 AD 459 the liquor license is not property but it may enhance the value of the property indirectly.
 - *The ROR there was a mistake in the income services and they did not know that it was property in an indirect means.*
- *SIR v Sturrock Sugar Farms (Pty) Ltd* 1965 (1) SA 897 (AD), 27 SATC 31 the SIR argued that the value for a sugar quota should be included in the value of the property and the SIR succeeded in the SCA and the sugar or even the KWV quota will form part of the property;
 - *The liquor license is not an inherent quality and it is a privilege granted from an external group. It must be inherent and integral part of and enhance the value of the land.*

- **Problem Areas (5)**

Improved versus unimproved property

- Problems arise where the improvements are made in connection with the acquisition of the property.
- *SIR v Wispeco Housing (Pty) Ltd* 1973 (1) SA 783 (AD) could the value of the land and the ground taken together? No the value because of the contract it was consideration was paid up front for the improvement of the property. The duty paid included the house to be built and the land thus the duty included it.
- *If one is vendor then register as a vat vendor.*

General

Study

- Definitions in s 1
- Exemptions in s 9
 - ✓ **NB:** (Especially) look at s 9(15) exemption – no transfer duty is payable if VAT is levied
 - ✓ Also s 9(1)(i)
- **NB:** By whom, when and to whom is transfer duty payable? - s 3

05/10/2011

law of Taxation

lecture 18

CAPITAL GAINS TAX

- **Why CGT? (1) NB for the exam a minimum of ½ of the exam!**
- Why CGT? It is to make you aware we do not have proper capital gains tax, 1 October 2001 was the valuation date to value all your capital assets and any increase would then be taxed in principle
 - Primary residence exclusion
- Most of RSA's trade partners have CGT in one form or another
- USA - 1913
- UK - 1965
- Canada – 1971

- Australia – 1985
- Also African countries like Botswana, Nigeria, Egypt and Zimbabwe
- **Why CGT? (2)**
- ❑ **CGT in the rest of the world (2001)**
- Africa 29 out of 43 countries – 68%
- North & South America 17 out of 19 countries – 89%
- Europe 31 out of 31 countries – 100%
- **Why CGT? (3)**
- **Horizontal** equality - persons in the same circumstances should be liable to the same tax burden
- **Vertical** equality – moneyed residents (with strong financial capacity) should pay more CGT. Thus, increases the progressive nature.
- Makes it easier to track **evasion**
- **Economic considerations** – investment in fixed property instead of machinery and equipment
- **Broadening the tax base** – can lead to reduction of tax rates
- **Why CGT? (4)**
- To bring capital receipts and accruals within the tax net. Flow chart – definition of gross income – excludes capital gains
- Many rich people’s wealth is tied up in capital assets (that increase in value) the profits (gain) of which are never taxed.
- Strange – the super rich sometimes pay less income tax than ordinary employees – reasons – live off dividend income – included in gross income – exempt ito s10(1)(k) ITA – flow chart
- Originally, didn’t mean much additional tax income for the fiscus
- It’s complicated and expensive to administer
- Katz Commission – didn’t want SA to institute CGT – SA didn’t have the capacity to implement and administer it properly – SARS would have had to recruit an additional 400 employees
- Politically correct – tax the rich – satisfies the people

- Question is though – will the super rich actually pay CGT?

Background (1) Announced in the 2000 Budget Speech

Came into operation on 1 October 2001 (“valuation date”) [par 2(1)]

- Section **26A** was added – flow chart – includes capital gains as calculated in **8th Schedule**, must be a resident and the property in SA of a non-resident in SA and even assets outside can be part of this tax. It is ring fenced except the taxable capital gains. Thus its purpose to determine the taxable capital gain or not.
- Added to the **taxable income** of tax payer
- Only **capital gains** is included in taxable income
- If there is a **capital loss** - carried forward to the following year of assessment – can only be written off against future capital gains.

11/10/2011

Law of Taxation 441

Lecture 18

Who must pay CGT? [par 2(1)]

- **SA Residents** – natural and persons other than natural persons – “resident” defined in s 1 of the Act
- CGT payable on “disposal” of any “asset” – can be situated in SA or foreign country
- **Also non-residents** – on immovable property – also on mineral rights in SA
- Also on assets of “permanent establishment” operated in SA [s 1]. Refer to def: “*permanent establishment*” in *article 5 of OECD Model Tax Convention*

How does CGT work?

- Did a “**resident**” “**dispose**” of an “**asset**” on or after the “**valuation date**”?
- or*
- Was there a “**deemed disposal**” by the resident?
- Did a **non-resident** or a non-resident’s **permanent establishment** do the above?

Capital gain (1) [par 3]

- ❑ **Capital gain for a “year of assessment” =**
- Amount by which the **proceeds** received or accrued iro disposal of an asset **exceed the base cost** of that asset
- or*
- **Proceeds** of disposal which were **not taken into account** in **previous** year of assessment.

- So much of the **base cost** as has been **recovered** or **recouped** during the current year of assessment

Capital gain (2) [par 3] EXAMPLE

100 shares are bought by a resident on 1 October 2001 (“valuation date”) @ R100 000 and are sold on 1 October 2010 for R1 100 000	
“Asset”	100 shares
“Disposal”	sale of shares
“Proceeds”	(sales price) 1 100 000
“Base cost” allowable in terms of PARA 20 of the 8 th Schedule	(purchase price) 100 000
“Capital gain”	1 100 000 – 100 000 = <u>1 000 000</u>

Capital loss (1) [par 4]

- Amount by which the **base cost** of the asset **exceeds the proceeds**, or
- So much of the **proceeds** received or accrued in a **previous year** of assessment, **lost** due to cancellation, termination or variation of an agreement, prescription, any other event
 - ✓ became **irrecoverable** during the **current** year of assessment
 - ✓ **has been repaid** or has become repayable
- So much of the **base cost not** taken into account in any year of assessment

Capital loss (2) [par 4] EXAMPLE

100 shares are bought by a “resident” on 1 Oct 2001 (“valuation date”) @ R150 000 and are sold on 1 Oct 2010 for R100 000	
“Asset”	100 shares
“Disposal”	Sale of shares
“Proceeds”	(sales price) 100 000

“Base cost”	(purchase price)150 000
“Capital loss”	100 000 – 150 000 = (50 000)

Aggregate capital gain (1) [par 6]

- The amount by which the **sum** of a person’s **capital gains** for **that year** exceed the sum of:
 - The person’s **capital losses** for that year
 - and
 - In the case of a **natural person** or a special trust, that person or trust’s **annual exclusion [par 5]** for that year

Aggregate capital gain (2) [par 6]

“Capital gain” on sale of shares	100 000
“Capital loss” on sale of hotel	<u>(60 000)</u>
Sum of “Capital gain” exceed “Capital loss”	40 000
Annual exclusion [par 5] - ie R17 500 of the CG is ignored [20 000 from 1/3/2011]	<u>17 500</u>
“Aggregate capital gain”	<u>22 500</u>

Aggregate capital loss (1) [par 7]

- Amount by which the **sum** of a person’s **capital losses** for that year exceed the **sum** of:
 - That person’s **capital gains** for **that year** and
 - In the case of a **natural person** or a special trust, that person or trust’s **annual exclusion** for **that year**

Aggregate capital loss (2) [par 7]

“Capital gain” on sale of shares	100 000
“Capital loss” on sale of hotel	<u>(300 000)</u>

Sum of “Capital loss” exceeding “Capital gain”	(200 000)
Annual exclusion [par 5] ie R17 500 of the capital loss is ignored [20 000 from 1/3/2011]	<u>17 500</u>
“Aggregate capital loss”	<u>(182 500)</u>

Net capital gain (1) [par 8]

- Amount by which that person’s aggregate capital gain for **that year**
- **Exceeds** that person’s **assessed capital loss** for the **previous year of assessment**

Net capital gain (2) [par 8]

“Aggregate capital gain” for 2011	250 000
Assessed capital loss for 2010	<u>(50 000)</u>
“Net capital gain” for 2011	<u>200 000</u>

Assessed capital loss (1) [par 9]

- Amount by which person’s **assessed capital loss** for the **previous year** of assessment exceeds the amount of that person’s **aggregate capital gain** for **that year**
- **Sum** of that person’s **aggregate capital loss** for that year and that person’s **assessed capital loss** for the **previous year**; or
- Where that person has **neither an aggregate capital gain nor an aggregate capital loss** for that year, the assessed capital loss is the amount of that person’s **assessed capital loss** for the **previous year** of assessment
- **An aggregate capital loss can never be part of his taxable income!** Can manipulate the time of disposal and that one can make a capital gain and loss

Assessed capital loss (2) [par 9]

“Aggregate capital loss” for 2011	(100 000)
Assessed capital loss for 2010	<u>(50 000)</u>

Assessed capital loss for 2011 to be carried over	(150 000)
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Annual exclusion [par 5]

- Natural person and a special trust's annual exclusion iro a year of assessment = R17 500 [20 000 from 1/3/2011]
- Where a person dies during the year of assessment, that person's annual exclusion for that year is = R120 000 [200 000 from 1/3/2011]. There is a deemed disposal of all his assets per para 40 and if a person dies and he has shares with a capital gains then he as estate duty and normal tax. But one may deduct the tax liability I terms of the section 4(b) of the Estate duty act. If there is a spouse and is left to them is a roll-over not a deemed deduction per para 60

Taxable capital gain (1) [par 10]

"Net capital gain"	100 000
Inclusion rate eg. a natural person per para 10	X 25%
= " Taxable capital gain " thus only!!!	<u>25 000</u>
<u>NB</u> : NOW YOU INCLUDE " Taxable capital gain " IN "TAXABLE INCOME"	
Normal tax marginal rate → 40% x 25 000 Add R 100 000 + 25 000 then >>>>	Effective rate is thus only ► 10% ► <u>10 000</u>

Because of tax thresholds he will not pay normal tax nad the lowest tax threshold is R 57000

Taxable capital gain (2) [par 10]

Type of Tax payer	Inclusion rate- %	Normal % tax rate	Effective CGT rate
Natural person or a <u>special trust</u>	25	0-40	0-10
Ordinary trust	50	40	20
Collective investment scheme in securities	0	30	0 unless I see my shares then I might pay CGT

Company	50	28	14
S 12E small business corporation	50	0-28	0-14

Asset [par 1]

Includes:

- Property of whatever nature, movable or immovable, corporeal or incorporeal
- Excluding: any currency, but including any coin that is made mainly of gold or platinum
- A right or interest, of whatever nature, to or in such property

Disposal? (1) [par 11(1)]

- Any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset
- **Also includes:**
- Sale, donation, expropriation, conversion, grant, cession, exchange or any other alienation or transfer of ownership of an asset
- Forfeiture, termination, redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry or abandonment of an asset
- Scrapping, loss or destruction of an asset
- Vesting of an interest in an asset of a trust in a beneficiary
- Distribution of an asset by a company to a shareholder
- Decrease in value of a person's interest in a company, trust or partnership as a result of a value shifting arrangement (reduction of ones value in a capital object but the other person gains more of a value in the object.). As stated in para 1 and 23
- If it is insured then it could be a gain, but one must look at it if is a gain or a loss.

Not disposal [par 11(2)]

- Asset transferred as security for a debt, or transferred back by creditor upon release of the security
- Wrt issue or cancellation of any bond, debenture, note or other borrowing of money or obtaining of credit
- Distribution of an asset of a trust to a beneficiary to the extent that that beneficiary has a vested interest in that asset

- Where a disposal is made to correct an error in the deeds registry of immovable property in that person's name

Treated as (deemed) disposals (1) [par 12] NB!

- Person ceases to be a resident, the a deemed disposal of all assest except for immovable property
- Assets not kept as trading stock – begin to be kept as trading stock
- Asset ceases to be held as a personal use asset
- Assets cease to be kept as trading stock
- Person who commences to be a resident – is deemed to have disposed of all his assets and to have acquired each of those assets at market value ▶ ▶ ▶

Treated as (deemed) disposals (2) [par 12(5)]

- **Debt reduced / discharged** by a creditor without consideration / for consideration which is less than the amount by which the face value of the debt has been so reduced – par 12(5)
- A loans B R 1 Million, cant get it back and writes it off. Then in effect 12(5) comes into force and B will make a capital gain of R 1 million. The base cost is 0 and it is deemed that B has deemed to have disposed of the amount for or equal to the amount of the debt.
- A has a capital loss of R 1 Million
 - ✓ such person (**debtor**) is **deemed**
 - ✓ to have **acquired a claim**, to as much of that debt as was reduced or discharged for no consideration, which claim has a **base cost of zero; and**
 - ✓ to have **disposed** of that **claim** for **consideration equal to the reduction or discharge**
 - ✓ *ITC 1793 (2005), 67 SATC 256 (G)*
 - ✓ *Here the testator sold assets in shares to a family trust and the T owes the money to A, but A donates the debt to the Trust at death. Thus the family trust can then write the debt off and thus para 12(5) was applicable and the action that the testator had written off the debt in the act of writing her will. Thus the trust made a capital gains and thus also estate duty due for this.*
 - ✓ *The trust argued that this 12(5) provision did not apply to when it is written off in a testament and in the alternative if it does apply then it iwas not where the debt was written off but in reality a set-off.*

- ✓ *Court held that it was not the act of set off it was the act that amounted to the discharge of the debt and coming into the force of the testament and she wrote it off before her death*
- ✓ *ITC 1835 (2008), 71 SATC 105 study!!!*
- ✓ *Two spouse placed the residue of their estate in the trust and they had debt due to them from the trusts. The spouse dies and the trust still owes money but he does not pay it off but states that it is a debt on the trust and then written off. The CSAR states that this is wrong*
- ✓ *TAX court: the claim against the trust was not specifically made or the debt was not bequeathed to the trust and it was not the deceased's intention to bequeath the claim to the trust. No intention to write off the debt, and it differentiates the above case against this one.*

12/10/11

Law of taxation

Lecture 19

Proceeds (1) [par 35 (1)]

❑ Proceeds of a disposal are:

- Equal to the amount received or accrued or deemed to be received by or accrued to the person making the disposal
- Includes ►
 - ✓ amount by which any debt owed by that person has been reduced or discharged – by another person – par 12(5)
 - ✓ any amount received by or accrued to a lessee from the lessor of property for improvements effected to that property. The lessor will have a deduction as a base cost if the improvement still exists at the date of disposal.

Proceeds (2) [par 35 (3)]

❑ Proceeds are reduced by:

- Any **amount** of the proceeds that must be or was included in the **gross income**/ that must be or was taken into account when determining the taxable income (before the **inclusion** of and taxable CG) – of the person making the disposal. It is a double taxation prohibition.
- Any **amount** of the proceeds that has been **repaid** to the person to whom the asset was disposed of
- Any **reduction**, as the result of the cancellation, termination or variation of an agreement or due to the prescription or waiver of a claim or release from an obligation etc, of an **accrued amount**

Base cost of asset (1) [par 20 (1)]

- ❑ **Base cost** of an **asset** = **sum of** expenditure actually incurred iro:
 - Acquisition or creation of that asset
 - Valuation of the asset for the purpose of determining a capital gain or capital loss
 - ▶ ▶ ▶ less capital gain if the base cost is too high.

Base cost of asset (2) [par 20 (1)]

- **Amounts** actually incurred as expenditure - **directly** related to the **acquisition** or **disposal** of that asset:
 - ✓ remuneration of surveyor, valuer, auctioneer, accountant, broker, agent, consultant or legal advisor, for services rendered
 - ✓ transfer costs, stamp duty, transfer duty, advertising costs, cost of moving the asset, installation costs,
 - ✓ costs of defending a legal title
 - ✓ costs of improvements – proviso – **improvement still reflected at time of asset's disposal**

Base cost (3) [par 20 (1)(c)(vii)]

- [Par 20(1)(c)(vii)] disposal of an asset by a person by means of a **donation** as contemplated in **par 38**,
- So much of any **donations tax** payable by that person iro that donation, as **determined in accordance with par 22** ▶ ▶ ▶

Koos donates his holiday house with a market value of 1 100 000 to his son Klaas. Base cost of the house before donations tax taken into account = 500 000	
Market value of donated asset	1 100 000
Art 56(2)(b) exemption	<u>(100 000)</u>
	<u>1 000 000</u>
DT @ 20% =	200 000

Base cost of asset (5) [par 20 (1)(c)(vii)] - eg (cont)

▶ ▶ Allowable addition to base cost ito Par 22 formula	$(MV \text{ asset} - bc) \times 200\ 000$ MV of asset
--	--

$\frac{=(1\ 100\ 000 - 500\ 000) \times 200\ 000}{1\ 100\ 000}$
= 600 000 / 1 100 000 x 200 000
= 109 090
Thus base cost ito par 20(1)(c)(vii) & par 22:
500 000 + 109 090
= 609 090

Base cost of asset (6) [par 20 (2)]

- **Base cost** does not include any of the following amounts [par 20(2)]:
 - ✓ borrowing costs, including any interest as contemplated in s 24J or raising fees
 - ✓ expenditure on repairs, maintenance, protection, insurance, rates and taxes and
 - ✓ municipal taxes or similar expenditures

But: allowable if asset was used wholly and exclusively for business purposes [par 20(1)(g)] but if only for private residence then it is not allowed

NB: Base cost must be reduced by deductions, allowed to determine taxable income of that person [par 20(3)]

Time of disposal [par 13(1)]

- **Agreement that is subject to a suspensive condition**
 - ✓ the date on which the condition is satisfied
- **Agreement that is not subject to a suspensive condition**
 - ✓ date on which the agreement is concluded

Time of disposal [par 13(1)]

- **Donation of an asset**
 - ✓ date of compliance with all legal requirements for a valid donation
- **Expropriation of an asset**
 - ✓ date on which the person receives the full compensation agreed to, or finally determined by a competent tribunal or court

Time of disposal [par 13(1)]

- **Conversion of an asset**
 - ✓ date on which that asset is converted
- **Exercise of an option**
 - ✓ date on which option is exercised
- **In any other case**
 - ✓ date of change of ownership

Disposal by spouse married in community [par 14]

- ❑ **Disposal of any asset by one spouse where asset:**
 - Falls within joint estate – treated as having been made in equal shares by each spouse
 - Excluded from joint estate – treated as having been made solely by the spouse making the disposal

Limitation of losses (1) [paras 15-19]

- ❑ Capital losses iro certain assets are disregarded – can thus not be used.
 - **NB:** The assets may not be in use for purpose of carrying on a trade
 - Capital gains iro the same assets are however taken into account
 - **Reason:** Certain assets depreciate (by use) and therefore such capital losses are disregarded

Limitation of losses (2) [par 15-19]

- ❑ **[Par 15] personal-use assets, rights and interests belong to:**
 - Aircraft with an empty mass exceeding 450 kg
 - Boat exceeding ten metres in length
 - Any fiduciary interest, usufruct or other similar interest, the value of which decreases over time

Limitation of losses (3) [par 15-19]

- ❑ **[Par 16] intangible assets acquired prior to valuation date:**
 - Goodwill, patent, copyright, trademark or intellectual property right/ intangible property
 - From a “connected person”

Base cost of pre-valuation date assets [par 25]

- ❑ **Base cost of a pre-valuation date asset**

=sum of the valuation date value of that asset determined ito par 26, 27 or 28 **plus** the par 20 base cost

- ✓ BC = valuation date value + after 1 Oct 2001 expenditure (ito par 20)

Valuation date value [par 26, 27 & 28]

- ❑ “Valuation date” value of an asset can be determined in various ways eg:
 - The **market value** of the asset on the “valuation date” ito par 29
 - **20% x** (“proceeds” minus par 20 expenditure incurred after 1 Okt 2001)
 - **Time-apportionment base cost** of the asset determined ito par 30 (only take note of this)

Market value on 1 Oct 2001 (1) [par 29]

- Par 29 is about “transition measures” in determining the market value on 1 Oct 2001
- Contains provisions re: how to determine valuation date values
- Further refer to par 31 in order to determine the market value of an asset on 1 Oct 2001

Market value on 1 Oct 2001 (2) [par 29]

- ❑ **NB:** Can only use **market value** as **base cost**
 - ✓ If asset’s market value as on 1 Oct 2001, was valued by 30 Sept 2004 [par 29(4)]
 - ✓ Other methods can be disadvantageous eg [par 26(1)(b)]: 20% x (“proceeds” – par 20 expenditure incurred after 1 Oct 2001)

Market value (1) [par 31]

- **Par 31 contains rules re:** how to calculate market value of an asset that is not covered by par 29
- **General rule = the market value is the price that can be obtained in the open market – arm's-length agreements**

Market value (2) [par 31(1)(f) & (4)]

- ❑ “Agricultural land value” can only be used at **death** and **donation** if:
 - A *bona fide* farming undertaking is being carried on immovable property and
 - “Agricultural land value” is used for the purposes of par 26 or 27 – ie iot determine the valuation date value
 - The donor or testator him/herself, obtained the agricultural property at “agricultural land value” by means of an inheritance or donation to him / her

Disposal by way of donation, consideration not measurable in money par 38

- ❑ Where asset is donated or the consideration for an asset at disposal is not measurable in money:
 - It is **deemed** that the **person** that disposed of the asset, disposed of it at **market value** and
 - The **person** that received the asset is **deemed** to have acquired it **at market value**

18/10/11 Law of Taxation Lecture 19

- CAPITAL GAINS is 50 marks, 30 marks on VAT and 20 on transfer duty
- 2 hours 100 marks

Primary Residence Exclusion (1) (NB: study par 44-51) NB NB

- ❑ **Par 45 determines that a natural person or a special trust:**

Must disregard R1,5 million of a capital gain or capital loss in respect of the disposal of a “primary residence” of the person disposing of the asset

Para 45(1)(b): if the total of the proceeds is R 2 million and less than, one may disregard for capital gains.

Where more than one person jointly holds an interest in a primary residence at the same time, the amount to be disregarded must be apportioned in relation to each interest so held.

A person can only have one primary residence at a time – where persons eg own more than one “residence” then must choose one as his or her primary resident.

If has more than one wife, and two residences then one must choose one residence.

WILL OR COULD BE A QUESTION!

Primary residence exclusion (2)

- ❑ **Par 44 contains definitions re: the primary residence exclusion:**
 - **“Primary residence”** = A residence in which a natural person or a special trust holds an interest; and
 - Ordinarily resides in or resided in as his/her main residence and
 - Uses or used mainly for domestic purposes
 - **“Residence”** =
 - Any structure, including a boat, caravan or mobile home, that is used as a place of residence by a natural person, together with any appurtenance (*aanhangsels*) belonging thereto and enjoyed therewith

Primary residence exclusion (4)

- ❑ **Par 46 limits the size of the residential property that qualifies for exclusion to:**
 - Two hectares
 - That is used mainly for domestic or private purposes together with that residence
 - And is disposed of at the same time and to the same person as that residence

Primary residence exclusion (5)

- ❑ **Par 47 - apportionment in respect of periods where, not ordinarily resident :**
 - Where a natural person or special trust disposes of an interest in a primary residence - **and**
 - ✓ if that person or a spouse of that person or beneficiary
 - ✓ was not **ordinarily resident in that residence throughout the period**
 - ✓ then the portion of the capital gain or capital loss to be **disregarded in terms of par 45 must be determined with reference to the portion of that period during which that person,** beneficiary or spouse was so ordinarily resident
 - NB: This par is subject to par 48

Primary residence exclusion (6)

- ❑ **Par 48 - A natural person or a beneficiary of a special trust must for purposes of par 47 be treated as having been ordinarily resident in a residence for a continuous period of not more than 2yrs where:**
 - It had been offered for sale
 - That residence was being erected on land acquired for that purpose in order to be used as that person's primary residence
 - The residence had been accidentally rendered uninhabitable
 - The death of that person

Primary residence exclusion (7)

- ❑ **Par 49 determines that where a primary residence is also used for non-residential purposes:**
 - Capital gain and capital loss that must be disregarded ito par 45
 - Must be reduced by the (exclude that portion of the resident) portion of non-residential use of the primary residence ▶ ▶ ▶

- ❑ **Par 49 example:**

- Assume the capital gain in respect of a primary residence of which 30 % is used for non-residential purposes = R1 2 00 000
- Only 70% x 1 200 000 = 840 000 thus qualifies for the par 45 exclusion
- Thus the **capital gain** is:
1 200 000 minus 840 000 = **360 000**
- If the capital gain is 3 500 000 in the same example: 70% x 3 500 000 = 2 450 000 – qualifies for the par 45 exclusion
 - ✓ R1,5 million can be disregarded and the **capital gain** is: 3 500 000 minus 1 500 000 = **2 000 000**

Primary residence exclusion (9)

Par 50 Rental periods

- Where a primary residence was being let for not more than 5 years, **and**
 - ✓ no other residence was treated as the primary residence of that person or beneficiary during any such period, **and**
 - ✓ they were temporarily absent from the Republic, **or**
 - ✓ worked more than 250 km from that residence
- Must it for purposes of par 49 be treated as if the residence was used for domestic purposes during any continuous period of absence there from

Other exclusions (1) [par 52-64]

- ❑ **Par 53 – personal-use assets of a natural person or a special trust are excluded:**
 - **Includes** assets such as furniture, cars, equipment, paintings/art
 - **Does not include:** coins made mainly from gold or platinum, immovable property, boat longer than ten metres in length, any fiduciary right, usufruct or other similar right ▶ ▶ ▶

Other exclusions (2) [par 52-64]

- ❑ **Par 54 – retirement benefits**
- ❑ **Par 55 – long term assurance**
- ❑ **Par 59 – compensation for personal injury, illness or defamation**
- ❑ **Par 60 – gambling, games and competitions that are authorised and are operated, in terms of RSA acts, played by a natural person ▶ ▶ ▶**

Other Exclusions (3) [par 52-64]

- ❑ **Par 61** - collective investment schemes in securities - portfolio in such a scheme contemplated in par(e)(i) of the definition of “co” in s 1 – must disregard any capital gain or capital loss

NB: – holder of interest must calculate capital gain or capital loss at disposals

- ❑ **Par 62** – donations and bequests to PBO’s and exempt persons

Roll-overs (1) (par 65-67A)

- ❑ **Roll-overs** were specially included in order to allow a capital gain to carry over until there is a disposal of the:

- Replacement asset or
- When an asset received from a spouse bmo a donation or inheritance is eventually disposed of ▶ ▶ ▶

Roll-overs (2) (par 65-67A)

- ❑ **Par 65:** involuntary disposal e.g. expropriation, loss (by e.g. theft) or destruction . can elect to have these applicable to you and have the loss or gain roll over to a future date. Must within three year must place the capital asset back into use.
- ❑ **Par 66:** re-investment in replacement assets e.g. production machinery is replaced ▶ ▶ ▶

Roll-overs (3) (par 65-67A)

- ❑ **Par 67: transfer of assets between spouses:**

- **Transferee** spouse shall be deemed to
 - ✓ have **received** the **asset** on the **same date** as the transferor
 - ✓ **at the par 20 cost** that counted for the transferor on the date of transfer
 - ✓ **used** the **asset** in the **same manner** as the transferor before the transfer.
- A has a asset and at valuation date it was R 1million and at a stage had allowable base costs of R 100 000 and at this time he donates the house to B his spouse thus the roll over takes place and it is deemed that B has received the asset the house on the same date as the transferor received the house thus the value of the R 1million plus R 10000 for the para 20 base costs, thus the CGT is R 11million

Trusts (1) [par 80]

- ❑ **General rule = that conduit pipe principle counts in the same way as in the case of normal tax:**
- Capital gain must be disregarded by the trust and is attributed to the beneficiary
 - ✓ if capital gain in the “year of assessment” **flows through** to the **beneficiary** that did not have a vested right
- Where a **capital gain** is *held back* the **trust** must **include** the **net capital gain** in its taxable income @ inclusion rate of **50% !** ▶ ▶ ▶
- Trust has property and there is a capital gain of R 5 million in a YOA and if this 5 million is allocated to the beneficiary then it will be taxed under the beneficiary's rate of 25% and not the trust which is 50%. Thus the beneficiary will be used.
- What of a capital loss? Cannot be transferred to the beneficiary and not given over thus remains in the Trust.

Trusts (2) [par 80]

- Rule only counts if beneficiary is a “resident” – otherwise capital gain is attributed to the trust
- Wording of the trust deed is NB – must make it possible for capital gain to flow through to a natural person – advantageous
- Trustees must have a wide discretion to let capital gain flow through – unless beneficiary is e.g. a minor
- Capacity to award capital gain to more than one “resident” beneficiary

Trusts (3) [par 35]

- ❑ **Disposal of assets to a trust**
- When a person reduces or releases a trust's debt to him then:
- A deemed disposal i/o par 12(5) (slide above) occurs by the debtor (trust) and for the value of the released debt with a base cost of zero - implication
- Solution: natural person donates cash to a trust and gets s 56(2)(b) exemption of R100 000 pa
- Trust can then repay the money to the person (creditor) without any CGT consequences

Deceased estates (1) [par 40]

- ❑ **Deceased person must be treated as having disposed of his/her assets -**

- To his/her deceased estate
- For proceeds equal to the market value of those assets as at the date of that person's death
- The deceased estate must be deemed to have acquired those assets at a cost equal to that market value, which costs must be treated as an amount of expenditure actually incurred and paid for the purposes of par 20(1)(a)

Deceased estates (2) [par 40]

- ❑ **Deceased person must be treated as having disposed of his/her assets, except-**
 - Assets transferred to the surviving spouse of that deceased person as contemplated in par 67(2)(a)
 - Asset left to an approved PBO as contemplated in par 62
 - The proceeds of a long term assurance policy of the deceased – if the proceeds would be disregarded ito par 55

Deceased estates (3) [par 40]

- **Means that there has been a disposal of all assets except those specifically excluded in par 40(1)(a) – (d)**
- Last return of income of deceased – must calculate CGT as for a natural person
- Concession: par 5(2) annual exclusion in year of death = R120 000

Deceased estates (4) [par 40]

- Executor calculates CGT – taxable capital gain is deductible ito s 4(b) of the Estate Duty Act
- Estate acquires assets @ base cost = mv
- Disposal of an asset by the deceased estate of a natural person must be treated in the same way as if that asset was disposed of by any natural person him/herself
- Inclusion rate [par 10(a)] = 25% and annual exclusion [par 5(1)] = R17 500
- When executor disposes of assets in estate?

Heirs and legatees

- Will be deemed to have acquired assets at base cost of the assets for the estate and = mv
- **CAUTION:** Executor must not write off the debts of heirs against the estate else par 12(5) can be applied
- When surviving spouse inherits assets a roll-over occurs ito par 67, then:-

- ✓ No disposal
- ✓ Assets deemed to have accrued to surviving spouse at the same base cost as for the deceased

Attribution of capital gains [par 68-73]

- ❑ Attribution of capital gains (same principle as in s 7):
 - To spouse [par 68]:
 - To parent of a minor child [par 69] – s 90 may recover tax paid
 - That is subject to conditional vesting [par 70] – s 90 may recover tax paid
 - That is subject to revocable vesting [par 71] – donor must be a resident – s 90 may recover tax paid
 - That vests in a person who is not a resident

[par 72]

Value shifting arrangement (1) [par 1 & 23]

- ❑ An arrangement by which a person retains an interest in a company, trust or partnership:-
 - But which, after a change in the rights or entitlements of the interests in that company, trust or partnership
 - The market value of the interest of that person decreases and
 - Value of the interest of a connected person of that person in that company, trust or partnership increases; or
 - Connected person in respect of that person acquires an interest in that company, trust or partnership ▶ ▶ ▶

Value shifting arrangement (3) [par 1 & 23]

- ❑ It is an deemed disposal ito – par 11(1)(g)
- ❑ Base cost is recalculated ito par 23:

$$Y = \frac{(A - C)}{A} \times B$$

A

- ✓ Y = amount to be calculated
- ✓ A = mv of the person's interest immediately prior to the disposal
- ✓ B = the person's base cost of the interests calculated immediately prior to the disposal

- ✓ C = the mv of the person's interests immediately after the disposal ▶ ▶ ▶

Value shifting arrangement (4) [par 1 & 23] Example

- John is the only shareholder of XYZ (Pty) Ltd with 2 issued shares
- Market value of the shares = R36 000
- Base cost = R12 000
- XYZ issues one additional share to John's son Mark for R3
- Now the total market value of the three shares in XYZ = R36 003
- Now John only holds 2/3 of the share capital which is = R24 002
- Mark in turn holds an interest of R12 001 ▶ ▶ ▶

Value Shifting Arrangement (5) [par 1 & 23] Example

- $Y = \frac{(36\ 000 - 24\ 002)}{36\ 000} \times 12\ 000$

$$36\ 000$$

$$= \frac{11\ 998}{36\ 000} \times 12\ 000$$

$$36\ 000$$

$$= 3\ 999 \text{ (base cost on deemed disposal)}$$

- The deemed proceeds of the disposal ito par 35(2) = amount with which John's mv decreased due to value shifting = 11 998
- John's capital gain on the deemed disposal:- $R11\ 998 - 3\ 999 = R7\ 999$
- Mark's base cost:- $R3 \text{ (cost)} + 11\ 998 \text{ (deemed proceeds accruing to John)} = R12\ 001$