South African Institute of Tax Professionals

29 September 2017

The South African Revenue Service

Lehae La SARS, 299 Bronkhorst Street

PRETORIA

0181

BY EMAIL: policycomments@sars.gov.za

RE: CHAPTER 16 (DECEASED ESTATES) OF THE DRAFT COMPREHENSIVE GUIDE TO CAPITAL GAINS TAX (ISSUE 16)

We write to comment on the deceased estates chapter of the draft comprehensive guide to capital gains tax which has been revised to reflect the changes brought about by the introduction of section 9HA and substitution of section 25 of the Income Tax Act.

A. Background

A number of significant amendments affecting deceased persons and their deceased estates came into operation on 1 March 2016 and apply to persons dying on or after that date. Section 9HA deals with the deceased person and section 25 deals with the deceased estate and the heirs and legatees, including the surviving spouse. The deceased person is deemed to have disposed of his/her assets (with some exceptions such as certain interests in retirement funds and long-term insurance policies) to the deceased estate at market value on the date of death. However, roll-over treatment is afforded from the deceased person to the surviving spouse. Income is no longer permitted to flow through the deceased estate to an ascertainable heir or legatee. The deceased estate must account for all income and gains/losses until the liquidation and distribution account becomes final.

B. **Comments for consideration**

We highlight our comments by referring to the numbers used in the guide:

16.1 "the estate must account for all its income until the liquidation and distribution account becomes final"

- While we acknowledge that this might well be the correct interpretation of the law as it stands, we would like to highlight that it causes significant problems in practice, which are very difficult to overcome within this interpretation. <u>The fact that the estate must account for the income until the Liquidation and Distribution Account (L&D) becomes final and not only until it is drawn is the concern</u>. The L&D only becomes final when it has lain for inspection without objection for 21 days. The L&D is drawn as at a point in time and the income arising in the estate up to that point in time is accounted for in that L&D. The L&D includes, as a liability, the estate's liability to SARS for the assessment/s relating to the income accounted for in that L&D. The L&D is submitted to the Master of the High Court & SARS for audit and, only once the audits are completed and the Master's requirements complied with, does the Master authorise the executor to advertise the account. The 21-day advertising period runs its course and, if no objections are lodged, the L&D becomes final. If objections are lodged, the dispute/s relating thereto may take a considerable time to be settled, at the end of which, it may be that the objections are not sustained and the L&D only then becomes final. Consequently, significant time passes after the point in time to which the L&D has been drawn and the income accounted for and assessed by SARS to the point in time that the L&D becomes final. During this time significant further income frequently arises which would, as per this guide, need to be taxed in the estate. This would require further income tax returns to be submitted & assessed, the liability for which would not have been reflected in the L&D and which, had they been so reflected, may have prompted further objections. In addition, while the revised assessment/s are being finalised, further income would continue to arise which, in turn would require yet further returns & assessments, and so on, ad infinitum. Therefore, an amendment is needed to the effect that the estate must account for income up to the point in time <u>to which the L&D is drawn</u> not the point in time it becomes final. The income in the estate thereafter will have to be taxable in the hands of the heirs, perhaps on the basis that it is received directly on their behalf.

Another consideration regarding the cut-off point of post-death estate income is that even after the point in time that the L&D “becomes final”, further income arises until the actual distributions to the heirs take place. This sometimes takes a while, particularly where, for example non-resident heirs are involved or fixed property needs to be transferred. Income on estate accounts & investments as well as rental income from fixed properties will continue. The suggestion that the taxing of the post-death income in the estate terminates at the point in time that the L&D is drawn would mean that the income from the point in time to which the L&D is drawn to the final distribution from the estate would then be taxed in the hands of the heirs.

16.2.1 “The surviving spouse, provided he or she is a resident, inherits the base cost and all aspects of the history of the asset (date of acquisition and usage) from the deceased spouse under s 25(4) and will have to account for any capital gains or losses when the asset is ultimately disposed of”

- "provided he or she is a resident" needs to be qualified by adding "or a non-resident in respect of immoveable property or asset of permanent establishment..." based on par 67 read with par 2(1)(b) of the Eighth Schedule.
- It should also be clarified that the non-resident surviving spouse will qualify for the deceased's portion of the primary residence exclusion.
- Clarity/confirmation needs to be provided for a situation where an asset was the deceased's primary residence and the surviving spouse lives/lived separately in his/her own primary residence. Does the surviving spouse now qualify for the primary residence exclusion on both properties (albeit with an apportionment in respect of the deceased's property) despite "overlapping" periods of primary residence use?

16.2.2 "CGT may also be payable by the estate if the asset has increased in value between the date of death and the date of sale by the executor"

- we suggest that, for the sake of clarity "CGT may also be payable by the estate" could be reworded to say "a capital gain will arise in the estate"

16.2.8 "The annual exclusion is designed to grant a measure of relief for the 'bunching effect' that occurs as a result of the simultaneous deemed disposal of all the assets of the deceased"

- The estate duty R3.5 million rebate not utilised by the predeceased spouse is available on the surviving spouse's death. Consideration should be given to introducing legislation to apply the same principle to the annual exclusion on death for CGT purposes.

16.2.10 "Importantly, the roll-over treatment does not apply if the surviving spouse is a non-resident"

- "Unless the asset is immoveable property or asset of permanent establishment" qualification needs to be included throughout this chapter wherever the disposal to and rollover relating to surviving spouse is dealt with.

16.3.4 "The R2 million exclusion in para 45 may be set off only against the portion of the gain applicable to the first two years following the date of death"

- In order to further clarify this, the point could perhaps be made that this would require a valuation to be carried out at the two-year mark.

16.4.8 "When, the CGT relating to the taxable capital gain of the deceased person exceeds 50% of the net value of the deceased estate, as determined for the purposes of the Estate Duty Act, 45 of 1955, before taking into account that tax"

- It should be made clear that the CGT contemplated here is the total CGT relating to the deceased on all disposals (not just the CGT relating to the specific asset to be taken over) i.e. refer to "the taxable gains" not "the taxable gain"

16.4.8 - The net value of an estate is determined under s4 of the Estate Duty Act before deducting the R3,5 million allowance under s4A

- This is not necessarily R3.5 million as it would also include the unutilised s4A allowance from the predeceased spouse.

Matter not dealt with – assets bequeathed to but not acquired by surviving spouse

- Something not dealt with and which may be worth clarifying in the guide is the position where the entire estate is bequeathed to the surviving spouse but during the course of the winding up of the estate after the date of death, certain assets are sold (e.g. shares in a portfolio). It seems that the surviving spouse would not have "acquired" the asset/s concerned as contemplated in section 9HA(2) and therefore the deceased will be treated as having disposed of those assets on death at market value in terms of section 9HA(1) which would become the base cost for the subsequent disposal by the post-death estate, despite the fact that the asset/s were bequeathed to the surviving spouse.

We welcome the opportunity to comment on the draft guide and look forward to future engagements.

Yours sincerely

Erika de Villiers

Head of Tax Policy