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BULLETIN

Davis Tax Committee - Estate Duty Report Hypothesis

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Background

The Davis Tax Committee published their report on how to modernise the approach to Estate Duty in South Africa in January 2015. The report highlighted the importance of an efficient system for taxation to generate and collect such tax.

Based on the Katz Commission suggestion that Estate Duty should equate to circa 1% to 1.5% of tax revenues the report suggests that this translates into an addition R10 billion to R15 billion per annum for the South African fiscus.

Taking into account the challenges South Africa currently faces in reducing its national debt level, this additional tax revenue would make a valuable contribution.

The initial report made several sweeping recommendations to make the above possible and put this out to consultation last year.

Updated Report

A revised report is expected to be published at the end of January 2016 but requires approval by the Finance Minister. The amendments will be recommended to Government with the expectation that certain changes will take place in the 2016/17 Budget and any remainder would be implemented the following year.

We have already seen the overfunding of domestic retirement provision being addressed, which formed part of the initial paper, with the amendment to the Estate Duty Act, Section 3 (bA). This clearly demonstrates that unlike many reviews we can expect a wide adoption of the report's final recommendations.

Committee Feedback

Rather than regurgitate the original set of recommendations, which were not favourably received by the industry, this update provides our view on how the DTC might respond to the consultation and highlights areas of the report that could be amended.

- **Domestic Trusts and the Conduit Principle:** The report looked to abolish this principle which would have resulted in all gains and income paid or arising in domestic South African trusts being taxed at the highest rate of tax.

  Following consultation, it seems likely that this principal will be repealed, a very welcome step as it would have resulted in many individuals paying tax at higher levels than in their own right. It would also have discouraged the legitimate use of trust to provider for future generations.

Committee Feedback continued...

- **Offshore Trusts and Taxation on Distributions:** The report recommended taxing any distribution from an offshore trust to income tax when received by a South African tax resident individual.

  This would have resulted in the possible double taxation of dividends and importantly seen the distribution of capital taxed to income. Where capital was originally settled into trust from tax paid funds, it would have created a significant double tax position with no possibility of relief.

  The expectation, following feedback, is that this approach will be modified. The 8th Schedule of the ITA could be amended to deal with the taxation of capitalised income and gains and the tax thereon. This should provide a fair outcome as true capital would not be affected and the tax on rolled up gains and/ or income would continue to be deferred until distributed.

- **Interest Free Loans in Trusts:** One potential outcome is that the revised Estate Duty report will focus on interest free loans from trusts and look to bring these loans into the estate of the borrower.

  Currently loans to beneficiaries can create a tax free synthetic income and/ or avoid capital gains tax and/ or income tax which would have been triggered on distribution. The expectation is that Section 3 (3) of the Estate Duty Act may be amended to address this by way of improved anti-avoidance measures. This is expected to take a similar shape as the amendment to Section 3 (bA) in relation to overfunding of domestic pension, retirement and provident funds which formed part of the original recommendations and was incorporated into law on the 1st January 2016.

- **Estate Duty Abatement:** The initial report looked at increasing the abatement level to R5.7 million with the surviving spouse being able to use the deceased's unused abatement. The expectation is that this will be amended and that each individual will get an abatement of R15 million but with no roll over and no spousal exemption.

- **Non-Disclosure of Foreign Assets:** The DTC has raised its concerns over the lack of disclosure by South African residents that hold undisclosed offshore assets or are beneficiaries of offshore trusts where income or other taxable distributions are being made but not disclosed.

  The South African Revenue Services' Voluntary Disclosure Programme is available to those that want to regularise their affairs. For those that don't the introduction of the Automatic Exchange of Information under the Common Reporting Standard global initiative on tax evasion will potentially flush out those that are not disclosing. It is expected that these individuals will be dealt with harshly as every opportunity has been provided to regularise one's affairs with minimal penalty.

The above is a summary of OTAPs understanding of the current positon and changes that may result given the consultation process. This view should not be seen as anything other than that and should not be acted on or relied upon. The actual outcome of the DTC will only be known once the final paper is officially published later this year.

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