SOUTH AFRICAN REVENUE SERVICE

DRAFT
COMPREHENSIVE GUIDE
TO
CAPITAL GAINS TAX
(Issue 6 – Chapter 16)

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Chapter 16 – Deceased estates

16.1 Introduction

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. For the position before 1 March 2016, see the previous issue of this guide.

The changes affecting CGT involved moving some of the rules in paras 40, 41 and 67 to the main body of the Act in the form of a new s 9HA and a redrafted s 25. Section 9HA deals with the deceased person, while s 25 deals with the deceased estate and heirs or legatees, including a surviving spouse. Some of the more noteworthy effects of these changes are the following:

- Before 1 March 2016 there was no deemed recoupment of capital allowances on the date of death. An allowance asset was deemed to be disposed of at market value under para 40(1) on the date of death but this disposal applied only for purposes of the Eighth Schedule. Consequently the difference between the deemed proceeds and the base cost (tax value) of an asset was accounted for as a capital gain or loss. On or after 1 March 2016 an allowance asset is deemed to be disposed of on the date of death under s 9HA(1) for the purposes of the Act as a whole, thus potentially bringing any previously claimed allowances within the ambit of s 8(4)(*a*) and s 11(*o*). Thus the deemed disposal of an allowance asset under s 9HA(1) may trigger an income inclusion under s 8(4)(*a*) or revenue loss under s 11(*o*). A capital gain could also arise in addition to any recoupment if the market value of the allowance asset on the date of death exceeds its cost.

- Before 1 March 2016 the amount by which the market value of trading stock held and not disposed of on the date of death exceeded its closing stock value was dealt with as a capital gain because the trading stock was regarded as held by the deceased on the date of death for the purposes of s 22(1) while for CGT purposes it was regarded as disposed of. Now s 9HA deems trading stock to be disposed of on the date of death at market value, which results in the deemed consideration being included in the deceased person's gross income and hence excluded from proceeds under para 35(3)(*a*).

- Similarly, before 1 March 2016 farmers included the standard value of livestock on date of death in closing stock, with the difference between market value and standard value giving rise to a capital gain. On or after 1 March 2016 the livestock is no longer held and not disposed of as a result of the deemed disposal under s 9HA(1) and a farmer must include the market value of livestock in gross income on the date of death. The market value of produce will similarly be included in gross income on the date of death and will no longer be accounted for as closing stock.

- The roll-over treatment afforded under para 67 continues under s 9HA(1)(*a*) and (2) for the deceased person and under s 25(4) for the surviving spouse, but has now been extended to allowance assets, trading stock, livestock and produce.

- Section 25 used to permit income derived by the estate to flow through to ascertainable heirs or legatees, while capital gains and losses realised by the executor had to be accounted for by the estate. Thus, under the previous system relatively few estates had to be brought on register for income tax purposes. It was only those estates that derived a taxable capital gain or those exceptional estates in which there were no ascertainable heirs or legatees which could have been potentially liable for income tax. On or after 1 March 2016 the position regarding capital gains remains unchanged. If the estate realises a taxable capital gain, it will be liable for any resulting CGT in its own right. The substantial change has come about with the treatment of income derived by the estate. Income is no longer permitted to flow through to an ascertainable heir or legatee and the estate must account for all its income until the liquidation and distribution account becomes final. The estate qualifies for the interest exemption of R23 800 which may prevent registration if the estate has interest of less than that figure, but given that an estate does not qualify for the primary, secondary or tertiary rebates, even R1 of taxable income will render it liable to income tax. For example, if its interest income exceeds R23 800 or it has other taxable income such as rental income, taxable dividends from a REIT or a taxable capital gain, it will need to register as a separate taxpayer. This treatment is likely to result in many more estates having to register as separate taxpayers. The deceased estate is given its own tax number and its returns of income can be submitted via efiling.

This chapter considers the position of the following persons:

- The deceased person [s 9HA(1) and (2), para 62]
- The deceased estate [s 25(1), (2), (3)(*a*), (5) and (6) and para 40(3)]
- The heirs or legatees [s 9HA(3), s 25(3)(*b*), (4) and (6)]

Upon death a natural person's year of assessment comes to an end and a new entity comes into existence, namely, the deceased estate. In reality a deceased estate is not a person but simply a collection of rights and obligations of the deceased person administered by an executor.

In *Estate Smith v cIR*[693] the court held that an executor was not a representative taxpayer in respect of income derived by the estate. Undeterred by this setback, the Commissioner then sought to appoint the executor as agent for the tax due by Smith's estate. On appeal, in *CIR v Emary NO*[694] the court held that a deceased estate was merely an aggregate of assets and liabilities and not a person. It was therefore not possible to appoint the executor as agent of a non-existent person.

The Act was subsequently amended to rectify the shortcomings highlighted in the *Smith* and *Emary* cases. More particularly, paragraph (*b*) of the definition of 'person' in s 1(1) includes 'the estate of a deceased person'. The definition of 'representative taxpayer' in s 1(1) provides that a representative taxpayer must be a natural person who resides in South Africa, and in relation to a deceased estate is the executor or administrator of such deceased estate 'in respect of the income received by or accrued to any deceased person during his lifetime and the income received by or accrued to the estate of any deceased person'. For the purposes of the definition of 'representative taxpayer', income includes any amount received or accrued or deemed to have been received or accrued in consequence of the disposal of any asset envisaged in the Eighth Schedule. The term 'executor' is defined in s 1(1) to mean

> 'any person to whom letters of administration have been granted by a Master or an Assistant Master of the High Court appointed under the Administration of Estates Act, 1965 (Act No. 66 of 1965), in respect of the estate of a deceased person under any law relating to the administration

[693] 1960 (3) SA 375 (A), 23 SATC 399.
[694] 1961 (2) SA 621 (A), 24 SATC 129.

> of estates, and includes a person acting or authorized to act under letters of administration granted outside the Republic but signed and sealed by such a Master or Assistant Master for use within the Republic and, in any case where the estate is not required to be administered under the supervision of such a Master or Assistant Master, the person administering the estate'.

Under para (*a*) of the proviso to s 66(13)(*a*) in the year of assessment in which a person dies, a return must be made for the period commencing on the first day of that year of assessment and ending on the date of death. Under s 6(4) the primary, secondary and tertiary rebates must be apportioned for a period of assessment of less than 12 months.

The first return for the deceased estate commences on the day after the date of death and ends on the last day of February or, if earlier, on the date on which the liquidation and distribution account becomes final. For subsequent years of assessment the executor of a deceased estate must continue to submit returns of income for each year of assessment until the liquidation and distribution account becomes final. The deceased estate of a natural person is excluded as a provisional taxpayer.[695]

16.2 The deceased person

16.2.1 Deemed disposal by deceased person [s 9HA(1)]

A deceased person is treated as having disposed of his or her assets at the date of death for an amount received or accrued equal to the market value under para 31 of those assets on that date, other than the following assets:

- Assets disposed of to a surviving spouse as contemplated in s 9HA(2). These assets are subject to roll-over treatment under s 25(4). This relief is similar to that granted to a deceased spouse for estate duty purposes under s 4(*q*) of the Estate Duty Act 45 of 1955. 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. The provision is not an exclusion from CGT but merely a deferral measure that has the effect of shifting the incidence of the tax from the deceased to the surviving spouse. The surviving spouse will pay CGT only upon disposal of the asset. The roll-over relief applies automatically and neither the deceased person nor the surviving spouse can elect out of it.

- A long-term insurance policy of the deceased, if any capital gain or capital loss that would have been determined in respect of a disposal that resulted in proceeds of that policy being received by or accruing to the deceased would have been disregarded under para 55. Capital gains or losses on long-term policies held by individuals are determined within the individual policyholder fund of a long-term insurer and are not taxed again at policyholder level.

- An interest of the deceased in
  - a pension, pension preservation, provident, provident preservation or retirement annuity fund in South Africa; or
  - a fund, arrangement or instrument situated outside South Africa which provides benefits similar to a pension, pension preservation, provident, provident preservation or retirement annuity fund,

[695] Paragraph (*ff*) of the definition of 'provisional taxpayer' in the Fourth schedule.

if any capital gain or capital loss that would have been determined in respect of a disposal of that interest that resulted in a lump sum benefit being received by or accruing to the deceased would have been disregarded under para 54. Lump sums from these various retirement funds are subject to income tax according to a separate set of annual cumulative tables and thus do not also attract CGT.

The market values as specified in para 31 must be used in determining the amount deemed to be received or accrued – see **8.35**.

16.2.2 Bequests to specified exempt or partially exempt bodies

Under para 62 any capital gain or loss determined in respect of an asset bequeathed to the Government of South Africa in the national, provincial or local sphere, a PBO contemplated in para (*a*) of the definition of a 'public benefit organisation' in s 30(1) approved by the Commissioner under s 30(3), a recreational club approved by the Commissioner under s 30A, or certain other entities exempt under s 10 must be disregarded. See **12.11**.

Any capital gain or loss arising on the disposal of an asset by an executor in order to give effect to a cash bequest to a PBO will not be excluded in the hands of the deceased person under para 62. In addition, 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. In order to qualify for the exclusion under para 62, the deceased must bequeath a specific asset to the PBO. See **12.11**.

16.2.3 Record-keeping and valuation issues

An executor will have to select a valuation method for any pre-valuation date assets held by the deceased at the date of death. Should the deceased have failed to determine the market value of an asset (other than financial instruments whose prices were published in the *Gazette*) on 1 October 2001 during the three years ending 30 September 2004, the executor will have to resort to either the time-apportionment method (if a record of pre-valuation date expenditure exists) or the '20% of proceeds' method. Taxpayers should keep records of costs and valuations performed in order to enable their executors to properly determine capital gains and losses. In finalising the deceased's tax returns up to date of death, the executor will be bound by whatever asset identification method was adopted under para 32 by the deceased (specific identification, FIFO or weighted average) for South African-listed shares, participatory interests in portfolios of collective investment schemes, and gold or platinum coins.

If the deceased failed to keep a record of post-valuation date value expenditure, it may be possible for the executor and SARS to agree on an estimated assessment under s 95(3) of the Tax Administration Act 28 of 2011.

16.2.4 Trading stock, livestock and produce and allowance assets

For persons dying on or after 1 March 2016, the market value of trading stock, livestock and produce must be included in the gross income of the deceased person on the date of death under s 9HA(1) except if such assets have been bequeathed to a surviving spouse. Consequently, such amounts will be excluded from proceeds under para 35(3)(*a*).

Livestock or produce acquired on or after the valuation date (1 October 2001) will have a base cost of nil under para 20(3)(*a*) to the extent that the cost of its acquisition has been allowed as a deduction under s 11(*a*). While the deduction granted to a farmer for livestock may be limited under para 8 of the First Schedule, para 8(3) provides that para 8 does not apply to livestock no longer held and not disposed of. Since the deceased farmer is deemed to have disposed of all livestock on date of death under s 9HA(1), para 8 cannot apply to such livestock, meaning that the deduction for livestock, if previously limited, will be allowed in full on the date of death. On the question of game livestock, see Interpretation Note 69 "Game Farming".

Post-valuation date trading stock allowed as a deduction under s 11(*a*) or s 22(2) (opening stock) will also have a base cost of nil under para 20(3)(*a*).

The deemed disposal of an allowance asset on the date of death under s 9HA(1) may potentially trigger a recoupment of previous capital allowances under s 8(4)(*a*) or at the election of the executor, a loss on disposal under s 11(*o*). A capital gain will usually arise if the amount received or accrued exceeds the cost of the allowance asset.

Example 1 – Recoupment of capital allowances plus capital gain on death under s 9HA(1)

Facts:

Rene acquired an aircraft in 2015 at a cost of R10 million on which she had claimed capital allowances of R6 million at the time of her death on 31 January 2017. The market value of the aircraft on her date of death was R12 million.

Result:

	R
Cost of aircraft	10 000 000
Less: Capital allowances	(6 000 000)
Tax value	4 000 000
Amount deemed received or accrued on deemed disposal	12 000 000
Difference	8 000 000

The difference comprises a recoupment under s 8(4)(*a*) of R6 million plus a capital gain of R2 million. The capital gain is determined as follows:

		R
Amount deemed to be received or accrued on deemed disposal		12 000 000
Less: Recoupment under s 8(4)(*a*) [para 35(3)(*a*)]		(6 000 000)
Proceeds		6 000 000
Less: Base cost		
Cost of aircraft	10 000 000	
Less: Capital allowances [para 20(3)(*a*)]	(6 000 000)	(4 000 000)
Capital gain		2 000 000

Example 2 – Livestock on hand at date of death of taxpayer

Facts:

At the time of his death on 31 January 2017 Farmer Brown held a bull acquired in 2014 at a cost of R50 000. It was subsequently accounted for in closing and opening stock at standard value of R50. The market value of the bull on 31 January 2017 was R70 000.

He also held six cows, five of which were purchased in 2014 at a total cost of R50 000, with the remaining cow being bought in November 2016 at a cost of R12 000. The standard value of the cows was R40 each and their market value on date of death was R15 000 each.

Determine the effect of s 9HA(1) on Farmer Brown's taxable income for the 2017 year of assessment. Farmer Brown had sufficient income from farming operations to make para 8 of the First Schedule inapplicable.

Result:

Deemed amount received or accrued on date of death:

	R
1 Bull @ market value	70 000
6 cows market value of R15 000 × 6	90 000
	160 000
Less:	
Opening stock	
1 bull	(50)
5 cows 5 × R40	(200)
Cost of cow acquired in November 2016	(12 000)
Net increase in taxable income	147 750

There are no CGT consequences for Farmer Brown because the amounts were fully taken into account on revenue account:

Proceeds:

	R
Deemed amount received or accrued on date of death R70 000 + R90 000	160 000
Less: Amount included in gross income [para 35(3)(*a*)]	(160 000)
Proceeds	-

Base cost:

Cost of acquisition of bull in 2014	50 000
Cost of acquisition of 5 cows in 2014	50 000
Cost of acquisition of 1 cow in November 2016	12 000
Total cost	112 000
Less: Amount allowed under s 11(*a*) [para 20(3)(*a*)]	(112 000)
Base cost	-

Example 3 – Determination of taxable capital gain of natural person in year of death

Facts:

Richard Spectre died on 31 August 2016 leaving the following assets:

	Base Cost	Market value on date of death
	R	R
Primary residence	1 000 000	3 100 000
Holiday home	250 000	350 000
Household furniture and effects	500 000	800 000
Yacht (11 metres in length)	300 000	200 000
Endowment policy	100 000	150 000
Second-hand endowment policy	200 000	300 000
Listed shares	600 000	900 000

In his will he stipulated that

- the holiday home was to be left to his surviving spouse,
- the endowment policy was to be left to his son,
- the second-hand endowment policy was to be left to Retina South Africa, a registered public benefit organisation, and
- the remaining assets were to be sold and the proceeds split equally between his wife and son.

Result:

The taxable capital gain or loss of Richard Spectre is determined as follows:

Asset	Base Cost	Market value	Capital gain/(loss)	Exclusions/ roll-overs	Total	Provision conferring non-disposal, exclusion or roll-over
	R	R	R	R	R	
Primary residence	1 000 000	3 100 000	2 100 000	(2 000 000)	100 000	45(1)
Holiday home	250 000	350 000	N/A – no Disposal			s 9HA(1)(*a*) read with s 9HA(2)
Household furniture and effects	500 000	800 000	300 000	(300 000)	-	para 53(1)
Yacht	300 000	200 000	(100 000)	100 000	-	para 15
Endowment policy	100 000	150 000	50 000	(50 000)	-	s 9HA(1)(*b*) read with para 55(1)(*a*)(i)
Second-hand endowment policy	200 000	300 000	100 000	(100 000)	-	para 62
Listed shares	600 000	900 000	300 000	-	300 000	
					400 000	

	R
Sum of capital gains and losses	400 000
Less: Annual exclusion	(300 000)
Aggregate capital gain	100 000
Taxable capital gain (40% × R100 000)	40 000

16.2.5 Pre-valuation date livestock

The base cost of pre-valuation date livestock is calculated in the normal way, using the time-apportionment, market value or '20% of proceeds' method. Although livestock could in certain circumstances conceivably qualify as identical assets, the weighted-average method may not be used for these assets, since it is reserved for listed shares, participatory interests in collective investment schemes, gold and platinum coins and listed s 24J instruments [para 32(3A)]. Livestock qualifying as identical assets must therefore be identified using the specific identification or first-in-first-out method.

Under s 26(2) a person who enters into a sheep lease is deemed to continue farming operations and must account for the livestock in question under the First Schedule. Paragraph 3(3) of the First Schedule deems any livestock which is the subject of a sheep lease to be held and not disposed of by the grantor of the sheep lease. The effect of this provision is to disregard the fact that in reality many of the original livestock may no longer be alive at the time when the sheep lease terminates (for example, when the grantor dies). If the sheep lease was entered into before the valuation date and expires on the death of the grantor after the valuation date, the livestock on hand at the date of the grantor's death will be regarded as pre-valuation date assets and the valuation date values may be determined using the market value on valuation date, time-apportionment base cost or '20% of proceeds' method.

16.2.6 Plantations and growing crops

Under common law, growing timber and crops accede to the land (*superficies solo cedit* – whatever is attached to the land forms part of it).

Plantations: Paragraph 14(1) of the First Schedule provides that any amount received by or accrued to a farmer in respect of the disposal of any plantation shall, whether such plantation is disposed of separately or with the land on which it is growing, be deemed not to be a receipt or accrual of a capital nature and shall form part of such farmer's gross income. However, to fall within para 14(1) the taxpayer must be a farmer. In *C: SARS v Kluh Investments (Pty) Ltd*[696] the respondent company had allowed another company to conduct plantation farming for that company's own account and that company's only obligation was to return the plantation intact when the agreement came to an end. Shortly afterwards the respondent sold the plantation to this company and at issue was whether the portion of the consideration relating to the plantation had to be included in the respondent's gross income under paragraph 14(1). The court held that paragraph 14 did not apply to the respondent because it was not carrying on farming operations. It did not have

- the right to the yield of the plantation;
- the use of the land and the plantation; or
- derive any income from it.

Except when an asset is bequeathed to a surviving spouse, s 9HA(1) deems the asset to be disposed of for an amount equal to its market value. It will therefore be necessary to split

[696] 2016 (4) SA 580 (SCA), 78 SATC 177.

that market value into its capital and revenue components in order to give effect to para 14(1) of the First Schedule.

Paragraph 14(2) of the First Schedule sets out how the allocation is to be made. It provides that When any plantation is disposed of by a farmer with the land on which it is growing, the amount to be included in the farmer's gross income under para 14(1) shall

- if the amount representing the consideration payable in respect of the disposal of the plantation is agreed to between the parties to the transaction, be the amount so agreed to; or

- failing such agreement, be such portion of the consideration payable in respect of the disposal of the land and the plantation as represents the consideration payable for the plantation. In such event, the executor must apportion the market value of the land and the plantation based on the relative market values of the respective assets on the date of death.

The portion representing the plantation must be included in the deceased's gross income while the portion relating to the land will represent a receipt or accrual of a capital nature, assuming the farm was held on capital account, and thus form part of proceeds under para 35.

Growing crops: When a farm property is disposed of on a going-concern basis, there is no requirement to include the value of any growing crops in gross income, except when the sale agreement specifies an amount in respect of those crops.[697] The result is that the value of the crops is simply treated as part and parcel of the value of the land and is an amount of a capital nature.[698] The same treatment applies on death, and the value of the standing crops will simply be included in the market value of the farmland and will form part of the proceeds on disposal of the farmland on date of death under s 9HA(1).

16.2.7 Usufructs created on death

Usufructs created on the death of a person must be valued under para 31(1)(*d*). This valuation involves determining the present value of the annual right of use at 12% a year over the expected life of the person receiving the benefit, or when the right of enjoyment is a lesser period, over that lesser period. Under para 31(2) the Commissioner can determine a percentage other than 12% upon being satisfied that the usufruct could not reasonably be expected to produce an annual yield of 12%. Typically listed shares tend to produce a dividend yield of only 2 to 3%. See *C: SARS v Klosser's Estate,*[699] an estate duty case in which the court upheld the Commissioner's use of an annual yield of 2,5% for listed shares. The court held that the Commissioner was required to make predictions as to the future yield and that these could be based only on facts which included the yield at the time of death and in the past. The Commissioner had invited the taxpayer to provide statistics of the yield over the past three years but the taxpayer had not responded to the request. The court also rejected the taxpayer's argument that the assets could be subject to change in future because no evidence to this effect had been adduced. In the result the court upheld the Commissioner's use of an annual yield of 2,5% for the listed share portfolio.

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[697] See 'Farming – Growing Crops, Sale of' *Income Tax Practice Manual* [online] (My LexisNexis: June 2015) at [A:F15].

[698] *Baikie v CIR* 1931 AD 496, 5 SATC 193.

[699] 2000 (4) SA 993 (C), 63 SATC 93.

Paragraph 31(2) prescribes the method for determining the market value of a usufruct.

A part-disposal will be triggered in the hands of the deceased person when a usufruct is bequeathed to a surviving spouse. The usufruct portion of the part-disposal will qualify for roll-over treatment under s 9HA(2) (see **16.2.10**).

See **24.1.1** for a more detailed explanation and a number of examples dealing with usufructs.

16.2.8 Annual exclusion in year of death

Under para 5(2) the annual exclusion of a deceased person in the year of death is R300 000 (2013 to 2018); R200 000 (2012); R120 000 (2008 to 2011), R60 000 (2007) and R50 000 (2006 and earlier years of assessment). 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. It is not subject to apportionment even when the period of assessment is less than a year. For more on the annual exclusion see **5.3.**

16.2.9 Small business asset relief

Under para 57 a deceased person may qualify for relief from CGT on capital gains adding up to R1,8 million (2013 to 2018); R900 000 (2012); R750 000 (2007 to 2011); R500 000 (2006 and earlier years of assessment) in respect of the disposal of small business assets. Death is listed as a qualifying disposal event in para 57(2). This amount is a once-in-a-lifetime concession, and will be unavailable on a person's death if the concession had already been fully used during the person's lifetime. In order to qualify for the exclusion, all qualifying assets must be realised within a period of 24 months commencing with the first disposal. This requirement will be met if all qualifying assets are disposed of on the date of death under s 9HA, or if the first qualifying disposal occurred within the 24 months preceding the date of death. The market value of all the assets of the small business may not exceed R10 million.

The small business asset relief must be determined on an asset-by-asset basis. Under para 57(2) the asset must have been held for a continuous period of at least five years before disposal. It will therefore be necessary for the executor to determine when each asset held on the date of death was acquired by the deceased. If any small business asset was acquired within the five years preceding the date of death, it must be excluded from consideration for the exclusion. See **12.6 – Disposal of small business assets on retirement**.

16.2.10 Assets transferred to a surviving spouse [s 9HA(2)]

Section 9HA(2) applies when assets are transferred by a deceased person to a surviving spouse who is a resident by

- testamentary succession or *ab intestato*;
- as a result of a redistribution agreement between the heirs and legatees of that person in the course of liquidation or distribution of the deceased estate of that person; or
- in settlement of a claim arising under s 3 of the Matrimonial Property Act 88 of 1984.

In each of these situations the assets of the deceased transferred to the resident surviving spouse are subject to roll-over treatment under s 9HA(2)(*b*) read with s 25(4). Importantly, the roll-over treatment does not apply if the surviving spouse is a non-resident. From a policy point of view, the *fiscus* would be prejudiced if such a roll-over were permissible, since a non-resident spouse is taxable only on the limited range of assets listed in para 2(1)(*b*). It would therefore not make sense to allow unrealised gains to roll over to a non-taxable person.

It is a requirement under s 9HA(2)(*a*) for the roll-over to apply that the surviving spouse must 'acquire' the relevant assets. Such an acquisition would occur if the surviving spouse acquired ownership or beneficial ownership in the assets.

If the deceased's last will and testament provides that the deceased's assets are to be disposed of to a testamentary *bewind* trust for the benefit of a surviving spouse, the roll-over treatment under s 9HA(2) and s 25(4) will apply, since under such a trust the surviving spouse would be the owner of the relevant assets. The same treatment would apply to assets bequeathed to a vesting trust for the benefit of the surviving spouse provided that the surviving spouse has beneficial ownership in the assets concerned. Caution needs to be exercised when determining whether a trust asset has in fact vested in a beneficiary. In some cases the beneficiary may have a right to trust capital as opposed to a right in an individual asset and a right to trust capital may not necessarily equate to a vested interest in a trust asset. Rather, such a right may merely represent a right to the residue of the trust at a future date (see **14.11.5.3**).

Assets bequeathed to a surviving spouse under the deceased's last will and testament which are disposed of by the executor to a third party before the liquidation and distribution account has become final do not qualify for roll-over treatment under s 9HA(2) because they are not acquired by the surviving spouse.

The words '*ab intestato*' mean 'from a person dying intestate' which results in the deceased's assets devolving upon the heirs according to the law of intestate succession.[700]

Section 2C of the Wills Act 7 OF 1953 provides that a benefit to which a descendant (other than a minor child or mentally Ill descendant) of the deceased was entitled under a will will vest in the surviving spouse if the surviving spouse is entitled to a benefit under the will and the descendant renounces his or her right to the benefit. This provision is replicated in s 1(6) of the Intestate Succession Act 81 of 1987. Section 1(4)(*b*) of the latter Act provides that in applying s 1 the term 'intestate estate' includes any part of an estate which does not devolve by virtue of a will. It follows that an asset obtained by the surviving spouse in this manner is treated as having been acquired *ab intestato* and will therefore qualify for roll-over relief under s 9HA(2) read with s 25(4).

Under testamentary succession assets are bequeathed under a valid last will and testament. Roll-over relief does not apply to the transfer of an asset from the deceased estate to a surviving spouse in satisfaction of a maintenance claim by the surviving spouse under s 2 of the Maintenance of Surviving Spouses Act 27 of 1990 since such a claim does not arise by testamentary succession.

Under a redistribution agreement the heirs can agree to redistribute the assets of the estate amongst themselves. Heirs receiving assets worth more than what they originally inherited may, under the agreement, have to pay in the difference to the estate. The liquidation and distribution account will reflect the effect of the redistribution agreement and it will therefore be possible to finalise the CGT consequences for the deceased person and the surviving

[700] Intestate Succession Act 81 of 1987.

spouse only once the account has lain open for inspection for the prescribed period without objection having been lodged against it.[701] See **16.4.7** for more on redistribution agreements.

The Matrimonial Property Act 88 of 1984 makes the accrual system automatically applicable to a marriage out of community of property unless its application is specifically excluded in the antenuptial contract.[702] Under the accrual system a claim will arise on death in the hands of one spouse against the other for the difference in growth of the estates of the spouses,[703] For example, if the growth in value of spouse A's estate during the marriage is R100, and the growth in value of spouse B's estate is R50, spouse B will have a claim of R25 against spouse A on dissolution of the marriage.

The accrual system does not result in a splitting of capital gains and losses between spouses. A capital gain or loss on disposal of an asset by a person married out of community of property must be accounted for by the spouse that owns the asset. A claim under the accrual system arises only on death or divorce of a spouse[704] or under an order of court.[705] It does not affect the tax treatment of the spouses during the subsistence of the marriage or even on its termination. It is a claim for a sum of money, not a pre-existing entitlement to specific assets or income of the other spouse. The accrual claim is thus contingent on death or divorce and its quantum also depends on the value of the estates of the spouses at the time of those events. It might happen, for example, that gains accumulated earlier in a marriage are later lost or expended. It does not therefore have any impact on the incidence of an accrual of an amount of gross income or proceeds on disposal of an asset.

When assets of the deceased person are given to the surviving spouse in settlement of an accrual claim arising on death under s 3 of the Matrimonial Property Act, the transfer of such assets will be subject to roll-over treatment under s 9HA(2) read with s 25(4).

In each of the above situations, under s 9HA(2)(b) the deceased spouse is treated as having disposed of the asset for an amount received or accrued equal to, in the case of

- trading stock, or livestock or produce contemplated in the First Schedule, the amount that was allowed as a deduction in respect of that asset for purposes of determining that person's taxable income, before the inclusion of any taxable capital gain, for the year of assessment ending on the date of that person's death; or
- any other asset, the base cost of that asset, as contemplated in the Eighth Schedule, as at the date of that person's death.

The purpose of this rule is to place the deceased person in a tax-neutral position, avoiding a net income gain or loss on the disposal of trading stock, livestock or produce, a recoupment under s 8(4)(*a*) on the disposal of allowance assets or any capital gain or capital loss on the disposal of assets other than trading stock, livestock or produce. With trading stock, livestock and produce, the consideration is equal to the amount allowed as a deduction in the year of

701 Section 35(12) of the Administration of Estates Act 66 of 1965.
702 Section 2 of the Matrimonial Property Act 88 of 1984.
703 Section 3 of the Matrimonial Property Act 88 of 1984.
704 Section 3 of the Matrimonial Property Act 88 of 1984.
705 Under s 8 of the Matrimonial Property Act 88 of 1984 the court can order the division of the accrual of the estate of a spouse if that spouse's conduct is seriously prejudicial to the other spouse's ultimate accrual claim on dissolution of the marriage [s 8(1)]. The court can also exclude the accrual system completely [s 8(2)].

death. Amounts claimed in earlier years are ignored. For example, if a farmer acquired a bull for R100 000 in year 1 and claimed a deduction of R100 000 under s 11(*a*) in that year, and died in year 3 still holding the bull, the deduction at the beginning of year 3 would be equal to the standard value of the bull of R50 included in opening stock, and this amount would comprise the deemed consideration for the deceased person. Under the one-and-the-same-person principle in s 25(4), the surviving spouse would be deemed to have acquired the bull for R50, since the amount of R100 000 had already been claimed by the late spouse and the same amount cannot be claimed by both persons. However, there would be no CGT consequences for the surviving spouse, since the opening stock would be eliminated from base cost under para 20(3)(*a*).

Example – Disposal of assets to surviving spouse by deceased person

Facts:

Irvine died leaving his holiday home to the value of R750 000 acquired at a cost of R80 000 to his wife Janice. The remainder of his assets, none of which qualified for any exclusions, were acquired by him at a cost of R500 000 and were valued at R1,2 million at the time of his death.

All assets were acquired after the valuation date.

Result:

Under s 9HA(1) Irvine is treated as having disposed of the assets not left to Janice for proceeds of R1,2 million as at the date of his death resulting in a capital gain of R700 000 (R1 200 000 proceeds – R500 000 base cost).

Under s 9HA(2)(*b*)(ii) Irvine is treated as having disposed of the holiday home bequeathed to Janice for proceeds of R80 000, resulting in neither a capital gain nor a capital loss. under s 25(4) Janice is deemed to have acquired the holiday home at a cost of R80 000 and must use that figure in determining the base cost of the holiday home when she ultimately disposes of it.

Assets inherited from a spouse before valuation date

The predecessor to s 9HA(2), namely,, para 67(2), did not apply when a surviving spouse inherited an asset from his or her spouse before valuation date. In such a case there was no roll-over of expenditure or dates of acquisition and incurral from the deceased spouse to the surviving spouse under the previous roll-over provisions of para 67. There are several reasons for this result. First, under para 67(2)(*a*) the deceased was deemed to have *disposed of* his or her assets to his or her spouse for the purposes of para 67(1). Under para 2, the Eighth Schedule applies only to disposals on or after the valuation date, and this included a deemed disposal under para 67(2)(*a*). Secondly, para 97 applied to disposals between spouses during the transitional period, which implies that para 67(2)(*a*) did not apply retrospectively. Finally, there is a general presumption against the retrospective interpretation of a statute (see **1.2.7)**. Since para 67(2)(*a*) does not apply, the cost and date of acquisition must be ascertained from the facts. It is submitted that the time of acquisition in most cases is the date on which the survivor became unconditionally entitled to the asset. In most cases this would be the date on which the liquidation and distribution account became final under s 35(12) of the Administration of Estates Act. The cost of acquisition must be determined in accordance with common law principles taking into account the extinction of the personal right to claim delivery – see **8.5A**. Usually 'B' in the time-apportionment formula will be equal to the market value of the asset at the time of its acquisition by the transferee spouse. 'N', being the number of years before the valuation date will be determined from the actual date of acquisition described above, and not from the date on which the deceased spouse acquired the asset.

16.3 The deceased estate

16.3.1 Acquisition of assets by deceased estate from deceased person [s 25(2)]

Except for an asset bequeathed to a surviving spouse, the deceased estate is treated as having acquired an asset from the deceased person for an amount of expenditure incurred equal to the market value contemplated in para 31 of the asset as at the date of death of the deceased person.

An asset bequeathed to a surviving spouse is treated as having been acquired by the deceased estate for an amount of expenditure incurred equal to

- trading stock, or livestock or produce contemplated in the First Schedule, the amount that was allowed as a deduction in respect of that asset for purposes of determining that person's taxable income, before the inclusion of any taxable capital gain, for the year of assessment ending on the date of that person's death; or
- any other asset, the base cost of that asset, as contemplated in the Eighth Schedule, as at the date of that person's death.

The deemed acquisition rule in s 25(2) must be read with the deemed disposal rule in s 25(3)(*a*), which together provide for a tax-neutral transfer of assets from the deceased estate to heirs or legatees, including a surviving spouse.

16.3.2 Assets disposed of to third parties during the winding-up period

Section 25(1) provides that the following amounts must be treated as income of the deceased estate of the deceased person

- any income received by or accrued to or in favour of any person in his or her capacity as the executor of the estate of a deceased person.
- Any amount received or accrued as contemplated in the above bullet point which would have been income in the hands of that deceased person had that amount been received by or accrued to or in favour of that deceased person during his or her lifetime.

The second bullet point will be relevant when determining the capital or revenue nature of amounts received by or accrued to the deceased estate from the disposal of assets. For example, if the estate disposes of livestock or produce and the deceased carried on farming operations, the amounts realized by the estate on disposal of the livestock or produce will be included in its gross income irrespective of whether it can be argued that the estate is not carrying on farming operations.

The deceased estate is a separate person for tax purposes[706] and is required to account for all income and capital gains and losses during the winding-up period. The executor must account for all income and capital gains and losses up until the liquidation and distribution account becomes final. For commentary on determining the date on which the account becomes final, see **16.4.1** under the heading 'Time of acquisition'.

Example – Determination of taxable capital gain of deceased estate

Facts:

Richard Spectre died on 31 August 2016. Under his will the following assets were not bequeathed to specific heirs and his executor, Argie Bargie, proceeded to dispose of them over two years of assessment.

2017 year of assessment

Household furniture and effects with a base cost of R800 000 were sold for R850 000.

Listed shares with a base cost of R900 000 were sold for R980 000.

2018 year of assessment

Richard's primary residence with a base cost of R3,1 million was sold for R3,3 million.

The yacht was acquired by the estate from Richard at a base cost of R200 000 and sold for R250 000. In order to realise a better price for the yacht, Argie Bargie had the navigation equipment upgraded at a cost of R5 000. .

Result:

The taxable capital gain of Richard's estate will be determined as follows:

2017 year of assessment

	Proceeds	Base cost	Capital gain
	R	R	R
Household furniture and effects	850 000	800 000	50 000
Listed shares	980 000	900 000	80 000

The household furniture and effects are personal-use assets and any capital gain or loss on their disposal would have had to be disregarded in Richard's hands under para 53. Accordingly, the capital gain in his estate will also be disregarded under para 40(3).

The estate will be liable for CGT on the listed shares, calculated as follows:

	R
Capital gain	80 000
Less: Annual exclusion	(40 000)
Aggregate capital gain	40 000
Inclusion rate	40%
Taxable capital gain	16 000

[706] See para (*b*) of the definition of 'person' in s 1(1). The executor is the 'representative taxpayer' as defined in s 1(1) under para (*e*) of that definition in relation to the deceased person and his or her estate.

2018 year of assessment

	Proceeds	Base cost	Capital gain
	R	R	R
Primary residence	3 300 000	3 100 000	200 000
Yacht	250 000	205 000	45 000

The capital gain on the disposal of the primary residence must be disregarded, since it is covered by the primary residence exclusion of R2 million.

The base cost of the yacht is its market value on Richard's death (R200 000) plus the R5 000 spent on upgrading it. The taxable capital gain on disposal of the yacht is calculated as follows:

	R
Capital gain	45 000
Less: Annual exclusion	(40 000)
Aggregate capital gain	5 000
Inclusion rate	40%
Taxable capital gain	2 000

16.3.3 Assets disposed of to heirs or legatees [s 25(3)(a)]

Under s 25(3)(*a*) the deceased estate is treated as having disposed of an asset to an heir or legatee for an amount received or accrued equal to the amount of expenditure incurred by the deceased estate in respect of that asset. The purpose of this rule is to ensure that the deceased estate does not suffer an income gain or loss on the disposal of trading stock, livestock or produce and that it does not incur a capital loss or derive a capital gain on assets other than trading stock, livestock or produce. This rule also applies to assets transferred to a surviving spouse, since such surviving spouse would also be an heir or legatee.

16.3.4 Deceased estate treated as natural person [s 25(5) and para 40(3)]

A deceased estate must, other than for the purposes of s 6 (normal tax rebates), s 6A (medical scheme fees tax credit) and s 6B (additional medical expenses tax credit), be treated as if that estate were a natural person. Thus a deceased estate will be taxed on the same sliding scale as a natural person and will enjoy the interest exemption under s 10(1)(i)(ii) of R23 800. While the deceased estate is treated as a natural person, it is not deemed to be the same natural person as the deceased person. Thus any assessed loss (s 20) or assessed capital loss (para 9) existing at the time of death will be forfeited and not carried over to the deceased estate. The deceased estate and the deceased person are not deemed to be one and the same person, unlike the position with an insolvent estate and the person before sequestration under s 25C.

Paragraph 40(3) contains a similar but more specific rule. It provides that for the purposes of the Eighth Schedule, the disposal of an asset by the deceased estate of a natural person shall be treated in the same manner as if that asset had been disposed of by that natural person. This deeming provision means that the deceased estate will be entitled to the various exclusions and inclusion rate applicable to natural persons.

The estate will, in particular, be entitled to an annual exclusion (2017 and 2018: R40 000; 2016: R30 000) in the year in which it comes into existence, that is, in its first year of assessment commencing on the day after the date of death and ending on the last day of February (or date of finalisation of the estate if earlier). The annual exclusion is not apportioned in the first or last year of assessment of the estate, even though the period of assessment may be less than a year.

Under para 48(*d*) a primary residence held by a deceased estate is treated as being ordinarily resided in by the deceased person for a maximum period of two years after the date of death. Should the executor take longer than two years to dispose of the residence, the period exceeding two years will not qualify as a primary residence, and the gain or loss must be apportioned. 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 – see **11.7.4**.

The deceased estate is not entitled to any unused portion of the small business asset exclusion of R1,8 million in para 57 because it would not have held the assets for at least five years, having acquired them from the deceased person on date of death. In this regard, while the deceased estate is treated as having disposed of an asset in the same manner as the deceased person, it is not treated as having acquired it on the same date as the deceased person. In addition, the date of acquisition of an asset by the deceased person is not carried over to the deceased estate.

The deceased estate is entitled to disregard any capital gain or loss under para 53 for the disposal of any personal-use assets, that is, assets used mainly for purposes other than carrying on a trade. Typical examples include furniture, household appliances, private motor vehicles and stamp collections. However, para 53(3) excludes specified assets from qualifying as personal-use assets. These excluded assets include among others, gold and platinum coins whose value is mainly attributable to their metal content, immovable property and large boats and aircraft, financial instruments, usufructs and fiduciary interests.

16.3.4 Pre-valuation date estates

Reading para 2 with para 40(1) it is evident that para 40(1) dealt only with disposals occurring on or after the valuation date.

The notion that valuations can be carried out retrospectively for an unlimited period also conflicts with the whole scheme of the Eighth Schedule. See in this regard the commentary in **9.4** on para 38, which also applies prospectively. When a person has died before the valuation date and the estate is not finalised by that date, the executor will be regarded as having acquired the assets for an expenditure of nil. In these circumstances the executor should have considered determining a market value as at 1 October 2001 in respect of the assets acquired before 30 September 2004.[707] The need for the executor to determine a valuation would have been unnecessary for South African-listed shares, South African unit trusts, South African-listed warrants and agricultural and financial futures. The prices of these assets were published in the Government Gazette and are therefore established. An executor who has failed to value assets whose prices were not published in the Gazette must resort to the time-apportionment or '20% of proceeds' method.

[707] Paragraph 29(4)(*a*) contains the cut-off date for performing valuations.

16.3.5 Deceased estate of a non-resident

When a non-resident dies leaving South African assets, it will be necessary for the Master to appoint an executor to wind up the South African portion of the estate.

Under para 2(1)(*b*) a non-resident is liable to CGT only on the disposal of

- immovable property situated in South Africa held by that person or any interest or right of whatever nature of that person to or in immovable property situated in South Africa including rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources; and
- any asset effectively connected with a permanent establishment of that person in South Africa.

Under para 2(2) the term 'interest in immovable property' includes other interests such as shares in a company holding immovable property in South Africa if the shareholder owns at least 20% of the shares and 80% or more of the value of the shares is directly or indirectly attributable to immovable property in South Africa (excluding trading stock).

A non-resident who dies holding the above assets will accordingly be deemed to dispose of them under s 9HA(1) and his or her deceased estate will be deemed to acquire them under s 25(2).

Thus, for example, the deceased estate of a non-resident would potentially be liable for CGT on post-death growth in value on the disposal of a holiday home in South Africa, whether held under freehold, sectional title or by means of an interest in a share block company. If the holiday home were held in a company (assuming it to be the company's only asset)and the deceased estate holds at least 20% of the shares, the sale of the shares by the executor will also potentially attract CGT on any growth in the value of the shares after date of death.

By contrast, the deceased estate of a non-resident will not be liable for CGT on the disposal of an asset falling outside para 2(1)(b) for at least two reasons. First, such an asset would not have been deemed to have been disposed of by the deceased person under s 9HA(1) and hence could not be acquired by the deceased estate under s 25(2)(*a*). Secondly, the disposal would be governed by para 40(3) .

Under para 40(3) the deceased estate of a natural person must be treated in the same manner as if that asset had been disposed of by that natural person. In other words, the deceased estate of a non-resident must be treated in the same manner as if that deceased estate were also a non-resident.

The provisions of any tax treaty applicable to the deceased person should also be considered to determine whether South Africa's taxing rights have been excluded in relation to para 2(1)(*b*) assets. For example, the tax treaty with the United Kingdom grants the country of residence an exclusive taxing right in respect of listed shares, even if held in a land-rich company.

16.4 Heirs or legatees

16.4.1 Acquisition of assets by heirs or legatees [s 25(3)(b)]

Under s 25(3)(*b*) an heir or legatee is treated as having acquired an asset for an amount of expenditure incurred equal to the expenditure incurred by the deceased estate in respect of the asset.

Such expenditure can be divided into two categories, namely,

- expenditure deemed to be incurred by the deceased estate under s 25(2) in acquiring an asset from the deceased person; and
- expenditure actually incurred or deemed to be incurred by the deceased estate under some other provision (not addressed in s 25 but under the core rules).

Assets acquired from the deceased person [s 25(2)]

For an heir or legatee other than a surviving spouse, the expenditure incurred by the deceased estate in respect of an asset acquired from the deceased person is the amount referred to in s 25(2)(*a*), which in turn refers to the amount in s 9HA(1). That amount is equal to the market value of the asset contemplated in para 31 on date of death.

In determining the base cost of assets acquired by a surviving spouse, a distinction needs to be drawn between

- assets formerly owned by the deceased person; and
- assets acquired by the deceased estate which were not owned by the deceased person.

For an asset acquired from the deceased person, a surviving spouse is not governed by the general acquisition rule in s 25(3)(b) but is rather subject to roll-over treatment under the more specific provisions of s 25(4). Were s 25(3)(b) to be followed, the incorrect result would be obtained. For example, assume that the deceased acquired an asset before valuation date for R100. The deceased is deemed under s 9HA(2)(b) to dispose of the asset at its 'base cost' at the date of death. Such a hypothetical 'base cost' may well be indeterminable because in order to determine the valuation date value for a pre-valuation date asset using the time-apportionment or '20% of proceeds' method, it is necessary to know the amount of the proceeds. Even assuming it was possible to use market value, it would mean that the estate was deemed to acquire the asset for expenditure equal to that market value, and that expenditure would then become the surviving spouse's expenditure, which would conflict with the expenditure roll-over rule in s 25(4).

For an asset acquired by the deceased estate other than from the deceased person, a surviving spouse must, like any other heir or legatee, follow s 25(3)(*b*) and take over the expenditure of the deceased estate in respect of the asset. This issue is discussed in more detail below.

Expenditure incurred by executor after date of death

It may happen that an executor will acquire further assets during the winding-up period which were not owned by the deceased person at the date of death. Such assets could take the form of purchased assets, assets acquired by distribution *in specie* or as a capitalisation share. The executor may also incur further expenditure on assets acquired from the deceased person, such as improvement expenditure under para 20(1)(*e*) or one-third of the interest on monies borrowed to purchase listed shares or collective investments under para 20(1)(*g*). Such expenditure incurred on assets awarded to heirs or legatees (including a surviving spouse) will be taken over by those heirs or legatees under s 25(3)(*b*).

The base cost of shares acquired by the estate as a distribution in specie from an existing share portfolio must be determined in accordance with the applicable base cost rule. For instance, shares received as a distribution in specie have a base cost equal to market value under para 75(1)(*b*). However, if such shares are acquired as a result of an unbundling transaction under s 46, it will be necessary for the executor to allocate some of the base cost of the unbundling company shares held on date of death to the unbundled company shares, and in that event para 75(1)(b) will be inapplicable. Capitalisation shares received by the deceased estate will have a base cost of nil under s 40C. In such instances, it is imperative to establish the exact nature of the underlying transaction so that the applicable base cost rules can be applied. Although applying the appropriate base cost rule will not impact on the estate when the assets are awarded to heirs or legatees because of the no gain or loss treatment afforded to the deceased estate under s 25(3)(*a*), it will be of importance to the heirs or legatees in establishing the base cost of their inherited assets under s 25(3)(b).

Time of acquisition

The exact date on which an heir or legatee acquires an asset from the deceased estate can be of importance, for example, under s 9C(2) for the purpose of determining whether a share has been held by an heir or legatee for at least three years and is thus on capital account. Section 25(3)(b) does not contain a time of acquisition rule and reliance must therefore be placed on common-law principles for determining the time of acquisition of an inherited asset. The position of a surviving spouse acquiring an asset from the deceased is, however, different since s 25(4)(b)(i) carries over the date of acquisition of an asset from the deceased to a surviving spouse.

It is submitted that the deceased estate disposes of an asset to an heir or legatee (other than the surviving spouse) on the date on which the heir or legatee becomes unconditionally entitled to the asset. An heir or legatee becomes so unconditionally entitled when the liquidation and distribution account becomes final. An heir will not necessarily be entitled to all assets reflected in the account. For example, an heir will not be entitled to an asset that must be used to settle a creditor's claim. In the latter event the asset remains the property of the deceased estate until it is disposed of in order to settle the creditor's claim.

The liquidation and distribution account is required to lie open for a period not less than 21 days for inspection by any person interested in the estate.[708] This period must be stipulated by the executor in the Government Gazette and in one or more newspapers circulating in the district in which the deceased was ordinarily resident.[709]

The estate becomes distributable after the period stipulated in the notice assuming no objection has been lodged against the account, and it is at this point that the account

[708] Section 35(4) of the Administration of Estates Act 66 of 1965.
[709] Section 35(5)(*a*) of the Administration of Estates Act 66 of 1965.

becomes final.[710] Until the liquidation and distribution account is confirmed, no dominium in any asset vests in an heir or legatee.[711]

Should objection be lodged against the account, the date on which an heir becomes entitled to an estate asset will depend on the facts. For example, if the objection is sustained and the revised liquidation and distribution account lies open for inspection for a further 21 days, the account will become final after that period assuming no further objection has been lodged against the revised account. If the Master dismisses the objection and the aggrieved party applies to court to have the Master's decision set aside, the account will become final only when the court process is completed.

On the reckoning of the 21-day period, s 4 of the Interpretation Act 33 of 1957 provides as follows:

> '**4. Reckoning of number of days.—**When any particular number of days is prescribed for the doing of any act, or for any other purpose, the same shall be reckoned exclusively of the first and inclusively of the last day, unless the last day happens to fall on a Sunday or on any public holiday, in which case the time shall be reckoned exclusively of the first day and exclusively also of every such Sunday or public holiday.'

Thus, if the account was advertised in the Gazette on Tuesday 3 January 2017, the period of 21 days will end at midnight on Tuesday 24 January 2017. The heir or legatee will thus acquire the asset on 25 January 2017, even if it is actually distributed after that date.

Stipulation in will that assets must be realised

Should the will state that the assets of the deceased are to be sold and the proceeds distributed amongst a number of heirs, and one of those heirs agrees to take over a specific asset in part or full settlement of his or her share, s 25(3)will still apply. The estate will dispose of the asset at neither a gain nor a loss, and the heir will acquire the asset at an amount equal to the expenditure incurred or deemed to be incurred by the deceased estate. Should a surviving spouse elect to take such an asset instead of a cash award, the asset will be subject to roll-over treatment under s 25(4), assuming it was owned by the deceased.

Bequest price

An heir acquiring an asset from a deceased estate in return for agreeing to take over a liability of the estate, or on condition of accepting a future obligation, must disregard that liability or obligation for purposes of determining the base cost of the asset. The need to disregard such a liability follows from s 25(3)(*b*), which deems the expenditure in respect of the acquisition of the asset to be the expenditure incurred by the deceased estate.

Example 1 – Inheritance of asset subject to acceptance of liability

Facts:

Mary's late father's estate comprised a house with a market value on date of death of R500 000. The house was bonded to the extent of R450 000. Mary informed the executor that she was willing to take over the bond. With the bank's consent, the house was awarded to Mary by the executor.

[710] Section 35(12) of the Administration of Estates Act 66 of 1965.
[711] ITC 816 (1955) 20 SATC 496 (T) at 498; *Greenberg & others v Estate Greenberg 1955* (3) SA 361 (A) at 366; *CIR v Estate CP Crewe & another* 1943 AD 656, 12 SATC 344 at 377.

Result:

Under s 25(3)(*b*) the base cost of the house in Mary's hands is deemed to be R500 000. The fact that she will have to repay the bond of R450 000 is not taken into account.

Example 2 – Acceptance of asset subject to future obligation

Facts:

Under the last will and testament of his late father, Jimmy inherited the family farm subject to the condition that he pays an annuity of R60 000 a year to his mother for the remainder of her life. The farm had a market value on date of death of R2 million disregarding the annuity obligation.

Result:

Under s 25(3)(*b*) the base cost of the farm in Jimmy's hands is deemed to be R2 million. Jimmy will not be entitled to add the cost of the annuity to the base cost of the farm. While the R60 000 a year cost to Jimmy is a cost to him of acquiring the farm, s 25(3)(*b*) takes precedence and is the sole and exclusive mechanism for determining the para 20 acquisition cost of the farm, and any actual acquisition costs incurred by Jimmy must be disregarded. Paragraph 21 will also prevent any double deduction. Jimmy's mother will be taxed on the annuity under para (*a*) of the definition of 'gross income'.

16.4.2 Asset transferred directly to heir or legatee [s 9HA(3)]

Section 9HA(3)[712] deals with the situation in which an asset is transferred directly from the deceased person to an heir or legatee instead of being routed through the deceased estate. Such a transfer can happen, for example, with certain second-hand or foreign endowment policies.

It provides that the heir or legatee must be treated as having acquired the asset for an amount of expenditure equal to the market value of the asset under para 31 as at the date of death of the deceased person.

16.4.3 Assets acquired by surviving spouse [s 25(4)]

Section 25(4) applies to an asset acquired by a surviving spouse of a deceased person as contemplated in s 9HA(2) for purposes of determining the amount of any

- allowance or deduction to which that spouse may be entitled or that is to be recovered or recouped by or included in the income of that spouse in respect of that asset; or
- the amount of any capital gain or capital loss in respect of a disposal of that asset by that spouse.

[712] The equivalent rule used to be contained in para 40(1A) and applied to persons dying before 1 March 2016.

Such a surviving spouse is treated as one and the same person as the deceased person and deceased estate with respect to

- the date of acquisition of that asset by that deceased person;
- any valuation of that asset effected by that deceased person as contemplated in para 29(4);
- the amount of any expenditure and the date on which and the currency in which that expenditure was incurred in respect of that asset
    - by that deceased person as contemplated in s 9HA(2)(*b*); and
    - by that deceased estate, other than the expenditure contemplated in s 9HA(2)(*b*);
- the manner in which that asset had been used by the deceased person and the deceased estate; and
- any allowance or deduction allowable in respect of that asset to the deceased person and the deceased estate.

The purpose of s 25(4) is to enable the surviving spouse to step into the shoes of the deceased person as regards the history of the asset. The roll-over of the dates of acquisition will be of relevance should the surviving spouse wish to use the time-apportionment method for determining the valuation date value of the inherited assets. It will also be of relevance when determining whether a share has been held for at least three years under s 9C.

16.4.4 Pre-valuation date inheritances

Paragraph 40(2) applied only to acquisitions by heirs on or after the valuation date because under para 2 the Eighth Schedule applies only to disposals on or after the valuation date, and this includes a deemed disposal under para 40(1).

Nevertheless, an asset acquired by inheritance before the valuation date will have an expenditure for the purposes of para 20 equal to its market value on the date on which it was unconditionally acquired – see **8.5A**. The presence of expenditure in respect of pre-valuation date inherited assets is relevant for the purposes of determining 'B' in the time-apportionment base cost formula. Other options for determining the valuation date value of inherited assets include the market-value and '20% of proceeds' methods.

An heir acquiring an asset from a pre-valuation date estate on or after the valuation date acquires it at the base cost of the estate. Under these circumstances the executor is regarded as having acquired the assets for an expenditure of nil, and unless that executor determined a market value before 30 September 2004 (for assets whose prices were not published in the Gazette), the heir may be faced with the prospect of taking over a nil base cost or, if the executor has incurred some post-valuation date expenditure, a low base cost from the estate.

A person who inherited an asset before valuation date from his or her spouse is not entitled to a roll-over of expenditure or dates of acquisition and incurral under para 67(1) (see **13.3.4**).

16.4.5 Assets acquired by inheritance from non-resident estates

The base cost of an asset acquired by an heir from a person who at the time of his or her death was not a resident must be determined under s 25(3)(*b*) if that asset is one contemplated in para 2(1)(*b*) (immovable property in South Africa or assets of a permanent establishment in South Africa), or

- para 20(1)(*h*)(v) in any other case.

Under para 20(1)(*h*)(v)[713] the base cost is equal to

- the market value of the asset immediately before the death of the person, and
- any expenditure contemplated in para 20 incurred by the executor in respect of the asset in the process of liquidation or distribution of the deceased estate.

16.4.6 Massed estates

Massing occurs when spouses draw up a joint will providing for the massing of their estates. It is sometimes prompted by the prohibition on the subdivision of agricultural land under the Subdivision of Agricultural Land Act 70 of 1970. Massing is governed by s 37 of the Administration of Estates Act 66 of 1965. Typically the surviving spouse will receive the usufruct over the deceased's assets in return for giving up the bare dominium in his or her own assets. The bare dominium given up by the survivor is dealt with by the executor as if it were an asset of the deceased. Upon adiation, the surviving spouse's share of the bare dominium is disposed of to the deceased estate.

The CGT consequences for the deceased spouse are governed by s 25(3)(b) and (4). As regards the deceased person, a capital gain or loss must be determined on the disposal of the bare dominium to the deceased estate under s 9HA(1), and the deceased will qualify for roll-over relief under s 9HA(2) in respect of the usufruct granted to the deceased's surviving spouse.

The base cost of the bare dominium disposed of by the deceased person to his or her estate must be determined under the part-disposal rules in para 33. The proportion of the expenditure and any market value on valuation date to be allocated to the usufruct is determined in accordance with the ratio that the market value of the usufruct on date of death bears to the market value of the total asset on the same date. The portion of the total expenditure and any market value on valuation date attributable to the bare dominium is the balance (that is, the total expenditure and any market value less the portion attributed to the usufruct).

Massing can result in a donation for donations tax purposes if the value of the usufruct received is less than the value of the bare dominium given up by the surviving spouse. However, this does not mean that para 38 will apply to the disposal by the surviving spouse to the deceased estate. First, a donation for the purposes of para 38 is something wholly gratuitous and the survivor usually receives the usufruct in return. Secondly, even if the proceeds do not represent an arm's length price, the surviving spouse and the deceased estate are not connected persons in relation to each other in respect of an asset disposed of

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[713] Under s 107(2) of the Revenue Laws Amendment Act 20 of 2006 para 20(1)(*h*)(v) came into operation as from the commencement of years of assessment ending on or after 1 January 2007.

by the surviving spouse to the estate. A surviving spouse will not be able to add any donations tax paid under para 20(1)(*c*)(vii) to the base cost of the assets disposed of unless a common law donation has been made (that is, no quid pro quo is received) and the market value of the asset exceeds the allowable para 20 expenditure excluding the donations tax (para 22). See **8.7**.

There is some uncertainty how the proceeds received by the surviving spouse in respect of the usufruct are to be determined. Likewise, there is uncertainty how the base cost of the bare *dominium* acquired from that surviving spouse must be determined by the deceased estate. It is submitted that the matter must be dealt with under the core disposal rules on the basis of a barter transaction. To the extent that the value of the usufruct received by the surviving spouse exceeds the value of the bare *dominium* given up, the excess will be regarded as pure inheritance not forming part of the barter transaction.

Example – Massed estates

Facts:

John and Jane were married in community of property in 1987 and entered into a joint will that provided for the massing of their estates. Under the will, Jane is to receive a usufruct over her remaining life in respect of the family farm while the bare *dominium* in the farm is to be left to the John Family Trust. The farm was acquired by the couples' joint estate at a cost of R1 million in 2010. John passed away on 30 January 2017, and Jane then adiated (accepted the terms of the joint will). At the time of her husband's death Jane would have been 65 at her next birthday. The market value of the farm on date of death was R5 million. Ignore the primary residence exclusion. What are the CGT implications for John and Jane?

Result:

John

Expectation of Jane's life according to Table A = 15,18 years

Present value of R1 a year for life: 6,841 61

Value of usufruct left to Jane:

R2 500 000 × 12% × 6,841 61 = R2 052 483.

Value of bare *dominium* left to John Family Trust = R2 500 000 – R2 052 483 = R447 517.

Base cost of bare *dominium* = R500 000 × R447 517 / R2 500 000 = R89 503

Capital gain = R447 517 – R89 503

= R358 014

Under s 9HA(1)(*a*) there is no disposal of the usufruct by John, since it is subject to roll-over treatment under s 9HA(2).

Jane

Jane has disposed of her share of the bare *dominium* in the farm which had a market value on the date of John's death of R447 517. She has received a usufruct with a market value of R2 052 483. Of this R447 517 represents proceeds under a barter transaction in respect of the bare *dominium* she has given up, while the balance (R1 604 966) represents pure inheritance.

Jane retains the usufruct portion of her share of the farm. She therefore has a capital gain, determined as follows:

	R
Proceeds	447 517
Less: Base cost	(89 503)
Capital gain	358 014

The base cost of Jane's usufruct is made up as follows:

Acquired from John's estate R500 000 – R89 503	410 497
Own portion retained	410 497
	820 994

When Jane passes away there will be a disposal of the usufruct under para 11(1)(*b*) without any proceeds (see **24.1.1**).

The John Family Trust

The John Family Trust acquires the bare *dominium* in the property from John's deceased estate at a base cost equal to the base cost in the estate [s 25(3)(*b*)]. The base cost of the bare *dominium* in the estate is made up as follows:

	R
Acquired from John	447 517
Acquired from Jane	447 517
	895 034

The base cost of the amount acquired from Jane is equal to the cost to the estate of awarding John's usufruct to Jane. In other words, it is similar to the result that would be obtained under a barter transaction under which the cost to each party is the market value by which that party's assets have been diminished.

Reconciliation

Assuming that the farm was disposed of to a third party immediately before John's death:

	R
Proceeds	5 000 000
Less: Base cost	(1 000 000)
Capital gain	4 000 000

Sum of capital gains assuming farm sold at market value on day after date of death

	R	R
John – bare *dominium*		358 014
Jane – bare *dominium*		358 014
Jane – assuming usufruct sold		
Proceeds R2 052 483 × 2	4 104 966	
Less: Base cost	(820 994)	
Capital gain	3 283 972	
John Family Trust		
Proceeds R447 517 × 2	895 034	
Less: Base cost	(895 034)	
No gain or loss	-	-
Total		4 000 000

16.4.7 Redistribution agreements

Heirs of full capacity may freely renounce, waive or dispose of their rights under a will.[714] They can agree to reshuffle the assets that were bequeathed to them under the will by entering into a redistribution agreement. Such a contractual arrangement can overcome the problem of co-ownership that might otherwise arise and enables heirs to agree among themselves on the assets they would like to inherit. Each heir that is a party to such an agreement must contribute something and receive something in exchange for the arrangement to constitute a redistribution agreement. The liquidation and distribution account will reflect the effect of the redistribution agreement.

In *Klerck NO v Registrar of Deeds*[715] the deceased had been married in community of property and bequeathed his half of the joint estate to his stepson. One of the assets in the estate comprised immovable property encumbered by a mortgage bond. The stepson agreed to take over the property and the debts of the estate and paid the surviving spouse an amount to equalize their positions. As a result of the bond and other debts in the estate the executor would have had to dispose of the immovable property in order to discharge the debts with the result that it would not have devolved upon the surviving spouse or heir. Since the immovable property would not have gone to the stepson or surviving spouse, there was no immovable property available for distribution to the surviving spouse which could then form part of a redistribution agreement. Clayden J stated that[716]

> ‘in every redistribution there must be involved sale, exchange, or donation between one heir and another, or between the heir and the surviving spouse. But the mere fact that a sale between two heirs or between an heir and the surviving spouse is entered into does not necessarily mean that a redistribution is brought about by that sale’.

Dowling J continued as follows:[717]

> ‘There is contemplated some sort of reshuffle of assets in the estate, which would in any case have passed to the heirs, in a way which departs in some respect from the actual disposition of the will or the normal course of devolution *ab intestato*.’

[714] *Bydawell v Chapman, NO & others* 1953 (3) SA 514 (A) at 523.
[715] 1950 (1) SA 626 (A).
[716] At 629. See also *Hoeksma & another v Hoeksma* 1990 (2) SA 893 (A).
[717] At 631.

In *Bydawell v Chapman*, NO & others[718] the court held that a family agreement cannot alter the terms of a will or the devolution of an estate. Beneficiaries may contract[719] to render to each other the fruits of the devolution, if and when they mature or accrue, but cannot alter the devolution by contract.

A family agreement or arrangement must be distinguished from a redistribution agreement. The former attempts to change the administration of an estate or the devolution under a will[720] while the latter deals with the assets which devolve upon each heir. The former is invalid while the latter is not, provided the necessary formalities are complied with.

Section 14(1)(*a*) of the Deeds Registries Act 47 of 1937 provides that

> 'transfers of land and cessions of real rights therein shall follow the sequence of the successive transactions in pursuance of which they are made, and if made in pursuance of testamentary disposition or intestate succession they shall follow the sequence in which the right to ownership or other real right in the land accrued to the persons successively becoming vested with such right'.

Section 14(1)(*b*) of the same Act then confirms that

> 'it shall not be lawful to depart from any such sequence in recording in any deeds registry any change in the ownership in such land or of such real right'

The proviso to s 14(1)(*b*) then makes an exception to this rule by stating that

> '(iii) if in the administration of the estate of a deceased person (including a fiduciary) any redistribution of the whole or any portion of the assets in such estate takes place among the heirs and legatees (including ascertained fidei-commissary heirs and legatees) of the deceased, or between such heirs and legatees and the surviving spouse, the executor or trustee of such estate may transfer the land or cede the real rights therein direct to the persons entitled thereto in terms of such redistribution'.

Section 14(2) provides as follows:

> '(2) In any transfer or cession in terms of any proviso to subsection (1)(*b*), there shall be paid the transfer duty which would have been payable had the property concerned been transferred or ceded to each person successively becoming entitled thereto.'

Despite s 14(2), the Transfer Duty Act provides an exemption in s 9(1)(*e*)(i) for an heir or legatee in respect of

> 'property of the deceased acquired by *ab intestato* or testamentary succession or as a result of a re-distribution of the assets of a deceased estate in the process of liquidation'.

While this exemption is unrelated to CGT, it is helpful in understanding that a real right in the inherited property first flows to the legatee to whom the testator bequeathed the property, and that real right is then disposed of by contractual arrangement under the terms of the redistribution agreement.

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[718] 1953 (3) SA 514 (A). See also (June 2013) 123 *TSH* 5 for extracts from other cases dealing with family agreements.

[719] Through the process of *Schichten en deelen* under Roman-Dutch law.

[720] *Starkey & others v McElligott & others* 1984 (4) SA 120 (D) at 130. See also *Greenberg & others v Estate Greenberg 1955* (3) SA 361 (A) at 377.

Redistribution agreement not involving a surviving spouse

In determining whether a redistribution agreement gives rise to a disposal, the position of an agreement that does not involve a surviving spouse will first be considered. Under these circumstances there are two disposals, namely,

- from the deceased estate to the heirs under s 25(3) in accordance with the will or the law of intestate succession; and
- from one heir to another in accordance with the terms of the redistribution agreement between the heirs.

Under s 25(3)(*b*) an heir acquires an asset from the deceased estate for an amount of expenditure incurred equal to the expenditure incurred by the deceased estate in respect of the asset. Generally such expenditure would be equal to the market value of the asset on the date of death but could also include post-death qualifying base cost expenditure incurred on the asset by the executor. Any redistribution of the assets of the deceased estate can occur only once the liquidation and distribution account has become final, for it is only at that point that the assets of the estate accrue to the heirs. In the latter regard in ITC 816 Faure Williamson J stated the following:[721]

> 'In the case of a deceased's estate the principle is quite clear that an heir or legatee has in fact no right to claim the payment of any amount at all until the confirmation of the liquidation and distribution account, except where special provision is made in a will to the contrary. Furthermore it is quite clear that until the liquidation and distribution account is confirmed no *dominium* in any asset or any right in the estate vests in an heir or legatee.'

The finalisation of the liquidation and distribution account represents a suspensive condition under a redistribution agreement and hence the time of disposal of assets by the parties to such an agreement is determined under para 13(1)(*a*)(i) as the date on which the condition is satisfied. The implication for an heir who enters into a redistribution agreement is that a capital gain or loss could arise if the market value of the asset being swapped has changed from the date of death. Paragraph 38 will apply to substitute market value for any consideration that does not represent an arm's length price between connected persons. This point is of importance because heirs are often relatives[722] in relation to one another and hence connected persons.

Heirs receiving assets worth more than what they originally inherited may, under the agreement, have to pay in the difference to the estate.

Donations tax may become payable if the parties do not receive full consideration for the assets being disposed of. A portion of such donations tax may qualify to be added to the base cost of the asset being disposed of or acquired (see **8.7** for donations tax paid by donor and **8.8** for donations tax paid by donee).

[721] (1955) 20 SATC 496 (T) at 498. See also *Greenberg & others v Estate Greenberg* 1955 (3) SA 361 (A) at 377 and *CIR v Estate CP Crewe & another* 1943 AD 656, 12 SATC 344 at 377.

[722] See definition of 'relative' in s 1(1) which treats as relatives persons related within the third degree of consanguinity. This definition must be read with para (*a*)(i) of the definition of 'connected person' in s 1(1).

Example 1 – Redistribution agreement not involving a surviving spouse

Facts:

During year 1 Bob died and bequeathed his estate to his two sons Jack and Darryl in equal shares. On the date of death the estate comprised 100 shares in XYZ Ltd worth R1 million (base cost: R200 000) and a bank balance of R1,1 million. The estate expenses amounted to R100 000 leaving cash of R1 million available for distribution.

During year 2 Jack and Darryl entered into a redistribution agreement. At the time the shares had grown in value to R1,2 million. Darryl agreed to exchange his 50 shares worth R600 000 in return for a cash payment of R600 000. Jack paid R100 000 of his own funds into the estate to facilitate the transaction. During year 3 the liquidation and distribution account became final. It reflected that Jack was to receive 100 shares while Darryl was to receive R1,1 million.

Result:

Bob

Bob is deemed to have disposed of the 100 shares for proceeds determined under s 9HA(1) of R1 million resulting in a capital gain of R800 00 (proceeds of R1 million less base cost of R200 000). The disposal of Bob's bank account at face value results in neither a capital gain nor a capital loss.

Darryl

When the liquidation and distribution account becomes final, Darryl will dispose of his 50 shares acquired by inheritance with a base cost of R500 000 determined under s 25(3)(*b*) in return for cash proceeds of R600 000. Darryl will thus realise a capital gain of R100 000 (proceeds of R600 000 less base cost of R500 000).

Jack

When the liquidation and distribution account becomes final, Jack will acquire the 100 shares at a base cost of R1,1 million comprising

- R500 000 for 50 shares acquired from the deceased estate determined under s 25(3)(*b*); and
- R600 000 for 50 shares acquired from Darryl being the expenditure actually incurred under para 20(1)(*a*). In other words, this amount was paid out of R500 000 in cash acquired from the deceased estate by inheritance and R100 000 paid out of Jack's own resources.

Bob's deceased estate

Under s 25(2)(*a*) Bob's deceased estate is deemed to acquire the 100 shares at a base cost of R1 million. In accordance with Bob's will these shares are disposed of to Jack and Darryl in equal shares for proceeds equal to the base cost of the estate under s 25(3)(*a*) resulting in neither a capital gain nor a capital loss. The fact that 50 of the shares were simultaneously disposed of by Darryl to Jack under a contractual arrangement which the executor gave effect to does not affect the deceased estate.

The estate acquired its bank account from Bob for a base cost of R1,1 million under s 25(2)(*a*). The executor settled the estate expenses of R100 000 thus reducing the base cost of the estate's bank account to R1 million. Under the will the estate must award R500 000 to Jack and Darryl. Under s 25(3)(*a*) this disposal is made for proceeds equal to the base cost to the estate resulting in neither a capital gain nor a capital loss (proceeds of R500 000 × 2 = R1 million less base cost of R1 million).

Under the redistribution agreement the estate received a further R100 000 from Jack which was deposited into its bank account. The base cost of this deposit, being the expenditure actually incurred for the purposes of para 20, is R100 000 because the estate is correspondingly obligated to pay the amount to Darryl. Under para 35(1)(*a*) the proceeds on disposal of this amount are equal to the amount of the debt discharged of R100 000 when Darryl is paid, also resulting in neither a capital gain nor a capital loss.

Redistribution agreement involving a surviving spouse

The only place in the Act in which reference is made to a redistribution agreement is s 9HA(2)(*a*)(ii). Under that provision, a deceased person must, if his or her surviving spouse is a resident, be treated as having disposed of an asset for the benefit of that surviving spouse if that asset is acquired by that surviving spouse as a result of a redistribution agreement between the heirs and legatees of that person in the course of liquidation or distribution of the deceased estate of that person.

The effect of s 9HA(2)(*a*)(ii) read with s 25(4) is to apply roll-over treatment to the deceased person and his or her surviving spouse. In other words, the surviving spouse steps into the shoes of the deceased person and takes over the details of the asset from the deceased person such as cost and date of acquisition for the purposes of determining the base cost of the asset. As a practical matter it will be possible to finalise the tax position of the deceased person and the surviving spouse only once the redistribution agreement has been signed because it is only at that point that it can be established with reasonable certainty which assets will be acquired by the surviving spouse. In practice the redistribution agreement tends to be signed shortly before the liquidation and distribution account is advertised.

The Eighth Schedule does not state how an heir who transacts with a surviving spouse under a redistribution agreement must be treated. For example, assume asset X devolves upon heir A and asset Y devolves upon surviving spouse and they decide to exchange assets under a redistribution agreement. The surviving spouse is deemed under s 25(3)(*b*) to acquire asset X from the deceased estate and not from heir A. If full effect is given to this fiction then heir A could not have acquired the asset from the deceased estate and must be treated as not having disposed of it to the surviving spouse. The only logical conclusion therefore is that heir A must disregard the disposal of asset X to the surviving spouse and must be regarded as having acquired asset Y directly from the deceased estate. If heir A has to pay the surviving spouse any additional consideration for asset Y, such consideration must be disregarded for the purposes of determining the base cost of asset Y. Similarly, if surviving spouse pays heir A for asset X that transaction must be disregarded for the purposes of determining the base cost of asset X, since the sole method for determining the base cost of asset X is through the roll-over rules in s 25(4).

Example 2 – Redistribution agreement involving a surviving spouse

Facts:

Under his last will and testament, Jack bequeathed his farm valued at R3 million to his wife Jill and his share portfolio valued at R2,5 million to his son Walter. The base cost of the farm in Jack's hands was R500 000, and that of the share portfolio, R700 000. Both the farm and the shares were acquired by Jack after valuation date. There is no primary residence on the farm. Jill and Walter entered into a redistribution agreement under which

- Walter would take over the farm and pay R500 000 into the estate for the benefit of Jill, and
- Jill would take over the share portfolio.

What are the CGT implications for Jack, Jill and Walter?

Result:

Jack

Jack will have a capital gain on disposal of his farm, determined as follows:

	R
Proceeds from deemed disposal under s 9HA(1)	3 000 000
Less: Base cost	(500 000)
Capital gain	2 500 000

No capital gain or loss arises in respect of the disposal of the shares, since there will be a roll-over to Jill under s 9HA(2).

Jill

Jill will acquire the share portfolio at Jack's base cost of R700 000 under s 25(4).

Walter

Walter will acquire the farm at a base cost of R3 million under s 25(3)(*b*). The R500 000 paid by Walter to the estate is disregarded, since s 25(3)(*b*) is the sole determinant of Walter's acquisition cost for the purposes of para 20(1)(*a*).

When spouses are married in community of property, the surviving spouse's half share in the joint estate is administered by the executor. As a result it is possible for such a surviving spouse to enter into a redistribution agreement with the heirs even if that surviving spouse is not an heir.[723] A surviving spouse who disposes of his or her half share in the assets to heirs in exchange for movables such as cash or the other half of those assets will trigger a disposal with attendant CGT consequences for that surviving spouse.

[723] *Klerck NO v Registrar of Deeds* 1950 (1) SA 626 (A) at 629.

Example 3 – Redistribution agreement involving marriage in community of property and a surviving spouse who is not an heir

Facts:

Dennis and Barbara were married in community of property. Dennis passed away on 28 February of year 1. The assets of the joint estate at the time of Dennis's death comprised immovable property (not a primary residence) worth R2 million, furniture and personal effects worth R500 000 and a savings account containing R1,9 million. After paying the estate expenses of R400 000 the savings account contained R1,5 million. The base cost of the immovable property was 800 000.

Dennis bequeathed his half of the joint estate to his son Clive. Barbara and Clive entered into a redistribution agreement under which Barbara agreed to dispose of her half in the immovable property worth R1 million in return for the remaining half share in the furniture and personal effects worth R250 000 plus a cash payment of R750 000. The market value of the assets in the joint estate remained unchanged until the liquidation and distribution account became final at the end of year 2.

Result:

Dennis

Under s 9HA(1) Dennis is deemed to dispose of his half of the assets in the joint estate for proceeds equal to their market value. He will thus have a capital gain on disposal of his half of the immovable property determined as follows:

	R
Proceeds R2 million × 1 / 2 (para 14)	1 000 000
Less: Base cost R800 000 × 1 / 2 (para 14)	(400 000)
Capital gain	600 000

Any capital gain or loss on disposal of the furniture and effects is disregarded under para 53, since these comprise personal-use assets. The disposal of the savings account does not give rise to a capital gain or loss, since the proceeds deemed to be derived under s 9HA(1) are equal to the base cost of the account.

Barbara

The disposal by Barbara of her half share in the immovable property to Clive under the redistribution agreement gives rise to a capital gain in her hands determined as follows:

	R
Proceeds R2 million × 1 / 2 (para 14)	1 000 000
Less: Base cost R800 000 × 1 / 2 (para 14)	(400 000)
Capital gain	600 000

The proceeds of R1 million comprise furniture and effects of R250 000 plus cash of R750 000 received from Clive.

The base cost of the furniture and effects is increased by R250 000 while the base cost of the amount deposited by Barbara in her bank account is increased by R750 000. In both instances these amounts represent the expenditure actually incurred for the purposes of para 20 by Barbara in giving up her half in the immovable property worth R1 million.

Clive

Clive acquired the following assets under the will at the base cost specified, determined under s 25(3)(*b*):

	R
Half share in immovable property	1 000 000
Half share in furniture and effects	250 000
Half share in savings account (R1,9 million – R400 000) / 2	750 000

Clive disposed of the furniture and fittings and savings account in exchange for the remaining half share in the immovable property. No capital gain or loss arises on the disposal of the furniture and fittings and savings account, since the proceeds of R1 million, equal to the value of the immovable property received, are equal to the base cost of these two assets. The immovable property has a base cost of R2 million, comprising R1 million determined under s 25(3)(*b*) (the portion acquired from the deceased estate) and R1 million, being the expenditure actually incurred by Clive under para 20 in giving up the half share in the furniture and effects and savings account that he inherited under the will.

Dennis's deceased estate

Dennis's deceased estate acquired the immovable property, furniture and effects and savings account at market value on the date of death under s 25(2)(*a*). Under the will the executor disposed of these assets to Clive after first settling the estate expenses for proceeds equal to their base cost. Consequently no capital gain or loss arose in the deceased estate.

16.4.8 Tax payable by heir of a deceased estate [s 25(6)]

A natural person is treated under s 9HA(1) as disposing of all of his or her assets, with some exceptions, on the date of death. Capital gains tax will, therefore, be levied on the growth in the value of assets while estate duty will be levied on the net value of the deceased estate. There may be instances in which a significant capital gains tax charge arises owing to the growth in the value of the assets although the deceased estate is heavily indebted and would not be liable for estate duty.

Such a scenario may have an impact on the liquidity of the deceased estate, resulting in the assets having to be sold to meet the CGT liability. Section 25(6) provides an opportunity for the heir to acquire an asset from the estate provided that the heir accepts a part of the CGT liability. This option would, for example, allow a family farm to be retained by the descendants of the deceased.

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, and
- the executor of the deceased estate is required to dispose of an asset to pay that tax,

an heir or legatee who would have been entitled to the asset may accept both the asset and the liability on condition that the portion of the CGT exceeding 50% of the net asset value described above is paid by him or her. This liability must be paid within three years of the executor obtaining permission to distribute the asset and would bear interest at the rate prescribed by the Minister.[724] Under s 23(*d*) the interest payable to SARS is not deductible. 50% of the net value of the estate must be used to settle the remaining CGT liability. Situations may arise in which the estate has insufficient cash resources to settle the portion of the CGT liability not taken over by the heir. In these circumstances the heir could inject the necessary funds into the estate in order to enable the executor to settle the estate's portion of the CGT liability. This option would, of course, depend upon the heir's ability to raise the necessary funds.

The net value of an estate is determined under s 4 of the Estate Duty Act 45 of 1955 before deducting the R3,5 million allowance under s 4A. The amount remaining after deducting the allowance is referred to as the 'dutiable amount', and is irrelevant for the purposes of s 25(6).

Example – Tax liability of estate taken over by heir

Facts:

After Luke had passed away the net value of his estate before any CGT liability was as follows:

Assets	R
Share portfolio (base cost: R400 000)	3 000 000
Private motor vehicle	120 000
Cash at bank	50 000
Liabilities	
Bank loan secured over share portfolio	(2 500 000)
Sundry creditors	(350 000)
Net value of estate before CGT liability	320 000

The sole heir of Luke's estate, Luke Jr, informed the executor that he would like to take over the share portfolio of his late father's estate. In order to facilitate the transfer he was, if possible, also prepared to take over any remaining liabilities of the estate, and meet the costs of winding-up. Luke Jr's father was paying tax at the maximum marginal rate at the time of his death on 31 January 2017. Luke indicated that as he was a bit cash strapped, he would like to take maximum advantage of s 25(6).

Result:

The CGT payable by the estate and the portion of it that can be taken over by Luke Jr is determined as follows:

[724] The definition of 'prescribed rate' is contained in s 1(1). See **13.1.8** for a table of prescribed rates of interest.

Step 1 – Determine CGT liability attributable to asset to be taken over

	R
Deemed proceeds on disposal of share portfolio	3 000 000
Less: Base cost	(400 000)
Capital gain	2 600 000
Less: Annual exclusion	(300 000)
Aggregate capital gain	2 300 000
Taxable capital gain 40% × R2 300 000	920 000
Tax on taxable capital gain at 41%	377 200

Step 2 – Determine 50% of net value of estate before CGT liability

	R
Net value of estate before CGT liability	320 000
50% × R320 000	160 000

Step 3 – Allocate CGT liability between estate and heir

	R
Total CGT liability – as above	377 200
Less: Portion to be paid by estate – 50% of net value of estate	(160 000)
Portion to be taken over by Luke Jr	217 200

The executor then sold the motor vehicle for R120 000 and paid SARS R160 000. Luke Jr arranged with his local SARS office to settle his portion of the CGT liability of R217 200 in monthly instalments over three years commencing from the time the Master authorised the distribution of the assets of the estate. He was obliged to pay interest at the prescribed rate on the amount outstanding.