1.1 In Chapter 7 of its Third Interim Report the Commission dealt with the issue of capital taxes.

1.2 Since this Interim Report is intended to be self-contained and in view of the fact that its readers may not have easy access to the Third Interim Report of the Commission, it is considered that it would be desirable, in the interests of convenience, to quote in this introductory section various paragraphs from Chapter 7 of that Report.

1.3 The Commission has already pointed out that, in its approach to the overall fiscal structure of South Africa, it is appropriate to accord a place to a wealth tax. References in the Commission’s previous reports to wealth taxes include taxes on capital.

1.4 In its earlier reports, the Commission stated its view that a major justification for a wealth tax is that it promotes vertical and horizontal equity. It is established that there is a huge disparity of incomes and assets between the various groups in South Africa. There is a significant concentration of wealth in the hands of relatively few people.

1.5 In the interests of continuity the views of the Commission as set out in paragraphs 7.1.4 to 7.1.14 of Chapter 7 of the Third Interim Report are set out hereunder:

"7.1.4 As pointed out in the Report of the Margo Commission, views may differ regarding the appropriate tax treatment of persons with different taxable capacities, as approaches to vertical equity inevitably involve value judgments. It is recognised, furthermore, that redistribution is better achieved by other means, particularly through the expenditure side of the budget. The actual and perceived redistributive effects of the tax system are nonetheless important, particularly in the current circumstances in South Africa. In the Commission’s view, the contribution which a tax on wealth can make to the overall fairness of the tax system should not be underestimated.

7.1.5 Another factor in favour of wealth taxes, also pointed out in the Margo Report, is that capital contributes to a person’s ability to pay taxes, and consequently offers a further base for levying tax.

7.1.6 This latter reason was supported in a somewhat reformulated form in a recent publication on tax reform under the editorship of Cedric Sandford. Sandford discusses the taxation of wealth as follows:

There is a strong case in principle for including some sort of wealth tax as part of the tax structure of a country. Wealth adds to the taxable capacity of its owner over and above any income it may yield. Moreover there are three possible bases for personal taxation: income, consumption and wealth; they each tax a different facet of ability to pay and it can be argued that the fairest tax system will utilise them all.
By wealth in this context we mean the generality of wealth. A personal wealth tax is a tax on the whole of a person’s assets except for any express exclusions. Thus a real property tax is not a wealth tax as here defined because it relates only to a particular class of property - though real property would constitute part of the assets subject to a wealth tax.

In this connection the words ‘wealth’ and ‘capital’ are synonymous.

There are two situations in which wealth, as distinct from the income from it, may be taxed:

(1) Taxing the stock of wealth at a particular point in time, say January 1 each year. This is an annual wealth tax (AWT).

(2) Taxing wealth when it is transferred from one person to another by gift or as a result of a death - a wealth transfer tax (WTT). Although a capital gains tax, which taxes the appreciation of wealth, has similar purposes and some similar problems to the other two forms, it is not strictly a wealth tax but ... it is more akin to income tax. Our concern is therefore with the other two - annual wealth tax and death and gift taxes.

Although an AWT and a WTT may have similar objectives, they differ as to emphasis and practicability.

7.1.7 A further benefit of wealth taxes arises from the inevitable defects of the taxation, in practice, of income and consumption. As is pointed out in the international literature on tax design, not all of the objectives of the tax system can be satisfied simultaneously and comprehensively. Trade-offs between the objectives of administrative simplicity and certainty and of equity are unavoidable. In the design of the income tax, for example, it is not practical to include all possible forms of income, nor can the value added tax be designed to impact fairly on all forms of consumption. Taking into account all other tax instruments and rates, and their incidence on the poor, the fairness of the tax system is enhanced by the imposition of some taxation of wealth. In order to compensate partially for the practical deficiencies of income taxes and value added taxes, it becomes necessary, apart from all other considerations, to include wealth taxes in the system. This is a necessity despite the known defects in wealth taxes.

7.1.8 With regard to the difficulties of designing wealth taxes, a recent study states: 2

In theory, taxes on wealth, on capital gains, and on inheritance could be designed as progressive tax instruments that would cause relatively few distortions. They must be designed carefully, however, to be administerable and to limit disincentives to saving. In practice, neither wealth taxes (other than urban property) nor inheritance taxes are major sources of revenue. The reason is the difficulty of enforcing these taxes. Wealth taxes and capital gains
taxes can be evaded or contested in court relatively easily, given the problems of valuing assets, particularly those that are not transacted frequently. Inheritance taxes are more feasible, but to be equitable it is critical that they be complemented by gift taxes - otherwise gifts become a means for reducing the base of the inheritance tax. Gifts, however, are more difficult to identify and tax, particularly when the transfer is in kind. For these reasons, wealth and inheritance taxes in developing countries are likely to remain relatively minor components of the system of direct taxation in the near future.

7.1.9 Having concluded that there is a strong case for taxing wealth, the Commission has examined the various forms of wealth tax which might be selected, taking account of relevant practical and other considerations. The options include:

(a) an annual wealth tax, or possibly a once-off wealth tax;
(b) a transfer tax, imposed on wealth when it is transferred from one person to another, either as a gift or as a result of death; and
(c) a national land tax or other property taxes.

7.1.10 The Commission’s views on a possible national land tax appear in Chapter 4.

7.1.11 In the Commission’s view, the arguments against an annual or once-off wealth tax outweigh the arguments in favour. Of particular importance in this regard are the difficulties of assessment and effective administration which are associated with annual or once-off wealth taxes.

7.1.12 The Commission favours a capital transfer tax in South Africa. South Africa effectively has a capital transfer tax at present in that there is both estate duty (payable on death) and donations tax, being a tax on transfers of wealth inter vivos.

7.1.13 Having taken a decision in principle to recommend a capital transfer tax in South Africa, the Commission must immediately point out that it requires to do considerably more work on this topic before it can make detailed recommendations.

7.1.14 The reason why the Commission has considered it appropriate to make a recommendation in principle, even before completing the necessary detailed research, is to defuse speculation. The Commission is aware that a high level of speculation exists as to whether or not wealth taxes will be recommended, and the Commission therefore considers it appropriate to indicate its general approach on this topic at the earliest possible stage."

1.6 The research which has been undertaken, both domestically and outside of South Africa since the compilation of the Third Interim Report, generally supports the approach to the topic of capital transfer tax which has hitherto been adopted by the Commission.
1.7 The following emerges from all the comparative researches undertaken by the Commission:

(a) capital transfer taxes are prone to be extremely complex;
(b) the complexities referred to above result in problems of administration and high costs of collection;
(c) anti-avoidance measures, in addition to having to comply with equitable principles, must be designed so as to result in taxation of transactions that should be subject to the relevant taxes but, on the other hand, must endeavour not to include within the tax net transactions that have legitimate commercial and other justifications;
(d) capital transfer taxes have a notoriously low yield, that is, revenue collected minus costs of collection; and
(e) regrettably a worldwide phenomenon of capital transfer taxes is that it gives rise to an unproductive estate planning industry.

1.8 A recent article which appeared on December 22, 1996 in The New York Times, under the heading "For Wealthy Americans, Death is More Certain Than Taxes" provides a useful summary of these problems with a capital transfer tax regime and for this reason is reproduced as Appendix D to this report.

1.9 Much of the research cited related to countries which enjoy sophisticated methods of tax collection. If these countries have not been entirely successful in achieving an effective capital transfer tax, South Africa, which, at this stage, is in the infancy of establishing an effective revenue department, must avoid an overzealous effort to design its capital transfer taxes so as to be beyond avoidance or evasion. This could result in an undesirable deflection of resources away from other areas where there are potentially greater yields from good tax collection.

1.10 In addition to the concerns raised above, it is notorious that death and gift taxes represent a minute percentage of the Gross Domestic Product (GDP) in industrial countries. In this regard attached hereto as Appendix E are extracts entitled "Taxation of Bequests, Inheritances, and Gifts" from the IMF Tax Policy Handbook published by The Fiscal Affairs Department of The International Monetary Fund 1995. It is of particular importance that attention be drawn to the following extracts from that Handbook, page 191:

"Revenue Importance of Death Taxes

Death and Gift taxes represent a minute percentage of GDP in industrial countries. Several countries recently reduced property transfer taxes (e.g., Canada, the United Kingdom, and the United States), on the grounds that they fell too heavily on agriculture, private business, or both. Tax revenue growth in France is explained by the substantial increases in the rates of inheritance tax by the socialist government in 1982. The increase in Japan is explained by the rapid growth in national wealth associated with the high savings ratio of its citizens.

In the United States, the estate tax was first introduced in 1916 with rates ranging from 1 percent and 10 percent. The top marginal rate was gradually increased, reaching 77 percent in 1940. A separate gift tax was introduced in 1924 with rates
between 1 percent and 25 percent. Gift tax rates also increased gradually but they always remained below those of the estate tax.

In 1976, the following several major changes took place: (1) unifying the gift and estate taxes (with rates from 18 percent to 70 percent); (2) introducing a comprehensive levy on generation-skipping transfers; and (3) expanding the marital deduction.

Even after allowing for large tax reliefs and differentiated rates for social policy considerations, the revenue yield should have been higher than observed today in the United States. Of the $123 billion of wealth slated to be transferred at death in 1986, only $36 billion was included on estate tax returns and $6 billion paid in taxes, resulting in an effective tax rate of 5 percent.

Wealthy people avoid the transfer tax through an array of estate planning techniques while maintaining full control of their assets. Placing a low value on wealth already accumulated may be a primary method of tax avoidance. To some extent, tax avoidance affects real economic behaviour, such as the nature of investments or property use. In most cases, however, tax avoidance consists of hiring legal experts to arrange property rights in appropriate ways. In 1992, some 16,000 lawyers in the United States were specialized in trust, probate, and estate law. Accountants also engage in the estate planning market. Moreover, taxpayers spend considerable efforts on avoidance schemes."

1.11 There are numerous reasons, none of which is exhaustive, which explain why gift and death taxes have not yielded significant revenue in any known tax system. These reasons include the following:

(a) Few jurisdictions require proper books of account to be kept by non-business entities. Gifts among private individuals are therefore inherently difficult to trace. This is especially true when they are not gifts of physical assets;
(b) In both nuclear and extended families, in virtually all segments of South African society, the ownership of family assets is seldom clearly demarcated. It is almost as though the family were a partnership in which the partners’ shares were continually changing and only informally defined. Gift taxation becomes very difficult in such circumstances. Making an inventory of a deceased estate presents unique problems;
(c) Within families the distinction between outright donation and the mere discharging of "the duty of support" is not always easy to draw; and
(d) When the transfer of assets by gift or bequest is taxed in any significant way, their physical transfer slows down. Instead their owners use them (often less productively) to create environments and opportunities in which risk/reward ratios are low and beneficiaries are able to accumulate wealth of their own without much effort. An example in this regard is where the "owners" are the parents and the "beneficiaries" are the children. There are numerous other examples.

1.12 The objective of an appropriate design for a capital transfer tax in South Africa must be to reconcile in the best possible manner the following factors:
(a) the most effective utilisation of the limited resources available to the South African Revenue Service;
(b) the avoidance of unnecessary complexity; and
(c) the greatest possible attainment of vertical and horizontal equity in our tax system.

1.13 This is an appropriate stage to embark upon a brief review of the approach adopted in other countries to this topic.

1.14 Special attention is drawn to the fact that the Commission is about to undertake a holistic review of the entire structure of the South African tax system. The research and recommendations which appear in this report must not be viewed as any attempt to pre-empt any of the findings and conclusions that may emerge from such holistic review.

2.1 The schedule set out in Appendix A to this Report contains certain pertinent information regarding the estate duty position in the United States of America, Canada, the United Kingdom, Australia, New Zealand, Kenya, Nigeria, Botswana and Zimbabwe.

2.2 What is immediately evident from Appendix A is that Canada, Australia, New Zealand, Kenya and Nigeria have no form of death duty.

2.3 It is also significant that the United States has a relatively high rate of estate duty (55%) at $3 million and a strict regime.

2.4 The two African countries reviewed which have death duties, namely Botswana and Zimbabwe, have relatively low rates of estate (death) duty, and a much less harsh and complex regime than that which exists in the United States.

2.5 With the exception of New Zealand (in part) and Kenya, all the countries selected have a form of Capital Gains Tax. As is set out above, a Capital Gains Tax is more of an income tax than a wealth tax.

2.6 The schedule set out in Appendix B to this Report contains an analysis of capital taxes in the Commonwealth countries. This schedule was compiled from information tabled at a conference held in 1995 of Tax Administrators of Commonwealth Countries. It is of interest in this regard to point out that the previous South African estate duty rate of 15% was in line with the rates in those countries set out in Appendix B which impose estate duty.
3.1 South Africa has a flat rate of tax applicable both to donations and estates. This rate is at present 25%. There is relief on a sliding scale where the same asset is taxable twice by reason of a second death occurring within 10 years of a preceding death.

3.2 The rates referred to above must also be viewed against the fact that there is at present a R25000 per annum per donor rebate in respect of donations, and a R1000000 rebate in respect of an estate.

3.3 In addition to the a foregoing, all assets bequeathed to the surviving spouse of the deceased are not subject to estate duty.
4.1 The schedules set out in Appendix C to this Report reflects the amount of donations tax and estate duty paid annually over the last 10 years in South Africa.

4.2 It is evident that in real terms the amount that has been collected has reduced. The amount of R100 million paid in estate duty in 1984/85 is equivalent in real terms to approximately R400 million today.
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Chapter 5 - PROPOSALS OF THE COMMISSION IN RESPECT OF CAPITAL TRANSFER TAX

5.1 It is the view of the Commission, based on its researches, including a study of certain international capital transfer tax systems, in order to achieve horizontal and vertical equity, that South Africa should have a capital transfer tax.

5.2 Notwithstanding the disadvantages set out above relating to capital transfer taxes, there are compelling reasons in the South African context which justify this view. South Africa does experience a marked concentration of wealth. Thus, even if income tax were levied on saved income and capital gains, inheritances would remain as an untaxed item in the absence of capital transfer taxes. Similarly, *inter vivos* gifts would escape taxation which would, in the context of South Africa, raise serious questions about the equity of the tax system.

5.3 The Commission is also fortified in its contentions by the fact that effectively South Africa at present has a capital transfer tax in that *inter vivos* transfers of capital are subject to a donations tax and transfers on death are subject to estate duty.

5.4 In summary, a form of capital transfer tax legislation exists at present and its repeal would raise serious questions about the equitable balance of the tax system whether or not its amendment would raise relatively more revenue than is presently the case. In addition, as noted in the IMF *Tax Policy Handbook* (*supra*) a tax on death may create fewer distortions in the type of investment decisions of a potential donor over his lifetime than a comprehensive income tax.

5.5 Two questions arise in the design of the capital transfer tax:

(a) should there be an estate tax or an inheritance tax; and

(b) should both *inter vivos* transfers and transfers on death be dealt with in a single statute?

5.6 As regards the issue raised in paragraph 5.5 (a) above, it is pointed out that, in an inheritance tax, the heirs are taxed on their share of the assets passing, whereas in an estate tax, the estate itself is subject to the tax. Of the countries reviewed, all, except Botswana, levy tax on the donor and the testator. The United Kingdom also has an inheritance tax.

5.7 The Commission is of the view that donations tax should be retained.
5.8 The Commission is of the further view that South Africa should retain its system of estate duty rather than having an inheritance tax. The reasons in support of this approach are as follows:

(a) An inheritance tax is more complex to administer as it involves a greater number of tax entities. Estate duty levies tax on one entity. In this regard attention is drawn to paragraphs 7.3.2 and 7.3.3 of the Third Interim Report of the Commission, which read:

"7.3.2 The first important issue of principle is what form the proposed capital transfer tax should take. In particular, a choice must be made between an estate tax or an inheritance tax. In this regard, the following passage from More Key Issues in Tax Reform is highly instructive:

The strong case for taxing intergenerational transmissions of wealth on grounds of vertical equity ... leaves open the question of what form the tax should take. In particular, should it be donor- or donee-based, i.e. an estate duty type or an inheritance tax?

The case for the inheritance-type death duty (with accompanying gift tax) is that, better than estate duty, it fulfils what may be regarded as the prime objective of death taxation, i.e. reducing inequality of wealth. An inheritance-type death duty taxes what is received irrespective of the size of estate from which it comes. It thus strikes at the heart of the problem of inequality, for it is large inheritances, not large estates as such, that perpetuate inequality. The inheritance tax also offers an incentive to estate owners to spread their wealth widely, for, by so doing, they can reduce the amount of tax paid and thus exercise control over the ultimate disposition of a larger part of their fortune.

This second argument may be of very limited significance, for most wealth owners may well wish to concentrate their wealth in the hands of their immediate family irrespective of the tax regime. However, the first argument is fundamental.

There are further equity arguments in favor of an inheritance tax. It seems more logical and equitable to tax what is received by a living person instead of imposing tax by reference to a sum which may bear no relationship to an individual’s benefit and which, in Winston Churchill’s words, ‘attempts to tax the dead instead of the living’... Furthermore, the inheritance tax offers more scope for adjusting tax on the beneficiary according to prevailing concepts of equity. Thus, for example, granting relief by having a higher threshold or a lower rate on legacies to a minor child of a
deceased parent, can be simply accommodated under an inheritance tax; and many countries with an inheritance tax provide for different rate scales or/and thresholds according to the relationship between the deceased and the inheritor - the closer the relationship, the lower the scale. (Such a provision, however, is likely to run counter to the primary purpose of reducing wealth inequalities.)

The advantage of an estate duty lies in greater ease of administration. Under an inheritance tax separate accounts are required for all beneficiaries of an estate whose legacies are above the exemption limit, whereas under estate duty only one account is required for each estate. But the modest addition to administrative costs is a small price to pay for the advantages of an inheritance tax.

It is sometimes argued that an estate duty is a better revenue-yielder than inheritance tax; but, save in its ultimate form, this argument rests on a misconception. Of course it is true that if the same rate scale was applied to both an estate duty and an inheritance tax, the estate duty would yield more. Only when an estate was left to one person would the yield be the same; in all other cases the inheritance tax would yield less. But the rate scale does not need to be the same. A rate scale for an inheritance tax could be devised with the equivalent yield to any given estate duty. It would mean that where an estate was left to one or a very small number of people, the inheritance tax rates (and the tax yield) would be higher than under an equivalent estate duty; whereas where an estate was widely dispersed the tax yield of an inheritance tax would be less.

The ultimate sense in which an inheritance tax might raise less revenue, even though established on a revenue-neutral basis with a particular estate duty is that, if, as we would expect, the inheritance tax was more successful than the estate duty in bringing about a reduction in inequality, then the revenue from the inheritance tax would fall. But this would be a sign that it was doing its job!

7.3.3 In evaluating the relative merits of the inheritance tax and the estate duty, the following further factors arise:

(a) the capacity of the tax administration to collect each of these taxes; and
(b) The fact the estate duty has been in place over many years, is well documented in the existing reference sources and has been the subject matter of numerous judicial decisions, and that administrative systems in the Master’s office and the office of the Commissioner for Inland Revenue are geared to an estate duty.

(b) The retention of the existing estate duty system would result in a minimum of deflection of resources. The collection systems are well-established, there is a body of decided case law which means that we are relatively rich in precedent, which results in greater certainty and hence a greater ability to plan one’s affairs; and

(c) Resources available to the South African Revenue Service can be used more effectively elsewhere.

5.9 Conceptually donations tax should be combined with estate duty into one statute. However, the resources required to undertake this exercise might outweigh the immediate attainment of the conceptual advantages. For this reason the matter is best left to the decision of the South African Revenue Service. In considering the matter, South African Revenue Service may also decide that the appropriate location for donations tax should remain in the income tax system since the purpose of donations tax is as much to protect the income tax base from income-splitting as it is to prevent the dissipation of estates.

5.10 There are numerous deficiencies in the existing legislation. These are currently enjoying the attention of the South African Revenue Service and it is understood that remedial legislation will, in due course, be passed.
The determination of an appropriate rate of capital transfer tax is clearly a policy decision which must be taken by Government and not the Commission. There are, however, relevant factors which it is the function of the Commission to identify and draw to the attention of Government. It is then Government's prerogative to determine the rate.

An important question is whether there should be a relatively low flat rate of tax (as at present), or a progressive rate, increasing with the cumulative amount of donations or with the size of the estate. The question does not admit of an easy answer as contrasting the existing relatively low flat rate with a progressive rate may prove to be confusing. The existing rate of 25% combined with an annual and initial exemption of R25000 and R1 million respectively results in a progressive tax. For example, on an estate of R1.5 million R125000 is payable. This is an effective rate of 8,3%. On an estate of R3 million, the estate duty payable is R500000, which is an effective rate of 16,7%.

A flat rate is simpler to administer. Each year is treated separately insofar as donations are concerned. A system which attempts to have a lifetime cumulative regime requires that a lifetime list of donations be maintained. This would be administratively burdensome.

It is less burdensome administratively to institute a progressive rate scale in respect of estate duty alone. There is only one taxable year to consider. A difficult question does, however, arise, namely, should donations *inter vivos* be added back for the purposes of the computation of estate duty (with a credit given for donations tax previously paid)? The "add back" of donations would be a complex requirement, giving rise to difficulties of enforcement and implementation. The Commission is therefore opposed to such a regime. It will be appreciated that there would be no need to add back *inter vivos* donations should a flat rate system be implemented with a uniform rate for estate duty and donations tax (and no initial or annual exemptions).

The question remains whether a highly progressive rate should be instituted in respect of estate duty. Industrialised countries tend to have progression in the computation of estate duty (over and above the reducing protection of the rebate). It should, however, be borne in mind that there is little international consistency. Canada, Australia and New Zealand have no form of death duty (Canada and Australia do have a capital gains tax, which, in the case of Canada, may be triggered on death).
6.6 Whilst equity considerations appear to point towards a progressive regime and high rates with regard to estate duty, there are considerations which appear to point to a relatively low flat rate. These factors include the following:

(a) International experience supports the contention that where capital taxes materially exceed 15%, extensive planning results in significant avoidance and evasion, which reduces the effective yield. In this regard there is a useful discussion in J Whalley, (1974), "Estate Duty as a Voluntary Tax", 84 Economic Journal, 638; and

(b) An extensive avoidance industry represents a wasteful utilisation of resources. As appears from the extracts quoted above from the IMF Handbook (at p191) there are "16000 lawyers in the United States who in 1992 specialised in trust, probate and estate law".

6.7 Insofar as concerns rebates, the Commission has no reason to suggest a change to the present rebate system, namely the first R25000 of annual donations per donor being exempt and the first R1000000 of an estate being exempt. In this regard, the Commission points out that since the rebates were instituted, the impact of inflation has reduced their value in real terms, and this factor will recur in the future. It would thus be advisable to review these rebates in the future to assess the impact of inflation thereon.

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Chapter 7 - INTEREST-FREE OR LOW INTEREST LOANS

7.1 References in these paragraphs to interest-free loans also include loans at low interest rates. This is a scheme that is often used in estate planning to reduce or fix the dutiable value of an estate.

7.2 In its research into the position in foreign jurisdictions, the Commission found that effective action against interest-free loans is relatively rare. The United States has made endeavors in this regard, which have resulted in horrendous complexity, with questionable effectiveness.

7.3 A review of countries that do recognize and seek to counter the avoidance advantages inherent in interest-free loans reveals that they split the problem into two sections:

(a) interest-free demand loans; and

(b) interest-free term loans.

The complexity of the system employed in the United States is illustrated by the following summary of the position of below-market gift loans cited in American Jurisprudence, 1996 Volume 34A, paragraph 147, 351:

"Certain interest-free and below-market interest rate loans result in a gift from the lender to the borrower for gift tax purposes. Generally, the amount of the gift is determined by comparing, for a demand loan, the interest payable on the loan to the Applicable Federal Rate (AFR), or, for a term loan, the amount loaned to the present value of all payments due under the loan. For a demand loan, the lender is treated as transferring to the borrower an amount equal to the foregone interest, generally on the last day of the year. For a term loan, the lender is treated as transferring cash in an amount equal to the excess of the amount loaned over the present value of all required payments, generally on the day the loan is made. There is an exception provided for certain de minimize loans - generally for gift loans directly between individuals where the aggregate outstanding loans between the individuals doesn’t exceed $10,000. But this exception doesn’t apply to loans directly attributable to buying or carrying income-producing assets."

7.4 Some countries, for example the United Kingdom and New Zealand, typically take no action with regard to interest-free demand loans (on the basis that such loans could be repaid at any time and confer no lasting benefit) except for the United States, which, for income tax purposes,
does have an imputed benefit on an annual basis in respect of interest-free demand loans.

7.5 An attempt to follow this precedent can only encourage the use of a range of derivative instruments designed to circumvent the legislation, hence necessitating complex legislation.

7.6 There are various other factors which add to the complexity. An identification of one of the issues in this regard is where an asset is sold and the purchase price remains payable on demand. This is only one of many possibilities that exist. It is both impossible and unnecessary to describe all of them. Suffice it to state that any remedial action embodied in specific legislation would be highly complex in the extreme.

7.7 For these reasons, the Commission has decided against a recommendation of specific legislation to remedy the problem of interest-free loans.

7.8 It is open to the South African Revenue Service to consider the introduction at a later time of specific, as opposed to general, anti-avoidance measures. See also the discussions relating to "Anti-Avoidance Measures" below.
8.1 Another effective method of reducing the dutiable value of an estate is for the planner to dispose of assets to a company during his lifetime under an arrangement in terms of which the consideration is discharged by means of issuing low-coupon preference shares.

8.2 The factors set out in paragraph 7 above with regard to interest-free loans applies equally in the context of preference share schemes.

8.3 Thus the Commission does not recommend the adoption of specific legislation to remedy the problem of preference shares.

8.4 To the extent that the preference shares are used to maintain control of the company, the problem for inland revenue turns on the valuation of the shares. In this regard, to the extent that section 5(1)(f)bis of the Estate Duty Act does not provide for revaluation in such circumstances, it should be appropriately amended.
9.1 An important question that arises is the extent to which the fisc should be armed with anti-avoidance measures to render the capital transfer tax more effective.

9.2 Interest-free loans and preference share schemes have already been identified as avoidance measures.

9.3 The inclusion of an anti-avoidance measure is made much more complex by the interposition of companies. Thus a company established by the father makes interest-free loans to a trading company, the shares in which are owned by his son. Should this transaction fall into the net?

9.4 The Commission does not favor general (as opposed to specific) anti-avoidance measures in the context of estate duties, inter alia, for the following reasons:

(a) At the time when the transaction is challenged, the founder would have died. This makes the entire issue of evidence and the evaluation thereof very difficult;

(b) There would be much uncertainty and confusion which would undermine the sensible planning of one’s affairs; and

(c) There would be a wasteful proliferation of litigation.

9.5 Over a period of time specific anti-avoidance measures could be introduced into the legislation in addition to the existing measures which include sections 3(5) and 5(1)(f)bis of the Estate Duty Act. Future guidance can also be sought in the provisions in the Inheritance Tax Act in the United Kingdom. This would include, for example:

(a) Provisions in respect of "associated operations". This enables transactions to be treated as gifts, whether made directly or indirectly, and whether by way of two or more operations;

(b) Restriction on the freedom to dispose. Ralph Ray and John Redman, in their book entitled Practical Inheritance Tax Planning, Third Edition, deal with this provision as follows:-

"Provisions in a contract whereby the right to dispose has in some way been artificially excluded or restricted are to be ignored in valuing the transfer to the extent that such exclusion of restriction is not for a consideration in money or money’s worth. This anti-avoidance provision is particularly designed to deter artificial arrangements in partnership
agreements, for instance, as regards options below market value and transfers of goodwill, and pre-emption provisions in articles of association of a company which aim at artificially reducing the market value of the shares.”;

(c) Artificial reductions in the value of property can be attacked in certain circumstances; and

(d) Related property provisions. This anti-avoidance measure is described as follows by Ray and Redman (supra):

"This anti-avoidance provision acts as a deterrent against the sort of transaction where, for example, there is a sale on which the purchaser pays or the vendor delivers more than one year after the original disposal and where either the purchaser pays more than the market value of the asset (i.e. a disguised gift of cash) or the vendor receives a lower purchase price than the true value of the asset (i.e. a disguised partial gift of the asset). Section 262 then assumes that the chargeable transfer is made at the time the payment is made or the asset is transferred at the current value on each occasion. The section is an anti-avoidance measure to prevent a transfer of value in advance of an asset likely to increase in value."

9.6 These specific anti-avoidance provisions from the Inheritance Tax Act in the United Kingdom are cited for illustrative purposes to show that where widespread use is made of a specific method of avoidance, consideration can be given to introducing specific anti-avoidance measures designed to counter those avoidance schemes. Considerable care will have to be taken in the drafting of these anti-avoidance measures. Clearly, it is not the Commission’s function to attend to this; the responsibility rests with South African Revenue Service.
10.1 Reference was made in the Third Interim Report to the use of generation skipping trusts as an avoidance mechanism. Typically, such trusts acquire assets from the planner on the basis that the assets so acquired will be held by the trusts for a period extending beyond one generation. In an extreme situation, the assets can be held indefinitely on the basis that allocations of capital and income will be made to the children of the various generations. These inter-generational transfers of capital usually take place on a basis that does not attract any liability to pay tax.

10.2 On the basis of the present law relating to the taxation of trusts, the position can be summarised as follows:

(a) Income received by, or accrued to, a trust, which is distributed to beneficiaries of the trust during the fiscal year in which the income is received by or accrued to the trust will, on the basis of the conduit principle, be subject to tax in the hands of the beneficiary and not in the hands of the trust; See section 25B of the Income Tax Act and Secretary for Inland Revenue v Rosen, 1971 1 SA 172 (AD).

(b) If the trust traps the income in the year in which it is received by, or accrued to, the trust in the sense that it is not distributed to beneficiaries in that year, then the trust itself will be liable to tax in respect of that income unless, by virtue of the provisions of section 7(5) of the Income Tax Act, liability for such income attaches to the founder of the trust.

10.3 The Commission has given careful consideration to the question as to whether:

(a) Assets of a trust established as aforesaid should be subject to capital transfer tax on the basis that there will be periodic valuations of the assets of such trust which will then be subjected to a capital transfer tax; and

(b) Distributions of capital from a trust should also be subject to the capital transfer tax. Clearly, distributions of income will continue to be governed by the provisions as set out in paragraph 10.2 above.

10.4 As regards the question raised in paragraph 10.3 (a) above, it was considered that, on the basis of achieving equity and consistency, there is
a strong argument in favour of subjecting to capital transfer tax the assets of trusts on a periodic basis.

10.5 Counter-arguments have been raised with regard to suggestions that trusts should be subjected, on a periodic basis, to the imposition of capital transfer tax. These counter-arguments include the following:

(a) The complexity of the legislation that would be necessary to achieve the objective of subjecting the trust to capital transfer tax; and

(b) The appropriateness of subjecting commercial trusts as opposed to family planning trusts to capital transfer tax.

10.6 As regards the contention set out in paragraph 10.5 (a) above, whilst the potential complexity should not be underestimated the Commission considers that it is possible to embody such a provision in capital transfer tax legislation. There are useful precedents that exist in overseas legislation.

10.7 As regards the argument set out in paragraph 10.5 (b) above, the Commission is of the opinion that:

(a) If planners wish to use a trust to carry on their business activities as opposed to using a more conventional business form, then they must accept all the consequences of doing so; and

(b) In any event, there is no cogent commercial reason why business activities should be conducted through the vehicle of a trust as opposed to other conventional vehicles such as companies and close corporations. In fact, very often a trust is selected for the purposes of conducting therein business activities so as to avoid the company law obligations, such as the maintenance of capital provisions, which would attach to conducting business activities in a company, and also to achieve a more favourable tax dispensation than would have applied had the business activities in question been conducted through a conventional company.

10.8 The Commission can find no adequate justification for exempting trading trusts from the capital transfer tax provisions, bearing in mind that trading trusts are usually used to avoid compliance with normal company law and tax provisions that would otherwise have applied. Even if trading trusts were not subjected to the capital transfer tax provisions, there are cogent arguments that would require trading trusts to be subject to the company law and tax regimes applicable to conventional companies.
10.9 It is therefore the recommendation of the Commission that trusts be subjected to the capital transfer tax provisions on the basis that, at periodic intervals, the net assets of the trust will be valued and subjected to capital transfer tax at the rate applicable to inter vivos donations and assets without any rebates. The frequency of the period must be a matter determined by Government and it should ordinarily reflect a single generation and any period within the range of 25 to 30 years would be appropriate.

10.10 The Commission further recommends that, in the interests of sensible transition, provision should be made for trusts that are already in existence at the date of commencement of the new provisions to come into the new regime after the lapse of a reasonable time. Alternatively, provision could be made for existing trusts to be wound up without fiscal disadvantage;

10.11 It is not the purpose of this report to draft the necessary legislation. This is the responsibility of the South African Revenue Service. In undertaking such drafting the Commission considers that care should be taken of the numerous types of trusts which will necessitate the exercise of care to prevent any double taxation. The different types of trusts include, for example:

(a) The normal asset protection trust (in which the income beneficiaries include the founder, the spouse of the founder and their children and grandchildren whilst capital beneficiaries include the children and grandchildren of the founder) which arose from a donation by the founder or the disposal of assets to such trust by the vendor in consideration for a loan account;

(b) The so-called “perpetual” trust where the capital beneficiaries are the founder’s heirs and the income beneficiaries are the same parties as referred to in the preceding sub-paragraph;

(c) The vesting trust in which a vesting takes place in certain capital and/or income beneficiaries of rights either in respect of capital or income or both; and

(d) The discretionary trust in which there are no vested rights between successive generations.

10.12 As regards distributions of capital out of trusts, such distributions should be subjected to the capital transfer tax regime in all circumstances other than where to do so would result in the imposition of double capital transfer tax. If an individual retains assets in the form of shares or a cash deposit, the interest would be taxable in the hands of the individual and
the balance thereon after paying tax would form part of the individual’s capital. A transfer thereafter of such capital by the individual during his lifetime would be subject to donations tax and any amount retained at the date of death would be subject to estate duty. The same provisions should apply to the trust, namely if it accumulates income earned by it after the imposition of tax and thereafter distributes the capital, it should be in the same position as would be applicable to an *inter vivos* donation. As regards the periodic valuation for capital transfer tax purposes amounts accumulated and retained but not distributed should be subjected to the same tax treatment as all other assets of the trust during a periodic valuation for capital transfer tax purposes.

10.13 The legislation will thus need to define the concept of distribution to include the act of vesting rights in the trust in a beneficiary or beneficiaries. For this reason a vested right will have been subjected to the tax on distribution and will not be subject to the generation skipping tax. In this context, and particularly for the purposes of ensuring that there is no double taxation, care will have to be taken in the formulation of the necessary legislation to ensure that:

(a) In the case of a testamentary trust where the assets forming part of the trust have formed part of the dutiable value of the estate, there will only be subjected to capital transfer tax in respect of distributions from such trust amounts in excess of the amounts on which estate duty was paid on the formation of such trust;

(b) Similarly, in the case of an *inter vivos* trust where donations tax had been paid on the establishment of any such trust, there will only be subjected to capital transfer tax arising from distributions from such trust any amounts in excess of the amounts on which donations tax was paid on the inception of such trust; and

(c) Similarly, where an amount is deemed to be a distribution in a vesting trust by virtue of any vesting, such amounts will no longer form part of the assets of the trust which will be subjected to capital transfer tax on the periodic valuation of the trust assets for the purposes of the generation skipping provisions.

The aspects referred to in sub-paragraphs 10.13 (a) to (c) above are not intended to be exhaustive but are some of the more important features and those that will arise most often in practice, that will have to be taken into account so as to avoid double taxation.

Furthermore, consideration will also have to be given, in the drafting of the relevant legislation to the making of provision in the case of a vesting in successive beneficiaries over certain time periods to the
recommencement of the suggested 25 or 30 year period on the occurrence of each such successive vesting. As an alternative, consideration should be given to exempting from the periodic capital transfer tax trusts where there is successive vesting in circumstances which attract a liability to pay estate duty on rights passing, or deemed to pass, on the occurrence of such vesting.

10.14 Concern has been expressed that there can be avoidance of the foregoing regime by the establishment of a family holding company by the founder without the interposition of a trust. In these circumstances the founder’s assets would be sold to the family holding company in consideration for a loan account or preference shares. The ordinary shareholder would be the founder’s children and grandchildren. After the death of the founder, the children and grandchildren could procure the liquidation of such family holding company. The answer to this concern is that in order to retain control, which, had the trust been interposed, would have been exercised by the founder through the use of the trust by the power to appoint a majority of the trustees or through loaded voting mechanisms at meetings of the trustees, would have to be exercised in the case of the family company by the preference shares which the founder has enjoying multiple votes for control purposes. This would, in terms of the existing law, relating to estate valuation, swell the value of the founder’s dutiable estate.

10.15 Consideration might be given to the inclusion of an anti-avoidance measure similar to that contained in section 64C in the Income Tax Act to prevent a circumvention of the proposal by means of indefinite loans to beneficiaries.

10.16 On purely humanitarian grounds it is recommended that there should be exempted from the foregoing provisions, both in respect of generation skipping and distributions from trusts, those trusts that are established by a parent, an immediate relative or guardian and the sole beneficiaries of which are the mentally or physically disabled children or further issue of such parent, immediate relative or guardian. Similarly there should be exempted trusts established to provide for employee benefits such as death, disability, unemployment insurance and medical benefits.
11.1 In terms of the existing law, bequests in favor of a surviving spouse are exempted in the calculation of the dutiable value of the estate of the first dying spouse.

11.2 The question may be posed whether there is any intellectual justification for the retention of this exemption, particularly in the light of:

(a) The equality provisions in the Constitution, which are generally to the effect that, in our current society, provisions which differentiate on the basis of gender or marital status are not justifiable; and

(b) The fact that the unit for income tax purposes is the individual taxpayer and not the marital unit.

11.3 Notwithstanding the powerful arguments set out in paragraphs 11.2 (a) and 11.2 (b) above, the Commission recommends the retention of the surviving spouse exemption. This recommendation is based entirely on pragmatic grounds, and takes cognizance of the evidence submitted to the Commission. Moreover, sociological factors currently prevailing in South Africa appear to encourage the retention of this exemption. Reference to these sociological factors have been set out in paragraphs 1.11 (b), 1.11 (c) and 1.11 (d).
12.1 Evidence submitted to the Commission suggests that there is meaningful support for the estate duty regime to be modified to encourage socially and economically beneficial bequests.

12.2 Certain non-Governmental organizations would be identified on a periodic basis by Government preferably after consultation with provincial governments. The organizations so identified would be referred to in a Proclamation issued from time to time in terms of the Estate Duty Act. Although the Commission can clearly not be prescriptive in this regard, it would naturally be important for the attainment of the objectives sought to be achieved by this recommendation that the organizations so identified must be such that the testator can meaningfully identify with them.

12.3 Any bequest made to an organization proclaimed as aforesaid:

(a) would continue to form part of the dutiable value of the estate; and

(b) the amount of the bequest would be a deemed discharge to that extent of the estate duty payable by that estate.

12.4 The purpose of the foregoing is to encourage bequests by wealthy individuals to promote causes which Government identifies as being important to the public good. As set out above, the Commission cannot be prescriptive in the determination of the causes which should qualify for the foregoing treatment, as these must be determined by Government.

12.5 In order to qualify, the bequest must represent an outright divestment of control of the amount in question. There must be no retention of any interest whatsoever by the estate in the amount or asset in question.

12.6 The recommendations in this paragraph must not be seen as making any inroad in the approach of the Commission in the case of the Income Tax system. The Commission remains firmly of the view that the tax base must be widened by the elimination of special concessions and allowances. The Commission’s approach in this regard, as set out in Chapter 7 of the First Interim Report, continues to represent the Commission’s views.
12.7 Certain of the Commissioners were of the view that the periodic tax to be levied on trusts in accordance with the aforementioned recommendations could be discharged by donations to the aforementioned proclaimed organizations, and that lifetime donations to such organizations could be exempted from donations tax.
13.1 South Africa generally taxes on a source basis with regard to the imposition of income tax. To the extent that the present capital transfer system (i.e. donations tax and estate duty) is levied on a source basis, the question arises as to whether it should remain as the system or be expanded to refer to a residence basis.

13.2 Reference to the relevant clauses in the Income Tax Act and the Estate Duty Act reveal that South Africa is on the source basis for capital transfer tax. While there are some anomalies between the Income Tax Act and Estate Duty Act, the general impact of these taxes is that capital assets acquired offshore - for example acquired by inheritance or donation from non-residents - fall outside the net.

13.3 Ideally, it may be attractive to consider extending South Africa’s capital transfer tax to worldwide assets - regardless of source - in respect of individuals ordinarily resident in South Africa. However, the Commission considers that such extension would exceed the enforcement capabilities of South Africa.

13.4 The present position in terms of which South African assets and foreign assets previously exported from South Africa are taxable should be retained where the alienator is ordinarily resident in South Africa at the date of donation or death.

13.5 In this context, the Commission points out that South Africa has double estate duty treaties with only the following countries:

(a) Lesotho;
(b) Sweden;
(c) the United States of America; (to be ratified);
(d) the United Kingdom; and
(e) Zimbabwe.

13.6 The Commission suggests that the Commissioner for Inland Revenue, who is at present negotiating a number of new double income tax treaties, should also, in due course, give consideration to the negotiation of further double estate duty treaties.
13.7 The existence of further estate duty treaties will be a factor in encouraging the investment of capital in this country and the immigration of individuals able to contribute to the economy.
The Commission accordingly recommends that:

14.1 Donations tax should be retained (paragraph 5.7);

14.2 Estate duty should be retained rather than having an inheritance tax (paragraph 5.8);

14.3 There is no pressing need at present to combine donations tax and estate duty into a single statute. This can be done as and when there are resources available to the South African Revenue Service (paragraph 5.9);

14.4 The current deficiencies in the existing legislation can be cured as and when there are resources available to the South African Revenue Service (paragraph 5.10);

14.5 The determination of an appropriate rate of capital transfer tax is a policy decision which must be taken by Government (paragraph 6.1);

14.6 Whilst the determination of the appropriate rebates is also a policy decision which must be taken by Government, it is considered that, for pragmatic reasons, the existing rebates should continue to remain in force (paragraph 6.7);

14.7 There should be no specific legislation at this time to remedy the problem of interest-free loans (paragraph 7.7), but specific anti-avoidance legislation to deal with this issue can be considered by South African Revenue Service in the future (paragraph 7.8);

14.8 There should be no specific legislation at this time to remedy the problem of preference shares in estate duty avoidance schemes (paragraph 8.3), but specific anti-avoidance legislation to deal with this issue can be considered by South African Revenue Service in the future;

14.9 There should not be general anti-avoidance measures in the context of estate duties, but rather specific ones (paragraphs 9.5 and 9.6);

14.10 There should be provisions to deal with generation skipping trusts which would result in capital transfer tax being imposed on a periodic basis on the value of the assets of a trust (paragraph 10.9);

14.11 In providing for capital transfer tax on the value of a trust, on a periodic basis, due regard must be had to achieve sensible transition. This could
include provision for existing trusts to be wound up without fiscal disadvantage (paragraph 10.10);

14.12 The distribution of capital from trusts should be subject to the imposition of capital transfer tax (paragraph 10.12) and once again sensible provision should be made for transition (paragraph 10);

14.13 There should be exempted from the a foregoing provisions, both in respect of generation skipping and distributions from trusts, those trusts that are established by a parent, an immediate relative or guardian and the sole beneficiaries of which are the mentally or physically disabled children or further issue of such parent, immediate relative or guardian. Similarly there should be exempted trusts established to provide for employee benefits such as death, disability, unemployment insurance and medical benefits (paragraph 10.16);

14.14 The exemption from estate duty for bequests in favor of a surviving spouse should remain in force (paragraph 11.3);

14.15 Bequests to certain identified non-Governmental organizations, determined on a periodic basis by Government, should constitute a pro tanto discharge of the estate’s obligation to pay estate duty (paragraph 12); and

14.16 Capital transfer tax should not be imposed on a worldwide basis (paragraph 13).
4th Report - CAPITAL TRANSFER TAX  
APPENDIX A - ESTATE DUTY AND DONATIONS TAX POSITION IN OTHER JURISDICTIONS

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<th>AUSTRALIA</th>
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<th>ZIMBABWE</th>
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<td>DONATIONS TAX</td>
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Sources: 1996 International Tax Summaries - Coopers & Lybrand  
1995 African Tax Systems - International Bureau of Fiscal Documentation  
Notes:  
1 If within 7 years of death ✓ = Yes  
2 Only for term loans X = No  
3 12.5% for companies ? = Information not Available  
4 If within 5 years of death  
Terms: Progressive: Average Rate Rises with Dutiable Amount  
Generation Skipping: Benefits Paid to Grandchildren (or Beyond) of Founder
4th Report - CAPITAL TRANSFER TAX
APPENDIX B - CAPITAL TAXES IN COMMONWEALTH COUNTRIES

A = ESTATE DUTY
B = INHERITANCE TAX
C = CAPITAL TRANSFER TAX
D = GIFTS TAX
E = WEALTH TAX
F = CAPITAL GAINS TAX (It must be pointed out that although this information has been included a capital gains tax is more akin to an income tax).

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<td>Tanzania</td>
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<td>Tonga</td>
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<td>Trinidad &amp; Tobago</td>
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<td>United Kingdom</td>
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<td>Zimbabwe</td>
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**Source:** 1995 Conference of Tax Administrators of Commonwealth Countries

**Notes:** Rates given in brackets are the highest marginal rate

* Kenya: Levy of capital gains tax has been suspended.

+ Malaysia & Tanzania: Capital gains levied only on real property

** UK: Capital Transfer Tax was replaced by Inheritance Tax

Not available: Details not available

Member countries are kindly requested to update these statistics.
4th Report - CAPITAL TRANSFER TAX  
APPENDIX C2 - AMOUNTS COLLECTED FROM DONATIONS TAX

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Donations Tax (R)</th>
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<tr>
<td>1985 / 86</td>
<td>4 720 889,65</td>
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<tr>
<td>1986 / 87</td>
<td>3 180 435,01</td>
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<tr>
<td>1987 / 88</td>
<td>3 851 673,49</td>
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<td>1988 / 89</td>
<td>5 473 086,76</td>
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<tr>
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<td>3 223 031,03</td>
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<tr>
<td>1990 / 91</td>
<td>4 330 106,43</td>
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<td>1991 / 92</td>
<td>6 507 833,16</td>
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<tr>
<td>1992 / 93</td>
<td>6 828 572,99</td>
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<tr>
<td>1993 / 94</td>
<td>19 968 120,97</td>
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<tr>
<td>1994 / 95</td>
<td>38 955 670,00</td>
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</table>

Source: Department of Finance - SARS REVENUE STATISTICS
4th Report - CAPITAL TRANSFER TAX

APPENDIX D - EXTRACTS FROM ARTICLE WHICH APPEARED IN THE NEW YORK TIMES DATED 22 DECEMBER 1996 UNDER THE HEADING "FOR WEALTHY AMERICANS, DEATH IS MORE CERTAIN THAN TAXES"

"A decade after Congress closed some of the biggest loopholes in the tax on wealth handed down from one generation to the next, the Federal estate tax has become so easy to avoid that some experts believe that much of it is voluntary, at least for those who start planning early.

‘I think the estate tax is voluntary in two senses - how much you eventually need to pay within a family and when you pay it,’ said William D Zabel, a New York estate lawyer and the author of ‘The Rich Die Richer and You Can Too.’ ‘I wouldn’t say all of it, but you can eliminate much of it.’

Techniques for circumventing the estate tax vary widely; some of them are extraordinarily elaborate and creative. All together, they form a broadening pattern of tax avoidance that Congress sought to halt only 10 years ago, and they include these strategies:

- Corporate executives have found ways to pass millions of dollars worth of stocks, and options to buy stocks, to their children without owing estate taxes.

- Investors are putting every sort of property, from vacation homes to stock portfolios, into partnerships for their children so that they are valued for tax purposes at 30 to 70 percent less than what they would be worth in the marketplace. Any rise in the property’s value escapes the estate tax, and a separate gift tax is reduced."

Another passage reads as follows:-

"Some of the nation’s wealthiest individuals have organized their financial affairs in a manner so intricate and impenetrable that the I.R.S. on occasion has given up its claim to higher estate taxes.

Conceived after the turn of the century, in an era of dynasties like the Rockefellers and the Du Ponts, the estate tax was designed to reduce the concentration of wealth. Today, some analysts say, the proliferation of avoidance strategies is having the opposite effect.

Though the estate tax has never gone as far as its sponsors envisioned in leveling wealth, it ‘makes a significant contribution to whatever progressivity exists in the nation’s tax system,’ said Michael J. Graetz, a Yale Law School professor who served as a Treasury Department tax policy official during the Bush
Administration.

‘It’s demoralizing to the average citizen that the wealthiest people in the country can so easily avoid this tax,’ he added.

The vast majority of Americans are either too poor or too shrewd to worry about the estate tax. As of 1993, the most recent year for which data were available, only 1.5 percent of adult deaths - 32,000 - involved individuals whose estates were worth at least $600,000 and were taxed.

There is no way to calculate just how much wealth is escaping estate taxation. Many of those who exploit the techniques are in middle age, and the loss of tax revenue will not be significant until they die.

What is most striking, experts say, is what could happen in coming years. The nation stands on the cusp of the largest transfer of wealth in its history, the $5 trillion to $10 trillion in assets that belong to the generations preceding the baby boomers. A significant share of that wealth could pass untaxed, some economists note, if the estate tax remains so easily circumvented. That could contribute to what several studies show is a growing concentration of wealth among the most prosperous 5 percent of households.

Finally, attention is drawn to the following:-

"The idea of taxing the estates of wealthy Americans at death took hold at a time of widespread concern about the growing concentration of economic power. Shortly after the turn of the century, with a handful of families controlling vast oil, railroad and manufacturing fortunes, President Theodore Roosevelt called for ‘a progressive tax’ so that enormous fortunes would not pass in their entirety from one generation of super-rich to the next.

Supporters of the estate tax believed that it would help spread wealth more evenly across the economy and make for a more just society. But by the time Congress established the estate tax in 1916, a second motivation had emerged: a need to increase Government revenues as the nation slid toward involvement in World War I.

Congress shut down big loopholes in the 1980s in an effort to apply the taxes more fairly and make them harder to avoid. Some analysts believe that the issue of loopholes should be revisited.

‘There is a great disparity between appearance and reality in the estate tax, and that does not create confidence in the fairness of the tax system,’ said Max B. Sawicky, tax economist at the Economic Policy Institute, a research organization backed by unions.
It appears unlikely that Congress will eliminate the tax. But Republican officials said the new Congress could well raise the basic exemption, to $750,000 in total gifts and bequests from $600,000, and extend additional breaks to small business and farmers.

‘I am quite torn about the estate tax,’ said William G. Gale, an economist at the Brookings Institution in Washington. Given the growing concentration of wealth, ‘one can make a case that an estate tax in principle is an appropriate tax.’ But, he said, ‘it is not obvious that there is too much concentration,’ enough to harm the economy, ‘or that the estate tax is effective in breaking it up.’

Still, he said, the estate tax remains an important backstop.

‘A lot of income escapes the income tax,’ he said. ‘There’s lots of deferred income and capital gains that are avoided. So the estate tax is a way to capture taxes on money that has escaped taxation during the lifetime of the individual.’"