THE LEVYING OF CAPITAL GAINS TAX AT DEATH

By

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DECLARATION

I, Jaco van Jaarsveld, identity number........... student number ..........., enrolled student for the programme LLM Tax Law, Faculty of Law hereby declare that my minor dissertation, the levying of capital gains tax at death, submitted for the LLM Tax Law degree to the University of Johannesburg, apart from the help recognised, is my own work and has not been submitted previously to another university or institution of higher education for a degree.

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ABSTRACT

Capital Gains Tax (“CGT”) was introduced with effect from 1 October 2001 by the insertion of section 26A and an Eighth Schedule into the Income Tax Act 58 of 1962, by the Taxation Laws Amendment Act 5 of 2001.

Paragraph 40(1) of the Eight Schedule provides that a deceased person must, with certain exceptions, be treated as having disposed of his assets to his estate for proceeds equal to the market value of those assets as at the date of death.

Paragraph 40(1A) of the Eight Schedule provides that if an asset of a deceased person is treated as having been disposed of under paragraph 40(1) and is transferred directly to the estate of the deceased person, the estate must be treated as having acquired the asset at a cost equal to its market value as at the date of death for base-cost purposes, and if the asset is transferred directly to an heir or legatee, the heir or legatee must be treated as having acquired the asset at a cost equal to its market value as at the date of death for base-cost purposes. The capital gain will be the difference between the market value of a taxable asset of the deceased on the date of his death and its base cost to him, which is included in his final income tax assessment and which will have to be settled out of the estate’s assets.

There are many arguments in favour of the discontinuance of the levying of CGT at the death of a taxpayer in South Africa, which arguments become evident when comparing the South African CGT provisions regarding the levying of CGT at death with tax jurisdictions such as Australia, the United States, the United Kingdom, Canada, Botswana and Nigeria. Canada for example abolished their inheritance tax in 1972 which in that particular situation justifies the levying of CGT at death.

If CGT will continue to be levied at the death of a taxpayer it is suggested that a carry-over approach in terms of which the heir inherits the asset at its acquisition cost and the CGT liability is deferred until the heir actually disposes of the asset should be followed. This approach is currently followed in Australia, Botswana and Nigeria.
The holder of an inherited bare dominium will suffer at the hands of a CGT anomaly where the deceased created a limited interest, for example a usufruct over a fixed property bequeathed by him to the bare dominium holder. The anomaly that transpires is that the limited interest created by the deceased will result in an artificial drop in the base cost of the fixed property so bequeathed and there will be no adjustment to the base cost when the bare dominium holder succeeds to full ownership of the fixed property, for example when the usufructuary passes away, meaning that the same capital gain will be taxed twice.

It is submitted that legislative amendments are required to provide for an increase in the base cost applicable to the bare dominium holder when the usufructuary eventually passes away. Alternatively the SARS”s current practice in this respect should be altered to avoid the unbearable situation where a capital gain may be taxed at 2 separate instances.

At least two anomalies exist when dealing with capital losses in the deceased’s final period of assessment and in the winding up of the deceased’s estate. Firstly a capital loss may not be carried forward from the deceased’s final assessment to his deceased estate to be set off against capital gains that may be realised in the winding up of the estate. Secondly a capital loss incurred on the sale of a capital asset during the winding up of a deceased estate cannot be carried over from the deceased estate to the heirs of the deceased and will thus remain unutilised.

It is suggested that the method followed in Canada in respect of capital losses that occurred in the year of a taxpayer’s death should be followed in South Africa, ie that such capital loss may be carried back three years in order to reduce any taxable capital gains that occurred in those years or that the capital losses may be utilised to reduce other income of the taxpayer in his final return. It is further suggested that this method should also be followed in respect of unutilised capital losses that occurred in the winding up of the estate, alternatively the capital losses so realised must be carried over to the heirs of the deceased.

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CHAPTER 1

THE LEVYING OF CAPITAL GAINS TAX AT DEATH, A SOUTH AFRICAN PERSPECTIVE

1.1 Introduction

Capital gains tax (“CGT”) was introduced in the Republic of South Africa (“South Africa”) with effect from 1 October 2001 by the insertion of section 26A and an Eighth Schedule into the Income Tax Act 58 of 1962 (“the Income Tax Act”), by the Taxation Laws Amendment Act 5 of 2001.\(^1\) CGT has been introduced as an integral part of the Income Tax Act and the levying, collection and administration thereof will accordingly take place in terms of the provisions of the Income Tax Act.\(^2\)

The Katz Commission in its report into tax reform raised many arguments in favour of and against the introduction of a CGT, ultimately concluding that having regard to especially the problems of tax administration in South Africa and the low potential yield of CGT that it should not be introduced.\(^3\) Some of the arguments in favour of the introduction of a CGT were that it would limit tax arbitrage, *ie* it would reduce the incentive for taxpayers to avoid tax by switching income into capital gains, it would bring about tax equity, result in a comprehensive income taxation and protect the income tax base.\(^4\) Despite the recommendation by the Katz commission the introduction of CGT was announced by the former Minister of Finance, Mr. Trevor Manual, in his budget speech on 23 February 2000, and even though it was at first to be introduced with effect from 1 April 2001, the introduction was deferred for a further six months and only took effect on 1 October 2001.\(^5\)

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CGT forms part of a natural or legal person’s taxable income and is levied upon capital gains resulting from the disposal of certain assets by the taxpayer during a particular year of assessment. A capital gain is the difference between the base cost of an asset, which is essentially the initial purchase price of an asset or the value thereof as determined on 1 October 2001, calculated in terms of part V of the Eighth Schedule, plus the proceeds derived from the disposal of that asset, less capital expenditure and certain other expenses in respect of such asset. The definitions and calculations pertaining to the last-mentioned will be discussed in detail below.

Certain assets including personal use assets, cash assets and a person’s primary residence (to an extent) are specifically excluded from CGT. The assets so excluded and other specific exclusions such as the annual exclusions will be dealt with comprehensively below. With the introduction of CGT the rate of donations tax was reduced 20% and the rate of estate duty was reduced to 20%. Last-mentioned was due to the fact that CGT is triggered by the death of a person, which will be discussed in greater detail below.

CGT is calculated by means of a specific inclusion rate that is applied to the rate at which the natural or legal person pays income tax. In the case of a natural person the inclusion rate is 33.3% and in the case of a legal person, including an inter vivos and mortis causa trust (other than a special trust in certain circumstances), it is 66.6%. The rate at which CGT is levied on a natural person is linked to his personal marginal tax rate multiplied by the inclusion rate applicable to a natural person, for example 40% multiplied by 33.3% resulting in an effective CGT rate of 13.3%. CGT levied on a legal person is similarly linked to the income tax rate payable by the legal person or trust, namely 28% and 40% respectively, multiplied by the inclusion rate of 66.6% resulting in an effective CGT rate of 18.6% for legal persons other than trusts and an effective rate of 26.6% for trusts (save for special trusts in certain circumstances).

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7 See par 1.4 and 1.5.
9 See par 1.3.
11 See par 1.2.
In terms of section 4(b) of the Estate Duty Act 45 of 1955 the CGT liability that arises at the death of the deceased is an allowable deduction when calculating the estate duty liability of the deceased estate.\(^\text{12}\)

The former Minister of Finance, Mr. Trevor Manual, referred to \textit{inter alia} Australia, Canada, the United Kingdom and the United States in his announcement of a CGT.\(^\text{13}\) African Countries that currently levy a CGT includes South Africa, Nigeria and Botswana. Below I will compare the South African CGT provisions and specifically the provisions regarding the levying of CGT at death in depth with that of the United States, the United Kingdom and Nigeria and briefly discuss the position in Canada, Australia and Botswana.\(^\text{14}\)

I will further make suggestions with a view to addressing various anomalies, including those suffered by bare dominium holders where the deceased created a limited interest relating to the property bequeathed and anomalies that exist when dealing with capital losses in the deceased’s final period of assessment and in the winding up of the deceased’s estate.

\section*{1.2 Legislative provisions regarding the levying of CGT at death}

Paragraph 40(1) of the Eight Schedule to Income Tax Act 58 of 1962 (“the Eighth Schedule”), which in short provides that a deceased person must, with certain exceptions, be treated as having disposed of his assets to his estate for proceeds equal to the market value of those assets as at the date of death, reads as follows:

\section*{40 Disposal to and from deceased estate}

\begin{quote}(1) A deceased person must be treated as having disposed of his or her assets, other than-
\end{quote}

\begin{footnotes}
\item[\textsuperscript{12}] s 4(b) of the Estate Duty Act 45 of 1955.
\item[\textsuperscript{13}] See ch 2.
\item[\textsuperscript{14}] Nedbank / Old Mutual Budget Competition Submission 2000 http://www.economics.ox.ac.uk/members/alberto.behar/rw/cgt.html- (07-05-2010).
\end{footnotes}
(a) assets transferred to the surviving spouse of that deceased person as contemplated in paragraph 67(2)(a);

(b) ...

c) a long-term insurance policy of the deceased which, if the proceeds of the policy had been received by or accrued to the deceased, the capital gain or capital loss determined in respect of that disposal would be disregarded in terms of paragraph 55; or

d) an interest in pension, provident or retirement annuity fund in the Republic or a fund, arrangement or instrument situated outside the Republic which provides benefits similar to a pension, provident or retirement annuity fund which, if the proceeds thereof had been received by or accrued to the deceased, the capital gain or capital loss, determined in respect of the disposal of the interest would have been disregarded in terms of paragraph 54,

to his or her deceased estate for proceeds equal to the market value of those assets at the date of that person’s death, and the deceased estate must be treated as having acquired those assets at a cost equal to that market value, which cost must be treated as an amount of expenditure actually incurred and paid for the purposes of paragraph 20(1)(a).\(^{15}\)

Paragraph 40(1A) of the Eighth Schedule provides that if an asset of a deceased person is treated as having been disposed under paragraph 40(1) and is transferred directly to the estate of the deceased person, the estate must be treated as having acquired the asset at a cost equal to its market value as at the date of death for base-cost purposes, and if the asset is transferred directly to an heir or legatee, the heir or legatee must be treated as having acquired the asset at a cost equal to its market value as at the date of death for base-cost purposes.\(^ {16}\)

\(^{15}\) Par 40 of the Eighth Schedule to the Income Tax Act 58 of 1962 as amended by s 111 of the Taxation Laws Amendment Act 17 of 2009.

\(^{16}\) Par 40 of the Eighth Schedule to the Income Tax Act 58 of 1962 as amended by s 111 of the Taxation Laws Amendment Act 17 of 2009.
A deceased person will thus, with certain exceptions, be treated as having disposed of his assets to his deceased estate for proceeds equal to their market value on the date of his death and his estate, heirs or legatees, as the case may be, must in return be treated as having acquired the assets for a cost equal to the same market value.

Paragraph 67 of the Eighth Schedule deals with the transfer of an asset between spouses and provides in paragraph 67(1)(a) that, save for the circumstances in which an asset is disposed of to a non-resident spouse as provided for in paragraph 67(3) of the Eight Schedule but excluding a disposal pursuant to a divorce order or an agreement of division of assets which has been made an order of court as provided for in paragraph 67(2)(b) of the Eight Schedule, any capital gain or capital loss that arose from the disposal of an asset by a person to his spouse must be disregarded.\(^\text{17}\)

“Disposal” is defined in paragraph 1 of the Eight Schedule, read together with par 11 of the Eighth Schedule, as any event, act, forbearance or operation of law in terms of which an asset is created, varied, transferred or extinguished, including the sale, donation or any other transfer of ownership of an asset.\(^\text{18}\)

Paragraph 67(2)(a) of the Eighth Schedule goes further to say that –

\(\text{(2) \quad For the purposes of subparagraph (1) -}\)

\(\quad (a) \text{ a deceased person must be treated as having disposed of an asset to his or her surviving spouse, if ownership of that asset is acquired by that surviving spouse by ab intestato or testamentary succession or a result of a re-distribution agreement between the heirs and the legatees of that deceased person in the course of liquidation or distribution of the deceased estate of that person.}\(^\text{19}\)\)

\(^{17}\) Par 67(1)(a) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 108(a) of Act 45 of 2003.

\(^{18}\) Par 1 and par 11 of the Eighth Schedule to the Income Tax Act 58 of 1962.

\(^{19}\) Par 67(2)(a) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 56 of Act 20 of 2006.
Not all the assets of the deceased will be subject to CGT. An asset for CGT purposes includes all movable or immovable, corporeal or incorporeal property of the taxpayer, excluding any currency, but including any coin made mainly from gold or platinum, and a right or interest of whatsoever nature to or in such property. At first glance it is clear that any form of currency, whether local or foreign, is excluded from the definition of an asset. Any cash funds will thus not be subject to CGT, but will more than likely be subject to some other form of taxation. A possible reason for this exclusion is to eliminate the deduction of a capital loss due to, for example, theft of money.

There are however certain assets that are specifically excluded from the operation of CGT. The exclusions are dealt with in paragraphs 52 to 64 of the Eighth Schedule and include *inter alia* personal use assets, for example a person’s personal vehicle, retirement benefits, disposal by a creditor of debt owed by a connected person in relation to such creditor, disposal of small and micro business assets, compensation for personal injury, illness or defamation, gambling, games and competitions in respect of South African organised gambling, collective investment schemes in securities (unit trusts), disposal of an interest in the equity share capital of a foreign company and the other exclusion referred to above.

An asset that is subject to CGT will be referred to herein as a “taxable asset” or a “capital asset”.

1.3 *CGT exemptions and exclusions*

Paragraph 67(1)(a) of the Eight Schedule referred to above provides for an exemption from CGT if an asset, that would otherwise have been subject to CGT, is transferred by a person to his spouse. In terms of paragraph 67(1)(b) of the Eight Schedule however there will be no step up in the base cost of such asset as will be discussed in detail below.

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21 Dennis, Olivier and Urquhart *Juta’s Income Tax* (1999-) Sch 8 par 1-7.
22 Par 52 to 64 of the Eighth Schedule to the Income Tax Act 58 of 1962.
Paragraph 67(2)(a) makes the exemption from CGT in respect of assets transferred between spouses applicable at the death of the first-dying spouse, but once again paragraph 67(1)(b) of the Eight Schedule will apply and there will be no step up in the base cost, in other words the asset is deemed to have been disposed of to the surviving spouse by the deceased at its base cost to him.\footnote{Par 67(2)(a) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 56 of Act 20 of 2006.} Thus no capital gain and importantly also no capital loss will arise for the deceased on an asset that is bequeathed to his spouse. The exemption that applies to the surviving spouse is however not a full exemption: the surviving spouse will still be taxed at his or her death or in the event of the asset being sold by him or her before his or her death. It is thus only a roll-over relief from the first-dying spouse to the last-dying spouse. Other exemptions include qualifying long-term insurance policies on which the capital gains would have been exempt from tax and in certain circumstances interests in a pension, provident or retirement annuity fund in the Republic or a fund, arrangement or instrument situated outside the Republic that provides benefits similar to a pension, provident or retirement annuity fund.\footnote{Par 40(1) of the Eighth Schedule to the Income Tax Act 58 of 1962 as amended by s 111 of the Taxation Laws Amendment Act 17 of 2009.}

The are two more applicable exclusions namely the primary residence exclusion dealt with in paragraphs 44 to 51 of the Eighth Schedule and the annual exclusion dealt with in paragraph 5 of the Eighth Schedule.\footnote{Par 5, 44 to 51 of the Eighth Schedule to the Income Tax Act 58 of 1962.} The primary residence exclusion in short provides that if a natural person or special trust, in certain circumstances, disposes of his, her or its primary residence, a capital gain to the amount of R2 million will be disregarded for purposes of CGT. Only the primary residence and two hectares land adjacent thereto will qualify for the exemption. Costs incurred in respect of the acquiring of a capital asset, for example legal fees, stamp duty and valuation fees, and costs incurred in respect of the selling of the asset, for example estate agent commission and legal costs, will generally be deductible when calculating the capital gain realised, if any.\footnote{Par 20 of the Eighth Schedule to the Income Tax Act 58 of 1962.} The current annual exclusion for a natural person or special trust in respect of a year of assessment is R30 000, and R300 000 in the year of assessment that a person passes away.\footnote{Rates and Monetary Amounts and Amendment of Revenue Laws Act 13 of 2012.}
Paragraph 40(3) of the Eighth Schedule provides that the disposal of an asset by the deceased estate of a natural person must be treated in the same manner as if it had been disposed of by the deceased himself.\textsuperscript{29} This means that the estate would be entitled to the same exemptions and reliefs as would have been available to the deceased before his death, for example, on the sale of what was his primary residence or personal-use assets.

The deceased estate will, taking into account all of the exemptions and exclusions referred to above, be deemed to have disposed of the taxable asset to an heir, legatee or to the trustee of a trust for proceeds equal to the base cost (ie market value on the date of death) to the deceased estate and the heir, legatee or to the trustee of a trust will in turn be deemed to have acquired the asset at a cost equal to that amount.\textsuperscript{30} In other words there will be no capital gain or capital loss on the disposal of a asset by the estate to an heir, legatee or trustee, subject to par 12(5) of the Eighth Schedule, which deems a capital gain to arise when a debt has been reduced or discharged by a creditor for no consideration or for a consideration that is less than the amount by which the face value of the debt has been reduced or discharged.\textsuperscript{31} In this instance the effect of par 12(5) is to deem a capital gain to have arisen when a debt owing by an heir or legatee or a trust is discharged in terms of the will of a deceased person.

When the heir, legatee or trustee of the trust subsequently disposes of an asset, they will realise a capital gain or capital loss equal to the difference between the proceeds from the disposal and the base cost (ie market value on the date of death) of the asset to the estate. If the estate however disposes of an asset to anyone else, for example, an independent buyer, or if an asset is for example sold on a public or private auction out of the estate, there will be a capital gain or capital loss equal to the proceeds of the sale less the base cost (ie market value on the date of death) of the asset to the estate.

\textsuperscript{29} Par 40(3) of the Eighth Schedule to the Income Tax Act 58 of 1962.

\textsuperscript{30} Par 40(2) of the Eighth Schedule to the Income Tax Act 58 of 1962 as amended by s 82 of Act 74 of 2002, s 50 of Act 20 of 2006 and s 79(1)(c) of Act 60 of 2008.

\textsuperscript{31} Par 12(5) of the Eighth Schedule to the Income Tax Act 58 of 1962.
1.4 How CGT will be calculated at death

The capital gain will be the difference between the market value of a taxable asset of the deceased on the date of his death and its base cost to him, which is included in his final income tax assessment and which will have to be paid from estate funds. The determination of the market value of an asset will be discussed below. Paragraph 20 of the Eighth Schedule *inter alia* provides that the base cost of an asset is the sum of the expenditure actually incurred in respect of the cost of acquisition or creation of that asset and a list of other expenditures actually incurred in respect of such asset. This means that, in his final assessment up to the date of his death, the deceased will make a capital gain or a capital loss of an amount equal to the difference between the market value of a taxable asset on the date of his death and its base cost to him, taking into account the exemptions and exclusions referred to above.

If there are insufficient funds in the estate and the heirs cannot provide such funds it may be necessary to sell all or part of the estate assets in order to obtain the necessary funds, except where paragraph 41 of the Eighth Schedule applies. In short paragraph 41 provides that where the taxable capital gain of a deceased person exceeds 50% of the net value of the estate determined for purposes of estate duty and the executor of the estate is required to dispose of any asset of the estate for purposes of paying the amount of tax so determined, any heir or legatee of the estate may elect that that asset be distributed to that heir or legatee upon the condition that the amount of tax which exceeds 50% of that net value be paid by him or her within a period of three years after the date that the executor obtained permission to distribute the assets of the estate.

1.5 Valuation of assets for purposes of CGT

When valuing a taxable asset of the taxpayer for purpose of CGT the rules set out in paragraph 29 and paragraph 31 of the Eighth Schedule must be applied. Paragraph 29 deals with the

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32 See par 1.5.
33 Par 20 of the Eighth Schedule to the Income Tax Act 58 of 1962.
34 Par 41 of the Eighth Schedule to the Income Tax Act 58 of 1962.
valuation of an asset as on the 1st of October 2001, being the “valuation date” or date on which CGT came into effect.\textsuperscript{35} Paragraph 31 deals with the market value of an asset on a specified date.\textsuperscript{36} Of specific importance to the discussion in this dissertation is the provisions contained in paragraphs 31(1)(d), 31(1)(e) and 31(1)(g) of the Eighth Schedule:

\textbf{31 Market value}

\begin{enumerate}
\item The market value of an asset on a specified date is in the case of –
\begin{enumerate}
\item a fiduciary, usufructuary or other similar interest in any asset, an amount determined by capitalizing at 12 per cent the annual value of the right of enjoyment of the asset subject to that fiduciary, usufructuary or other like interest, as determined in terms of subparagraph (2), over the expectation of life of the person to whom that interest was grated, or if that right of enjoyment is to be held for a lesser period than the life of that person, over the lesser period;
\item any asset which is subject to a fiduciary, usufructuary or other similar interest in favour of any person, the amount by which the market value of the full ownership of that asset exceeds the value of that fiduciary, usufructuary or other like interest determined in accordance with item (d);
\item any other asset, the price which could have been obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arm’s length in an open market.\textsuperscript{37}
\end{enumerate}
\end{enumerate}

\textsuperscript{35} Par 29 of the Eighth Schedule to the Income Tax Act 58 of 1962.
\textsuperscript{36} Par 31 of the Eighth Schedule to the Income Tax Act 58 of 1962.
\textsuperscript{37} Par 31(1)(d) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 83(1)(b) of Act 60 of 2001 and by s 78(1)(b) of Act 74 of 2002; Par 31(1)(e) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 78(1)(b) of Act 74 of 2002; Par 31(1)(g) of the Eighth Schedule to the Income Tax Act 58 of 1962 as amended by s 49(a) of Act 20 of 2006.
The Income Tax Act therefore makes provision for a general rule, namely that the market value of an asset will be the price which could have been obtained upon the sale of an asset between a willing buyer and a willing seller dealing at arm’s length in an open market, and then refers to specific assets to which other rules or certain formulas will apply. Two of the specific assets referred to are a usufruct (paragraph 31(1)(d) of the Eighth Schedule) and a bare dominium (paragraph 31(1)(e) of the Eighth Schedule). Both these concepts and the concept of a usufructuary interest will be discussed in detail below.\(^{38}\)

In terms of paragraph 31(1)(d) of the Eighth Schedule the value of a usufruct will be determined by taking an amount equal to 12% of the market value of the full ownership of the asset, being the annual value of the right of enjoyment of the asset subject to that usufruct, over the life expectancy of the usufructuary, or if the usufructuary interest is to be held for a lesser period than the life of the usufructuary, over such lesser period. The value of the usufruct is therefore equal to the market value multiplied by 12% divided by either the life expectancy of the usufructuary or such lesser period over which the usufructuary right is to be held.\(^{39}\) In terms of paragraph 31(1)(e) of the Eighth Schedule the value of the bare dominium will be the difference between the market value of the full ownership of the asset and the value of the usufruct as determined in terms of paragraph 31(1)(d) of the Eighth Schedule.

1.6  \textit{Determination of base cost of assets for purposes of CGT}

It is important to know how the base cost of a taxable asset will be determined since the capital gain of a specific taxable asset of the deceased will be the difference between the market value on the date of his death and the base cost of such asset. The calculation of the base cost of an asset is the first step in determining what the capital gain or capital loss in respect of the specific taxable asset will be.

\(^{38}\) See par 1.8.

\(^{39}\) Par 31(1)(d) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 83(1)(b) of Act 60 of 2001 and by s 78(1)(b) of Act 74 of 2002.
The general rule is that the base cost of an asset will be the expenditure actually incurred by the taxpayer in respect of the acquisition or creation of the asset, together with other qualifying expenditure such as certain capital expenditure incurred in respect of the taxable asset, costs for the valuation of the asset for CGT purposes, transfer costs, remuneration of for example the agent when a property has been sold etc.\textsuperscript{40} This rule will however only be applicable to a taxable asset that was acquired or created on or after 1 October 2001. If the taxpayer had for example acquired a fixed property on or after 1 October 2001 the purchase price thereof would constitute the base cost of the said property, but the capital expenditure incurred by him to build an extra garage on the property and also the agent’s commission payable by him when he sells the property would be added to the original purchase price paid in order to calculate the base cost.

The legislator has however made CGT legislation retrospective in that a taxable asset of the taxpayer acquired by him before 1 October 2001 will be subject to CGT when he disposes of the asset or is deemed to have disposed of the taxable asset on or after 1 October 2001. When the taxable asset was acquired before 1 October 2001 three methods are used for calculating the base cost of such a taxable asset.\textsuperscript{41} The first method entails determining the “market value” of such asset as on 1 October 2001.\textsuperscript{42} This method usually gives the best result for the taxpayer but can only be used if a value of the asset was determined between 1 October 2001 and 30 September 2004. Taxpayers had until 30 September 2004 to obtain a valuation reflecting the value of such asset as on 1 October 2001.

In terms of the second method the value of a taxable asset as on 1 October 2001 will be 20% of the proceeds of the asset when the asset is disposed of, from which proceeds any expenditure incurred on or after 1 October 2001 as contemplated in paragraph 20 of the Eighth Schedule must be deducted.\textsuperscript{43} This is usually the method that is used as a last resort as it will more often

\textsuperscript{40} Par 20 of the Eighth Schedule to the Income Tax Act 58 of 1962.

\textsuperscript{41} Par 26 of the Eighth Schedule to the Income Tax Act 58 of 1962.

\textsuperscript{42} Par 26(a) of the Eighth Schedule to the Income Tax Act 58 of 1962; Par 29 of the Eighth Schedule to the Income Tax Act 58 of 1962.

\textsuperscript{43} Par 26(b) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 74(1)(b) of Act 74 of 2003.
than not mean that a relatively large capital gain has been realised. This method will be used if no valuation was obtained or can be determined as described above and also if no records were kept. If proper records were kept the time-apportionment base cost method referred to below would normally be applied.

The third method is known as “time-apportionment base cost” in terms of which the value of a taxable asset will be calculated by using one of two formulas contemplated in paragraph 30 of the Eighth Schedule.\(^4^4\) The following formula will be applied when a portion of the expenditure in respect of a taxable asset was incurred on or after 1 October 2001:\(^4^5\)

\[
\text{Formula: } P = R \times \frac{B}{(A + B)}
\]

Where: 
- \(P\) is the proceeds attributable to the time the asset was held for prior to 1 October 2001;
- \(R\) is the total amount of proceeds on disposal of the asset;
- \(A\) is the allowable expenditure in respect of the asset incurred on or after 1 October 2001;
- \(B\) is the allowable expenditure in respect of the asset incurred before 1 October 2001.

In the event that all the expenditure in respect of a taxable asset was incurred before 1 October 2001 (the valuation date), the following formula will be used to calculate the base cost:\(^4^6\)

\[^4^4\] Par 26(1)(c) of the Eighth Schedule to the Income Tax Act 58 of 1962 as amended by s 78(1)(a) of Act 60 of 2001.

\[^4^5\] Par 30(4) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 70(1)(d) of Act 31 of 2005.

\[^4^6\] Par 30(4) of the Eighth Schedule to the Income Tax Act 58 of 1962 as substituted by s 70(1)(d) of Act 31 of 2005.
Formula: \[ Y = B + \frac{(P - B) \times N}{T + N} \]

Where:

- \( Y \) is the base cost.
- \( B \) is the allowable expenditure in respect of the asset from date of acquisition to 30 September 2001;
- \( P \) is the proceeds from the disposal of the asset;
- \( N \) is the number of years from date of acquisition to 30 September 2001, but may in this instance not exceed 20 years because it is assumed that the expenditure was incurred in more than one year of assessment;
- \( T \) is the number of years from 1 October 2001 until date of disposal.

When it has been established what the base cost of a taxable asset is it is possible to calculate the capital gain in respect of such asset, where-after firstly the aggregate capital gain (after deducting capital losses and the annual exclusion), then the net capital gain (after deducting the assessed capital loss from the previous year) and eventually the CGT payable (by multiplying the inclusion rate of 25% or 50% with the rate at which the individual, trust or legal person is taxed) can be calculated.

1.7 **Anomalies in respect of capital losses at death**

By virtue of the South African CGT provisions applicable to capital losses any capital loss of the deceased may be set off against the capital gains made by the deceased in his or her final period of assessment, *ie* the period from 1 March until the date of his or her death in that financial year.\(^{47}\)

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\(^{47}\) Par 6 to 9 of the Eighth Schedule to the Income Tax Act 58 of 1962.
It is SARS”s view that an assessed loss or assessed capital loss cannot be carried forward to the deceased estate of a deceased taxpayer because two separate entities exist, namely the deceased and the deceased’s estate, each of which is a separate legal entity. It has been remarked that the way capital losses are dealt with depicts one of the unjust features of the South African tax system.

The first anomaly that exists in respect of capital losses at death is that a capital loss may eliminate the capital gains in the final period of assessment but such portion of the capital loss that exceeds the capital gains would be relinquished since it cannot be carried forward to the deceased estate and the deceased would obviously have no further periods of assessment. The result of the aforesaid is that while a CGT liability may arise on a taxable capital gain during the deceased’s final period of assessment, which liability must be settled out of the estate’s assets, the deceased’s aggregate capital loss is merely disregarded and such loss may not be used to set off against capital gains that may be realised in the winding up of the estate.

The second anomaly that exists in respect of capital losses is that a capital loss incurred on the sale of a taxable asset during the winding up of a deceased estate cannot be carried over from the deceased estate to the heirs of the deceased and will thus remain unutilised. This is in sharp contrast when where the executor sells a taxable asset to a third party and realises a capital gain, in which event he must render a return in the name of the deceased estate and account for the gain. It appears that the estate would be prejudiced in the event that a capital loss is incurred in the aforesaid circumstances, unless some other taxable gain exists against which such loss could be set off, in that such loss would effectively remain unutilised and forfeited.

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51 Goebel “Capital Gains Tax on Death” volume 1 Conspectus 1-2.
52 Goebel “Capital Gains Tax on Death” volume 1 Conspectus 1-2.
53 Goebel “Capital Gains Tax on Death” volume 1 Conspectus 2.
1.8 **CGT anomaly suffered by bare dominium heirs**

1.8.1 **The usufruct**

It is a common feature of estate planning for the testator or testatrix to bequeath an asset to an heir, for example a child, mother, father etc., subject thereto that his or her surviving spouse will have an unfettered right to use the asset for his or her lifetime or for such a period or until the happening of such an event as stipulated by the testator or testatrix. The surviving spouse will in such an instance be known as the usufructuary, and the heir as the bare dominium holder. The right so created is known as a usufruct, a Latin word meaning „use of fruits”, allowing the usufructuary to use the asset subject to the usufruct in any manner as he or she deems fit so long the very essence of the asset is not impaired.\(^{54}\) The usufructuary is in other words obliged to „give over” the asset to the eventual heir in the same condition, reasonable wear and tear excluded. It is for this very reason that a usufruct cannot be created over a consumable asset.

The usufructuary will have full use over the asset and will be entitled to the civil fruits (for example rental income received from the letting of a fixed property) and natural fruits (for example the offspring of a flock of sheep) of the asset. The bare dominium holder cannot sell the asset for so long as the usufructuary right exists, save with the consent of the usufructuary.\(^{55}\)

There could be many reasons for the creation of a usufruct including the provision of income to a specific person or the preservation of an asset for the eventual heir, especially where the heir is a minor and the testator or testatrix does not wish to leave the asset in trust for such minor child but still wants the minor child to obtain full ownership of the asset eventually. In terms of section 4(q) of the Estate Duty Act 45 of 1955 any benefit, including a usufruct created in favour of the surviving spouse of a deceased person, that accrues to the surviving spouse will be disregarded, *ie* qualify as a deduction, for purposes of calculating the estate duty payable by the estate of that

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\(^{54}\) Ger and Hartzenberg “Bare dominium heirs may also inherit tax problems” November 2005 *De Rebus* 42.

A usufruct does not necessarily need to be created in favour of the surviving spouse, it could for example be created over fixed property in favour of the testator’s mother in order for her to have a place to live until she passes away, in which event the section 4(q) deduction described above will not apply.

In the event that a usufruct is created the value of the asset subject to the usufruct will, at the death of the testator or testatrix, be split between the value of the right of use, being the usufruct value as described above, and the value of the right of ownership, being the bare dominium value as described above. The usufructuary’s right to use the asset will revert back to the originally nominated heir upon the death of the usufructuary, after a specific period or after the occurrence of a specific event (for example when the usufructuary remarries). The bare dominium holder will thereafter have full ownership over the asset and may dispose thereof at his or her sole discretion. It is at the latter event that the bare dominium holder is likely to suffer certain anomalies in respect of CGT which will be discussed below. Even though a usufruct may be used as an estate planning tool it is not always the case (for example the creation of a usufruct for the benefit of the testator’s mother as described above). The SARS has attempted over the years to curb the use of a usufruct as an estate planning tool but it is submitted that the anomalies suffered by bare dominium holders and other circumstances that arise in this respect as will be discussed below is prejudicial to taxpayers and requires legislative amendment.

1.8.2 Reduced base cost

When a testator or testatrix creates a usufruct in his or her last will and testament the value of the assets will be split between the bare dominium value and the usufruct value as described above.

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56 s 4(q) of the Estate Duty Act 45 of 1955.
57 See par 1.5.
58 See par 1.8.2.
59 See par 3.3.
60 See par 1.5 and 1.8.1.
The bare dominium value will constitute the base cost for the bare dominium holder, which will in most cases be a very low value as will appear from the example used below. The creation of the usufruct thus results in what is called “an artificial drop in the base cost of an asset” in that the base cost for the bare dominium holder is not the market value of the asset as at the date of the death of the testator or testatrix, but the lesser (often close to zero) bare dominium value.\(^61\)

The anomaly that exits is that when the usufruct expires the rights in respect of the usufruct pass to the bare dominium holder but his low base cost is not adjusted to at least the full value of the asset as on the date at which the usufruct was created. The result is that a substantial capital gain may arise when the former bare dominium holder who now has full ownership of the asset disposes of the asset.\(^62\)

The problem therefore lies not in the fact that a reduced base cost is attributed to the bare dominium holder, but the way in which the SARS deals with the expiry of the usufruct, \textit{ie} that the expiry of the usufruct does not give rise to a corresponding acquisition in the hands of the bare dominium holder, that results in the anomaly described above.\(^63\)

If the expiry of the usufruct were to give rise to a corresponding acquisition on the part of the bare dominium holder, it would in majority of the cases have resulted in an increased base cost for the bare dominium holder.\(^64\)

The base cost could be increased to the value of the asset as on date of death or to the value of the asset on expiry of the usufruct. It is submitted that such a deemed corresponding acquisition in the hands of the bare dominium holder would be the correct way to deal with this particular situation.

The anomaly could be explained by way of the following example: Mr. X owned a holiday home which he acquired in 2004 for an amount of R600 000.00. He passed away in March 2011 and left the holiday home to his son, Mr. X (Jnr.) in terms of his last will and testament, subject to a

\(^{61}\) Ger and Hartzenberg “Bare dominium heirs may also inherit tax problems” November 2005 \textit{De Rebus} 42.

\(^{62}\) Ger and Hartzenberg “Bare dominium heirs may also inherit tax problems” November 2005 \textit{De Rebus} 42; Stein \textit{Capital Gains Tax} (2011) 10.7.

\(^{63}\) Ger and Hartzenberg “Bare dominium heirs may also inherit tax problems” November 2005 \textit{De Rebus} 42; Cassiem “Capital gains tax and the bare dominium holder” March 2009 \textit{Insurance and Tax Journal}.

\(^{64}\) Ger and Hartzenberg “Bare dominium heirs may also inherit tax problems” November 2005 \textit{De Rebus} 42.
life-long usufruct in favour of his wife, Mrs. X. Mr. X rented out the holiday home for the greater part of each year and by creating the usufruct in favour of his wife he was looking to guarantee that she will be entitled to the income generated from the renting out of the holiday home. Mrs. X. will turn 40 at her next birthday. Her life expectancy according to the available tables in this respect (table A) is 35.48 years and the present value of R1 per annum over her remaining life is 8,183,86. The market value of the holiday home as on date of death and therefore also the base cost for Mr. X’s estate is R1 200 000.00. The difference between the original purchase price of R600 000 plus any capital expenditure and any other qualifying expenditure in respect of the holiday home, being the initial base cost applicable to Mr. X, and the market value of the holiday home at death will, with certain exceptions and exclusions such as the annual exclusion, be subject to CGT. The estate will thereafter be deemed to have disposed of the holiday home to the heir, Mr. X (Jnr.), and the usufructuary, Mrs. X, for proceeds equal to the market value on the date of death (the new base cost in respect of the holiday home) and Mr. X (Jnr.) and Mrs. X will accordingly be deemed to have acquired the holiday home for an amount of R1 200 000. There will be no further CGT payable at his stage. A portion of the base cost will however be allocated to the bare dominium and a portion to the usufruct. The market value of or base cost allocated to the usufruct will be calculated by taking an amount equal to 12% of the fair market value of the holiday home and capitalising such amount over the life expectation of the usufructuary. In this instance the base cost of the usufruct will be R1 178 475.84 (R1 200 000 x 12% x 8.18386) and the base cost of the bare dominium will be R21 524.16 (R1 200 000 – R1 178 475.84). Mr. X (Jnr.) will thus receive the bare dominium of the holiday home with a base cost of R21 524.16.

Mrs. X passes away in 2020 with the effect that the full ownership in respect of the holiday home passes to Mr. X (Jnr.). The value of the holiday home then is R2 million and Mr. X (Jnr.) now wishes to sell the holiday home. One would have thought that when the full ownership passed to Mr. X (Jnr.) so did the full base cost of the holiday home, ie R1 200 000, but there is in fact no


66 Strauss “Capital gains tax and limited interests” June 2002 De Rebus 51.
adjustment to the base cost and the original base cost applicable to the bare dominium holder, namely R21 524.16 will remain. CGT will thus be payable on the difference between R2 million and R21 524.16 and not on the difference between R2 million and R1 200 000 which is respectfully submitted should have been the case. Had Mr. X not created a usufruct in favour of his wife Mr. X (Jnr.) would have inherited the holiday home with a base cost of R1 200 000 and less CGT would have been payable on the sale of the holiday home. The testator’s or testatrix’s wish to bequeath an asset to for example their children and simultaneously make adequate provision for, for example, his or her spouse or parents by creating a usufruct over the asset in their favour, may therefore have very serious CGT complications further down the line.

Another example which highlights an even more peculiar situation is where the deceased passed away before CGT was introduced, ie he passed away before 1 October 2001, and bequeathed an asset that would initially not have been subject to CGT, for example a farm acquired before 1 October 2001, to his son subject to a usufruct in favour of his surviving spouse. The South African provisions in respect of CGT is applicable to assets acquired both before and after the date on which CGT was introduced in South Africa. In such an instance the usufruct and the bare dominium of the farm will be valued as on 1 October 2001 according to the method referred to above. The base cost of the farm will be the value of the bare dominium as on 1 October 2001 which will be low compared to the value of the usufruct held by the surviving spouse. When the farm is sold the full value of the farm will be realised if the surviving spouse no longer holds the usufruct and a significant CGT liability may arise.

The same situation would arise when a fideicommissum is created by the deceased. An example of a fideicommissum is where the deceased bequeaths his farm to his son on condition that the farm will pass to his grandson when his son passes away. The grandson of the deceased is acquiring a fiduciary interest in the asset and would for base cost purposes be deemed as

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67 Strauss “Capital gains tax and limited interests” June 2002 De Rebus 52.
68 See par 1.5 and par. 3.1.
having acquired the fiduciary interest at no cost. The anomaly then arises that if there had been no *fideicommissum* but X had simply been bequeathed the asset, X would have a base cost of the market value referred to in par 40(1), whereas if X only receives a fiduciary interest, X will have no base cost even though the *fideicommissum* could fall away soon afterwards if Y predeceases X."\(^{70}\)

Only one commentator could be found who does not have a problem with the fact that the bare dominium holder would lose out on the base cost in respect of the inherited asset. He remarks that there is no substance in the argument by other commentators that the base cost should be increased when the usufruct expires. His reasons are that the bare dominium is in actual fact only worth the low value placed on it at the date of acquisition because of the encumbrance of the asset by the usufruct and also that the subsequent increasing in the value of the asset was obtained for no additional consideration by the bare dominium holder.\(^{71}\) He then endeavours to prove that the overall tax burden would have been the same in the instance where a usufruct is created over an asset with a lesser base cost remaining applicable after the usufruct has expired and in the instance that the deceased disposed of the full ownership in respect of the property on the day before he died.\(^{72}\)

It is respectfully submitted that an argument claiming that the overall tax burden would be the same regardless of the bare dominium holder’s base cost not being stepped-up when the usufructuary passes away, is unfounded. If the deceased sold the asset the day before he died that part of the proceeds that constitutes a capital gain would be subject to CGT, less certain exclusions for instance the annual exclusion. The full value of the asset, which could either be the purchase price or a higher value provided that the higher value was subject to CGT, will be the new base cost to the new owner. I therefore have to respectfully agree with the commentators and writers who clearly illustrate that a CGT anomaly does in fact arise in respect of the bare dominium holder in this instance.


To date no clarity has been obtained from SARS in respect of the above and it seems that their view as expressed in the comprehensive guide to CGT stands, namely that the expiry of the usufruct does not give rise to a corresponding acquisition for bare dominium holder and there will therefore be no adjustment to the bare dominium base cost on expiry of the usufruct.\(^7^3\) It is clear from the above that the bare dominium holder is prejudiced by the method used to value the bare dominium without a corresponding adjustment to the base cost value when the usufructuary passes away and it is submitted that the concerns raised by the abovementioned commentators and writers in respect of this CGT anomaly are well-founded.

Save for the fact that it does not appear from research as if the anomaly suffered by a South African bare dominium holder in respect of a taxable asset over which a limited interest was created by the deceased is suffered by taxpayers in the jurisdictions with which the South African CGT provisions and specifically the CGT provisions at death are compared to in this dissertation, no further comparative analysis will be done in this respect.

CHAPTER 2

THE LEVYING OF CAPITAL GAINS TAX AT DEATH: A COMPARATIVE PERSPECTIVE

2.1  CGT provisions in Canada

The tax system of Canada has been structured in a way that allows for personal and corporate tax to be levied by the federal government and or by any one of its nine provincial governments. The federal government of Canada introduced CGT in 1972 to bring about an equitable taxation system and to finance the social security system of Canada and currently levies CGT through its Income Tax Act. Federal estate tax was however abolished simultaneously with the introduction of CGT and following the abolition of the federal estate tax in 1972, all of the provinces eventually abolished the inheritance tax previously levied by them, the last being the province of Quebec which abolished its inheritance tax in 1985.

It can be said that Canada’s abolished death tax, which can be classified as a direct tax on personal wealth, is now imposed indirectly through the CGT system. This is achieved by a deeming provision very similar to the one that can be found in the South African tax law in respect of the levying of CGT on certain assets at death. The general rule in Canada is that a capital asset owned by the deceased at the date of his death, with certain exceptions, is deemed to

76 R.S.C., 1985, c. 1(5th Supp.).
80 s 70(5) of the Income Tax Act (R.S.C., 1985, c. 1(5th Supp.)).
have been sold by him immediately before his death at a price equal to the fair market value of the asset at that time.\textsuperscript{81} The estate or other person or entity that acquires the asset will be deemed to have acquired the asset at a cost equal the fair market value of the asset as on date of death.\textsuperscript{82} The capital gain will be the difference between the price at which the asset is sold, which in this case is the fair market of the asset belonging to the deceased on date of his death, and its original cost to the taxpayer, in this case the deceased, known as the “cost amount” or “tax basis”.\textsuperscript{83}

Similar to the South African CGT provisions applicable at death, Canada’s CGT provisions provide for roll-overs in certain circumstances. One of the events that will qualify as a roll-over is the transfer of a capital asset by a taxpayer to his spouse during his life-time or to his surviving spouse or to a “spouse trust” on his death, unless the executor or administrator of the estate elects that the roll-over will not apply.\textsuperscript{84} There will however be no step up in the cost amount or base cost in respect of such asset and the cost amount applicable to deceased will remain applicable to his or her spouse.\textsuperscript{85} CGT exemptions in Canada include profits made from registered retirement savings plans (RRSP’s), registered education savings plans (RESP’s) and registered retirement income funds (RRIF’s) but only in certain circumstances.\textsuperscript{86}

Despite the fact that the Canadian CGT provisions applicable at death are very similar to the South African CGT provisions applicable at death, and despite the fact that Canada had abolished their estate tax after the introduction of CGT specifically for the reason that CGT is applicable at the death of a Canadian taxpayer, South Africa only reduced estate duty as will be explained in greater detail below.\textsuperscript{87}

\begin{itemize}
\item \textsuperscript{81} \textsuperscript{s 70(5)(a) of the Income Tax Act (R.S.C., 1985, c. 1(5\textsuperscript{th} Supp.).}
\item \textsuperscript{82} \textsuperscript{s 70(5)(b) of the Income Tax Act (R.S.C., 1985, c. 1(5\textsuperscript{th} Supp.).}
\item \textsuperscript{83} \textsuperscript{s 39 and s 248(1) of the Income Tax Act (R.S.C., 1985, c. 1(5\textsuperscript{th} Supp.).}
\item \textsuperscript{84} \textsuperscript{s 73(1) of the Income Tax Act (R.S.C., 1985, c. 1(5\textsuperscript{th} Supp.).}
\item \textsuperscript{85} \textsuperscript{s 73(1) of the Income Tax Act (R.S.C., 1985, c. 1(5\textsuperscript{th} Supp.).}
\item \textsuperscript{86} EconomyWatch “Capital Gains Tax in Canada” http://www.economywatch.com/tax/canada/capital-gains.html (07-05-2010).
\item \textsuperscript{87} See par 3.1.
\end{itemize}
In Canada capital losses that occurred in the year of a taxpayer’s death may either be carried back three years in order to reduce any taxable capital gains that occurred in any one or all of the three tax years before the year of death, or the capital losses may be utilised to reduce other income of the taxpayer in his final return, in which event any surplus capital losses may not be carried back as described above.88

2.2  CGT provisions in Australia

CGT was introduced in Australia with effect from 20 September 1985 and only applies to a taxable asset acquired on or after such date, referred to herein as a “post-CGT asset”.89 The Australian CGT provisions can be found in sections 100-1 to 152-425 of the Income Tax Assessment Act 1997.90 Section 104-5 sets out a total of 52 events that will have CGT consequences,91 the most common event being A1, disposal of an asset, in which event a capital gain will arise if the proceeds from the disposition exceeds the cost base (which is generally the acquisition cost of such asset) and a capital loss will arise if the proceeds from the disposition is less than the cost base.92

The general rule in respect of the levying of CGT in Australia is that CGT will apply to any change of ownership of a post-CGT asset subject to various exceptions and further subject to a special CGT rule that a capital gain or capital loss made on a post-CGT asset will be disregarded in the event that a taxable asset owned by the deceased passes directly to his legal personal representative or to a beneficiary, or in the event that such asset passes from the legal personal representative to a beneficiary.93 When an Australian taxpayer passes away his assets will either

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pass directly to a beneficiary or beneficiaries, being the person or persons named in the will of the deceased or the person or persons entitled to the assets in terms of the laws of intestacy, or it will pass directly to the deceased’s legal personal representative, namely the executor appointed by the will or if there is no will, an administrator appointed to wind up the estate, who may either dispose of any one or all of the assets or pass them to the beneficiary or beneficiaries.  

There will therefore be no CGT payable on the death of an Australian taxpayer, as long as a taxable asset will eventually be transferred to a beneficiary appointed by him in his last will and testament or in terms of the Australian laws of intestacy. There are however exceptions to this rule, namely where the deceased bequeaths an asset to a tax-advantaged entity, for example an exempt entity such as a charity or the trustee of a complying superannuation fund, or to a foreign resident, in which event any capital gain or capital loss made must be taken into account in the deceased’s final tax return, with further exceptions to the said exception.

In addition to there not being CGT payable on the death of an Australian taxpayer, with aforementioned exceptions, Australia also do not currently levy a capital transfer tax in the form of a death or estate duty.

Similar to South African CGT provisions in respect of roll-overs the beneficiaries are deemed to have acquired a taxable asset, either directly from the deceased estate or from the legal personal representative, at the deceased’s date of death without a step up in the base cost. In other words

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the base cost that was applicable to the deceased will remain the base cost for the beneficiaries and will not be stepped-up or increased to the market value of the asset as at date of death, with important differences. The most important difference is that, because CGT was not made applicable retrospectively, an asset acquired before 20 September 1985, referred to herein as a “pre-CGT asset”, will be deemed to have been disposed of to the beneficiary at the market value of such asset at the date of the deceased’s death and the Australian taxpayer will thus enjoy the benefit of a higher base cost, being the value of the pre-CGT asset as on date of death, without a corresponding CGT liability for the estate of the deceased.\textsuperscript{98} The asset will however after it has been transferred to the beneficiary lose its pre-CGT status and will be subject to CGT when the beneficiary eventually disposes thereof.\textsuperscript{99}

It may be argued that because the Australian beneficiary receives a post-CGT asset together with a CGT liability as a result of there not being a step-up in the base cost, the rules applied in Australia in this respect does not differ materially from the rules applicable in South Africa because CGT will eventually have to be paid. On the face of it such an argument may seem to hold some merit, but it does not take into account the fact that the CGT liability is deferred until that beneficiary decides to dispose of the asset at some date in the future, if ever, and if the asset has not been disposed of by the time of that beneficiary’s death the roll-over will again apply. The advantages of a deferral in the CGT liability become evident in the following example:

Mr. X acquired a holiday home on 5 October 2002 in order for him and his family to go on holiday from time to time. The idea is that the holiday home will stay in the family and be used by generations to come. Mr. X passes away on 10 January 2012 and leaves the holiday home to his wife, Mrs. X. No CGT arises in the estate of the late Mr. X and Mrs. X. inherits the holiday home together with a CGT liability but will only have to pay CGT if she disposes of the holiday home. If she does not dispose of the holiday home and bequeaths it to her children in her will, or if there is no will and they inherit the holiday home as a result of the laws of intestacy, they will also inherit the holiday home with the CGT liability but once again the liability is deferred. If


they do not sell the holiday home and transfer it to their children CGT will once again not be payable and so it can go on for generations and generations. In terms of South African CGT provisions the above will not apply and when the holiday home is transferred to anyone but the surviving spouse or from the surviving spouse to the children there will be a CGT liability in the estate, even though it was never the intention to dispose of the holiday home.

In conclusion Australia generally do not levy a CGT at the death of an Australian taxpayer and also do not levy a capital transfer tax in the form of a death or estate duty. Furthermore a taxable asset acquired before 20 September 1985 will not be subject to CGT and if such asset is not disposed of by an Australian taxpayer before his or her death, the base cost of such asset will be stepped up to the value of such asset as on the date of his or her death, without a corresponding CGT liability for his or her estate.

2.3 **CGT provisions in Botswana**

Botswana tax legislation currently provides for both a CGT and a capital transfer tax in the form of an inheritance tax. Botswana does not have a separate CGT and any chargeable capital gains will, by virtue of Section 35 the Botswana Income Tax Act denoted as Chapter 52:01 Income Tax, “The Botswana Income Tax Act”, be included in the taxable income of an individual in a specific tax year.

Paragraph 12(1) of the tenth schedule to the Botswana Income Tax Act in short provides that the net aggregate gain of any person shall be the amount by which the aggregate amount of gains exceeds the aggregate amount of any losses for a specific tax year and that any excess loss may be carried forward to the following tax year. The Botswana Income Tax Act does not contain a

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102 Paragraph 12 of the Tenth schedule Chapter 52:01 Income Tax.
specific provision regarding whether or not the death of a Botswana taxpayer constitutes a deemed disposal of a capital asset with a subsequent tax liability in respect of a potential capital gain realised in respect thereof.

Paragraph 5 of the tenth schedule to the Botswana Income Tax Act provides that when the beneficiary disposes of the asset which he or she has inherited the acquisition cost, which is referred to as the „base cost” in South Africa, will be the acquisition cost that was applicable to the deceased and not a stepped-up base or acquisition cost, namely the market value of the asset as at the death of the deceased taxpayer. 103 The acquisition cost of an asset that had been acquired by way inheritance and subsequently disposed of shall be the market value as at 1 July, 1982, if the asset had been acquired by the deceased taxpayer before such date, and where the asset was acquired by the deceased taxpayer on or after 1 July, 1982 it shall be the market value as at the date of such acquisition. 104 When determining the market value expenses incurred and taxes or duties paid in respect of the inherited asset may, with certain exclusions, be taken in account. 105

Botswana taxpayers will pay a capital transfer tax on the disposal of an asset by way of inheritance. 106 Inheritance tax will be levied on the net aggregate gain of all of the assets of the deceased, whether movable or immovable, corporeal or incorporeal. 107 In addition assets that are situated outside of Botswana that has been bequeathed to a person who is not a resident of Botswana will be exempt from Botswana inheritance tax as well as household goods and personal belongings which have been inherited from a deceased person up to a maximum amount of P 15,000. 108 Similar to the provision contained in section 4(q) of the Estate Duty Act

103 Paragraph 5 of the Tenth schedule Chapter 52:01 Income Tax.
104 Paragraph 5 of the Tenth Schedule Chapter 52:01 Income Tax.
105 Paragraph 5 of the Tenth Schedule Chapter 52:01 Income Tax.
applicable in South Africa there will be a roll-over in respect of assets bequeathed to the spouse of the deceased and no inheritance tax will be payable in this instance.\textsuperscript{109}

In conclusion it is clear from the fact that the beneficiary is deemed to have received a taxable asset at a value equal to the original acquisition cost thereof or at the value as at 1 July 1982, as the case may be, instead of a provision deeming him or her to have received the asset at the market value thereof on date of death, that there will in fact not be any CGT consequences and also not a step up in the base cost in respect of a taxable asset owned by the deceased taxpayer at his or her death. There will however be an inheritance tax payable on the net aggregate gain of all of the assets of the deceased, with certain exceptions.

2.4 \textit{CGT provisions in The United States}

The federal government and the different state and local governments of the United States ("US") each have the authority to levy taxes.\textsuperscript{110} The federal government mainly imposes income and payroll taxes, the state governments mainly impose income and sales taxes and local governments will generally impose property taxes and in some cases income taxes.\textsuperscript{111} US citizens are subject to US tax on their worldwide income no matter where in the world they reside.\textsuperscript{112} Considering that there are fifty states in the US it will be impossible to analyse the tax treatment of capital gains and deceased estates by each one of the states and only the federal tax treatment thereof will be considered. Most of the states impose their own personal and corporate income taxes, which may include taxes on capital gains, and wealth transfer taxes such as a donation tax and an inheritance tax.\textsuperscript{113}

\textsuperscript{112} Hugh, Brian and Repetti \textit{Comparative Income Taxation: A Structural Analysis, The United States} (2004) 141; s 61 of the IRC.
The US federal tax law is almost exclusively embedded in the Internal Revenue Code (“IRC”) which was enacted in 1913. The Internal Revenue Service (“IRS”) is responsible for the administration and enforcement of federal taxes.

The federal government imposes a tax on the transfer of wealth through a unified estate and gift tax commonly referred to as federal estate tax. A tax credit of $5 000 000 for individuals and $10 000 000 for married couples is applicable in respect of deaths that occurred after 2010 with a maximum tax rate of 35% being applicable thereafter. No estate tax liability will therefore be incurred on an estate with a net value of $10 000 000 or less or $5 000 000 or less as the case may be. If a couple was married and the husband for example passed away first leaving behind an estate of $2 000 000, the wife will be entitled to use the remaining $8 000 000 of the tax credit at her death. Certain assets left to the surviving spouse, provided that he or she is a US citizen, or to a special trust called a “Qualified Domestic Trust” shall be exempted from federal estate tax. The US also levies a so-called “generation-skipping tax” in order to protect its estate tax base. The generation-skipping tax is currently levied at a rate of 35% in respect of transfers in trust and / or outright transfers with the effect that a generation is skipped, for example if the grandfather leaves his farm in trust for his grandchild, with a life-time exclusion of $5 000 000 in favour of the grantor.

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117 s 2010(c) of the IRC as amended by s 302(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010; s 2001 of the IRC as amended by s 302(a)(2) of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.
118 s 2056 of the IRC.
119 s 2056A of the IRC.
120 Emil, S Stotsky and JG Stotsky The Tax System in Industrialized Countries, The United States (2002) 385; s 2631 of the IRC; s 2641 of the IRC; s 2010(c) of the IRC as amended by s 302(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010; s 2001 of the IRC as amended by s 302(a)(2) of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.
Section 61(a)(3) of the IRC provides that capital gains derived from “dealings” (not defined in the IRC) in property will be included in the gross income of the taxpayer.\textsuperscript{121} The manner in which capital gains are calculated is determined by section 1001(a),\textsuperscript{122} which reads as follows:

“The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.”\textsuperscript{123}

The regulations issued in respect of the IRC expand on section 1001(a) and provides that from the amount realised upon the sale or exchange of property must be subtracted the cost or other basis of such property, adjusted for receipts, expenditures, losses, allowances, and other items chargeable against and applicable to such cost or other basis, the remaining amount being the realised gain. In the event that the adjusted basis is in excess of the amount realised a capital loss is sustained to the extent of the difference between such adjusted basis and the amount realised.\textsuperscript{124} Before it can be determined what the “adjusted basis” of an asset is it must first be established what the “basis” of an asset is, also referred to as the original or unadjusted basis.\textsuperscript{125} Section 1012 provides that the basis of property shall be the cost of such property unless provided otherwise in that or other subchapters of the IRC.\textsuperscript{126} The basis would therefore generally be the historical cost of the asset, but may also be such other amount provided for by a special statutory, administrative or judicial rule.\textsuperscript{127} Once it has been established what the taxpayer’s original or unadjusted basis is it has, in terms of section 1011(a), to be adjusted under section 1016 in order to determine the “adjusted basis” and subsequently whether and to what extent a capital gain or capital loss has been realised.\textsuperscript{128} The original or unadjusted basis will be

\textsuperscript{121} s 61(a)(3) of the IRC; Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 40-2.
\textsuperscript{122} Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 40-2.
\textsuperscript{123} s 1001(a) of the IRC.
\textsuperscript{124} IRC reg 1001(a); Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 40-2.
\textsuperscript{125} Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-3.
\textsuperscript{126} s 1012 of the IRC.
\textsuperscript{127} Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-3.
\textsuperscript{128} s 1011(a) of the IRC; Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 42-2.
increased by such an amount that constitutes capital improvements or other capital outlays in respect of the asset and it will be decreased by any amounts relating to depreciation of or tax allowances claimed in respect of such asset.  

In terms of section 1221 all the capital assets of a taxpayer will be subject to CGT, which includes all the assets of the taxpayer except inventory (a relative term based on the nature of the business of the taxpayer), depreciable property or real property used in the trade or business of the taxpayer, copyrights, literary, musical works, etc. produced by the taxpayer, accounts or notes receivable acquired in the ordinary course of business or from the sale of inventory and lastly publications of the US Government. The fact that a capital gain or loss has been realised does not however mean that such a gain or loss will be recognised for tax purposes as one or other exemption, derived from the specific non-recognition provisions and rules contained in the IRC, may apply.  

The IRC does not contain a specific non-recognition provision in respect of an asset that has been bequeathed by a deceased taxpayer. Section 1001(a) provides that a capital gain or loss on a “sale or other disposition of property” is calculated by subtracting from the “amount realised” the adjusted basis of that particular property and section 1001(c) provides that a capital gain or loss is recognised only on a sale or exchange of the property. The question that arises is whether a sale or other disposition (for example exchange) of property includes a bequest of property. From the discussion to follow the answer would appear to be no, the reason in short being that on the reasonable interpretation of the applicable sections of the IRC, read together with section 1014(a), it is clear that the legislature does not intend to treat death as a realisation event. Two leading US authors explain the situation as follows:

129 s 1016 of the IRC; Bittker and Lokken Federal Taxation of Income, Estates and Gifts (3d ed) 41-4.
131 s 1011(c) of the IRC; Amico Introduction to the US Income Tax System (1993) 20-21.
132 Zelenak Taxing Gains at Death (1993) (n 3) 363.
133 s 1001(a) and s 1001(c) of the IRC; Bittker and Lokken Federal Taxation of Income, Estates and Gifts (3d ed) 40-9.
Because donors and testators do not ordinarily realise anything of monetary value and a gift or bequest is not a sale or exchange, the statutory language implies that gifts and bequests are not the kind of dispositions that section 1001(a) is concerned with. This implication, however, is not ineluctable since, without undue strain on the statutory language, taxpayers making gifts and bequests could be viewed as receiving non-economic satisfactions equal to the value of the transferred property. Indeed, this rationale is the foundation of many cases in the assignment-of-income area, which received its classic expression in Mr. Justice Stone’s opinion in *Helvering v. Horst*, holding that the donor of negotiable interest coupons (detached from bonds that he owned) realised income when the donee collected the interest at maturity later in the year…“

Based on the abovementioned expression of Mr. Justice Stone it is believed that because a bequest has substantially the same consequences as a sale of property the appreciation or depreciation of an asset bequeathed by the deceased taxpayer may constitute a capital gain or loss respectively. The US Congress has however in the past consistently treated bequests as non-taxable events and not as a specific type of disposal, and although the legislative intent is not explicitly set out in the IRC it would appear that the legislative intention is to provide for a CGT roll-over in respect of bequests, not so much from the actual wording of section 1001(a) itself but rather from the fundamental and persistent legislative decisions interpreting the applicable sections of the IRC to give effect to the intent of the legislature.

Moreover the provisions of section 1014(a) are applicable and in short provide that the basis of property acquired from a deceased taxpayer is either the fair market value of that property on the date of death or such other value provided for in that section or in sections 2032, 2032A or 2031(c), hereinafter referred to as the “date-of-death basis”.

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1014 Basis of property acquired from a decedent

a) Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent’s death by such person, be –

(1) the fair market value of the property at the date of decedent’s death,

(2) in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections,

(3) In the case of an election under section 2032A, its value determined under such section, or

(4) To the extent of the applicability of the exclusion described in section 2031(c), the basis in the hands of the decedent.\(^{138}\)

In terms of section 1014(b)(1) the date-of-death basis will apply to property acquired by way of bequest, devise or inheritance, or by the deceased’s estate from the deceased.\(^{139}\)

In the event that a capital asset of the deceased has not been distributed, sold, exchanged or otherwise disposed of by his or her executor within six months after his death, the executor may in terms of section 2032 elect to use the asset’s fair market value six months after the deceased’s death, which value will subsequently be the basis of the asset.\(^{140}\) It may mean that the basis will

\(^{138}\) s 1014(a) of the IRC.

\(^{139}\) s 1014(b)(1) of the IRC; Bittker and Lokken *Federal Taxation of Income, Estates and Gifts* (3d ed) 41-39.

be a higher amount but it is important to consider that the estate tax liability will also possibly be higher. If no election is made in terms of section 2032 the basis of the asset will automatically be the fair market value of such asset as at date of death, alternatively if the capital asset is distributed, sold, exchanged or otherwise disposed of within six months after the deceased’s death the basis of the asset will be the fair market value of such asset on the date of distribution, sale, exchange or other disposition.\textsuperscript{141} Section 2032A provides for an alternative valuation in respect of certain real property, referred to as “qualified real property” owned by a US citizen or resident at his death.\textsuperscript{142} Section 2031(c) provides for an exclusion of “the applicable percentage of the value of land subject to a qualified conservation easement.”\textsuperscript{143}

The date-of-death basis of a capital asset will be applicable irrespective of when the heirs become entitled to the asset, for example if the deceased bequeathed the asset to his child for his life and then outright to his grandchild, similar to the fideicommissum applied in South Africa, the date-of-death basis of the asset will still be applicable when the grandchild ultimately receives the property regardless of the value thereof at that time.\textsuperscript{144} The date-of-death basis will however be increased by capital improvements or other capital outlays in respect of the asset brought about after death and it will be decreased by the amount by which the asset depreciated after death or in respect of tax allowances claimed in respect of the asset after death.\textsuperscript{145}

Regardless of whether the fair market value of a capital asset as on date of death or the fair market value thereof six months after the date of death is used it will in most instances mean that there is a step-up in the basis of that capital asset commonly referred to as the “stepped-up-basis”.\textsuperscript{146} The date-of-death basis of a capital asset will be a stepped-up-basis if the fair market

\textsuperscript{141} s 2032(a)(2) of the IRC.
\textsuperscript{142} s 2032A of the IRC.
\textsuperscript{143} s 2031(c) of the IRC.
\textsuperscript{144} Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-44.
\textsuperscript{145} Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-44.
value at death or six months thereafter as the case may be is higher than the adjusted basis of the capital asset which will be true in most circumstances. The result is that the appreciation in respect of such asset escapes CGT altogether, which may lead to a very substantial capital gain not being taxed.\textsuperscript{147} The failure to tax unrealised appreciation at death has been described as the most serious defect in the US federal tax structure.\textsuperscript{148}

It is however conceivable that the fair market value of a capital asset at death or at such other valuation date may be less than the adjusted basis of such asset due to depreciation or inflation in which event there will be a step-down in the basis.\textsuperscript{149} It is submitted that the provision for a step-up and step-down in the basis of a capital asset will however in most instances be to the advantage of the taxpayer, firstly due to the fact that the value of the majority of capital assets, especially in respect of real estate, will appreciate over time. When an investment or another type of capital asset held as an investment and which is subject to the risk of depreciation, starts to depreciate the investor will in all likelihood sell it or change his portfolio. Secondly the taxpayer or the executor of the deceased estate always has the choice to keep an asset that has appreciated and obtain the advantage of the step-up in the basis or to sell an asset that depreciated, avoid the step-down in the basis and convert an unrealised loss into a deductable loss.\textsuperscript{150}

The IRC contains specific rules in terms of which certain capital assets will not receive a date-of-death basis at the taxpayer’s death. These include property received from the deceased during his or her lifetime which was sold, exchanged or otherwise disposed of before the deceased’s death, property acquired by the executor of the deceased with funds received on the disposal of estate assets and fixed property that was used by the deceased for farming or trading activities.\textsuperscript{151}


\textsuperscript{149}Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-37.

\textsuperscript{150}Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-37, 41-38.

\textsuperscript{151}s 1014 of the IRC; IRC reg 1.1014-3(c); Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-49, 41-50.
If the deceased acquired a gift within one year from his death and bequeaths that gift back to the donor or the donor’s spouse, the appreciation in respect of such asset will also not be considered. One of the arguments in favour of the date-of-death basis that is applied in terms of section 1014 of the IRC is that it eliminates the possibility of a capital asset being subject to double taxation, namely CGT and the federal estate tax. There are however various counter arguments against this argument, one of them being that because the exemption in respect of federal estates is so substantial, double taxation will only arise in respect of a few deceased estates that are in fact subject to federal estate tax.

Some US academic writers have called for section 1014 of the IRC to be repealed and replaced with rules providing for unrealised capital gains and losses to be recognised at death. It has been mentioned above that some academic writers have gone as far to say that the fact that the appreciation in a capital asset will escape CGT altogether in the event of the passing away of the taxpayer who owned such capital asset is the most serious defect in the US federal tax structure. Arguments that the step-up in the basis is justified due to the fact that the appreciation in a capital asset is subject to estate tax have been faulted for two reasons. The first reason is that the step-up in basis may be applicable to a capital asset that were not, or were only partially subject to estate tax due to the exemptions referred to above. The second reason is that income and estate taxes differ conceptually and practically, conceptually there is no reason why the appreciation should not be subject to both income and estate tax and practically the gratuitous transfer of income would generally be subject to both such taxes due to the fact that a gain realised by the taxpayer during his life would have been subject to CGT and estate tax.

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would be applicable to the net proceeds at his death. The fact that the appreciation is not subject to CGT at the death of the taxpayer therefore results in what has been described as horizontal inequity, ie taxpayers of similar income and wealth are treated differently, and vertical inequity, ie more wealthy taxpayers receive preferential treatment due to the fact that “a greater portion of their income tends to be in the form of unrealised appreciation transferred at death”.

It has been proposed that the permanent forgiveness of CGT may be eliminated in one of the following two methods. The first method would simply be to tax capital gains at death, which had been proposed by the US Treasury in 1969 as part of their program for tax reform. This feat would be achieved by treating property held at death as if it had been sold for fair market value and accounting for the gain or loss in the deceased’s final income tax return. The heirs of the deceased would receive a capital asset at its market value and would only be taxed on the subsequent appreciation. Justification for such proposal was that the inequities referred to above would be eliminated and that the “lock-in effect” caused by the step-up in basis provided at death would be reduced. The lock-in effect is the unwillingness of a taxpayer to dispose of a capital asset during his life in which event the gain would be subject to CGT and rather holding on to that asset until his death in which event the appreciation will escape CGT altogether.

159 Zelenak Taxing Gains at Death (1993) 364.
respect of double taxation it was said that any CGT liability would be allowed as a deduction for estate tax purposes and therefore no situation of double taxation would arise.\textsuperscript{166}

The second method is a carryover basis in terms of which the basis of a capital asset will be transferred to the heirs of the deceased together with the said capital asset, *ie* the heir receives the capital asset at the basis that was applicable to the deceased and there will be no CGT liability at the death of the deceased.\textsuperscript{167} When the heir however disposes of the asset the original basis will be applicable in determining the CGT liability and not the, often higher, market value of the asset as at the date of the death of the taxpayer who previously owned the said asset, meaning that there is no longer a permanent forgiveness of a portion or possibly all of the appreciation in respect of such asset. It has been remarked that the carryover basis will help solve the problem of pre-death lock-in due to the fact that a taxpayer will be conscious of the fact that there will not be a death time step-up in respect of a capital asset, but it will create a post-death lock-in problem since the heir who inherits the asset at the often lower carryover basis will be discouraged from selling the asset.\textsuperscript{168} The US Congress attempted to introduce such carryover basis as a replacement for the section 1014 stepped-up death basis applicable to inherited property as part of the Tax Reform Act of 1976.\textsuperscript{169} The carryover provisions were however added very late in the legislative process without providing interested groups with adequate opportunity to give their inputs or leaving enough time to ensure that the provisions were drafted in technically sound manner, which led to widespread opposition and criticism on both technical and policy grounds.\textsuperscript{170} The effective date for the implementation of the carryover provisions were initially postponed until 1978 but repealed retroactively from 1980.\textsuperscript{171}

\textsuperscript{166} Burke and McCouch *Death Without Taxes?* (2001) 511-512.
\textsuperscript{168} Zelenak *Taxing Gains at Death* (1993) (n 28) 367.
Until as recent as 2010 the situation of unrealised appreciation escaping CGT in respect of a capital asset held by the deceased at his death remained. However on 1 January 2010 section 1022 of the IRC was enacted by section 542 of the Economic Growth and Tax Relief Reconciliation Act of 2001 which effectively replaced section 1014 and provided for a new carryover basis regime.\textsuperscript{172} Even then it was believed that section 1014 would very likely be reenacted retroactively\textsuperscript{173} and so it has been with effect from 1 January 2011. Section 1022 is therefore only applicable on deaths that occurred during 2010 and even then the executor of the estate may elect to either apply the provisions of section 1022 or section 1014.\textsuperscript{174} Section 1022 in short provides that the basis of the property acquired from the deceased who passed away after 31 December 2009 shall be the lesser of the adjusted basis of the deceased or the fair market value of the property at the date of the deceased’s death.\textsuperscript{175} Section 1022 further provides for an aggregate basis increase of $1,300,000 in respect of all estates and an additional $3,000,000 in respect of property acquired by the surviving spouse.\textsuperscript{176} The estate of a taxpayer who is not a US citizen or resident will however only receive a basis increase of $60,000.00.\textsuperscript{177}

The current status however is that section 1014 will be applicable to deaths that occurred on or before 31 December 2009 as well as to deaths that occurred on or after 1 January 2011 due to the fact that Section 1022 is only applicable to deaths that occurred between 1 January 2010 and 31 December 2010.\textsuperscript{178}


\textsuperscript{173} LE Cunningham & NB Cunningham Realization of Gains Under the Comprehensive Inheritance Tax (2009-2010) (n 5) 272.


\textsuperscript{175} s 1022(a) of the IRC.

\textsuperscript{176} s 1022(b) and (c) of the IRC; Barreira “Traps for the Unwary Regarding Internal Revenue Code Section 1022 for 2010 Deaths” http://estatetaxation.info/2010/12/09/traps-for-the-unwary-regarding-internal-revenue-code-section-1022-for-2010-deaths (14/04/2012).

\textsuperscript{177} s 1022(b)(3) of the IRC.

In conclusion there will, save when an election is made by the executor in respect of a US taxpayer who passed away during 2010 and in which event the heirs of the taxpayer will enjoy the benefit of a step-up in the base cost in respect of a taxable asset, be no CGT consequences at the death of a US taxpayer. There may be arguments in favour of a CGT or a carryover basis method at the death of a US taxpayer. Two important considerations in choosing which method to follow are the complexity in administration and the revenue that will be produced. It is argued that a CGT at death will generate more revenue than the carryover basis method and will also be simpler to apply than the last-mentioned method despite the fact that similar administrative difficulties such as the determination of the base cost of the asset would apply in both instances.

2.5 **CGT provisions in The United Kingdom**

CGT came into effect in the United Kingdom (“UK”) on 6 April 1965 and is currently levied in terms of the Taxation of Chargeable Gains Act 1992 (“CGT Act of 1992”), with effect from 6 April 1992. CGT will generally be payable when a chargeable person, *ie* a person who is a UK resident or ordinarily resident in the UK, disposes of a chargeable asset, which includes all assets save for a few exceptions including motor vehicles and currency which is not foreign currency, and thereby realising a chargeable gain, unless a specific exemption or relief applies. A chargeable gain will generally arise when the consideration received on the disposal of a chargeable asset, which could either be the price at which such asset is sold at arm’s length or the market value thereof on date of disposal, exceeds the allowable deductions as provided for in the

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179 See par 3.1.
183 Barlow, King and King *Wills, Administration and Taxation: A Practical Guide* (8th ed) 98.
CGT Act of 1992.\textsuperscript{185} Section 38 of the CGT Act of 1992 provides that the initial expenditure in respect of the asset, including the original purchase price or market value thereof plus incidental costs incurred in the acquisition thereof, the subsequent expenditure incurred in enhancing the value of that asset, and lastly the incidental costs incurred on the disposal of that asset, will qualify as allowable deductions when determining the capital gain that has been realised.\textsuperscript{186}

CGT was previously levied at a flat rate of 18\% but from 22 June 2010 CGT has been levied at a rate of 18\% or 28\% depending on the total amount of an UK taxpayer’s taxable income.\textsuperscript{187} The CGT rate in respect of the disposals made by the executor or personal representative of a deceased estate is 28\%.\textsuperscript{188} The deceased estate will however, during the period that it is under administration, qualify for the annual exempt amount referred to below, limited to the annual exempt amount in the year that the deceased person passed away plus the annual exempt amount for the following two tax years.\textsuperscript{189} Various exemptions and reliefs are available to UK taxpayers, including the current annual relief of £10 600.\textsuperscript{190}

The UK levies an inheritance tax at a rate of 40\% and currently the estate of the deceased UK taxpayer will qualify for a tax allowance of £325 000 and £650 000 for married couples and registered civil partners, which has been the applicable threshold since 6 April 2009.\textsuperscript{191} It was only as recent as October 2007 that the inheritance tax legislation was amended to the effect that

\begin{footnotes}
\item[185] Barlow, King and King \textit{Wills, Administration and Taxation: A Practical Guide} (8th ed) 99.
\item[187] HM Revenue and Customs “Capital gains tax rates and annual tax-free allowances” http://www.hmrc.gov.uk/rates/cgt.htm (04-06-2012).
\item[189] HM Revenue and Customs “Capital gains tax rates and annual tax-free allowances” http://www.hmrc.gov.uk/rates/cgt.htm (24-06-2012).
\end{footnotes}
the surviving spouse or registered civil partner could inherit the unused inheritance tax allowance.\textsuperscript{192} In other words only a net estate with a value of more than \pounds 325 000 in the event of an individual and \pounds 650 000 in the event of a married couple or registered civil partners will be subject to inheritance tax and the 40\% estate duty will only be payable from \pounds 325 001 or \pounds 650 001, as the case may be, upwards. Bequests to the deceased’s spouse or registered civil partner and bequests to “qualifying” charities will be exempt from estate duty, and there are also other exemptions that may apply.\textsuperscript{193}

In the UK the death of a taxpayer does not, save in limited circumstances when dealing with settled property, result in a liability to pay CGT.\textsuperscript{194} Section 62 of the CGT Act of 1992 provides for the following in subsections 1(a), 1(b), 4(a) and 4(b):

62  Death: general provisions

(1) For the purposes of this Act the assets of which a deceased person was competent to dispose –

(a) Shall be deemed to be acquired on his death by the personal representative or other person on whom they devolve for a consideration equal to their market value at the date of death, but

(b) Shall not be deemed to be disposed of by him on his death (whether or not they were the subject of testamentary disposition).

(4) On a person acquiring any asset as legatee (as defined in section 64)–

(a) no chargeable gain shall accrue to the personal representatives; and


\textsuperscript{193} HM Revenue and Customs “Capital gains tax rates and annual tax-free allowances” http://www.hmrc.gov.uk/rates/cgt.htm (04-06-2012).

\textsuperscript{194} Barlow, King and King Wills, Administration and Taxation: A Practical Guide (8h ed) 98.
(b) the legatee shall be treated as if the personal representatives’ acquisition of the asset had been his acquisition of it.\textsuperscript{195}

A “legatee” is defined in section 64(2) as: “any person taking under a testamentary disposition or on an intestacy or partial intestacy, whether he takes beneficially or as trustee, and a person taking a donatio mortis causa shall be treated…as a legatee and his acquisition as made at the time of the donor’s death.”\textsuperscript{196}

The effect of section 62(1) of the CGT Act of 1992 is that a taxable asset which a deceased person was competent to dispose of prior to his or her death will be deemed to have been acquired by the personal representative at his or her death at an amount equal to the market value of the asset as at the date of death.\textsuperscript{197} Despite the deemed acquisition however there is no corresponding deemed disposal of a taxable asset and therefore no CGT liability arises at the taxpayer’s death, neither will there be any CGT consequences for the co-owner of the asset if applicable.\textsuperscript{198}

By virtue of section 62(4) of the CGT Act of 1992 there will also not be any CGT payable on the transfer of a taxable asset from the personal representative to the legatees of the deceased, since the personal representative’s acquisition is treated as the legatees’ acquisition.\textsuperscript{199} It is thus clear that the heirs or legatees of the deceased, whether nominated in a will or not, will receive the asset at the market value on date of death without and CGT liability on the part of the personal representative, even if the asset’s value had increased since date of death.

In terms of section 274 of the CGT Act of 1992 the market value of the asset that has been ascertained for inheritance tax purposes will also constitute the asset’s market value for CGT.

\textsuperscript{195} s 62 of the Taxation of chargeable gains act 1992.
\textsuperscript{196} s 64 of the Taxation of chargeable gains act 1992; Barlow, King and King Wills, Administration and Taxation: A Practical Guide (8th ed) 109.
\textsuperscript{197} Barlow, King and King Wills, Administration and Taxation: A Practical Guide (8th ed) 108.
\textsuperscript{198} Barlow, King and King Wills, Administration and Taxation: A Practical Guide (8th ed) 108.
\textsuperscript{199} Barlow, King and King Wills, Administration and Taxation: A Practical Guide (8th ed) 109-110.
In order for the rule in section 274 of the CGT Act of 1992 to apply inheritance tax must have been chargeable on the value of the deceased’s estate immediately before his death and the value of an asset forming part of his estate had to be “ascertained”. The value will not be ascertained in certain instances, for example when a taxable asset is passed to the surviving spouse, in which event a roll-over relief similar to the roll-over relief between spouses as provided for in South African tax law would apply, or if a 100% business or agricultural relief applies to the specific asset.

Even though a higher value would result in a higher amount of inheritance tax payable, the personal representative or legatees are at a great advantage as there will be a corresponding step-up in their base cost by virtue of section 62(1) of the CGT Act of 1992. The personal representative will not receive and the legatees will not inherit the asset at the base cost of the asset to the deceased, but at the higher market value as ascertained on the deceased’s date of death, with no CGT liability to the deceased estate. It is thus this higher value which constitutes the new base cost of the asset in respect of either the personal representative or legatee(s). If the personal representative subsequently needs to sell a taxable asset in the course of administrating the estate a CGT liability will only arise if the price for which the asset was sold, less any applicable capital expenditure and qualifying costs, exceeds the market value of that asset as on date of death, being the new base cost of the asset as explained above.

Despite the fact that the personal representative would have to pay CGT at a rate of 28% if he disposes of a taxable asset and a capital gain is in fact realised, it is submitted that, except in extraordinary circumstances where there was a lengthy delay in the winding up of the estate and

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201  Barlow, King and King Wills, Administration and Taxation: A Practical Guide (8th ed) 108.
the value of the taxable asset increased drastically from the date of death until the asset was realised, the UK taxpayer will generally receive a much more favourable tax treatment than the tax treatment received by a taxpayer who was not entitled to a similar step up in the base cost of a taxable asset forming part of his estate.

The UK tax legislation contains another beneficial provision for the taxpayer namely that even if there are certain reliefs available in respect of inheritance tax payable it will, subject to a few exceptions, not reduce the valuation of a taxable asset for CGT purposes.\textsuperscript{206}

Section 62(2) of the CGT Act of 1992 provides that if a deceased person has any unutilised capital losses from tax years previous to the year in which he or she passed away, such losses may be carried back and may be set-off against capital gains realised by the deceased in the three tax years preceding the year in which he or she passed away, starting with the later years, and if CGT was in paid in any of those earlier years it would be possible to claim a rebate in respect of such CGT paid.\textsuperscript{207} If there are unutilised capital losses the personal representative would not be able to set-off such capital losses against any capital gains made by the personal representative as a result of the sale of a capital asset out of the estate, however, due to the fact that surplus capital losses cannot be transferred to the legatees in terms of the applicable UK tax provisions the personal representative may also elect, in the event that a taxable asset has decreased in value after date of death, to transfer the asset to the heir or legatee and let them dispose thereof and then offset the capital loss against other capital gains that might have been realised by them.\textsuperscript{208}

In conclusion a taxable asset of a UK taxpayer will be deemed to have been acquired by the personal representative at the market value of the asset as at the date of death, thus providing for a step up in the base cost without any CGT being payable at the death of the taxpayer. There will also not be any CGT payable on the transfer of a taxable asset from the personal representative to

\textsuperscript{206} Barlow, King and King \textit{Wills, Administration and Taxation: A Practical Guide} (8h ed) 108.
\textsuperscript{207} s 62 of the Taxation of chargeable gains act 1992.
\textsuperscript{208} Barlow, King and King \textit{Wills, Administration and Taxation: A Practical Guide} (8h ed) 109.
the legatees or heirs of the deceased taxpayer. Furthermore a taxable asset acquired by a UK taxpayer before 6 April 1965 will be exempt from CGT and as long as the asset is not disposed of by the taxpayer no CGT will be payable in respect of such asset.

2.6 CGT provisions in Nigeria

Nigerian tax law features a mixture of direct and indirect taxes. The Federal Government imposes all personal and corporate taxes and only delegates the power to collect the taxes to the respective states in respect of certain taxes. There is currently no inheritance tax in Nigeria. One of the taxes imposed by the Federal Government is a CGT on any capital gain realised by an individual or a corporate body when they dispose of a chargeable asset at a profit. CGT was introduced in Nigeria through the Capital Gains Tax Act 44 of 1967 (“the CGT Act”) with effect from the 1st of April 1967.

A “chargeable asset” is widely defined in section 3 of the CGT Act as:

3 Subject to any exceptions provided by this Act, all forms of property shall be assets for the purposes of this Act whether situated in Nigeria or not, including-

(a) options, debts and incorporeal property generally;

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(b) any currency other than Nigerian currency;

(c) any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired... ²¹⁶

“Disposal” is also widely defined in section 6 of the CGT Act as:

6 Disposal of assets

(1) Subject to any exceptions provided by this Act there is, for the purposes of this Act, a disposal of assets by a person where any capital sum is derived from a sale, lease, transfer, an assignment, a compulsory acquisition or any other disposition of assets, notwithstanding that no asset is acquired by the person paying the capital sum, and in particular –

(a) Where any capital sum is derived by way of compensation for any loss of office or employment;

(b) Where any capital sum is received under a policy of insurance and the risk of any kind of damage or injury to, or the loss or depreciation of, assets;

(c) Where any capital sum is received in return for forfeiture or surrender of rights, or for refraining from exercising rights;

(d) Where any capital sum is received as consideration for use or exploitation of any asset; and

(e) Without prejudice to paragraph (a) of this section, where any capital sum is received in connection with or arises by virtue of any trade, business, profession or vocation. ²¹⁷


Certain exclusions and deductions as provided for in the CGT Act will be applicable. Generally the cost in respect of the acquisition of the chargeable asset, expenditure incurred by the taxpayer on the improvement of the chargeable asset and expenses incidental to the disposal of such asset will be deducted from the selling price in order to determine the capital gain realised, subject to the exclusions of deductible expenditure as provided for in the CGT Act.\textsuperscript{218}

Certain capital gains will be totally exempt from CGT, including gains that accrue to ecclesiastical, charitable and educational institutions\textsuperscript{219} and gains accruing to a person on disposal of his investment in a retirement benefit scheme as defined,\textsuperscript{220} his rights under a policy of assurance or contract for a deferred annuity, subject to certain exceptions,\textsuperscript{221} or from the disposal by him of Nigerian government securities, stocks and shares.\textsuperscript{222}

When CGT was introduced section 2 of the CGT Act provided that CGT will be levied at a rate of 20% on the total amount of chargeable gains accruing to a person in a year of assessment on or after 1 April 1967.\textsuperscript{223} CGT is however currently generally levied at a rate of 10%.\textsuperscript{224} Of particular importance is the specific section relating to death contained in the CGT Act, which reads as follows:

8  \textit{Death}

(1) \textit{On the death of an individual any assets of which he was competent to dispose of shall for the purposes of this Act be deemed to be disposed of by him at the date of his death}


and acquired by the personal representatives or other person on whom the assets devolve for a consideration equal to –

(a) in a case where the amount of the consideration for which the asset was last disposed of by way of a bargain made at arm’s length is ascertainable, that amount; and

(b) in any other case, the market value of the asset at that date.

(2) The gains which accrue in consequence of subsection (1) of this section shall not be chargeable to capital gains tax under this Act.

(3) In relation to property forming part of the estate of a deceased person the personal representatives shall for the purposes of this Act be treated as being a single and continuous body of persons (distinct from the persons who may from time to time be the personal representatives), and the body shall be treated as having the deceased’s residence and domicile at the date of death.

(4) On a person acquiring any asset as legatee-

(a) no chargeable gain shall accrue to the personal representatives; and

(b) the legatee shall be treated as if the personal representatives’ acquisition of the asset had been his acquisition of it.

(5) In this section references to assets of which a deceased person was competent to dispose of are references to assets of the deceased which (otherwise than in right of a power of appointment) he could, if of full age and capacity, have disposed of by his will assuming that all the assets were situated in Nigeria and, if he was not domiciled in Nigeria, that he was domiciled in Nigeria.
(6) If not more than two years after a death any of the dispositions of the property of which the deceased was competent to dispose of whether by will, or under the law relating to intestacies, or otherwise, are varied by deed of family arrangement or similar instrument, this section shall apply as if the variations made by the deed or other instrument were effected by the deceased, and no disposition made by the deed or other instrument shall constitute a disposition for the purposes of this Act.

(7) In this section –

“legatee” includes any person taking under testamentary disposition or on an intestacy or partial intestacy whether he takes beneficially or as trustee, and a donatio mortis causa shall be treated as a testamentary disposition and not as a gift;

“personal representatives” means—

(a) The executor, original or by representation or administrator for the time being of a deceased person under any law in force in Nigeria;

(b) Persons having in relation to the deceased under the law of another country any functions corresponding to the functions for administration purposes under any law in force in Nigeria or personal representatives as defined under paragraph (a) of this subsection,

And references to personal representatives as such shall be construed as references to the personal representatives in their capacity as having such functions as aforesaid.225

It is clear from the above provisions above specifically subsections 8(1) and 8(4) of the CGT Act that there is a deemed disposal of a taxable asset from a Nigerian taxpayer to his estate and a

corresponding acquisition by his personal representative as defined or by a legatee of the estate as defined for purposes of CGT at his death. By virtue of section 8(2) of the CGT Act a full exemption will however apply and no CGT liability will therefore arise at the death of a Nigerian taxpayer, whether in respect of the deceased estate, the personal representative and / or the legatee(s).

Subsection 8(4) of the CGT Act puts it beyond doubt that irrespective of whether the legatee of the estate as defined receives the asset directly from the deceased person or from the personal representative, no CGT will be payable. Subsection 8(1) of the CGT Act distinguishes between the situation where the deceased acquired, at arm”s length, a taxable asset for an amount that might be less, the same or more than the market value of that asset provided that the amount is ascertainable, and the situation in which the amount paid for the taxable asset is not ascertainable, in which event the market value of the asset as on date of death needs to be determined.

It is respectfully submitted that on the proper interpretation of subsection 8(1) of the CGT Act and if the first mentioned method of determining the value of a taxable asset is applicable, *ie* that an at arm’s length purchase price in respect of the asset can be determined, it must be applied and that will be the applicable amount at which the personal representative and / or the legatee as the case may be will take over such asset. It is only when it is not possible to determine the amount at which the asset was previously acquired at arm’s length, or in the event that the previous transaction was not done at arm’s length but between connected persons, for example between a husband and wife or between partners of a firm, when the second part of subsection 8(1) of the CGT Act will be applicable.226 If that is the case the market value of the taxable asset on date of acquisition will be the value at which the personal representative and / or the legatee as the case may be will take over such asset. This interpretation may however be influenced by subsection 22(3) of the CGT Act which will be referred to below.

In respect of the last-mentioned method of determining the value of a taxable asset two concepts are of importance. Firstly it must be established what constitutes the date of acquisition and secondly it must be established how the market value will be determined. Section 11 of the CGT Act is applicable in respect of the date of acquisition or disposal of a taxable asset and reads as follows:

11 Date of acquisition or disposal, etc

For the purposes of this Act any asset acquired or disposed of by any person chargeable to capital gains tax shall subject to section 23(4) of this Act be deemed to have been so acquired or disposed of at the date at which there is an enforceable right to acquire or a binding duty to dispose of the asset or any right or interest therein, and in particular-

(a) Where any contract is to be performed subject to any condition the date of acquisition or disposal of the asset shall be deemed to be the date when the condition is satisfied, but where a consideration of such a contract does not depend solely or mainly on the value of the asset at the time the condition is satisfied, the acquisition or disposal shall be treated as if the contract had never been conditional, in which case the date of the acquisition or disposal of the asset shall be the date of the contract;

(b) Where any capital sum is received as consideration for use or exploitation of any asset; and

(c) where an option is conferred by virtue of any contract, the date of acquisition or disposal of the asset shall be the date when the option is exercised.227

Section 23 of the CGT Act deals with transactions between connected persons in which other rules will be applicable and fall outside the scope of this discussion.228

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Section 22 of the CGT Act provides the method for calculating the market value of a taxable asset and reads as follows:

22 Valuation: Market Value

(1) For the purpose of computing capital gains, unless the context otherwise requires, “market value” in relation to any assets (whether capital or not) means the price at which those assets might reasonably be expected to fetch on a sale in the open market.

(2) In estimating the market value of any asset no reduction shall be made in the estimate on account of the estimate being made on the assumption that the whole of the asset is to be placed on the market at one and the same time.

(3) In re-estimating the market value of any assets acquired, if the market value exceeds the consideration actually paid by the acquirer, the asset shall be deemed to have been acquired for the amount actually paid by the acquirer.229

In reading subsection 22(3) of the CGT Act I am of the respectful opinion that subsection 8(1) of the CGT Act should be interpreted as indicated above, but with the important difference that the market value of a taxable asset can only be used if the amount paid for such asset is not ascertainable, and not only when the amount paid for the asset is less than the market value of such asset. It will be the market value of a taxable asset, or if the amount is ascertainable and the transaction was concluded at arm’s length then that amount, which amount may be less, the same, or based on my interpretation above, more than the market value of the asset, which will in South African terminology constitute the “base cost” of the asset. The capital gain realised will then be the selling price, less the base cost, less qualifying expenditure as referred to above. The special rule at death as described in detail above however provides that no CGT will be payable in the event that the taxpayer passes away.

In conclusion a CGT is not currently levied on a taxable asset of a Nigerian taxpayer at his or her death. There will however not be a step up in the base cost of such asset. Furthermore there is currently no form of capital transfer tax, such as an inheritance tax, applicable at the death of a Nigerian taxpayer.
3.1 Conclusions

The death of a taxpayer is a problematic event for purposes of CGT given that there is no future opportunity to dispose of the taxable asset. In analysing the CGT provisions of the United States, the United Kingdom, Canada, Australia, Botswana and Nigeria, it has been observed that when a specific country levies a CGT and a capital transfer tax such as an inheritance tax at death, it is common to exempt an asset that would have been subject to CGT from CGT at the death of a taxpayer, or as is the case in Canada, to abolish inheritance tax altogether and only levy a CGT at death.

Three approaches have been identified when dealing with a taxable asset at the death of a taxpayer for purposes of CGT. The first approach is the deemed realisation approach which in short entails that the deceased taxpayer is deemed to have disposed of a taxable asset to his estate and taxed accordingly. This approach is currently followed by South Africa and Canada, last-mentioned however having abolished its inheritance tax. Another approach is the carry-over approach in terms of which the heir takes over the asset at its acquisition cost and the CGT liability is deferred until the heir actually disposes of the asset. This approach is followed in Australia, Botswana, Nigeria and was briefly followed in the US. The last approach is the stepped-up approach where the heir receives the asset at a cost equal to the market value on date of death and any unrealised gains remain untaxed. This approach is followed in the United

232 See par. 1.2 and par 2.1.
234 See par. 2.2, par. 2.3, par. 2.4 and par 2.6.
States and the United Kingdom.\textsuperscript{236}

The treatment of a Canadian taxpayer’s deceased estate for purposes of CGT is very similar to the South African CGT provisions applicable at death.\textsuperscript{237} The significant difference is however that whereas Canada abolished their inheritance tax after the introduction of CGT, South Africa only reduced estate duty payable from 25% to 20% and currently provides for an estate duty abatement in the amount of R3.5 million, \textit{i.e.} if the net value of the deceased’s estate is R3.5 million or less no estate duty will be payable.\textsuperscript{238} Everything over and above that, including life insurance policies on the life of the deceased, with certain exceptions, will attract 20% estate duty. The Estate Duty Act 45 of 1955 was only recently amended to the effect that if the deceased bequeathed all his assets to his spouse, thereby utilising the section 4(q) deduction provided for by the Estate Duty Act 45 of 1955, the R3.5 million abatement will be transferred to the surviving spouse, thereby increasing the threshold at her death to R7 million, a legislative amendment welcomed by the South African taxpayers.\textsuperscript{239}

There will generally not be CGT payable on the death of an Australian taxpayer, as long as a taxable asset will eventually be transferred to a beneficiary appointed by him or her in his or her

\textsuperscript{236} See par 2.4 and par 2.5.
\textsuperscript{237} See par 2.1.
\textsuperscript{238} s 4A of the Estate Duty Act 45 of 1955 as amended by The Taxation Laws Amendment Act 17 of 2009; Muller \textit{A framework for wealth transfer taxation in South Africa} (2010 thesis UP) 4 “The introduction of capital gains tax into the South African tax system in 2001, which provided for a deemed disposal of all the deceased’s assets to his or her deceased estate at the moment of death, has awakened the speculation that estate duty may be abolished in the not too distant future. Mazansky commented that it is foreseeable that the revenue derived from capital gains tax payable at death could at some point in the future prompt estate duty and donations tax to land in the ‘fiscal dustbin’”; Muller \textit{A framework for wealth transfer taxation in South Africa} (2010 thesis UP) 112 “Although the introduction of capital gains tax (and a deemed-realisation approach on death) did not supplant the existing estate duty and donations tax regimes, the question was posed whether the South African tax system has the perfect window of opportunity to get rid of these wealth transfer taxes… For example, the abolition of wealth transfer taxation in Canada in 1972 was indeed justified by the introduction of a capital gains tax, which provided for a deemed realisation in respect of transfers on death.”

\textsuperscript{239} s 4A of the Estate Duty Act 45 of 1955 as amended by The Taxation Laws Amendment Act 17 of 2009.
last will and testament or in terms of the Australian laws of intestacy, neither does Australia levy a capital transfer tax in the form of a death or estate duty.\textsuperscript{240} There will also not be CGT payable in respect of a taxable asset acquired before CGT was introduced (\textit{ie} 20 September 1985) and it will thus be beneficial for an Australian taxpayer to hold on to such asset for as long as possible, knowing that when he or she dies the heir to such asset will enjoy the benefit of a stepped up base cost, being the value of such asset as on the date of his or her death, without a corresponding CGT liability for his or her estate.\textsuperscript{241}

In Botswana there is no CGT payable on potential capital gains realised by a Botswana taxpayer at his or her death.\textsuperscript{242} Paragraph 5 of the tenth schedule to the Botswana Income Tax provides that the acquisition cost of an inherited asset shall be the market value of the asset as at 1 July 1982 if the asset was acquired before the said date, and where the asset was acquired by the deceased taxpayer on or after 1 July 1982, it shall be the market value as at the date of such acquisition, meaning that there will not be a step up in the base cost of such asset at the death of a Botswana taxpayer.\textsuperscript{243} A capital transfer tax in the form of an inheritance tax is however levied on the net aggregate gain of all of the assets of the deceased Botswana taxpayer at his or her death, with certain exceptions.\textsuperscript{244}

There will be no CGT consequences at the death of a US taxpayer, expect possibly where an election is made by the executor in respect of taxpayers who passed away during 2010, and the heirs of the taxpayer will enjoy the benefit of a step-up in the base cost in respect of a taxable asset.\textsuperscript{245} If the asset has however depreciated in value it could be sold by the executor at a loss instead of the heir receiving the asset at a stepped-down value.\textsuperscript{246} Considering that a tax credit of

\begin{itemize}
\item \textsuperscript{240} See par 2.2.
\item \textsuperscript{241} See par 2.2.
\item \textsuperscript{242} See par 2.3; Paragraph 5 of the Tenth Schedule Chapter 52:01 Income Tax.
\item \textsuperscript{243} Paragraph 5 of the Tenth Schedule Chapter 52:01 Income Tax.
\item \textsuperscript{244} See par 2.3; Jmanso “Botswana: taxation of international executives” http://www.kpmg.com/Global/en/...TIES/...BOTSWANA_2010_TIES.pdf 12 (26-07-2011).
\item \textsuperscript{245} See par 2.4.
\item \textsuperscript{246} See par 2.4; Bittker and Lokken \textit{Federal Taxation of Income, Estates and Gifts} (3d ed) 41-37, 41-38.
\end{itemize}
$5,000,000 for individuals and $10,000,000 for married couples is currently provided to a US taxpayer in respect of estate duty, it seems that most US taxpayers will not be liable to pay any taxes at their death.\textsuperscript{247}

It became apparent that some US academic writers prefer the method of taxing capital gains at death which they believe is superior to the carryover basis method in terms of simplicity, efficiency and equity, and also due to the fact that it will generate significantly more revenue than the carryover basis method.\textsuperscript{248} Arguments in favour of a CGT at death include that the maximum deferral possibility is limited to a single lifetime, the person who earned the capital gain is taxed, CGT is levied at an ideal time in terms of ability to pay and it provides a complete solution to the lock-in problem.\textsuperscript{249} Arguments in favour of a carryover basis method are however that it postpones CGT until a taxable asset is actually disposed of, the asset does not need to be valued at date of death and CGT is levied at a time when the taxpayer is likely to have the necessary funds to pay the CGT.\textsuperscript{250} When considering which method should be followed the complexity in administration and the revenue that will be produced are important factors to consider, it is argued that a CGT at death will generate more revenue than the carryover basis method and will also be simpler to apply.\textsuperscript{251}

Similar to the position in Australia a taxable asset acquired by an UK taxpayer before CGT was introduced (\textit{ie} 6 April 1965) will be exempt from CGT and as long as the asset is not disposed of by the taxpayer and no CGT will be payable in respect of such asset.\textsuperscript{252} Moreover a taxable asset of the deceased person will be deemed to have been acquired by the personal representative at

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\item \textsuperscript{247} See par 2.4.
\item \textsuperscript{248} LE Cunningham & NB Cunningham \textit{Realization of Gains Under the Comprehensive Inheritance Tax} (2009-2010) 274; Dodge \textit{Further Thoughts on Realizing Gains and Losses at Death} (1994) 1829.
\item \textsuperscript{249} Zelenak \textit{Taxing Gains at Death} (1993) 367.
\item \textsuperscript{250} Zelenak \textit{Taxing Gains at Death} (1993) 367.
\item \textsuperscript{251} See par 2.4; Zelenak \textit{Taxing Gains at Death} (1993) 368; LE Cunningham & NB Cunningham \textit{Realization of Gains Under the Comprehensive Inheritance Tax} (2009-2010) 276-280; Zelenak \textit{Taxing Gains at Death} (1993) 368-375.
\item \textsuperscript{252} HM Revenue and Customs “Statements of Practice” http://www.hmrc.gov.uk/practitioners/sop.pdf (06-04-2012).
\end{itemize}
\end{scriptsize}
the market value of the asset as at the date of death, thus providing for a step up in the base cost at death, without any CGT being payable and there will also not be any CGT payable on the transfer of the asset from the personal representative to the legatees or heirs of the deceased.\footnote{253}{See par 2.5; s 62 of the Taxation of chargeable gains act 1992.} It is submitted that the main reason why there is no CGT liability at the death of a taxpayer in the UK is because the UK already levies another type of tax on the transfer of the wealth of the taxpayer at his or her death, namely an inheritance tax.

In Nigeria section 8 of the Capital Gains Act 44 of 1967 (“the CGT Act”) provides for a total CGT exemption at death.\footnote{254}{See par 2.6; s 8 of the Capital Gains Tax Act 44 of 1967, Cap.42 L.F.N. 1990 Act Cap. C1 L.F.N. 2004.} In terms of subsection 8(1) of the CGT Act the base cost of a taxable asset that was applicable to the deceased will remain the base cost for the beneficiaries, \textit{i.e.} the base cost will not be increased or stepped-up to the market value of such asset as at date of death.\footnote{255}{See par 2.6; s 8 of the Capital Gains Tax Act 44 of 1967, Cap.42 L.F.N. 1990 Act Cap. C1 L.F.N. 2004.} Here the argument may again be raised that because the Nigerian beneficiary receives a CGT asset together with a CGT liability as a result of the base cost not being increased to the market value of the asset as on date of death, the rules applied in Nigeria in this respect do not differ materially from the rules applicable in South Africa because CGT will eventually have to be paid.\footnote{256}{See par 2.2.} The counter argument will however again be that the Nigerian CGT provisions are more beneficial to the Nigerian taxpayer because the CGT liability is deferred until that beneficiary decides to dispose of the asset at some date in the future, if ever, and if the asset has not been disposed of by the time of that beneficiary’s death the roll-over will again apply.\footnote{257}{See par 2.2.}

In terms of the current South African tax provisions the net value of a taxable asset of the deceased will be subject to estate duty, with certain exemptions and abatements, and the increase in the value of such taxable asset, \textit{i.e.} the difference between the original base cost plus qualifying expenditure and the value of the taxable asset as on date of death, will be subject CGT, with certain exemptions. The reason why CGT will be payable in respect of a taxable asset at the
death of a South African taxpayer is because the South African tax provisions do not provide for either a step-up in the base cost at death without a corresponding CGT liability or a general roll-over provision in favour of all of the heirs of the deceased. An argument that might be raised by the South African tax legislature it that adequate relief is provided by section 4A of the Estate Duty Act 45 of 1955 (“the Estate Duty Act”), especially in light of the recent legislative amendment in terms of which such part of the section 4A relief that has not been utilised at the deceased person’s death will be carried over to the surviving spouse.\textsuperscript{258} Section 4A, and the regulations published in respect thereof, currently provides that the first R3.5 million of the net estate of a deceased person will not be subject to estate duty. If for example Mr. and Mrs. X were married to each other and Mr. X bequeaths everything to his wife no estate duty will be payable as it is exempt in terms of section 4q of the Estate Duty Act and his section 4A relief of R3.5 million will be carried over to his wife, meaning that at her death she will be entitled to relief in the amount of R7 million, or R3.5 million plus whatever the amount of relief is at that stage. This has no application to CGT but it does constitute a relief in respect of the overall tax paid by the estate.

Despite the above there is a compelling argument in favour of the South African taxpayer for either estate duty to be abolished in its entirety, and not only for the general abatement referred to above to apply, or for a step-up in the base cost in respect of a taxable asset to be provided at the death of the taxpayer without a CGT liability to his or her estate, or at the very least a general roll-over at his or her death to apply so that a heir receives the taxable asset at its original base cost without a CGT liability to the estate of the deceased. The argument is that since a taxable asset of the deceased is potentially subject to both CGT and estate duty a scenario of double taxation arises in respect of such asset.\textsuperscript{259} In the USA and the UK for example the double taxation that would otherwise have occurred as a result of CGT and a transferor-based wealth transfer taxation has forced both countries to implement a stepped-up approach for purposes of CGT on the death of a taxpayer.\textsuperscript{260} It is due to the fact that a scenario of double taxation may

\textsuperscript{258} s 4A of the Estate Duty Act 45 of 1955 as amended by The Taxation Laws Amendment Act 17 of 2009.
\textsuperscript{259} Muller \textit{A framework for wealth transfer taxation in South Africa} (2010 thesis UP) 115-116
\textsuperscript{260} See par 2.4 and 2.5; Muller \textit{A framework for wealth transfer taxation in South Africa} (2010 thesis UP) 114-115.
arise in the absence of a stepped-up approach that previous efforts to impose a carry-over (roll-over) or deemed-realisation approach on death were unsuccessful.\textsuperscript{261}

It is submitted that the roll-overs, exclusions and exemptions provided for in \textit{inter alia} paragraph 5 of the Eight Schedule to the Income Tax Act, which currently provides for an annual exclusion of R30 000 and a R300 000 exclusion in that year the taxpayer passes away,\textsuperscript{262} paragraph 67(1)(a) of the Eight Schedule to the Income Tax Act, which provides for a roll-over between spouses,\textsuperscript{263} the primary residence exclusion contained in paragraphs 44 to 51 of the Eighth Schedule\textsuperscript{264} and the deduction of the CGT liability from estate duty as provided for in section 4(b) of the Estate Duty Act\textsuperscript{265} is insufficient to address the problem of double taxation and harsh tax treatment of South African taxpayers in this respect.

The roll-over relief currently provided has too a narrow application and the relatively small exclusion of R300 000 in the year that the deceased passes away will mean that the majority of his or her capital assets, excluding a portion of his or her primary residence, will be subject to both estate duty and CGT, unless such capital assets is bequeathed to his or her spouse, if married. It is conceivable that the deceased may have wanted to leave a capital asset or all of his or her capital assets to his or her descendant’s or to some family member or friend, in which event his or her estate will suffer at the hands of the harsh tax treatment currently imposed, with a possibility that some of the capital assets will have to be realised in order to pay for the taxes levied at death.

3.2 \textit{Recommendations}

3.2.1 \textit{Levying of CGT at death}

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\textsuperscript{261} Muller \textit{A framework for wealth transfer taxation in South Africa} (2010 thesis UP) 114-115.
\textsuperscript{262} See par 1.3; Rates and Monetary Amounts and Amendment of Revenue Laws Act 13 of 2012.
\textsuperscript{263} See par 1.3; Par 67(1)(a) of the Eighth Schedule to the Income Tax Act 58 of 1962.
\textsuperscript{264} See par 1.3; Par 5, 44 to 51 of the Eighth Schedule to the Income Tax Act 58 of 1962.
\textsuperscript{265} See par 1.1; s 4(b) of the Estate Duty Act 45 of 1955.
\end{flushleft}
It is suggested that the South African legislature will have to revise the current position in respect of the levying of both a CGT and an estate duty at the death of a taxpayer and if it decides to continue to levy an estate duty at death such regime will have to be coupled with a regime in terms of which a step-up is provided in respect of an inherited taxable asset without any corresponding CGT liability to the deceased estate or to the heir, alternatively with a regime where the base cost in respect of the taxable asset that was applicable to the deceased is simply carried over to the heir without any CGT liability at the death of the deceased.

It would appear that the carry-over (roll-over) approach currently followed in Australia, Botswana and Nigeria,\footnote{See par 2.2, par 2.3 and par 2.6.} in terms of which the heir inherits the asset at its acquisition cost and the CGT liability is deferred until the heir actually disposes of the asset, would be the reasonable approach to follow as there will not be a permanent forgiveness of capital gains realised as is the case when a stepped-up approach is followed. It is submitted that it will also be easier to implement the carry-over approach since the South African Income Tax Act already contains certain roll-over relief measures and these only need to be expanded upon.

3.2.2 Capital Losses at Death

It is submitted that the current tax provisions in South Africa providing that a capital gain realised at death will generally be subject to tax but that a capital loss will be disregarded in the instances described above is untenable.\footnote{See par 1.7.}

It is suggested that the method followed in Canada in respect of capital losses that occurred in the year of a taxpayer’s death should be followed in South Africa, \textit{ie} that such capital loss may be carried back three years in order to reduce any taxable capital gains that occurred in those years or that the capital losses may be utilised to reduce other income of the taxpayer in his final return.\footnote{See par 2.1.} It is further suggested that this method should also be followed in respect of unutilised
capital losses that occurred in the winding up of the estate, *ie* where the executor sold a capital asset out of the estate at a loss and there are no capital gains in the estate against which to offset such capital loss, alternatively the capital losses so realised must be carried over to the heirs of the deceased.

### 3.2.3 CGT and Bare Dominium Heirs

It is clear that a CGT anomaly arises in the instance where the deceased creates a usufruct over a specific asset because of the way South African CGT provisions are applied firstly to the death of a taxpayer and secondly to the bare dominium holder.\(^{269}\) At the death of a South African taxpayer he himself is liable for CGT on his capital assets as he is deemed to have disposed of the assets to his estate at the market value of such assets at the date of his death.\(^{270}\) Any capital gain will be included in the last tax return of the deceased, much the same as if he had disposed of the asset just before he passed away. If the deceased however creates a usufruct over a specific asset such asset remains subject to CGT as described above but the base cost is significantly reduced in the hands of the bare dominium holder and is never restored to the full market value, which value was in fact subject to CGT before (deceased’s date of death), meaning that the same capital gain will in actual fact be taxed twice.\(^{271}\)

It is therefore submitted that legislative amendments are required to the current South African CGT provisions in order to provide for an increase in the base cost applicable to the bare dominium holder when the usufructuary eventually passes away. Alternatively the SARS”s current practice in this respect should be altered to avoid the unbearable situation where the same capital gain may be taxed at 2 separate instances.

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\(^{269}\) See par 1.8.

\(^{270}\) See par 1.2.

\(^{271}\) See par 1.8.
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