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Tax talk

Estate planning is important

Most people do not realise the tax consequences involved when concluding a deceased estate.

There is a misperception that the estate duty will be paid by the estate, which can be true if the liquidity of the estate is sufficient, but in most cases the heir/legatee will be liable to pay the estate duty on the property/asset inherited by way of a donation mortis causa (donation due to the event of death), otherwise the property/asset will have to be sold in order to settle the estate duty.

Estate planning is necessary for heirs to enjoy the maximum benefit from the property inherited, but also to limit the estate duty/capital gains tax payable on the property by either the deceased or the heir so as to ensure that the property/asset is kept in the family.

The most efficient way to do this is by way of a will that needs to be drawn up by a lawyer. The problem arising from estate duty is that all property or deemed property of the deceased will be included in the planner's estate, which means estate duty will be payable on all the property. All liabilities and deductions made against the property will decrease the value of the estate, but in cases where large value property such as farms are included, the estate will most probably lead to a hefty sum of estate duty.

To ensure that there is sufficient funds available to settle the estate duty in the event of the planner's death, the planner has to make sure that the estate duty anticipated is a realistic reflection of the actual event and to ensure that the estate's liquidity is sufficient to cover estate duty without valuable property/assets having to be sold.

The most common solution is a life insurance policy on the planner's life. The planner can either take out a policy himself, or he can inform the heirs/legatees of the possible estate duty and encourage them to take out a life insurance policy on the planner's life. The problem with this option is that the value of the life insurance policy will automatically be included in the estate of the deceased, even though he did not pay any of the premiums. The only exception to this rule is if a policy is paid out in terms of an ante-nuptial agreement which will be used for the maintenance of the surviving spouse and/or child. It is critical to remember that in addition to the estate duty,

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the planner might also be liable to pay capital gains tax on some of the assets owned by him on date of death. (There are some exceptions such as personal use assets etc.)

Another option is to transfer the property/asset to the heir/legatee before the event of death takes place or to a trust created for the heir. This will have capital gains tax implications (if it is not a personal use asset), but also donations tax consequences of 20% on the value of the asset if no consideration is paid by the heir for the property/asset obtained.

The problem for the planner is that control over this asset/property will be lost and will most likely have administration requirements (for example trusts). The planner can also consider transferring the property to a trust on a loan account (which will ensure that no donations tax will be payable) and decrease the loan amount by making an annual donation of R100 000 to the trust (each person can donate up to R100 000 per annum without any donations tax consequences).

The balance of the debit loan will then be included in the planner's estate, but this will ensure that the growth in value of the property/asset is 'frozen', in other words the maximum value of the property/asset to be included in the estate is the value of the property/asset on the date that is was transferred to the trust.

The planner has to keep in mind that the trust needs to have an independent trustee in order to ensure that the property in the trust is not included in his/her estate. If there is no independent trustee, SARS might argue that the planner was capable of selling the property for his own benefit, even though it was registered in the trust's name.

The tax consequences of the various options have to be weighed in order to determine the best possible option. When looking at the first option, the transfer of land is a disposal for tax purposes which will result in capital gains tax having to be paid. This might be a material amount today, but one must consider the difference in the capital gains tax payable now versus the estate duty and taxes that will have to be paid if the land is left to be inherited.

To conclude, one must at least consider the increase in market value of property in future, the liquidity of the estate, the ability of the heirs to pay estate duty as well as the ability to pay capital gains tax now when planning one's estate.