

## **EXTERNAL GUIDE**

# **ESTATE DUTY IMPLICATIONS ON BUY-AND-SELL ARRANGEMENTS, WHERE SHARES ARE HELD IN TRUSTS**

## 1 PURPOSE

- The purpose of this reference guide is to explain the Estate Duty implications on “buy-and-sell” arrangements where shares are held in trust.

## 2 SCOPE

- The guide expresses the views of SARS regarding the application of section 3(3)(a)(iA) of the Estate Duty Act, 1955 (the Act) and any letter previously issued by a SARS office of which the content differs from the views expressed in this document, is hereby withdrawn

## 3 REFERENCES

- Estate Duty Act, 1955

### 3.1 LEGISLATION

TYPE OF REFERENCE	REFERENCE
Legislation and Rules administered by SARS:	<b>Estate Duty Act, 45 of 1955.</b> <b>Tax Administration Act, 28 of 2011 (effective: 1 October 2012)</b>
Other Legislation:	None.
International Instruments:	None.

## 4 DEFINITIONS AND ACRONYMS

<b>SARS</b>	South African Revenue Service
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## 5 BACKGROUND

- In terms of section 3(3)(a) of the Act, any amount due and recoverable under any policy of insurance which is a “domestic policy” (as defined in section 1 of the Act) upon the life of the deceased is regarded as “deemed property” of the deceased. The requirement for inclusion in the estate of the deceased as deemed property for estate duty purposes is not whether the deceased was the owner of the policy or not but whether it was his life which was assured.
- Regardless of whether the proceeds are payable to the deceased’s estate, ceded to a beneficiary during his lifetime or paid to a nominated beneficiary, if it is a “domestic policy on the life of the deceased” it falls within the ambit of section 3(3)(a) of the Act. It may, however, be mentioned that in cases where a public benefit organisation or the surviving spouse is the beneficiary of the policy, the proceeds of the policy qualify for a deduction in terms of section 4(h) or 4(q) of the Act, respectively. Except for the deductions as mentioned above, the only other exclusions available in terms of the Act are those listed in section 3(3)(a)(i), (iA) and (ii) of the Act. If one of the said exclusions or deductions does not apply, the proceeds of the “domestic policy upon the life of the deceased” would be subject to estate duty.

## 6 GOVERNING LEGISLATION

### 6.1 SECTION 3(3) – ESTATE DUTY ACT

- The relevant part of section 3(3) of the Estate Duty Act reads as follows:
  - “(3) Property which is deemed to be property of the deceased includes-

- o (a) so much of any amount due and recoverable under any policy which is a 'domestic policy' upon the life of the deceased as exceeds the aggregate amount of any premiums or consideration proved to the satisfaction of the Commissioner to have been paid by any person who is entitled to the amount due under the policy, together with interest at six per cent per annum calculated upon such premiums or consideration from the date of payment to the date of death: Provided that the foregoing provisions of this paragraph shall not apply in respect of any amount due and recoverable under a policy of insurance, if -
  - o (i)...; or
  - o (iA) the Commissioner is satisfied that the policy was taken out or acquired by a person who on the date of death of the deceased was a partner of the deceased, or held any share or like interest in a company in which the deceased on that date held any share or like interest, for the purpose of enabling that person to acquire the whole or part of-
    - (aa) the deceased's interest in the partnership concerned; or
    - (bb) the deceased's share or like interest in that company and any claim by the deceased against that company,
    - and that no premium on the policy was paid or borne by the deceased; or"
- Section 3(3)(a)(iA) policies are commonly referred to as "buy-and-sell" policies.

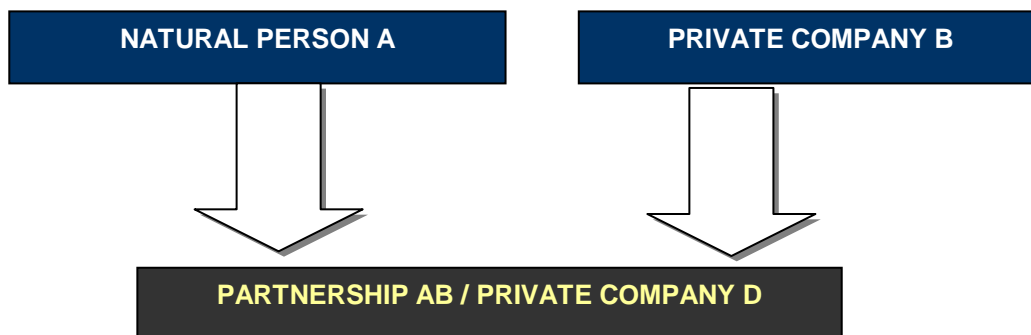
## 6.2 THE SUB-SECTION CAN BE ANALYSED AS FOLLOWS:

- To qualify for the exclusion, the policy must have been taken out or acquired by a person who was the partner (co-shareholder/co-member) of the deceased as at date of his death. Not only policies taken out by the partner or co-shareholder of the deceased as at date of death, will qualify as an exclusion, but also policies acquired by way of cession. The requirement that the deceased may not have paid or borne any premiums of the policy, shall however, still apply. The meaning of this is that the policy will qualify as an exclusion if the retiring partner cedes his policy on the life of the remaining partner to the new partner who joins the partnership. If, however, the deceased paid the first few premiums of the policy and the policy was then ceded to his partner to enable the latter to buy his/her interest in the partnership, private company or close corporation, such policy does not qualify for the exclusion
- On the date of death of the deceased the person who acquired the policy must have been a partner of the deceased, or have held any share or like interest in a company in which the deceased on that date held any share or like interest. The focus is on the date of death of the deceased. If the deceased and the policyholder had ceased to be partners (co-shareholders or co-members), the exclusion does not operate. For the exclusion to take effect, section 3(3)(a)(iA) of the Act refers to a partner and co-shareholder of the deceased if such relationship was still in force as at date of death of the deceased. The reason for this is that the interest of the deceased in the private company or partnership forms part of the assets in his estate, which comprise "property" for estate duty purposes.
- The purpose of the policy must be to enable that person to acquire the whole or part of the deceased's interest in the partnership or the deceased's share or like interest in that company and any claim by the deceased against that company. If the policy was taken out for any other purpose than that envisaged by the section, the exclusion does not apply, whether the proceeds were used to acquire the deceased's interest or not. According to the wording of the section the purpose of the policy must be to obtain the deceased's share in the partnership (or private company) and any claim by the deceased against the company. According to SARS's view the proceeds of the policy would not qualify for the exclusion if the purpose of the policy was to obtain the deceased's claim against the company without obtaining his shares in that company.
- No premiums on the policy were paid or borne by the deceased. In cases where the premiums are either paid directly by the deceased, or indirectly by someone else on behalf of the deceased out of funds provided by the deceased, such policy does not qualify for the exclusion. Say, for example, a company pays the premiums of a policy on the life of A and debits A with the amount thereof as a loan, it will be deemed that A has paid or borne the premiums.

- It is possible that the proceeds of the policy may exceed the amount required to buy the interest of the deceased. If the difference in the proceeds of the policy and the valuation of the partnership or company as at date of death are substantial, the Commissioner may exercise his discretion by not allowing the exclusion. The grounds for the disallowance in such a case will be “the intention of the parties”. However, if the difference can be verified, for instance by a general drop in that specific type of business which occurred shortly before the death of the partner or co-shareholder, the intention of the parties will be beyond doubt.
- In the absence of the exclusion in terms of section 3(3)(a)(iA) of the Act, both the deceased’s interest in the partnership, private company or close corporation and the proceeds of the policy would be subject to estate duty in the deceased estate. The effect of the exclusion is to exempt the policy from estate duty.
- If the Commissioner, after considering the information submitted regarding the policy, is not satisfied that it complies with the said requirements and does not allow the exclusion, the executor or person liable to pay the duty may object and appeal under section 24(1) of the Act. The executor will, however, be limited in his/her grounds of objection to those relating to review proceedings, namely that the Commissioner exercised his/her discretion *mala fide* or has not properly applied his/her mind to the matter, or that his/her decision is unreasonable.

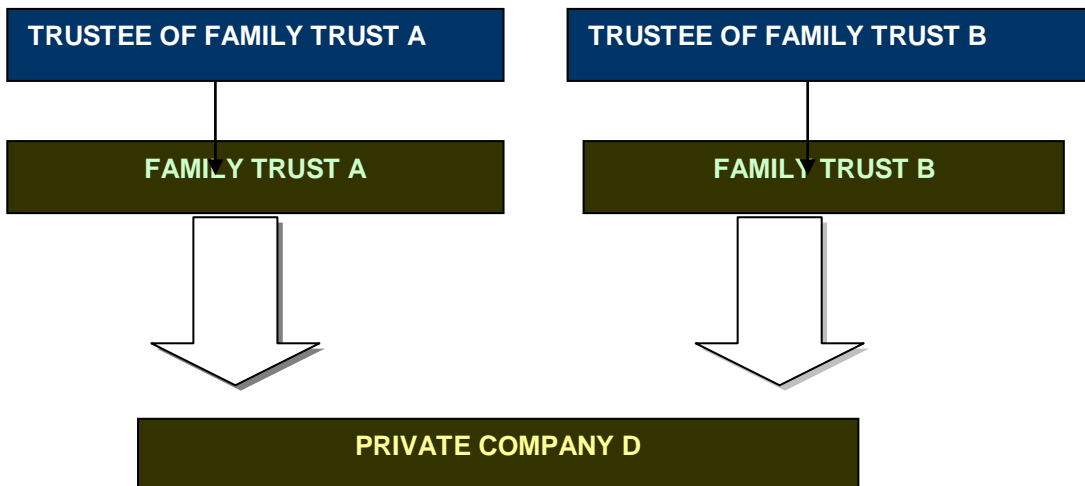
### 6.3 DIFFERENT SCENARIOS:

- **A natural person A and private company B are partners (co-shareholders) of a partnership AB (private company D)**
  - Does the exclusion apply where, say for instance, A (a natural person) and B (a private company) own the shares in company D and company B took out a policy on A’s life to enable company B to purchase A’s interest in the company D when A dies, assuming that all the other requirements of the section have been met?



- This scenario must be tested against the requirements of the exclusion. The first requirement is that the policy must be taken out or required by the “person” who was a partner (co-shareholder) of the deceased as at date of death. For estate duty purposes a “person” is not defined by the Act. The definition of person in terms of the Interpretation Act, Act No 33 of 1957 reads as follows:
  - 'person' includes-
    - *any divisional council, municipal council, village management board, or like authority;*
    - *any company incorporated or registered as such under any law;*
    - *any body of persons corporate or unincorporated;”*
  - As the definition of “person” in the Interpretation Act includes a company, the proceeds of such policy will qualify for the exclusion from estate duty in terms of section 3(3)(a)(iA) of the Act, subject to the condition that all the other requirements have been met.





- If trustee B took out the policy on the life of trustee A, it can be said on the strength of the ruling given as discussed above, that such policy was taken out by a “person”, however, all the other requirements must be met to qualify for the exclusion.
- As it is a requirement in terms of section 3(3)(a)(iA) of the Act for the exclusion to apply, that the person who took out the policy (the trustee of trust B), as well as the deceased (the person whose life has been insured – A as trustee of trust A) must hold a share in the company as at date of death of the deceased, it is clear that in this case, A (the deceased and trustee of trust A), does not hold a share in the company D as his share has been transferred to his family trust and therefore the policy does not qualify as an exclusion. For the same reason, B the trustee of trust B, also does not hold a share in company D.
- Under these circumstances all the requirements of the exclusion are not met and the proceeds of the policy constitute “deemed property of the deceased”.

## 7 QUALITY RECORDS

- None.

## 8 DOCUMENT MANAGEMENT

Designation	Name / Division
Business Owner:	GE: Contact Centre Operations and Branch Operations
Policy Owner:	Executive: Enterprise Business Enablement Policy and Standards
Author:	S Matimba
Detail of change from previous revision:	Updated the legislation with Tax Administration Act
Template number and revision	POL-TM-07 - Rev 3