IN THE INCOME TAX SPECIAL COURT

BEFORE

The Honourable Mr Justice L I Goldblatt	President
H A Coetzee	Accountant Member
H V Hefer	Commercial Member

In the appeal of: "A"

CASE NO ED 79

(Heard at Johannesburg on 27 January 2003)

JUDGMENT

JOHANNESBURG 12 March 2003.

GOLDBLATTJ:

1. This appeal relates to the duty imposed in terms of the Estate Duty Act no 45 of 1955 ("the Act") upon the estate of the late "A" who died on the 1st of June 1999.

2. During his lifetime the deceased had bound himself as surety and co-principal debtor to "B" ("the bank") in respect of the indebtedness of two trusts, the "C" and the "D" ("the trusts").

3. Mr. "E" the branch manager of the bank gave evidence that after the death of Mr "A" his widow, who was his executrix testamentary, instructed the bank to utilise the proceeds of various life assurance policies which had been ceded to them as security to pay the amounts owing to it in terms of the suretyships. The bank did this and *inter alia* credited the account of the "C" with R1 442 153,00 and the account of the "D" with the sum of R2 009 511,00. These amounts were owing by the two trusts in respect of mortgage bonds registered over the properties of the trusts in favour of the bank.

4. In the determination of the net value of the estate the executrix deducted the above amounts as being debts due by the deceased in terms of the suretyships entered into by the deceased contending that these amounts fell to be deducted in terms of section 4(b) of the Act. The section reads:-

"*The net value of any estate shall be determined by making the following deductions from the total value of all property included therein in accordance with section 3, that is to say –*

(a) *……*

(b) *All debts due by the deceased to persons ordinarily resident within the Republic which it is proved to the satisfaction of the Commissioner have been discharged from property included in the estate;"*

5. The Commissioner for the South African Revenue Service disallowed such deduction and the appellant now appeals against his decision.

6. (a) The appellant submitted that the monies paid to the bank were paid in settlement of debts due by the deceased and accordingly fell to be deducted from the value of the estate in terms of section 4(b) of the Act. The appellant further submitted that the right of recourse acquired against the trusts was acquired after the death of the deceased and accordingly could not be considered as an asset in the estate of the deceased.

(b) The respondent's counter to these arguments was -

(i) The debt was not a "due debt"; and

(ii) The value of the estate was increased by the right of recourse against the trust acquired when the monies were paid.

7. The appellant submitted that because the deceased was bound to the bank as a surety and co-principal debtor he owed the monies to the bank and thus the debt was due and payable. In this regard the appellant adopted the argument set out in paragraph 28.4 of Meyerowitz on Administration of Estates and Estate Duty, 2001 Edition where the learned authors said -

"In the narrowest sense a "debt due" may be said to be a liquidated amount which is due and payable. But it is submitted that the words are used in a wider sense to mean any claim which the deceased was obliged to pay, even though the time for payment may not have arrived at the date of death. If this were not so, the estate for estate duty would be inflated beyond its true value by the non-deduction of obligations incurred by the deceased but not yet payable at the time of his death, eg. Mortgage bonds, notice of repayment of which has not been given or expired at the date of death, or delivery of

property sold by the deceased for which he has in his lifetime received the purchase price etc.

On this basis, if the deceased had a contingent liability, which only became payable after death, it will nevertheless be deductible for estate duty, since the liability arises through obligations assumed by the deceased in his lifetime. Such contingent liability is only deductible if paid by the deceased's executor. But until the estate is released from liability it cannot be determined whether the debt will in fact have to be paid. The practical course would then be to arrange with the Master that estate duty be calculated excluding the contingent liability, subject to a refund should be contingency eventuate.

It is submitted that where the deceased has bound himself to make payments for a period or until due notice such as rent under a lease or interest on a loan, the liability of the estate to make these payments constitutes debts due by the deceased since they were incurred by him and not his executor in the course of administration."

8. Meyerowitz's opinion finds support in the judgment of Kuper J in Myer No v. CIR 1956 (5) SA (T) where the learned judge said at 345 A - D -

"it is in my view, clear from the wording of the section that before any debt can be deducted from the gross estate of a deceased person, that debt must have been du by the deceased and in this regard a distinction must be drawn between the deceased and the executor of a deceased estate. If, for example, the deceased was the owner of a building which, after death, was administered b the executor of his estate, and a tenant in that building obtains damages against the estate because of the negligence of the executor, the amount of damages could not be deducted from the gross estate. The only liabilities incurred by the executor after death which can be deducted are those referred to specifically in sec. 4 and particularly those set out in sub-paras (c), (d) and (e) of the section. On the other hand if the deceased had a contingent liability, which only became payable after death, such a liability could be deducted because it arose from an obligation of the deceased incurred during his lifetime. The fact that the debt is not due and payable at the moment of death is irrelevant as long as the debt when due was not one incurred by the executor in the liquidation and administration of the estate but arose because of some action taken or obligation assumed by the deceased."

9. While we see no reason to disagree with what was said by both Meyerowitz and Kuper J their reasoning is not apposite to the facts of the present case for the reasons set out hereunder.

10. The deceased was only liable to the bank as a surety. The fact that he bound himself as co-principal debtor did not render him liable to the bank in any capacity other than that of a surety that had renounced the benefits ordinarily available to a surety against the creditor. (See Neon and Cold Cathode Illumination Ltd v Ephron 1978 (1) SA 463 (A) at 471 C-F).

11. "Suretyship is an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), primarily that the principal debtor, who remains bound, will perform his obligation to the creditor and secondarily, that if and so far as the principal debtor fails to do so, the surety will perform it or,

failing that, indemnity the creditor" per Caneys The Law of Suretyship, Third Eition, by C F Forsyth and J T Pretorius at pages 27/28.

12. Thus the liability of the deceased and his estate was contingent on principal debt being due and payable and the bank electing to claim from the estate. The debt would not be due until both these conditions had been fulfilled. No evidence was lead to establish whether or not the principal debts were due and payable or whether the principal debtors were in default or that the bank had elected to claim the debts from the estate (See Trans Drakensberg Bank Limited v the Master and others 19632 (4) SA 416 (C) at 422). The evidence was that the executrix. Without being called upon so to do, paid the amounts owing by the trusts.

13. In the circumstances the appellant failed to prove that the monies paid were in respect of debts due by the deceased.

14. In (sic) we are wrong and the estate was obliged to pay the debts of the trusts then it would have a right of recourse to recover from the trust the monies which were paid to the bank (Caneys Law of Suretyship supra page 157 et seq). The surety has, in our view, a contingent right of recourse which comes into existence from the moment that he binds himself as a surety. Such right is contingent on the surety paying the debt. Thus when the deceased died he had such contingent right which became an unconditional right when the monies were paid. On the same basis that a contingent debt can be treated as a debt owing by the deceased (see paragraph 7 above) a contingent asset must be treated as an asset when the contingency occurs. Any other reasoning would be absurd. Thus the amount claimable from the trust, there being no evidence that they could not pay the amounts, must be included in the assets of the estate and would balance the amount paid to the bank. The result would leave the assessment for death duties unaffected.

15. Support for this view is to be found in "Die Beredderingsproses van Bestorwe Boedels APJ Bouwer Tweede Uitgawe p 379 where the learned author sets out the process to be followed in the instance of payments on the basis of a suretyship agreement..

"*UITBETALINGS WEENS BORGKONTRAK*

Word die boedel ingevolge die borgkontrak aangespreek en genoodsaak om die verpligtinge n ate kom, ontstaan 'n eis teen die hoofskuldenaar. Die eksekuteur kan ook eis dat die skuldeiser sy vorderingsreg en enige sekuriteite wat sy mag hou, aan die boedel sedeer. Op die boedelrekening sal die eis wat betaal is, onder laste verskyn, terwyl die terugvorderingsreg onder die boedel se bates betoon word."

Also see Meyerowitz supra at 15 – 43 where the learned author states –

"*An alternative method, if it proves practicable, is for the executor to pay the creditor in which event he will have a right of recourse against the principal debtor if there is one. In his account he will then reflect the liability and show the amount owing by the principal debtor (to the extent that it may be recoverable) as an asset."*

16. CONCLUSION

The appeal is dismissed and the assessment confirmed

On behalf of Mr H A Coetzee (Accounting Member)

Mr H V Hefer (Commercial Member) and myself

SIGNED

L I GOLDBLATT - PRESIDENT

This judgment should be reported YES NO

Adv Piet Marais SC, instructed by attorney Rudolph Botha of Centurion, appeared on behalf of the appellant.

Mr M Jorge represented the Commissioner of the South African Revenue Service.