Estate duty implications for non-resident individual investors in South African assets

Author: Heinrich Louw.

On 21 January 2016, the South African Revenue Service (SARS) issued Binding Private Ruling 217 (Ruling). The Ruling deals with the estate duty implications for non-resident individual investors (Investors), specifically where such an Investor, who is a resident in Country X, purchases a linked investment plan from a company incorporated and resident in Country X, which carries on the business of life insurance (the Company). The key issue was how certain sections of the Estate Duty Act, No 45 of 1955 (EDA), would apply.

The Company applied for this Ruling. It proposes to offer each Investor a linked investment plan, which offers exposure to South African assets and to assets located in Country X. The Company indicated that South African unit trust funds would be offered as underlying asset options to the Investors. The proposed linked investment will offer Investors the following:

- firstly, it will be a discretionary savings vehicle;
- secondly, it will allow each Investor to have complete liquidity and earn dividends and interest from either or

both the Country X and South African assets;

- thirdly, it will be a single premium discretionary (non-compulsory) product held under Linked Investment Service Providers; and
- fourthly, it will be a single contract with the Company to purchase multiple underlying unit trust products in Country X or South Africa, or both.

The Investor will be the beneficial owner of the underlying investment funds or unit trust funds, which will be held in the name of an independent nominee of the Company on behalf of the Investor. Upon the death of the Investor, the investment policy will fall into the Investor's estate and be dealt with by his/her executor.

The purchase of a linked investment plan triggers the application of the EDA as follows:

- Section 2(1) of the Estate Duty Act states that estate duty is payable in respect of the estate of any deceased person.
- Section 3(1) of the EDA states that a deceased person's estate consists of all the deceased person's property at his/her date of death and of property deemed to be that of the deceased person at date of death.
- The definition of 'property' in s3(2) of the Act, includes any interests in property held by the deceased immediately prior to his/her death.
- As the linked investment plan offered Investors the option of earning dividends and interest from South African assets held through the plan, which could constitute rights in property, the Company seems to have sought clarity on whether such amounts received would in fact be subject to estate duty.

SARS considered these provisions of the EDA and issued its Ruling in the following terms:

1. Estate duty, in terms of the EDA, will be payable by an Investor’s estate, in respect of any underlying South African assets held under the linked investment plan.
2. The South African investments held by an independent nominee of the Company on behalf of the Investor, will constitute property of the Investor’s deceased estate.
3. The Investor would still be entitled to claim any rebates in terms of s4A of the EDA in determining the dutiable amount. This means that amounts received by the Investor from South African assets in terms of the linked investment plan, up to an amount of R3.5 million, would be exempt from estate duty. If the deceased was the spouse of a deceased person, receipts of up to R7 million could be exempt from estate duty tax, depending on how much of the R3.5 million rebate the deceased spouse claimed.
4. The estate duty would be levied at the rate of 20% in terms of the First Schedule of the EDA.

The Ruling provides certainty to non-resident companies, who wish to provide their local investors with an opportunity to invest in South African assets regarding the estate duty consequences of such investments. It makes it clear that any income received by a non-resident investor, by virtue of his investment in South African assets, will be subject to the provisions of the EDA, upon the Investor’s death.

SARS explains 2015 Tax

Administration Amendments

Author: Lorys Charalambous (Tax-News.com)

On December 17, the South African Revenue Service (SARS) issued an explanatory memorandum on the 2015 Tax Administration Laws Amendment Bill (TALAB).

In particular, the memorandum looks at the TALAB provisions giving effect to the collection of information from South African financial institutions (FIs), and the associated obligation on the FIs to register with SARS regarding the Foreign Account Tax Compliance Act (FATCA) intergovernmental agreement (IGA) with the United States that was signed in July last year.

The TALAB implements a framework under which SARS may require South African FIs to collect information under an "international tax standard," such as the OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters, which encompasses the Common Reporting Standard (CRS).

Under the new provisions, reporting FIs will be obliged by statute to obtain the information required and provide it to SARS. It has been confirmed that a public notice will subsequently be published indicating the types of FIs required to register and submit a return. This will be in line with the registration process that currently exists for purposes of the FATCA IGA.

In order to implement the standard on a consistent and efficient basis, FIs will report on all foreign-resident account holders and controlling persons, irrespective of whether South Africa has a double taxation agreement (DTA) with their jurisdiction of residence or whether the jurisdiction is a CRS participating jurisdiction.

It is intended that this will ease the compliance burden on reporting FIs, as they would otherwise have to effect system changes and collect historical information each time a jurisdiction adheres to the CRS or South Africa concludes a new DTA.

Within the proposed new definition of an international tax standard, the TALAB also includes the country-by-country reporting standard for multinational enterprises, as introduced by the OECD base erosion and profit shifting project.

In relation to South Africa’s permanent Voluntary Disclosure Program, the memorandum specifies that the TALAB further clarifies the persons who qualify for the program, the relaxed requirements for voluntary disclosure, and the broadened ambit of voluntary disclosure relief.

Click links below:

- LAPD-LPrep-EM-2015-01 – Explanatory Memorandum on the TLA Bill 29 of 2015
- LAPD-LPrep-EM-2015-02 – Memorandum on the objects of TALA Bill of 2015

Estate planning: Tax trouble

for trusts

Authors: Ruan Jooste and Maarten Mittner (Financial Mail)

The Davis Committee’s recommendations on the taxation of trusts and estate duties are punitive in their present form, say industry players, and could lead to new forms of legal avoidance.

If the recommendations are implemented, all SA resident trusts and their beneficiaries or donors will be taxed as separate taxpayers.

Trusts will be taxed at a flat income tax rate of 41% and an effective capital gains tax (CGT) rate of 27,31%.

The way the trust was funded or constructed, which could minimise tax obligations, will no longer be relevant.

Where offshore trusts are concerned, the distinction between income and capital distributions to SA beneficiaries will fall away. At present they are subject to different tax rates. All payments from the foreign trust will be taxed at the (higher) personal income tax rate applicable to the recipient.

In addition, all income derived by such trusts will be considered a “donation” from an SA resident and subject to the 20% donations tax as defined in the SA Income Tax Act.

Currently and in lay terms, depending on the type of trust – local or foreign – legislation prescribes that income should either be taxed in the hands of a beneficiary (usually a vesting trust) or the trust itself on its income accrued (probably a discretionary trust).

This basic application could change depending on different circumstances and based on certain principles contained in the act. So the taxpayer, the type of tax applicable and the rate payable could all change.

The committee, however, suggests in its first interim report, released on July 13, that many tax benefits applicable to the use of trusts must fall away.

In addition, it has been recommended that the generous allowances to minimise or defer estate duty (currently 20%) on deceased estates should be revisited.

The committee also wants the donations tax rate of 20% to increase.

The removal of the various exemptions and introduction of increases could improve estate duty collections by between R10bn and R15bn from the current R1,486bn, which the committee says will be a useful contribution in reducing national debt levels.

Because of suggestions contained in the report, the efficiency of trusts as an estate planning tool is being questioned. But tax experts say it is too early to call all trusts dead, as some, notably special trusts, will still hold significant benefits. Special trusts for children or people with disabilities, for example, will still be taxed at lower rates.

Eugene du Plessis, Grant Thornton’s tax head in Johannesburg, says the proposed amendments may be simple, but they hold potentially important consequences. He adds that there is no reason for panic just yet.

The proposals are still in draft form and are up for debate. The public has until September to comment. The potential amendments also have to jump through various legislative hoops before becoming law.

Meanwhile, taxpayers might find alternative ways to structure and protect their future nest eggs.

“The best estate planning remains emigration,” says Webber Wentzel director Dan Foster. Many countries do not have estate duty or donations tax.

Estate duty and CGT applicable to a deceased estate discourage long-term savings in this country, Foster says, as the state takes a significant portion of wealth accumulated when a taxpayer dies.

Many people are already considering emigration, so in future trusts will probably be used more as a pre-emigration tool, Foster says, and not a way to manage future tax obligations.

He says liquidating SA investments and sending them abroad on emigration does not help investment and growth in SA. “But this is the impact of high taxation. The state must understand that people and their capital are not obliged to stay in SA, and tax rules should be designed to encourage people to stay,” he says.

Foster adds that the CGT charge (deemed asset disposal on emigration) is part of the problem. It discourages people from bringing capital to SA, as it applies to all assets (excluding real estate), even foreign assets acquired prior to coming to the country.

Other tax experts agree that government cannot legislate individuals into keeping their money in SA. The negative impact of exchange controls on capital flows is proof of that. Not to mention the number of locals with offshore bank accounts, as revealed by leaks from HSBC Bank’s Swiss subsidiary. The Davis Committee’s attempts to discourage offshore trust formation, by raising foreign trusts’ potential tax bills, will also force capital flow elsewhere.

Another potential hindrance to attracting foreign investment and boosting local savings – and probably an unforeseen consequence of the recommendations – is the fact that trusts are not only used by individuals but by companies as well.

For example, trusts are used to facilitate a portfolio of investments, such as a collective investment scheme.

Hanneke Farrand, a tax director at ENS, says that although corporates are not dealt with in the committee's report, a broad-brush amendment of established principles would naturally also affect these arrangements.

"It is hoped that during this extensive consultative process, solutions can be found to the issues identified in the report without adopting the punitive tax measures contained therein," Ferrand says.

This article first appeared on financialmail.co.za.

Davis Tax Committee – Significant changes proposed to Estate Duty and Tax on Trusts

Pictured from left are: Vuyo Jack, Nirupa Padia, Cecil Morden, Former Finance Minister Pravin Gordhan, Matthew Lester, Judge Dennis Davis, Kosie Louw, Tania Ajam, Nara Monkam, Annet Wanyana Oguttu and Ingrid Woolard. Mr Morden and Mr Louw are ex-officio members of the committee.

True to its mandate, the Davis Tax Committee (DTC) has been hard at work reviewing the South African tax system. Since its formation in 2013, it has already issued reports on small and medium enterprises (SMMEs), Base Erosion and Profit Shifting (BEPS) and VAT. It also compiled a macro analysis of the South African tax system, a World Bank study on the effective tax burden in South Africa and presented carbon tax proposals.

However, on 13 July the committee issued the "Estate Duty Report" which deals with a variety of topics sure to spark outcry and fierce debate, especially from more wealthy taxpayers. Whatever the outcome of the report may be following consultations, taxpayers will need to review their estate and tax plans to accommodate the impending changes.

The Estate Duty Report

The terms of reference the Minister of Finance extended to the DTC included an investigation of the role and continued relevance of estate duty to support a more equitable and progressive tax system, especially in the light of estate duty being abandoned in many developed countries. In this inquiry, the DTC had to consider the interaction between capital gains tax (CGT) and estate duty. The main findings and recommendations of the report are as follows

Estate Duty recommendations

In real terms, estate duty collection has declined in the 20 years and represents a mere 0,1% of total tax collections. This situation has mainly developed as result of the allowances that subject most estates to both capital gains tax (CGT) and estate duty, but only upon the death of both spouses, and thereby defers estate duty collection for many years.

To address the estate duty system's shortfalls, the DTC considered three alternatives:

• Repealing the Estate duty Act completely, moving away from the concept of treating death as a taxation event;

• Amending the Act to achieve a simpler, more efficient and just system; or

• Replacing the existing estate duty system with a new form of wealth taxation.

The DTC based their recommendations on the following overarching principles:

• There is no prospect of capital taxes, regardless of its form, being a “silver bullet” to increase South African tax revenue substantially;

• Despite its inherent faults, the current Estate Duty Act, coupled with Donations Tax, remain the only direct tax on wealth in South Africa. Given the country's huge disparity in wealth distribution, repealing these taxes without any replacement is hard to justify;

• With some modifications, the estate duty system could achieve many of the objectives without resorting to the drastic measure of implementing a Capital Transfer Tax (CTT).

The DTC is of the opinion that aggressive estate planning can be deterred by addressing the income tax regime for trusts (see below) without devoting substantial resources to implement a CTT or Net Wealth Tax. Such a deterrent is expected to result in increased estate duty and CGT collections, which will contribute to overall tax collections significantly but without burdening the tax system with new, complicated and administratively challenging alternative taxes.

Other proposed estate duty and related reforms include:

• Withdrawing the principle of inter-spouse estate duty exemptions and roll-overs, or subjecting these to a specific limit;

• Removing the inter-spousal donations tax exemption, which permits tax free donations of substantial cash amounts in anticipation of death;

• The donations tax exemption of any bona fide contribution made by a donor towards the maintenance of any person as the Commissioner considers being reasonable, should be made subject to various categories of expenditure and limits. For example, food, clothing, medical, education and cost-of-living expenses and possibly even the cost of a small motor vehicle could be included. This would act as a deterrent to substantial abuse;

• Increasing the existing primary estate duty abatement of R3,5 million per taxpayer to R6 million;

• Retaining the current flat rate of 20% for both estate duty and donations tax.

Recommendations in respect of trusts

The use of trusts in estate planning is well known. However, the DTC indicated that trusts are also often used as income-splitting vehicles through section 25B of the Income Tax Act, which allows trust income to vest and be taxed in the hands of a beneficiary. This despite the attribution rules of Section 7 of the Income Tax Act, which that are aimed at countering the abuse of section 25B. An additional tax avoidance measure is to escape donations tax through the transfer of assets into trusts by leaving the transfer consideration outstanding through an interest-free loan account.

To address the deficiencies of the estate duty system and the use of trusts to avoid or defer estate duty, the DTC recommended these fundamental legislative amendments:

- Maintaining the flat tax rate on trusts (currently 41%);
- Repealing the deeming provisions of Sections 7 and 25B should be repealed, in respect of RSA-resident and non-resident trust arrangements;
- Taxing trusts as separate taxpayers; and
- Not attempting to implement transfer pricing adjustments in instances where financial assistance or interest-free loans are advanced to trusts.

From an estate duty perspective, these proposals mean taxpayers wanting to make use of trusts to postponement estate duty will remain at liberty to do so. However, upon sale of the trust's assets the gain will be taxed in the hands of the trust at a higher tax rate, thus compensating for the estate duty loss.

The DTC report, which was submitted to Minister Nene in January 2015, recognises that a repeal of the attribution provisions will have diverse and far-reaching implications. It recommends that in the interests of equity and certainty, the repealing of the attribution provisions should be announced in the 2015 National Budget Speech but only be implemented from 1 March 2016. However, no such mention was made in the 2015 Budget Speech and the report was only released for public comment in July 2015. It is therefore expected that the announcement will only be made in the 2016 Budget Speech and that the final announcement will be affected by the current consultation process.

The effect on offshore trusts

In respect of offshore trusts, sections 7(8) and 25B (2A) have previously been amended to specifically deal with the taxation consequences of offshore trusts with South African donors and beneficiaries. The DTC’s view is that there is no need to consider an additional specific offshore amnesty programme.

To address remaining difficulties in respect of offshore trusts, the DTC proposes that all distributions of offshore trusts be taxed as income in the hands of beneficiaries. In addition, the DTC recommends inserting a separate criminal offence provision in the Tax Administration Act, which could lead to criminal charges against taxpayers who fail to disclose their direct or indirect interests in foreign trust arrangements.

It will be interesting to hear the comments made by affected and interest parties to these recommendations. The reforms to estate duty and the taxation of trusts have been mooted for quite some time now and come as no surprise. The recommendations will however, have significant effects on existing trust structures and future estate planning. Please proceed with caution and contact Grant Thornton to assist in reviewing your plans.

Potential tools in a well-structured estate plan

Author: Anton Maskowitz (Moneyweb)

Offshore trusts and companies could be essential.

Although recent statistics have shown a steady decrease in the volume of offshore trusts and companies being established by South Africans for tax planning purposes, their value is just as relevant today for estate planning purposes as it had been in years gone by.

This decline is largely due to, amongst other things, enhanced transparency, ever increasing regulatory requirements and aggressive changes in tax legislation, both locally and abroad. This, understandably, has in most cases given rise to an incremental increase in professional fees charged by the service provider, usually situated in a suitable financial services centre such as one of the Channel Islands, Mauritius or Cayman, to name a few.

From this it is clear that offshore trust- and company structures are no longer for everyone. However, that said and for those of you who are fortunate to have substantial assets situated in a foreign jurisdiction or multiple foreign jurisdictions, the fees may be a small price to pay considering the estate planning benefits these structures may hold.

Much has been said and written about the single Will/multiple Will conundrum when it comes to holding assets in foreign jurisdictions and especially if those foreign jurisdictions are Civil Law (forced heirship) countries. The conclusions seem to favour the use of multiple Wills and very careful planning, but very little has been said about any alternatives.

An offshore company can be utilised very efficiently to combat the succession laws and potential inheritance tax applicable in some common law and most civil law countries alike. This is, simply put, because the company does not die with the shareholder and as a consequence the assets owned by the company are unaffected by the death of a shareholder. It is rather the shareholding of the company that will be subject to succession laws and inheritance taxes of the country where the company is situated. If this country is among the ones mentioned above, no inheritance tax is applicable and the shareholding can generally be dealt with in terms of a simple offshore Will or even in terms of a single worldwide South African Will. The shareholding will however still form part of the dutiable South African estate.

In addition to the South African estate duty obligations, some countries like the United Kingdom and the United States of America will also seek to levy estate taxes, at death, on most assets (especially fixed assets) owned by an individual if the assets are situated in those countries (“situs assets”). Both the UK and the US broadly levy estate tax/inheritance tax at a rate of 40%. Estate tax in the US will largely be applicable if a non US tax resident owns US situs assets in excess of $60,000. Inheritance tax in the UK will be applicable if the UK situs assets are in excess of GBP325,000. The fact there are existing estate duty double taxation treaties in place between South Africa, the UK and the US unfortunately does not eliminate the application of US or UK estate taxes, and the application thereof merely reduces the total tax liability from 60% to 40%.

It is therefore quite possible to consolidate foreign assets, owned in multiple jurisdictions, under one umbrella i.e. by transferring/acquiring foreign assets in multiple jurisdictions in an offshore company established in a suitable financial services centre. On death, neither the succession laws nor the estate/inheritance taxes in the countries where the assets are situated will apply to the assets owned by the company. The shareholding of the company must however, on death, be dealt with in accordance with the deceased's Will, but as mentioned these will be subject to the succession laws of the country where the company is incorporated. If this country is among the financial services centres mentioned above, the succession laws are such that an offshore Will drafted under English law or a South African Will, will be able to deal with the shareholding effectively.

For individuals who own assets or are contemplating acquiring future assets in multiple jurisdictions spread across common and civil law countries, the use of a foreign company may be the ideal vehicle to eliminate the requirement of various Wills drafted in accordance with each specific countrr' legal requirements and may have the additional benefit of reducing unnecessary foreign estate- or inheritance taxes.

An offshore trust established in a suitable financial services centre can also provide similar benefits as discussed above, however, given that the trust concept is not widely recognised in many civil law countries, the use of a trust in isolation may be cumbersome and may result in negative tax consequences. Special inheritance tax rules are also applicable in the UK if UK assets are held directly by the trust. Such assets may, therefore, nevertheless be subject to a form of UK inheritance tax. A combination of an offshore trust and company is often utilised to combat the above disadvantages. In this instance the formation of a trust would generally be the first step. Once the trust is established and funded the trustees would incorporate and fund a wholly owned offshore company (generally in the same jurisdiction where the trust is established). The company would then acquire the assets in the multiple foreign jurisdictions, which can include most civil law countries.

On the demise of the settlor, who is generally also the person who funded the trust, the trust and the company would continue to operate unaffected and the assets held by the company or trust would not be subject to any of the succession or inheritance tax laws that would have applied had the settlor owned the assets in his personal capacity.

The only assets the settlor/funder will have to deal with at time of death will be the value of any outstanding loans payable by the trustees to him. This can, however, be dealt with in terms of his Will. As from 1 March 2013, any outstanding loan can be bequeathed to the trustees without any capital gains tax consequences. The loan would however still form part of his South African estate for estate duty purposes.

**Please note: The scope of this article is limited to the potential estate planning benefits offered by trusts and companies. Various other issues such as* *any applicable domestic and foreign income taxes, capital gains taxes, withholding taxes and the application of double tax treaties should be given careful consideration. The reader is also strongly advised to obtain professional tax advice on these and related matters prior to establishing any of these structures or transferring or acquiring assets as such.*

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