LEVERAGE

March 2018

Legal and Technical Update

Note from the editor

Sharon Hamman (née Teubes), Senior Legal Adviser: Advice and Wealth Management

We have seen some interesting developments in SA recently; with a new president and cabinet the overall sentiment is one of cautious optimism for what the future holds. The Budget brought about some expected increases in taxation in an attempt to neutralise the mismanagement of funds over the last few of years. Unfortunately, it is the voting public and taxpayers that have to foot the bill for ineffective and corrupt leaders. We are not the first and will not be the last country where that happens.

In this issue, we have the first 'A day in the life of a legal adviser' section where Odette Kriel gives us a glimpse into what it is like being a legal adviser. We trust that this section will highlight the value that legal advisers provide in the field and the valuable business tool that you have at your disposal as a Momentum financial adviser.

We also have a very short recap on the most prominent developments in the Budget. We will wait for the actual legislation to be published before going into any more detail. Ivan Matee sheds some light on the changes to the taxation of foreign pensions. In conclusion, Arthie Kander provides some insight into international estate planning – something that we are faced with daily since the world has become such a small place.

Happy reading!

A day in the life of a legal adviser

By Odette Kriel, Legal Adviser: Western Cape

I recently met with a financial adviser and his clients who are farmers. Following the trend of large property value increases in the Western Cape, farmers are in dire need of sophisticated financial planning advice. Farmers have a greater need for expert estate planning, continuity planning and legal advice than their urban counterparts because the farm is their homestead, income stream, capital wealth and legacy.

After studying their documentation and liaising with their auditor, I found that the farm belongs to a family trust, but the farming operations are conducted in Mr Farmer's personal name. Mr Farmer has three daughters, of which only one lives on the farm and is interested in farming.

After assisting the financial adviser with reviewing their entire situation and wishes, the clients agreed to the advice and suggestions made:

- A private company would be registered and the farming operations would be transferred into that entity to ensure that the farming operations and income stream continues once the farmer dies. It is beneficial from a tax point of view and contributes to the continuity plan. This was supported by the auditor, who was instrumental in giving tax advice associated with the structure and also setting the structure up.
- The company shares would be transferred to, and would be held in the family trust. This would be done prior to any operations taking place in the entity – to ensure that the shares are transferred to the trust as a low value.
- On Mr Farmer's death, the trustees of the trust will appoint a farm manager who will work with the daughter as employees to ensure that the farming operations continue after Mr Farmer's death.
- The company will pay the trust monthly rent for farming on its property.
- The rental income as well as dividends declared in the company will devolve to the beneficiaries (insofar it is not required to maintain the trust assets) of the trust in terms of the trust deed and it will be taxed in terms of the conduit principle – being taxed in the hands of the beneficiaries.
- Their life insurance and will was also revisited to ensure the entire plan is cohesive.

The clients are satisfied with this solution that will ensure Financial Wellness for them and their descendants in perpetuity. This shows the impact of teamwork when doing a client's financial planning – the financial adviser being the centre-point, supported by the legal adviser, the Momentum marketing adviser (MA), the Momentum Trust fiduciary specialist and the client's auditors and attorneys. As they say, it takes a village to raise a child, but in the case of Financial Wellness – it takes a team of professional experts.

Legislation

The 2018 Budget will be known as the one and only for Finance Minister Gigaba and also the Budget where the bold step was taken to increase VAT from 14% to 15% (effective 1 April 2018). In addition, we saw very little movement in the tax rates and medical tax credits in an attempt to retain as much revenue as possible, whist being a meagre attempt to curb the effect of inflation. It is also the Budget where we as the taxpayers of SA have to 'pay back the money' so to speak.

There was speculation on how this would be done and VAT being one of the options many experts mentioned. In addition, the implementation of a wealth tax was on many minds. Even though nothing came from the wealth tax concerns directly, indirectly the increase in the ad valorem taxes on luxury goods can be viewed as a type of wealth tax – motor vehicles alone saw an increase from 25% to 30%.

Another indirect wealth tax is the increase of estate duty and donations tax. In the past, the dutiable estate over and above R3 500 000 would be subject to estate duty at 20%. This has been amended to 20% on the dutiable estate up to R30 million and 25% on the dutiable estate in excess of R30 million. This also applies to donations made – where donations are made up to R30 million the rate of 20% will prevail; however, for donations in excess of R30 million, that amount will be subject to donations tax at 25%. This might urge financial advisers to revisit their wealthier clients to review their estate plans and assess the impact this change can have on their liquidity requirements versus provisions. If a client has a dutiable estate of R50 million ('dutiable' meaning that after the deduction of allowable deductions and exclusions as provided for in the Estate Duty Act), the estate duty prior to the amendment would be R10 million. After the amendment, it will be R6 million on the first R30 million and R5 million on the next R20 million – therefore, a total of R11 million.

Other **anticipated** tax amendments are as follows:

- Tax treatment of contributions made to retirement funds outside SA will be revisited. The interaction between the Income Tax Act and double taxation agreements will be investigated to ensure that tax deductions for contributions are only enjoyed if the proceeds or pension paid eventually will be subject to tax. So, where the income is exempt from that foreign fund, the contributions made to that fund whilst employed abroad should not be tax deductible.

- Align the tax treatment of preservation funds upon emigration with that of retirement annuities. At the moment if a member emigrates, that person can access their retirement annuity (RA) fund value as a withdrawal lump sum (subject to income tax on lump sums). However, where a member has already used their one withdrawal on the preservation fund, a subsequent withdrawal will not be possible – even in the case of emigration. This difference will be addressed.

- Allowing transfers to preservation funds post retirement. Amendments were made in the 2017 Taxation Laws Amendment Act to allow post-retirement preservation of retirement benefits by transferring that entire benefit into a retirement annuity fund, thereby preserving that retirement benefit for a later date.

  When the amendment was made, preservation funds were deliberately excluded from being used due to the one withdrawal option being available, which would be counterproductive when preserving a retirement benefit. The retirement fund administrators and industry bodies have indicated that the removal of the one withdrawal option for post-retirement preservation benefits held in preservation funds is possible and should not be seen as a stumbling block; therefore, preservations funds as another alterative post-retirement preservation vehicle is being investigated.

Once the changes are legislated we will delve a bit deeper into the actual changes and their practical implications.

As always, sin taxes were increased to ensure that those sinners among the taxpayers cough up more. Some of the 'new' sins include using light bulbs that are not energy efficient and driving gas guzzlers, which will come with an increased cost. The sugar tax will also become a reality in April 2018. The cherry on top – the age-old sins of smoking and drinking will bear a higher costs – so let us rephrase 'Pour that man a Bells' to 'Pour the taxpayer a privately stoked craft gin' to overcome the shock of paying back the money.

Financial planning

Foreign pension lump sum and annuity income accruing to SA residents

By Ivan Matee, Legal Adviser (Financial Planning and Advice)

As the SA tax system is based on residency, in essence, the gross income of a SA taxpayer is made up of all income earned anywhere in the world, subject to the exemptions as provided for by the Act and the provisions contained in double taxation agreements, where relevant.

Prior to the 2016 amendment, Section 10(1)(gC) provided for an exemption in respect of foreign pensions attributed to the services rendered by the SA taxpayer abroad, irrespective of whether the pension was paid by a foreign retirement fund or by a SA fund. For example – Peter was employed by a multi-national company his entire life and he worked abroad for 20 years of his total 40 years' service. During this time he contributed to his SA registered pension fund. When he receives a pension benefit from this fund, 20/40 (50%) would be exempt from income tax.

The amendment of the section brought about a stricter application of the exemption as it no longer applied to retirement benefits received by a SA tax resident from a retirement fund registered in the Republic, unless the funds in that retirement fund was transferred from a foreign fund into the SA fund. So in Peter's case, the full pension would now be taxable as it is paid by a SA registered fund. If however, Peter contributed to a pension fund registered in the foreign country where he worked and his pension was paid by the foreign fund, the exemption would still apply. Or, if he transferred the fund value from the foreign fund to a SA fund, the exemption would also still apply.

The Taxation Laws Amendment Act 17 of 2017

Subsequently further amendments have been made to this section and it reads as follows:

Section 10 – Exemptions - (ii) there shall be exempt from tax:

- Lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic as consideration for past employment outside the Republic other than from any pension fund, pension preservation fund, provident fund, provident preservation fund and a retirement annuity fund as defined in Section 1(1) or a company that is a resident and that is a registered in terms of the Long Term Insurance Act as a person carrying on long term insurance business excluding any amount transferred to that fund or that insurer from a source outside the Republic in respect of that member.

The effect of this amendment is that the annuity income to a SA resident arising from services rendered abroad will only be exempt from income tax if it is paid by a foreign insurer or by a local insurer where the underlying funds, which is funding the income, was transferred from a foreign fund.

The following case study will be used to illustrate the application of the amendment applicable to foreign pension's exemption:

Thabo Maponya is a SA resident who rendered services to a registered company in the UK. While pursuing his trade in the UK, Thabo contributed to an offshore pension fund registered in that country. Upon completion of his employment services abroad he subsequently transferred his retirement benefit accumulated while working abroad to a SA registered fund. During his working life he also contributed to a SA RA fund with which he has now purchased a living annuity with an insurer in SA with both funds from a SA insurer.

Tax consequence:

1. Any lump sum received from a SA pension fund that consists purely out of the funds transferred from a foreign fund will be exempt from income tax;
2. Any annuity income payable by a living annuity attributed to the funds transferred from the foreign fund will be exempt from income tax;
3. Any lump sum received from a SA RA will be subject to income tax in terms of the Second Schedule to the Income Tax Act;
4. Any annuity income payable by a living annuity attributed to the funds received from the RA will be subject to income tax.
5. If the lump sum and annuity was payable directly by an offshore retirement fund or an insurer based in a foreign country it will also be exempt from tax in SA.

Conclusion

This current change to foreign pensions and annuity income will have an effect that SA tax residents with foreign service-related retirement income from a local retirement fund and registered insurer within the republic can face additional tax liability. Therefore, it will be recommended that affected SA tax residents reassess and review their financial and/or retirement plan to cater for additional tax implication they did not anticipate before. It can also have an impact on the net annuity income they receive from local insurers.

Fiduciary Corner

Foreign assets and dutiable estate

By Arthie Kander, Senior Fiduciary Specialist

It is imperative that SA residents who invest in offshore jurisdictions, such as the UK or USA appreciate and plan for the possible costs of death consequences on owning assets within such offshore jurisdictions. The SA offshore investor who holds assets within these jurisdictions could find themselves, liable for UK inheritance tax (IHT) or US estate tax together with SA estate duty. This article aims to address the position of SA resident clients, non-domiciled in the UK and who own assets situated in the UK.

Some aspects which may trigger a liability for IHT or US estate tax together with SA estate duty will depend on factors such the tax residence status, domicile; lex situs (the law applicable in the jurisdiction where the asset is located); asset type; the value of the investments and beneficiary of the estate. SA resident clients, non-domiciled with UK connections may be affected by IHT through ownership of UK property. Such foreign domiciled assets owned by the client, is commonly referred to as situs assets. Situs is a Latin word and refers to the place to which, for purposes of legal jurisdiction or taxation, a property belongs. IHT is principally charged on assets situated in the UK (being the situs of the asset) on a person's death but may also apply to some lifetime gifts and trust assets.

IHT is a tax on the market value of property transferred on death and on the loss to a person's estate resulting from certain lifetime gifts. The location of the assets along with domicile is a vital connection for IHT in an international context. The relevant tax depends on the type of event which gives rise to a charge. In all cases, there is a nil rate band whereby tax is charged at 0% on the value of the property within the band at a relevant time. The current threshold, also known as the "nil rate band", for which no IHT is payable, is £325 000. Therefore, assuming that the client is non-resident and non-domiciled in the UK, they would enjoy an exemption on UK situs assets up to a maximum amount of £325 000. The IHT tax rate applied to amounts exceeding this threshold is 40%. Bequests to non-domiciled spouses qualify for a further exemption of £325 000 with the result that a non-UK domiciled investor may transfer up to £650 000 to a spouse on death free of IHT. Certain assets such as holdings in authorised unit trusts or open-ended investment companies; shares where the share register is kept outside of the UK; and exempt British government securities (exempt gilts) are also excluded from IHT on death of non-resident, non UK domiciled investors.

The table below illustrates the estate duty or death tax implications for a SA resident, SA domiciled person with assets situated in SA, UK and USA.

Jurisdiction	SA	UK	USA
Individual tax exempt threshold	R3 500 000	£325 000	$60 000
Deductions for spousal bequests	Yes, in full	Yes, limited to a maximum of £325 000 where the spouse is not domiciled in the UK.	No, unless assets are held in a qualified domestic trust.
Some examples of exemptions or deductions of some asset classes	Gross value of the deceased's world-wide assets is taxable subject to a number of exclusions and deductions as contained in the Estate Duty Act, 1955.	• Foreign currency bank account maintained in UK. • Holdings in authorised unit trusts or open-ended investment company. • Shares where share register is kept outside of the UK. • British government securities referred to as 'exempt gilts'.	• Cash deposits in a US bank; • US government and corporate bonds; • Retirement plans; • Life insurance death benefits
Tax rate	20%	40%	Sliding scale between 18% to 40%

Continued on next page

Continued from previous page

The example below explains how a share portfolio situated in the UK and owned by a SA resident, non-domiciled in the UK, could be affected by IHT.

The client is a SA resident (non-domiciled in the UK) and owns a portfolio of individual UK registered shares valued at £1 000 000. He is not married and intends to pass his estate to his children and enquires whether his UK portfolio is exposed to IHT. According to the Double Death Duties Agreement (DDDA) between SA and UK, the UK may levy IHT on the shares registered in the UK – even if an individual is considered domiciled in SA. Therefore, even though the client will be liable to pay SA estate duty on his worldwide estate, he will also be liable for IHT on the value of the UK shares as a result of them being UK situs assets. The IHT on the UK shares will be £1 000 000 less the nil rate band of £325 000, which leaves £675 000 subject to IHT at 40% = £270 000. However, in terms of the DDDA, the client will be allowed to apply for a credit from the South African Revenue Service (SARS) up to the value of the estate duty attributable to the UK registered assets.

SA tax residents are liable for estate duty (subject to exemptions) on their death on all worldwide assets, whilst many foreign jurisdictions (such as the UK) levy estate or inheritance taxes on certain assets situated in those jurisdictions, irrespective of the tax residency or domicile of the owner. Such double taxation affects the estate of a SA offshore investor. Double taxation agreements (DTAs) for the purposes of taxes are in place with the UK and USA to give some relief to such clients. DDDA also exists between SA and the UK. According to the DTA between SA and UK, taxes due in SA and UK shall first be deducted from taxes due according to SA fiscal law. SA will allow a tax credit against any UK tax computed by reference to same taxes computed in SA levied on such assets. Where the estate duty rate in the foreign jurisdiction is higher than the SA rate, a portion of the foreign estate tax suffered, remains with no SA tax credit on that portion.

As with estate duty taxes, IHT may not affect SA investors on a day-to-day basis; however, the potential impact on a client's wealth is likely to be significant on death, when the liability will arise. Therefore, clients who own assets situated within offshore jurisdictions such as the UK, must plan for both IHT and estate duty costs. Several strategies exist for effective planning to minimise the cost of death costs such as by changing the situs of the asset to a domicile which will not attract IHT.

This article also serves to encourage investors to seek advice from their professional advisers upon investing so as to maximise tax efficiencies and utilise the exemptions and reliefs that may be available.

About Leverage

Momentum Leverage is prepared by the Momentum Legal Advisers: Financial Planning and Fiduciary Specialists from Momentum Fiduciary Services. For financial advisers, please contact your legal adviser or fiduciary specialist should you have any questions. For clients, please contact your financial adviser should you have any questions.