LEVERAGE

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Note from the editor

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

The Momentum Myriad claim statistics have been published. On the one hand, it is upsetting to know that so many bad things happen every day; on the other hand, it is comforting to know that for many it is not the end. We tend to focus on bad news, what does not work and more often than not, we choose to criticise rather than praise. Reading the statistics, I experienced relief, peace of mind and gratitude. Relief that I am covered, peace of mind that my loved ones are taken care of even when I will not be able to do so and gratitude that the amazing industry we work in exists. As you know, Momentum's main objective is to ensure that our clients become financially well; but, without the financial adviser that will not be possible, and for that I salute and thank you!

In this issue, Rone Heymans invites us into her day and shows us the value of a legal adviser. Our legal advisers are highly qualified and as a general rule each has in excess of 10 years' experience. By partnering with a legal adviser you not only add to your value proposition but your client will benefit from knowing that you have consulted with industry experts to ensure the highest level of advice. With the value-added tax (VAT) increase being a reality, Andre Schoeman sheds some light on the impact VAT has on financial planning. Sanusha Naidoo and Arthie Kander both focus on estate liquidity, each viewing it from a different angle. This issue will also underpin the need for estate planning.

Happy reading!

Legislation:

Value-added tax (VAT) considerations when doing estate planning

By Andre Schoeman, Legal Adviser: Advice and Financial Planning

The estate planner's estate may include certain taxes (for example, estate duty, capital gains tax [CGT], income tax, etc.). These taxes are usually planned for in advance. However, determining how much value-added tax (VAT) the deceased estate will have to pay is often forgotten.

The VAT increase to 15% from 1 April 2018 may result in a delay in the finalisation of an estate if there is not enough liquidity available to absorb the VAT liability. VAT has a direct impact on the estate when assets transferred or realised are subject to VAT. Therefore, the estate planner must determine in advance the potential VAT liability on death (if any) and plan for it.

In Section 7(1)(a) of the Value-Added Tax Act (the VAT Act), VAT is charged on "the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him".

Thus, it must be determined whether the testator operated a VAT enterprise as defined. A person is required to register as an enterprise for VAT purposes if they operate an enterprise and the taxable supplies' total value made by them exceeded R1 000 000 (in the period of 12 months and in the course of carrying on the enterprise). A taxable supply is the supply of goods or services which is chargeable with tax under the provisions of the VAT Act's Section 7(1)(a). Not all supplies that a VAT enterprise makes are taxable supplies. Certain supplies are exempt. The VAT Act provides for taxable supplies at a standard rate (15% since 1 April 2018) and at a rate of 0% (the VAT Act's Section 7).

The question is then, what are the VAT implications during the administration process?

Executor's fee

The amount an executor can recover for their compensation was increased from 3.99% to 4.025%.

Enterprise's termination

The distribution of assets during the settlement of an estate is not normally considered as a supply of goods or services in the course of or furthering an enterprise. However, the definition of 'enterprise' in the VAT Act's Section 1 stipulates that anything done in connection with the termination of an enterprise shall be deemed to be done during its operation to the enterprise's benefit. Therefore, the assets' distribution in a deceased estate is a delivery in progress or in favour of an enterprise if the testator was or should have been a registered as a VAT vendor.

Value of delivery

The VAT Act's Section 10(5) determines that the delivery's value by the deceased estate is the lesser of the cost or the open market value. If the assets are transferred to connected persons, being a relative or trust of which a relative is a beneficiary, the value will be equal to that asset's market value (VAT Act's Section 10[4]).

When is VAT applicable to an estate?

VAT will apply to the trading assets' transfer of a testator who (in their personal capacity):

- Was registered as a VAT vendor;
- Had to be registered as a VAT vendor; and
- Would have had to register during the next 12 months if they did not die.

VAT implications regarding estate planning

Delivery of a going concern

VAT will be charged at a zero rate if the assets transferred by the executor to the heir are regarded as a going concern. In this case, no VAT will be payable (VAT Act, Section 11[I][e]).

For example, if a farmer owns three farm properties and he bequeaths the farm properties to each of his sons and divides the farms, tractors, farm equipment and livestock between them, then each person's inheritance will be regarded as a going concern.

Executor ends the enterprise

Should the executor terminate the enterprise, then the enterprise's assets are transferred to the heirs and the executor will have to levy VAT on the assets' value.

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Such VAT will be charged at the lowest of market value or the assets' cost price.

If the heir is a registered VAT vendor and would be able to use such assets, then they will be able to obtain a VAT credit.

Executor sells the assets before the estate's settlement

If the executor sells the estate's assets, then they must levy VAT on the commercial assets' selling price, if the testator was registered or had to register as a vendor. The result is that the heirs who inherit cash instead of assets will be in a weaker financial position because VAT has to be included in the selling price.

Value-added tax (VAT), estate duty and donations tax

VAT can complicate a financial plan as shown below.

Example

The farmer's assets consist of a farm, implements, tractors, livestock and further cash. He is married in community of property and has two sons. The estate' value is approximately R30 000 000. It is the farmer's wish that the assets should be divided equally between his spouse and sons. With only one farm, that would be impossible and not allow the farm to pass as a going concern to avoid the VAT implication.

Possible consideration:

Bequeath the enterprise to a business entity

The enterprise can be bequeathed as a going concern to a company or trust. In a company's case, the shareholders' interest may be owned by a trust to limit future estate duty and estate costs. VAT will be charged at a zero rate and there will be no VAT payable.

Currently, the enterprise runs as a separate entity

Planning proactively, the testator can transfer his farm property to a trust and the farming enterprise to a company. Then, his assets will not have to be transferred to an heir upon his death. In practice, the heir becomes the trust's trustee and the company's shareholder or director. A company's shares are VAT-exempt. In a trust's case, nothing is transferred to the heir; except, if they have a vested right in trust assets obtained.

Conclusion

VAT can complicate estate planning. By planning carefully, VAT, estate duty, CGT and income tax can be avoided or limited. Life insurance plays an important role in creating the necessary estate liquidity to absorb any or all costs.

A day in the life of a legal adviser

By Rone Heymans, Legal Adviser: Advice and Financial Planning

We all know the different marital regimes but often the intricacies of a specific marital regime, the legal implications thereof and the impact that a specific marital regime may have on a client's overall financial plan are underestimated.

I am currently assisting a financial adviser, his client and the client's attorney with some practical issues relating to the client's divorce and the inclusion or exclusion of retirement funds and living annuities for the purposes of calculating the accrual.

There seems to be a bit of confusion in practice whether retirement funds and living annuities are included in the accrual claim's calculation on the dissolution of a marriage, whether by divorce or upon death. It is important to distinguish between the position on death versus the position on divorce as the events are treated differently in practice.

The Divorce Act read with the Pension Funds Act takes into account a person's pension interest for the division of assets where the spouses are married in community of property or married with an antenuptial contract (ANC) with the accrual's inclusion. Upon death, it is a different story. The value of the retirement annuity (RA), pension, provident and preservation funds will not be taken into account when calculating the accrual on death. The Pension Funds Act's Section 37C states that the fund's trustees will determine how to apply the death benefits in terms of the Act; therefore, the benefit remains outside the estate for accrual purposes.

This client and the interaction I had with the financial adviser and attorney highlighted how working together ensured the best outcome for the client.

Financial planning

The impact of business planning on personal estate planning

By Sanusha Naidoo, Legal Adviser: Advice and Financial Planning

According to Benjamin Franklin: “Nothing in this world is certain but death and taxes”. Thus, the only way to ensure peace of mind is to plan and prepare for this certainty.

Financial planning is a powerful tool that businesses should use to protect themselves in the event of the loss of a valuable director or an employee. In many businesses, the death or disability of one of its top income-generating salespersons or directors could result in detrimental financial loss or a decrease in the business profit that could potentially threaten the company’s ability to continue operating. Business planning involves risks around succession planning, death or illness of a key individual or director in the business. Loss of income to the business could have an impact on their estate and the liquidity in their personal estate.

For many business owners there is no separation between their personal and professional lives. Therefore, we encounter substantial risk when it comes to the impact that business financial planning has on individuals’ estates from a liquidity and estate duty point. In many instances, the director’s personal estate may be equally liable for those decisions made in business.

Business and personal finances are intricately linked: The business risk faced by many business owners is that they invest all or most of their disposable assets or cash into starting up and growing that business. If holistically done, business and estate planning can provide certainty and reduce unnecessary costs and expenses upon death. It will ensure a smooth process for the deceased’s remaining business owners, dependents and family members.

Proper business planning needs to address the important factor of the business’, remaining business owners’ and deceased’s estate’s liquidity needs. Liquidity is fundamental to every business; depending on the business solutions implemented, it can have a direct impact on the business’ director or key persons’ personal estates.

It is important to determine all existing liquid assets in the business and personal estate when completing a liquidity analysis. Liquid assets are not limited to cash and depend on asset types and the speed at which they can be converted into cash. For example, houses are not liquid assets because of the time it could take to sell them and convert them into cash. Shares in listed companies, stock and/or cash in bank accounts qualify as liquid assets.

Liquid assets identified need to be weighed up against the business’ and the business owner’s personal estate’s liquidity needs to determine if the liquidity provisions have a shortfall or surplus. Executors should not be forced to sell off non-liquid assets to satisfy obligations – this could result in the sale of family homes and/or heirlooms never earmarked for sale.

One has to consider the business continuity solutions to ensure sufficient liquidity is provided where there is a shortfall. The business plan’s impact has to be considered in the personal financial plan.

A buy-and-sell arrangement will secure the business’ continuity to the remaining business owners while providing the remaining parties with liquidity to buy the business interest from the deceased, which in turn results in liquidity for the deceased estate. Key person protection will ensure liquid funds for the business to meet its financial commitments when that key individual is no longer there to generate income. Contingent liability protection will ensure that the business has sufficient funds to settle debts which will release the business owner guarantor’s personal estate – thereby, ensuring that their personal financial plan is not impacted by the business’s debts.

When implementing the above business planning strategies, you have to consider the estate duty implications on the policies used to fund it. In the case of a buy-and-sell policy, the policy may qualify for estate duty exemption, which is also possible in the event of a key person protection policy. The contingent liability policy will generally attract estate duty. Therefore, the affected policies’ sum insured should be increased to provide for the additional estate duty liability. It is of no use to implement a strategy that indirectly results in reduced liquidity in the personal estate.

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If it is determined that a policy will be subject to estate duty, you have to increase the sum insured to secure the desired net amount. Estate duty is levied at a rate of 20% on the dutiable estate up to R30 million and 25% on the dutiable estate in excess of R30 million. Depending on the estate value, the required sum insured will be divided by either 0.8 to provide for 20% estate duty or 0.75 to provide for 25% estate duty. If the total dutiable estate value is not known, then it is best to provide for the worst case scenario in which case the 0.75 factor will be used.

In addition to increasing the cover amount to cater for any estate duty, all the necessary agreements and resolutions should be in place to ensure that the funds from the policies are indeed applied in accordance with the plans.

Once the business plans' impact on the personal estate's liquidity is determined, you will assess the liquidity shortfall or surplus in the estate. Leaving the estate liquid with cash available for heirs will also ensure that they are able to pay bills and continue living. Life policies are an excellent solution to ensure liquidity for the heirs and/or the estate. Once again, the estate duty's impact must be considered when determining the sum insured. In addition, executor's fees can also impact the net amount available to the estate; therefore, additional provision should be made for executor's fees.

The final step is to revisit the client's will to ensure that the financial plans are accurate, can be implemented and that there are enough funds. Liquidity risk may be eliminated when adequately catering for needs that may impact on the business and personal estate.

Practicalities to consider when wishing to avoid insufficient liquidity in your estate

By Arthie Kander, Senior Fiduciary Specialist

One in four deceased SA estates has insufficient cash to pay all the administration costs. A common reason for delay in finalising an estate is a cash shortfall. Even when an estate has more assets than liabilities, there may still be a liquidity shortfall. Few people realise the financial implications at death. Others may be aware of significant debt (like a bond that needs settling), but not aware of other hidden administration expenses and taxes. This results in failure to provide for post-death expenses, which expose the individual's estate and heirs to financial risks or undesired consequences and add to the family's trauma.

According to professional deceased estate executors, when drafting a will in isolation of an estate plan, costly mistakes are made. An estate plan, estate liquidity plan and understanding of the estate planner's intentions, are all integral parts of a will that allows for seamless execution by the deceased's estate executor. An example where costs may or may not be triggered, is the capital gains tax (CGT) implication on the estate planner's estate, who bequeaths a share portfolio to their surviving spouse which will result in the postponement of CGT (by capital gains rollover) until the surviving spouse's death; versus an instance where the estate planner instructs the executor to reduce the share portfolio to cash in the estate, which may trigger CGT which will become an estate liability. The estate planner must understand the difference between a 'legatee' and 'residuary heir'. Legacies are paid before the residuary heir's inheritance is distributed, resulting in the residuary heir having to bear an asset's costs which they did not receive; or, the residuary heir could inherit far less than intended by the estate planner, should the estate plan not be effective.

The estate planner must consider the distribution timeline in respect of the four asset class framework (Four Buckets). For example, depending on the life policy product provider, a policy may pay out within a month of two of the death event; trustees of pension funds distribute benefits after six to 12 months, and distribution of inheritance to heirs from the deceased estate, can take up to 12 months. It is imperative that the estate planner provide adequately for day-to-day living expenses of dependents and not rely on retirement funding distribution to beneficiaries' cover liquidity on estate costs. Complications may arise; but, for the purposes of explaining timeline distribution it is imperative that the estate planner recognise that should they be reliant on the residuary heir receiving the pension benefits to pay estate expenses, such benefits will only be received by the heir after all estate debts and costs become liable by the executor. This will cause further delays and the possible sale of property in order to finalise the estate.

The most common and cost-effective method to avoid a cash shortfall in an estate is sufficient life insurance. A common mistake made by estate planners is to nominate a policy beneficiary to receive the proceeds and pay estate expenses in order to avoid executor's fees on the policy's proceeds. A problem that can arise is that the beneficiary could spend the money or invest it before taking care of the estate's shortfall. The estate planner must consider nominating the estate for a proceeds percentage to cover estate expenses together with a beneficiary in order to minimise executor's fee.

Experienced financial planners will implement the asset class framework (Four Buckets) as an integral part of an estate plan. This results in the creation of estate liquidity; thus, the will may be executable by the testator's desired intents.

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.