ESTATE PLANNING

RS GREEN, COX YEATS

As at the 1st March 2017 the relevant rates of tax are as follows:

Estate Duty – Estate duty is payable at the rate of 20% of the net value of assets in the estate in excess of the sum of R3 500 000,00. Estate duty is not payable on assets bequeathed to a surviving spouse. If the estate of a spouse does not utilise the whole of the abatement of R3 500 000,00, the estate of the last dying of the spouses may have the benefit of the unused portion of the abatement. Spouses therefore can enjoy a combined abatement of R7 000 000,00.

Capital Gains - Capital gains in a company are taxed at a rate of 22,4%. Capital gains in a trust are taxed at a maximum effective rate of 36%. Capital gains in the hands of a special trust or an individual are taxed up to a maximum of 18%, depending upon the marginal tax rate of the individual. A person who dies is deemed to have disposed of his or her assets for an amount equal to the market value of those assets at the date of death. The capital gains in the estate are taxed to the extent that they exceed R300 000,00, subject to the proviso that assets transferred to a surviving spouse are treated as having been disposed of for an amount equal to the base cost of the assets. Accordingly the assessment of the capital gain and payment of tax on the capital gain is deferred until the death of the surviving spouse.

In the case of a natural person capital gains in any tax year up to a maximum of R40 000,00 are free of tax. The first R1 800 000,00 capital gain arising from the sale of a small business by an individual who is at least 55 years of age will be excluded from tax.

Donations - Donations of up to R100 000,00 a year are free of donations tax. Donations in excess of this amount, other than donations between spouses, which are tax free, attract tax at the rate of 20%.

Trusts - A trust other than a special trust pays income tax at a flat rate of 45%. The conduit principle applies to income, including capital gains, awarded by the trustees to a beneficiary. Subject to certain anti-avoidance rules, the income or capital gain so passed on is taxed in the hands of the beneficiary and not in the hands of the trust. The trustees are required to pass a resolution before the financial year end to record the distribution of income to beneficiaries and the award of capital gains.

THE ESTATE PLAN

Trusts have proved to be a useful tool for the protection of long term investments and the separation of control of assets from the enjoyment of those assets or the income earned from such assets. Skilled trustees administer assets on behalf of beneficiaries who may lack financial skills.

In a growing economy aided by an inflationary environment the value of investments is likely to increase over time. One of the principal objects of an estate plan is to limit the growth in the value of an estate and thereby to reduce liability for estate duty. A convenient means of achieving this objective is for the estate planner to transfer investments which are likely to increase in value with the passage of time to a trust created for the benefit of his descendants.

The Davis Tax Committee has submitted a report on estate duty and on trusts and it is clear that the government wishes to limit the use of trusts and make them unattractive for investment purposes. Any change in the law relating to trusts will require very careful analysis and consideration. Caution should be exercised in setting up a new trust. The advantages need to be weighed against the disadvantages which have been created by recent legislation and the stated intention of the Treasury to continue to use legislation to discourage the use of trusts by estate planners.

Trusts

1. A trust is brought into existence as a result of a contract between a donor or founder and the trustees. The beneficiaries of a trust are designated in a deed of trust. Generally a distinction is made between income and capital beneficiaries. The estate planner may be a trustee but if the estate planner is also a beneficiary, there should be at least one independent trustee. The powers accorded to the trustees in the deed of trust should be such as to enable the trustees to take advantage of the tax planning opportunities afforded by a trust. The principal beneficiaries of a trust will be the descendants of the estate planner, including or excluding spouses.

2. Under normal circumstances the estate planner will wish to avoid the payment of donations tax and so will donate only a nominal sum to the trust. The estate planner will lend money to the trust to enable it to purchase assets or, alternatively, the estate planner will sell assets to the trust. The purchase price will be a debt owing by the trust to the estate planner on loan account. Depending upon the requirements of the estate planner the loan may be free of interest or it may attract interest. If interest is charged the rate of interest should not exceed a market related rate.

3. If no interest is charged on the loan accounts of beneficiaries or the interest charged is less than the official rate of interest (currently 8% per annum), the trustees of the trust are obliged to pay interest to the beneficiaries and any company which is a connected person at 8% per annum. If the trust does not have sufficient income to pay then the beneficiaries will need to lend money to the trust to enable the trust to pay the interest on which tax will be payable. Alternatively if interest is not paid, donations tax will be payable by the beneficiary on the deemed interest which should have been paid. If no other donations have been made in a tax year by a beneficiary, the first R100 000.00 of the deemed interest will be free of donations tax. In other words a loan of R1 250 000.00 or less will not attract donations tax. Certain trusts such as vesting trusts are exempt from the obligation of the trustees to pay interest on loan accounts.

4. The trust deed should contain a stipulation that the trustees can lend money to the beneficiaries, including the estate planner, with or without interest. However loans to beneficiaries by the trustees should only be made as a temporary measure.

5. The estate planner may be both an income and a capital beneficiary. In some cases, the estate planner and his or her spouse will be income beneficiaries only. If the estate planner and/or his spouse are to be capital beneficiaries, two independent trustees should be appointed to achieve a divestment of control of the assets in the trust.

6. The loan account of the estate planner in the trust can be reduced over time by payments made to the estate planner by the trustees. Upon the estate planner's death the growth which will have taken place in the value of the assets held by the trust will not attract estate duty. There will also be no taxable capital gain if the assets in the trust are not realised.

7. There can be a saving in income tax if taxable income of the trust is distributed amongst beneficiaries who have little or no other sources of taxable income such as grandchildren or a spouse who is a housewife. Income distributed to a beneficiary may be lent back to the trust and credited to a loan account. Beneficiaries should record the credit loans to the trust by means of loan agreements concluded with the trustees of the trust. If the exemption on interest is included, the current thresholds below which no income tax is payable are R99,550,00 per annum for persons under the age of 65 years, R151 800,00 per annum for persons between the age of 65 years and below 75 years and R165 650,00 for persons 75 years and over. Any income distributed over and above these amounts up to the sum of R188 800,00 will attract income tax at the rate of 18% only. Thereafter the marginal rate increases to 41% on income over R708 310.00 and to 45% on amounts earned over R1 500 000.00.

8. If the estate planner has a loan account, income distributed to the estate planner's minor children will not benefit from the conduit principle because income distributed to minor children will attract income tax in the hands of the estate planner. Income may be distributed to those of the estate planner's children who have attained their majority, grandchildren and charitable, educational or religious institutions if they are included as beneficiaries.

9. The transfer of assets to a trust does not mean the estate planner is no longer possessed of assets. The estate planner is a creditor of the trust by virtue of holding a loan account in the trust which will be an asset in the estate of the estate planner. The assets convert into a debt owing to the estate planner.

10. If a trust disposes of assets and makes a capital gain, the trustees may, subject to certain anti-avoidance rules, award the capital gain to capital beneficiaries who are resident in the Republic to enable the gain to be taxed in the hands of the beneficiaries at a maximum rate of 18% as opposed to a flat rate of 36% if the trust pays the tax. The beneficiaries can lend the proceeds back to the trust to provide for continued investment by the trust. The trustees and beneficiaries should record the loan in a signed agreement.

11. Caution should be exercised if a beneficiary of a trust is a non-resident for tax purposes. Income credited or paid to such a beneficiary may need to be included in the world-wide income of the non-resident beneficiary. If the distribution of the income can be attributed to a donation to the trust, the income could be taxed in the hands of the donor. A capital gain in a trust should not be awarded to a non-resident

beneficiary as the trust will remain liable for the payment of income tax on the capital gain.

12. The vesting in a beneficiary of an asset in a trust will give rise to capital gains tax in the hands of the beneficiary. The distribution of cash to a capital beneficiary either during the existence of the trust or on termination of the trust will not give rise to the payment of tax as the tax would have been paid on disposal of the assets by the trust.

A Deed of Trust like a Will should be examined on a regular basis and, if necessary, amended to take account of changes in fiscal legislation.

Primary Residence

The home in which an estate planner lives should be registered in the name of the estate planner or his or her spouse. On the sale of the property the first R2 000 000,00 of any capital gain will be exempt from capital gains tax. This exemption does not apply if the property is owned by a legal entity. There are instances however when it might be preferable to acquire a home through a trust. Although the exemption from capital gains tax will not apply, the trustees will be exempt from paying interest on loan accounts if the property owned by a trust is used by a beneficiary of the trust or a spouse as a primary residence.

Planning

The above are some of the considerations an estate planner should take into account. Each estate plan needs to be carefully tailored to meet the individual needs and circumstances of the estate planner.

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