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DOMESTIC FAMILY WEALTH PLANNING

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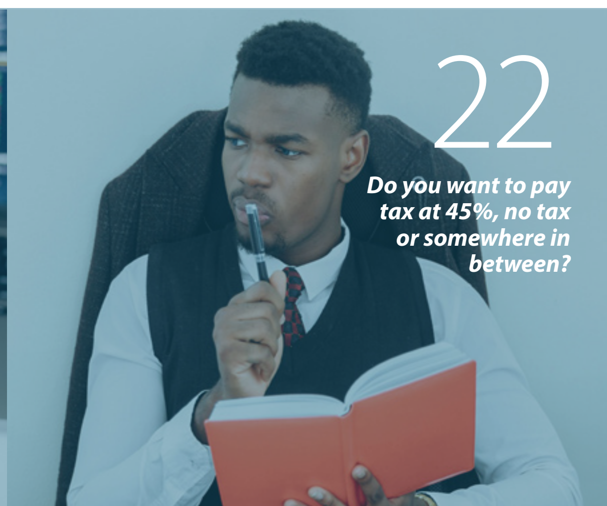

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Tell us what you think. Questions and suggestions can be sent to mmaseko@thesait.org.za

FINDUS

Postal address
PO Box 712
Menlyn Retail Park
0063

Editorial head office
Summit Place Business Park
Building 3, Ground Floor
221 Garsfontein Road, Menlyn
Pretoria
South Africa
0081

Advertising sales
Muzikayise Mike Maseko
mmaseko@thesait.org.za

THETEAM

Editoral Specialist
Dinah Ramonyai

Supporting Editor
Dr Annamarie Mostert

Editorial Advisors
Muzikayise Mike Maseko
Keith Engel

Design, layout and cover illustration
Neo Wilma Makaleng

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GUEST CONTRIBUTORS

Anne Klein
annekzj@outlook.com/
+27 82 465 3533

Anne is the Founder of LuciaDeKlein Private Office, which focuses on creating aligned solutions for the industry with a focus on servicing intergenerational families. She holds B Juris and LLB degrees and is a qualified attorney, notary, and conveyancer. She further has a Certificate in Advanced Trust Law from the University of Pretoria.

Bronwin Richards
bronwin@taxconsulting.co.za/
+27 82 575 3908

Bronwin is a Tax Attorney at Tax Consulting South Africa. She holds an LLB and specialises in corporate, domestic, international and payroll taxes.

Chanel Schoeman
chanelvr@sentineltrust.co.za/
+27 74 411 5312

Chanel serves as an Admitted Attorney, and full member of the Society of Trust and Estate Practitioners, and a registered Fiduciary Practitioner of South Africa member, as well as a member of the Fiduciary Institute of Southern Africa. Chanel assist clients with holistic estate planning, structuring and fiduciary services at Sentinel International Advisory Services (Pty) Ltd.

Hannah Myburgh
hannah@crue.co.za/
+27 21 530 8500

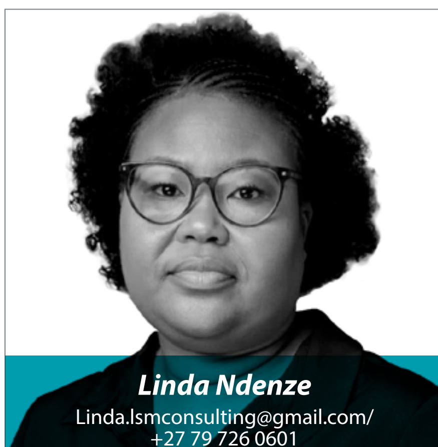
Hannah is a Certified Financial Planner® at Crue Invest (Pty) Ltd where she has also been instrumental in growing the assets under management of the practice's accumulator market. Hannah read for her BComm Financial Planning degree at Stellenbosch University followed by her Post-Graduate Diploma in Financial Planning which she passed cum laude. She has a special interest in tax and estate planning.

Harry Joffe
harryj@discovery.co.za/
+27 11 529 5603

Harry is the Head of Legal Services at Discovery Life and Discovery Life International. He holds a BA LLB, HDip (Tax Law), LLM, CFP, and an Advanced Diploma in Corporate Law. He also specialises in insurance, investments, estate planning, personal tax and trusts.

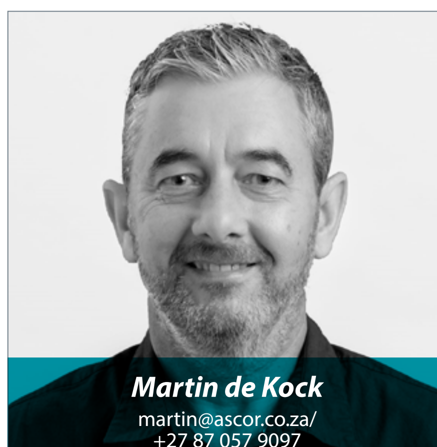
Kobus Muller
mullertax8@gmail.com/
+27 83 453 6411

Kobus is the founder of Muller Webber & Wilsnach Accountants, a firm that has been in business since 1977. His specialties include providing guidance to owner-managed small and medium-sized enterprises, corporate and trust planning, estate planning, farming, and international tax. He also acts as an expert witness in accounting and taxation matters for clients who are preparing for High Court proceedings in Gauteng.



Linda Ndenze
Linda.lsmconsulting@gmail.com/
+27 79 726 0601

Linda is a Certified Financial Planner® professional and a retirement planning specialist who offers comprehensive financial planning to clients with an objective to educate them through the process of financial planning in order to help them achieve their desired financial goals as a consequence of following a customised financial plan.



Martin de Kock
martin@ascor.co.za/
+27 87 057 9097

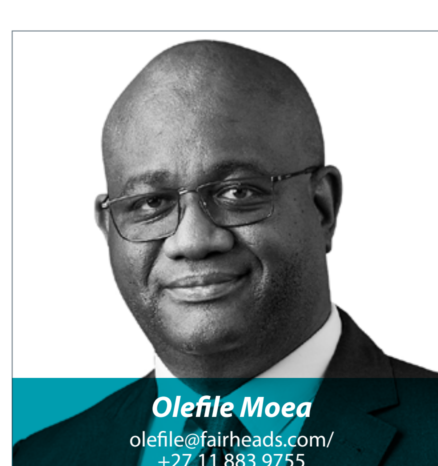
Martin specialises in retirement, estate and investment planning and has a passion to assist clients in growing, protecting, and transitioning their wealth in an efficient and tax-friendly way. He helps clients live their best life possible within the boundaries determined by their wealth accumulated. He holds a Hons BCompt (Unisa) and Advanced Postgraduate Diploma in Financial Planning (UFS).

Mbonisi Ndlovu
Mbonisi.Ndlovu@cdhlegal.com/
+27 82 692 3613

Mbonisi is an Associate Attorney and notary at Cliffe Dekker Hofmeyr Inc in the Trusts and Estate Department, specialising in serving high-net-worth private clients. He has a robust background as a fiduciary specialist with a primary focus on estate planning. His expertise extends to both onshore and offshore estate planning.

Micaela Paschini
micaela@taxconsulting.co.za/
+27 66 276 0943

Micaela is a Tax Attorney at Tax Consulting South Africa. She holds an LLB and specialises in corporate, domestic, international and payroll taxes.



Olefile Moea
olefile@fairheads.com/
+27 11 883 9755

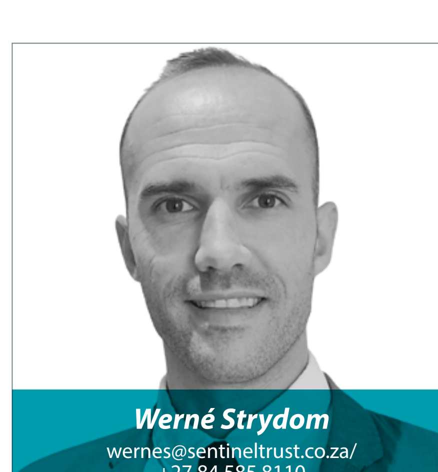
Olefile holds a Masters' Degree in Development Finance. He has over 17 years of experience in the financial services sector. Olefile joined Fairheads in 2007 as an Operations Manager and has held various senior management roles. Olefile serves as Chairperson and Trustee on the board of trustees of the Fairheads Umbrella Beneficiary Fund.

Phia van der Spuy
phia@trusteeze.co.za/
+27 10 312 5777

Phia is CEO and co-founder of Trusteeze. She is a Chartered Accountant with a Master's degree in local and International Tax and specialises in trusts and estate planning.

Roxshanna du Toit
roxshanna@aurorasolutions.co.za/
+27 84 754 5869

Roxshanna is a specialist in trust and deceased estate administration, tax compliance and SARS third-party data reporting. Her interest sphere is streamlined solutions to overcome the administrative and operational challenges of trustees, accountants, tax practitioners and executors.



Werné Strydom
wernes@sentineltrust.co.za/
+27 84 585 8110

Werné is a member of the Fiduciary Institute of Southern Africa. After obtaining his Bachelor's degree in Internal Auditing, Werné started his career as a financial planner. Werné is currently a Head of trust at Sentinel Advisory Services offering trust, accounting and tax-related advice to his trust clients.

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FUNDING THE TRUST: DONATION, LOAN, BEQUEST OR SETTLEMENT OF OBLIGATION

▶ **PHIA VAN DER SPUY,** CEO and co-founder at Trusteeze

Traditionally, estate planners were advised to sell their paid-up assets on an interest-free loan basis to a trust to 'freeze' their estates. It simply made sense to transfer an asset worth R1 million into the trust on an interest-free loan basis. Fifty years later, the same loan amount reflects in the estate of the deceased funder (on which Estate Duty is payable), while the asset grew to R100 million over the years in the trust, with no estate duty and other death costs applicable to such growth. It was a 'no-brainer'.

However, since the introduction of Section 7C of the Income Tax Act (discussed below) in March 2017, all of a sudden, serious tax consequences, such as paying death taxes in advance, need to be considered. After SARS recently beefed up their trust tax return, many tax practitioners and advisors also woke up to the fact that other old tax measures, such as the 'Attribution Rules' (assignment or allocation), which were seldom considered or implemented, also need to be considered. The resultant income and capital gains (or a portion thereof) will be attributed to the donor/funder — and taxed in their hands — for as long as they live. Upon the death of the donor/funder, it will be taxed in the trust unless it is distributed to a beneficiary, who will then pay the tax. These provisions override any other provisions aiming to tax trust income or capital gains. They are, in fact, beneficial provisions, with individuals now (potentially) paying less tax than trusts. When these anti-avoidance provisions were first introduced many years ago, individuals paid tax at a higher rate than trusts, so SARS then introduced these measures to prevent people from structuring their affairs in a trust to pay less tax.

Assets can be transferred into a trust during one's lifetime by donation, sale (on a loan account basis), settlement of an obligation or upon death in terms of one's will. Assets can also be purchased directly in the trust, with the trust using its funds (such as a donation or bequest received, its accumulated profits or through liquidating its existing assets), or through funding that it raises—either from the estate planner or a third party funder such as a bank.

Regardless of whether an asset is donated or sold (on a loan account basis or acquired with the trust's cash) to a trust, Capital Gains Tax will be payable by the seller. Care should be taken if assets are sold to the trust by 'connected persons', as it may trigger tax consequences.

Before any transaction is approved, careful planning should be done and calculations performed to establish whether it would be wise to move one's assets into a trust, and if so, at what stage and in which manner.

Do the trustees have the power to enter into the transaction?

Before the trustees can enter into any transaction (or a combination of transactions, such as acquiring assets on loan account), they must ensure that they have the power to do so in terms of the trust instrument. Without a specific power, they are not allowed to do so since trustees may only act within the confines of the trust instrument.

Donation of money or goods

A donation of money or goods will attract Donations Tax. At least then, there are no further Donations Tax consequences relating to Section 7C of the Income Tax Act. The person donating (donor) is liable for Donations Tax, based on the market value of the asset (discounted with 30% on farms for bona fide (genuine or real) farming undertakings). High-net-worth individuals with Estate Duty concerns may use their R100 000 annual Donations Tax exemption applicable to each South African resident individual (or R200 000

per couple) for Donations Tax purposes to move assets into an inter vivos trust, of which family members are the beneficiaries. Such donations can be made in cash or in the form of other assets. The tax is 20% of the amount of the donation if the aggregate of that amount and all other donations during a person's lifetime (on or after 1 March 2018), excluding all exempt donations during the same period, is less than or equal to R30 million; it is 25% of the amount of the donation if the aggregate of that amount and all previous donations during a person's lifetime (on or after 1 March 2018), excluding all exempt donations during the same period, exceeds R30 million. The rationale behind this is that Donations Tax and Estate Duty are both charged on a gratuitous disposition (during your life and at death) at the same rates. Take note that there is no sliding scale. The rate at which you pay tax literally jumps from 20% to 25% if you have made cumulative donations of R30 000 001 compared to R30 000 000. Cumulative donations should, therefore, be constantly monitored as part of your estate plan. As the same scale is applied upon your death for Estate Duty purposes (treated separately from cumulative donation), it may be cost-effective if you postpone donations when you reach this threshold and rather deal with those assets in your will. Similarly, you may donate sufficient cumulative assets during your lifetime (up to this threshold) to keep the value of your estate, which will be subject to Estate Duty, below this threshold.

The utilisation of donations by the trust for investment in an endowment is a tax-effective manner to transfer assets into a trust. One should physically pay the money out of your personal bank account into the trust's bank account. A lump-sum payment or monthly payment is then made into the investment by the trust. Upon maturity, the premiums paid, plus their growth, are accessible in the trust's hands. They will be subjected to the favourable tax

rate of the Individual Policyholder Fund as per Section 29A of the Income Tax Act. This tax is levied in the hands of the life insurance company and there is, therefore, no need to account for any tax in the trust's hands on an annual basis and the trust receives after-tax money. The potential tax saving is significant and is dependent on who the trust beneficiaries are. Where the trust's beneficiaries are natural persons, the growth in the endowment policy will be taxed at 30% on interest and net rental income and 12% on capital gains. In contrast, if the trust were taxed in its own hands, the rates would have been 45% on income and 36% in respect of capital gains. This mechanism bypasses all the punitive tax rates for trusts, as well as the anti-avoidance provisions in terms of Section 7 of the Income Tax Act.

"Regardless of whether an asset is donated or sold (on a loan account basis or acquired with the trust's cash) to a trust, Capital Gains Tax will be payable by the seller. Care should be taken if assets are sold to the trust by 'connected persons', as it may trigger tax consequences"

Sale of assets to the trust on loan account

Few people are aware that when moving paid-up assets into a trust on loan account, the loan will remain an asset in your estate until it is repaid by the trust, which seldom happens because trusts do not generally generate sufficient cash to repay loans. This loan account will be seen as an asset in the transferor's estate for Estate Duty purposes and in the event of insolvency. During insolvency, all assets held in the trust may be subject to the claims of the estate planner's creditors if the loan account is called up and the trust is unable to repay the loan amount. As a general rule, one should, therefore, strive to keep such loan balances as low as possible.

- Another important aspect to consider is the interest rate charged on the loan. In the past, sellers usually charged no interest on the loan, as Income Tax would be payable on such interest charged on the loan and the interest would increase the estate of the seller — either as the interest is physically paid to the seller or if the interest is capitalised to the loan — on which Estate Duty would be payable upon the seller's death. Interest-free or soft loans between persons trigger several anti-tax avoidance provisions in the Income Tax Act, depending on the nature of the lender and the borrower and, in some instances, the nature of the assets transferred. For example, whether they are income-producing or not and whether they are sold for a profit. Generally speaking, the application of the anti-tax avoidance provisions results in the lender being taxed on trust income and/or capital gains attributed (assigned or allocated) to them, limited to a notional amount of interest calculated on the loan and the lender is also deemed to have donated interest (that should have been charged) to the borrower. Since the introduction of anti-avoidance provisions (Section 7C of the Income Tax Act, which taxes loans that carry interest below the variable official rate of interest [repo rate plus one per cent—currently 9.25% per annum]), one has to perform detailed calculations to determine which interest rate will produce the most favourable tax position. Naturally, this must be defendable in a Court of Law.

One should draw up a loan agreement when one sells one's assets to a trust on a loan account, otherwise, it may be alleged that the trust is not run as a separate entity (its form may be disregarded) and it may even be regarded as a donation by SARS. Loan terms indicating potential control by the funder of the trust should be avoided. Therefore, instead of referring to the loan in the financial statements as 'payable on demand' or 'with no terms of repayment', rather refer to it as 'payable as agreed between the parties', in line with the wording of the loan agreement.

There should also be a real intention to repay the loan. As such, the trustees may consider taking out life cover or a term endowment (discussed above) and use the proceeds to repay the loan. There are four main ways of reducing or extinguishing a loan account: through donations, replacement funding from third parties, payments from excess cash in the trust or bequest of the loan upon the funder's death.

Trust purchases assets with third-party debt

Subject to the trust's balance sheet strength and/or the support of persons (typically family members in a family trust), the trust may apply for its debt from a third party. It is not advisable for the trust to purchase assets on credit from a third-party creditor unless no other assets are exposed through this debt, as it may expose other assets in the trust to such creditors. In this instance, rather 'ring-fence' the asset acquired in a separate trust directly or through a company held by the separate trust.

Bequeathing your assets to a new testamentary trust upon your death

Assets can be bequeathed to a testamentary trust, which is created upon one's death. This is typically done when the testator or testatrix has minor children or dependent family members. The will serves as the trust instrument, which is to be registered with the Master of the High Court. Sufficient detail should be provided within the trust instrument to ensure the assets are properly protected and dealt with for the benefit of the beneficiaries, as envisaged by the testator or testatrix. Although most testamentary trusts are vesting or bewind trusts, they may also be discretionary trusts.

Capital Gains Tax, Estate Duty and Executor's Fees will be paid first before any assets can be moved into the newly created testamentary trust. If there is insufficient liquidity in the estate, the Executor may have to sell assets to pay these costs before anything can be transferred into the trust. For these reasons, it is not recommended to wait until your death to move your assets into a trust. Rather, establish a trust during your lifetime (inter vivos trust) and grow your assets within that trust to avoid or minimise these death costs.

Bequeathing your assets to an existing trust upon your death

In many instances, it may make sense to utilise existing trust(s) as part of your legacy plan. Your assets can be bequeathed to an existing trust — if the trust instrument allows for it. If this is the case, the trustees of that trust have to be specifically empowered in terms of the trust instrument to accept such a bequest. Review the trustee power clause to ensure that the trustees can accept further donations or bequests.

An obvious asset to bequeath to a trust is a loan owed by the trust to the testator or testatrix. Such loans typically originate from the sale of assets to a trust. The testator or testatrix can also bequeath other assets to one or more existing trusts.

A bequest to a vesting inter vivos trust was successfully tested in. It confirmed that a bequest to an inter vivos trust is valid without the terms of the trust being incorporated into the will, as required in terms of a testamentary trust. This case did not deal with discretionary trusts, where trustees have full discretion to deal with trust assets, which, in certain instances, may be equated to a delegation of testamentary powers to trustees. It appears that the level of discretion afforded to the trustees in the trust instrument is the determining factor whether a person can bequeath their assets to a discretionary inter vivos trust. One would, therefore, need to study the terms of the trust instrument before bequeathing one's assets to a discretionary trust and effect amendments if necessary.

Assets put in trust in settlement of an obligation

A trust is also a useful tool to utilise in a divorce settlement, whereby a divorce settlement can be transferred into a trust and be applied for the benefit of typically minor children and a spouse. If a person is obliged in terms of a Court order to transfer assets into a trust, it is unlikely that Donations Tax would be leviable on that transaction since it is not motivated by pure liberality or generosity — a requirement for the application of Donations Tax.

The ABC of estate planning for the 'middle-class nuclear family'

▶ **LINDA NDENZE,** Certified Financial Planner® at Fairbairn Consult

Estate planning is a complex process that requires the services of one or a few professionals to be confident that they have carried it out earnestly with sufficient provision for the eventual transfer of wealth into the hands of its new owners, i.e. 'the heirs or legatees'. The heirs inherit the residue or balance of a wind-up estate, whereas legatees receive specific assets from a deceased estate.

In short, 'estate planning' can be described as a process undertaken to manage or allocate the individual's assets in the event of their death to their inheritors, helping to create a legacy for their loved ones as desired. There are many challenges that face individuals as they plan to set up estate plans and most importantly, these estate plans get more complex as the individual gets wealthier. However, there is no exclusion of planning for one's estate because a person or couple believes that they do not have a big enough estate and therefore has less to worry about! So, everyone should work on establishing an estate plan that is adaptable to the individual's life-changing moments over their lifetime journey.

Anyone who is creating wealth in their own lives has a duty to undertake the process of estate planning and ensure the families' wealth is carefully preserved and, after that, successfully transferred to their heirs or legatees.

The A's of estate planning: Assurance of legacy

An estate refers to the 'net assets' or 'net worth' of an individual's total assets, including physical and non-physical assets and crypto assets included, if any exist, less their liabilities, with the net estate value computed representing the actual value of that specific individual's estate. So, to summarise, see below:

Mr A's Net Estate =
Gross assets (includes all valuable items that the individual owns)
Less
Gross Liabilities (includes all debt accounts the individual has)

Now that we are all clear on the term 'estate', we are ready to tackle the next step to consider when we have a married couple with no reference to an antenuptial contract in place; therefore, this couple is deemed to be married in community of property. What does this mean for each of the individuals in the marriage fitting this description? Let us summarise below.

Mr A and Mrs A, being married in community of property, where Mr A has a net asset value of R3 million and Mrs A has a net estate value of R2 million, the couple now has a joint net estate worth R5 million. In the event of death of either of these married individuals, the R5 million will be divided into two equal parts, equalling R2.5 million for each individual; the living partner or spouse will retain half of the estate and the other half will be distributed according to the will and testament of the deceased partner or spouse.

This subject brings us comfortably to the next phase of our ABC journey on estates, namely the 'Deceased estate'. What does the term refer to and how can middle-class nuclear families look out for themselves? Keep reading to ensure you are well protected and your loved ones can grieve without worrying about financial burdens from the lack of comprehensive planning on your side.

The B's of Estate Planning: Be intentional about your legacy preservation

Deceased estates and executors are the next topics to focus on. Simply, when an individual dies, their 'estate' continues to live on, the difference is that the person who created or owned it, is now deceased, hence the term 'deceased estate'.

How would death affect the A's family from the scenarios above?

In the event of death in Mrs A's life, considering that her net deceased estate would be declared as half of their marital joint estate, being R2.5 million, in this case, Mrs A would be liable to pay taxes on her share of the joint estate, now termed a deceased net estate due to her death. Taxes will be levied against the estate according to the Estate Duty Act, 45 of 1955, applicable in South Africa. The Act's main purpose is to levy or impose tax on all estates of deceased persons.

So, the estate duty tax levied on deceased estates is a major primary factor to be considered by any individual wishing to successfully transfer their wealth onto their heirs or legatees in an effort to create a legacy for their families. This tax is also the 'negative financial blind spot' for many who fail to successfully transfer their wealth onto their heirs or inheritors, as desired or intended.

The costs related to a deceased estate also include the cost of securing an executor, the person who is appointed to be the representative of the deceased on all matters relating to their estate, until such time as the estate has been wound up and the residue from the estate (after all costs have been paid and settled), is successfully transferred to the heirs or legatees.

The Estate Duty Act, 45 of 1955, describes the executor as the person who receives authority to act as administrator on behalf of a deceased person, granted such powers by the Master of the High court, wherein such an individual will assume control over the assets of the deceased until such time as the estate has been wound up.

Some of the duties of the executor, may include, but are not always limited, to the following:

- Must be appointed either through the will or other mandate;
- Must have a Letter of Authority issued under their name, obtainable from the Master of the High Court;
- Once the authority over the estate has been settled, they assume control over the deceased's assets;
- Have a duty to open an Estate Late Account, in the name of the deceased;
- Notify third parties on the death of the individual;
- Settle liabilities;
- Sell or transfer assets, as they deem fit to ensure the smooth processing of all estate matters; and
- Any other related activities that assist in winding up the estate to ensure the wealth, if any still exists at this point, is transferable to the heirs as intended or desired by the deceased.

So, we have already identified two financial costs relating to deceased estates, namely estate duty tax and executor fees.

Just how much do these cost an individual? In the event of death, we will show the cash movement below, which is not presented to alarm you; rather, to shock you into taking action in your own life, sooner rather than later, to ensure you have provided for these two major costs in your own estate.

Maximum Amounts levied on deceased estates

Estate duty tax is applicable at 20% of all net estates, less any allowable deductions to the value of R30 Million and 25% of all net estate values above the R30 million mark, from the first rand thereafter.

Executor fees are levied at 3.5% of the gross estate, these are negotiable and the individual must undertake the process of securing the services of an executor as soon as possible, while they are alive to negotiate these costs and gain familiarity with the process that their family will be taken through in the eventuality of their death. The determination of estate duty can be summarised as follows in Table 1 below.

Table 1: An example of an estate calculation prepared for a deceased estate

All property of the deceased person at date of death	RXXX
Property deemed to be property of the deceased estate at date of death	XXX
Gross value of the deceased estate	**XXX**
Less: allowable deductions	(XXX)
Net value of the deceased estate	**XXX**
Less abatement amount	(3 500 000)
Dutiable amount	**XXX**
Estate Duty calculated on the dutiable amount	**XXX**
Estate Duty payable by the deceased estate	(XXX)
Estate Duty payable by beneficiary (if applicable)	(XXX)

Extracted: SARS Website, 2024. https://www.sars.gov.za/types-of-tax/estate-duty/

Note: 'Estate Duty is *due within 1 year of date of death* or 30 days *from date of assessment* if assessment is issued within 1 year of date of death. Currently, *interest is levied* at 6% p.a. *on late payments*.'

"Anyone who is creating wealth in their own lives has a duty to undertake the process of estate planning and ensure the families' wealth is carefully preserved and, after that, successfully transferred to their heirs or legatees"

In summary, estates become liable for estate duty when the value of an estate (after deductions and estate expenses) exceeds the estate duty exemption or abatement. The abatement is currently stated as R3.5 million on the estate of an individual or, in the case of a married couple, the R3.5 million abatement is available to the first dying spouse or life partner within the joint estate. Section 4A of the Act relates to the abatement section of estates, this value is also shown in the corresponding section on the estate calculation in Table 1, shared above.

There are a few additional allowable deductions against an estate that one needs to be aware of in terms of estate administration, these are stated below:

- Funeral expenses;
- The costs the executor incurs;
- The fees the executor charges;
- Outstanding debts and taxes paid by the estate;
- Accrual claims by surviving spouses; and
- Amounts left to a surviving spouse or life partner.

Now that you have an idea about some of the costs that you need to provide for and, thereafter, which costs are also deductible against the estate, you are now armed with information to help with your estate planning to ensure a smooth transitional period for your family from your point of death until your estate is finally wound up.

Let us tackle the last section of our estate planning journey by showing below how best to provide a financial cushion for the successful transfer of your own estate to your heirs and legatees.

The C's of estate planning: Confidence in transferring your legacy successfully!

We will tackle two steps that you can follow to ensure that your estate plan is financially foolproof; anyone who has these two steps in place should be able to comfortably create and preserve their wealth, being confident of a successful transfer to their heirs and legatees, as desired.

Step 1: Ensure you have a valid will in place

Have a valid will in place that caters for all your desires and wishes in the event of your death, incorporate provision plans for your minor children, special financial dependents like your parents, as well as any other children you provide for besides your own, to ensure that the lives of your loved ones in your immediate and extended families are catered for in terms of the will so that their lives can continue with minimal financial changes, as they learn to live without your physical presence.

Quick check-ins regarding a valid will:

- The testator must be older than 16 years of age.
- The testator must sign their will.
- None of the beneficiaries must witness the will to minimise complications when the estate is being administered.
- Cater for your minor children and special dependents by clearly stating desired terms in the will.
- Update the will as and when your life changes, regularly review the document to ensure the most updated copy is kept safely on record and filed with your preferred executor or administrator.

Step 2: Cater for sufficient financial provision to transfer the wealth

Meet with your financial advisor to quantify your net worth and current estate value. Ascertain, based on these values, how much provision you currently have in place to know the value of your financial gap in terms of provision for related capital to administer your estate successfully until transferred to your heirs, with sufficient liquidity to sustain them into the future, as you desire for them.

Once you have the value of the financial gap in your estate plan, make an informed decision about how best to provide for this cash or financial gap with the following three available options:

- **Sufficient investment capital** in the form of all your liquid investments that can be utilised to administer the related deceased estate costs and retain enough funds to transfer the wealth to the heirs, or:
- **Take up a risk insurance policy,** specifically for the purpose of providing for the calculated financial or cash gap in your estate plan; ideally, the policy should be left to the 'Estate' as the sole beneficiary, the policy proceeds will then pay-out directly to the estate and all costs can be paid off from that provision and lead to a successful administration of your estate, and:
- **Use both your investment value and major risk insurance** to bridge the calculated financial or cash gap in your estate plan.

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STOCK BUYOUTS ON DEBTS: PLANNING FOR THE DEATH OF YOUR PARTNER OR FELLOW SHAREHOLDER (how to keep the business liquid)

CHANEL SCHOEMAN, Fiduciary Specialist at Sentinel International Advisory Services (PTY) LTD and **WERNÉ STRYDOM**, Head of Trusts at Sentinel International Advisory Services (PTY) LTD

In the world of business, particularly in South Africa, preparing for unexpected events like the death of a business partner or fellow shareholder is essential. In addition to emotional turmoil, it could also create significant financial and operational challenges for a company. Proper planning for such circumstances can ensure the company remains liquid and sustainable — even in the face of loss.

This article explores the reasons for planning ahead and identifies planning tools for the death of a partner or shareholder; however, it will not engage with the different stock buyout on debts mechanisms.

When a partner or shareholder passes away, the ownership of their shares often becomes a critical issue. In the absence of a Shareholders' Agreement, the deceased's shares may be inherited by their spouse and family, sold to another party or retained in the company, depending on the terms set out in the company's agreement and/or the stipulations of the deceased's will.

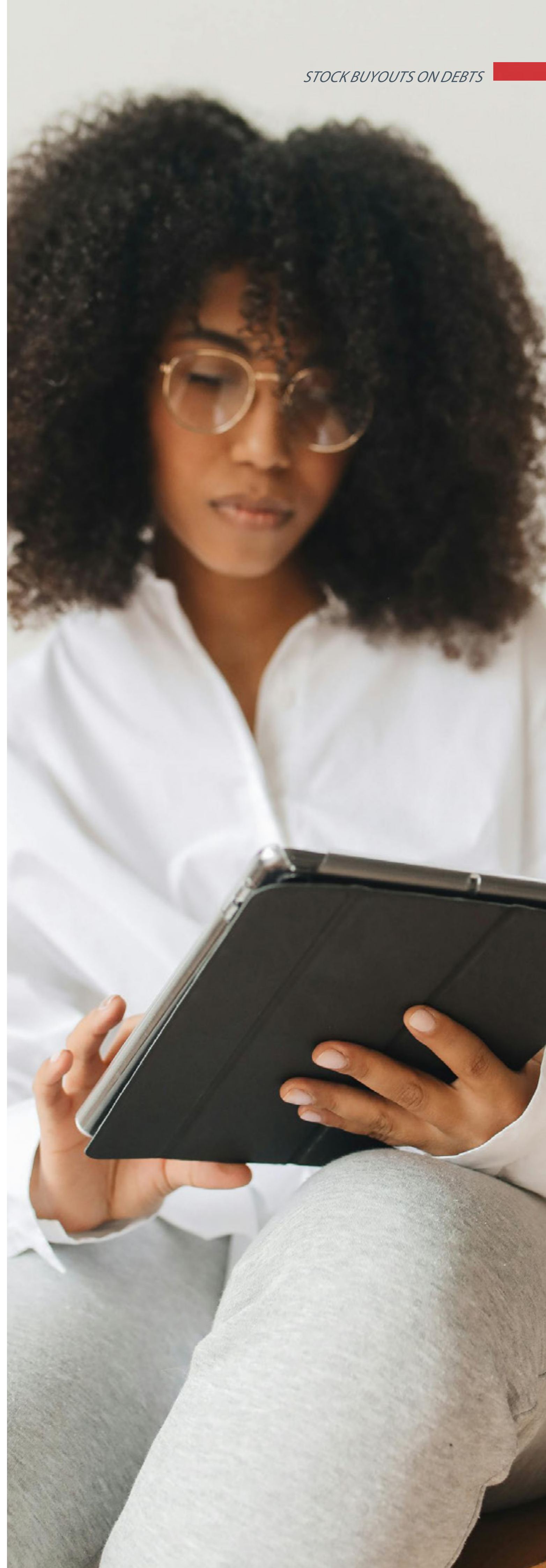
Key reasons why succession planning is needed

1. **Maintaining control:** By buying out the deceased partner's shares, the remaining shareholders can maintain control and direction of the business within clear boundaries. New parties often do not see the value, understand the structure/vision and can lead to significant implications for the stability of the company.
2. **Simplicity in operations:** New shareholders may bring differing interests and goals, complicating decision-making and potentially disrupting business operations. The hard reality is that disruptive operations can place the company at significant risk.
3. **Workforce stability:** Succession planning is crucial for the well-being of employees. Without a clear succession plan in place, employees may feel uncertain about their job security or career trajectories in the organisation, which negatively impacts employee/talent retention. The fear of abrupt leadership changes can create a volatile work environment, hinder collaboration and foster a culture of insecurity, which could result in decreased operational efficiency and even financial losses.

4. **Financial stability:** Many companies do have an element of loan funding or alternative financial support instruments, such as a shareholder's loan or a key person signing surety for loan funding. Should the buyout result in significant change in the financial position of the company, an action plan for ensuring liquidity and functionality should be discussed in advance.
5. **Prevention of legal disputes:** Disputes may arise between the deceased's estate and interested parties (directors, partners, shareholders) regarding the value and ownership of the shares. Resolving disputes often leads to a lengthy process with high legal costs — not in the best interest of any of the parties. Carefully planned and well-prepared agreements can prevent potential legal battles.
6. **Protecting the asset:** The biggest challenge any executor of a deceased estate faces is protecting the asset. Upon the passing of a key person (shareholder/director/funder), the company will face several challenges and risks that your executor would need to mitigate to protect the asset.

Planning tools

1. **Create a shareholders' agreement:** A comprehensive shareholders' agreement is crucial. It should outline the processes for valuing shares, buyout procedures and other details in the event of a shareholder's death. When preparing the agreement, ensure it is fit for purpose and practically enforceable. Not all off-the-shelf shareholders' agreements provide solutions and/or protection for the interested parties. Often, an off-the-shelf agreement, if not properly evaluated and adjusted to fit the company's needs, can be the cause of delays/disputes in the deceased's estate.
2. **Determine share valuation:** There is a variety of methods to value shares, such as earnings multiples (income-based), book value (asset-based) or discounted cash flow, to determine the fair value of the deceased's shares. Often, the valuation of a company can be significantly impacted by the passing of a key person, such as one of the founding partners of a law firm, where the brand/reputation of the company is built around certain individuals. Shareholders should do a careful analysis to determine the impact the passing of a shareholder could have on the value of the company and how this could influence existing funding mechanisms.
3. **Consider a buy-sell agreement:** This contract provides a method for the remaining shareholders, management or the business to purchase the deceased's shares. In principle, a buy-sell agreement can be a very useful tool to provide protection/liquidity to the deceased's family and the remaining shareholders. There are several books and caselaw regarding the advantages and pitfalls around buy-sell agreements. Again, this is not the type of off-the-shelf agreement one should attempt. Seek professional advice and ensure the agreement is regularly reviewed to remain relevant and in line with the parties' succession planning.
4. **Secure funding:** There are a variety of options for funding buyouts. This may include company reserves, loans or insurance policies taken out on the lives of the shareholders. Circumstances may change from time to time; the funding mechanism plays a significant role in the success of a buy-sell agreement.



"Drafting a living Liquidation and Distribution Account can provide detailed insights into the successful structuring of the last will and testament. This will also provide peace of mind for the fellow shareholders, knowing possible family disputes are minimised, funding (if applicable) is secured and the estate remains liquid"

A common method for funding buyouts in the event of a partner's death is life insurance. Each shareholder takes out a life insurance policy on the other shareholders. In the event of death, the payout is used to buy the deceased's shares. This ensures immediate availability of funds and minimises the financial burden on the remaining shareholders of the company. This may sound like an easy solution; however, this may be an expensive policy to maintain long term as key individuals age with time, coupled with yearly policy increases. Unfortunately, we often see policies cancelled after years of religious monthly payments being made due to their becoming unaffordable and having nothing to gain from them years later.

5. **Review and carefully structure your will:** The shareholders' last will and testament play a vital role in succession planning. The last will and testament must be read with any agreements between shareholders, make provision for the sale of shares and can contribute to securing funding/liquidity for the company.

Drafting a living Liquidation and Distribution Account can provide detailed insights into the successful structuring of the last will and testament. This will also provide peace of mind for the fellow shareholders, knowing possible family disputes are minimised, funding (if applicable) is secured and the estate remains liquid.

The cost of dying

Passing away can prove to be costly. Here is why:

- The hard realisation for families on the passing of the shareholders (in full-time employment) puts an end to receiving monthly income.
- The last pre-death tax due to SARS up until the date of passing.
- Possible significant capital gains and the tax thereon on the sale of shares.
- Bequeathing loans and/or shares — triggering 20–25% estate duty (excluding the spousal rollover relief).
- Different policies being included in the estate as Deemed Assets subject to estate duty.
- Executor fees of a maximum of 3.5% plus VAT.
- The unexpected costs: master fees, advertising, conveyancing and so on.

Owing to the above costs and depending on the assets and value in the estate, your estate may have a cash shortfall and the bequest of loans or shareholding may not be possible, which could result in a forced sale of shares to create liquidity in the estate. This is where proper planning and having a living Liquidation and Distribution Account drafted in conjunction with your last will and testament could potentially save your family years of financial hardship and uncertainty.

SECTION 3(3)(a) OF THE ESTATE DUTY ACT: THE HIDDEN STING?

HARRY JOFFE, Head of Legal Services at Discovery Limited

When detailing what constitutes an estate for potential estate duty,[1] Section 3(3) of the Estate Duty Act brings into calculation certain 'deemed' assets.

These are assets that are typically not physically in the estate at the time of the death of the deceased but are still, nonetheless, deemed to be an asset in the estate for the computation of estate duty. The section reads as follows:

> *"Property which is deemed to be property of the deceased includes –*
>
> (a) *So much of any amount due and recoverable under any policy of insurance which is a 'domestic policy', upon the life of the deceased as exceeds the aggregate amount of any premiums or consideration proved to the satisfaction of the Commissioner to have been paid by any person who is entitled to the amount due under the policy, together with interest at six per cent per annum calculated upon such premiums or consideration from the date of payment to the date of death…"*

A domestic policy is defined in the Long-term Insurance Act as follows:

> *"'Domestic Policy' means any life policy as defined in section 1 of the Long-term Insurance Act, 1998 (Act 52 of 1998), issued anywhere upon an application made or presented to a representative of an insurer (or to any person on behalf of such a representative) at any place in the Republic, excluding a life policy which has been made payable at a place outside the Republic at the request of the owner, but including any life policy issued outside the Republic which has subsequently been made payable in the Republic at the request of the owner"* (Emphasis added).

This means that apart from a few types of policies that are issued and are payable outside South Africa, generally any life insurance policy that is issued on a person's life will be a deemed asset in their estate and subject to estate duty when they die. This includes a policy that is owned by another party, including a trust. If a policy is owned by a trust, and the trust is the beneficiary and pays the premiums, then although the policy is a deemed asset and estate dutiable on death of the life assured, there will be an exemption for estate duty of the premiums paid by the trust compounded at 6%.[2] Note that it is vitally important to be able to prove to SARS that the trust, in fact, paid the premiums to qualify for the premiums plus 6% exemption. I have seen many cases where the trust is the owner of a life policy but, in fact, has not paid the premiums. This needs to be checked and corrected by any financial advisors/ trust accountants when doing the life assured's estate planning.

Exemptions/deductions

The major and simplest deduction is the paragraph 4q spousal deduction. Any policy where the spouse is the beneficiary, although a deemed asset in the estate on death, will become estate duty neutral, as the proceeds will qualify as a deduction under paragraph 4q of the Estate Duty Act for accruing/paying to a surviving spouse.[3]

The buy-and-sell exemption

Subparagraph (i)(a) allows an exemption where:

> *"the Commissioner is satisfied that the policy was taken out or acquired by a person who on the date of death of the deceased was a partner of the deceased, or held any share or like interest in a company in which the deceased on that date held any share or like interest, for the purpose of enabling that person to acquire the whole or part of- (aa) the deceased's interest in the partnership concerned; or (bb) the deceased's share or like interest in that company and any claim by the deceased against that company, and that no premium on the policy was paid or borne by the deceased;"*

This allows a policy to be exempt from estate duty where:

- It has been taken out or acquired in order to fund a purchase of the deceased's shareholding in a company/interest in a partnership;
- It has been taken out and is owned by a person[4] who is a co-shareholder or partner to the deceased on the date of death of the deceased; and
- The deceased never paid any premiums on the policy.

What can go wrong with the buy-and-sell exemption?

I have seen many common mistakes when buy-and-sell arrangements are structured, which results in the policy not being exempt from estate duty:

- The life assured takes an existing personal policy and cedes it to their new co-shareholder. They would have paid their own premiums prior to the cession, with the result being that the exemption is lost.
- The life assured and their co-shareholder each take a policy on each other's lives. Instead of paying the premiums personally, they run the premiums through their company. They neglect to set up and reconcile loan accounts with the result that the company has paid the premiums and not them. In such a scenario SARS will not allow the exemption.[5]
- The same facts as above, where the company pays the premiums but, in this case, loan accounts are set up and reconciled; the premiums are simply split equally between the shareholders. That means one of the shareholders is subsidising their own premiums [do the maths!] and the exemption on their policy will be lost.

What happens when the shares are not personally owned?

There are cases where the exemption cannot apply. This is normally where the life assured's shares are owned in a trust/company. If the life assured does not own shares personally, then the policy on their life cannot be owned by 'a person who is a co-shareholder or partner to the deceased' and that policy will be estate dutiable. The premiums plus 6% exemption should still apply.

Note that section 11 of the Estate Duty Act reads as follows:

"11. Person liable for duty

The person liable for the duty shall be –

(b) *where duty is levied on property which, in accordance with subsection (3) of section three, is deemed to be property of the deceased- (i) as to property referred to in paragraph (a) of that subsection, the executor: Provided that where the amount due under the policy is recoverable by any person other than the executor, the person liable for the duty shall be the person entitled to recover the amount due under the policy;" (emphasis added).*

This means that in such a case, the owner of the policy who receives the proceeds of the policy will have to refund the duty to the deceased estate. Therefore, It is vital that the policy is increased to take account of the amount of duty to be paid, so that the policy owner and co-shareholder is not out of pocket when they receive the proceeds of the policy and use them to purchase the deceased's shares.[6]

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[1]Remember, the estate might not end up qualifying for estate duty, as it might be less than the R3.5m or R7m abatement, as the case may be.

[2]Note that the Act does not say compounded, but SARS allows the compounding in practice.

[3]See the definitions section in the Estate Duty Act as to who qualifies as a spouse.

[4]A discussion of the meaning of 'a person' in this sub-paragraph is beyond the scope of this article.

[5]See SARS' guidance note on buy-and-sell policies on their website.

[6]There is a formula how to calculate the amount of cover required-if the estate duty to be paid is at the rate of 20%, then it is amount required/0.8. If the rate is 25%, then it is amount required/0.75

"This means that apart from a few types of policies that are issued and are payable outside South Africa, generally any life insurance policy that is issued on a person's life will be a deemed asset in their estate and subject to estate duty when they die"

Conclusion

Using a policy as part of an estate planning exercise can be complex. The planner often fails to understand that the policy is a deemed asset in their estate and subject to duty, especially when they nominate a beneficiary or have it owned by a trust.[7] In addition, when the policy is being taken out as part of a buy-and-sell structure, the policy is often incorrectly structured or its premiums incorrectly paid. This results in unnecessary estate duty. Finally, where a buy-and- sell policy does not qualify for the exemption, the workings of section 11 are often misunderstood, with the result that the surviving co-shareholder is out of pocket when they have to refund the estate duty to the deceased estate. In such a case, the amount of cover should be increased to cover the duty.

Finally, note that there is one more exemption — section 3(3)(a)(ii), or the 'keyperson exemption', a discussion which is beyond the scope of this article.

Estate planners should always be aware of the sting in the tail — the deeming provisions and exemptions thereto in the Estate Duty Act — when using policies for estate planning!

[7] Note that a trust owned policy generally does not qualify for the keyperson exemption, a discussion of which is beyond the scope of this article

60 minutes CPD

PENSION PLANNING AND ESTATE DUTY, RELIEF MECHANISMS AND TRAPS FOR THE UNAWARE

MARTIN DE KOCK, Director at Ascor Independent Wealth Managers

Retirement planning is a complex process involving many steps that need to be followed.

The reason why it is so important is that if not done properly, it could mean the difference between retiring comfortably and barely making ends meet at a time when you can no longer earn income or generate wealth.

The phases of retirement planning to be discussed in more detail are:

- Pre-Retirement;
- Retirement;
- Post-Retirement; and
- Leaving a legacy.

Pre-Retirement

Last will and testament

Having a properly drafted and signed last will and testament is crucial when considering retirement planning. When drafting your last will and testament, you need to consider the following:

- Who will be the appointed executor of your deceased estate?
- Validity — properly witnessed by witnesses who qualify to sign as witnesses.
- Marital status.
- Who are your descendants?
- Who will be the heirs and beneficiaries?
- Provisions in case of simultaneous death.
- Distinguish between heir and legatee.
- Conditional bequests along with sanctions if conditions are not met.

The above list is not exhaustive.

It can be costly should there not be sufficient liquidity in your deceased estate to settle all debts, taxes and the costs of winding up your deceased estate. If there is a cash shortfall in the estate, it may mean that the executor needs to sell assets to generate funds to settle the mentioned costs. This forced sale can result in an asset being disposed of at a value lower than the market value.

Retirement contributions

It is important to fully utilise your tax-deductible retirement annuity or pension fund contributions pre-retirement, as this is the only investment that offers a tax break on contributions made. See later in the article the results of excessive retirement annuity contributions and how these can be used as an estate planning tool.

Use of a trust

An inter vivos trust can be used as an estate planning tool. Make sure that you obtain professional advice when using a trust.
The following are the benefits of making use of a trust for estate planning purposes:

- Provides for control and management of your assets after death.
- Value pegging: Selling or donating assets to the trust fixes the value in your estate and future growth occurs in the trust.
- Tax planning: This should not be the primary reason for using a trust.
- Creditor protection — Note: This protection is lost if a loan is owed by the trust to the individual at the time of sequestration.
- Protection of a vulnerable spouse and minor children.
- Conduit principle: By distributing income to beneficiaries, the income is taxed at the income tax rates of the individual and not the 45% rate of the trust.

What to consider when deciding to use a trust:

- Annual cost of maintaining a trust, e.g. accounting and tax fees, trustee remuneration for an independent trustee etc.
- Control of the planner's assets is being transferred to the trustees of the trust.
- Ever-changing tax legislation and a renewed focus on trusts by SARS as these entities have often in the past been used to evade tax.
- Divorce proceedings can complicate the practical functioning of the trust if both parties to the divorce are trustees.
- Interest-free loans to a trust are subject to Section 7C of the Income Tax Act No. 58 of 1962. This section requires that interest be charged on the loan at the official interest rate determined by SARS or that this deemed interest be seen to be a donation by the lender and the donation tax of 20% is paid (after accounting for the R100 000 tax-free donation)

Donations

By donating to your spouse, you can equalise assets between husband and wife and can thereby achieve better tax structuring opportunities pre- and post-retirement. Donations to a spouse are exempt from donations tax. Be aware that this donation cannot be reversed in case of divorce proceedings unless the parties to the divorce agree.

A person and their spouse/partner can each donate R100 000 free of donations tax annually. By utilising this annual tax-free donation, a couple's estate can be reduced by R200 000 annually, thereby saving R40 000 future estate duty (R200 000 x 20%).

The above donations can also be made to minor children and these donations are often invested into a Tax-Free Savings Account (TFSA) in the name of the minor child. Two things to keep in mind when doing this is that you are utilising the R500 000 lifetime limited contribution on behalf of the child, which means that if the limit has been reached, the child cannot contribute to such an investment when they become majors. Furthermore, the donor's intention may be that the child only accesses these funds at the death of the donor or later in the child's life. As the child is the registered owner of the investment, they can withdraw this investment as soon as they become majors (at age 18).

It is important to nominate beneficiaries on all your risk policies and retirement products. At death, the proceeds of all products with nominated beneficiaries do not flow through the deceased estate, thereby avoiding incurring unnecessary executor fees on these proceeds. The standard executor fee is 4 025% (3.5% plus VAT), e.g. on a life policy of R1 000 000 one saves potential executor fees of R40 250 if you nominate a beneficiary on the policy. This is money that can go to an heir.

Be aware of the following: Section 37C of the Pension Funds Act, 1956, requires that the trustees of the fund (pension or retirement annuity fund), determine whether there are dependents, the extent of dependency and whether the beneficiary nomination is aligned with this financial dependency. Your listed beneficiary nomination will be used as a guideline but it is possible that the trustees make distributions to additional dependents who have not been nominated.

Asset allocation

Be careful not to move too much of your retirement funds to risk-free investments prematurely, thereby forgoing potential growth.

Retirement

At retirement, there are numerous critical decisions that need to be made. Some of these decisions include:

- Retirement age;
- Products available at retirement; and
- Cash withdrawals from retirement products.

Retirement age

Due to the advance of medical technology, longevity is becoming a bigger problem each year as life expectancy increases. Be prepared to spend a longer time in retirement than was previously the norm. Most individuals have not saved sufficiently for a comfortable retirement.

Due to the impact of compound interest on your retirement investments, you would be surprised at the effect of delaying your retirement by a few years. Unfortunately, this option is often not available to individuals working in a corporate environment with retirement prescribed by the company's pension fund rules.

Consider taking on a consulting role on a part-time basis to augment your retirement income or reduce the income required from your retirement funds for the first few years of retirement.

"It is important to fully utilise your tax-deductible retirement annuity or pension fund contributions pre-retirement, as this is the only investment that offers a tax break on contributions made"

Drawdown strategy

There are two main types of investments when saving for retirement: Discretionary investments and compulsory (retirement products) investments. The difference between these investments is how they are treated for tax purposes.

No tax benefit is obtained when contributing to discretionary investments; hence, you are not taxed on the proceeds when you start withdrawing during retirement. The capital gains generated when selling the investment to generate income will be taxed. This CGT effective tax rate is lower than normal income tax rates.

Contributions to a retirement product are, on the other hand, deductible for tax purposes. When you start withdrawing from your retirement products, the withdrawals are taxed using the income tax tables. There are also limitations on how you can withdraw from retirement funds when you reach retirement. Contributing to both discretionary and compulsory retirement funds and having both types of investments at retirement allows you to structure your drawdown tax efficiently. At retirement, you withdraw more from your discretionary funds and less from your retirement funds, thereby reducing your annual tax liability. As you age during retirement and have bigger rebates available, you can then gradually start drawing down more on your retirement funds.

Investment products to consider at retirement

When retiring from a pension fund or retirement annuity, the following options are available:

- Living annuity;
- Guaranteed or Life annuity; and
- A hybrid product including both a living and life annuity.

Living annuity

Your retirement capital (pension fund or retirement annuity) is paid into a living annuity at an insurer or investment platform and you elect an annuity of between 2.5% and 17.5% per annum. The rate of withdrawal can be changed every year in the anniversary month of the living annuity. The capital in the living annuity will grow or decrease based on the underlying funds in which the capital is invested. This is where you need the advice of an experienced investment professional.

Guaranteed or life annuity

The terms 'life annuity' or 'guaranteed annuity' are used interchangeably. With a guaranteed annuity, you pay the insurer a capital lump sum and, in turn, the insurer guarantees to pay you a life-long monthly annuity. Considerations when buying a guaranteed annuity:

- Level annuity (amount stays the same throughout): Annuity that escalates at a fixed percentage annually, annuity that escalates with inflation annually, and a with-profit annuity (smoothed bonus). Detailed explanations for each of these options fall outside the ambit of this article.
- Additional life: A spouse can be included, which means that the monthly annuity will be paid out until the longest surviving spouse passes away.
- Decrease of annuity at first-dying spouse: The monthly income decreases by 25% (or other % elected). The reason for this is the assumption that the monthly income requirement reduces when there is one less person that needs to be provided for financially.
- Guarantees: At simultaneous death, the annuity will still be paid to beneficiaries for the term of the guarantee, be it 5, 10, 15, 20 or 25 years.
- Capital guarantees: A portion of the annuity is allocated to a risk policy that protects the capital invested at the start.

Each option above has an impact on the monthly annuity that is quoted by the insurer

Hybrid product (combination of living and guaranteed annuity)

A combination of the two annuities can be used during retirement. Cover critical expenses, e.g. medical aid, daily living costs and accommodation with a guaranteed annuity and utilise the balance of retirement funds in a living annuity to cover discretionary expenses, e.g. a new vehicle every six years, the annual holiday, etc.

Cash withdrawal at retirement

When retiring from a pension, provident or retirement annuity fund, you may withdraw one-third in cash, with the first R550 000 (assuming you have not utilised any part of this tax-free portion previously) of the withdrawal being tax-free. Depending on the quantum of your discretionary funds available at retirement, it may make sense to withdraw more than the tax-free portion because the retirement tax tables applied to calculate the tax are lower than the normal income tax tables.

It is important to have access to funds in the case of an emergency as the funds in a living annuity are not accessible bar the monthly annuities paid out. The tax-free portion and any additional amounts withdrawn become part of your discretionary pot of money, which is readily accessible.

Post-Retirement

The costliest mistake retirees make during retirement is to invest too conservatively, thereby foregoing desperately needed growth.

The saddest thing is when a person reaches the end of their life with a big pot of money (estate) and many unfulfilled dreams (the bucket list that has not been ticked off). This normally happens because very few retirees know how much they can spend during retirement. This problem would have been addressed if they had used the services of a good Certified Financial Planner® professional.

Retirement planning is normally done by projecting income needs forward in a linear line. The reality is that as you progress in age during retirement, your levels of energy gradually start to wane and, accordingly, your income requirement will reach a plateau and gradually start declining.

Guaranteed annuities

A retiree can consider moving from a living annuity to a guaranteed annuity during retirement. The annuity rates get better as the remaining years to the end of life reduces. Note that the transfer only applies one way, i.e. from living annuity to guaranteed annuity and NOT vice versa.

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Transferring real estate to the trust: Special considerations

The question of how to plan for a family's wealth is frequently asked, particularly by younger individuals. It is a crucial matter often discussed during casual conversations between friends or neighbours around a braai.

Discussing wealth planning with friends and older and experienced family members about such matters and with relevant consulting professionals is important.

Professional wealth planners

Before making any decisions, seeking assistance from a professional advisor is recommended. Additionally, it is important to involve a specialised professional in the final decision-making process for asset planning, which might be one or more of the following industries:

- Law;
- Accounting or auditing;
- Taxation;
- Registered financial professionals; and
- Real estate brokers.

When seeking advice or guidance from a professional, it is important to ensure that they have experience in your specific field of interest. Do not hesitate to ask the professional if they have the relevant experience. Additionally, it is recommended that you inquire whether the professional belongs to any recognised controlling body and if they are required to complete CPD (continuous professional development) hours each year. This indicates that they stay updated on the latest legislation and court cases. Whereas a young professional may be energetic and knowledgeable, the experience of a seasoned professional is invaluable.

Long-term or short-term planning

When planning their family's wealth, people often consider future generations beyond their children, such as their grandchildren and great-grandchildren. Therefore, it is crucial to think long-term and plan for at least forty years, taking into account the power of compound interest over time to build wealth.

For instance, if you invest R1 000 per month with a 10% interest rate for ten years, you will have R204 844 after this period. This amount will increase to R2 260 487 after 30 years and to R6 324 079 after 40 years.

It is vital to consult a professional to determine which investment vehicle will offer the best return. In this article, we will focus on trusts as an investment option. However, please note that we cannot cover all investment options here, such as public and private company shares, mutual funds, money markets, primary residences, offshore investments, etc.

Types of trusts

Broadly speaking, there are a number of ways in which South African trusts can be classified. This includes the following classifications:

- An 'Inter vivos trust': Is a type of trust created during a person's lifetime through an agreement between the founder (usually a father or mother) and trustee(s). The purpose of this trust is to benefit the beneficiaries, who may include children and their descendants, among others. At present, this type of trust is very common in South Africa.
- A 'testamentary trust': Is created by a person's last will and testament and takes effect after their death. The trustees' duties are explicitly defined in the document and they must comply with all their obligations.
- In a 'bewind trust': The founder or settlor transfers ownership of assets or property to the trust's beneficiaries, but control over the assets or property is given to the trustee(s).
- In an 'ownership trust': The founder or settlor transfers ownership of assets or property to the trustee(s) (in a fiduciary capacity) to be held for the benefit of defined or determinable beneficiaries of the trust.
- Specific application trusts may be classified as the following types of trusts based on the application of a trust, e.g.:
  - Trading (business) trusts;
  - Asset-protection or realisation trusts;
  - Charitable trusts;
  - Land rehabilitation trusts;
  - Share incentive scheme trusts;
  - Broad-based Black Economic Empowerment (BEE) trusts;
  - Collective investment scheme (CIS) trusts; or
  - Special trusts.
- For tax purposes, the following types of special trusts are recognised:
  Special Trust Type A - A trust created solely for the benefit of a person(s) with a mental or physical 'disability' as defined in section 6B(1).
- Special Trust Type B - A trust created solely for the benefit of a person(s) who is a relative of the person who died and who is alive on the date of death of that deceased person (including those conceived but not yet born), and the youngest of the beneficiaries is younger than 18 years on the last day of the year of assessment.

Persons involved in a trust

Trusts, as defined by the Trust Property Control Act 57 of 1988, are intended to separate the assets held within them from the personal estates of the founders and trustees. In any trust there must be at least three types of persons:

- The founder;
- The trustees; and
- The beneficiaries.

Can a trustee be a company? Yes, it can be a company or a natural person.

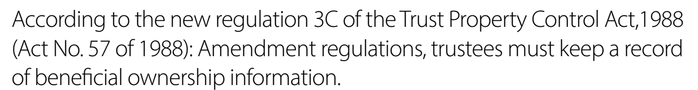
Must all trusts have an independent trustee? Yes, in the court case of *the Land and Agricultural Development Bank of SA vs. Parker and Others,* Case no: 186/2003, the case led to the introduction of an *independent trustee.*

Any of the following: A company, trust or natural person, can be designated as a trust beneficiary.

This separation is a fundamental principle of trust law intended to safeguard the assets for the benefit of the beneficiaries. It is of the utmost importance to ensure that the assets within a trust are protected and used for their intended purposes. By creating a trust, individuals can ensure that their assets are managed and distributed according to their wishes while protecting any potential legal claim against their personal estate.

The primary reason for transferring assets to a trust is to ensure that they do not fall under the name of the founder's estate, thereby avoiding estate duty. In the 1980s and 1990s, this was the main reason for creating a trust; founders/trustees would register a trust and leave the trust deed in a drawer, thereby not submitting tax returns and opening themselves to possible prosecution. Doing this has also withheld them from obtaining huge benefits from registering a trust. However, over the past few years, the duties of trustees and independent trustees have become increasingly important. This is reflected in the 2022 amendment to the Trust Property Control Act 1988, which states that trustees must fulfil certain obligations to maintain the trust: *"When a new trust is registered, a more comprehensive list of information is required, and we refer you to the Master's Office form J401 to obtain the full list of information".*

"When planning their family's wealth, people often consider future generations beyond their children, such as their grandchildren and great-grandchildren. Therefore, it is crucial to think long-term and plan for at least forty years, taking into account the power of compound interest over time to build wealth"



According to the new regulation 3C of the Trust Property Control Act,1988 (Act No. 57 of 1988): Amendment regulations, trustees must keep a record of beneficial ownership information.

(1) A trustee must keep a record of the following information relating to each identified beneficial owner of the trust, in the register contemplated in section 11A(1) of the Act:

(a) The full names;
(b) Date of birth;
(c) Nationality;
(d) An official identity document number or passport number, indicating the type of document and the country of issue;
(e) Citizenship;
(f) Residential address;
(g) If different from the residential address, the beneficial owner's address for service of notices;
(h) Other means of contact;
(i) If the person is a registered taxpayer in the Republic, the person's tax number;
(j) The class or category of beneficial ownership under which the person falls;
(k) The date on which the person became a beneficial owner of the trust; and
(l) Where applicable, the date on which the person ceased to be a beneficial owner of the trust.

(2) Where a beneficial owner is a minor, a trustee must also keep a record of the information referred to in sub-regulation (1) in respect of the minor's legal guardian.

(3) A trustee must keep a certified or verified copy of an official identity document or passport of each identified beneficial owner of the trust. The information recorded in terms of sub-regulation (1)(a) to (d) must appear in the same way as it appears on the certified or verified copy of the identity document or passport.

As everyone can observe, there has been a significant transformation in the sharing of information over the past few decades. This change is essential and much needed. Unfortunately, some individuals have taken advantage of this shift in sharing information for their own benefit. The abovementioned adjustments made to the system will help reduce the misuse of information by such individuals.

Taxation

Income tax

When we discuss income tax, the tax rates for the income tax year 2024/2025 will be used.

The question always arises about how it could be possible to use a trust as a vehicle and not pay the highest income tax rate if the income tax rate of a trust is 45%, that of an individual is also 45% and that of a company is 27%.

Allow me to provide an example to make the explanation easier. Let us suppose there is Trust A with Founder B, Trustees C and D and an independent Trustee E. C and D are a married couple. The Children of the trustees are the beneficiaries of Trust X, Y and Z.

- The trust's founder must have paid the initial trust fund of R 1 000 into the trust's bank account.

The trust has bought a commercial property after it obtained a bond from a commercial bank for a purchase price of R10m; a Transfer duty of 10% on the purchase price is payable; therefore, a total cost of R 11m and the bond also R10.99m. There is one exception that The Court held in the *CIR vs. Freddies Consolidated Mines Ltd* case of 1957 that the word 'acquired' (which is required for a 'transaction' to take place under the Transfer Duty Act) means the acquisition of a 'right'.

The trust got a long-term tenant who received the following income and paid the following expenses.

Rent received	R 1 000 000
Less expenses: Accounting fees	R 3 500
Bond Interest	R 725 000
Other expenses	R 5 000
Net profit before distributions to Beneficiaries	R 266 500
Distributions to beneficiaries	0 .

If the trustees of Trust A decide not to distribute the profit to the beneficiaries, the tax payable is 45% or R 119 925. However, the trust deed gives the trustees the right to decide how they want to distribute the trust's income. In this case, the three trustees have decided to distribute the profit as follows:

- X: R 95 000 (tax payable: Nil)
- Y: R 90 000 (tax payable: Nil)
- Z: R 81 500 (tax payable: Nil)

The total profit is R 266 500. The total tax payable is R nil because they have applied the conduit principle. Therefore, in this case, the tax is much less than 45% of the normal tax of a trust.

It is crucial for the trustees of the trust to decide on the distribution before the year-end and document it in the minutes of the trust meeting. The year-end for all trusts is at the end of February. If the year-end ends in February 2024 and the distribution is made in March or later, the trust will be taxed at 45% on the full amount of R 266 500 for the February 2024 tax year. Additionally, the beneficiaries will be taxed on the mentioned amounts in the 2025 tax year.

Taxation of non-resident beneficiaries of trusts

(Applicable provision: Section 25B of the Act)

This proposal is complete and will take effect from 1 March 2024. If distributions are made before the end of February 2024, they will be taxed in the hands of beneficiaries X, Y and Z, as mentioned above. If beneficiary Z emigrates after February 2025 but before 28 February 2026 (and the same amounts would apply for the 2026 tax year), the taxation of the group will be as follows:

- X: R 95 000 (tax payable: Nil)
- Y: R 90 000 (tax payable: Nil)
- Z: For the 2026 tax year. Due to the change in legislation from 1 March 2024, the amount distributed to this beneficiary for this year will be taxed in the trust at the trust's tax rate of 45%, which amounts to R29 340.

Capital gains tax

If the same 'Trust A' as the above is used and the property was bought after 1 October 2001, the trustees have made an addition to the property to the amount of R 3m, which brings the total cost price during the 2025 tax year to R 14m (R 11m + R3m), and have decided to sell the property for R20m, the trust has a capital gain of R 6m (20m-14m); the best taxation for the group will be as follows:

Proceed	R 20m
Base cost (Purchase price plus additions)	R 14m
Capital Gain	**R 6m**
Distribution to X	R 2m
Distribution to Y	R 2m
Distribution to Z	R 2m
Capital profit in trust	Nil

Each individual beneficiary will be taxed as follows:

Capital Gain	R 2m
The inclusion rate of 40%	R 800 000
Taxation on this amount after the primary rebate	**R 211 411.61**

Three beneficiaries will receive a total amount due of R 634 324.83, representing 10.57% and not 45% or 36% of the total capital gain of R 6 million.

When discussing trust matters, it is important to consult with a professional and inquire about the implications of section 7(C) on all transactions. Due to time constraints, this article cannot discuss this topic in detail.

It is important to note that if a property is sold after the beneficiary has emigrated, the beneficiary's portion will be taxed at the trust rate, rather than the individual rate.

The source of income, such as capital gains, is declared to the beneficiary. For instance, if a trust receives a capital gain and distributes it to the beneficiary, the beneficiary will be taxed on the capital gain. When the trustee declares a dividend to the beneficiary, the beneficiary will be taxed on the dividend.

On the other hand, if the trustees choose not to sell the property and pay off the bond, the beneficiaries become the next-generation trustees. This means that the property can continue to grow in value. For example, if it grows at a rate of 10% annually over a period of 50 years, it could be worth up to R 1.1 billion.

Conclusion

To answer the initial question, the important decisions made in conjunction with good, up-to-date planners will determine the lowest rate[1].

[1] The information mentioned above has been collected from various sources such as the Trust Property Control Act 57 of 1988, the SARS Guide to Taxation of Special Trusts, the Income Tax Return for Trusts (ITR12T), the Tax Registration of a Trust, and a helpful article by Phia van der Spuy. Additionally, the Income Tax Act 58 of 1962, as amended. *De Rebus* journal has also been used as a reference.

ARE GIFTS TO YOUR CHILDREN SUBJECT TO DONATIONS TAX?

MICAELA PASCHINI, Tax Attorney at Tax Consulting South Africa and
BRONWIN RICHARDS, Tax Attorney at Tax Consulting South Africa

For parents who generously give their children gifts, understanding the tax implications of these gestures is crucial. These gifts are often expressions of love, appreciation or to support the needs of the child.

While one might perceive the taxation of gifts as unfair or unjust, the tax legislation provides for very clear instances where donations tax is payable on a gift. This tax is payable irrespective of whether the relationship between the giver and the receiver of the gift is that of parent and child.

The giving of, or payment for something to or on behalf of a child may, however, point towards the parent's maintenance obligation towards that child instead. In certain circumstances, donations tax could be avoided by alleging that the gift is in pursuance of a maintenance obligation.

As a starting point, it is important to discuss South Africa's donations tax framework in order to understand to what extent a taxpayer can legally demonstrate that the underlying rationale for the giving of a gift is *in lieu* of maintenance.

Gifts as donations

A donation refers to the disposal of property (including money) made gratuitously (without expecting anything in return) by one person to another. The definition of 'property' is cast in broad terms to refer to "*any right in or to property movable or immovable, corporeal or incorporeal, wheresoever situated*". Therefore, purchasing a vehicle for a child, for example, could conceivably fall within the ambit of a donation, which may be subject to donations tax.

As held by the Court in *Ogus v Secretary for Inland Revenue* 40 SATC 100, "*… the donations tax was introduced to make up for loss of revenue by way of income tax and estate duty when certain types of donations are made. The mischief aimed at was the practice by taxpayers of reducing their assets by making donations and thereby reducing their income on which income tax is payable….*"

"The giving of, or payment for something to or on behalf of a child may, however, point towards the parent's maintenance obligation towards that child instead. In certain circumstances, donations tax could be avoided by alleging that the gift is in pursuance of a maintenance obligation"

The example quoted above clearly illustrates that the rationale for the introduction of donations tax was to prevent a loss of tax revenue in circumstances where taxpayers divert assets or funds in order to circumvent income tax or estate duty.

Expanding on this view, the Appellate Division in *Ovenstone v Secretary for Inland Revenue* 42 SATC 55 held that, "*[t]he relationship of parent and minor child affords a particularly easy means of diverting taxable income, since the parent in effect contracts with himself. It is also a particularly attractive method, because the minor child usually has no means of his own (and pays no tax) and the parent usually has in any event to support him. It was this rather obvious mischief which Parliament intended to suppress.*"

Following the guidance provided by the courts as outlined above, the South African Revenue Service (SARS) may very well look to transactions between a parent and their child, in concluding that certain payments or gifts are donations on which donations tax may be levied. This tax is imposed at a rate of 20 per cent to the extent that the total value of donations made during a year of assessment do not exceed R30 million and 25 per cent on the value in excess of R30 million.

Donations exempt from donations tax

Section 56 of the Income Tax Act (the Act) provides for dispositions that are exempt from donations tax; these include all donations by natural persons, the total value of which does not exceed R100 000 in a year of assessment.

In the context of provisions from a parent to their child, there is an express exemption from donations tax afforded to certain of these transactions. In this regard, section 56(2)(c) exempts "*so much of any bona fide contribution made by the donor towards the maintenance of any person as the Commissioner considers to be reasonable*." (emphasis added)

Maintenance is obviously not a topic discussed at length within a tax context; however, it has been significantly developed in our courts in the jurisdiction of family law matters.

In terms of the common law, parents have an obligation to maintain their children. The meaning of maintenance was expanded on in the matter of *CIR v Hickson* 1960 (1) PH T7 (AD) (*Hickson*), where the Court held that 'maintenance' of a taxpayer, his family, or establishment, means "*feeding and clothing himself and his family, providing them with the necessities of life, and comforts, and, as it were, maintaining a certain standard of living, and keeping up his establishment.*"

The maintenance of a child may thus extend to the provision of clothing, accommodation, education and food. The addition of 'comforts' in *Hickson* leads to the assumption that the scope of what is considered the 'necessities of life' is broadened.

It is evident that the concept of maintenance should be interpreted widely and could arguably incorporate a variety of 'gifts' from a parent to a child. However, the enquiry does not stop here and, to determine whether the donations tax exemption would apply, one must also establish whether such provision of maintenance would be deemed '*bona fide*' and 'reasonable'.

What constitutes a '*bona fide*' contribution is not defined in the Act. The ordinary meaning of the term bona fide has been accepted by our courts to mean "*acting in good faith and without the intention to deceive*." Therefore, in the context of the donations tax enquiry, the term bona fide speaks to a genuine intention to maintain the child. Stated differently, where a taxpayer merely simulates an act of maintenance in the giving of a gift, such a gift would be viewed as a donation and subject to donations tax.

The crux of the maintenance exemption, which deserves the most attention, is whether the contribution is considered to be 'reasonable' in the discretion of the Commissioner for SARS (the Commissioner).

Reasonableness in the context of maintenance

The Act does not provide a definition of 'reasonable'; however, its ordinary meaning has been accepted by our Courts. As confirmed in *CBA (Pty) Ltd v Commissioner for the South African Revenue Service* (24674) [2020] ZATC 21, the Court accepted the definition as provided by the Oxford English Dictionary, which provides that 'reasonable' means, "*within the limits of reason; not greatly less or more than might be thought likely or appropriate.*".

Ordinarily, taxpayers may turn to a SARS Guide, interpretation note or even case law to understand the meaning of a particular term contained in the Act. It is noteworthy that no guidance of this nature is provided by SARS in the context of the donations tax exemption applicable to maintenance.

With respect to the determination of a reasonable contribution towards the maintenance of another, the Maintenance Act, as well as judgements handed down in the maintenance courts, may provide guidance. While not necessarily considered tax law precedent, in the absence of these concepts being developed by the tax courts, the aforementioned legislation and case law remains valuable.

The Maintenance Act, while not defining the term 'reasonable', does outline, in section 15(3), the following factors to be considered by the maintenance court when handing down a maintenance order:

> "*(a) Without derogating from the law relating to the support of children, the maintenance court shall, in determining the amount to be paid as maintenance in respect of a child, take into consideration—*
>
> *(i) that the duty of supporting a child is an obligation which the parents have incurred jointly;*
>
> *(ii) that the parents' <u>respective shares of such obligation are apportioned between them according to their respective means</u>; and*
>
> *(iii) that the duty exists, irrespective of whether a child is born in or out of wedlock or is born of a first or subsequent marriage.*
>
> *(b) Any amount so determined shall be such amount as the maintenance court may consider <u>fair in all the circumstances of the case</u>."* (emphasis added)

It is, therefore, clear that the reasonableness enquiry involves considering the circumstances of the parties, including factors such as the means of the person maintaining the child and what may be considered fair by the maintenance court, in the circumstances of the case. Two known cases which deal with maintenance are *M v M* (A301/17) [2018] ZAGPPHC 607, which discussed what is considered 'just', and *L v L* (A3008/2021) [2022] ZAGPJHC 21, which concerned the 'means' test.

Upon returning to a tax context and applying the principles gleaned from the maintenance courts, there are two important guiding pillars of which taxpayers must remain cognisant where they intend to argue that they are maintaining a child and are, therefore, not subject to donations tax.

Proving that an amount is not subject to donations tax

The first pillar is found in section 102(1)(a) of the Tax Administration Act, which places the onus on the taxpayer, in proving that "*an amount, transaction, event or item is <u>exempt</u> or otherwise not taxable*".

The second guiding pillar entails that this onus of proof must be discharged on a balance of probabilities, which refers to the degree of certainty which an adjudicator must have in deciding in favour of a taxpayer's position adopted. This does not require absolute certainty but rather a belief that it is more likely than not (i.e. greater than a 50 per cent chance) that the position is correct.

This means that, in order to discharge the onus of proof, a taxpayer would need to retain supporting evidence to substantiate an averment that a gift should not be considered as a donation, subject to donations tax. Rather, that it was given in the context of a parent's duty to maintain their child. This notwithstanding, it remains challenging to produce substantiating evidence to support the position that donations tax is not payable.

SARS enforcement hurdles

The practice of parents buying gifts for their children or directly making payment to a supplier means that these transactions do not always fall within SARS' radar. It is, therefore, often difficult for SARS to become aware of such transactions which may be liable to donations tax where there is no paper trail. Further, while the responsibility to declare donations to SARS lies with the taxpayer, in practice, this is not always done.

It is for this very reason that there is limited authority on the topic, and taxpayers are cautioned to exercise prudence when concluding such transactions. Similarly, where SARS may not have pursued these transactions rigorously in the past, this does not mean that SARS will not focus on them in future.

Conclusion

Where parents generously give gifts to their children, it is essential to recognise the potential tax implications attached to these gestures. Despite the loving intent behind such gifts, the Commissioner may still exercise his discretion to consider these gifts as subject to donations tax.

Distinguishing between gifts or payments which attract donations tax and those which are sincerely made in contributing to the maintenance of a child, proves to be a murky topic to navigate and should be assessed on a case-by-case basis, since no hard and fast rules exist.

Therefore, parents should tread carefully, understanding the nuances of taxation to navigate these waters effectively and fulfil their obligations without unexpected financial burdens.

DONATIONS
SPREAD YOUR LOVE TO OTHERS
FUNDRAISING
SUPPORT
GIVING
VOLUNTEER

KEEPING ALL YOUR COINS SAFE IN YOUR PIGGY BANK: **SAFEGUARDING YOUR ASSETS WITH TRUSTS**

▸ **ROXSHANNA DU TOIT,** Director at Aurora Trust Solutions

'Trust' you are well

We use the word almost daily. It features in nearly every opening line of a professional email or introductory note: *"Trust you are well".*

In this context specifically, it serves as a verb conveying hope that your reader is found to be in good health and in good spirits. It can also serve as the foundation for every good relationship we are fortunate enough to find in life; it is often well-rooted amongst the leadership of every established and long-standing business venture that has successfully stood the test of time.

The word 'trust' encompasses all these things. Beyond having a meaning so deeply impacting our lives, 'trust' can also materialise through a legal establishment, bringing to life an arrangement designed to safeguard your wealth and assets and preserve your legacy for generations to come.

Blimey, it's teatime, shall we have some tea? The history of trusts

The emergence of trusts in South Africa can be dated as far back as the 18th century. As the British established control over various regions of South Africa, they brought with them legal structures and institutions, including the concept of trusts derived from English common law.

Fast forward three centuries and trusts are still well utilised in our world today. They have proved their worth, evolving and adapting to changing economic landscapes and legal reforms and becoming increasingly utilised for various purposes, including estate planning, asset protection and charitable endeavours.

While the first trusts in South Africa found their origination from English common law, the Trust Property Control Act 57 of 1988 was promulgated on 17 June 1988, bringing into South African law the legal provisions that now apply to trusts, their establishment and management, as well as their administration by the trustees appointed for this specific purpose.

Who took the cookies from my cookie jar? Using a trust to safeguard your assets

If you have ever heard of the saying 'another day, another dollar', you would appreciate the meaning behind having worked hard to accumulate your assets and grow your wealth.

When one understands that most people work for the greater portion of their lives to grow their assets and leave a legacy to those held most dear to them, it is of paramount importance to protect the assets they have worked so hard to accumulate.

With this in mind, setting up a trust as an asset protection vehicle for safeguarding your assets from potential risks like claims from creditors, litigation or financial uncertainties may well be worth your while.

Setting up a trust for this purpose will involve transferring your assets into a trust and appointing a trustee who will be responsible for administering your trust and managing the assets housed therein for the benefit of nominated beneficiaries in accordance with the terms as outlined in the trust deed, which is drafted upon the creation of the trust.

The primary goal of an asset protection trust is to shield assets from being seized or depleted by creditors or legal judgements.

By placing your assets into a trust, you as the founder or person establishing the trust, relinquish direct ownership of your assets, thereby making it more difficult for creditors to access your assets in the event of a legal dispute or financial crisis. You can establish this type of trust for yourself, your family or your business in seeking to mitigate financial risks and safeguard your wealth for future generations.

Beyond providing an added layer of protection against financial risks and serving as an asset protection device, placing your assets in a trust offers several other potential benefits:

1. Estate planning: Housing assets in a trust can facilitate the efficient transfer of assets to beneficiaries, simplify your estate and save you on high executor fees based on the value of your estate.
2. Control and management: Trusts allow you as the founder to specify how assets are managed and distributed, even after your passing, ensuring assets are used according to your wishes.
3. Tax efficiency: With careful tax planning, trusts can offer tax advantages such as potentially reducing your estate duty. Your trust will be recognised as separate from you for tax purposes and all assets that are held in your trust will be excluded from your estate in calculating estate duty.
4. Creditor protection for beneficiaries: Assets held in trusts can also protect your beneficiaries from creditors or divorcing spouses, ensuring their long-term financial security.

Along with the benefits that can be reaped by housing your assets in a trust, it is equally important to remember that setting up a trust to hold onto your assets involves careful tax planning, ensuring that all regulatory checkboxes are being ticked by your trustees responsible for administering your trust.

This involves a very careful balance between protecting your assets and ensuring compliance with the legal and tax obligations that apply to trusts.

"When one understands that most people work for the greater portion of their lives to grow their assets and leave a legacy to those held most dear to them, it is of paramount importance to protect the assets they have worked so hard to accumulate"

"You weren't kidding!" (Not) An April Fool's Joke: Embracing the 1 April 2023 changes to the Trust Property Control Act

The first of April 2023, saw the dawn of a new compliance era for trusts with the Trust Property Control Act being amended to include 'beneficial ownership' regulations. This was no April fool's joke and saw trusts facing new compliance requirements with both the Master of the High Court and SARS.

In understanding why the Trust Property Control Act was amended and why trusts are now heavily on the radar of both the Master and SARS, it is necessary to backtrack to October 2021, when the Financial Action Task Force (FATF), the global money laundering and terrorist financing watchdog, concluded their mutual valuation conducted on South Africa.

The report evaluated South Africa's anti-money laundering (AML) and counter-terrorism financing (CTF) laws and found there were gaps in South Africa's AML and CTF framework.

With trusts being flagged as high-risk vehicles that can potentially be used to facilitate money laundering and promote tax evasion, the Trust Property Control Act was amended following the FATF findings to include beneficial ownership regulations with effect 1 April 2023.

'Who is a beneficial owner of a trust?', you may ask.

Taking guidance from the 'beneficial owner' definition contained in section 1 of the Trust Property Control Act, a beneficial owner is the natural person who directly or indirectly owns the trust property or assets or is any natural person who exercises effective control of a trust in the capacity of a trustee, founder or named beneficiary of the trust. These persons are seen to be the 'warm bodies' that ultimately control or exercise effective control over the trust and these are the warm bodies that SARS and the Master are interested in knowing more about.

The inclusion of the beneficial ownership regulations in the Trust Property Control Act has not only resulted in trusts needing to report the details of beneficial owners to the Master through the submission of a 'beneficial ownership register', but it has also triggered changes being implemented at SARS when it comes to trusts, namely:

1. At the onset of registration as a taxpayer with SARS, the trust needs to identify and report all beneficial owners of the trust;
2. The trust income tax return has been enhanced to include reporting on beneficial owners; and
3. IT3(t) third-party data reporting has come into effect, with 30 September 2024 marking the very first third-party data reporting deadline for trusts. This reporting is similar to IRP5 reporting for employers in declaring staff salaries and payroll taxes to SARS or medical aids in declaring to SARS the medical aid contributions made by their members. Trusts now fall under the third-party reporting umbrella, which requires declaring to SARS all income and capital gains vested or distributed to any person participating in the trust, including those identified as beneficial owners from the 2024 tax year onwards.

"All's well that ends well": Leaving a legacy by protecting your assets in a trust

With this changed compliance landscape that trusts now face, it is your trustees who face additional compliance reporting to both the Master and SARS.

It is important for you to know what these responsibilities entail and what information your trustees need to report to SARS and the Master in relation to you, your trust and the trust beneficiaries.

You can choose to look at these changes as a more onerous form of trust administration being imposed on your trust or to consider these changes rather as an extended form of due diligence, giving you peace of mind that your trust is being properly administered and offering greater comfort and security that your trust assets are safe and protected.

Finding inspiration in Andy Warhol's philosophy, *"The aim is not to live forever, but to create something that will"*, outside of paintbrushes and a magnificent palette, entrusting your assets to a trust could be the brushstroke of genius that shapes your life's ultimate masterpiece— your legacy.

BENEFITING FROM ECONOMIES OF SCALE: UMBRELLA STRUCTURES FOR THE MID-MARKET

▶ **OLEFILE MOEA**, Executive Director, Fairheads Benefit Services

Tax professionals acting as trustees or practising in the fiduciary sector or are exposed to this sector, should be interested to know about two umbrella vehicles for housing and managing assets on behalf of beneficiaries that benefit from economies of scale and can relieve the professional burden of managing assets that may be quite modest.

The two vehicles are umbrella trusts and beneficiary funds. Whereas administered in similar ways, they fall under different regulatory regimes, differ in the source of funds they may receive and vary in terms of taxation.

Umbrella trusts were established in the late 1980s, initially to receive and hold death benefits on behalf of the financial dependants of deceased retirement fund members; these trusts expanded during the 1990s. They are governed by the Trust Property Control Act, as well as the Master of the High Court. The Fidentia scandal in 2007 led to the replacement of umbrella trusts by beneficiary funds in 2009 as the default vehicle to receive retirement death benefits. Beneficiary funds are modelled on umbrella trusts but are regulated under the Pension Funds Act and, as such, are subject to the strict governance and compliance regime supervised by the Financial Sector Conduct Authority and the Prudential Authority.

An overview of these two vehicles follows below. It is important to note that while umbrella trusts no longer receive death benefit lump sums, they can accept funds from various other sources and have an important role to play. Indeed, we are noting renewed interest in umbrella trusts as a solution to house testamentary money and other benefits for the middle-income market.

Umbrella trusts

Trusts became part of South African law after the British occupied the Cape in 1806. South African trust law, as we know it today, was developed incrementally as a combination of English law, Roman-Dutch law and South African rules.

Unfortunately, over the past few decades, the use of trusts to avoid tax became widespread; this led to tax agencies around the world clamping down on them and, in some instances, rendering them disadvantageous. South Africa is no exception.

However, when properly set up and used, a trust remains a powerful estate-planning tool, entirely compliant with the regulatory framework governing it in the relevant jurisdiction.

It is important to note that the fundamental purpose of a trust is to place assets under the protection of another on behalf of a beneficiary until some date or condition has been met. Many families choose to use a trust to guide succession and inheritances.

There are many different types of trusts, but the most common are vesting or bewind trusts, where the assets vest in the beneficiary but are looked after by trustees. The need for these trusts remains, but the costs of establishing and maintaining a stand-alone trust can be prohibitive, particularly for smaller estates below R2 million.

Compounding the issue of costs are the delays waiting for the Master of the High Court to register the trust deed and issue letters of authority appointing the executor of the estate.

Advantages of umbrella trusts

Therefore, it is no surprise that there has been a renewed interest in umbrella trusts to house benefits due to minor beneficiaries. As the term suggests, an umbrella structure houses various sub-trusts, leading to economies of scale and other advantages, which include:

- Not having to register a new trust deed and enabling instant liquidity so that settlement can occur quickly and money can flow to the beneficiary;
- An umbrella trust, founded by a reputable provider, has a professional and experienced board of trustees in place to oversee the best use of the benefits;
- As mentioned above, the costs are low compared to a stand-alone trust because these costs are shared by all the beneficiaries of the trust; and
- In best practice, investments are handled at arm's length by best-of-breed asset managers, with the board of trustees working together with an investment consultant.

Contrast these advantages with establishing a stand-alone trust, which involves the drafting of the deed, the appointment of trustees, the registration with the Master of the High Court and administering the trust, including all accounting and governance functions—let alone being responsible for the skilful investment of trust funds.

So, whereas a stand-alone trust can be tailored to meet very specific objectives, the settlor (the founder of the trust) must understand the costs associated with those objectives and weigh up whether it is truly worth it.

> **"The two vehicles are umbrella trusts and beneficiary funds. Whereas administered in similar ways, they fall under different regulatory regimes, differ in the source of funds they may receive and vary in terms of taxation"**

Sources of funds and tax treatment

The umbrella trust is registered with the Master of the High Court and with SARS as a taxpayer.

Trusts may receive benefits from a variety of sources (see below) and may or may not be taxed depending on the source of the benefit. In a vesting trust, all income and gains automatically vest in the beneficiaries for tax purposes and the benefits are not subject to tax in the trust. Income and gains that vest in beneficiaries may be taxable in their hands.

Examples of sources of funds:

- Inter vivos trusts
- Testamentary bequeathment
- Road Accident Fund (RAF)
- Medical malpractice payments
- Life insurance payments
- Private trusts

How to place funds into an umbrella trust

The settlor will make a settlement into the trust by using a deed of settlement to stipulate the conditions upon which the benefit is to be held in trust (for an umbrella trust, the settlor can nominate the vest condition, i.e. the date or condition upon which the benefit will be paid to the beneficiary, as well as the level of income that should be paid to the beneficiary or their caregiver or guardian for maintenance and upkeep).

Alternatively, testators may make provision in their will for a benefit bequeathed to an heir to be placed in a trust, setting out the conditions to be satisfied in order for the heir to receive the full benefit. For an umbrella trust, the provision in a will allows the executor of the estate to make a settlement into the trust.

The above emphasises the need to have a properly executed and up-to-date will. It is extraordinary that the majority of South Africans die without a will, which is arguably the most important document of your life, setting out your legacy for the loved ones whom you leave behind. If you do not have a valid will, your estate will devolve in a fairly complex manner in terms of the Intestate Succession Act, 1987. If a beneficiary is a minor (younger than 18 years) their inheritance will have to be held by the Guardian's Fund unless a testamentary trust is set up at death for the benefit of the minor child — to be specified in your will. The Guardian's Fund has recently seen many of its officials suspended due to possible involvement in fraudulent activity.

Beneficiary funds

Beneficiary funds are a uniquely South African vehicle, introduced in 2009 to receive, administer, invest and pay the death benefits due to the dependants of deceased retirement fund members, who are most commonly minor children. Beneficiary funds can receive only employer/employee-related death benefits. The beneficiary fund market currently stands at approximately R17 billion.

Section 37C of the Pension Funds Act places an onerous duty on the boards of retirement funds to deal with the benefits of a deceased retirement fund member.

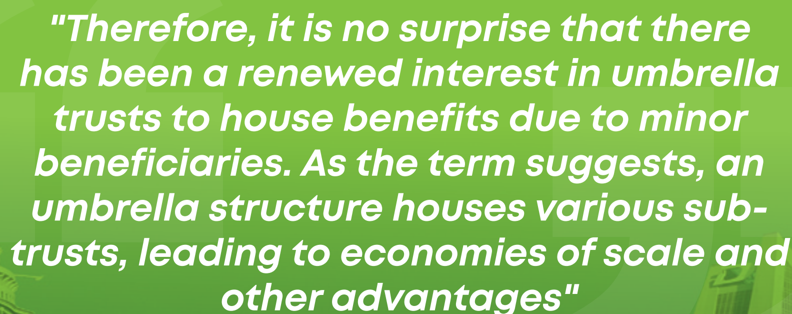
Here, the public cannot access the product themselves but rather needs to stipulate the potential use of a beneficiary fund in their retirement fund nomination form to guide the trustees of their retirement fund once they pass away. There is a need for general consumer education about the existence of beneficiary funds in particular, given their tax advantages.

Retirement fund death benefits are excluded from the estate of the deceased member and the retirement fund trustees must decide who will receive them. They must carefully consider all the dependants of the deceased, decide on an equitable split between them and minors, and determine the most appropriate mode of payment.

Where the guardian or caregiver is not able to manage large sums of money, the trustees will pay the money to the beneficiary fund. The guardian or caregiver can also elect to have the money paid to the beneficiary fund should they choose to.

Retirement fund trustees should consider, among other things:

- The guardian's personal financial and educational circumstances;
- Evidence that the guardian has squandered money in the past or been declared insolvent or had a business declared insolvent;
- Any indication that the guardian intends to use the money for something other than the minor's benefit;
- Experience in handling large sums of money or any investments;
- Whether the guardian has a legal disability (mental disability, under curatorship/administration/spendthrift).



"Therefore, it is no surprise that there has been a renewed interest in umbrella trusts to house benefits due to minor beneficiaries. As the term suggests, an umbrella structure houses various sub-trusts, leading to economies of scale and other advantages"

We believe that the decision to place a minor's benefits into a beneficiary fund should not be seen through the lens of depriving the guardian of their right to administer the benefit but rather that of providing the guardian with the assistance required to navigate dealing with a large amount of money in a complex world.

Advantages, including tax

While the primary purpose of a beneficiary fund is to protect minor dependants' assets and make sure that these benefits are stretched as far as possible, there are other benefits as well, such as institutional investment expertise and pricing, professional trusteeship and an entirely tax-exempt environment. The benefit is taxed before it is paid into the fund; it is not taxed in the fund and payments out of the fund to the beneficiary are tax-free. In addition, the beneficiary fund itself is tax-exempt.

One of the trends we have seen in recent years is the emergence of death benefits being placed in our beneficiary funds for elderly parents of deceased retirement fund members. This is notable because beneficiary funds have, since their inception, been primarily seen as a vehicle to house benefits for minor dependants of deceased retirement fund members.

How does it work?

Each member (dependant) of a beneficiary fund has their own sub-account, which is separately invested and accounted for. Investments are allocated according to the member's individual needs. Family consultation about how the beneficiary fund works, how they can access its service and what they can claim for, is a critical part of ensuring that the money is used for the benefit of the member.

The beneficiary fund allows for capital to be distributed by way of regular income paid to the guardian or caregiver, ad hoc capital requests to pay for educational and other related services or final termination payment when the child reaches the age of majority.

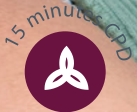
A regular income can be paid to the guardian or caregiver to cover the daily living needs of the member. If the regular income is not required, it will be reinvested and the capital will grow.

Priority is given to paying the education costs of the member. These include school fees, stationery and transport or uniform costs. Importantly, there must be a mechanism to ensure that capital is not over-distributed so that the money lasts until the member has completed their education.

When the member reaches the age of majority, the benefit is paid to them if they so choose, or they can opt to leave the money in the beneficiary fund until they need it.

Conclusion

The above serves as an overview of managing relationships at scale through umbrella trusts and beneficiary funds. There are other aspects not covered here, such as the fees structure, compliance and governance. Tax practitioners may find it interesting to find out more.



BASIC ESTATE DUTY PLANNING FOR A MIDDLE-CLASS NUCLEAR FAMILY

▶ **MBONISI NDLOVU,** Associate Attorney at Cliffe Dekker Hofmeyr

Contemplating mortality and what remains behind upon your passing is a topic many prefer to avoid. However, despite its discomfort, estate duty planning is necessary. Delaying this important task can lead to undesirable outcomes, particularly for the loved ones you leave behind.

Briefly, estate duty is what is colloquially known as 'death taxes' which are payable by your estate upon your passing and is levied on your worldwide assets. It is governed by the Estate Duty Act 46 of 1955 ('Act'). The dutiable amount is calculated based on the net value of the estate, with certain deductions and exemptions available.

Consider the following scenario of a middle-class nuclear family:

- The Jones family, consisting of Mr Jones and Mrs Jones who are married out of community of property with the application of the accrual system and their two children, John (13) and Jean (9). The family recently faced an unexpected blow when Mr Jones suddenly passed away, as you would have it. Despite having a will that bequeaths 50% of his estate to his wife and 50% to his children, the will does not consider estate duty planning in depth.
- Having regard to the impact of estate duty and the significant taxes on the late Mr Jones's estate, Mrs Jones is now aware of the fact that estate duty potentially threatens the financial security of her children's legacy. Promptly, she seeks legal and tax advice in this regard.
- By structuring her assets strategically in order to leverage tax exemptions, as will be seen in the paragraphs below, she manages to minimise her tax liability. Consequently, she is safeguarding the legacy of her children.
- This scenario underscores the importance of estate duty planning. Neglecting this aspect can lead to serious financial and tax obligations that expose the security of loved ones and the legacy one wishes to leave behind.

When conducting estate planning, particularly with regard to estate duty, it is important to consider the nature of your assets, as not all assets are subject to estate duty.

Assets included for estate duty purposes

The Act defines 'estate' to encompass all property of the deceased at the time of their death, including deemed property. It defines property broadly, covering both movable and immovable assets. This includes various types of corporeal and incorporeal property, such as interests in property, annuities and more. However, certain types of property are excluded, such as:

- Pension, Provident, and Retirement Annuity Funds — that portion of benefits due and payable from these funds is excluded. Contributions that exceed the threshold are included;
- Property outside South Africa (this depends on the jurisdiction the foreign property is situated);
- Intellectual property rights;
- Stocks or shares; and
- Property bequeathed to a surviving spouse.
- Certain assets are deemed to be property for estate duty calculations, such as:
- The excess of life insurance payouts over the combined premiums paid;
- Property donated by the deceased that was exempt from donations tax is included;
- The amount of accrual acquired by the deceased's estate against the surviving spouse under the Matrimonial Property Act;
- Property the deceased was able to dispose of for their benefit immediately before death; and
- Contributions to pension, provident or retirement annuity funds that exceed the defined threshold.

Calculating the net value of an estate

The net value of the estate is determined by deducting various items from the total value of the property, including funeral expenses, debts in South Africa, allowed estate administration and liquidation costs, taxes and certain other factors.

Consider the Jones's scenario.

Upon Mr Jones's passing, he leaves his estate as follows.

Assets		
Primary Residence	R4 500 000	
Shares	R1 500 000	
Vehicles	R1 200 000	
Life Insurance	R3 000 000	
Total	**R10 200 000**	
Liabilities		
Home Loan		R300 000
Estate expenses		R720 000
Total		R1 020 000
Less abatement		**R3 500 000**
Section 4q		**R3 300 000**
Net estate		**R2 380 000**
Estate Duty at 20%		**R476 000**

> **"It must be borne in mind that when disposing of assets, other taxes such as capital gains tax and donations tax will potentially be triggered, subject to various exemptions. Furthermore, other costs associated with disposing of assets may be incurred. Therefore, this planning exercise requires the aid of a tax advisor"**

R416 000 is an amount that would have been saved if the estate duty planning had been done properly. It can certainly go a long way for a nuclear family such as the Joneses.

The dutiable amount is calculated by deducting an abatement of R3 500 000 from the net value of the estate. If the deceased had multiple spouses who previously passed away, the calculation is adjusted based on the net value of the estate of the previously deceased spouse(s).

The estate duty rate depends on the dutiable amount, namely 20% if the estate is below R30 000 000 and 25% if the estate exceeds R30 000 000.

Spousal Exemption

The spousal exemption as envisaged in section 4 of the Act allows for the transfer of assets between spouses without incurring any estate duty. If a surviving spouse inherits assets from a deceased spouse, the dutiable amount is reduced by the value of those assets and any unused abatement 'rolls over' to the surviving spouse's estate.

In the case of the Joneses, because Mr Jones bequeathed 50% of his estate to his children, his estate will, therefore, be liable for 50% of the estate duty payable.

Reducing the value of your estate

Effective estate planning requires that you dispose of assets, as early as possible, with a high potential for growth, such as immovable property or shares to either:

1. **Your beneficiaries** while you are still alive. In the Jones's scenario, it is not ideal for Mrs Jones to relinquish ownership of her assets to her minor children as she will not have control over her assets. There may be donations tax payable for such disposals.
2. **A trust**— it appears that the best option for Mrs Jones is to relinquish ownership of her assets to a trust. This way, the value of her estate is substantially diminished and less estate duty will be triggered upon her death. However, she may, in her capacity as trustee, manage the assets, provided she is a trustee. This is to ensure that the value does not grow in her personal estate, thus increasing the value of her estate. Rather, it grows in the trust. Trusts are not subject to estate duty.

It must be borne in mind that when disposing of assets, other taxes such as capital gains tax and donations tax will potentially be triggered, subject to various exemptions. Furthermore, other costs associated with disposing of assets may be incurred. Therefore, this planning exercise requires the aid of a tax advisor.

Effective estate duty planning requires that you ensure that there is sufficient liquidity in the estate to cover all administration costs and duties payable upon your death.

Alan Lake maintains, "*Planning is bringing the future into the present so that you can do something about it now.*" The importance of planning can never be overly emphasised as it minimises the impact of estate taxes and it ensures that your heirs receive the assets you intended them to have, with less tax burden.

Do not be a 'Mr Jones' and leave things to fate, in other words, leave Mrs Jones to pick up the pieces. Be a 'Mrs Jones' and plan ahead for your children's legacy.

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INTERGENERATIONAL WEALTH TOOLS

FOR SUCCESSFUL FAMILIES AND THEIR ADVISORS

▶**ANNE KLEIN**, Founder of Lucia de Klein Private Office

"The hardest thing in the world to understand is the income tax."
Albert Einstein

The ever-changing and uncertain nature of private wealth and tax advisory

It is estimated that a 5% wealth tax on multimillionaires and billionaires in the G20 countries could generate $1.5 trillion annually. A taxation system overhaul would significantly impact the private wealth and tax advisory landscape.

Private advisory continues to demand a different set of skills

Fiduciary advisors and tax practitioners must continually upskill themselves to assist families in navigating the global succession challenges for family wealth.

Supporting families effectively means understanding their unique needs and circumstances, including unravelling their definition of family, what wealth means to them, their values and their vision.

With the help of diligent advisors, families can make informed decisions and effectively brief their teams to manage future changes.

Tax expertise in a global economy
Wealthy families often require international tax expertise to navigate the complex tax codes. A detailed handrail note for tax is essential for families, trusts, businesses and individuals, mainly when dealing with multiple jurisdictions and complex wealth structures. This can assist in developing quick and long-term investment, succession and tax planning strategies.

For those practising in the wealth and fiduciary field, here are some points to consider

Preparing a Family and Business Charter (also known as a 'Family and Business Constitution')
Families can record their values, vision and mission for the Family and Business Charter with expert advisors' aid to safeguard their legacy's generational continuity. Various generational and enterprise families have successfully used family and business charters over many generations.

Furthermore, by capturing formal dispute resolution strategies, future generations are empowered and seated at the table. This approach helps ensure that families can continue to thrive for future generations.

It is more than a balance sheet
Wealthy families have privileges and responsibilities. Managing wealth purposefully and responsibly involves focusing on succession planning, asset diversification, unique investment opportunities, family office arrangements, inter-generational estate planning, philanthropy, business strategies and reporting.

Offshore family members
Advisors should understand the family's reasons for choosing different jurisdictions and be knowledgeable about various topics, such as tax and fiduciary matters. This will help steer the next generation towards sustainable solutions.

Last Will and Testament
Depending on various factors, clients might have multiple wills when dealing with specific jurisdictions or worldwide assets. The different wills must work harmoniously; one should not override the other.

Compliance is a service
Staying compliant is crucial and the role of the family tax advisor is constantly evolving due to global themes and fear factors.

Encourage intergenerational understanding and communication
Multi-generational families are often admired for their resilience in difficult times. However, as new generations emerge, new and old challenges may arise. These challenges can be attributed to a lack of familiarity and shared experiences among family members. To overcome these challenges, embracing change, fostering an innovation environment and developing sustainable strategies are essential.

Map the stakeholder network
Analysing and mapping the stakeholder network is crucial to comprehend a family's distinct values, missions and visions. A family business may involve various individuals, such as company representatives, CEOs, CIOs, CFOs, shareholders, business owners and professionals like directors, trustees, accountants and lawyers working for the family or the family enterprise.

By analysing the stakeholder and the network of influencers, one gains valuable insights into the complexities and nuances of different dynamics that shape decisions which align or misalign matters but put things in perspective.

The power of influence
Non-family board members, married-ins, extended family members, family council members, leaders, next-generation family members and lawyers or representatives for family members may play a vital role in the stakeholder network and the client engagement journey. Their influence should not be underestimated.

Gatekeepers keep score
Identify the gatekeepers of the family legacy to help uncover gaps in the current landscape, provide a better understanding of the investment and succession philosophy and capture the enterprising spirit needed to keep the legacy alive.

Risk management and uniqueness
Gaining insight into risk management, the types of assets held, and the definition and allocation of assets for succession is crucial. Each family's unique characteristics impact their property and lifestyle management, thus emphasising the importance of tailored services and next-generation education.

Neglecting security risks, including personal and cyber threats, must be explored. Social media risks for families must be addressed, as they significantly impact family dynamics and wealth. It is imperative to analyse the effect of these often-unspoken factors.

Essential tools and knowledge sharing
Managing and safeguarding accounting knowledge, intergenerational knowledge transfer, balance sheet optimisation, deal structuring and financial optimisation are crucial topics for families and advisors. Understanding and managing businesses, corporate structures, family governance structures, legal entities and financial services is vital. Seeking business advice is critical for family-owned companies.

"Supporting families effectively means understanding their unique needs and circumstances, including unravelling their definition of family, what wealth means to them, their values and their vision"

Clients bring skills and insights to advisory businesses

Families with substantial investments and business expertise are not inexperienced. Most investors who invest millions in a business have already earned millions in that sector. This awareness changes service models and outlooks, customising advisory solutions.

Here are other strategies to take note of or consider for intergenerational families

Private Trust Company

A Private Trust Company for a family acts as a gatekeeper for wealth and provides trustee services, ensuring business continuity. It consolidates complex family structures and offers access to critical family decision-makers.

Choosing structures

Choosing the appropriate estate planning structure is essential. Trusts and companies are two common types, each with advantages and disadvantages.

Trustees owe a fiduciary duty to the trust's beneficiaries, ensuring asset protection and ownership planning.

The role of a protector is mainly used in offshore structures

A protector can be appointed to perform certain functions in a trust; it is crucial to comprehend the restrictions and limitations that must be considered. Typically, a protector oversees the trustee's actions and ensures that the legal and ethical aspects of the trust are maintained.

Impact investments

Families might be interested in impact investing, which benefits society and the environment while providing returns. This reflects a shift towards sustainable outcomes across all activities rather than just focusing on philanthropy.

Family philanthropy remains vital, ensuring long-term sustainability for prosperous societies

To create a cohesive philanthropic strategy for a family, one should prioritise open communication, engage in meaningful discussions and incorporate diverse viewpoints aligned with shared values. Consider creating a separate family philanthropy plan or incorporating the philanthropy framework into an existing Family and Business Charter outlining governance principles.

A starter pack for young family members

Some families use strategies to empower and teach the next generation by offering a 'starter pack'. Depending on the family's wishes, the starter pack can create a feeling of independence and empowerment. The family uses the opportunity to talk about topics relevant to family wealth and succession and tends to observe how the starter pack is treated. This will coincide with an advisory planning session and ongoing discussions.

Junior boards

Younger family members can be encouraged to engage in legacy-building techniques by creating a junior or shadow board or involving them in family philanthropy.

Advisory boards

Families benefit greatly from a diverse and robust advisory board, including family and non-family members. The board can provide valuable insights and advice, with family representatives equipped to oversee family governance-related matters.

Individual support for family members

Some families appoint a specific advisor for family members or units to ensure fairness. The advisor acts as a communication conduit and assists with important decisions and choices. The fundamental relationship plays a critical role in maintaining harmony in the family.

Conclusion

Advising wealthy families is an intricate and highly skilled business. As South Africans continue to globalise their wealth, business interests and families, their advisors must keep up to date with myriad factors, including compliance, reporting, taxation and estate planning.

TRUST AS AN ASSET PROTECTION DEVICE

HANNAH MYBURGH, Certified Financial Planner® at Crue Invest (Pty) Ltd

In an ever-changing financial environment, many people seek the security of their assets. From protecting their assets from creditors and legal obligations to reducing future tax liabilities, the role of a trust may prove valuable. This article unwraps the role of trusts in asset protection, discusses various considerations before establishing a trust and explains how a trust may aid your financial planning.

The use of a trust is ideal when an individual seeks to move assets out of their personal capacity and into the management of others. By transferring the assets into the trust, the individual ceases ownership of the assets. This transfer can be beneficial to those who do not want to hold the assets in their own capacity for various reasons. A trust is a legal relationship where assets are transferred into the safekeeping of the trustees of the trust to provide for the nominated beneficiaries. There are various role players when forming and managing a trust. The role of the trust founder is to determine the purpose of the trust and transfer the initial assets into the trust. The role of the elected trustees is most important as they will manage the assets in the trust; they have the power to make decisions regarding the assets held in the trust for the sole purpose of benefiting the nominated beneficiaries of the trust. The trustees should be financially astute, good decision makers and it would be preferable for them to have experience in this role. The nominated beneficiaries of the trust have the right to benefit from the trust. However, the manner in which these beneficiaries will receive the benefit will be stipulated in the trust deed and whether the trust is a vested trust or a discretionary trust. The trust deed is essentially the instruction manual for the trust; this explanatory document should include the precise details of the trust and the administrative process.

There are various scenarios where a trust is advantageous; however, the primary purpose is to ring-fence the assets in the trust from your personal assets. A trust serves as an effective tool to safeguard assets from creditors or individuals who are unable to make sound financial decisions—ultimately protecting your wealth. By holding your assets in a trust, these assets are protected from creditors, meaning that any personal debt and obligations would not be tied to the assets in a trust.

Another prominent use of trust is to leave a legacy through generational wealth in the most effective way. Before setting up a trust, careful consideration should be given to the purpose of the trust. A trust should not be set up with the sole purpose of avoiding tax. The value of the assets held in trust does not form part of your estate at death, effectively reducing your future estate duty and executor's fee payable upon passing. Estate pegging is when an asset that is expected to increase in value over time is transferred to a trust at its current value and any growth following the transfer will occur in the trust. While a trust may assist with reducing taxes in your personal capacity, trusts are not exempt from tax.

It is important to understand the structure of the transfer of assets into the trust. This process is not a simple transfer of assets into the name of the trust. The most common way to structure the transfer is to set it up as a loan from the estate planner to the trust and by structuring it in this way, donations tax is avoided. However, this structure can take some time as one may only donate up to R100 000 each tax year exempt from donations tax, meaning that the loan will only be written off over many tax years depending on the value of the assets transferred.

> **"One must be wary of an alter ego trust, where a trust is established, but the trust founder continues to exercise control and benefits from the trust assets without allowing the trustees to make decisions and the beneficiaries to benefit"**

A further factor to consider is the impact of Section 7C of the Income Tax Act, which may deem the non or low-charging of interest on a loan a donation. That is to say when no interest or a low interest rate is charged on a loan to a trust then the interest on the loan that is not charged is deemed to be a donation.

It is important to understand the requirements of a valid trust and the strict administration requirements. There will be serious consequences if the trust is believed to be set up as a front. One must be wary of an alter ego trust, where a trust is established, but the trust founder continues to exercise control and benefits from the trust assets without allowing the trustees to make decisions and the beneficiaries to benefit. A case where the founder is the sole beneficiary of the assets with no intention of benefiting the beneficiaries, serves as an example. While the trust may be valid and meet the requirements, the trust founder fails to act with the necessary care, diligence and skill required in terms of the Trust Property Control Act. The consequence of this is that the creditors may attach their claim to the assets in the trust and request the court to investigate the assets in the trust. This may lead to the court viewing the assets as if they were never held in trust; they are no longer protected in trust, which takes away from the sole purpose of the trust in the first instance. A sham trust is where a trust did not meet the requirements of a valid trust when established and the founder intended to create a perception of a trust, the court may deem that the trust never existed, meaning that the assets, too, are not protected.

It is the trustees' responsibility to report on the accountable institutions they engage with and to record the beneficial ownership of the trust. In December 2022, there were further stringent amendments made to the Trust Property Control Act, including a change in the trustees' reporting and in the introduction of a new definition of 'beneficial owner'. This has increased the administrative burden on the trustees to meet the requirements set out by the Financial Intelligence Centre (FIC) Act. Failing to adhere to these requirements may result in fines of up to R10 million and imprisonment of up to five years, or both.

As previously mentioned, trusts are not exempt from taxes; trusts are taxed more harshly than individuals. Therefore, how the trust will be taxed is an important consideration for managing a trust effectively. In terms of the Income Tax Act, a special trust may be set up to provide for a disabled beneficiary. If the trust qualifies as a special trust, it is taxed as a natural person and, in addition, can make use of tax exemptions, which is more favourable. There are costs involved in setting up and managing a trust, such as administration costs, accountants' costs, and trustee remuneration. Therefore, it is necessary to understand what outflows are due from the trust's assets and to determine the liquidity in the trust.

In summary, a trust is a complex creature with various intricacies that are advantageous to the protection of assets and legacy planning through generational wealth. However, this article highlights the importance of being financially astute when establishing and managing a trust. Understanding the responsibility and accountability of each role player in a trust and the various tax consequences and costs that need to be provided for can set you in good stead for establishing a trust.

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