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FIDUCIARY FOCUS

5TH EDITION - JULY 2017

FIDUCIARY FOCUS - 5TH EDITION
CONTENTS:

WELCOME TO THE FIFTH EDITION OF OUR FIDUCIARY FOCUS NEWSLETTER

In this edition, we look at fiduciary matters from an international perspective
Investing some of your wealth internationally is becoming increasingly attractive and to a large extent non-negotiable from a diversification point of view. However, it's important to understand the small print to make sure your assets are protected and that there aren't any unintended consequences for you and your dependants.

Through this series of articles, we highlight the various aspects of ensuring that your international investments comply with the relevant legislative and regulatory framework, including tax implications, suitable structures, and whether to have a separate will or not.

Personal advice forms the foundation of our fiduciary service offering
Our fiduciary experts pay close attention to developments in industry regulations and changes in legislation to help ensure that your wishes are protected. We understand that every individual's needs, family situation, and risk profile are different, which is why personal advice forms the foundation of our fiduciary services.

We hope you find these articles informative – enjoy the read.

Kind regards
FIDUCIARY SPECIALIST TEAM

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THE CHANGING REGULATORY ENVIRONMENT – NO PLACE TO HIDE

Compliance with the relevant regulations is more important than ever

The global regulatory and legislative landscape that affects financial institutions and our clients – particularly relating to the disclosure of information about foreign accounts – has evolved and continues to evolve at a rapid pace. These significant changes mean it is becoming more and more important to ensure that your financial affairs are managed appropriately and in compliance with the relevant legislative and regulatory frameworks.

Increasingly stringent global money laundering laws were introduced to combat terrorism

The September 11 attacks in 2001 led to a worldwide focus on the enactment of global money laundering laws and regulations. This was in an attempt to combat terrorist activities that are primarily financed through illegal activities, since the perpetrators try to disguise the original source of their funding, resulting in money laundering. The radical change in the legislative and regulatory landscape was aimed at cutting off the lifeline (so to speak) to the much-needed money that finances terrorist activities.

There is pressure on governments around the world to monitor financial transactions

Accordingly, there has been significant and mounting pressure placed on governments around the world to increase the monitoring of financial transactions. The Financial Action Task Force (FATF) is an inter-governmental body whose main purpose is to develop and promote national and international policies to combat money laundering and terrorist financing. Stringent anti-money laundering (AML) systems and procedures invoking strict requirements on banks and other financial institutions appear to be the norm in most jurisdictions.

In South Africa, FICA was introduced to fight financial crime

Bringing it closer to home, the Financial Intelligence Centre (FIC) was established in 2001 to act as the primary authority over AML efforts in South Africa. Accountable institutions are obligated to identify and verify their clients and third parties with whom they transact. Non-compliance results in fines or even imprisonment. This has placed onerous obligations on accountable institutions to ensure that they are able to verify their clients, which is why we often request updated Know Your Customer (KYC) documentation from our clients.

In addition, tax authorities around the world have turned their attention to tax enforcement

As a result of tax data leaks, most notably the Swiss, Panama and Bahama data leaks, tax authorities around the world are turning their focus towards tax enforcement, resulting in another major shift in the legislative and regulatory landscape. As bizarre as it may seem, it is the innocent who are yet again carrying the brunt of this. In the past, an individual could transfer funds to another jurisdiction and there would be no obligation placed on the recipient – for example, a bank in a foreign jurisdiction – to report on those funds to the relevant authorities in the country where the individual is tax resident. With the increase in cross-border transactions, it became evident that tax administrators needed to introduce measures to counter international tax avoidance and evasion.

Regulating the exchange of information between tax authorities ensures tax transparency

The Organisation for Economic Cooperation and Development (OECD) has taken the leading role in developing policy and technical solutions for the exchange of information between various tax authorities.
This exchange of information is now commonly known as the Automatic Exchange of Information (AEOI), which started with the introduction of a withholding tax regime, most notably in the US, called Foreign Account Tax Compliance (FATCA). This was quickly followed by reciprocal exchanges of information being agreed to by some European countries under Intergovernmental Agreements (IGA). The OECD launched a global AEOI standard known as the Common Reporting Standard (CRS) in July 2014.

CRS is aimed at improving international tax co-operation between governments and achieving global tax transparency to counter international tax avoidance and evasion. The CRS requires that all financial institutions must report financial account information on those clients that are identified as being foreign tax residents to the local revenue authority. The local revenue authority will automatically exchange that information with other jurisdictions on an annual basis. To date, one hundred jurisdictions have committed to CRS and more jurisdictions are expected to commit by 2018.

You need to declare all investments held in different jurisdictions

With the introduction of FATCA and CRS, it has become increasingly important for an individual to declare all their investments held in different jurisdictions for tax purposes.

We are here to help you navigate all these regulatory changes. Please contact your relationship manager if you have any queries about how this affects you and what actions you need to take.

UNDERSTANDING THE TAX IMPLICATIONS OF BUYING A UK RESIDENTIAL PROPERTY

Owning global property as part of your estate plan requires careful planning

Estate planning involves planning and managing your assets both during and after your lifetime. During your lifetime, it is about ensuring that your assets are structured optimally to protect your wealth against events such as divorce or death. But what happens after you pass away? How do you ensure that your assets are administered efficiently and that your dependants benefit the way you intended? This is where proper estate planning is essential.

If you own immovable property, this is one of the assets that must be provided for in your estate plan. In addition, owning property in another country, such as the UK, means the taxes and costs of the property may be different than what applies in the local market. This makes it even more important to make informed decisions when you buy the property.

Focus on the UK – there have been several changes to the way UK residential property is taxed in recent years

The table below, compiled by Marcus Prevel, Director of Nedgroup Trust Limited (Guernsey), shows what non-UK residents must consider when planning to purchase a UK residential property. Please note that not all the provisions below apply to UK commercial property (eg retail spaces, businesses, industrial) – it does however relate to residential premises that are commercially let.

Costs and charges you need to consider when purchasing a UK residential property

The following list summarises the costs and charges set out in more detail in the table:

- How you will be taxed in the UK on receiving rental income
- What your annual costs will be
- How you will be taxed in the UK on the sale of the property
- How UK inheritance tax works
- The costs associated with using letting agents and tax advisors

The provisions below set out the UK tax consequences but not the South African tax consequences

South Africa has a residence basis of taxation, which means South African residents are taxed on their worldwide income in South Africa. There are however tax agreements in place between South Africa and other countries that need to be considered to determine which country has taxing rights.

Please note that the information in the table is a guide only

This table is for illustrative purposes only and should not be used as a basis for purchasing a UK property without first getting professional advice. If you own residential property in the UK or are interested in buying property, speak to your relationship manager who can put you in touch with the relevant tax specialists.

<table>
<tr><th rowspan="2"></th><th colspan="5">OWNERSHIP OPTIONS</th></tr>
<tr><th>Sole name</th><th>Joint names</th><th>Trust</th><th>Company</th><th>Trust/Company structure</th></tr>
<tr><th>Income tax on rental income</th><td colspan="2">Band / Taxable income / Tax rate
Personal Allowance / Up to £11 500 / 0%
Basic rate / £11 501–£45 000 / 20%
Higher rate / £45 001–£150 000 / 40%
Additional rate / Over £150 000 / 45%</td><td>• First £1 000: 20%
• Thereafter: 45%</td><td>20%</td><td>20% (when the income is earned within the company)</td></tr>
<tr><th>Capital gains tax on sale of property</th><td colspan="2">28% above allowance</td><td>28% (gains can be attributed to UK resident beneficiaries when the proceeds are distributed to them)</td><td colspan="2">• 20%
• 28% if the residential property is subject to ATED (annual tax on enveloped dwellings)</td></tr>
<tr><th>Annual property charge for 2017/2018

(Annual tax on enveloped dwellings – ATED)</th><td colspan="3">Not applicable</td><td colspan="2">Market value of property / Charge
£500k–£1m / £3 500
£1–£2m / £7 050
£2–£5m / £23 550
£5–£10m / £54 950
£10–£20m / £110 100
£20m+ / £220 350

These charges will increase annually.
Please note: Not applicable to commercially let or business property</td></tr>
<tr><th>Inheritance Tax (IHT)</th><td>40% above £325 000 allowance</td><td>40% above £325 000 allowance x 2</td><td>• Chargeable to settlor on all UK situs assets if the settlor/spouse is a beneficiary of the trust

• Also see the 10-year charge below</td><td colspan="2">• Currently not applicable
• However, from 2018 IHT may be applied to UK property in international companies

(The draft provisions for this legislation were introduced in 2017 – it is currently on hold)</td></tr>
<tr><th>10-year charge applicable?</th><td colspan="2">No</td><td>• Yes – charged at a maximum of 6% of the value of UK situate assets worth more than £325 000 every 10th trust anniversary
• Can be offset by lending</td><td>No</td><td>• No
• However, once the provisions in the row above come into force – then yes (the application will be the same as for trusts)</td></tr>
</table>

	OWNERSHIP OPTIONS				
	Sole name	**Joint names**	**Trust**	**Company**	**Trust/Company structure**
Deductibility of allowable interest against UK tax (Note – any reductions benefit from a standard rate reduction of 20%)	• 100% allowed at full marginal rate in 2016/2017 • 75% in 2017/2018 • 50% in 2018/2019 • 25% in 2019/2020 • 0% from 2020/21 • Interest allowed at standard rate of tax only			All allowable interest allowed at corporate rate of tax	
Tax advisor cost to file a 10-year charge return	Not applicable		Approximately £750 every 10 years	Not applicable	
Other death duty chargeable on value of assets in home jurisdiction?	Possibly		Unlikely	Possibly to shareholders	Unlikely
Stamp duty chargeable: • £0–£125k = 0% • £125k–£250k = 2% •£250k–£925k = 5% • £925k–£1.5m = 10% •More than £1.5m =12%	An additional 3% will be levied on the adjacent charges where this is a second, third or more property (globally)		An additional 3% applies to discretionary trust	• 15% if subject to ATED rules • If ATED does not apply then adjacent bandings plus 3%	
Letting agent costs: 10%–15% of rental income	Applies if the owner is not resident in the UK to handle the letting of the property		Yes		

	OWNERSHIP OPTIONS				
	Sole name	**Joint names**	**Trust**	**Company**	**Trust/Company structure**
Tax advisor costs	Depends on the individual's ability to complete UK tax returns themselves		£600 – £700 per year Note: This is in addition to the tax advisor charge of £750 for filing a 10-year charge return	£600 – £700 per year	
Insurance	Yes		Yes – Nedgroup Trust Limited can often negotiate a more favourable premium		
Structure costs (once up and running) **Estimates do not include the setup costs of the trust and/or company and administration involved with the initial purchase of the property**	None		Approximately £3 000 + per year plus external costs, depending on value	Approximately £3 700 per year plus external costs, depending on value	Approximately £5 200 per year plus external costs, depending on value
Borrowing terms	Various		• Up to 60% of property value • Arrangement fee: 1.25–1.50% • Interest: 2–3% above base rate		
Legal title held in whose name	Own name	Own names	Nedgroup Trust on behalf of the trust	Company name	

Figures correct as at June 2017.

TAX CONSEQUENCES FOR SOUTH AFRICAN RESIDENTS INVOLVED IN INTERNATIONAL TRUSTS

Diversifying your investment portfolio internationally can offer you better risk-return characteristics over time and give you access to opportunities that are not available locally. In fact, we encourage clients to take a global view of their wealth. An international trust can help protect your global investments from costs such as estate duty. It is however important to understand the tax implications of international trusts for South African residents.

The easing of exchange controls has made international investing more accessible

There has been a gradual easing of exchange controls over the past 20 years. In the past, international exposure was mostly gained indirectly (where the proceeds must ultimately be returned to South Africa and paid in rand), in one of two ways:

1. investing in South African-based companies that have dual listings; or
2. investing via an institutional foreign investment allowance (known as 'asset swap' investments).

Today, South African resident individuals can obtain 'direct' exposure to international investments using the following exchange control allowances:

- R1 million annual discretionary allowance that can be used for various purposes (for example as a travel allowance); the unused portion can be used for investment purposes
- R10 million annual individual foreign capital allowance

In addition to this, the South African Reserve Bank is considering applications submitted on behalf of individuals to obtain permission to employ additional amounts – over and above these amounts – internationally.

South Africans must declare their global income and capital gains for tax purposes

South African residents are taxed on a residence-based system of taxation when investing internationally. This means that no matter where in the world your assets are situated or how they were acquired, you will be taxed on, and obliged to declare, your global income and accruals (capital gains).

You are also liable for estate duty on your international assets

South African residents are, with relatively few exceptions, liable for South African estate duty on their international assets, including assets acquired using the investment allowance facilities. Many South Africans are not aware of this fact, or the impact it can have. Estate duty rates in South Africa are currently at 20%, and these rates may increase even further while the rand depreciates. This means the rand value of international investments for estate duty purposes will likely increase over the years, thereby increasing liability to estate duty.

An international trust can help protect your international investment from estate duty liabilities

In light of this increasing liability, it is important to consider 'pegging' the value of the assets in rands for South African estate duty purposes. This can be achieved by setting up an international trust.

For more background about international trusts, read our previous article 'International structuring – The impact of the Davis Tax Committee proposals on foreign trusts', which appeared in the second edition of Fiduciary Focus.

In addition to 'pegging' the value of the assets in rands, international trusts offer several other advantages:

- Continuity: The death of the settlor has no effect on the ongoing management of the trust or the trust assets.
- Orderly distribution after death: Probate formalities (including the related cost) as well as the attendant freezing of assets (possibly for a prolonged period) while the estate is being administered are avoided.
- Flexibility: The trust can be structured at the outset to allow for changes in regulations and best practice.
- Protection for dependants: This includes financial protection for minors or those with disabilities as well as planning for the education of children or grandchildren of the settlor.
- Protecting assets from seizure: The legal ownership is that of the trust and not the individuals, which makes seizure more difficult.
- To mirror South African planning: Due to exchange control regulations, South African trusts may not own direct international assets. This means an international trust is required for exactly the same reason why a South African trust is established.

It is advisable for an international trust to be managed offshore for tax purposes

If the 'place of effective management' of the international trust is not in South Africa, then the international trust will not be a taxpayer in its own right. It is therefore advisable to ensure that all trust-related decisions are taken and implemented by the trustees outside of South Africa. This includes all investment-related decisions as well as the implementation of these decisions.

Understanding how donations and loans are taxed is important

An international trust can be settled by way of a donation or a loan. With relatively few exceptions, a donation is taxed at 20%. The first R100 000 of the donation is free of donations tax. It is important to remember that the interest forgone on interest-free loans is treated as a donation and is subject to donations tax. In so far as South African trusts are concerned, this is the result of the recent introduction of section 7C of the Income Tax Act, which we wrote about in the previous edition of Fiduciary Focus – read the previous article for more detail. Loans to international trusts that fall into the definition of 'affected transaction' are however subject to section 31 of the Income Tax Act (see below)

South African residents are taxed in their own hands when involved with an international trust

According to current South African tax legislation, South African resident individuals are taxed in their own hands whenever they are involved with an international trust, whether it is as a funder and/or beneficiary.

This is accomplished in three ways, depending on the role of the South African resident and the nature of the tax trigger:

Attribution provisions (triggered by donations) (section 7(8) and/or paragraph 72)	• This applies when a South African resident is a funder of an international trust and makes a 'gratuitous disposal' such as a donation to the trust and the trust earns taxable income. • Although an interest-free loan is not in itself a donation, the interest forgone (interest that could have been charged on the loan) could be viewed as a donation. • Where a South African resident therefore enters into an interest-free loan with an international trust, any actual income earned or any realised gains will be attributed to the South African lender, but limited to the extent of the interest forgone. The same principle applies when the trust pays interest at a rate lower than the official interest rate. • By paying the donations tax on the interest not charged, the gratuitous element of the disposition will have been eliminated by the operation of section 31, which removes the element of gratuitousness (donation, settlement or other disposition) that is necessary to trigger the attribution provisions.
Conduit principle (section 25B and paragraph 80)	This applies when a South African resident is a beneficiary of an international trust and receives a distribution comprising taxable income from the trust, eg realised gains, interest, foreign dividends or property rental.

Transfer pricing provisions (section 31)	• This applies to any transaction, operation, scheme, agreement or understanding between a South African resident and an international trust with which the resident is involved (known as an 'affected transaction') that results in a tax benefit. • The taxable income or tax payable from the tax benefit must be calculated as if the transaction had been entered into on terms and conditions that would have existed had those persons been independent persons dealing at arm's length. • The difference between any amount linked to the tax benefit and any amount that would have applied must be deemed to be a donation made between the resident and international trust. (This means the impact is very similar to the impact of section 7C as it relates to loan agreements, where the trust fails to pay interest on the loan or pays interest at a lower rate.)

Important considerations when applying an interest rate to a loan

Where interest is actually charged on a loan, the interest charged will be taxed in the South African lender's hands. Where interest is charged at the official rate of interest there would be no tax benefit or 'gratuitous disposal'. This means neither the transfer pricing provisions nor the attribution provisions would apply.

The following should be considered when applying an interest rate to such a loan:

- The actual interest rate is a function of the currency of the loan.
- Any interest accruing to a South African resident will be fully taxable in the resident's hands.
- The loan is an asset for the purposes of calculating estate duty. Therefore, if the interest is capitalised on the loan – that is, the interest is not physically paid – the value of the loan will increase.

Please contact your relationship manager if you have any questions or if you would like to arrange a meeting with a fiduciary specialist for expert advice on international trusts.

OWNING ASSETS IN A FOREIGN COUNTRY – IS THERE A NEED TO HAVE A SEPARATE WILL?

More and more South Africans own assets in foreign countries and clients often ask whether they need to have a separate will for those assets. While many people choose to have a single worldwide will, this is not always the best option. There are several complexities to consider, such as the nature of the assets you hold and the type of jurisdiction.

There are different ways to deal with international assets in a will

Generally speaking, the different options for dealing with South African and international assets are:

1. a single will that applies to your worldwide estate, ie including both South African and international assets;
2. a separate will(s) limited to the jurisdiction where the international asset(s) is/are situated, and a separate will dealing with South African assets; or
3. one will dealing with worldwide assets outside South Africa (across jurisdictions), and a separate will dealing with South African assets.

The nature of your assets and the jurisdiction will determine which will is most suitable

The first choice for most clients is to have a worldwide will. However, this is not always practical. The nature of your international assets and the jurisdiction in which they are situated will determine whether you require a separate will.

- Immovable property in another country

  If you own immovable property in another country, it is almost always essential to have a separate will to deal with the succession of the property. This is because the foreign jurisdiction may only recognise a will executed in that jurisdiction to dispose of the property. We advise you to approach a lawyer in the jurisdiction where the property is situated for advice and assistance with drafting such a will.

- Unit trusts or shares in another jurisdiction

  If you own unit trusts or shares in another jurisdiction, it is usually recommended that you have a separate will for those assets. If you own these assets in more than one jurisdiction, it is not necessary to have a separate will for each jurisdiction – a practical solution would be to have a will for your assets in South Africa and an international will for your assets in all other jurisdictions (option 3 in the list above). However, it's important to know that a South African estate and an estate in a foreign jurisdiction cannot always be administered simultaneously. The reason for this is that court-sealed and certified copies of the letters of executorship must often be obtained for the foreign country's authority to be issued. Having a separate will for those assets will make the facilitation of the administration process much easier.

- **Assets in a civil law jurisdiction**
  If you own assets in a civil law jurisdiction, such as Italy, France, Portugal or Germany, you need to beware of forced heirship rules. These rules provide that certain family members inherit a portion of your estate, regardless of what is stipulated in your will. In other words, your South African will may not overrule the effect of forced heirship. It is therefore advisable to have a separate will for those assets.

- **International bank account**
  If your only international asset is a bank account, it is usually not necessary to have a separate will. Let's consider the Isle of Man as an example to illustrate:

  - Each bank in the Isle of Man has its own threshold to determine whether the bank will release the funds in the account without an Isle of Man court authority or probate (similar to letters of executorship issued by the Master's office in South Africa). The average threshold is approximately £10 000.

  - If the funds in the account exceed this amount, probate will be required by the financial institution holding the assets (such as a bank, building society, life insurance company, asset manager, or stockbroker) as proof that the correct person or persons have the court's authority to administer a deceased person's estate. The document issued by the court is called a Grant of Representation

  - There are three main types of grants:
    1. Probate – issued to the executor(s) named in the will

    2. Letters of Administration with the will annexed – issued to someone other than an executor when the deceased left a will, for example, an attorney, residuary beneficiary, or beneficiary or person entrusted in the country of domicile of the deceased

    3. Letters of Administration – issued when the deceased did not leave a will (ie they died intestate) to one or more (up to a maximum of four) of the person(s) entitled to the estate in accordance with the law of the place where the deceased domiciled

In these circumstances, a worldwide will is appropriate. However, like with unit trusts and shares, having a separate will may help with the administration process.

Get advice from your relationship manager on the need for a separate will

These considerations should highlight the importance of telling your relationship manager if you have international assets to determine whether you need a separate will. It is equally important to tell your relationship manager if you already have a foreign will – if you fail to mention this, a later will may accidentally revoke your initial foreign will.

The detailed wording of your separate will is crucial

It is important to carefully consider the country/jurisdiction in which your assets are registered. For example, the Republic of Ireland, Isle of Man, Jersey and Guernsey are separate jurisdictions from the UK. If you own assets there and want a separate will, make sure that it is worded appropriately and does not refer to your 'UK assets'.

There are other alternatives to a foreign will, depending on the nature of your assets

If you would prefer to avoid the need for a foreign will and probate altogether then, depending on the nature of the assets and the associated tax consequences, the following may be viable alternatives:

- transferring ownership of your international assets to an international trust during your lifetime; and/or
- holding your international investable assets through an international endowment such as the Old Mutual International Investment Portfolio Plus.

Please contact your relationship manager if you wish to discuss anything further or if you would like to arrange a meeting with a fiduciary specialist.

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