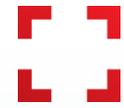


momentum

investments

# Fiduciary Services

## Presentation to FISA (KZN)



Jeffrey Wiseman

15 March 2013



# Contents

- Introduction
- Buy-and-sell insurance
- Company-owned policies:
  - Contingent liability cover
  - Key person cover
- Conclusion





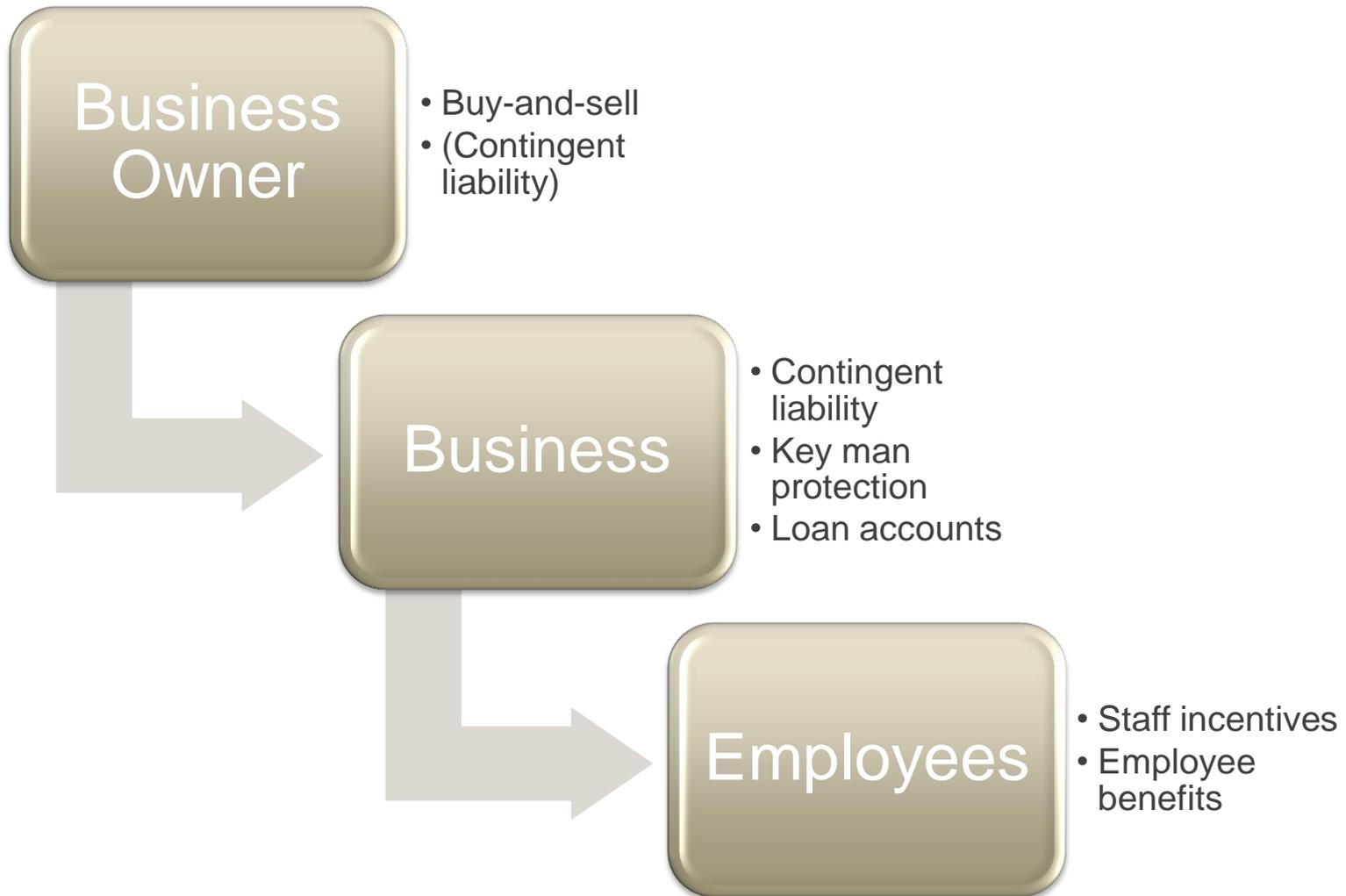
# Introduction

# Introduction



- Rising unemployment:
  - Entrepreneurs create jobs, but what about the risk
- Estate planning very important for business owners:
  - Structuring – trusts to protect assets
  - The role of insurance:
    - Business continuity
    - Buy-and-sell
    - Key man
  - Provides peace of mind to the business owner, the business and the employees
- Focus on insurance

# Financial planning for businesses





## Buy-and-sell Insurance

# Typical buy-and-sell Structure



- Obligation to buy and sell the business interest
  - How is “interest” defined?

“Interest” means a Business Owner’s “shareholding” in the Business including any loan account as at the Sale Date;

- Firm obligation created between the parties:

On death, the SELLER shall sell and the BUYER shall buy ...

- What is meant by “death”?
- Disability benefits yes, but why critical illness?

# Typical Buy-and-sell Structure



- Purchase price and payment
  - Purchase price must be clearly determinable – risks of fixing:

The purchase price for the Seller's Interest shall be the greater of:

- The net proceeds (after providing for the payment of any taxes, duties, levies and/or interest) of the Polices together with the proceeds of the total capitalized amount in the fund referred to in clause ..., if any, or
- An amount determined by the Auditor and/or Business Owners under and pursuant to the provisions set out in clause ... of this agreement.

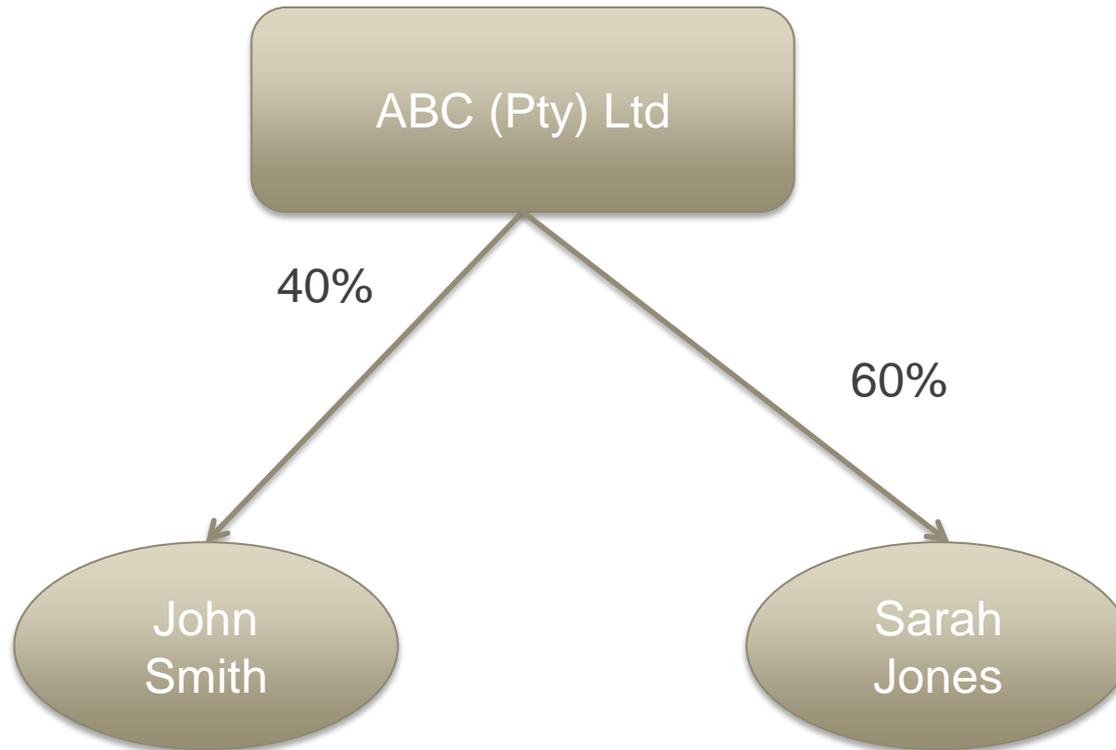
- Section 58(1) of the Income Tax Act:
  - Disposal of assets below market value may result in a deemed donation

# Buy-and-sell: the estate duty position

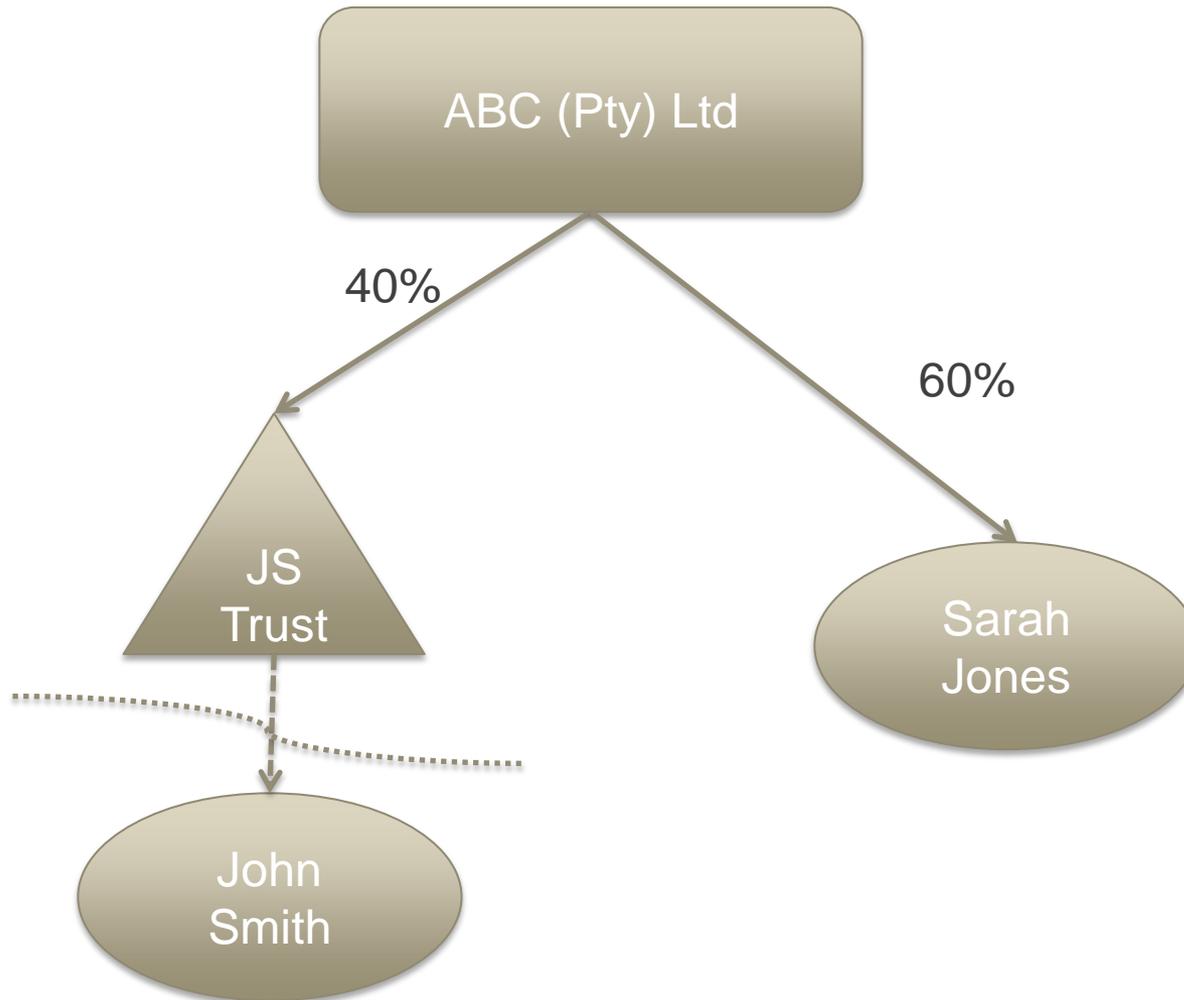


- To qualify for exemption in terms of section 3(3)(iA), SARS must be satisfied that the policies:
  - Were taken out or acquired by a person who on the date of death of the deceased was a partner of the deceased, or held any shares or any like interest in a company in which the deceased was a co-shareholder at the date of death;
  - Were taken out or acquired by the partner or co-shareholder for the purpose of enabling him to acquire the whole or a part of:
    - the deceased's interest in the partnership; or
    - the deceased's interest in the company and any claim by him against the company; and
  - No premium on the policy was paid or borne by the deceased
- What about trusts?
  - Rationale?

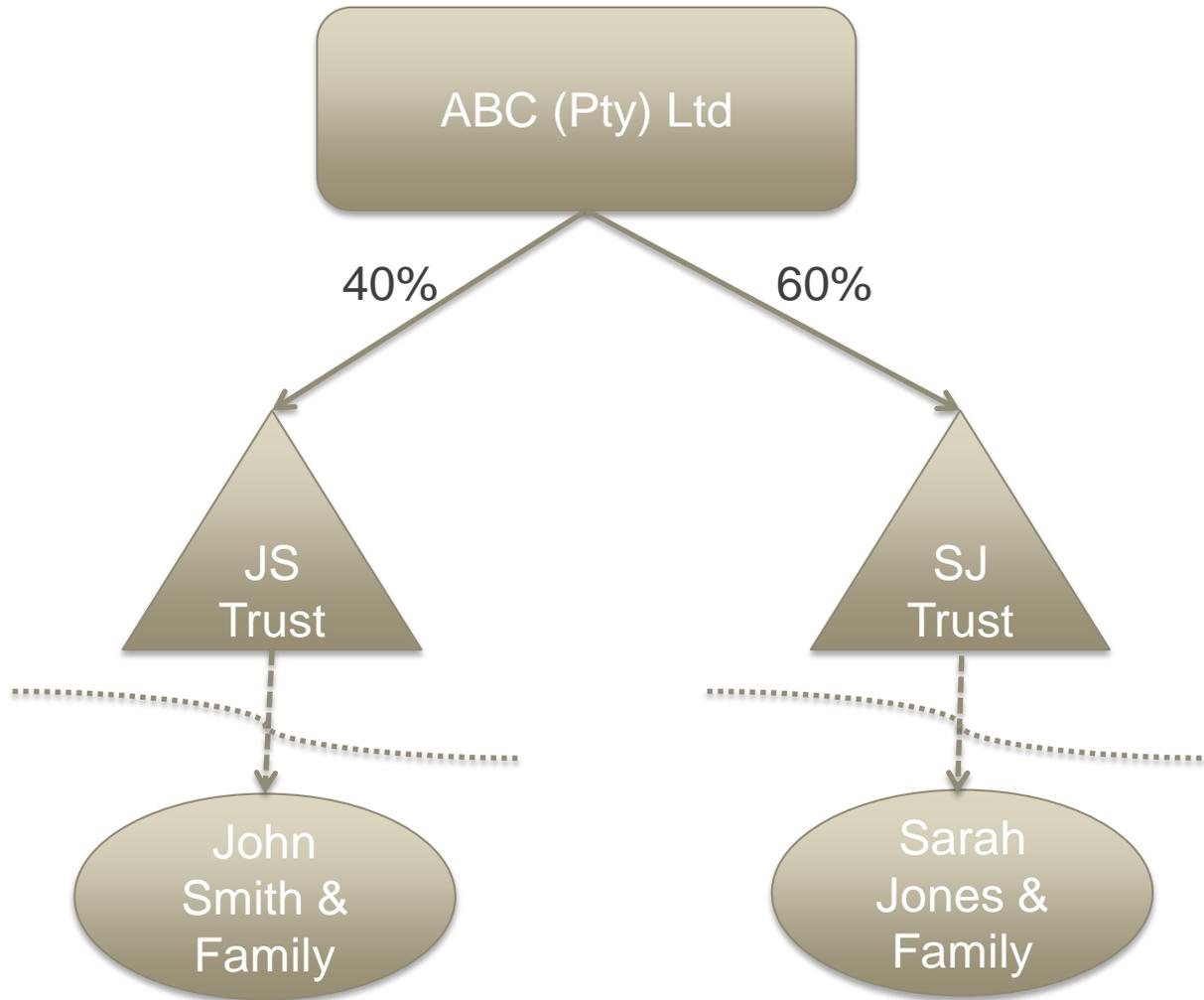
# Buy-and-sell Insurance



# Buy-and-sell Insurance



# Buy-and-sell Insurance



# Share buy-backs

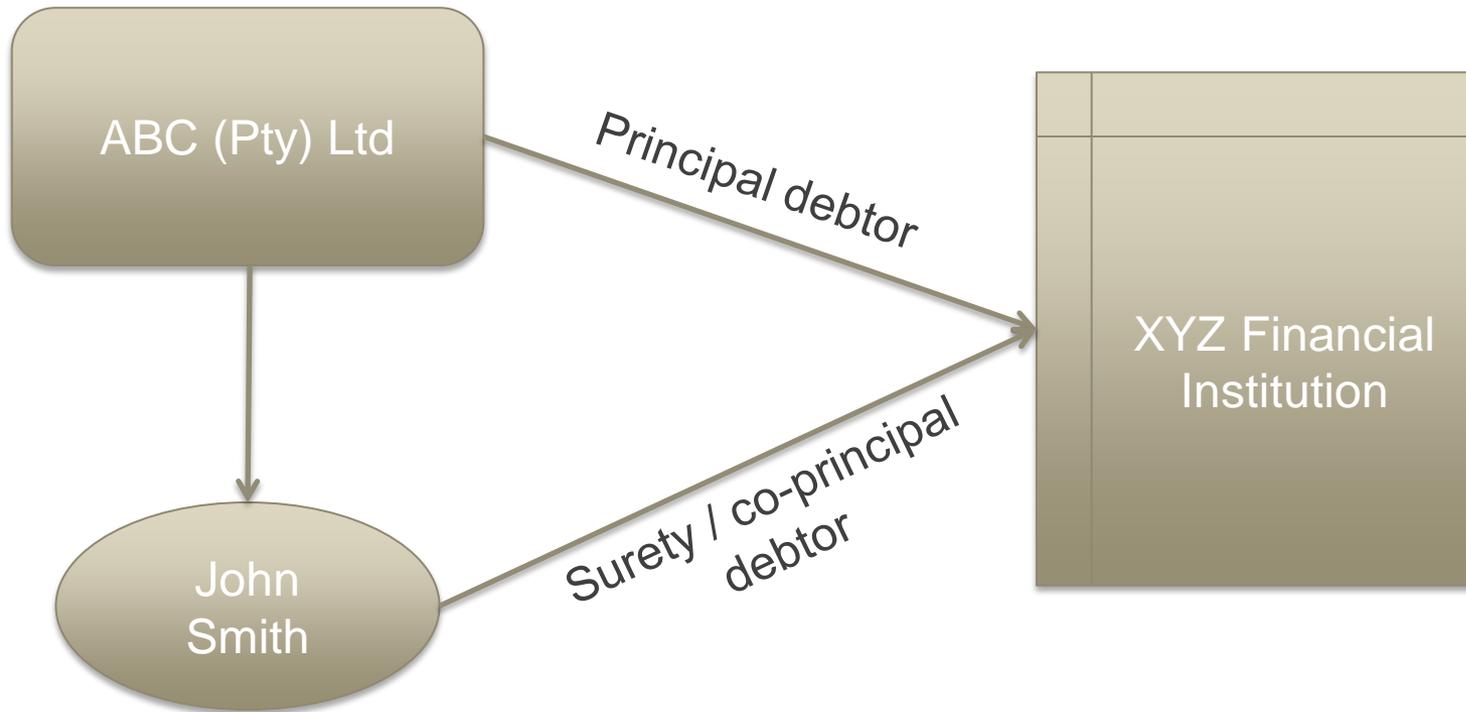


- Why?
  - Because it's allowed...
  - Avoid unequal life insurance premiums
- But, not so efficient:
  - Companies Act (section 48):
    - solvency and liquidity test at the time of the transaction creates uncertainty
    - special resolution if more than 5% of issued share capital
  - Tax, tax and more tax...
    - Income tax – structure as non-conforming
    - Estate Duty (section 3(3)(a)(ii) – will benefit the family of the deceased
    - DWT (dividend) / CGT (return of capital)
- Company can't buy back all of its shares

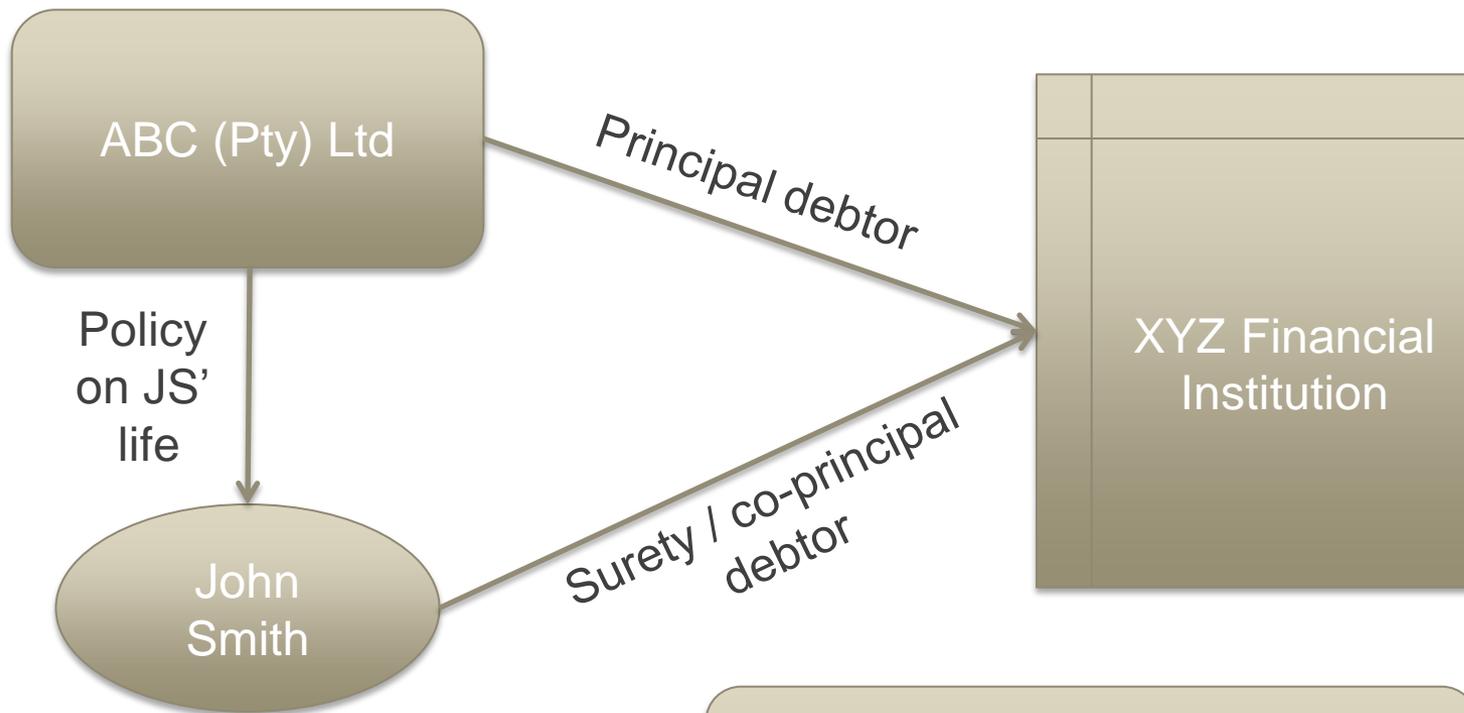


## Contingent liability / Key man cover

# Contingent liability



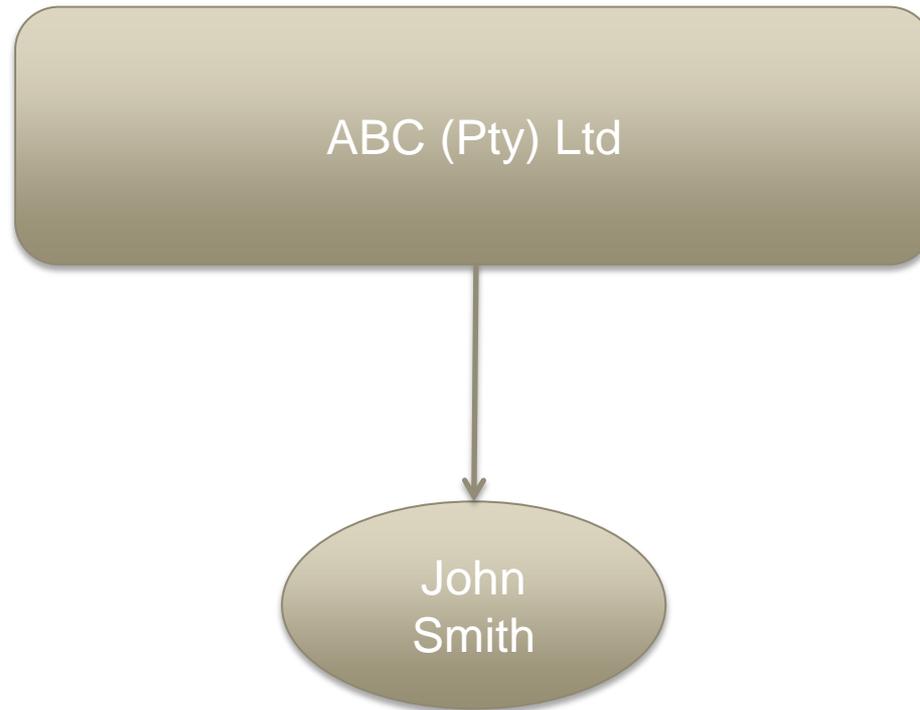
# Contingent liability



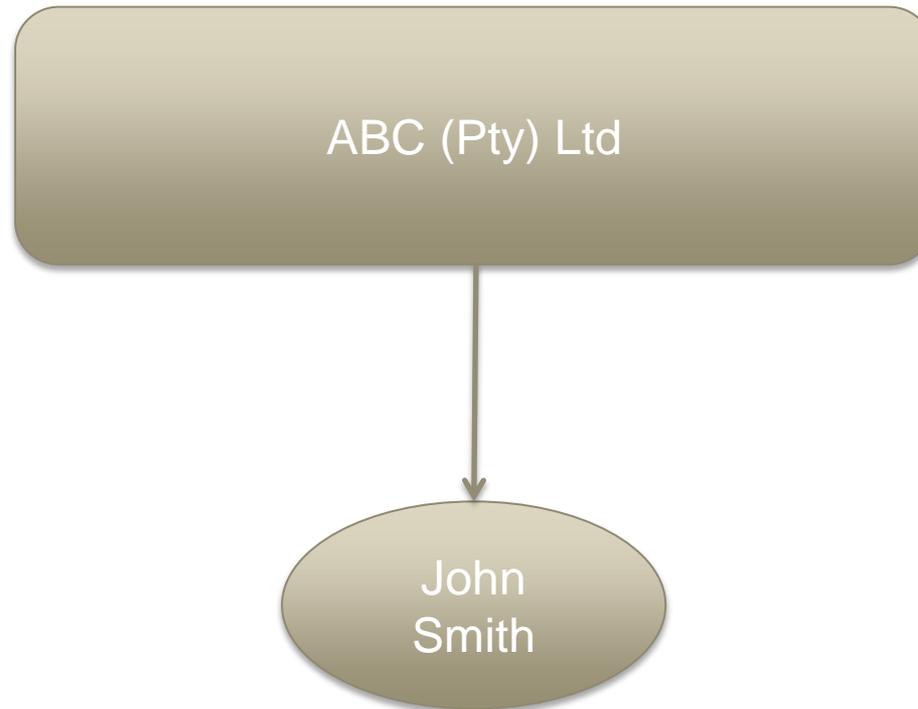
- Employer takes out policy on JS' life and cedes to XYZ
- Non-conforming

# Key man cover

m



# Key man cover



Cost of replacement – capital and revenue expenditure

# Contingent liability / key man | tax position



- The new section 11(w)
  - Section 11(w)(i): policies provided as a fringe benefit (unapproved group life cover)
  - Section 11(w)(ii) requirements:
    - Policy taken out by employer to insure employee against death, disability and/or severe illness
    - Policy must be pure risk policy – no cash value
    - Taxpayer must be owner at time of payment of premiums
    - Policy must state that section 11(w)(ii) applies to it
- New provision much simpler, but took a while to get here!
- Applies to Key Man only

# Company policy comparison



<b>Company Owned Policies – Taxation Laws Amendment Act 2011</b>					
	<b>Unapproved Group Life</b>	<b>Income Protection Insurance</b>	<b>Key-Person Insurance</b>	<b>Deferred Compensation</b>	<b>Capital Protection Plans *</b>
<b>Premiums Paid on Policy – Pre – 1 March 2012</b>					
<b>Employer</b>	Tax deductible under section 11(a) if incl. in gross income of employee	Tax deduction under section 11(a) as part of salary expense and included in gross income of employee	Policyholder could elect whether the policy was conforming or not. Conforming policy's premiums are tax deductible	Policy is conforming therefore premium is tax deductible	Policyholder could elect whether the policy was conforming or not. Conforming policy's premiums are tax deductible
<b>Employee</b>	Included in gross income and no associated tax deduction	Included in gross income with no deduction (as the employee did not pay the premium)	No inclusion in gross income	No inclusion in gross income	No inclusion
<b>Premiums Paid on Policy – Post – 1 March 2012</b>					
<b>Employer</b>	Tax deductible under section 11(w)(i)	Tax deductible under section 11(w)(i)	Tax deductible under section 11(w)(ii) if policyholder 'opted in'	Tax deduction under section 11(w)(i)	Not tax deductible as it is for capital protection and not against a loss
<b>Employee</b>	Included in gross income as a fringe benefit under par 2(k) of Seventh Schedule	Included in gross income as a fringe benefit under par 2(k) of Seventh Schedule and the employee is entitled to a deduction	No inclusion in gross income	Included in gross income as a fringe benefit under par 2(k) of Seventh Schedule	No inclusion in gross income

\* Capital Protection Plan refers to contingent liability, loan account protection and share buy-back policies

Source: Momentum Myriad

# Contingent liability / key man | estate duty position m

- To qualify for the estate duty exemption in terms of section 3(3)(a)(ii), the policy must:
  - Not have been effected by or at the instance of the deceased;
  - No premium on the policy paid or borne by the deceased;
  - No amount paid into the estate of the deceased; and
  - No amount paid to any relative of the deceased or any person who was wholly or partially dependent for his maintenance upon the deceased, or any company which was at any time a family company in relation to the deceased.
- Family Company:
  - company ... which at any relevant time was controlled or capable of being controlled directly or indirectly, whether through a majority of the shares thereof or any other interest therein or in any other manner whatsoever, by the deceased or by the deceased and one or more of his relatives;
- Family trust:
  - Unlikely ever to qualify for the exemption, since no relative or dependent of the deceased is permitted to benefit.

## A few points ...



- Sections 3(3)(a)(iA) and 3(3)(a)(ii) exclude policies from the estate duty net:
  - Must be disclosed on Estate Duty Return
  - SARS also indicated that they are informed whenever R500,000 paid out
- Trusts a vital part of planning in this market – policy should be to level the playing field, not tax punitively
- Benefits to employees from implementing these plans:
  - Clear succession – likely to remain employed
  - Business settles debts efficiently- no calling up of outstanding debt
  - Funds to carry the business through a difficult transition period



## Conclusion

# Conclusion



- Estate planning essential to business owners / entrepreneurs:
  - Trusts by far the most suitable; surely the structure offers benefits to small business as well...
  - The sooner business owners start, the better to avoid a high CGT bill
- Many benefits of insurance planning:
  - Allows business owner to extract fair market value for his share in the business at death
  - Succession isn't only a buy-and-sell: who is going to take over?
  - Security for employees – often overlooked, but so important in South Africa



Questions?

Thank you

