Wealth under the spotlight

With the gap between rich and poor widening in South Africa, it is inevitable that the tax net will be adjusted to gather in more of the resources of the wealthy, says Ronel Williams.

ACROSS THE WORLD, research has shown that inequality is a cause of economic and social problems, and South Africa is notoriously one of the most unequal societies in the world. So it is no surprise that attempts to address income inequality focus on the wealthy, and National Treasury has identified two areas in which it believes South Africa significantly under-performs: the collection of estate duty and donations tax.

Discretionary trusts are regularly used for estate planning, because they allow wealthy individuals to "freeze" their estates during their lifetime by selling their growth assets to a trust. The assets are replaced in the estate of the founder of the trust by a loan account, while all future growth happens in the trust. Beneficiaries are not entitled to the assets or income while they are in the trust, so generally speaking, a beneficiary's creditors cannot attach the trust assets in the event of insolvency, and the trust assets do not form part of his or her estate upon death. These benefits have led to a perception that wealthy individuals establish trusts to evade their tax obligations, so there has been increased scrutiny of trusts in recent years.

For a long time, too, there have been concerns around the world about wealthy individuals who have assets in countries other than their countries of residence and who fail to disclose such assets to the tax authorities.

Now changes are proposed or in progress that will affect discretionary trusts and the disclosure of assets in other countries.

The Davis Tax Committee

THE COMMITTEE WAS ESTABLISHED IN 2015 AND tasked with exploring alternative ways to bring about a more progressive and equitable tax system. It issued a First Interim Report on Estate Duty in 2015 and, after taking into account submissions from the public, a Second Interim Report on Estate Duty in August 2016. The following recommendations relate to trusts and estate planning:

- The attribution rules in section seven of the Income Tax Act should be removed to the extent that they relate to trusts. These rules provide that, where a person makes a loan to a trust and charges interest at less than the official rate (eight percent in December 2016), and the income or gains generated by the trust are not distributed to the beneficiaries, the South African Revenue Service (SARS) attributes a certain portion of the income and capital gains to the lender and taxes him or her accordingly. This can provide some opportunity for tax planning if the lender is on a tax rate lower than that of the trust. Trusts are taxed at the flat rate of 41 percent. (Special trusts, created for the protection of people with disabilities or minor children, are taxed on a sliding scale of 18 to 41 percent, as a natural person would be.)
- The conduit principle in section 25B of the Income Tax Act should be removed. This principle enables income and capital gains generated by a trust to be distributed to the income and/or capital beneficiaries and taxed in their hands. If this principle were removed, the distribution would be taxed at the trust's rate of 41 percent, rather than at the (possibly lower) tax rate of the beneficiaries.
- The inter-spousal abatement in the Estate Duty Act (a total of R7 million on the combined estate) should be withdrawn. In terms of the abatement, the value of assets accruing to a spouse is treated as a deduction for estate duty.
- The primary estate duty abatement (R3.5 million) should be increased to R15 million per taxpayer, irrespective of his or her marital status.
- The estate duty rate should be increased from 20 percent to 25 percent of the dutiable value of an estate exceeding R30 million.
- The capital gains tax (CGT) rollover provisions for inter-spousal bequests (whereby CGT is deferred to such time as the spouse disposes of the asset) should be repealed and replaced with a death exemption of R1 million that applies to all taxpayers. The current exemption on death is R300 000.
- The inter-spousal donations tax exemption should be removed, except if >>

>> the donation is applied for the reasonable maintenance of the taxpayer and his or her family.

- Section 3(3)(d) of the Estate Duty Act should be enhanced to include trust assets where a person made an interest-free or low-interest loan to the trust. This section provides that certain assets not owned by a person shall be included in his or her estate for estate duty purposes if he or she was deemed to have control over those assets.

The proposals relating to trusts are harsh, but should not be viewed in isolation, because trusts should never be established purely to obtain a tax benefit. The asset-protection benefits of family trusts remain relevant, and trusts will continue to play an important role in overall estate planning.

It should be noted that the Davis Tax Committee's proposals are just that and you should not make any rash decisions until there is certainty about their implementation.

Interest-free loans to trusts

THE DRAFT TAXATION LAWS AMENDMENT BILL of 2016 proposes to introduce a new section 7C of the Income Tax Act. This section is scheduled to come into operation on March 1, 2017 and applies to any amount owed by a trust in respect of a loan, advance or credit provided to the trust by a natural person before, on, or after that date.

The section provides that, where interest on such a loan, advance or credit is charged at a rate lower than the official rate of interest (eight percent), an amount equal to the difference between the amount that was charged and the amount that would have been charged using the official interest rate will be treated as a donation made to the trust, on the last day of the year of assessment, by the person who made the loan to the trust. Donations tax will be levied on the amount at a rate of 20 percent. There are certain exemptions where this section will not apply.

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This section will typically apply to loans where a person sells an asset (a property, for example) to a trust on an interest-free loan, or charges interest on the loan at a rate lower than the official rate. It will also apply where the trustees of a trust make a distribution to the trust's beneficiaries and the beneficiaries lend the money back to the trust.

If the person who made the loan makes no other donations during the tax year, the annual donations tax exemption of R100 000 will be applied against the deemed donation to determine the amount of donations tax payable. Alternatively, the person can donate R100 000 to the trust to reduce the value of the outstanding loan.

Note that, at the time of writing (December 2016), the Draft Taxation Laws Amendment Bill had not been promulgated into law.

International information sharing

THE ORGANISATION FOR ECONOMIC Co-operation and Development has implemented the Common Reporting Standard (CRS) to facilitate and standardise the exchange of information on residents' assets and income, primarily for tax purposes, among jurisdictions around the world. It is a global reporting standard for the sharing of information on financial accounts and investments, among the local authorities of the different member countries that are parties to the agreement. By March 2, 2016, 96 countries (including South Africa) had committed to implementing the CRS to comply with the automatic exchange of information to address tax evasion.

In essence, the programme requires financial services providers to collect information about their account-holders and provide it to SARS. SARS will process information relevant to South African-resident taxpayers and will share information on account-holders who are resident in other signatory countries with the tax authorities of those countries. In turn, SARS will receive information about South African tax residents who hold accounts outside South Africa.

Fifty-five of the signatory countries (including, but not limited to, South Africa, Isle of Man, Guernsey, Jersey and the United Kingdom) have already entered a reporting and information-sharing period, which started on March 1, 2015, with the aim of automatically exchanging information by September 2017 and annually thereafter. A further 41 signatory countries will proceed with reporting by September 2018.

National Treasury has warned that, with these new global standards for the automatic exchange of information, "time is running out for taxpayers who still have undisclosed assets abroad". There is currently a Special Voluntary Disclosure Programme (SVDP) to provide non-compliant taxpayers with a final opportunity voluntarily to disclose offshore assets and income held on February 29, 2016 before the automatic exchange of information comes into operation. For more information on the SVDP, see **page 40**.

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