



FISA®

International succession into the future

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 Lester
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Introduction

International succession into the future

Increased mobility of people

- **The conflict of laws** – connecting factors that link people to legal systems. The rise of “habitual residence” .

Increased diversification of investments

- **Situs of assets** – where are our assets located? Popularity of passive investing – where are exchange traded funds situated?

Political upheaval?

- **Brexit** – will the United Kingdom remain an attractive place to invest in the future? I will look at some of the favourable UK inheritance tax rules for non-domiciled investors.

Conflict of laws

Private international law – connecting factors

- Principles that connect us to foreign legal systems – known as “connecting factors” .
- Every legal system throughout the world applies different connecting factors to decide which law should apply to a particular situation.
- Some countries use “nationality” as the connecting factor. Some use varying forms of “last residence” or “habitual residence” and others use the concepts of “domicile” and “lex situs” .

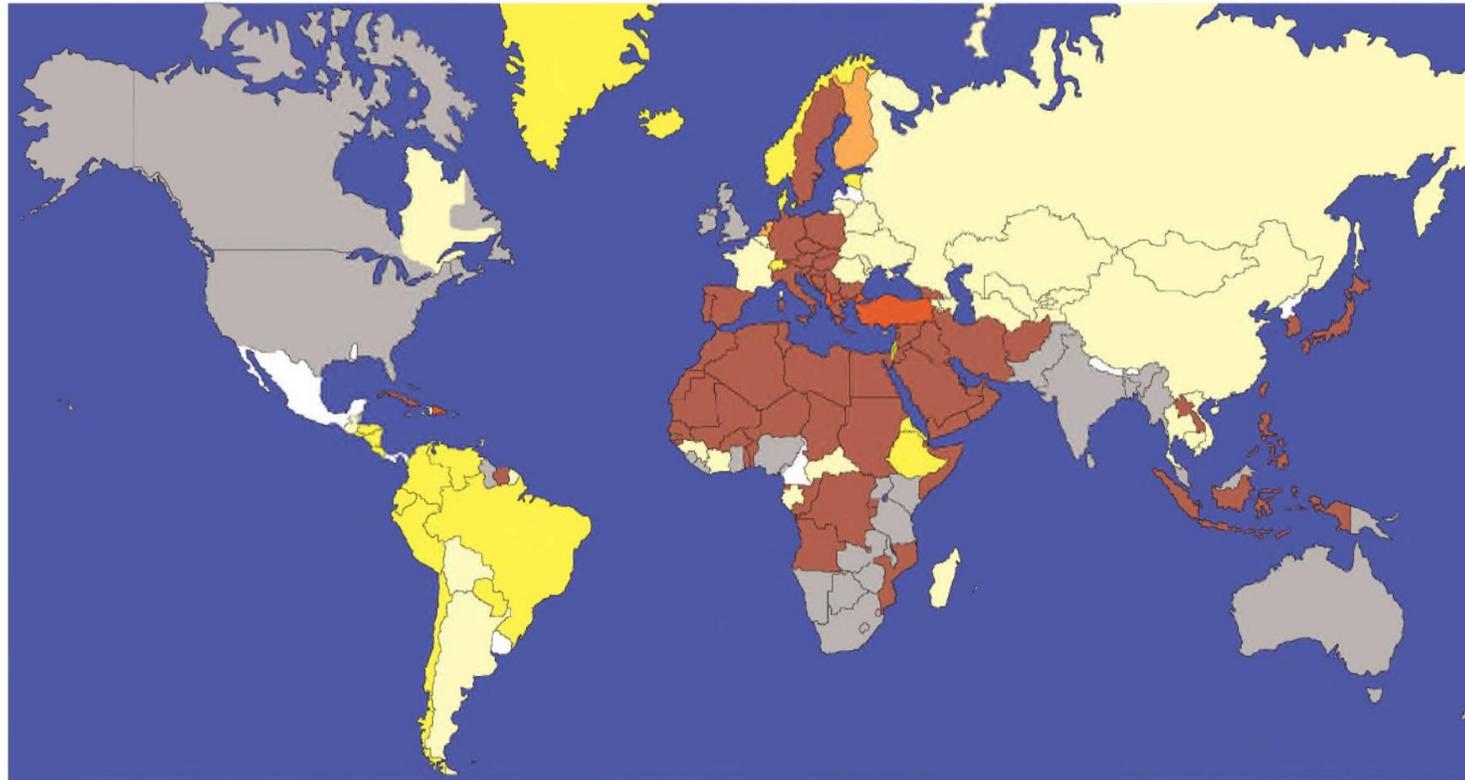


Why are connecting factors important?

- **What law will apply?** Establishing which law will apply to the succession of those assets;
- **Second Will/ offshore Will?** Analysing whether one Will or a separate Will should be prepared to govern the succession of a foreign asset;
- **Foreign estate tax?** Determining whether a foreign estate tax will be applied.

Conflict of laws

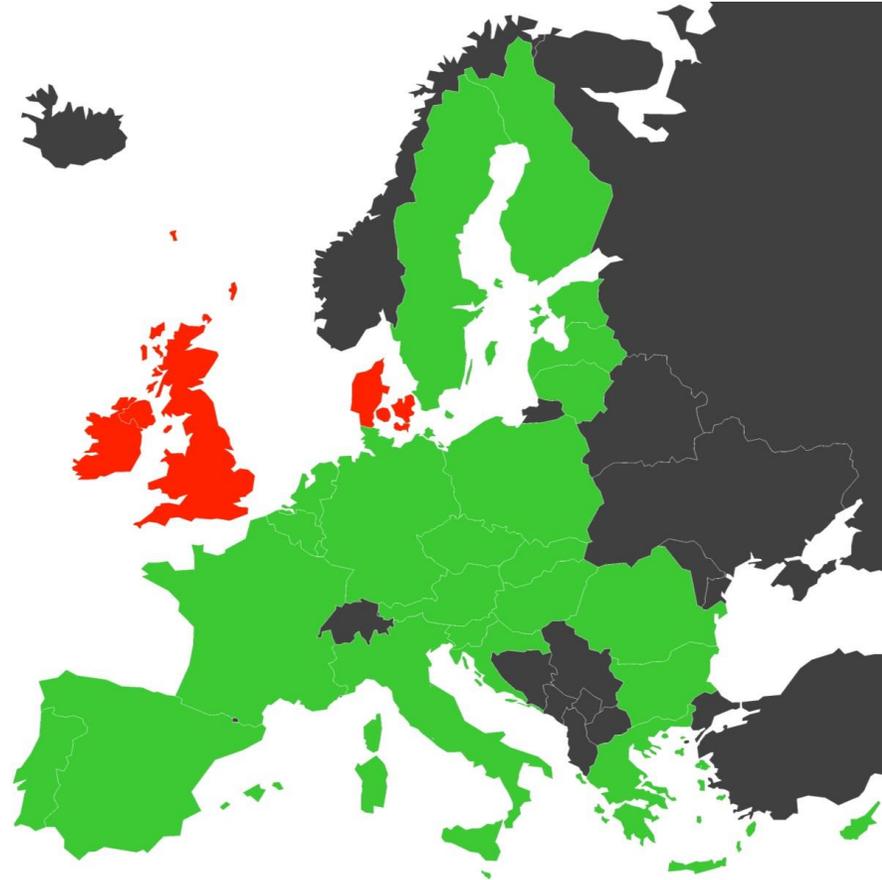
Conflict of laws in successions (prior to the EU Succession Regulation)



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| <ul style="list-style-type: none"> Deceased's Nationality/
Nationalité du défunt Scission: Deceased's Nationality for Movables + Lex rei sitae for Immovables/Scission : Nationalité du défunt pour les meubles + lex rei sitae pour les immeubles Last Residence, if more than 5 years, otherwise nationality/
Dernière Résidence, si plus de 5 ans; sinon nationalité | <ul style="list-style-type: none"> Deceased's Last Residence/
Dernière Résidence du défunt Scission: Deceased's Last Residence for Movables + Lex rei sitae for Immovables (French system)/
Scission : Dernière Résidence du défunt pour les meubles + lex rei sitae pour les immeubles (système français) | <ul style="list-style-type: none"> Common Law = lex rei sitae for immovables, (common law) "domicile" for movables/
Common Law = lex rei sitae pour les immeubles, "domicile" (au sens de la common law) pour les meubles Lex rei sitae also for movables or Lex fori or unknown /
Lex rei sitae aussi pour les meubles ou Lex fori ou inconnu |
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The European Succession Regulation

The Green Area – European countries that will apply “habitual residence”



The development of “habitual residence”

- Connecting factors should lead to the law that is most appropriate for governing and controlling personal transactions of an individual.
- The difficulty with the concepts of “domicile” and “nationality” is that they can lead to unpredictable and inappropriate laws or jurisdictions.
- Habitual residence as a concept was developed by the Hague Conference on Private International Law.
- **Europe - clarity on which law will apply – habitual residence**
- For EU member states that have adopted the Regulation, the new rules are an attempt to provide clarity on which laws will apply to the succession of assets located in these member states. If there is no election, the default connecting factor is habitual residence.

Habitual Residence

- Estate of the late Jean-Philippe Smet (Johnny Hallyday)



The estate of Johnny Hallyday

- Mr Hallyday passed away in December 2017 – in Paris – a French national – leaving a wife (Laeticia), two natural children (David and Laura) and two adopted children (Jade and Joy);
- The estate comprises assets located in France, California and the Caribbean island of St Barts.
- In 2014, Mr Hallyday made a Will in California, which names Laeticia, Jade and Joy as beneficiaries.
- David and Laura were not included in the Will.
- David and Laura have made steps to contest the Will on the basis that the provisions in the Will are contrary to French succession law.

The estate of Johnny Hallyday

- David and Laura secured a court order in France to freeze the assets located in France and St Barts.
- The next stage of the proceedings is to see where Mr Hallyday was “habitually resident” when he passed away.
- If it is decided that Mr Hallyday passed away habitually resident in France, the children will each be entitled to claim 18.75% of the estate.
- What is “habitual residence” ?
- Not defined in the Regulation, but the preamble outlines that, “...The habitual residence should reveal a close and stable connection with the State concerned taking into account the specific aims of this Regulation”.

Habitual residence under EU law

- European Court of Justice has provided the meaning of habitual residence as:
- “the place where the person had established, on a fixed basis, his permanent or habitual centre of interests, with all the relevant facts being taken into account for the purpose of determining such residence”
- One cannot be habitually resident in more than one country at the same time.
- The test involves ascertaining the “centre of interests” .
- Where was the late Johnny Hallyday’ s centre of interest when he passed away? The State of California or France?



Habitual residence – State of California

- **Time** - over the last three years of his life - approximately half the year spent in California;
- **Family** - wife and two adopted children based in California;
- **Property** – assets held in California;
- Will made in California – declared that he was a resident of Los Angeles;
- Moved away from France - upset with France for imposing high taxes on wealthy individuals.



Habitual residence – France

- **Time** - over the last three years of his life - approximately half the year spent in France;
- **Property** – assets held in France and Saint Barts;
- French national - born in France and died in France;
- Performed concerts in major venues in France until the end of his life;
- French icon - seen as a “national monument” in France.



The Nanterre Court in Paris has ruled

Where was the habitual residence?

- The French court placed emphasis on the following aspects:
- Evidence submitted via the deceased's Instagram account – to show the deceased's ties to France in the years preceding his death.
- Nationality of the deceased.



How does this affect practitioners in SA?

Two key takeaway points for practitioners in SA

- For practitioners in SA with clients who own assets in one or more member states, the following should be considered:
 - **Choice of law**
 - If your clients are South African nationals, analyse if an express choice of law should be inserted in the Will;
- **Will structuring**
- Analyse if one or more Wills are suitable for your client's circumstances.



Situs of assets

The importance of determining where assets are situated

- Identifying where an asset is situated – important to determine which law will apply and whether a foreign estate tax may apply.
- Example – United Kingdom – does not include Jersey, Guernsey or the Isle of Man;
- Example – shares and investments – are they requested in the UK or the USA – if so, UK inheritance tax or US estate tax may apply.



Passive investing

The rise of exchange traded funds, index funds and tracker funds

- **Replicating market success** - can star fund managers continually generate returns in excess of the market year after year? Many people consider that it is difficult to outperform the stock market consistently.
- **Significantly reduced charges** - even if a fund manager beats the market, will the management charges negate the growth that has been achieved?



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Exchange Traded Funds

What are ETFs?

- **Funds that issue shares** - traded on a stock exchange - ETFs can be traded at any time when the exchange that it is listed on is open.
- **Passive investment** – many ETFs follow the performance of a market index, such as the FTSE 100 or the S&P 500.
- **Reduced costs** - passively tracking an index is less expensive than active fund management.
- **Diversification** - ETFs provide instant access to international markets or commodities.



Exchange Traded Funds

Where are they located for UK inheritance tax purposes?

- **Exchange or issuer location?** Is the situs of an ETF where the exchange is located or where the issuer of the ETF is resident?
- In the UK – the general principle is that ETFs are located where the issuer is resident or domiciled.
- When analysing the position for ETFs – the residence or domicile of the company offering the ETF will have to be examined closely – this will have implications for succession and tax purposes.
- **USA** - Is your ETF domiciled in the USA? If so, caution, is US estate tax applicable?
- **Republic of Ireland** – Is Capital Acquisitions Tax applicable?

Asset Swaps

Where are asset swap investments located for tax purposes?

- Due to restrictive Foreign Investment Allowances, some South African investors will use asset swaps to diversify and achieve offshore investment exposure.
- Some investment houses will use their ability to invest offshore on behalf of their clients.
- Depending on the asset swap arrangement, is the investment segregated and specifically reported to the client?
- Is it correct to say that the investment house does not have the ultimate beneficial ownership in the offshore investment that was achieved through the asset swap? If so, do we agree that this is akin to a nominee arrangement?



The United Kingdom

- Brexit? Will it happen?
- Does the UK remain a good place to invest?
- Non-domiciled investors - overview of advantages from an inheritance tax perspective.

UK



Key UK inheritance tax (IHT) principles

- UK domiciled individuals are liable to IHT on their worldwide property.
- “Domicile” can either be the English common law meaning or the artificial “deemed” or fiscal domicile imposed by tax legislation.
- Those who are non-UK domiciled are only liable on the property which is situated in the UK. For SA domiciled individuals, this is also modified by the double-taxation convention between SA and the UK.
- IHT is currently charged at two rates: £0 - £325,000 is charged at 0% (“the nil-rate band”). The amount above £325,000 is charged at 40%.
- For a married couple (or civil partnership), the nil-rate band can potentially be transferred to the survivor – doubling the nil-rate band for the survivor to £650,000.
- Unlimited spouse exemption if both the married couple are domiciled outside of the

Investments excluded from UK IHT

- **UK bank account** – is excluded property if it is denominated in a foreign currency and the account holder is an individual who is not resident or domiciled in the UK.
- Sterling/ GBP accounts held in the UK may be excluded from UK IHT under the double taxation convention between SA and the UK.
- GBP funds held in a bank registered outside of the UK = excluded property.
- **UK government securities** – subject to a number of conditions, may be excluded property.

The Double Taxation Convention (DTC)

Between SA and the UK (SI 1979 No 576)

- Shares
- Under the DTC, shares are to be taxed on the basis of locality.
- Shares listed and registered in the UK would be subject to assessment in the UK - if the value is above the taxable threshold.
- **Alternative Investment Market (AIM)** - AIM listed shares may qualify for business property relief – if they have been held for over two years and meet a number of qualifying criteria.

Excluded Property – non-domiciled estates

- **Excluded property** - there are several types of asset which, if specific conditions are satisfied, are classed as excluded property and not subject to UK IHT.
- **Authorised funds** – a holding in an authorised unit trust or a share in an open-ended investment company is excluded if the owner is not domiciled in the UK.
- **Authorised unit trust** – is a unit trust scheme approved under section 243 of the Financial Services and Markets Act 2000.
- **Open-ended investment company (OEIC)** – has the meaning given in section 236 of the Financial Services and Markets Act 2000.
- **Foreign situs assets** – property which is situated outside of the UK is excluded property if the beneficial owner is not domiciled in the UK. However, non-doms are unable to escape IHT on UK residential property owned through the use of structures that include offshore companies, partnerships or trusts.

The new “Residence Nil-Rate Band”

- RNRB will be available when, on an individual’s death, all or part of their home passes to a direct descendant.
- **Downsizing provisions** - If at the time that the individual passes away, they did not have an interest in a property sufficient to use the allowance in full, they can possibly include the value of a home that they previously owned – provided that was at some time after 8 July 2015.
- The new RNRB is available on deaths after 5 April 2017 and has been phased in as follows:

£100,000 in 2017/ 2018

£125,000 in 2018/ 2019

£150,000 in 2019/ 2020

£175,000 in 2020/ 2021

The new “Residence Nil-Rate Band”

Key rules

- **“Brought forward allowance”** - widows and widowers will be able to claim an extra allowance if it was not used on their spouse’s earlier death.
- **“Closely inherited”** - only homes given to “lineal descendants” , are eligible for the new allowance. The expression has an extended meaning – relief is extended to gifts to spouses, widows and widowers of “lineal descendants” .
- **“Qualifying residential interest”** - only one home can be counted. The property does not have to be the individual’s home when they die, but it must have been their home at a time when they owned all or part of it and does not need to be a main home.
- **“Taper threshold” - loss of RNRB in larger estates** - the allowance is restricted and may be lost altogether for those whose assets are worth more than £2 million when they die. £1 of relief is lost for every £2 that exceeds the £2 million.

The new “Residence Nil-Rate Band”

An example of how these new rules may work for a married SA couple



The new “Residence Nil-Rate Band”

An example of how these new rules may work for a married SA couple

- Harry and Meghan are a SA married couple, both domiciled in SA with one child.
- During their careers, Harry and Meghan had spent time working in London, where they had purchased a property.
- The London property is currently valued at £950,000 without a bond/ mortgage and is Harry and Meghan’s only asset situated in the UK.
- If both Harry and Meghan were to pass away now (Harry first) leaving the UK property to their child, there would be no exposure to UK inheritance tax.

The new “Residence Nil-Rate Band”

An example of how these new rules may work for a married SA couple

- Harry and Meghan’s estates would benefit from the following:

Meghan’s NRB: £325,000

Harry’s TNRB: £325,000

Meghan’s RNRB: £150,000

Harry’s RNRB: £150,000

Total IHT allowance: £950,000

- In this case, there will be no IHT when Harry passes away as there will be an unlimited spouse exemption;
- In addition, there will no IHT when Meghan passes away as her executors will be able to utilise both the transferrable nil-rate band (“TNRB”) and Harry’s unused residence nil-rate band (“RNRB”).

United Kingdom – The Future

The future for South African investment into the UK

- Hopefully, the United Kingdom will remain an attractive destination for South Africans to invest in businesses, commercial and residential property, authorised unit trusts, open-ended investment companies, shares in public limited companies, bonds and cash accounts – to name a few examples.
- Let' s hope our Members of Parliament can bring some certainty and stability to our political landscape.



If I had time...

...what additional topics would I have discussed?

- **US Estate Tax** - the threshold (estate tax exemption amount) for a non-resident alien is set dangerously low at only \$60,000 with a top estate tax rate set at 40%. The SA and US double-taxation convention operates so that the US will have the privilege of taxing stocks in companies that are registered in the US.
- **Mental Capacity** – planning for incapacity where assets are held in a foreign jurisdiction.
- **Digital Assets** – effective estate planning techniques for digital assets.
- **Will Structuring** – one Will, two Wills or more.



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Oliver is an English solicitor specialising in the administration of cross-border estates and estate planning for individuals with assets in multiple jurisdictions. To complement his specialism, Oliver is a practising notary public and a member of the Fiduciary Institute of Southern Africa.