# TRUSTS Tax Efficient Investing

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# **TRUSTS** Tax Efficient Investing

## Introduction

- Taxation of Trusts – the basics
- Financial Planning for Trusts
    - Powers in the Trust Deed
    - Beneficiaries and their needs
    - Mandate
- Structures
- Funds
- Offshore Investing

# **TRUSTS** Tax Efficient Investing

## Taxation of Trusts: the basics

- Definition of Trust in ITA: very broad and includes *inter vivos* and testamentary trusts; also foreign trusts
- Trusts also included in definition of “person” in ITA
- Income tax: 45% flat rate
- Capital gains: 80% inclusion rate resulting in 36% effective rate
- No allowances or rebates
- Conduit principle created by case law: income allocated to beneficiaries during the same tax year retains its nature
- Sec 25B & par 80: determines who will be taxed on trust income and capital gains
  - Effectively codifies the conduit principle
- Section 7: tax-back provisions/attribution rules
  - Application of section 25B is subject to application of section 7

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## Financial Planning for Trusts

- Trustees' powers
  - Trust Deed
  - Trust Property Control Act

- Beneficiaries and their needs
  - Minor beneficiaries
  - Retired beneficiaries
  - Where do they live?
  - Income vs Capital beneficiaries
  - Settlor's wishes

- Investment Mandate
  - Investment objective
  - Time horizon
  - Risk profile

## Structures

- Policy Wrappers
  - Governed by the Long-Term Insurance Act
  - Tax efficient investment vehicles – income tax converted to a 30% tax rate from 45% and the effective capital gains tax rate converted from 36% in the hands of the Trust to 12% in the policy wrapper.
  - Restrictions on withdrawals during the first 5 years (term) of the policy
  - Restrictions on contributions to the policy limited (120% rule) during and after the initial term

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## Structures

- Endowment
  - Must appoint a life assured
  - Benefit must pay out on death of the last life assured
  - CGT will be deducted
  - Will be deemed an asset in the estate of the life assured (as he/she created the sale)

**Almost no scenario for a Trust to invest in an endowment!**

- Sinking Funds
  - Endowment without a life assured
  - Can run into perpetuity

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## Funds

*funds are not created with tax efficiency as primary objective

- Dividend Funds
    - 20% DWT compared to 45% income tax in a trust
    - Could also be CGT on units on redemption
    - Must still be appropriate taking into account investment mandate

- Collective Investment Schemes
    - Depends on mandate of fund
    - Could result in income tax on interest income accrued (even if rolled up in fund)
    - Capital gains tax on redemption

- High Yield Income Fund
    - Long term income and capital growth
    - Careful consideration needed when picking fund manager

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## Offshore Investing

- Exchange Control regulations
  - No foreign allowance or direct offshore investing allowed for local trusts
  - Retaining direct foreign assets inherited - allowed in exceptional circumstances

- Asset Swap Contract
  - What: A contract using financial institutions' unused foreign investment allowance to get funds physically invested abroad. Funds must be repatriated on withdrawal.
  - Advantages:
    - Means to gain offshore investment exposure without direct externalisation
    - Rand hedged investment
    - Exposure to broader global market
  - Disadvantages
    - Exposure to financial institution's balance sheet
    - Funds must be repatriated on withdrawal
    - Costs of these structures tend to be higher
    - Set up is onerous

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## Offshore Investing

- Rand denominated Feeder Funds
  - What: Indirect means of gaining offshore exposure when no Rands are physically transferred offshore, and investments remain domiciled in SA. Underlying exposure is global.
  - Advantages:
    - Foreign investment allowance not needed
    - Means to gain offshore investment exposure without direct externalisation
    - Rand hedged investment
    - Exposure to broader global market
    - Cheaper than Asset Swap contract
  - Disadvantages:
    - Units in Feeder Fund is local asset and denominated in Rand

- Asset Swap vs Feeder Fund

Questions