OFFSHORE TAX PLANNING OPTIONS FOR SA TAX RESIDENTS

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Outline

- Establishment of an Offshore Trust
- Management of an Offshore Trust
- Tax issues when funding an Offshore Trust
- Limited tax benefits where trust makes conservative passive investments
- SA Exchange Control issues
- SA tax implications arising from trust distributions to SA beneficiaries
- Information sharing in terms of the Common Reporting Standard (CRS)
- Terminating SA Tax residency

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Establishment of an Offshore Trust

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Creating an Offshore trust

- A valid trust must be created according to SA Trust Law
    - A mere ‘declaration’ of trust by trustees is not sufficient
    - A donation of an asset to benefit beneficiaries is necessary
    - No “sham” or “blind” trusts, and avoid “dummy” settlors

- The trust must not be SA tax resident
    - Not “established” or “formed” in SA (settlor must be outside SA at the time that the trustees communicate to the settlor their acceptance of the donation into trust)

Creating an Offshore trust

  - "place of effective management" of the trust outside SA
  - keep documentary evidence

- Impermissible Tax Avoidance Arrangements
  - sections 80A to 80L of ITA
  - sole or main purpose to obtain a tax benefit (s80G presumption) and
  - in a manner not normally employed for bona fide purposes, <u>or</u>
  - not arms length or abuse of ITA

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Management of the Offshore Trust

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Management issues

- Settlor control or influence
- Independent decisions by foreign trustees
- Role of a Protector
- Discretionary Beneficiaries
- The Trust Deed should be vetted by a SA tax advisor

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Tax Issues When Funding an Offshore Trust

Donations

- Most (not all) donations incur 20%+ donations tax (s54 of ITA)
- Application of the donor attribution or "tax-back" rules (s 7(8) of ITA for revenue gains and paragraph 72 of 8th Schedule to ITA for capital gains)
- Certain assets do not incur donations tax yet get no estate duty exemption (see s56(1)(g) of ITA)

Loans

- A loan by a SA Person to an offshore trust is an "affected transaction" under s31(2) of the ITA
- s31(1) deems a market related interest rate to accrue to the SA lender
- The deemed donation rules under s7C do NOT apply (see s7C(5)(e) to ITA)
- Capital Gains Tax (CGT) on repayment and repatriation of the loan to Rands
- Currency of the loan and the "official interest rate"

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Limited tax benefits where trust makes conservative passive investments

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Considerations related to passive investments

- Annual tax on interest bearing loans
- Annual tax on trust income arising from donations
- Limited estate duty sheltering on foreign currency denominated loans
- CGT on Rand value of foreign currency loans in deceased estate
- Annual cost of maintaining an offshore trust
- Certain sophisticated estate planning structures exist, but are costly, make sense only to large sums, and risk application of impermissable tax avoidance arrangements
- Offshore trusts have far more SA tax benefits where trust funds are applied to high risk-high return foreign trading and speculative investments (usually requiring use of offshore companies)

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SA Exchange Control Issues

Exchange Control considerations

- Ensure that the Trust is funded with Excon (SARB) approved funds
- SARB considers an offshore Trust to be a “SA resident” for the purposes of the Excon Regulations if the beneficiaries or funders are SA residents
- The Trust may not, directly or indirectly, (such as through an offshore company) invest in SA assets (“loop” structure under Regulation 10(1)(c))
- The Trust may not make loans to any SA resident

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SA Tax Implications arising from Trust Distributions to SA Beneficiaries

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SA Tax Implications related to Trust Distributions to SA Beneficiaries

- "Repatriating offshore funds-when and how?" (May/June issue of TaxTalk)
- Approaching the trustees correctly
- Repayment of Loans
    - Tax neutral except CGT on Rand value of foreign currency loan repaid

Trust distributions to beneficiaries

- Trust distributions to beneficiaries
  - The “flow through” principle, particularly with same year distributions
  - Clear understanding of taxation for beneficiaries receiving distributions of prior year revenue and capital gains made by the Trust (s25B (2A) of ITA for revenue gains and paragraph 80(2) and 80(3) of the 8th Schedule to ITA on capital gains)
  - Critical for trustees to keep careful accounting records and allocate what historical gains are being distributed to a SA beneficiary
  - Example: Trust distributes previous years dividend income arising from 10% to 50% shareholding in a foreign company. No SA tax due to foreign dividend income exemption (s10B(2)(a)) of ITA)
  - The Remittance Process
    - Balance of Payment protocols
    - Distribution to beneficiaries is categorized as a foreign gift (code 401)

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Information Sharing in terms of the Common Reporting Standard (CRS)

Information Sharing in terms of Common Reporting Standard (CRS)

- Reporting to the country of residency of the settlor, and of beneficiaries if distributions are made
- Applicable to both “technical” settlors and “commercial” settlors
- Declaration of Trust deeds that do not disclose the settlor are ineffective and counter-productive
- Applicability to discretionary beneficiaries only applies in a reporting year when distributions to beneficiaries occur

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Terminating SA Tax Residency

Terminating SA Tax residency

- Not simply a case of spending less than 183 days in SA
- Termination of SA Tax Residency is achieved where-
  - Taxpayer is able to demonstrate no longer being "ordinarily" resident in SA (see SARS Interpretation Note 2 (Issue 3) of 20 June 2018 ("IN2")), <u>and</u>
  - Taxpayer is no longer subject to the "physical presence test" for SA tax residency (see SARS Interpretation Note 4 (Issue5) of 3 August 2018 ("IN4")),
  - Alternatively, the taxpayer is considered <u>solely</u> tax resident in another country according to the Double Taxation Agreement (DTA) between that country and SA

Factors to consider

- Key “ordinarily” resident factors-
  - Personal intention supported by objective facts
  - Main “habitual abode” and permanent residency status are important (take Dubai as an example)
  - “real home” and “where will you return from your wanderings”
- Breaking the “physical presence” test
  - Spend less than 92 days in SA in the first SA tax year (1 March-28 February)
  - Terminating SA tax residency in March, April or May means that your last year of assessment is less than 92 days
  - Thereafter ensure that in aggregate not more than 915 days over 5 consecutive years are spent in SA

Impact of a DTA

- Applying a DTA can be a shortcut and provide certainty applying clear “tie-breaker rules”-
  - “home permanently available”
  - personal and economic interests or “centre of vital interests”
  - “habitual abode”
  - Nationality

Financial Emigration

- Applicability of Financial Emigration through SARB
  - Financial emigration is <u>not</u> a prerequisite for terminating SA tax residency
  - <u>But</u> financial emigration will be persuasive to support no longer being “ordinarily” resident in SA
  - Financial emigration releases you from almost all restrictive Excon Regulations (such as invoicing your SA company for services rendered by you outside SA)
  - Note that financial emigration process is likely to be scrapped from March 2021

Tax implications when terminating SA tax residency

- Tax implications when terminating SA tax residency
  - Deemed disposal of worldwide assets for CGT purposes (s9H(2) of ITA)
  - Excludes SA immovable property held in personal name
  - Does <u>not</u> exclude shares held in immovable property rich SA companies

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