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The pitfalls of offshore trusts

THE tax and foreign exchange control amnesty attracted about 43 000 applications. Although the window period for applying for amnesty has long passed, the tax consequences arising out of the applications submitted to the authorities are complex and are often misunderstood.

This article aims to identify some issues needing consideration when reviewing the tax consequences arising out of funds owned by an offshore trust on which the donor applied for and received amnesty.

One of the major concerns amnesty applicants had was whether the assets owned by the offshore trust for which they were seeking amnesty would fall into their estate on their death.

The amnesty deemed the assets to belong to the donor applying for amnesty for income tax purposes only, and did not result in those assets becoming legally owned by the donor personally. In many cases, the donor would have paid the 2% domestic tax levy to mitigate the donations tax that would otherwise have become payable on the donation of funds to the trust abroad.

The authorities therefore confirmed that the assets held by the offshore trust will not fall into the estate of the amnesty applicant on their death. The offshore trust therefore remains an attractive vehicle for owning the offshore assets where the donor applied for amnesty.

Under the rules governing the amnesty, the assets owned by the offshore trust are deemed to belong

to the applicant until those assets are disposed of or until the applicant dies. The income derived from the assets in the form of interest, rentals and dividends constitutes income which is liable to tax in SA.

Where the offshore trust disposes of assets, it is necessary to ascertain the capital gains arising therefrom that will be subject to capital gains tax (CGT) in SA.

A point sometimes overlooked is that the assets are deemed to belong to the donor for income tax purposes with effect from March 1 2002. Reference must be made to the market value of the assets owned by the trust at March 1 2002 and not the date on which CGT was introduced, namely October 1 2001.

Any income derived from the offshore trust will be taxed in the hands of the donor and must be reflected in their tax return to the South African Revenue Service (SARS).

The amnesty law provides that the deeming rule will cease to operate when the trust disposes of the assets on which amnesty was granted or when the donor passes away. Once the donor passes away, the income will not be taxed in SA unless that income is awarded to a beneficiary resident in the country.

On the donor's death, he is deemed to have sold the assets owned by the trust at current market value. He will be liable to CGT on the assets owned by the trust.

Where the offshore trust makes awards to South African residents on income on which income tax was previously paid in SA under the rules



Graphic: KAREN MOOLMAN

applicable to amnestied assets, no further tax will be payable in this country.

The trustees should award trust capital to beneficiaries in SA where that capital arose prior to March 1 because such amounts will not on any basis become liable to tax in SA. The amnesty, against payment of the levy, sought to exclude such amounts from income tax in future years of assessment.

It is important for the trustees of the offshore trust to identify the nature of the award made to the beneficiaries resident in SA so they can properly deal with the award in their tax return in the country. Where the award consists of amounts derived by the offshore trust after the death of the donor, such amounts will fall

to be taxed in SA as normal income unless they constitute capital gains, in which case those gains will be taxed as capital gains subject to a maximum tax rate of 10%.

If the offshore trust disposes of assets, the donor in SA will be liable to CGT on the difference between the proceeds received on the sale of the assets and the base cost. Where the assets were held by the trust at March 1 and the assets owned by the trust were valued in the prescribed manner, the market value may constitute the base cost. Where the assets were acquired by the trust after March 1, the donor will have to take account of the actual costs incurred in acquiring the asset and deduct that from the proceeds received on the sale of the assets.

Where the offshore trust wishes to invest in SA, and that trust has beneficiaries resident in the country, the exchange control department will treat such an investment as contravening regulation 10(1) (c) of the exchange control regulations.

The donor of the assets to the trust is required to disclose the income derived by the offshore trust in their personal tax return.

However, the assets do not belong to the donor personally and should therefore not be included in the donor's statement of assets and liabilities submitted to SARS.

Further, the beneficiaries of the trust must disclose they are beneficiaries of the offshore trust and specify the name of the trust, the place where it is located, and indicate whether they have received any awards therefrom. The income tax return is specific in the information required to be submitted regarding beneficiaries of trusts, both domestic and offshore trusts.

Amnestied foreign trusts remain effective for estate planning because the assets owned by such trusts do not belong to the deceased for estate duty purposes in SA.

It is important though, that it can be shown, if called on to do so, that the offshore trust is a genuine one and that it cannot in any way be said to be the alter ego of the deceased. Failure to ensure the trust is genuine may result in the donor forfeiting the expected estate duty advantage.

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/en,s,dawfir/ noun a natural painkiller created by the brains of ens lawyers and tax practitioners that allows you to enjoy yourself at the gym knowing that all of your legal, tax and forensic problems are being solved by teams of experts in these fields.



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