CHARTERED ACCOUNTANTS

PHYSICAL 1st FLOOR, 67 FLORIDA ROAD, DURBAN, KWAZULU NATAL, SOUTH AFRICA
POSTAL PO BOX 48619, QUALBERT 4078
TEL + 27 31 303 6130 FAX + 27 31 303 4399
EMAIL global@sjcasa.co.za WEB www.sjcasa.co.za

MoneyTalk

Using tax-free donations to save on Estate Duty

WITH the amount that can be donated free of donations tax by natural persons having been increased to R100 000 in February's Budget, an old estate planning technique has once again become attractive. The plan works as follows:

Husband and wife are each allowed to donate R100 000 per year. Because donations between spouses are exempt from donations tax, which means R200 000 per year can be donated per couple.

Assuming one spouse is wealthier than the other, the wealthier spouse can donate R100 000 to the poorer spouse, who can then donate the R100 000 as part of his or her tax-free donation.

The couple therefore donates R200 000 per year to a trust. Note that there is no loan account — the money belongs to the trust.

The trust then invests the money in a growth investment. The most ideal vehicle for a trust to invest in is an endowment policy, as then there is no direct tax on the policy for the investor.

This means the high rate of tax on a trust is effectively bypassed. In addition, it means section 7 of the Act is not applicable, as there is no tax to attribute to the donor.

The policy then matures tax free, as that is the current SA Revenue Service practice. The proceeds belong to the trust as the owner. The trust then lends the money back to the donor.

The trust deed must make provision for the trust to make loans. There is no need to charge interest on the money, as there is no employer-employee relationship between the trust and the donor.

Note that it is important that the donor does not use the loaned money to build up assets, as that would increase his estate and defeat the purpose of the scheme.

The whole idea is that the donor uses the money 'on loan', and when he dies he owes the money to the trust. This is a liability in his estate and reduces his estate duty further. The donor would leave assets to his family trust on death anyway, so there is no prejudice in having to repay the loan to the trust.

BENEFITS OF THE SCHEME

R100 000/R200 000 per annum is removed from the donor's estate. It grows in the trust as a "nest egg".

This money belongs to the trust – there are no loan accounts. This makes it harder for creditors of the donor to attach the policy, assuming no actions were taken to defraud creditors.

The donor still gets use of the money later, just on loan, which reduces the donor's estate duty even further. There is therefore a double estate duty benefit – the money is first removed from the estate, and then the liability is created.

There is no negative capital gains tax effect as the policy is originally owned by the trust, so the proceeds pay out to the trust free of CGT.

This article is extracted from a publication, Tax Breaks, written by Harry Joffe.

This publication is subject to our standard Disclaimer to be found at our website www.sjcasa.co.za.

April 07