CONSEQUENCE PRIVATE WEALTH

FROM BUDGET SPEECH TO YOUR POCKET – WHAT'S THE REAL IMPACT?

Two Budget Speech items caught our attention earlier in the year. We felt at the time that they could seriously impact our clients - more so than the usual increases in tax bands etc. We now have more information from Treasury and can better analyse the proposed amendments.

Firstly, we have a clearer idea of future client Retirement Funding options.

Secondly, we have further indications of Treasury's views on future tax treatment of Trusts.

Both items fall under the broad banner of Estate Planning, which essentially means they relate more to how we own our investments rather than what we invest in. In other words which investment structures are best for your personal circumstances given the proposed changes?

The goals of financial planning, and estate planning more specifically, are to maximise: 1.) investments and income in life and 2.) transfer of wealth on death. Tax is a critical consideration and our analysis focusses there. SARS encourages savings through tax incentives - it is up to the planner and client to best apply these.

1. Retirement Funding

Treasury seeks to harmonise the tax treatment and accessibility of the various types of Retirement Funds. In our view the technical differences between Provident, Pension, Preservation and Retirement Annuity (RA) Funds have confused and discouraged potential investors so this is a welcome step. The focus will be on decreasing access to funds before retirement.

Importantly, the public will now have an increased choice as to how they save for retirement – and the key change here is in the wording regarding contributions.

Address: 23 Lady Anne Ave, Newlands, Cape Town, 7700 **Phone:** 021 674 2222 **Cell:** 082 833 1875 **Fax:** 086 653 4999
Email: info@consequence.co.za **Web:**www.consequence.co.za
Consequence Private Wealth (Pty) Ltd(Registration Number 2009/005302/07)
Registered Financial Services Provider: 39659 **Directors**: Michael Furter, Jeff Middelmann

To date Treasury has effectively limited individual choice by only allowing a maximum deductible contribution of 15% of "non-pensionable" income to be invested annually in a private Retirement Annuity.

We have many clients who are members of compulsory company pension or provident funds. These often have very high fees, limited or prescriptive fund choice and poor performance. Employees thus opt to contribute as little as possible. Their membership however renders their entire salary as "pensionable" and so they have no ability to make use of the 15% deduction since none of their income is then "non-pensionable".

Treasury indicates this will change in 2015. A maximum annual deductible contribution of 27.5% of <u>all</u> taxable income will be allowed into whichever Retirement Funds the individual chooses. Employees will therefore be able to drop contributions to a minimum if they are dissatisfied with their company fund and still invest privately whilst enjoying a tax deduction. The annual deduction will be capped at R350,000 but contributions above this will carry over to retirement as untaxed withdrawals.

The private RA Funds we advise clients to invest in are only pure investment RA funds which have low fees and superb underlying fund and share portfolio options. Their Life assurance counterparts are to be avoided given their high fees and surrender penalties.

Conclusion:

We see a growing trend towards pure investment RAs. Increasingly, clients are using large RA contributions to reduce their Estate Duty liability (particularly in light of concerns re Trusts) and also enjoy a tax-free trading environment. Zero Capital Gains Tax allows for great flexibility in terms of on-going portfolio rebalancing. The proposed legislation will encourage this trend.

2. Tax Treatment of Local Trusts

Trusts separate assets from founders and beneficiaries, with control handed to Trustees who must abide by a Trust Deed. As such they are useful in enforcing some financial discipline from one generation to the next and can serve as steady and prudent accumulators of wealth over the years.

In removing assets from one's estate and control, one also removes the asset's future Estate Duty liability (20% after exemptions and R3.5M abatement). SARS counters this by taxing donations to Trusts and by retaining an Estate Duty liability on any loan accounts payable by Trusts to founders' estates.

Treasury is now also contemplating removing the "Conduit Principle" which in certain circumstances allows Capital Gains and Income to be vested with beneficiaries and taxed at their individual rates. Gains would be taxed at an effective rate of 26% within the Trust as opposed to the maximum 13% for individuals and income at a flat 40% with no exemptions available for either (dividends would remain unaffected as they are taxed at source).

It is too early to say whether the amendment will be enacted or what the full effects will be but clearly there is merit in remaining aware of all estate planning options.

One interesting option is the housing of Trust investment assets within Endowments. These are tax structures which wrap around underlying investments. Endowments, like RAs, have a poor reputation due to miss-selling by Life Assurance companies.

Fortunately there are now pure asset management Endowments which have no extra fee layers or surrender penalties and come with excellent underlying unit trust fund and share portfolio options. Capital gains are taxed at a flat 9.9% and Income at 30% within the Endowment. Dividends cannot be paid directly from the structure but withdrawals and loans are allowed so there is some liquidity. In circumstances where regular income is not required we believe this is an excellent tool with which Capital Gains Tax can be minimised.

Another increasingly discussed route is the Offshore Trust. Fees are relatively prohibitive and moving cash offshore can be onerous but there is value given that in many jurisdictions the Capital Gains and Income tax rates within the Trust are far lower or even nil. Gains or Income distributed out are of course still taxed in beneficiaries' hands in SA.

Conclusion:

Trusts will remain integral to long term wealth planning but as legislation evolves we believe other strategies will increase in relevance. For many clients a blend of the vehicles discussed above is appropriate. In all cases, we believe that estate planning should be an on-going process so that legislation is adhered to and anticipated.

Address: 23 Lady Anne Ave, Newlands, Cape Town, 7700 **Phone:** 021 674 2222 **Cell:** 082 833 1875 **Fax:** 086 653 4999
Email: info@consequence.co.za **Web:** www.consequence.co.za
Consequence Private Wealth (Pty) Ltd (Registration Number 2009/005302/07)
Registered Financial Services Provider: 39659 **Directors**: Michael Furter, Jeff Middelmann