Using foreign polices with Discovery to solve offshore estate planning problems

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Intro

Discovery

- South Africans all want to be offshore. They want their life cover, investments and planning to all be offshore
- However, being offshore carries with it problems that they don’t think about, such as:
- Foreign probate, wills, executors and laws
- Situs taxes and death duties
- Estate duty back in SA
- Income and capital gains tax back in SA

Intro-different offshore wrappers

- Offshore wrapper 1-The **Dollar Life policy** is a pure life policy issued through Discovery's Guernsey office. It covers death, disability, severe illness. No cash value. The premiums are payable in USD and the proceeds are payable in USD anywhere in the world

- The premiums can be payable from SA using the client's R1m SDA allowance, OR they can be paid directly from offshore in USD if the client has offshore cash resources. However, if paid from offshore the premiums must be paid as an annual premium

- The policy can be owned by an individual on their own life, or, **if the premiums are being paid from money already offshore and the Forex allowances are not being used, then the policy can be owned by an offshore trust or offshore company.**

- Offshore wrapper **2-The Global Endowment policy**, which is an investment wrapper and contains a varied option of different unit trusts. It is issued under the SA LTIA as a policy, although it's an investment. Premiums payable as a lump sum from proceeds already offshore

Problem 1- probate and forced heirship

- **Probate** is the need to wind up an offshore estate. It is complex and time consuming, and involves different laws. In many European countries they have **forced heirship**, which means assets go to the spouse and children in fixed percentages and they ignore any will to the contrary

- Investor might need a foreign will to ensure they don't breach that foreign country's laws. That is difficult to arrange in SA and expensive. Try arranging a Belgian will from SA!

- Although a SA will is valid overseas, the process is tricky. The original needs to be sent overseas when the Master in SA is finished. Will the SA will be valid overseas? Try sending an Afrikaans will to France!

- An offshore executor is expensive and not always that easy to arrange

- **Discovery's Global Endowment and Dollar Life policies allow the nomination of a beneficiary for proceeds, so on death of the investor the assets are not part of any probate process. Don't need to have an offshore will or offshore executor. Remember, proceeds will pay in $ anywhere in the world!**

Problem 2-Situs Tax

- **Situs Tax** is particularly relevant for those holding assets in the US/UK

- If a South African dies with assets in these countries, then they will pay estate duty there. **In the US, for example, non-US citizens pay estate duty at up to 40% on their US Situs assets, with the rebate only $60 000. US citizens get a much bigger rebate [around $11m]. In the UK there is a bigger rebate [325 000 pounds], but still situs tax at up to 40%**

- Offshore assets are dutiable in SA as well. If dutiable offshore already, then get a credit back in SA up to the amount of the duty you would have paid here. Does not help, as we only pay a maximum of 25% in SA, so can't use the full credit. **Using a Discovery Global Endowment avoids Situs Tax on offshore assets**

- **Example:** X owns a property in the US for $750 000. When he dies, he will pay Situs tax in the US. He sells the property now, pays his CGT and transfers to a global endowment where he can still buy a US property portfolio if he wants to. When he dies there is no Situs Tax, as the Global Endowment is not in the US but Guernsey. **Will therefore only pay SA estate duty at 20/25% PLUS no need for US Will**

Problem 3-Covering foreign death duties/situs tax

- **Situs Tax** is particularly relevant for those holding assets in the US/UK

- Remember, **In the US, non-US citizens pay estate duty at up to 40% on their US Situs assets, with the rebate only $60 000. In the UK there is a bigger rebate [325 000 pounds], but still situs tax at up to 40%**

- **Example:** X owns a property in the US for $810 000. He did not manage to sell the property and move the proceeds to a Global Endowment. When he dies, he will pay Situs tax in the US. Assuming no other assets or rebates, he will pay 40%x $750 000**=$300 000**. Where does he get the cash from to pay this duty?

- **Answer-he can take out a Dollar Life policy with Discovery, which policy itself is not estate dutiable in SA if structured correctly. He can use a short form Ocorian trust as the beneficiary, which trust will have as its mandate the obligation to use the proceeds to settle his foreign death duties. Anything left over from the duty/ liability can be used for his family.**

Problem 4-estate planning for 2nd generation

- X has a global endowment. He has two sons he wants to benefit. If he nominates them as the beneficiaries for proceeds, then the endowment is an asset in the deceased estate for estate duty purposes, and the proceeds are an asset in the sons' estates going forward
- X might also have a Dollar Life plan, which although free of estate duty in his estate, [see later], will not be free in the estate of his family if he nominates them as a beneficiary
- He would like to use an offshore trust, but these normally cost $5000 to set up, and $5000 a year to run. How does he set up a more affordable structure?
- In addition, if X has minor beneficiaries, how does he protect their benefits?
- Answer: Discovery’s offshore short form trust-the Ocorian Trust

Problem 4 cont.-estate planning for 2nd generation

- A short form trust that can only be the beneficiary of a Dollar Life and/or a Discovery Global Endowment policy

- Its only costs $450 in year one, and $450 a year thereafter to run

- So using a Dollar Life policy with an Ocorian trust as the beneficiary, X has full estate duty efficiency for him and the 2nd generation for Dollar Life, dollars are made available to pay any estate duty in his personal estate, and heirs anywhere in the world can benefit without forex issues

- The Ocorian trust can also be the beneficiary of a Discovery Global Endowment, so that on death of the life assured the proceeds pay into the trust, and are not an asset in the 2nd generation's estate [**although dutiable in the deceased's estate**]

Estate Planning for 2nd generation cont.

- Therefore, if he nominates the Discovery Ocorian Trust as the beneficiary, then on his death the proceeds pay straight into the trust. It will then not fall into the beneficiary's estates going forward, and will not be dutiable for them, as long as they don't take a distribution from the trust

- In addition, because it was not introduced into the trust by loan or donation, there is no anti-avoidance legislation for SARS to apply. As long as the money stays in the trust, it will grow tax free. There <u>will only be tax when money is taken out of the trust-</u> **Section 25B (2A)**

- Off course if they leave the money in the trust, and only take a distribution when they go live in a more tax friendly country, they can avoid even this problem!

Cont.

- Some detail on the Ocorian Trust:

- It is a short form trust, so can only be the beneficiary of Discovery Policies
- It only costs $450 a year and not $5000 a year like normal offshore trusts!
- Can do a letter of wishes and normal beneficiary nomination
- On death, proceeds pay into the trust. Beneficiaries then have a choice-keep the trust [but it then becomes a full trust] or ask trustees to pay out the proceeds. Trustee will be guided by letter of wishes
- Ideal for estate planning for 2nd generation, AND to protect minors who are beneficiaries. Ideal for BOTH Global Endowment AND Dollar Life

- **NB-the new Dollar Life 2 allows Dollar to be owned by a foreign trust/company, and thereby facilitate even more efficient estate planning and structuring!**

Problem 5-forex problems

- Dad lives in JHB, son lives in Dubai. Local Discovery life/endowment policy on dad's life, son is the beneficiary. What happens when dad dies?
- SA insurer will only pay proceeds to a **LOCAL BANK ACCOUNT**
- Son [the non-resident beneficiary] will then have to approach the SARB to take the proceeds offshore
- The new SARB rules allow proceeds to go offshore if paying to an heir, but the rules are really complex. If more than R1m son will need a Tax Clearance Certificate. Does he have a tax number? Will he get TCS? Is he a resident or a non-res for tax purposes? Does he get the R1m SDA?
- **NB-much simler option is for dad to use a Dollar Life/Global endowment policy**-money is already offshore, so no forex issues on death. No TCS needed.
- **Dollar Life/global endowment is the perfect solution for people with beneficiaries offshore**. It takes the heirs out of any forex complexity. Removes the need for a TCS

Problem 6-Avoiding estate duty on a Life policy

- **A traditional SA Life policy is estate dutiable as a deemed asset [Unless one of the exemptions apply]**
- **Dollar Life however is NOT estate dutiable when life assured dies [Endowment is]**
- **Why not?**
- Is the life policy a deemed asset in the deceased estate **and estate dutiable in South Africa-ie-is it a domestic policy?**

"Domestic Policy' means any life policy as defined in section 1 of the Long-term Insurance Act, 1998 (Act 52 of 1998), issued anywhere upon an application made or presented to a representative of an insurer (or to any person on behalf of such a representative) at any place in the Republic, **excluding a life policy which has been made payable at a place outside the Republic at the request of the owner**, **but including any life policy issued outside the Republic which has subsequently been made payable in the Republic at the request of the owner"**

Problem 6-Life policy and estate duty

- Policy will **not** be a domestic policy as long as it does **not** pay into a local bank account. If it pays offshore to a foreign bank account, then it will have been "made payable at a place outside the Republic at the request of the owner" and fall outside the definition of domestic policy. <u>It then will not be a deemed asset in terms of 3 (3) (a).</u>

- Section 3 (3) (a) reads:

"Property which is <u>deemed</u> to be property of the deceased includes-

(a) so much of any amount due and recoverable under any policy of insurance **<u>which is a "domestic policy</u>**", upon the life of the deceased…"

NB-a non-domestic policy is therefore <u>specifically excluded</u> from being a deemed asset

- **Dollar life is therefore not estate dutiable if structured correctly. It is more efficient than a local policy!**

Problem 7- the tax schlep with offshore investments!

- **Scenario: X invests $2m in a suite of foreign unit trusts**
- At the end of the tax year, he will need to declare all foreign dividends, interest and CGT made on his SA tax return. Even if he is roll up funds, he will need to report any CGT made
- The unit trust company will have to be asked for tax forms, and when they eventually send them, it will all be in USD. X will have to convert to rands on his tax return. Not such a simple calculation!
- Trying to work out CGT is a nightmare with all the different methods and currency issues
- **If he rather invests in a Global Endowment, all the tax is paid in the fund, and he does not need to report anything on his local tax return**
- **This means he does not need to report foreign dividends, interest and capital gains on his tax return, with the extra schlep of converting into rands..**

Cont.

- Assuming your investor is at the top marginal tax rate, in a unit trust he will pay income tax on interest earned at 45% and CGT on gains at the rate of 18%. The rand based rebates [R40 000 CGT and R23 800 interest don’t go very far when earning in USD]

- However, if he rather invests in a Global Endowment, the tax is lower in the policy [30% income tax rate and 12% CGT rate]

- Remember, tax is paid inside the Global Endowment on CGT made, even if invested in roll up funds. Remember also that Discovery does have a PE in Mauritius, so all tax is calculated in USD. Only actual gains made in USD are taxable, no tax is paid on pure rand depreciation

- **NB-by using a global endowment with a SA Insurer, the investor gets tax certainty in SA through the five fund tax system AND has a fully offshore investment that can payout anywhere in the world**

Conclusion-make your life simple!

- Global Endowment makes your life simpler on the estate planning side. No need for foreign wills, executor’s, probate or to worry about Situs Tax
- It is an easy way to get assets to the next generation, wherever they are living
- It also makes your life simpler on the tax side-don’t need to do complex calculations on your tax return, as its all done for you inside the policy. You also get the benefits of lower rates
- Dollar life is estate duty free in SA, provides offshore cash to pay foreign death duties, can be linked to a trust to do foreign estate planning AND gets around the forex complexity of having beneficiaries living offshore.
- Using foreign policies can solve most of your clients estate planning problems offshore