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IN THIS ISSUE

Offshore investments require careful succession planning, as foreign estate taxes, probate rules and asset ownership structures can significantly reduce inherited wealth. Regular reviews ensure portfolios remain tax-efficient, aligned with family circumstances and effective for future generations.

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EXEMPT AT HOME, EXPOSED ABROAD:

OFFSHORE WEALTH STRUCTURING

FOR EFFECTIVE SUCCESSION PLANNING

RUAN BREED | FINANCIAL ADVISOR, BRENTHURST STELLENBOSCH

WHY THE ASSETS SARS CANNOT TOUCH MAY STILL BE THE MOST HEAVILY TAXED ASSETS IN YOUR ESTATE, AND WHAT CAN BE DONE ABOUT IT.

> ***If a significant portion of your wealth is held offshore, especially through an inheritance, it's worth reviewing the structure before your options become limited, says the author.***

A few months ago, I sat down with a client – I'll name her Annelie. She is 59 years old, recently retired, and holds a portfolio of US-listed shares and ETFs worth around $600 000. The portfolio was not built through her own annual offshore allowances.

It came to her through an inheritance from an uncle who had lived in the UK for most of his adult life and passed away there. She simply kept the account running just as she inherited it – added nothing, withdrawing nothing and assuming that, because the money 'came from overseas', her estate planning was already taken care of.

She was half right. But the half she had wrong could have cost her heirs close to a third of that portfolio.

Brenthurst Wealth Management (PTY) LTD FSP No. 7833

THE HALF SHE HAD RIGHT: A VALUABLE EXEMPTION AT HOME

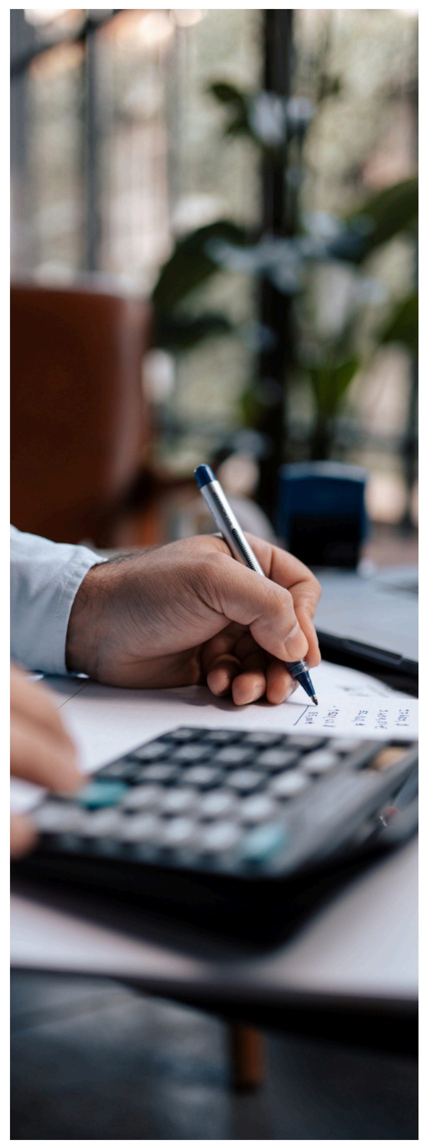
South African residents are taxed on their worldwide assets when they die. Estate duty is levied at 20% on the dutiable estate up to R30 million and 25% above that, so a $600 000 portfolio would ordinarily fall in that bracket.

However, the SA Estate Duty Act contains a carve-out for exactly Annelie's situation. Where a South African resident holds an asset positioned outside the country, and that asset was acquired by way of an inheritance or donation from a person who was not ordinarily resident in South Africa at the time, the asset falls outside the dutiable estate altogether.

Parliament's logic was sound, wealth that was created abroad, taxed abroad and transferred by a foreigner, should not be swept into the South African net merely because the recipient happens to live here.

So, upon her death, the South African Revenue Service (SARS) would levy no estate duty on this portfolio at all. Annelie knew this, at least in broad terms, and it is what led her to believe her house was in order.

THE HALF SHE HAD WRONG: THE COUNTRY OF THE ASSET GETS ITS SHARE



What the exemption at home does not do is protect the asset from death taxes in the jurisdiction where it is located. Most developed markets impose some form of inheritance or estate tax on assets physically or legally situated within their borders, regardless of where the owner lives.

This is commonly referred to as situs tax, and the United States is the most aggressive example.

A South African who dies holding US-registered shares directly is treated as a non-resident alien for US estate tax purposes. The exemption available to South Africans is not the generous threshold American citizens enjoy; it is a mere $60 000.

Everything above that is taxed on a sliding scale that climbs to 40%. On Annelie's $600 000 portfolio, the exposure works out to roughly $180 000, around 30% of the portfolio, and because the tax scale is progressive, the effective rate creeps closer to 40% as the portfolio grows. If she lives another 20 years and the portfolio compounds to $2 million or more, the amount at risk becomes genuinely frightening.

It gets worse before it gets better. Before her heirs can take transfer of the shares, her executor would need to obtain a grant of probate in the US, and that grant is generally only issued once the estate tax has been settled. The estate must, therefore, find the cash to pay the tax before it can access the very asset intended to fund it.

Add South African executor's remuneration of up to 3.5% plus VAT, foreign legal fees and capital gains tax triggered by the deemed disposal on death, and it is entirely realistic for half of the portfolio's value to dissipate from the time of her death until the time her heirs receive the money.

IN OTHER WORDS: THE ASSET THAT IS FULLY EXEMPT FROM ESTATE DUTY IN SOUTH AFRICA WAS ON TRACK TO BE THE MOST HEAVILY TAXED ASSET IN HER ENTIRE ESTATE.

THE TOLL GATE: PAYING CAPITAL GAINS TAX (CGT) NOW TO ESCAPE HIGHER TAXATION LATER

Fixing the problem means changing the structure through which the shares are held, and changing the structure means selling.

A sale triggers CGT in South Africa at an effective rate of up to 18% for an individual and, in Annelie's case, the gain was meaningful because her base cost was set at the market value on the date she inherited, and the portfolio had grown well since. In other words, this big capital gain can push her up to the 18% effective CGT rate, even if her marginal income might be low.

In any event, CGT will eventually be payable on this portfolio, whether on death or on eventual sale by her heirs. Paying it now resets the base cost, and in exchange she removes a foreign estate tax exposure running at 30% to 40% of the entire capital value, not merely on the growth.

Paying 18 cents to the rand on the gain to eliminate a potential 40 cents per rand of capital is one of the easier trades in portfolio structuring. The real question is, what structure to move to once the shares have been sold.

THE OPTIONALITY OF STRUCTURES

Broadly, a South African investor in this position has three categories of vehicles available to them, all accessible through the mainstream offshore investment platforms operating in our market. Each solves a different part of the problem, however, none of them solves everything. So, in all probability, the perfect solution will be structured as a combination.

The first option is an offshore investment account administered through a South African nominee structure, holding collective investment funds rather than direct shares. Because the underlying unit trusts are not US situs assets, the American estate tax problem disappears immediately. The difficulty is what replaces it.

The nominee entity is located in South Africa, which makes the investment a South African situs asset, and that drags it straight back into the local dutiable estate, forfeiting the very exemption that made Annelie's position attractive in the first place.

Succession runs through her South African will, which is administratively effective, but executor's fees apply and estate duty of 20% or more would now be payable, where previously none was due.

For an investor without Annelie's inheritance history this structure would make perfect sense, but for Annelie it will amount to exchanging a foreign tax problem for a local one.

The second option is a similar type of flexible investment account, except that it is administered through a nominee entity domiciled offshore. Now the asset is located in neither the US (no situs tax because the funds held are not US registered), nor South Africa (the foreign nominee keeps it outside the local net, and the inheritance carve-out continues to apply).

Succession can still be dealt with under her South African will, and the account remains fully accessible during her lifetime. She can draw from it, switch funds or unwind it whenever she chooses.

The residual costs are executor's remuneration on death and CGT on the deemed disposal where the asset passes to someone other than a spouse.

These structures were originally designed with emigrants and externalised families in mind, but they are equally available to residents. And for assets carrying this particular exemption, they are quietly one of the most effective tools on the shelf.

The third option is an offshore endowment or sinking fund wrapper issued by a life company. In this case the policyholder fund, not the investor, owns the underlying assets, and a life company can never die, so foreign situs tax falls away even if the wrapper were to hold US instruments directly.

Beneficiaries can be nominated on the policy, which means the proceeds bypass the estate administration process entirely: no executor's fees on this asset, no waiting for a foreign grant of probate, and where a nominated beneficiary elects to continue the policy rather than cash it in, the death event need not even trigger CGT.

Within the wrapper, tax is settled by the fund at flat rates of 30% on income and an effective 12% on capital gains, which is a genuine saving for anyone whose marginal rate lies above those levels. On paper, this is usually the structure that delivers the largest returns in the hands of the family.

Using Annelie's portfolio as the base case, the chart below projects each structure 20 years on, and then factors in every cost that would apply upon her death: foreign situs tax, South African estate duty, executor's remuneration and capital gains tax, to illustrate what actually ends up in her heirs' hands.

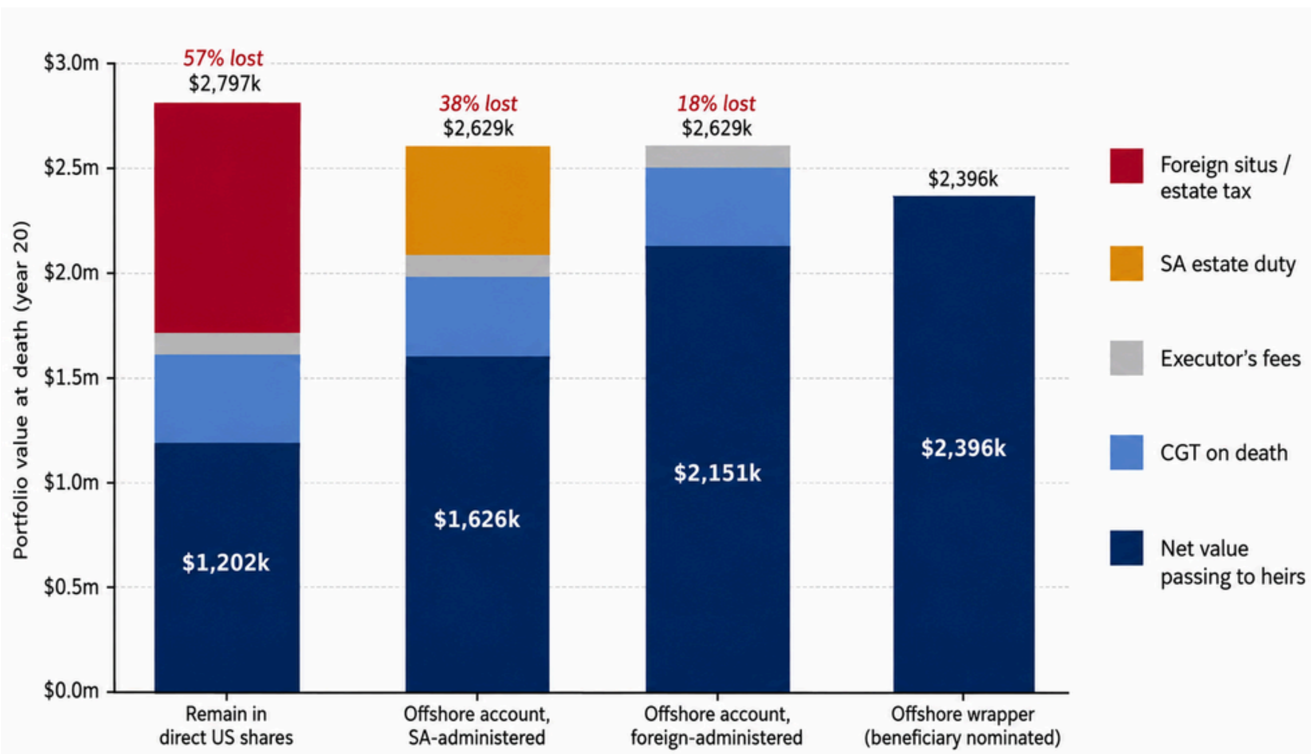


FIGURE 1: ESTIMATED VALUE PASSING TO HEIRS AT DEATH, PER STRUCTURE (YEAR 20)

Illustrative only. Assumes 8% p.a. growth (7.5% net of fund-level tax within the wrapper); CGT of $36 000 paid upfront on restructuring; US estate tax on the non-resident scale; executor's remuneration at 3.5% plus VAT; estate duty at 20%; wrapper proceeds carried over through beneficiary nomination, with the policy continued. Tax interactions simplified.

Left where it is, the portfolio surrenders more than half of its value between Annelie's death and her heirs receiving the money.

Restructured into a South African-administered account, the foreign tax problem is solved, but estate duty claws back a fifth of the capital that was previously exempt.

The foreign-administered account preserves the exemption and loses only executor's fees and terminal CGT, while the wrapper (with a beneficiary nominated and the policy continued) passes the full amount, having already settled its tax along the way at fund level.

WHY THE BEST NUMBER IS NOT ALWAYS THE BEST ANSWER

And yet, I did not simply recommend the wrapper because the paper answer ignores a question that matters more than the arithmetic: where do the heirs live?

A policy issued into a South African taxpaying policyholder fund is an excellent vehicle when both the owner and the eventual beneficiaries are South African residents.

It becomes far less so when a beneficiary lives abroad. Several jurisdictions look through these policies and tax them under their own rules and, in some cases, treat the proceeds as income in the beneficiary's hands, whilst others deem annual gains on a look-through basis. The result can be tax leakage in two countries simultaneously.

Annelie's daughter has been living in Australia for six years and has no intention of returning. Wrapping the portfolio neatly for South African purposes while creating an annual tax headache for her daughter in Sydney would not have been good advice.

The result is a blended outcome. The portion of her offshore wealth destined for her son, who lives in Pretoria, went into the wrapper, with him nominated as beneficiary.

The portion destined for her daughter went into the flexible account under the foreign nominee arrangement to pass under her will, preserving the inheritance exemption and allowing her daughter to receive a clean capital asset rather than a foreign policy.

THE BROADER LESSON

Three points from this case apply to almost anyone holding offshore assets. First, an exemption in one country tells you nothing about your exposure in another.

The question is never simply "Will SARS tax this?", but "Which revenue authority, anywhere in the world, has a claim on this asset when I die?" Direct holdings of US and UK instruments are the most common blind spots I encounter.

Second, the source of your offshore money matters as much as its size. Funds you externalised yourself and funds you inherited from a non-resident are treated completely differently upon death, and carelessly restructuring the latter can destroy an exemption that can't be recreated.

Third, modern platform pricing allows investments to be split between products and moved between them as circumstances change, usually without additional platform cost.

The structure which suits you at the age of 59 years, with two resident children, may not suit you at 70 years, with one child abroad. And it does not have to, provided the portfolio is reviewed with succession in mind, rather than solely on performance.

Offshore investing solves the concentration problem of holding all of one's wealth in a single, small economy. But it introduces a structuring concern of its own, and the death taxes of other countries are unforgiving.

If a meaningful share of your wealth is offshore, and especially if any of it was derived from an inheritance from abroad, the time to test the structure is now, while every option is still available.

Even more so if you are an investor with offshore wealth and planning to leave it to your children.

This article reflects general principles and does not constitute advice; readers should consult a qualified advisor on their specific circumstances.

RUAN BREED | FINANCIAL ADVISOR, BRENTHURST STELLENBOSCH

Ruan joined Brenthurst Wealth in 2021 as Wealth Manager in our Stellenbosch office. He obtained his BCom Financial Sciences degree from the University of Pretoria in 2018 and subsequently enrolled with CIMA (Chartered Institute for Management Accountants) as a prospective CGMA candidate. In addition, he completed a Postgraduate Diploma in Investment Management at the University of the Free State in 2021.

Before joining Brenthurst, Ruan gained valuable experience in the tax and advisory field at Crowe Tax and Advisory Services in Stellenbosch. Ruan is fully qualified to provide advice on all investment matters.

Phone: +27 (0) 21 882 8706 | **Email:** ruan@brenthurstwealth.co.za

CONTACT ANY OF OUR HIGHLY QUALIFIED FINANCIAL ADVISORS AT OUR NINE OFFICES COUNTRYWIDE TO DISCUSS YOUR INVESTMENT STRATEGY

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BRENTHURST OFFICES

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SATELLITE OFFICES

LIMPOPO: Ruan Breed | +27 82 551 3299
FREE STATE: Iniel Van Zyl | +27 72 298 3212
NORTH WEST: Maria Smit | +27 79 696 6860
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