08 OCTOBER 2021

TRUSTS & ESTATES **ALERT**

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Are endowments all that they're trumped up to be? - An estate duty consideration

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Are endowments all that they're trumped up to be? - An estate duty consideration

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In terms of section 1 of the Long-Term Insurance Act 52 of 1998 (LTI Act), a "*life policy*" is defined as "*a contract in terms of which a person, in return for a premium, undertakes to (a) provide policy benefits upon, and exclusively as a result of, a life event; or (b) pay an annuity for a period*".

The LTI Act defines a "*premium*" as follows:

> "*...in respect of a:*
>
> *(a) registered insurer, means the* **consideration given or to be given** *in return for an undertaking to provide policy benefits; and [own emphasis]*
>
> *(b) licensed insurer has the meaning assigned to it in the Insurance Act [18 of 2017].*"

It is relevant for the purposes of this article to note that a "*life event*" is defined in the LTI Act as, among other things, death.

What is an endowment policy?

An endowment policy is enjoyed primarily as a saving tool. A sum is built up by a once-off contribution or regularly paid premium (which is invested in underlying funds, locally or abroad, to ensure protection and growth), and the sum is only released on a set maturity date (a "*life event*" which has continued for a set period, e.g. 10 years), or on the death of the investor.

During the investor's lifetime, they have access to the funds held in an endowment (subject to certain restrictions imposed by the LTI Act).

The investor may nominate a beneficiary to receive the saved sum upon the investor's death. This is why endowments have become so popular as estate planning tools. The investor is able to move funds out of their estate during their lifetime, and ring fence them for a beneficiary, thus ensuring that the funds do not form part of the investor's estate on death.

Why is this relevant?

Depending on where they are situated, assets which form part of a deceased estate are subject to certain administration (also known as probate) processes which take time and generate a fee that is payable by the deceased estate.

In South Africa, executor's remuneration is charged at a fixed tariff (provided that a different figure has not been agreed to, which is a possibility) calculated at 3,5% of the gross value of the assets in the deceased estate on death, plus a 6% collection commission on all income collected after the date of death. In other jurisdictions, no tariff is set, and the result is that foreign administration fees can be easily accumulated.

It is therefore clear that individuals enjoy endowments as a way in which to avoid the costs and timelines associated with the administration of a deceased estate.

Additional benefits on death:

- As it is not subject to the estate administration processes, the pay-out from an endowment is accessible by the beneficiary a lot quicker.
- Where an investor elects for their contribution or premiums to be invested in underlying funds which are abroad, *situs* taxes are avoided as the endowment itself is South African based.

Are endowments all that they're trumped up to be? - An estate duty consideration*...continued*

The pay-out to a nominated beneficiary will accordingly not form part of a deceased estate for administration purposes...but will be added back when calculating estate duty.

But ...

On death, an individual's worldwide estate is subject to South African estate duty, provided that the individual concerned is normally resident here in the 12 months prior to their death. For an individual, assets in excess of R3,5 million are taxed at 20%, and assets in excess of R30 million are taxed at 25%.

Section 3 of the Estate Duty Act 45 of 1955 (ED Act) sets out what constitutes an estate. Section 3(3) goes further and defines "*deemed property*" which also constitutes an estate (and is accordingly subject to estate duty).

The relevant sections of 3(3) read:

> *"Property which is deemed to be property of the deceased includes:*
>
> *(a) so much of any amount due and recoverable under any policy of insurance which is a 'domestic policy'...*
>
> *(d) property ... of which the deceased was immediately prior to his death competent to dispose of for his own benefit or for the benefit of his estate."*

A "*domestic policy*" is defined in section 1 of the ED Act as *"any life policy as defined in section 1 of the LTI Act ... excluding a life policy which has been made payable at a place outside the Republic at the request of the owner..."*

The general view is that the pay-out from an endowment is subject to estate duty – whether in accordance with section 3(3)(a) or 3(3)(d) of the ED Act. The pay-out to a nominated beneficiary will accordingly not form part of a deceased estate for administration purposes, as set out above, but will be added back when calculating estate duty.

And yet ...

One may consider whether, using the definition of "*domestic policy*" in the ED Act, a pay-out to a foreign nominated beneficiary may be excluded for estate duty purposes.

Although uncertain whether this would succeed (the South African Revenue Service may use the backup section 3(3)(d)), considering the prevalence of endowments, and the large sums invested in them, a keen investor may wish to further contemplate whether there is any merit in such an argument.

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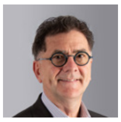

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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