Endowments play a vital role in a diversified portfolio

Limiting the tax that you pay can have a significant impact on the growth of your share portfolio and other investments over time. Investing through an endowment policy can not only reduce your tax burden, but also offers many more benefits.

What is an endowment?

An endowment is an investment policy (with a minimum five-year term) with tax advantages for affluent individuals and their trusts (with natural beneficiaries only).

In addition to being tax efficient, there is also no limit to the amount of offshore exposure you can have in your endowment – increasing its attractiveness as investors seek to diversify offshore.

Essentially an endowment is a life insurance policy, as defined in the Insurance Act. A policy is a contract between a policy holder and a provider whereby the provider agrees to meet an insurance obligation upon the happening of a life event, in return for the receipt of a premium from the client. An endowment policy will pay out any remaining funds, not drawn as an income, on your death.

A tax-efficient investment

The personal income tax bracket of 45% introduced in 2017 remains daunting for high income earners, supporting the need for investors to look for more tax-efficient ways to grow their discretionary savings.

When does an endowment make sense?

There are a number of factors to consider when choosing between a pure discretionary investment plan or an endowment. This includes availability of interest and capital gains allowances as well as required access to capital within the first five years.

A key consideration in how to choose between the two products is your tax rate. Individuals in an investment plan are taxed at marginal rates of up to 45%, resulting in an effective tax rate on capital gains of 18%. Where the individual invested in an endowment, tax on income will be 30% and effective tax on capital gains will be at 12%. Within the two products (endowment and investment plan) there is no differentiation for dividend tax, which is withheld at 20% either way.

How much can you save on tax in an endowment?

For high income earners the endowment can offer significant tax savings. Consider an individual that has no interest and capital gains allowance available and invests R5m for five years. Assume a balanced fund-type investment with 11% return per annum and 20% trading of the portfolio each year.

After five years, allowing for redemptions for payment of income tax annually, such an investment would have grown to R7.93m in an investment plan. An equivalent investment in an endowment would have grown to R8.09m, saving the investor R161 000 over the period. This consists of:

- income tax saving (30% versus 45% marginal rate assumed)
- capital gains tax saving (on realised capital gains)
- additional return earned as a result of compounding from a higher base.

If the investor completely sells out of the investment after five years, the tax saving when realising the remaining capital gains would be an additional R90 000 when opting for the endowment.

Do the math

Trusts or individuals with significant discretionary savings and high marginal tax rates could consider an endowment. There are restrictions that may not make it a suitable option, but multiple benefits and the significant potential tax saving are not to be ignored.

More reasons to consider an endowment

In addition to tax savings, an endowment offers the following advantages:

- Simplified tax administration as tax is recovered within the endowment and taken care of on behalf of the investor.
- Insolvency protection – the entire value of the policy will be protected against creditors after three years as long as the policy owner or their spouse is the life insured under the policy. This protection will continue for five years from the date on which the policy benefits were provided. This is especially attractive to business owners.
- There is no restriction on maximum levels of equities and offshore investments, as in the case of retirement savings products.
- Unlimited additional investment amounts can be added during the first year with no impact

on the five-year restricted term. From the second year onwards, additional amounts can still be added, subject to legislated limits.
- After the five-year restricted period has ended you have the ability to draw an income from your investment, as there are no longer any restrictions on the number or amount of withdrawals. All other benefits remain in place – it is merely the restricted period that ends.
- There is a certain level of liquidity available to you during the five-year term. During that period, you're able to make one withdrawal and one zero-interest loan (subject to legislated limits). You can also set up multiple policies to further increase your available liquidity.
- Estate planning benefits, such as a saving on executor's fees if a death benefit is paid to a beneficiary (these fees can be up to 4.025%).
- Beneficiaries will receive the proceeds relatively quickly as the payment of the death benefit does not depend on the winding up of the estate.
- If no beneficiary is nominated, the money will be paid into the estate, creating liquidity for the payment of debt.

A sinking fund (essentially an endowment, but with no life assured on the policy), allows you to appoint a nominee for ownership who will become the new policyholder on your death. The nominee could be an individual or a trust with individuals as beneficiaries. The trust will benefit from the tax advantages offered by the sinking fund.

Offshore endowments

If you're looking to obtain direct foreign exposure in your investment portfolio (including your share portfolio), you could do so via the Global Life Plan from Glacier International, an offshore endowment, or via the Global Investment Plan which is an offshore sinking fund. These structures allow you to customise your investment using a combination of foreign currency investment options while still enjoying all the benefits offered by an endowment or sinking fund policy.

In the case of the Global Life Plan, because you're investing via an offshore endowment issued by a South African Life company, you don't create an offshore asset, and therefore don't require an offshore will. An additional benefit is that you won't need to appoint international representatives to help wind up your offshore estate, which can be both costly and time consuming. The endowment also ensures that your estate is not subject to foreign inheritance tax which can be as high as 40%. Once again, the sinking fund policy – the Global Investment Plan – is available to trusts as well as individuals.

If you are looking to optimise your portfolio, whether local or offshore, speak to your financial adviser about how an endowment plan could enhance your investment portfolio.

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The Global Life Plan is an offshore endowment policy and the Global Investment Plan is an offshore sinking fund. Both policies are issued by the Sanlam Life Insurance Bermuda branch.

The Glacier Vantage Life Plan is an endowment policy underwritten by Sanlam Life Insurance Limited, a licensed financial services provider.

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