Foreign pension trusts: SARS ruling

08 September 2022
By Diane Seccombe, National Head of Taxation at Mazars Academy

Binding class ruling (BCR) 080, issued by the South African Revenue Service (SARS), was published on 12 August 2022 and deals with the tax consequences for resident beneficiaries of a foreign pension trust (FPT).

BCR 080

A BCR is issued by SARS in response to an application and clarifies how SARS will interpret and apply the tax laws relating to specific transactions described in the application. Once issued, a BCR applies only to the class of persons who will be involved in the specific transactions and SARS. In BCR 080 the applicant is an SA company and the founder of an FPT. The class of persons to whom the BCR applies are the resident investors who will make contributions to, and become beneficiaries of, the FPT. While it is important to note the parameters of BCR 080, we can nevertheless gain insight into the manner in which SARS believes investors in similar foreign pension trusts should be taxed.

In respect of contributions to the FPT, as the FPT is not a recognised retirement fund in terms of the Income Tax Act (ITA) the contributions are not regarded as tax deductible. The contributions will also not be regarded as a donation and therefore no donations tax will be triggered, despite the fact that contributions may be made on a once-off or on an *ad hoc* basis.

The FPT described in BCR 080 is clearly a discretionary offshore trust. Investors will make their contributions with the expectation of becoming beneficiaries of the FPT and receiving certain retirement benefits in the form of lump sums and/or annuities, subject to the trustees of the FPT exercising their discretion in accordance with the scheme rules. The applicant further states that "investors will not have beneficial control of the contributions made to the FPT and any growth thereon" and that "the FPT will provide protection from creditors and will not form part of the investor's personal assets".

What happens on the death of the investor?

On the death of the investor the FPT rules state that should the investor pass away before what is described as “normal retirement age” then “the designated dependants of the deceased may become beneficiaries of the FPT. These beneficiaries may receive annuity payments or lump sum payments from the FPT subject to the trustees exercising their discretion in terms of the scheme rules”.

Furthermore “with respect to beneficiary nominations, an investor’s assets may be passed to any nominated beneficiary or into a trust on the death of an investor. Assets will not go through probate.” Frustratingly the mechanism by which this will occur is not described in BCR 080, and as such it is uncertain whether this is done by way of a letter of wishes (as is the norm in similar vehicles) or part of the FPT rules.

Tax consequences

Despite the discretionary nature of the FPT described, SARS is of the view that the investor will, upon becoming a beneficiary of the FPT, acquire “a vested personal right to the income and capital of the FPT, subject to the time-based restrictions stipulated in the scheme rules”. As a result of this view, substantial tax consequences arise.

During their lifetime the investor will be taxed in terms of the onerous section 7(1) of the ITA. This section deems an accrual to the investor, and thereby a potential annual tax consequence of income that has been ‘….reinvested or accumulated or capitalised or otherwise dealt with…’ in the name of the investor. Importantly section 7(1) overrides section 25B. Section 25B ((specifically section 25B(2A) in respect of offshore trusts)) is commonly used in respect of discretionary trusts and provides that tax consequences for a beneficiary only arise when trustees exercise their discretion in favour of the beneficiary.

Any annuity paid to the investor once they reach retirement age, will be included in the gross income of the investor. However, if any portion of an annuity has already accrued to the investor in terms of section 7(1), that portion cannot be included in the gross income of the investor again.

The “vested personal right” that SARS believes the investor acquires in the FPT, is regarded as an asset in the hands of the investor. As such, a deemed capital gains tax (CGT) event will be triggered at the death of the investor and estate duty implications will arise.

From a CGT perspective, the contributions made by the investor will form the base cost of the asset. As the FPT rules dictate that retirement benefits paid to the investor will first be made from the investor’s capital contributions, these will have to be set off against the base cost.

An investor that passes away before retirement age will have a deemed disposal of the vested right in terms of section 9HA of the ITA. Proceeds equal to the market value of the right less the base cost of the right will be used to calculate the CGT. The right must also be included in "property" for the purposes of estate duty, at the market value of the right and this will increase the value of the dutiable estate.

Estate duty

For Estate duty purposes, BCR 080 only refers to the "right to an annuity" when the investor passes away after retirement. The right to an annuity will be considered property for estate duty purposes and valued as such.

The deemed disposal for CGT, when an investor passes away after retirement date, will be calculated on the disposal of both the right to an annuity held by the deceased and a right to a lump sum. Each will be disposed of for proceeds equal to market value and it is assumed the base cost will have to be apportioned.

Conclusion

For all investors in FPT's, BCR 080 makes it clear that SARS wants more tax consequences to arise from these investment structures than are currently being recognised. The practical implementation and accurate disclosure of the approach adopted by SARS in the BCR will be extremely challenging for investors and the FPT administrators.

Glacier Financial Solutions (Pty) Ltd.

A member of the Sanlam Group
Private Bag X5 | Tyger Valley 7536 | Email client.services@glacier.co.za | Tel +27 21 917 9002 / 0860 452 364 | Fax +27 21 947 9210 | Web www.glacier.co.za | Reg No 1999/025360/07
Licensed Financial Services Provider | Glacier Financial Solutions (Pty) Ltd. is also a Licensed Discretionary Financial Services Provider FSP 770, trading as Glacier Invest | Sanlam Multi-Manager International (Pty) Ltd. | A member of the Sanlam Group

Private Bag X8 | Tyger Valley 7536 | Tel +27 21 950 2600 | Fax +27 21 950 2126 | Web www.smmi.com *|*Reg No 2002/030939/07
Licensed Discretionary Financial Services Provider, acting as Juristic Representative under the Glacier Financial Solutions FSP 770
Glacier International is a division of Sanlam Life Insurance Limited
Sanlam Life Insurance Ltd. | Email life@sanlam.co.za | Tel + 27 21 916 5000 / 0860 726 526 | Fax +27 21 947 9440
Reg No 1998/021121/06 | Licensed Financial Services Provider