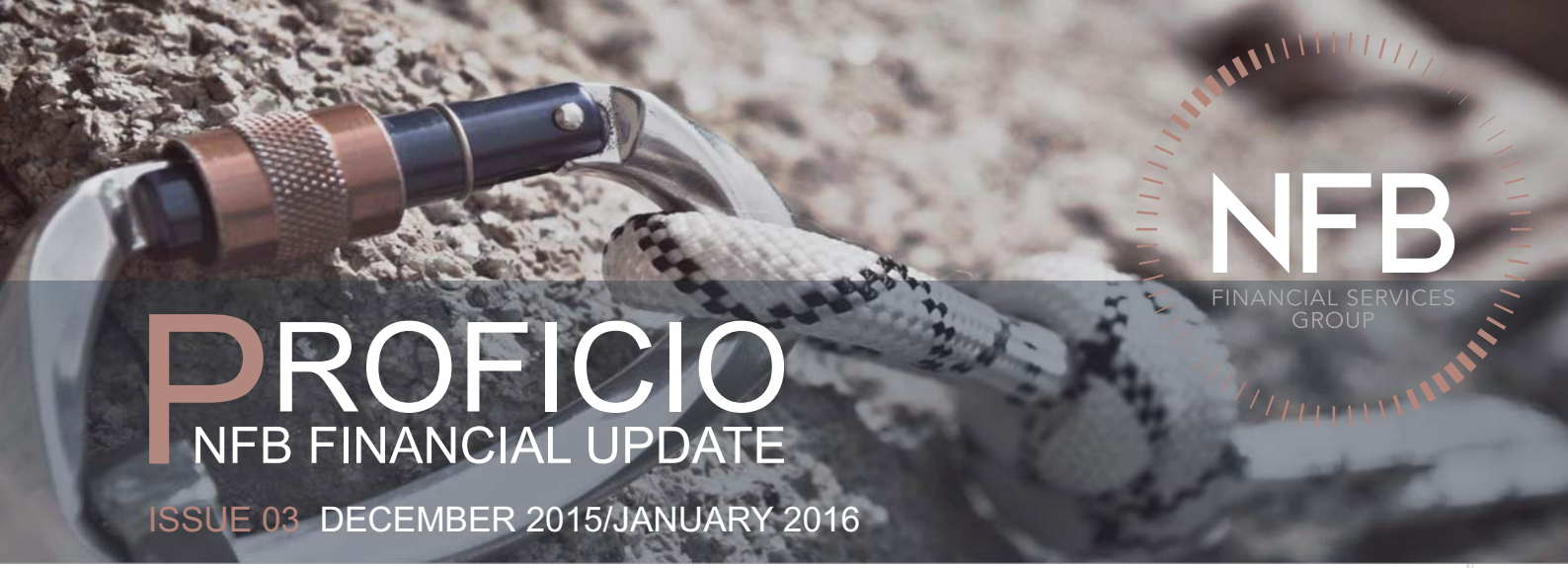


PROFICIO
NFB FINANCIAL UPDATE

ISSUE 03 DECEMBER 2015/JANUARY 2016

NFB FINANCIAL SERVICES GROUP

FROM THE CEO's DESK

Yesterday saw the share price of Anglo close below R100! This is extraordinary, and when recognizing the historical dominance of our market by these dwarfs of their former selves, now replaced by an online business and beer manufacturer, we get the picture that things can, and will change. What is important is to recognize this and be able to act when necessary. NFB Asset Management, our own in-house analyst and creator of rather effective solutions, recognized some of this a few years back and removed some of the resource focused funds from our preferred list. This did not mean that we enjoyed a crystal ball event, it was simply to avoid what appeared to be an end of a trend. These actions are done after rather rigorous analysis and with caution, more often than not, resulting in the change being after the "peak" value is reached. At other times, we might have acted prematurely. The point is, we acted after professionally considering the tax and cost implications and any other relevant issues.

Humans seldom do this of their own accord. We are a strange bunch, most often reacting quite emotionally, sometimes being influenced by fear, recurrence of an historical event or personal experience, sometimes displaying what are called behavioural biases. The experts compare "homo economicus" who think logically and unemotionally, and "homo sapiens", who, like us, will knee jerk, panic, fear the unknown, and almost always be unsure. So I guess what I am on about is rationalizing NFB's advice. Hopefully we offer more than just an answer to the question about which fund, Endowment, RA or share to invest through. The need is often the result of an event in your life, sometimes of relatively little impact, such as the sale of a property or business, or simply an existing investment reaching its contractual maturity, other times a major event like retirement, redundancy, a death and inheritance or illness. These are where a great relationship which rewards all parties can be invaluable. I have found, personally and in my family, a sounding board, who you can trust, to be invaluable.

On the subject of inheritance and estate duty, NFB has divisions in both East London and Johannesburg which specialize in drafting of Wills and Execution of Estates. They also, like I trust we do in the advisory business, offer much more. The conversation regarding wills, bequests, charitable bequests, control of assets, in the case of inexperienced beneficiaries, the effective use of trusts, direct bequests, taxation and liquidity issues can be daunting!

These teams do this work professionally and alongside the Advisory business, and can make a difference in this somewhat confusing and often uncomfortable challenge to us and our families. Another point is that legislation affecting Wills and Estates is currently under review. You might have seen reference to the report and review Judge Denis Davis is responsible for. The initial recommendations are indeed rather concerning, and deal with bequests to spouses being much less tax and cost effective, alongside this donations taxes changing in sync, Trusts losing the ability to "conduit" income and gains to beneficiaries in order to reduce effective tax. If this sounds confusing, it is! This is exactly why we've seen fit to incorporate this value add service to what was originally just an advisory offering investment solution. I would encourage all of our clients to have a discussion and review your Wills and Trust Deeds. These simple steps could materially improve the benefits we all would like to leave to our beneficiaries. The last point, made obvious by the Denis Davis process, is that this should not be done once in a blue moon. I would promote you instructing us to engage in a review every few years, and certainly if any major change occurs in your financial or family circumstance.

Finally, as noted in my last editorial, NFB has become a significantly larger advisory as a result of the creation and listing of NVest Financial Holdings. An immediate benefit of this has been several conversations, some instituted by our institutional partners regarding management fees on their products and other interesting developments. These will bear fruit, and in some cases already have, resulting in the gradual and consistent improvement of overall management costs of our clients' investments. Whilst these improvements are measured in fractions of percentages, they are important and compound for as long as the investment is in place. Gratifying also, that in some cases the institutions have approached us, rather than being pressured.

In closing, markets remain volatile. Calm, considered, rational action is required. It remains true that cash and inflation are good friends. Investing for the long term and achieving the correct income (as tax efficiently as is possible), growth, local or offshore exposure and sustained inflation beating returns (ensuring cash maintains its real value) cannot be achieved in money markets. If one considers the need in retirement to draw an income, together with tax and inflation, a cash type investment stands no chance of meeting these demands and maintaining your buying power. This leaves one no alternative but to look for investments and assets which will "do the job". Investing in growth assets in pre-retirement years becomes obvious, guided by smart conversations with your chosen advisor. The eventual portfolio makeup is dependent on your risk budget, which becomes more flexible, the lower your income need as a percentage of your portfolio is, in retirement.

Both of the topics I have tried to highlight in this editorial are important and if at all confusing or concerning, should be discussed with our advisory team. We have specialists to support your direct advisor in each of these and other aspects of your investment needs.

This is our last edition of Proficio for 2015. My, the year has flown by! May I, on behalf of our directors and staff, thank you for your support of NFB, wish you well over the Festive Season, and ask that you take me up on the invite to engage with us on these issues.

> "...markets remain volatile. Calm, considered, rational action is required."

Mike Estment CFP® professional
BA / Chief Executive Officer
NFB Financial Services Group Gauteng

DAVIS TAX COMMITTEE REPORT AND ITS RECOMMENDATIONS IN TERMS OF TRUSTS

Whilst the use of trusts remain a topical issue, it is useful to recap their current advantages and whether they remain viable post these reforms.

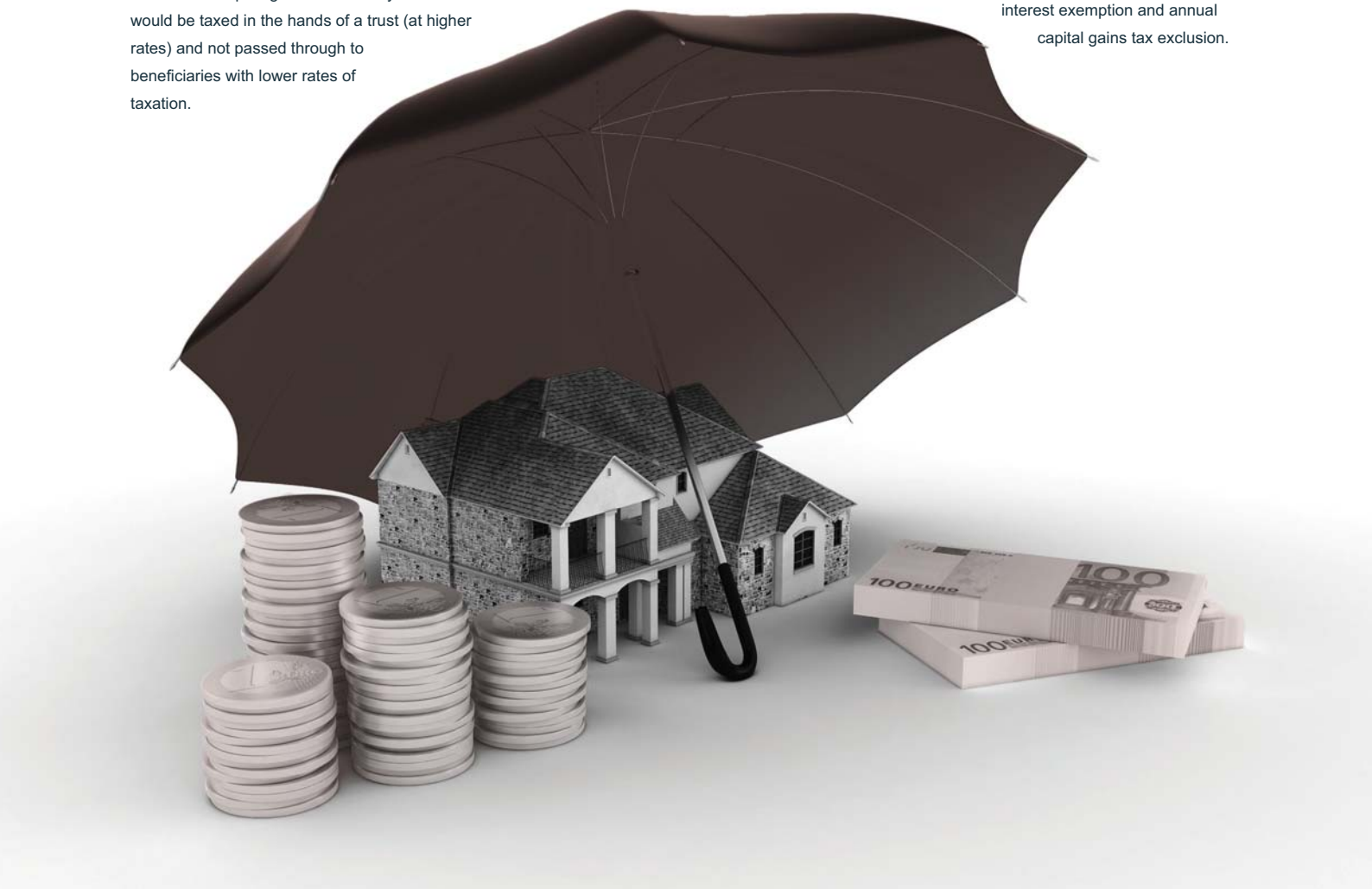
Earlier in the year, the Davis Tax Committee (DTC) released its first report in respect of estate duty in terms of the continued role and relevance of estate duty in South Africa.

One of the aspects the report looked at was the way in which trusts are to be taxed. In this regard they proposed the removal of the 'attribution principles' (section 7 and 25B of the Income Tax Act), which would effectively remove the *conduit pipe* principle, in that all income and capital gains received by a trust would be taxed in the hands of a trust (at higher rates) and not passed through to beneficiaries with lower rates of taxation.

The report states that the attribution rules were originally intended as an anti-avoidance measure to prevent income splitting opportunities (back in 1972 the maximum rate for individuals was 78%), but today they no longer serve this purpose. In fact, the opposite is true – they now represent a concession to high net worth individuals. At best, income will be taxed at the same rate of 41%, but it could be taxed at anything from 0% to 41%, depending on the level of taxable income of the donor.

The removal of the section 7 and 25B (as applicable to RSA residents) would result in income being taxed in the hands of a trust at 41% from R1 (same marginal tax rate as an individual, although an individual is taxed on a progressive scale) and capital gains being taxed at a rate of 27.3% (vs. 13.65% in the hands of an individual).

It would effectively remove the income splitting opportunity to spread income amongst beneficiaries with lower tax rates, and in certain cases, with the added benefit of an interest exemption and annual capital gains tax exclusion.



> Despite the proposed changes referred to above, a trust nevertheless remains a viable option in the pursuit of a commercial benefit, provided the sole reason is not purely driven by estate duty or income tax benefits.

Other DTC recommendations:

- Flat rate to be maintained for Trusts at existing levels;
- The deeming provisions of section 7 and 25B to be retained insofar as they apply to non-resident trust arrangements;
- Trusts taxed as separate taxpayers;
- Relief to be available for special trusts (definition to be revisited);
- Status quo to remain in respect of interest free loans.

Whilst the use of trusts remain a topical issue, it is useful to recap their current advantages and whether they remain viable post these reforms.

ADVANTAGES OF TRUSTS

- **Estate Freezing**
  This is the most common perception in considering whether to form a trust or not. Assets which are expected to grow substantially in value are either sold to a trust (for the benefit of the seller and his family) or acquired by a trust in the first instance. Any increase in the value of assets is excluded from such person's estate for estate duty purposes as the growth in the value of the assets takes place in the trust.

There are however many other reasons and advantages in forming a trust:

- Protection against creditors where a person may be exposed to business risks and creditors' claims.
- Estate skipping mechanism whereby an inheritance is passed to a trust on behalf of a beneficiary instead of directly to the beneficiary. This has the benefit of avoiding any further estate duty on such assets, but also acts as an effective planning mechanism for future generations, protection of an heir from the consequences of a marriage break-up, business risks and creditors' claims.
- It allows for efficient succession where assets are held in trust: there is no impact (in the form of estate duty, delays in administering an estate etc.) on the death of the original donor of the asset or on the death of any one of the beneficiaries of the trust. The asset continues unimpeded for the use and enjoyment by the remaining beneficiaries.
- A trust can be used to achieve the same benefits as a usufruct without necessarily creating any estate duty implications on the death of the person enjoying the benefit (i.e. the usufructuary).
- Trusts can be used to hold assets such as farming property which are incapable of sub-division in terms of the Agricultural Land Act, receive lump sums from Retirement Funds for the benefit of minor beneficiaries, allocation of income amongst beneficiaries, preserving family assets over time, looking after the founder's family after his death, maintaining a spouse or child after a divorce.

It is important to note that in order to achieve the above benefits, the founder of a trust has to relinquish ***ownership and control*** of his assets. If this is not done properly then Section 3(3)(d) of the Estate Duty Act may be applied which deems property of the deceased to include any property which he was competent to dispose of for his own benefit and such property will be included in his estate at the market value thereof at date of death (notwithstanding that it may be housed within a trust).

The issue of control, or lack thereof, over assets to be placed in a trust has often been the prime dilemma faced by potential founders of trusts.

Despite the proposed changes referred to above, a trust nevertheless remains a viable option in the pursuit of a commercial benefit, provided the sole reason is not purely driven by estate duty or income tax benefits.

OTHER ISSUES RAISED BY THE DAVIS TAX COMMITTEE

Estate Duty

- Complete withdrawal of Section 4q deduction (spouse rollover) and consequently the CGT rollover, or allowing such rollovers subject to a specified limit.

  Estate duty will no longer be deferred to the death of the last dying spouse, but will trigger on the death of the 1st dying spouse and again on the death of the 2nd dying spouse. This may create possible liquidity problems in the estate of the 1st dying spouse.

- Considering an increase in the primary estate duty abatement to R6.0m (currently R3.5m) to compensate for the withdrawal of the 4q spouse deduction. Also looking at reframing the 'portable' spouse abatement.

  It is envisaged that the spouse abatement of the surviving spouse can be anticipated in the estate of the 1st dying spouse i.e. a total upfront abatement of R12.0m (up to R12.0m free from estate duty).

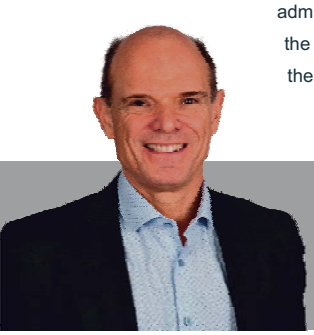
- No changes envisaged in inter spouse donations, with the exclusion of all interests in fixed property or companies.

Retirement Annuities

- Contributions to a retirement annuity to form part of an individual's estate to the extent of disallowed contributions.

  This recommendation can now be found in the wording of the recently released draft Taxation Laws Amendment Bill 2015 which provides that any contribution to a pension fund, provident fund or retirement annuity fund not taken into account in terms of its utilisation against remuneration or taxable income, the receipt of any lump sum from retirement, or set off against a compulsory annuity, will be treated as property in the estate of the deceased. The proposed amendment will apply to the estates of persons dying on /after 1 January 2016 in respect of contributions made from 1 March 2015 onwards.

Should you require further information on taxation within Trusts and how this may affect you, speak to one of our financial advisors at one of our NFB offices in Johannesburg, East London, Port Elizabeth, Stellenbosch or Cape Town. ■



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> The issue of control, or lack thereof, over assets to be placed in a trust has often been the prime dilemma faced by potential founders of trusts.

MAKING SURE YOUR CHILDREN ARE TAKEN CARE OF

If tomorrow never arrives...? Who will take care of your children?

We don't like to consider our mortality. We take it for granted that we will be around to not only watch our children grow up and go to university, but that we will see them get married and have children of their own too (in that order).

But what if tomorrow never arrives...? Who will look after our children?

GODPARENTS vs GUARDIANS

GODPARENTS - A godparent, in Christianity, is someone who sponsors a child's baptism. Nowadays, the secular view of a godparent tends to be an individual chosen by the parents to take an interest in the child's upbringing and personal development, and to take care of the child should anything happen to the parents. A godparent is, however, essentially a spiritual role, not a legal one.

LEGAL GUARDIANS - A legal guardian, on the other hand, is the person who will make all the important decisions regarding your child's welfare should you die or become incapacitated – decisions about where your child will live, schooling and general care until the age of 18.

The legal guardian, as named in your will, must be formally appointed by the Master of the High Court.

Your children's godparents have no legal role when it comes to the children's protection and well-being after your death, whereas their guardians have a legal role with long-term responsibilities with regards to their protection and well-being.

> "It is recommended that you stipulate who you would like to appoint as your child's legal guardian in your will."

When choosing a potential legal guardian for your child, consider someone who:

- Has a cultural background and family values similar to yours
- Your child knows and is comfortable with
- Lives in the same neighbourhood, ensuring continuity of schooling
- Keeps regular contact with you and your children
- Is relatively stable financially and can be trusted to handle your children's financial affairs honestly.

It is recommended that you stipulate who you would like to appoint as your child's legal guardian in your will. You can also include a short motivation for your choice, in a separate annexure to your will.

If one parent dies, the other biological parent will become the legal guardian, irrespective of any divorce agreement that may exist. If both parents die, the Master will consider your recommendation of legal guardian. If no guardian has been recommended, the Master will consider the closest living relatives for the role. The Master may, when deciding who to appoint, take into account any godparents who have been named, since these people are likely to be family members or close friends trusted by the parents.

Whereas godparents are usually selected for life, your choice of legal guardian should be reviewed on a regular basis. "People's personal circumstances change and the candidate you selected at the birth of your child may no longer be an appropriate choice 10 years later."

The guardian should be asked beforehand if they feel up to the task, and informed in detail of the financial arrangements that have been made (such as education policies and testamentary trusts). This gives both parties the opportunity to raise and resolve concerns, ensuring peace of mind that your chosen legal guardian will look after your child in the way you intended. The guardian will be legally obligated to take care of your child only until the age of 18.

Should you need to ensure that your Will is in order, or require assistance in setting up a Testamentary Trust, speak to one of our qualified financial advisors at one of our NFB offices in Johannesburg, East London, Port Elizabeth, Stellenbosch or Cape Town. It will definitely be time well spent to secure your children's legacy.

> "People's personal circumstances change and the candidate you selected at the birth of your child may no longer be an appropriate choice 10 years later."

Nonnie Canham
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