Davey's Locker

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Retirement funds

The CGT exclusion, and offshore boondoggles

by Tony Davey

Contributions: as you were

In 156 *TSH* 2015, I looked at the new tax treatment of contributions to retirement funds, effective as from 1 March 2016, pointing out that, since 'taxable income' includes a taxable capital gain, a greater base against which contributions may be deducted had been established, subject to the annual cap.

But the draft Revenue Laws Amendment Bill, 2016 proposes that, with effect as from the very same date, s 11(*k*) of the Income Tax Act be amended, so as to introduce a new paragraph (v):

> (v) any deduction in terms of this paragraph must apply for the purpose of determining the total amount of taxable income, before any deduction in terms of section 18A or the inclusion of any taxable capital gain of the person, whether derived from the carrying on of any trade or otherwise;

Thus the taxable portion of a capital gain, although ordinarily included in taxable income under s 26A, will specifically be excluded from comprising part of the taxable-income base for purposes of the deduction of retirement fund contributions.

Nevertheless, investment income other than capital gains is included, and thus added to other taxable income in the determination of the taxable income against which the 27,5% deduction is available.

Offshore retirement funds

The too-good-to-be-true offshore retirement fund product and its variations I described in 105 *TSH* 2011 has finally been exposed for its shortcomings, by the Davis Tax Committee, in its second report on estate duty, published on 24 August 2016 (see the Monthly Listing).

I both expressed my concerns in these pages and provided negative tax opinions to financial advisers enticed by large commissions by offshore suppliers to market these products to high-net-worth South African clients.

My recommendation in favour of an advance tax ruling from SARS (in the interests of certainty) was dismissed by the offshore suppliers, who claimed that an investment in these offshore retirement funds incurred no donations tax, deferred income tax (if any income tax at all) or estate duty.

The DTC observes otherwise:

> This arrangement, in the view of the Committee, represents a concealment of the true arrangement between the SA taxpayer and the offshore trust/retirement fund. The true arrangement is that the taxpayer has a vested interest in both the capital and income of the offshore trust/retirement fund. As such, the income of the arrangement is taxable in the hands of the SA resident taxpayer and the capital should be included in the estate duty computation. Alternatively, if the true arrangement between the parties is indeed a donation, it should be subject to donations tax and the income deemed to be that of the SA taxpayer in terms of section 7(8).
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> The DTC recommends that the above arrangements be further investigated by SARS.

In its chapter 1 summary, commenting generally on foreign discretionary trusts (also those housing such products) it said:

> SARS should establish a separate investigations unit to thoroughly and comprehensively examine foreign trust arrangements. Where disclosure deficiencies are detected, the penalty provisions of the Tax Administration Act...should be rigidly applied.

The DTC and I may both be wrong, but, under s 102(1) of the Tax Administration Act, the onus of proof lies with investors in these products to prove their tax consequences. It's likely to be a busy season for SARS.