Moneyweb

Tax

Investing in UK and US shares?

Avoid foreign death taxes.

Oliver Phipps, FISA / 30 November 2016 12:30 **10 comments**

For South African investors wishing to access global markets and hedge against volatile exchange rates, externalising assets offshore can present great opportunities. However, when planning what companies or funds to invest in, it is worth considering what the tax implications would be if you were to pass away. Of course this is not a cheerful thought, but a sensible one, as it is prudent to ensure that your investments are structured in a tax efficient fashion and preserved for future generations.

It is well known that South Africa has double taxation conventions (DTCs) for the purposes of death taxes in place between the United Kingdom and the United States of America. Estate duty is known as inheritance tax (IHT) in the UK and estate tax in the US.

For individuals who are domiciled in South Africa, care must be taken when investing in UK or US shares as there is the possibility of punitive tax rates if an investor were to die. The possibility of an estate getting caught by UK IHT or US estate tax depends on the type of investment, the value of those investments and the beneficiary of the estate. To illustrate problems that can be encountered, I will discuss the position in the UK and US separately using some examples.

UK shares

When an individual dies domiciled in South Africa owning shares in UK registered companies and listed on the London Stock Exchange, the value of those shares will be subject to assessment for IHT by the UK tax authority.

The current threshold, also known as the "nil rate band", for which no UK IHT is payable, is £325 000. Subject to certain exemptions and reliefs applying, any amount over this threshold is subject to inheritance tax at 40%. A surviving spouse may be able to use their predeceased spouse's nil rate band and leave up to £650 000 free of IHT. There is also an unlimited spouse exemption if, for example, a South African domiciled spouse leaves all of the UK shares to his spouse. However, the following example is designed to illustrate how a share portfolio could be caught by UK IHT:

Randolph is domiciled in South Africa and owns a portfolio of individual UK registered shares valued at £1 000 000. Randolph is not married and plans to pass his estate to his children. Randolph wishes to analyse if his UK portfolio is exposed to UK IHT.

In accordance with the DTC between South Africa and the UK, the convention states that shares registered in the UK will be taxable in the UK – even if an individual is considered domiciled in South Africa.

So in this case, the UK IHT would be the total value of the UK shares, £1 000 000 less the nil rate band of £325 000 which would leave £675,000 subject to UK IHT at 40% = £270 000. If estate duty was also levied in South Africa, Randolph would be able to apply for a credit from Sars up to the value of the estate duty attributable to the UK registered assets.

Randolph is keen to keep his UK shares and seeks advice on how to shelter his offshore portfolio from UK IHT. Randolph is told that he can avoid exposure to UK IHT by arranging for a nominee registered outside of the UK to hold the UK registered shares. This is a common pitfall. If the UK stock portfolio was held in a nominee capacity only, the beneficial ownership of the shares would remain in Randolph's personal estate and would still be subject to UK IHT.

US shares

South Africans investing in US stocks should tread very carefully as the implications for poor estate planning could be severe.

US tax law will consider a South African domiciled individual who is also a non-US citizen as a "non-resident alien" (NRA). The threshold (estate tax exemption amount) for an NRA is set dangerously low at only $60 000 with a top estate and gift tax rate set at 40%. The DTC between

South Africa and the US for estate duty/estate tax operates so that the US will have the privilege of taxing stocks in companies that are registered in the US.

The result is that if a South African who is considered as an NRA passes away owning US stocks valued at over $60 000, a punitive tax could be lurking just around the corner. To add insult to injury, unlike the unlimited spouse exemption offered in the UK, the US does not offer the equivalent exemption, so even if the US shares pass to a lawful spouse, there is no spouse exemption – unless the surviving spouse is a US citizen.

The following example is designed to illustrate an unexpected tax liability for a South African investor:

Pamela is married to Charles and owns a nominee investment portfolio in her sole name, which is registered in the UK. The investment portfolio contains a number of individual US registered stocks valued at $500 000. Both Pamela and Charles are domiciled in South Africa and are South African citizens.

Sadly, Pamela passes away and by her will she leaves her entire worldwide estate to her spouse, Charles. Although the nominee investment account is registered in the UK, this does not shift the situs/ location of the US stocks and for the purposes of US tax law, Pamela is still considered to own $500 000 of US stocks at death.

In these circumstances, there will be no spouse exemption in the US and estate tax will be levied on the US stocks in accordance with a unified rates schedule for the date that Pamela passed away. Depending on the value of the US stocks that are owned at death the estate tax rate can be up to 40%.

Using the example in this case, even if the investment manager in the UK had not requested a US estate tax clearance certificate (known as a federal transfer certificate), this would not remove the executor's obligation to ensure that the estate tax position is settled in the US.

To conclude, this article is not designed to discourage South African investors from diversifying offshore or from investing directly in UK and US stocks, but hopefully the examples serve to encourage investors to check with their professional advisors that they have invested in a tax efficient manner and utilised the exemptions and reliefs that are available.

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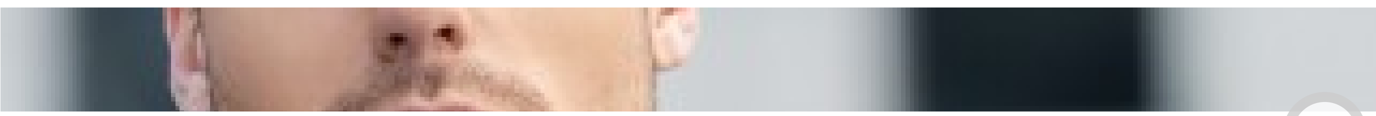

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