# UNITED STATES TAX PLANNING FOR SOUTH AFRICAN CONNECTED STRUCTURES OR INVESTORS

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Current depressed valuations, although unfortunate, present a unique tax planning opportunity for South African ("SA") individuals with United States ("US") connections. Two common problems we encounter with SA individuals are (1) foreign non-grantor trusts with US beneficiaries, and (2) SA individuals who hold US securities in offshore investment structures or accounts. Both situations can present severe adverse US tax consequences, but there are ways to mitigate or even eliminate the adverse US tax consequences. These solutions often come at a short-term cost in a booming economy – a cost that may cause clients to delay or avoid addressing the problem. Under current economic conditions, however, that cost may be dramatically reduced or eliminated so it is important to consider addressing the problems now.

Foreign (non-US) non-grantor trusts that have US beneficiaries are potentially subject to an onerous US tax regime referred to as the "throwback tax," which imposes a punitive tax on income earned by the trust in one year and then distributed to a US beneficiary in a subsequent year. The beneficiary is taxed as if the income had been distributed in the year it was earned but he or she failed to report it. Interest charges are imposed for the deemed late payment of tax, and certain categories of income otherwise subject to preferential tax rates (such as certain dividends and capital gains) lose their preferential treatment. The longer the trust has been accumulating income, the greater the problem becomes. In the worst case scenario, the US tax can consume the entire distribution.

The ideal solution to this problem is to transfer the trust assets to a new trust that is structured to be a revocable *grantor* trust for US tax purposes. A revocable grantor trust enables accumulated income and realized capital gains to be distributed tax-free to US beneficiaries during the grantor's lifetime and immediately after his or her death. The main drawback of restructuring a trust in this manner from a South African perspective is that such a transfer triggers South Africa capital gains tax. However, given the current economic climate and the lower asset values, the capital gain tax on such a transfer may be reduced or eliminated, making this prudent restructuring a worthwhile consideration. With proper planning South African Donations Tax and Estate Duty can be avoided altogether.

Another common problem facing SA individuals with US connections is the problem of the US estate tax. SA individuals who own US securities in an investment account or trust often do not realize that the securities would be subject to estate tax upon death, either because the securities are owned personally or because the trust is not structured in a way that would block the tax. Such individuals are subject to US federal estate tax on US-situs assets at graduated rates between 26% and 39% for assets valued between $60,000 and $1,000,000, and 40% for assets valued in excess of $1,000,000 (the first $60,000 is not subject to tax). US securities are considered US-situs assets for US federal estate tax purposes but not for US federal gift tax purposes, which means estate tax exposure can be easily avoided by gifting US securities to a trust that is a valid US estate tax blocker. If such a gift would give rise to donations tax, a sale to the trust often presents a solution as long as the capital gain tax cost is not prohibitive. Again, such tax may be reduced or eliminated under current economic conditions.

Now more than ever, SA individuals are in a unique position to undertake planning and restructuring to mitigate, or even avoid, adverse US tax consequences. We are not SA advisors, but we can assist you in getting the advice you need. Please contact Peter Rosenberg, David Elwell or Brittany Yodis if you have any questions.

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## FOR MORE INFORMATION

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