



Foreign inheritance and donations: the decisions that could preserve or forfeit an estate duty deduction



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Ask a client where their offshore investment came from, and most conversations stop at “inheritance” or “a gift from family abroad”. However, skipping the follow-up question can turn out to be costly for clients.

If the money came from someone who was not a South African tax resident at the time, that origin can carry a legislated estate duty deduction on the full value of the investment. Miss the question, and the client could miss the deduction. Once the money is repatriated or reinvested locally, the deduction is gone for good.

The benefit: section 4(e) of the Estate Duty Act

South African tax residents are, as a general rule, taxed on their worldwide estate at death. A notable and often underused exception relates to instances where a South African resident inherits (or receives by donation) foreign-situated property¹ from someone who at the time was not ordinarily resident in South Africa. Section 4(e) of the Estate Duty Act allows that value to be deducted in arriving at the dutiable value of the estate. This foreign property and any proceeds derived from it fall outside the South African estate duty net.

This deduction is only available to the person who received the inheritance or donation directly from the non-resident. It does not carry forward in the event of their subsequent death. The next recipient can only claim the same deduction if their benefactor (the deceased or donor, as applicable) was not ordinarily resident in South Africa and the property remained situated outside of South Africa.

1. For the purposes of this article, “property” refers to investment capital.

Keeping the benefit alive

The deduction is generous, but it is conditional on the property remaining foreign property. This is where many families unintentionally give the benefit away. Two decisions can determine whether this benefit is used or lost altogether.

1 Repatriating the property to South Africa would convert it into South African-situated property. Even if section 4(e) applied on the property when it was received, the reinvestment in South Africa means the asset would no longer meet the requirements under section 4(e) and the value would no longer be deductible for estate duty purposes. A common, easily overlooked mistake relates to the use of remitting bank accounts. Often a foreign inheritance is paid into a remitting bank account before it is reinvested on a platform. If that bank account is domiciled in South Africa, the funds could be treated as repatriated, causing the section 4(e) deduction to be lost. The remitting bank account should therefore also be domiciled outside South Africa.

2 Deciding to keep the funds offshore, in a product that is itself foreign-situated, preserves that foreign-situs status for as long as the investment remains offshore.

Building the paper trail

The practical implication is that the decision to repatriate or retain is, for many families, a once-off choice that cannot be reversed once the funds have been converted, spent, or blended with South African assets. It deserves the same care as any other irreversible estate-planning decision. Preserving the benefit is a paperwork exercise as much as an investment one: be sure to keep thorough documentation of the inheritance, including proof of the benefactor's tax residency status, a death certificate, a copy of the will, investment statements, and evidence of the subsequent flow of funds.

Since March 1998, South African residents have not been required to declare a foreign inheritance from a bona fide non-resident estate, and may retain both the capital and any income it generates abroad without SARB approval.

How this relates to the Ninety One Investment Platform

Not every product that is priced or reported in foreign currency is foreign-situated for South African estate duty purposes. The Ninety One Global Life Portfolio and Ninety One International Investment Portfolio are both domiciled outside South Africa. Assets held in either can, in principle, continue to satisfy the foreign-situs requirement under section 4(e). The Ninety One Global Investment Portfolio, while a convenient way for South African residents to access global markets and avoid the requirement for offshore probate, is administered through a South African nominee structure. It is therefore treated as South African property for estate duty purposes, regardless of the underlying international exposure.

Ninety One product	Foreign-situated for estate duty?
Global Life Portfolio	Yes, Guernsey domiciled
International Investment Portfolio	Yes, Guernsey domiciled
Global Investment Portfolio	No, South African nominee company

Case study

Consider Mary-Anne, a South African tax resident whose late father was, at the time of his death, only a tax resident of the United Kingdom. Mary-Anne inherits GBP 500 000. This was held in a UK investment account. Mary-Anne has two children who will inherit from her. The eldest has settled in South Africa, and the other in the United Kingdom.

Mary-Anne appoints her South African advisor to consider investment options for this inheritance. Since she has sufficient capital to provide for her retirement in South Africa, the purpose of this capital will be to leave a legacy for her two children. She intends for them to inherit an equal share of any investment vehicle chosen. Mary-Anne and her advisor explore the three investment options on the Ninety One Investment Platform.

Beyond the potential estate duty saving, the choice of product and structure also affects inheritance options for the next generation. Mary-Anne could choose to bequeath these investments to her children directly and/or to offshore trust(s). Where investments are left to a trust, the investment value and subsequent growth would not form part of their estates for South African estate duty purposes in the future, based on current legislation.

Assessing the options

The International Investment Portfolio and Global Investment Portfolio would be distributed in accordance with the wishes in her will. Where a South African advisor is appointed on the International Investment Portfolio (subject to additional requirements), Ninety One would not require a foreign grant of probate. Her local executor could instruct that the units be transferred to the beneficiaries, or that the proceeds be paid into her estate's bank account, from where distributions to beneficiaries could be made. The investment would be subject to capital gains tax on the deemed (or actual) disposal at Mary-Anne's death. Assuming her marginal income tax rate is 45%, the rate of capital gains tax would be 18%. Since these investments would be administered by the executor as part of her general estate, executor fees would apply.

Choosing the Global Life Portfolio means she could nominate her children or trust(s) as beneficiaries. For the purposes of this case study, it is assumed that Mary-Anne would nominate both her children as beneficiaries. Upon her death, they would have the option to continue ownership of the policy (where no capital gains tax would be deducted on change of ownership) or elect to receive the proceeds in cash. Since the benefit would pass directly to the beneficiaries, an executor would not be involved and therefore no executor fees would apply. We assume that Mary-Anne's child who lives in South Africa would opt to continue with the policy and therefore no capital gains tax would be deducted from this share of the policy. Her child in the UK would choose to receive cash proceeds. Capital gains tax of 12% would be deducted from this share of the policy, before making the cash payment.

Deciding between the investment products may seem arbitrary at first. However, when carefully considered in light of the potential estate duty saving, the Global Life Portfolio or International Investment Portfolio may be better suited as these products would not attract estate duty on her death, as shown in the table on page 5. Had she invested the funds in the Global Investment Portfolio or repatriated and reinvested the funds in a local product, the deduction under section 4(e) would not be available in her estate.

Three Ninety One product options for Mary-Anne's offshore inheritance: impact on her estate at death

	Global Investment Portfolio	International Investment Portfolio	Global Life Portfolio
Value on death (10 years later)	£987 391	£987 391	£987 391
Executor fees (4.025%)	£39 742	£39 742	0
Capital gains tax	£90 333	£90 333	*£30 111
Estate duty (25%)	£214 329	0 – section 4(e) deduction	0 – section 4(e) deduction
Net to children	£642 987	£857 316	£957 280

Source: Ninety One. For illustrative purposes only. The following assumptions apply: annual growth of 8% (not guaranteed to occur); higher rate taxpayer of 45%; executor fees of 4.025% and estate duty of 25%; dutiable estate exceeds R30 million. *Capital gains tax only payable on 50% elected as cash by child in the UK; South African child continues with policy and therefore no capital gains tax deducted from this portion. GBP-USD exchange rate of 1.35 used for calculation of platform admin fees. Result shown after platform fee and advice fee of 0.58%. No exclusions or abatements considered for tax or estate duty calculation purposes.

What this means for Mary-Anne's beneficiaries

Mary-Anne's estate duty, if applicable, would be settled in her estate and does not depend on where her children live. Assuming the section 4(e) deduction is applied, no estate duty would be payable on these offshore investments.

For the child who is a South African resident, the section 4(e) deduction would not carry forward if Mary-Anne was an SA tax resident on the date of her death, regardless of the product in which these offshore investments were held. For the child living in the United Kingdom, consideration must be given to the ongoing tax treatment of the investment once they hold it. A United Kingdom resident holding a Guernsey-domiciled investment such as the International Investment Portfolio or Global Life Portfolio may be affected by the United Kingdom's offshore fund and reporting fund rules.

Summary

Section 4(e) is one of the more generous benefits in the Estate Duty Act, but preserving it requires careful planning. For offshore capital received as an inheritance or a donation, the benefit depends on it staying offshore: repatriate it, blend it with local assets, or fail to establish its origin, and the deduction falls away. Combining the 4(e) deduction with a trust structure can extend the estate duty advantage across future generations, by keeping the capital outside the client's personal estate altogether.

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