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TAX CLARITY

on investing in offshore insurance plans

A recent binding private ruling by the South African Revenue Service (SARS) serves as a useful reminder that investors need to consider many different angles before entrusting their hard-earned money to an investment scheme.

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The ruling deals with an investment by a private individual in a single premium whole life (so called open-ended) investment offered by a foreign insurer (not registered in South Africa). The nature of these policies, both in South Africa and offshore, is that the death benefit and cash value at any time is directly linked to the underlying investment portfolio, which is structured according to the wishes of the investor and is selected, normally, from a wide range of investment linkages.

As with all assurance products, the investor does not directly own the underlying assets in the portfolio but owns the policy, which in turn gives the investor a right to participate in the performance of these assets which are directly owned by the insurer.

In the ruling, SARS determined that despite the fact that the investor did not own the underlying assets, all amounts received or accrued from the investment may, depending on the circumstances, be taxable in the hands of the investor, which no doubt will come as quite a surprise to many investors.

It is well understood that since South African assurers pay income tax and capital gains tax to SARS on behalf of investors via the four-fund approach, generally, the proceeds of policies issued by South African assurers are not taxed in the hands of the investor.

However, in the days before the partial relaxation of exchange controls and South Africa's re-entry into the global financial markets, many South Africans invested in the offshore equivalent of these insurance products. This was mainly because they did not generate any income streams which would be taxable in South Africa. Many of these investments were regularised by South African resident investors in the 2003 tax and exchange control amnesty; however, the tax status has up until now remained unclear. To compound the problem many, if not all, of these offshore insurers closed their local offices or faced the obligation of registering in South Africa. As a result it has become the responsibility of local South African independent financial advisers to pick up the difficult advice burden of these orphan products.

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The lesson here is when considering unusual or offshore investments, it is always best to consult with your financial adviser regarding these products; their experience and expertise can assist you and help you mitigate any negative repercussions of uninformed investment decisions in the long term.