

Tax Efficient Investment Vehicle - Endowments

When meeting with our clients, we as Wealth Managers find that their main concern is not only their return on investment, but the tax aspect as well.

Today we will be taking a look at one of the tax efficient investment vehicles you can use to legally reduce taxes and will be exploring the benefits of using an endowment.

What Is an Endowment?

An endowment is a tax efficient investment vehicle with a 5-Year minimum investment term. There is liquidity flexibility during the first 5-Year period, should you need to withdraw. However, withdrawals are restricted.

Who Will Benefit from Investing into an Endowment?

The ideal investor has a lump sum amount available to invest with a marginal tax rate above 31% (an endowment is not recommended for an individual investor with a marginal tax rate of less than 30%). Furthermore, utilizing a trust, especially where there are large sums of money involved, can be a very effective mechanism to distribute income to beneficiaries.

Endowment Tax Benefits for the Individual Investor and Trusts

The maximum income tax rate of 30% applies for the individual investor. For trusts, taxability of income is dependent on the circumstances of the trust (45% income tax rate will apply where the trust itself is taxed and not the beneficiaries). A maximum Capital Gains Tax (CGT) of 12% applies, compared to the maximum rate of 18% for most investors. No additional tax administration is required, as all taxes are recovered within the endowment.

As illustrated in **Table 1** (below), the tax rates of an endowment are attractive when compared to other Investment Plans or Unit Trust Investments.

Table 1 : Endowment versus other Investment Plan/Unit Trust Investments

	Endowment	Investment Plan/Unit Trust
Individuals and special trusts		
Income	30%	Up to 45%
Capital Gains	12%	Up to 18%
Trusts, other than special trusts		
Income	30%	45%
Capital Gains	12%	36%

Tax Efficient Investment Vehicle - Endowments

Estate Planning

While estate duty may be payable within an endowment, no executor fee will apply if a beneficiary has been appointed. In the event of the investors' death, the endowment is transferred directly to the nominated beneficiary and no CGT will apply.

Let's Look at A Practical Example

Peter Peters is 45 years old. He inherited R 5,000,000 from his father and wants to invest it in either a Flexible Investment Option or a Flexible Endowment Option. He would like to know which one will be most beneficial from a tax point of view.

Assume an annual rate of return of 12% which equals R 600,000. Of this, 20% is interest (R 120,000), 10% is dividends (R60,000) and 70% is capital growth (R 420,000).

For the purpose of the calculation, it is assumed the investment is disposed of at the end of the year to illustrate the impact of CGT. It is assumed that the annual rebate is applied iro his salary and, therefore, ignored when calculating the tax payable in his personal capacity.

Refer to **Table 2** (below).

Tax Efficient Investment Vehicle - Endowments

Table 2 : Practical Example Comparison

	Flexible Endowment Option Individual policyholder fund	Flexible Investment Option Owned by Trust with natural persons as beneficiaries	Flexible Investment Option Owned by a Natural Person
Tax Situation at the end of the Year	<p>Interest earned is fully taxable:</p> <p>$R120\,000 \times 30\% = R36\,000$</p> <p>Dividends earned will be exempt from income tax.</p> <p>Taxable capital gain: $(R420\,000 \times 40\%) = R168\,000$</p> <p>Taxed at 30% = R50 400</p> <p>Net return on the investment = R513 600</p>	<p>Interest earned is fully taxable:</p> <p>$R120\,000 \times 45\% = R54\,000$</p> <p>Dividends earned will be exempt from income tax.</p> <p>Taxable capital gain: $(R420\,000 \times 80\%) = R336\,000$</p> <p>Taxed at 45% = R151 200</p> <p>Net return on the investment = R394 800</p>	<p>Interest earned is fully taxable:</p> <p>$R120\,000 - R23\,800$ (exemption) = R96 200</p> <p>Marginal rate 26% = R25 012</p> <p>Marginal rate 31% = R29 822</p> <p>Marginal rate 36% = R34 632</p> <p>Marginal rate 39% = R37 518</p> <p>Marginal rate 41% = R39 442</p> <p>Marginal rate 45% = R43 290</p> <p>Dividends earned will be exempt from income tax.</p> <p>Taxable capital gain: $(R420\,000 - R40\,000) \times 40\% = R152\,000$</p> <p>@ 26% = R39 520</p> <p>@ 31% = R47 120</p> <p>@ 36% = R54 720</p> <p>@ 39% = R59 280</p> <p>@ 41% = R62 320</p> <p>@ 45% = R68 400</p> <p>Net return on the investment:</p> <p>Marginal rate of 26% = R535 468</p> <p>Marginal rate of 31% = R523 058</p> <p>Marginal rate of 36% = R510 648</p> <p>Marginal rate of 39% = R503 202</p> <p>Marginal rate of 41% = R498 238</p> <p>Marginal rate of 45% = R488 310</p>
Executor's Fees	Assume a beneficiary is nominated on policy: No executor fees payable	N/A	Assume fund value on date of death equal to R5 600 000 Executor's fees at the maximum rate of 3.5% plus VAT (3.99%) = R223 440

Tax Efficient Investment Vehicle - Endowments

As Wealth Managers we take a holistic approach when giving advice to our clients. In order to help each client, achieve their financial goals we consider and integrate various aspects, including spending and saving, investment management, debt management, insurance, taxes, estate planning, employee and government benefits.

When investing into an endowment, it is important to remember that the investment portfolios within an endowment vary from product to product, as endowments are considered 'wrappers' around investments and can include a range of local and offshore unit trusts and share investments that suit your risk profile and investment objectives. At Seed we offer various endowment options on a variety of platforms, both local and international, and will ensure that we offer you the most cost-effective solution.

Our Wealth Managers understand your journey and are available to answer any questions that you may have. Please feel welcome to get in touch with us on +27 21 914 4966 or via email on info@seedinvestments.co.za for more information.

Kind regards,



Angelique Du Preez NQF 5

Wealth Manager

Source(s) : Momentum Endowment Study (V4 June 2017).

All data in this document is intended for illustrative purposes only and does not constitute financial, investment or tax advice.

Tax Efficient Investment Vehicle - Endowments

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