GRAYISSUE

What taxes do I pay when I invest offshore?

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Investing offshore allows you to diversify and benefit from a broader universe of investment ideas, but what about the tax you may have to pay? As with any other investment, it is important to get the full picture before you make any decisions. When you invest offshore, the tax you may be required to pay depends heavily on the way you choose to invest.

You get some offshore exposure when you invest in local unit trusts that are mandated to invest a percentage globally, and of course many of the companies listed on our local stock market have operations around the world. But if you want more offshore exposure there are two ways to achieve this goal:

1. Invest in a rand-denominated offshore unit trust offered by a local manager.
2. Invest directly in foreign currency with a foreign manager or through an offshore platform.

Each route has different benefits and downsides and it is critical that you consider these carefully.

If you use rands to invest in rand-denominated offshore unit trusts:

You use your investment manager's offshore allowance
When you invest in rands you are not required to get a tax clearance certificate. Managing foreign exchange headaches like this becomes your unit trust manager's problem.

You pay capital gains tax on all gains
You pay tax on all gains on your original rand investment, regardless of whether those gains are from capital growth or currency movement.

You pay tax on interest and dividends
Foreign dividends are included in your taxable income and are taxed at an effective rate of 20%. The full value of foreign interest is included in your taxable income.

If you use foreign currency to invest in foreign funds:

You use your own foreign investment allowance
You can take up to R1m offshore annually without having to apply for a tax clearance certificate, but if you want to invest more you will have to apply for tax clearance from SARS.

You may save on capital gains tax
You don't pay tax on currency movement while you are invested. When you sell assets bought in a foreign currency, the foreign capital gain or loss is first calculated and then translated into rands using either the average exchange rate (available on the SARS website) or the exchange rate on the date of sale.

Consider this example, along with Table 1:
Let's assume a South African investor took R100 and invested it offshore some years ago. At the time, the rand/dollar exchange rate was a fictitious R10/US$ and one investment unit cost US$1. Effectively, the investor therefore invested US$10 at R10 to the dollar and paid R100 for 10 units.

Several years later, the underlying investment had increased from US$1 to US$2 per unit (10 units would now be worth US$20), but the exchange rate had weakened from R10 to R20/US$.

If the investor had invested through a South African unit trust company, she would have invested R100 and sold at R400 (10 units x US$2 x R20) and paid tax on the capital gain of R300 (R400 – R100).

If she invested directly with an offshore manager, she would have invested US$10 and sold the investment at US$20 (ten units x US$2). In this scenario, the gain would be US$10 (US$20 – US$10) and the tax would only be levied on the gain of the underlying investment of R200 (US$10 x R20). In this scenario, the portion of the gain derived from rand depreciation would not be taxed.

In other words: if the rand weakens, it is more tax efficient to be invested directly offshore; if the rand strengthens, it is more tax efficient to be invested in a rand-denominated offshore unit trust.

Table 1 Capital gains tax on offshore investments

	Investment	R/US$	Unit price	Investment (US$)
At investment	R100	R10	US$1	US$10
At sale	R400	R20	US$2	US$20

Capital gains	In a feeder fund	Direct offshore
Disposal	R400	US$20
less investment	R100	-US$10
Capital gain	R300 gain	US$10 gain Taxed as a R200 gain

Source: Allan Gray research

You pay income tax on foreign dividends and foreign interest
The tax rate on foreign dividends is 20% and interest on foreign investments is fully taxable.

Is there any way to pay less tax on offshore investments?

South Africa uses a residency-based system to calculate personal tax. This means that South African tax residents are required to pay tax in South Africa on their worldwide income.

That said, the tax system does allow exemptions for certain types of income, and double taxation agreements, which give you credit for foreign taxes paid, are in place with many countries.

What happens when you die?

Death taxes in South Africa
An estate duty of 20% is applied on South African residents' worldwide assets on death. This includes any investments offshore – regardless of how they were made.

Death taxes in foreign countries
For assets registered in some foreign countries you may have to pay estate duties even if you are not a resident of that country. This is the case in the UK and US.

Generally, where inheritance tax or estate tax is levied on an investment by a foreign country, South African estate duty would also still apply. South Africa has double tax agreements with some countries that make allowance for estate duties so that you don't have to pay tax twice. None of the jurisdictions currently accessible via the Allan Gray Offshore platform have foreign death tax implications for South African tax residents.

Investing via the Allan Gray Offshore platform allows South African tax residents to hold offshore assets solely under South African tax jurisdiction. An investment through the Allan Gray Offshore platform will also not require a foreign executor on an estate, but rather the estate may be wound up purely by a South African executor.

Investing offshore is more complex than local investing; consulting with a good independent adviser can help you find a plan that works for your circumstances.

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