We've said before and we say it again...markets are almost always incorrectly priced. It is merely the direction and magnitude that varies. This view not only stresses the importance of market sentiment in driving asset prices, but also just how fickle sentiment can be. 2015 was a great example of this as it not only showed how differently assets were treated, but also how quickly the mood changed.

LOOKING BACK 7

The ultra low monetary policy environment seen in the last six years or so resulted in a very simple general modus operandi, namely to buy half decent assets and trust to in the 'Bernanke Put' (the belief that monetary policy would keep driving prices higher).

These conditions primed buying and encouraged risk taking, pushing the market ever higher resulting in stretched valuations, making the market vulnerable to a change in the conditions. The mood seemed to change in mid 2015 evidenced by a far more selective approach to assets, with some remaining very sought after and others to be sold down.

A POLARISED MARKET

The buying momentum continued in early 2015 (Q1) with only 25% of the JSE top 40 constituents registering negative (capital) returns. Things changed though from the 2nd quarter, as the market became quite polarised, with one 'group' still producing strong returns and another 'group' succumbing to heavy selling and recording big losses in the 2nd, 3rd and 4th quarters.

The first group of shares enjoyed continued support, generally driven by strong momentum (and subsequently produced good returns) as the market ignored what appeared to be ever stretching multiples due to:

1. The apparent assumption that past performance (in earnings and price) could be projected well into the future, especially of those companies labelled 'superstars'.
2. The market seemingly unconcerned about fundamentals such as realistic EPS, growth rates and how these related to the implied valuations, and
3. Many of these (local) companies are seen as rand hedges.

These include Steinhoff (+32%), SAB (+55%), BATS (+38%), Brait (+114%), Capitec (+58%), Woolworths (+30%), Naspers (+40%), Discovery (+23%), and PSG (+75%) to name a few. It is noteworthy how many of these are foreign listed or Rand hedges.

The second group of shares (those that were weak) represented shares that had been battling for some time, but included a few past (recent) darlings that fell sharply in 2015.

The shares that had been battling for some time included resources shares (on the rout in commodity prices) with examples being Anglos (-68%), Amplats (-46%), BHP Billiton (-25%), but also included banking shares Standard Bank (-21%), and Nedbank (-24%), as well as a few others e.g. Astral foods and Grindrod.

The most interesting action though was the historic market darlings that the market appeared to fall out of love with. These included Aspen (-24%) , Mr Price (-15%), MTN (-40%), Shoprite (15%), Tiger Brands (-14%) as well as those not in the top 40 including Massmart (-30%), PPC (-44%), and Coronation (-54%).

JSE ALSI Shares Grouped by Annual Return

Down			Between	UP		
+30%	25%	20%	-20%/+20%	20%	25%	+30%
17%	4%	7%	45%	6%	2%	18%
22%					20%	

The polarity in the market is well summarised in the table above, that shows how 42% of the JSE ALSI were either up by 25% or more or down by 25% or more in 2015. This is relevant especially when we consider a mere 1.8% return on the index. What is also noteworthy is how the winners were either active on the corporate action front or driven by the Rand.

SO....WHAT DOES THIS MEAN?

The massive sell-off of past market darlings serves as a stark reminder of how quickly markets can turn and why it is so important to be deliberate in the price you pay for an asset.

We remain wary of those shares that continue to defy gravity and trade on excessive valuations, but more importantly we see the recent sell off presenting us with good buying opportunities.

We urge all investors to critically assess each position in their portfolio, so as to ensure that return expectations are met in the medium to long term.

OUR FOCUS

Korner Perspective follow a very simple philosophy. We aim to expose clients to assets (companies) that have solid business models, are well run (i.e. have strong and decisive management), good (and reasonably predictable) earnings growth prospects and offer a realistic chance of producing inflation beating returns.

HISTORIC MODEL PORTFOLIO

Illustrated opposite is the concept model equity component (local portfolio) of a balanced equity portfolio in mid-2010.

Also illustrated opposite is a graphic showing the significant increase in the annual foreign investment allowance and our corresponding foreign concept asset allocation percentage.

The relatively low foreign investment allowance as recently as 2006 not only greatly reduced the potential offshore allocation, but impacted our local portfolio construction.

As can be seen, our model portfolio (in 2010) had a distinct big cap, defensive share bias, as many of these companies (e.g. BAT, Bidvest, MTN, RMB) looked to be well placed (e.g. in their ability to drive revenue growth), well run, with decent growth prospects (many were delivering earnings growth better than their smaller cap peers).

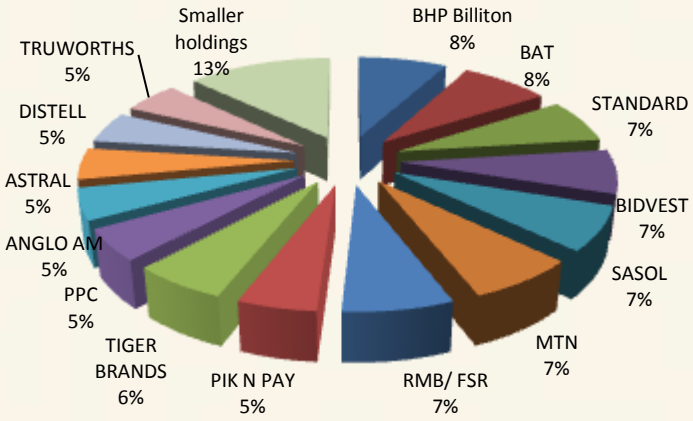
As such, our concept balanced portfolio in mid-2010 had very little mid/small cap exposure, with our satellite allocation at less than 20%.

Invariably though, we were forced to sell some shares. As long term value oriented investors however, we only ever sell (not trim) shares when we:

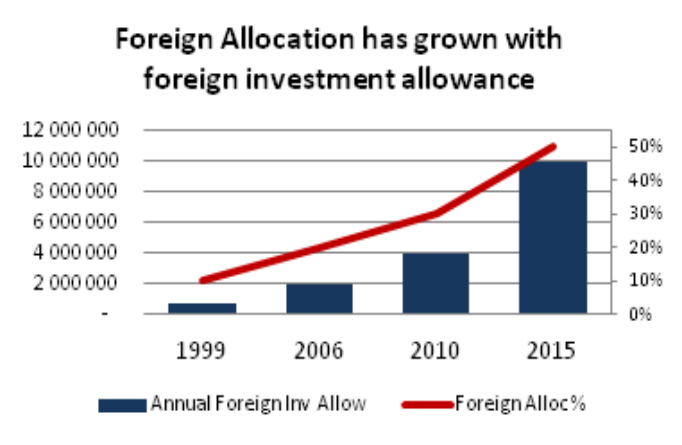
- Feel that the story has changed significantly and/or
- We lose faith in their ability to deliver reasonable EPS growth and/ or
- We simply lose faith in management.

A CHANGING MODEL

While portfolios (e.g. weightings) are dynamic and morph over time, we have effectively culled almost 30% of our 2010 model holdings over the past 5 years and down weighted others (e.g. BAT, Sasol, RMB/ FirstRand and BHP). This meant that over a third of the concept equity portfolio in 2010 needed to be reallocated.



KP Model (Local) balanced equity portfolio 2010



Company	Date sold	Reason
Tiger Brands	Mar 2012	Poor outlook and concerns over Africa strategy. Management concerns
Pick and Pay	Mar 2012	Concerns over management and model. Dull results and high base
PPC	Aug 2013 –Feb 2014	Increased competition. Slow infrastructure roll out. Big concerns over Africa strategy. Management concerns.
Astral		Duties risked AGOA. Input prices. Margins would be decimated
MTN	Nov 2015	Fine raised serious concerns about management and slowing ARPUs in key markets

KP Model holdings sold 2011 to 2015

The dilemma however was where to put the cash realised from sales and trimming. While there was a degree of up weighting of a few model holdings and preferred satellite holdings (e.g. Reinet, Zeder, Discovery, City Lodge) this only represented a few percent.

There were four real challenges around allocating the realised weightings, namely:

1. Quite a few industries were looking vulnerable and increasingly competitive (e.g. poultry or telecoms).
2. A number of the local big and mid-caps are looking tired and are falling victim to a sluggish economy, with many battling to drive top line growth. It was looking quite likely therefore that many old favourites would actually battle to deliver decent real earnings growth.
3. We felt it wise to limit our resources exposure for a variety of reasons, and
4. Valuations (locally) were looking stretched in most of the market with 'defensives' looking especially expensive, with many on PEGs of 2 or more.

All this meant that only two big caps made it into the local model balanced equity portfolio, namely Discovery and Steinhoff.

After careful consideration (over the years) therefore, we progressively reached the following three conclusions, and this is already reflecting in client portfolios:

1. To increase our clients' offshore exposure. This was partly because of the more generous foreign investment allowances, but principally because we were seeing better value in foreign equities.
2. To reduce the allocation to model holdings and increase the weighting in 'satellite' holdings (to roughly a third of portfolio). This was mainly because we weren't able to find shares that were seen as true model holdings and we already had significant individual weightings in existing model holdings, and
3. To significantly increase the satellite holdings list and target more small and mid-caps shares. Opposite is a list of a few recently added satellite holdings.

It is clear therefore that we have consciously and deliberately increased our offshore concept allocation (and often preferred our royal blue chip exposure through offshore companies) and adjusted our local model portfolio to include a wider range of smaller and mid cap assets.

Illustrated opposite is our assessment of the potential to hold offshore assets as alternatives or proxies for South African assets.

Local sector (example)	Offshore alternative (example)	Comment
Defensive retail (Shoprite)	Global FMCG (P&G or Reckitt)	Global FMCG offers better EPS growth prospects than SA retail
Medical and Pharma (Aspen or Netcare)	Global pharma (GSK) or related (e.g. J&J, Siemens)	Local healthcare stocks are expensive with tough operating outlook
SA Consumer brands (Tiger or AVI)	Pure food plays (Nestle) or FMCG (Unilever)	Offshore food and FMCG have better prospects and more levers to pull than SA
SA Focussed banks (Firstrand)	Global banks (HSBC)	Global banks have more levers to pull and more diversification. Better div yields offshore
SA Industrial conglomerate (Remgro)	Focussed industrial (GE, Siemens)	More true industrials offshore with better Med term prospects

Company	Reason
Argent	Improving performance after shedding problem assets. Deep discount to NAV
Sun International	Reasonably defensive. Spend in Latam and Sun City should help boost EPS growth
Grand Parade	Strong balance sheet and BEE credentials auger well. Strong management
York Timbers	Deep discount to understated NAV. Good strategic path will drive med term EPS

Recently added satellite holdings

Source: caglecartoons.com

IS THE DRAGON LOSING ITS PUFF?

The big story of 2015 had to be China, and more particularly the slowdown in growth. In recent years global growth has heavily depended on strong economic growth from China. Unfortunately the economic powerhouse has lost the potency of superior growth; instead growing at sub 7% (along with other disappointing data points) is causing downward pressure on risky assets/emerging markets/ emerging market currencies.

The Chinese change in economic focus (away from an infrastructure and export economy towards an internal consumption economy) might bear fruit in the future, but unfortunately the implementation thereof requires strong economic reform and financial openness both which are cumbersome in nature.

Further evidence of poor economic growth and other data points, will in our minds see further stimulus packages and liquidity injection, which will have a positive effect on risky assets in the short term.

SA IS BECOMING GOOD AT SCORING OWN GOALS

While we have had long standing concerns around the effectiveness of some government departments and parastatals, big concerns at local authority level and about our widening budget deficit, we must concede that the firing of finance minister Nhlanhla Nene was one of the low points in our recent economic history…. and proper own goal!

We say this as it almost immediately triggered a massive selloff in the Rand and bonds as the markets read this as an indication the strong fiscal discipline of Min. Nene would be abandoned, with the inevitable rating downgrade to follow.

South Africa clearly needs committed and decisive leadership at this very difficult time in our economic and political history, and we welcome the strong position taken by Min. Gordhan, Mr Mantashe and the private sector for us (as a people) doing everything we can to avoid a rating downgrade.

It is also comforting to see the Rand clawing its way back to 16 to the Dollar and 23 to the Pound. Sadly the inflation pressure is building on the weaker Rand and the high food prices, and this has already seen 0.75% increase in domestic interest rates.

EMERGING MARKETS

The emerging market complex was placed under fair pressure, courtesy of risk off conditions and weaker commodity prices, causing emerging market currencies to tumble.

With inflation on the rise, and lower growth prospects, we are increasingly concerned on the outlook for Emerging Markets specifically from the 'Fragile Five' (Brazil, Russia, Indonesia, South Africa and Turkey). In the medium to long term we still see superior growth from Emerging Markets, but feel that strong policy reform is needed. Our preference for exposure to EMs still remains through global companies with EM exposure, as opposed to direct exposure.

MONETARY POLICY DIVERGENCE AND DEFLATION FEARS

The Fed finally, on the 16 December 2015, pulled the trigger and did what they had been talking about for what seemed like a very long time…they raised US interest rates by 0.25%. It is however not a clear cut story that they will continue to raise rates, as the Fed remain 'data dependent', and seem to keep moving the goalposts. Deflation fears could also dampen the appetite for further hikes this year.

The ECB and Japan (and to a lesser extent China) are still embarking on easy monetary policy and stimulus packages in order to revive the economy (stronger growth for China) by creating more sustainable growth. Deflation fears (in the case of the ECB and Japan) might increase the scale and time frame of stimulus.

We expect this divergence to continue in 2016, which will no doubt add volatility to global markets.

ECONOMIC PERFORMANCE

2015 is best described as producing fairly divergent economic performances from the key economies (e.g. the US remained solid but emerging markets produced weak growth), and by a fairly strong divergence in the performance of the equity markets and currencies along with them.

This resulted in very different central bank actions, with the US moving toward monetary policy normalization, but the ECB adopting an even more accommodative stance, in an effort to fend off the risk of crippling deflation. Emerging economies all saw massive currency weakness, resulting in the inevitable rises in inflation and interest rates.

GLOBAL MARKETS

Global markets produced a mixed bag of results (along with significant volatility) across the board, driven by growth, currencies and the composition of the indices.

Swings were yet again dictated by news flow, predominantly from:

1. China. Initially simply caused by slowing growth, but then morphed into the fears of a hard landing in China. This led to accommodative policies and liquidity injections, neither of which seems to have had much of an impact.
2. The Euro Zone. While growth is reasonable (GDP + 1.6% p.a.) fears of deflation risks are mounting significantly. The ECB responded by cutting rates again and adding more QE, and
3. The United States. While growth remains uninspiring, the Fed was probably forced to hike rates. The US is also however talking of the risks of deflation, making monetary policy in 2016 somewhat of a lottery.

The US S&P500 and Dow Jones posted modest losses for 2015, with the S&P down 0.7%, and the DJIA down 2.2%. We sense that the relatively poor showing of US markets was driven by the high base after a few good years, the impact of higher rates (on the real economy and demand for assets), uncertainty on the outlook for monetary policy, and concerns around corporate earnings (especially on the strength of the dollar). Tech and pharma however did well gaining 5.7% for 2015.

The DAX (German exchange) and CAC (French exchange), did well in 2015, with the DAX up 9.5% and the CAC up 8.5%. Both benefited from a weaker Euro (and ultimately stronger exports) and stimulus by the ECB. The IBEX (Spanish Exchange) and the FTSE however were weaker in 2015, losing 7.2% and 5% respectively. The FTSE weakness (-43.9%) was mainly attributable to weaker resources and some weakness in financials.

NAME	2015 Performance	1 Jan 2016 to Date
S&P 500	-0,7%	-6,9%
DOW JONES	-2,2%	-7,2%
NASDAQ	5,7%	-8,8%
DAX	9,6%	-8,6%
FRANCE CAC	8,5%	-6,0%
IBEX	-7,2%	-8,9%
LONDON FTSE	-4,9%	-5,3%
NIKKEI 225	9,1%	-12,2%
KOSPI	2,4%	-4,6%
HANG SENG	-7,2%	-13,9%
CSI 300	5,6%	-21,2%
JSE ALSI	1,9%	-6,2%
JSE TOP 40	4,2%	-6,9%

Asian markets were generally stronger in 2015 with the Nikkei up over 9% (with strong performances from cyclicals and better than expected earnings), the CSI 300 up 5.6%, and the KOSPI up 2.4%. Stimulus provided a clear platform for market performance in the period.

The Hang Seng however was under a fair amount of pressure (down over 7%) as we saw large scale selling amid concerns over Chinese economic growth, whilst coinciding with Chinese financial reform allowing mainland investors to trade in the 'free market' on the Hang Seng contributing to selling pressure from multi year highs.

2016, A TOUGH START TO THE NEW YEAR

Markets have not been kind to investors in the opening days of 2016 with large scale sell pressure gathering momentum (across all major indices). Asian markets were particularly hard hit, with CSI 300 down 22%, the Nikkei losing over 12% and the Hang Seng down 14%. European and American indices also fell on average between 7-8% whilst our local index shed over 6%.

The fear around a slowing China, interest rate increases by the Fed, and deflation is playing a major role in the recent sell off, which in our view is not only healthy but will present us with good buying opportunities, both locally and offshore.

PROTRACTED COMMODITY SELLOFF

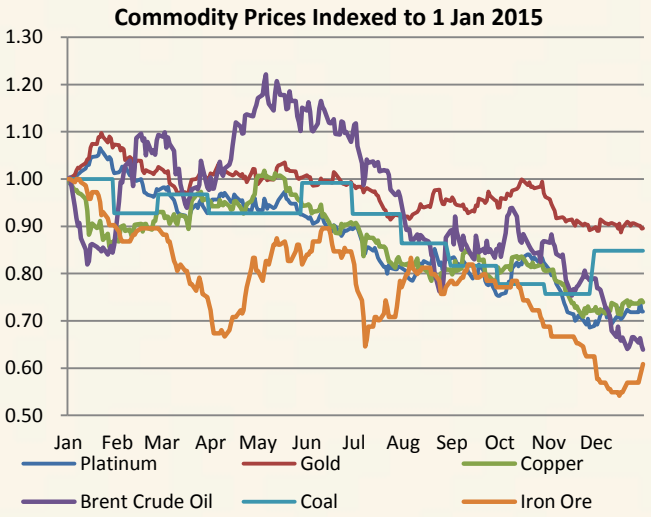
We have discussed the aggressive selloff in commodities in a few of our previous editions as it is not only important for resources companies and resources dependant currencies, but serves as something of a 'leading indicator' for China and the emerging market complex.

Depressed commodity prices clearly point to a disrupted supply/demand situation, with clear evidence of oversupply. 2015 saw commodity prices tumble, in some cases reaching multi year lows with very little support seen in late 2015.

The chart (opposite) clearly shows weakness in a variety of commodities, with Iron Ore and Brent crude the hardest hit (down 39% and 36% respectively). While complex, we see the weakness in oil having been triggered by OPEC's insistence (some time back) to maintain output despite demand easing. The weakness in iron ore is in part attributable to China's lower growth scenario (along with already large stock piles) and in part to the ongoing ramp up at mega projects.

Gold on the other hand held up well in reasonably well, only losing 10.5%.

KP maintains the opinion that supply demand dynamics will change in the medium term, especially as smaller (higher cost) producers are forced to close loss making operations. We sense we are seeing early signs of this in the recent stabilization in and modest uptick in some commodity prices in early 2016.



NAME	1 YR Chg. 2015	1 Jan '16 to Date
JSE TOP 40	4,2%	-6,2%
JSE ALL SHARE	1,9%	-5,5%
RESOURCES	-39,4%	-4,8%
FINANCIALS	-0,1%	-8,0%
INDUSTRIALS	-12,5%	-3,6%
MID CAPS	-10,1%	0,0%
SMALL CAPS	-8,0%	-5,8%
LISTED PROPERTY	2,4%	-6,6%
BANKS	-16,3%	-7,61%

THE JSE BUOYED BY A FEW STARS

The Top 40 posted a mildly positive return in 2015, in spite of the weakness in resources, with the TOP 40 up 4.2% for the year.

Share	Top 40 weight	Gain in 2015
SABMiller	12.2%	55%
Naspers	13%	40%
Richemont	9.5%	6%
BAT	3.9%	38%
Steinhoff	3.4%	32%

The market was clearly propped up by a handful of foreign listed heavyweights, with the notable driver being SAB Miller that rose an incredible 55% in the year, on the back of the AB Inbev offer and the weaker Rand.

As discussed in our piece on market polarity, a common theme amongst the strong performers is the strong rand hedge component (the rand lost 34% to the USD in 2015).

Industrials disappointed with a 12.5% loss, in spite of the strong performances illustrated above, on the back of weakness in heavyweights such as Aspen (-24%), MTN (-40%) and retailers, including Massmart (-30%).

Weighing quite heavily on the index in 2015 however was resources and banking shares, with these indices losing 39% and 16.3% respectively.

While we were early on our call to avoid listed property (not the offshore parts), our view is proving correct, with local listed property recently coming under significant pressure.

As noted earlier markets started 2016 with lots of red on the screens, registering a YTD performance on the Top 40 of -6.2%. Most notable downward pressure came from financials (on downgrade fears), listed property (on rising yields) and small Caps (on liquidity).

Once again, we stress that we see the recent selloff presenting opportunities to add good shares at sensible prices. We plan to add shares when value is seen, but we will however add slowly.

Some value is seen in resources and banks, but other shares that look interesting include York, Discovery, Sun International, Foschini and Grand Parade.

GEOPOLITICS REVISITED

We made the point in our Sept 2014 (8th volume) newsletter that geopolitics would become very relevant in 2015 and this assessment proved correct.

Now, in early 2016, we thought it worthwhile to have another look at geopolitics to assess whether geopolitics is likely to have as big an impact in 2016 and 2017, and if the risks have changed (both in potential impact and origin).

While the major geopolitical risks are much the same as in late 2014, a few of these have morphed and there are a number of new risks, most of which have been brought on by the weakness in commodity prices and the impact hereof on many developing economies.

RUSSIA

While the Ukrainian situation appears to have 'settled down', we believe that the risks around Russia have increased significantly given the Syrian and Turkish situations and the economic pressure brought on by the sanctions and the falling in energy prices. Most worrying is the potential for the world to relapse into a cold war style standoff.

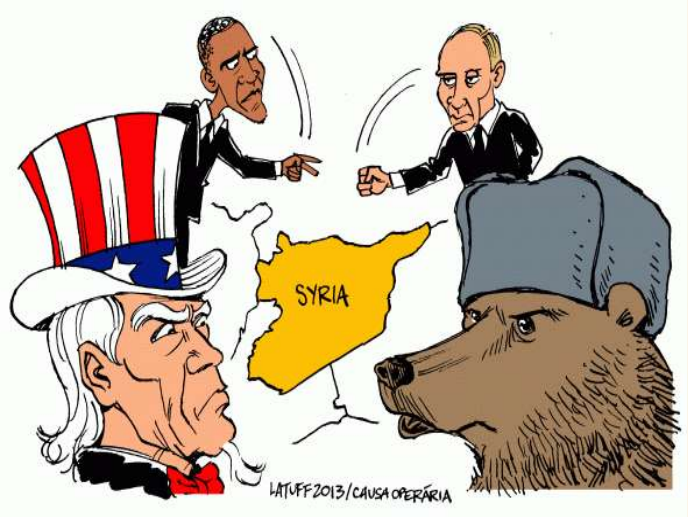
ISLAMIC STATE

Our concerns raised in Sept 2014 (about ISIS) proved well founded. IS did everything we feared and more. IS not only broadly destabilised the middle east (mainly Iraq and Syria), but we believe they added significantly to the tensions between key regional powers (based on the schools or sects of Islam) and also launched deadly terror attacks in Europe.

Ironically, we sense that risks around IS may actually be decling, as the Paris terror attacks effectively 'mandated' France and the UK to significantly increase their military strikes against IS with a focus on key IS strongholds and their financial lifeblood.

NORTH KOREA

North Korea recently claimed to have detonated a hydrogen bomb (nuclear device), but many analysts are deeply sceptical on this claim. While many see North Korea as an idle geopolitical risk, one cannot ignore the rising tensions (especially between North and South) and the risk that an insignificant event could quickly cascade into something serious.



Source: https://latuffcartoons.files.wordpress.com

Source : www.bbc.com

ISRAEL AND ITS NEIGHBOURS

Israel's ongoing occupation and development in the west bank is not only putting strain on their relations with their neighbours and the Palestinian authority, but also causing a significant and rapid deterioration in their relations with key supporters (e.g. the US). We sense that the risks around Israel and its neighbours have increased over the last year.

CHINA

We believe that China will increasingly flex its political, economic and military muscle and ultimately look to dominate the region. Tensions in the South China sea are mounting, evidenced by China recently landing a plane on an artificial island (built by China) in a contested part of the South China sea. On the medium term, the real risks in China relate to:

- The risk of a drastic economic slowdown (and the impact on society).
- The risk of more state control in an effort to drive the economy, and
- China's increasing allegiance to Russia (e.g. Syria).

All in all, the risks in and around China are growing as China becomes an ever more powerful force.

CYBER RISK

While the digital age brings many advantages, it also brings massive risks. These include identity theft and fraud for individuals and corporate espionage, hacking, system ransom and fraud for companies. Governments, government agencies and SOCs (e.g. utilities) are at risk from terror attacks and system ransom.

The biggest risk here by far is the real threat of cyber terrorism.

ENVIRONMENTAL RISKS

Climate change (weather, water and pollution) already appears to be having a profound impact on the world. What were once thought of as distant risks (e.g. water and food security) seem to have become a reality sooner than we feared. The key risks are:

- Lower food production could drive food prices sharply higher and potentially resulting in food shortages, resulting in rising social unrest.
- The risk of water shortages, potentially triggering military conflict, and
- The risk that intolerable pollution (e.g. as in parts of China) will result in the forced shutdown of manufacturing etc..

ECONOMIC INSPIRED RISKS

The massive fall in commodity prices is placing many (mainly developing) economies under huge strain and this has the potential to destabilise these economies and/ or result in the governments in countries targeting the private sector to help plug the current account or budget gaps. MTN may be a good example of a company at risk, but others include Standard Bank, Shoprite and Sun International, all of whom have operations in Nigeria.

Source: www.marketwatch.com

Source: blog.udemy.com/democrats-vs-republicans/

GRIDLOCKED POLITICS

We see the political gridlock in the key economies with two dominant parties (e.g. in the US or the UK) or weak collation governments as one of the biggest medium to long term risks facing the world.

All things considered, while some the old risks have eased some of the new ones, such as cyber terrorism present significant risk, effectively making the world potentially more vulnerable to geopolitical risks in 2016 than 2015.

A legacy can be defined as "the unique footprint we want to leave for our time on earth" or "something transmitted by or received from an ancestor or predecessor or from the past".

While many people think of a legacy purely in financial terms (e.g. creating a charitable trust), a true legacy extends far beyond just the financial, to include other important elements, such as the promotion of values or empowerment. It is also important to note that a well-structured PBO can (and should) not only provide for financial assistance, but also the qualitative.

People often think that a legacy is something you create after your death, but a legacy is something that can (and many argue should) be started during your lifetime.

We discuss below some of the benefits and disadvantages of establishing a PBO during one's lifetime and creating a PBO in your will.

SETTING UP A PBO WHILE YOU ARE STILL ALIVE

The big disadvantages of establishing a PBO during your lifetime relate to the costs (e.g. of administration) and the time and effort that you will personally need to put in.

There are however many benefits of establishing a PBO while you are alive, including:

- It ensures that the vision and purpose are well defined and that the board has first-hand insight into the wishes of the founder.
- It helps the board (and the founder) fine tune the objects and operating procedure, especially where there are initial practical problems.
- It helps to ensure more effective administration and governance.
- Potential tax benefits. There are for example CGT, Dividend withholding tax (DWT) and income tax benefits and the PBO may be able to secure other donations from 3rd parties.
- The personal satisfaction of seeing making a difference and the comfort in seeing your entity be effective and well run, and
- There may be estate duty and personal CGT benefits.

HAVING A PBO SET UP AFTER YOUR DEATH

While there are many benefits to establishing a PBO during your lifetime, there are also situations in which this is not practical.

In such circumstances, one can set up a PBO trust in terms of your Will.

It is however vital that your will is well crafted, to ensure that all the clauses comply with legislation. Since no one else can amend the clauses in your Will, your executor or the nominated trustees will have to apply to a court to amend any problem clauses. This may become a time consuming and expensive exercise.

The biggest advantage of only establishing a PBO from your will is that it ensures that the real surplus capital is allocated to this purpose.

The biggest disadvantage of creating a PBO from your will is that you will have very little (if any) input into how the organisation will be managed and if the trustees will truly understand your intention and apply the funds exactly how you envisaged them to be used.

CONCLUSION

Establishing a PBO will greatly assist you in leaving a lasting legacy. It is however vital that careful thought be given to when and how this should be done.

This can frankly be a technical process and we encourage you to call us for help.

INTEREST FREE LOAN AND DONATIONS TAX

If you have a family trust, you will probably know that the easiest way to capitalise the trust is by way of an interest free loan (to prevent a 20% donations tax liability). The trust will either purchase assets from you by way of a loan or borrow funds from you and purchase its own assets. This has the benefit that the value of the asset value is pegged in your estate and growth continues in the trust.

Another added benefit (for now at least) is that the Income Tax Act allows for the "conduit principle" in terms whereof income or capital gains on trust assets can be vested in a beneficiary and the beneficiary will pay tax on such vested interest at their marginal tax rate (as opposed to the flat rate of 41% for trusts). However, in terms of the so-called anti-avoidance provisions (section 7), income or capital gains on assets donated or sold on an interest free loan and so vested, might be deemed to be the income or capital gains of the donor. This is the case where, for instance, a father is the donor who donates or sells property to the trust and a minor child is the beneficiary in whose name the income or capital gains is vested.

Another aspect that has not received as much attention as the anti-avoidance provisions is the donations tax provisions that might be applicable to interest free loans. The Act states that donations tax will be levied where assets (movable or immovable; corporeal or incorporeal) has been disposed of for a consideration which is not adequate. It has been argued that although you might sell the property for an adequate consideration, if you do not charge interest on the loan you are forgoing an income stream (in the form of interest) for income tax purposes and that can be seen as a deemed donation.

TERM LOAN VS DEMAND LOAN

For purposes of calculating the deemed donation value, a distinction should be made between a term loan (where the repayment term is stipulated in an agreement) and a demand loan (where the repayment will only be made on demand of the lender). With a term loan SARS will be able to calculate the forgone interest (and thus the value of the deemed donation) from the start of the loan, however, with a demand loan the forgone interest will have to be calculated on an annual basis up until such time that the loan has been repaid.

TO WAIVE OR NOT TO WAIVE

It has been suggested that should the loan agreement specify an interest rate to be charged and the donor waives this right, it will be a donation. On the other hand, should the loan agreement be silent on an interest rate or the interest rate not be market related, there will be a deemed donation in favour of the lender.

Clearly monitoring the terms and conditions of all interest free loan agreements will be an administratively intensive exercise and this might be one of the reasons why it is currently not general practice for SARS to levy donations tax on interest free loans. However, it does not mean that SARS could not start to levy it at any time.

It is however clear that SARS has resolved to address the issue of the loopholes created by trusts (see the new tax return format).

We suggest that all trustees consult their tax specialists and conclude written loan agreements that stipulate the terms and conditions of the loan to avoid any confusion. Should there be any further developments from the Davis Tax Committee on this situation, we will advise accordingly.