The copyright of this thesis rests with the University of Cape Town. No quotation from it or information derived from it is to be published without full acknowledgement of the source. The thesis is to be used for private study or non-commercial research purposes only.
Student Name: Zanele Sogoni

Student number: sgnzan002

Programme: Post Graduate Diploma in Tax Law

Lecturer: T.S. Emslie

Date: September 2009

Dissertation Topic:
The taxation of income and expenditure of trusts in South Africa

- Are they still the cosy vehicles of tax avoidance?

Plagiarism declaration:

1. I know that plagiarism is wrong. Plagiarism is to use another’s work and pretend that it is one’s own.
2. I have used the footnote* convention for citation and referencing. Each contribution to, and quotation in, this essay/report/project/…………………from the work(s) of other people has been attributed, and has been cited and referenced.
3. This essay/report/project/………………… is my own work.
4. I have not allowed, and will not allow, anyone to copy my work with the intention of passing it off as his or her own work.
5. I acknowledge that copying someone else’s assignment or essay, or part of it, is wrong, and declare that this is my own work.

[Signature]

Signed by candidate

Signature:..................................................... Student No.........................
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>4</td>
</tr>
<tr>
<td><strong>Section A</strong></td>
<td></td>
</tr>
<tr>
<td>The background of trusts</td>
<td>6</td>
</tr>
<tr>
<td>Definitions</td>
<td>7 - 8</td>
</tr>
<tr>
<td>Parties in a trust</td>
<td>9 - 11</td>
</tr>
<tr>
<td>The creation of trusts</td>
<td>12 - 16</td>
</tr>
<tr>
<td>Types of trusts:</td>
<td></td>
</tr>
<tr>
<td>• Testamentary trusts</td>
<td>17 - 18</td>
</tr>
<tr>
<td>• Inter vivos trusts</td>
<td>18 - 20</td>
</tr>
<tr>
<td>• Special trusts</td>
<td>20 - 21</td>
</tr>
<tr>
<td>• Trading trusts</td>
<td>21</td>
</tr>
<tr>
<td>• Family trusts</td>
<td>22 - 23</td>
</tr>
<tr>
<td>• Public benefit trusts</td>
<td>23</td>
</tr>
<tr>
<td>• Non –resident trusts</td>
<td>23 - 24</td>
</tr>
</tbody>
</table>
**Section B**

The taxation of trusts:

a) Income tax  

* the income of the beneficiary  

* the income of the trust  

* the income assessable to the donor  

* the trustee as representative taxpayer  

* income and capital distributed by the foreign trust  

b) Donations tax  

c) Transfer duty  

d) Capital gains tax  

**Section C**

Conclusion: Are they still the cosy vehicles of tax avoidance?  

Bibliography
Introduction

For many decades men have made provisions for their illegitimate children and mistresses by using secret trusts – hiding their embarrassing secrets from their families and friends\(^1\). Many politicians and other public figures have been known to transfer assets to a trustee to manage in secret in order to avoid conflict of interest\(^2\). Businesses employ trusts to protect the interests of debenture holders, to manage pension funds and to create employee share purchase and management incentive schemes\(^3\). Parents set up trusts to preserve funds for their children, others to support a religious or social cause\(^4\). For decades the trust has been a key tool in estate planning for wealthier individuals and for a very long time trusts have been described as cosy vehicles for tax avoidance. But recently, as a result of the changes in the tax legislation, trusts have received some bad press.

Gone are the days where one could put all their assets into a trust to avoid tax\(^5\). With the introduction of capital gains tax in 2001 and transfer duty, avoiding tax in a trust these days seems to be a little harder. The tightening of the money-laundering legislation internationally has meant that offshore trusts have also lost their status as safe havens to hide their illegal offshore funds from the Reserve Bank and the Receiver of Revenue\(^6\). And to top it off SARS has now entered into agreements with 35 tax havens such as the Seychelles, Mauritius, the Bahamas, Bermuda, the Isle of Man, the British Virgin Islands and Liberia, to improve transparency and to establish the effective exchange information in tax matters\(^7\).

With all these changes and updates in the tax legislation affecting trusts one question arises: are they still the cosy vehicles of tax avoidance?

---

\(^1\) A. J. Oakley, *Parker and mellows: the modern law of trusts* 7ed (1998) 6
\(^3\) Cameron (note 2)
\(^4\) Cameron (note 2).
\(^6\) Ibid.
This research paper explores today’s taxation of the income and expenditure of trusts. It digs deep into the mechanics of trusts to see if they are still worth to have. In order to answer all these questions this paper begins by exploring the background of trusts in section A, section B deals with the way they are taxed encompassing all the recent changes. Finally section C aims to answer the questions posed above and exactly why trusts enjoy ever-increasing and considerable popularity, even with all these unfavourable changes in the legislation.
Section A

The background of trusts

Trusts originated in English law but now they are recognised and employed in most legal systems in the world\(^8\). After the British occupation of the Cape in 1806, the trust was imported into South African law by common usage\(^9\). It is now a vibrant and reliable institution of modern South African law, for which the courts have devised distinctively South African rules and principles, and for which new uses are constantly being devised\(^10\).

In the strict sense a trust exists when the founder of the trust has handed over or is bound to hand over to another the control of the property\(^11\) which, or the proceeds of which, is to be administered or disposed of by the other (the trustee or the administrator) for the benefit of some person other than the trustee as beneficiary or some impersonal object\(^12\). A trust in this sense creates a fiduciary obligation. In the wide sense a trust exists whenever someone is bound to hold or administer property\(^13\) on behalf of another or for some impersonal object and not for his or her own benefit\(^14\). Such a person has at the minimum a duty to keep the property administered separate from personal property\(^15\) and to avoid a conflict of interest with the beneficiary or the trust object\(^16\).

The source of our Trust law is the\(^17\):

- Unit Trust Control Act 54 of 1981
- Companies Act 61 of 1973
- Trust Property Control Act 57 of 1988

---

\(^8\) Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 1-2
\(^9\) Cameron (note 8) at 2
\(^10\) Cameron (note8) at 2
\(^11\) Cameron (note8) at 4
\(^12\) Cameron (note8) at 4
\(^13\) Cameron (note8) at 3
\(^14\) Cameron (note8) at 3
\(^15\) Cameron (note8) at3
\(^16\) Cameron (note8) at3
Definitions

The Hague Convention on the Law applicable to Trusts and their Recognition of 10 January 1986 provides that the term ‘trust’ refers to the legal relationship created inter vivos or on the death by a person, the settler, when assets have been placed under the control of a trustee for the benefit of a beneficiary or a specified purpose. Though South Africa is not party to the convention, the features of a trust in the strict sense as it developed in our law conform to the definition, which now reflects widespread international understanding and usage in relation to the trust concept.

An authoritative statutory definition of “trust” was introduced into South African law by the Trust Property Control Act 57 of 1988, which came into operation on 1 March 1989. The Act defines the following terms to mean the following:

'trust' means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed-
(a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or
(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument, but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965 (Act 66 of 1965);

---

18 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 5
19 Cameron (note 18) at 5
20 Cameron (note 18) at 2
21 Trust Property Control Act 57 of 1988 s1.
22 Trust Property Control Act 57 of 1988 s1
In the law of Income Tax a trust is treated by a statute as a person (the definition of a person in section 1 if the Income Tax Act specifically includes a trust) which means that a trust is subject to normal taxation\(^{23}\).

'trustee' means any person (including the founder of a trust) who acts as trustee by virtue of an authorization under section 6 and includes any person whose appointment as trustee is already of force and effect at the commencement of this Act\(^ {24}\);

'trust property' or 'property' means movable or immovable property, and includes contingent interests in property, which in accordance with the provisions of a trust instrument are to be administered or disposed of by a trustee\(^ {25}\).

Section 1 of the Income Tax Act 58 of 1962 defines a beneficiary in relation to a trust as a person who has a vested or contingent interest in all or portion of the receipts or accruals of the assets of that trust\(^ {26}\).

In *Estate Kemp v MacDonald’s Trustee* Solomon JA said that “the underlying concept of a trust is that while the legal dominium is vested in trustees, they have no beneficial interest but are bound to hold and apply the property for the benefit of some person or persons or for the accomplishment of some special purpose. In the same case Innes CJ held that the English word “trustees” means persons entrusted (as owners or otherwise) with the control of property with which they are bound to deal for the benefit of others”\(^ {27}\).


\(^{24}\) Trust Property Control Act 57 of 1988 s1

\(^{25}\) Trust Property Control Act 57 of 1988 s1

\(^{26}\) Income Tax Act 58 of 1962 s1

\(^{27}\) *Estate Kemp & others v MacDonald’s Trustee* 1915 AD 491; David Clegg and Rob Stretch ‘Income tax in South Africa: estates trusts and income arising from gratuitous events’ vol 1 (October 2008) SI 34 Available at [http://butterworths.uct.ac.za/nxt/gateway.dll?f=templates$fn=default.htm$vid=mylnb:10.1048/enu](http://butterworths.uct.ac.za/nxt/gateway.dll?f=templates$fn=default.htm$vid=mylnb:10.1048/enu) [Accessed 3 September 2009]
Parties in a trust

There are three parties in a trust, namely the:

Founder - the donor is also known as the founder or testator. A trust cannot be established without a donor. Although the donor plays an important role, it is usually very short-lived. Once the trust is created, the donor plays no role in the management of the trust. The donor may however have a role in the administration of the trust if the trust deed contains provisions to that extent. However, a donor could also be the trustee and even beneficiary. Once the donor has donated the trust property, he/she loses control over the property. Even if the donor is the trustee as well, his power has ended. The trust property that the founder donates is any type of property, including moveable and immovable property.

Trustee - the basic duty of a trustee is to hold legal title to the trust property. They are bound to hold and apply the property for the benefit of one or more individuals or organisations (i.e. the beneficiary, usually specified by the founder) for the accomplishment of some special purpose. The trustees owe a fiduciary duty to the beneficiaries, who are “beneficial” owners of the trust property. They have the power and duty (in respect of which to he or she may be held) to account, manage, employ or dispose of the trust assets in accordance with the terms of the trust deed and the special duties imposed by law. The trustee may also be beneficiary of the trust and even the sole beneficiary but the trustee cannot be both sole trustee and sole beneficiary. This way, every trust therefore imports the

29 Ibid.
30 Ibid.
31 Ibid.
32 Ibid.
33 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 553
35 Ibid.
36 Ibid.
37 Wikipedia, the free encyclopedia ‘Trust law’ Available at http://en.wikipedia.org/wiki/Trust_law
[Accessed 15 July 2009]
38 Ibid
39 Ibid
40 Cameron (note 33) at 11
41 Cameron (note 33 ) at 11
42 Cameron (note 33 ) at 553
element of holding or administering property in part at least for a person or object other than the trustee.\textsuperscript{43}

**Beneficiary** – any person, born or unborn, natural or juristic, may be a beneficiary of a trust.\textsuperscript{44} The trustee may be a beneficiary and even the sole beneficiary\textsuperscript{45} but the trustee cannot be not sole trustee and sole beneficiary\textsuperscript{46}, since in that case there would be no element of administration for another and so no trust\textsuperscript{47}. The founder may be a beneficiary, even the sole beneficiary, as is often the case with nominee trusts\textsuperscript{48} (a trust created for the purpose of holding property for beneficiaries whose identities are kept secret).\textsuperscript{49}

The beneficiaries may be designated by name or description\textsuperscript{50}. If the name or description used does not unequivocally designate any one person or body the court may declare which, on the true interpretation of the trust deed was intended\textsuperscript{51}. Often beneficiaries are designated as a class, such as ‘X’s children’ or ‘my grandchildren’\textsuperscript{52}.

Trusts for unborn descendants of the founder are common and are accepted as valid\textsuperscript{53}. So are trusts for unformed companies, which are not trusts in the strict sense\textsuperscript{54}. Sometimes the designated beneficiary is not a person\textsuperscript{55} but an entity like a trust or unincorporated association which does not possess juristic personality\textsuperscript{56}. Such a designation is not invalid but the beneficiaries are taken to be the trustees, committee of the association or members in their capacity as such\textsuperscript{57}. They take not for their private benefit but for the purposes of the trust or association\textsuperscript{58}.

\begin{flushright}
\textsuperscript{43} Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 11
\textsuperscript{44} Cameron (note 43) at 553
\textsuperscript{45} Cameron (note 43) at 553
\textsuperscript{46} Cameron (note 43) at 553
\textsuperscript{47} Cameron (note 43) at 553
\textsuperscript{48} Cameron (note 43) at 553
\textsuperscript{49} ‘Trust definition’ Available at http://dictionary.reference.com/browse/trust [Accessed 14 July 2009]
\textsuperscript{50} Cameron (note 43) at 553
\textsuperscript{51} Cameron (note 43) at 553-554
\textsuperscript{52} Cameron (note 43) at 553
\textsuperscript{53} Cameron (note 43) at 553
\textsuperscript{54} Cameron (note 43) at 553
\textsuperscript{55} Cameron (note 43) at 553
\textsuperscript{56} Cameron (note 43) at 553
\textsuperscript{57} Cameron (note 43) at 553
\textsuperscript{58} Cameron (note 43) at 553
\end{flushright}
Some beneficiaries are entitled to receive income from the trust property, or to receive the property itself. The extent of a beneficiary’s interest depends on the wording of the trust document. One beneficiary may be entitled to income (for example, interest from a bank account), whereas another may be entitled to the entirety of the trust property when he attains a certain age. There is a difference between beneficiaries with vested rights and those with contingent rights. A beneficiary with vested rights will succeed to income or capital and one with contingent rights may never succeed unless the trustees exercise their discretion or an event occurs. The founder has much discretion when creating the trust, subject to some limitations imposed by law.

A vested right is ‘immediate’ in the sense that it does not depend on any further contingency such as the survival of the beneficiary to a given age or at the death of a given person. A vested right in this sense is therefore transmissible to the successors of the beneficiary on death or insolvency and forms an asset in the beneficiary’s estate. It is generally alienable.

In contrast, a contingent right does not form part of an asset in the beneficiary’s estate on death or upon insolvency. It is a mere expectation, which can in general be ceded, though the cession by an insolvent of a contingent right is valid only if the insolvent estate is not adversely affected by it.

‘Contingent right’ has been described by the special court as merely a spes – an expectation which might never be realised. From its very nature it could not have a definite present value. In the income tax sense, therefore, a vested right is an accrued right.

---


60 Ibid.

61 Ibid.


63 Huxham (note 62)


66 Cameron (note 66)

67 Cameron (note 66)

68 Cameron (note 66)

69 Cameron (note 66)

The creation of trusts

Trusts can be created by the expressed intentions of the founder \(^{73}\) (the founder can be anyone who has the capacity to undertake contractual obligations \(^{74}\)) or they can be created by operation of law \(^{75}\) (trusts can be set up by the court, by statute, or on statutory authority \(^{76}\)). Typically, one of the following ways creates a trust:

1. A written trust document created by the founder and signed by both the founder and the trustees (often referred to as an inter vivos trust or ‘living trust’) \(^{77}\);
2. An oral declaration \(^{78}\);
3. The will of a decedent, usually called a testamentary trust; or a court order (for example in family proceedings) \(^{79}\).

In *Thorne and Molenaar NNO v Receiver of Revenue, Cape Town* Van Wilsen J described the creation of a trust as follows \(^{80}\):

…in general a trust is created by contract, very often by a contract of donation or in virtue of an antenuptial contract or by way of a will. It is created in respect of defined property transferred to a trustee, who is burdened with the obligation to administer the property for the benefit of a third person, the latter being accorded a right against the trustee to enforce the trustee’s compliance with his obligations towards the beneficiary concerned. Generally trusts contemplate an extended continuation of the administration of the trust property in favour of the beneficiary until terminated on the

---


\(^{72}\) Ibid.


\(^{74}\) Edwin Cameron et al *Honore’s South African law of trusts* 5ed (2002) 117

\(^{75}\) Cameron (note 74)

\(^{76}\) Cameron (note 74) at 118

\(^{77}\) Cameron (note 74) at 118

\(^{78}\) Cameron (note 74) at 118

\(^{79}\) Cameron (note 74) at 118

happening of some specified future event. A trust can also, of course, be created by statute…

When a trust is being created by way of a written document, the document in question is known as the ‘trust document’. The trust is governed by the terms of the trust document, which is usually written and occasionally set out in deed form. The trust deed is a legal document created by contract. It is a contract entered into by a founder who places certain assets under the administration of the trustees for the benefit of beneficiaries. The parties are the founder and the trustees (in certain instances beneficiaries are party to the contract). The trustee is obliged to administer the trust in accordance with both the terms of the trust document and the governing law.

For a valid trust to be created:
(a) the founder must intend to create one – the intention to create a trust in the strict sense is whereby the founder intends that the transferee should hold an office by virtue of which duties attaching to the office will descend to a successor in office rather than to the deceased trustee’s executor. Such a person is to purely hold the property in an administrative capacity. The intention to create a trust between living persons (inter vivos) must be shared by the founder and the prospective trustee.

Cameron argues that words such as ‘trust’ and administrator’ point to the creation of a trust but are not conclusive, since they may have been employed by mistake, or may denote trusts

---

81 Wikipedia, the free encyclopedia ‘Trust law’ Available at http://en.wikipedia.org/wiki/Trust_law
[Accessed 15 July 2009]
82 Ibid.
83 Ibid
84 Ibid.
85 Ibid.
86 Ibid.
87 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 117
88 Cameron (note 87) at 118
89 Cameron (note 87) at 118
90 Cameron (note 87) at 118
91 Cameron (note 87) at 118
92 Cameron (note 87) at 118
93 Cameron (note 87) at 119
or trust–like arrangements only in a wide sense. He refers to the *Conze v Masterbond Participation Trust Managers* case to illustrate his point, where investors advanced money to a company against the issue of debentures secured by a debenture mortgage bond over immovable property and executed in favour of Masterbond as trustee for the debenture holders. Masterbond was referred to throughout the trust deed as the ‘trustee’. The full bench of the Cape Provincial Division observed that this usage applied even where, in terms of the trust deed, Masterbond was patently acting as agent for the company to which the moneys invested were advanced. The argument was that the use of the word ‘trustee’ in the trust deed with reference to Masterbond, indicated that a trust in the strict sense had been created but when a testator appointed H ‘sole and universal administrator of my estate and effects’ with no further directions and appointed J executor it was held that he intended not to create a trust but to appoint H sole heir.

Cameron further argues that the intention maybe inferred even though no words referring to a ‘trust’ appear at all. He uses the *Coetzee NO v Universiteit Stellenbosch* case as an example where the testator had after the happening of certain events willed the yearly yield of a capital sum as a bursary for the best student in physiology at the University of Stellenbosch. The residual heir sought the nullification of this bequest on the ground of vagueness, pointing out that no trustee had been appointed or named. The court upheld the bequest as a peculiar form of trust, observing that the testator is entitled to rely on the machinery of the law, which exists precisely to remedy such an omission.

---

95 Cameron (note 94)
96 Cameron (note 94)
97 Cameron (note 94)
98 Cameron (note 94)
99 Cameron (note 94)
100 Cameron (note 94)
101 Cameron (note 94)
102 Cameron (note 94)
103 Cameron (note 94)
104 Cameron (note 94) at 119- 120
105 Cameron (note 94) at 119- 120
legal effect of lack of intention to create a trust:

When the testator or donor uses words that are held to be indefinite\textsuperscript{106}, so that an intention to create a trust is lacking, the effect depends on whether the testator or donor intended to benefit the person to whom the property was given\textsuperscript{107}. If the intention to benefit was present, the supposed trust is disregarded and the legatee or donee takes free of any burden\textsuperscript{108}. If, on the other hand, the person to whom the property is given is not intended to be a beneficiary\textsuperscript{109}, the gift is invalid and may be recovered by the founder or his estate\textsuperscript{110}. If the intention to create a trust is lacking because the trustee is insufficiently independent\textsuperscript{111}, the maxim that the real transaction prevails over the apparent one applies and the transaction is construed as agency, partnership, sale etc according to the intention of the parties\textsuperscript{112}.

(b) the founder’s intention must be expressed in a mode appropriate to create an obligation\textsuperscript{113} - an intention to create a trust however clearly expressed is not enough unless couched in some form \textsuperscript{114}, such as a will, contract, transfer, statute, treaty or judicial order, which is apt to create a legal obligation\textsuperscript{115}. The obligation is either i) the obligation resting on the trustee to administer the property for the trust object\textsuperscript{116}, or ii) the obligation resting on the founder to ensure that the property is administered by the trustee\textsuperscript{117}.

(c) the property subject to the trust must be defined with reasonable certainty\textsuperscript{118} - The property subject to the trust must be clearly identified\textsuperscript{119}. One cannot, for example, settle "the majority of my estate", as the precise extent cannot be ascertained.\textsuperscript{120} Trust property can be any form of specific property, be it real or personal, tangible or intangible\textsuperscript{121}.

\textsuperscript{106} Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 137
\textsuperscript{107} Cameron (note 106)
\textsuperscript{108} Cameron (note 106)
\textsuperscript{109} Cameron (note 106)
\textsuperscript{110} Cameron (note 106)
\textsuperscript{111} Cameron (note 106)
\textsuperscript{112} Cameron (note 106)
\textsuperscript{113} Cameron (note 106) at 117
\textsuperscript{114} Cameron (note 106) at 137
\textsuperscript{115} Cameron (note 106) at 137-138
\textsuperscript{116} Cameron (note 106) at 138
\textsuperscript{117} Cameron (note 106) at 138
\textsuperscript{118} Cameron (note 106) at 117
\textsuperscript{119} Wikipedia, the free encyclopedia ‘Trust law’ Available at \url{http://en.wikipedia.org/wiki/Trust_law} [Accessed 15 July 2009]
\textsuperscript{120} Ibid.
\textsuperscript{121} Ibid.
(d) the trust object, which may either be personal or impersonal, must be defined with reasonable certainty\textsuperscript{122}. The beneficiaries of the trust must be clearly identified, or at least be ascertainable\textsuperscript{123}. For instance in *Harter v Epstein* the testator appointed executors and trustees\textsuperscript{124}, made a specific bequest to his daughter and went on\textsuperscript{125}: ‘the balance of my estate to be left to the discretion of my executors’\textsuperscript{126}. It was held that the balance of the estate went on intestacy\textsuperscript{127} since no valid trust was created nor could it be implied that the daughter was heir to the residue\textsuperscript{128}. In the case of discretionary trusts, where the trustees have power to decide who the beneficiaries will be, the settlor must have described a clear class of beneficiaries\textsuperscript{129}. Alternatively, the object of a trust could be a charitable purpose rather than specific beneficiaries\textsuperscript{130}, and finally

(e) the trust object must be lawful\textsuperscript{131} - the objects of a trust will have to conform with the disavowal of unfair discrimination under the 1996 Constitution and the Promotion of Equality and Prevention of Unfair Discrimination Act\textsuperscript{132}.

\textsuperscript{122} Edwin Cameron et al *Honore’s South African law of trusts* 5ed (2002) 117
\textsuperscript{123} Wikipedia, the free encyclopedia ‘Trust law’ Available at [http://en.wikipedia.org/wiki/Trust_law](http://en.wikipedia.org/wiki/Trust_law)
[Accessed 15 July 2009]
\textsuperscript{124} Cameron (note 122) at 151-152
\textsuperscript{125} Cameron (note 122) at 152
\textsuperscript{126} Cameron (note 122) at 152
\textsuperscript{127} Cameron (note 122) at 152
\textsuperscript{128} Cameron (note 122) at 152
\textsuperscript{129} Cameron (note 122) at 152
\textsuperscript{130} Wikipedia, the free encyclopedia ‘Trust law’ Available at [http://en.wikipedia.org/wiki/Trust_law](http://en.wikipedia.org/wiki/Trust_law)
[Accessed 15 July 2009]
\textsuperscript{131} Cameron (note 122) at 117
\textsuperscript{132} Cameron (note 122) at 117
Types of trusts

In essence, there are two main types of trusts in South Africa. These are the inter-vivos (also known as the “living trust”) and the testamentary trust. A living trust is created during the lifetime of a person and may continue to operate after death\textsuperscript{133}, a testamentary trust is one created upon death, in terms of the provisions of a will of a deceased person\textsuperscript{134}.

Testamentary trusts - A testamentary trust is a legal entity created as specified in a person's will, and is occasioned by the death of that person\textsuperscript{135} i.e. it only becomes effective after the founder's death\textsuperscript{136}. The guiding document in determining the ambit of the trust is therefore the last will and testament\textsuperscript{137}. It is created to address any estate accumulated during that person's lifetime or generated as a result of the death itself\textsuperscript{138}, such as a settlement in a wrongful-death suit, or the proceeds from a life insurance policy held on the founder\textsuperscript{139}.

As the donor of a testamentary trust is, by definition, deceased by the time the trust becomes active, they confer all powers of trusteeship to another individual, the trustee\textsuperscript{140}. The trustees will be named in the will, or in a separate document attached to the will but dealing specifically with the provisions of the trust\textsuperscript{141}. It is also because of this reason that the founder will generally not have any influence over the trustee's exercise of discretion\textsuperscript{142}, however the founder can offer documented instruction or guidance regarding the way in which the trustees should act\textsuperscript{143}. This can be done by the donor providing binding instructions.

\textsuperscript{133} Edwin Cameron et al *Honore’s South African law of trusts* 5ed (2002) 117
\textsuperscript{134} Keith Huxham and Phillip Haupt *Notes on South African income tax* 26 ed (2007) 579
\textsuperscript{136} Ibid.
\textsuperscript{137} ‘General trust info’ Available at [http://www.graffs.co.za/general_trusts.htm](http://www.graffs.co.za/general_trusts.htm) [Accessed on 15 July 2009]
\textsuperscript{138} Ibid.
\textsuperscript{139} Ibid.
\textsuperscript{140} Estates or trusts ‘What is a testamentary trust’
[http://www.estatesortrusts.co.uk/what-is-a-testamentary-trust.html](http://www.estatesortrusts.co.uk/what-is-a-testamentary-trust.html) [Accessed 29 August 2009]
\textsuperscript{141} Ibid.
\textsuperscript{142} Ibid.
\textsuperscript{143} Ibid.
to trustees in the trust deed\textsuperscript{144}, as well as non-binding guidance in a document known as a ‘letter of wishes’\textsuperscript{145}.

It is quite common for testamentary trusts to be designed to benefit individuals who are not yet of an age at which they could manage assets that have been given to them in the will\textsuperscript{146}. The trustee is appointed to direct the trust until a set time when the trust expires\textsuperscript{147}, such as when the minor beneficiaries reach a specified age or accomplish a deed such as completing a set educational goal or achieving a specified matrimonial status\textsuperscript{148}.

In practical terms, testamentary trusts tend to be driven more by the needs of the beneficiaries (particularly infant beneficiaries) than by tax considerations\textsuperscript{149}, which are the usual considerations in \textit{inter vivos} trusts\textsuperscript{150}. A testamentary trust is taxed on the income it retains and its beneficiaries are taxed on the income it distributes\textsuperscript{151}.

\textit{Inter - vivos trust / living trust} - The term “inter-vivos” is a Latin term meaning ‘during life’\textsuperscript{152}, thus, a living trust is constituted during the lifetime of the donor\textsuperscript{153}, and also comes into effect within this period. The founding document is the trust deed\textsuperscript{154} (a special contract defining all the specifics of the operation of the trust\textsuperscript{155}). The trust is created by drafting a trust deed, usually in co-operation with an attorney specialising in trust law, and registering the trust with the local High Court\textsuperscript{156}.

\begin{footnotesize}
\begin{enumerate}
    \item Estates or trusts ‘ What is a testamentary trust’
      http://www.estatesortrusts.co.uk/what-is-a-testamentary-trust.html [Accessed 29 August 2009]
    \item Ibid.
    \item Ibid.
    \item Wikipedia, the free encyclopedia ‘ Testamentary trust’ Available at
    \item Ibid.
    \item Ibid.
    \item Ibid.
    \item Keith Huxham and Phillip Haupt Notes on South African income tax 26 ed (2007) 579
    \item Wikipedia, the free encyclopedia ‘ Living trust’ Available at
    \item ‘General trust info’ Available at http://www.graaffs.co.za/general_trusts.htm
      [Accessed on 15 July 2009]
    \item Ibid.
    \item Ibid.
    \item Ibid.
\end{enumerate}
\end{footnotesize}
To establish a living trust, an individual transfers title of assets from himself as donor\textsuperscript{157}, to a trustee of the trust to administer for the benefit of himself and at least one other person\textsuperscript{158}. Assets can be transferred into the living trust by selling it to the trust (through a loan granted to the trust) or donating cash to it\textsuperscript{159}.

The creation and revocation of inter-vivos trusts and the acquisition of rights by the beneficiaries under them are regulated by the rules of contract law\textsuperscript{160}. There exist two types of contracts, namely

- A contract between the donor and the trustee\textsuperscript{161}

- A contract between the trustee and the beneficiary(ies)\textsuperscript{162}

In the contract between the donor and the trustee, the trustee accepts the duties imposed upon him/her in terms of the trust deed\textsuperscript{163} and the trustee acquires formal ownership of the trust assets subject to the terms prescribed in the trust deed\textsuperscript{164}. In the contract between the trustee and the beneficiary(ies)\textsuperscript{165}, the trust benefits are offered to the beneficiary by the trustee and accepted by the beneficiary\textsuperscript{166}.

The trust is managed by the trustees for the benefit of the beneficiaries\textsuperscript{167}. Since this trust is formed by a living person that means that the founder could be liable for tax on income received by the trust\textsuperscript{168}. Once the founder has died they can no longer be taxed, therefore the trust and the beneficiaries will only be able to be the only taxpayers subject to tax\textsuperscript{169}.

\textsuperscript{157} Wikipedia, the free encyclopedia ‘Living trust’ Available at http://en.wikipedia.org/wiki/Living_trust [Accessed on 15 July 2009]
\textsuperscript{158} Ibid
\textsuperscript{159} Ibid
\textsuperscript{160} ‘General trust info’ Available at http://www.graffs.co.za/general_trusts.htm [Accessed on 15 July 2009]
\textsuperscript{162} Ibid.
\textsuperscript{163} Ibid.
\textsuperscript{164} Ibid.
\textsuperscript{165} Ibid.
\textsuperscript{166} Ibid.
\textsuperscript{167} Wikipedia, the free encyclopedia ‘Living Trust’ Available at http://en.wikipedia.org/wiki/Living_trust [Accessed on 15 July 2009]
\textsuperscript{168} Keith Huxham and Phillip Haupt Notes on South African income tax 26 ed (2007) 579
\textsuperscript{169} Huxham (note 168)
There are two types of living trusts in South Africa, namely **vested trusts** and **discretionary trusts**\(^\text{170}\). A vested trust, is one in which the beneficiaries have a personal right to claim their portion of the benefits from the trustees on the happening of a certain event specified in the trust deed\(^\text{171}\), whereas in discretionary trusts the trust beneficiaries have no rights whatsoever to claim the trust benefits except until the trustees have exercised their discretion and named the beneficiary and the award\(^\text{172}\). Beneficiaries in discretionary trusts are such in name only and are named only as eligible for benefits but not entitled thereto\(^\text{173}\). Because the beneficiary has no rights whatsoever, in the event of death or insolvency\(^\text{174}\), nothing can pass to the estate or creditors\(^\text{175}\). This structure is therefore effective for estate planning from both the perspective of saving estate duty but also for protecting assets against creditors\(^\text{176}\).

**Special trusts**- in section 1 of the Income Tax Act 58 of 1962 paragraph (a) of the definition of ‘special trust’ refers to a special trust as a trust that is created solely for the benefit of a person who suffers from a mental illness or a serious physical disability that prevents him from earning sufficient income for his maintenance\(^\text{177}\). This type of trust can be created inter vivos or in terms of a will (testamentary)\(^\text{178}\).

When the person for whose benefit the trust has been founded dies, the trust will no longer be deemed to be a special trust for the purposes of years of assessment ending on or after the date of death\(^\text{179}\).

---


\(^{	ext{172}}\) ‘General trust info’ Available at [http://www.graaffs.co.za/general_trusts.htm](http://www.graaffs.co.za/general_trusts.htm) [Accessed on 15 July 2009]

\(^{	ext{173}}\) Ibid.

\(^{	ext{174}}\) Ibid.

\(^{	ext{175}}\) Ibid.

\(^{	ext{176}}\) Ibid.

\(^{	ext{177}}\) Income Tax Act 58 of 1962 s1

\(^{	ext{178}}\) Professor Keith Jordaan et al Silke: South African income tax (2008) 659

\(^{	ext{179}}\) Jordaan (note 178)
When the trust is created in terms of the will of a deceased person\textsuperscript{180}, solely for the benefit of his relatives who are alive or conceived (even though not yet born) on the date of his death will\textsuperscript{181}, it will also be classified as a special trust if the youngest beneficiary is under the age of 21\textsuperscript{182} on the last day of the year of assessment of the trust\textsuperscript{183}. The trust will cease to be a special trust the year of assessment when the youngest beneficiary attains the age of 21\textsuperscript{184}.

The benefit of being classified as a special trust is that for income tax purposes the rate will not be the fixed 40\% that is applicable to ordinary trusts\textsuperscript{185}, but the sliding scale that varies from 18\% to 40\% that is applicable to individuals\textsuperscript{186}.

\textit{Trading trusts} - A trading trust is a trust that carries on a business. A trading trust has a trust deed and\textsuperscript{187}: can confer wide powers and discretions on trustees, e.g. the power to carry on a business\textsuperscript{188}, and the power to hold non-diversified, high-risk investments\textsuperscript{189}. Trading trusts usually have wide borrowing and lending powers\textsuperscript{190}, they can make provision for a corporate trustee and contain an adequate indemnity for trustees\textsuperscript{191}.

A trading trust may be used as an alternative to other business structures such as the traditional limited liability company\textsuperscript{192}.

\textsuperscript{180} Professor Keith Jordaan et al \textit{Silke: South African income tax} (2008) 659
\textsuperscript{181} Jordaan (note 180)
\textsuperscript{182} Jordaan (note 180)
\textsuperscript{183} Income tax act 58 of 1962 s1 (par (b) of the definition of ‘special trust’); Professor Keith Jordaan et al \textit{Silke: South African income tax} (2008) 659
\textsuperscript{184} Jordaan (note 180) at 659
\textsuperscript{185} Jordaan (note 180) at 659
\textsuperscript{186} Jordaan (note 180) at 659
\textsuperscript{187} Inland Revenue ‘For businesses and employers: trading trusts’ \url{http://www.ird.govt.nz/yoursituation-bus/bus-aust-nz/types-bus/tradingtrusts/} [Accessed on 17 August 2009]
\textsuperscript{188} Ibid.
\textsuperscript{189} Ibid.
\textsuperscript{190} Ibid.
\textsuperscript{191} Ibid.
\textsuperscript{192} Inland Revenue ‘For businesses and employers: trading trusts’ \url{http://www.ird.govt.nz/yoursituation-bus/bus-aust-nz/types-bus/tradingtrusts/} [Accessed on 17 August 2009]
Family trusts - The term family trust refers to a discretionary trust set up to hold a family's assets or to conduct a family business. Generally, they are established for asset protection or for tax purposes.

A family trust:

is generally established by a family member for the benefit of members of the 'family group'. It can be the subject of a family trust election which provides it with certain tax advantages, provided that the trust passes the family control test and makes distributions of trust income only to beneficiaries of the trust who are within the 'family group'.

They can assist in protecting the family group's assets from the liabilities of one or more of the family members (for instance, in the event of a family member's bankruptcy or insolvency), and they provide a mechanism to pass family assets to future generations; and can provide a means of accessing favourable taxation treatment by ensuring all family members use their income tax "tax-free thresholds".

A family trust has many other potential benefits, including avoiding issues such as challenges to the will following a death of a senior member of the family.

The problem with many family and trading trusts is that they are often specifically designed to be controlled by the founder, beneficiaries and / or by their agents for their own benefit. Unashamed control of a trust in this manner can cause the trust to be regarded as a sham or a front, with the consequences that the assets under the so-called trust would

---


194 Ibid

195 Ibid.

196 Ibid

197 Ibid

198 Ibid

199 Ibid

200 Ibid

201 Ibid

202 Ibid

203 Ibid

204 Ibid

205 Professor Walter Geach ‘when a trust is not a trust: trading and family trusts under the spotlight’ Available at http://www.mba.co.za/article.aspx?rootid=6&subdirectoryid=1607 [Accessed on 3 May 2009]
be regarded as those of the person or persons who control the trust\textsuperscript{209}, and the protection and planning opportunities afforded by trust ownership would be lost\textsuperscript{210}.

\textit{Public benefit trusts}. The definition of a non-profit organisation, according to section 1(1)(x) of the Non- Profit Organisations Act 71 of 1997, is: “a trust, company or other association of persons established for a public purpose: and the income and property of which are not distributable to its members or office- bearers except as reasonable compensation for services rendered\textsuperscript{211}.” Section 56 (1) (i) of the Income Tax Act 58 of 1962 exempts any income retained by the trust or distributed by the trust of such nature\textsuperscript{212}.

\textit{Non-resident trusts}. A trust will be a non-resident if it was established outside the Republic and has its place of effective management outside the republic\textsuperscript{213}. The formation of offshore trusts is becoming increasingly popular with South African residents\textsuperscript{214} and there are a significant number of South Africans who have set up trusts offshore in which the majority of beneficiaries are resident in South Africa\textsuperscript{215}.

In a study done in the year 2000\textsuperscript{216}, it was estimated that about 60\% of the world’s transactions took place offshore\textsuperscript{217}. It was further estimated that more than 40\% of these transactions were done via trusts\textsuperscript{218}. This implies that today more than a quarter of the world’s funds are housed in offshore trusts\textsuperscript{219}.

\textsuperscript{209} Professor Walter Geach ‘ when a trust is not a trust : trading and family trusts under the spotlight’ Available at \url{http://www.mba.co.za/article.aspx?rootid=6&subdirectoryid=1607} [Accessed on 3 May 2009]
\textsuperscript{210} Ibid
\textsuperscript{211} Non- Profit Organisations Act 71 of 1997 s 1(1)(x)
\textsuperscript{212} Income Tax Act 58 of 1962 s56 (1) (i)
\textsuperscript{213} Keith Huxham and Phillip Haupt \textit{Notes on South African income tax} 28 ed (2009) 729
\textsuperscript{307}
\textsuperscript{215} Oguttu (note 214) at 307
\textsuperscript{216} Oguttu (note 214) at 307
\textsuperscript{217} Oguttu (note 214) at 307
\textsuperscript{218} Oguttu (note 214) at 307
\textsuperscript{219} Oguttu (note 214) at 307
There are various reasons for setting up such trusts\textsuperscript{220}, for instance, non-resident trusts could be used for estate planning purposes\textsuperscript{221}, to protect assets from creditors\textsuperscript{222}, to avoid exchange control regulations\textsuperscript{223}, as a hedge against the devaluation of the currency and political uncertainty\textsuperscript{224}, to build up funds to finance children’s education\textsuperscript{225}, as a vehicle for overseas retirement funds\textsuperscript{226}, and also to make it easier to engage in international transactions\textsuperscript{227}. When a trust is set up in a low tax jurisdiction\textsuperscript{228}, this often results in some tax advantages that the founders country of residence may try to restrict\textsuperscript{229}.


\textsuperscript{221} Oguttu (note 220) at 307
\textsuperscript{222} Oguttu (note 220) at 307
\textsuperscript{223} Oguttu (note 220) at 307
\textsuperscript{224} Oguttu (note 220) at 307
\textsuperscript{225} Oguttu (note 220) at 307
\textsuperscript{226} Oguttu (note 220) at 307
\textsuperscript{227} Oguttu (note 220) at 307
\textsuperscript{228} Oguttu (note 220) at 307
\textsuperscript{229} Oguttu (note 220) at 308
Section B

The taxation of trusts

In the law of income tax a trust is treated by the statute as a person (the definition of a person in section 1 of the Income Tax Act 58 of 1962 specifically includes any trust\(^{230}\)) which means that a trust is subject to income tax. Trusts are taxed at a flat rate of 40%\(^{231}\) and special trusts are taxed on a sliding scale that varies between 18% and 40\(^{232}\). A trust is not a natural person\(^{233}\) therefore it does not qualify for a primary or secondary rebate in terms of section 6 of the Income Tax Act\(^{234}\) or for the general dividend and interest exemption in terms of S10(1)(i)(xv)\(^{235}\).

The nature of income from a trust (the conduit pipe principle): Two Appeal court cases, *Armstrong v CIR 1938 (AD)* and *SIR v Rosen (AD)* held that income passing a trust retains its identity\(^{236}\). The trust merely acts a conduit pipe through which the income flows\(^{237}\). Therefore, if a trust receives South African dividend income and distributes it to a beneficiary in the year of receipt\(^{238}\), it retains its nature as a dividend, and is exempt from tax in the beneficiaries’ hands\(^{239}\). In Rosen’s case the court held that, even where a beneficiary received an annuity from a trust\(^{240}\), the income would still retain its identity so that if the trust had only dividend income, the full annuity received by the beneficiary would constitute the receipt of a dividend\(^{241}\). However, s10 (2) (b) states that the dividend exemption in terms of s10(1)(k) does not apply in the case of dividends received as an annuity\(^{242}\).

---

\(^{230}\) Income Tax Act 58 of 1962 s1

\(^{231}\) Professor Keith Jordaan et al *Silke: South African income tax* (2008) 658

\(^{232}\) Jordaan (note 231) at 659

\(^{233}\) Jordaan (note 231) at 659

\(^{234}\) Jordaan (note 231) at 659

\(^{235}\) Jordaan (note 231) at 659

\(^{236}\) Keith Huxham and Phillip Haupt *Notes on South African income tax* 28 ed (2009) 728

\(^{237}\) Huxham (note 236)

\(^{238}\) Huxham (note 236)

\(^{239}\) Huxham (note 236)

\(^{240}\) Huxham (note 236) at 729

\(^{241}\) Huxham (note 236) at 729

\(^{242}\) Income Tax Act 58 of 1962 s10 (2)(b); Keith Huxham and Phillip Haupt *Notes on South African income tax* 28 ed (2009) 729
The most important taxes from the point of view of the law of trusts are: a) income tax b) donations tax c) transfer duty and as well as a capital gains tax (which was introduced with effect from 1 October 2001).

\[ a) \text{ income tax} \]

Income tax is a tax on income received by or accruing to in favour of any person during the year of assessment, excluding receipts or accruals of a capital nature. In the case of a resident the tax is levied on worldwide income, while in the case of any person other than a resident the tax is levied on income from a source within or deemed to be within the Republic. In relation to a trust the word “resident” means a trust established or formed in the Republic or which has its place of effective management in the Republic.

Section 25B of the Income Tax Act is the principal taxing section relating to trusts. The section provides that the income received by or accrued to or in favour of any person in his capacity as the trustee of a trust shall, subject to the provisions of section 7, to the extent to which such income has been derived for the immediate or future benefit of any ascertained beneficiary with a vested right to such income, be deemed to be income which has accrued to the beneficiary, and to the extent to which such income is not so derived, be deemed to be income of the trust. However section 25B is made subject to section 7 of the Income Tax Act, which means that, where section 7 applies, it overrides the provisions of section 25B.

Section 7 is an anti-avoidance provision aimed at taxing in the hands of the donor, any income which has resulted from a donation or similar disposition. Section 7 effectively seeks to tax the person who introduced the assets into the trust on the income generated by

---

244 Cameron (note 243)
245 Cameron (note 243) at 444
246 Cameron (note 243) at 444
247 Cameron (note 243) at 444
248 Cameron (note 243) at 444
250 Income Tax Act 58 of 1962 s25B (1)
251 Huxham (note 249) at 720
252 Huxham (note 249) at 720
253 Huxham (note 249) at 720
those assets i.e. it is concerned with the persons who transferred the assets into the trust and not with who formed or created the trust\textsuperscript{254}.

There are therefore three possibilities as regards the incidence of tax on income that is the subject of a trust\textsuperscript{255}. Such income may be 1) the income of the beneficiary\textsuperscript{256}, or 2) the income of the trust fund which by statute possesses legal personality for income tax purposes\textsuperscript{257}, or 3) the income of the donor\textsuperscript{258}.

\textit{The income of the beneficiary}

Where the terms of the trust deed are such that the beneficiary has acquired a vested right to any income in consequence of the exercise by the trustee of a discretion vested in him in terms of the trust deed, agreement or will of a deceased person, such income shall be deemed to have been derived for the benefit of the beneficiary\textsuperscript{259}. The income accrues to the beneficiary when the right to receive it\textsuperscript{260}, whether presently or in the future is vested in him in the year of assessment\textsuperscript{261}, whether or not the income is actually paid to him in that year\textsuperscript{262}. This means that it is the beneficiary and not the trustee that will be taxed on the income. In \textit{Estate Munro v CIR} it was held that even if income from a trust is not paid directly to the beneficiary but is expended by the trustee for his benefit, the income will be taxed in the hands of the beneficiary\textsuperscript{263}. This rule also applies where the income is accumulated or capitalised or otherwise dealt with in the beneficiary’s name\textsuperscript{264}.

\textsuperscript{254} Keith Huxham and Phillip Haupt \textit{Notes on South African income tax} 28 ed (2009) 720
\textsuperscript{255} Edwin Cameron et al \textit{Honore’s South African law of trusts} 5ed (2002)
\textsuperscript{256} Cameron (note 255)
\textsuperscript{257} Cameron (note 255)
\textsuperscript{258} Cameron (note 255)
\textsuperscript{259} Income Tax Act 58 of 1962 s25B(2)
\textsuperscript{260} Cameron (note 255) at 446
\textsuperscript{261} Cameron (note 255) at 446
\textsuperscript{262} Cameron (note 255) at 446
\textsuperscript{263} \textit{Estate Munro v CIR} 1925 TPD 693; David Clegg and Rob Stretch ‘Income tax in South Africa: estates trusts and income arising from gratuitous events’ vol 1 (October 2008) S1 34 Available at http://butterworths.uct.ac.za/nxt/gateway.dll?f=templates$fn=default.htm$vid=mylnb:10.1048/en [Accessed 3 September 2009]
\textsuperscript{264} Ibid.
The principle of taxing the beneficiary and not the trustee will be applicable only if the beneficiary has a vested right to such income during the year in which the income arises or, if he has no such right and he receives the income on distribution by the trustees, prior to the tax year end in which it has accrued to the trust. If he has no right, it cannot be said that the income has accrued him.

Where the beneficiary has a vested right to the income retained in the trust, s7 (1) applies. This means that the beneficiary is certain to get the income at some time in the future, only his enjoyment of it has been postponed. If he dies before the income is paid out to him, it will go to his estate. Therefore as the income is effectively the beneficiary’s and nobody else’s, he will be taxed on it.

If the terms of the trust deed are such that no beneficiary is entitled to the trust income at present, and such income is accumulated and distributed to the beneficiaries in a later year, the income is subject to tax in the hands of the trustees as representative taxpayer.

In the case of a discretionary trust there can be no accrual of an ascertainable amount of the income to a beneficiary until the trustee exercises his power of discretion and distributes the income to a beneficiary, when he becomes assessable on the income so distributed. The reason for this is that until the discretion of the trustee has been exercised, the

---

266 Ibid
267 Ibid
268 Income Tax Act 58 of 1962 s7(1)
269 Keith Huxham and Phillip Haupt Notes on South African income tax 28 ed (2009) 726
270 Huxham (note 269) at 726
271 Huxham (note 269) at 726
272 Huxham (note 269) at 726
274 Ibid
275 Ibid
276 Huxham (note 269)
277 Huxham (note 269)
278 Huxham (note 269)
279 Huxham (note 269)
beneficiary has no more than a contingent right and it is only on the exercise of this discretion by the trustee that the right to the income vests in the beneficiary and he becomes taxable thereon.

Any deduction or allowance which may be made under the provisions of the Income Tax Act in the determination of the taxable income shall, to the extent to which such income is deemed to be income of the beneficiary be deemed to be a deduction or allowance which may be made in the determination of the taxable income of that beneficiary. However, the deduction or allowance to which a beneficiary is entitled in a particular year of assessment is limited to the trust income which is deemed to accrue to the beneficiary in that year.

Any amount that the beneficiary is precluded from claiming as a deduction or allowance in terms of this provision may be claimed as a deduction or allowance of the trust, provided that the sum of the deductions and allowances shall be limited to the or allowance be carried forward and claimed by the beneficiary in the succeeding year of assessment.

Receipts and accruals of the trust that are deemed to have accrued to a beneficiary retain the same character in the hands of the beneficiary and is exempt from tax in the beneficiary’s hands. The trustee is regarded as a mere conduit pipe through which the amount passes to the beneficiary.

---

281 Huxham (note 280)
283 Income Tax Act 58 of 1962 s25B(3)
The income of the trust

Amounts that are received by or accrue to the trustee are deemed to accrue to the trust and where the income is retained in the trust, it will be taxed in terms if s25B, to the extent to which such income has not been derived for the immediate or future benefit of any ascertained beneficiary with a vested right to such income, in which case it will be taxed in terms of s7 (1) where the beneficiary will be taxed. Where a trust receives or accrues income, and it is not paid out to the beneficiaries because there is a stipulation in the trust deed which prohibits the payment to the beneficiaries until the happening of some event s7 (5) will apply and the income will be taxed in the trust. Where the trust receives income not vested in a beneficiary, and which also cannot be said to arise in consequence of a donation, settlement or similar disposition, the trust will be taxed on such income. Income not distributed by the trust will be taxed in either in the trust’s hands or the donor’s hands, so that if it is distributed after the year-end, it has already been taxed and cannot be taxed again. The accumulated income becomes capital of the trust.

In the determination of the liability for tax, the trustee may deduct any expenditure incurred in respect of which the trust qualifies. This will include expenditure such as trustees’ remuneration, interest paid, and the premium on a fidelity bond, and may give rise to an assessed loss. Any deduction or allowance that may be made under the provisions of the Income Tax Act in the determination of the taxable income derived by way of such income is deemed to be a deduction or allowance that may be made in the determination of the taxable income.

---

451
289 Huxham (note 288)
290 Huxham (note 288)
291 Huxham (note 288)
292 Huxham (note 288)
294 Ibid.
income derived by the trust. In addition any amount that is disallowed as a deduction or allowance by a beneficiary in terms of s25B of the Income Tax Act can be claimed as a deduction or allowance by the trust.

If income of a non-resident trust does not vest in a beneficiary and is not subject to section 7 it will be subject to tax in the trust if it is from a source or deemed South African source. If such income is not from a South African source it is not subject to tax in South Africa.

The income assessable to the donor

There are certain cases where the income that would otherwise be treated as income of the beneficiary or of the trust is deemed to income of the donor, who may be either the founder or funder of the trust. The donor must then pay the tax but can recover the amount from the person entitled, whether on his own behalf or in a representative capacity, to the receipt of the income. The cases all arise with trust inter vivos.

In terms of s7(3) when a parent creates a trust of which the minor child is a beneficiary income that would normally be treated as the child’s income is deemed to be that of the parent. Under the Act income is deemed to have been received by the parent of the minor child if by reason of any donation, settlement or other disposition made by the parent or has accrued to or in favour of the child; or has been expended for the maintenance, education or benefit of the child; or has been accumulated for the benefit of the child.

---

296 Income Tax Act 58 of 1962 s25B (5)(a)
298 Huxham (note 297)
299 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 454
300 Cameron (note 299 )
301 Cameron (note 299 )
303 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 454
304 Income Tax Act 58 of 1962 s7(3)
305 Income Tax Act 58 of 1962 s7(3); Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 454
A donation is a wholly gratuitous disposal, made out of the liberality or generosity of the donor. ‘Donation’ here includes a donation in trust for the child. A ‘settlement’ is a gratuitous disposal of property subject to specific terms and conditions, usually to the trustees of a trust. In Overstone v SIR ‘disposition’ was interpreted as meaning any disposal of property made wholly or to an appreciable extent gratuitously out of the liberality or generosity of the disposer. In Joss v SIR, Coetzee J indicated that ‘other disposition’ excluded transactions made for full value in money or money’s worth and that there had to be an element of liberality.

S7(4) of the Act deems income to be of the parent when he or she or his spouse makes a donation, settlement or other disposition or gives some other consideration in favour directly of a person who makes a disposition for the benefit of the parent’s minor child. This provision is aimed at reciprocal trusts and settlements, as when A creates a trust in favour of B’s minor children in consideration of B’s creating a trust in favour of A’s.

S7(5) states that if someone has made a donation, settlement, interest-free loan, or similar gratuitous disposition to a trust then the income arising out of such a gratuitous disposition is deemed to be the income of the person who made the disposition (if the income is retained in the trust due to a stipulation in the trust deed which states that the income shall not be distributed until the happening of some event). This means that the income of a discretionary trust which arises from a donation, settlement or disposition will always be taxed in the ‘donors’ hand in terms of s7(5) unless it is distributed to the beneficiaries. Such income will only be taxed in the trust once the donor has died.

308 Huxham (note 306) at 584
309 Overstone v SIR 1980 (2) SA 721 (A); Huxham (note 306) at 584
310 Joss v SIR 1980 (1) SA 664 (T); Huxham (note 306) at 584
311 Income Tax Act 58 of 1962 s7(4); Cameron (note 307) at 584
312 Cameron (note 307) at 584
313 Income Tax Act 58 of 1962 s7(4); Huxham (note 306) at 581
314 Huxham (note 306) at 581
315 Huxham (note 306) at 581
Income is also deemed to be that of the donor if a deed of donation, settlement or other disposition contains any stipulation that the right to receive any income thereby conferred may, under powers retained by the person by whom that right is conferred, be revoked or conferred upon another, so much of any income as in consequence of the donation, settlement or other disposition is received by or accrues to or in favour of the person on whom that right is conferred, shall be deemed to be the income of the person by whom it is conferred, so long as he retains those powers. - s7 (6)\textsuperscript{316}

*The Woulidge principle* - In *C: SARS v Woulidge* the Court found that where a disposition in the form of an interest-free loan leads to income attributable to the creditor, the limitation of the attribution of that income to an amount equal to the capital outstanding on a cumulative basis (based upon a notional interest forgone) must apply\textsuperscript{317}.

*The trustee as representative taxpayer*

The trustee as representative taxpayer is liable to pay normal tax in respect any income received or controlled by him in his private capacity\textsuperscript{318}. The trustee is however entitled to recover the amount from the person on whose behalf it is paid, or to retain out of any moneys that are in his possession or come to him in his representative capacity the amount so paid\textsuperscript{319}. But a representative taxpayer is personally liable for any tax payable in a representative capacity, while it remains unpaid, he or she a) alienates, charges or disposes of the income in respect of which the tax is chargeable, or b) disposes of or parts with any fund of money, which is in his or possession or comes to him or her after the tax is payable, if the tax could legally have been paid from or out of that fund of money\textsuperscript{320}.

\textsuperscript{316} Income Tax Act 58 of 1962 s7(6); Edwin Cameron et al *Honore’s South African law of trusts* 5ed (2002) 458
\textsuperscript{318} Income Tax Act 58 of 1962 s90 (1)(a); Edwin Cameron et al *Honore’s South African law of trusts* 5ed (2002) 461
\textsuperscript{319} Income Tax Act 58 of 1962 s96 (1); Edwin Cameron et al *Honore’s South African law of trusts* 5ed (2002) 461
\textsuperscript{320} Income Tax Act 58 of 1962 s97
Income and capital distributed by the foreign trust

If a trust is formed in an offshore jurisdiction, its income cannot be taxed in South Africa unless it is distributed to a resident beneficiary\(^ {321}\). However should the offshore trust be managed in South Africa (i.e. if the trustees carry out the day-to-day management of the trust in the republic)\(^ {322}\), South Africa may apply the residence basis of taxation to tax the worldwide income of that trust\(^ {324}\).

If the beneficiary of a non-resident trust is a South African resident all of the income which vests is subject to tax in South Africa in that resident’s hands\(^ {325}\).

If the beneficiary of a non-resident trust is also a non-resident, one has to determine whether the source of the distribution is the trust itself or the asset owned by the trust\(^ {326}\). This depends on the terms of the trust deed\(^ {327}\). If the obligation on the trustees is to distribute the income arising from the assets to the beneficiaries\(^ {328}\), the non-resident beneficiary would be taxed on the income arising from the South African assets, unless an exemption applies\(^ {329}\).

In terms of s 25B (2A) where during any year of assessment, any resident acquires a vested right to any amount representing capital of any trust which is not a resident, that amount must be included in the income of the resident if; a) that capital arose from any receipts or accruals of the trust which would have constituted income if such trust had been a resident, in any previous year in which the resident had a contingent right to that amount; and b) that amount has not been subject to tax in the republic\(^ {330}\).


\(^{322}\) Oguttu (note 321)

\(^{323}\) Oguttu (note 321)

\(^{324}\) Oguttu (note 321)

\(^{325}\) Keith Huxham and Phillip Haupt Notes on South African income tax 28 ed (2009) 731

\(^{326}\) Huxham (note 325)

\(^{327}\) Huxham (note 325)

\(^{328}\) Huxham (note 325)

\(^{329}\) Huxham (note 325)

\(^{330}\) Income Tax Act 58 of 1962 s25B (2A); Huxham (note 325) at 731
b) **donations tax**

Donations tax is payable on the net transfer of assets from one person to another\(^{331}\), therefore when a donor transfers assets to a trust he/she is said to have made a donation. The donations tax provisions are contained in section 54 to 64 of the Income Tax Act 58 of 1962\(^{332}\). Donations tax is not an income tax; it is a tax on the transfer of wealth\(^{333}\). The tax fulfills a two-fold function\(^{334}\); it imposes a tax on persons who may want to donate their assets in order to avoid normal income tax on the income derived from those assets\(^{335}\), and / or estate duty when those assets are excluded from their estates\(^{336}\). It is a tax payable on the value of any property disposed of under any donation (at a flat rate of 20%) by a South African resident (the same as estate duty)\(^{337}\). Donations tax provisions do not apply to non-residents even if they donate South African assets\(^{338}\).

For tax purposes ‘donation’ means any gratuitous disposal of property or any gratuitous waiver or renunciation of a right\(^{339}\). The word ‘donee’ means any beneficiary under a donation including, where property is donated to a trustee to be administered by him for the benefit of any beneficiary, such trustee\(^{340}\). ‘Property’ means any right in or to property movable or immobile, corporeal or incorporeal, wherever situated\(^{341}\).

A donation takes effect when all the legal formalities have been complied with\(^{342}\). An oral donation takes effect on the date of delivery\(^{343}\). A promise to donate that has not yet been completed by delivery takes effect when the donor commits the promise to writing and signs the relevant document\(^{344}\). There must be acceptance by the donee for a valid donation to be constituted\(^{345}\). Therefore, a donation will not take effect until it is accepted by the donee\(^{346}\).

---

\(^{331}\) Professor Keith Jordaan et al Silke : South African income tax (2009) 645

\(^{332}\) Jordaan ( note 331) at 645

\(^{333}\) Jordaan ( note 331) at 645


\(^{335}\) Huxham (note 334) 665

\(^{336}\) Huxham (note 334) 665

\(^{337}\) Huxham 666

\(^{338}\) Huxham (note 334) 665

\(^{339}\) Income Tax Act 58 of 1962 s55

\(^{340}\) Income Tax Act 58 of 1962 s55

\(^{341}\) Income Tax Act 58 of 1962 s55

\(^{342}\) Jordaan ( note 331) at 647

\(^{343}\) Jordaan ( note 331) at 647

\(^{344}\) Jordaan ( note 331) at 647

\(^{345}\) Jordaan ( note 331) at 647

\(^{346}\) Jordaan ( note 331) at 647
The person liable to pay the tax is the donor, but if the donor fails within 3 months of the donation taking effect, the donor and the donee are jointly and severally liable for the tax\textsuperscript{347}. A donee who is a trustee is a representative taxpayer in respect of donations to the trust\textsuperscript{348}, thus the trustee is bound to pay the donations tax if the donor does not\textsuperscript{349}. Even for purposes of exemption the trustee may be treated as donee\textsuperscript{350}.

There is, however, for any given purpose only a single donation to the trustee or beneficiary; otherwise tax would be payable twice\textsuperscript{351}. For example\textsuperscript{352} in \textit{ITC 891} the donor gave R40 000.00 by notarial deed to trustees to pay the income to his daughter until her death or until she abandoned her right, then to her children born or unborn, the capital to be distributed in equal shares to the donor’s grandchildren when the youngest attained 21 with provisions for substitution and accrual. The Special Court held that the donor had made a single donation to the trustee, not a series of donations to the various beneficiaries, and was therefore taxable on the basis that he made one donation of R40 000.00.

The Act creates a general of deemed donations. It is provides that if in the opinion of the Commissioner property has been disposed of for an inadequate consideration the property is for purposes of donations tax deemed to have been disposed of under a donation\textsuperscript{353}. The amount of the deemed donation will be the value of the property less the consideration payable by the person acquiring it\textsuperscript{354}.

Exemptions from donations tax:
In terms of s56 (1) of the Act, donations tax is not payable in respect of the value of any property that is disposed of under a donation\textsuperscript{355} (the following exemptions apply to the law of trusts):

\textsuperscript{346} Professor Keith Jordaan et al \textit{Silke : South African income tax} (2009) 647
\textsuperscript{347} Keith Huxham and Phillip Haupt \textit{Notes on South African income tax} 28ed (2009) 671
\textsuperscript{348} Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 462
\textsuperscript{349} Cameron (note 348) at 462
\textsuperscript{350} Cameron (note 348) at 462
\textsuperscript{351} Cameron (note 348) at 462
\textsuperscript{352} Cameron (note 348) at 462
\textsuperscript{353} Income Tax Act 58 of 1962 s58
\textsuperscript{354} Huxham ( note 347) at 672.
\textsuperscript{355} Income Tax Act 58 of 1962 s56 (1)
a) to or for the benefit of the spouse of the donor under a duly registered antenuptial or
postnuptial contract or under a notarial contract entered into as contemplated in s21 of
the Matrimonial Property Act 88 of 1984\(^\text{356}\);

b) to or for the benefit of the spouse of the donor who is not separated from him under a
judicial order or notarial deed of separation\(^\text{357}\);

- for exemptions (a) and (b) a donation to trustees in trust for the donor’s spouse
should be treated as a donation to the spouse\(^\text{358}\). Otherwise there would be an
unjustifiable difference between the exemptions available in the case of direct
donations to a spouse and indirect donations to a spouse through a trustee\(^\text{359}\). But the
exemption will not apply to that part of the donation that is intended to benefit
persons other than the spouse of the donor, eg children of the marriage\(^\text{360}\).

d) in terms of which the donee will not obtain any benefit there under until the death of
the donor\(^\text{361}\);

- the Transvaal special court has decided that, though no beneficiary obtains a benefit
until the donors death, the trustees to whom the bare dominium is transferred during
the donor’s lifetime must pay donations tax on the value of the bare dominium, since
the definition of ‘donee’ includes a trustee and the benefit envisaged need not be a
profit but an advantage obtained on behalf of the ultimate beneficiaries\(^\text{362}\).

e) which is cancelled within six months from the date on which it took effect\(^\text{363}\).

h) by or to any person ( including any government ) referred to in s10(1) (a), (b), (cA),
(cE), (cN), (d) or (e)\(^\text{364}\);

i) by or to any institution for the advancement of science or art or of a charitable,
educational or religious nature, if the Minister of Finance is satisfied that the
operations of such institution are in the interest of the public\(^\text{365}\);

- For example\(^\text{366}\). Last year the Jacob Zuma trust known as the ‘Friends of Jacob Zuma
Trust’ came under the spotlight when the South African official opposition party the

\(^{356}\) Income Tax Act 58 of 1962 s56(a)
\(^{357}\) Income Tax Act 58 of 1962 s56(b)
\(^{358}\) Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 465
\(^{359}\) Cameron ( note 358) at 465
\(^{360}\) Cameron ( note 358) at 465
\(^{361}\) Income Tax Act 58 of 1962 s56(d)
\(^{362}\) Cameron ( note 358) at 465
\(^{363}\) Income Tax Act 58 of 1962 s56(e)
\(^{364}\) Income Tax Act 58 of 1962 s56(h)
\(^{365}\) Income Tax Act 58 of 1962 s56(h)
\(^{366}\) I-Net Bridge ‘Zuma’s trust’s implications questioned’ Available at
Democratic Alliance (DA) questioned the then Commissioner of the South African Revenue Services (SARS) whether the trust has been registered as a non-profit organisation and whether SARS would pursue any donors who made donations to the trust for a donations tax. The definition of a non-profit organisation, according to section 1(1)(x) of the Non-Profit Organisations Act 71 of 1997, is: “A trust, company or other association of persons established for a public purpose: and the income and property of which are not distributable to its members or office-bearers except as reasonable compensation for services rendered.” Because the purpose of the trust was to fund Jacob Zuma’s private interests and since the money generated by the trust would not be distributed to its members, the trust was not benefiting the public and the people who made donations would be subject to donations tax if their donations for the year exceeded R100 000.

1) if the property is disposed of under and in pursuance of any trust…

- literally it renders all donations in trust exempt from tax provided that the donor had previously undertaken to create a trust. This is because the transfer of property to the trustee is then done in pursuance of a trust though not ‘under a trust’. But clearly a more restricted interpretation is called for. The most obvious application of the exemption is in the case where the trustee pays over income or capital to the beneficiary. It may be argued that though the trustee is not impoverished by making the payment it nevertheless amounts to a donation by him to the beneficiary. In that case exemption (l) prevents payment attracting donations tax.

The value for donations tax is calculated on a similar basis to that for estate duty. For purposes of fiduciary, usufructuary or other like interest in property, an amount is determined by capitalising 12 percent the annual value of the right of enjoyment of the property. Annuities are also calculated the same way.

---

367 Income Income Tax Act 58 of 1962 s56(l)
368 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 465
369 Cameron (note 368) at 465
370 Cameron (note 368) at 465
371 Cameron (note 368) at 465
372 Cameron (note 368) at 465
373 Cameron (note 368) at 465
374 Cameron (note 368) at 466
375 Income Income Tax Act 58 of 1962 s62 (1) (b); Cameron (note 368) at 466
Donations tax is not payable on so much of the sum of the values of all property donated by a natural person as does not during any year of assessment exceed R100 000.00 and it is also not payable on the value of any casual gifts made by a donor (other than a natural person) during the year of assessment is less than or more than 12 months, the R10 000 limit must be adjusted proportionately.\textsuperscript{376}

Tax free donations can also be used to save on estate duty especially for those people with larger estates.\textsuperscript{377} For example: With the amount that can be donated free of donations tax by natural persons having been increased to R100 000 in 2007\textsuperscript{378}, an old estate planning technique once again became attractive.\textsuperscript{379}

The plan works as follows:

- Husband and wife are each allowed to donate R100 000 per year. Because donations between spouses are exempt from donations tax, which means R200 000 per year can be donated per couple. Assuming one spouse is wealthier than the other, the wealthier spouse can donate R100 000 to the poorer spouse, who can then donate the R100 000 as part of his or her tax-free donation.

- The couple therefore donates R200 000 per year to a trust. Note that there is no loan account - the money belongs to the trust.

- The trust then invests the money in a growth investment. The most ideal vehicle for a trust to invest in is an endowment policy, as then there is no direct tax on the policy for the investor. This means the high rate of tax on a trust is effectively bypassed. In addition, it means that section 7 of the Act is not applicable, as there is no tax to attribute to the donor.

- The policy then matures tax free, as that is the current SA Revenue Service practice. The proceeds belong to the trust as the owner. The trust then lends the money back to the donor. The trust deed must make provision for the trust to make loans. There is no need to charge interest on the money, as there is no employer-employee relationship between the trust and the donor. Note that it is important that the donor does not use the loaned money to build up assets, as that would increase his estate and defeat the purpose of the scheme.

\textsuperscript{376} Income Income Tax Act 58 of 1962 s56 (2)
\textsuperscript{377} Bruce Cameron ‘a trust is a key tool in planning your estate’. Available at http://www.persfin.co.za/index.php?fSectionId=706 [Accessed 7 June 2009]
\textsuperscript{378} Ibid.
\textsuperscript{379} Ibid.
\textsuperscript{380} Ibid ( PLEASE NOTE: THE ENTIRE EXAMPLE IS FROM REFERENCE FOOT NOTE 377)
The whole idea is that the donor uses the money ‘on loan', and when he dies he owes the money to the trust. This is a liability in his estate and reduces his estate duty further. The donor would leave assets to his family trust on death anyway, so there is no prejudice in having to repay the loan to the trust.

Benefits of the scheme:

- R100 000 / R200 000 per annum is removed from the donor's estate. It grows in the trust as a "nest egg".
- This money belongs to the trust - there are no loan accounts. This makes it harder for creditors of the donor to attach the policy, assuming that no actions were taken to defraud creditors.
- The donor still gets use of the money later, just on loan, which reduces the donor's estate duty even further. There is therefore a double estate duty benefit - the money is first removed from the estate, and then the liability is created.
- There is no negative capital gains tax effect as the policy is originally owned by the trust, so the proceeds pay out to the trust free of CGT.

If the trust is cancelled under a power contained in the trust deed, the resulting retransfer by the trustee to the donor would be a disposition “in pursuance of a trust”381. The Commissioner would not treat the retransfer (of the trust assets to the donor) as taxable, and it may be argued that as the trustee is not impoverished by the retransfer there is no donation382. A trustee who revests property in the donor pursuant to an agreement to cancel the trust does not make a donation to the donor and needs no statutory protection to avoid payment of donations tax383.

---

381 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 465
382 Cameron (note 380) at 465
383 Cameron (note 380) at 465
c) **Transfer duty**

Transfer duty is an indirect tax paid on the transfer of fixed property in South Africa\(^{384}\). Property is valued for transfer duty purposes either when the consideration is payable by the person who acquires the property, at the amount of the consideration or when no consideration is payable, at its declared value\(^{385}\).

The Transfer Duty Act 40 of 1949, states that transfer duty varying from 0 to 8 percent is payable on the value of any property acquired\(^{386}\). If the acquirer or beneficiary of the renunciation is a natural person, the rate of the duty varies from 0 to 8 percent according to the value of the property\(^{387}\), if a person other than a natural person, i.e. a juristic person, the rate is a flat rate of 8 percent\(^{388}\). For the purposes of s2 of the Transfer Duty Act, a trustee or administration of a trust or any other person acting in a fiduciary capacity is deemed to be a person other than a natural person, in respect of any property acquired by him or any property held by him of which the value is enhanced\(^{389}\).

The duty is payable by the person who has acquired the property or in whose favour or whose benefit any interest in or restriction upon the use or disposal of property has been renounced\(^{390}\). A trustee will normally have to pay transfer duty on the transfer of property to him in trust\(^{391}\). If the property is transferred into the name of the trustee, the duty is payable at the rate of 10 percent\(^{392}\).

In December 2002 the transfer duty legislation was amended and in terms if this amendment transfer duty is specifically triggered in discretionary trusts when the names of one or more beneficiaries, with a contingent right to any (residential) property, have been changed or

---

385 Edwin Cameron et al Honore’s South African law of trusts 5 ed (2002) 489
386 Transfer Duty Act 40 of 1949 s2
387 Transfer Duty Act 40 of 1949 s2(b)
388 Transfer Duty Act 40 of 1949 s2 (a)
389 Cameron (note 384) at 486
390 Cameron ( note 384) at 487
391 Cameron ( note 384) at 487
392 Cameron ( note 384) at 487

41
added\textsuperscript{393}. This amendment was the result of the tax court ruling in Johannesburg case number 11286\textsuperscript{394}.

Though a trustee will normally have to pay transfer duty on the transfer of property that is to form part of the trust property, no further duty is usually payable when the property is later transferred to the trust beneficiary\textsuperscript{395}.

No duty is payable:

\begin{itemize}
  \item[a)] in respect of a change in the registration of property required as a result of the termination of the appointment of an administrator of a trust under a will or other written instrument or of a trustee of an insolvent estate\textsuperscript{396}; or
  \item[b)] when a trust has been founded by a natural person for a ‘relative’ as defined in the Estate Duty Act, roughly one within the third degree of that relative\textsuperscript{397};
  \item[c)] where trust property is restored by the trustee of an insolvent estate to the insolvent\textsuperscript{398}
\end{itemize}

For the exemption to apply not only must the trustee transfer the property to the beneficiary but the transfer must be made in pursuance of the written instrument under which the trustee was appointed\textsuperscript{399}. The transfer of trust property by one trustee or administrator to another is also exempt\textsuperscript{400}.

\begin{flushright}
\textsuperscript{394} Ibid.
\textsuperscript{395} Edwin Cameron et al Honore’s South African law of trusts 5 ed (2002) 488
\textsuperscript{396} Transfer Duty Act 40 of 1949 s9 (4) (a)
\textsuperscript{397} Transfer Duty Act 40 of 1949 s9(4) (b)
\textsuperscript{398} Transfer Duty Act 40 of 1949 s(9) (c)
\textsuperscript{399} Cameron (note 394) at 488
\textsuperscript{400} Cameron (note 394) at 489
\end{flushright}
d) **capital gains tax**

A trust is a non-natural person therefore 50% of the net capital gain is included in taxable income, unless it is a special trust. Parts X and XII of the 8th Schedule have provisions which deem the trust’s income to be taxable in the hands of a donor or a beneficiary.

A trust will have a disposal for capital gains tax (CGT) purposes in one of two ways: either by concluding a transaction for the disposal with a third party (for example the sale of a trust asset to a third party) or by vesting a trust asset in a beneficiary (par 11(d) of the 8th schedule). A transaction with a third party at arm’s length will result in a normal capital gain calculation. When an asset vests in a beneficiary, the proceeds will be deemed to be the market value, as the trust and the beneficiary are connected persons and the base cost for the trust will usually be the value when the trust acquired the asset, either by way of a bequest, donation or purchase. Paragraph 80, which is subject to paragraphs 68, 69, 71 and 72, provides that if a trust distributes an asset to a beneficiary (who is a South African resident), the gain made by the trust on the disposal of that asset is taxable in the beneficiary’s hands and not in the trust's hands. This is subject to anti-avoidance provisions where the beneficiary is a spouse (par 68) or minor child (par 69).

Where the non-resident trust distributes a capital gain (that would have been considered a capital gain had the trust been resident) to a South African resident, the resident is taxed on the gain, whether it arose that year or in a previous year (par 80 (3)). This does not apply if the gain has already been subject to tax in South Africa e.g. if it is from a South African source. If foreign tax has been paid on the gain, the resident will be able to claim a section 6quat rebate of the foreign tax against the resulting South African tax and if a South African trust makes a gain and distributes it to a non-resident, the trust is taxed on the gain (unless it can be attributed to a resident donor under par 72).

---

401 Keith Huxham and Phillip Haupt *Notes on South African income tax* 28 ed (2009) 824
402 Huxham (note 400) at 824
404 Jordaan (note 402) at 671
405 Income Tax Act 58 of 1962 8th schedule par (38); Jordaan (note 402) at 671
406 Huxham (note 400) at 824
407 Huxham (note 400) at 824
408 Huxham (note 400) at 824
409 Huxham (note 400) at 824
410 Huxham (note 400) at 824
Capital gains attributed to the donor- par 73 states that where both an amount of income and capital gain are derived by reason of, or are attributable to a donation, settlement or other disposition, then the capital gain attributed to the “donor” may be limited\textsuperscript{411} to what the trust earned by reason of the fact that the donor did not charge a market related rate of interest\textsuperscript{412}.

Capital gain retained by the trust - par 70 states that if a South African resident makes a donation, settlement, or similar disposition to a trust and the trust makes a capital gain as a result of that donation or disposition, the resident is taxed on the capital gain\textsuperscript{413} instead of the trust if the gain is not distributed or vested to a beneficiary who is a South African resident\textsuperscript{414}. This is beneficial if the resident is an individual as only 25% of the gain is taxed instead of the 50% that would be taxed if the gain was taxed in the trust’s hands and if the resident is a natural person, the capital gain is further reduced by the annual exclusion\textsuperscript{415}.

Capital gains distributed by the trust- according to par71, if a distribution of a capital gain is made a beneficiary and the donor has the right to revoke the beneficiary’s right to the capital distribution\textsuperscript{416}, then the creator is taxed on the gain so distributed ( to the extent that it is attributable to the gratuitous disposition made by the donor)\textsuperscript{417}. If the gains are distributed or vest in anon- resident then the South African resident donor/ disposer is taxed on the gain instead of the non- resident or the trust\textsuperscript{418}.

\textsuperscript{411} Keith Huxham and Phillip Haupt\textit{Notes on South African income tax} 28 ed (2009) 826
\textsuperscript{412} Huxham (note 410) at 826
\textsuperscript{413} Huxham (note 410) at 826
\textsuperscript{414} Huxham (note 410) at 826
\textsuperscript{415} Huxham (note 410) at 826
\textsuperscript{416} Huxham (note 410) at 826
\textsuperscript{417} Huxham (note 410) at 826
\textsuperscript{418} Huxham (note 410) at 826
SECTION C

So ask we ourselves are trusts really “tax havens”? I guess we could look at it in two ways: Firstly, trusts are in essence a taxpayer of last resort i.e. if there is no beneficiary or donor to tax, and then the trust is taxed. But ultimately someone is taxed and the tax is quite heavy i.e. it is taxed at the highest marginal rate of 40%, the inclusion rate for capital gains tax is at 50% (unlike an individual who’s inclusion rate is 25%) and the transfer duty is higher in a trust as it is levied at a flat rate of 8%. Plus there is no dividend nor an interest exemption because it is not a natural person.419. When the assets are transferred in to the trust, a donations tax is charged and if fixed property is being transferred transfer duty becomes payable. Then there is still the danger of the the loss of legal control of assets- as they are handed over to the trust and managed by the trustees for the benefit of the beneficiaries420.

However, we could look at it from another perspective and focus on the reason that makes them unique even with the unfavourable changes in the legislation: which is that the trust remains the only legal entity which will afford total asset protection and estate duty savings along with a myriad of other benefits421. Even with all these changes, it remains separate from its donors or beneficiaries422. A trust is not owned by anyone, it never dies or terminates (unless it is terminated by agreement or it is sequestrated if it is unable to pay its debts)423. Ultimately this why more than a quarter of the worlds wealth is held in trusts424.

There is a big fallacy that one needs to be wealthy to set up a trust- its misleading and far from the truth, in fact the less one has the more a trust is needed because in most cases the wealthy do just fine when facing a financial crisis, but it’s usually the ordinary people that are most likely to lose everything if not protected425.

419 Professor Keith Jordaan et al Silke: Soth African income tax (2008) 659
420 Bruce Cameron ‘a trust is a key tool in planning your estate’. Available at http://www.persfin.co.za/index.php?fSectionId=706 [Accessed 7 June 2009]
421 ‘What is a trust and why the benefits cannot be ignored”. Available at http://www.evolvepro.co.za/TrustBenefits.asp [ Accessed 6 September 2009]
422 Ibid.
423 Ibid.
425 What is a trust and why the benefits cannot be ignored”. Available at http://www.evolvepro.co.za/TrustBenefits.asp [Accessed 6 September 2009]
It is inevitable that most people in life will go through a number of situations which could potentially result in one losing all of their hard earned assets, cash, investments and properties. For example:

- An existing business, or a new business which ends up in trouble often results in people having to make good to creditors, for unpaid rental agreements, suppliers, staff, the Receiver of revenue, loans, overdrafts and the like.

- Surety for any person or on a business would mean that one would be exposed to that claim if it is not settled.

- Usually in a divorce assets get sold and most of the time it’s the assets that one did not intend to part with that are sold.

- People often face claims by creditors of their spouse if they are married in community of property.

- Generally if one has creditors, they could lay claim to personal assets if the debt is not paid.

- Financial vulnerability could also be experienced as a result of retrenchment, which could mean that meting obligations might be a problem thus leaving assets at risk to creditors.

- The individual can face a claim for damages; this might cause the assets to be attached.

---

426 What is a trust and why the benefits cannot be ignored”. Available at http://www.evolvepro.co.za/TrustBenefits.asp [Accessed 6 September 2009]

427 Ibid.
428 Ibid.
429 Ibid.
430 Ibid.
431 Ibid.
432 Ibid.
433 Ibid.
The above paints a pretty negative picture but the solution to these frightening situations is simple and they can be avoided or contained through the establishment of a trust, or a combination of trusts. The way it works is that once the assets have been moved into the trust, they no longer belong to the individual. However, there are certain laws that need to be borne in mind before the assets are safe for example; there is a window period prescribed in the Insolvency Act. It is known to afford creditors protection from delinquent creditors. It is important that assets are safely moved into a trust, but caution needs to be taken to the time periods so that the assets that have been moved are not liable to attachment under the relevant sections of the Act. The Insolvency Act states that if a creditor has a claim against an individual who is solvent, and who has moved, sold, transferred or donated assets, the creditor may if the assets were moved within a 6 month period, reverse such transactions and attach the assets and sell them.

If the individual is insolvent at the time of the shifting of assets, the period is then extended to 24 months before the assets are safe from a creditor reversing such transferred assets.

But the big benefits of putting assets into a trust are realised upon death as there would be:

*No capital gains tax* – at the time of death, all the assets that a person owns, including properties, attract CGT at a rate of 10%. The unfortunate part is the fact that the tax is due even though no money has changed hands or been received. In some cases, this leaves the estate in an illiquid position. However should the assets be placed in a trust, the CGT will not be triggered as the trust does not die. The good thing about a trust (even before death)
it that it has the flexibility to transfer the proceeds on the sale of assets to the beneficiaries who then pay the CGT\textsuperscript{446}. Although their marginal tax rate may be 40\% they will only pay CGT on 25\% of the profit and there is no tax charged on the distribution, unlike with the company structure\textsuperscript{447}.

\textit{No estate duty} - Any person (residents and non-residents) who die owning property in the republic will be subject to estate duties. Residents will be taxed on their worldwide assets and non-residents on immovable property situated in the republic. The tax is levied at a rate of 20\% of the value of any assets in excess of 3.5 million at the date of death (after certain deductions have been made). As the trust does not die no estate duty will have to be paid. Section s3(3)d of the Estate Duty Act 45 of 1955 could prohibit this benefit from applying if the deceased was immediately before death competent to dispose of the property in the trust for his own benefit or for the benefit of his estate. The deceased is deemed to have been competent to dispose of property if he retained the power under any deed of donation, settlement, trust or other disposition made to him to revoke or vary the provisions of the disposition relating to the property.

There are even more benefits created by trusts upon death, such as:

\textit{No executors fees} - An executor is the person or company or firm that winds up the estate of the individual, for this task they are entitled to a maximum fee of 3.5 \% of the gross value of the estate plus VAT in certain circumstances\textsuperscript{448}. Again the solution to this is the formation of a trust, as the individual will not own any assets, and all property will be held by a trust or combination of trusts, the estate should be zero or inconsequential, thereby eliminating the executor’s fees payable\textsuperscript{449}.

\textit{Protection of minors} - Our law does not allow for minors to directly inherit\textsuperscript{450}, therefore an individual who wants to leave all or any assets to minor persons will not be able to do so\textsuperscript{451},

\textsuperscript{446} What is a trust and why the benefits cannot be ignored”. Available at http://www.evolvepro.co.za/TrustBenefits.asp [Accessed 6 September 2009]

\textsuperscript{447} Ibid.

\textsuperscript{448} Ibid.

\textsuperscript{449} Ibid.

\textsuperscript{450} Ibid.

\textsuperscript{451} Ibid.
or persons not adequately addressing the issue in their wills or via testamentary trusts will end up with a situation where all the assets will be liquidated into cash. This is the position as the funds or the cash needs to be held by the guardians fund. The fund can only hold cash as they do not have the ability or resources to administer property, the fund is controlled by the Government, and pays interest of +3% in the event monies are not claimed, they are forfeited to the state very often this leads to limited or no access to the fund for the minors needs, education, health, wellbeing housing. As the trust survives your death; any beneficiary may benefit and access assets immediately.

SARS has made various amendments to combat many tax saving practices, and as result a scheme that would result in the avoidance, postponement or reduction of tax liability is presumed to be entered into solely or mainly for the purpose of obtaining a tax benefit. Certain tax avoidance schemes are treated as nullities and disregarded by the Commissioner, who may, if satisfied that the scheme falls within the ambit of s103 of the Income Tax Act. The Commissioner could fix the tax liability as if the schemes had not been entered into or carried out, or in whatever way is deemed appropriate to prevent or diminish the tax avoidance.

So are they really cosy tax avoidance measures? Well maybe they are not completely the tax avoidance measure it used to be. In the past trusts were seriously abused for taxed purposes but since 1991 the government has made amendments to combat these practices. In fact it is pretty hard to avoid tax in a trust as SARS looks at them very closely. Without a doubt though they sure do minimize the incidence of tax especially upon death but right now they are not really “the tax havens” they used to be. However they are still the best way for one to protect their assets. They are indeed great estate planning tools. But SARS is closing the loop holes in the tax legislation and pretty soon there will be no place to hide!

---

452 What is a trust and why the benefits cannot be ignored”. Available at [http://www.evolvepro.co.za/TrustBenefits.asp](http://www.evolvepro.co.za/TrustBenefits.asp) [Accessed 6 September 2009]
453 Ibid.
454 Ibid.
455 Ibid.
456 Ibid.
457 Ibid.
458 Ibid.
459 Edwin Cameron et al Honore’s South African law of trusts 5ed (2002) 460
460 Cameron (note 458) at 460
461 Cameron (note 458) at 460
Bibliography

Primary sources

Cases

Estate Kemp v MacDonald's 1915 AD 491
Thorne & Molenaar NNO v Receiver of Revenue, Cape Town 1976 (2) SA 50 (C)
Conze v Masterbond Participation Trust Managers 1996 (3) SA 786 (C)
Coetsee NO v Universiteit Stellenbosch 1959 (2) SA 172 (C)
Harter v Epstein 1953 (1) SA 287 (A)
Overstone v CIR 1980 (2) SA 721 (A)
Joss v SIR 1980 (1) SA 664 (T)
C:SARS v Woulidge 2002 (1) SA 68 (SCA)
ITC 891 1959 24 SATC 354
Armstrong v CIR 1938 (AD) 343
SIR v Rosen 1871 (1) SA 172 (A)
TC Case No 11286
Estate Munro v CIR 1925 TPD 693

Statutes

Trust Property Control Act 57 of 1988
Estate Duty Act 45 of 1945
Non- Profit Organisations Act 71 of 1997

Secondary Sources

Books

Internet sources


www.moneywebtax.co.za

http://www.mba.co.za/article.aspx?rootid=6&subdirectoryid=1607


www.absa.co.za

www.usig.org/countryinfo/laws/SouthAfrica/SouthAfrca-trustpropertycontrolact57of1988

http://en.wikipedia.org/wiki/Trust_law

http://butterworths.uct.ac.za/

http://www.estatesortrusts.co.uk/what-is-a-testamentary-trust.html


http://www.graaffs.co.za/general_trusts.htmwww.cleardocs.com

http://www.evolvepro.co.za/TrustBenefits.asp

http://www.persfin.co.za/index.php?SectionId=706

http://www.mg.co.za/article/2006-08-08-zuma-trusts-tax-implications-questioned

http://www.cleardocs.com/extra-family-trust.html

http://www.estatesortrusts.co.uk/what-is-a-testamentary-trust.html


http://dictionary.reference.com/browse/trust

http://dictionary.reference.com/browse/trust

http://www.cleardocs.com/extra-family-trust.html