THE TAXATION OF TRUST INCOME IN SOUTH AFRICA

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INTRODUCTION

The subject of trusts, even in the particular area of income tax, is vast. Therefore, it is important that I discuss from the outset the outline of my approach in order to give my treatment of the subject under consideration form and direction. And that is what I propose to do briefly here.

The discussion consists of five parts. The first of these is the Background which includes definitions and an historical note which I consider to be necessary in view of the largely common law - as opposed to a codified magnus opus[1] - basis of South African law of trusts, where

> "Other statutes are superimposed, like a ship upon the water, on the common law without replacing it ...."[2].

The second part also has some historical element, but this is limited to the Taxability of Trusts, qua trusts or legal personae, in income tax law; while the third deals with kinds of Trusts and Their significance. The fourth looks at Income Tax Avoidance Opportunities while the last considers Anti-Avoidance Provisions of the Act[3] Relevant to Trusts, interspersed with one or two examples of schemes not only immune to the specific anti-avoidance provisions of Section 7 but probably also to the general anti-avoidance provisions of Section 103 (1).

Examples will be liberally used for purposes of illustration.

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1 Hahlo and Kahn 67

2 ibid. 70

3 Unless the context indicates otherwise, Act shall mean the Income Tax Act No. 58 of 1962.

A BACKGROUND

The trust institution is of English law origin dating from the 11th century[4]. It was accepted de facto into South African law with the arrival of the British at the Cape. De jure there was no wholesale reception by way of legislation; instead

> "there was a cautious acceptance, subject to reconciliation with Roman-Dutch doctrinal frame-work (and minimal[5] legislation in specific areas)".

It was in the light of such cautious acceptance and absence of wholesale legislative reception that Hahlo observed some forty years ago that:

> "when it comes to trusts in our law, even the most elementary propositions cannot be regarded as settled. It will take the work of several generations of judges and text-writers before our law of trusts reaches maturity[6]".

This has proved to be true, for, as recently as 1991 one such unsettled proposition was the taxability of the trust as a person in terms of the provisions of the Act.

Initially, acceptance of the institution of trust[7] by South African courts was at times on the basis of Roman-Dutch "doctrinal frame-work" instead of accepting it as a foreign institution altogether. For instance the testamentary trust was regarded as an unconditional fideicommissum mortis causa[8], while

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4 Hutchison, 82

5 Loc cit.

6 Hahlo 1952 Salj 349

7 see Corbettet al 403 and infra

8 Estate Kemp V McDonald's Trustee

the <u>inter vivos</u> trust was explained as <u>stipulatio alteri</u>[9]. However, the trust is now accepted as an institution <u>sui generis</u> without Roman-Dutch antecedents.

The Act defines trust as : any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity where such person is appointed under a deed of trust or by agreement or under the will of a deceased person.

In my opinion, with respect, a more useful definition is that given by the Trust Property Control Act No.57 of 1988 which defines trust as :

> " The arrangement through which the ownership of property of one person is by virtue of a trust instrument made over or bequeathed to another person, the trustee, to be administered for the benefit of another, the beneficiary, but does not include the case where the property of another is to be administered by any person as executor, tutor or curator or in terms of the provisions of the Administration of Estates Act 1965".

The essential features of the trust emerge clearly from the definition and these are firstly that, the ownership and control of the property are separated from the beneficial enjoyment thereof; and secondly, there are the original owner of the property, called the donor or settlor (or testator in the case of a testamentary trust), the trustee and the beneficiary. The separation of <u>dominium</u> from beneficial enjoyment and the interrelationships among the various subjects involved in the trust, give rise to the problem as to who of the donor, trustee and beneficiary is liable to tax on the income arising from the trust. This problem will be considered at length below in

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9 <u>CIR V Estate Crewe</u>

relation to vesting and anti-avoidance provisions. But before that I shall look at the taxability of trusts as such.

B. TAXABILITY OF TRUSTS

1. REVENUE DEPARTMENTAL PRACTICE

Before the provisions of the Income Tax Act were amended in 1991 in anticipation of the Phillip Frame Trust decision, the Revenue Department taxed trusts as unmarried persons as a matter of course - the same way as it had taxed deceased estates until the cases Estate Smith and Emary were decided. The latter two cases brought about a change in the law regarding the taxability of deceased estates.

In Estate Smith and Emary it was held that a deceased estate is not a person and therefore not taxable. In response the Act was amended to reverse the effects of the decisions by expressly providing for the definition of person to include a deceased estate.

It is remarkable, however, that the Revenue practice of taxing trusts as unmarried persons remained unchallenged for so long - even after the amendment of the Act to include deceased estate in the definition of person pointedly omitted to include trust in such definition.

2. CHARGING SECTION

The charging section of the Act is section 5(1) which provides for the annual payment of an income tax in respect of taxable income received by or accrued or in favour of any person or company during the year of assessment. So, unless an entity is a person either at common law or as defined in the Act, or is a company in terms of the Companies Act 1973, it will not be liable to income tax.

The question arises, is a trust a person? And that was the question for decision in the Phillip Frame Trust case where the court held that a trust was not a person for the purposes of the Income Tax Act. This decision was anticipated by Jooste who wrote in 1987 that there was

"...ample authority that a trust is not a legal persona in terms of the common law and it is contended that Emary's case and Mac Neillies case have put paid to any argument that a trust is a person in terms of the Interpretation Act"[10].

However, other writers are in agreement with neither Jooste nor with the Phillip Frame Trust decision. Nevertheless, it being unnecessary to pursue the matter any farther, suffice it to say that the definition of person in the Act was subsequently amended in 1991 with effect from 1st March 1986 to read as follows:

"person includes the estate of a deceased person and any trust fund consisting of cash or other assets which are administered and controlled in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person".

Strictly speaking what I have said about the taxability of trusts qua trusts is part of the historical background because statute has long since settled the matter. However, I consider it important enough to warrant special treatment. Now I go on to consider the main issues in the taxation of trusts in general, beginning with an outline of the various types of trusts and their consequences.

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[10] Jooste 130

C KINDS OF TRUSTS

The importance of distinguishing types of trusts lies in the fact that the tax implications of a trust depend in many cases on whether it is a trust of one kind or another. Trusts are differentiated in two ways in terms of whether they are inter vivos or testamentary trusts or whether they are vesting or discretionary trusts. However, they may also be classified as either trading trusts or charitable trusts.

A testamentary trust is constituted when a testator bequeaths property to the trustee or administrator with an instruction to administer it for the benefit of another person or other persons appointed by the will[11]; while an inter vivos trust involves effecting such gift over by the donor or settler during his life time.

However a more important distinction for our purposes is that between a discretionary and a vesting trust which could either be testamentary or inter vivos, depending on the liberality or otherwise of the donor or testator. Indeed,

> "The trust accommodates the autocrat, present and posthumous, and the liberal. (The) founder may give the beneficiaries fixed rights or may by setting up a discretionary trust allow the trustee a wide discretion to give or to withhold benefits...."[12]

The trust which gives beneficiaries what Honore calls fixed rights is called a vesting or non-discretionary trust, while the "variable" one is called a discretionary trust. And seeing that the term "Vesting" is central to the distinction between discretionary and non-discretionary (Vesting) trust, I shall briefly attempt to define it and thereafter consider the income

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[11] see note 7 above.

[12] Honore 14

tax implications of discretionary and vesting trusts.

1. VESTING

There are two meanings of "vesting" or "vested" that are relevant to the discussion.[13]

1.1 A right is said to be vested in a person when he owns it and he "has all the rights of enjoyment".[14] However, property may vest in someone purely for purposes of administration without the right of enjoyment. An example of this is when property vests in a trustee while the right of enjoyment accrues to the beneficiary. That is the basis of the institution of trust.

1.2 A second sense of the term denotes what is certain, as in "vested right" (real or personal) as opposed to contingent or conditional right. This is the sense in which "vesting" or "vested" is used in the context of vesting and discretionary trusts.

However, it is important to note that while income may both vest and accrue to the same person, it is possible for vesting and accrual or enjoyment to happen at different dates, dies cedit and dies venit.

2. VESTING OR NON-DISCRETIONARY TRUST

You have a vesting trust when the income of the trust vests in the beneficiaries whether it is paid to them or not. An example of such trust could be where the deed of trust provides that the trustees shall pay to the beneficiaries

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13 Honore ibid 471

14 Jewish Colonial Trust case 175

all income as and when it accrues to the trust. In that case the income vests in the beneficiaries on the date it accrues to or is received by the trust even if the actual payment to the beneficiaries - and thus enjoyment by them - will take place only on a later date.

Thus if we recall the three possibilities for liability for tax mentioned under A above, ie whether the income concerned will be taxed in the hands of the trust (T) or donor (D) or beneficiary (B), we see that in the case of a vesting trust, in the normal course of events, only B will be taxed. However where B is a minor child of D, section 7(3) will intervene and D will be taxed[15].

3 **DISCRETIONARY TRUST**

Suppose there are two deeds of trust, the first providing that the income of the trust shall accrue to the beneficiaries but the trustees shall have a discretion as to whether, and how, to invest the income for the benefit of the beneficiaries or to pay it to them. The second provides that it is up to the trustees to decide whether or not to pay the income to the beneficiaries or to somebody else. The two are both examples of discretionary trusts with one crucial difference. The first example involves a vested right even if enjoyment is restricted and thus, strictly speaking, is a vesting trust (or paradoxically a non-discretionary trust). The second trust involves a right contingent upon the trustees' decision. It is precisely that contingency that determines a truly discretionary trust. See C supra[16].

The general tax position is that in the case of a discretionary trust (discretionary in the restricted

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15 see E5.2 Infra

16 And Honore as to nature of discretion

sense), the trust as such will be liable where there has not been a distribution to the beneficiaries and the donor is not alive. And where there has not been a distribution and the donor is alive, the latter may be liable in terms of section 7(5) considered below. Lastly, where there has been a distribution to beneficiaries, the beneficiaries themselves will be liable subject to the provisions of section 7(3).

4. THE CONDUIT-PIPE PRINCIPLE

It is appropriate at this point to consider the above. One of the most important principles in the law of trusts and one typical of vesting trusts is what is called the conduit-pipe principle which states that, income passing through a trust retains its identity, the trust merely being a conduit-pipe through which the income flows. See the cases Armstrong and Rosen. In the former case, Stratford C.J. held:

"In the simple case... of a trio comprising a company, the intervening trustee, and the beneficiary, it is manifest that in the truest sense the beneficiary derives his income from the company, for that income fluctuates with the fortunes of the company and the trustee can neither increase nor diminish it, he is a mere conduit-pipe"[17].

It is clear from this judgement that the principle is of particular relevance to vesting trusts and not necessarily so to discretionary trusts. This view was confirmed obiter by Trollip J.A. :

"The trust deed may ... entitle or oblige the trustee to administer the dividends in such a way that he is

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[17] and Honore 473 as to nature of discretion

not a mere conduit-pipe for passing them on to the beneficiary, that in his hands their source as dividends can no longer be identified or they otherwise lose their character and identity as dividends, and that the beneficiary is thus entitled to receive mere trust income in contradistinction to the benefit of the dividend rights in terms of the above crucial phrase"[18]

In other words a discretionary trust may be treated as the fons et origo of the income instead of being the conduit-pipe linking the beneficiary to the originating cause.

The example given by Trollip J A in the Rosen decision of loss of character and identity of dividend income where the trustee is not a mere conduit-pipe, is of particular importance for tax planning.

In view of the fact that dividends are exempt from income tax ("normal tax") in terms of section 10(1)(K), the taxpayer who received dividend income via a trust would prefer the conduit-pipe principle to apply in his case and would thus prefer that a vesting trust rather than a discretionary trust be set up for the purpose.

5. RECAPITULATION

Using trust income as a vested or contingent right of beneficiary, the essentials discussed under part C so far may be summarised schematically as follows:

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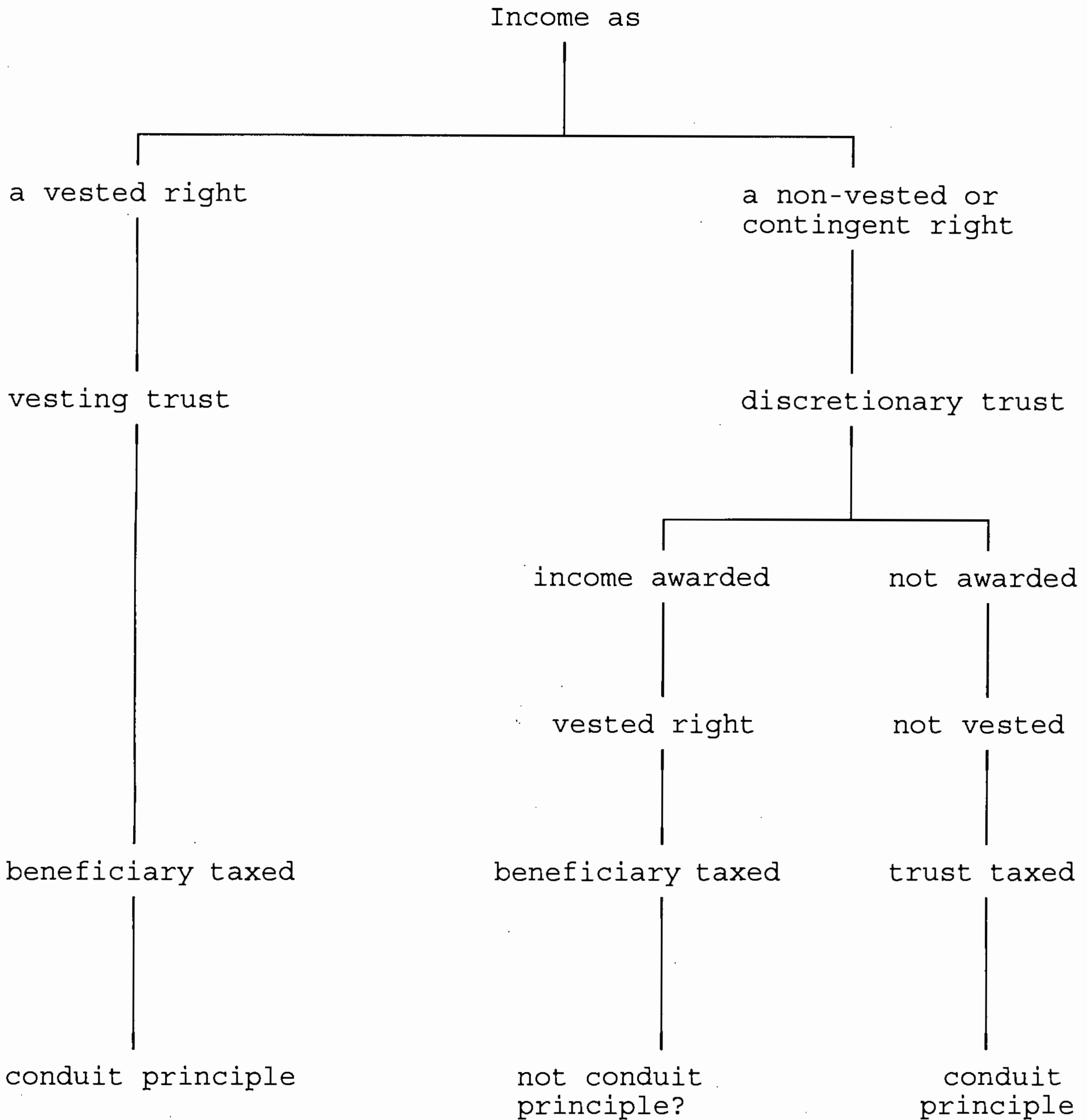
18 SIR v Rosen at 269



Regarding the taxation of the beneficiary when income has vested in him and that of the trust when there has been no vesting in the beneficiary, bearing in mind the problem introduced by the Phillip Frame Trust case (see B above), the legislature has gone farther and enacted Section 25B to put the matter beyond doubt[19] and some. Naturally, I now look at Section 25B.

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[19] By specifically providing for the taxation of the trust as illustrated in the schema instead of merely providing for the definition of "person" to include "trust" for purposes of charging Section 5(1) of the Act.

6. SECTION 25B

6.1 The first of three subsections is section 25B(1) which provides that, any income received by or accrued to or in favour of any person in his capacity as a trustee of a trust fund shall, subject to section 7, to the extent that it has been derived for the immediate or future benefit of an ascertained beneficiary with a vested right, be deemed to be income accrued to the beneficiary, otherwise be deemed to be income of the trust fund.

The subsection is self-explanatory and is in accordance with the schema under C5 above. Nothing more needs to be said about it.

6.2 The second is section 25B(2) which provides that, where the beneficiary has acquired a vested right in consequence of the exercise by the trustee of a discretion vested in him by the trust deed, such income is deemed to be derived for the benefit of the beneficiary.

The provisions of this subsection too are illustrated in the above schema-in particular by the left hand side sub-branch.

6.3 Section 25B(3) provides that, any deduction or allowance which may be made under the Act in calculating the taxable income and which relates to the income which has accrued to a beneficiary or to the trust fund, is deemed to be a deduction which is permitted in the hands of the person who is deemed to have derived the income, <u>to the extent to which the income is deemed to accrue to the beneficiary or to the trust fund</u>. (my emphasis)

There are two possible interpretations of the underlined part of the subsection. The first is that deductions will not be allowed to exceed income. In other words there can be no assessed loss. Obviously this is an unlikely interpretation as it is contrary to the provisions of section 20(1) of the Act regarding assessed losses.

The second, and more likely interpretation, is that the subsection provides for the apportionment of the expenditure between the beneficiary and the trust on the basis of the ratio of the respective incomes to total income. However, this interpretation is not without problems since it gives not just a different, but also an anomalous[20], result from that prior to the introduction of the subsection as the following example will show.

Example

Consider a trust with income R100 000 and expenditure R40 000. If the trust distributed R60 000 to the beneficiary, the position prior to section 25B(3) would be as follows.

Income	**R100 000**
Expenditure	**(40 000)**
Distribution	**60 000**
	========
Taxable income of trust	**NIL**
	========
Taxable income of beneficiary	**R60 000**
	========

20 See Emslie 229

The effect of section 25B(3) is as follows.

Taxable income of trust :

Income	**R100 000**
Distribution	**(40 000)**
Exp. 40 000 x 40 000	
1 100 000	**(16 000)**
Taxable income	**R 24 000**
	========

Taxable income of beneficiary:

Income	**R 60 000**
Exp. 40 000 x 60 000	**(24 000)**
Taxable income	**R 36 000**
	========

7. ANOMALOUS EFFECT OF SECTION 25B

The effect of the section in the example given above is to decrease the taxable income of the beneficiary by R24 000 while increasing that of the trust from zero by the same amount. As far as this particular result is concerned, the ficus is the loser in those cases (probably the majority) where the trust's marginal rate of tax is lower than the beneficiary's. However, that is not the point. The point is that the trust, having distributed all its net income to the beneficiary, now has to pay tax which under the circumstances it can pay only out of capital. There lies the anomaly which Professor Emslie discusses extensively and gives possible solutions in his article[21].

7.1 One obvious "solution" is for the trustees to pay the beneficiary what has vested in him less a proportionate share of the expenditure.

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[21] Ibid

This works out as follows.

Income of trust		**R100 000**
Expenditure		**(40 000)**
Income vested in B	**60 000**	
Proportionate exp. 60 000 / 100 000 x 40 000	**(24 000)**	
Payable to B and taxable in his hands		**(36 000)**
Taxable income of trust		**R24 000**
		=======

However there is a question. Is it that obvious that the income referred to in section 25B(1) as having been "derived for the immediate or future benefit of an ascertained beneficiary" refers to the R60 000 and not R36 000 in our example? The answer is that it is not obvious and this could lead to problems. I now come to Emslie's proposed solution.

7.2 According to Professor Emslie the solution lies in construing the words "has been derived for the immediate or future benefit of an ascertained beneficiary".

"As requiring the hypothesis that but for the expenditure and allowances, contemplated in section 25B(3) the 'income' would be so derived"[22].

Adoption of this construction would simply restore the status quo aute as follows.

Gross income of trust	**R100 000**
Less exempt income	**-**
"Income" derived for benefit of B	**100 000**
Less deductible expenditure	**(40 000)**
Taxable income of B	**R 60 000**
	========

22 Emslie Ioc. cit., referring to the total income of R100,000.

This construction also results in the beneficiary being entitled to claim the deduction of a revenue loss sustained by the trust as in the following example.

Gross income of trust	**R100 000**
Less exempt income	**-**
"Income" derived for benefit of B	**100 000**
Less expenditure, say,	**(120 000)**
Loss claimable by B	**R 20 000**
	========

The anomaly discussed thus far is in respect of a vested trust where, as we have seen above, the trustee is a mere conduit-pipe passing the income from its originating cause to the beneficiary. As you can imagine, a discretionary trust presents a more intractable problem. And Professor Emslie readily admits that the construction of section 25B(3) proposed by him in respect of trust income which has vested in the beneficiary "does not easily fall into place in the case of a discretionary trust". (Emslie 230). Indeed, if the income of the trust is R100 000, its net income is R60 000 and the trustee exercises his discretion to vest R60 000 or R10 000 in the beneficiary, what is the proportion of the expenditure and allowances relating to the "income" of the trust which the beneficiary is entitled to deduct under the section?

In the case of a vested trust it is a simple matter, as we have seen above, to assume that but for the trust's expenditure the whole of the R100 000 would have vested in the beneficiary. But can we extrapolate and say that because the trustee exercised his discretion to vest the whole of the trust's net income or R10 000 in the beneficiary, therefore the whole or one-sixth of the trust's "income" vested in the beneficiary? The same question is posed by Professor Emslie and his answer is that it is doubtful whether such an assumption can be made

but then, ",,, if it is not made there would, in the case of a discretionary trust, be the same extraordinary result we postulated earlier in the case of a vested interest". (Loc. cit.)

All this clearly indicates that the legislature must step in to remove the anomalous consequences of Section 25B (3) before there can be certainty in the application of its provisions. On that note we end our general discussion of trusts and move on to specific cases, starting with tax avoidance opportunities presented by various sections of the Income Tax Act.

D TAX AVOIDANCE OPPORTUNITIES

> "It is trite law that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the Taxing Acts. They incur no legal penalties and, strictly speaking, no moral censure if, having considered the lines drawn by the legislature for the imposition of taxes, they make it their business to walk outside them[23]".

That is the essence of tax avoidance as opposed to fraudulent tax evasion. And there are many instances where taxpayers can legitimately and legally make such arrangements, through the use of trusts, as will enable "their cases to fall outside the scope of the Act". The trust institution may be used in this connection either to avoid the burdensome effects or to take advantage of such provisions of the Income Tax Act as sections 41 and 42 on NRST; section 22(1) on shares as trading stock; and section 20(1) and (2A) on assessed losses. Below I look at each of these in turn.

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[23] Viscount Summer in Levene V IRC at 227

1 NON-RESIDENT SHAREHOLDERS' TAX

In terms of section 42(1) non-resident shareholders' tax on dividends is payable in respect of dividends payable to: a person not ordinarily resident nor carrying on business in the Republic; a deceased estate of such person; a company which is not a South African Company. These provisions make possible the avoidance of NRST as shown below

Example

Suppose Taxpayer is a non-resident and is not carrying on business in the Republic. Suppose also that he is in receipt of, or is due to receive, R10 000 dividend from a South African Company. His position will be as follows:

Dividend	**R10 000**
Withholding tax 15% (section 45)	**1 500**
Balance due to T	**R 8 500**
	=======

If, however, T forms a discretionary trust in the Republic which becomes the shareholder and recipient of the dividend, and the trustee distributes the dividend to T long after the end of the tax year, there will be a tax saving as follows:

1.1 The dividend will not vest in T immediately it is declared and paid into the trust. So T will not be liable to NRST.

1.2 The trust is not a non-resident person because it was formed in the Republic. Therefore it will not be liable to NRST on the dividend accruing to it.

1.3 It will also not be liable to income tax as dividends are exempt in terms of section 10(1)(K).

1.4 The result will be a saving of R1 500.

2. SHARES AS TRADING STOCK

Section 22(1) provides that, except for shares held by a company as trading stock, the amount which shall be taken into account in respect of the value of any trading stock held and not disposed of shall be the cost price or net realisable value of such trading stock.

Example

Suppose there are two sharedealing taxpayers, company C and Trust T. Suppose also that during year 1, their first year of trading, they each purchase a stock of shares for R50 000 and that they each sell 50% of their shares for R50 000. Assume further that at the end of the tax year the remaining shares have become worthless.

The effect of section 22(1) on their respective tax positions will be as follows:

	C	T
Year 1		
Opening stock	-	-
Purchases	(50 000)	(50 000)
Sales	50 000	50 000
Closing stock	25 000	
Taxable income	25 000	NIL
	=======	========
Year 2		
Opening stock	(25 000)	-

The advantage of the trust is obvious in this example. At the end of year 1 the company will be taxed on R25 000 while the trust will be taxed on nothing. The advantage of the trust remains even if "disadvantageous" closing stock of R25 000 of year 1 of the company will be the "advantageous" opening stock of R25 000 in year 2 in terms of section 22(2)(a); for a rand in the hand is worth more than a rand in the future taking into account inflation and present value and interest considerations.

It must be noted however that the same result could be achieved with an individual taxpayer or a partnership as with a trust.

3. ASSESSED LOSSES

Section 20(1) provides for set-off against income from trade of any balance of assessed loss from any previous year (subject to certain provisos) and any assessed loss incurred during the same year in carrying on any other trade.

The provision for set-off of any balance of assessed loss against income from trade has been interpreted as applying only if there has been trading during the tax year.

" A deduction or set-off is admissible only against income derived from carrying on a trade. As the appellant carried on no trade during the year under consideration it was not competent for it to set-off in its income tax return for that year the balance of assessed loss incurred by it in previous years".[24]

It must be noted, however, that apart from the requirement of continuity of operations as required by the S.A. Bazaars

[24] S.A. Bazaars (Pty) Ltd V CIR at 245

decision the "trade" concerned must fall within the definition of section 1 which does not for instance include the earning of interest. Hence the importance of subsection (2A)(a) of section 20 in respect of non-company taxpayers.

Subsection (2A)(a) and (b) provides that in the case of a taxpayer other than a company, subsection (1) of section 20 will apply in determining the taxable income derived otherwise than by carrying on a trade; and that such non-company taxpayer shall not be prevented from carrying forward a balance of assessed loss merely by reason of the fact that he has not derived any income during the year of assessment.

In short, to obviate the problem created by section 20(1) in the light of the S.A. Bazaar decision, and to take advantage of the opportunities created by section (2A), one would be well advised to form a trust which would be able to do the following:-

3.1 To carry forward assessed losses from previous years even if it did not trade during the year.

3.2 To set-off trade losses against non-trade income.

4. AVOIDANCE BY " SKIRTING" AND BY "SCHEME"

All the above examples are avoidance opportunities involving, to paraphrase Levene[25], walking outside the lines drawn by statute through employment of the trust institution as opposed to operating either as an individual or through a company. This particular type of avoidance is in my opinion pedestrian or perfectly acceptable to the taxman. Other forms of avoidance involve not so much the

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[25] Supra

employment of "taxpayer - friendly" forms of business enterprise to circumvent or "skirt" tax pitfalls as the carrying out of "abnormal" "transactions, operations or schemes"[26] whose object and effect is the avoidance of tax. Such schemes are proscribed by the general anti-avoidance provisions of section 103(1) and the trust-specific anti-avoidance provisions of section 7. The latter provisions will be considered at some length below, while the former, being of more general application, merit no further consideration.

E TRUST-SPECIFIC ANTI-AVOIDANCE PROVISIONS

1. GENERAL

As a variant of the Levene[27] theme, I would like to quote Broomberg:

"Most people, at the best of times, dislike paying tax; but nothing infuriates them more than the knowledge that others, in like circumstances, are honestly and legitimately paying less tax"[28].

And if any group of taxpayers should dislike paying tax more than any other, it must be high-income individual persons whose income tax position is worsened by progressive rates of tax exacerbated by conditions of high inflation - a combination of what are called bracket creep and fiscal drag.

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26 see section 103(1) of the Act

27 Supra

28 Broomberg 3

Example

Consider unmarried taxpayers P,Q,R, and S with respective taxable incomes of R20,000, R35,000, R40,000 and R60,000. Suppose each receives an extra income of R1000. Their net after tax position on the R1000 will be as follows.

Taxpayer	Taxable Income	Marginal rate of Tax	Tax On R1000	Net Aftertax
P	20 000	28%	280	720
Q	35 000	36%	360	640
R	40 000	41%	410	590
S	60 000	43%	430	570

In the circumstances there will be great pressure on the taxpayer, especially R and S in the example, to seek to "forego" any extra income by converting it into income accruing to some dependent or other who will be either exempt from tax or will have a low marginal rate of tax. Creation of a trust would be one way of achieving this - spreading the incidence of tax to minimise the overall tax burden. He may also attempt to use the trust to postpone the payment of tax on the principle that tax deferred is tax saved; or he may seek to retain control of the trust assets so that he will always be able to decide, in accordance with his own tax position, as to who should be paid as beneficiary and how much.

Below I will look at such "elaborate avoidance by scheme" possibilities hinted at under D above and the specific anti-avoidance provisions of the Income Tax Act designed to counter them. However, before proceeding I briefly want to map out how I propose to tackle the rest of part E. Firstly, I want to bring donations tax into the picture as an anti-avoidance measure in its own right. Secondly, I

will give an example around which most anti-avoidance measures will be considered, starting with the effects of donations tax and how these may themselves be avoided. Lastly, I will look at specific provisions of section 7 and the relevant case law.

2. DONATIONS TAX

Donations tax, while it is more concerned with countering estate duty avoidance than income tax avoidance, is nevertheless relevant as an anti-avoidance measure in the taxation of trusts because many trusts have donations back of them. It is not a tax on income but a tax on the net transfer of assets. Nevertheless it is an important link in the chain. It serves to discourage the setting up of trusts for the purpose of avoiding income tax.

" It imposes a tax on persons who may want to donate their assets in·order to avoid normal tax (and) estate duty"[29]

It is not my intention to say more about the tax except to refer to two sections of the Income Tax Act which are:

2.1 Section 55(1) which defines donation as any gratuitous waiver or renunciation of a right; and

2.2 Section 64 which provides that the rate of donations tax in respect of the value of any property disposed of under a donation shall be 15% of such value.

3. ILLUSTRATION

Having given the barest outline of donations tax, I now proceed with the discussion by starting off with an example

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[29] Huxham and Haupt 455

for purposes of illustrating some of the various aspects of income tax avoidance donations tax and section 7 provisions were designed to thwart.

Example

3.1 Consider a married taxpayer - or married person as defined in section 1 of the Act - with 2 children and a taxable income of R175 000. His income tax is as follows:

Tax on R75 000	**R20 175**
Tax on R100 000 (43% marginal rate)	**43 000**
Total tax payable	**R63 000**
	=======

3.2 Now suppose that he sets up a trust in favour of his wife and two children as beneficiaries with some of his capital, which has the effect of reducing the income coming direct to him by R100 000; which sum now accrues to his wife A and children B and C as follows:

A	**R34 000**
B	**R33 000**
C	**R33 000**

3.3 Assuming A,B, and C receive no other income and that they have no deductions to claim against income for tax purposes, they would be assessed as follows:

Due by A	R 7 390
B	R 5 980
C	R 5 980
Total tax	R19 350
	=======

3.4 The resulting tax saved is as follows :

Total tax without trust		**R63 000**
Due by taxpayer	**20 175**	
Due by beneficiaries	**19 350**	
Total due with trust		**R39 525**
Tax saved		**R23 650**
		=======

It must be noted however, that the saving of R23 650 would hold only prior to the introduction of donations tax and after the 1991 amendment of the section of the Act that deemed the income of the wife to be that of the husband and before the introduction of section 7(2). I will now consider the effects of all these provisions on the example given above and what, if anything, actually remains of the tax saving.

4. DONATIONS TAX EFFECT

Let us assume the taxpayer donated property to the value of R1 million to the trust, which earned the income of R100 000 which was distributed to A,B and C in the above example.

Now in terms of section 56(1)(b) of the Act, property donated for the benefit of the donor's spouse is exempt from donations tax. Therefore we may take it that of the R 1 million only R660 000 will be subject to the tax. A further exemption is provided by subsection (2)(b) of section 56 which exempts from tax amounts up to R20 000, which means that of the remaining R660 000 only R640 000 will be subject to tax at 15%. This results in donations tax due by taxpayer of R96 000.

However, even as a once-off payment, I think donations tax of R96 000 could prove too heavy a price to pay up-front

for an annual saving of R23 650. But surely there must be a way out of the donations tax bind?

The solution lies in removing the element of donation, or all talk of donation, from the fund or property establishing the trust. Thus the R96 000 donations tax can be avoided by the taxpayer by selling to the trust the property concerned for its full market value of R1 million[30]. The trust, for its side of the bargain, being without the means of paying, will create a loan account with the taxpayer as creditor. That being the case, donations tax will not affect the R23 650 savings.

5. SECTION 7 ANTI-AVOIDANCE MEASURES

These are section 7(2) affecting spouses of taxpayers as beneficiaries, section 7(3) affecting minor children of taxpayers as beneficiaries, section 7(4) proscribing cross-donations in avoidance of section 7(3), and sections 7(5) and 7(6) affecting donors with retained powers in the control of trust property.

5.1 WIFE BENEFICIARY AND SECTION 7(2)

The R34 000 given as the income of the wife from the trust[31] would be taxed in the hands of the taxpayer in terms of section 7(2) which provides that

- Income received by or accrued to one spouse (recipient) is deemed to be the other spouse's income if the income was derived in consequence of a donation settlement or other disposition made by the donor on or after 20 March 1991.

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30 Avoidance scheme suggested by Prof. Emslie in lectures at UCT

31 see 3.2 of example under E3 <u>supra</u>

The significance of 20 March 1991 in the section is that after that date married women began to be taxed separately from their husbands, whereas before then, as already mentioned above, the income of a married woman was deemed to be that of her husband and was taxed in his hands. Therefore, before that date a wife's receipts or accruals from a trust set up by her husband as donor would have had no tax significance because the husband would have been taxed on such receipts or accruals in the normal way.

However, the amendment of the law in 1991 to allow separate assessments introduced tax-avoidance opportunities for high-income husbands or wives to divert their incomes to their wives or husbands via trusts. And that is precisely what section 7(2)(a) seeks to prevent. I now turn to look closely at the section to see how it affects the saving of R23 650 in the example.

5.1.1 DONATION, SETTLEMENT OR OTHER DISPOSITION

Before considering the practical application of section 7(2) I shall briefly examine the phrase, "donation, settlement or other disposition" which runs through almost all section 7 provisions.

"Donation" has the meaning contained in section 55(1) in relation to donations tax - a common law meaning referring to disposal of property for no consideration.

"Settlement" is a term less frequently encountered but refers to a gratuitous disposal of property "subject to specific terms and conditions, usually to the trustees of a trust"[32]

[32] Huxham and Haupt 519

In ovenstone[33] it was held that the words "other disposition" should be interpreted eiusdem generis with "donation" and "settlement" such that the whole phrase should be read as "donation, settlement or other similar disposition".

> "any donation, settlement or other disposition... also covers any disposal of property made under a settlement or other disposition for some consideration but in which there is an appreciable element of gratuitousness and liberality or generosity"[34]...

It must be noted, however, that although ovenstone is applicable as to the meaning of "other disposition", the decision itself was with respect to circumstances covered by section 7(3) whose wording is similar to section 7(2) in common respects. Also where section 7(2) speaks of "in consequence of ", section 7(3) speaks of "by reason of," both of which have a similar import of apportionment[35].

The section 7(2) groundwork having been laid, so to speak, I now go on to address the problem posed by the section in the example in relation to the taxpayer's wife's income from the trust.

5.1.2 EFFECT OF SECTION 7(2) ON WIFE'S INCOME

I now look at the effect of section 7(2) on the wife's income from the trust and in doing so I will continue with the assumption of apportionability, and that is that the

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33 Ovenstone v. SIR

34 Ovenstone ibid 740

35 see below

wife's income amounting to R34 000 is attributable to her R340 000 share of the property put into the trust by her husband. With regard to this amount there are two possible scenarios: where it is put into the trust as an outright donation and where it is put as a loan.

Where the R340 000 was given to trust as a donation then the income concerned, ie R34 000, is taxable in the hands of the taxpayer (husband) in terms of section 7(2)(a) as already mentioned. As a result the taxpayer will be required to pay R34 000 x 43% or R14 620 in addition to the R20 175[36] due by him. This amounts to an overall tax increase of R7 230 which we obtain by subtracting the amount of tax the wife would pay were section 7(2)(a) in-operative from the additional tax due by the taxpayer because of the operation of the section (that is R14 620 less R7 390). This in turn reduces the tax saving of R23 650 to R16 420.

On the other hand, where the amount was given as a loan there are three possibilities: it was given interest-free, or it was given as a soft loan at below market rate of interest, or it was given at the going market rate.

In the case involving a loan at market rate section 7(2)(a) would not apply because of the absence of gratuity or liberality or generosity in the transaction. Thus all things being equal, the tax saving of R23 650 would not be affected. However, in the case of no-interest or below market-interest loan, an element of gratuity is involved in terms of <u>Ovenstone</u> and thus section 7(2) would apply as shown below.

" Now where the consideration, while not being due consideration, is nevertheless appreciable, it will

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[36] See E3.1 <u>Supra</u>

mean that the income in question under section 7(3) will usually have accrued or been received by reason of both elements of gratuitousness and consideration. I see no reason why in those circumstances the income should not then be apportioned, between the two elements. The words, 'by reason of', themselves suggest some apportionment in order to give proper effect to the real cause of the accrual or receipt of the income"[37].

Suppose the market rate of interest is 8%. In that case an interest-free loan of R340 000 amounts to a gift-over or "other disposition" of R27 000. Since the income from the trust works out at 10% of capital, the element of income derived "in consequence of" the R27 000 "other disposition" amounts to 10% interest which is R2 720. And that is the amount taxable in the hands of the taxpayer in terms of section 7(2)(a). This results in additional tax of R191 which reduces the tax saving of R23 650. Details of the calculation are as follows:-

Wifes income ex trust	**R34 000**
Taxable in taxpayers hands	**(2 720)**
	--------
	31 280
	========
Tax due by wife	**6 411**
Tax due by taxpayer (2 720 x 43%)	**1 170**

Total tax due	**7 581**
Wifes tax without section 7(2)(a)	**7 390**

Additional tax	**191**
	=====

[37] <u>ovenstone</u> loc cit 740

The effects of section 7(2)(a) in the case where the element of gratuity is an interest charge of less than 8% can be found in a way similar to the above.

I'm afraid we seem to have got lost in some maze of detail which is nevertheless essential for a full explanation of the effects not only of section 7(2) but also of other section 7 provisions including section 7(3), which I consider next in the context of our example - now in relation to B and C.[38].

5.2 CHILD BENEFICIARIES AND SECTION 7(3)

I now look at the provisions of the Act affecting the taxation of income received by or accrued to children of the taxpayer from a trust set up with funds donated by him. The provisions concerned are contained in section 7(3) which provides that:

"Income shall be deemed to have been received by the parent of any minor child, if by reason of any donation, settlement or other disposition made by that parent of that child -

(a) It has been received by or has accrued to or in favour of that child or has been expended for the maintenance, education or benefit; or

(b) it has been accumulated for the benefit of that child"

Although the essential elements of the thread running through most section 7 provisions including the words, "by reason of" have been dealt with under the discussion of

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[38] See E3.2 above

section 7(2) above, some case law must be considered in the specific context of section 7(3) regarding these very words.

"Difficulty is often experienced in deciding whether or not income received by children is "by reason of" a donation made by the parent. The difficulty arises where one is faced with so-called income on income, ie the income which accrues from the re-investment of the income from donation" (Huxham and Haupt 520)

In Kohler V CIR the father had donated R10 000 to each of his daughters. The income from the investment was used to purchase shares which yielded dividends. It was held that the proximate cause of the dividends was the income from the investment and not the investment itself, which was the remote cause and that, "once income has accrued to or been received by the minor and has been capitalized, its subsequent earning or product is attributed not to the source from which the original income was derived but to the advantageous employment of the minor's new capital".

In CIR v Widan, however, without overruling Kohler, it was held that where the original donation was intended to produce income which would be used to acquire shares, the resultant dividend was by reason of the donation.

Having made those remarks, we see that in terms of section 7(3) the taxpayer will be liable to tax on the R66 000 if B and C are minor children in example E3 above. Major children would be taxed in their own hands as is assumed in the example. Now, if, because of section 7(3), the taxpayer can derive no tax advantage via the trust mechanism in respect of minor children, what advantage would there be in creating a similar trust in respect of major children who are likely to be self-supporting anyway? The answer lies in the avoidance of estate duty which is

not really our concern here but is of interest, nonetheless.

In terms of the Estate Duty Act estate duty is payable at 15% of net value of deceased estate in excess of R1 million. It would, therefore, seem to be logical that the taxpayer should either donate his estate to his children during his life time or set up an intervivos trust in their favour instead of bequeathing to them a dutiable estate. However, donations tax, both in case of a direct donation to the children and in case of a donation to the trust, would render the exercise futile[39] unless the loan trick of E4 above is resorted to.

5.3 **AVOIDANCE BY MEANS OF CROSS-DONATIONS**

Taxpayer X with child D and taxpayer Y with child E could together work out a scheme to obviate the problem of section 7(3), whereby X denotes funds to trust YE in favour of E and Y reciprocates by donating an equal sum to trust XD in favour of D, where D and E are minors. Under such a "reciprocal" scheme or cross-donations the R66 000 trust income in favour of B and C, the minor children of the taxpayer in example E3, could be taxed in their hands.

However, I have my own doubts if such obviously "abnormal" "I give you x you give me x" scheme would escape the net of the general anti-avoidance provisions of section 103(1) of the Act. But just in case it did, there is section 7(4) to catch it. The latter section provides as follows.

"any income received by or accrued to or in favour of any minor child of any person, by reason of any donation, settlement or other disposition made by any other person, shall be deemed to be the income of the

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[39] In fact in view of the R1 million rebate, payment of estate duty would make better sense

parent of such minor child, if such parent or his spouse has made a donation, settlement or other disposition or given some other consideration in favour directly or indirectly of the said other person or his family".

Specifically in view of section 7(4) and also, I think, more generally in view of section 103(1), a successful way of avoiding section 7(3) could be by way of a "granny trust".

The wording of section 7(3) does not prevent a grandparent from setting up a trust in favour of his minor grandchild such that the income accruing to the grandchild from the trust is taxable in the grandchild's hands. Where such grandparent is obliged to support his minor grandchildren and does so, which is not uncommon, and is a high-income earner, setting up such a trust would make a lot of sense for him. However where the grandparent does not support his grandchildren and is not obliged to do so, he would not go to the trouble of setting up a trust for the benefit of the grandchildren unless they were his heirs and he wanted to avoid estate duty or there was some quid pro quo. If, however, such quid pro quo took the form of a cross-donation or some other "abnormal" tax-avoidance scheme, it would fall foul of section 7(4) or section 103(1).

From now on I took at a class of anti-avoidance provisions slightly different from what has been considered so far. Thus I will not refer very often, if at all, to the example of E3 as I have been doing so far. Where necessary ad hoc illustrations will be used.

5.4 **AVOIDANCE BY POSTPONEMENT: SECTION 7(5)**

One other possible way of avoiding income tax is postponement of liability through the use of a

discretionary trust in which distribution to the beneficiary is delayed. However, where the beneficiary has no immediate vested right to the income, then the income is taxable in the hands of the trust immediately it accrues or is received in terms of section 25B(1) discussed under C above. In my opinion the only worthwhile postponement would be where the income is taxable neither in the hands of the donor nor those of the trust while vesting in the beneficiary is held in abeyance.

This may be one of the instances illustrated in the following passage.

"sometimes it happens that beneficiaries are not specified in a trust deed, but the trustees are legally obliged to pay over the income to the beneficiaries nominated by them in the exercise of a discretionary power conferred upon them by the deed. In such circumstances, the income is regarded as having been received by the beneficiaries so nominated."[40]

My understanding of this statement is that the trust will not be taxed on the income it receives during year one, say, but only the beneficiaries after having been designated during year three, say. However I don't think this is possible in South African law, for, even if the trust were not immediately taxed on the income in terms of section 25B(1) - which is unlikely - the donor himself would be taxed in terms of section 7(5) which provides that:

"if any person has made any donation, settlement or other disposition which is subject to a stipulation or condition, whether made or imposed by such person or

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[40] Riseborough 3

anybody else, to the effect that the beneficiaries thereof or some of them shall not receive the income or some portion of the income thereunder until the happening of some event, whether fixed or contingent, so much of any income as would, but for such stipulation or condition, in consequence of the donation, settlement or other disposition be received by or accrue to or in favour of the beneficiaries, shall, until the happening of that event or the death of that person, whichever first takes place, be deemed to be the income of that person".

However, before proceeding to consider section 7(5) I may mention in passing that in the absence of the possibility of total suspension of the incidence of tax until the trustees have exercised their discretion, retention of the income in the trust and the taxability of the income in the hands of the trust, in itself offers a measure of tax avoidance. For, as Broomberg observes:

"It stands to reason that it will often be advantageous for income to be trapped in a trust, and be subjected to tax in the hands of the trustee, rather than to suffer tax at maximum rates in the hands of the settlor or beneficiary of the trust"[41].

However, Broomberg goes on to say that section 7(5) was "designed to prevent this happening"[42] - ie the trapping of income in the trust and the taxation of the trust itself instead of the settlor or beneficiary? With respect, I don't think that was the purpose of section 7(5); rather it was to provide for the taxation of the donor,

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41 Broomberg 212

42 Loc. cit.

"where and so long as the donor does not permit the beneficiary of the gift to enjoy immediately the income derived therefrom by deeming the income in question to be that of the donor"[43].

This is different from the case where income is trapped in a trust wherein the trustees have a discretion to award it to the beneficiaries and the income remains so trapped simply because such discretion has not yet been exercised by the trustees. In that case section 25B(1) would apply to tax the trust and not section 7(5) to tax the donor.

As far as section 7(5) is concerned there are two requirements for the application of its provisions, and these are as follows[44].

5.4.1 A stipulation the effect of which is that the beneficiaries shall not receive the income until the happening of a certain event (eg attainment of age 25); and

5.4.2 but for the stipulation the income would be received by or accrue to the beneficiaries.

The stipulation of age 25 given as an example in the first requirement gives rise to a contingent right in case of an 18 year old, say, such that he would not immediately be entitled to the income, it being conditional upon his attaining the age of 25. Now, given the present age of the beneficiary as 18, what is the effect of the second requirement, or alternatively what is its interpretation? Let me use an example to explain.

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43 Meyerowitz 567

44 Ibid. 467

<u>Example</u>

Suppose donor x sets up a trust stipulating the attainment of age 25 before income could vest in his grandson y, the beneficiary of/ the trust, who is now aged 18. Suppose also that income amounting to R50 000 accrues to the trust - at least in terms of the trust deed - now.

The question is, what will make the R50 000 "accrue" to y now and not in 7 years time? And, more important, would the R50 000 have accrued to y <u>now</u> but for the age 25 stipulation, such that x becomes immediately taxable in terms of section 7(5)?

In <u>Estate Dempers</u> where the facts were similar in essential respects, the answer to the last question in the example was held to be yes. And it was further stated that,

"... the application of the devolutionary portion of the subsection (5.42) involves a hypothetical, notional enquiry which cannot be directed solely to questions such as whether the beneficiaries' right to income is vested or contingent. The question which the court must ask itself is whether, in the absence of the stipulation withholding trust income, this income would have been received by or have accrued to the beneficiary. In answering this question regard must be had to the terms of the instrument generally, the donor's benevolent intention, as evinced by the terms of the instrument and all the relevant circumstances."

So, according to this decision, never mind the effect of the stipulation (whether there is immediate vesting or vesting after 7 years). Simply ignore it and decide what the position would be were the stipulation not in place.

In the circumstances of the example used for illustration, there would be immediate vesting in the beneficiary. Ergo the donor is liable in terms of section 7(5).

There is one other aspect of section 7(5) that is in need of clarification and that is, whether the exercise by the trustees of their discretion under circumstances provided for by the section is an "event" in terms of that section. That question has not yet been decided by the courts. However, in my opinion, such exercise of discretion would constitute such event. The object of the section is to tax in the hands of the donor what for the time being can't be taxed in the hands of the beneficiary because of lack of vesting in the latter by reason of the former's stipulation. And if such stipulation is coupled with a discretion given the trustees, which discretion has the effect of continuing and sustaining the prohibition of vesting, it will only be after the trustees have exercised their discretion that the stipulation "package" ceases to be effective and the beneficiary will have a vested right and the need to substitute the donor for tax purposes will fall away. Therefore, the exercise by the trustees of their discretion would under the circumstances constitute an event as contemplated by section 7(5). This should mean then that, the incidence of tax would continue to be on the donor until such time as the trustees have exercised their discretion.

Example

An example of a "stipulation package" could be as follows:

"The beneficiary shall not be entitled to receive the income until he has attained the age of 25 and the trustees have exercised their discretion to give it to him".

So, when the trustees finally exercise their discretion on the beneficiary's 27th birthday, say, and decide to give him the money then, that decision would constitute an event.

If, on the other hand, that decision does not constitute an event in terms of section 7(5), we would have the following incidences of tax:

During the period up to (but excluding) the time the beneficiary turns 25, the incidence of tax would be on the donor in terms of section 7(5) - the 25th birthday being the event.

During the two year period beginning with the beneficiary's 25th birthday up to the time the trustees exercise their discretion, the incidence would be on the trust in terms of section 25B(1) as an ordinary discretionary trust.

Clearly the interpretation of the exercise of the trustees' discretion as a "non-event" in the example would be favourable to the donor taxpayer.[45] In that case the court might be inclined to decide contra fiscum should it be called upon to decide the matter and should it find section 7(5) not incapable of such interpretation[46]. However, until such time as the matter has been decided by the court one can only speculate as to whether or not the trustees decision under the circumstances illustrated is an event in terms of section 7(5).

This very nearly brings us to the end of our discussion and only the last section in the series remains and that is section 7(6) which I propose to consider under the rubric: avoidance by "Flexibility".

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45 See reference to note 41 above

46 Hulett and Sons case at 764

5.5 **AVOIDANCE BY "FLEXIBILITY" : SECTION 7(6)**

Huxham and Haupt give an example of a donor who may seek to avoid tax by setting up a trust with a deed giving him power to vary beneficiaries at will. According to the authors:

> "It would be a simple matter to establish from year to year which of the beneficiaries had the lowest marginal rate of tax and to direct that the income accruing to the trust should be paid to that particular beneficiary"[47].

The authors give this as an example of tax avoidance specifically countered by section 7(6). But in my opinion the donor could achieve the same result by circumventing section 7(6) and creating a discretionary trust with the power to appoint and dismiss or to vary beneficiaries being conferred upon the trustees with no power reposing upon himself. For section 7(6) provides that,

> "If any deed of donation, settlement or other disposition contains a 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 the 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".

However, I must point out that substituting the powers of trustees for those of the donor himself, while obviating the

[47] Huxham and Haupt 523

pitfalls of section 7(6), might not suit the purpose of the donor unless the trustees would exercise no independent discretion but would merely carry out the bidding of the donor, which would be legally untenable. Having said that, let me nonetheless make the general observation that actually what is usually involved in sections 7(6) and 7(5) schemes is more the avoidance of estate duty than income tax.

This is done via a reluctant or half-hearted making over of assets and divestment of <u>dominium</u> and control from donor to trust. Effective power and control, which are inherent in the right of ownership, continue to be enjoyed by the donor under the convenient trappings of a trust. However, if such a trust is recognised as such for estate duty purposes, then its assets will not be subject to estate duty as part of the deceased donor's estate even though the deceased will have enjoyed considerable powers of control over the assets of the trust prior to his death. If, on the other hand, the deceased donor's powers were such that he could have disposed of the assets of the trust for his own benefit, then Estate Duty Act's own anti-avoidance provisions of section 3(3)(d) would come into play and deem the assets concerned to be part of the deceased donor's estate and thus dutiable. Regardless of the eventual estate duty position of the trust assets, section 7(6) is a means of getting an income tax cut of the revenue from the trust during the reluctant donor's life time.

5.6 **"ODD MAN OUT" : SECTION 7(1)**

Section 7(1) is oddman out in the section 7 provisions in that it does not refer to the distinctive refrain of "donation settlement or other disposition". However, in view of the fact that it deems income which has vested in a person to have accrued to him and immediately taxable in his hands even if he has not yet received it, it belongs to the group of provisions that prevent possible postponement of liability for trust income and hence prevent avoidance by postponing payment of tax. The

subsection provides that:

> "Income shall be deemed to have accrued to a person notwithstanding that such income has been invested, accumulated or otherwise capitalised by him or that such income has not been actually paid over to him but remains due and payable to him or has been credited in account or re-invested or accumulated or capitalised or otherwise dealt with in his name or on his behalf, and a complete statement of all such income shall be included by any person in the returns rendered by him under this Act".

This brings us to the end not only of the part dealing with anti-avoidance provisions specific to trusts but also of our discussion as a whole. In the conclusion I shall briefly look at prospects in the light of the current tax debate.

CONCLUSION

The longest part of the discussion has been that dealing with specific anti-avoidance provisions for the simple reason that these contain a sizeable body of law both statute and case law and involve many fundamental issues. This is evidence of the legislature's awareness of the potential use to which the trust may be put as a tax-avoidance device in "abnormal" arrangements, and shows its determination to minimise the chances of success for such schemes by deploying a formidable array of special provisions in addition to the "catch-all" provisions of section 103(1).

However, just as it is concerned with closing revenue leaks, the lawgiver is also concerned with widening the tax base and increasing revenue intake whenever fiscal or social considerations demand. Indeed, on the eve of the new South Africa, the ANC, widely tipped to be the next government, has

unveiled its Reconstruction and Development Programme amid endless rumours of all manner of new taxes.

Thus "more interesting times" might be in store for trusts as the new government might decide trusts are for "fat cats" and close the tax avoidance opportunities discussed under part D or levy a higher tax on them. A movement precisely in the latter direction could well have been presaged by the Margo Commission when it recommended that trust income should be taxed at maximum marginal rate should the trustees fail to distribute it to the beneficiaries when it is within their power to do so[48].

Should these tax pressures materialise we could expect to see a decline in the use of trusts in favour of CC's in general and in the area of estate planning in particular, taking into account the additional factor of high administrative costs of trusts compared to CC's[49].

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48 Margo Commission Report paragraph 11.56-7

49 Terry Betty Sunday Times Business Times 20/02/94

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Emslie, T. 1992 the Taxpayer 227
Jooste, R. 1987 Income Tax Reporter 126

5. NEWSPAPER ARTICLES

Betty, T. Sunday Times Business Times 20/02/1994

6. CASES

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CIR v Emary No (1961 AD) 24 SATC 129
CIR v Estate Crewe 1943 AD 656
CIR v McNellies Estate 1961(1) SA 833(A)
Estate Dempers v SIR (1977 AD) 39 SATC 93
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Hulett & Sons v Resident Magistrate,
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Trustees of the Phillip Frame Will Trust
v CIR 1991(2) SA 340(W) 53 SATC 166

7. REPORTS

Margo Commission (RP 34/1987)

APPENDIX

TAXATION TABLES
PERSONS OTHER THAN COMPANIES

FOR THE YEAR OF ASSESSMENT ENDING 28 FEBRUARY 1993
(OR 30 JUNE 1993)

Normal Tax
(Before the deduction of rebates)

Tax Rates

MARRIED PERSONS'		
Taxable income	**Tax**	
R R	R	R
0- 5 000	17% of each R1	
5 000-10 000	850 + 18% of the amount over	5 000
10 000-15 000	1 750 + 19% " " " "	10 000
15 000-20 000	2 700 + 20% " " " "	15 000
20 000-25 000	3 700 + 21% " " " "	20 000
25 000-30 000	5 800 + 28% " " " "	30 000
30 000-40 000	8 600 + 36% " " " "	40 000
40 000-50 000	12 200 + 41% " " " "	50 000
50 000-60 000	16 300 + 42% " " " "	60 000
60 000-80 000	24 700 + 43% " " " "	80 000
80 000+		

UNMARRIED PERSONS'		
Taxable income	**Tax**	
R R	R	R
0- 5 000	17% of each R1	
5 000-10 000	850 + 19% of the amount over	5 000
10 000-15 000	1 800 + 21% " " " "	10 000
15 000-20 000	2 850 + 24% " " " "	15 000
20 000-30 000	4 050 + 28% " " " "	20 000
30 000-40 000	6 850 + 36% " " " "	30 000
40 000-50 000	10 450 + 41% " " " "	40 000
50 000-56 000	14 550 + 42% " " " "	50 000
56 000+	17 070 + 43% " " " "	56 000

UNMARRIED PERSONS'		
Taxable income	**Tax**	
R R	R	R
0- 5 000	17% of each R1	
5 000-10 000	850 + 19% of the amount over	5 000
10 000-15 000	1 800 + 21% " " " "	10 000
15 000-20 000	2 850 + 24% " " " "	15 000
20 000-30 000	4 050 + 28% " " " "	20 000
30 000-40 000	6 850 + 36% " " " "	30 000
40 000-50 000	10 450 + 38% " " " "	40 000
50 000+	14 250 + 40% " " " "	50 000

A married person is :

(a) a man who during any portion of the period of assessment was married and not living apart from his wife in circumstances which, in the opinion of the Commissioner, indicate that the separation is likely to be permanent; or
(b) a widow or widower; or
(c) a person who is entitled to a child rebate.

Adapted from Meyerowitz