

Offshore trusts and foreign income – the specific anti-avoidance provisions

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I INTRODUCTION

In the absence of the application of any anti-avoidance measures, foreign (ie non-South African source) income received by or accruing to an offshore (non-resident¹) trust is only taxable in South Africa if it vests in a resident beneficiary in the year in which it is received by or accrues to the trust. This is the combined effect of s 25B and the 'gross income' definition in s 1 of the Income Tax Act.² Section 25B of the Act provides that if there is a beneficiary with a vested right to trust income it is taxed in the beneficiary's hands and if there is no beneficiary with a vested right the trust is taxed. However, in terms of the 'gross income' definition an amount can only be included in a non-resident's gross income if it is from a source within or deemed to be within the Republic of South Africa. It is, in any event, a rule of international law that a non-resident can only be taxed on local source income.³ It follows that in the absence of anti-avoidance measures residents could easily avoid tax on foreign income through the utilization of offshore trusts. By shifting foreign income-producing assets into an offshore trust and avoiding the vesting of the foreign income in a resident beneficiary in the year that it is received by or accrues to the trust, tax is avoided. If it is vested in that year in a non-resident beneficiary no tax is payable. If it is not vested in anyone the capitalized income can be remitted to a resident beneficiary as a tax free capital receipt in a subsequent year.

When a fully-fledged residence-based tax system was introduced in 2001,⁴ the legislature, mindful of the possibility of avoidance of tax on foreign income through the use of trusts, enacted two provisions aimed specifically at preventing such avoidance. They are sections 7(8) and 25B(2A) of the Act.⁵ Section 9D of the Act is not applicable to offshore

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¹ The term 'resident' is used in this article in the sense indicated by the definition of 'resident' in s 1 of the Income Tax Act 58 of 1962.

² Act 58 of 1962 hereinafter referred to as 'the Act'.

³ See, for example, R. S. J. Martha *The Jurisdiction to Tax in International Law* (1989) 47; A. Knechtle *Basic Problems in International Fiscal Law* 36.

⁴ See the Revenue Laws Amendment Act 59 of 2000.

⁵ Similar provisions to s 7(8) and s 25B(2A) were included in the previous s 9D of the Act which was introduced in 1997 and imputed 'investment income' of a 'controlled foreign

trusts. Section 9D in broad terms, imputes the income of a foreign entity to its South African 'owner(s)' if the foreign entity constitutes a 'controlled foreign entity' as defined in s 9D(1). A trust is expressly excluded from the definition of a 'controlled foreign entity'. Section 9D is essentially aimed at companies 'owned' by South African residents.

The objective of this article is to examine s 7(8) and s 25B(2A) with a view to determining the extent to which Revenue has the means to combat the avoidance of tax on foreign income through the use of offshore trusts. The avoidance of tax on foreign capital gains is not considered although it is to be noted that there are provisions in the Act similar to s 7(8) and s 25B(2A) aimed at such avoidance.⁶

II SECTION 7(8)

(1) *The provision and its applicability to trust income.*

Section 7(8) provides as follows:

'Where by reason of or in consequence of any donation, settlement or other disposition (other than a donation, settlement or other disposition to a foreign entity, as defined in section 9D, of a public character) made by any resident, income is received by or accrues to any person who is not a resident (other than a controlled foreign entity as defined in section 9D in relation to such resident), there shall be included in the income of such resident so much of the amount of any income as is attributable to such donation, settlement or other disposition: Provided that any amount of income received by or accrued to such person by way of foreign dividends, shall for the purposes of this section be determined in accordance with the provisions of section 9E, as if such person had been a shareholder who is a resident.'

It appears that in relation to offshore trusts⁷ s 7(8) is intended to apply where a resident (hereafter referred to as 'the donor') makes a 'donation, settlement or other disposition' and 'by reason of or in consequence of such disposition income is 'received by or accrues to an offshore trust and is either retained in the trust or is vested in a non-resident beneficiary of the trust. Section 7(8) deems such income to be the donor's.

What is not clear is whether s 7(8) operates where the income vests in a resident beneficiary. Section 7(8) operates where the income is 'received by or accrues to' a non-resident. When income derived by the offshore

entity', which then included an offshore trust, to its South African 'owner(s)'. Sections 7(8) and 25B(2A) came into operation on 1 January 2001 and apply in respect of years of assessment commencing on or after that date.

⁶ See para 72 and para 80(3) of the Eighth Schedule to the Act respectively. Para 80(3) was added by the Revenue Laws Amendment Act 60 of 2001.

⁷ Section 7(8) clearly does not only apply where an off-shore trust is involved which is obvious from the fact that trusts are not referred to in s 7(8). However, there is no doubt that s 7(8) targets offshore trust income.

trust vests in a resident beneficiary has there been a receipt or accrual in the hands of the trust for the purpose of s 7(8) giving rise to the operation of the provision because the trust is a non-resident? It is true that by virtue of the conduit principle (a principle enunciated by the courts prior to the inclusion of a 'trust' as a 'person' in the definition of 'person' in s 1 of the Act and the enactment of s 25B(1) and s 7(8))⁸ where trust income vests in a trust beneficiary the trust is treated as a mere administrative conduit-pipe and the beneficiary is treated as having a receipt or an accrual of the income. However, does the conduit-pipe principle apply for the purposes of s 7(8)? In s 25B(1) the legislature expressly envisages a receipt or accrual in the hands of the trustee of a trust even though the income has vested in a trust beneficiary.⁹ Section 25B(1) states that when trust income arises it is received by or it accrues to the trustee irrespective of any vesting of the income in any beneficiary. The provision then proceeds to deem the income to be the beneficiary's in the case of a vesting and the trust's in the absence of such vesting. However, such deeming does not apply if any of the provisions of s 7 are applicable.¹⁰ Does it not follow, therefore, that where income arises in an offshore trust the requirement of s 7(8) of a receipt or accrual by a non-resident has been satisfied? It is true that s 25B(1) refers to a receipt or accrual in the hands of the *trustee* as opposed to the trust but does anything turn on the distinction bearing in mind that the trustee is as much an administrative conduit-pipe as the trust? Although it is submitted that the legislature's intention was not to apply s 7(8) in circumstances where the offshore trust income vests in a resident beneficiary legislative amendment is called for for clarity purposes.

(2) 'Income'

In order for s 7(8) to apply, 'income' must be received by or accrue to the offshore trust. It follows that if trust funds are invested in funds or bonds or other instruments which confer no right to income,¹¹ s 7(8) cannot apply.¹²

Although s 7(8) is undoubtedly aimed primarily at foreign income it is clear that it also applies to South African source income. Accordingly by

⁸ See *Armstrong v CIR* 1938 AD 343; 10 SATC 1 and *SIR v Rosen* 1971(1) SA 172 (A); 32 SATC 249.

⁹ Section 25B(1) provides that 'any income received by or accrued to or in favour of any person during any year of assessment 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 who has a vested right to such income during such year, be deemed to be income which has accrued to such beneficiary, and to the extent which income is not so derived, be deemed to be income which has accrued to such trust.'

¹⁰ See the words 'subject to the provisions of section 7' in s 25B(1).

¹¹ Referred to as 'roll-up' funds and 'wrap' bonds.

¹² Nor can s 25B(2A) apply. See below.

also applying to local income, s 7(8) appears to have a role additional to its main role of ensuring the efficacy of the residence-based tax system. By also applying to local income s 7(8) secures the taxation of the income at the donor's marginal rate of tax and also facilitates the collection of tax which can prove difficult where the recipient of the income is a non-resident.

A possible flaw in s 7(8) which may nullify it completely is that 'income' as defined¹³ is 'gross income' less exempt income, and 'gross income' as defined¹⁴ for a non-resident excludes income from a foreign source. On this interpretation, therefore, s 7(8) cannot apply to foreign income accruing to an offshore trust. It might be argued, however, that 'income' must not be given its defined meaning in the context of s 7(8)¹⁵ but must be used in the wider sense of 'profits', irrespective of their source. A case providing some support in this regard is *CIR v Simpson*,¹⁶ in which the court held that the word 'income', as used in the equivalent of s 7(2), had to be construed as meaning the profits and gains accruing to the wife of a taxpayer and not income in the sense of gross income less exemptions, as it is defined in the Act. A counter to this argument is that the same defect existed in s 25(2A)¹⁷ and the legislature saw fit to rectify it there,¹⁸ but has not amended s 7(8), indicating that 'income' in s 7(8) must be given its definition meaning.

Related to the question of what is 'income' for the purposes of s 7(8), is the issue of the availability to the donor of the deductions and allowances relating to the 'income' included in his or her income in terms of s 7(8).¹⁹ For example, a resident donates a block of flats situated in London to an offshore trust. In a particular year of assessment R1million of rental income accrues to the trust and the trust incurs R400 000 of expenditure which would be deductible in terms of the Act in the ordinary course of events. Is the donor taxed, in terms of s 7(8), on R1million or R1million less R400 000, i.e. R600 000? Unfortunately there is no express provision in the Act that resolves this issue. The legislature has seen fit to deal expressly with the treatment of deductions and allowances where income accrues to trust beneficiaries in circumstances where the s 7 anti-avoidance provisions do not apply²⁰ but not where it is deemed to accrue to the donor in terms of s 7(8).²¹ It will be recognized that if 'income' is

¹³ See s 1 of the Act.

¹⁴ See s 1 of the Act.

¹⁵ In fact in the context of s 7 as a whole.

¹⁶ 1949 (4) SA 678 (A), 16 SATC 268.

¹⁷ See below.

¹⁸ See s 14(b) of the Revenue Laws Amendment Act 19 of 2001. See further below.

¹⁹ This is an issue which also arises in relation to the other anti-avoidance provisions in s 7.

²⁰ See s 25B(3).

²¹ Or in terms of any of the other provisions in s 7.

given the meaning of 'profits' or 'gains' the problem could be solved (albeit in a crude and unsatisfactory way) because expenditure is deducted in arriving at a profit or gain.²² To tax the donor on the gross income would obviously be highly inequitable and it is likely that in practice Revenue will give the donor the benefit of the deductions and allowances relating to the income. However, an amendment to the Act expressly providing for this effect is called for.

(3) *'[B]y reason of or in consequence of any donation, settlement or other disposition'*

Crucial to the application of s 7(8) is the meaning of the phrases 'donation, settlement or other disposition' and 'by reason of or in consequence of'. In order for a donor to be taxed in terms of s 7(8) the donor must have made a 'donation, settlement or other disposition' and 'by reason of or in consequence of' the disposition, income must accrue to the offshore trust.

In terms of s 7(9) of the Act, a 'donation,' includes, in addition to a completely gratuitous disposition, the disposal of an asset for a consideration less than market value. It is unclear why the legislature saw fit to make this inclusion²³ because this extension of its meaning had already been clearly accepted by the Appellate Division of the Supreme Court. In *Ovenstone v SIR*²⁴ Trollip JA held that:

'the words "donation, settlement or other disposition" all have this feature in common: they each connote the disposal of property to another otherwise than for due consideration, ie otherwise than commercially or in the course of business. "Donation" and "settlement" all have this further feature in common: the disposal of property is made gratuitously or (occasionally in the case of a settlement) gratuitously to an appreciable extent.'

As far as the meaning of the phrase 'other disposition', which is also used in the other anti-avoidance provisions in s 7, is concerned, following the above dictum, Trollip JA said:

'Since "disposition", the general word that rounds off the critical phrase, was not intended to have its wide, unrestricted meaning, I think that this is an appropriate situation in which to circumscribe its scope by extending that common element of gratuitousness to it too by the *ejusdem generis* or *noscitur a sociis* rule. The critical phrase should in other words be read as "any donation, settlement or other similar disposition" So construed, "disposition" means any disposal of property made wholly or to an appreciable extent gratuitously out

²² It does not, of course, solve the problem of 'allowances' not involving any expenditure.

²³ Section 7(9) was inserted in the Act by the Revenue Laws Amendment Act 59 of 2000.

²⁴ 1980 (2) SA 721 (A), 42 SATC 55 at 74. See also *Joss v SIR* 1980 (1) SA 674 (T), 41 SATC 206 and *C:SARS v Woulidge* [1999] 4 All SA 519 (C), 62 SATC 1.

of the liberality or generosity of the disposer. It need not flow from a unilateral contract.’

On the basis of the judgments in the *Ovenstone* and *Joss* cases²⁵ it has been accepted that ‘other disposition’ within the meaning of s 7 includes: a disposal of an asset for a consideration appreciably lower than its market value; an interest-free loan or a loan at an interest rate appreciably lower than the market rate of interest; and allowing a purchase consideration to remain outstanding interest free, or subject to the payment of interest at an interest rate appreciably lower than the market rate of interest.²⁶

In order for s 7(8) to operate, income must be received by or accrue to the offshore trust ‘by reason of or in consequence of’ the donation, settlement or other disposition made by the resident. Thus there must be a certain nexus between the income and the donation, settlement or other disposition. It is noteworthy that, whereas the other anti-avoidance provisions in s 7²⁷ use either the phrase ‘by reason of’ or ‘in consequence of’, s 7(8) uses both. The combination of both phrases indicates that a very liberal interpretation of the nexus required by s 7(8) may be called for and that the legislature intended the ambit of s 7(8) to be even wider in this regard than the other anti-avoidance provisions in s 7.

In determining the nature of the nexus required by the anti-avoidance provisions in s 7 other than s 7(8), the Appellate Division has held in *CIR v Widan*²⁸ that there must be some causal relationship between the donation and the income in question and that in determining whether a causal relationship exists, one must look not necessarily to the cause which is proximate in time but to the real efficient cause of the income being received. In addition, and of significance, is the Appellate Division’s acceptance of the donor’s motive as an important factor in ascertaining whether the necessary connection is present. In *Widan*’s case the court found that the donor’s ‘all-embracing design’ in making the donation was that it should give rise to the income in question which ‘puts it beyond question that the income accrued by reason of the donation’. The court accepted that:

²⁵ At (n 24) above.

²⁶ It is noteworthy that s 7(9) only enlarges on the meaning of ‘donation’. Accordingly, the inclusion by the courts of interest-free and low-interest loans (cheap loans) within the meaning of ‘other disposition’ appears not to be affected by s 7(9). If s 7(9) was enlarging on the meaning of ‘other disposition’ it may well have been arguable that by including only a disposition for a consideration less than market value, the implication was that ‘cheap’ loans were excluded, thus rendering s 7(8) ineffective, and for that matter s 7(2), (3), (4), (5), (6) and (7) too.

²⁷ See ss 7(2)(a), 7(3), 7(5), 7(6) and 7(7).

²⁸ 1955 (1) SA 226 (A), 19 SATC 341 at 350.

'[it] does not lie in a man's mouth to say that the consequence he deliberately planned and procured is too remote for the law to treat as a consequence'.²⁹

What is stated in *Widan's* case is clearly applicable to the nexus requirement in s 7(8).

In the light of the above, it appears that s 7(8) has the scope to apply in a wide range of circumstances. For example, it could apply where a resident arranges for an offshore trust to be formed which in turn forms an offshore company in which the trust holds all the equity shares.³⁰ The resident then makes an interest free loan to the trust which in turn makes an interest free loan to the company and the company utilizes it to generate foreign income. It is submitted that the foreign income generated by the company will be deemed to be the donor's in terms of s 7(8).³¹ It is clear that for s 7(8) to operate the income in question does not have to accrue to the person to whom the interest-free loan is made, so it does not matter that the income accrues to the company and not the trust. The issue here is simply whether the income accruing to the company is 'by reason of or in consequence of' the interest-free loan made by the donor to the trust. Is the necessary nexus between the loan and the income present? It is submitted that the nexus is present. The liberal approach to the interpretation of the term 'by reason of' adopted by the Appellate Division in *Widan's* case described above, as well as the combination of the phrases 'by reason of' and 'in consequence of' in s 7(8), could well lead to this conclusion. If the court is satisfied that it was the donor's 'all embracing design'³² that his interest-free loan to the trust should be 'on-lent' interest free to the company in order to generate income in the company's hands, it is unlikely that the court would find that this consequence 'is too remote for the law to treat as a consequence'.³³ It is unlikely that the 'on-lending' by the trust to the company will be viewed as a *novus actus interveniens* which severs the connection between the loan to the trust and the income accruing to the company.

What may also be of relevance here is the approach taken by the Appellate Division in *Erf 3183/1 Ladysmith (Pty) Ltd v CIR*³⁴ which might assist a court in the situation under scrutiny in inferring an agreement between the resident and the trust that the resident made the

²⁹ The quote is from *Pollock Law of Torts* 13 ed at 344 which the court approved of in *Widan's* case (n 28) above at SATC 352.

³⁰ The offshore company will accordingly not be a 'controlled foreign entity' within the meaning of s9D of the Act and, accordingly, the income accruing to the company will not be imputed to the resident by s9D.

³¹ Section 7(8) would clearly apply if the loan was made directly by the resident to the company.

³² See *Widan's* case (n 28) above at SATC 352.

³³ See *Widan's* case (n 28) above at SATC 352.

³⁴ 1996 (2) SA 942(A); 58 SATC 229.

loan to the trust on condition that the funds lent were on-lent by the trust to the company. Such an agreement would clearly support the conclusion that the income accruing to the company was 'by reason of or in consequence of' the interest-free loan made by the resident. In *Erf 3183/1 Ladysmith (Pty) Ltd v CIR*³⁵ the court found that in addition to certain written contracts there was an additional unwritten agreement that had to be inferred and which gave rise to tax liability.

The 'on-lending' attempt to avoid s 7(8), described above, is a fairly obvious one. However, other less obvious possibilities could be devised. For example, a variation on the above situation is one where the resident, instead of making the loan to the offshore trust, subscribes for redeemable preference shares in the offshore company and the company lends the proceeds of the issue interest free to the offshore trust which the trust uses to generate foreign income. Is the resident to be taxed on that income in terms of s 7(8)? It appears that the causation requirement ('by reason of or in connection with') is satisfied for the same reasons given in relation to the previous situation. In other words, the required nexus exists between the subscription for the shares in the company and the foreign income generated by the trust. However, has the resident made a 'donation, settlement or other disposition'? Is the subscription for redeemable preference shares in these circumstances a 'donation, settlement or other disposition', assuming that a market-related coupon rate is stipulated for in the terms of issue? If it is clear to a court that the company is simply an empty shell with the inability to pay any dividend, would the court find that there is the 'appreciable element of gratuitousness and liberality or generosity'³⁶ required for the subscription for the redeemable preference shares to constitute a 'disposition' within the meaning of 'donation, settlement or other disposition'? Would the court conclude that the resident has effectively made an interest free loan to the trust and ignore the company on the basis that it is a party interposed between the resident and the trust without serving any purpose other than tax avoidance?

The answer to these questions may depend to a large extent on whether our courts follow the so-called 'Ramsay' approach to tax avoidance,³⁷ which has sometimes been adopted in the United Kingdom. The Ramsay approach to tax avoidance arose in the United Kingdom as a result of the absence of a general anti-avoidance measure and the success of many complex avoidance schemes, which led the courts

'... to adopt what in effect amounts to an alternative general anti-avoidance

³⁵ *Ibid.*

³⁶ *Ibid.*

³⁷ Named after the decision of the House of Lords in *Ramsay v IRC* [1982] AC 300.

measure by changing their attitude to the application of tax statutes in avoidance cases'.³⁸

The Ramsay approach in applying a provision of the tax legislation involves the abandonment of the literal approach to tax avoidance schemes and is one whereby the courts will look at a series of transactions as a whole and not take each step at its face value. Where additional parties or transactions have been interposed without serving any purposes other than tax avoidance, the court, when adopting this approach, will ignore the interposed party or transaction. The development of this approach has been, as Morse says,

'uneven, with clear tensions between those judges who perceive their role as the guardians of public finance and those who take a moral restrictive view of their role'.³⁹

An example in the United Kingdom of the Ramsay approach is to be found in *IRC v McGuckian*⁴⁰ in which the shareholders of a company transferred their shares to an offshore trust. The trust then assigned its right to dividends about to be declared by the company to X for consideration which amounted to 99 per cent of the value of those dividends. On the face of it, whereas the receipt of the dividend in the hands of the trust would have been taxable, the consideration received was not. The House of Lords, in following the Ramsay approach, ignored the interposed transaction and taxed the trust as if it had received the dividend.

If the Ramsay approach was taken to the scheme in question it may be possible for the court to ignore the interposed company and the interposed transaction (the issue of the redeemable shares) and tax the resident as if he or she had made a loan (or donation) directly to the trust.

In the absence of local jurisprudence dealing with offshore structures, it is not inconceivable that South African courts may be swayed by foreign judgments including those in the United Kingdom adopting the Ramsay approach. The Ramsay approach has been applied in South Africa in other areas. Thus in *Relier (Pty) Ltd v CIR*⁴¹ in an attempt to avoid the provisions of paragraph (h) of the gross income definition, which includes

³⁸ See G Morse 'Countering Tax Avoidance – The South African and United Kingdom Experience' (1998) *JBL* 217. See also A Derksen 1990 (107) *SALJ* 416 and 2002 *Taxpayer* 82.

³⁹ *Ibid.*

⁴⁰ [1997] STC 908. See also *Burmah Oil v IRC* [1984] STC 153; *Furniss v Dawson* [1984] STC 153; *Craven v White* [1985] STC 531; *Fitzwilliam v IRC* [1995] STC 432; *DTE Financial Services Ltd v Wilson* (Inspector of Taxes) [2001] STC 777. Cf *Pigott v Staines Executors* [1995] STC 14; *Griffin v Citibank Investments* [2001] STC 1010; *MacNiven v Westmoreland Investments Ltd* [1997] STC 1103; [2001] STC 237; 2001 [2] WLR 377 (HL).

⁴¹ (1998) 60 SATC 1.

leasehold improvements in gross income, a scheme was entered into which interposed a tax exempt body between the owner of the land and the ultimate lessee. The issue was whether the owner had a right to have improvements effected to the land which it had leased to a provident fund which had, in turn, sub-let it in terms of a lease agreement which obliged the sub-lessee to effect the improvements. The Supreme Court of Appeal upheld Revenue's contention that the owner did have a right as envisaged in para (h) and that the value of improvements fell into the owner's gross income.⁴²

A further difference between the wording in s 7(8) and the other anti-avoidance provisions in s 7 (in addition to s 7(8)'s use of both phrases 'by reason of' and 'in consequence of') is that the latter deem the income which has the necessary nexus to the disposition to be the donor's, whereas s 7(8) requires the necessary nexus and then goes on to include in such person's income 'so much of the amount of any income as is attributable to'⁴³ such disposition. It is doubtful whether anything turns on this aspect of the difference in wording.

It is clear from *CIR v Widan*⁴⁴ that, as in the case of the other anti-avoidance provisions in s 7, s 7(8) can apply to 'income on income'. In other words, if, for example, a resident made a donation to an offshore trust and by reason thereof foreign investment income accrued to the trust which was reinvested, generating further foreign investment income, both the original investment income and the further investment income could be included in the donor's income in terms of s 7(8).

Where a s 7(8) disposition is not completely gratuitous, the income will have accrued by reason of or in consequence of both elements of gratuitousness and consideration, in which case an apportionment is necessary in order to give proper effect to the real efficient cause of the income.⁴⁵ Thus if a resident sells his or her foreign income-producing asset to an offshore trust for half of its market value, only half of the foreign income accruing to the trust will be included in the resident's income in terms of s 7(8). Where the assets are sold, as is very often the case, to the trust at market value on interest-free or low-interest loan account, an apportionment is required in terms of which the amount of income to be included in the resident's income in terms of s 7(8) is limited to the interest that would have been outstanding if interest at a reasonable

⁴² *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* (n 34) above indicates 'an embryonic *Ramsay* approach'. See *Morse* (n 38) above at 218.

⁴³ Writer's emphasis.

⁴⁴ See (n 28) above.

⁴⁵ See *Ovenstone v SIR* 1980 (2) SA 721 (A), 42 SATC 55 and *Joss v SIR* 1980 (1) SA 674 (T), 41 SATC 206.

rate of interest had been stipulated for.⁴⁶ The same applies where the resident makes an interest-free loan or low interest loan to the trust. The hypothetical question to be asked is what interest rate could reasonably have been charged on a loan of the currency that was actually lent. The amount of income included in the resident's income in terms of s 7(8) is then limited to that amount.

Where a disposition has given rise to income to which s 7(8) applies and also a capital gain to which an attribution rule in Part X of the 8th Schedule to the Act applies, the total amount of that income and gain cannot exceed the amount of the benefit derived from that disposition.⁴⁷ For example, if a donation of R100 is made to the trust and the total sum of the income and the capital gain attributable to the donation is R120, only R100 thereof can be attributed to the donor. The amount of the benefit derived from the disposition is R100.⁴⁸ What is not clear is how much of the R100 is to be treated as income and how much as capital gain. This is an important question because of the different tax treatment of income and capital gains. An equitable method of resolving the issue would be to apportion the R100 in the ratio that the attributable income and capital gain bear to the R100. So, for example, if the income in question is R80 and the capital gain R40 the portion of R100 that will be attributable to the donor as income would be R66,66 and the portion attributable as a capital gain, R33,33.⁴⁹

It is noteworthy from a tax planning point of view that the sale of the assets at market value on interest free loan account is more advisable than an outright donation. Apart from the donations tax implications of an outright donation, it is likely that all flows of income thereafter (until the resident's death or emigration) will be construed as being 'attributable' to the donation and accordingly taxable in the resident's hands in terms of s 7(8). On the other hand, in the case of 'cheap' loans, no donations tax is payable and, as far as s 7(8) is concerned, its applicability can be terminated through repayment of the loan. Section 7(8) also cannot operate in respect of income in excess of the outstanding notional

⁴⁶ See *Joss v SIR*; *C SARS v Woulidge* (n 24) above. In *Woulidge's* case it was decided that in making the apportionment, the *in duplum* rule has no application, which means that the notional amount of uncharged interest is not limited to the capital amount of the loan.

⁴⁷ Para 73 of the Eighth Schedule. 'Benefit' means 'the amount by which the person to whom that donation, settlement or other disposition was made, has benefited from the fact that it was made for no or an inadequate consideration, including consideration in the form of interest' (para 73(2)).

⁴⁸ In the case where there is no donation but an interest free or low interest loan the benefit appears to be the amount of interest that the recipient of the loan would have had to pay having regard to a notional market-related rate of interest. This is what seems to be implied in the definition of 'benefit' in para 73(2) where reference is made to a disposition made 'for no or an inadequate consideration, including consideration in the form of interest'.

⁴⁹ $\frac{80 \times 100}{120} = 66,66$ and $\frac{40 \times 100}{120} = 33,33$

interest. Sight must, however, not be lost of the possibility of Revenue applying the transfer pricing provision⁵⁰ so as to deem the resident to have received a market-related rate of interest on the loan.

(4) *Residency requirement*

Section 7(8) is only applicable if the donation, settlement or other disposition was made by a resident. This raises the question whether s 7(8) can apply where a person prior to becoming a resident made a donation, settlement or other disposition and by reason of or in consequence thereof foreign income accrues to an offshore trust after the person becomes a resident. In other words, does s 7(8) only apply if at the time the disposition was made the person making it was a resident? It will be recognized that, if the narrower interpretation is the correct interpretation, it would be simple for an immigrant to South Africa to avoid the application of s 7(8) by donating his or her foreign income-producing assets to a discretionary offshore trust prior to becoming a resident.⁵¹

It is submitted that s 7(8) is ambiguous in this regard and being a provision designed to prevent tax avoidance a court may give it its wider meaning. As stated by Botha JA in *Glen Anil Development Corp Ltd v SIR*,⁵² the *contra fiscum* rule of interpretation does not apply to tax avoidance provisions and they should be interpreted

‘. . . in such a way that it will advance the remedy provided by the section and suppress the mischief against which the section is directed.’⁵³

If the disposition giving rise to the operation of s 7(8) was an interest-free or low-interest loan and the loan is still outstanding when the non-resident becomes a resident, it is arguable, on the basis that the loan is a continuing donation, that s 7(8) becomes applicable once residence status is attained. In *CIR v Berold*⁵⁴ Hoexter JA held:

‘When the taxpayer sold and transferred a large number of valuable assets to Luzen, he did so on credit and without charging interest on the purchase price. In effect he lent a substantial sum of money to Luzen, and as long as he refrained from compelling Luzen to repay that sum, there was a *continuing donation* by him to Luzen of the interest on that loan.’⁵⁵

It must also be borne in mind that in these circumstances, no matter what form the disposition takes, if foreign income accrues to the offshore trust and is not distributed in the year of accrual, but is retained and

⁵⁰ Section 31(2) of the Act.

⁵¹ Donations tax is not payable on donations made by non-residents. See s 54 of the Act.

⁵² 1975 (4) SA 715 (A).

⁵³ At 727–28.

⁵⁴ 24 SATC 729.

⁵⁵ At 735–36 (writer’s emphasis).

capitalized, it is possible that s 7(5) of the Act may operate and deem the income to be the immigrant's in that year.

Section 7(5) of the Act provides as follows:

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

It is not an express requirement of s 7(5), as it is in s 7(8), that the donor must have been a resident at the time the donation was made and it is difficult to see how such a requirement can be implied.

What is contentious regarding s 7(5) is whether the exercise of a discretion is an 'event' as contemplated by s 7(5). The issue remains controversial although the Appellate Division, in *Estate Dempers v SIR*,⁵⁶ despite finding it unnecessary to decide the issue, nevertheless found some force in arguments made by counsel for the taxpayer in support of the view that in the context of a provision similar to s 7(5) such an exercise of a discretion was not an event. It may of course be, and this is very likely, that it is stipulated in the trust deed that the trust is to come to an end after a fixed time, in which case the arrival of the date of termination will be an 'event' for the purposes of s 7(5) and there will be no need for Revenue to argue that the exercise of the discretion is an event.⁵⁷

It is also noteworthy that s 7(5) cannot apply if the income is distributed by the trust to a trust beneficiary in the year that it accrues to the trust. So, in order to avoid the application of s 7(5) and s25B (which would apply if the trust beneficiary was a resident), the immigrant could arrange for the income to be distributed to a non-resident (for example an offshore company or another offshore trust).

If the donor is a resident when the disposition was made and then ceases to be a resident, can s 7(8) continue to operate in respect of such person? It is clear that it cannot operate in respect of foreign income but what is the position if it is local income? The words in s 7(8) 'there shall be included in the income of such resident' perhaps indicate that the donor

⁵⁶ 1977 (3) SA 410(A).

⁵⁷ This is in effect what happened in *Estate Dempers v SIR* 1977 (3) SA 410 (A) and also in *SIR v Sidley* 1977 (4) 913 (A).

must be a resident at the time when the income is included in his income in terms of s 7(8). However, clarification is called for.

If Revenue is not able, for the reasons given above, to tax the immigrant in terms of either s 7(8) or s 7(5) and capitalized income is, in a year subsequent to the year of accrual to the trust, distributed to the immigrant or some other resident beneficiary, s 25B(2A) may apply. Section 25B(2A) is dealt with below.

(5) *Retrospectivity*

It is not clear whether s 7(8) applies to dispositions made prior to its commencement.⁵⁸ Revenue apparently takes the view that s 7(8) does apply. In support of the view that it does not apply is the fact that the legislature has seen fit to provide expressly that s 7(7) applies to dispositions made prior to its commencement.⁵⁹

(6) *Recovery of tax*

As in the case where the 'donor' is taxed in terms of s 7(3), (4), (5), (6) or (7), the 'donor' who is taxed in terms of s 7(8) may recover the tax paid from the offshore trust in terms of s 90(c). The rationale behind these anti-avoidance provisions is not to penalize the donor but to tax the income at the 'donor's' marginal rate of tax.

(7) *The proviso*

The proviso in s 7(8) ensures that the donor is afforded the same treatment regarding foreign dividends as he or she would have if he or she had been a shareholder of the company distributing the dividend income referred to in the proviso.

(8) *Disclosure*

Any resident who makes any donation, settlement or other disposition contemplated in s 7(8)⁶⁰ is required to disclose that fact in writing to the Commissioner when submitting his return for the year in which the disposition is made and at the same time furnish such information as may

⁵⁸ Section 7(8) came into operation on 1 January 2001 and applies in respect of years of assessment commencing on or after that date. Its predecessor, s 9D(3) came into effect on 1 July 1997.

⁵⁹ Section 7(7) expressly applies to dispositions made prior to the commencement of 'the Act' but, as has been pointed out, the necessary implication is that it applies to dispositions made prior to the commencement of the section. See D Clegg and R Stretch 'Income Tax in South Africa' (Butterworths) para 17.3.7.

⁶⁰ And also in any other provision in s 7.

be required by Revenue for the purposes of the section.⁶¹ The implication of the wording of s 7(10) is that the disclosure of dispositions made prior to its commencement⁶² is not required.

Failure to comply with the disclosure obligation in s 7(10) can lead to criminal sanctions.⁶³ Default can also lead to the raising of additional assessments in terms of s 79 of the Act and also to the falling away of the three-year limit on re-opening assessments laid down by s 79.⁶⁴

Section 7(8) is not a provision that, like s 103(1) (the general anti-avoidance provision), must be invoked by Revenue in order for it to operate. Section 7(8) operates of its own accord and requires the taxpayer to disclose the income that is deemed to accrue to him in terms thereof. It appears therefore that the disclosure obligation imposed by s 7(10) does not really create any new obligation that did not exist prior to the enactment of s 7(10). Section 7(10) simply reinforces a pre-existing obligation and also 'sweeps away any possible plea for mitigation based on ignorance of the requirement to report'.⁶⁵

III SECTION 25B(2A)

(1) *General*

The other specific anti-avoidance provision aimed at the avoidance of tax through the use of offshore trusts is s 25B(2A).

Section 25B(2A) provides as follows:

'Where during any year of assessment any resident acquires any vested right to any amount representing capital of any trust which is not a resident, and –

(a) such capital arose from –

(i) income received by or accrued to such trust; or

(ii) any receipts and accruals of such trust which would have constituted income if such trust had been a resident

in any previous year of assessment during which such resident had a contingent right to such income or receipts and accruals; and

(b) such income has or receipts and accruals have not been subject to tax in the Republic in terms of the provisions of this Act,

such amount shall be included in the income of such resident in such year of assessment.'

⁶¹ See s 7(10) of the Act which came into operation on 1 January 2001 and applies in respect of years of assessment commencing on or after that date.

⁶² *Ibid.*

⁶³ See s 75 and s 104 of the Act.

⁶⁴ The general rule is that an assessment cannot be raised in respect of an amount more than three years after the year of assessment in which the amount should have been assessed. The general rule, however, does not apply if, *inter alia*, there has been non-disclosure of material facts. See s 79(1)(f).

⁶⁵ See (2002) Tax Shock: Trust Save/Cost Tax? BSP Seminars 36.

Section 25B(2A) is aimed at the accumulation by an offshore discretionary trust of foreign income beyond a year-end with the idea that it will be distributed as a capital and, accordingly, non-taxable award to a resident beneficiary. The trust being a non-resident cannot be taxed on the income. Section 25B(2A) overrides any possible argument that when the accumulated income vests in the beneficiary it is of a capital nature and therefore not taxable.

(2) *'Income'*

As in the case of s 7(8), 'income' must be received by or accrue to the trust and, accordingly, if the trust funds are invested in funds or bonds or other instruments which confer no right to income ('roll-up' funds and 'wrap bonds'), s 25B(2A) cannot apply.

Section 25B(2A) does not suffer from the same possible flaw that s 7(8) might suffer from, namely that it cannot apply to foreign income.⁶⁶ When s 25B(2A) was first introduced it did have this defect but this was rectified.⁶⁷ The wording of s 25B(2A)(a)(ii) now makes it clear that s 25B(2A) applies to foreign income. Section 25B(2A) is, however, not only applicable to foreign income. It is clear from s 25B(2A)(i) that it also applies to South African source income. However, as in most instances such income will be 'subject to tax' in South Africa in terms of the other provisions of the Act, it will be excluded by s 25B(2A)(b).

At first blush the reference to 'any previous year of assessment' in s 25B(2A)(a) indicates that s 25B(2A) can apply to a foreign amount that was received by or accrued to the trust in a year prior to the coming into effect of s 25B(2A).⁶⁸ However, in terms of s 25B(2A)(a)(ii), the provision can only apply to such a receipt or accrual if it would have constituted income if the trust had been a resident at the time of the receipt or accrual. Accordingly, s 25B(2A) cannot apply to pre-1 January 2001 receipts and accruals because, being non-South African source, they would not have constituted 'income' at that time.⁶⁹

(3) *No double taxation*

It is clear from s 25B(2A)(b) that if the accumulated foreign income has been subject to tax in South Africa in terms of s 7(5) or s 7(8) of the Act it cannot be taxed again in terms of s 25B(2A). Double taxation is therefore

⁶⁶ See above.

⁶⁷ By s 14(b) of the Revenue Laws Amendment Act 19 of 2001.

⁶⁸ Section 25B(2A) came into operation on 1 January 2001 and applies in respect of years of assessment commencing on or after that date.

⁶⁹ At that time the 'gross income' definition did not distinguish between residents and non-residents and a requirement of the definition was that the receipt or accrual had to be from a South African source or deemed to be from a South African source.

averted. Accordingly, it will only be in those circumstances where the pre-conditions for the operation of s 7(5) and s 7(8) (for example, that there has been a donation, settlement or other donation) have not been met, that s 25B(2A) will come into the picture.

(4) *No choice*

It is submitted that if s 7(5) or s 7(8), as the case may be, has not been applied to income in the year of its accrual to the trust, in circumstances in which one or both of these provisions was applicable, Revenue will be unable to apply s 25B(2A) to the accumulated income in a subsequent year when it is distributed as capital. It was 'subject to tax' as required by s 25B(2A) in the year of accrual to the trust and Revenue, accordingly, does not have a choice whether to apply s 7(5) or s 7(8) in the year of accrual of the income to the trust, on the one hand, or s 25B(2A) in the year of distribution of the accumulated income, on the other.

(5) *'Contingent right'*

For s 25B(2A) to operate, it is essential that the beneficiary in whom the capital is vested had a contingent right to the income (that has been capitalized and vested in him or her) in the year that it accrued to the trust.⁷⁰ So, for example, if capitalized income is distributed to a trust beneficiary who only became a trust beneficiary subsequent to the year in which the income accrued to the trust, s 25B(2A) cannot operate.

It also follows that if an award is made to a beneficiary out of 'genuine' capital as opposed to capitalized income, s 25B(2A) cannot operate. Care will have to be taken to ensure that 'genuine' capital is identifiable as such so as to prevent any dispute as to the source of an award, bearing in mind that money loses its identity through *commixtio*.⁷¹ Transferring all income in the year of its accrual to another offshore trust may be a prudent way to achieve this. The onus of proving that the distribution has been made out of genuine capital is, of course, on the taxpayer.⁷²

What constitutes a 'contingent right' to income within the context of s 25B(2A)? There is little doubt that the term is used in its technical sense and in contrast to the term 'vested right' which is also used in s 25B(2A). When all the investitive or operative facts which are necessary to create a right have occurred then the right is said, in the technical sense, to have vested.⁷³ By contrast where one or more of the investitive facts has already happened, but one or more has not yet happened, and may never happen, the prospective right is contingent in the technical sense of that

⁷⁰ See s 25B(2A)(a).

⁷¹ Foreign trustees should obviously have s 25B(2A) brought to their attention.

⁷² See s 82 of the Act.

⁷³ See D V Cowen 'Vested and contingent rights' 1949 *SALJ* 404 406.

term.⁷⁴ Thus in *Jewish Colonial Trust Ltd v Estate Nathan*⁷⁵ Watermeyer CJ observed that the word 'vest' is used 'to draw a distinction between what is certain and what is conditional: a vested right is distinguished from a conditional right'. In *Durban City Council v Association of Building Societies*⁷⁶ the same judge pointed out that the word 'contingent' as opposed to 'vested' 'is used to describe the conditional nature of someone's title to the right'. It thus follows that if a trust instrument provides, for example, that the trust's income shall be accumulated and distributed to a trust beneficiary when, for example, he or she gets married, the trust beneficiary has a contingent right to the income. As the investitive fact necessary to create the vested right, namely, getting married, has not happened and may never happen, the right is contingent. As Cowen says:

'Now, though it is true that during the period of pendency, while it remains uncertain whether an inchoate and conditional title will be completed, the expectancy of a benefit is strictly speaking merely in the process of becoming a right, it is, nevertheless, expedient to continue to use the well-known expression contingent (conditional, inchoate) right. As we shall see presently, the expression is in fact frequently used in its technical sense in some important branches of our statute law. Moreover, as *von Tuhr* observes, popular usage in this regard is fully justified; for when part of the title of a right has already occurred, the law may reasonably, and generally does, regard the chance or possibility of an eventual right as being sufficiently real to recognize and protect in various ways, and such recognition and protection is, after all, characteristic of the notion of a legal right.'⁷⁷

Section 25B(2A) is undoubtedly aimed primarily at *discretionary* offshore trusts and this raises the vital question whether a beneficiary of such a trust has a contingent right within the meaning of the provision. Some commentators⁷⁸ are of the view that the interest of such a discretionary beneficiary may not be a 'contingent right' but more properly described as a *spes*, ie a mere 'hope'. It is submitted that the interest of a discretionary beneficiary is a 'contingent right' within the meaning of s 25B(2A). As Honore and Cameron say:⁷⁹

'If, however, the trustee has a discretion not merely how but also whether to pay income or distribute capital to the beneficiary the latter's right is merely contingent. The same is true if the trustee has a discretion as to how much to

⁷⁴ *Ibid.*

⁷⁵ 1940 AD 163 at 175.

⁷⁶ 1942 AD 27 at 33.

⁷⁷ See (n 73) above at 407–408.

⁷⁸ See e.g. D Clegg and R Stretch 'Income Tax in South Africa' (Butterworths) para 17.3.8.

⁷⁹ T Honore, E Cameron *Honore's South African Law of Trusts* 4ed (Juta & Co Ltd) 473.

pay or distribute. One advantage of this is that a merely contingent right is not in general subject to income tax nor does it form part of the beneficiary's estate for insolvency or estate duty purposes.⁸⁰

(6) *Avoidance of s 25B (2A)*

A devious way of possibly avoiding the application of s 25B(2A) would be to provide in the trust deed that no income may be awarded to a resident beneficiary by the trust in the year that it accrues to the trust. The argument could then be that when capitalized income is distributed to a resident beneficiary, s 25B(2A) is not applicable because in the year that the income accrued to the trust the beneficiary did not have a contingent right to the income. It is submitted that on the current wording of s 25B(2A), Revenue may have difficulty in applying the provision and that legislative amendment may be necessary to close this loop-hole.

It may be that s 103(1) of the Act (the general anti-avoidance provision) could be applied to such a ploy. It is clear that there is a scheme, the effect and purpose⁸¹ of which is to avoid normal tax, and the only real hurdle which Revenue has to overcome is that it will have to prove⁸² that the 'abnormality' requirement of s 103(1) has been satisfied. The extraordinary fact that a resident beneficiary can only be awarded the income once it has been capitalized may satisfy the court that the scheme has created a right or obligation which would not normally be created between persons dealing at arm's length, in which case the 'abnormality' requirement will be met.⁸³ On the other hand if the liberal approach taken by the Supreme Court of Appeal in *CIR v Conhage (Pty) Ltd* (formerly *Tycon (Pty) Ltd*)⁸⁴ is adopted, Revenue may be unsuccessful. In terms of the judgment in that case, a taxpayer who sets out to achieve a *bona fide* commercial objective can do so through a structure specifically aimed at the avoidance of tax even though the contracts involved in such structure create abnormal rights and obligations. Also in the taxpayer's favour is the fact that the abnormality requirement in s 103(1) is expressly required by the section to be viewed 'having regard to the circumstances under which the transaction, operation or scheme was entered into or

⁸⁰ Cases cited by Honore and Cameron in support are *CIR v Sive's Est* 1955 1 SA 249 (A), 1955 1 PH G1 (A); *Est Munro v CIR* 1925 TPD 693, 1 SATC 163; *De Beer v CIR* 1932 CPD 443, 5 SATC 287; *Hulett v CIR* 1944 NPD 263 269, 13 SATC 58; *Burger v CIR* 1956 1 SA 534 (W), 1956 1 PH T5 (W).

⁸¹ It must be borne in mind that once Revenue has proved that the effect is to avoid tax the onus swings to the taxpayer to prove that the sole or main purpose was not to avoid tax (s 103(4)).

⁸² See *CIR v Conhage (Pty) Ltd* (formerly *Tycon (Pty) Ltd* 61 SATC 391; 1999 SA (4) 1149 (SCA) where it was decided that the onus of proving 'abnormality' is on Revenue.

⁸³ See s 103(1)(b)(ii).

⁸⁴ See (n 82) above.

carried out'.⁸⁵ Also, a special relationship between the parties must be taken into account to give effect to the concluding words in s 103(1)(ii) which refer to 'the nature of the transaction, operation or scheme in question'.⁸⁶ These requirements narrow down the ambit of what constitutes abnormality in the particular circumstances and makes Revenue's task more onerous.

(7) 'Trust'

For s 25B(2A) to operate the income must accrue to an offshore 'trust'. The definition of 'trust' in the Act⁸⁷ provides that a 'trust' means:

'... 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.'

Whether a particular offshore institution meets the requirements of this definition will depend on the facts. Of significance in this regard is whether the so-called 'non-charitable purpose trusts'⁸⁸ constitute trusts within the definition meaning. Certain jurisdictions,⁸⁹ for example the Isle of Man,⁹⁰ the British Virgin Islands,⁹¹ Jersey,⁹² the Cayman Islands⁹³ and Mauritius⁹⁴ recognize the establishment of a trust without ascertainable beneficiaries, but with a particular purpose (which need not be charitable) stated in the trust instrument. An independent 'enforcer' is usually appointed in the trust instrument. The main feature of such trust is the lack of ascertainable beneficiaries rather than the ability to establish a trust for a particular purpose (which may bear little resemblance to its true purpose), and it is this characteristic that has attracted the business and estate planning community. These trusts are widely utilized to disguise and obfuscate ownership of assets and other structures. An enlightening comment on the usefulness of such trusts is as follows:

⁸⁵ See *Hicklin v SIR* 1980 (1) SA 481 (A), 41 SATC 179.

⁸⁶ See *SIR v Geustyn, Forsyth & Joubert* 1971 (3) SA 567 (A), 33 SATC 113; *CIR v Louw* 1983 (3) SA 551 (A), 45 SATC 113.

⁸⁷ See s 1.

⁸⁸ Also known as 'STAR' trusts.

⁸⁹ English law does not recognize non-charitable purpose trusts and this is one of the most controversial issues in the contemporary trust scene. See P Baxendale-Walker 'Purpose Trusts – the Definitive Discussion' (published by Butterworths, London).

⁹⁰ See the Purpose Trusts Act 1996.

⁹¹ See s 584 of the Trustee Act.

⁹² From 24 April 1996 Jersey Law recognized the creation of non-charitable purpose trusts.

⁹³ The Cayman Islands has the so-called STAR Trust regime. See A Duckworth *STAR Trusts* (published by Gostick Hall Publications).

⁹⁴ See the Offshore Trusts Act 1992.

‘During the trust period the assets can be, but do not have to be, applied towards the purpose. Simply holding the assets in itself can be a purpose. At termination of the trust, the remainder of the assets, if any, must be disposed of in favour of the ultimate recipient. Considering that the enforcer could be remunerated, various structures holding assets for ultimate recipients, with or without payments at intervals during the duration of the trust and with the benefit of insulation from beneficial ownership, can be envisaged. Funds applied to the purpose during the duration of the trust could furthermore indirectly benefit the ultimate recipient or anyone else who the trustees may want to benefit, as long as the enforcer has no reason to believe that it is contrary to the purpose. All of this makes the purpose trust a very flexible planning tool.’⁹⁵

Whether a trust without beneficiaries could constitute a trust as defined in our Act depends on whether the trustee can be said to be acting in a fiduciary capacity, an essential requirement of the definition. The trustee clearly has contractual duties but whether he or she is acting in a fiduciary capacity depends on how widely the term ‘fiduciary’ is interpreted.⁹⁶

It is noteworthy that if the purpose trust is not a trust as defined in the Act, s 7(8) also cannot apply to income accruing to it or received by it. A trust is not a juristic person⁹⁷ and, accordingly, if it is not a ‘trust’ as defined and therefore not a ‘person’ as defined in the Act,⁹⁸ s 7(8) cannot apply.

In the context of the ‘trust’ requirement in s 25B(2A) it is relevant to note that in certain circumstances Revenue may be relieved of having to resort to anti-avoidance provisions in the Act. It may be able to prevent the avoidance of tax by attacking the integrity of the trust. In other words, Revenue may be able to have the trust set aside as a sham in which case

⁹⁵ See E Cassell Maitland & Co <http://www.maitlandco.com/article4.htm>.

⁹⁶ It is of interest that the definition of a trust in the Trust Property Control Act 57 of 1988 is wide enough to cover a purpose trust. It provides that:

“‘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 . . .’

The common law definition of a trust is also wide enough to cover a purpose trust. According to Honore and Cameron (Honore’s *South African Law of Trusts* by T Honore and Cameron 4ed Juta & Co Ltd at 3) ‘a trust exists when the creator of the trust, whom we will call the founder, has handed over or is bound to hand over to another the control of property which, or the proceeds of which, is to be administered or disposed of by the other (the trustee or administrator) for the benefit of some person other than the trustee as beneficiary, or for some impersonal object’.

⁹⁷ See *CIR v Friedman and Others* 1993 (1) SA 353 (A); 55 SATC 39.

⁹⁸ The definition of ‘person’ in s 1 of the Act includes a ‘trust’ as defined.

the trust's assets will be regarded as still beneficially vested in the settlor of the trust. Any 'trust' income will accordingly be the settlor's income and no resort to any anti-avoidance measure will be necessary. In order for Revenue to succeed in this regard the court will have to be satisfied that the trust is a façade, that the settlor had no real intention⁹⁹ to pass ownership and control of his or her assets to the trustees. What is of substantial importance in this regard is the fact that Revenue does not bear the onus of proving that the trust is a sham. Revenue may simply assess the settlor on the trust income and in order for the settlor to successfully object to the assessment the onus provision in s 82 of the Act would require the settlor to prove that the trust is genuine.¹⁰⁰

IV CONCLUSION

The extent to which the legislature has closed the door on attempts to avoid tax on foreign income through the use of offshore trusts depends largely on how widely the courts interpret the specific anti-avoidance provisions, s 7(8) and s 25B(2A). It may also rest on legislative amendments to these provisions to eliminate uncertainties and loopholes created by the chosen wording. Elaborate structures combining offshore trusts and offshore companies, sometimes in multiples, aimed at avoiding s 7(8), s 25B(2A) and s 9D, are already very much in evidence and likely to proliferate. Consequently, Revenue will have to use all the means at its disposal if the residence based tax system is to be effective.

Success in applying s 103(1) may be hampered if the liberal approach adopted by the Supreme Court of Appeal in *CIR v Conhage (Pty) Ltd* (formerly *Tycon (Pty) Ltd*)¹⁰¹ is followed. The attitude exhibited by the court in this case will also not inspire Revenue with much confidence in a court adopting the *Ramsay* approach to tax-avoidance followed in the United Kingdom, although cases such as *Relier (Pty) Ltd v CIR*¹⁰² and *Erf 3183/1 Ladysmith (Pty) Ltd v CIR*¹⁰³ may raise Revenue's expectations. Ultimately, the inadequacy of the anti-avoidance provisions in dealing in certain cases with the ingenuity of tax planners may force Revenue as a last resort to attack the integrity of the trust.

⁹⁹ Regarding the intention to create a trust see Honore and Cameron (n 79) above at 96 ff.

¹⁰⁰ It is unnecessary for Revenue to have to resort to the court of the foreign country where the trust was formed where the burden of proof is almost certainly going to be on Revenue and where the integrity of the trust is likely to be vindicated. An example of a case where it was not vindicated is *Rahman v Chase Bank* 1991 JLR 103 (Royal Court of Jersey).

¹⁰¹ See (n 82) above.

¹⁰² See (n 41) above.

¹⁰³ See (n 34) above.