CERTAIN ASPECTS RELATING TO THE TAXATION OF COLLECTIVE INVESTMENT SCHEMES IN SOUTH AFRICA

In partial fulfilment of the requirements of the Masters in Law,
University of Cape Town, 2004

Lecturer: Professor DM Davis

Student: Stewart Truswell

September 2004

Summary Index

Executive Summary

This paper examines certain aspects of the taxation relating to collective investment schemes (sometimes referred to- both generally and in this paper- as unit trusts), particularly equity collective investment schemes structured as trusts.

1. Background information on the collective investment scheme industry will be provided. A summary of how collective investment schemes operate in practice will be provided, together with an example of a model trust deed.

2. A summary of trusts and their taxation will be provided, with a conclusion of the relevance of these to the collective investment schemes.

3. The provisions of the Income Tax Act relevant to the collective investment schemes in question will be summarised.

4. From this the 'open' taxation questions in relation to the collective investment schemes will be determined. These questions will be analysed in the light both of case law and policy considerations.

5. Conclusions will be outlined.

1. An Introduction to the Collective Investment Scheme Industry in South Africa Including The Definitions of a Collective Investment Scheme and Management Company

An Introduction to the Collective Investment Scheme Industry in South Africa

In essence a collective investment scheme (formerly, and sometimes still, known as a 'unit trust'- this paper too still refers to 'units' and 'unit holders' whereas the formal terms per the Collective Investment Schemes Control Act are 'participatory interests' and 'investors') comprises an aggregated 'pool' of investments obtained from members of the public and managed by a professional fund manager.

Collective investment schemes were first introduced into South Africa in 1965. The ensuing times having, in the main, seen equities as an asset class perform well.

In general, historically, equities as an asset class have provided a higher level of returns than other asset classes. As an example, since 1964 equities have outperformed property as an asset class by approximately 2,75% per annum. Since 1960, equities have outperformed cash by approximately 5,8% p.a., and outperformed inflation (CPI) by nearly 8% p.a.

But this level of return by its nature comes with a higher level of risk. One manifestation of this higher risk is the higher variability of return. To demonstrate this simplistically, one can note the following, with reference to the above outperformance by equities (note that the following time intervals are being referred to: 1. end Feb 1990 to end Feb 1995; 2. end Feb 1995 to end Feb 2000; 3. end Feb 2000 to end June 2004)

- Property has outperformed equities cumulatively for the second and third of those three intervals;
- Cash has outperformed equities cumulatively for each of those three intervals;
- Bonds have outperformed equities cumulatively for each of those three intervals.

(Of course other asset classes have volatility too.)

Collective investment schemes have proved a key way for 'the man in the street' in South Africa to gain access to investments in shares, and other asset classes, managed by professional investment managers. Without pooling, the individual with relatively modest assets would not

have been able to access such specialised investment skills. The risk of even small investment amounts is thus spread. Further, there are economies of scale in relation to administration and similar costs when compared to making small direct investments.

Collective investment schemes are governed by the Collective Investment Schemes Control Act (refer below), which provides inter alia for the manner in which the investment activities must take place including as to restrictions thereon.

Collective investment schemes have become a popular form of saving in South Africa. Ntoi notes:

> "A historical glimpse of the local savings environment shows the phenomenal rise of unit trusts as a receptacle for domestic savings. From a 1.28% share of the local savings market at the end of the first quarter of 1990, unit trust investments made up 5,66% of the entire savings pie in South Africa at the end of 2000. The rise in the proportion of local savings housed in unit trusts seems to have come at the expense of banking deposits...A look at the most current allocation data shows that the pattern has not changed much since the end of 2000. Unit trusts now make up about 5,80% of the savings market. This might be because of the restructuring of many investment vehicles into unit trusts with the advent of capital gain tax. Some may also argue that the growth in the proportional allocation of savings to unit trusts has come as a result of big movements in the market. However, a simple regression analysis shows that only 22% of the changes in total size of unit trust industry can be attributed to capital gains in the stock market."

Ntoi goes on to note that there appears, prima facie, scope for unit trusts to increase their share of the investment pie, given that, for example, in Australia the unit trust industry accounted for 11,70% of the total savings in that economy at the end of 2001. Although the lack of bank deposit data in the UK makes a direct comparison impossible, Ntoi concludes that the allocation of UK savings to unit trusts is higher than in South Africa.

At 30 June 2004 there were 497 registered unit trust funds, in a wide variety of classifications (domestic, foreign, and worldwide) with sub-categories, housing investments totalling approximately R268bn.

The Definition of a Collective Investment Scheme

The Collective Investment Schemes Control Act, 2002, defines a collective investment scheme to mean

"a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which-

(a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and
(b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or any other basis determined in the deed,

but not a collective investment scheme authorised by any other Act;"

A 'manager' defined to mean "[a] person who is authorised in terms of this Act to administer a collective investment scheme".

A 'participatory interest' is defined to mean "[any] interest, undivided share or share whether called a participatory interest, unit or by any other name, and whether the value of such interest, unit, undivided share or share remains constant or varies from time to time, which may be acquired by an investor in a portfolio".

The Collective Investment Schemes Control Act replaced The Unit Trusts Control Act 54 of 1981 (as amended), which had defined a unit trust scheme as:

> "any scheme or arrangement <u>in the nature of a trust</u> in pursuance of which members of the public are invited or permitted, as beneficiaries under the trust, to acquire an interest or undivided share (whether called a unit or by any other name) in one or more unit portfolios and to participate proportionately in the income or profits derived therefrom" (emphasis added).

For the purposes of this paper, it is worth highlighting certain key differences between the Collective Investment Schemes Act and the Unit Trust Control Act. In particular the former (newer) Act sought to bring South Africa closer into line with international investment developments. This included allowing a larger range of investment opportunities for some or all of the public than previously, and creating the framework and specifying the circumstances in which this increased investment scope will occur. This includes that structures (e.g. Open Ended Investment Companies), other than merely trust structures, are now permitted and governed by the Collective Investment Schemes Act.

In summary, any structure, including a trust structure, which "pools" investments and is available to the public is governed by the Collective Investment Schemes Act. The Collective Investment Schemes Control Act does not define the public *per se*, other than to note certain parties included in the term "members of the public" and that the term excludes "persons confined to a restricted circle of individuals with a common interest who receive the invitation in circumstances which can properly be regarded as a domestic or private business venture between those persons and the person issuing the invitation".

In practice, certain industry players seeking to bypass the restrictions of this Act (including as to either or both of: firstly, the requirement for management companies; or, secondly, on the restrictions on a unit trust's investment activities) have interpreted the definition of public to exclude the 'sophisticated' investor, i.e. one who is, in relative terms, more one or more of knowledgeable or wealthy. The Financial Services Board ('FSB'), which has the responsibility for regulating the collective investment scheme industry's activities, has been known to take a broad definition, i.e. any two legal entities coming together to pool their investments into a trust structure would, from the FSB's perspective, constitute the public.

This means that the Collective Investment Schemes Act has very wide application. Almost any investment which has involved the 'pooling' of funds and has not fallen within the scope of legislation applicable to the insurance industry would fall within its scope, thus in practice limiting seriously the scope for pooled investment activities.

In practice by far the majority of collective investment schemes are still in the nature of trusts, i.e. as described in the old Unit Trusts Control Act, and it is these structures which this paper will address.

Description of the Workings of Collective Investment Schemes

The Scheme

In effect the 'scheme' is the trust arrangement between the manager and the trustee, as recorded in the trust deed. This is the main structure, without which there can be no 'offering'. In the deed, the parties determine their respective rights and obligations and the rights and obligations of investors. This then is the 'scheme' that is offered to investors. (The term is not a defined term in the Collective Investment Schemes Control Act.)

The collective investment scheme is, in the case of the trust-type structures, includes a separate fund, which is approved by and registered with the Financial Services Board.

Annexure A shows an example of a model trust deed.

The Manager

The manager is in effect responsible for all operational issues relating to the scheme, including the asset management of the unit trusts, although the asset management and a variety of other duties may be outsourced to others.

To operate as a manager, one must be registered by the Registrar and meet certain criteria.

The Collective Investment Schemes Act lists the duties of the manager which include that conflicts of interest between it and the investor must be avoided, that proper records be maintained, etc.

It is also necessary that the manager have a specified minimum level of capitalization, and that the manager must always invest 'seed capital' in new funds until the fund size reaches a statutory minimum level.

The Trustee/Custodian

A scheme can either be based on a trust structure or (since the introduction of CISCA on 3 March 2003) on an Open-ended investment company (OEIC) structure.

In the case of a trust structure the entity fulfilling fiduciary duties is called the trustee and in the case of an OEIC structure it is called the custodian. (In other words one scheme has either a trustee or a custodian, depending on the scheme structure.)

In effect it is the role of the trustee/custodian to take care of the fiduciary functions and to safeguard the assets of the investors, including ensuring that those assets are always kept separate from the assets of the manager.

In Practice

The unit holders invest into the fund, obtaining a pro-rata shared interest in the pool of the funds invested. Thus, if, prior to a unit holder's investment, the total funds invested are R100, and the new unit holder invests R25, the new unit holder will, immediately on investment, have a 20% interest in the fund (R25/ R125), and, until any subsequent investment of divestment, be exposed to 20% of the gain or loss in the funds.

The manager is responsible, in terms of CISCA to manage the portfolios (funds) created under the deed. (Portfolios can be created (initially) within the main deed or by way of supplemental deed to the main deed.) The manager therefore gets this responsibility as a party to the deed (i.e. the contract between the manager and the trustee, forming the scheme). Should the manager outsource the actual asset management task to a third party asset manager, the manager stands in a principal capacity and the third party asset manager manages the assets as the manager's agent. However, it is important to note that the manager, at all times acts on behalf of the scheme (i.e. the "trust") and only has powers allocated to it within the deed, with such powers including items prescribed by law.

The manager has a statutory obligation, also recorded in the scheme, to repurchase any units offered to it by any investor. The exact mechanics of how this takes place operationally is contained in the deed to ensure operational efficiencies for all parties. The manager does this repurchase on behalf of the portfolio (actually on behalf of the overall scheme, because the portfolio itself does not have a "life" without it being part of the scheme).

2. Trusts

Background

This paper is not about trusts or their taxation *per se*, but consideration of certain of the key principles relating thereto is relevant to a consideration of taxation in relation to collective investment schemes.

Trusts were not originally a South African concept. The first SA case on the validity of a trust was *Estate Kemp v McDonald's Trustee 1915 AD 494* (involving a testamentary trust). The court here concluded that whilst the English law of trusts formed no part of our jurisprudence, the concept of placing assets under a trustee's custodianship for the benefit of others (not the trustee) was so firmly rooted in practice that it needed to be given legal recognition, and that there was nothing in Roman Dutch law which was inconsistent with trusts which could be accommodated in our common law.

Kourie & Ryder note that it had "not been possible for our courts to rely on concepts such as freedom of testation to find a suitable home in our law for *inter vivos* trusts, these being instruments executed and brought into operation in planner's lifetime. The landmark cases concerning *inter vivos* trusts are *CIR v Estate Crewe 1943 AD 656, CIR v Smollan's Estate 1955 (3) SA 266 (A)* and most importantly *Crookes and Another v Watson and Another 1956 (1) SA 277 (A).* These cases emphasised that the English law of trusts formed no part of SA law, but that there was no reason why the problem presented by such trusts could not be solved by the application of our Roman Dutch law principles (of) contract". Kourie & Ryder continue, noting that "[the] first two cases.... classified an *inter vivos* trust as being a contract for the benefit of a third party (the Latin term being *stipulatio alteri*)".

Whilst the *stipulatio alteri* in general might allow for greater rights of revocation than is the case say under English trust law, this right of revocation would not apply in certain instances. In the case of *CIR v Merensky 1959 (2) SA 600 (A),* it was held that the settlor does not have a right to revoke unilaterally if the trust property is donated irrevocably. Honore believes further that a founder's right to revoke must be subject to the trustees' decision (which they can only agree to if the decision is in the interests of the founder and the beneficiaries). Honore also views the trustee as the holder of public office. Most trust deeds only permit the variation of a trust with the permission of the trustees. Importantly, founders would not be able to revoke a trust, irrespective of whether the consent of the trustees has been obtained, unless those beneficiaries who have already accepted benefits have agreed wholly to the variation.

Essentials of a Valid Trust in South Africa

The Common Law Position

Honore categorises the essentials of a valid trust in South Africa into the following five requirements, summarised here:

- The founder must intend to create a trust;
- The founder must "express his intention in a mode apt to create an obligation", e.g. in a contract, will, statute, or a court order, provided that the mode is such that it places a legal obligation on the trustee, once he has accepted the office, to administer for the trust object;
- The trust's subject matter "must be defined with reasonable certainty". This is a self-explanatory requirement;
- The trust object must be defined with reasonable certainty. The trust fund must be for the benefit of named or ascertainable beneficiaries and/or have at least an impersonal object (such as devoting funds to combat environmental abuse);
- The trust object must be lawful. This is self-evident.

The Requirements of the Trust Property Control Act (No 57 of 1988)

The important requirements arising from this act are:

- A requirement that a copy of the trust instrument be lodged with the Master of the Supreme Court (s 4);
- That the Master must given written approval for the trustee's appointment (s 6);
- That the trustee must exercise due care and skill;
- That trust assets must be separately identified and registered;
- That trust property must not form part of the personal estate of the trustees (s 12).

The Status of a Trust-Like Collective Investment Scheme in South Africa

It is possible to draw certain conclusions regarding the status of a trust-like collective investment scheme.

Firstly, such a collective investment scheme meets the requirements for a valid trust as provided in the common law and within the Trust Property Control Act.

More specifically, a unit trust is an *inter vivos* trust in which the beneficiaries have rights to income which rights are, in the main, vested rights. (Certain unit trust deeds may allow the withholding of certain income. To this extent, beneficiaries' rights would only be discretionary. However, this will be disregarded here (i.e. beneficiaries' rights will be regarded as vested) for reasons including that this would not occur frequently in practice and would only be temporary if it occurred (note that to the extent that income was withheld this would in any event reflect in a capital benefit).)

The beneficiaries also have vested rights to capital which are manifested either by the sale by a beneficiary of his or her unit (this in practice would be the far most likely scenario), or by receipt of a capital distribution from the unit trust.

The Taxation of Trusts in South Africa

The position prior to 1991 was that trusts were not defined as persons in the Income Tax Act. Honore, writing in 1985, noted that:

> "[income] tax is, broadly speaking, a tax on income received by or accruing to any *person*...Although the estate of deceased person has now by statute been clothed with legal personality for income tax purposes, a trust as such does not count as a legal person. In some cases the trust income can be treated as income of the founder or the beneficiary. In these cases the trustee may be compelled to pay the tax due as a "representative taxpayer" but, if he does, he can recover the amount paid from the person he represents, viz. the founder or the beneficiary. In other cases the income is treated as income of the trust itself. (Of course, this is illogical, since the trust is not a legal person. The law treats the trust for certain purposes *as if* it were a bachelor.) The trustee as representative taxpayer is then bound to pay the tax from the trust assets but, as a trust is not a legal person, he does not strictly speaking represent any person but merely the trust estate.

> There are therefore three possibilities as regards income the subject of a trust. Such income may either be (i) the income of the beneficiary or (ii) the income of the trust estate treated for this purpose as an entity, though it does not possess legal personality, or (iii) the income of the founder".

Honore noted further that:

> "Unit trust portfolios (mutual funds) are neutral for tax purposes, so that interest or dividends accruing to them which are distributed or which the Commissioner is satisfied will be distributed to the unit holders are exempt from tax in the hands of the mutual fund but taxable in the hands of the unit certificate holders. The holders will pay tax at normal rates in the case of interest; in the case of dividends the conduit principle will apply so that the holder will not be fully taxed on them if there is a dividends deduction."

In 1991, a trust was defined as a person within the Income Tax Act, backdated to 1986.

A trust is taxed in its own right unless one of the Income Tax Act's deeming provisions deem the income to be the taxable income of another party, notably the founder or beneficiary/ ies. Specifically, Section 25B(2) provides that where a beneficiary has obtained 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 such beneficiary.

It has been held that income passing through a trust retains its nature. Emslie et al note that: "The intervention of a trustee between companies paying dividends and a trust beneficiary (as beneficial shareholder and 'shareholder' as defined) does not stand in the way of a direct accrual in favour of the beneficiary. The trustee is a mere 'conduit pipe'. The relevant cases are *Armstrong v CIR* 1938 *(AD)* and *SIR v Rosen* 1971 *(AD).*

3. Income Tax Treatment in Terms of the Income Tax Act 58 of 1962 in Relation to Collective Investment Schemes

Collective Investment Schemes

Definition of Collective Investment Scheme as a Company

A distinction has been made within the Income Tax Act between non-property collective investment schemes and property collective investment schemes. This paper focuses on non-property schemes.

By virtue of the definitions contained in the Income Tax Act, a non-property collective investment scheme is treated as a public company for tax purposes. A company is defined to include, inter alia,

"e) any –

i) portfolio comprised in any collective investment scheme in securities contemplated in Part IV of the Collective Investment Schemes Control Act, 2002, managed or carried on by any company registered as a manager under section 42 of that Act for purposes of that Part , if –

aa) such portfolio was created on or after the date of commencement of the Unit Trusts Control Amendment Act, 1962 (Act No. 11 of 1962);

bb) such portfolio was created before that date and the relevant trust deed has after that date been amended in order to create further units in that portfolio;

ii) arrangement or scheme carried on outside the Republic in pursuance of which members of the public are invited or permitted to invest in a portfolio of a collective investment scheme, where two or more investors contribute to and hold a participatory interest in a portfolio of the scheme through shares"

Note that s. 38 of the Income Tax Act states, *inter alia*:

"1) For the purposes of this Act a company shall in respect of each year of assessment be recognized as either a public or a private company, and the Commissioner shall upon the request of any

company inform that company whether it is recognized as a public company or as a private company.

2) The following companies shall, subject to the provisions of section 39, be recognized as public companies, namely--

a) any company all classes of whose equity shares are publicly quoted on the specified date by a stock exchange in the list issued under its authority, provided the Commissioner is satisfied--

i) any portfolio of a collective investment scheme referred to in paragraph (e)(i) of the definition of 'company' in section one" (emphasis added)

Income of Collective Investment Schemes

The principle is that collective investment schemes are not taxed on income, provided that that income is distributed promptly to the unit holders, in whose hands the income is taxed in its original form, which is consistent with the conduit principle of trust taxation. In particular, Section 10 provides that certain income received by the non-property collective investment scheme will be exempt from tax:

"s. 10 Exemptions

"(1) There shall be exempt from the tax-

iA) in the case of any portfolio of a collective investment scheme referred to in paragraph (e)(i) of the definition of 'company' in section 1, so much of the income received by or accrued to such portfolio as has been distributed, or as the Commissioner is satisfied will be distributed, by way of a dividend or a portion of a dividend, to persons who have become entitled to such dividend by virtue of their being holders of participatory interest in such portfolio.

...

k)

i) dividends (other than foreign dividends) received by or accrued to or in favour of any person: Provided that this exemption shall not apply--

aa) to dividends (other than those distributed out of profits of a capital nature and those received by or accrued to or in favour of any person who is neither a resident, nor carrying on business in the Republic) distributed by a company the shares of which are 'property shares' as defined in section 47 of the Collective Investment Schemes Control Act, 2002, on shares included in a portfolio comprised in any collective investment scheme in property managed or carried on by any company registered as a manager under section 42 of that Act for purposes of Part V of that Act; or

bb) to so much of any dividend as has been distributed by any portfolio of any collective investment scheme constituting a company in terms of paragraph (e)(i) of the definition of 'company' in section 1 –

A) out of income derived by such portfolio which is exempt from tax in the hands of such portfolio under the provision of paragraph (iA), and

B) out of amounts received by or accrued to such portfolio by way of dividends referred to in section 11(s)"

The dividends paid out by a non-property unit trust are included within the definition of dividend, which includes inter alia that it means

> "any amount distributed by a company (not being an institution to which section 10(1)(d) applies) to its shareholders or any amount distributed out of the assets pertaining to any portfolio referred to in paragraph (e) of the definition of 'company' "

Regarding the Secondary Tax on Companies (STC), Section 64B (5) (d) provides inter alia as follows:

"There shall be exempt from the secondary tax on companies--

> d) so much of any dividend declared by a portfolio of a collective investment scheme referred to in paragraph (e)(i) of the definition of ''company'' in section 1 as represents a distribution of dividends referred to in section 11(s) received by or accrued to such portfolio
>
> j) any dividend declared by a company contemplated in paragraph (e)(i) of the definition of "company" in section 1."

Note that prima facie the above section j) appears erroneous in that it doesn't limit the exclusion to dividends from a collective investment scheme portfolio which are really interest. That is, 'real' equity dividends are excluded from STC, and consequently from STC credits in the hands of those recipient unit holders which are companies.

It is understood that the CIS industry has taken this apparent error up with Revenue.

(Note that the comparable section in the Income Tax Act prior to the enactment of CISCA read as follows (in effect the point below combines points d) and j) above):

> "There shall be exempt from the secondary tax on companies-
>
> so much of any dividend declared by a unit portfolio referred to in paragraph *(e)* (i) of the definition of 'company' in section 1 as represents a distribution of interest or of dividends referred to in section 11 *(s)* received by or accrued to such unit portfolio" (emphasis added).

Consequently, the 'correct' position is that the portion of the dividend distributed by the unit trust constituting non-interest and non-property dividends is subject to the 12,5% STC but only on the "net amount" which is, in effect, the excess of dividends declared over dividends received during the dividend cycle.

Capital Gains Tax

The unit trust is exempt from CGT because of Section 61 of the Eighth Schedule"

> A portfolio in a collective investment scheme contemplated in paragraph (e)(i) of the definition of 'company' in section 1, must disregard any capital gain or capital loss.

Unit Holders

Dividends and Other Income

The general principle is that income of the scheme, provided distributed (or provided that there is an intention to distribute) is taxable in the hands of unit holders and retains its nature.

A shareholder is defined in Section 1 to include:

> "b) in relation to any company referred to in paragraph (e) of the said definition, the holder of any participatory interest included in the relevant portfolio, except that where some person other than the holder of any participatory interest is entitled, whether by virtue of any provision in the deed entered into for the purposes of the relevant collective investment scheme or under the terms of any agreement or contract, or otherwise, to all or part of the benefit of the rights of participation in the profits, income or capital attaching to the participatory interest, that other person shall, to the extent that such other person is entitled to such benefit, also be deemed to be a shareholder"

As regards exemptions, Section 10 provides, inter alia that:

"1) There shall be exempt from the tax-

k)

i) dividends (other than foreign dividends) received by or accrued to or in favour of any person: Provided that this exemption shall not apply--

aa) to dividends (other than those distributed out of profits of a capital nature and those received by or accrued to or in favour of any person who is neither a resident, nor carrying on business in the Republic) distributed by a company the shares of which are 'property shares' as defined in section 47 of the Collective Investment Schemes Control Act, 2002, on shares included in a portfolio comprised in any collective investment scheme in property managed or carried on by any company registered as a manager under section 42 of that Act for purposes of Part V of that Act; or

bb) to so much of any dividend as has been distributed by any portfolio of any collective investment scheme constituting a company in terms of paragraph (e)(i) of the definition of 'company' in section 1 –

A) out of income derived by such portfolio which is exempt from tax in the hands of such portfolio under the provision of paragraph (iA), and

B) out of amounts received by or accrued to such portfolio by way of dividends referred to in section 11(s)" (emphasis added).

These proviso's to the dividend exemption in effect mean that the dividends not exempt in the hands of a unit holder include those from a fixed property company and other interest type income received by a non-property unit trust which the unit trust distributes or commits to distribute. This is so that these dividends (which are inherently interest) are treated as interest in the hands of the shareholders.

Income and Capital Split- An Industry Quirk

All unit holders are treated *pari passu* including as regards the proportion of their units which at any stage are determined by the management company to comprise capital and alternatively revenue. In practice income does not accrue evenly to the fund but is accrued as it becomes due from the underlying investments. One effect in practice of these two points taken in conjunction is that certain buying and selling unit holders will take on or sell a unit whose capital/ revenue split (as determined by the management company) is at odds with the split which should correctly have been attributable. As one example, a unit buyer who purchases a unit with accrued but undistributed income will in effect be swapping capital for revenue. This anomaly is one which, in time, has little net effect, both because of relatively modest quantum (distributions of income occur frequently), and because of the extent to which the anomaly could apply in either direction (thus having a tendency to even out over time).

Capital Gains and Losses

The following provisions are relevant to the determination of the capital gain in the hands of a unit holder:

"s. 67A

1) A holder of a participatory interest in a portfolio comprised in any collective investment scheme managed or carried on by any company registered as a manager under section, 42 of the Collective Investment Schemes Control Act, 2002, for the purposes of Part V of that Act must determine a capital gain or capital loss in respect of any participatory interest in that portfolio only upon the disposal of that interest.

2) The capital gain or capital loss to be determined in terms of subparagraph (1) must be determined with reference to the proceeds from the disposal of that participatory interest and its base cost.

3) For the purposes of subparagraph (2) proceeds include the amount of any

cash received and the market value on the date of acquisition of any assets acquired by a holder of a participatory interest from the collective investment scheme prior to the disposal of his or her participatory interest to the extent that that amount and that market value do not constitute gross income in the hands of that holder.

4) Any asset acquired by a holder of a participatory interest as contemplated in subparagraph (3) must be treated as having been acquired for expenditure equal to the market value of that asset on the date of acquisition, which expenditure must be treated as an amount of expenditure actually incurred and paid for the purposes of paragraph 20(1)(a)."

"s. 20 Base cost of asset

g) the following amounts actually incurred as expenditure directly related to the cost of ownership of that asset, which is used wholly and exclusively for business purposes or which constitutes a share listed on a recognised exchange or a

participatory interest in a portfolio of a collective investment scheme -

i) the cost of maintaining, repairing, protecting or insuring that asset;

ii) where the asset is immovable property, rates or taxes on that property; and

iii) interest as contemplated in section 24J on money borrowed to finance directly the expenditure contemplated in items (a) or (e) in respect of that asset (including money borrowed to refinance those borrowings):

Provided that if that asset constitutes a share listed on a recognised exchange or a participatory interest in a portfolio of a collective investment scheme, the expenditure in respect of that asset must for the purposes of this subparagraph be reduced by two-thirds"

"31. Market value

1) The market value of--

c) an asset which is not listed on a recognised exchange which constitutes a right of a holder of a participatory interest in –

i) any company contemplated in paragraph (e)(i) of the definition of "company" in section 1 of the Act, or any portfolio comprised in any collective investment scheme in property contemplated in Part V of the Collective Investment Schemes Control Act, 2002, carried on in the Republic, the price at which a participatory interest can be sold to the management company of the scheme on the date of disposal; or

ii) any arrangement or scheme contemplated in paragraph (e)(ii) of the definition of 'company', the price at which a participatory interest can be sold to the management company of the scheme on the date of disposal or where there is not a management company the price which could have been obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market"

The effect of the CGT provisions is that unit trusts are, in effect, a CGT deferral mechanism. In ordinary trust taxation the CGT liability would accrue either to the trust, the settlor, or the beneficiary.

Management Companies

In all respects for Income Tax Act purposes (i.e. including, inter alia, in respect of the gross income and general deduction provisions), save as mentioned below, a management company is treated as any other company would be.

Management companies are likely to receive, in addition to the fees such as initial fees and service fees, income in respect of their statutory holdings in the underlying unit trust investments.

Dividends a management company receives from a fixed property company are treated as interest.

Other dividends received by the management company will be exempt in its hands.

Dividends paid by a management company are subject to STC and to the provisions of S64B including in respect of dividend cycles and STC credits. This means that the income made by a management company loses its nature once paid out to its shareholders by dividend.

Managers can either trade in the the units of the underlying collective investment schemes they manage (in which case in that regard they will be treated as traders, with profits on such trades taxable) or they can 'clear' their positions (other than those holdings they might be required to hold) daily, i.e. not hold any stock of units after discharging obligations in favour of third party unit holders, in which case such activities will not attract taxation.

4. Open Taxation Questions in Relation to Collective Investment Schemes

Although the Income Tax Act in large part clarifies the tax treatment in relation to collective investment schemes, certain questions remain open. The main questions relation to trading, both within collective investment schemes and by unit holders.

Collective Investment Schemes

As was noted above, unit trusts are exempt from capital gains tax.

There is though a *possible* tax liability because of the wording of Section 10(1)(iA) of the Income Tax Act, 1962, which exempts from income tax:

> "In the case of any portfolio of a collective investment scheme referred to in paragraph (*e*)(i) of the definition of 'company' in section 1, so much of the income received by or accrued to such portfolio as has been distributed, or as the Commissioner is satisfied will be distributed, by way of a dividend or a portion of a dividend, to persons who have become entitled to such dividend by virtue of being holders of participatory interest in such portfolio."

The effect of this section is that revenue income of the unit trust, if there can be any, which is not distributed (or which will not be distributed) to unit holders is potentially subject to income tax in the hands of the unit trust.

In order to analyse this issue, the workings of unit trusts will be examined in the light of the Income Tax Act (including case law thereon). Policy issues will also be considered.

Firstly, it is important to examine further the workings of unit trusts, specifically the following two related aspects:

- How a unit trust makes and distributes income; &
- The investment objectives of unit trust funds, and how those objectives translate into practice.

How a Collective Investment Scheme Makes and Distributes Income

In theory a unit trust can make income in only the following two ways:

- From receipts of income from its underlying investments (interest, dividends).
- From the sale of underlying investments.

To all intents and purposes, unit trusts can be seen as being obliged to distribute all the income they receive.

Gains made from the sale of underlying investments on the other hand are not distributed. Unit trusts 'price in' such gains to their quoted prices, and the unit holder thereby benefits, initially in the form of an unrealised gain (a 'paper profit') since the unit trust's prices are 'marked to market' daily, and then in the form of a realised gain once the unit is sold. The price obtained by the selling unit holder in effect includes unrealised profit which is accounted for no differently than is realised profit.

Absent any other provision, therefore, the Income Tax Act does not preclude the unit trust fund being taxed on gains made from the sale of underlying investments in the event of those gains being determined to be revenue gains.

Investment Objectives of Unit Trust Funds

The Financial Services Board ('FSB') oversees the unit trust industry and approves every collective investment scheme. This includes approving the fund's mandate which states the investment objective. The FSB must ensure, inter alia, that the fund's mandate is in the interests of the public.

The investment mandates of equity unit trusts (the subject of this paper) always include the objective of capital growth.

The Income Tax Act does not distinguish between capital and revenue. Various tests have been used by the courts for distinguishing between capital and revenue receipts and accruals.

A receipt or accrual must though be regarded either as capital or revenue (*Pyott Ltd v CIR 1945 AD 128*), nothing in between, noting though that in *Tuck v Commissioner for Inland Revenue 1988 (3) SA 819 (A),* it was found that a single amount could be apportioned between capital and revenue.

One test is to regard an asset which is held for the purposes of producing income as a capital asset, and to regard revenue as being the product or fruit of that machine or tree. The potential application of this test is, though, limited by the fact that not all assets produce a product or fruit.

Emslie et al note that where there is no certainty the first step is generally to have regard for the intention of the taxpayer at the time of the acquisition of the asset. Absent a change of intention since purchase, that intention prevails. Sometime there is no clear intention at the time of purchase in which case one needs to look to the intention which emerges over time. In the case of mixed intentions, one needs to look to the dominant intention.

They note further that

> "factors which are taken into account in ascertaining intention include the taxpayer's ipse dixit, the length of time an asset is held, the frequency of such transactions, the nature of the taxpayer's business, the existence of an income flow from the holding of the asset (eg dividends arising from the holding of shares), and the reason for the disposal of the asset. None of these is decisive, and the paramount test if always the taxpayer's intention"

Emslie et al note further that

> "the consistently applied test for distinguishing between capital and revenue receipts or accruals, confirmed in *CIR v Pick 'n Pay Employee Share Purchase Trust [85],* is the inquiry whether a taxpayer was engaged in a 'scheme of profit-making'."

They note that this has to do with the taxpayer's 'object, his aim, his actual purpose', not with what might have been. The only exception to this is where profit-making is inevitable.

The principle established in the Pick 'n Pay case (1992) was that if the share trust were able to demonstrate that its acquisition and sale of shares was not in the pursuance of a scheme of profit making, it would have discharged the onus of showing that its profits and losses were of a capital nature. This means that there was not necessarily any limit on the frequency of transactions, provided they were not in pursuance of a scheme of profit making.

In order to determine if a unit trust is involved in pursuance of a scheme of profit making, it is useful to look at cases. In Pick 'n Pay (where the trust was determined not to be so engaged), similarities include that:

- the share trust and the unit trust were/ are both obliged to effect purchases and sales on the instruction of others;
- profit was not inevitable in either case;
- there was no profit-making purpose in either case. Instead both had fiduciary obligations in relation to others in terms of specified objectives which were not short term in nature.

Conversely, in *Barnato Holdings Ltd v Secretary for Inland Revenue 1978 (2) SA 440 (A)* (where the company's profits on the sale of shares were held to have been taxable), the company was able to extract profits. The unit trust does not extract profits per se; instead the unit holders extract profits by selling units.

An exception was noted above to the principle in the Pick 'n Pay case, viz. where it is inevitable that profits will be made. This exception does not apply in the case of collective investment scheme portfolios, whose fortunes are closely linked to those of the equity markets, which, as noted above, demonstrate a high variability in return, and can often show losses.

There seems a good case therefore that unit trusts are not involved in schemes of profit making and therefore that the profits it makes are not taxable.

But insofar as this 'scheme of profit making' test in Pick 'n Pay is not an overriding one, it is then necessary to refer to other case law.

There are two main lines of approaches which have been taken by the courts in relation to the question of the disposal of shares when considering the investment intention:

- that securities are purchased and disposed of regularly is not inconsistent with an investment intention, and therefore does not necessarily make profits on disposal taxable. Put differently, the following of active investment policy to maintain the yield does not necessarily imply trading in securities (*CIR v Middelman* 1991 (1) SA 200 (C));

- that the shares must have been acquired with the intention that they not be sold, in order for profits on disposal to be regarded as capital (*CIR v Barnato Holdings Ltd* 1978 (2) SA 440 (A), African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A)).

In the African Life case, the court determined it necessary to distinguish between a passive and an active investment policy. The former was defined as:

> "a practice of acquiring shares and securities with a view to retaining them indefinitely and only realising them or switching them after a course of time should they prove to have depreciated".

The active policy was defined as:

> "seeking a portfolio of sound shares and securities, well spread over a number of business fields, which would show rising dividends over the years, watching the portfolio the whole time and watching critically every share comprised in the portfolio and effecting realisations of shares or securities from time to time, whether at a profit or a loss, whenever reasons exist for supposing that the investor could do better by switching to other shares or securities".

The Court determined that shares managed under an active policy were in effect to be regarded as being held for trading and thus as 'stock-in-trade'.

The reality of contemporary markets, both in aggregate and when looked at on a share by share level, show massively increased volatility and complexity when compared to the time of that case. A fund manager adopting purely a passive policy would amongst other things be unlikely to procure funds to manager and arguably would not be best discharging the fiduciary duty to protect and grow his clients' capital.

A more contemporary case, which appears more consistent with the realities of modern day fund management, is *CIR v Guardian Assurance Co SA Ltd* 1991 (3) SA 1 (A) in which the Commissioner submitted as a general proposition that it was inherent in the management of any share portfolio that an amount of share-dealing for profit would be involved because shares are risky investments which must be reviewed periodically, with commensurate portfolio adjustment being made. Thus the intention is not of any consequence. Unless and until the shares are made part of the permanent structure of the investor on which its business rests and the shares are in effect taken out of its business, they remain part of its floating capital. In its argument, counsel for the Commissioner cited, inter alia, a passage from *CIR v Richmond Estates 1956 (1) SA 602 (A).* The court rejected counsel's argument, noting inter alia the following (17-18):

> "Neither case is authority for the proposition that a genuine investor in long-term dividend-producing shares is obliged to hold

on to each and every counter in his portfolio irrespective of the fortunes – or possible demise – of the companies concerned or run the risk of being taxed as a sharedealer. Indeed both cases are based on the hypothesis that there is a distinction between a share investor and a share-dealer and both taxpayers were found to have been an amalgam, using their investments as both capital and stock-in-trade for sale at a profit. Therefore, as Schreiner JA [in the Richmond case] made clear, as the profits made by a company are generally speaking part of its income, profits derived from the sale of assets held as both capital and stock-in-trade are taxable. But nothing in the reasoning of the learned judge can be regarded as authority for the broad proposition that the management of a wide and varied share investment portfolio, irrespective of the care and long-term investment intention with which it had been compiled, causes it to be regarded as floating capital... continuous monitoring of the portfolio by LIBAM in the performance of its steward mandate on behalf of the [taxpayer's] shareholders did not serve to convert what had been compiled as a capital base for the production of fruits into a pool of floating capital. Neither in law nor in logic can dogged adherence to a counter or carelessness in the management of a share portfolio be posited as prerequisites for qualification as a capital investor. Prudence and foresight cannot be equated with an intention to speculate."

Also, it has been established (see *CIR v Stott* 1928 AD 252) that:

- the realisation of a capital asset does not of itself constitute a change of intention; and

- there is also no such change in intention merely because the taxpayer chooses to adapt his asset to the realities of the market in order to realise it to best advantage.

The considerations which might lead a manager of a collective investment scheme fund to dispose of shares include:

- the necessity to 'rebalance' its portfolio to comply with restrictions laid down by the CIS Act, the regulations promulgated under that Act, or any other legislation or regulations governing that CIS Fund;

- changes in a market sector caused by, new listings, de-listings or mergers, etc.;

- changes in a market sector caused by, new listings, de-listings or mergers, etc.;

- dealing with the requirements of Regulation 28 of the Pension Funds Act

- a need to rebalance its portfolio due to market movements, in adherence with its fund mandate (for example where it is tracking an index);

- a change in the fund mandate;

- a change in the portfolio managers of the unit trust fund and a resultant change of opinion regarding investments to be held by the fund;

- a poor forecast from an investee company;

- responding to the time horizons of investors (liquidity might need to be created in relation to disinvestments), such horizons on occasion being shorter than those which might apply to those for example in the insurance industry (given the five year maturity period of endowment policies as laid down in the Long Term Insurance Act, 1988).

The disposals thus resulting are easily argued to be, of themselves, not prima facie evidence of a change to the initial capital intention.

Derivatives

Although this is not the main focus of the paper, it is worth noting certain points relating to derivatives within collective investment scheme funds.

In terms of the recently enacted sections 40 and 46 of the Collective Investment Schemes Control Act, 2002 the Registrar of Collective Investment Schemes ("the Registrar") may determine, in relation to a collective investment scheme in securities:

- securities or classes of securities that may be included in a portfolio of a collective investment scheme in securities; and

- the manner in which and the limits and conditions subject to which securities or classes of securities may be included in such a portfolio.

The regulations promulgated by the Registrar in Notice 571, Government Gazette No. 24984 ("the Regulations", effective 3 March 2003) were duly effected. In terms of the Regulations, a

manager may "include in the portfolio financial instruments on the conditions and subject to the limits determined in Chapter II".

A "financial instrument" is not defined in either CISCA or the Regulations. "Securities" are, though, defined in the Regulations to mean the following "listed financial instruments":

- a futures contract;
- an option contract;
- a warrant;
- an index tracking certificate; and
- an instrument based on an underlying asset.

A "financial instrument" was defined in the regulations previously promulgated by the Minister of Finance under the Unit Trusts Control Act (Notice No. R. 1256, Government Gazette No. 22877 of 30 November 2001), which determined that the securities allowed in the portfolio of a unit trust were the above derivatives.

Therefore it appears that "financial instruments" as referred to in the Regulations are to mean the above derivatives.

An "underlying asset" is defined in paragraph 4 of the Regulations, in relation to a financial instrument, to mean:

- any security;
- an index determined by an exchange;
- a group of securities which is the subject matter of the financial instrument, whether such group of securities is represented by an index or not; or
- in the case of a warrant, option contract or futures contract, any underlying asset referred to in the bullet points immediately above.

Other than the SATRIX instrument, it would be an exception if the duration of any listed futures contract, option contract or warrant were to exceed a three year period. In the main such instruments have a shorter duration.

Whereas the default rule in taxation law is that receipts in relation to an asset without that asset are regarded as income, that is not always the case (*SIR v Struben Minerals (Pty) Ltd 1966 (4) SA 582 (A).*)

The types of derivatives permissible in a collective investment scheme portfolio will in the main only give rise to a receipt or accrual in the hands of the fund on maturity or disposal. It is generally argued that the tests which should then apply are as per those which would apply to a sale of a share.

Derivatives are likely to be held mainly for the purposes of:

- Making a profit on resale- profits here would absent any other overriding reason (e.g. the application of the Pick 'n Pay case (supra)) be regarded as taxable;
- Earning a return on the derivative or the underlying asset- profits here would be regarded as capital;
- Hedging an existing risk- the nature of profits in this regard is still open to discussion in South Africa. Hutton's view is that such amounts should be taxed on a similar basis on a comparable basis to how an insurance policy would treat such amounts. South African courts apply the test established in the English case of *Burmah Steamship Co Ltd v IRC 1930) 16 TC 67 (Court of Sessions), 1931 SC 156*: do the insurance proceeds 'fill a hole' in the taxpayer's profits (they are then regarded as revenue) or in its income-producing structure (they are then regarded as capital). The nature of receipts from a hedging transaction would be determined by the character of the underlying asset or exposure hedged, i.e. where the derivative has a capital protection purpose, the amounts in relation thereto should be regarded as capital, and the same for revenue (again absent any potential overriding rule such as that in the Pick 'n Pay case (supra)). In an analogous way, in *ITC 1498* (1989) 53 SATC 260 and *ITC 340 (*1935*)* 8 SATC 362) derivatives were regarded as having taken the form of forward foreign exchange contracts.

It is important that the fund be able to prove the capital hedging intention, and that it was in relation to an existing risk and sufficiently closely connected thereto. The facts the court is likely to examine to determine the intention are wide and include the *ipse dixit*, the fund mandate, the relevant paperwork and disclosure, and the fund's historic dealings in similar instruments.

Given the purpose of this paper, it will not go into further detail regarding derivatives which might apply to collective investment scheme funds, e.g. as to the nature of their settlement (cash vs. delivery of physical, exercise of option) or period for which they are held.

Policy considerations

The Jacobs' Committee (1992) was tasked to look at how to achieve fair competition in relation to the investment of funds in South Africa.

Whilst the main focus was not on unit trusts, they were considered, being regarded (at p57) as agents for individual investors.

It was recognized (p70) that taxation "is often used as an example of unlevel playing-fields".

Certain changes were recommended in relation to tax but no changes were recommended to the way unit trusts were taxed.

It was concluded (p110): "[The Committee]...has chosen...to acknowledge that perfect neutrality between institutions is not possible."

If anything it would appear that the reasons for reaching those conclusions would be stronger were the situation to be re-evaluated now. As an example, insurance products enjoy taxation benefits not available to collective investment schemes.

Further, given the significant liberalizations in exchange controls and South Africa's re-positioning in the South African investment market have made more important the attractiveness of South African unit trusts, both for local and for foreign investors.

Unit holders

It is interesting to note briefly the wording of the CGT exclusion referred to above. Section 67A in the Eighth Schedule provides in sub-section (1) that "[a] holder of a participatory interest in a portfolio comprised in any collective investment scheme managed or carried on by any company registered as a manager under section, 42 of the Collective Investment Schemes Control Act, 2002, for the purposes of Part V of that Act must determine a capital gain or capital loss in respect of any participatory interest in that portfolio only upon the disposal of that interest".

A question arises as to the meaning of the emphasised phrase. Does this phrase (when read in conjunction with the rest of the section) mean that, *where there is a capital gain*, such capital gain must be determined only at a specified time (viz. on disposal)? If this meaning is applied, this has the effect of ensuring that there is no capital gains tax liability until

the sale of the unit, thus clarifying that there is no deemed capital gain for the unit holder by virtue of the activities of the underlying collective investment scheme. But this interpretation does not preclude the possibility that a gain on the sale of a unit is a revenue gain (see below).

Or does the emphasised phrase mean that *any gain on the sale of a unit must be determined as a capital gain rather than analysing that gain to determine if it is of a capital or revenue nature*?

If the former interpretation is utilised, gains or losses on the sale of units should first be analysed to see if they are of a revenue or capital nature, which would determine their tax treatment.

To do this, the same type of rules should apply as do to the profits or losses on the sale of shares. As Emslie et al note, "as was emphasised in [*SIR v The Trust Bank of Africa Ltd.*],

> 'The question whether any amount received by a taxpayer is a capital or revenue accrual for the purpose of the definition of "gross income" in the Income Tax Act is essentially a question to be decided upon the facts of each case.' "

For example, the findings in *CIR v Nussbaum 1996 (4) 1156 (A), 58 SATC 283* (regarding the sale or trading in shares) ought to be equally of relevance, including as to:

- Scale and frequency of transactions- not of conclusive but of major importance;
- Whether there was a secondary, revenue driven purpose, notwithstanding a capital intention.

To the extent that there are gains which are be concluded to be of a revenue nature, it presumably follows that there would be scope to deduct any expenditure incurred in the production of those gains.

It appears an industry practice that all gains and losses made on the sale of units are regarded as capital. Consequently gains were not taxed prior to the advent of CGT and now all gains and losses are regarded as being caught in the CGT net.

Conclusions/ Recommendations

To the writer's knowledge, SARS has never taxed a unit trust or collective investment scheme on perceived revenue gains. But such possibility in theory exists, and is raised occasionally as a discussion point in the broader investment arena.

There are two main reasons why this paper concludes that it would be inappropriate to tax collective schemes:

- Policy reasons;
- Appropriate tax treatment:
    - Collective investment schemes are not schemes or business for making profit;
    - The case law regarding selling investments to best advantage consistent with a capital intention means that the selling activities of collective investment schemes should create capital consequences.

But it is recommended that collective investment schemes be mindful of the potential risks of expanding the scope of their activities. Once for example collective investment schemes undertake scrip lending, the risk of their being concluded to be profit-making businesses increase.

Derivatives open a further category of potential risk, unless it is evident that they are being utilised for capital purposes. It is recommended that, if a derivative is acquired for hedging purposes, that that, together with the capital asset being hedged, be identified on acquisition.

In general it is recommended that collective investment schemes are disciplined in having all their behaviour and documentation reflect capital intentions. That includes that the mandate be consistent with capital growth though that of itself will not guarantee that receipts and accruals are not regarded as revenue (*African Life Investment Corporation v SIR 1969 (4) SA 259 (A)*). It is recommended that all minutes and financial records (including financial statements and prospectuses) demonstrate the capital intention. Further it is recommended that detailed records regarding each disposal are maintained, so as to be able to show that these were motivated by capital, not revenue, reasons.

In time it might be appropriate to categorise collective investment schemes according to their activities (capital vs. revenue) which would have the benefit of protecting nearly all the collective investment schemes (whose activities are capital) from the activities of the potentially tiny minority some of whose activities might be regarded as revenue.

Bibliography

An Analysis of the Allocation of Savings in the South African Economy (working paper prepared for ipac South Africa Limited in July 2002), Ntoi HV

Report of the Committee of Investigation into the Promotion of Equal Competition for Funds in Financial Markets in South Africa, September 1992, Chairman Dr. A.S. Jacobs

Income Tax Cases and Materials, 3rd Edition (2001), Emslie TS, Davis DM, Hutton SJ, Olivier L, The Taxpayer

Law and Estate Planning Easiguide 1997, Kourie MA & Ryder K, Butterworths

Notes on South African Income Tax, 21st Edition (2002), Huxham K & Haupt P, H& H Publications

The South African Law of Trusts, 3rd Edition (1985), Honore T, Juta & Co.

The Taxation of Derivatives in South Africa, Hutton S, The Taxpayer (September 1998)

Workings provided by the Association of Collective Investment Schemes.

Workings provided by Strategic Investment Service Management Company Limited.

Annexure A

DRAFT 2: 29/4/2002

D E E D

Made and entered into by and between

.....

("the manager")

and

.....

("the trustee") / ("the custodian")

PREAMBLE

A. The manager and the trustee/custodian have agreed to establish a collective investment scheme to be known as the ..... scheme under the Collective Investment Schemes Control Act, 2002 (Act No. .... of 2002) and to create thereunder, by means of supplemental deed, one or more separate portfolios.

B. The manager intends, subject to the Act and this deed, to make available to members of the public for investment participatory interests in one or more portfolios.

C. To protect and secure the interests of investors in a portfolio -

- the manager undertakes to invest money or other assets on behalf of investors in one or more portfolios of the collective investment scheme under the supervision and control of the trustee; and

- the trustee/custodian agrees to accept delivery of and to hold in safe custody the assets of a portfolio.

D. The parties have reached agreement on the following matters relating to the establishment and administration of the scheme and its portfolios:

PART 1

Definitions

1.1 In this deed a word defined in the Act bears the meaning so assigned to it.

1.2 In this deed, unless inconsistent with the context -

1.2.1 "**accounting period**", in relation to the first distribution in respect of a portfolio to be made in terms of this deed, means the period not exceeding 12 months commencing on the date of commencement of such portfolio as declared by the manager in consultation with the trustee/custodian and ending on the day immediately prior to either the first day of ..... or the first day of ..... as may be determined by the manager in consultation with the trustee/custodian and, in relation to each subsequent distribution, means the period beginning with the last ex dividend date and ending on the day immediately prior to the next ex dividend date: Provided that after the first distribution in respect of that portfolio the financial year end of a portfolio shall each year coincide with the end of one of such dates;

1.2.2 "**certificate**" means a certificate or statement issued to an investor pursuant to the provisions of this deed which serves as evidence of the title of the investor to the participatory interest referred to therein and properly acquired by the investor;

1.2.3 "**distribution date**" shall not be later than the last business day of ..... and the last business day of ..... of each year, or such other day or days as may be determined by the manager and the trustee/custodian by supplemental deed: Provided that the first distribution date of each portfolio created under this deed shall not be more than 12 months after the date of creation of such portfolio;

1.2.4 **"electronic"** includes created, recorded, transmitted or stored in digital or other intangible form by electronic, magnetic, optical or any similar means as agreed upon with the investor;

1.2.5 "**ex dividend date**" means the first business day of ..... and the first business day of ..... of each year or such other day or days as may be determined by the manager and the trustee/custodian and approved by the registrar;

1.2.6 "in writing" includes any visible electronic form;

1.2.7 "**made-up price**", in relation to a participatory interest, means the price referred to as the 'made-up price' in clause 27;

1.2.8 "**manager's charge**", if any, in relation to a participatory interest means that portion of the made-up price of a participatory interest which represents the manager's charge in respect of expenditure incurred and administration performed by it in connection with the creation, issue, selling, repurchase or cancellation of such participatory interest which:

- is expressed as a percentage of the made-up price; or

- may be calculated, as agreed with an investor in writing, in terms of clause 30.2 in accordance with a sliding scale;

1.2.9 "**market value**" means in respect of securities, the value determined in terms of section 94 of the Bill or in respect of a participatory interest, the repurchase price of that participatory interest referred to in clause 36, exclusive of permissible deductions from such repurchase price;

1.2.10 "**participatory interest in issue**" for a portfolio, that may consist of different classes means all participatory interests which have been created and which have been entered in the register of that portfolio, including those held or deemed to be held by the manager;1.2.11"**payment in lieu of income accruals**" means the amount which the manager must pay into the income account of a particular portfolio on the creation of new participatory interests to afford such participatory interests equal participation in the relative income which has accrued (including payments received in lieu of income accruals) from the last ex dividend date to the date on which the participatory interests are created. Such amount must be calculated by dividing the total number of participatory interests in issue of a portfolio at the time at which the calculation is made into the total amount then standing to the credit of the relative income account and by multiplying the quotient by the number of new participatory interests created at the time at which the calculation is made;

1.2.12 "**permissible deductions**" means any deduction in connection with the administration of a portfolio referred to in section 84 of the Act;

1.2.13 "**register**" means the register of investors whatever form it may take;

1.2.14 "**scheme**" means .....;

1.2.15 "**service charge**" means the periodical charge stipulated in the deed or as agreed with investors in writing, to remunerate the manager for the administration of a portfolio, expressed as .....;
1.2.16 **"the Act"** means the Collective Investment Schemes Control Act, 2001 (Act No .... of 2001).

PART II : THE COLLECTIVE INVESTMENT SCHEME

2. The constitution and name of the scheme

The manager and the trustee/custodian hereby establish the scheme, which may include various portfolios.

3. Object of scheme

The object of the scheme is to provide a medium through one or more separate portfolios whereby investors can obtain participatory interests in diversified assets of local or foreign origin. In order to achieve this object the manager may, subject to the Act and this deed -

- create and issue an unlimited number of participatory interests in a portfolio established in terms of a supplemental deed to this deed;

  or

- establish a variety of portfolios in order to provide investors with investment opportunities in diversified assets.

PART III : THE MANAGER

Appointment of manager

4. Subject to the Act and this deed ..... Limited is the manager of the scheme.

Remuneration of manager

5.1 The manager is entitled by way of remuneration for its services and to cover its expenses in performing its obligations under this deed to receive the service or other charge referred to in clause 51.

5.2 The manager may at any time in its discretion waive or rebate any, or any portion of, the charges or amounts mentioned in this clause.

Powers of manager

6. Subject to the Act and this deed, the manager may in its absolute and uncontrolled discretion:

- do all such things and enter into all such arrangements as are necessary for the administration of the scheme and to achieve the investment objectives of a portfolio of the scheme;

- select, purchase, sell, exchange or alter any of the assets of a portfolio;
- borrow money ..... **provide only**
- engage in scrip lending .... ***if approved***
- appoint, in writing such persons to exercise such powers and perform such duties on its behalf as it may deem expedient and, in particular and without derogating from the generality of the aforegoing, appoint transfer secretaries, secretaries and agents of every description; and

- act on the advice or information obtained from professional advisers and others considered by it to be experts.

Voting rights on assets

7.1 On being furnished with such reasonable indemnity against costs as the trustee/custodian may require, the trustee/custodian may delegate to the manager or its nominee the right to attend or to vote at meetings of the issuers of assets included in a portfolio, and to take part in or consent to any action of the issuers of such assets. No investor shall have any right in relation to any asset, to attend or to vote at such meetings or to take part in or consent to any such action.

Proxies, etc.

7.2 The trustee/custodian must execute such proxies, powers of attorney or other documents as the manager may require in order to enable it or its representative or its nominee to attend or to vote at any such meetings and to take part in or consent to any such action.

Meaning of vote

7.3 The word "vote" used in this clause includes not only a vote at a meeting but also any decision relating to any arrangement, scheme or resolution, or to any alteration in or abandonment of any rights attaching to any part of the assets, and the right to requisition or join in a requisition to convene any meeting or to give notice of any resolution or to circulate any statement.

Trustee/custodian to forward notice to manager

8. The trustee/custodian must on receipt thereof forward to the manager notice of a meeting, a report, circular and all other documents received by it, or its nominee.

Manager to prepare documents

9. The manager must, at its own expense -

- prepare all cheques, warrants, notices, accounts, summaries, declarations, offers or statements which the trustee/custodian under the provision of this deed is required to issue, serve or send, and deposit the same with the trustee/custodian together with stamped and addressed envelopes, if so required, so as to afford the trustee/custodian sufficient time to examine, check and timeously dispatch such cheques and documents; and

- prepare, sign and execute all certificates and all transfers of assets which, but for this provision, would fall to be prepared by the trustee/custodian, and deposit the same with the trustee/custodian for signature and execution.

Retirement and substitution or liquidation of manager

10.1 The manager may, with the written approval of the trustee/custodian and the registrar, in writing appoint any other company qualified to act as such in terms of the Act, as manager in its stead, and may assign to such appointee all its rights and duties as manager under this deed. Such appointee must execute an instrument in a form as approved by the trustee/custodian and the registrar in terms of which it undertakes to fulfil all the obligations of the retiring manager. The retiring manager is then, upon payment to the trustee/custodian of all sums then due by it to the trustee/custodian (without prejudice to the rights of the trustee/custodian, investors or other persons, in respect of any act or omission prior to such retirement) absolved and released from all its duties and obligations under this deed. The new manager thereafter exercises all the powers, enjoys all the rights, and performs all the duties and obligations of the manager under this deed, as if the new manager had originally been a party to this deed.

10.2 The retiring manager remains entitled to all participatory interests in respect of which no certificate or valid claim is outstanding at the date of retirement and may require the trustee/custodian to issue to it a certificate in respect of any such participatory interests and to enter its name in respect thereof in the register or otherwise record its ownership of such participatory interests. The retiring manager continues to enjoy all the rights of an investor in respect of all participatory interests held by it.

10.3 If the manager is liquidated, the trustee/custodian must take immediate steps in terms of subclause 10.1 for the appointment of a new manager.

PART IV : THE TRUSTEE/CUSTODIAN

Appointment and powers of trustee/custodian

11. Subject to the Act and this deed, ... Limited is the trustee/custodian of the scheme. The trustee/custodian has all the powers necessary to protect the interests of investors in terms of the Act and this deed and has, save as otherwise provided in this deed, powers necessary to perform the functions of the scheme and to achieve the objectives of the scheme and its portfolios.

Legal proceedings relating to a portfolio of the scheme

12.1 Legal proceedings relating to a portfolio of the scheme must be instituted by or against the trustee/custodian in its capacity as such, and the trustee/custodian may institute, prosecute, intervene in or defend any legal proceedings relating to or concerning a portfolio of the scheme or its affairs and, as a prerequisite to such action, may require the manager to indemnify it against all costs, expenses and liabilities thereby incurred.

12.2 The trustee/custodian may delegate its powers contained in subclause 12.1 to the manager if the manager is not a party opposing the trustee/custodian or if the manager has not been joined in action with another party.

12.3 The trustee/custodian is not liable to make any payment hereunder to any investor except out of any funds held by or paid to it for that purpose under the provisions of this deed.

Remuneration of trustee/custodian

13.1 In every accounting period, the manager must -

- pay to the trustee/custodian by way of remuneration for the trustee's/custodian's services, such amount as may be agreed between them; and
- refund to the trustee/custodian the amount of all its disbursements incurred in connection with the scheme, other than disbursements expressly required by this deed to be paid out of a portfolio, and other than disbursements incurred by it as a result of its own negligent and unlawful conduct.

13.2 Such remuneration and amounts are in addition to any sums that the trustee/custodian may receive or retain under any other provision of this deed.

Registration and retention of assets by trustee/custodian

14.1 The assets of a portfolio must be registered either in the name of the trustee/custodian or with the written consent of the registrar in the name of a nominee company of the trustee/custodian. Any reference in this deed to the trustee/custodian in relation to the vesting, registration or holding in its name of assets, or to its rights, powers obligations as the registered owner of the assets, is, unless inconsistent with the context, deemed also to be a reference to the said nominee company. The trustee/custodian is liable for any act or omission of the nominee company in relation to any assets held in the name of the nominee

company. Despite the foregoing, the trustee/custodian must take delivery of and retain in safe custody and under its own supervision and control the documents of title to the assets.

14.2 The assets must be held by the trustee/custodian in its name in trust for the investors and the trustee/custodian may not allow the whole or any part of such assets to be pledged or encumbered in any way: Provided that scrip lending or the borrowing of money by a manager in terms of this deed or a supplementary deed is excluded from this prohibition.

Trustee/custodian not obliged to furnish security

15. The trustee/custodian shall not be obliged to furnish security to the Master of the High Court or to any other official for the due performance by it of any of its obligations in terms of this deed.

Trustee/custodian may deal in participatory interests and act as banker to the scheme

16.1 The trustee/custodian may –

- purchase, hold, deal in or dispose of participatory interests for its own account or otherwise;
- if the trustee/custodian is a bank, act as banker for the scheme;
- enter into any financial, banking or other transaction with the manager or an investor, or with a concern any of whose shares or securities form part of the assets;
- hold any security in any such concern.

16.2 The trustee/custodian is not accountable in any way to the manager or investors for any profits made or benefits derived by it from any of the aforesaid matters.

Trustee/custodian may accept signed request from manager

17. Subject to section 52 of the Act, the trustee/custodian is not liable for anything done or omitted or suffered by it in good faith and in accordance with or pursuant to any written request, notice, direction, advice or other communication of the manager. The trustee/custodian may accept any document signed on behalf of the manager by a duly authorised person and directed by the manager to the trustee/custodian, as sufficient evidence of any request, notice, direction, advice or other communication from the manager to the trustee/custodian.

Trustee/custodian may act on advice of competent person

18. The trustee/custodian may act upon the advice, statements of or information obtained from lawyers, the manager, bankers, accountants, members of any exchange or other persons considered by the trustee/custodian to be experts in relation to the matters upon which they are consulted.

Trustee/custodian and manager may interpret deed

19. Subject to this deed and without prejudice to the right of any person to have recourse to the Courts, the trustee/custodian and the manager may resolve all questions of interpretation of the provisions of this deed.

Removal of trustee/custodian

20.1 Subject to the Act, the manager may with the written approval of the registrar -

- pursuant to a ballot of investors in all portfolios (to which ballot clause 71 of this deed applies); or

- at the written request of not less than 50% of the investors excluding the manager, in all the portfolios, holding not less than 50% in value of the total number of participatory interests then in issue,

require the trustee/custodian by notice in writing to resign from office.

20.2 A trustee/custodian appointed in the place of a retiring trustee/custodian must execute an instrument in a form approved by the manager and the registrar in terms of which it undertakes to fulfil all the obligations of the retiring trustee/custodian. The retiring trustee/custodian shall (without prejudice to the rights of the manager, investors or other persons, in respect of any act or omission, liability, negligence or dishonesty, prior to such retirement) be absolved and released from all further obligations under this deed. The new trustee/custodian shall thereafter exercise all the powers, enjoy all the rights, and be subject to all the duties and obligations of the trustee/custodian under this deed, as fully as if such new trustee/custodian had originally been a party to this deed.

20.3 A trustee/custodian is deemed to have resigned if its certificate of registration is revoked or suspended under section 49(3) of the Act, and the manager must in that event immediately substitute another person as trustee/custodian and apply for the registration of such trustee/custodian, to which subclause 20.2 applies.

PART V : PORTFOLIO

Number of portfolios

21. The scheme may consist of one or more portfolios established by supplemental deed.

Trustee/custodian entitled to reject asset

22. The trustee/custodian may refuse to accept as part of the assets of a portfolio, any asset which according to its judgement, infringes the terms of this deed or a supplemental deed or the Act and the manager must, in such an event, deposit with the trustee/custodian cash or assets of equal value which comply with the terms and objects of this deed.

PART VI : CREATION, SALE, REPURCHASE OR CANCELLATION OF PARTICIPATORY INTEREST

Initial or additional portfolio and offer of participatory interests

23. The initial and each additional portfolio must each have a minimum market value as determined by the manager after consultation with the trustee/custodian and comprise assets or cash received or deemed to be received by the manager. The manager is responsible for the payment of all expenses (including permissible deductions) arising out of and relating to the formation of the initial and any additional portfolio. The participatory interests issued to the manager in respect of such assets or cash are deemed to be the first participatory interests in issue in a particular portfolio and must be issued at a minimum price determined by the manager. At the date on which the manager commences the sale of participatory interests to the public, the market value of each portfolio must be at least an amount as determined by the manager after consultation with the trustee/custodian. The first issue of participatory interests in a portfolio to the public is made in such a manner as the manager may decide. The said first issue may take the form of an offer by the manager of a specified number of participatory interests at a fixed price not exceeding the made-up price on a previous date, which date shall not be more than 28 days before the closing of the offer.

Creation, subdivision or consolidation of participatory interests

24.1 The manager has the exclusive right to secure the creation and issue of participatory interests in a portfolio.

24.2 The manager may, with the consent of the trustee/custodian and the approval of the registrar, in writing, at any time effect any subdivision or consolidation of participatory interests in issue in any particular portfolio without prejudice to the rights and privileges of the then existing investors. For the purpose hereof the manager is obliged to send a written notice to all investors which must include the following minimum information:

- full particulars of the subdivision or consolidation;
- in the case of a subdivision, the number of additional participatory interests to which the investor is entitled and which have been entered in the register or record; or
- in the case of a consolidation, the number of participatory interests to which the investor is entitled and which have been entered in the register or record.

The costs involved in the subdivision or consolidation of participatory interests must be borne by the manager which must within 21 days after the date on which the subdivision or consolidation takes place, issue additional certificates or certificates replacing existing certificates to investors or, if certificates are no longer issued, notify investors as contemplated in subclause 24.2. If an investor tenders participatory interests to the manager for repurchase after the date of the subdivision or consolidation but before additional certificates are issued or existing certificates replaced, or investors are notified as aforesaid, a certificate issued before the subdivision or consolidation is deemed to represent the number of participatory interests to which the investor is entitled after the subdivision or consolidation.**Undivided interest in portfolio**

25. Each investor is, equally with the holder of another investor, entitled to one undivided equal participation in a portfolio but shall, subject to clause 34, not be entitled to any particular asset of the portfolio. Every fraction of a participatory interest shall rank *pari passu* proportionately with a participatory interest.

Minimum number of participatory interests that may be sold

26. The minimum number of participatory interests that may be sold to an investor must be determined by the manager .

Made-up and sale price of participatory interest

27. Unless participatory interests are offered at a fixed price pursuant to section 85(1) of the Act, the manager must issue participatory interests in a portfolio at the made-up price per participatory interest, which price is calculated on the date on which any participatory interest is issued or the previous date, whichever is consistently applied, according to the formula –

$$\frac{A + B + C}{D}$$

Where:

A = the aggregate market value of the assets in the portfolio, excluding the income accruals and payments referred to in B, on the last valuation point determined by the manager on the last pricing date, which valuation point may not be more than 24 hours prior to or after such date;

B = the aggregate of all income accruals and payments received in lieu of income accruals from the creation of new participatory interests in the portfolio, during the relevant accounting period up to the said date, but excluding:

- any part of those income accruals and payments in lieu of income accruals, set aside at the last preceding ex distribution date for distribution, but not yet distributed, in respect of the accounting period which ended on the day prior to that last ex distribution date; and

- such further amount, out of those income accruals and payments in lieu of income accruals, as in the opinion of the manager represents a fair proportion, at the said date, of the permissible deductions for the relevant accounting period;

C = the manager's charge, if any, payable in terms of clause 30 of this deed in respect of all the participatory interests in issue in the portfolio on the said date; and

D = the total number of participatory interests in issue in the portfolio on the said date.

Price at which manager may sell participatory interest owned by it for own account

28. The manager may at any time for its own account sell any participatory interest owned or deemed to be owned by it and for the time being outstanding, at any price not exceeding the price at which a new participatory interest in the relative portfolio would at that time be issued in accordance with the provisions of clause 27, and the manager may retain for its own use and benefit all monies received by it in respect of such sale. Any commission, remuneration or other sum payable to an authorised agent of the manager in respect of the sale of any such participatory interest, must be paid by the manager.

Manager may sell participatory interest in exchange for asset

29.1 Subject to and in accordance with the following provisions, the manager may secure the creation and issue of, or sell a participatory interest in a particular portfolio by way of exchange for an asset upon such terms as the manager may think fit.

29.2 The value of the participatory interest so sold is calculated according to the purchase price at the time when such participatory interest was so sold.

29.3 Any permissible deductions incurred in acquiring such asset must be paid out of the relevant portfolio.

29.4 The manager and the trustee/custodian must be satisfied that the exchange is not likely to prejudice existing investors.

Charge of Manager

30.1 The amount of the charge of the manager, if any, to be included in the made-up price of a participatory interest shall be fixed by the manager in its discretion : Provided that not less than three months' written notice must be given to investors of any increase in the manager's charge or any change in the method or calculation thereof that could result in an increase thereof, or the introduction of any additional charge.

30.2 Nothing herein contained shall preclude the manager from reducing its charges and the scale of charges applicable to the varying sizes of investment, if any, must be determined and published by the manager in all marketing material.

Variations in charge of manager

31. Any reduction in the charge of the manager, if any, shall be passed on to investors in respect of the uncompleted portion of any contract for

the sale of participatory interests. Any increase in the charge, if any, may not be applied to any contracts for the sale of participatory interests entered into at a date prior to the date on which such increase came into effect.

Conditions for sale of participatory interest

32. The manager may not sell or offer any participatory interest for sale except on the terms set out below:

- each purchase of participatory interests must be a completed transaction and ownership of the participatory interests passes to the purchaser as soon as the manager has accepted an offer to sell participatory interests and the purchase price has been paid;

- the manager must immediately after each purchase transaction take steps to register the transfer of the participatory interests to the purchaser in the register of the portfolio; and

- the manager must issue a Purchase Note or a statement of account to a purchaser reflecting the sale of the relevant participatory interests: Provided that the purchaser may at any time demand a certificate referred to in clause 40 in respect of the participatory interests so purchased if the minimum number of participatory interests referred to in clause 26 is purchased.

Manager to furnish trustee/custodian with information

33. In order to enable the trustee/custodian to give effect to the provisions of this deed, the manager must furnish to the trustee/custodian on request statements of all issues of participatory interests and of the prices at which they were issued, particulars of any assets which it intends or plans to purchase or sell for the account of the scheme, and

any other information which the trustee/custodian may reasonably require.

Manager to repurchase participatory interests

34.1 It shall be incumbent on a manager to repurchase any number of participatory interests offered to it by an investor as determined in this deed.

34.2 For the purposes of subclause 34.1 and subject to subclause 34.3 the manager must determine a point in time by when repurchase requests must be received for the purpose of determining which valuation point will be utilised for the pricing calculation on a pricing date, which valuation point may not be more than 24 hours prior to or after the time when repurchase requests must have been received.

34.3 The time determined in terms of subclause 34.2 may not be changed unless 30 days' prior written notice has been given to investors.

34.4 A manager, when it receives a request for repurchase of participatory interests under circumstances prescribed by the registrar under section 105(3)(f) of the Act-

(i) may, with the prior consent of the trustee of custodian, or
(ii) must, without delay when the trustee or custodian so requires,

suspend the basis of the repurchase of the relevant participatory interests, if the manager, trustee or custodian, as the case may be, is of the opinion that the circumstances referred to, warrant the suspension in the interests of investors.

34.5 The repurchase of such participatory interests shall be priced and settled in accordance with conditions prescribed by the registrar under section 105(3)(f) of the Act.

Notice to repurchase

35.1 An investor who wishes to sell his or her participatory interests may at any time, by notice in writing to the manager or its duly authorised agent, require the manager to repurchase all or any of such participatory interests.

35.2 No notice requiring the manager to repurchase a participatory interest is valid unless the investor delivers to the manager or its authorised agent, the certificate, if any, representing the participatory interests offered for repurchase or, at the option of the manager, produced such evidence of his or her title to the participatory interest to be sold as the manager may consider sufficient. The said notice must be accompanied by an instrument of transfer and such other necessary documents referred to in clauses 43 and 46 of this deed. If the repurchase price is not paid to the investor on delivery of the said documents to the manager, the investor must be issued with a receipt for such documents.

Repurchase price

36. Subject to clause 34 the repurchase price per participatory interest payable by the manager may not be less than an amount ascertained by dividing the total number of participatory interests in issue in a portfolio at the time when the notice referred to in clause 35 was received by the manager, into the market value of all assets of that portfolio at the last valuation point determined under clause 34 and all income accruals and payments received in lieu of income accruals

PART VII : PARTICIPATORY INTEREST CERTIFICATES

Certificate

40. When any participatory interest is created and sold, the trustee/custodian must deliver to or to the order of the manager, a certificate representing the said participatory interest in the name of the person entitled thereto, if so requested by the said person. The trustee/custodian may not countersign any certificate unless it has received from the manager payment for the participatory interests sold in the form of cash or assets in terms of the Act and this deed, together with all documents necessary to effect transfer of the participatory interests.

Form of certificate

41. A certificate must be in the form determined by the manager and the trustee/custodian. A certificate must, for each separate portfolio, contain at least the serial number of the certificate; the number of participatory interests represented thereby; the full name and address of the investor; the name and address of the manager and the trustee/custodian; and the date on which the name of the investor has been entered in the register as the investor represented by the certificate.

Signature of certificate

42. Each certificate, if any, other than a statement, must be signed, either graphically or otherwise, by a duly authorised official on behalf of the manager and countersigned either graphically or otherwise by a duly authorised official on behalf of the trustee/custodian. No certificate may be issued or is valid until so signed.

Manager may nominate person to receive certificate

43.1 A certificate shall be issued to the manager, should it require one, and to an investor, if requested, in respect of a participatory interest to which the manager or such investor is for the time being entitled.

43.2 If the intention of the manager is to resell any repurchased participatory interest in the future it shall not be required to enter it's name into the register.

Number of participatory interests for which certificate is issued

44. A certificate may represent any number of participatory interests determined by the manager.

Exchange and consolidation of certificates

45. Subject to this clause, an investor in a particular portfolio may exchange his or her certificate or certificates for one or more new certificates representing a like number of participatory interests in that portfolio. The manager may determine a charge for each such new certificate. Before any such exchange takes place the investor must surrender to the manager the certificate which is to be exchanged. Every new certificate must be in the same name as the surrendered certificate, which must be cancelled and particulars of the new certificate must be entered in the register of the relevant portfolio.

Replacement of destroyed, mutilated or lost certificates

46.1 If any certificate is worn out or defaced, the manager, on production of the certificate must cancel the same and issue a new certificate in place thereof. If any certificate is lost, stolen or destroyed, then on proof to the satisfaction of the manager of such loss, theft or destruction and on such indemnity (if any) as the manager may deem adequate being given, and on such terms as the manager may decide, a new certificate in lieu thereof must be given to the person entitled to such lost, stolen or destroyed certificate. An entry as to the issue of the new certificate and the indemnity (if any) must be made in the register.

46.2 In the case of loss, theft or destruction of a certificate, the person availing himself or herself of the provisions shall pay to the manager all expenses incidental to the investigation of the evidence of the loss, theft or destruction and of the preparation of the said indemnity. In addition, any person to whom a new certificate is issued in terms of subclause 46.1 shall pay a charge to the manager as the manager may determine for each new certificate so issued.

PART VIII : RECEIPTS AND DISTRIBUTIONS

Payment of receipts to trustee

47.1 The following receipts in cash must be deposited in a separate trust account for each or all portfolios with a bank, registered in terms of the Banks Act, 1990 (Act 94 of 1990), or the Mutual Banks Act, 1993 (Act 124 of 1993), being an account under the control and supervision of the trustee/custodian:

- All monies which are received for investment as a result of the sale of participatory interests;
- all dividends, interest or other income which accrue to the underlying assets; and
- the proceeds of all capital profits, rights and bonus issues.

47.2 If any receipts are to be deposited with a foreign bank not registered as aforesaid, it shall be deposited with a bank, agreed upon between the manager and the trustee/custodian, and finally registered as a bank in terms of the laws of a foreign jurisdiction applying regulatory standards which are not less stringent than the equivalent standards in South Africa.

47.3 All assets received as a result of the sale of a participatory interest must be taken into account as an investment for the benefit of the relevant portfolio and new participatory interests shall be created in terms of this deed to represent such investment.

47.4 All income accruals received during an accounting period must be credited to an account called the "Income Account" in the books of account of the portfolio concerned and shall form part of such portfolio under the supervision and control of the trustee/custodian. If a portfolio receives any bonus, right or benefit in respect of any of the assets, whether in cash or scrip or by warrant, cheque, credit or otherwise, which is in the nature of income, the manager must convert such bonus, right or benefit into cash for the credit of the relative Income Account. Any other bonus, right or benefit must be treated as a capital gain and must be included in the relevant portfolio. No new participatory interests may be created out of income accruals or such capital gains.

47.5 All amounts received in lieu of income accruals from the creation and sale of participatory interests in a portfolio during an accounting period and all amounts received as income accruals in terms of subclause 47.4 must be credited to the Income Account and must be available for distribution to investors in that portfolio at the next ex dividend date.

Manager's decision on nature of bonus conclusive

48. If any doubt arises as to whether any bonus, right or benefit referred to in subclause 47.4 constitutes an income accrual or a capital gain, such question must be resolved by the manager after consulting the trustee/custodian and the auditors, and such resolution is conclusive.

Distribution of income

49.1 The trustee/custodian must on each distribution date distribute to investors (including the manager in respect of any participatory interests to which it is entitled) registered in the register of a portfolio as at the commencement of business on the immediately preceding ex dividend date, pro rata to the number of participatory interests then held by such investors in a portfolio, the amount available for distribution in that portfolio as hereinafter provided in respect of the accounting period immediately prior to such ex dividend date.

49.2 On each ex dividend date, the amount required to effect a distribution must be set aside and may no longer be taken into account in determining the market value of a portfolio for the purpose of calculating the selling and repurchase prices of a participatory interest. On each distribution date the said amount shall be transferred from the Income Account to a Distribution Account under the supervision and control of the trustee/custodian, which must distribute the same for the benefit of investors as herein provided. The amount to be distributed in respect of each participatory interest must be rounded down to the nearest one hundredth of a cent, and the amount to be distributed to any one investor must be rounded down to the lower cent. The aggregate balance remaining to the credit of the Distribution Account on completion of the distribution shall be carried forward and added to the amount available for distribution in the next accounting period.

49.3 If an investor makes a written application to the manager to that effect, the distribution due to him or her must automatically be reinvested in participatory interests for his or her benefit.

Determination of amount available for distribution

50. An amount equal to the income accruals during the accounting period plus all payments in lieu of income accruals received by the portfolio during the accounting period, and any balance carried forward, less any permissible deductions, must be distributed to investors.

Charges and method of calculation

51.1 The charges that may be levied in respect of a portfolio and the method of calculation of those charges must be prescribed in the supplemental deed of a portfolio: Provided that in respect of a portfolio of which any charge was fixed prior to 1 June 1998, i.e. the date of coming into operation of section 7 of the Unit Trusts Control Amendment Act, 1998 (Act No. 12 of 1998), such charge shall remain so fixed unless the investors affected agree to any change thereof in terms of section 89 of the Act.

51.2 The manager may, subject to subclause 51.1, change any charge of a portfolio or change the method of calculation of such charge or introduce an additional charge: Provided that any such change or introduction of an additional charge that could result in an increase of charges for investors shall be of no force unless the manager has given not less than 3 months' written notice to every investor and has effected the necessary amendment to the supplemental deed.

Payment of service charge

52. As soon as practicable after the end of each calendar month, the trustee/custodian must pay to the manager from the Income Account of a portfolio in respect of the service charge, an amount equal to 1/12th of the applicable percentage rate, of the market value of the total assets of a portfolio (excluding income accruals and permissible deductions, if any) at the end of the respective calendar month: Provided that in the event of there being a shortfall in the Income Account –

(a) participatory interests may be issued to the manager; or
(b) an amount deducted from the Capital Account,

equal in value to such shortfall for payment of the service charge.

PART IX : REGISTER OF INVESTORS

Register of investors

53. A register of investors in respect of each portfolio must be kept by the manager and the manager may for this purpose appoint transfer secretaries acceptable to the trustee/custodian. The remuneration of the transfer secretaries must be paid by the manager out of its own funds and the manager is liable for any act or omission, dishonesty or negligence on the part of a transfer secretary, when acting as such.

Contents of register

54. The manager must enter in the register of each portfolio the name and address of each investor, the number of participatory interests held by each investor and the serial number of his or her certificate, if any, or account number; the date of entry and, if participatory interests are transferred, a sufficient reference to the name and address of the transferor. If new participatory interests are created, the manager must enter the number of such participatory interests in the register.

Register is evidence

55. The register is proof that a registered investor is the owner of the participatory interests registered in his or her name. The manager need not recognise any trust or other right affecting the ownership of a participatory interest or the rights incidental thereto unless such trust or other right is recorded in a trust instrument as defined in the Trust Property Control Act, 1988 (Act No. 57 of 1988).

Change of name or address

56. If an investor wishes to register a change of name or address such investor must give notice thereof in writing to the manager who must change the register accordingly.

Inspection of register

57. The trustee/custodian may at all reasonable times during business hours inspect a register of investors. Any other person may inspect the register during business hours on payment of a fee determined by the manager.

Closing of register

58. A register may be closed at such times and for such period as the manager may with the approval of the trustee/custodian determine: Provided that it shall not be closed for more than 14 consecutive days or more than 30 days in any period of twelve months.

Death, insolvency or other disability of investor

59.1 The manager may require such evidence of the death, insolvency or other disability of an investor as it may think fit.

59.2 On the death of any one of joint investors, the survivor(s) shall be the only person(s) recognised by the manager as having any title to or interest in the participatory interest in respect of which they are registered.

59.3 The executor or administrator of a deceased investor, or the trustee of an insolvent investor, or the curator of an investor under a legal disability (not being one of several investors) including the trustee/custodian in respect of this scheme (if appointed as executor, administrator, trustee or curator) shall be the only persons recognised by the manager as having any title to or interest in a participatory interest held by the deceased, insolvent or disabled investor.

59.4 Any person becoming entitled to a participatory interest in terms of subclauses 59.2 or 59.3, upon producing such evidence as sustains the capacity in which he or she seeks to act or of his or her title as the manager considers sufficient and on delivering of the relevant certificate (if any) to the manager for cancellation, shall be entitled (subject to the rights of any joint investor) to elect either to be registered himself or herself or to have some other person nominated by him or her to be registered as an investor and subject to clause 43 of this deed to have a new certificate issued in his or her name, or in the name of his or her nominee, as the case may be. If the person so becoming entitled shall elect to be registered himself or herself, he or she shall deliver or send to the manager a notice in writing in a form prescribed by the manager, signed by him or her, stating that he or she so elects. If he or she elects to have his or her nominee registered he or she shall testify his or her election by executing in favor of his or her nominee, a transfer of such a participatory interest. All the provisions of this deed relating to the transfer of a participatory interest shall be applicable to any such notice of transfer as aforesaid as if the death, insolvency or other disability of the investor had not occurred and the notice of transfer were a notice of transfer executed by such investor.

59.5 A person entitled to a participatory interest in terms of subclauses 59.2 or 59.3 shall be entitled to receive and may give a discharge for all monies payable in respect of such participatory interest; Provided that he or she shall not be entitled to receive notices of or to take part in any ballot of investors until he or she has been registered as an investor.

59.6 The trustee/custodian may hold in trust any monies payable in respect of a participatory interest of which any person is in terms entitled to be registered, or of which a person is entitled to transfer, until such person or his or her nominee has been registered as an investor.

Participatory interest owned by manager

60. The manager shall be deemed to hold, and shall be treated for all purposes of this deed as an investor during such times as there is no other person registered or entitled to be registered as an investor. All such participatory interests shall be deemed to be in issue. Nothing herein contained shall prevent the manager from becoming an investor.

Transfer of participatory interest

61. Every investor shall be entitled to transfer a participatory interest held by him or her by a written instrument in such form as the manager may approve: Provided that no transfer shall be registered if the registration thereof would result in the transferor or the transferee becoming the holder of a lesser number of participatory interests than is prescribed for the time being by the manager. The instrument of transfer accompanied by such evidence as the manager may require to prove the title of the transferor or his or her right to transfer the participatory interest (together with any necessary declarations or other documents) shall be duly completed and executed by the transferor and (unless otherwise determined by the manager) by the transferee, and shall be lodged with the manager, and within 14 days thereafter the manager

must register the transferee as an investor referred to in such instrument of transfer and must, if required, issue to such transferee a new certificate representing the participatory interest so transferred. The transferor shall remain entitled to the participatory interest to be transferred by any such transfer until the name of the transferee is entered in the register in respect thereof. No transfer or purported transfer of a participatory interest, other than a transfer made in accordance with this clause, shall entitle the transferee to be registered in respect thereof nor shall any notice of such transfer or purported transfer be entered in the register. The manager shall retain all instruments of transfer.

Balance certificate

62. If only some of the participatory interests represented by any certificate are transferred, the transferor shall, subject to the terms of this deed be entitled to a new certificate free of charge in respect of the balance of such participatory interests.

Responsibility for transfer cost

63. In all cases where the transfer of participatory interests between an investor and the manager is effected, the manager shall be responsible for the payment of all costs necessarily incurred in connection with such transfer. In all other cases the costs so incurred shall be the responsibility of the persons concerned and not of the manager and the manager shall be entitled to charge a fee determined by the manager, for each transfer.

Cancellation of participatory interest

64. The manager shall have the exclusive right to effect a reduction of a portfolio by means of a cancellation of a participatory interest or by requiring the trustee/custodian to cancel a participatory interest, subject to surrender of the appropriate certificate of a participatory interest to the trustee/custodian or verification by the trustee/custodian that the appropriate participatory interest has been struck from the register of investors. The manager shall retain records, which may be inspected by the trustee/custodian at all reasonable times during business hours, of the number of participatory interests so cancelled and the amount paid to the manager in respect thereof, which amount must be calculated in terms of clause 65 of this deed. Before exercising such right, it shall be the duty of the manager to ensure that a portfolio includes (or will include upon completion of the sale of assets which may have to be sold as a result of the cancellation of a participatory interest) sufficient cash to pay the amount payable to the manager upon such reduction.

Payment to manager for cancelled participatory interest

65. In respect of any cancellation of a participatory interest, the manager shall be entitled to receive out of a portfolio an amount per participatory interest ascertained by dividing the number of participatory interests then in issue into the market value of such portfolio, including income accruals, on the day of such notice less an amount to cover the pro rata share of permissible deductions incurred during the accounting period in which the cancellation takes place, of that portion of the underlying assets represented by the participatory interest cancelled. The said amount shall be payable to the manager out of cash forming part of the portfolio concerned and against surrender to the trustee/custodian of the certificates to be cancelled or against delivery

to the trustee/custodian of particulars of the participatory interest to be cancelled in respect of which no certificate was issued. Upon such payment and surrender or delivery the participatory interest in question shall be deemed to have been cancelled.

PART X : FINANCIAL MATTERS

Financial year-end of portfolio

66. The financial year-end for each portfolio of the scheme shall be the end of ..... of each year.

PART XI : WINDING UP OF PORTFOLIO

Period of scheme

67. The manager may at any time, after consultation with the trustee/custodian and on written application to the registrar and subject to such terms and conditions as the registrar may determine, wind up such portfolio: Provided that at least three months' notice in writing must be given to investors of such winding-up.

Certificate on completion of winding up

68. The manager or the trustee/custodian as the case may be, must, within thirty days after the completion of the liquidation of a portfolio in terms of clause 67 submit to the registrar a certificate by the auditors to the effect that all the assets and income accruals in such portfolio have been realised and that the net proceeds thereof have been distributed amongst the investors and the manager in proportion to their respective interests.

Manner in which trust property be dealt with on liquidation of manager

69.1 In the event of the winding up of the manager, the trustee/custodian shall take immediate steps to:

- Cause any of the assets constituting each portfolio not yet in the name of the trustee/custodian to be transferred into the name of the trustee/custodian; and

- with the approval of the registrar, transfer the portfolios in terms of the Act and clause 10.3 of this deed to another manager.

69.2 If the transfer of a portfolio as envisaged in subclause 69.1 fails, the trustee/custodian must, unless the registrar has given any direction to the contrary in terms of the Act, realise all assets of such portfolio as expeditiously as possible with due regard to the interest of all investors.

69.3 The net proceeds of such realisation shall be distributed by the trustee/custodian amongst the investors and the manager in proportion to their respective interests therein.

69.4 Pending the realisation of the assets the trustee/custodian shall collect all dividends, bonuses and other distributions accruing or due in respect thereof and shall distribute it, after deduction of any charges necessarily incurred by it in connection with such collection and distribution, amongst the investors and the manager in proportion to their respective interests.

PART XII : GENERAL

Deed binding on all parties

70. This deed shall be binding on the trustee/custodian, the manager and an investor and any person claiming through them respectively as if such investor or person had been a party hereto.

Amendment of deed and balloting of investors

71. The consent of investors for an amendment of this deed must be obtained in the following manner:

71.1 Where such an amendment only affects one or more than one class of participatory interests in a portfolio, the investors, excluding the manager, holding no less than 25% in value of the total number of participatory interests then issued in that class of participatory interests or those classes of participatory interests of that portfolio, as the case may be, must respond in writing in a ballot conducted by the manager. The amendment must be consented to by investors holding a majority in value of the participatory interests held by the investors who have responded.

71.2 Where the amendment affects more than one or all the portfolios in the scheme, investors, excluding the manager, holding no less than 25% in value of the total number of participatory interests then issued in those portfolios affected, must respond in writing. The amendment must be consented to by investors holding a majority in value of the participatory interests held by the investors who have responded.

71.3 If investors holding less than 25% in value of the total number of participatory interests then issued have responded in accordance with subclauses 71.1 and 71.2, a second ballot must be conducted. In this ballot investors holding a majority in value of the participatory interests held by the investors who have responded, must consent to the amendment.

71.4 Every registered investor shall have a right to vote in the case of a ballot in respect of each participatory interest held by him/or her: Provided that an investor or his or her duly authorised representative shall be entitled to exercise all his or her voting rights as aforesaid, but shall not be obliged to exercise all his or her votes or exercise all the votes he or she is entitled to in the same way.

71.5 When a ballot is necessary the manager shall dispatch to every investor a ballot paper and a memorandum approved by the Registrar containing the reasons for the proposed amendment.

71.6 For the purpose of subclauses 71.1, 71.2 and 71.3 only ballot papers which are received by the manager within thirty business days after dispatch to investors shall be taken into account and be regarded as valid. Ballot papers shall be counted by the auditors and their finding, as conveyed in writing to the manager, shall be final and binding.

71.7 Where a registered investor is holding participatory interests as a nominee or other person duly appointed to act on behalf of the beneficial owners of such participatory interests, the nominee or such appointed person must obtain written instructions from such owners as to how to respond to the proposed amendment of this deed.

71.8 If, for the purposes of subclause 71.7, some beneficial owners are in favour of the proposed amendment but others are against it, the nominee or such appointed person must respond accordingly and for that purpose the nominee or such appointed person is entitled to respond in favour of and against the proposed amendment.

71.9 The provisions of subclauses 71.1, 71.2 and 71.3, which deal with the weighting of the response by an investor, also apply in the case of the responses by a nominee or such appointed person.

Copies of deed and inspection thereof

72. A copy of this deed must at all times during normal business hours be made available by the manager or the trustee/custodian at their respective head offices for the inspection by an investor or an intending purchaser of a participatory interest. Any investor shall be entitled to receive from the manager a copy of this deed on production of his or her certificate or other acceptable evidence of his or her holding, upon request to the manager and on payment to the manager of such amount as the manager may require for each copy of the document required. The manager shall on demand and at its expense supply to the trustee/custodian such copies of this deed as the trustee/custodian may require.

Payment to investor

73. Any monies payable under this deed to an investor must be paid by crossed cheque marked "not transferable" and made payable to or to the order of, and sent through the post to the registered address of such investor, or be paid or delivered in such other manner as the manager and the trustee/custodian consider, in the interests of the investor to be safe and convenient, or in the case of joint investors may be made payable to or to the

order of and sent through the post to the registered address of that one of the joint investors who is first named in the register, or otherwise as agreed, at his or her risk. In the event of an investor or the joint investor who is fist named in the register, having given a mandate in writing to the manager, in such form as the manager must approve, for payment to the bankers or other agent or nominee of the investor or joint investors, then the same must be sent through the post to the address given in such mandate, or otherwise be dealt with in accordance with such mandate. Payment as set out above shall be a good discharge to the manager and the trustee/custodian.

Receipt by one of joint investors' valid discharge

74. The payment or posting to the joint investor who is first named in the register of any money payable to joint investors, or of a certificate, written notice or other document intended for joint investors, shall be deemed to be payment or posting to all such joint investors.

Notices

75.1 Any notice required to be served on an investor shall be deemed to have been duly given if sent by post to or delivered at his or her registered address and be deemed to have been served four days after the same was posted or delivered. In proving such service it shall be sufficient to prove that the envelope or wrapper containing the notice was posted. Any notice sent to an investor by means of a facsimile shall be deemed to have been served on the date of transmission. If so requested by an investor any notice may be sent electronically and shall be deemed to have been served on the same day.

75.2 Any notice or document sent by post to or delivered at the registered address of an investor shall, notwithstanding that such investor is deceased, insolvent, or under any other legal disability, and whether or not the trustee/custodian or the manager has notice of his or her death,

insolvency or other disability, be deemed to have been duly served, and such service shall be deemed a sufficient service on all persons interested in the participatory interests concerned, whether jointly with or as claiming through or under him or her.

75.3 The accidental omission to give notice to an investor, or the non-receipt of any notice by any investor, shall not give rise to any claims of whatsoever nature by such investor against the scheme, the trustee/custodian or the manager, and shall not invalidate any matter or thing done pursuant to or in terms of such notice.

75.4 Any notice between a manager and trustee/custodian shall be in writing.

Custody and disposal of documents

76.1 The manager shall be entitled to destroy or otherwise dispose of all instruments of transfer in its custody after the expiration of six years from the date of registration thereof and all certificates in its custody which have been cancelled at any time after the expiration of six years from the date of cancellation thereof and all registers, statements and other records and documents, other than this deed, relating to the scheme at any time after the expiration of six years from the termination of the scheme. The manager shall not be under any liability whatsoever in consequence of any such destruction. Unless the contrary is proved, every instrument of transfer so destroyed shall be deemed to have been a valid and effective instrument, duly and properly registered, and every certificate so destroyed shall be deemed to have been a valid certificate, duly and properly cancelled.

76.2 The provisions of this clause shall apply only to the destruction of a document in good faith and without notice of any claim or dispute, regardless of the parties thereto, to which the document might be relevant.

76.3 The provisions of this clause shall not apply to any document expressly excluded by the trustee/custodian by notice in writing to the manager.

Electronic and telephonic transacting

77.1 The manager and the trustee/custodian have agreed to allow for transacting via electronic and telephonic means, subject to subclauses 77.2 and 77.3 and the consent of the investor.

77.2 If the investor consents to electronic or telephonic transacting, the investor must be fully apprised in the initial application form used for electronic and telephonic transacting and in all application forms posted on the manager's website, of the conditions of electronic and telephonic transacting.

77.3 Such application forms must at least provide for-

77.3.1 the procedure to effect electronic or telephonic transacting and the costs involved;

77.3.2 the procedure for registration of an electronic or telephone transaction;

77.3.3 the legal implications of such a transaction for the investor; all disclaimers by the manager;

77.3.4 any limitation of liability afforded to the manager;

77.3.5 the security risks and risk of interception inherent to electronic and telephone transacting;

77.3.6 related precautionary or security measures;

77.3.7 confirmation to investors that telephone calls are recorded and that such records shall be retained for a period of five years;

77.3.8 confirmation by the manager that its website complies with relevant legislative requirements applicable to S.A. residents;

77.3.9 warning that taxation of other jurisdictions are not taken into account;

77.3.10 warning that information contained on the website does not constitute advice.

77.4 The terms and conditions under which electronic or telephonic transacting will be done must be displayed on screen or verbally communicated, as the case may be.

Signatures

78. SIGNED AT ..... THIS .....
DAY OF 2001

AS WITNESSES:

1. .....
2. ..... For .....
(the Manager)

.....
AUTHORISED SIGNATORY
Who is duly authorised to do so.

SIGNED AT ..... THIS ..... DAY OF
..... 2001

AS WITNESSES:

1. .....
2. ..... For .....
(the Trustee/Custodian)

.....
AUTHORISED SIGNATORY
Who is duly authorised to do so.