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DISSERTATION TOPIC :

"Trusts have now pervaded all fields of social institutions in common law countries. They are like those extraordinary drugs curing at the same time toothache, sprained ankles and baldness, sold by peddlers on the Paris boulevards; they solve equally well family troubles, business difficulties, religious and charitable problems. What amazes the sceptical civilian is that they really do solve them.....The trust has everywhere planted itself like a cuckoo in the nest of civil law; and this is, as you will agree, a remarkable circumstance."
(Sir Maurice Amos (1936-7) Harvard Law Review 1249 at 1263-4)

'As endless in it's facets as mankind in it's characteristics and peculiarities, and exactly as interesting, the estate plan is far too worthwhile as an intellectual excercise to be made dependent upon tax quirks and loopholes; and it deserves to be co-joined with a motive far more noble than mere tax economics. The philosophical approach of the draftsmen and advisor is all-important. His first task is to make certain of his philosophy and of his fundamental respect for his own creation.'
(Farr, J.S. An estate planner's handbook, quoted by Bobbert, M.C.J. Grondlyne van Strategiese boedelbeplanning, Tydskrif vir Regswetenskap, 1976 : 4)

Discuss the use of trusts as a vehicle for estate (tax) planning in South Africa. BF Fareed
Reference should be made to the implications of tax statutes on trusts as well as to any relevant developments in the law with regard to the taxation of trusts.

INTRODUCTION

Estate planning has been described as the process whereby a person acquires property, ensuring that he derives maximum benefits from his ownership and the enjoyment thereof during his lifetime, and that as much as possible and in the most economical manner with the minimum erosion thereof shall devolve upon his heirs when he dies. (1) The objective of estate planning is thus, in essence, the disposal of property during the estate owner's ('the planner') lifetime or upon his death.

Trusts have over the years been an indispensable tool in the estate planner's armoury for achieving these objects. This has been so primarily because trusts, as an institution, bring about separate rights of ownership –not jointly– over an object, all equally valid, and, at the same time, each in the separate hands of at least two different persons, the one sporting a legal title, the other an equitable one. (2) In the past certain income tax benefits and estate duty savings contributed to the popularity of trusts in South Africa as business and estate planning tools. Trusts have been useful for estate planning purposes in order to peg the value of assets in a deceased's estate thereby reducing estate duty liability and insodoing preserve the estate for the heirs. To this end family trusts have become popular in practice since the growth in the asset(s) occur in the trust and not in the planner's estate; this (I submit) is particularly advantageous in inflationary conditions.

The vexing question today is whether trusts will continue to play such a pivotal role in achieving the estate planner's objectives. In this dissertation I will discuss this pertinent issue with reference to the recent Katz Commission recommendations as well as to possible future legislative threats to planning with trusts. In addition, I will deal with the position of trusts in South African law with particular emphasis on :

- the essential features of a trust;
- the advantages of inter vivos trusts in estate planning;
- the legal nature of the trust beneficiary's right to the trust property : a distinction between vested and contingent rights;
- a comparison between the use of trusts, companies, close corporations and partnerships as trading structures for tax planning; and
- the basic principles of taxation of trust income as embodied in sections 7 and 25B of the Income Tax Act 58 of 1962 ('the Act').

CHAPTER 1

THE ESSENTIAL FEATURES OF A TRUST

1.1.THE DEFINITION OF A TRUST

A trust is a contract whereby the founder transfers asset(s) to a trustee(s) in terms of a trust deed which provides that the trustee(s) shall have no beneficial interest in the trust property and shall apply the trust property for the benefit of some person(s) or for the accomplishment of some special purpose. (3) The essence of a trust is, thus, the separation of control or administration (usually ownership) of an asset(s) from the beneficial enjoyment thereof. In this regard legal concepts such as vested and contingent rights are of particular significance. (4)

It is evident from the nature of a trust that it provides a means for ensuring that income is derived by persons other than the owner of the asset(s) transferred to the trust. As a consequence of this feature trusts have frequently been employed in income tax planning, particularly as a means for ensuring income-splitting or of diverting income from a person paying tax at a higher marginal rate to a person paying tax at a lower marginal rate. In this regard the legal effect of section 7 (read with section 25B) of the Act is of particular significance. (5)

Huxam & Haupt (6) point out that from an estate planning perspective a trust has the following advantages :

(i) it enables the founder to divest himself of his assets;

(ii) the beneficiaries need not have a vested right to the assets;

(iii) the trust is not a living person and will thus not have an estate duty problem.

The principles surrounding trusts in South African law are derived from English law, with it's concept of dual ownership, and have been incorporated into our law through usage. Maitland (7) considered trusts to be "the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence." The South African law of trusts is governed by the provisions of the Trust Property Control Act 57 of 1988. Section 1 (8) provides that trust property refers to movable or immovable property, and includes contingent interests in property, which in, accordance with the

provisions of a trust instrument, are to be administered or disposed of by a trustee. The said Act defines a trust as:

"an arrangement through which ownership in property of one person is by virtue of a trust instrument made over or bequeathed –

(a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument, but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act 66 of 1965." (9)

Section 1 of the Income Tax Act defines a trust as "any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person".

In Phillip Frame Will Trust v CIR (10) it was held that a trust is not a 'person' for the purposes of the Act. In CIR v Friedman & Others NNO (11) it was held that '[i]t is clear therefore that a trust is not an incorporated company. Nor is a trust a body of persons unincorporate whose common funds are the collective property of all it's members. There is also no basis for a submission that because the statutory definition of 'person' in s1 of the 1962 Income Tax Act was further extended to include a deceased estate, it should by analogy be further extended to include a trust. The conclusion is inescapable that a trust is not a 'person' within the meaning of that word in the 1962 Income Tax Act.' Consequently, the Act was amended so that section 1 of the Act now includes a 'trust' in the definition of "person" for income tax purposes. This amendment is deemed to have come into operation as from the commencement of years of assessment which commenced or commence on or after 1 March 1986. Thus a trust is a taxable entity liable for tax in respect of the undistributed trust income of the trust. (12)

The essential features of a trust are (13) :

(i) a founder (donor or settlor) with an intention to create a trust; (14)

(ii) the identification and segregation of the asset(s) by the founder. The asset(s) placed in the trust must be clearly identified and will no longer be "owned" by the founder. The trust asset(s) are transferred to the trustee(s) in whom bare (unbeneficial) ownership of the asset(s) vest, coupled with an obligation to administer it for the benefit of the beneficiary or for some purpose other than the trustee's own benefit (so called "purpose trust"); (15)

(iii) the nomination of trustee(s) to administer the trust for the benefit of the trust beneficiary;

(iv) the identification of the trust beneficiary, that is the person entitled to the capital and/or income of the trust. It may include the founder and trustee(s);

(v) the placing of an asset(s) under the control of trustee(s) who are empowered to act in their fiduciary capacity by virtue of letters of authority issued by the Master of the High Court (16). The founder is obliged to divest himself of, at least, part of his legal power in respect of the trust property. He may, however, be a trust beneficiary or trustee (but not sole trustee). (17) In it's strictly technical sense the trust is a legal institution sui generis. The trustee(s) is regarded as the owner of the trust property for purposes of administration of the trust but qua trustee he has no beneficial interest therein. On termination of the trust the trustee, in his capacity as such, acquires no personal benefits emanating from the trust property. On the trustee's death neither his heir(s) nor legatee(s) will succeed to the trust property. (18) However, the trust property does form part of the trustee's personal estate in so far as he, as trust beneficiary, is entitled to it; (19)

(vi) the directions for the administration of the trust as embodied in the trust instrument. Purpose trusts apart, provision must be made in the trust instrument for the ultimate destination of the trust capital otherwise there is a nudum praeceptum which has the effect that the income beneficiary obtains full ownership of the trust property; (20)

(vii) the object or purpose of the trust must be legal; (21)

(viii) vesting depends on the terms of the trust instrument, although parties to the trust may have concurrently vested interests : the trustee(s) has bare dominium with control; the income beneficiary may have a vested right to the

income of the trust; and the capital beneficiary may have a vested right to claim ownership of the trust capital at some future date;

(ix) trusts (in a strict sense) exclude other institutions (such as guardianship, curatorship and executorship) which also entail one person holding property for and on behalf of another person; (22)

(x) ownership (minus control) may be vested in the trust beneficiary – a bewind trust. (23)

1.2 CLASSIFICATION OF TRUSTS

Trusts are classified, in the first instance, according to it's method of creation, in which regard one can distinguish between the following types of trusts :

(a) Testamentary trusts – these are incorporated in a person's will. Academics seem to disagree as to it's moment of creation. While some academics (24) consider that a testamentary trust does not come into being until the trustee(s) has ownership of the trust asset(s), others (25) are of the view that the trust exists from the testator's date of death, though it takes effect only later. It is beyond the scope of this dissertation to discuss the merit of these conflicting views, suffice it to say that the latter view seems to be the correct one.

(b) Trusts mortis causa – these come into existence contractually but they are only registered in accordance with the provisions of Act 57 of 1988 and become effective upon the planner's death. It may be described as being a hybrid between testamentary trusts and inter vivos trusts but, because it is not a testamentary disposition, it need not comply with the formalities governing valid wills as embodied in the Wills Act 7 of 1953.

(c) Inter vivos trusts – these are formed during the lifetime of the founder, emanate from a contract (eg. a contract between founder and trustee(s) or a contract contained in an ante-nuptial contract), exists from the moment when such contract is executed, and are registered in accordance with the provisions of Act 57 of 1988. (26)

It is submitted that, in so far as estate planning is concerned, testamentary trusts are ideal for holding property for the benefit of a person(s) who is incapable of looking after his/her own affairs (eg. minors); for protecting beneficiaries against

themselves; for obviating the creation of too big an estate for a surviving spouse; for achieving a better tax structure; for holding property such as farms or mineral rights which cannot be held in undivided shares, and for those cases in which a usufruct, annuity or fideicommissum can be improved upon. (27) It is my view that testamentary trusts and trusts mortis causa are, in comparison with inter vivos trusts, not ideal estate planning vehicles since they only become effective and operative on the death of the planner. It is my submission that inter vivos trusts can, as a rule, be accepted as the more appropriate vehicle for effective estate planning. This is so because they provide an excellent means for receiving property from the estate owner in order to peg the value of the estate in the owner's hands; for protecting assets against the owner's creditors; and for undertaking trading in the event of insolvency. (28)

Secondly, trusts are classified according to the nature of the trust beneficiaries' rights as embodied in the trust deed. In this regard one can distinguish between three distinct categories of trusts (29) :

(i) a bewind trust – this is a trust in the wide sense. Here real rights of ownership in the trust asset(s) vest in the trust beneficiaries. Should a beneficiary die prior to the termination of the trust, then the trust asset(s) to which such beneficiary was entitled are transmissible to his/her heirs, subject to the terms of the trust deed. The management and control of the trust asset(s) vest in the trustee(s) who are mere administrators and not owners thereof. (30)

(ii) a vested trust – here both the ownership in and control of the trust asset(s) vest in the trustee(s) in their representative capacity on behalf of the trust. The beneficiaries enjoy a mere personal right to claim their share in the trust asset(s) upon the happening of the uncertain future event specified in the trust deed. In this sense capital and/or income beneficiaries have a vested right either in respect of capital or income or both because, in the event of a beneficiary's death prior to the fulfilment of the stipulated condition, such beneficiary's personal right is transmissible to his/her heirs. (31)

(iii) a discretionary trust – this is a trust in the narrow sense. Here the trustee(s) have a discretion as to whether, and to what extent, trust income is to be distributed to the trust beneficiary. Here both the ownership in and control of the trust asset(s) vest in the trustee(s) in their representative capacity. Any claim by a trust beneficiary to the trust benefits is dependent on the exercise of the trustee's discretion. Prior to the exercise of such discretion the beneficiaries have no rights so that nothing is

transmissible to a trust beneficiary's estate should he/she die prior to the exercise of such discretion. In other words, there are no vested rights between successive generations. (32)

In light of the above explanation, I submit that the bewind and vested trusts are not effective vehicles for estate duty savings since the benefits of a trust beneficiary are, in the event of death, transmitted to his/her estate and, consequently, the value thereof is included in his/her estate for estate duty purposes in accordance with the provisions of the Estate Duty Act 45 of 1955. The discretionary trust, on the other hand, may be considered an effective tool for estate duty savings in that trust benefits are not transmissible to a deceased beneficiary's estate prior to the exercise of the trustee's discretion and hence is not included as an asset in his/her estate.

1.3 SUMMARY

The basic idea of a trust is the holding of property by a trustee(s), not for personal benefit, but for the benefit of named or determinable beneficiaries. Within the framework of a trust there is a separation of the formal ownership of an asset from the enjoyment of the benefits of ownership in relation to such an asset. Neither the inter vivos nor the mortis causa trusts possess legal personality. Although the common law does not recognise a trust as a legal person, (33) for insolvency purposes the trust estate is a 'debtor' in terms of the provisions of the Insolvency Act 24 of 1936 but not a 'corporate body' which means that a trust is to be sequestrated and not liquidated. For income tax purposes a trust is a taxable entity; the Act defines 'person' to include 'any trust'. (35)

CHAPTER 2

THE ADVANTAGES OF INTER VIVOS TRUSTS

2.1 WHY CHOOSE AN INTER VIVOS TRUST?

A trust can be employed as a vehicle to protect or preserve the trust fund for the benefit of one or more beneficiaries (or a succession of beneficiaries) over a period of time. It can also served as a safe-haven to protect the founder and his family from the financial vicissitudes that could arise from his economic or business activities. (36) Transferring asset(s) to a trust with power vesting in the trustee(s) to dispose of it carries with it the distinct advantage of creating a flexibility which the simpler form of bequest (eg. a usufruct or fideicommissum) cannot give and also allows the trustee(s) to bring a more impartial mind to bear on the question whether the property concerned ought to be retained or sold and the proceeds re-invested. (37)

It is my submission that the primary consideration in the formation of an inter vivos trust is tax and estate duty benefits. Care must, however, be taken to ensure that this purpose does not unduly inhibit the beneficiaries' use and enjoyment of the trust asset(s) which they would have enjoyed had the asset(s) not been placed in trust. The emphasis is thus on the creation of a trust which not only allows for the enjoyment of tax and estate duty benefits, but also optimum benefit of the asset(s) transferred to the trust.

2.2. THE BENEFITS OF AN INTER VIVOS TRUST

In light of my submission above, namely that an inter vivos trust is a more effective vehicle for estate planning than testamentary trusts and trusts mortis causa, one ought to consider the distinct benefits applicable to the formation of an inter vivos trust. (38)

(a) The first category of benefit is defined as custodianship benefits and are applicable to all types of trusts outlined above.

(i) Asset protection

Placing assets in trust protects the assets from possible squandering and wasteful disposal thereof by, inter alia, minors, insolvents, incapacitated persons, and persons inexperienced in financial affairs. Further examples include the placing into trust of

pension, provident or retirement annuity fund lump sums on behalf of immature, young and incapacitated persons, and placing into trust an amount sufficient to cover the maintenance of a surviving spouse under the Maintenance of Surviving Spouses Act 27 of 1990. (39)

The Katz Commission 4th Report (at p.13) pointed out that the normal asset protection trust arises from a donation by the founder or disposal of an asset(s) to such trust by the founder in consideration for a loan account. The income beneficiaries thereof include the founder, the spouse of the founder and their children and grandchildren whilst the capital beneficiaries include the children and grandchildren of the founder. It also said that another form of trust is the so-called 'perpetual' trust where the capital beneficiaries are the founder's heirs and the income beneficiaries are the same as that in the normal asset protection trust outlined above.

(ii) Asset management

Where there same asset is owned by many persons with divergent requirements and expectations, the placing of such an asset into trust will facilitate the management and control thereof. (40)

(iii) Reservation of rights

The estate planner may reserve certain rights for himself which he would not have been able to do had he donated the asset outright. For instance, he can reserve the right to a portion of the trust income and/or the right to have a say in the distribution of the trust income/capital.

(iv) Insolvency protection

The 'creditor protection' which a discretionary trust affords is one of the pertinent benefits of the creation of an inter vivos trust. As a general rule, a creditor of an insolvent planner or beneficiary will not be able to set aside a trust transaction. This rule is, however, subject to :

(a)the normal insolvency rules in respect of impeachable transactions; (41)

(b)the estate planner being solvent at the time of the transfer of the asset(s)

to the trust. That is, the sequestering of an asset(s) in trust must not, at the time it is sequestered, result in the planner's liabilities exceeding his assets. (42)

Subject to the aforementioned two conditions, a planner engaged in any trade which could reduce his estate or carries with it the risk of insolvency can protect himself and his family from financial slumps by placing his assets into trust and thereby protect it from the grasp of his creditors. To achieve this goal a trust deed can, in so far as any trust beneficiary is concerned, exclude the vesting of any trust asset(s) in such person(s) (43) or it can provide that such beneficiary would, in the event of such circumstance arising, lose his right in favour of another (eg. a spouse or any of his children), that is the so-called gift-over. (44) A trust beneficiary can be protected from the effects of insolvency by the inclusion of a clause in the trust deed which provides that in the event of a beneficiary becoming insolvent or an attempt be made to attach his share of the trust assets or should he attempt to cede his rights under the trust, such beneficiary's trust interest is to cease and devolve upon someone else. Such a clause may be coupled with a rider that, should the occasion for the forfeiture cease to operate, the trustee(s) could, in the exercise of their discretionary powers, restore the beneficiary's rights to him/her. (45)

(v) Subsidiary purpose

The Subdivision of Agricultural Land Act 70 of 1970 prohibits subdivision of agricultural land in undivided shares without the consent of the Minister of Agriculture. Should such consent not be forthcoming one could place the farm concerned into a trust to be administered for the benefit of more than one beneficiary.

(b) The second category of benefit relating to inter vivos trusts is fiscal benefit, predominantly applicable to discretionary trusts. (46)

By divesting oneself of ownership of growth assets in favour of a trust one can achieve significant estate duty and related savings. The result of such divestment is that, from the date of transfer to the trust to the date of the planner's death, growth in the assets so transferred takes place in the trust. What the planner retains is merely the

value of the asset as at the date of transfer, usually in the form of a loan account. The planner's loan account can be reduced during his lifetime in one of two ways :

(i) by interest-free loan repayments which are tax-free; and/or

(ii) by means of tax-free donations not exceeding R 25 000 per annum from the planner to the trust. Section 56(2)(b) of the Act provides that 'donations tax shall not be payable in respect of so much of the sum of the values of all property disposed of under donations by a donor who is a natural person as does not during any year of assessment exceed R25 000'.

The aforementioned methods of reducing a loan account reduces the planner's potential estate duty liability. The use of interest-free loans, while contributing to estate duty savings, is not necessarily effective from an income tax point of view in that section 7 of the Act deems income accruing from trust assets financed by interest-free loans to be the planner's income. In this regard see CIR v Berold 1962 (3) SA 748 (A); Joss v SIR 1980 (1) SA 674 (T); Ovenstone v SIR 1980 (2) SA 721 (A). Other taxes and costs saved by successive generations of trust beneficiaries include transfer duty, stamp duty, marketable securities tax, master's fees, executor's fees and conveyancing costs. These savings result from the mere retention of an asset(s) in trust on successive deaths of trust beneficiaries. A further fiscal benefit is the saving of income tax. As a consequence of the splitting of income after the death of the planner between the various trust beneficiaries, lesser income tax will be paid due to beneficiaries falling into lower tax brackets. In addition, the planner could, in his will, bequeath to the trust any balance owing to him on the loan account by the trust as at the date of his death. While the value of such bequest would constitute an asset in the planner's estate for estate duty purposes, the fiscal benefit achieved for the trust is that the trust is no longer indebted to the planner's estate in the amount of the loan. In this way a potential cash flow problem for the trust could be averted.

2.3 METHODS OF TRANSFERRING ASSETS TO INTER VIVOS TRUSTS

Transfer of an asset(s) to an inter vivos trust can take place either by way of donation, sale, or a combination of both a sale and donation, each of which method have attendant cost implications.

(a) Donation of an asset(s) to the trust

In accordance with the decision in Ovenstone v SIR (supra), a donation is a gratuitous disposal of property or a gratuitous waiver or renunciation of a right by the donor thereof, the donee being thereby enriched and the donor correspondingly impoverished. If a planner donates his asset(s) to the trust he/she becomes liable, in terms of s64 of the Act, to pay donations tax of 25% of the market value of the asset(s) donated (subject to the applicability of the exemption provided for in s56(2)(b) of the Act). In terms of s59 read with s60 of the Act, the donor is liable for the payment of donations tax within three months from the date the donation takes effect, failing which the donor and donee are jointly and severally liable therefor.

With regard to the tax implications of a donation, it is submitted that a disadvantage to the planner could be created in that it could create a cash flow problem and, furthermore, because it, in effect, means that the planner will be paying estate duty in advance. A further disadvantage relates to the loss of control by the planner with regard to the asset(s) donated as such. It must, however, be borne in mind that the planner will be saving estate duty on any growth in the asset(s) between the date of transfer of the asset(s) and his/her date of death, as the growth of the asset(s) takes place in the trust. In addition, the planner's estate will be reduced by the amount of donations tax paid and by the growth in value by which such amount paid would have increased up to the date of his/her death.

However, if the latest Katz Commission recommendations are accepted then it will be possible, firstly, that a tax will be levied on the increase in the value of assets in a trust every 25 or 30 years so as to prevent the generation-skipping effect of trusts (47) and, secondly, that distributions from trusts will, in certain situations, be subject to a capital transfer tax. (48) It is submitted that, if this proposal were to be implemented, a donor may still be able to countenance the effect thereof by including an escape clause in the trust deed which will enable the trustee(s) to vest the trust capital in the beneficiaries, or possibly other trusts. (49)

(b) Sale of an asset(s) to the trust

Here the planner sells the asset(s) to the trust, there being a resultant loan account in favour of the planner in the amount of the purchase price. The asset must be sold at it's fair or current market value so as to prevent the possible invocation of the provisions of s58 of the Act. Section 58 provides that 'where any property has been disposed of for a consideration which, in the opinion of the Commissioner, is not an

adequate consideration that property shall be deemed to have been disposed of under a donation'.

The disadvantage of such a loan account is that it is executable for the purposes of any third party liability claim and, furthermore, it constitutes an asset in the planner's estate for estate duty purposes. The loan may, however, be donated back to the trust at R25 000 per annum, which is, according to s56(2)(b) of the Act, the maximum value of donations which may be made annually by a natural person without incurring liability for donations tax; insodoing the monetary value of the planner's estate may be reduced.

In practice it is common for such loan account to be interest-free or subject to a low (that is, below-market) interest rate so as to reduce or fix the dutiable value of an estate. The loan account is also, usually, repayable on demand which has the advantage that the planner retains a degree of control in the sense that he/she can call-up the loan account at anytime. In the case of interest-free or low interest loans the planner ensures that the value of his estate does not increase annually by the amount of interest which would otherwise have been payable to him. Also, by granting interest-free or low interest loans the planner can minimise his annual gross income thereby limiting his income tax liability. It is, however, possible that Revenue officials could argue that the granting of, for instance, an interest-free loan results in the loan being a 'continuous (deemed) donation' or a 'disposition' subject to tax in the hands of the planner in terms of section 7(3) and (5) of the Act. See Ovenstone v SIR (supra) and CIR v Berold(supra). Accordingly, it is submitted that the issue as to whether interest ought to be charged (or, if charged, the rate thereof) must, in the totality of the situation, be weighed in the light of the income tax and estate duty implications thereof. With regard to such loans, the Katz Commission 4th Report (at p.9) recommended that no specific legislation be introduced at this point in time to combat this 'scheme' but that it is open to the South African Revenue Services (SARS) to consider the introduction at a later stage of specific, as opposed to general, anti-avoidance measures.

If shares and unit trusts are transferred to the trust then marketable securities tax (MST) of 0.25% on the market value of the asset so transferred is payable. If fixed property is transferred to the trust then transfer duty at a flat rate of 10% is payable; no transfer duty is payable for any subsequent transfer from the trust to a beneficiary. To this end it ought to be noted that the Katz Commission 4th Report (at p.6) has recommended that South Africa should introduce a capital transfer tax (that is a tax on the appreciation of wealth) in order to achieve horizontal and vertical

equity. In this regard the Commission (at p.12-13) has recommended that trusts be subjected to capital transfer tax on the basis that, at periodic intervals of 25 to 30 years, the net assets of the trust be valued and subjected to capital transfer tax at the rate applicable to inter vivos donations and assets without any rebates. This recommendation of a 'generation skipping tax' was made in order to curb the use of generation skipping trusts as a tax avoidance mechanism. Such trusts acquire assets from the planner on the basis that the assets so acquired will be held by the trust for a period extending beyond one generation. In an extreme situation, the assets can be held indefinitely on the basis that allocations of capital and income will be made to the children of the various generations. However, the Commission also recommended that certain trusts should be exempted from capital transfer tax. These are trusts established by a parent, an immediate relative or guardian and the sole beneficiaries of which are the mentally or physically disabled or further issue of such parent, immediate relative or guardian.

The table below sets out the tax implications of transferring an asset(s) to an inter vivos trust as well as the calculation of potential fiscal advantages in doing so.

Form of transfer of asset to trust	Nature of asset	Value-added Tax (VAT) payable	Transfer duty payable	Donations tax payable	Marketable Securities Tax (MST) payable
Donation of asset(s) to the trust	movable	NIL	NIL	25%	NIL
	immovable	NIL	10 % of the value of the asset	25%	NIL
	shares	NIL	NIL	25%	0,25 % of market value of asset

Sale of asset(s) to the trust	movable	14% if entity (trust) is an enterprise	NIL	NIL	NIL
	immovable	14%	10% of the value of the asset	NIL	NIL
	shares	NIL	NIL	NIL	0,25 % of the market value of asset
NOTE: In the case of a sale of immovable property to a trust either transfer duty or VAT is payable on the purchase price (NOT both).					

2.4 THE CONTROL OF TRUST ASSETS

The question of control over trust asset(s) is particularly important to an estate planner because it is only natural that a person who has through 'sweat and blood' built up a sizeable estate is wary of placing control of his asset(s) in the hands of others. However, to a certain degree this is necessitated by s3(3)(d) of the Estate Duty Act 45 of 1955 which provides that 'property which is deemed to be property of the deceased includes any property of which the deceased was immediately prior to his death competent to dispose of for his own benefit or for the benefit of his estate'. In other words, if this were the case, a liability for estate duty would arise in respect of such property. It is thus important that a planner is not in a position to dispose of the asset(s) which he has donated or sold to the trust for his own benefit or for the benefit of his estate. To achieve this goal one must ensure that the planner is, in relation to the other trustees, in a minority position. He could thus be appointed as a trustee subject to the following limitations :

(a) that he is one of at least three trustees appointed in the trust deed;

(b) that a quorum for any meeting of trustees shall consist of at least two trustees other than the planner himself; and

(c) that the planner does not have the power of appointment and removal over his co-trustees.

The question which then arises is to what extent can a planner himself benefit from the trust and how is a planner protected against any 'scheme' by his co-trustees?

(a) the planner may be designated an income beneficiary;

(b) he can benefit from the capital of the trust in terms of loan repayments;

(c) he can be empowered in terms of the trust deed to borrow from the trust, the amounts so borrowed being set-off against his loan account;

(d) he can be empowered in terms of the trust deed to repurchase the asset(s) from the trust at any time, which will effectively end the trust for all practical purposes; and

(e) his loan account can be made repayable on call. This represents a powerful weapon in the hands of the planner in the event of him being at logger-heads with his co-trustees.

CHAPTER 3

THE LEGAL NATURE OF THE TRUST BENEFICIARY'S RIGHT TO THE TRUST PROPERTY: A DISTINCTION BETWEEN VESTED AND CONTINGENT RIGHTS

3.1. INTRODUCTION

If trust property vests in the trustee(s) then the trust beneficiary has a ius in personam against the trustee(s) for the proper administration of the trust. (50) There exists no general rule which defines precisely the nature of the beneficiary's right to the trust property (income or capital). (51) Section 7 read with s25B of the Income Tax Act 58 of 1962 provides that trust income may, in certain instances, be taxed in the hands of the trust beneficiary. The determinative factor in each case is whether the beneficiary's right to the income is vested or not. The vested right is required to be unconditional. A right of this nature constitutes an asset in the beneficiary's estate. (52) A survey of our case law reveals that the content of the trust instrument is the decisive factor in determining whether the beneficiary's right to the income is vested or not. (53)

3.2. VESTED AND CONTINGENT RIGHTS DISTINGUISHED

To determine whether vesting has taken place the so-called vesting test can be applied. With regard to trusts this test involves asking the question whether the disposal of an asset by the founder in favour of a particular beneficiary causes the right thereto to vest in the beneficiary upon the occurrence of a stipulated uncertain future event, or whether vesting takes place before such occurrence, for instance, at the date the trust becomes operative. The application of this test involves a distinction drawn in our jurisprudence between vested and contingent (or conditional) rights. (54)

Hutchinson (63) submits that contingent rights are rights subject to a suspensive, as opposed to a resolutive, condition. The legal effect of a suspensive condition, in the realm of the law of contract, is that it suspends the full operation of the contractual obligation and renders it dependent on the occurrence of an uncertain future event; whereas in the case of a resolutive condition the normal consequences flow from the contract from the moment of it's conclusion, but on the happening of the stipulated future event these consequences are terminated. (64)

Similarly, Cowen (65) submits that it is in cases of rights subject to a suspensive condition, 'where the title (of the right) may never be completed and the prospective right may, therefore, never come into existence, that the idea of a contingent right in the strictly technical sense is associated. The case where all of the investitive facts are certain in the ordinary course of nature to occur in the future stands in sharp contrast. Thus, in Romanistic jurisprudence generally, and in South African law in particular, investitive facts which are yet to occur but are certain to do so, are, as a general rule, deemed to have occurred and the title, and consequent right, are regarded as complete. When all of the investitive facts which are necessary to create a right have occurred, then, in what is commonly regarded as the strictly technical sense of the term, the right is said to be 'vested' – a vested right in the technical sense being simply one the title of which is complete and unconditional. By contrast, where one or more of the investitive facts has already happened, but one or more has not yet happened and may never happen, the prospective right is contingent in the technical sense of that term.' The *Oxford Companion to Law* defines an 'investitive fact' as 'a fact which invests a person with a particular legal right.'

Corbett et al (66) explains "vest" (at p.133) as follows :

'In legal parlance the terms 'vest','vested' and 'vesting' bear different meanings depending on the context in which they are used. When used in connection with rights of succession they indicate what is fixed and certain as distinct from that which is conditional or contingent. Thus an inheritance, bequest or other interest in a deceased estate is said to "vest" in the heir, legatee or other beneficiary concerned if and when the right thereto has become unconditionally fixed and established in such person. A vested interest of this nature is normally transmissible to the heirs or representatives of the beneficiaries upon his death or insolvency and forms an asset in his estate. This is not so in the case of a conditional or contingent interest: it confers no transmissible right upon the beneficiary unless and until the condition is fulfilled.'

In ITC 76 (55) the court held that 'a vested right was something substantial; something which could be measured in money; something which had a present value and could be attached. A contingent interest was merely a spes – an expectation which might never be realised.' CIR v Estate Crewe (56) held that 'a right is vested if the beneficiary is determined and his ownership of the right is unconditional; it is contingent if his ownership of it is conditional upon some uncertain event.'

In Jewish Colonial Trust Ltd v Estate Nathan (57) the court, per Watermeyer JA, explained the distinction between vested and contingent rights in the context of testamentary succession. The learned Judge held that the word 'vest' bears different meanings according to it's context. In terms of one meaning, the word is used 'to draw a distinction between what is certain and what is conditional; a vested right as distinguished from a contingent right. When the word vested is used in this sense Austin (Jurisprudence vol.2 lect 53) points out that in reality a right of one class is not being distinguished from a right of another class but that a right is being distinguished from a chance or a possibility of a right, but it is convenient to use the well-known expressions vested right and conditional right. Now whenever a bequest is made in words which indicate that the right bequeathed is not to be enjoyed or exercised until some future date (that is some future date after the testator's death), then the question always arises whether the words indicating future enjoyment were inserted for the purpose of making the bequest conditional or merely for the purpose of postponing the enjoyment of the bequest. The answer to that question ultimately depends on the intention of the testator as gathered from the terms of the will, but there are many rules of construction which assist in the decision of the question. If the bequest is unconditional then the legatee acquires a vested right in the bequest from the date of the death of the testator (dies cedit) though he cannot enjoy it until the time arrives for enjoyment (dies venit); if on the other hand the bequest is conditional, he acquires no vested right .....' This dictum has been confirmed by the Supreme Court of Appeal. See Durban City Council v Association of Building Societies (58) and (more recently) Mcalpine's case (supra) (at 762), as well as the authorities cited there.

The ratio decidendi of the Jewish Colonial Trust case (supra) is that whether in a particular case words of futurity postpone vesting or merely enjoyment depends on intention. In the case of a trust it is the intention of the founder as embodied in the trust deed which will determine the time of vesting of the benefits in the trust beneficiaries. If the right of a beneficiary is made conditional upon the happening of an uncertain future event then, in the absence of indicia of a contrary intention, the founder intended vesting to be postponed until the condition is fulfilled. However, compare Wynn NO and Westminster Bank Ltd NO v Oppenheimer and Others (59).

In Trustees of the Hull Trust Fund v CIR (supra) the trustees of an inter vivos trust were assessed as representative taxpayers on income received by them from funds they held in trust. The donor donated two sums, one expressed to be for the benefit of his existing grandchildren (the Schedule A beneficiaries) and the other for the benefit of his grandchildren yet to be born (the Schedule B beneficiaries). In terms of the trust deed each grandchild was entitled to receive his/her benefits only if and

when he reaches the age of 25. The Commissioner assessed the income arising from the two funds as the income of one trust. Objection was made, inter alia, on the basis that each Schedule A beneficiary should be assessed separately. The legal question which arose was whether the Schedule A beneficiaries had a vested or accrued right or interest in or to any of the trust funds and consequently that each such beneficiary could be separately assessed. The court (60) held that the true import of the trust deed was that the benefits to a Schedule A beneficiary was conditional on him/her attaining the age of 25. Should any such beneficiary die prior to reaching the age of 25 without leaving any issue, then such beneficiary's share would pass back to the trust to be held for the benefit of the Schedule B beneficiaries. It held further (61) that 'on consideration of the Trust deed as a whole, it created a fideicommissum in favour of the Schedule A beneficiaries, but conditional in that the funds vested entirely in the trustees until the fulfilment of the condition.' To this end the court (per Krause J) adopted the principles laid down in Estate Kemp v Macdonald's Trustees (supra) where Innes CJ (62) expressed the view that 'the general presumption, where a testamentary disposition is expressed in the form of a fideicommissum, is that the testator intended to postpone any vesting in the fideicommissary heirs until the happening of a specified condition. Pending that event, the dominium is in the fiduciary, and a mere spes in the remainderman. But this presumption must yield to the clearly expressed intention of the testator to the contrary.....The ordinary rules of vesting (and hence transmissibility) of rights under a fideicommissary bequest must give way when in conflict with the intention of the testator.' In the circumstances the court held that since there had been no vesting in the Schedule A beneficiaries prior to the fulfilment of the condition in question, the trustees had been correctly assessed.

Similarly, in Estate Dempers v SIR 1977 (3) SA 410 (A) the court interpreted what constitutes a 'fixed or contingent event' in the context of s7(5) of the Act. It held that a 'contingent event' is one which may or may not happen. 'Contingent', it held, is also used to describe a right which is conditional and uncertain, as opposed to a vested right which is certain, unconditional and immediately acquired, even though in some instances enjoyment of the right may be postponed. In casu it was held that a vested right was not a sine qua non for the application of s7(5), although the presence thereof is a strong, even decisive, factor leading to the conclusion that, but for the stipulation withholding the income, it would have been received by the trust beneficiaries. However, contra ITC 1328 43 SATC 56 where the court held that it was not a necessary consequence of vesting that the beneficiaries concerned have a legal right to claim payment. On the facts of that case the court concluded that the beneficiaries had indeed acquired an immediate right to the income even though enjoyment thereof had been postponed until the exercise of the trustee's discretion in their favour.

In Hilda Holt Will Trust v CIR 1992 (4) SA 661 it was held that it is possible for an uncertain but ascertainable amount in futuro to vest immediately and where a will contemplates that there will be a residue for distribution to ultimate beneficiaries, then the intention to postpone vesting is not present. The usual condition of survivorship found in a true fideicommissum bequest is not present where the ultimate beneficiary is a charity with an apparently indefinite future existence, and there can be an immediate vesting of capital, including income which is surplus to the amount necessary to pay a stipulated annuity.

3.3. TAXATION OF TRUST BENEFICIARIES

Trust beneficiaries are taxed on income which form part of their 'gross income' as defined in the Income Tax Act. Gross income is defined in s1 of the Act as including 'the total amount.....received by or accrued to' any person. CIR v Lategan (67) held (per Watermeyer J) that if a beneficiary has no vested right to income but merely a contingent right, then it cannot be said that the income has 'accrued to' him for the purposes of 'gross income' (as defined). For income tax purposes trust income which the trustee(s) have 'credited in account or re-invested or accumulated or capitalized or otherwise dealt with' in the name of or on behalf of the trust beneficiary is deemed to have accrued to such beneficiary. (68)

For many years uncertainty prevailed in our law as to the precise meaning of the words 'accrued to' for the purposes of 'gross income'. (69) However, the controversy ended when the court in CIR v People's Stores (Walvis Bay) (Pty) Ltd (70), after reviewing our law as to the interpretation of the words 'accrued to', upheld the interpretation of Watermeyer J in the Lategan case (supra) as to the meaning of 'accrued to'. The court (per Hefer JA) held that 'no more was required for an accrual than that the taxpayer had become entitled to an amount. Thus any right acquired by a taxpayer during the year of assessment and to which a money value could be attached represented an accrual irrespective of whether it was immediately enforceable or not.' (71) The 'entitled to' principle was extended in Mooi v SIR (72) where it was held that accrual takes place only when the taxpayer becomes unconditionally entitled to an amount (in cash or otherwise). The effect hereof is that an entitlement which is conditional upon the happening of a future event does not result in an accrual until the event has occurred.

In a non-discretionary trust the income thereof vests in the beneficiaries whether it is paid to them or not. In such a case the beneficiary is said to have a vested right to the income (ie. it is their income). (73) Income which has vested as such in a

beneficiary is deemed to have accrued to such beneficiary and is taxable in his hands. Section 25B(1) of the Act provides that any income received by or accrued to a trustee shall, to the extent to which the income has been derived for the benefit of any ascertained beneficiary with a vested right to the income, be deemed to be income which has accrued to the beneficiary. In the case of a discretionary trust (ie. a trust in which the trustee(s) has the power not to distribute the trust income or some portion thereof to the trust beneficiary), prior to the exercise of the discretion the beneficiary has no more than a contingent right; on the exercise thereof the beneficiary acquires a vested right to the trust income and becomes taxable thereon. (74) The legal implication hereof is that there can be no accrual of trust income to a beneficiary unless and until the trustee exercises his discretion in favour of a particular beneficiary. Silke refers to this as the application of the discretionary income rule which provides that :

'where the trustee exercises a discretion vested in him and the beneficiary acquires a vested right to income, the income is deemed to have been derived for the benefit of the beneficiary unless the provisions of section 7 of the Income Tax Act intervene; thus it is treated as the beneficiary's income.' (75)

A beneficiary who has a vested right to income and capital must include in his gross income (as defined) the distributions of trust income received by him as well as any non-deductible expenses. However, if a beneficiary is entitled merely to the net income of the trust then non-deductible expenditure is not added to the beneficiary's income; it is added to the income of the trustee in his representative capacity and is taxable in the hands of the trust. (76) According to s25B(3) any deduction or allowance which applies in respect of income received by or accrued to a trustee will be deemed to be deductible in the hands of the beneficiaries but only to the extent that the income is deemed to accrue to the beneficiaries. For example, if a trustee receives trust income amounting to R100 000 and deductions in the amount of R25 000 may be claimed in respect of such income, then if 60% of the income is deemed to accrue to the beneficiaries they will be entitled to claim 60% of the deductions. Furthermore, trust beneficiaries may deduct expenditure or losses incurred in deriving income from a trust, provided they incur an unconditional obligation to make the payments and the trust income vests in the beneficiaries concerned. In this regard the court in ITC 1483 (77) held (per obiter) that 'if profits of a trust vest in the beneficiaries.....(then) this should include the losses'. On this basis it upheld the taxpayer's appeal against the Commissioner's disallowance of a loss incurred in operating a speculative business venture through a trust.

3.4 SUMMARY

In terms of s12 of Act 57 of 1988, trust property does not form part of the trustee's personal estate except in so far as he as trust beneficiary is entitled to the trust property. As a consequence of the fiduciary relationship which exists between the trustee and the trust beneficiary with respect to the trust property, the property vested in the trustee must at all times be administered for the benefit of the beneficiary. The trust property does not vest in the beneficiary and he, accordingly, enjoys mere personal rights against the trustee for the duration of the trust. The nature of the rights of the trustee and the beneficiary is such that the trust property cannot, for the duration of the trust, form part of their personal estates. (78) The Katz Commission 4th Report (at p.13-14) has recommended that distributions of capital out of trusts should be subjected to capital transfer tax, except where this would result in double capital transfer tax being imposed. In this regard it recommended that legislation will have to define 'distribution' to include the act of vesting rights in a trust in the trust beneficiary. For this reason the vested right would be subjected to capital transfer tax and not the generation-skipping tax proposed by the Commission.

CHAPTER 4

A COMPARISON BETWEEN DIFFERENT FORMS OF TAX PLANNING STRUCTURES : A PARTNERSHIP, CLOSE CORPORATION (CC), COMPANY AND TRUST

4.1.1 PARTNERSHIPS

Legally, a partnership does not have a separate existence. A partnership may be described as 'a particular type of business association formed by persons who intend to make and share profits. More technically it may be defined as a legal relationship based on an agreement between two or more persons who undertake to contribute something to a lawful enterprise which is carried on with the object of making a profit and sharing it between the partners.' (79)

A partnership is not defined in the Act, and for income tax purposes it is not regarded as a taxpaying entity, although it is recognised as such for Value-Added Tax purposes. (80) It's status under the Act is, in effect, a reflection of it's common law position. Under the common law a partnership is not a separate persona in that it is not separate and distinct from it's constituent members. A partnership is allowed a maximum membership of 20 partners. (81) A partner does not have to be a natural person and any company, CC or trust may be a partner in which event the taxation principles applicable to each of those trading structures will apply in relation to their aliquot share of the partnership income, losses, taxable income and assessed losses.

With regard to taxation, section 66(15) of the Act provides that 'persons carrying on any business in partnership shall make a joint return as partners in respect of such business.....and each partner shall be separately and individually liable for the rendering of the joint return.' In practice the SARS usually accepts a copy of the partnership's financial statements from any one of it's partners. Section 77(7) provides that 'separate assessments shall, notwithstanding the provisions of s66(15), be made upon partners'. In other words, the partners are liable for tax in their individual capacities according to their profit-sharing ratio. (82) Each partner will thus pay tax according to a progressive ratio. (83) In terms of section 24H(2) each partner, notwithstanding the fact that he may be a limited partner, is deemed to be carrying on the trade or business of the partnership. In terms of s24H(5)(a) any income which has been received by or accrued to the partnership is deemed to be received by or accrued to the partners in their profit-sharing ratio on the same date on which it is received by or accrues to the partnership. According to this same formula, deductions and allowances relating to

such amounts are also deemed to be those of the individual partners. (84) The purpose of this provision is to override a legal principle established in Sacks v CIR (85) where it was held that the partner's share of profits only accrued to him at the end of the partnership's financial year when the profits were brought to account. It is submitted that the practical difficulties created by this provision may, to an extent, be overcome by making the partnership's tax year-end the same time as that of the partners.

With regard to assessed losses, these may be set-off in much the same way as in the case of a sole proprietor. Section 20(1)(b) provides that 'for the purpose of determining taxable income derived by any person from carrying on any trade within the Republic, there shall be set-off against the income so derived by such person any assessed loss incurred by the taxpayer during the same year of assessment in carrying on in the Republic any other trade either alone or in partnership with others .....' The set-off of any balance of assessed loss is, in the case of a corporate partner, admissible only against income derived from carrying on a trade; the assessed loss will be irretrievably lost if it ceases trading in the year subsequent to the assessed loss being incurred. (86)

The Act restricts the deductions of limited partners. Section 24H(1) defines a 'limited partner' as 'any member of a partnership en commandite, an anonymous partnership or any similar partnership, if such member's liability towards a creditor of the partnership is limited to the amount which he has contributed or undertaken to contribute to the partnership or is in any other way limited'. In terms of s24H(3) allowances or deductions which may be granted to any limited partner (excluding the marketing allowance available in terms of s11bis of the Act) shall not in the aggregate exceed the sum of the amount which such partner is or may be liable to creditors of the partnership and any income received by or accrued to such partner from the partnership business. Section 24H(4) provides that 'any allowance or deduction which has been disallowed under s24H(3) shall be carried forward and be deemed to be an allowance or deduction to which the taxpayer is entitled in the succeeding year of assessment'.

With regard to partnerships, the planner ought to pay careful attention to provisions relating to goodwill as those aspects will affect him in the event of a subsequent termination of the partnership. Goodwill may be explained as that which the planner would hope would be built up in his future partnership as a result of sound and successful trading. It is an element which can be regarded as "whatever adds value to a business by reason of situation, name and reputation, connection, introduction

to old customers and agreed absence from competition." (87)

Gross income is defined as 'excluding receipts or accruals of a capital nature.' (88) Since the purchase and sale of goodwill is essentially a transaction on capital account, therefore, generally, an outgoing partner who receives a lump sum for his share of the partnership goodwill is in receipt of capital and hence a non-taxable receipt. Conversely, the remaining partner(s) who make such goodwill payment will have a non-deductible capital expense. (89) However, if the outgoing partner receives payment for goodwill by way of an annuity he will be taxed thereon (90) whereas the remaining partner(s) will not be allowed any deduction for the annuity payments insofar as those payments constitute expenditure of a capital nature. (91) The essential features of an annuity are that it must be a fixed periodical payment even if divided into instalments, it is repetitive (that is, it is payable over some period) and it is chargeable against some person. (92) If payment for goodwill is made in instalments which do not constitute an annuity, then the receipt of such monies will not be taxed in the hands of the recipient nor deductible in the hands of the one effecting payment thereof. In addition, where the outgoing partner is not paid a lump sum for goodwill but is paid a share of the future profits of the partnership over a specified period, such partner will be taxed on the amount so received as it constitutes income in his hands, whereas the remaining partners will not be entitled to any deduction for the share of profits so paid insofar as the payments will represent expenditure in the acquisition of a capital asset or, alternatively, a disposal of earnings after their accrual in favour of the remaining partners. (93) It is submitted that if one wishes to link an outgoing partner's goodwill payment to future profits of the partnership then one ought to do this by way of an out-and-out cession by the remaining partner(s) to the outgoing partner of the agreed percentage of the future profits over the specified period. In this way the remaining partner(s) will avoid the imposition of tax on the amount so paid to the outgoing partner although the latter will be taxed thereon insofar as the receipt thereof constitutes income which, but for the cession, would have accrued to or been received by the partnership.

4.1.2 A COMPARISON BETWEEN PARTNERSHIPS AND TRUSTS

The partnership, as a legal concept, has several peculiar characteristics restricting it's usefulness. These are, inter alia, that it's lifetime is limited and uncertain; on the death or insolvency of a partner the partnership terminates; and any partner can normally terminate it at any time. Furthermore, because partners are jointly and severally liable for all partnership debts, a partnership may be appropriately described as a commercial marriage for which people can pay dearly if matters go wrong. (94)

Having regard to these factors it is submitted that a trust ought to be preferred to a partnership for achieving a better tax dispensation. In this regard one ought to take cognisance of the fact that the duration of a trust is not dependent on the resignation or death of a trustee; the trustee(s) are generally not held personally liable for their actions as trustee(s) since they enjoy a form of limited liability; and all income and expenditure in a partnership vests in the partnership whereas in the case of a trust it could vest either in the trust, the beneficiary, the founder or be apportioned between all of them. (95)

4.1.3 SUMMARY

A partnership is not taxed as a separate legal entity. The essence of the taxation of a partnership is that there exists no separate legal identity for income tax purposes between the partnership and it's partners; a partner's pro rata share of the income derived or loss made by the partnership is added to, or subtracted from, the partner's income from other sources; where the partner is a natural person his share of any partnership assessed loss may be carried forward to a succeeding tax year even if no income is derived in the former year of assessment; there is no additional action needed to extract profits from the partnership involving any further potential tax consequences; and the reporting requirements are the same as that of a sole proprietor, namely there is no obligation to submit an annual audit of the trading activities nor is it required to furnish a year-end report. From a tax perspective a partnership is an attractive trading structure because of it's flexibility and the advantageous tax positions of the partners and because of it's facility for multiple membership without legal incorporation. It's shortcomings stem from legal considerations such as the absence of protection from unlimited personal liability for partnership debts, the absence of perpetual succession for the partnership business and multiple membership is limited statutorily.

4.2.1 CLOSE CORPORATIONS AND COMPANIES

Companies and close corporations (CC), to some extent, offer businessmen an important tax shelter from high personal taxation rates. The legal position of a CC is governed by the Close Corporations Act 69 of 1984 and that of a company is regulated by the Companies Act 61 of 1973. Taxation of both these trading structures is governed by the Income Tax Act 58 of 1962.

Until 1990 it was more advantageous to use a CC than a company because distributions to CC members were not subject to normal tax, whereas dividends

declared by companies were subjected to tax in the hands of shareholders, who were natural persons. This fiscal advantage has, however, disappeared by virtue of s10(1)(k) of the Act (96) in terms whereof dividends received by South African residents are exempt from tax. Thus, from a tax perspective there is no longer any material difference between a company and a CC and the liability for Secondary Tax on Companies (STC) is the same mutatis mutandis for both these trading structures. (97) Accordingly, depending on circumstances, sound commercial and practical advantages may exist for using a CC instead of a company as a trading structure, and vice versa.

In so far as companies are concerned, a distinction is, for income tax purposes, drawn between public and private companies. (98) Since the abolition of undistributed profits tax, the significance of this distinction lies, firstly, in that public companies are not subjected to tax on donations (99) and, secondly, that amounts payable to directors of private companies are not subject to Pay As You Earn, whereas amounts payable to directors of public companies are subjected as such. (100) Section 1 of the Act includes a CC in the definition of a 'company' and it will be regarded for taxation purposes as a private company (101) so that a donation made by a CC is taxed in the donor's hands in the same way as if the donation had been made by a private company. (102)

The following is a list of some of the more important advantages relating to companies and close corporations alike, namely :

(i) Perpetual Succession

In contrast with partnerships and sole proprietorships, their operations and existence as a separate legal entity are not affected by the death, resignation or insolvency of it's directors, shareholders or members (as the case may be).

(ii) Corporate Structuring

It is common for businessmen to form separate companies or CCs for each separate business venture. In this way they ensure compartmentalization of their business affairs with a view to more effective managerial control, and, in some instances, for income tax purposes as well.

(iii) Limited Liability

Flowing from the existence of a company and a CC as a separate legal entity is the

principle of limited liability of the shareholder, director or member (as the case may be). In the case of a partnership, for instance, the partners are jointly and severally liable for all partnership debts. However, the Companies Act and the Close Corporations Act do contain provisions providing for personal liability for directors or members (as the case may be) should they contravene certain of the provisions of the Acts concerned. See for example s63 and s64 of the Close Corporations Act.

(iv) Taxation

Some of the tax benefits which companies and CCs enjoyed in the past have been reduced by the imposition of STC with regard to the declaration of dividends. Currently STC is payable on all dividend distributions at the rate of 12,5%. (103) STC will not be payable when the company or CC is wound up or liquidated and the profits are distributed by the liquidator. (104) Even though currently operating through a company and CC can be disadvantageous from a tax perspective, it is submitted that this complication can be overcome by distributing all available profits as owners or members (as the case may be) salaries and interest on capital. In appropriate circumstances the lower tax rate applicable to companies and CCs, that is 35%, can be utilized. This can be done, for example, when there is an assessed loss in the company. With regard to fringe benefits, there are undoubted tax benefits to be derived from operating through a company or CC, such as medical contributions, retirement benefits, and allowances. (105) Also, with the current differential of 10% between company (including CCs) tax and individual tax rates, the purchase of an existing business with goodwill can, provided certain requirements are met, save tax at 10% of the purchase price. Where a company has been converted into a CC, or vice versa, the Act deems such company and CC to be the same company for the purposes of the Act. The tax implications of such conversion are, inter alia, (i) the assessed loss of the former entity is carried over to the new entity and (ii) certain allowances claimed by the former entity will have to be added back to income of the new entity in the following year of assessment (for eg. s11(j) debtor's allowance, s24 credit agreement allowance and s24C allowance in respect of future expenditure on contracts).

The following disadvantages exist in respect of companies and close corporations, namely :

(i) Profits are generally distributed by way of dividend. (106) This distribution is subject to 12,5% STC but may burden the taxpayer more directly should dividends once again become taxable in the hands of the recipient at a rate higher than the rate at which a shareholder indirectly bears the brunt of STC. (107)

(ii) These structures have limited use of their assessed losses in that (a) unlike a sole proprietorship or partnership, they will forfeit any balance of assessed loss should no trade be conducted during an entire year of assessment and (b) they are only entitled to set-off their assessed losses against income derived from trade. (108)

(iii) The rate of tax payable in respect of taxable income is, in the case of an adoption of a policy to distribute all, or a substantial portion of, it's profits a disincentive to the use of these structures for trading purposes when an alternative trading structure attracting an effectively lower rate of tax can be used.

(iv) Groups of companies are not recognised for tax purposes in South Africa. (109) Accordingly, there cannot be set-off against the aggregate income of the "group" the aggregate expenses and losses thereof. This is unlike the position with regard to partnerships, trusts and sole proprietorships where there is only one tax imposed on the aggregate of the taxpayer's income derived from all it's ventures less allowable expenditure and by virtue of which a set-off of the profits of one trade conducted through such a medium against the losses of another trade similarly conducted, operates automatically. Also, expenditure incurred by one company within the group and which results in another receiving income, is not deductible. (110) In view of the fact that group taxation is not allowed, businesses which expect start-up losses prefer only to convert to companies or CCs once they become profitable.

(v) Any company (111) is a provisional taxpayer (112) and must make provisional tax payments as prescribed in Schedule 4 of the Act. A disadvantage in using a CC, as opposed to a company, is that a member of a CC who is ordinarily resident in the Republic is, unless the Commissioner directs otherwise, a provisional taxpayer (113) whereas a shareholder of a company (114) who is a South African resident is not a provisional taxpayer by reason merely of such share holding.

(vi) Undistributed profits in the hands of dormant companies (including close corporations) cannot be withdrawn on loan, so that owners of such companies must chose either to declare a dividend subject to STC or liquidating the company. It must be borne in mind that in a process of liquidation only profits of a capital nature can be distributed free from STC.

(vii) In the event that a shareholder or member (as the case may be) requires to draw funds from the company concerned in excess of his remuneration or credit loan balance, such drawing may also be taxed as a dividend, resulting in unnecessarily high taxation rates.

(viii) In the case of companies holding quoted share investments, there appears to be a greater risk of realised profits being taxed. This is primarily due to a difference in

Revenue's practice of assessing such transactions in the hands of a company (including a CC) as compared with such transactions in the hands of an individual taxpayer. In the case of the latter, isolated and sporadic sales are normally not queried.

(ix) If share holding is carried on as a trade thereby resulting in shares being held as 'trading stock', then, in terms of s22(1), the individual taxpayer may write same down to market value. This concession is, however, not available to companies and CCs.

(x) Partnerships and sole proprietors are allowed more readily the deduction of home study costs for income tax purposes.

(xi) Section 38 of the Companies Act prohibits a company from giving financial assistance to any person for the acquisition of it's own shares. This section may, effectively, force shareholders to liquidate the company in order to avoid tax on a deemed dividend. Although businessmen may, through liquidation, avoid the payment of STC, such a move may prove to be costly since the Master's fee (apart from other liquidation costs) could be as much as R25 000. (115) Unlike s38 of the Companies Act, a CC may, in terms of s40 of the Close Corporations Act, give financial assistance to any person for the purpose of, or in connection with, any acquisition of a member's interest in that corporation provided the prior written consent of all it's members is obtained and provided also the CC meets the solvency and liquidity requirements of the Close Corporations Act. It is submitted that where a member borrows money to invest in a CC, the interest he pays will be deductible for income tax purposes because the distributions he receives from the CC is subject to STC.

4.2.2 A COMPARISON BETWEEN A COMPANY AND A TRUST

As regards the issue whether a trust is a vehicle more viable for tax planning purposes than a company (or vice versa), it is submitted that there are compelling reasons to prefer a trust to a company. Firstly, with a trust one can avoid the restrictions and costs of an audit, annual financial statements (unless the Master so requires), as well as annual general meetings (in the case of a trust this is optional) required by the Companies Act. Secondly, a trust can enjoy the benefit of perpetual succession that a company has together with the limitation of liability that adheres to shareholders of a company but without protection being afforded to creditors in the form of maintenance of capital, solvency and liquidity. (116) With the prevailing tax laws and the restrictions imposed by s38 of the Companies Act, it is probably not advisable to form a separate company to hold fixed property, although this may be

considered a viable option on the grounds of commercial expediency and practical advantages where ownership is joint. A trust is flexible while a company, on the other hand, is rigid and not adaptable to changing circumstances. Also, Olivier (117) points out that the mere fact that a trust can be discretionary is reason enough for it to be preferable in every case where there is a choice between a trust and a company. From a Value-Added Tax (VAT) and Transfer Duty perspective, companies may provide a benefit above other business entities. When fixed property is to be sold out of a company, the company shares may either be sold or the fixed property itself. If the shares are sold, then stamp duty of 0,5% is payable instead of 10% transfer duty or 14% VAT. Where all the shareholders are natural persons and less than ten in number, stamp duty or transfer duty could be avoided entirely if the company is converted to a close corporation, since the transfer of member's interest is not subject to stamp duty. (118)

4.2.3 A COMPARISON BETWEEN A CLOSE CORPORATION AND A TRUST

As regards the choice between a trust and a close corporation as a suitable vehicle for tax planning, it is submitted that there are good reasons too for preferring the former over the latter. Firstly, while there are no restrictions on a trust as to the persons or entities who may be beneficiaries, membership of a CC is limited to ten natural persons. While a testamentary trust qualifies for membership of a CC, neither a company nor an inter vivos trust qualifies for such membership. The restriction on the nature and number of members of a CC has the effect, inter alia, that :

-a CC cannot become a subsidiary of a company or another CC. Consequently it is not possible to include a CC in a group structure other than as a holding company.

-a CC cannot be sold to a company. In order to effect such sale, the CC would first have to be converted to a company and then sold as a going concern.

-members cannot transfer their interests to an inter vivos trust or a company, nor can they participate as members other than as individuals. (119)

In addition, the Close Corporations Act contains various provisions which restricts the usefulness of a CC as a trading structure when compared to a trust. These provisions relate, inter alia, to the general powers which members have to enter into transactions which will bind the CC, the cumbersome procedure prescribed when amending the founding document, the restrictions which apply to corporation agreements and to agreements between or among members, the numerous instances where members or past members can be held liable for debts of the CC, and the

requirements regarding accounting records and financial statements. (120) A trust is not burdened with these requirements and prescriptions. The great flexibility of the trust, the ease with which assets can be taken out and conveyed to beneficiaries, the separation between formal ownership and the enjoyment of benefits, and the total absence of all sorts of restrictive statutory provisions serve to emphasise the usefulness of trusts as a trading structure. (121)

4.2.4 SUMMARY

Depending on circumstances, it is submitted that the potential tax disadvantages attendant upon companies and CCs may well out-weigh their advantages of largely unlimited liability and perpetual succession. In light hereof, estate planner's may be well advised to consider the viability of conducting trading activities through one or other of the unincorporated trading structures (eg. a business trust).

4.3 A TABULATED COMPARISON BETWEEN THE DIFFERENT TRADING STRUCTURES

Below is a table reflecting a comparison between the taxation of the different business enterprises.

Factor	Company	Partnership	Sole Proprietor	Close Corporation	Trust
1. Income Tax : Rate	Flat rate: 35% Gold mining: 42% STC:12,5%	Progressive rate : 19% (R30000) - 45% (R100 000)	Progressive rate : 19% (R 30000) - 45% (R100000)	Flat rate : 35% STC: 12,5%	Progressive rate : 17% (R5000) - 45% (R100000)
2. Splitting of income: Possible ?	No	Yes	No	No	Yes

3.Taxpayer	Company	Partners	Sole proprietor	Close corporation	(i)Founder (s7(3)-(7)) (ii)Trustee (s25B(1)) (iii) Trust Beneficiary (s25B(2)-(3))
4. Limited Liability	Yes	No	No	Yes	Yes
5. Limited Liability: Statutory exemptions	Yes, s423-424 of the Companies Act 61 of 1973	Not applicable	Not applicable	Yes, s63-64 of Act 69 of 1984	No
6.Continuity	Indefinite	Uncertain	Uncertain	Indefinite	Indefinite
7.Formation	(i)Memo. & Articles of association (ii)certificate of incorpor.	Valid partnership agreement (oral or in writing)	No requirement	(i)Founding statement (ii)certificate of incorpor.	(i)Trust Deed (ii)Will (iii)Statute (iv)Court order
8. Stamp duty on registration	R350 -CM2 registration R50 -reserve name R5 for every R1000 share capital or part thereof R60-certificate to commence trading	Not applicable	Not applicable	R100 -CK1 registration R50 -reserve name	R100 -inter vivos trust

9. Transfer duty	10%	1%- R60000 5%-R60001-R250000 8%-Above	1%-R60000 5%-R60001-R250000 8%-Above	10%	10%
10. Transfer duty: Payable on change of members	No, but stamp duty payable	Yes	Not relevant	No	Trustee: No Beneficiary: Yes, depending on facts
11. Who owns the assets?	Company	Owned jointly by partners	Sole proprietor	Close corporation	Trustee who holds no beneficial interest in it
12. Who represents the entity?	Directors	Partners	Sole proprietor	Members	Trustees
13. How many members are allowed? Maximum	(i)Public company -7 to unlimited (ii) Private - 1 to 50	2-20	1	1-10	Trustees : 1-20 Beneficiary: unlimited
14. Statutory limits to the number of members?	No	No	No	Yes, (i)no juristic person (ii) no inter vivos trust	No
15. Statutory limits to Management	Yes, s218 of the Companies Act 61 of 1973	No, except contractual capacity	No, except contractual capacity	Yes, s47 of the Close Corporations Act 69 of 1984	Yes

16. Financial Statements	Compulsory i)in public company - bi-annually to Registrar ii)in private company - annually (but not to Registrar)	Optional	Optional	Compulsory. To be submitted annually	Master may require - to be submitted annually
17. Auditing	Compulsory	Optional	Optional	Compulsory	Master may require
18. Auditor requirement	Chartered Accountant	No	No	Accounting Officer	Preferably as with Close Corporation
19. Termination	Through (i) Liquidation (ii)De-registration	Through death / insolvency / insanity	Through death and insolvency	Through liquidation and de-registration	Through dissolution and insolvency
20.Security : interest	Yes	Yes	Not applicable	Yes, but problematic	Vested interest: Yes
21. Annual General Meeting	Compulsory	Optional	Not relevant	Optional	Optional
22. Prohibition on financial assistance	Yes	Not applicable	No	No	No
23. Restrictions on entry	i)in public company - no ii) in private company - yes by consent	Not applicable	Yes by consent	Yes by consent	Yes by consent

24. Application of ultra vires doctrine	Yes	No	No	No	No
25. Perpetual succession	Yes	No	No	Yes	Yes
26. Juristic person	Yes	No	No	Yes	Not really
27. Pre - incorpor. contracts	Yes	No	No	Yes	Yes
28. Agent's right to bind the entity and the application of Turquand rule	Yes	Not applicable	Yes, but no Turquand rule	As with partnership	As with partnership
29. Owner's implied right to manage	No	Yes	Yes	Yes	No
30. Maintenance of capital	Yes	No	No	Not really	No

CHAPTER 5

Taxation of Trusts : Basic Principles

5.1 TAXATION OF TRUSTS

5.1.1 GENERAL

In terms of Practice note 21 inter vivos trusts must be registered for income tax purposes at the office of Receiver of Revenue in whose area the office of trustee(s) is situated. The income tax assessment is raised on the trustee as representative taxpayer. (122) Trust income is taxed according to the tax table applicable to persons other than natural persons and is not entitled to the primary rebate applicable to natural persons. The tax year-end for the individual trustees, and in practice for the trust itself, is the end of February each year. SARS approval is required for any other date. (123)

Currently the taxation of trusts is governed by sections 1, 7 and 25B of the Act. Trust income may be taxed either in the hands of the donor, the trust, the trust beneficiary or a combination of any of these persons. When the issue of taxation of trust income arises one must consider several factors, inter alia, the terms of the trust, whether or not the trust income is distributed, and whether the beneficiaries are majors or minors. Generally, beneficiaries are taxed on any previously untaxed distributions received by them from the trust (unless s7(3),(4) or (6) of the Act apply). The trust itself is usually taxed on any undistributed income left in it's hands (unless s7(5) or (7) of the Act apply). (124) When determining the trust's tax liability trustee(s) may deduct any expenditure incurred which the trust may deduct in terms of s11 or any other provision of the Act. (125) Generally, tax due by the trust is payable out of trust funds. However, s97 of the Act imposes personal liability on the trustee(s) in respect of taxes which he was liable to pay in his representative capacity, if, while the tax remains unpaid the trustee(s) alienates, charges or disposes of the income in respect of which the tax is payable, or where the trustee(s) disposes of any fund or money which is in his possession or comes to the trustee(s) after the tax is payable or could legally have been paid out of such fund or money.

5.1.2 THE CONDUIT PRINCIPLE

With regard to the nature of trust income, it has been held that where income is received by a trust and then distributed to trust beneficiaries, the trustee(s) act as

a mere administrative conduit pipe through which the income flows. (126) In SIR v Rosen Trollip JA (at 186-7) explained the conduit-pipe principle as follows :

'In effect the Legislature in those provisions has adopted a principle that can be conveniently termed the conduit principle : the registered shareholder is regarded as a mere conduit-pipe for passing dividends on to the deemed shareholder, the true recipient of them, in whose hands they consequently retain their identity and character as dividends. The function of the principle is mostly apposite to trust cases, the mere inter-position of the trustee between the dividend-paying companies and the beneficiary not being regarded as sufficient to change the character of the dividends as they pass to the latter.' The learned Judge went on to say the following (per obiter dictum) :

'A trust deed may endow the trustee with the discretion to pass on dividends to the beneficiary or to retain and accumulate them. If he decides on the latter, I think (but express no firm view) that the dividends might then lose their identity and character as dividends, so that, if they are paid out to the beneficiary in a subsequent year, they might possibly no longer be dividends in his hands, for the conduit-pipe had turned itself off at the relevant time. But if he decides on the former, that is to pass the dividends on to the beneficiary, the condition suspending the beneficiary's entitlement thereto is fulfilled, and they would constitute dividends in his hands in the same way as if he had been originally entitled to them unconditionally under the trust deed, that is as if the conduit-pipe had always been open.'

In other words, in terms of the conduit principle the trust acts as a mere pipe through which the income flows to a beneficiary; therefore the income retains it's identity. A trustee will not incur any tax liability in his representative capacity if all the trust income is distributed to the beneficiaries because the income passes through the trust and is taxable in the beneficiaries' hands. Vesting in the trust beneficiary must, however, occur in the year of receipt or accrual of the income; income which vests in the beneficiaries will not first be taxed in the trust and thereafter in the hands of the beneficiaries. (127) Vested income, whether paid or accrued to a beneficiary, is taxed in the hands of the beneficiary except where s7(3),(4) or (6) of the Act apply. Any income retained in trust is taxed in the hands of trust, except where s7(5) or (7) of the Act apply. Any distribution from retained income is deemed to be of a capital nature and is therefore not taxed in the hands of it's recipient. (128)

In circumstances where the conduit principle finds application, trust beneficiaries are entitled to claim any tax exemptions which apply to trust income distributed to them,

except if the income is paid in the form of an annuity. (129) Therefore if dividend income received by a trust is distributed to a beneficiary in the same year in which it is so received, it retains it's identity as dividend and is, accordingly, in terms of s10(1)(k) exempt from tax in the beneficiary's hands. In Rosen's case the court held that the conduit principle applies even where a beneficiary received income in the form of an annuity from a trust. For eg., assume that a trust receives R100 000 interest income and R50 000 dividend income in a tax year. It pays an annuity of R5000 per month to a beneficiary. In terms of the decision in Rosen's case the beneficiary will be taxed on R40 000 (interest) and R20 000 (tax-free dividend) while the trust is taxed on the retained portion of interest income. However, in terms of s10(2) of the Act the exemption in s10(1)(k) does not apply in the case of dividends received as an annuity. (130) This means that annuities paid to trust beneficiaries are fully taxable in their hands, regardless of the source of the income out of which the annuities are paid (131) A further example of a tax exemption is s10(1)(hA) of the Act which exempts interest earned by non-residents. It is submitted that this provision is advantageous from a tax planning perspective in that if a trust, the beneficiaries whereof are both resident and non-resident, is in receipt of interest income as well as dividend income, then a trustee(s) may award the interest income to the non-resident (in whose hands such income is tax exempt) and the dividends to the resident beneficiaries (in whose hands such distributions are exempt from tax).

5.1.3 TRUSTS AND IT'S ASSESSED LOSSES

Section 20(1) of the Act allows a trust, for the purpose of determining it's taxable income derived from the carrying on of any trade in the Republic, to set-off against it's income any balance of assessed loss incurred by it in any previous year which has been carried forward from the preceding tax year. Conshu (Pty) Ltd. v CIR (132) held that the word 'income' in s20(1) should not be construed in it's defined sense but rather as taxable income but for the set-off of an assessed loss. This means that a set-off under s20(1) only arises if there would otherwise have been taxable income, ie. pre-tax profit. The expression 'balance of assessed loss' refers to a situation where the income or taxable income of a particular tax year is more than swallowed up by deductions, a current year's assessed loss and/or the assessed loss of a previous year, resulting in a balance of assessed loss which can then be carried forward to the succeeding year of assessment and set off against the income of that year. If in a year (year 2) subsequent to that in which such balance of assessed loss was ascertained (year 1) the taxpayer derives no income from carrying on a trade against which such balance can be set-off to arrive at a fresh balance of assessed loss to be carried forward, then in the following year (year 3), the taxpayer is precluded from setting off the initial balance (ie. from year 1) against it's income by the requirement that the balance to be set-off must have been carried forward from the preceding

year of assessment (year 2). (133) SA Bazaars (Pty) Ltd. v CIR (134) held that the balance of assessed loss may only be set-off against income derived by the taxpayer from the carrying on of a trade; and where no trade is carried on the balance of assessed loss is irretrievably lost. However, in the case of a trust, s20(2A)(b) provides that an assessed loss is not lost if a taxpayer other than a company (eg. a trust) does not derive any income during a particular tax year so that such assessed loss may therefore be carried forward to a succeeding tax year.

5.1.4 TAXATION UNDER SECTION 25B

Undistributed trust income which does not vest in a beneficiary is subject to tax in the hands of the trust. Section 25B(1) of the Act provides that 'any income received by or accrued to or in favour of any person in his capacity as the trustee of a trust as referred to in the definition of 'person' in section 1, shall, subject to the provisions of section 7, to the extent to which such income has been derived for the immediate or future benefit of any ascertained beneficiary with a vested right to such income, be deemed to be income which has accrued to such beneficiary, and to the extent to which such income is not so derived, be deemed to be income which has accrued to such trust.' (135) The words 'ascertained beneficiary with a vested right' means a beneficiary entitled to the trust income and whose right passes to his estate on death even if the income is payable only at the termination of the trust. (136)

Section 25B(2) provides that 'where a beneficiary has acquired a vested right to any income referred to in section 25B(1) in consequence of the exercise by the trustee of a discretion vested in him in terms of the relevant deed of trust, agreement or will of a deceased person, such income shall for the purposes of that subsection be deemed to have been derived for the benefit of such beneficiary.' (137) This section leaves the conduit principle (discussed earlier) intact.

It is permissible for a trust to deduct expenditure and losses incurred in the production of income to the extent to which such expenses and losses were laid out or expended for the purposes of trade. (138) Prior to the enactment of s25B(3) losses and deductions were not available to beneficiaries but were retained by the trust. Section 25B(3) provides that 'any deduction or allowance which may be made under the Act in the determination of the taxable income derived by way of any income referred to in s25B(1) shall, to the extent to which such income is under the provisions of that subsection deemed to be income which has accrued to a beneficiary or to the trust, be deemed to be a deduction or allowance which may be made in the

determination of the taxable income derived by such beneficiary or trust, as the case may be.'

Practice note 23 states that the wording in s25B(3) 'to the extent to which' does not have a ring-fencing effect but in fact means that deductions and allowances relating to income which has been allocated between a trust and trust beneficiary must be apportioned between them in the same proportion. The effect hereof is that the deduction is not only allowable against trust income, but may be deducted against any income received by or accrued to the beneficiaries. In addition, a trust beneficiary is permitted to deduct the trust's tax losses to the extent that the trust income vests in such beneficiary. (139) For example, a trust receives income in a particular year of assessment amounting to R30000 and expenditure amounting to R10000 was made in the production of such income. Assume that 60% (R18000) of the income vests in the beneficiary and the remaining 40% (R12000) vests in the trust. The trust can then claim 40% of the deductions (R4000) while the beneficiaries can claim 60% (R6000). The beneficiary will also be able to claim pro rata any allowances which relates to the earning of such trust income (eg. capital allowances).

5.1.5 TAXATION UNDER SECTION 7

With regard to the taxation of trust income the provisions of section 7(3)-(7) of the Act are of particular importance. A detailed analysis of each of these sub-sections, however, falls beyond the scope of this dissertation. For the purposes hereof I will endeavour merely to provide an analysis of some of the most important concepts embodied in these sub-sections and outline the principles that have been enunciated by our courts in respect thereof.

5.1.5.1 Requirements for the application of s7(3)-(7)

In order for s7(3)-(7) of the Act to be operative certain requirements must be satisfied. These are:

- there must be a donation, settlement or other disposition.
- the income sought to be taxed must be received or accrued by reason of the donation, settlement or other disposition.
- in order for s7(3) to apply the income must be received by or accrued to a minor child of the donor. See also s7(4) which serves as an anti-avoidance

measure for s7(3). Section 7(3) does not apply to grandparents making a donation, settlement or other disposition to their grandchildren. Neither s7(3) nor s7(4) apply to grandchildren or majors, nor do they apply once the donor dies since he is no longer an income taxpayer.

- in order for s7(5) to apply the donation, settlement or other disposition must be made subject to a condition or stipulation that the beneficiaries or some of them shall not receive the trust income or part thereof until the happening of some event, whether fixed or contingent.

- the person making the donation, settlement or other disposition must still be alive.

- in order for s7(6) and (7) to apply a right to receive income must be transferred.

5.1.5.2 General Concepts embodied in s7(3)–s7(7)

(a) The meaning of 'donation, settlement or other disposition' in s7(3)–s7(7) of the Income Tax Act

A requirement appearing in each of the aforesaid sub-sections which must be satisfied in order to render them operative, is that relating to the expression 'donation, settlement or other disposition'.

The meaning of 'donation'

In terms of Roman-Dutch law a 'donation' is regarded as a disposal of property for no consideration, that is a wholly gratuitous disposal of property made out of liberality or generosity. In Ovenstone v SIR (140) the court (per Trollip JA) (at 736H) highlighted the meaning of 'donation' as follows :

'In a 'donation' the donor disposes of property gratuitously out of liberality or generosity, the donee being thereby enriched and the donor correspondingly impoverished, so much so that if the donee gives any consideration at all therefor, it is not a donation.'

This construction of 'donation' was further amplified in CIR v Berold 1962 (3) SA 748 (A) (at 753F–G) where the court (per Hoexter JA) held that an interest-free loan by the taxpayer could be regarded as a 'continuous donation' for the purposes of s7. On

the facts of that case it was held that as long as the taxpayer refrained from compelling a company to which he had sold valuable assets to repay the amount owing, on which no interest was payable, there was a continuing donation to the company of the interest on that loan. On the facts, this donation was held to render s7(3) operative. However, the court in Joss v CIR (141) (at 682H, 683A & D] was of the view that an interest-free loan formed part of the term 'or other disposition' within the phrase 'donation settlement or other disposition'. (142)

The meaning of 'settlement'

In Joss v SIR (supra) (at 680F & 681B) it was held that 'the settlement would not include a transaction made for full value in money or money's worth' and that 'the notion of 'settlement' is inextricably bound up with motives of liberality (there is usually a 'beneficiary' in whose favour the settlement is made for the purpose of his enjoyment of the asset so settled)'. This view was later confirmed in Ovenstone v SIR (supra) at 737A-E. (143) A 'settlement' differs from a 'donation' in that a settlement is a disposal of property made subject to specific terms and conditions. This difference was pointed out by Trollip JA in Ovenstone's case (supra) (at 737A - E) in the following words :

'In a settlement the property is usually disposed of upon specific terms and conditions as set out in a deed of settlement, to or through the medium of a trustee or trustees for the benefit of some person, or for the benefit of persons in succession as in a fideicommissum.....As far as the beneficiaries are concerned a settlement is also generally made gratuitously out of liberality or generosity in the sense that no consideration usually passes from them to the settlor for the benefits conferred on them. 'Settlement' is thus usually of the same genus as 'donation'. True, consideration may sometimes pass for a settlement, but the kind of 'settlement' envisaged by the critical phrase 'donation, settlement or other disposition'.....is a gratuitous one or one that is gratuitous to an appreciable extent. For if a settlement is made for due consideration, it would, in reality be a purely commercial or business transaction, which .....would fall outside the scope of s7(3)-(6).'

The meaning of 'or other disposition'

The word 'disposition' is not defined in the Act. The meaning of the words 'other disposition' were the subject of judicial consideration in Joss v SIR (supra) and later in Ovenstone v SIR (supra).

In the Joss case, Coetzee J (at 769B–C) held that the words 'other disposition' in the context of s7 of the Act could not possibly mean every disposition which is recognised in law since such an interpretation would lead to absurd results. He held that because there is an element of liberality or benefaction in most settlements therefore 'settlement' would not include a transaction made for full value in money or money's worth. Accordingly, he held that 'other disposition' in the expression 'donation, settlement or other disposition' must be construed eijusdem generis, and 'other disposition' does not include a transaction for full consideration or value and must include an element of gratuity or liberality. Coetzee J went on to say that if a disposition was partly gratuitous and partly for consideration then one may apportion the income attributable to the element of gratuity and the element of consideration.

The decision in the Joss case (supra) was confirmed by the Appellate Division in Ovenstone's case (supra). In casu the court held that although the ordinary meaning of the word 'disposition' is wide and encompasses any making over, parting with or transferring of property to another, (144) it's use in s7 indicates that it does not bear it's ordinary unrestricted meaning. This is so because :

'it would then include a disposition of property made under a bona fide commercial, business, or at arm's length contract for full or fair consideration in money or money's worth to not only a minor child (s7(3) and (4)) but also to any other person (s7(4),(5) and (6)). It is inconceivable that the Legislature could have intended (by these provisions) to hamper persons who wish to enter into contracts of that kind. The transactions the Legislature seems to have had in mind in enacting (these provisions) are those in which a taxpayer seeks to achieve tax avoidance by donating, or disposing of income-producing property to or in favour of another under the ..... specified conditions or circumstances, thereby diverting it's income from himself without replacing or being able to replace it.'

Trollip JA in Ovenstone's case (supra) confirmed that the words 'other disposition' must be construed eijusdem generis with 'donation' and 'settlement' so that the expression 'donation, settlement or other disposition' should be read as 'donation, settlement or other similar dispostion', and that the word 'disposition' means any disposal of property made wholly or to an appreciable extent gratuitously out of liberality or generosity of the disposer. In so doing the learned Judge rejected the view adopted in Barnett v COT (145) to the extent that the court in that case held that 'disposition' could include a disposition for due consideration, that is a commercial transaction. Trollip JA, in reaching his conclusion, said the following (at 74) :

'Hence the words 'donation, settlement or other disposition' all have this feature in

common : they each connote the disposal of property to another otherwise than for due consideration, that is otherwise than commercially or in the course of business. 'Donation' and 'settlement' have this feature in common : the disposal of property is made gratuitously or (occasionally in the case of 'settlement') gratuitously to an appreciable extent. Since 'disposition', the general word that rounds off the critical phrase, was not intended to have it's wide, unrestricted meaning, I think that it is an appropriate situation in which to circumscribe it's scope by extending that common element of gratuitousness to it too by the eijusdem generis or noscitur a sociis rule. The critical phrase should, in other words, read as 'any donation, settlement or other similar disposition'. So construed, 'disposition' means any disposal of property made wholly or to an appreciable extent gratuitously out of the liberality or generosity of the disposer.' Trollip JA (at 76) summarised the position as follows :

'To sum up: the critical phrase in section 7(3) – 'any donation, settlement or other disposition'– excludes any disposal of property that is a wholly commercial or business one, that is made for due consideration; it covers any disposal of property made wholly gratuitously out of liberality or generosity; it also covers any disposal of property made under a settlement or other disposition for some consideration but in which there is an appreciable element of gratuitousness and liberality or generosity.'

With regard to apportionment, Trollip JA (at 740B–F) said the following :

'If the consideration is merely illusory, simulated or minimal, the disposal will, of course, be regarded as wholly gratuitous. On the other hand, merely because the settlement or disposition contains some element of bounty or gratuitousness that is insufficient to render s7(3) applicable; such element must be appreciable for that to happen.....Now where the consideration, while not being due consideration, is nevertheless appreciable, it will mean that the income in question under s7(3) will usually have accrued or been received 'by reason of' both elements of gratuitousness and consideration. I see no reason why in those circumstances the income should not be apportioned between the two elements. The words 'by reason of' themselves suggest some apportionment in order to give effect to the real cause of the accrual or receipt of the income. If such apportionment is not possible, or if insufficient evidence is adduced to enable the court to effect it....., the composite disposal will usually, because of it's appreciable element of bounty, be then simply treated as a gratuitous settlement or disposition, as the case may be, that falls within the scope of the critical phrase.'

In Joss v CIR (supra) it was held that an interest–free loan in respect of the purchase price of shares acquired was deemed to be a 'disposition' within the meaning of s7(3).

(146) This was confirmed by the Appellate Division in Ovenstone's case (supra). In light of these two cases it is trite law that an interest-free loan is a 'disposition', being eijusdem generis with 'donation' and 'settlement'.

(b) The meaning of 'by reason of' in Section 7(3)-s7(7) of the Income Tax Act

The words 'by reason of', as employed in s7(3)-s7(7), establish a causal connection between the donation, settlement or other disposition and the income which is deemed to be the donor's income. (147) These words have been interpreted by our courts in the context of s7(3) and, it is submitted, there is no good reason why the same interpretation cannot be applied to s7(4)-(7). (148)

In terms of s7(3) income is deemed to be received by the parent ('donor') of a minor child and is taxable in the hands of the parent where the income is received by, accrued to or accumulated in favour of such child 'by reason of any donation, settlement, or other disposition by such parent'. In Kohler v CIR (149) the court discussed the meaning to be attributed to the words 'by reason of'. In casu the taxpayer settled a sum of money on each of his minor children under a deed of donation which conferred on him the power to acquire further investments with the income made from any investment of such money. The taxpayer later used interest earned through the investment of the original donation to purchase shares for the donees in a company from which the donees received 8728 pounds in the 1946 tax year. During the same year certain deposits of accumulated income in a savings account by one of the donees earned 9 pounds interest. The legal issue in casu was whether it was 'by reason of' the donation made by the taxpayer that the sums concerned had been received by or accrued to the donees or were deemed to have been so received or accrued thereby entitling the Commissioner to tax it in the hands of the donor. The court (per Murray J) held that once income had (actually or by deeming) accrued to or been received by a minor, and had been capitalised, it's subsequent earning or product was to be attributed not to the source from which the original income was derived, but to the advantageous employment of the minor's new capital. (150) In this respect the 'income upon income' stood on the same footing as income derived by the minor from the employment of other capital of his (whether borrowed, earned or bequeathed). The court held further that income upon income did not fall within the provisions of s7(3) of the Act on the grounds that the words 'by reason of' referred to the proximate and not the remote cause and that the causal connection between the donation and the accrual (or receipt) of income upon income was interrupted by the introduction of a novus actus, namely the re-investment of the original income, and it was 'by reason of' this re-investment that

such accrual (or receipt) took place. On the facts it was held that the purchase of the shares in the private company and the re-investment of income in a savings account amounted to such a novus actus interveniens. The court concluded that although the original donation may have been a sine qua non it was not the causa 'by reason of' which the amounts concerned were derived by the minors.

The Appellate Division in CIR v Berold (supra) the court adopted the decision in Widan's case, namely that for s7(3) to find application there had to be a causal connection between the donor's donation and the income earned. On the facts of the case it was held that the effective cause ('by reason of') of the dividends being received in the trusts for the benefit of the donor's children was the donation of the parent and s7(3) could, accordingly, be successfully invoked.

The reasoning in Kohler's case regarding the interpretation of the words 'by reason of' was not followed in CIR v Widan (151) where it was held that these words implied that there must be some causal relation between the donation and the income in question and that in ascertaining if such causal relation exists one must not necessarily look to the cause which is proximate in time but to the real efficient cause of the income being received. If the latter cause is the donation by the parent then s7(3) applies. It held that the real efficient cause is a matter to be ascertained in light of all the facts and circumstances of the case in question. Centlivres CJ said, with regard to Kohler's case, that Murray J came to his conclusion on the grounds that the words 'by reason of' should be interpreted as referring to proximate and not the remote cause. The Chief Justice held that if this reasoning was correct then it would follow that interest earned by the investment of capital donated to a minor by it's parent would not fall under s7(3) for in such a case the proximate cause (as understood by Murray J) which resulted in the earning of interest would be the act of investment and not the donation itself. In other words, the operation of s7(3) would be confined to cases where a parent donated to his minor child invested capital which produced income at the time the donation was made.

It must, however, be pointed out that while the Appellate Division in Widan's case did not expressly overturn the decision in Kohler's case , it held that it was unlikely that the legislature intended that the words 'by reason of' should have such a narrow interpretation as employed by Murray J. The Appellate Division held that the determination of the proximate cause was a matter of fact and the question whether any income was received or accrued 'by reason of' a donation by a parent was purely a factual one. Accordingly, the question whether income upon income falls within the provisions of s7(3) does not admit of an absolute answer and must be answered on

the merit of each case. (152)

(c) The meaning of 'stipulation or condition.....to the effect that the beneficiaries ..... shall not receive the income.....until the happening of some event, whether fixed or contingent.....' in s7(5)

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

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

Section 7(5) applies only in respect of income 'in consequence of' the donation, settlement or other disposition. It does not apply to any ôther income which may have been received by the trust, and which was not received by reason of these acts. (153)

Estate Dempers v CIR (154) (at 421F–E) the court held that in determining the applicability of section 7(5) of the Act one must first decide whether the hypothesis is satisfied, that is whether the trust deed contains a stipulation to the effect that the beneficiaries of the donation, settlement or other disposition shall not receive the income thereunder or some portion thereof until the happening of some event, whether fixed or contingent. If it does then so much of the income as would in consequence of any donation, but for the stipulation, be received by or accrue to or in favour of the beneficiaries be deemed to be the income of the donor until the happening of the event or the death of the donor, whichever takes place first. The court (per Corbett CJ) held further (at 425F) that :

'In the application of s7(5) a vested right to the accumulated income is not a sine qua non. Naturally, if the beneficiaries have a vested right this would be a strong, possibly decisive, factor leading to the conclusion that, but for the stipulation withholding the income, it would have been received by them. That (section 7(5)) is not confined in it's application to instances where the beneficiary has a vested right

to the income which is to be withheld, is indicated, in my view by the use of the words 'fixed or contingent' in denoting the event until the happening of which he is not to receive the income. A 'contingent event' is an event which may or may not happen.' Corbett CJ then went on to say (at 426C et seq) that :

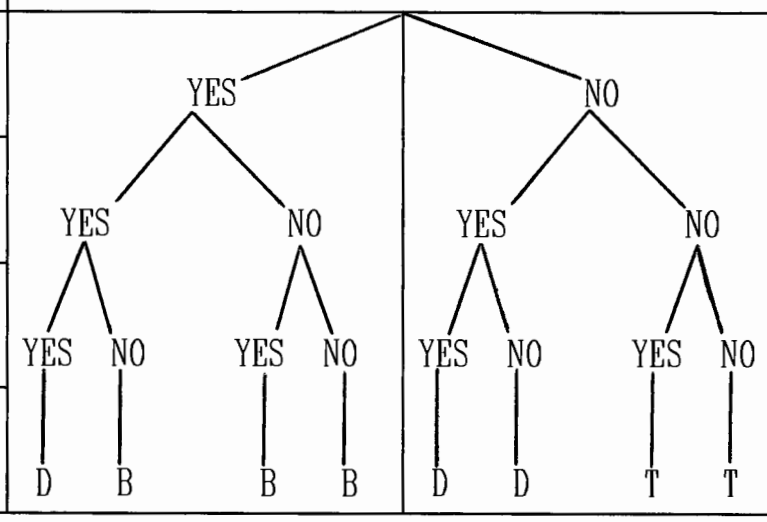
'In truth the application of the devolutionary portion of the subsection involves a hypothetical, notional enquiry which cannot be directed solely to questions such as whether the beneficiary's right to income is vested or contingent. The question which the court must ask itself is whether, in the absence of the stipulation withholding trust income, the income would have been received by or accrued to the beneficiary. In answering this question one must have regard to the terms of the instrument generally, the donor's general benevolent intention as evinced by the terms of the deed, and all other relevant circumstances. In this inquiry the fact that in terms of the instrument as a whole the beneficiary had a vested right to the income would be.....an important factor, but it would not be the sole touchstone.'

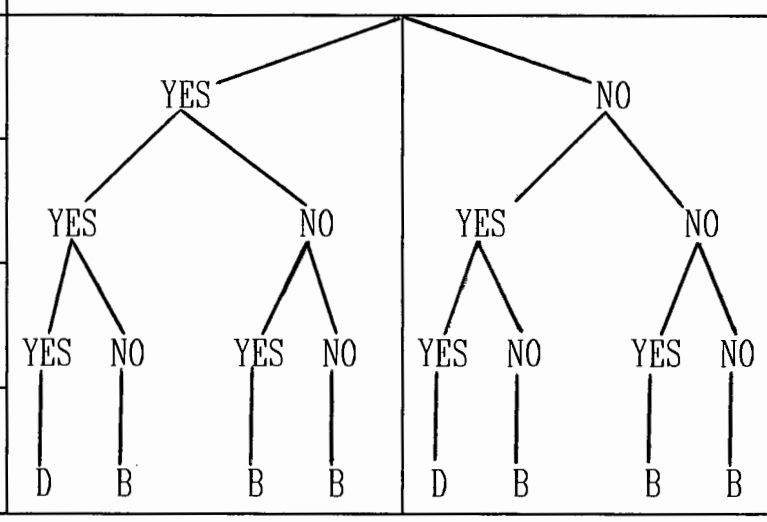
It must, however, be pointed out that in ITC 1328 (155) the court (per Milne J) held that s7(5) will not apply where the beneficiary has a vested right to the income in the sense that his right to the income is certain albeit that the enjoyment thereof is postponed; in such an instance the income is deemed to be that of the beneficiary in terms of s7(1). Furthermore, Milne J held that s7(5) postulated a situation where, because of the condition withholding receipt of the income, there was no receipt or accrual; consequently, if there was an accrual despite the condition withholding receipt then s7(5) was inoperative. In other words, s7(5) did not apply to any income, the receipt whereof being withheld, which had accrued to or was deemed to have accrued to the beneficiary. Although the view expressed in ITC 1328 does not accord with the tenor of the decision in the Dempers case, the Commissioner applies it as such in practice. It is accordingly submitted that a planner may be able to circumvent the provisions of s7(5) by making a distribution of trust income to a beneficiary on loan account without actually paying it out to such beneficiary.

The 'event' referred to in s7(5) may be the death of a certain person, the attainment of a certain age, the date of marriage of a beneficiary or some other clearly defined future happening. (156) Although our courts (157) have on occasion held that the exercise of a trustee's discretion with regard to the withholding or distribution of trust income qualifies as an 'event' for the purposes of s7(5), there has unfortunately been no authoritative ruling on this issue. The Appellate Division (158) has on two occasions had the opportunity to pronounce on this issue, but found that it was unnecessary on the facts of the case to do so.

5.2. TABULATED SUMMARY OF TAXATION OF TRUSTS

Huxam and Haupt (159) explains the taxation of trusts with reference to the following two tables :

1. Discretionary trust?	YES
2. Distribute income to beneficiaries	
3. Donor alive?	
4. Beneficiary a minor of donor?	
5. Tax	
Key :	D = Donor B = Beneficiary T = Trust

1. Discretionary trust?	NO
2. Distribute income to beneficiaries?	
3. Donor alive?	
4. Beneficiary a minor of donor?	
5. Tax	
Key :	D= Donor B= Beneficiary T= Trust

Below is a table which summarises the taxation of trust income and that of trust beneficiaries.

PERSON TAXED	TAXATION OF TRUST INCOME	SECTION OF THE ACT/ CASE
1. SETTLOR : Parent		BENEFICIARY : Minor Child (own child)
(a) Parent	Income received by or accrued to minor that is attributable to parent's gratuitous disposition.	Section 7(3) CIR v Widan CIR v Berold Ovenstone v CIR
(b) Minor Child	Income received by or accrued to minor for full consideration, ie. disposition for full value.	Section 7(1) Joss v SIR Ovenstone v SIR Section 25B(1) & (2)
2. SETTLOR : Parent		BENEFICIARY : Major Child
(a) Beneficiary	(i) income actually received (ii) income due and payable, ie. accrued but not received.	Section 1 'gross income' Section 7(1) ITC 1328 Section 25B(1)
(b) Parent	Income not received by or accrued to beneficiary as a result of settlor's stipulation or condition.	Section 7(5) ITC 1328 Estate Dempers v SIR SIR v Sidley
(c) Trustee (if settlor is dead)	Income withheld in terms of trustee's discretion and which does not accrue to beneficiary.	Section 1 'gross income' Section 25B(1)
3. SETTLOR : Any Person		BENEFICIARY : Minor Child (not own child)
(a) Beneficiary	(i) income actually received (ii) income accrued but not received.	Section 1 'gross income' Section 7(1) ITC 1328 Section 25B(1) & (2)

(b) Settlor	Income not received by or accrued to beneficiary in terms of settlor's stipulation or condition.	Section 7(5) ITC 1328 Estate Dempers v SIR SIR v Sidley
(c) Trustee (if settlor is dead)	Income withheld in terms of trustee's discretion and which does not accrue to beneficiary.	Section 1 'gross income' Section 25B(1)
4. SETTLOR : Any Person		BENEFICIARY : Another person's minor child with reciprocal benefits for settlor or his family
Parents of Beneficiary	Income received by or accrued to minor child.	Section 7(4)
5. SETTLOR : Husband or Wife		BENEFICIARY : Other Spouse (living together)
Husband if wife is beneficiary, or vice versa	Income received by or accrued to wife/husband can be taxed in the other spouse's hands if provisions of section 7(2) are met.	Section 7(2)
6. SETTLOR : Any person who confers a right to income but retains the power to revoke or confer the right upon another BENEFICIARY : Any Person		
Settlor	Income received or accrued in terms of conferred right so long as the power to revoke is retained.	Section 7(6)
7. SETTLOR : Any person who donates/settles a right to receive income in such a manner that he remains the owner or retains an interest, or is entitled to regain ownership or the interest in the income-producing property or the right to receive income. BENEFICIARY : Any Person		

Settlor/Donor	Any income (eg. rent, dividends, interest) received by the beneficiary.	Section 7(7)
NOTE : With effect from 1 March 1995 the income of a trust is taxed according to the tax table applicable to persons other than natural persons.		

SUMMARY

In the case of trusts, income tax savings is no longer as beneficial due to the implementation of sections 7 and 25B of the Act. Section 7 is essentially a general anti-avoidance provision which, when operative, overrides s25B. Depending on the wording of the trust instrument, the trust can be a conduit for the distribution of income to the beneficiaries. (160) Income received by or accrued to a trust which is distributed to trust beneficiaries during the fiscal year in which the income is received by or accrued to the trust will be taxed in the hands of the beneficiary. (161) This is the position even if the income has not actually been paid over to the beneficiary but has been invested, accumulated or otherwise capitalised on their behalf. (162) If the trust traps the income in the year in which it is received by, or accrued to, the trust in the sense that it is not distributed to beneficiaries in that year, then the trust itself will be liable to tax in respect of that income unless, by virtue of s7(5) or (7) of the Act, liability for tax in respect of such income attaches to the founder of the trust. As in the case of partnerships and sole proprietors, tax is levied at a progressive rate; no rebates are, however, available. If trust income vests in a trust beneficiary then such beneficiary may, in terms of s25B(3), off-set losses and deductions against his taxable income in the same proportion in which the income is allocated between the trust and the beneficiary. The distinction between vested and discretionary trusts is thus important. The distribution of trust property to beneficiaries is not regarded as a donation for the purposes of donations tax. (163) If fixed trust property is transferred to trust beneficiaries in terms of the provisions of the trust instrument, then no transfer duty is payable under certain circumstances. (164)

CHAPTER 6

CONCLUSION

The issue as to whether a trust is an effective vehicle for estate planning is in each case a factual one. In the determination of this issue tax considerations play an important (but not over-riding) role. Other objective factors must also be considered. These include, inter alia, the planner's specific needs and goals, economic and commercial considerations, practical application, flexibility, the promotion of family harmony, and limited liability. When considering these factors the viability of other structures as suitable alternatives must, of necessity, be considered. A dream of tax saving can easily be converted into a nightmare if these factors are not afforded due consideration. With regard to taxation in particular, it must be emphasised that the taxation of trusts is, at present, a grey area. Uncertainty prevails as to the imposition of, inter alia, a capital transfer tax , periodic valuations, and also a generation skipping tax. To countenance possible future legislative threats to planning with trusts, it is advisable for planners to prepare trust instruments which allows considerable flexibility, particularly in so far as it relates to the powers of the trustee(s) to accelerate or postpone the termination date of the trust. In this way planners will be able to effect adjustments in accordance with their future needs, taking into consideration legal developments, so as to minimise a potential tax liability.

FOOTNOTES

1. Olivier 1990 : 222. See also Meyerowitz, D 1965 : The Taxpayer p.1.
2. Olivier 1990.
3. Estate Kemp v McDonald's Trustees 1915 AD 491.
4. See Chapter 3 infra.
5. See Chapter 5 infra.
6. 1995 : 505.
7. Selected Essays (1936) 129.
8. Act 57 of 1988.
9. Section 1 of the Act.
10. 1991 (2) SA 341 (W).
11. 1993 (1) SA 353 (A) at 370 H.
12. A trust is also defined as a 'person' in s1 of the Value-Added Tax Act 89 of 1991 and s1 of the Transfer Duty Act 40 of 1949.
13. Honore 1985 : 6; Olivier 1990 : 37; Corbett et al. 1980 : 418.
14. Goodricke & Son (Pty) Ltd. v Registrar of Deeds, Natal 1974 (1) SA 404 (N).
15. Estate Kemp v McDonald's Trustee's (supra).
16. s6 of Act 57 of 1988.
17. Pretorius v CIR 1984 (2) SA 619 (T).
18. Braun v Blann & Botha 1984 (2) SA 850 (A) at 859.
19. s12 of Act 57 of 1988.
20. Morley v Standard Bank Trustees Department 1970 (4) SA 299 (W).
21. Pretorius v CIR (supra).

22. Hahlo 1990 : 206.

23. See infra pg.6.

24. van der Merwe and Rowland 1990 : 349; Joubert 1968 : THRHR 125 at 129.

25. Honore 1985 : 3 at note 11; Olivier 1990 : 27–28.

26. Crookes v Watson 1956 (1) SA 277 (A); Honore 1985 : 91 & 383 et seq; Olivier 1990 : 26–28.

27. Olivier 1990 : 223.

28. Olivier 1990 : 223.

29. Kourie, M. 'Classification and Predominant Use of Trusts' , Insurance and Tax, vol. 9 No.2 1994 p.27.

30. Ibid. p.27.

31. Ibid. p.27.

32. Ibid. p. 27–8.

33. CIR v MacNeillie's Estate 1961 (3) SA 833 (A) at 840; Friedman and others NNO v CIR : In re Phillip Frame Will Trust 1991 (2) SA 341 (W).

34. Magnum Financial Holdings v Summerley 1984 (1) SA 160 (W).

35. Section1 of the Act.

36. The Taxpayer April 1994 63 at p.63–4.

37. Ibid. p.66.

38. Kourie, M. Ibid. at p.28–31.

39. Ibid. p.29.

40. Ibid. p.30.

41. Smith, C. The Law of Insolvency 1988 p.119–147.

42. Kourie, M. Ibid. p.30–31.

43. Trustees of the Hull Trust Fund v CIR 1931 WLD 193.

44. The Taxpayer April 1994 : 64.

45. Ibid.

46. Kourie, M. Ibid. p.28–29.

47. Katz Commission 4th Report.

48. Katz Commission 5th Report.

49. Huxam & Haupt 1995 : 506.

50. Honore 1985 : 342; Olivier 1990 : 88.

51. Olivier 1990 : 96–97.

52. Trustees of the Hull Trust Fund v CIR (supra).

53. Hiddingh v CIR 1941 AD 111; CIR v Smollan's Estate 1955 (3) SA 266 (A); Estate Kemp v McDonald's Trustees (supra) at 505; CIR v Sive's Estate 1955 (1) SA 249 (A).

54. Borman en De Vos NNO en 'n Ander v Potgietersrusse Tabakkorporasie Bpk. en 'n Ander 1976 (3) SA 488; Erasmus v Havenga 1979 (3) SA 1253 (T); Jubelius v Griesel NO en Andere 1988 (2) SA 610 (C); De Leef Family Trust and Others v CIR 1993 (3) SA 350; Mcalpine v Mcalpine NO and Another 1997 (1) SA 736 (A).

55. (1927) 3 SATC 68 at 70.

56. 1943 AD 656 at 669.

57. 1940 AD 163.

58. 1942 AD 27 at 34.

59. 1938 TPD 359 at 364–365.

60. At 207.

61. Ibid.

62. At 500.

63. (1989) 106 SALJ 1 at 6–7.

64. Law of South Africa 1978 vol.5 (first re–issue) at paras. 191–192; Havenga et al 1995 : 87–88; Sharrock 1996 : 154–156.

65. 1949 SALJ 404 at 405–6.

66. Law of Succession in South Africa.

67. 1926 CPD 203.

68. Section 7(1) of the Act.

69. See CIR v Lategan (supra); CIR v Delfos 1933 AD 242; Hersov's Estate v CIR 1957 (1) SA 471 (A); SIR v Silverglen Investments (Pty) Ltd. 1969 (1) SA 365 (A).

70. 1990 (2) SA 353 (A).

71. At 365A – B.

72. 1972 (1) SA 675 (A).

73. Huxam & Haupt 1995 : 517.

74. De Koker & Urquhart 1995 : 17–25.

75. De Koker 1996 : 12–24.

76. Williams 1994 : 384.

77. (1990) 52 SATC 306 (T).

78. CIR v Sive's Estate (supra).

79. Van Dorsten 1993 : para. 4.1.

80. Section 1 sv 'person' of the Value-Added Tax Act 89 of 1991.

81. Section 30(1) of the Companies Act 61 of 1973.

82. Section 77(7) of the Act read with s24H(5)(a).

83. Olivier, L 1997 : 3 (unpublished article)

84. Section 24H(5)(b).

85. 1946 AD 31.

86. SA Bazaars (Pty) Ltd. V CIR 1952 (4) SA 505 (A); ITC 777 19 SATC 320.

87. CIR v CADAC Engineering Works (Pty) Ltd. 1965 (2) SA 511 9A) at 523B.

88. Section 1 of the Act.

89. Section 11 of the Act read with s23.

90. Para (a) of the 'gross income' definition in s1 of the Act.

91. Section 11 of the Act read with s23.

92. SIR v Watermeyer 1965 (4) SA 431 (A); KBI en 'n Ander v Hogan 1993 (4) SA 150 (A).

93. Van der Merwe v SBI 1977 (1) SA 462 (A).

94. Olivier 1990 : 247.

95. Ibid.

96. As amended by the Income Tax Act 101 of 1990.

97. Meyerowitz and Spiro on Income Tax, para 1294A.

98. Section 38 of the Act.

99. Section 56(1)(n) of the Act.

100. Schedule 4 sv 'remuneration' (c)(iii). Cf Practice note 14. See also Olivier, L 1997 : 8.

101. Section 3892)(b) and (3) of the Act.

102. Sections 54 and 59 of the Act.

103. Section 21(1)(d) of the Income Tax Act 36 of 1996.

104. Section 1 sv 'dividend' para. 1 excludes liquidation dividends of a capital nature.

105. See Schedule 7 of the Act which provides specific formulas for calculating the taxation of fringe benefits. These formulas do indeed result in a reduced tax liability in comparison with the position that would have prevailed had the fringe benefit been included in the taxpayer's gross income as, for example, part of his salary.

106. A CC distribution falls within the definition of 'dividend' in terms of s1 of the Act; a member of a CC is defined as a 'shareholder' for income tax purposes and therefore a distribution by a CC to it's members falls within the definition of 'dividend' in s1 of the Act.

107. Hardy 1994 (unpublished LLM thesis).

108. Section 20. See also SA Bazaars (Pty) Ltd. V CIR 1952 (4) SA 505 (A) at 510–511.

109. Save to the limited extent provided in section 14 which recognises groups of companies in respect of shipping.

110. Cf. ITC 1124 31 SATC 53 and CIR v Sunnyside Centre (Pty) Ltd. 1997 (1) SA 68 (A).

111. As defined in s1 of the Act.

112. Schedule 4 of the Act sv 'provisional taxpayer'.

113. Ibid.

114. Section 1 of the Act sv 'shareholder' includes a member of a close corporation.

115. Olivier, L 1997 : 11.

116. 'Estate and Tax Planning : The Use of Trusts', The Taxpayer, April 1994 63 at 64.

117. 1990 : 246.

118. Olivier, L 1997 : 11.

119. South African Institute of Chartered Accountants, 1991, 'Close Corporations : An introduction and guide to some of the more important aspects of the Close Corporations Act 69 of 1984'.

120. Olivier 1990 : 247.

121. Olivier Ibid.

122. Section 1 of the Act read with s95(1). See also definition of 'trustee' in s1 of the Act.

123. Section 1 of the Act sv 'year of assessment'.

124. Huxam & Haupt 1997 : 537.

125. De Koker & Urquhart 1995 : 17–25.

126. Armstrong v CIR 1938 AD 343 at 349; SIR v Rosen 1971 (1) SA 172 (A) at 186–188.

127. Van Dorsten 1993 : 468.

128. Estate Dempers v CIR 1977 (3) SA 410 (A) where the court held that once income had been taxed in the donor's hands under s7(5) it is deemed for all time to be his income and cannot later be taxed as accruing to the trust beneficiaries. This is so because of the rule against double taxation in South Africa.

129. Section 10(2)(b) and s19(6) of the Act read with s1 sv 'gross income'.

130. In the absence of a legislative definition of an annuity, our courts have held that the essential characteristics of an annuity are (i) an element of recurrence in the sense of annual payments (even if made quarterly), (ii) that

the payment must be repetitive in the sense that the beneficiary has the right to receive more than one annual payment payable from year to year for some time, and (iii) that the right to receive payment is chargeable against some person – KBI en 'n Ander v Hogan 1993 (4) SA 150 (A).

131. Section 1 of the Act sv 'gross income'.

132. 1994 (4) SA 603 (A).

133. ITC 664 16 SATC 125. See also Emslie et al 1995 : 815–816.

134. 1952 (4) SA 505 (A).

135. As to the meaning of 'accrual', see Chapter 3 above.

136. Van der Westhuizen & Chait 1996 : 1996.

137. As to the meaning of 'vested', see Chapter 3 above.

138. Section 11(a) read with s23(g) and s25B(3) of the Act.

139. Section 25B(3). See also ITC 1483 (1990) 52 SATC 306 (T) at 309. Trust beneficiaries who are obliged in terms of the trust deed to cover trade losses suffered by the trust may deduct such losses in calculating their taxable income.

140. 1980 (2) SA 721 (A), 42 SATC 55.

141. 1980 (1) SA 664 (T), 41 SATC 206.

142. Olivier 1990 : 179. See also Clegg, D.J.M. 'Interest–free loans', Tax Planning, vol.7, 1993. p.64.

143. Olivier Ibid.

144. Ovenstone v SIR (supra) at SATC 72.

145. 1959 (2) SA 713 (FC) where the court interpreted a provision substantially similar to that in s7(3).

146. Contra CIR v Berold (supra)where an interest–free loan was held to be a 'continuous donation'.

147. Olivier 1990 : 180.

148. Olivier Ibid.

149. 1949 (4) SA 1022 (T).

150. At 1028.

151. 1955 (1) SA 226 (A).

152. Meyerowitz on Income Tax, para.3.53.

153. Van der Westhuizen & Chait Ibid. : 42.

154. 1977 (3) SA 410 (A).

155. (1980) 43 SATC 56.

156. Estate Dempers v CIR (supra).

157. Hulett v CIR 1944 NPD 264; ITC 1033 SATC 73.

158. Estate Dempers v CIR (supra); SIR v Sidley 1977 (4) SA 913 (A).

159. 1997 : 537.

160. Armstrong v CIR (supra); SIR v Rosen (supra).

161. See s25B of the Act and SIR v Rosen (supra).

162. Section 7(1) of the Act read with CIR v People's Stores (Walvis Bay) (Pty) Ltd. (supra).

163. Section 56(1)(l) of the Act.

164. Section 9(4)(b) of the Transfer Duty Act 40 of 1949.

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