TAXATION IN RELATION TO TRUSTS
AN INTRODUCTION

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INTRODUCTION

While the focus of this paper is an introduction to taxation in relation to the Trust as established in South African Law today it is clear that tax law and legislation is extremely complex in its diverse application. It is accordingly beyond the scope of this paper to provide a detailed analysis of the current tax laws as applied to Trusts.

It will first be necessary to briefly examine the origins of South African Trust Law and historic development through the authorities to present day.

THE TRUST CONCEPT

The basis of the Trust is to be found in the Germanic concept of *Treuhand.* It developed as a means of circumventing the then laws of the Germanic peoples relating to deceased estates. Private ownership of property was originally alien to the culture of the Franks who were unable to relate to the concept of individuals dealing with property as they saw fit. Property belonged to families not to individuals and passed into the hands of the family as a unit and not to an individual member on death.

These rules and concepts were codified in what was known as the Lex Silica. Special provision was made for those who wished property to devolve to persons who would not ordinarily acquire the property by inheritance. Thus the owner of property would transfer it to an intermediary who would in turn transfer it to a named beneficiary on the death of the original owner. The intermediary became known as the *Treuhander* and he became owner of the property not for his own personal benefit but swore an oath to carry out his duty to make over the property to the named beneficiary.

It is thus clear that this early concept accords with the notion upon which the latter day Trust is based, passing ownership over property in a limited form to an intermediary who was to administer that property for the benefit of a third person. The *Treuhander* could thus be described by the following formulae: *to be the entitled party, not for oneself but for another or for a particular impersonal purpose.* [1]

After the Norman conquests of England and the implementation of the feudal system the continental *Treuhand* system was embraced and adapted by lesser nobles and tenants. It became known as "Use". This was used in order to rid themselves of the stifling burden of the feudal dues enforced upon them by the feudal Lords.

Shrand [2] suggests that the origins of "Use" may be ascribed largely to difficulties experienced by religious bodies who were in danger of having their land expropriated by the Crown. Religious institutions were exempted from paying taxes to the Crown in respect of the land they held and thus denied the Crown the income they would ordinarily receive were the land held by private individuals. To avoid being stripped of their entitlement these religious organisations entered into agreements with ordinary landowners whereby the landowner became the legal owner of the land and the religious body occupied the position of beneficiary which entitled it to the beneficial occupation of the land.[3] The "use" was also employed by significant landowners during the civil wars in England which allowed them to avoid having their property confiscated for acts which may have been deemed to be treasonable.

Practically, this concept was implemented, to some extent, along the following lines:-

The owner or freeholder of the land, beholden to pay taxes to the Lord of the fief, would transfer or make over the land to the transferee or "feoffee" for the use of a beneficiary other than the feoffee. Thus "A" transferred to "B" for the benefit of "C". "B" became the owner , not for his benefit but for the benefit of "C". The feoffee would carry out his rights and obligations with regard to the property in terms of his arrangement with "A" and would have no direct ties or obligations vis a vis the "Lord" of the fief.

The legal nature and development of the system of "Use" was further ascribed to the two tiered court system existing during this time. The feoffee was seen as the legal owner of the property, his rights being protected by the so-called Common Law court (which strictly applied common law principles). In the very real eventuality that the feoffee reneged on his duties to hold land for the beneficiary, the aggrieved beneficiary was unlikely to obtain relief in the Common Law court being thus forced to approach the Chancery court (where decisions were made according to principles of equity). The Chancery court would force the feoffee to abide the arrangement with the transferor and make over the land to the beneficiary. " It was natural for the chancellor to seek to enforce *Use*. What was unforeseen was that his efforts gave rise to the view that the beneficiary was entitled to a type of equitable ownership or proprietary interest in the land" [4]
Thus two types of property rights were recognised in relation to the development of *Use* in English Law.

Inevitably legislation was introduced by the Monarchy by way of "The Statute of Uses" which sought to vest both the legal ownership and equitable ownership directly in the beneficiary thus avoiding the feoffee. To circumvent this legislation the transferor "A" would transfer property to the feoffee "B" "to the use of " a beneficiary "C" who would hold it "to the use of" a further beneficiary "D".
In this way the "use" upon a "use" gradually became known as a Trust, "C" becoming known as the Trustee and holding the "legal estate" whilst "D" as holder of the equitable estate, was known as the beneficiary.

Thus it was that the basics of the Trust concept as we know it today became established in English law. Due to colonial expansion by the British Empire much of its legal system, including the law relating to Trusts, was introduced to "foreign" jurisdictions.

".....English settlers, wherever they went, carried with them the principles of English Law.....Where, however, the territory was acquired by cession or by conquest, more particularly where there was an existing system of Law, it has always been considered that there was an absolute power in the Crown, as far as was consistent with the terms of cession....., to alter the existing system of Law though until such interference the laws remain as they were before the territory was acquired by the Crown....." [5]

When the British Fleet landed at the Cape in 1806, there was an existing system of Law in the Cape, having its roots in the Roman-Dutch Law as developed in the Netherlands. The Trust concept as enunciated above was unknown to Roman- Dutch law [6]

"The Cape Articles of Capitulation dated 18 January 1806 stipulated that the rights and privileges which the inhabitants had hitherto enjoyed should be preserved to them. Among those privileges the retention of their existing system of law was undoubtedly included" [7]

In 1827 the Charter of Justice remodelled the court system. The Cape Supreme Court was established with English becoming the only language permitted in the Courts. Practitioners had to be barristers of the English, Scottish and Irish Bars of at least five years standing. This, together with the ready references to English authorities, reinforced the English influence even in areas where there was no formal introduction. Reference to the English sources came easily to the majority of practitioners who were trained at the Inns of Court in London or the Scots or Irish Bar. The Supreme Court at the Cape further adopted the English approach that the legal point settled in a previous decision was binding and could not be departed from. So it was that by 1891 the law of the Cape Colony remained Roman- Dutch but now had a heavy overlay of English law influence. [8]

In the case of **Estate Kemp and Others v McDonald's Trustee** [9] The Appellate Division of the South African Supreme Court (as it then was) had occasion for the first time to construe a testamentary trust as formulated in terms of English Law. The Court acknowledged that the English law of Trusts forms no portion of South African jurisprudence but did not necessarily preclude South African legal principles being applied to testamentary dispositions couched in the form of English law Trusts. The Court went on to liken the testamentary Trust to the Roman- Dutch *fideicommissum purum* and a trustee to be regarded as covered by the term fiduciary. It can be said that this decision allowed the authoritative introduction of a Testamentary Trust into South African Law despite being criticised in subsequent decisions.

In **Estate Watkins-Pitchford and Others v Commissioner for Inland Revenue** [10] Van Den Heever JA remarked that the so-called "administrative peg" given to trustees without beneficial interest as fiduciaries has nothing in common with the legal position of a fiduciary.

In **Greenberg and Others v Estate Greenberg** [11] Schreiner JA stated at 368G " *.....there seems to be no advantage in continuing to call a trust a fideicommissum and a trustee ' a fiduciary in the nature of an administrative peg' or ' a fiduciary under a feicommissum purum' or the like"*

As expressed by KW Ryan in his unpublished doctoral thesis **The Reception of the Trust in the Civil Law** [12] "The essence of the Trust is the separation of titular from beneficial rights over property. The *fideicommissum* is concerned with the relations of those successively entitled, not with the relations of the titular and beneficial owner. The attempt made in South Africa to subsume trusts under the law of *fideicommissum* and to equate the division between the concurrent interests of Trustee and Beneficiary with that between the successive interests of instituted heir, is therefore inadmissible.

In the case **Braun v Blann and Botha** [13] the Appellate division examined various authorities, among them those quoted above, and came to a unanimous decision that the Trust can, in our law, be considered a legal institution *sui generis* and that it is both historically and jurisprudentially incorrect to identify the Trust with the *fideicommissum*. The Court further decided that our courts have evolved and are still in the process of evolving our own law of Trusts by adapting the Trust idea to the principles of our own legal roots without adopting, wholesale, the English Law of Trusts with its dichotomy of legal and equitable ownership.

As stated earlier the evolution was a gradual one and it is not possible to separate out the strands that come together, Hahlo & Kahn [14] use the term 'osmosis" to describe the manner in which these evolutionary changes in our law took place. ".....Continuous development has come through adaptation to modern conditions, through case law, through statutes, and through the adoption of certain principles and features of English Law....." [15]

THE NATURE AND CHARACTERISTICS OF A TRUST

In determining the taxation or taxability of the Trust as established in South African Law it is necessary first of all to examine the legal nature or structure of the Trust and to determine who is assessable for tax vis a vis the Trust.

The true nature of the Trust has been the subject of much judicial postulating and debate.

It has been said that the Trust, in all its forms, does not possess legal personality.

As Steyn CJ stated in **CIR V Macneillie's Estate** [16]

"like a deceased estate, a trust , if it is to be clothed with juristic personality, would be a persona or legal entity consisting of an aggregate of assets and liabilities. Neither our authorities nor our courts have recognised it as such a person or entity."

Steyn CJ went on to examine the Income Tax Act 31 of 1941 and did not find a definition for "person" in the Act that would include a trust. Steyn CJ further stated that " *the introduction of another persona consisting of those assets and liabilities for the purposes of the imposition and collection of a tax when there is a trustee ready to hand would be an extra ordinary measure.*"

In the case of **Magnum Financial Holdings (Pty) Ltd (In Liquidation) v Summerly** [17] the court had occasion to examine the nature of a Trust in relation to the provisions of the Insolvency Act [18] with a view to sequestration of the Trust and under the Companies Act [19] with a view to liquidation proceedings. The court held that the Trust should be sequestrated on the basis that it does not constitute a body corporate within the definitions of the relevant acts and accordingly cannot be placed under liquidation. It is clear that the trust estate is for certain purposes regarded as forming a separate estate from the personal estate of the trustee and is considered a "debtor" for insolvency purposes. According to Honore [20] the Trust possesses in this regard a kind of "quasi-personality".

In terms of section 12 of the Trust Property Control Act [21] " Trust property shall not form part of the personal estate of the Trustee except in so far as he, as the trust beneficiary, is entitled to the trust property."

In **CIR v Friedman & Others NNO** [22] the court, after examining various authorities held that, as a Trust was not a separate legal entity and was further not a legal *persona* within the definition of *'person'* in the Income Tax Act [23] *as it then was*, it was not a taxable entity liable for tax in respect of the undistributed trust income of the Trust.
It was mainly as a result of this decision that the definition of "*person*" in the Income Tax Act was amended in 1991 (backdated to 1 March 1986) so as to include a Trust in all its forms.

In its wider sense a Trust can exist when 'property' is held by one 'person' on behalf of another or for some person other than his own benefit. [24]
It may be said that the Trust is created when the Creator, **Settlor** or Founder, having the **intention** to create a Trust, **expresses such intention** in a mode **creating an obligation** to hand over control of **clearly defined property** to be **administered by a Trustee**, in his capacity as such, with the personal or impersonal **lawful object** of benefiting some beneficiary other than the Trustee. [25]

From this definition one can distil the basic elements required for creation of a Trust.

1. FORMATION OF A TRUST - Intention

The intention to create a Trust is essential for its formation and cannot be created unintentionally. So-called constructive and resulting Trusts do not form part of our Law. [26] The intention to create a Trust must be expressed in some form. The Founder need not specifically refer to the Trust to create one. The intention may be inferred from the circumstances, the formality of the arrangement, the words used by the Founder. So long as the trustee is obligated to administer the defined trust property for the Trust object [27]
Trusts are created in various ways depending on the Founders intention and the method of its creation. Trust Law, as it has developed in South Africa, is responsible for the distinction between the various Trusts such as Testamentary Trusts, *Inter Vivos* Trusts and Charitable Trusts. Tax Law, on the other hand, is responsible for the fact that it is useful to further divide each of the above types into discretionary and non-discretionary trusts. [28]
Although oral Trusts are possible [29] the Trust is normally reduced to writing and, depending on the method of creation must comply with statutory formalities.

So it is that a Trust created in a Will, codicil or other testamentary disposition, the so-called Testamentary Trust or Trust *mortis causa*, must comply with the formalities prescribed by the Wills Act 7 of 1953. [30]
The Will, codicil or other testamentary writing contains the conditions, stipulations and powers granted to Trustees and all other essentials of the Trust. The Testamentary Trust obviously only has legal efficacy upon the death of the Testator (Founder) and acceptance of the Testamentary writing by the Master of the High Court. The fact that the Testamentary Trust only comes into operation on the death of the testator allows the Testator freedom during his life (and so long as he is *compos mentis*) to deal with the subject matter of the Will and Trust and to alter the provisions thereof.

The so-called *Inter Vivos* Trust is created by contract between the Founder and the designated Trustees, with or without the co-operation of the beneficiaries. Any contract, such as an Ante Nuptial contract or contract of Donation may also be used for this purpose. The Trust Deed or Trust instrument comes into operation during the lifetime of the Founder. A distinction may be drawn between the 'underhand' Trust Deed and the Notarially executed Trust Deed. Both of these methods of drawing the Trust Deeds are registered with the Master of the High Court in terms of the Trust Property Control Act [31]
In the case of **Crookes v Watson** [32] the Court had occasion to determine the construction of the trust *inter vivos* and likened it to a contract for the benefit of a third party. *(Stipulatio Alteri*). According to the Courts construction of the *stipulatio alteri* a contract comes into being between the Founder and the Trustee. Once the Trustees accept their appointment the Founder cannot unilaterally revoke or amend the Trust without having specifically reserved to himself the right to amend. The beneficiary is not a party to the contract between the Founder and the trustee, nor does he have any right against the trustee in terms of that contract. However, after he has notified his acceptance to the trustee he obtains a claim against the trustee a so-called *ius in personam*.

A trust *inter vivos* therefore involves two legal transactions: a contract between the Founder and the trustee and a contract between the trustee and beneficiary. [33]

Section 14 of the Trust Property Control Act [34] stipulates that ' *whenever a trust beneficiary under tutorship or curatorship becomes entitled to a benefit in terms of a trust instrument, the tutor or curator of such a beneficiary may on behalf of the beneficiary agree to the amendment of the provisions of a trust instrument, provided such amendment is to the benefit of the beneficiary* '.

Even if the beneficiaries have not accepted the benefits bestowed in terms of the Trust Deed, some writers [35] are of the view that the founder and trustee are not always at liberty to agree to the variation or revocation of the trust. Although the matter has not been authoritatively decided, the view is that, because a trustee holds an office and is not merely a party to a contract with the Founder, the trustee is only entitled to agree to a revocation or variation if he thinks it is in the interests of both the Founder and the actual or potential beneficiaries. [36] This accords with the fiduciary duties of the Trustee.

As stated above, Trusts are created with a specific intention and object and so one finds various ' labels ' attaching to the Trust depending on the *dominant purpose* for which the Trust was created. [37] The Charitable Trust, for example, has as its object the advancement of charitable causes and may, subject to the fulfilment of certain requirements, enjoy tax relief. [38]

2. TRUST PROPERTY

The Trust property may consist of any assets or group of assets, movable or immovable, corporeal or incorporeal, as long as the subject matter can be determined with reasonable certainty. Although transfer of the assets is not required for the *existence* of a valid trust, *proper administration* thereof will dictate that assets are formally transferred.

The requirement is that the Founder is placed under an obligation to give the control of the property to the Trustee. [39]
The assets which form the trust property must be separated from the control and administration of the Founder and placed under the control of the Trustee. This requirement has significant Tax implications as we shall see further on. Ownership in immovable property is, in terms of the Deeds Registries Act [40] transferred by registration of a Title Deed by the Registrar of Deeds in the Deeds Office.

Since the abstract system for the transfer of ownership applies, transfer takes place notwithstanding a void underlying contract as long as there is a valid real agreement. [41]

Despite the above however, it is submitted that, in terms of the provisions of the Alienation of Land Act [42] , the "underlying contract", in this instance the Trust instrument, giving rise to the transfer of immovable property must be in writing and must of necessity be valid.

One of the predominant purposes for which a Trust is created is to ensure the segregation of the Trust property from the control of the Founder or, in the case of a Testamentary Trust, from control of the beneficiaries either for tax planning purposes or for protection of the *sub-stratum* of the Trust property. Accordingly a Trust cannot be created where the Founder remains the sole trustee and sole beneficiary because every Trust imports the element of holding or administering property, in part at least, for a person or object other than the Trustee. It is to be noted also that the founder cannot set up a trust by transferring assets to himself as sole trustee, though he may do so by a transfer in trust to himself and another. [43] Once the Trust is in existence it will not be extinguished merely because the Founder becomes the sole trustee, provided he is not also the sole beneficiary. [44] See also **Ex Parte Leandy** [45] in which the Court granted an application to have the Founder or Settlor of a Trust appointed as co-trustee.

It is apropos at this point to deal with the provisions of section 3(3) (d) of the Estate Duty Act [46] which includes property deemed to be property of the deceased being:

" (d) property (being property not otherwise chargeable under this Act or the full value of which is not otherwise required to be taken into account in the determination of the dutiable amount of the estate)of which the deceased was immediately prior to his death competent to dispose for his own benefit or for the benefit of his estate; and

For the purpose of section 3(3)(d), section 3(5) provides that:

(a) the term "property " shall be deemed to include the profits of any property;

(b) a person shall be deemed to have been competent to dispose of any property –

(i) if he had such power as would have enabled him, if he were sui juris, to appropriate or dispose of such property as he saw fit whether exercisable by will, power of appointment or in any other manner;

(ii) if under any deed of donation, settlement, trust or other disposition made by him he retained the power to revoke or vary the provisions thereof relating to such property;

(c) the power to appropriate, dispose, revoke or vary contemplated in paragraph (b) shall be deemed to exist if the deceased could have obtained such power directly or indirectly by the exercise, either with or without notice, of power exercisable by him or with his consent;"

From the above therefore it is clear that, in order to avoid falling foul of the provisions of section 3(3)(d) read with section 3(5) of Act 45 of 1955, a prudent Founder will ensure that he is not appointed as sole trustee in a Trust in which he or his estate is a beneficiary. More specifically, the Founder should ensure that there is no power conferred or retained by him in the trust deed to alter its provisions or to appoint or remove trustees. See also in this regard the section dealing with the deeming provisions of section 7(6) of Act 58 1962.

Honore insists that it is ' essential that the founder should actually divest himself.....of a part at least of his legal power over the trust property' [47] and let the trustee administer the property (at least partially) for a person/ impersonal object other than the founder himself.

3. OWNERSHIP OF TRUST PROPERTY

As we saw earlier the Trust idea requires the separation of control and benefit in the trust property.

The Trust concept as developed in our law recognises essentially two forms of ownership in Trust property. The more customary form requires that the Founder settles property on the Trustee who then holds the property not for his own benefit but for the benefit of the Trust beneficiaries. Thus ownership and control vests in the Trustee, but *qua* Trustee and he has no beneficial interest in it. In administering the Trust assets the Trustee avoids placing himself in a position where his personal interests conflict with those of the beneficiaries [48] and he must keep the Trust property separate from his own. [49]

As we saw earlier the separation of Trust property from the personal assets of the Trustee is statutorily entrenched in terms of section 12 Act 57 of 1988. Furthermore *' A trustee shall in the performance of his duties and the exercise of his powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another* '[50]

In **SIR v Rosen** [51] the appeal court had, amongst other issues, occasion to examine the nature of the Trust and Trustees *qua* trustees as regards the 'conduit pipe ' principle espoused in **Armstrong v CIR** [52]. [see also the section on *income assessable to the beneficiary*] The court examined various authorities and concluded that " the common factor is that the trust shares and income were vested in ownership in the trustees. The beneficiary therefore had merely a *jus in personam* against the trustees for securing the payments to him , and not a *jus in personam ad rem acquirendam* in any sense "

Another possible construction of the Trust is that the Founder settles or bequeaths property to the beneficiaries to be held in Trust and administered by trustees. In the case of **Schaumberg v Stark** [53] the court concluded that a *fideicommissum* had been created in the Testators Will and notwithstanding the appointment of a Trustee, dominion in the estate did not vest in the Trustee. Here he was only the administrator while the beneficiary was the owner. The court here recognised the Dutch " bewind" without stating as much. There has been some dispute in our legal literature on the question of whether the "bewind" can be considered as a form of Trust.

This is now of mere academic interest as the legislator has recognised the concept in the definition of Trust in Act 57 of 1988 which reads as follows:-
'trust' *means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed-*
(a).....
(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....."

4. SUBJECT MATTER AND PARTIES

As stated one of the essential elements of the Trust concept requires that the subject matter and the beneficiaries must be clearly defined and easily ascertainable. A Trust without beneficiaries is a nullity. *' A Trust will be null and void if there are no clearly indicated beneficiaries or if the impersonal objectives cannot be clearly ascertained '* Beneficiaries can either be named or can be ascertained from the definition in the Trust Deed from a specified group of beneficiaries [ie. Beneficiaries described in a Testamentary Trust as " my grandchildren" without specifically naming them] The trustees can be left with the discretion to select from time to time a beneficiary or beneficiaries from a designated class of beneficiaries. The *ius in personam* vis a vis the trustee has been described as a contractual nexus between the beneficiary and the Trustee in terms of which the latter has a fiduciary duty for the proper administration of the trust property for the benefit of the beneficiary. [54]

In the case of a fully discretionary trust, it appears as if the beneficiaries only possess a conditional *ius in personam* and where there are more than one beneficiary to select from, the beneficiaries only obtain a *ius in personam ad rem acquirendam* if and when the trustees resolve to vest a specific property, which is part of the trust capital, in such beneficiary. [55] The Trustee appointed or (more correctly in terms of a testamentary trust) nominated, only has the authority to act as such once authorised in writing by the Master of the High Court. [56] If he acts prior thereto his act is not validated by the conferral of authority thereafter – his act cannot be ratified.

TAXATION IN RELATION TO TRUSTS

Up to now we have dealt briefly with the Trust as a concept and its construction. The focus of this paper is essentially an introduction to the taxation of the Trust and the parties thereto. Taxation or duties levied by the *fiscus* on the trust and the parties thereto takes various forms and includes the following:-

- **Tax on income;**
- **Donations Tax;**
- **Transfer Duty on immovable property;**
- **Capital Gains Tax**

A. INCOME TAX

In assessing who is liable to income tax one looks, in the first instance, to the definition of gross income defined in section 1 of Act 58 of 1962 as: *" gross income, in relation to any year or period of assessment, means, in the case of* ***any person, the total amount,*** *in cash or otherwise,* ***received by or accrued to or in favour of such person*** *during such year or period of assessment from a source within or deemed to be within the Republic, excluding receipts or accruals of a capital nature"* In light of the recent amendments to the Act and the residence basis of taxation introduced with effect 1 January 2001 the definition has been amended in terms of section 2 of Act 59 of 2000. Essentially '*person* ' has been replaced by *resident* [as defined] the term '*excluding receipts or accruals of a capital nature'* has been expanded by the inclusion of *' but including without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder, namely-'* It goes on to expand on the definition most notably to include in receipts and accruals dividends, be they from a foreign origin or not.

It is clear, from the Act, that tax is levied on income , *received by or accrued to or in favour of* [a resident or deemed source within the Republic] the taxpayer during a year of assessment, and there must be a receipt or an accrual of income before there can be any liability to tax.

With the more recent amendments to the Act by way of the Taxation Laws Amendment Act 5 of 2001 [see the section on Capital Gains Tax] a person is assessable to tax on his taxable capital gain [as defined]. This taxable capital gain is included in taxable income in terms of Section 26 A of the Act [as amended].

In the context of the Trust structure as developed in our law [as discussed above] there are essentially three possible persons or entities [or any combination of them] liable to tax on income received by or accrued to a trust. These are:

- The Trust [the trustee as representative taxpayer];
- The Beneficiary;
- The Donor, Settlor

1) Income assessable to the Trust

As was determined earlier, the Trust as developed in our Law was not considered a separate legal entity and was not a 'person' assessable to tax.

A seminal case in this regard may be said to be **CIR v Friedman & Others NNO** [58] In this case the court was called upon to firstly examine the issue of whether the Income Tax Act (as it then was) imposed any liability for income tax on undistributed income not accruing to any potential income beneficiary on the trust as taxpayer *per se*. A second issue which the court had to decide was whether the trust was a 'taxable entity' in terms of the Act despite its lack of legal personality. A further issue for consideration was whether the CIR was legally entitled to treat the trustees, in terms of s 95(1) of the 1962 Act, as representative taxpayers for the purpose of levying income tax in respect of the undistributed income of the trust which did not accrue to any potential income beneficiary.

The court proceeded to examine the Act and authorities in relation to the three issues for consideration. With regard to the first issue the court examined the definition of 'taxpayer' defined as 'any *person* chargeable with any tax...." The court found that the definition of 'person' in the Act did not include a Trust and further that the charging section provided for a levy of tax in respect of taxable income received by or accrued to any *person*..... On the second issue the court went on to examine various authorities and found nothing in the 1962 Act which manifested an intention by the legislature to regard a trust as a 'taxable entity'. The court found, in regard to the third issue, that a 'representative taxpayer' represents someone for purposes of assessment and payment of income tax, *viz* a 'person'. The taxable income on which the income tax is levied is that of the represented person, the real taxpayer who is primarily liable for payment of income tax. The court went on to determine the answer to the crisp question of 'who is the 'person' or real taxpayer that would be represented by the trustee as 'representative taxpayer'. The court determined that it was not the trust because it did not qualify as a person' or 'taxable entity'. It could not be the trustees representing themselves and furthermore the Act did not provide for an independent imposition of a levy on trustees *qua* trustees aside from the charging provisions of section 5(1). Common law principles did not allow for representation of non-existent principles.

Largely as a result of the Friedman case the definition of 'person' in the Income Tax Act [59] was amended *(backdated to 1 March 1986)* so as to include a Trust. Person now being defined as: *'person' includes the estate of a deceased person and 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.* "

A trust being defined 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* ". [60]

Trustee has been defined in Act 58 of 1962 *as ' ....in addition to every person appointed or constituted as such by act of parties, by will, by order of declaration of court or by operation of law, includes an executor or administrator, tutor or curator, and any person having the administration or control of any property subject to a trust, usufruct, fideicommissum or other limited interests or acting in any fiduciary capacity or having, either in a private or in an official capacity, the possession, direction, control or management of any property of any person under legal disability '*

The Trustee acts as representative taxpayer *Nomine Officio* in relation to the Trust [61] Section 95 of Act 58 of 1962 deals with the liability of the representative taxpayer who shall be *'.....subject in all respects to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially.....'*

SARS Practice Note 21 States that all Trusts must register as taxpayers.
In relation to gross income [62] received by or accrued to or in favour of any Trust there are three possible taxpayers (or any combination of them) assessable to tax on such income.
These are :

- The Trustee (as representative taxpayer of the trust)
- The beneficiaries
- The Founder / Donor

The decision as to who will be taxed depends on a number of factors such as:

- The terms of the Trust Deed
- Whether or not the income is distributed
- Whether or not the beneficiaries have a vested right to the income
- Whether the beneficiaries are major or minor children of the Donor
- Whether the Donor is alive at the time of assessment

Where the terms of the Trust instrument grant the Trustees discretion whether to distribute the income or not, the Trust is said to be discretionary. For a Trust to be assessable to tax on income the Trust must, in the first instance, be a discretionary Trust. Secondly the Trustee must have exercised discretion in the sense of *not* distributing the income in a particular year of assessment for the benefit of the beneficiaries. In other words the beneficiaries *must not have a vested right* to such income. [63] Sections 7(1) or 7(5) must *not* be applicable. This is because section 25B is subject to section 7. Section 25B inserted into the principle Act by s27 (1) of Act 129 of 1991 and amended by s 22 of Act 141 of 1992. In essence section 25B provides that [25B (1)] any income received by or accrued to or in favour of any person in his capacity as a trustee of a trust fund shall, *subject to the provisions of section 7,* to the extent that it has been derived for the immediate or future benefit of an ascertained beneficiary with a vested right be deemed to be income accrued to the beneficiary otherwise be deemed to be the income of the trust fund. [25B (2)] Where the beneficiary has acquired a vested right in consequence of the exercise by the trustee of a discretion vested in him by the trust deed such income is deemed to be derived for the benefit of such beneficiary. [25B (3)] Any deduction or allowance which may be made under the Act in calculating the taxable income and which relates to the income which has accrued to a beneficiary or to the trust fund, is deemed to be a deduction which is permitted in the hands of the person who is deemed to have derived the income, to the extent to which the income is deemed to accrue to the beneficiary or the trust fund. Inland Revenue issued practice note 23 in June 1994 aimed at clarifying the application of s25B of the Act. This effectively confirmed the view that the ' conduit pipe' principle as espoused in **SIR v Rosen** 1971 AD was entrenched in s 25 B of the Act. [see the discussion on income assessable to the beneficiary]

In terms of section 95(2) *' any abatement, deduction, exemption or right to set off a loss which could be claimed by the person represented by him shall be allowed in the assessment made upon the representative taxpayer in his capacity as such. '* Accordingly a Trust may, depending on compliance with the applicable provisions of section 10, enjoy exemption from income tax.

2) Income assessable to the beneficiary

Section 25B(1) [64] provides that income received by or accrued to or in favour of any Trustee (in his capacity as such) shall, subject to the provisions of section 7, to the extent that it has been derived for the immediate or future benefit of an ascertained beneficiary with a *vested right* be deemed to be income accrued to such beneficiary otherwise be deemed to be the income of the Trust. This essentially means that a beneficiary with a vested right, subject to section 7, will be assessable to such income whether the income is paid to him or retained in the trust to be paid at a later date.

The question then is when can it be said that a beneficiary has a vested right. In **Jewish Colonial Trust Ltd v Estate Nathan** [65] the court suggested that the term ' vested right' was used to draw a distinction between what is certain and what is conditional; a vested right as distinguished from a contingent or conditional right. Honore describes the term ' vested right' as follows: (a) A right is said to be ' vested ' in a person if he 'owns' it. (perhaps more correctly if he is the *holder* of a right) (b) the word vested is used to draw a distinction between what is certain and what is conditional.

The date when a beneficiary gets a vested right to claim delivery of the benefit unconditionally is called *dies cedit* . The time at which a beneficiary's right to claim delivery becomes enforceable is called *dies venit.* The enjoyment of a benefit may thus be postponed by, for example, a time clause stating that the beneficiary will receive capital of the trust at age 21. The

beneficiary in this instance obtains a vested right immediately but enjoyment is postponed. *Dies cedit* is immediate whilst *dies venit* is postponed.
The Founder can also thus postpone *dies cedit* and *dies venit* until a certain time. As occurs in so-called discretionary Trusts, the Trustees enjoy a discretion as to whether, and in some cases to whom, they are to distribute the trust income. In this sense the distribution is subject to a suspensive condition thus postponing both *dies cedit* or ' vesting' and *dies venit* 'enjoyment or benefit. The beneficiary will thus not be taxed on the income and provided section 7 is not applicable the Trust will be taxed. Once *dies cedit* occurs (the discretion is exercised) and the beneficiary gets a vested right then, subject again to section 7, the beneficiary will be taxed on the income [66] even if *dies venit* is postponed (the payout to the beneficiary is delayed).

This follows from the Appellate Division decision in the case of **CIR v People's Stores (Walvis Bay) Pty Ltd** [67] which approved the definition of "accrued" as equating "entitled to" as espoused in **CIR v Lategan** [68]

The court in the **People's Stores** case went on to quote the proposition in the **Lategan** case *that ' income, although expressed as an amount in the definition of gross income, need not be an actual amount of money but may be: " every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.....including debts and rights of action "'* According to Watermeyer J at 209-210 [69] *".....he has acquired a right to claim payment of the debt in the future. This right has vested in him, has accrued to him in the year of assessement, and it is a valuable right which he could turn into money if he wishes to do so."*

Once it is established that the beneficiary has a vested right to income received by, accrued to or in favour of a Trust then the income is taxed in the beneficiaries' hands. Income passing through the Trust to a beneficiary retains its identity.

This principle is known as the *'conduit pipe* 'principle as established in **Armstrong v CIR** [70] and followed in **SIR v Rosen** [71]

In the **Rosen** case the court had to decide on whether dividends received by a discretionary trust retained its identity as dividends and thus properly allowable as a deduction in terms of section 10(1)(k)(ii) of the Income Tax Act [as it then was] from taxable income. The court went on to refer to the case of **Bell's Trust v CIR** 1948 (3) SA 480 (A) in which the Appellate Court held that the legal entitlement of a beneficiary under a trust agreement to receive from the trustee, the registered shareholder, a proportionate part of the dividends that he had received from the company concerned rendered the beneficiary *pro tanto* a 'deemed shareholder'. The court deduced that dividends paid by a company to a registered shareholder as are passed on by him to a deemed shareholder by virtue of the latter's legal entitlement thereto, must also be regarded as having been distributed by the company through the registered shareholder to him. Consequently they also constitute 'dividends' as defined in his hands. The court stated " the function of the principle is mostly apposite to trust cases, the mere imposition 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 court accepted that the **Armstrong** case authoritatively established the conduit principle for general application in our system of taxation in appropriate circumstances. The court stated further that the principle rested upon sound and robust common sense; for by treating the intervening trustee as a mere administrative conduit-pipe, it has regard to the substance rather than the form of the distribution and receipt of the dividends. The court, in **SIR v Rosen** went on to express the opinion that, where income is not distributed during the year in which it accrued to the Trust it *may* lose its identity and if distributed in a subsequent year may no longer have the characteristics of the original income. Income accumulated by the Trustee and taxed in his hands, once distributed, will retain its identity as a receipt of

a capital nature and is not then taxed again in the hands of the beneficiary once paid out.

Prior to the introduction of section 25B [72] a loss in a trust was not able to be used by the beneficiaries. Up to the years of assessment ending 28 February 2001 Section 25B(3) provides that where income is received by a trustee, but vests in a beneficiary, any deduction or allowance which may be made under the provisions of the Income Tax Act [73] in the determination of the taxable income derived by way of such income which vests shall, to the extent to which such income is deemed to be the beneficiary's, be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by such beneficiary. Section 25B (3) has been amended by Section 32(1)(b) of Act 59 of 2000 [74] to the extent that it excludes income contemplated in section 25B(2) in application of sub-section (3). In other words a beneficiary acquiring a vested right to income referred to in sub-section (1) by the exercise of a discretion by a Trustee of a Trust will not enjoy the deduction or allowances contemplated in section 25B(3) *as amended.* Section 25B has been further amended by the insertion of sub-section 2A [75] In essence this subsection contemplates the taxation of so much of any amount that has not been subject to tax in the RSA as representing capital of a non-resident trust to which a resident has in *that year of assessment acquired a vested right* and which is made up of income received or accrued to such trust in previous year of assessment. See also what is said with regard to Offshore Trusts on the section dealing with tax avoidance.

3. **Income assessable to the Donor / Founder / Settlor**

In this instance it is perhaps apropos to briefly examine the motivation or rationale behind a Donor / Founder / Settlor creating a Trust and settling property on Trustees or beneficiaries in terms thereof. Trusts are utilised by persons essentially as an estate planning mechanism. Meyerowitz [76] has

aptly described estate planning as " *the arrangement, management, securement and disposition of a person's estate, so that he, his family and other beneficiaries can enjoy and continue to enjoy the maximum benefits from his worldly possessions during his lifetime and after his death.*"

Estate planning is in essence planning one's affairs in such a manner that assets are not only preserved and increased but that the amount of tax levied, **in all its forms**, is minimized. There has been an ongoing struggle between the taxpayer and the tax authorities with regard to the issue of taxation. Whilst the *fiscus* seeks to levy the maximum tax and, through consistent changes to tax legislation close all possible tax 'loopholes', the taxpayer seeks to pay the minimum tax and is constantly endeavouring to find more inventive ways to utilise existing laws and business structures so as to minimise his tax liability. This amounts essentially to tax avoidance.

As suggested by the court in **COT v Ferera** [77] " the avoidance of tax was an evil " Tax avoidance should, however, be distinguished from tax evasion. To evade tax would mean that the taxpayer intentionally involves himself in schemes and activities which improperly and illegally allow him to circumvent liability for tax on his income in various ways. In all reputable jurisdictions, tax evasion is unacceptable and amounts to criminal conduct.
As we have seen it is generally only in cases were one is dealing with a discretionary trust that the Trust will be assessable to tax and then only if the beneficiaries do not obtain a vested right to the income and the donor is no longer alive.
Section 7 of the Income Tax Act [78] is, in essence, a specific anti-avoidance section aimed at taxing, in the hands of the Donor, any income which has resulted from a donation, settlement or other disposition. The sub-sections which apply specifically to trusts are (3), (5),(6), and to a lesser extent (7).

This section revolves around the interpretation of the terms ' *donation, settlement or other dispositions* ' A donation, in terms of our Roman – Dutch

common law is a disposal of property for no consideration being a wholly gratuitous disposal, made out of the liberality or generosity of the donor. "Settlement" is a gratuitous disposal of property subject to specific terms and conditions, usually to the trustees of a trust.

The English case of **Bulmer v IRC** [79] held that a settlement had an element of bounty. In the Rhodesian case of **Barnett v COT** [80] the court held that a *disposition* did not only mean a gratuitous disposition but also included transfer, transaction, plan, scheme or arrangement not in the form of a gift or donation. This decision understandably led to some uncertainty as virtually all forms of transferring ownership would fall within the ambit of section 7. This uncertainty was settled in the case of **Ovenstone v SIR** [81] the court felt that the words *'other disposition'* should be interpreted *ejusdem generis* with "donation" and "settlement" and that the section should be read as ' donation, settlement or other *similar* disposition.'

The court stated that " the transactions the Legislature seems to have had in mind in enacting subsections (3)-(6) 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 therein specified conditions or circumstances, thereby diverting its income from himself without his replacing or being able to replace it." The court went on to find that the words ' donation, settlement or other disposition ' all have the common feature of connoting the disposal of property to another otherwise than for due consideration. 'Donation' and 'settlement' commonly featuring a disposal of property made gratuitously or gratuitously to an appreciable extent.

Dispositions, therefore, should be interpreted as meaning any disposal of property made wholly or to an appreciable extent gratuitously out of the liberality or generosity of the disposer.

Transactions made for full value in money or money's worth was not included in the term "other disposition" as there had to be an element of liberality per Coetzee J in **Joss v SIR** [82]

Sections 7(3) to 7(9) will, accordingly only apply where as a result of a gratuitous or liberal disposition of an asset by a donor income has accrued to the beneficiary.

Thus, in terms Section 7(3), the taxpayer shall be deemed to be the recipient of income, *if by reason of* any donation, settlement or other disposition made by the taxpayer, it is received by, accrues to or in favour of the taxpayers minor child or has been expended for maintenance, education or benefit of that child; or it has been accumulated for the benefit of that child. This is aimed at preventing the taxpayer directly making over assets to a minor child or expending income to maintain that child without being liable to tax on that income or reducing his liability to tax. This is because the parent is obliged to maintain and educate the child anyway and any further benefit far from being a necessity will imply gratuity and tax should be paid on all such amounts.

The term ' *if by reason of* ' in section 7(3) has created some difficulty where one is faced with so called income on income. In **Kohler v CIR** [83] the court had to decide, in essence, whether the donor was liable to assessment on income received by the donor's daughters derived from shares purchased with income accrued to them from investment of the original donation.
The court contended that the section [7(3)] requires a strict construction and that some limit should be taken to have been imposed by the Legislature on the taxability of the parent in respect of the benefit derived by the minor child from the settlement.
In finding in favour of the donor [taxpayer] the judge said the following: "*Once income has (actually or by deeming) accrued to or been received by the minor, and has been capitalised, its subsequent earning or product is attributed not to the source from which the original income was derived but to the advantageous employment of the minor's new capital. In this respect the 'income upon income' now in issue stands, as I see it, on the same footing as income derived by the minor from the employment of other capital of his borrowed, earned or bequeathed.*"

The court found that though the original donation may have been a *causa sine qua non* it was not the *causa* "by reason of which" the amounts now in issue came to the minors. The re-investment of income in a savings account essentially amounted to a *novus actus interveniens* or supervening cause. [conduit –pipe principle?]

The Appellate Division subsequently took a somewhat different view and in **CIR v Widan** [84] it was held that 'income upon income' was indeed as a result of the original donation. The court in deciding against the taxpayer suggested that there were no hard and fast rules and that each case would have to be judged on its merits. The court, in determining the application of the words ' by reason of', contended that one has to ascertain what the proximate cause giving rise to the income is. Centlivres CJ went on to quote from **Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd** 1918 AC 350 at 369 ' *To treat proximate cause as if it was the cause which is proximate in time is.....out of the question. The cause which is truly proximate is that which is proximate in efficiency. That efficiency may have been preserved other causes meantime have sprung up which have not yet destroyed it, or truly impaired it, and it may culminate in a result of which it still remains the real efficient cause to which the event can be ascribed.'* In this context Centlivres CJ said: *"There must be some casual relation between the donation and the income in question. Difficult cases may conceivably arise. Where for instance, a father donates a sum of money to a minor child and the child buys a business to which he contributes his skill and labour and from which he earns an income that income may be regarded as being attributable to two causes, viz. the donation and the skill and labour of the child. In such a case it may be impossible to say which part of the income was the result of the donation and which part the result of his skill and labour and it may be that the Commissioner would not apply s 9(3)."* [read 7(3)]

He concluded that the income was by reason of the donation because the original donation, settlement or other disposition was *intended* to produce income which would be used to acquire the shares in the second company

and was clearly the *proximate cause* by reason of which the 'income on income' had been received.

In terms of section 7(4) the taxpayer shall be deemed to be the recipient of any income received by, accruing to or in favour of the taxpayers minor child in exchange for which, directly or indirectly, the taxpayer or his spouse makes a donation, settlement or other disposition or gives some other consideration. This sub-section prevents the possible avoidance of s 7(3) by means of cross donations.

Section 7(5) affects income which accrues to, or is received by the trust, and which is not paid out to the beneficiaries because there is a stipulation in the trust deed which prohibits the payment to the beneficiaries until the happening of some event. Section 7(5) only applies in instances where income accrues to the trust and is not distributed to the beneficiary.

A further requirement evident from the definition is that, *but for* the stipulation or condition, the income would have been received by, or accrued to or in favour of the beneficiaries. This income is again deemed income of the donor.

In the Appellate Division decision in **Estate Dempers v SIR** [85] the court dealt with the question of whether s 7(5) applied only where there was a vested right to accumulated income. The court found that vesting was not a *sine qua non* (the so-called *but for* test) to the application of this section. Per Corbett JA (as he then was) " *That section 9(5) [now section 7(5)] is not confined, in this 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 words ' fixed or contingent' in denoting the event until the happening of which he is not to receive the income."*

The court was confronted with an argument as to whether the exercise by a trustee of a discretionary power constituted an event for the purposes of

S7(5). Corbett JA, acknowledging that there was ' undoubtedly some force ' in the argument that a discretionary power did not constitute an event for the purposes of section 7(5), did not however pronounce on the correctness of such an argument. He went on to hold the view that there are other occurrences stipulated for in the deed of trust (other than the exercise of a discretion by the trustees) which constituted events in terms of section 7(5) and which were not vulnerable to similar arguments.

The court further held that in applying the section involved a hypothetical, notional enquiry, having regard to the terms of the deed generally, the donor's general benevolent intention, as evinced by the terms of the deed, and all relevant factors.

Where the income is not paid out , but vests in the beneficiaries, the '*but for* 'stipulation requirement in the section is not met and so section 7(5) cannot apply.
In a special court decision **ITC 1328** in 1980, the court found that where the beneficiaries had a vested right to the income, such income accrued to the beneficiaries in terms of section 7(1) notwithstanding the fact that the income was not actually paid out to them.

Whenever income has accrued to a beneficiary in terms of a deed of donation, settlement or other disposition, which contains a stipulation that the right to receive the income thereby conferred may, under powers retained by the person by whom that right is conferred, be revoked or conferred on another, such income shall be deemed to be that of the person who conferred the right. –Section 7(6) This section again is a deeming provision and is aimed at countering a type of tax avoidance which is achieved by being in a position to decide on an annual basis in whose hands the income in the trust should be taxed. See also what has been said above regarding Estate Duty implications of just such a right to revoke.

See also what is said with regard to Offshore Trusts under the section dealing with tax avoidance.

Further deeming provisions which may impact on the liability of a donor for tax as a result of donations, settlements or other *similar* dispositions includes section 7(2) [Act 58 of 1962] which deems income received by the donors spouse to be the income of the donor himself when the donation, settlement or disposition was made after 20 March 1991 and / if the sole purpose of the transaction involved was the reduction, postponement or avoidance of tax liability. This is to target so-called sham transactions whereby liability for tax is transferred from a spouse in a high income bracket to his partner who is taxed in a lower bracket.

Section 7 has been amended [section 5 of Act 59 of 2000] by the additions of subsections (8) –(10) . Sub-section (8) essentially provides that: 'Where by reason of or in consequence of any *donation, settlement or other disposition* made by any resident, income is received by or accrued to any person who is not a resident *(as defined in terms of section 2(h) of Act 59 of 2000)* there shall be included in the income of such resident so much of the amount of any income as is attributable to such donation, settlement or other disposition: Provided that any amount of income received by or accrued to such person by way of foreign dividends, shall for the purposes of this section be determined in accordance with the provisions of section 9E, as if such person had been a shareholder who is a resident."

Sub-section (9) deems, as a donation, a disposal of an asset at less than market value to the extent that the true market value exceeds the consideration.

TAX AVOIDANCE

What has been said above with regard to utilisation of the trust in an estate plan and more particularly in tax planning may be expanded upon by a further examination of issues related to so-called tax avoidance.

Residence basis of taxation w.e.f. 1 January 2001

It is to be noted that with effect from years of assessment commencing from 1 January 2001 South Africa has introduced a residence basis of taxation. This in effect means that any person who is considered to be a South African resident (as defined) will be taxed on their worldwide income although certain categories of income and activities undertaken outside South Africa will be exempt from South African tax. Foreign taxes paid by these residents will however be allowed as a credit against the South African tax liability. Non residents will still be taxed on their South African sourced income.

As we have noted, the deeming provisions of section 7 aims to prevent avoidance or minimization of tax and these are specific anti-avoidance sections. Further provisions in the Income Tax Act [58 of 1962] which may have an impact on trusts include the general anti- avoidance provision contained in section 103(1) [Act 58 of 1962] It has been said that the liability for tax at which s 103(1) is aimed is an anticipated liability for tax, not an existing liability. [86]

As was held in **CIR v King** [87] *'There is a real distinction between the case of one who so orders his affairs that he has no income which would expose him to liability for income tax, and that of one who so orders his affairs that he escapes from liability for taxation which he ought to pay upon income which in reality is his.'*

The Appellate Court , in **SIR v Geustyn, Forsyth and Joubert** [88] stated that in order for the secretary to invoke the provisions of section 103(1) all of the requisite elements of the section had to be met. The court went on to examine the wording of the section and stated *" While it may well be that 'effect' and 'result' as respectively used in subsections (1) and (4) of s103 of the Act have*

the same meaning, it is clear that the former subsection distinguishes between 'effect' and 'purpose'. The vital enquiry on this part of the case relates to the question of whether or not avoidance, postponement or reduction of tax was ' the sole or one of the main purposes' of the conversion of the partnership into a company."

In examining the requirements as contained in the section, the court in **Hicklin v SIR** [89] held that where a transaction, operation or scheme was an agreement, as in the case before the court , it was important to determine first whether it was one concluded *' at arm's length '*, the criterion postulated in 103(1)(b)(ii). For 'dealing at arm's length' was a useful and often easily determinable premise from which to start the enquiry. It connoted that each party was independent of the other and, in so dealing, would strive to get the utmost possible advantage out of the transaction for himself.
In an arm's length agreement the rights and obligations created were more likely to be regarded as normal than abnormal. When considering the normality of the rights and obligations so created or of the means or manner so employed, due regard had to be paid to the surrounding circumstances. [90] See also the inclusion of the 'arm's length ' criteria in the the provisions of another anti-avoidance section, being section 31 of the Income Tax Act which deals with transfer pricing and thin capitalisation. This section was introduced into the Act in 1995 and applies to goods or services supplied or acquired on or after 19 July 1995.

Generally, South African Trusts acquire assets in one of two ways: (a) By donation; and (b) by purchase and sale. Transfer of assets by donation is restricted to relatively low value assets to avoid donations tax implications (see below). Most often assets are sold (at market value) to the Trust by the Founder/ Settlor.
Invariably one finds that, with a family Trust, the sale is financed by a loan by the Founder/ Settlor to the Trust. More often than not the loan is interest free. With a domestic trust this does not normally attract donations tax. An interest

free loan to an offshore trust will, however, be susceptible to attract domestic tax in terms of the provisions of section 31(2) [Act 58 of 1962]

Section 31(2) states that : Where goods or ***services*** are supplied or acquired in terms of an international agreement *and* the acquirer is a ***connected person*** in relation to the supplier *and* the price of the goods or services is not an arm's length price the CIR may adjust the price to an arm's length price in calculating the taxable income of the acquirer or supplier.

The definition of "services" is defined in section 31(1) and specifically includes, *" the granting of financial assistance, including a loan, advance of debt, and the provision of any security or guarantee "*.

The definition of ' International Agreement' has been amended in terms of Act 59 of 2000 [section 37] owing to the recent change in South Africa's basis of taxation effective from years of assessment ending on or after 1 January 2001. The acquirer must be a connected person in relation to the supplier of the service.

A connected person is defined in section 1 of the Income Tax Act as : *"In relation to a natural person (i) any relative: and (ii) any trust of which such natural person or such relative is a beneficiary."*

If therefore, a person resident in South Africa or his relative *(being a spouse or relative of his or his spouse to the third degree of consanguinity)* is a beneficiary of a trust, the trust is a connected person to such a resident. From the above therefore it is clear that an interest free loan to an offshore trust is not an arms length transaction if the Founder / Settlor is a connected person to that trust.

It is important to note at this juncture the provisions of section 103(7) with regard to expanding on the definition of 'tax benefit' for purposes of section 103(1) so as to include *" any avoidance, postponement or reduction of liability for payment of any tax, duty or levy imposed by this Act or by any other law administered by the Commissioner."*

This amendment was brought about mainly due to the decision in **SIR v Gallagher** [91] and has the effect now that , a scheme implemented for the sole or main purpose of avoiding estate duty for example (or any other law administered by the Commissioner such as VAT and transfer duty) can be attacked if its *effect* is also to avoid any tax levied in terms of the Income Tax Act and , in addition, the abnormality requirement is satisfied.

Section 103(2) is a further anti-avoidance provision aimed at preventing trafficking in the assessed losses of Companies (close corporations) . Where any scheme is accordingly entered into for the sole or main purpose of utilising the assessed loss of a company in order for another person to avoid a liability for income tax, Revenue may disallow the set-off of such loss against income which has been derived by the company as a result of the scheme.

The provisions of this section have been extended to Trusts. Revenue may now apply them were there is any change in the trustees or beneficiaries of a trust, and such change is effected for the sole or main purpose of utilising any assessed loss of the trust. This measure will be of greater applicability as the tax losses of trusts may no longer flow through to the beneficiaries. It applies to any agreement so affecting a trust entered into on or after 29 June 1998, or to any change in trustees or beneficiaries effected on or after that date.

Dealing with anti-avoidance legislation in relation to Trusts mention need be made of sections 9C & 9D which were introduced into the Income Tax Act effective 1 July 1997. The expansion of the deeming provisions of the Act was introduced in order to deal with non-South African source *passive* income. (passive income embracing interest, dividends, rent royalties etc.) This is because, up until very recently, South African income tax was based on source as opposed to residence. [92] Section 9C dealt with taxation of investment income and 9D with investment income of controlled foreign entities and the investment income arising from *donations, settlements or other (similar) dispositions.* Section 9C has been entirely repealed by section 9 of Act 59 of 2000. [93] with effect from 1 January 2001.

Section 9D is in essence an anti-avoidance provision. These provisions have the effect of taxing foreign investment income which accrues to a South African resident in South Africa. In effect therefore such income is taxed on a residence basis. Up until the recent amendments to the section [94] the provisions of section 9D defined a foreign entity as any person other than a natural person that has its place of *effective management* in a country other than the Republic and includes a company and Trust. Controlled Foreign Entity was defined as any foreign entity, ie. a Trust, in which a resident or residents of the Republic hold more than 50% of the participation rights, being the right to participate directly or indirectly in the capital or profits of, dividends declared by, or any other distribution or allocation made by any *such* entity, or are entitled to exercise more than 50% of the votes or control of such entity.

A Trust has been specifically excluded in the definition of a foreign entity I terms of the amendments to section 9D. Accordingly a Trust can no longer be a Controlled Foreign Entity (CFE).

In terms of sub-section 4 of section 9D, prior to amendment by section 10(1) (h), where by reason of a *donation, settlement or disposition* made by a resident, income was received by or accrued to any person- (a) who was not a resident; or (b) who was a resident and to whom sections 7(3), (4), (5), (6) or (7) would have applied had such income been from a Republic source, there was included in the income of such resident so much of such income as is *attributable to such* donation, settlement or disposition. Accordingly, if a South African resident had assets abroad which where transferred to trustees of a non-resident Trust, the investment income of that Trust would have taxable in his hands for so long as investment income accrued to the non-resident Trust. Sub-section 9D(4) was deleted from the principle Act by section 10(1)(h) of Act 59 of 2000 with effect from 1 March 2001.

B. DONATIONS TAX

As we have seen above, the Income Tax Act contains a plethora of deeming provisions and anti-avoidance sections relating to disposal of property made *wholly or to an appreciable extent gratuitously out of liberality or generosity of the disposer.* Donations tax is specifically covered by sections 54 to 64 of the Income Tax Act. In terms of s 54 of Act 58 of 1962 [as amended] donations tax is payable on the cumulative taxable value of all property disposed of (whether directly or indirectly *and whether in a trust or not*) under donations which take effect on or after 1 July 1962 by any person (donor) who is ordinarily resident in the Republic. It is not a tax on income, but a tax on the net transfer of assets and is in effect, estate duty paid in advance.

Property is defined as any right in or to property movable or immovable, corporeal or incorporeal, wheresoever situated. [s55(1)]

In terms of section 59 of Act 58 of 1962 donations tax is payable by the donor within 3 months of the date upon which the donation took effect, failing which, the donor and donee are jointly and severally liable. Donation is defined as: *any gratuitous disposal of property or any gratuitous waiver or renunciation of a right.* In addition to the definition of donation section 58 provides that a disposition of property for an inadequate consideration may be deemed, by the Commissioner, to be a donation. A Donee includes a trustee where property is donated to a trustee to be administered by him for the benefit of any beneficiary. Donations tax payable by a trustee may be recovered by him from the assets of the trust. [s 55(1)]. A donation is deemed to take effect when all the legal formalities have been complied with, ie. offer and acceptance, delivery, registration etc.[s 55(3)] For the purposes of donations tax the value of the donated property is the fair market value of such property as at the date upon which the donation takes effect. [62(1)(d)] In terms of sections 62(1) (a)-(c) there are certain exceptions and the concomitant donations tax calculations thereon relate to fiduciary, usufructuary and other like interest in property, rights to an annuity and rights of ownership in any property that is subject to a usufruct or other like interest.

Section 56 of Act 58 of 1962 contains certain exemptions from the imposition of donations tax and provides that:

56(1) Donations tax shall not be payable in respect of the value of any property which is disposed of under a donation-

(a) – (f) .....

(g) if such property consists of any right in property situated outside the Republic and was acquired by the donor –

(i) Before the donor, being a person other than a company, became ordinarily resident in the Republic for the first time or, in the case of a company, became for the first time, a domestic company; or

(ii) by inheritance from a person who at the date of his death was not ordinarily resident in the Republic or by a donation if at the date of donation the donor was a person (other than a company) not ordinarily resident in the Republic; or

(iii) out of funds derived by him from the disposal of any property referred to in sub-paragraph (i) or (ii) or , if the donor disposed of such last mentioned property and replaced it successively with other properties (all situated outside the Republic and acquired by the donor out of funds derived by him from the disposal of any of the said properties), out of funds derived by him from the disposal of , or from revenue from any of those properties; or

(iv) out of funds derived by him from any trade carried on by him outside the Republic; or

(v) in the case of immovable property, not less than ten years before the date on which the donation takes effect;

(g A).....

(h) by or to any person (including any government) referred to in paragraph (a),(b),(c A), (c B), (c C), (c D), (c E), (d) or (e) of subsection (1) of section 10;

(i)-(k).....

(l) if such property is disposed of under and in pursuance of any trust;

In terms of Section 56(2) exemptions include so much of the sum of the values of all property donated by a natural person on or after 1 March 1996, as does not during any year of assessment exceed R 25 000,00. The rate of donations tax has been reduced W.E.F. 1 October 2001 from an effective 25% to 20% .

As we have seen the *inter vivos* trust may be used as an effective estate planning tool, not only for avoidance or reduction of income taxes but all duties imposed by the fiscus. Accordingly the above exemptions may be effectively utilised if the trust to which a donation is made falls within the 'persons' mentioned in s 56 (1)(h). A method of disposing of immovable property to a family trust without falling foul of the donations tax provisions was by way of a loan to the trust. Essentially the owner of the immovable property transfers the property to the trust. The trust may not have the funds

to finance the purchase in which case the transferor effectively loans the trust the purchase price of the property. In cases such as these the market value of the property is utilised to avoid the CIR imposing the relevant anti-avoidance legislation such as sections 58 and 103(1).

Section 58 providing that *' whenever property has been disposed of for a consideration which in the opinion of the Commissioner is not adequate such property shall be deemed to have been disposed of under a donation the value of the donation will be the value of the property reduced by the consideration.'*
In transactions involving family trusts and familial relationships one can be sure that the fiscus will carefully scrutinise the transaction. Transfer duties payable on the transfer of immovable property to the trust is currently calculated at 10% (ten per centum) of the consideration or fair market value. [See the section on transfer duty] Any attempts to transfer the property at a value less than fair market value or 'an arms length ' value may expose the parties to tax penalties under section's 103 and 58. Once the property is in the trust the transferor will have a credit loan account in the trust whereby the trust owes the transferor the loan amount. The loan may attract interest or it may be interest free. The transferor may then also reduce the loan by making annual donations of R 25000, 00 to the trust thus effectively reducing the asset base in his estate. It should be noted that each spouse is entitled to this exemption. This strategy may be motivated by a desire to ultimately reduce the incidence of estate duty in the transferor / donors' personal estate. Interest free loans to a trust should furthermore be approached with caution because of the very real possibility of the imposition of the provisions of section 103.

C. TRANSFER DUTY ON IMMOVABLE PROPERTY

Transfer duty is a duty payable to the SARS on transfer of immovable property. It is governed by the Transfer Duty Act 40 of 1949. In terms of section 2(1): *' Subject to the provisions of section 9, there shall be levied for the benefit of the Consolidated Revenue Fund a transfer duty (hereinafter referred to as the duty) on the value of any property (which value shall be determined in*

accordance with the provisions of sections 5,6,7 and 8) acquired by any person on or after the date of commencement of this Act by way of a ***transaction*** *or in any other manner, or on the amount by which the value of any property is enhance by the renunciation, on or after the said date, of an interest in or restriction upon the use or disposal of that property, at the rate of – (a) 10 per cent of the said value or the said amount, as the case may be, if the person by whom the property is acquired or in whose favour or for whose benefit the said interest or restriction is renounced is a person other than a natural person; or (b)....."*

Transaction is defined in section 1 – *" means an agreement whereby one party thereto agrees to sell, grant, donate, cede, exchange, lease* ***or otherwise dispose of*** *property to another, or any act whereby any person renounces any interest in or restriction in his favour upon the use or disposal of property."*

As is clear from the above, any disposal of immovable property to a Trust will, subject to section 9, attract transfer duty at the rate of 10% on the value as determined. The transfer duty act has been amended by The Taxation Laws Amendment Act 5 of 2001. In terms of section 9(17) of the Transfer Duty Act 40 of 1949 [as amended] conditions which must be met on the transfer of a residence from a trust are as follows:- The acquirer of the residence is a natural person and the residence constitutes his 'primary' residence as defined in paragraph 44 of the Eighth Schedule – the acquisition takes place on or after the promulgation of the taxation laws amendment act [20 June 2001] but not later than 30 September 2002- the person disposed of the residence to the trust by way of donation, settlement or other similar disposition or financed all the expenditure actually incurred by the trust to acquire and to improve the residence- the person or his spouse ordinarily resided in the residence and used it mainly for domestic purposes from 5 April 2001 to the date of registration in the deeds registry of the residence in his or jointly in his and his spouses name- the registration of the residence must take place not later than 31 March 2003. The exemption only applies in respect of the portion of the property contemplated in paragraph 46, that is the land on which the residence is situated and unconsolidated adjacent land as does not exceed two hectares, is used mainly for domestic purposes

together with the residence, and is disposed of at the same time and to the same person as the residence.

D. CAPITAL GAINS TAX

The Taxation Laws Amendment Act 5 of 2001 was published in GG22389 of 20 June 2001 and came into operation on that day. It amends the Income Tax Act 58 of 1962 by the introduction of an eighth schedule to provide for the introduction of capital gains tax. Once a person's *[as defined]* taxable capital gain has been determined it is included in his taxable income in terms of section 26A of the Act. Thereafter the normal rates of tax are applied to his taxable income to determine the tax payable by him. The definition of ' taxable income' in section 1 has, as a consequence, been amended. In its amended form it means the aggregate of;

- *The amount remaining after deducting from the income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income, and*
- *All amounts to be included or deemed to be included in the taxable income of any person in terms of this Act.*

An important point in the new legislation is that, if a person suffers an assessed capital loss for a year of assessment *it cannot* be set-off against his taxable income. An assessed capital loss, accordingly, does not;

- *Reduce a persons taxable income, and*
- *Increase a person's assessed loss.*

It is said that an assessed capital loss is *'ring-fenced'* and can be set –off only against capital gains arising during future years of assessment.

Capital Gains Tax will apply to *disposals* [as defined] that take place on or after the valuation date, being 1 October 2001. A wide meaning has been given to the word 'disposal' as defined in paragraph 11(1) of the Eighth Schedule. A disposal is any;

- Event, act, forbearance or operation of law; which results in the;
- Creation, variation, transfer, or extinction of an asset.

A list of events is included in the definition of a 'disposal' and includes;

- .....
- *The vesting of a Trust asset in a beneficiary*;

Accordingly, in the case of a discretionary Trust, the exercise of a discretion by the Trustee resulting as it will in vesting a trust asset in the beneficiary will be treated as an event triggering a 'disposal' for CGT purposes.

Paragraph 11(2) lists a number of specific events which *will not be treated as a 'disposal'* and includes;

- .....
- *The distribution of a Trust asset by a Trustee to a beneficiary who has a vested right in the asset.*

Capital Gains Tax legislation has introduced a new term, namely, a value shifting arrangement which broadly involves the effective transfer of value from one entity to another without constituting an ordinary disposal for CGT purposes.

The term 'value shifting arrangement' has been defined in paragraph 1 of the Eighth Schedule as

*'An arrangement by which a person retains an interest in a company, **trust** or partnership, but following a change in the rights or entitlements of the interests in that company, **trust** or partnership (other than as a result of a disposal at market value as determined before the application of paragraph 38), the market value of the interest of that person decreases and-*

*(a) the value of the interest of another person held directly or indirectly in that company, **trust** or partnership increases; or*

*(b) Another person acquires a direct or indirect interest in that company, **trust** or partnership.'*

It is submitted that this specific legislation was introduced to avoid the real probability that entities could manipulate the value of assets in order to avoid CGT or obtain a benefit. It is found typically between so-called 'connected' persons. As was stated in the section on tax avoidance above, a connected person as defined in section 1 in relation to a natural person is *(i) any relative and (ii) **any trust of which such natural person or such relative is a beneficiary.** '*

It is to be noted that the Eighth Schedule contains overriding definitions of a 'connected' person relating specifically to certain paragraphs such as paragraph's 39(3) and 42(3) defining as it does 'connected' persons for the purposes of those paragraphs so as to exclude " any relative of a natural person other than his spouse, parent, child, brother, sister, grandchild or grandparent.

It is submitted further that, with the amendment to the general anti – avoidance section of the Income Tax Act, namely, section 103, any transaction, operation or scheme which satisfies the requirements of that section and is 'entered into or carried out' and which 'has the effect' of avoiding or postponing liability for the payment of any tax, duty or levy imposed by the Act may be susceptible to the scrutiny of the Commissioner who may determine such tax, duty or levy as if the transaction, operation or scheme was not carried out. [See the section on tax avoidance]

In terms of the provisions of the Eighth Schedule all capital gains or capital losses determined in respect of personal-use assets of a *natural person* or *special trust* [see below] is disregarded. Paragraph 53(3) determines personal-use assets to be all the assets of a natural person or special trust except to the extent that the assets are used for the purpose of carrying on a trade or assets specifically not regarded as personal-use assets as listed in paragraph 53(3)."Special Trust" as defined in section 1 of the Act [as amended] means a trust created solely for the benefit of a person who suffers from any " mental illness" as defined in section 1 of the Mental Health Act, 1973, or any serious physical disability, where this illness, or disability incapacitates him from earning sufficient income for his maintenance, or from managing his own financial affairs.

Capital losses on certain personal use assets not used for trade purposes but which may remain in the CGT system is disregarded in terms of paragraph 15. These assets may be held in a trust the interest in which is directly or indirectly owned by a natural person. The trust accordingly owns certain assets which would, if owned by a natural person be personal use assets. In such event, any decrease in the value of these assets of the trust after the

person acquired the interest and upon subsequent disposal will be disregarded and such person will be treated as having disposed of the interest at proceeds equal to market value as if the market value of the assets in the trust had not decreased. [Paragraph 37(1) Eighth Schedule] This is a further example of an "anti-avoidance" provision in the Act.

In the case of a South African resident CGT will apply to the disposal of any asset [as defined], irrespective of whether it is situated in South Africa or elsewhere. A non-resident will be subject to CGT on the disposal of – any immovable property or any interest or right in immovable property situated in South Africa; and – any asset of a permanent establishment of the no-resident through which a trade is carried on in South Africa during the year of assessment. In terms of the CGT provisions R 1 Million of the capital gain made on the disposal, by a natural person or special trust, of a *primary residence* [as defined] is to be disregarded for purposes of determining CGT.

'Primary residence' is defined as a residence in which a natural person or a special trust [as defined] holds an interest, and which he or the beneficiary of the trust or his spouse or the spouse of the beneficiary ordinarily resides or resided in as his main residence, and who uses or used it mainly for domestic purposes.

Accordingly residences owned by companies, close corporations or trusts do not qualify for this concession. In order to allow natural persons whose primary residences are presently owned by a company, close corporation or trust to enjoy the R 1million exclusion, a number of tax concessions are made to facilitate transfer of ownership of property. A limited period is proposed during which the transfer can be made free of transfer and stamp duty.
In terms of paragraph 51(1), for the concession to transfer a residence from a trust to a natural person without fiscal disadvantage a number of criteria must be met. The natural person must acquire the residence from the trust on or

after 20 June 2001 [the date of promulgation of the Taxation Laws Amendment Act 5 of 2001], but not later than 30 September 2002; and
The person must have, alone or together with his spouse personally and ordinarily resided in the residence using it mainly for domestic purposes from 5 April 2001 to date of registration. The original disposition to the trust or funds allowing acquisition of the residence by the trust must have been made by such natural person or together with his spouse by way of donation, settlement or other similar disposition. The registration into the name of the natural person or his spouse or together with his spouse must take place no later than 31 March 2003.

The transfer must be at market value and no CGT will be payable on the gain. The trust is treated as having disposed of the residence at market value on the valuation date and the natural person is treated as having acquired the residence at market value on the valuation date.

Thus in the case of a residence owned by a Trust, the *primary condition* is that the natural person must have disposed of the residence to the trust by way of donation, settlement or other similar disposition or must have financed all the expenditure actually incurred by the trust to acquire and to improve the residence. A person's capital gain in respect of the disposal of an asset is the amount by which the proceeds received or accrued in consequence of the disposal exceeds the base cost of that asset, capital loss being the exact opposite. CGT is determined on the net capital gain for that year of assessment less the assessed capital loss for the previous year of assessment. The time of disposal of an asset due to – the vesting of an interest in an asset of a trust in a beneficiary, is the date on which that interest vests.
As we have seen, in terms of section 26A of the Act, once a person's taxable capital gain has been determined it is included in his taxable income. Thus a capital gain arising from the disposal of a trust asset will be taxable either in the hands of the trust, beneficiary or donor. [See also the specific sections

relating to taxing these persons] We have seen earlier that a definition of 'disposal' includes the vesting of a trust asset in a beneficiary. Thus in discretionary trusts the exercise of discretion by the trustee will constitute a 'disposal' event in relation to determination of who is liable to the capital gain. The aggregate capital gain or loss [as defined] is disregarded in relation to the determination of the trusts liability but taken into account in determination of the beneficiaries' liability. [Paragraph 80(1)] Interestingly, a capital gain arising in a trust during a particular year of assessment in which a trust beneficiary, who is a resident, acquires or has a vested interest in the *capital gain* but not the underlying asset giving rise to that gain will be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust but will be taken into account in relation to the beneficiary in whom such gain vests. [paragraph 80(2)] The provisions of paragraph 80 will not apply unless vesting [see the discussion on vesting above] has occurred. Accordingly the assets of a discretionary trust will be treated as those of the trust until it is vested in a beneficiary. Any capital gain that does not vest in any beneficiary in the year in which it arises will, therefore, be taxed in the hands of the trust at the effective rates unless the gain was derived by reason of a donation, settlement or other similar disposition and is subject to conditional vesting. Paragraph 70 determines that in such event the tax on a capital gain is attributable to the person who made the donation, settlement or other *similar* disposition. For paragraph 70 to apply the following circumstances must prevail: Where the *resident* donor, by way of donation, settlement or similar disposition, has made over assets being, it is submitted, the *proximate* cause, giving rise to a capital gain subject to a stipulation or condition to the effect that such gain or portion thereof shall not vest in the beneficiaries until the happening of some fixed or contingent event ; and the gain has not vested the gain is taken into account in determining the aggregate capital gain or aggregate capital loss of the resident donor. Compare to the provisions of section 7(5) of the Act discussed above.

Paragraph 71 of the Schedule further provides, in relation to attributing gains to persons other than beneficiaries or the trust, that capital gains arising as a result of revocable vesting may be attributed to the donor. " Where a

donation, settlement or other disposition confers a right upon a beneficiary who is a resident to receive a capital gain attributable to the donation, settlement or other disposition, or any portion of the gain- the right may be revoked or conferred upon another by the person who conferred it, and a capital gain attributable to the 'donation' has in terms of the right vested in the beneficiary during a year of assessment throughout which the 'donor' has been a resident and has retained the power to revoke the right" As can be seen, the provisions of paragraph 71 are similar to that of the provisions of section 7(6).

The provisions of paragraph 69 are similar to the provisions of sections 7(3) and (4) in terms of which income received by, accruing to, or in favour of, or expended for the benefit of a minor child, is in certain circumstances deemed to be that of the parent of the minor child. In terms of paragraph 69 any amount of a minor child's capital gain or of a capital gain that has vested in, or is treated as having vested in , or has been used for his benefit during the year in which it arose and is attributable wholly or partly to a donation, settlement or other disposition made by his parent, will be disregarded in determining such child's aggregate capital gain or loss and will be accounted for in determining the aggregate capital gain or loss of the parent. This will also apply where the gain is attributable to a donation, settlement or other disposition made by another person in return for some other consideration made or given by a parent of the minor child in favour, directly or indirectly, of a person or his family. [Compare with the provisions of section 7(4)]

CONCLUSION

As can be appreciated the Trust, properly structured and financed, can be an excellent estate planning vehicle for a Founder / Settlor. Whilst divesting his own estate of assets and placing them in a Trust to be administered by Trustees of his choosing, the Founder / Settlor can ensure wealth preservation and asset growth for his beneficiaries. What is also clear from the above, however, is due to the diverse and complex tax legislation applicable, the Trust, as a vehicle for persons to manipulate the system and avoid taxation properly attributable, is becoming less of an option.

There is no doubt that , despite the tax implications as espoused, the Trust will remain a useful estate planning tool. What is evident is that persons should not react to changing legislation without careful analysis of the implications and for this purpose specialists in the field should be consulted. The Trust, by its very nature, offers flexibility and properly structured will allow adaption to changing laws and legislation in order to fulfil its ultimate purpose.

With the recent amendments to the Income Tax Act as it relates to Capital Gains Tax and the concession granted to transfer "primary residences" out of a trust back to natural persons the automatic temptation is to accept the concession by Revenue. This should, however, be approached with circumspection as there is more to consider than the Capital Gains Tax concession. As we have seen above there are various factors which prompt a prudent estate planner to, in the first instance establish a trust, be it 'domestic' or offshore. To blindly accept the concession may amount to folly. The maximum primary residence concession cannot be worth more than R 105 000, 00, that is to say, the R 1000 000 primary residence concession multiplied by the maximum effective rate of Capital Gains Tax for individuals which is 10,5 %. If the concession is accepted benefits relating to transfer duties and conveyancing costs where properties are held in a separate legal entity are forfeited. The benefits of minimising estate duty exposure by registering a property in a family trust will further be forfeited if the concession is accepted. Estate duty is, from 1 October 2001, determined at a rate of 20% of dutiable estate. Business risk and marital situations must also be a factor. A person may not want to have their primary residence in their personal name because of the risk of business creditors laying claim to it. The possibilities are endless. Suffice to say that any estate plan or action should be carefully considered taking cognisance of all pros and cons.

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