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# **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

***MASTERS OF LAW : MINOR DISSERTATION - [20 000 WORDS]***

RESEARCH DISSERTATION PRESENTED FOR THE APPROVAL OF THE SENATE IN FULFILMENT OF PART OF THE REQUIREMENTS OF THE DEGREE OF MASTER OF LAWS IN APPROVED COURSES AND MINOR DISSERTATION .

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## CONTENTS

1.	Introduction	1
2.	Descriptions and Definitions	4
3.	Types of Trusts	9
4.	General Tax Principle Applicable to Trusts: 'Conduit Principle'	10
5.	The Meaning and Relevance of the Phrase: 'Vested Right' in Income Tax Law	17
6.	Parties to a Trust and in whose Hands is Trust Income Taxed'	26
6.1	Income of Trusts and Beneficiaries of Trusts	27
6.1.1	Section 25B(1)	27
6.1.2	Section 25B(2)	28
6.1.3	Section 25B(2A)	31
6.1.4	Section 25B(3)	32
6.1.5	Section 25B(4)	32
6.1.6	Section 25B(5)	34
6.1.7	Section 25B(6)	35
6.1.8	Section 25B(7)	35
6.2	Summary of Provisions of Section 25B (1) and (2)	36
6.3	Expenditure	37
6.4	The Elements	38
6.4.1	Expenditure and Losses	39
6.4.2	Actually Incurred	39
6.4.3	During the Year of Assessment	40
6.4.4	In the Production of Income	41
6.4.5	Not of a Capital Nature	42
6.5	Exemptions: Annuities	44

7.	When Income is Deemed to have been Accrued or to have Received	46
7.1	Discussion on Section 7	46
7.1.1	Section7(1)	46
7.1.2	Section7(2)	47
7.1.3	Section7(3)	48
7.1.4	Section7(4)	54
7.1.5	Section7(5)	55
7.1.6	Section7(6)	62
7.1.7	Section7(7)	63
7.1.8	Section7(8)	65
7.1.9	Section7(9)	65
7.1.10	Section7(10)	65
7.2	Summary of Section 7	66
8.	Commissioner for South African Revenue Service v Woulidge 2000 (1) SA 600C	68
8.1	The Facts of the Case in Brief	68
8.2	The Taxpayers Arguments	69
8.3	The Decision	70
8.4	The Implications	71
8.4.1	Example	73
9.	Conclusion	76
10	Bibliography	78
11	Case Register	80
12	Legislation	83

**1. INTRODUCTION**

In the past few years trusts has been singled out for harsh treatment by the South African Legislature, due to trusts being used as tax planning devices, the Legislature amended the Income Tax Act in an attempt to make trusts an unattractive tax planning tool.<sup>1</sup>

Diverse taxes typify South Africa's fiscal landscape, not all of which pertain to the use of the trust in estate and financial planning. The taxes pertinent to trusts Income Tax, Donation Tax, Estate Duty, Transfer Duty and Capital Gains Tax.<sup>2</sup>

The first indication of the fact that trusts other than special trusts are singled out for harsher treatment is to found in the rate at which undistributed trust income is taxed in the hands of the trust. Unlike individuals who pay tax according to a progressive scale ranging from **18% to 40%**., undistributed income of trust other than special trust<sup>3</sup> is taxed at flat rate of **40%**. Trusts are not entitled to primary rebates.

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<sup>1</sup>Olivier L *The Treatment of trust for income and capital gains tax purposes: The screws tighten* 2002.2 Tydskrif vir die Suid-Afrikaanse Reg (TSAR) pages 220-233

<sup>2</sup>Du Toit F *South African Trust Law: Principles and Practice* 2002 Butterworths

<sup>3</sup>Special trusts pay tax at the same rate that individuals do.

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

The most appropriate means of employing the usefulness of a trust is by using the explanation given by **Du Toit F** in his book *South African Trust Law : Principle and Practice*, in which, he said the following:

*“The multitude of diverse purposes of which trusts are put in today’s ever changing legal and commercial environment , bear testimony to the trust’s adaptability and usefulness. Trusts are employed by estate planners and asset managers to effect the prudent disposition of property, either inter vivos or upon death; trusts feature in the fiscal strategy of many individuals and corporate entities; businessmen frequently elect to structure business ventures as trusts rather than companies, close corporations or partnerships; companies utilise trusts to secure the interests of share and debenture holders, health and insurance enterprises employ trusts to manage medical aid schemes and pension funds whereas investment enterprises facilitate investment through various trust schemes. And as any trust practitioner will attest: the afore-mentioned applications of the trust represent only the proverbial tip of the iceberg.”*

However, the trust is by no means a prime vehicle for tax avoidance or tax savings. In fact, in most cases where a trust is employed, tax saving is but a secondary consideration. Moreover, the governments ever- changing fiscal policy may cause any tax benefit essential derived from the utilization of a trust to be rather short lived.<sup>4</sup>

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<sup>4</sup>Du Toit F *South African Trust Law: Principles and Practice* 2002 Butterworths

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

Although not exhaustive, this dissertation attempts to give a broad overview of the of the income tax treatment of trusts with particular reference to its income and expenditure as oppose to the various other types of trust taxation viz. estate duty, donation tax and transfer duty which also exist.

Furthermore, a discussion on the 'conduit principle', the term vested right and well as a discussion on governing sections 25B and 7 that relate specifically to trusts expanded upon.

Throughout the dissertation reference to case law is made and used to explain the requirements embedded in the relevant sections applicable to the income and expenditure of trusts. Where possible and example is illustrated to show clarity of a specific application.

**2. DESCRIPTIONS AND DEFINITIONS**

Various definitions relating to the concept of a trust exist. The origin of the present legislative provisions dealing with the income tax treatment of a trust can be found in a decision by the Supreme Court in 1991. In *Friedman v CIR : In Re Phillip Frame Trust v CIR*<sup>5</sup> it was found that a trust is not a legal person, it cannot be a taxable entity for the purposes of section 5(1), the charging section of the Income Tax Act 58 of 1962 (herein after referred to as the Act).

The result was that the trust was not a 'person' within the meaning of that word in the Act and the Commissioner was therefore entitled neither to levy tax on the trust nor appoint the trustees as the trust's representative taxpayer<sup>6</sup>. The 1991 Income Tax Act amended the Income Tax Act by adding a trust to the definition of a person and providing for the taxation of trust income introducing section 25B.

Income Tax is levied in terms of the Income Tax Act <sup>7</sup> (hereinafter referred to as the Act) on the income that is received by or accrues to a person. 'Person'<sup>8</sup> is defined in **section 1** of the Act as follows:

“person” includes an insolvent estate, the estate of a deceased person and any trust;

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<sup>5</sup>1991 (2) SA 340 WLD, see also Emslie TS 'Taxation of trusts under the spotlight' 1991 March De Rebus pages 171 -172

<sup>6</sup>The decision was confirmed on appeal , see CIR v Friedman 1993 1 SA 353 (A)

<sup>7</sup> Act 58 of 1962 (as amended)

<sup>8</sup>definition of “person” substituted by s 2(1) (b) of Income Tax Act 129 of 1991 and by s 2 (f) of Income Tax Act 141 of 1992.

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

For this purpose a trust is a 'person' and so liable to taxation. A 'trust'<sup>9</sup> is in turn defined in **section 1** of the Act 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”

Section 1 of the Income Tax Act <sup>10</sup>furthermore defines “**representative taxpayer**”( as defined in paragraph (c) of the definition of 'representative taxpayer' below) so as to include a trustee in respect of trust income. The trustee is the representative taxpayer *vis-à-vis* the trust in respect of taxable trust income.

“**representative taxpayer**' means—

- (a) in respect of the income of a company, the public officer thereof;
- (b) in respect of the income under his management, disposition or control, the agent of any person, including an agent as such under the provisions of section *ninety-nine*, and for the purposes of this paragraph the term 'agent' includes every person in the Republic having the receipt, management or control of income on behalf of any person permanently or temporarily absent from the Republic or remitting or paying income or receiving moneys for such person;

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<sup>10</sup>Act 58 of 1962

**THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

**(c) in respect of income the subject of any trust or in respect of the income of any minor or mentally disordered or defective person or any other person under legal disability, the trustee, guardian, curator or other person entitled to the receipt, management, disposal or control of such income or remitting or paying to or receiving moneys on behalf of such person under disability.**

(d) in respect of income paid under the decree or order of court or judge to any receiver or other person, such receiver or person, whoever may be entitled to the benefit of such income, and whether or not it accrues to any person on a contingency or an uncertain event;

(e) in respect of the income received by or accrued to any deceased person during his lifetime and the income received by or accrued to the estate of any deceased person, the executor or administrator of the estate of such deceased person,

(f) in respect of the income received by or accrued to an insolvent estate, the trustee or administrator of such insolvent estate,

but nothing in this definition shall be construed as relieving any person from any liability, responsibility or duty imposed upon him by this Act: Provided that for the purposes of this definition income includes any amount received by or accrued or deemed to have been received or accrued in consequence of the disposal of any asset envisaged in the Eight Schedule;”

The act, that came into operation on 31 March 1989, was a major landmark in the evolution of our trust law. The *Trust Property Control Act 57 of 1988* to which the operation of trusts are subject, defines a trust as follows:

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

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

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

(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act 66 of 1965).

The trustee (representative taxpayer) must make returns of income derived by the trust, admit resulting claims for tax against the assets of the estate and generally represent the estate in all matters relating to taxation. Although the trustee is made the representative taxpayer in respect of income that is the subject of a trust, he is not necessarily the person to be assessed in respect of the trust income. . This is evident from the ‘conduit principle’ discussed below.

**THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

Furthermore, the Commissioner's Practice Note 21 requires that an *inter vivos* trust be registered at the office of South African Revenue Services in whose area the office of the trustees is situated in order to ensure that effective control is exercised by South African Revenue Services over the tax liability of the donor and the beneficiaries.

### 3. TYPES OF TRUSTS

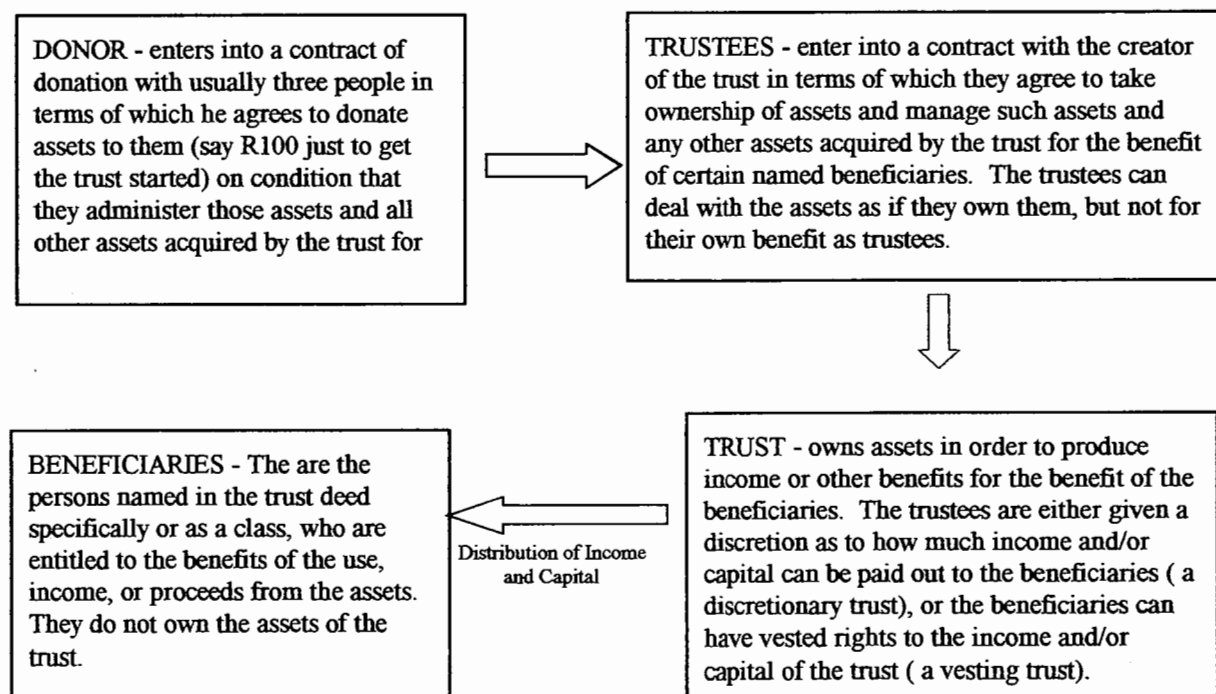
Under this Chapter the following types of trusts will be discussed briefly:

- A Testamentary Trust [*mortis causa* (this is a trust created in terms of a Will)].

The *mortis causa* trust is a trust which becomes effective only upon the death of the donor. It is contained in the donor's will. Because the trust does not take effect during the donor's lifetime, he is able to amend the terms of the trust at any time before his death. A *mortis causa* trust is usually simpler to form than an *inter vivos trust*, since account does not have to taken of the donor's interest and control during his lifetime.

- An *inter vivos* Trust (this is a trust created by contract during the lifetime of the creator).

According to **Keith Huxham and Phillip Haupt** the basic structure of an *inter vivos* trust relationship can be illustrated as follows:



#### **4. GENERAL TAX PRINCIPLE APPLICABLE TO TRUSTS: CONDUIT PRINCIPLE**

The general method of taxation of a tax-paying trust is that any income earned which is not paid over to a trust beneficiary in the year earned is taxed in the trust at special tax rates<sup>11</sup>, but without the benefit of any rebates<sup>12</sup>, however not all trust income is taxable in the hands of a trustee. On the other hand, trust income paid to a trust beneficiary in the year it is earned retains its original identity<sup>13</sup> and is taxed in the beneficiary's hands in that year. Income previously taxed in the trust and which is subsequently distributed to a trust beneficiary is not subject to taxation again, the beneficiary will therefore receive such income free of tax. Therefore the income does not render itself for double taxation. The "*conduit principle*"<sup>14</sup> dictates that income passing through a trust in favour of a beneficiary with a vested right to income, retains its identity as such and the trust or its trustees merely serve as a conduit through which the income flows to the beneficiary.

It was in the case of *Armstrong v CIR*<sup>15</sup> that the "*conduit principle*" was established. The facts were briefly as follows. The appellant in this case received £2000 each year and claimed the

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<sup>11</sup>Kourie MA, Keeste S, *Tax and Investments Easiguide* 1999 Vol 1 Butterworths pages 259 to 270.

<sup>12</sup>Effective for the 1992 tax-year, single primary rebate was withdrawn.

<sup>13</sup>For example, interest received by the trust is treated in the same manner, i.e. as interest, when paid to the beneficiary.

<sup>14</sup>The conduit principle applies to income which passes through a trust and is taxable in the hands of a trust beneficiary. The conduit principle imports that income derived by a trust does not lose its identity when it is received by the beneficiary. Thus for example, dividends derived by the trust are taxed as dividends in the hands of the beneficiary. R C Williams, *Income Tax in South Africa: Cases and Materials* 1995 Butterworths page 489. Therefore, if dividend income flows through the trust to the beneficiaries dividend income is received by the beneficiaries. The dividends may be exempt from tax or partly taxable. This will depend on the nature of the dividends received. However, if income is received by the trust in one tax year, and distributed to the beneficiaries in the next tax year and the income is tax in the hands of the founder or a trust in year one as a dividend, then in year two it is paid as "Capital" to the beneficiaries free of tax. The retention of the income until the following tax year means that the income has been "capitalised". The identity of income flowing through the trust is lost where the distribution out of a trust is in the form of an Annuity. Annuity is taxable in full in the hands of the recipient. Price Waterhouse Coopers *The Standard Trust Income Tax Guide 2000/2001* Butterworths 2000 pages 142 - 145.

<sup>15</sup>1938 AD 343.

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

s 10(1) (k)<sup>16</sup> exemption for dividends on the portion of the amount distributed to her that comprised of dividends. Stratford C J stated:<sup>17</sup>

“ In the simple case I am now examining, that of a trio comprising a company, the intervening trustee, and the beneficiary, it is manifest that in the truest sense the beneficiary derives his income from the company, for that income fluctuates with the fortunes of the company and the trustee can neither increase or diminish it, he is a mere ‘conduit pipe’. This leads on to the firm conclusion that the true test of exemption of the person beneficially entitled to the income is not the sue the company but the derivation of the income. This conclusion is strongly fortified by reference to the provisions relating to representative taxpayers...”

According writer **Lindsay Mitchell**<sup>18</sup>, the reasoning of Stratford C J who delivered the judgment in this case was twofold:

- Firstly, *the application of the conduit principle*, as Stratford C J’s view, the income in this beneficiary’s hands remained “dividends received from a company” and the interposition of the trustee between the company and beneficiary did not destroy their identity and character as dividends in the beneficiary’s hands, being the true recipient of them, and

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<sup>16</sup>Section 10(1) (k) of the 1925 Income Tax Act stipulated that “dividends received by or accrued from any company chargeable with the normal tax imposed by this act”

<sup>17</sup>At 348, At SATC 6

<sup>18</sup>Mitchell L “A rose for Rosen” *Tax Planning: Corporate and Personal* Vol 13 Number 2 1999 pages 43-46

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

- Secondly, *the construction of the Act*, to which Stratford C J said that the object of exempting provisions was to avoid the double taxation of income derived from companies and thus to exempt the true recipients of this income from tax which had been deducted at its source.

*Armstrong's*<sup>19</sup> case authoritatively established the conduit principle for general application in the system of taxation in appropriate circumstances<sup>20</sup>. This principle relies upon sound and robust common sense as it treats the intervening trust as a mere conduit pipe, it has regard to the substance rather than the form of the distribution and the receipt of the dividends<sup>21</sup>.

In *SIR v Rosen*<sup>22</sup>, the taxpayer was ordinarily resident in the United Kingdom. His wife received R7200 from the trustees of a trust administered in South Africa, of which R600 was an annuity. The remaining R6600 was a discretionary payment. The receipts and accruals of the trust was derived partly from interest and partly from dividends. The issues before the court was summarised as follows:

- Did any part of the R7200 constitute 'dividends received by or accrued to or in favour of Mrs Rosen in terms of s 10 (1) (k) (ii)<sup>23</sup> ?
- Did those dividends form 'any part of an annuity' in terms of s 10 (2) (b)<sup>24</sup>?

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<sup>19</sup> *Armstrong v CIR* 1938 AD 343

<sup>20</sup> *SIR v Rosen* 1971 (1) SA 173 (A), 32 SATC 249 ; Emslie TS, Davies DM, Hutton SJ, Olivier L *Income Tax: Cases and Materials* 3<sup>rd</sup> Edition The Taxpayer page 1016

<sup>21</sup> Mitchell L "A rose for Rosen" *Tax Planning: Corporate and Personal* Vol 13. Number 2 1999 pages 43-46

<sup>22</sup> 1971 (1) SA 173 (A)

<sup>23</sup> s 10 (1) (k) (2) exempted from normal tax dividends received by or accrued to or in favour of any person (other than a company) not ordinarily resident nor carrying on the business in the Republic.

<sup>24</sup> s 10 (2) (b) qualify the s 10 (1) (k) (ii) exemption providing that it would not apply in respect of any portion of an annuity

- Did the dividend portion of the annuity qualify for the deduction in terms of s 19(3)<sup>25</sup>?

In considering the first issue, the court examined the definitions of a 'dividend', a 'company' and a 'shareholder' in section 1 of the Act. It held that the dividends paid to a registered shareholder, must be regarded as having been distributed by the company through the registered shareholder to the deemed shareholder. The amount distributed therefore constituted dividends. This conclusion was supported by s 10 (2) (b), which accepts that portion of an annuity constitutes a dividend, as it provides that 'the said exemption shall not apply in respect of any annuity'<sup>26</sup>. The Legislature has thus accepted the conduit principle in the case of the receipts and accruals out of which an annuity is paid. In his decision in the case *Trollip JA*<sup>27</sup> stated:

'in effect the legislature in those provisions has adopted a principle that can be conveniently termed the conduit principle: the registered shareholder is regarded as a mere conduit-pipe for passing the dividend to the deemed shareholder, the true recipient of them, in whose hands they consequently retain the identity and character as dividends the function of the principle is mostly apposite to trust cases, the mere interposition of the trustee between the dividend-paying companies and the beneficiary not being regarded as sufficient to change the character of the dividend as they pass through the latter'.

The effect of the judgement in *SIR v Rosen*<sup>28</sup> is to make it clear that income flowing through a trust retains its identity, whether it is paid by way of annuity or in some other way, provided that

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<sup>25</sup>s 19(3) permitted a percentage of a dividend, determined according to a specified scale, to be deducted from income in the form of dividends derived by any person other than a company.

<sup>26</sup>*Kolitz M Annuities Distributed by Trusts II (1996) 10 Tax Planning, pages 8 - 11.*

<sup>27</sup>At 265-6

<sup>28</sup>*Supra* fn 19

it accrues to the beneficiaries in the same year of assessment as it accrued to the trust. Trollip JA stated (at 269)

‘It suffices to say that the trust deed may itself entitle or oblige a trustee to administer the dividends in such a way that he is not a mere conduit pipe for passing them on to the beneficiary, that in his hands their source as dividends can no longer be identified or they otherwise lose their character and identity as dividends, and that the beneficiary is thus entitled to receive mere trust income in contra distinction to the benefit of the dividend rights in terms of the above crucial phrase. Thus a trust deed may endow the trustee with the discretion to pass on dividends to the beneficiary or to retain or accumulate them. If he decides on the latter, I think ‘but express no firm view’ that the dividends might then lose their identity and character as dividends, so that, if they are subsequently paid out to the beneficiary, they might possibly no longer be dividends in his hands, for the conduit-pipe had turned itself off at the relevant time. But if he decides on the former, i.e. to pass the dividends on to the beneficiary, the condition suspending the beneficiary’s entitlement thereto is fulfilled and then they would constitute dividends in his hands in the same way as if he had been originally entitled to them under the trust deed...’

According to **Silke** the decision in *Rosen’s* case is still of importance, in that the view was expressed (although it was not firmly decided) that trust income may change its nature if it is retained and accumulated by the trustee and paid out to the beneficiaries in a later year, having already been taxed in the hands of the trustee. Nevertheless, if the income is passed to the beneficiaries in the same year in which it accrues to the trustee, it retains its nature in the hands of the beneficiaries.

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

The *Friedman* decision (as discussed above in chapter 2) prompted the legislator not only to amend the definition of “person” in section 1 of the act - to put it beyond doubt that a trust is regarded as a person for tax purposes.

As a result of the judgment handed down by the Witwatersrand Local Division of the Supreme Court in the case of *Trustees of the Phillip Frame Will Trust v Commissioner of Inland Revenue*<sup>29</sup>, the definition of “person” in Section 1 of the Income Tax Act (the Act) was amended to include a trust . Concurrent with this amendment, Section 25B of the Act was introduced with a view to governing the assessment of trusts and trusts beneficiaries, thereby confirming the conduit principle without affecting the commissioner’ taxing rights in terms of Section 7 of the Act.<sup>30</sup>

To affirm the workings of the ‘*conduit principle*’, Section 25B (Section 25B was amended by the 1998 Taxation Laws Amendment Act with three new subsections, discussed below in Chapter 6 provides that :

- Trust Income derived for the immediate or future benefit of a beneficiary with vested rights, is subject to s 7(1) to s7(7) of the Income Tax Act, deemed to be the beneficiary’s income,<sup>31</sup>

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<sup>29</sup>53 SATC 166, *Trustees of Phillip Frame Will Trust v CIR* 1991 (2) SA 340 (WLD). The aforesaid case overturned the tables on the conduit principle by deciding that a “Trust” was not a “person” as defined in the Income Tax Act by virtue of it not being a “legal person”. It held that a trustee could not be a representative taxpayer for a person that does not exist (pursuant to the Act). The potentially chaotic effect of this decision, which retroactively declared a long-held tax practice to be invalid, no doubt immediately prompted the authorities to amend the definition of “person” in the Act in 1991 to include a trust administered by a person in a fiduciary capacity under a trust deed , agreement or will. In the absence of such amendment Revenue would have face a myriad of claims by trusts for tax refunds. The status quo was restored by this amendment, retrospectively to 1/3/1986. Kourie MA, Keetse S *Tax and Investments EasiGuide* 1999 Vol 1 Butterworths pages 159-270

<sup>30</sup>Vitae Taxation of Trusts And Trusts Beneficiaries, Vol 15, Sept-Oct 1994, Commissioner of Inland Revenue, Practice Note: No 23 Government Gazette No 15805, 24 June 1994.

<sup>31</sup>s25B(1)

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

- Trust income not subject to a beneficiary's vested right as aforesaid is, subject to s 7(1) to s7(7), deemed to be the income of the trust.<sup>32</sup>
  
- Trust Income paid by the exercise of the trustee's discretion in the year earned to a beneficiary (obtaining a vested right thereto) is deemed to be the beneficiary's income,<sup>33</sup>
  
- Expenses, deductions and allowances on the above income in order to derive taxable income are claimable by the person subject to the tax thereon.<sup>34</sup> An implication of this was that a beneficiary could in his/her own right claim these deductions, and to the extent that such deductions exceeded the trust income derived by the beneficiary, the excess could be set-off against other income of the beneficiary.

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<sup>32</sup>s25B(1)

<sup>33</sup>s25B(2)

<sup>34</sup>This was changed by the 1998 Budget that noted that these provisions were being abused:

- For income-splitting, thereby reducing the marginal tax rate at which the income is ultimately taxed; and
- For channeling losses, incurred as a result of the deduction of expenditure and allowances via the trusts to their beneficiaries, who then set these losses against their other income (especially used in financing transactions of business and farming trusts). The Budget prosed that the taxation of trusts be investigated and that two changes be implemented, the first being that a bar be placed on trust beneficiaries using trust losses to set off against other income (effective from 11 March 1998 for new trusts and 1 January 1999 for existing trusts) and the second that a revised set of tax rates be implemented immediately- Section 25B was amended by the 1998 Taxation Law Amendment Act with three new subsections, s 25B (4), s 25B(5) and s 25B(6), Kourie MA, Keetse S, *Tax and Investments EasiGuide 1999* Vol 1 Butterworths pages 159-270

**5. THE MEANING AND RELEVANCE OF THE PHRASE 'VESTED RIGHT' IN INCOME TAX LAW**

A vested right must be distinguished from a contingent right. If a beneficiary has a contingent right to income, it is not certain that he will ever receive the income. Therefore, he cannot be taxed on it. This would be the case, for instance, where a trust deed provides that if one beneficiary dies, the accumulated income of the trust will be given to the other beneficiary, or where the trust deed provides that the trustees may pay out the income or accumulated income of the trust to the beneficiaries in whatever proportions they see fit.

According to **DV Cowen**<sup>35</sup> a legal right is a consequence attached by law to a fact or combination of facts which the law defines, often referred to as the 'title' of the right. The distinction between vested and other 'rights' serves to indicate the holder of the right's title to it.<sup>36</sup>

It often happens that the beneficiaries are not stipulated or specified in the trust deed, but the trustee is legally obliged to pay over the income to the beneficiaries nominated by him in the exercise of a discretionary power conferred upon him by the deed. Under these circumstances the income is regarded as having been received by the beneficiaries so nominated by the trustee.<sup>37</sup>

Vested rights are, for example relevant for the purposes of the law of succession, estate duty, transfer duty, insolvency and income tax. The word 'vest' or 'vested' is used in the Income tax Act 58 of 1962 without any definition being given of the term and its derivatives.<sup>38</sup>

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<sup>35</sup>Cowen DV 'Vested and Contingent Rights' (1949) 66 *South African Law Journal* (SALJ) 404-405

<sup>36</sup>*Durban City Council v Association of Building Societies* 1942 AD 27

<sup>37</sup>*Silke on South African Income Tax* Butterworths

<sup>38</sup>For example, the proviso to S 1 sv 'specified period', ss 9D (3) and (7), 25B (1) (2), 74C )8) (b) and 100 and para 93 (A)(b) of the Seventh Schedule.

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

Although the words 'vest', 'vested' and 'vests' are used and they are important to various branches of the law, whether or not rights are vested is considered most often in relation to rights in a will.<sup>39</sup>

Although income tax law usually depends on the effect of contractual agreements, the law of succession is relevant to determining the tax implications of, for example, a usufruct, a fideicommissum, or a testamentary trust.<sup>40</sup>

According to the case of *Jewish Colonial Trust Ltd v Estate Nathan*<sup>41</sup>, at 175 the meaning of the phrase 'vested rights' is analysed:

'Unfortunately the word "vested" bears different meanings according to its context. When it is said that a right is vested in a person, what is usually meant is that such person is the owner of that right — that he has all rights of ownership in such right including the right of enjoyment. If the word "vested" were used always in that sense, then to say that a man owned a vested right would mean no more than a man owned a right. 'But the word is also used in another sense, to draw a distinction between what is certain and what is conditional, a vested right as distinguished from a contingent or conditional right. When the word "vested" is used in this sense Austin (*Jurisprudence* vol 2 lect 53) points out that in reality a right of one class is not being distinguished from a right of another class but the right is being distinguished from a chance or a possibility of a right, but it is convenient to use the well-known expressions vested right and conditional or contingent right.'

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<sup>39</sup> *In Re Allen Trust* 1941 NPD 147 at 156.

<sup>40</sup> Van der Merwe BA: "Meaning and relevance of the phrase 'vested right' for income tax law" 2000 SA *Merc LJ* 319.

<sup>41</sup> 1940 AD 163

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

In terms of the Income Tax Act, an amount has to be included in a taxpayer's gross income as soon as it has accrued or been received.<sup>42</sup> The question is whether there has been an accrual or deemed accrual. The definition does not contain the word "vest". The term accrual has not been defined in the Act. According to **BA Van der Merwe**<sup>43</sup>, its meaning has to be gleaned from case law. It has become evident from case law that 'accrual' is equated with 'vesting'. Both terms are used to indicate the title of the right which a taxpayer has acquired.

In *Lategan v Commissioner for Inland Revenue*<sup>44</sup> at 209, Watermeyer J held that an amount accrues as soon as a taxpayer becomes entitled to it. In terms of the entitlement principle, an amount accrues to a taxpayer when he becomes entitled to claim payment, even if only at a future date. This view was further accepted by the Appellate Division in the case of *Commissioner of Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd*<sup>45</sup>.

Furthermore according to Watermeyer J in the *Lategan* case supra at 209-210 a taxpayer entitled to claim payment is the following:

'He has not entitled to a right to claim payment of the debt in the year of assessment, but he has acquired a right to claim payment of the debt in future. This right has vested in him, has accrued to him in the year of assessment, and is a valuable right which he could turn into money if he wished to do so'

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<sup>42</sup> s 1, Definition of Gross Income

<sup>43</sup> BA Van Der Merwe, University of South Africa.

<sup>44</sup> 1926 CPD 203

<sup>45</sup> 1990 (2) SA 353 (A) at 367 C-D.

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

If a person has a right to receive income from a trust, even though he may not physically receive it until a later date, the income accumulated for his benefit is treated as being his for tax purposes. He therefore has a “vested right” to the income and will be taxed on it. According to **Meyerowitz**,<sup>46</sup> a beneficiary<sup>47</sup> has a vested right to income if he has a right which cannot be defeated and passes to his cessionaries, (if he is permitted by the terms of the trust to do so) or to his estate on his death even if the income is payable at some future date after its accrual, example at the termination of the trust (*dies credit sed nondum venit*)<sup>48</sup>.

According to **Silke**<sup>49</sup> the general principle that the beneficiaries and not the trustee will be liable to tax applies only when it is clear that the beneficiaries have a vested right in the income, that is they have a right to claim the income. If they have no vested right to the income but merely a contingent right, it cannot be said that the income has accrued to them.

In *ITC 76 (1927) 3 SATC 68* at 70, it was held:

‘Vesting implied the transfer of dominium, and the children had clearly not in the year under review acquired dominium of the trust income in any portion thereof. A vested right was something substantial; something which could be measured in money; something which had a present value and could be attached. A contingent interest was merely a spes — an expectation which might never be realised. From its very nature could not have a definite present value. In the income tax sense, therefore, a vested right was an accrued right.’

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<sup>46</sup> Meyerowitz D Meyerowitz on *Income Tax 2002/2003 Taxpayer*

<sup>47</sup> The beneficiary may be a natural person or a juristic person, including a deceased estate or a trust fund.

<sup>48</sup> See *Jewish Colonial Trust Ltd v Estate Nathan* 1940 AD 163 at 175.

<sup>49</sup> *supra* fn 37

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

As indicated above, 'transfer of dominium' is normally not a necessary characteristic of vesting. A testamentary trust deriving no assets from a living person is governed wholly by s 25B. With an inter vivos trust, the application of s 25B is subject to s 7. The latter contains seven subsections, none of which refers to specifically 'vested rights'. Section 25B, however, refers expressly to 'vested rights'.

Apart from the provisions to income that is not taxed in the Republic, the deemed income rule established by s 25B does no more than codify the application of the general principles of accrual to income flowing to and through a trust.<sup>50</sup> Effectively, both the provisions of s 25B (1) and these principles are targeted at the ascertained beneficiary with a vested right to the trust's income.

Section 25B (1) states that:

'[a]ny income received by or accrued to or in favour of any person in his capacity as the trustee of a trust... shall...to the extent to which such income has been derived for the immediate or future benefit of any ascertained beneficiary with a vested right to such beneficiary...'

The above section of the act provides that where the income accrues to or is received by the trust for the immediate or future benefit of an ascertained beneficiary with a vested right to the income, the beneficiary and not the trust will be taxed on the income. If the income is not so derived, the trust is the taxpayer. The provision is in line with the general rule that when a person is entitled to an amount (an amount that accrues) a tax event for income tax purposes arises.

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<sup>50</sup> Silke on South African Income Tax

Section 25B (2) provides that where trust income is vested in a beneficiary as a result of the exercise of a discretion by the trustees, the beneficiaries will be taxed. Again, it is not a requirement that the income has to be physically paid out to the beneficiary- mere crediting of the amount to the account of the beneficiary is sufficient.<sup>51</sup> Implicit in the rule that the beneficiaries and not the trust will be taxed is the conduit principle. This principle provides that income does not first accrue to or is first received by the trustees, but that they serve as a mere conduit.<sup>52</sup>

Furthermore according writers **MA Kourie and S Keetse**<sup>53</sup> the tax treatment is primarily determined by the manner of funding the trust. The question is was the trust funded by a donation, settlement or other gratuitous disposition, such as an interest free or low interest loan, or, was the trust funded by a market –related transaction, such as a market-related interest rate on loan account or an outright purchase for cash? The former is referred to as a “gratuitous transaction” and the latter as a “market-related transaction”.<sup>54</sup>

**Keetse and Kourie** went further and explained the aforementioned as follows:

**(a) if the transaction was “market-related”**

The income arising from the trust and accumulated on the beneficiary’s behalf is deemed to be the trust beneficiary’s under section 7 (1) for tax purposes.

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<sup>51</sup> Olivier L “The treatment of trusts for income and capital gains purposes: The screws tighten” *Tydskrif vir die Suid - Afrikaanse Reg* (TSAR) 2002.2 pages 220-233

<sup>52</sup> See chapter 4.

<sup>53</sup> Authors of the *Momentum The Law and Estate Planning Easiguide* 1997 Butterworths

<sup>54</sup> Kourie MA, Keetse S *Tax and Investments EasiGuide* 1999 Vol 1 Butterworths Page 265

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

- Similarly, any income the trust pays over to the beneficiary is deemed, for tax purposes, to be the beneficiary's income upon the normal conduit principles of trust taxation.
- An assessed loss is deemed to be the beneficiary's assessed loss and the beneficiary may claim all related expenditure incurred by the trust in earning such income.
- If the Trust's assets unconditionally accrue to defined beneficiaries upon some future event, the trust itself cannot be held responsible for the tax on income accruing therefrom according to *ITC 1552 and 55 SATC 82*.
- Where the right to income depends on fulfilment of a condition, no accrual occurs until the condition has been fulfilled. According to *ITC 1484* this must be distinguished from a situation where the beneficiary obtains a vested right to income, but his entitlement to the immediate enjoyment thereof is postponed.
- In the latter case, vesting of the income accrues immediately in favour of the beneficiary. The latin terminology of "dies cedit" and "dies venit" is relevant to this distinction the first meaning the day the debt arises, and the second meaning the day the debt falls due for payment. An example of this is found in *ITC 1328* where a trust deed provided that the trust income should accrue to the beneficiary but that the trustee had the absolute right to determine, inter alia the extent to which the income should be paid out. Any unexpended income was to be invested by the trustee on behalf of the donee and paid over at the trustee's discretion. Any balance not paid to the beneficiary during her lifetime was, on her death paid to her estate. It was held that the donee had a vested right to the income, although not to the immediate enjoyment of it, and was thus subject to tax thereon.

**(b) If the transaction were gratuitous transactions**

- The tax treatment depends on whether the beneficiaries are minors or majors and also upon whether the donor (being a parent or his minor or major child beneficiaries ) is alive or dead.
  
- While the donor is alive and the beneficiary is a minor, the trust income arising from the transaction is deemed to be the donor's irrespective of whether or not it is physically paid over to the minor, Section 7 (3) of the Income Tax Act.
  
- The above treatment also applies to reciprocal donations, example " I will give an amount to your minor child, if you give the same or a similar amount to my minor child".
  
- Section 7 (4) deems the parent to have derive the income resulting from the reciprocal donation.
  
- While the donor is alive and the beneficiary is a major the relevant trust income is deemed to be the donor's only to the extent that it is not paid over to the beneficiary. If it is so paid, this income is deemed to be the beneficiary's in terms of the conduit principle. If it is not paid over, the donor is taxed thereon in the year the income is earned.
  
- Subsequent to the donor's death, whilst the beneficiary is a minor or major, any trust income accumulated on behalf of the beneficiary in the trust is deemed under section 7 (1) of the Income Tax Act to be the beneficiary's trust income, whereas income paid to

**THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

the beneficiary is taxed in his hands under the conduit principle. This treatment also naturally follows in respect of testamentary trusts.

According to **MA Kourie and S Keetse**<sup>55</sup> the above tax principles can be summarised as follows:

There are four possible ways( as depicted in the table below) to tax trust income and the applicable method or a combination of these depends on various factors for example:

- is the transaction gratuitous or market related,
- is the planner alive or dead;
- is the beneficiary major or minor;
- is the income accumulated in the trust or paid out;
- does the minor have revocatory powers or not;
- of four possible methods to trust income;
- is it bebind
- vested or
- discretionary trust.

1	2	3	4
Income deemed the donor's (he being alive) from a gratuitous transaction, i.e.S7(3), (4), (5) or (6)	Income deemed to be beneficiary's accumulated on his behalf S7(1)	Income taxed in the hands of trust as a single taxpayer without rebates on conduit principle	Income paid out to, and taxed in the beneficiary's hands on conduit principal

**Table 1. Possible ways to tax trust income.**

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<sup>55</sup> Supra 53

**6. PARTIES TO A TRUST AND IN WHOSE HANDS TRUST INCOME IS TAXED**

Any one or more of the parties to a trust listed below can be liable for income tax.

- The Founder of the Trust;
- The donor (other than the founder) of the Trust;
- The trustees as representative taxpayers on behalf of the trust;
- The beneficiaries in terms of the trust deed.

Liability will depend on the nature of the transaction, The Trust Deed itself, its terms, whether or not income was distributed or retained in the trust and whether the beneficiaries are majors or minors. Furthermore the Trust deed can provide that the trust is a discretionary trust or a fixed or vesting trust, in the former the beneficiaries have vested rights to all or part of the income or capital of the trust depending on the terms of the Trust Deed. This concept of 'vested rights' was defined as well as adequately explained above in chapter 5, for a more in-depth discussion of the term vested.

A discretionary trust, gives the trustee a discretion regarding when to distribute the income or capital to the beneficiary and to which of the beneficiaries. In a discretionary trust the beneficiaries do not obtain vested rights to the income until the trustees exercise their discretion and then only will the beneficiary in whose favour the trustee has exercise his/her discretion will acquire the vested right thereto.

## **6.1 Income of trusts and beneficiaries of trusts**

Section 25B of the Act prescribes how income tax is apportioned and calculated in respect of the income that accrued to a trust. Each subsection of s 25B will be analysed independently below with specific reference to case law where applicable. Furthermore, s25B (3) will be discussed with reference to the general deduction formula, more specifically s 11(a) and s 23(g) where applicable.

### **6.1.1 Section 25 B (1) <sup>56</sup>**

“Any income received by or accrued to or in favour of any person during any year of assessment in his capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which such income has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to such income during such year, be deemed to be income which has accrued to such beneficiary, and to the extent to which such income is not so derived, be deemed to income which has accrued to such trust”.

In summary, section 25B (1) provides as follows:<sup>57</sup>

- 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.

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<sup>56</sup>Income Tax Act 58 of 1962

<sup>57</sup>Huxham K, Haupt P *Notes on South African Income Tax* 2001 page 520

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

Section 25 B applies to the income received by or accrued to or in favour of a person during any year of assessment in his capacity as the trustee of a trust. Section 25B (1) of the act provides that where income accrues to or is received by the trust for the immediate or future benefit of an ascertained beneficiary with a vested right to the income, the beneficiary and not the trust will be taxed on the income. If the income is not so derived, the trust is the taxpayer. The provision is in line with the general rule that when a person is entitled to an amount (that is, the amount accrues), a tax event for income tax purposes arises.<sup>58</sup>

Section 25B (1) is specifically made subject to s7. The result is that income deemed to have been derived by someone, for example a spouse, or parent under s7 will remain taxable in the hands of that person and cannot be deemed to have been derived by a trust or its beneficiaries under section 25B. Section 25B therefore only comes into operation only to the extent that s 7 does not already apply.

### 6.1.2 Section 25B (2)

“Where a beneficiary has acquired a vested right to any income referred to in subsection (1) in consequences of the exercise by the trustee of a discretion vested in him in terms of the relevant deed of trust, agreement or will of a deceased person, such income shall for the purposes of that subsection be deemed to have been derived for the benefit of such beneficiary.”

In summary Section 25B (2)<sup>59</sup> provides:

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<sup>58</sup>Lategan v CIR 1926 CPD 203 and CIR v People Stores (Walvis Bay) (Pty) Ltd 1990 2 SA 353 (A). It may be argued that even in the absence of S 25B (1) the beneficiaries will still be taxed on income accumulated for their benefit under the provision of S 7 (1).

<sup>59</sup>Huxham K, Haupt P *Notes on South African Income Tax* 2001 page 520

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

- 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.

### **6.1.3 Section 25B(2A)**

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

(a) such capital arose from-

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

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

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

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

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

In summary, section 25B (2A) provides:

- that a resident who has acquired a vested right to any capital of a non resident trust
- during the year of assessment is required to
- include the amount acquired in his income in that year.
- the inclusions applies in respect of capital that arose from
- income received by or accrued to the trust ;or
- receipts or accruals that would have constituted income of the trust if it had been a resident

- during any previous year of assessment in which the resident had
- a contingent right to the income, receipts or accruals
- and only applies to income, receipts or accruals that have not already been subject to tax in the Republic.

#### **6.1.4 Section 25B (3)**

“ Any deduction or allowance which may be made under the provisions of this Act in the determination of the taxable income derived by way of any income referred to in subsection (1), shall, to the extent to which such income is under the provisions of that subsection deemed to be income which has accrued to a beneficiary or to the trust, be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by such beneficiary or trust, as the case may be.”

In summary section 25B (3)<sup>60</sup> provides:

- 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 to the trust fund”

The wording in section 25B (3) “ to the extent of which” can, therefore, not be construed as meaning that deductions and allowances be limited to the income of a trust or trust beneficiary.

What it in fact means is that such deductions and allowances are to be allocated between a trust

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<sup>60</sup>Huxham K, Haupt P *Notes on South African Income Tax* 2001 page 520

or trust beneficiary in the same proportion as the income has been allocated. Therefore, any deduction or allowance which could be available to a trust beneficiary in terms of section 25B in the determination of taxable income derived from trust income, will be deductible in full in the hands of such beneficiary.<sup>61</sup>

According to **Silke** allowable deductions, which may be made against the income received or accrued to the trustee during the year, follow the income to which they relate. The provisions of section 25B (3) apply to any deduction or allowance that may be made under the Act in the determination of the taxable income derived by way of income received by or accrued to or in favour of the trustee during the year of assessment in his capacity as trustee. To the extent to which the income is deemed to be that of a beneficiary or a trust, the deduction or allowance will be deemed to be a deduction or allowance that may be made in the determination of the taxable income derived by the beneficiary or trust.

Section 25B (3) authorises an apportionment of the expenditure incurred by the trustee between the income of the beneficiary and the income of the trust. The expenditure will be apportioned on a pro rata basis. If the amount apportioned to a beneficiary exceeds the income deemed to be his, the deduction of the loss is limited by the provisions of s 25B (4).

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<sup>61</sup>Vitae Taxation of Trusts And Trusts Beneficiaries Vol 15 Sept-Oct 1994 Commissioner of Inland Revenue Practice Note: No 23 Government Gazette No 15805 24 June 1994.

**6.1.5 Section 25B (4).**

“Notwithstanding the provisions of subsection (3), any deduction or allowance contemplated in that subsection which is deemed to be made in the determination of the taxable income of a beneficiary of a trust during any year of assessment shall be limited to the income which is deemed to be income which has accrued to such beneficiary in terms of subsection (1) during such year of assessment.”

In summary section 25B (4)<sup>62</sup>provides:

- any deduction or allowance
- allocated to a beneficiary
- shall be limited
- to the income accruing to the beneficiary from that trust in the year of assessment

Despite the fact that a beneficiary generally enjoys limited personal liability with regard to the debt of the trust, the provisions of s 25B granted a beneficiary the advantage of the loss without the risk of being held liable for payment to a creditor of the trust.

As a result thereof the s 25B (4) was inserted into the Act. It provided that the deductions and allowances which are deemed to be deductions and allowances of the beneficiary in terms of s 25B (3), be limited to the income of the beneficiary derived from the trust during the year of assessment.

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<sup>62</sup>Huxham K, Haupt P *Notes on South African Income Tax* 2001 page 520

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

Where the aggregate of the deductions and allowances exceeds the income of the beneficiary, s 25 B (5) provided that the excess may be set-off against the taxable income of the trust during the relevant year of assessment, provided that the excess does not exceed the taxable income of the trust, as calculated before allowing the abovementioned set-off.

Finally, Section 25B (6) specifies that where the aggregate of the deductions and allowances contemplated in s 25B (4) exceeds both the income contemplated in s 25 B (4) of the beneficiary and the taxable income of the trust contemplated in s 25B (5), this excess may be set-off against the income of the beneficiary which is derived from the trust in the immediate succeeding year of assessment. The effect of the application of the provisions of s 25 B (6) is that the excess carried forward may then be allowed as a deduction as envisaged in s 25B (3),(4)and (5) during the succeeding year of assessment.

A closer look at the precise wording of s 25 B (4) reveals that there will be situations where the provisions will not apply. Two points in particular are worth noting.<sup>63</sup>

- First, it applies only”in the determination of the taxable income of a beneficiary’ and
- Secondly, the deductions and allowances are ‘limited to the income which is deemed to be *income which has accrued to the beneficiary in terms of [ s 25B (1)]* during the...year of assessment’

According to writer **Lindsay Mitchell**, the provisions of section S 25B (4) can be therefore be avoided by ensuring that the person seeking to deduct the loss suffered by the trust:

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<sup>63</sup>Mitchell L “ Shifting Losses” *Tax Planning* vol 13 (1999) pages 2-4

- is not a beneficiary, or
- does not earn income which has accrued in terms of S 25B (1).

#### **6.1.6 Section 25B (5)**

“ The amount by which the sum of the deductions and allowances contemplated in subsection (4) exceeds the income contemplated in that subsection, shall –

(a) be deemed to be a deduction or allowance which may be made in the determination of the taxable income of the trust during such year of assessment: Provided that the sum of such deductions and allowances shall be limited to the taxable of such trust during such year of assessment as calculated before allowing any deduction or allowance under this subsection; or

(b) where the trust is not subject to tax in the Republic, be carried forward and be a deduction or allowance which may be made in the in the determination of the taxable income derived by such beneficiary by way of income referred to in subsection (1) during the immediately succeeding year of assessment.”

In summary section 25B (5)<sup>64</sup> provides:

- the excess of expenditure over income in s 25B (4)
- shall be deducted by the trust in that year
- but limited to the taxable income of the trust before the deduction of such expenditure

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<sup>64</sup>Keith Huxham, Phillip Haupt, Notes on South African Income Tax, 2001, 520

**6.1.7 Section 25B (6)**

“ The amount by which the sum of the deductions and allowances contemplated in subsection (4) exceeds the sum of the income contemplated in subsection (4) of such beneficiary and the taxable income of such trust contemplated in subsection (5), shall for the purposes of subsection (3) be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by such beneficiary by way of income referred to in subsection (1), during the immediately succeeding year of assessment.”

In summary section 25B (6)<sup>65</sup> provides:

- if the trust cannot absorb the full deduction or allowance disallowed to the beneficiary
- the excess may be granted as a deduction or allowance to the beneficiary
- in the next year of assessment
- subject to the same limitation as in section 25B (4)

**6.1.8 Section 25B (7)**

“ The provisions of subsections (4), (5) and (6) shall not apply in respect of any income which is deemed to have accrued to any beneficiary is not subject to tax in the Republic on such income.

In summary section 25B (7) provides:

- the provisions of S 25B (4) (5) and (6)

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<sup>65</sup>Keith Huxham, Phillip Haupt, Notes on South African Income Tax, 2001, 520

- do not apply to income that is deemed to accrue to a beneficiary in terms of section 25B (1)
- where the beneficiary is not subject to tax
- in the republic on the income

**6.2 Summary of the provisions of Section 25B (1) and (2)<sup>66</sup>**

- (a) Trust income under a testamentary trust is taxable in the hands of a trust beneficiary when:
- (i) such income is actually distributed to the beneficiary in the year of assessment, often by virtue of a vested right to such income held by the beneficiary (s 25B (1)); or
  - (ii) the beneficiary enjoys a vested right to such income in terms of a particular will, but distribution of income has not been / will not be effected to the beneficiary in the year of assessment( s 25B (1)); or
  - (iii) the beneficiary has obtained a vested right to trust income by virtue of the exercise of a discretion in his favour by the trust's trustee, whether or not distribution of income is effected to the beneficiary in the year of assessment (s 25B (1) and (2)).
- (b) Trust income under a testamentary trust is taxable in the hands of the trust and hence its trustees as representative taxpayers in all other circumstances (s 25B (1).

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<sup>66</sup>Du Toit F *South African Trust Law: Principles and Practice* 2002 Butterworths page 138

### **6.3 Expenditure**

Most deductions are allowed by virtue of a so-called general deduction formula comprising s11(a), which sets out what may be deducted and s23(g) which stipulates what may not be deducted.

Section 11(a) provides for the deduction of

‘Expenditure and losses incurred in the production of income, provide that such expenditure and losses are not of a capital nature.’

Section 23(g) provides that

‘No deductions shall in any case be made in respect of the following matters, namely...

(g) any monies, claimed as a deduction from income derived from trade, to the extent to which such monies was not laid out or expended for the purposes of trade.’

The term ‘trade’ is defined in s 1 as follows:

‘Trade includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act, 1978 ( Act 57 of 1978), or any design as defined in the Designs Act, 1993 ( Act 195 of 1993), or any trademark as defined in the Trade Marks Act, 1993 (Act 194 of 1993), or any copyright as defined by the Copyright Act, 1978 (Act 98 of 1978) or any other property which is of a similar nature.’

In *Joffe and Company (Pty) Ltd v CIR*<sup>67</sup> the judge defined 'trade' as earning of profit. The courts have laid down that s11 (a) and s23(g) must be read together when one considers whether an amount is capable of a deduction(*Port Elizabeth Electric Tramway Co Ltd v CIR*)<sup>68</sup>

#### **6.4 The Elements**

The current general deduction formula comprises ss 11(a) and 23(g) may be therefore broken down into the following elements:

- The expenditure and losses;
- must be actually incurred;
- during the year of assessment;
- in the production of any income;
- they must not constitute expenditure and losses of a capital nature; and
- if they are claimed as a deduction against income derived from trade, they must, either in part or in full, constitute monies that are laid out for the purposes of trade (s 23(g)).

The above elements, all of which must be satisfied before a deduction may be claimed. The following elements will be discussed briefly with respect to case law.

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<sup>67</sup>1946 AD

<sup>68</sup>1936 CPD

#### **6.4.1 Expenditure and Losses**

The Act refers to both expenditure and losses. In *Joffe and Company (Pty) Ltd v CIR*<sup>69</sup> the court considered that 'losses' had several meanings and that it was not clear that they meant anything other than expenditure, but that possible that 'losses' were expenditure of an involuntary nature. In *Port Elizabeth Electric Tramway Co Ltd v CIR*<sup>70</sup>, the court considered that the term may refer to losses of floating capital.

#### **6.4.2 Actually Incurred**

In deciding whether or not expenditure has actually been incurred, it is not essential to decide whether it was necessarily incurred. The word 'incurred' does not mean 'paid'. As long as the liability to pay an expense has been incurred it is deductible. In *Caltex Oil (SA) Ltd v SIR*<sup>71</sup> it was held that 'expenditure actually incurred' does not mean expenditure actually paid during the year of assessment, but means 'all expenditure for which a liability has been incurred during the year, whether the liability has been discharged during the year or not'. Botha JA, who delivered the judgement of the Appellate Division of the Supreme Court, said:

"It is in the tax year in which the liability for expenditure is incurred, and not in the tax year in which it is actually paid (if paid in a subsequent year), that the expenditure is actually incurred for the purposes of s 11(a)'.

The question of whether or not expenditure has been incurred was clearly summarised by Ackermann J in *CIR v Edgars Stores Ltd*<sup>72</sup> as follows:

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<sup>69</sup>Supra fn 66

<sup>70</sup>Supra fn 67

<sup>71</sup>1975 (1) SA 665(A)

<sup>72</sup>1988 (3) SA 876(A)

Another well-established principle, not challenged in this appeal, is that a distinction must be drawn between:

- (a) the case where the existence of the liability is conditional and dependent upon the happening of an event after the tax year in question, in which event the liability is not incurred in the tax year in question; and
- (b) the case where the existence of the liability is certain and established within the tax year in question, but the amount of the liability cannot be accurately determined at the year-end, in which event the liability is never the less regarded as having been incurred in the tax year in question.

#### **6.4.3 During the Year of Assessment**

The requirement is not specifically mentioned in s 11(a), but the courts have held that the expenditure which the taxpayer claims as a deduction, must be incurred during the year which it is claimed (*Concentra. (Pty) Ltd v CIR*)<sup>73</sup>. The general rule that no expenditure incurred in a particular year of assessment may be deducted in subsequent of assessment. However, according to s 25B (6) if the trust cannot absorb the full deduction or allowance disallowed to the beneficiary in terms of ss 25B (4) and (5) (as discussed in Chapter 6.1) the excess may be allowed as a deduction or allowance to the beneficiary in the next year of assessment subject to the same limitations as in s 25B (4).

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<sup>73</sup>1942 CPD 509

#### **6.4.4 In the Production of Income**

This is probably the most onerous requirement of s 11 (a). In terms of this requirement any expenditure that has not been incurred for the purpose of producing income will not be allowed as a deduction. The term 'in the production of income' has been subject of a number of court cases. The meaning of the expression 'in the production of income' was considered in *Port Elizabeth Electric Tramway Co Ltd v CIR*<sup>74</sup> The court held that compensation paid was incurred in the production of income. Watermeyer AJP who delivered the judgment of the Cape Provincial Division of the Supreme Court stated :

'... what attendant expenses can be deducted? How closely must they be linked to the business operation? Here, in my opinion, all expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it.'

Furthermore to determine whether an expense is in the production of income, two questions must be asked:

1. What act gave rise to the expense? In this case, the act of being involved in the accident gave rise to the expense.
2. Is this act closely connected with the income-earning activities? The act of being involved in an accident is a potential risk when driving any vehicle. This act is therefore closely

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<sup>74</sup>1936 CPD 241, 8 SATC 13

connected with the earning of income from transporting passengers. The expense is therefore deductible.

*Sub-Nigel Ltd v CIR*<sup>75</sup> is authority for the view that for expenditure to rank as a deduction during the year of assessment it is not necessary to show that it will have an effect upon the production of the income for that year. The income may be earned only in a future year, but as long as the expenditure has been laid out for the purpose of earning income, it is deductible.

#### **6.4.5 Not of a capital nature**

Section 11(a) requires that in order to rank as a deduction, the expenditure or loss should not be of a capital nature.

The courts have laid down some very useful tests for distinguishing between capital and revenue expenditure. The important dictum of Watermeyer CJ, who delivered the judgment, in *New State Areas Ltd v CIR*<sup>76</sup> stated that:

‘The distinction must be remembered between floating or circulating and fixed capital. When the capital employed in a business is frequently....then the capital so employed is floating capital. The problem which arises when deductions are claimed is therefore usually whether the expenditure in question should properly be regarded as part of the cost of performing the income-earning operations or as part of the cost of establishing or improving or adding of the income-earning plant or machinery.’

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<sup>75</sup>1948 (4) SA 580 (A)

<sup>76</sup>1946 AD 610

Another valuable view is that of Innes CJ, who delivered one of two judgments of the in *CIR v George Forest Timber Co Ltd*<sup>77</sup>

‘Now, money spent in creating or acquiring an income-producing concern must be capital expenditure. It is invested to yield future profit, and while the outlay does not recur the income does. There is a great difference between money spent in creating or acquiring a source of profit, and money spent in working it. The one is capital expenditure and the other is not...’

Although an expense may be deductible in terms of s 11(a), it would still have to pass s 23 (g) of the Act. The above are brief explanation of the elements that have to be complied with in order to qualify for a deduction under s 11(a) of the Act.

One of the reasons trusts may be attractive from an income tax point of view, is that the income may be taxed at a lower rate when it is distributed among a multiplicity of beneficiaries. This is achieved by not only distributing income to the beneficiaries, but also expenditure incurred by the trust. To address the use (or abuse) the legislature stepped in during 1998 and added several subsections to section 25B. Under subsection (4) trust deductions incurred by the trust and allowances to which the trust might have been entitled are limited to the amount of the income received from the trust. Any excess has to be claimed by the trust in the same year of assessment (s 25B (5)).

In the event of the trust not having sufficient taxable income to make use of the deduction and

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<sup>77</sup>1924 AD 516

allowances, the beneficiary may claim the excess in the subsequent year of assessment (s 25B (6)). As the section provides that the excess may be deducted by “such beneficiary” in the subsequent year of assessment, it may be argued that if the beneficiary dies before use can be made of the excess, the excess is forever lost. In other words, the excess cannot be transferred to another beneficiary.

The inserting of s 25B (4), this amendment obviously supersedes Practice Note 23 of 17/06/1994<sup>78</sup> which previously clarified the fact that s 25B (3) losses are claimable by the trust or trust beneficiaries as the case may be in proportion to the trust income allocated to the trust or beneficiary. This practice note meant that the relevant deduction was not limited to the amount of such income allocated to the beneficiary as was previously thought to be position.

The trustee is entitled to claim any deductions for which the trust qualifies in terms of the Act in the determination of the taxable income subject to tax in his hands as trustee. For example administration charges, such as the trustee’s remuneration, are deductible under s 11(a). Fees received by a trustee from a trust are regarded as amounts received for services rendered and are taxable in terms of para (c ) of the definition of ‘gross income’ in s 1

## **6.5 Exemptions: Annuities**<sup>79</sup>

There are exceptions to the general rule that trust income retains its identity. The exemptions from normal tax that apply to certain dividends ( s 10 (1) (k) and interest on government stock (s 10(1) (h) do not apply to any portion of an annuity (s 10 (2) (b)). Consequently, these exemptions do not

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<sup>78</sup>This Practice note has since been repealed.

<sup>79</sup>Silke AS Silke on South African Income Tax 2003

**THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

apply to an annuity derived by a beneficiary that is payable by the trustee out of dividend income or interest on government stock. A beneficiary of a trust who is not ordinarily resident or carrying on business in the Republic and who is entitled to the payment of an annuity out of interest on government stock derived by a trust will therefore be liable to tax on the annuity, and any beneficiary will be liable to tax on an annuity paid out of dividend income derived by a trust, since the exemptions in s 10(1) (k) and (h) will be unavailable. Section 10(2)(b) makes no reference to the s 10(1)(I) or s 10(1)(hA) exemptions. It is considered therefore that an annuity paid out of interest income derived by a trust will qualify for s 10(1)(I) or s 10(1)(hA) exemptions if the requirements of those provisions are met.

**7. WHEN INCOME IS DEEMED TO HAVE BEEN ACCRUED OR TO HAVE RECEIVED**

Section 7 of the Act is essentially an anti- avoidance provision. Subsections (2) to (8) are instrumental to the achievement of this goal by rendering income which a has resulted from a “Donation, settlement or other disposition” by a donor, taxable in the hands of such donor, thus precluding income splitting by an estate owner.

**7.1 Discussion on Section 7**

**7.1.1 Section 7(1)**

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

Section 7(1) provides that income shall be deemed to have accrued to a person, notwithstanding the fact that such income has been invested, accumulated or otherwise capitalised by such person or that such income has not been actually paid over to such person, but remains due and payable to him or has been credited in account or reinvested or accumulated or capitalised or otherwise dealt with in his name or on his behalf.

Section 7(1) occasions income retained in a trust for purposes of investment, accumulation or

capitalisation on behalf of beneficiaries who enjoy vested rights to such income, to be deemed to have accrued to such beneficiaries. The income is consequently taxable in the hands of the beneficiaries. Section 7(1) thus causes a trust beneficiary to be taxed on income to which he enjoys a vested right, even though the distribution of such income may be prospective rather than immediate.<sup>80</sup>

This section deems certain income which has been invested or accumulated on behalf a particular person to have accrued such person even though it has been paid over to him. A specific requirement is that the amount must be due and payable to the taxpayer or otherwise credited in his name or on his behalf. Here the person has a vested right to the income and is liable to tax, thereon even though it has not been over to him. Where a trust confers a vested right on a trust beneficiary to receive the trust's income/capital on reaching a certain age, the beneficiary will be taxed annually on this income. This section cannot be invoked where the taxpayer does not possess a vested right, as for example in the case of most deferred compensation policies.

### **7.1.2 Section 7(2)**

Section 7 (2) is an anti- avoidance provision aimed at preventing married couples from reducing their liabilities for normal tax by arranging for taxable income to be split between them. This provision will apply, for example, where the husband created a trust in favour of the wife by donating income-producing assets to a trust. In this instance the husband would be liable for tax on the income produced by those assets.

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<sup>80</sup>Abrie, Graham and Van der Spuy 150; Pace and Van der Westhuizen 66

**7.1.3 Section 7(3)**

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

- (a) it has been received by or accrued to or in favour of that child or has been expended for the maintenance, education or benefit of that child; or
- (b) it has been accumulated for the benefit of that child.’

There are two phrases in this section which are crucial to the understanding of the provision, namely there must be a “donation, settlement or other disposition made by the parent of the child” and ‘by reason of’ such donation etc income must be received by, or accrued to, the minor child.

A minor is any unmarried individual under the age of 21 years. A married person who is divorced or widowed while under the age of 21 does not revert to the status of a minor. It is concerned that emancipation does not alter the status of a minor for the purpose of the Income Tax Act.

The phrases of ‘Donation, settlement or other disposition’ are looked at more closely with reference to case law discussed below.

In *Ovenstone v SIR*<sup>81</sup> Trollip JA said:

‘[T]he critical phrase in s7(3)—“any donation, settlement or other disposition”—excludes any disposal of the property that is wholly commercial or business one, ie made for due consideration; it covers any disposal of property made wholly gratuitously out of liberality or generosity, it also covers the disposal of property made under a settlement or other disposition for some consideration but for there is an appreciable element of gratuitousness and liberality or generosity. I wish to add this observation about the last kind of composite disposal—one that is partly gratuitous and partly for consideration. If the consideration is merely illusory, simulated or minimal, the disposal will, of course, be regarded as wholly gratuitous. On the other hand merely because the settlement or disposition contains some element of bounty or gratuitousness, that is sufficient to render s 7(3) applicable; such element must be appreciable for that to happen.’

This section deems income earned by a minor as a result of a “donation, settlement or other disposition” from a parent, to be the parent’s income. It does not matter that the parent, used such income to maintain the child- it will still be taxed in the parent’s hands. The provision also hits minor’s income from a trust (set up by the parent) regardless of whether the income has been paid over to the minor or not. Upon the earlier of the donor’s death, or the child reaching 21, this section and its implications fall away. If spouses married in community of property make a donation to a child, the wife and husband are considered to have each donated half, and on the husbands subsequent death, the income on the wife’s portion of the donation continues to be deemed to be her income. This section does not penalise donations from grandparents.

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<sup>81</sup>1980 (2) SA 721 (A) at 740 A-C

In *Kohler v CIR*<sup>82</sup> it was held that the quoted words should be interpreted as referring to the proximate and not to a remote cause and that where income received by reason of a donation is invested or employed the “income on income” was not by reason of a donation since the causal connection was interrupted by a *novus actus viz*, the reinvestment of the original income. This approach was rejected in *Widan’s* case as well as *CIR v Berold*<sup>83</sup>. For this reason, Coetzee J held as follows in *Joss’s* case:

‘ In case such as the present one must be careful to distinguish between the disposition of the shares at a proper value and thereafter the loan to the company which is interest free. Thus there are *two* dispositions and it is only the latter which is a disposition within the meaning of s7(3) of the Act. It is also logically imperative to separate the interest free loan from the transfer of the shares, to determine the causal connection between the receipt of the income and the disposition. This flows from the words “by reason of” in the section. Hence, once an amount received by way of a dividend is clearly attributable as to part thereof to such a disposition and as to the balance to another, then an allocation must be made for tax purposes of the amount which was received “by reason of” the “donation, settlement or other disposition.”

*CIR v Widan*<sup>84</sup>, where it was held that there must be some causal relation between the donation and the income in question. The causal relationship and that in ascertaining whether such causal relation exists one must look not necessarily to the cause which is proximate in time but to the real efficient cause of the income being received. As Centlivres CJ said

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<sup>82</sup>1949 (4)SA 1022 T, 16 SATC 312

<sup>83</sup>1962 (3) SA 748 at 755D-E

<sup>84</sup> 1955 (1) SA 226 (A)

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

‘Every case must be decided on its own facts and if any particular case it appears that, apart from proof of any specific intention on the part of the parent, the effective cause of income accruing to a minor child was the donation made by the parent, then such income is deemed under s7(3) to have been received by the parent.’

If the real efficient cause is the donation by the parent then the section applies. The real efficient cause is a matter to be ascertained on all the facts and circumstances of the case and difficult cases may 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, the income, that income may be attributable to two causes, viz the donation and the skill and labour of the child. In such case it may be impossible to say which part of his income may be the result of the donation and which part the result of his skill and labour and it may be that the Commissioner would not be able to apply the section...’

In *Widan*'s case there were a series of transactions following on the original donation which the Court found to be a single all-embracing design, but the Court pointed out that a parent may have to pay tax even if there were not all-embracing design or no design of providing the child with income.

In *CIR v Berold*<sup>85</sup>, A parent had sold certain shares in a company A, the purchaser price remaining owing without interest being charged. Thereafter the parent donated his shareholding in A and a

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<sup>85</sup>1962 (3) SA 748 A

portion of his loan account to trustees under deeds of trust for the benefit of his children. Several years later company B was formed and the donor's mother donated to the trust shares in company B which had been allotted to her. The trustees then sold the shares in company A to company B. Subsequently company B received dividends from company A and in turn declared dividends which were received by the trustees by virtue of their shareholding in company B. The dividends were held to have been received by reason of the parent's donation and to be taxable in his hands in terms of section 7 (3).

In *Barnett v COT*<sup>86</sup> the facts were that the taxpayer in consultation with his brother - in- law E formed a company and sold his assets to it, the purchaser price being payable on demand free of interest. Ten shares at par were allotted to E who donated the shares to the taxpayer's minor children. Dividends that were subsequently declared by the company were held to be taxable in the hands of the taxpayer.

Each of the three Judges arrived at the conclusion for reasons of their own. Tredgold CJ held that section 9(3), the equivalent of our section 7(3), applied because "donation, settlement or other disposition" included an arrangement; Claydon FJ held an arrangement was not included and as the only disposition by the father was to the company the section did not apply. He held, however that section 9(4), the equivalent of our section 7(4), applied because there was an undertaking by the father to dispose of his shares in the consideration of E donating to his minor children and this consideration was sufficient for the purpose of the section. Briggs FJ held that section 9(3), the equivalent of our section 7(3), alternatively section 9(4), the equivalent of our section 7(4), applied.

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<sup>86</sup>1959 (2) SA 713

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

It is considered that under the Income Tax Act section 7(3) does not extend to an arrangement or scheme, but to a single transaction constituting a donation, settlement or other disposition, more particularly because the statute contains a general provision (section 103) dealing with a transaction, operation or scheme for the purpose of tax avoidance. *Barnett v COT*<sup>87</sup>

‘The critical phrase in section 7 (3) “any donation, settlement or other disposition” — excludes any disposal of property that is wholly commercial or business one, made for due consideration; it covers any disposal of property made wholly gratuitously out of liberality or generosity; it also covers any disposal of property made under a settlement or other disposition for some consideration but in which there is an appreciable element of gratuitousness and liberality or generosity’

In *Joss v SIR*<sup>88</sup> the taxpayer had sold assets to a company the purchase price on which remained a loan interest free. The taxpayer’s minor daughter was a shareholder in the company and received a dividend. The Revenue Department invoked section 7(3) to deem the dividend to be the taxpayer’s. The Court found that only that portion of the dividend accrued to the minor as was attributable to the interest free loan by her parent accrued by reason of a donation, settlement or other disposition. It directed that the assessment be amended to include in the taxpayer’s income only such portion of the dividend as represented the aggregate of interest that should have been charged on his loan account from their inception.

The words “other disposition” were interpreted in *Joss v CIR* and *Ovenstone v CIR* to be

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<sup>87</sup>1959 (2) SA 713

<sup>88</sup>1980 (1) SA 674 T

synonymous with a donation or gratuitous disposition.

This section does not affect income earned independently by a minor, nor income earned by a minor as a result of a market related transaction entered into with the parent. Therefore it is submitted that an “interest free loan account” falls within the ambit of these sections, as applicable to s 7 (3) and s 7(7).

#### **7.1.4 Section 7(4)**

‘Any income received by or accrued to or in favour of any minor child of any person, by reason of any donation, settlement or other disposition made by any other person, shall be deemed to be the income of the parent of such minor child, if such parent or his spouse has made a donation, settlement or other disposition or given some other consideration in favour directly or indirectly of the said other person or his family.’

Is designed to counter the circumvention of s 7 (3) by arranging that someone else donates assets to the children, and in return you donate assets to his children. In such event the minor’s income earned on the assets is deemed to be that of the parents ( as in s 7 (3)).

**7.1.5 Section 7 (5)**

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

Section 7 (5) provides that:

- if a person has made any donation, settlement or other disposition;
- that is subject to a stipulation or condition;
- whether made or imposed by that person or anybody else;
- to the effect that the beneficiaries or some of them will not receive the income or portion of the income;
- until the happening of some event, whether the event is fixed or contingent;
- so much of any income as would , but for the stipulation or condition;
- in consequence of the donation, settlement or other disposition;
- be received by or accrue to in favour of the beneficiaries;
- will, until the happening, of that event or the death of the person who made the donation; settlement or other disposition, whichever happens first;
- be deemed to be the income of the donor and is taxable in his hands.

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

The law which has developed on the issue of s 7 (5) is far from coherent. But the general rule is that the section is applicable in situations where:<sup>89</sup>

- there is undistributed trust income;
- there are ascertainable beneficiaries of a deed of trust who do not have a vested right to the income earned by the trust; and
- where the income is caused by a 'donation, settlement or other disposition' which was made to the trust.

However according to **Silke** s 7(5) contains the following requirements:

- Income must have been received by or accrued to the trust which was not distributed to the beneficiaries. The provision applies to the undistributed portion of the income received by or accrued to the trust.
- If not for the stipulation, the income would have been received by or would have accrued to the beneficiaries.

Furthermore according to **Silke** the result of the application of s 7(5) is, that the income retained in the trust cannot be taxed in the hands of the beneficiaries and tax will be levied upon the person who made the donation to the trust.

Each donor according to **Silke** will be taxed as follows:

- on the income retained in the trust;
- attributable to the donation, made by that donor.

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<sup>89</sup>O'Dougherty K: Measuring the income subject to S 7(5) Possible apportionment methods (1996) 10 Tax Planning 98-102

The general aim of section 7 (5) is to prevent the avoidance of tax liability where and so long as the donor does not permit the beneficiary of the gift to enjoy immediately the income derived therefrom by deeming the income in question to be that of the donor.

Prior to the decision in *Estate Dempers v SIR*<sup>90</sup> there had been uncertainty as to the proper construction of s 7(5). In *Estate Dempers v SIR*<sup>91</sup> the facts briefly were that the trust deed, averring that the donor out of love and affection for the donee (his grandchild) desired to make provision for him, settled a sum of money upon trustees and directed—

- (1) In clause 17 that:
  - (i) until the donor's death the annual income may be used by the trustees in their discretion in making charitable donations and/or for the benefit of the donee and/or his issue, any income not paid out during the year to become and form part of the capital of the trust;
  - (ii) after the donor's death, the annual income was to be used by the trustees in their discretion for the benefit of the donee and the balance of the income (if any) was to accumulate in the trust.

In the 1973 tax year (i) and (ii) were substituted by a clause which provided that the annual income may be used by the trustees for the benefit of the donee and/or issue.

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<sup>90</sup>1977 (3) SA 410 (A)

<sup>91</sup>Supra fn 89

(2) In Clause 18 that:

when the donee attained the age of 25, one-third of the total trust fund was to be paid to the donee; when he attained the age of 30 half of the remainder was to be paid to him, and when he attained the age of 35, the balance of the trust fund was to be paid to him. Should the donee die before all of the trust fund had been paid to him, his issue (or failing issue other beneficiaries) were substituted for the donee in respect of what remained. "Trust Fund" was defined in the trust deed as including accumulations of income.

The Commissioner taxed the donor for each of the years (from 1970-1973) on the income which had not been paid out by the trustees during that year, and his assessment was upheld by the Appellate Division. Corbett JA (Wessels JA, Trollip JA, Miller JA and Galgut AJA concurring) held that:

1. In regard to (a), **{ (a) being the exercise of a trustee's discretion was not an 'event' falling within the scope of the section and because the trustee could pay out the income there was no stipulation that the donee should not receive the income until the happening of an event }**, without deciding whether the exercise of a trustee's discretion was or was not an 'event', the provision that the capital plus accumulated income was to be paid to the donee when he attained the respective ages of 25, 30 and 35 years constituted a stipulation that the income was not to be received until the happening of the events.
2. In regard to (b), **{(b) being, the donee did not have a vested right to the income and therefore it could not be said that, but for the stipulation (if there was one), the**

income would have accrued to or been received by the donee}, that but for the stipulation the income would have been received by or accrued to the beneficiaries, it was held that a vested right *sine qua non* , although the beneficiaries have vested rights this would be a strong, possibly decisive factor, leading to the conclusion that, but for the stipulation withholding the income , would have been received by them. The courts view with reference to a 'fixed' or 'contingent' event indicated that the case of a beneficiary who in terms of the stipulation has only a contingent right to income falls within the intended scope of section 7(5). The court summed up the above as follows:

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

3. Having regard to these aspects of the case, it was clear that the donee was dominantly the object of the donor's bounty and that, consequently but for the stipulation, the income

would have accrued to or have been received by the donee.<sup>92</sup>

The judgment in *Estate Dempers v SIR* makes it clear that where income is deemed to be the donor's under section 7(5) its subsequent distribution to the beneficiaries does not attract tax in their hands, because once the income has been deemed to be the donor's it is so deemed for all time and there is no room for any finding that subsequently accrued to the beneficiaries as income.

This section is applicable to income generated from discretionary trusts arising from a "donation, settlement or other disposition" and not distributed to the beneficiaries during the tax year it is earned. It does not matter that the beneficiary is a major. The income is deemed to be the donor's income for tax purposes, he being alive, because it is retained in the discretionary trust.

If the income is distributed to the beneficiaries, however, it will be taxed in their hands, not the donor's. This section does not affect income which arises otherwise than by donation or settlement (example income on assets purchased at fair market value). In such case the trust pays the tax like a single taxpayer on income received by them during the year; This deemed accrual also does not apply after the donor's death - the trust itself is then taxed on income not distributed beneficiaries during the year, and the beneficiaries are taxed on the income distributed. Thus the same treatment applies as in the case of a testamentary trust<sup>93</sup>, i.e undistributed income - the beneficiary is taxed.

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<sup>92</sup>Emslie TS, Davis DM, Hutton SJ, Olivier L: *Income Tax, Cases and Materials*, Taxpayer 3<sup>rd</sup> edition 2001, the above was summarised by these four writers.

<sup>93</sup> Examples of written advice on the creation of separate testamentary trusts are Silke AS *Tax Avoidance and Reduction* at 149: "If a testator desires to create a trust for the benefit of his children, he may be saving much tax for his family on his death by the creation of a number of distinct and separate trusts in his will. For example, he bequeath a sum in trust for his four children, the income to be accumulated after his death and to be paid out together with the capital to his children on the happening of specified events. If the beneficiaries have a community of interest in the trust estate and it is clear that a separate and distinct trust has not been created for each child, the trustee is assessable on the whole of the income. On the other hand, where it is clear from the terms of the will that the testator has created a distinct and separate trust in respect of each child, it is not competent for the Commissioner to make an assessment upon the trustees as a single taxpayer since the incomes distinct and separate trusts cannot be amalgamated even where the same person is trustee of the different trusts. Testators would therefore, be well advised to draw up their wills in such a way that a

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

Where there are a number of donors, some of whom are alive, and others already dead, there will be different tax implications ( i.e the trust will be taxed on the retained income arising from the assets given by the deceased donors, while the surviving donors will pay tax on the retained income attributable to their donations).

According to **Meyerowitz** the current position under section 7(5) may be summarised as follows:

(a) Where a trust deed provides that the income or any portion thereof which is not paid out in the year of receipt or accrual (either because the deed prevents this or leaves it to the trustee's discretion) shall be accumulated until the happening of some fixed or contingent event, there is a stipulation which falls within the scope of section 7(5), namely that the accumulated income shall not be received by the beneficiaries until the happening of the stipulated fixed or contingent event.

(b) Where such a stipulation exists, section 7(5) deems the accumulated income to be the donor's if, in the absence of the stipulation, 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 the relevant circumstances, it can be predicted that the accumulated income would have accrued to or have been received by the beneficiaries (or some of them). If ITC 1328 be rightly decided, section 7(5) will not apply where the beneficiary has a vested right to

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distinct and separate trust is created in respect of each beneficiary. This may be achieved by dividing the amount to be settled on the trustees into specific portions, each will create distinct trusts in favour of the testator's children. The above arrangements make it possible for income to be split by the creation of a number of trusts for the purpose of gaining the advantage of a series of tax-free margins. To counter the abuse resulting from the creation of a number of trusts by one person, the Committee of Enquiry into the Income Tax Act recommended that where more than one trust is created, substantially all the assets of which are received from one person, class or group of persons, the income falling to be taxed in the hands of the trustee should be taxed as one trust in the hands of such one of the trustees as the Commissioner may determine. A provision along these lines should effectively counter any abuse resulting from the creation of a number of trusts.

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

the income in the sense that his right to the income in certain albeit that the enjoyment thereof is postponed; in such case the income is deemed to be the beneficiary's in terms of section 7(1).

(c) Current income which is paid out during the year of assessment by the trustee in the exercise of his discretion is not deemed to be the donor's income under section 7(5).

(d) Income which is deemed to be the donor's, does not constitute income in the hands of the beneficiaries when subsequently paid out to them, whether as capital or accumulated income.

### **7.1.6 Section 7(6)**

'If any deed of donation, settlement or other disposition contains any stipulation that the right to receive any income thereby conferred may, under powers retained by the person by whom that right is conferred, be revoked or conferred upon another, so much of any income as in consequence of the donation, settlement or other disposition is received by or accrues to or in favour of the person on whom that right is conferred, shall be deemed to be income of the person by whom it is conferred, so long as he retains those powers.'

This section is particularly relevant to trusts and provides that where a "donation, settlement or other disposition" is made whereby the donor retains the right to vary or revoke the benefits / beneficiaries, then any income arising from the donation is deemed to be the donor's. This section applies regardless of whether the income has been distributed to the beneficiary or not, and

regardless of the ages of beneficiaries. Where the donor in conjunction with the remaining trustees duly exercise such discretion under the constraints of a trust deed, as opposed to the donor having the right to act unilaterally, this section is not likely to apply. The purpose of the section is to prevent the donor from unilaterally deciding on an annual basis in whose hands income is to be taxed. The estate duty implications of the planner holding unilateral rights of revocation are more severe, in that in terms of s 3 (3) (d) Estate Duty Act the planner's objective of pegging the growth of the assets by means of the trust would in all likelihood not be recognised for estate duty purposes.

#### **7.1.7 Section 7(7)**

'If by reason of any donation, settlement or other disposition made, whether before or after the commencement of this Act, by any person (herein after referred to as the donor)-

- (a) the donor's right to receive or have paid to him or for his benefit any amount by way of rent, dividend, interest, royalty or similar income in respect of any movable or immovable property (including without limiting the foregoing any lease, company share, marketable security, deposit, loan, copyright, design or trade mark) or in respect of the use of, or the granting of permission to use, such property, is ceded or otherwise made over to any other person or to a third party for that other person's benefit in such manner that the donor remains the owner of or retains an interest in the said property or if the said property or interest is transferred, delivered or made over to the said other person or to a third party for the said other person's benefit, in such manner that the donor is or will be at a

fixed or determinable time entitled to regain ownership of or the interest in the said property; or

- (b) the donor's right to receive or have paid to him or for his benefit any income that is or may become due to him by any other person acting in a fiduciary capacity is ceded or otherwise made over to any other person or third party for that other person's benefit in such manner that the donor is or will at a determinable time be entitled to regain the said right,

any such rent, dividend, interest, royalty or income (including any amount which, but for this subsection, would have been exempt from tax in the hands of the said other person) as is received by or accrues to or for the benefit of the said other person on or after 1 July 1983 and which would otherwise, but for the said donation, settlement or other disposition, have been received by or have accrued to or for the benefit of the donor, shall be deemed to have been received by or to have accrued to the donor.'

This section deals with the situation where a taxpayer by way of "donation, settlement or other disposition" cedes his rights to income from property while retaining ownership thereof ( or if not retaining ownership, having the right to reclaim ownership of the property). It provides that the income nevertheless deemed to be the cedent's. Previously this was a method of reducing tax, especially where the taxpayer was subject to a high marginal rate of tax which he could conveniently reduce by a simple cession of income. This section requires the same element of a "gratuitous disposal".

**7.1.8 Section 7(8)**

‘Whereby reason of or in consequence of any donation, settlement or other disposition (other than a donation, settlement or other disposition to an entity which is not a resident and which is similar to a public benefit organisation contemplated in section 30) made by any resident, income is received by or accrued to any person who is not a resident (other than a controlled foreign company in relation to such resident), there shall be included in the income of that resident so much of the amount of any income as is attributable to that donation, settlement or other disposition: Provided that any amount of income received by or accrued to that 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 that person had been a shareholder who is resident.’

**7.1.9 Section 7(9)**

‘Where any asset has been disposed of for a consideration which is less than the market value of such asset, the amount by which such market value exceeds such consideration shall for the purposes of this section be deemed to be a donation.’

**7.1.10 Section 7(10)**

‘Any resident who, at the time during any year of assessment makes a donation, settlement or other disposition as contemplated in this section, shall disclose such fact to the Commissioner in writing when submitting his return of income for such year and at the

same time furnish such information as may be required by the Commissioner for the purpose of this section.

## **7.2 Summary : Section 7**

Trust income under *inter vivos* is taxable in the hands of a trust beneficiary when:

(i) such income is actually distributed to the beneficiary in the year of assessment, often by virtue of a vested right to such income held by the beneficiary (s 25B (1)), unless

- the beneficiary is a spouse of a donor to the trust, in which case s 7 (2) may render the income taxable in the hands of the donor's spouse; or
- the beneficiary is a minor, in which case s 7 (3) and (4) may render the income taxable in the hands of a parent of the beneficiary; or
- section 7 (6) or (7) applies, in which case the income may be render taxable in the hands of the donor to the trust; or
- the beneficiary is a non-resident, in which case s 7 (8) may render the income taxable in the hands of the resident donor.<sup>94</sup>

(ii) the beneficiary enjoys a vested right to such income, whether or not distribution is effected to the beneficiary in the year of assessment (s 25B (1)), unless

- the beneficiary is a spouse of a donor to the trust in s 7 (2) applies; or

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<sup>94</sup>Du Toit F *South African Trust Law: Principles and Practice* 2002 Butterworths page 139

## THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA

- the beneficiary is a minor and s 7 (3) or (4) applies; or
- s 7 (6) or (7) applies; or
- income is retained in the trust until the happening of some event, in which case s 7 (5) renders the income taxable in the hands of a donor of a trust; or
- section 7 (8) applies.

(iii) such income is actually distributed to the beneficiary in the year of assessment or the beneficiary enjoys a vested right to such income and the donor to a trust in whose hands such income would have been taxable in terms of section 7, has died, unless

- section 7 (4) applies.<sup>95</sup>

Trust income under an *inter vivos* trust is taxable in the hands of a trust's founder (as donor of the trust) or other donor to the trust when (and were appropriate) section 7 (2) to (8) applies.

Trust income under an *inter vivos* trust is taxable in the hands of either the trust's beneficiaries, the trust's founder or other donor to the trust is taxable in the hands of the trust and hence its trustees as representative taxpayers (s 25B (1)).<sup>96</sup>

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<sup>95</sup> Supra fn 94

<sup>96</sup> Supra fn 95

**8. COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE v WOULDIDGE 2000(1)SA  
600C**

This Chapter will discuss the decision in the case of Wouldidge based upon the article by **C West** and **P Surtees**.<sup>97</sup>

**8.1 The facts of the case in brief**

Wouldidge( herein after referred to as the taxpayer) had set up two trusts ( one for each of his children). The minor children of the taxpayer were beneficiaries of certain trusts. The taxpayer sold shares to each of these trusts for R 336 057, which was found to represent their market value. The purchase price was left on a loan account. The shares in four companies were sold to these trusts for full consideration on the loan account. The deed of sale provided for interest to be charged on the loan account at the discretion of the taxpayer. The taxpayer never charged the trust any interest. In terms of the sale agreement, the seller (the taxpayer) could, if he so chose, charge interest on the loan capital that did not exceed the bank prime rate. In the years of assessment under consideration, and in the preceding years of assessment, no interest was charged on the outstanding amount of the loan. The terms of repayment of capital sum were not fixed.

Six years after the trust purchased the shares from the taxpayer, they sold some of the shares to a third party — after a company, that was not a connected person to the taxpayer or his children, had become interested in the four companies held by the trusts, restructuring took place. The new

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<sup>97</sup>West C, Surtees P 'The Court Decision in the Case of Wouldidge- A Practical Application' Meditar, Accounting Vol 10 2002 pages 259- 294

group structure comprised a holding company that was installed between the holdings in the four companies and the trusts. Each trust sold 50% of its holdings to the company for a sum which each trust used to repay the outstanding loan that was owing to the taxpayer and to make loans and other investments. Income accrued as a result of these investment and the loan made by the trusts; some of the income was distributed to the beneficiaries of the trusts (the taxpayer's children). The Commissioner sought to attribute the income from these investments.

## **8.2 The Taxpayers arguments**

The taxpayer contended that the income should only be attributed to him to the extent that the interest was not charged on the outstanding balance of the loans to the trusts. He further more contended that it should be limited top the capital amount of the loans in terms of the *in duplum* rule, thereby conceding that the interest not charged fell within the provisions of section 7(3). The fact that the sale had taken place had full consideration was not disputed in the lower courts and, as such, and was not considered by the Supreme Court of Appeal.

The Commissioner sought to argue that the entire scheme contained an appreciable element of gratuitousness and, as such, all the income was by reason of the sale of shares by the taxpayer and that it should be taxed in his hands. Alternatively, it was submitted by the Commissioner that the taxpayer had not discharged the *onus* of apportioning the elements of gratuitousness and full consideration.<sup>98</sup>

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<sup>98</sup>Supra fn 97

### **8.3 The Decision**

The court did not address the issue regarding whether the entire scheme represents a sham or a simulation, because this argument had not been addressed previously and, in the interest of fairness, could not be raised in the Supreme Court of Appeal.

The Commissioner had previously attempted to treat the sale of the shares for full consideration as the causal link to the income and, as a result thereof to subject the taxpayer to tax on that income. However, Davis J in the judgment of the Cape High Court stated:

‘The transactions in question constituted an element of an estate planning exercise similar in nature to those featured in *Joss and Ovenstone (supra)*. In both cases, the courts had no difficulty in clarifying such a transaction as a genuine sale, a conclusion which is reported accurately in appellant’s *Income Tax Practice Manual* at A - 166(1). In both *Joss and Ovenstone (supra)* the court accepted a doctrine of apportionment based on a distinction between two separate transactions, namely the disposition of shares at a fair value and a loan which is interest free.’

The Supreme Court of Appeal held that the taxpayer had discharged the onus of demonstrating apportionment between the elements of gratuitousness and consideration. Moreover, the degree of gratuity was limited to the forfeited interests and the sale of full consideration, and the subsequent repayment by the trust did not contain an appreciable element of gratuitousness.

As a result of the appreciable element of gratuitousness, it was held by the Supreme Court of Appeal that the *in duplum* rule could not be applied, because its applicability was limited to real-

world commercial and economic transactions, which the forfeited interests was not.<sup>99</sup>

#### **8.4 The Implications**

The case of *Commissioner for the South African Revenue Service v Woulidge 2000(1)SA 600C, 63 SATC 483* was employed to establish the practical method to limit the application of section 7(3) of the Income Tax Act and submitted section 7(5) to the extent of the gratuitous element of the disposition. To do this the provisions of sections 7(3) and 7(5) as well as paragraphs 69 and 70 of the Eighth Schedule to the Act are examined and applied to example below. These were the assumptions made by **West** and **Surtees** in order to formulate practical applications.

The implications are drawn from the assumptions that have been made on precepts accepted from the judgments in *Joss v Secretary for Inland Revenue* and *Ovenstone v Secretary for Inland Revenue*. The assumptions and precepts made by **C West** and **P Surtees** are pivotal to the scenarios contained in the example discussed below.

- (a) It is only the gratuitous element of the donation, settlement or other disposition that are included in the scope of the relevant paragraphs of section 7 (and paragraphs 69 and 70 of the Eighth Schedule<sup>100</sup>);

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<sup>99</sup>Supra fn 97

<sup>100</sup>Paragraph 69 provides the following: ' where a minor child's capital gain or a capital gain that has vested in or is treated as having vested in or that has been used for that benefit of that child during the year of assessment in which arose can be attributed wholly or partly to any donation, settlement or other disposition.-

- made by a parent of that child; or
- made by another person in return for any donation, settlement or other disposition or some other consideration made or given by a parent of the child in favour directly or indirectly of that person or his or her family,

- (b) The income that accrues by reason of the disposition ( that is, a causal link must exist) should be apportioned between the gratuitous and the non-gratuitous elements (if the apportionment can be proved by the taxpayer in terms of the onus placed upon the taxpayer by the provisions of section 82 as is shown in Joss (SATC 1979: 215))<sup>101</sup>.

Where section 82 provides the following: 'the burden of proof that any amount is—

- (a) Exempt from or not liable to any tax chargeable under this Act; or
- (b) subject to any deduction, abatement or a set-off in terms of this Act; or
- (c) to be disregarded or excluded in terms of the Eighth Schedule,

shall be upon the person claiming such exemption, non-liability, deduction, abatement, or set-off, or such amount must be disregarded or excluded, and upon the hearing of any appeal from any decision of the Commissioner, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong'

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so much of that gain as can be so attributed must be disregarded when determining that child's aggregate capital gain or aggregate capital loss and must be taken into account in determining the aggregate capital gain or aggregate capital loss of that parent.'

Paragraph 70 'where -

- a person has made a donation, settlement or other disposition that subject to a stipulation or condition imposed by that person or anyone else in terms of which a capital gain or a portion of any capital gain attributable to that donation, settlement or other disposition shall not vest in the beneficiaries of that donation, settlement or other disposition or some of those beneficiaries until the happening of some fixed or contingent event;
- a capital gain that is attributable to that donation, settlement or other disposition has arisen during a year of assessment throughout which the person who made that donation, settlement or other disposition has been a resident; and
- the capital gain or a portion thereof has not been vested during that year in any beneficiary who is a resident,

that capital gain or that portion thereof must be taken into account in determining that aggregate capital gain or aggregate capital loss of the person who made that donation, settlement, other disposition and disregarded when determining the aggregate capital gain or aggregate capital loss of any other person.'

<sup>101</sup> Supra fn 97

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

The principle established in *Woulidge* according to **West and Surtees** is that the extent to which the income received by the minor is to be taxed in the parents hands is limited to the gratuitous portion of the disposition. It is therefore necessary for the taxpayer to prove the apportionment is appropriate, provided evidence on the how to apportion the disposition into gratuitous and full-consideration elements and also to prove the extent to which the income for the purposes of section 7(3) is to be limited.

**West and Surtees** further submitted that the above principle is applicable to section 7(5) as well, to the extent to which income is deemed to have accrued to the donor, and it depends on the extent of the gratuitous element of the disposition, applied to the income retained and not distributed to any beneficiary, based on a condition or stipulation in the trust.

According to **West and Surtees** the principle appears to be simple but the ramifications of its practical applications are vast and complex. The limit applied to *Woulidge* was the extent of the interest forfeited on the loan.

**West and Surtees** constructed the following example to illustrate the practical application of the principles established by *Woulidge* which is briefly discussed supra.

### **8.4.1 Example**

The following scenario has been considered in this example:

- there is only one beneficiary (a minor child, L.

The following facts are applicable to the scenario above:

P (the parent) sells a domestic interest-bearing investment on 1 March 2002 at the

**THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

prevailing market value of R 5 000 000 to a trust that is created for the benefit of his determined beneficiaries by way of an interest-free loan. On the date of sale of the investment, the base cost equaled the proceeds and as a result there is no capital gains tax effect. The investment has an average return of 20 per cent per annum and a market related interest rate on the loan account ( should interest be charged ) would amount to an average of 18 per cent per annum. No amount distributed, is considered to be an annuity. The distribution from the trust represents L's only income. It is assumed for the example that P has used all applicable exemptions provided for in the Act before the inclusions in terms of section 7 and is taxed at the highest marginal rate of 40%. For comparative purposes, the rebate granted in terms of section 6 of the Act is ignored.

Should P never have sold the interest bearing investment, the following would have occurred:

Addition to P's taxable income ( R 5 000 000 x 20 %)	R 1 000 000
Tax on interest-bearing investment return	R 400 000

It is submitted that the effect of limiting the application of section 7(3) to the extent of the disposition would have the following effects:

Market -related interest on loan capital balance and therefore the limit for distributions and retentions( R 5 000 000 x 18%)	R 900 000
Tax payable by P on inclusion of section 7(3) amount (R 900 000 x 40%)	R 360 000
Tax payable by L on taxable income[ {(R 100 000 -R 6 000)- R 80 000} x 30% + R 17 200]	R 21 400
	<u>R 381 400</u>
Resultant tax saving after the application of Wouledge (R1 000 000 x 40 % - R 381 400 )	R 18 600

Note:

1. The difference between actual investment income and the determined limit represents L's gross income, that is  $R\ 1\ 000\ 000 - R\ 900\ 000 = R\ 100\ 000$ .
  
2. The R 6 000 applied in this instant is the interest exemption in terms of the provisions of section 10 (1)(i) for the natural person under the age of 65 as announced by the Minister of Finance in the Budget presented to Parliament on 20 February 2002.
  
3. While the maximum marginal rate has been applied to the amounts attributed to P, the child's tax has been based on the tax rate tables for 2003 tax year of assessment and is the amount before any rebate is taken into account.<sup>102</sup>

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<sup>102</sup>Supra fn 97

## 9. CONCLUSION

The fact that Trust and Tax Law are some of the most complicated areas of law it is evident from the many unanswered questions which remain in respect of the tax treatment of income and expenditure of trusts. The legislator's attempts to impose harsher measures on trusts can be understood given several income tax benefits flowed from the fact that, legally, trusts assets does not form part of the estate of the founder or the beneficiaries. These measures are only applicable in so far as they amended existing trust law.

In the absence of specific legislation, the basic trust principles are still applicable. Trust taxation works on the basis any income earned which is not paid over to the trust beneficiary in the year it is earned, is taxed in the trust at individual tax rates but without the benefit of any rebates (effective from 1992 tax year the single primary rebate was withdrawn). On the other hand income paid to a trust beneficiary in the year that it is earned retains its original identity. Income previously taxed in a trust and which is subsequently paid to a trust beneficiary, is not subject to taxation. The above tax aspects are referred to as the 'conduit principle'.

In the case of trusts there are three possible taxpayers, namely the trust, the beneficiary or the donor. The general rules applicable to these taxpayers are however importantly affected by section 7 of the Income Tax Act. Section 25B now regulates the taxation of trust income and beneficiaries with effect from 1987 year of assessment. Section 25B was subsequently amended by the 1998 Taxation Laws Amendment Act with three new subsections namely section 25B (4) was inserted. It provided that deductions and allowances (expenditure) which are deemed to be deductions and allowances(expenditure) of the beneficiary in terms of section 25B (3), be limited

## **THE TAXATION OF TRUST INCOME AND EXPENDITURE IN SOUTH AFRICA**

to income of the beneficiary derived from the trust in the year of assessment. Where the aggregate of the deductions and allowances exceed the income of the beneficiary, section

25B (5) provides that the excess may be set-off against the taxable income of the trust during the relevant year of assessment, provided the excess does not exceed the taxable income of the trust as calculated before allowing the above mentioned set-off.

Finally, section 25B (6) specifies that where the aggregate of the deductions and allowances contemplated in section 25B (4) exceeds both the income contemplated in section 25B (4) of the beneficiary and the taxable income of the trust contemplated in section 25B (5), this excess may be set-off against the income of the beneficiary which is derived from the trust in the immediately succeeding year of trust assessment.

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