

IN THE TAX COURT
(PORT ELIZABETH)

Case No: 12246

In the matter between:

THE VII MS
TRUST
and

APPELLANT

THE COMMISSIONER FOR THE SOUTH AFRICAN
REVENUE SERVICES

RESPONDENT

JUDGEMENT

DAMBUZA J :

1. The appellant appeals against a re-assessment by the respondent of income tax payable by the Trustees of the appellant for the years 2001, 2002, 2003, 2004 and 2005.
2. The appellant is a Trust, established on 27 January 1994 in terms of the provisions of the **Trust Property Control Act No 57 of 1988**, with its principal place of business at **Port Elizabeth**. It was formed for the purpose of preserving, maintaining and enhancing the Trust Fund and investing in immovable properties for the benefit of its beneficiaries. Its beneficiaries, in equal shares, are; **The NB Family Trust, The EB Family Trust and The PJ Family Trust**.
3. In terms of the provisions of the Trust Deed, the beneficiaries are entitled to benefit from the income and capital of the Trust Fund according to their beneficial interests. Prior to 2006, **Clause 6 of the appellant's Trust Deed** provided that:

2.

“APPLICATION OF NET INCOME:

Until the termination of the Trust as herein provided, the Trustees shall distribute all the net income in each financial year to the beneficiaries.”

“Net income” is defined in the Trust Deed as the “income of the investment of the Trust Fund, after payment of all expenses lawfully incurred by the trustees in the performance of their duties hereunder and includes payment of the taxes.”

It is common cause that the trustees of the appellant distributed the income received by the appellant in each of the years in question to the beneficiaries without paying income tax thereon. The beneficiaries then paid income tax on the income they so received.

4. In April 2006, the appellant advised the respondent that its Trust Deed had been amended, retrospectively, to the formation of the Trust as follows:

“Until termination of the Trust as provided for herein, the Trustees shall have a discretion to to distribute the net income in each financial year to the beneficiaries; notwithstanding the definition of net income in clause 4.6 hereof, the Trustees shall have a discretion to distribute the income before payment of taxes or after payment of taxes as the Trustees may, in their sole and absolute discretion provide.”

5. In May 2006, the respondent, acting in terms of Section 79 of the Income Tax Act No 58 of 1962 (the Act), issued additional assessment in respect of income tax payable on income received during the years 2001 to 2005. The re-assessment was as follows:

2001	R395 342
2002	R200 586
2003	R219 205
2004	R745 758
2005	R162 459

The Basis of the re-assessment was that the income which had been distributed to the beneficiaries had accrued to the appellant (or the Trust) and was taxable in the hands of the Trust.

The respondent further levied 100% additional (penalty) tax in terms of Section 76 of the Act for what it considered to be returns submitted in contravention of Section 74 of the Act.

6. At the hearing it was submitted on behalf of the appellant, and the respondent conceded, correctly in my view, that the claims in respect of the assessments for 2001 and 2002¹ could not stand.
7. The respondent also conceded that the additional tax and penalties levied in terms of Section 76 of the Act should fall away as there was no evidence of fraud on the part of the appellant in the statements of income filled with the respondent.²
8. The appellant abandoned its reliance on the purported amendment of the Trust Deed. **Mr Beyleveld** who appeared for the appellant conceded, that the purported amendment could not have a retrospective effect as against the respondent or alter the legal incidence of tax liability in respect of the income in question. Indeed, the incidence of liability for payment of income tax could not be altered or determined by an amendment of the Trust Deed as the trustees sought to do. Income tax is a creature of the Act.

¹In terms of the proviso to section 79(1) of the Act, the commissioner shall not raise an assessment under subsection 79 (1) after the expiration of three years from the date of the assessment (if any) in terms of which any amount which should have been assessed to tax under such assessment was not so assessed or in terms of which the amount of tax assessed was less than the amount of such tax which was properly chargeable....In this case, the additional assessments in respect of the income in question were levelled in 2005.

²Section 76(1) of the Act provides that:

76. **Additional tax in the event of default or omission.** –(1) A taxpayer shall be required to pay in addition to the tax chargeable in respect of his taxable income-
- (a) if he makes default in rendering a return in respect of any year of assessment, an amount equal to twice the tax chargeable in respect of his taxable income for that year of assessment; or
 - (b) if he omits from his return any amount which ought to have been included therein, an amount equal twice the difference between the tax as calculated in respect of the taxable income returned by him and the tax properly chargeable in respect of his taxable income as determined after including the amount omitted;

Section 25 B of the Act provides that:

“25 B. Income of trust and beneficiaries of trust-

- (1) Any amount received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall subject to the provisions of section 7, to the extent to which such amount has been derived for the immediate or future benefit of an ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.³
- (2) Where a beneficiary has acquired a vested right to any amount referred to in subsection (1) in consequence of the exercise by the trustee of a discretion vested in him or her in terms of the relevant deed of trust, agreement or will of a deceased person, that amount shall for the purposes of that subsection be deemed to have been derived for the benefit of that beneficiary.”
9. It was common cause during argument that the amount (or income) in question had been derived for the benefit of the beneficiaries. The appellant contended that in terms of **Section 25 B of the Act**, the income in question was never taxable in the hands of the appellant and the Trustees incurred no income tax liability in respect thereof. **Clause 6** of the Deed of Trust, so the argument on behalf of the appellants went, imposed an obligation on the trustees to distribute, in each financial year, all the net income received by the trust to the beneficiaries; thus creating a vested right in favour of the beneficiaries to the income received in a particular year and triggering the deeming provisions of **Section 25 (B)(1) and (2) of the Act**.
10. The respondent, whilst accepting that the income in question was received by the trustees

(c) if he makes an incorrect statement in any return rendered by him which results or would if accepted result in the assessment of the normal tax at an amount which is less than the tax properly chargeable, an amount equal to twice the difference between the tax as assessed in accordance with the return made by him and the tax which would have been properly chargeable.

³Section 7 mainly deals with when it is that income is deemed to have accrued to a person; for example, in terms of section 7 (1) income shall be deemed to have accrued to a person notwithstanding that such income has been invested, accumulated or otherwise capitalized or has not been actually paid to him but remains due and payable to him....(This section is not relevant *in casu*).

for the benefit of the beneficiaries, contended that the beneficiaries **had not, during the relevant periods, acquired a vested right thereto**. This is because, so it was submitted, the appellant is a discretionary Trust and the income would only vest in the beneficiaries once the trustees exercised their discretion in favour of awarding the income to the beneficiaries. **Ms Thlakung** who appeared on behalf of the respondent, submitted further that **Clause 6 of the Trust Deed**, in terms of which the Trustees purported to distribute the income in question to the beneficiaries, was subject to Appendix three to the Trust deed, in terms of which the Trustees are empowered, amongst others, to deal with the income in question or assets of the Trust, as they deemed to be in the best interests of the Trust or as they would with their own assets. Consequently, so the argument went, the beneficiaries did not have a vested right to the income which the trustees, from time to time received as it was submitted on behalf of the trustees.

11. Whilst there is nothing wrong with the first submission insofar as it relates to the so-called discretionary trusts in general, both submissions made on behalf of the respondent, do not, in my view, take the matter any further. Even if I accept that the trust in question is a Discretionary Trust and that the amounts in question would only vest on the beneficiaries once the trustees exercised their discretion in favour of the beneficiaries, the fact is that in this matter the trustees did in fact exercise their discretion in favour of the beneficiaries. Once they did so, the beneficiaries acquired a vested right to the income. Unless **Section 7** intervenes, income discretionarily awarded to a beneficiary by a trustee will be treated as that beneficiary's income. See section 25 B of the Act.⁴
12. Whilst the definition of "income tax" in clause 4.6 of the Trust Deed refers to expenses as including "taxes", such taxes can only encompass income tax on income which is deemed to accrue to the Trust in terms of Section 25B. Just as the amendment to the Trust Deed could not alter the incidence of liability for payment of income tax, the definition of "net income" in the Trust Deed can also not alter that incidence. As Mr Beyleveld submitted on behalf of the appellant, income tax is regulated by the Act. "Income tax is a levy on the income of a person....whatever policy the Legislature may have pursued in imposing the tax, it is the statute alone that must be consulted in order to ascertain the tax position of person".⁵ It is in this context

⁴ See also: Silke on South African Income Tax, Volume 2 at 12-25.

⁵ Silke, op cit at 1-1, para 1.2

6.

that is deemed to be income of a beneficiary and that which is deemed to have accrued to the Trust.

13. I am satisfied that the amounts in question accrued to the beneficiaries and that the beneficiaries had a vested right thereto. Such income could therefore not be taxable in the hands of the appellant.

Consequently the appeal succeeds and:

1. The additional assessment by the respondent of income payable by the appellant or its trustees in respect of the years 2001, 2002, 2003, 2004 and 2005 is hereby set aside; and
2. The costs of this appeal are awarded in favour of the appellant.

N DAMBUZA
JUDGE OF THE HIGH COURT

Appellant's Counsel:

Mr Beyleveld

Respondent's Counsel:

Ms Thlakung