



Guide to the Taxation of Special Trusts **(Issue 3)**

Income Tax



South African Revenue Service

Guide to the Taxation of Special Trusts

Preface

The purpose of this guide is to assist users in gaining a more in-depth understanding of the taxation of special trusts.

This guide is not an “official publication” as defined in section 1 of the Tax Administration Act 28 of 2011 and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 89 of Chapter 7 of the Tax Administration Act. Should an advance tax ruling be required, visit the **SARS website** for details of the application procedure.

This guide reflects the income tax and tax administration legislation (as amended) at the time of publishing and includes the following amending acts which were promulgated on 15 January 2020:

- The Taxation Laws Amendment Act 34 of 2019 (as per *Government Gazette* 42951).
- The Tax Administration Laws Amendment Act 33 of 2019 (as per *Government Gazette* 42952).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 32 of 2019 (as per *Government Gazette* 42950).

All guides, interpretation notes, binding general rulings, forms and tables referred to in this guide are available on the **SARS website**. Unless indicated otherwise, the latest issue of these documents should be consulted.

Should you require additional information concerning any aspect of taxation, you may –

- visit the SARS website at **www.sars.gov.za**;
- visit your nearest SARS branch;
- contact your own tax advisor or tax practitioner;
- contact the SARS National Contact Centre –
 - if calling locally, on 0800 00 7277; or
 - if calling from abroad, on +27 11 602 2093 (only between 8am and 4pm South African time).

Comments on this guide may be emailed to **policycomments@sars.gov.za**.

Prepared by

Leveraged Legal Products

SOUTH AFRICAN REVENUE SERVICE

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Glossary

In this guide unless the context indicates otherwise –

- “**CGT**” means capital gains tax, being the portion of normal tax attributable to the inclusion in taxable income of a taxable capital gain;
- “**income tax**” means the normal tax on income;
- “**paragraph**” means a paragraph of the Eighth Schedule;
- “**Schedule**” means a Schedule to the Act;
- “**section**” means a section of the Act;
- “**special trust**” means a trust referred to in section 1(1) or paragraph 1;
- “**the Act**” means the Income Tax Act 58 of 1962;
- “**Trust Property Control Act**” means the Trust Property Control Act 57 of 1988;
- “**type-A trust**” means a special trust referred to in paragraph (a) of the definition of “special trust” in section 1(1) and paragraph 1;¹
- “**type-B trust**” means a special trust referred to in paragraph (b) of the definition of “special trust” in section 1(1);²
- “**VAT**” means value-added tax imposed under the VAT Act;
- “**VAT Act**” means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This guide has been prepared to assist those involved with special trusts to gain an understanding of the provisions of the Act relating to such special trusts, with particular reference to the income tax and CGT provisions. A brief summary of other taxes relating to special trusts has also been included. This guide focusses mainly on the tax implications for a special trust and not on the tax implications for its beneficiaries.

2. Background

Unlike conventional trusts which are taxed at a flat rate of tax, a special trust is taxed on the same sliding scale applicable to natural persons.

The Act makes provision for two types of special trust in section 1(1) which will be referred to as type-A and type-B trusts. In essence a type-A trust is created for a person or persons having a disability while a type-B trust is created on the death of the testator and can subsist only while it has a minor as a beneficiary.

The distinction between a type-A trust and a type-B trust is important because a type-A trust qualifies for specific relief from CGT which is not granted to a type-B trust. The definition of “special trust” in paragraph 1 applies for CGT purposes only (see 6.4).

¹ See 3.6 and 4.3.

² See 3.6 and 4.4.

3. Trusts under South African law

3.1 Types of trust

3.1.1 Ownership and *bewind* trusts

Under South African common law there are two types of trust:

- An “ownership trust”, under which the founder or settlor transfers ownership of assets or property to trustees to be held for the benefit of defined or determinable beneficiaries of the trust.
- A “*bewind* trust”, under which the founder or settlor transfers ownership of assets or property to beneficiaries of the trust, but control over the property is given to the trustees.

3.1.2 Curatorship trust

A “curatorship trust” is one in which the trustees administer the trust assets for the benefit of a beneficiary that lacks the capacity to do so, for example, a curator placed in charge of a person with a disability.³

3.2 Trust Property Control Act

The Trust Property Control Act defines “trust” in section 1 of that Act as follows:

“ **[T]rust**’ means 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, 1965 (Act No. 66 of 1965);”

The above definition therefore includes an ownership trust and a *bewind* trust.

3.3 Master of the High Court

Section 4 of the Trust Property Control Act provides that the trust deed of a trust must be lodged and registered with the Master of the High Court. Although the registration of a trust deed with the Master of the High Court does not impact on the legality of the trust deed, section 6(1) of the Trust Property Control Act states that no person may act as trustee without proper authorisation from the Master.

³ See section 72(1)(d) of the Administration of Estates Act 66 of 1965.

3.4 Description of trusts

Trusts can be described in a variety of ways, including the following:

- First, they can be described by their method of formation (*inter vivos* and *mortis causa* (testamentary) trusts). An *inter vivos* trust is created during the lifetime of an individual and a *mortis causa* trust is created upon the death of an individual under that individual's last will.
- Secondly, they can be described by the rights they confer on beneficiaries (vesting and discretionary trusts). Under a vesting trust the income (both of a revenue and capital nature) of the trust, the assets of the trust or the net trust capital (residue) are vested in the beneficiaries. The beneficiaries are said to have vested rights to the income, assets or the net trust capital of the trust. Under a discretionary trust the trustees usually have the discretion as to whether and how much of the income, assets or net trust capital of the trust to distribute to the beneficiaries. In these circumstances the beneficiaries merely have contingent rights to the income, assets or capital of the trust.
- Thirdly, they may be described by their purpose (trading trusts, asset-protection trusts, charitable trusts or special trusts).

These descriptions are not mutually exclusive. For example, an *inter vivos* trust can be either a discretionary trust or a vesting trust. While a trust can be described as being either vesting or discretionary, such a distinction can be misleading, because a trust may exhibit both vesting and discretionary characteristics. For instance, a discretionary trust may become a vesting trust *to the extent* that the trustees have exercised their discretion and vested the assets and income of the trust in the beneficiaries.

3.5 Commencement of existence of a trust

A testamentary trust exists from the testator's date of death while an *inter vivos* trust exists from the moment that the contract from which it emanates is executed.⁴

3.6 Trusts under the Income Tax Act

The definition of "person" in section 1(1) includes "any trust".⁵ This definition was inserted following the decision in *CIR v Friedman & others NNO*⁶ in which it was held that under common law a trust is not a person. However, since the definition of person in section 1(1) was amended to include "any trust", a trust has become a taxable entity in its own right.

The definition of "trust" in section 1(1) reads as follows:

“**[T]rust**’ means 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;”

⁴ PA Olivier, S Strydom & GPJ Van den Berg *Trust Law and Practice* 2 ed (2008) LexisNexis in paragraphs 2.5.1 and 2.5.2.

⁵ Paragraph (c) of the definition of "person".

⁶ 1993 (1) SA 353 (A), 55 SATC 39.

The Act has two definitions of “special trust”, one in section 1(1) and the other, more restrictive definition, in paragraph 1. Under the definition of “special trust” in section 1(1), special trusts fall into two categories:

- Trusts created solely for the benefit of one or more persons who is or are persons with a “disability” as defined in section 6B(1) which incapacitates the person or persons from earning sufficient income for their maintenance or from managing their own financial affairs. If the trust is created for the benefit of more than one person with a disability, they must be relatives in relation to each other (a type-A trust) (paragraph (a) of the definition).
- Testamentary trusts created solely for the benefit of relatives of the deceased person. The youngest of the relatives must be under the age of 18 years (a type-B trust) (paragraph (b) of the definition).

The Eighth Schedule defines a special trust to mean a trust contemplated in paragraph (a) of the definition of “special trust” in section 1(1) (see above). Thus, generally references in the Eighth Schedule to a special trust are to a type-A trust. Under the Eighth Schedule type-A trusts are granted additional relief from CGT in comparison to type-B trusts in respect of the annual exclusion, primary residence exclusion, personal-use assets, and compensation for personal injury, illness or defamation. Under paragraph 10 the 40% inclusion rate is applied to both type-A and type-B trusts.⁷

The trustee is the representative taxpayer of a trust.⁸ The trustee of a special trust will therefore be its representative taxpayer and will act on its behalf. The trustee is, amongst other things, obliged to ensure that a full and accurate disclosure is made of all relevant information as required in the income tax return (ITR12T) of the trust.

The definition of “trustee” in section 1(1) reads as follows:

“ **[T]rustee**, in addition to every person appointed or constituted as such by act of parties, by will, by order or declaration of court or by operation of law, includes an executor or administrator, tutor or curator, and any person having the administration or control of any property subject to a trust, usufruct, fideicommissum or other limited interest or acting in any fiduciary capacity or having, either in a private or in an official capacity, the possession, direction, control or management of any property of any person under legal disability;”

Although legal ownership of the trust assets vests in the trustees (other than a *bewind* trust), a trustee is not the beneficial owner of the trust assets.⁹ For tax purposes, however, the effect of the definitions of “person” and “trust” in section 1(1) when read together is to make the trust the owner of the assets administered by the trustees, except when the trust is a *bewind* trust. Assets held by a *bewind* trust remain the property of the trust beneficiaries and are merely administered by the trustees.

The definition of “beneficiary” in section 1(1) reads as follows:

“ **[B]eneficiary** in relation to a trust means a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust;”

⁷ Paragraph 10 refers to a “special trust” as defined in section 1 which includes type-A and type-B trusts.

⁸ Paragraph (c) of the definition of “representative taxpayer” in section 1(1).

⁹ See *Braun v Blann & Botha NNO & another* 1984 (2) SA 850 (A) at 859; *Crookes NO & another v Watson & others* 1956 (1) SA 277 (A) at 305; *CIR v MacNeillie’s Estate* 1961 (3) SA 833 (A), 24 SATC 282 and *Estate Kemp & others v McDonald’s Trustee* 1915 AD 491.

The authors of *Income Tax in South Africa* comment as follows on this definition:¹⁰

“The term ‘beneficiary’ is defined as meaning any person who has a vested or contingent interest in all or a portion of the receipts, accruals, or assets of a trust. This definition thus includes both capital and income beneficiaries. It is considered that so-called ‘discretionary beneficiaries’, whose interests are dependent upon the decisions from time to time of the trustees, have contingent interests as contemplated in the definition and are therefore ‘beneficiaries’ as defined, irrespective of whether or not they have ever been in receipt of any distributions or have formally accepted benefits. The same applies to members (named or unnamed) of any class of persons designated in the deed. Whether a particular person, whether or not identified by name, has such rights must always be a question of fact to be determined by examination of the trust deed. A contingent beneficiary whose rights are dependent upon reaching a specific age, will, it is submitted, also be a ‘beneficiary’ prior to that date, notwithstanding that the interest is entirely conditional upon survival to a future date;”¹¹

On the basis that the definition of “beneficiary” in section 1(1) includes a person having a contingent interest, SARS is in agreement with the above view.

To summarise, the definition of “special trust” in section 1(1), which includes type-A and type-B trusts, applies for the purposes of the Act as a whole. The Eighth Schedule defines a special trust to include only a type-A trust. Under the Eighth Schedule type-A trusts are granted additional relief from CGT in comparison to type-B trusts. The inclusion rate of the net capital gain of a type-A and type-B trust in taxable income is 40%.

4. The characteristics of a special trust

4.1 The law

Section 1(1) – Definition of “special trust”

“ [S]pecial trust’ means a trust created—

- (a) solely for the benefit of one or more persons who is or are persons with a disability as defined in section 6B(1) where such disability incapacitates such person or persons from earning sufficient income for their maintenance, or from managing their own financial affairs: Provided that—
 - (aa) such trust shall be deemed not to be a special trust in respect of years of assessment ending on or after the date on which all such persons are deceased; and
 - (bb) where such trust is created for the benefit of more than one person, all persons for whose benefit the trust is created must be relatives in relation to each other; or
- (b) by or in terms of the will of a deceased person, solely for the benefit of beneficiaries who are relatives in relation to that deceased person and who are alive on the date of death of that deceased person (including any beneficiary who has been conceived but not yet born on that date), where the youngest of those beneficiaries is on the last day of the year of assessment of that trust under the age of 18 years;”

¹⁰ D Clegg & R Stretch *Income Tax in South Africa* [online] (My LexisNexis: July 2018) in paragraph 24.1.1.

¹¹ See also *C: SARS v Airworld CC & another* 2008 (3) SA 335 (SCA), 70 SATC 48.

4.2 Rights of beneficiaries of a special trust

While a special trust as defined in section 1(1) can be a discretionary trust, a vesting trust or a *bewind* trust, the status of a trust as a special trust is of relevance only if in fact the income or capital gains fall to be taxed in the trust. Such treatment will occur only if the beneficiaries have contingent rights to the income, assets or capital of the trust.

Thus, when a beneficiary of a vesting trust has a vested right to the income or capital gains derived by the trust, that income or capital gain is to be taxed in the beneficiary's hands and the provisions of the Act relating to special trusts are not of any application. A *bewind* trust will similarly not benefit from being a special trust, since the beneficiary of the *bewind* trust will be taxed on the income and capital gains of the trust. A vesting trust in which the beneficiary has a vested right in the *trust income and assets* will be in the same position as a *bewind* trust for CGT purposes and the proceeds derived in consequence of the exploitation of the assets will be taxed in the hands of the beneficiary. See 5.1.1, 6.1 and 6.5.

4.3 Characteristics of a type-A trust

To qualify as a type-A trust, all the requirements in 4.3.2 to 4.3.6 must be met.

4.3.1 Modes of formation

A type-A trust can either be –

- an *inter vivos* trust created during the lifetime of the founder of the trust;
- a testamentary trust created by or under the will of a deceased person (testator); or
- a trust created as a result of a court order in favour of a specified natural person.

4.3.2 The “disability” requirement

The trust must be created solely (see 4.3.3) for the benefit of one or more persons who is or are persons with a disability as defined in section 6B(1).

The definition of “disability” in section 6B(1) reads as follows:

“**[D]isability**’ means a moderate to severe limitation of any person’s ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation—

- (a) has lasted or has a prognosis of lasting more than a year; and
- (b) is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by the Commissioner;”

The words “moderate to severe limitation”, in the context of a disability mean a significant restriction on a person’s ability to function or perform one or more basic daily activities after maximum correction. Maximum correction in this context means appropriate therapy, medication and use of devices.¹²

¹² See Part B of the “Confirmation of Diagnosis of Disability” (ITR-DD) on the **SARS website**.

4.3.3 The “sole benefit” requirement

The trust must be created *solely* for the benefit of one or more persons who is or are persons with a disability. In essence, this means that the trust deed must not provide for the possibility of any beneficiary who does not have a “disability” as defined in section 6B(1), for as long as the person or persons with a disability is or are alive.

The requirement that the trust must be created solely for the benefit of beneficiaries having a disability does not mean that the beneficiaries should have a vested right to the income or capital gains of the trust. Should the beneficiaries have such vested right, the income or capital gains, as the case may be, would be taxed in their hands and the fact that the trust is a special trust will not impact this accrual or the taxation of the income or capital gains in the beneficiaries’ hands (see 5.1.1 for commentary on “vested rights”).

The trust deed or will may not make provision for any person who is not a person with a disability to obtain a vested right or a discretionary right to any income or capital of the trust while a beneficiary or beneficiaries with a disability for whose sole benefit the trust was created, is or are alive. If a person who does not have a disability has or obtains a vested right, or a discretionary right, to the income or capital of a trust while a beneficiary with a disability is alive, the trust will not qualify as a type-A trust.

The trust deed may provide for the remaining assets or capital of a type-A trust to be distributed after the date of death of the last living beneficiary with a disability to beneficiaries who do not have a disability. Such a provision will not disqualify the trust from being a type-A trust, since the trust would still have been created solely for the benefit of beneficiaries with a disability until the last living beneficiary with a disability has died. The trust will be taxed as a normal trust and not a type-A trust from the commencement of the year of assessment in which the last living beneficiary with a disability dies (see 4.3.5 and 6.4.5).

The beneficiary of a type-A trust can be only a natural person because only a natural person can be a person with a disability.

A beneficiary of a type-A trust need not be a relative of the founder of the trust,¹³ but must be a relative in relation to any other beneficiaries with disabilities (see 4.3.6).

There is no age restriction for a person who is a person with a disability to be a beneficiary of a type-A trust.¹⁴

Example 1 – Type-A trust – Trust must be created solely for the benefit of one or more persons with a disability

Facts:

C, the founder of AB Trust, created the trust solely for the benefit of a friend, B, aged 42, who is a person with a disability. The trust deed provides that any assets remaining in the trust on B’s death must be distributed to C (who does not have a disability).

¹³ The beneficiaries of a type-B trust must be relatives of the deceased person [paragraph (b) of the definition of “special trust” in section 1(1)]. See 4.4.2.

¹⁴ In contrast, the youngest of the beneficiaries of a type-B trust must be under the age of 18 years (see 4.4.4).

Result:

AB Trust meets the “disability” and “sole benefit” requirements, since the trust was created solely for the benefit of B who is a person with a disability. The requirement that the beneficiaries of the trust be relatives in relation to one another (see 4.3.6) does not apply, since only one beneficiary with a disability (B) can benefit from the trust during that beneficiary’s lifetime. There is also no requirement that the founder of AB Trust has to be a relative of the beneficiary with a disability. The fact that B is a major (18 years or older) also does not result in the trust being disqualified as a type-A trust because no age restriction applies to beneficiaries of a type-A trust having a disability. While C, who does not have a disability, will benefit under the trust deed on B’s death, this fact does not disqualify AB Trust from being a type-A trust, since C is unable to benefit under the trust deed during B’s lifetime.

Example 2 – Type-A trust – Trust must be created solely for the benefit of one or more persons with a disability

Facts:

C, the founder of AB Trust, created the trust solely for the benefit of a friend, B who is a person with a disability. The trustees of AB Trust have the discretion to name the children of C, who are not persons with a disability, as beneficiaries of AB Trust while B is alive. C did not have any children at the time of drawing up the trust deed.

Result:

AB Trust does not qualify as a type-A trust, since the trust was not created solely for the benefit of a person or persons with a disability who are relatives in relation to each other. The fact that the children of C may be added as beneficiaries while B is alive disqualifies the trust from being classified as a type-A trust.

Note:

It is irrelevant that the trustees did not exercise their discretion to name the children of C as beneficiaries of AB Trust and that no children of C have as yet been born.

Example 3 – Type-A trust – Trust must be created solely for the benefit of one or more persons with a disability

Facts:

D created the EF Trust. The trust was created during D’s lifetime solely for the benefit of D’s two children, E and F. E was born with a mental illness. F is not a person with a disability.

Result:

EF Trust does not qualify as a type-A trust, since the trust was not created solely for the benefit of a person or persons with a disability. Only E is a person with a disability. F may benefit from the trust while E is alive which disqualifies EF Trust from being a type-A trust.

4.3.4 The “incapacity” requirement

For a trust to be a type-A trust, its beneficiaries must be incapacitated as a result of their disabilities from –

- earning sufficient income for their maintenance; or
- managing their own financial affairs.

A trust that has been created solely for the benefit of one or more beneficiaries with a disability will accordingly qualify as a type-A trust if either of the requirements listed in the bullet points above are met. For example, if a trust is created for the benefit of a beneficiary with a disability and the beneficiary is able to earn sufficient income for his or her maintenance, the trust will still qualify as a type-A trust if the beneficiary is unable to manage his or her financial affairs provided the other requirements are met.

Whether beneficiaries with a disability are incapacitated from earning sufficient income for their maintenance or from managing their own financial affairs as a result of their disabilities, is a factual issue and will depend on the specific circumstances of the beneficiaries concerned. Under section 102(1)(c) of the Tax Administration Act 28 of 2011 the onus is on the trustees of a type-A trust to prove that the beneficiaries with a disability meet the incapacity requirement relating to earning sufficient income or financial management. See 7. regarding the documentation that must be submitted when a trust is registered as a type-A trust with SARS.

4.3.5 The “living beneficiaries” requirement

It is a requirement that at least one of the beneficiaries, for whose sole benefit the trust was created, should be alive on the last day of February of the relevant year of assessment of the trust.

A trust will accordingly cease to be a type-A trust from the commencement of the year of assessment during which all the beneficiaries with a disability for whose sole benefit the trust was created, are deceased.

A trust deed may allow for other persons without a disability to become beneficiaries after the death of the last living beneficiary with a disability, but such a trust will no longer be taxed as a special trust from the year of assessment in which the last living beneficiary with a disability dies.

The following trusts will cease to exist after the death of all their beneficiaries:

- A *bebind* trust, since ownership of the trust assets vests in the beneficiaries.
- A discretionary trust with a single beneficiary if the trust deed stipulates that the trust must be dissolved upon the death of the beneficiary.

Example 4 – Type-A trust – The “living beneficiary” requirement

Facts:

GH Trust was created on 1 October 2005 for the sole benefit of H who is a person with a disability. H passed away on 16 March 2019.

Up to the date of H’s death the GH Trust met all of the requirements for a type-A trust.

Result:

GH Trust qualified as a type-A trust for the 2006 to 2019 years of assessment. GH Trust does not qualify as a special trust for the 2020 year of assessment because H passed away during the 2020 year of assessment. The taxable income of the trust will accordingly be taxed at the flat rate of 45% applicable to trusts for the 2020 year of assessment (see 5.7).

4.3.6 The “relatives” requirement

A trust that is created solely for the benefit of more than one person with a disability must be for the benefit of persons with a disability who are relatives in relation to each other. The relationship between the founder or settlor and the beneficiaries is of no consequence, since the requirement is that the *beneficiaries* having a disability must be relatives, and not the founder or settlor. The relationship between the beneficiaries and founder or settlor accordingly has no impact on whether a trust qualifies as a type-A trust.

The definition of “relative” in section 1(1) means in relation to any person –

- the spouse of that person;
- anybody related to that person within the third degree of consanguinity;
- anybody related to the spouse of that person within the third degree of consanguinity; and
- the spouse of anybody related within the third degree of consanguinity to that person or that person’s spouse.¹⁵

The definition of “spouse” in section 1(1) means in relation to any person a person who is the partner of such person –

- in a marriage or customary union recognised under the laws of the Republic;
- in a union recognised as a marriage in accordance with the tenets of any religion; or
- in a same-sex or heterosexual union which is intended to be permanent.

The following persons would be related to a person within the third degree of consanguinity:

- Children, including adopted children (first degree)
- Grandchildren (second degree)
- Great-grandchildren (third degree)
- Parents (first degree)
- Grandparents (second degree)
- Great-grandparents (third degree)
- Brothers and sisters (second degree)
- Nephews and nieces (third degree)
- Uncles and aunts (third degree)

The definition of “child” in section 1(1) in relation to any person includes any person adopted by that person under any of the laws mentioned in the definition. An adopted child is deemed to be related to his or her adoptive parent in the first degree of consanguinity for the purposes of determining the relationship between that child and any other person.

The degree of relationship between two persons is determined by counting the number of steps up to a common ancestor and then, if necessary, the number of steps down to the person concerned. For example, a cousin is related in the fourth degree [person [up to] parent (1) [up to] grandparent (2) [down to] uncle or aunt (3) [down to] cousin (4)].

¹⁵ See Interpretation Note 67 “Connected Persons” for commentary on the definition of “relative”.

Example 5 – Type-A trust – The “relative” requirement

Facts:

D’s last will provided for a trust to be formed for D’s two children B and C who are both persons with a disability. The BC Trust was created on date of death of D by operation of law solely for the benefit of B and C.

Result:

B and C are relatives within the second degree of consanguinity in relation to each other under the definition of “relative” in section 1(1). The BC Trust meets the “disability”, “sole benefit” and “relatives” requirements because it was created solely for the benefit of B and C who are persons with a disability and who are relatives in relation to each other.

4.4 Characteristics of a type-B trust

To qualify as a type-B trust, all the requirements in 4.4.1 to 4.4.4 must be met.

4.4.1 Modes of formation

A type-B trust can be created only by or under the will of a deceased person. Only a testamentary trust will therefore qualify as a type-B trust. An *inter vivos* trust is not created by or under the will of a deceased person and consequently will not qualify as a type-B trust.

4.4.2 The “relatives in relation to the founder” requirement

The trust must be created solely for the benefit of beneficiaries who are relatives in relation to the deceased person. See 4.3.6 for commentary on the meaning of “relative”. The beneficiaries need not be relatives in relation to each other.¹⁶

Example 6 – Type-B trust – Relatives in relation to the founder

Facts:

The JK Trust was created under L’s will for the benefit of L’s minor child J and a cousin, K.

Result:

The JK Trust does not qualify as a type-B trust, since K is not a relative in relation to the deceased person (L). K was not related to L within the third degree of consanguinity. All the beneficiaries must be relatives of the deceased person to qualify as a type-B trust.

4.4.3 The “living beneficiaries on the date of death of the deceased” requirement

The trust must be created solely for the benefit of beneficiaries who are relatives in relation to the deceased person and who are alive on the date of death of the deceased person.

For purposes of a type-B trust, a living beneficiary on the date of death of the deceased person includes any beneficiary who has been conceived but not yet born on the date of death of the deceased person.

¹⁶ The beneficiaries of a type-A trust must be relatives in relation to each other [paragraph (a) of the definition of “special trust” in section 1(1)]. See 4.3.6.

A trust will not qualify as a type-B trust if one of the qualifying beneficiaries of the trust dies before the date of death of the testator and the estate of that beneficiary benefits from the trust.

A trust will remain a type-B trust if one or more of the qualifying beneficiaries of the trust dies subsequent to the date of death of the deceased person (the testator) as long as the trust continues to comply with the other requirements of paragraph (b) of the definition of “special trust” in section 1(1), namely, that the remaining beneficiaries were alive on the date of death of the deceased person, are relatives in relation to the deceased person and the youngest beneficiary is under the age of 18 years on the last day of the year of assessment.

Example 7 – Type-B trust – Living beneficiaries on the date of death of the deceased

Facts:

L’s last will provided for a trust to be created solely for the benefit of L’s two minor children M and N. L’s last will did not allow for any substitution of beneficiaries. N was killed in a motor vehicle accident on 16 August 2019 and L passed away on 3 September 2019. The MN Trust was created on date of death of L, namely, on 3 September 2019 by operation of law, for the benefit of L’s surviving minor child, M.

Result:

The MN Trust has met the “relatives in relation to the founder” and “living beneficiaries on the date of death of the deceased” requirements notwithstanding that N was not alive when L passed away, because L’s last will did not allow for substitution of any of the beneficiaries (M and N) and M was a relative in relation to L and alive on the date of L’s death. If MN Trust’s deed of trust provided for N’s estate to benefit from the trust, the MN Trust would not have been created solely for the benefit of living beneficiaries of the trust and it would be disqualified as a special trust.

4.4.4 The “under the age of 18 years” requirement

The youngest of the beneficiaries of a type-B trust must be under the age of 18 years on the last day of the relevant year of assessment of the trust. Beneficiaries of a type-B trust may therefore include persons aged 18 years and older as long as any one of the beneficiaries is still under the age of 18 years.

A trust will cease to be a type-B trust as from the beginning of a year of assessment in which the youngest of its beneficiaries attains the age of 18 years.

Example 8 – Type-B trust – “Under the age of 18 years” requirement

Facts:

Trust X was created under P’s last will for the benefit of P’s three children and P’s father. P passed away on 15 January 2020. P’s children were respectively aged 18, 23 and 24 on 29 February 2020.

Result:

Trust X does not qualify as a type-B trust for the 2020 year of assessment because the youngest of the beneficiaries was not under the age of 18 years on 29 February 2020.

4.5 Resident status of a special trust and its beneficiaries

The definition of “special trust” in section 1(1) does not prescribe the resident status of either the trust or its beneficiaries. The following different scenarios may therefore exist:

- A resident special trust with resident beneficiaries.
- A resident special trust with non-resident beneficiaries.
- A resident special trust with resident and non-resident beneficiaries.
- A non-resident special trust with non-resident beneficiaries.
- A non-resident special trust with resident beneficiaries.
- A non-resident special trust with resident and non-resident beneficiaries.¹⁷

The income tax implications that arise in relation to resident and non-resident special trusts are dealt with in **5.2** and **5.3**, and the CGT implications in **6.2** and **6.3**.

5. Income tax provisions relating to a special trust

In the paragraphs below the Guide deals with some of the sections which may apply to a special trust.

5.1 Provisions of the Act applicable to a special trust (sections 7 and 25B)

The provisions of the Act that generally apply to a trust also apply to a special trust.

5.1.1 Amounts received or accrued taxable either in the trust or in the hands of a beneficiary [section 25B(1)]

Section 25B(1) provides that any amount received by or accrued to or in favour of a person during a year of assessment in that person’s capacity as the trustee of a trust will, subject to section 7 (see below), to the extent to which that amount has been derived for the immediate or future benefit of any 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.

A beneficiary may, for example, have a vested right to the relevant amount under the trust deed. Alternatively, the beneficiary may acquire a vested right to the amount received by or accrued to the trust through the exercise by the trustees of their discretion to distribute the amount to the beneficiary in the same year of assessment in which the amount was received by or accrued to the trust. The amount will be treated as having accrued to the trust if no beneficiary has a vested right to the amount in the year of assessment in which it accrues to, or is received by, the trust. Any exercise by the trustees of their discretion to vest income must be made in real time during the year of assessment in which the income arises. If the trustees exercise their discretion retrospectively after the end of the year of assessment, the income will be regarded as having been received by or accrued to the trust, unless it is attributed to a donor under section 7.

¹⁷ Definition of “resident” in section 1(1) (see **5.2**).

Thus, disregarding section 7, if a beneficiary does not have a vested right to the income of a trust under the trust deed, the income is treated as having accrued to the trust unless the trustees decide to make a distribution of that income to that beneficiary in the relevant year of assessment.

Vested rights v contingent rights

A “vested right” can have a different meaning depending on the context in which the words are used. Watermeyer JA stated the following in *Jewish Colonial Trust Ltd v Estate Nathan*:¹⁸

“Unfortunately the word “vest” 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 that a right is being distinguished from a chance or a possibility of a right, but it is convenient to use the well-known expressions vested right and conditional or contingent right.”

In referring to the *Jewish Colonial Trust* case cited above, Milne J stated the following in ITC 1328:¹⁹

“It is clear also from this case that a vested right may nevertheless be vested even though in some instances enjoyment of the right may be postponed.”²⁰

It may happen that a beneficiary has a vested right in the trust income while the trustees have the discretion over the timing of distributions. Such a discretion will, however, not prevent the accrual of the income. In *Samaradiwakara & another v de Saram & others*, Lord de Villiers, in delivering the judgment of the Privy Council, explained the distinction as follows:²¹

“The phrase used in Roman-Dutch law to indicate that a thing has begun to be owing, the right to which is therefore transmissible, is *dies cessit*, as distinguished from *dies venit*, when a time for enjoyment has arrived, and a thing can be claimed: see Voet (36.2.1.).”

A contingent right is merely a *spes* – an expectation which might never be realised.²² A beneficiary will, for example, have a contingent right when a trustee has a discretion to distribute the assets or income of the trust or over how much to distribute to a beneficiary. A beneficiary who has a contingent right merely has a right against the trustees to administer the trust in accordance with the trust deed.

¹⁸ 1940 AD 163 at 175 and 176.

¹⁹ (1980) 43 SATC 56 (N) at 60.

²⁰ See also *Estate Dempers v SIR* 1977 (3) SA 410 (A), 39 SATC 95; *In re Allen Trust* 1941 NPD 147; ITC 76 (1927) 3 SATC 68 (U); *CIR v Polonsky* 1942 TPD 249, 12 SATC 11; *CIR & others v Sive's Estate* 1955 (1) SA 249 (A); *Greenberg & others v Estate Greenberg* 1955 (3) SA 361 (A); *Hiddingh v CIR* 1941 AD 111, 11 SATC 205; *Hansen's Estate v CIR* 1956 (1) SA 398 (A), 20 SATC 246 and ITC 1656 (1998) 61 SATC 195 (C).

²¹ 1911 AD 465 at 469.

²² See *Wasserman v Sackstein NO* 1980 (2) SA 536 (O); *Jewish Colonial Trust Ltd v Estate Nathan* 1940 AD 163 and ITC 76 (1927) 3 SATC 68 (U).

In ITC 22²³ the last will of the testator provided for a testamentary trust under which the trust capital should not be distributed until the youngest of three sons reached the age of 25. Until that time the unexpended income was to be accumulated for their benefit and divided among them upon distribution. The trustee had the discretion to incur certain expenditure and to make advances to the beneficiaries. The Commissioner assessed the trust to tax on the income. On appeal the court held that the income had vested in the three beneficiaries and was taxable in their hands. The distribution of the income had merely been postponed.

The position is, however, different when the trust deed provides for the substitution of beneficiaries when an event occurs which will prevent a beneficiary's entitlement to the trust capital. In *Trustees, Hull Trust Fund v CIR*²⁴ the trust deed provided that the founder's grandchildren were to receive their share of the trust capital upon attaining the age of 25. If any of them died before attaining that age, that beneficiary's share was to be awarded to another trust. The Commissioner had assessed the trust to tax on the income for the year of assessment in question. On appeal the court confirmed that the beneficiaries did not have a vested right to the trust income.

The trust deed of a special trust with a single beneficiary must be carefully examined to determine whether the beneficiary has a vested right to the income of the special trust. Such a vested right may exist if there is only one beneficiary because the discretion granted to the trustees may be a nullity if it is clear under the trust deed that the income derived by the trust is for the immediate benefit of the single beneficiary. For example, the discretion which the trustees may have had in allocating the trust's income while there were multiple beneficiaries may fall away when there is only one remaining beneficiary.

Should the single beneficiary have such a vested right to the income of the special trust in the circumstances discussed above, the trust is essentially ignored under section 25B(1) and any income derived by the trust is deemed to accrue to the single beneficiary with any actions of the trustees merely being actions on behalf of, and for the benefit of, the beneficiary. Since the beneficiary of a special trust will not qualify for any special tax treatment, despite having a disability, the beneficiary will be taxed on the income derived by the trust on the same basis as all other individual taxpayers.

5.1.2 Deemed accrual of income [section 7(1)]

Section 25B(1) is made subject to section 7. Section 7(1) essentially provides that income will be deemed to have accrued to a taxpayer (a trust or beneficiary in this context) even though such income has –

- been invested, accumulated or otherwise capitalised by the taxpayer;
- been credited in account or reinvested or accumulated or capitalised or otherwise dealt with in the taxpayer's name or on the taxpayer's behalf; or
- not actually been paid over to the taxpayer, but remains due and payable to the taxpayer.²⁵

Thus, income vested by the trustees in a beneficiary and which is retained by the trust will still be regarded as having accrued to the beneficiary even though the income has not been paid to the beneficiary.

²³ (1924) 1 SATC 208 (C).

²⁴ 1931 WLD 193. See also ITC 37 (1925) 2 SATC 65 (C) in which a similar result ensued.

²⁵ See also ITC 919 (1959) 24 SATC 263 (T); *Collard v Findlay's Executors* 1907 T.S. 254 and ITC 417 (1938) 10 SATC 264 (U).

5.1.3 Attribution of income [section 7(2) to (8)]

Section 7(2) to 7(8) may have the effect that the income of a trust is taxable in the hands of the person who made a donation, settlement or other disposition to a trust. In some situations, this rule will apply even if the amounts have been vested in a beneficiary, such as when the beneficiary is a spouse and tax avoidance is involved or when the beneficiary is a minor child or when the donation is revocable at the instance of the donor.

The words “donation, settlement or other disposition” have received extensive judicial consideration in relation to section 7.²⁶ In *Ovenstone v SIR*²⁷ the appellant had lent his four children, two of whom were minors, money to enable them to acquire shares in a company without security and bearing interest at the same rate that the bank charged him. Having regard to the appellant’s business standing, wealth and relationship with his bank, that rate might well have been a special, low rate. The shares concerned had generated taxable dividend income, and the Secretary had included the dividends derived by the two minors in the appellant’s income under section 7(3) on the basis that the failure to charge an arm’s length rate of interest constituted a donation, settlement or other disposition. Dismissing the appeal, Trollip JA stated the following:²⁸

“To sum up: the critical phrase in s 7(3) – ‘any donation, settlement or other disposition’ – excludes any disposal of property that is a 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 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.”

The judge noted that when the transaction was partly gratuitous and partly for consideration, an apportionment between the two elements was permissible. Thus, for example, if an interest rate of 6% was charged but an arm’s length rate was 10%, the gratuitous element of 4% (10% – 6%) would comprise a “donation, settlement or other disposition” and result in attribution of income to that extent.

Unlike an interest-free or low-interest loan, when the income is generated from funds that were donated, the entire amount of such income will be deemed to be that of the donor under section 7 without any limitation.

Once the donor dies, no further attribution is possible to the donor because the donor will cease to exist as a “person” for income tax purposes.

In deciding whether income is attributable to a donation, settlement or other disposition,²⁹ the principle established in *CIR v Widan*³⁰ must be applied. In other words, there must be some causal relation between the income and the donation. In making this determination one must have regard to the real effective cause of the income being generated.

²⁶ See *Ovenstone v SIR* 1980 (2) SA 721 (A), 42 SATC 55; *The Master v Thompson’s Estate* 1961 (2) SA 20 (FC), 24 SATC 157; *Welch’s Estate v C: SARS* 2005 (4) SA 173 (SCA), 66 SATC 303; *CIR v Berold* 1962 (3) SA 748 (A), 24 SATC 729; *C: SARS v Woulidge* 2002 (1) SA 68 (SCA), 63 SATC 483 and *Joss v SIR* 1980 (1) SA 674 (T), 41 SATC 206.

²⁷ 1980 (2) SA 721 (A), 42 SATC 55.

²⁸ At SATC 76.

²⁹ See 6.1.1 for an example of a disposition made by a donor to a trust.

³⁰ 1955 (1) SA 226 (A), 19 SATC 341.

Income that is received by or which accrues to a trust will accordingly be taxed in either –

- the hands of the donor (the person who made a donation, settlement or other disposition which created the source from which the income is derived);
- the hands of the beneficiary of a trust; or
- the trust.

5.1.4 Deductions and allowances [section 25B(3) to (7)]

Section 25B(3) allocates deductions or allowances between the trust and its beneficiaries on the basis of the income allocated to those parties under section 25B(1).

Section 25B(4) to (7) contain loss limitation rules when deductions and allowances exceed the amount of income that is deemed to accrue to a trust or beneficiary under section 25B(1).

5.2 “Gross income” of a resident special trust [section 1(1)]

The definition of “gross income”, in relation to any resident, means the total amount in cash or otherwise received by or accrued to or in favour of such resident during the year of assessment, excluding receipts or accruals of a capital nature.³¹ A resident special trust is therefore subject to South African income tax on its worldwide receipts or accruals.

A “resident” that is not a natural person, is defined in paragraph (b) of the definition of “resident” in section 1(1) as follows:

“ **[R]esident**’ means any—

- (b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic,

but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation:”

A special trust established or formed in South Africa or which has its place of effective management³² in South Africa will be a “resident” for South African tax purposes provided a tax treaty does not deem that person to be exclusively a resident of another country for purposes of the application of any tax treaty.

A special trust established outside South Africa or which has its place of effective management outside South Africa will become a South African “resident” from the date that it is effectively managed in South Africa provided a tax treaty does not deem that person to be exclusively a resident of another country for purposes of the application of any tax treaty.

5.3 “Gross income” of a non-resident trust [section 1(1)]

The definition of “gross income”, in relation to a non-resident means the total amount in cash or otherwise received by or accrued to or in favour of such person *from a source within South Africa* during the year of assessment, excluding receipts or accruals of a capital nature.³³ A non-resident trust will accordingly be subject to South African income tax only on

³¹ Definition of “gross income” in section 1(1).

³² See Interpretation Note 6 “Resident – Place of Effective Management (Companies)” for a discussion of the words “place of effective management”.

³³ Definition of “gross income” in section 1(1).

receipts or accruals from a South African source which are not of a capital nature. Capital receipts are taxed in accordance with the Eighth Schedule (see 5.4 and 6).

5.4 Amounts received or accrued of a capital nature excluded from gross income [section 1(1)]

Amounts received by or accrued to a trust that are of a capital nature and not deemed to be gross income will generally be taken into account in determining a capital gain or capital loss of the trust under the Eighth Schedule. A capital gain arising in a trust could, depending on the circumstances, be taxable in the trust, or in the hands of a beneficiary or a resident donor (see 6).

5.5 The nature of income derived and distributed by a trust and apportionment of expenses

Amounts derived by a trust may be fully taxable or wholly or partially exempt from income tax depending on the nature of the receipt or accrual. If an amount derived by a trust is vested in a beneficiary during the same year of assessment in which it was received by or accrued to the trust, it will, subject to section 7, be deemed under section 25B(1) to be an amount that accrued to the beneficiary (see 5.1.1). Since it is the same amount which is deemed to accrue to the beneficiary, the amount will retain its character. Therefore, a dividend received by or accrued to a trust that is vested in a beneficiary before the end of the year of assessment is treated as having accrued to the beneficiary in that year of assessment and the exemption under section 10(1)(k)(i) may apply.

Deductions or allowances under section 25B(3) (see 5.1.4) for either the trust or the beneficiary must be apportioned between the various amounts that accrue to the trust or that are deemed to accrue to the beneficiary under section 25B(1), unless a deduction or allowance is incurred directly in the production of a specific amount. In the latter case the deduction or allowance must be made against that specific amount that may have accrued to the trust or be deemed to have accrued to the beneficiary.

In *C: SARS v Mobile Telephone Networks Holdings (Pty) Ltd* Ponnar JA stated the following on the apportionment of expenses:³⁴

“Apportionment is essentially a question of fact depending upon the particular circumstances of each case (*Local Investment Co v Commissioner of Taxes* (SR) 22 SATC 4). As Beadle J put it in *Local Investment Co* (at 11):

‘It does not seem possible to me to lay down any general rules as to how the apportionment should be made, other than saying that the apportionment must be fair and reasonable, having regard to all the circumstances of the case. For example, in one case an apportionment based on the proportion which the different types of income bear to the total income might be proper, as was done in the *Rand Selections Corporation’s* case, *supra*. In another case, however, such an apportionment might be grossly unfair; for example, in the case where the bulk of the expenditure was clearly devoted exclusively to operations intended to earn income, but which unfortunately in fact earned very little income, with the result that in the particular year of assessment the company earned very little ‘income’, but from operations which incurred little expense earned relatively large non-taxable amounts. In such a case to apportion the bulk of the expenses to the non-taxable amounts would be unfair. In another case a fair method of apportionment might be to take the proportion which the capital invested in the operations earning the non-taxable amount bears to the total capital invested, as was done in *ITC No 832 of 1956, supra.*’ ”

³⁴ 2014 (5) SA 366 (SCA), 76 SATC 205 at 213.

5.6 Exemptions of dividends and foreign dividends from normal tax (sections 10(1)(k)(i), 10(2)(b) and 10B)

Subject to section 7, dividends received by or accrued to a trust which vest in a beneficiary in the year of assessment in which the dividends are derived by the trust may be exempt in the beneficiary's hands under section 10(1)(k)(i), while foreign dividends that vest in a beneficiary in the same year of assessment as that in which they are derived may be wholly or partially exempt under section 10B. Dividends and foreign dividends received by or accrued to a trust in a year of assessment which are not vested in a beneficiary in that year and are distributed to a beneficiary only in a subsequent year of assessment, must be accounted for by the trust in the year of assessment in which they are received by or accrued to the trust, unless attributed to a donor under section 7. As these amounts are received by or accrued to the trust and not the beneficiary, the trust and not the beneficiary is entitled to claim the exemptions under section 10(1)(k)(i) and section 10B.

Section 10(2)(b) provides that the exemption under section 10(1)(k)(i) does not apply to income received in the form of an annuity. Section 10B(5) provides that the exemptions under section 10B shall not apply to any portion of an annuity or any payments made out of any foreign dividend.

Section 10B(3) provides for a partial exemption of foreign dividends not otherwise exempt under section 10B(2). The exemption under section 10B(3) is calculated in accordance with a ratio. For the 2020 year of assessment the ratio is 25 to 45 of the aggregate of foreign dividends received by or accrued to a natural person or special trust – see **Example 9**.³⁵

See Interpretation Note 93: “The Taxation of Foreign Dividends” for detailed commentary on section 10B.

5.7 Rates of tax applicable to a special trust [section 5(2)]

As mentioned previously, the income tax rate of a special trust is not the single rate that applies to a normal trust, but the sliding scale applicable to a natural person. For the 2020 year of assessment the rate varies from 18% to 45%.³⁶ For example, a special trust with a taxable income of R50 000 for the 2020 year of assessment will have a tax liability of R9 000,00 (R50 000 × 18%).

Example 9 – Taxation of a special trust

Facts:

X created the XYZ Trust solely for the benefit of Y. Y, who is X's child, has a mental impairment which incapacitates Y from managing Y's own financial affairs. Y does not have a vested right to either the income or the capital of XYZ Trust. The assets of the XYZ Trust were not funded by a donation, settlement or other disposition. Both the XYZ Trust and Y are residents. XYZ Trust received the following income and incurred certain expenditure during the 2020 year of assessment.

³⁵ Section 10B(3)(b)(ii)(aa).

³⁶ Section 5(2), read with section 1(1) and paragraph 1 of Schedule I to the Rates and Monetary Amounts and Amendment of Revenue Laws Act 32 of 2019.

| | Rental | Interest | Dividends | Foreign dividends | Total |
|------------------------------------------------------|-----------------|-------------------|-------------------|-------------------|-----------------|
| | R | R | R | R | R |
| Income | 60 000 | 25 000 | 12 000 | 100 000 | 197 000 |
| Expenses incurred in the production of rental income | <u>(15 000)</u> | <u> </u> | <u> </u> | <u> </u> | <u>(15 000)</u> |
| Net income | <u>45 000</u> | <u>25 000</u> | <u>12 000</u> | <u>100 000</u> | <u>182 000</u> |

No income was distributed to Y in the 2020 year of assessment.

Result:

XYZ Trust qualifies as a type-A trust. The net income of XYZ Trust is taxable in its hands under section 25B(1) because Y did not have a vested right to the income of the trust in the 2020 year of assessment. The tax liability of XYZ Trust is calculated as follows:

| | |
|----------------------------------------------------------------------|----------------|
| | R |
| Net rental income | 45 000 |
| Interest | 25 000 |
| Dividends (R12 000 – R12 000) (Note 1) | 0 |
| Foreign dividends [R100 000 – R55 556 (R100 000 × 25 / 45)] (Note 2) | <u>44 444</u> |
| Taxable income | <u>114 444</u> |
| Tax liability @ 18% | 20 599,92 |

Notes:

1. The dividends are exempt from income tax under section 10(1)(k)(i).
2. The foreign dividends are partially exempt from income tax under section 10B(3)(b)(ii)(aa).
3. The tax liability would have been calculated at the single rate of 45% had XYZ Trust not qualified as a special trust, namely, R51 499,80 (R114 444 × 45%).
4. If Y had had a vested right to the income of the trust or had acquired a vested right because of the exercise by the trustees of their discretion, that portion of the income that vested in Y would have been taxable in Y's hands under section 25B(1) and (2).

5.8 Rebates and exemptions

Although a special trust is taxable at the rates of normal tax applicable to a natural person, it is not a natural person and accordingly does not qualify for any rebate or exemption that applies only to natural persons, for example, the primary, secondary and tertiary rebates under section 6, the medical tax credits under sections 6A and 6B, or the interest exemption under section 10(1)(i).

5.9 Exemption of the capital amount of purchased annuities for certain type-A trusts (section 10A)

Under section 10A(2) the capital portion of an annuity bought from an insurer for a lump sum cash consideration that is payable to a “purchaser” is exempt from income tax. The definition of “purchaser” in section 10A(1) includes, amongst other persons, a trust created solely for the benefit of a natural person if the High Court –

- declared such person to be of unsound mind and incapable of managing that person's own affairs; and
- ordered the creation of such trust.

The capital portion of an annuity is calculated in accordance with the formula provided in section 10A(3)(a):³⁷

$$\frac{\text{Amount of the total cash consideration given by the purchaser under the annuity contract}^{38}}{\text{Total expected returns of all the annuities provided for in the annuity contract}} \times \text{Annuity amount}^{39}$$

A trust referred to in the definition of “purchaser” in section 10A(1) may qualify as a type-A trust provided the person of unsound mind can be said to suffer from a “disability” as defined in section 6B(1) and the further requirements of paragraph (a) of the definition of “special trust” in section 1(1) are met. Given that the court must be satisfied that the person concerned must be incapable of managing that person’s own affairs, the requirement in paragraph (a) of the definition of “special trust” in section 1(1) that the person or persons having a disability must be incapacitated “from managing their own financial affairs” would be met. While a trust established by order of court in the circumstances described in the definition of “purchaser” in section 10A(1) would in most circumstances qualify as a type-A trust, not all type-A trusts will necessarily qualify for the exemption of the capital portion of the annuities provided for in section 10A(2). For example, a beneficiary of a type-A trust may not be incapacitated from managing that person’s own affairs or the trust may not be established under a court order issued by the High court, meaning that the requirements of a purchaser in section 10A(1) are not met.

Example 10 – Exemption of the capital amount of a purchased annuity – Section 10A

Facts:

Trust B was created under an order by the High Court for the benefit of C who was declared by the court as a person of unsound mind and incapable of managing C’s own affairs. The severity of C’s affliction is such that it constitutes a “disability” as defined in section 6B(1).

The trustees of Trust B purchased an annuity from an insurer under an annuity contract for a lump sum cash consideration of R100 000. An annuity of R7 200 a year is payable and the total expected returns of all the annuities provided for in the annuity contract is R210 000. The annuity is payable to Trust B as from 1 March 2019. C does not have a vested right to the annuity. C was alive on the last day of the relevant year of assessment of Trust B.

Result:

Trust B qualifies as a type-A trust, since the trust was created solely for the benefit of C who is a person with a disability as defined in section 6B(1), the disability incapacitates C from managing C’s own financial affairs and C was alive on the last day of the relevant year of assessment of Trust B.

The annuity is payable under an annuity contract as defined in section 10A(1) and the capital amount of the annuity is exempt under section 10A(2).

³⁷ See section 10A(3)(b) for an alternative method of determination and limitation rule if any amount payable by way of annuity under the contract is uncertain at the date of first payment because of an unpredictable contingency.

³⁸ Definition of “annuity contract” in section 10A(1).

³⁹ The formula in section 10A(3)(c) is used if an annuity amount is payable in consequence of the commutation or termination of the annuity contract.

The exempt portion of each annuity amount is calculated as follows:

$$\begin{aligned} & \text{Cash consideration} / \text{Total expected returns} \times \text{Annuity amount} \\ & = \text{R}100\,000 / \text{R}210\,000 \times \text{R}7\,200 \\ & = \text{R}3\,428 \end{aligned}$$

The taxable portion of each annuity included in Trust B's income is R3 772 (gross income of R7 200 – exempt income of R3 428).

5.10 Cessation of a special trust

A trust will cease to be a special trust for income tax purposes in any of the following situations:

- The circumstances of a beneficiary of a type-A trust change in such a way that the beneficiary is able to earn sufficient income for that person's own maintenance and manage that person's own financial affairs.
- The beneficiaries with disabilities for whose sole purpose a type-A trust was created are all deceased.
- The youngest of the beneficiaries of a type-B trust is no longer under the age of 18 years on the last day of the year of assessment of the trust.
- The trust (type-A or type-B) dissolves.
- The trust deed of a type-A trust is varied to enable an additional beneficiary who does not have a disability to obtain a vested right to any income or capital of the trust while a beneficiary having a disability for whose sole benefit the trust was created is alive.
- The trust deed of a type-A or type-B trust is varied, added to, supplemented or amended in such a manner that the trust no longer complies with the requirements of a special trust.
- The type-A or type-B trust is involved in an impermissible tax avoidance arrangement under section 80A such that the existence of the trust may be ignored. SARS is empowered to determine the tax consequences under the Act as if a transaction (for example, the establishment of the trust) had not been entered into or carried out, when an impermissible tax avoidance arrangement is found to exist. SARS is also granted other remedies to combat impermissible tax avoidance arrangements under section 80B(1)(a) to (e).

A type-A or type-B trust that ceases to be a special trust will be taxed at the single rate⁴⁰ of normal tax applicable to a normal trust as from the commencement of the year of assessment of the trust during which any of the above events occurs.

⁴⁰ The rate is 45% with effect from years of assessment commencing on or after 1 March 2017.

5.11 Year of assessment

The year of assessment⁴¹ of a special trust will always end on the last day of February.⁴² A special trust that derives business income (that is, carries on a trade) may apply to SARS for permission to draw up accounts to a date other than the last day of February under section 66(13A) if the trust's business income cannot be conveniently returned for any year of assessment. However, while SARS may permit a trust to draw up accounts for a 12-month period that does not end on the last day of February, the year of assessment of the trust will always end on the last day of February. The last day of February will therefore be the operative date for all other purposes of the Act. For example, rebates and rates of tax will be governed by the relevant year of assessment and not the date to which the financial accounts are drawn. For more information on section 66(13A) see Interpretation Note 19: "Year of Assessment of Natural Persons and Trusts: Accounts Accepted to a Date other than The Last Day of February".

6. Capital gains tax provisions relating to a special trust

6.1 Provisions of the Eighth Schedule applicable to a type-A and type-B special trust

The provisions of the Eighth Schedule that apply to a trust generally also apply to a special trust as contemplated in section 1(1).⁴³ However, the inclusion rate of the net capital gain of a special trust in taxable income is 40% and not the 80% that applies to trusts in general (see **6.1.2**). Certain provisions of the Eighth Schedule apply to type-A trusts only – these provisions are dealt with in **6.4**.

A taxable capital gain (which is included in taxable income) or an assessed capital loss (which is carried forward to the following year of assessment for set-off against future capital gains) is determined for a special trust as follows:

Sum of capital gains and losses during the year of assessment

Less: Annual exclusion (type-A trust only)⁴⁴

= Aggregate capital gain or aggregate capital loss

Less / add: Assessed capital loss brought forward from previous year of assessment

= Net capital gain or assessed capital loss

Multiply a net capital gain by the inclusion rate (40%⁴⁵ for a special trust)

= Taxable capital gain to be included in taxable income.

Any resulting assessed capital loss is carried forward to the following year of assessment.

⁴¹ Definition of "year of assessment" in section 1(1).

⁴² Section 5(1)(c).

⁴³ Paragraph 6 of this guide is based on the *Comprehensive Guide to Capital Gains Tax*.

⁴⁴ See **6.4.1**.

⁴⁵ See **6.1.2**. The rate increased from 33,3% to 40% with effect from years of assessment commencing on or after 1 March 2016.

6.1.1 Attribution rules [paragraphs 68 to 72 and paragraph 80]

A capital gain or capital loss arising in a trust must be accounted for by the trust unless there is a specific rule which directs that the capital gain must be attributed to another person. Two sets of attribution rules exist, namely –

- rules that attribute a capital gain to a resident donor (paragraphs 68 to 72); and
- rules that attribute a capital gain to a resident beneficiary (paragraph 80).

A capital gain arising in a trust resulting from a donation, settlement or other disposition made by a donor is attributable to the resident donor in specified circumstances under paragraphs 68 to 72 (see 5.1.3 for a discussion of the phrase “donation, settlement or other disposition”). A capital loss arising in a trust cannot be attributed to a donor and must be accounted for in the trust.

The vesting of an interest in an asset of a trust in a beneficiary triggers a disposal by the trust.⁴⁶ A capital gain that is determined in a trust on vesting of an asset in a resident beneficiary must be disregarded by the trust and accounted for by the resident beneficiary under paragraph 80(1).

Paragraph 80(2) applies when a capital gain is determined on the disposal of an asset by a trust in a year of assessment during which a resident beneficiary has a vested interest or acquires a vested interest to an amount derived, directly or indirectly, from that *capital gain but not to the asset disposed of*. That amount must be disregarded in calculating the aggregate capital gain or aggregate capital loss of the trust and accounted for as a capital gain by the resident beneficiary.

No attribution of a capital gain is possible to a non-resident beneficiary because paragraph 80 does not make provision for such attribution.

For purposes of paragraph 80(1) and (2), any determination of a capital gain by a non-resident trust must be dealt with as if it were a resident. This requirement ensures that all amounts that would have been capital gains had the trust been a resident can be brought to account by a resident beneficiary, and not merely those capital gains on the limited range of assets on which a non-resident is subject to CGT (see 6.3).

Example 11 – Disposition made to a trust – Attribution of income and capital gain

Facts:

On 28 February 2017 D made an interest-free loan of R100 000 to ABC Trust, which qualified as a type-A trust. Had ABC Trust borrowed the funds from a bank, it would have paid interest at 10% a year. ABC Trust used the funds to purchase South African-listed shares for R100 000. During the 2018 to 2020 years of assessment dividends of R2 000 a year were received by ABC Trust. On 29 February 2020 the shares were sold for R133 000 and a capital gain of R33 000 (R133 000 – R100 000) was made.

ABC Trust did not distribute the income or the capital gain derived by it to the beneficiary in the 2018 to 2020 years of assessment.

⁴⁶ Paragraph 11(1)(d).

Result:

The interest-free loan advanced by D to ABC Trust constitutes a “disposition” for purposes of section 7(5) and paragraph 70. The benefit derived by ABC Trust during the 2018 to 2020 years of assessment from the interest-free loan is R30 000 ($R100\ 000 \times 10\% \times 3$). Dividends of R6 000 ($R2\ 000 \times 3$) that accrued to ABC Trust are deemed to be the income of D under section 7(5). The dividends of R6 000 are exempt from normal tax under section 10(1)(k)(i).

The remaining benefit of R24 000 ($R30\ 000 - R6\ 000$) is attributed as a capital gain to D under paragraph 70. D qualifies for the annual exclusion under paragraph 5(1).

The remaining portion of the capital gain of R9 000 ($R33\ 000 - R24\ 000$) must be accounted for by ABC Trust,⁴⁷ which will also qualify for the annual exclusion.

Notes:

- (1) The interest-free loan does not trigger an annual donation for donations tax purposes under section 7C, since the loan was provided to a type-A trust and is therefore excluded from section 7C under section 7C(5)(c) (see **8.6.2**).
- (2) D has a right to recover any normal tax on the income or capital gain attributed to D under section 91.

6.1.2 Inclusion rate of a net capital gain (section 9D(2A)(f) and paragraph 10)

A net capital gain of a special trust for the current year of assessment is multiplied by the inclusion rate applicable to special trusts to arrive at the trust's taxable capital gain which must be included in taxable income for the year of assessment. Under paragraph 10(a) the inclusion rate of both a type-A and a type-B special trust is 40% compared to the inclusion rate of a normal trust of 80% under paragraph 10(c).⁴⁸

A taxable capital gain attributed to a special trust from a controlled foreign company⁴⁹ is arrived at by multiplying the controlled foreign company's net capital gain by an inclusion rate of 40% under section 9D(2A)(f).

Example 12 – Calculation of a taxable capital gain of a trust

Facts:

During the 2020 year of assessment Trust X disposed of a fixed property held as a capital asset and made a capital gain of R1 250 000. The beneficiary of Trust X does not have a vested right in the capital gain. Trust X does not have any other taxable income for the 2020 year of assessment. The acquisition of the fixed property was not funded by a donation, settlement or other disposition.

⁴⁷ Paragraph 73 limits the total amount of the income and capital gain that can be taxed in the donor's hands to the amount of the benefit derived from the donation, settlement or other disposition by the person to whom it was made.

⁴⁸ These rates apply with effect from years of assessment commencing on or after 1 March 2016.

⁴⁹ Definition of “controlled foreign company” in section 1(1).

Result:

The capital gain is taxable in the trust because the trust is a taxpayer in its own right and the capital gain is not subject to attribution to a donor under paragraphs 68 to 72 or to a beneficiary under paragraph 80. The tax liability of Trust X for the 2020 year of assessment is calculated as follows, depending on the nature of the trust:

| Type of trust | Type-A trust R | Type-B trust R | Normal trust R |
|------------------------|-------------------|-------------------|-------------------|
| Capital gain | 1 250 000 | 1 250 000 | 1 250 000 |
| Annual exclusion | <u>(40 000)</u> | | |
| Aggregate capital gain | 1 210 000 | 1 250 000 | 1 250 000 |
| Inclusion rate | 40% | 40% | 80% |
| Taxable capital gain | <u>484 000</u> | <u>500 000</u> | <u>1 000 000</u> |
| Tax rate | sliding scale | sliding scale | 45% |
| Tax payable | 122 115,00 | 127 875,00 | 450 000,00 |

6.2 Application of the Eighth Schedule to a resident trust [paragraph 2(1)(a)]

A resident trust must determine a capital gain or capital loss on disposal of its worldwide assets on or after 1 October 2001 under paragraph 2(1)(a).

The definition of “asset” in paragraph 1 reads as follows:

“ ‘[A]sset’ includes—

- (a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and
- (b) a right or interest of whatever nature to or in such property;”

6.3 Application of the Eighth Schedule to a non-resident trust [paragraph 2(1)(b)]

Under paragraph 2(1)(b) a non-resident trust must determine a capital gain or capital loss on disposal of the following assets on or after 1 October 2001:

- Immovable property situated in South Africa held by the trust or *any interest or right of whatever nature of the trust to or in immovable property* situated in South Africa including rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources.
- Any asset effectively connected with a permanent establishment of the trust in South Africa.

An “interest in immovable property situated in South Africa” includes any equity shares held by the non-resident trust in a resident or non-resident company, or ownership or the right to ownership of the non-resident trust in any other entity or the vested interest of the non-resident trust in the assets of any other trust, if –

- the non-resident trust (whether alone or together with any connected person in relation to the trust), directly or indirectly, owns more than 20% of the equity shares in that company or ownership or right to ownership of that entity; and

- 80% or more of the market value of those equity shares, ownership or right to ownership or vested interest, as the case may be, at the time of its disposal is attributable directly or indirectly to immovable property.

6.4 Provisions of the Eighth Schedule applicable to a type-A trust

The following definition of “special trust” in paragraph 1 includes only a type-A trust:

“ **[S]pecial trust**’ means a trust contemplated in paragraph (a) of the definition of “special trust” in section 1;”

A type-A trust as defined in paragraph 1 is entitled to specified exclusions applicable to natural persons (for example, the annual exclusion, the primary residence exclusion and the personal-use asset exclusion).

For CGT purposes, any reference to a beneficiary of a special trust is a reference to the person or persons having a disability for whose sole benefit the trust is created and does not include any substitute beneficiary or person that does not have a disability that may obtain a vested right to the income or capital of the trust subsequent to the death of the person or persons with a disability for whose benefit the trust was created.

Unlike the treatment of the taxation of gross income, a type-A trust as defined for CGT purposes will continue to be treated as a special trust for CGT purposes notwithstanding the death of the beneficiary or beneficiaries with a disability until the earlier of the disposal of all the assets held by the trust or two years from the date of death of the last living beneficiary with a disability⁵⁰ (see 6.4.5). Therefore, if a special trust ceases to be a “special trust” as defined in paragraph 1 (that is, a type-A trust) because all the beneficiaries with disabilities have died, the trust will nevertheless continue to be treated as a special trust for CGT purposes, and will continue to be able to claim the beneficial CGT treatment discussed below, until the earlier of the date upon which the trust has disposed of all its assets or two years from the date of death of the last living beneficiary with a disability.

6.4.1 The annual exclusion (paragraph 5)

Unlike a type-B trust, a type-A trust must take into account an annual exclusion amount under paragraph 5 in the determination of the trust’s aggregate capital gain or aggregate capital loss. The purpose of the annual exclusion is to reduce compliance costs by keeping minor capital gains and capital losses out of the CGT system.

A type-A trust will have an aggregate capital gain if the sum of its capital gains and capital losses during the year of assessment produces a positive figure and there is still a balance remaining after reducing that sum by the annual exclusion.

A type-A trust will have an aggregate capital loss if the sum of its capital gains and capital losses during the year of assessment is a negative figure and there is still a balance remaining after reducing that sum by the annual exclusion.

The annual exclusion for a type-A trust for the 2020 year of assessment is R40 000.⁵¹

⁵⁰ Paragraph 82.

⁵¹ The annual exclusion increased from R30 000 to R40 000 with effect from years of assessment commencing on or after 1 March 2016.

6.4.2 The primary residence exclusion (paragraphs 44 to 50)

The primary residence exclusion in paragraph 45 applies to a “special trust” as defined in paragraph 1, namely, a type-A trust provided it meets the necessary requirements. A type-B trust will therefore not qualify for the primary residence exclusion.

Definitions of “primary residence” and “an interest”

In the context of a type-A trust, the definition of “primary residence” in paragraph 44 means a residence –

- in which the special trust holds an interest; and
- in which the beneficiary of the special trust or a spouse of the beneficiary ordinarily resides or resided in as that person’s main residence and uses or used it mainly for domestic purposes.⁵²

The definition of “an interest” in paragraph 44 includes –

- a real or statutory right;
- a share owned directly in a share block company or a share or interest in a similar entity which is not a resident; or
- a right of use or occupation.

but excludes any right or interest of whatever nature in a trust or an asset of a trust, other than a right of a lessee who is not a connected person in relation to the trust.

The exclusion from “an interest” of any right or interest of whatever nature in a trust or an asset of a trust includes a vested right in a residence held by a trust. This situation arises when the property remains registered in the name of the trust (legal ownership) even though the residence has been vested in the beneficiary (beneficial ownership). The word “vest” in this context means that the beneficiary has been granted unconditional entitlement to the residence, even though unfettered enjoyment of the residence may be postponed.

The primary residence exclusion and the type-A trust

Under paragraph 45(1) a type-A trust that is a discretionary trust must, when determining its aggregate capital gain or aggregate capital loss for a year of assessment, disregard –

- so much of a capital gain or capital loss determined on the disposal of the primary residence of that trust as does not exceed R2 million [paragraph 45(1)(a)]; or
- a capital gain determined on the disposal of the primary residence of that trust if the proceeds from the disposal of that primary residence do not exceed R2 million [paragraph 45(1)(b)].

The property legally and beneficially owned by a type-A trust will be a “primary residence” of that trust provided the beneficiary or a spouse of the beneficiary uses the property mainly (more than 50%) for domestic (that is, residential) purposes.

⁵² It was held in *SBI v Lourens Erasmus (Eiendoms) Bpk* 1966 (4) SA 434 (A), 28 SATC 233 that the word “mainly” prescribed a purely quantitative standard of more than 50%.

A type-A trust that disposes of a primary residence to a third party must claim the primary residence exclusion when determining its aggregate capital gain or aggregate capital loss provided the other requirements specified in paragraphs 45 to 50 are met and such a trust holds “an interest” in the residence occupied by its beneficiary.

The effect of vesting a primary residence in a beneficiary

The vesting of a primary residence in a beneficiary triggers a disposal by the trust of the primary residence under paragraph 11(1)(d). Since the trust and its beneficiary are connected persons in relation to each other, paragraph 38 applies and deems the transaction to take place at market value. The proceeds derived by the trust on the disposal are therefore equal to market value at the time of vesting, while the beneficiary acquires a vested right in the residence for a base cost equal to the same market value. Any capital gain arising in the trust must be disregarded by the trust and taken into account by a resident beneficiary under paragraph 80(1). Any capital loss will remain in the trust because capital losses may not be attributed.⁵³

The type-A trust must disregard any capital gain or loss to the extent that it does not exceed the primary residence exclusion. To the extent that a capital loss arises which exceeds R2 million, the excess will remain in the trust, since capital losses cannot be attributed to a beneficiary. To the extent that a capital gain arises which exceeds R2 million, the excess must be disregarded by the type-A trust in determining its aggregate capital gain or loss and taken into account by the beneficiary, provided he or she is a resident. The vesting in a beneficiary of the portion of a capital gain that has been disregarded under paragraph 45 by the trust does not have any CGT implications for a beneficiary, and is simply a distribution of after-tax capital.

After vesting, the residence is an asset in the beneficiary’s hands for CGT purposes but it is not a “primary residence” for the beneficiary for so long as it remains registered in the name of the trust because the beneficiary will not hold “an interest” as defined above in the residence. There are no further CGT consequences for the trust after vesting, since it disposed of the asset for CGT purposes on vesting and future CGT consequences fall on the beneficiary.

The vesting of an interest in a primary residence in a non-resident beneficiary will also trigger a disposal by the type-A trust under paragraph 11(1)(d), but any capital gain arising from that disposal must be accounted for by the type-A trust unless it is required to be accounted for by a resident donor under paragraphs 68 to 73. In this regard, paragraph 80 makes provision for attribution only to a resident beneficiary and the default position is that the capital gain must be accounted for by the trust unless one of the “attribution back to resident donor” rules in paragraphs 68 to 73 applies. Attribution to a donor under these rules cannot take place if the donor is deceased or is a non-resident, and in such event the capital gain must be accounted for by the type-A trust, which will potentially be entitled to the primary residence exclusion.

The effect of distribution

Any subsequent distribution of the residence to the beneficiary (that is, the registration of the residence in the name of the beneficiary) will not have any immediate CGT consequences for the trust or the beneficiary because the time of disposal will be taken back to the time of vesting under paragraph 13(1)(a)(iiA). The beneficiary will dispose of the vested right in the residence in exchange for a real right in the residence, and while this exchange of rights is a disposal, it does not result in a capital gain or capital loss because the base cost of the vested right will

⁵³ Neither paragraphs 68 to 73 nor paragraph 80 make provision for the attribution of capital losses.

be equal to the proceeds on disposal, being the market value of the real right on the date of vesting.

The residence can potentially become a primary residence for the beneficiary from the date on which the beneficiary becomes the legal owner.

Vesting of a capital gain on disposal of a residence in a beneficiary

A type-A trust that disposes of a primary residence to a third party must disregard so much of the resulting capital gain or loss that does not exceed the primary residence exclusion. To the extent that the portion of the capital gain which exceeds the primary residence exclusion is vested in a resident beneficiary who has a vested right in that capital gain but not in the residence, it must be –

- disregarded by the type-A trust in determining its aggregate capital gain or loss; and
- taken into account by the resident beneficiary in determining that beneficiary's aggregate capital gain or loss.

Bewind trust

A *bewind* trust is not the owner of its assets and accordingly does not hold “an interest” in a primary residence. The beneficiary of a *bewind* trust retains full ownership of a residence and the residence is, therefore, not an asset “of” the trust. The beneficiary of a *bewind* trust has an interest in the residence and can, therefore, claim the primary residence exclusion if all the requirements specified in paragraphs 45 to 50 are met.

Requirements relating to the primary residence exclusion

The primary residence exclusion under paragraph 45(1) is subject to the following conditions:

- The capital gain or capital loss to be disregarded under paragraph 45(1) has to be apportioned under paragraph 45(2) when the special trust and another person have an interest in the same primary residence at the same time.
- Under paragraph 45(3) only one primary residence may be a primary residence of a special trust for any period during which the special trust held an interest in more than one residence, subject to the exceptions provided for in paragraph 48 (see below).
- The exclusion of a capital gain under paragraph 45(1)(b) when the proceeds do not exceed R2 million is precluded under paragraph 45(4) if the beneficiary of the special trust or the spouse of the beneficiary –
 - was not ordinarily resident in the residence throughout the period commencing on or after 1 October 2001 during which the special trust held an interest in the residence; or
 - used the residence or a part of it for the purposes of carrying on a trade for any portion of the period commencing on or after 1 October 2001 during which the special trust held an interest in the residence.

Under paragraph 46 the primary residence exclusion applies to land on which a primary residence is situated (including unconsolidated adjacent land) to the extent that it –

- does not exceed two hectares;
- is used mainly for domestic or private purposes together with the residence; and
- is disposed of at the same time and to the same person as the residence.

Paragraph 47 provides that the portion of the capital gain or capital loss to be disregarded under paragraph 45(1)(a) must be determined with reference to the portion of the period during which the beneficiary of the special trust or the spouse of the beneficiary was ordinarily resident in the residence from 1 October 2001.

Under paragraph 48 no apportionment of a capital gain or capital loss under paragraph 47 is required if the beneficiary was absent from the residence for a continuous period not exceeding two years for any of the following reasons:

- The residence was a primary residence of the special trust at the time it was offered for sale and vacated because of the acquisition or intended acquisition of a new primary residence. This concession does not apply to any period during the two years in which the residence was let [paragraph 48(a)].
- The residence was being erected on land purchased with the intention of erecting a residence on it to be used as a primary residence of the special trust [paragraph 48(b)].
- The residence had been accidentally rendered uninhabitable, for example, through destruction by fire, flood, earthquake, landslide, wind or other similar event [paragraph 48(c)].
- The death of the last living beneficiary [paragraph 48(d)].

Paragraph 49 provides for apportionment of the capital gain or capital loss for purposes of the primary residence exclusion under paragraph 45(1)(a) if the beneficiary of the special trust used the residence or part of it for the purposes of carrying on a trade. The portion of the capital gain or capital loss to be disregarded under paragraph 45(1)(a) must be determined with reference to –

- the period on or after 1 October 2001 during which the beneficiary or the beneficiary's spouse used the residence for domestic purposes; and
- the part of the residence used by the beneficiary or the beneficiary's spouse mainly for purposes other than the carrying on of a trade.

Paragraph 50 allows a type-A trust to let the primary residence without that letting activity disqualifying that period of ownership as non-residential usage in certain circumstances. It essentially provides a safe harbour for the beneficiary or spouse to be temporarily absent from the residence without affecting the "ordinary residence" status of the beneficiary or the beneficiary's spouse in relation to the primary residence exclusion under paragraph 45(1)(a). This concession is subject to the following conditions:

- The primary residence may not be let for more than five years (preamble to paragraph 50).
- The beneficiary or the beneficiary's spouse must have actually resided in the primary residence for a continuous period of at least one year before and after the period that the primary residence was let [paragraph 50(a)].
- No other residence must have been treated as the primary residence of the beneficiary during the period that the primary residence was let [paragraph 50(b)].
- The beneficiary or the beneficiary's spouse must have been temporarily absent from South Africa or employed or engaged in carrying on business in South Africa at a location further than 250 kilometres from the residence [paragraph 50(c)].

Example 13 – Primary residence exclusion

Facts:

Trust C is a type-A trust and disposed of a residence owned by it and derived a capital gain of R2,5 million during the 2020 year of assessment. The beneficiary of Trust C ordinarily resided in the residence and used it mainly for domestic purposes. The beneficiary did not obtain a vested right to the capital gain. Trust C had no other taxable income for the 2020 year of assessment and its acquisition of the residence was not funded by a donation, settlement or other disposition.

Result:

The tax liability of Trust C on the capital gain is calculated as follows:

| | |
|--------------------------------------------------------|--------------------|
| | R |
| Capital gain | 2 500 000 |
| Less: Primary residence exclusion [paragraph 45(1)(a)] | <u>(2 000 000)</u> |
| | 500 000 |
| Less: Annual exclusion (paragraph 5) | <u>(40 000)</u> |
| Aggregate capital gain | <u>460 000</u> |
| Inclusion rate [paragraph 10(a)] | 40% |
| Taxable capital gain | <u>184 000</u> |
| Tax liability of Trust C (R184 000 × 18%) | 33 120,00 |

Note:

Had the trustees vested the taxable portion of the capital gain of R500 000 remaining after applying the primary residence exclusion (R2,5 million – R2 million) in the beneficiary, the trust would have disregarded that amount in determining its aggregate capital gain or loss, and the beneficiary would have taken it into account. If the trustees had vested the full amount of R2,5 million in the beneficiary, the trust would have disregarded the capital gain of R500 000 and the beneficiary would have had to take it into account in determining the beneficiary's aggregate capital gain or loss. The disregarded portion of the capital gain of R2 million would simply be a capital distribution for which there would be no CGT implications for the beneficiary.

Example 14 – Primary residence exclusion

Facts:

Trust X is a type-A trust and owned a residence in which the beneficiary and the beneficiary's spouse resided. Trust X disposed of the residence for R1,9 million on 15 March 2019 and made a capital gain of R1 million. The beneficiary and the beneficiary's spouse ordinarily resided in the residence since acquisition of the property in April 2002. The spouse used 20% of the residence for business purposes throughout the period that the residence was owned by Trust X.

Result:

Although the proceeds on disposal of the primary residence did not exceed R2 million, Trust X does not qualify for the primary residence exclusion under paragraph 45(1)(b) by reason of that fact because a portion of the residence was used for purposes of carrying on a trade. Nevertheless, a portion of the capital gain qualifies for the primary residence exclusion under paragraph 45(1)(a) read with paragraph 49. The beneficiary and the beneficiary's spouse used 80% of the residence as a primary residence. Therefore, 80% of the capital gain qualifies for the primary residence exclusion. Thus, R800 000 (R1 million × 80%) of the capital gain will be disregarded under paragraph 45(1)(a) and R200 000 (R1 million – R800 000) will be subject to CGT. The tax liability of Trust X on the capital gain is calculated as follows:

| | |
|--------------------------------------------------------|------------------|
| | R |
| Capital gain | 1 000 000 |
| Less: Primary residence exclusion [paragraph 45(1)(a)] | <u>(800 000)</u> |
| | 200 000 |
| Less: Annual exclusion (paragraph 5) | <u>(40 000)</u> |
| Aggregate capital gain | <u>160 000</u> |
| Inclusion rate [paragraph 10(a)] | 40% |
| Taxable capital gain | <u>64 000</u> |
| Tax liability of Trust X (R64 000 × 18%) | 11 520,00 |

Example 15 – Primary residence exclusion

Facts:

D, the beneficiary of Trust C, passed away on 31 October 2018. Trust C qualified as a type-A trust. Trust C owned a residence which was ordinarily resided in by D as D's main residence and used by D mainly for domestic purposes. Trust C sold the residence for R3 million on 1 March 2019 and made a capital gain of R1,4 million. D did not have a vested right in the capital gain and the acquisition of the primary residence was not funded by a donation, settlement or other disposition.

Result:

While D passed away in the 2019 year of assessment and the property was disposed of in the 2020 year of assessment, Trust C was entitled to claim the primary residence exclusion under paragraph 45(1)(a) read with paragraph 48(d), since the residence was disposed of within two years after the date of D's death. The primary residence exclusion of R2 million applies in these circumstances and the capital gain of R1,4 million must accordingly be disregarded by Trust C in calculating its aggregate capital gain or aggregate capital loss for the 2020 year of assessment.

6.4.3 The personal-use asset exclusion (paragraph 53)

A capital gain or capital loss determined on the disposal of a personal-use asset of a type-A trust must be disregarded under paragraph 53(1). A personal-use asset of a type-A trust is defined in paragraph 53(2) as an asset that is used mainly for purposes other than the carrying on of a trade.

Typical examples of personal-use assets include artwork, jewellery, household furniture and effects, a micro-light aircraft or hang glider with a mass of 450 kg or less, a boat that is 10 meters or less in length, veteran cars, private motor vehicles, stamp or coin collections (but excluding gold or platinum coins whose value is mainly derived from the metal content).⁵⁴

To qualify as a personal-use asset, the asset must be used mainly (more than 50%) for purposes other than the carrying on of a trade.

Example 16 – Personal-use asset exclusion

Facts:

Trust X, a type-A trust, disposed of a private motor vehicle owned by it that was used for purposes other than the carrying on of a trade at a capital loss of R15 000.

Result:

The capital loss of R15 000 must be disregarded by Trust X under paragraph 53(1) because the motor vehicle was a personal-use asset.

6.4.4 Compensation for personal injury, illness or defamation (paragraph 59)

Under paragraph 59 a type-A trust must disregard a capital gain or a capital loss on the disposal of a claim that resulted in the special trust receiving compensation for personal injury, illness or defamation of the beneficiary of the trust. The reason for this exclusion is that any compensation received would normally be intended to restore the person who has suffered harm to the position that person was in before the injury, illness or defamation.

Compensation of a revenue nature paid to a person under section 17 of the Road Accident Fund Act 56 of 1996 is exempt from normal tax under section 10(1)(gB)(iv), regardless of whether the payment is in the form of a lump sum or an annuity.

Example 17 – Compensation for personal injury of the beneficiary of a type-A trust

Facts:

Trust X, a type-A trust, was created for the benefit of Y who sustained severe permanent injuries in a motor vehicle accident. On 16 March 2019 the High Court ordered the Road Accident Fund to pay an amount of R12 million directly to Trust X for the benefit of Y. This amount was of a capital nature.

Result:

The proceeds of R12 million must be disregarded by Trust X under paragraph 59 because they resulted from a disposal of a claim for compensation for personal injury by Trust X on behalf of its beneficiary.

⁵⁴ Paragraph 53(3).

6.4.5 Death of the beneficiary of a type-A trust (paragraph 82)

Paragraph 82 is aimed at preserving the status of a type-A trust as a special trust for purposes of CGT regardless of the death of the beneficiary or beneficiaries for whose sole benefit the trust was created. The trust will continue to be treated as a special trust for CGT purposes until the earlier of –

- the disposal of all the assets held by the trust; or
- two years after the date of death of the last living beneficiary of the trust for whose sole benefit the trust was created.

All exclusions from CGT applicable to a special trust will still apply, including the annual exclusion under paragraph 5. The inclusion rate of the net capital gain in taxable income will remain 40% for a type-A trust under paragraph 10(a) until the earlier of the disposal by the trust of all its assets and two years after the date of death of the last living beneficiary of the special trust for whose sole benefit the special trust was created.

However, the rate of tax at which a taxable capital gain will be taxed will be the single rate that applies to trusts generally. The sliding scale applicable to a natural person can be applied only for the trust's years of assessment during which the last living beneficiary of a special trust was alive on the last day of those years of assessment (see **5.7** and **5.10**).

A capital gain arising after the disposal of all the assets held by the trust, or two years after the date of death of the last living beneficiary of the trust for whose sole benefit the trust was created, will not qualify for the CGT exclusions applicable to a special trust. The inclusion rate of 80% on a net capital gain will accordingly apply instead of the more favourable inclusion rate of 40%.

Example 18 – Death of the beneficiary of a special trust

Facts:

C was the beneficiary of Trust D, a discretionary type-A trust, and passed away on 15 January 2019. Trust D received taxable income of R300 000 for the 2019 year of assessment. All the assets of Trust D were disposed of by the trustees during October 2019. The sum of the capital gains on disposal of the assets amounted to R1,6 million. Other taxable income received by Trust D during the 2020 year of assessment amounted to R50 000. The trust was not funded by a donation, settlement or other disposition and none of the income or capital gains of the trust were vested in C or C's deceased estate during the 2019 and 2020 years of assessment.

Result:

The tax liability of Trust D is calculated as follows:

2019 year of assessment

| | |
|--------------------------|---------------------|
| Taxable income | R <u>300 000</u> |
| Tax payable @ 45% [Note] | 135 000,00 |

2020 year of assessment

| | R |
|----------------------------------|------------------|
| Sum of capital gains | 1 600 000 |
| Annual exclusion (paragraph 5) | <u>(40 000)</u> |
| Aggregate capital gain | <u>1 560 000</u> |
| Inclusion rate [paragraph 10(a)] | 40% |
| Taxable capital gain | 624 000 |
| Other taxable income | <u>50 000</u> |
| Taxable income | <u>674 000</u> |
| Tax payable @ 45% [Note] | 303 300,00 |

Note:

The graduated rates of normal tax applicable to a special trust do not apply to the year of assessment in which the last living beneficiary of the special trust for whose sole benefit the trust was created passes away or to subsequent years of assessment of the trust.

6.5 Vesting of asset v vesting of capital of a trust

The trust deed of a trust may indicate that a beneficiary has a vested right in a specific asset. Should the assets of the trust vest in the beneficiary, the trust is treated in the same way as a *bebind* trust with the assets belonging to the beneficiary.

Having a vested right to the assets of a trust does not mean that the beneficiary must be able to enjoy the trust assets immediately. Enjoyment can be postponed despite the beneficiary having unconditional entitlement to the assets.⁵⁵

In all instances it will be necessary to study the terms of the trust deed to determine the extent to which the special trust (as opposed to its beneficiary) is liable for CGT.

Some trust deeds provide that the beneficiary shall have a vested right to the “trust capital” as opposed to the trust assets. It then becomes necessary to consider the meaning of “trust capital” with reference to any definition in the trust deed and to determine whether it can be equated with a vested right in the trust assets. It may, for example, merely mean that the beneficiary has a vested right to the residue in the trust at the time of its termination or a vested right to profits of a capital nature, but not a vested right (ownership) in the trust assets.

An indicator that the beneficiary does not have a vested right to the assets of the trust would be if the trustees are empowered to borrow money in the name of the trust without the beneficiary being liable for such debts, since the trust will of necessity have to be the owner of the assets to meet its liabilities.

The trust deed may also indicate that the beneficiary does not have a vested right to the trust assets upon termination of the trust. A clause in the trust deed which provides that the trust assets must be distributed to another person, such as the beneficiary’s children or spouse on the death of the beneficiary, would indicate that the beneficiary does not have a vested right to the trust assets.

⁵⁵ *Goliath v Estate Goliath* 1937 CPD 312.

6.6 Termination (winding up) of a special trust

Upon termination of a discretionary special trust, any remaining unvested assets will be vested in the trust beneficiaries or will be disposed of by the trust to settle its liabilities. Any resulting capital gains must be dealt with under paragraph 80(1) (vesting of asset in resident beneficiary) or 80(2) (vesting of capital gain in resident beneficiary) unless paragraphs 68 to 72 apply (attribution to donor). The distribution of contributed trust capital and any accumulated income and capital gains from prior years should not give rise to any capital gains or capital losses in the special trust, since they represent a distribution of after-tax capital.

7. Procedures to register as a special trust for income tax and capital gains tax purposes

A trust which is required to submit a return for income tax must register with SARS. The trustees of a trust formed or established in South Africa must also lodge the trust instrument with the Master of the High Court.⁵⁶

A government notice is issued annually, indicating which persons must submit returns for a relevant year of assessment. For the 2020 year of assessment a resident trust is required to submit a return.⁵⁷ A trust that is not a resident must submit a return if it –

- carried on a trade through a permanent establishment in South Africa;
- derived income from a source in South Africa; or
- derived any capital gain or capital loss from the disposal of an asset to which the Eighth Schedule applies.⁵⁸

An IT77TR form “Application for Registration as a Taxpayer or Changing of Registered Particulars: Trust” should be completed for registration of a trust with SARS. The form makes provision for the registration of a trust as a “special trust”. A trust must be registered as from the year of assessment during which it started to exist.⁵⁹ The following documentation, amongst others, must be provided as stipulated on the **SARS website**:

- The certificate of registration from the Master's Office; or
- The trust deed registered with the Master's Office.

The following additional documentation must be submitted on request for a type-A trust:

- A medical report from a medical practitioner or medical institution confirming the nature of the disability of the beneficiary of the special trust.⁶⁰
- A medical report from a medical practitioner or medical institution confirming that the disability incapacitates the beneficiary from earning sufficient income for that person's maintenance or from managing that person's own financial affairs.

The trustees must indicate the type of trust on the return of income of the trust (ITR12T).

⁵⁶ Section 4 of the Trust Property Control Act. Section 8 of the Trust Property Control Act provides that that Act also applies to a person appointed outside South Africa as a trustee who is required to administer or dispose of trust property in South Africa.

⁵⁷ GN 741 GG 43495 of 3 July 2020 in paragraph 2(b).

⁵⁸ GN 741 GG 43495 of 3 July 2020 in paragraph 2(c).

⁵⁹ See 3.5 for a discussion of when a trust starts to exist.

⁶⁰ A “Confirmation of Diagnosis of Disability ITR-DD” form may be submitted in this regard.

8. Other taxes

A special trust does not enjoy relief from other taxes, unless specifically indicated below.

8.1 Provisional tax

A special trust that derives income must register as a provisional taxpayer.⁶¹ It is SARS's practice to register all trusts, except vesting trusts, as provisional taxpayers.

Provisional tax is not a separate tax but merely a mechanism to pay income tax during the year of assessment in which income is earned.⁶²

8.2 Employees' tax

A special trust may have people in its employ, for example, a nurse looking after a person with a disability. A special trust must register for employees' tax with SARS within 21 business days when its employees earn remuneration⁶³ that exceeds the liability threshold for the deduction of employees' tax.⁶⁴ The definition of "employees' tax" in paragraph 1 of the Fourth Schedule reads as follows:

“ **[E]mployees' tax** means the tax required to be deducted or withheld by an employer in terms of paragraph 2 from remuneration paid or payable to an employee;”

See the various SARS publications for more information on employees' tax.

8.3 Skills development levy

A compulsory levy to fund education and training is imposed under section 3(1) of the Skills Development Levies Act 9 of 1999 at 1% of the leviable amount. The leviable amount means the amount of remuneration as determined under the Fourth Schedule paid or payable or deemed to be paid or payable by an employer to that employer's employees during any month.⁶⁵

Employers whose total amount of remuneration will not exceed R500 000 in the following 12 months are exempt from paying the levy under section 4(b) of the Skills Development Levies Act. See the *Guide for Employers in respect of Skills Development Levy* for more information on the skills development levy.

8.4 Unemployment Insurance Fund contributions

Employers paying remuneration to their employees will be liable for Unemployment Insurance Fund contributions at a rate of 1% of remuneration paid or payable during any month under section 6(1) of the Unemployment Insurance Contributions Act 4 of 2002, unless they qualify for certain exemptions under section 4(1) of that Act. See the *Guide for Employers in respect of the Unemployment Insurance Fund* for more information on Unemployment Insurance Fund contributions.

⁶¹ See paragraph (a) of the definition of "provisional taxpayer" in paragraph 1 of the Fourth Schedule.

⁶² Definition of "provisional tax" in paragraph 1 of the Fourth Schedule read with paragraph 17(1) of the Fourth Schedule.

⁶³ Definition of "remuneration" in paragraph 1 of the Fourth Schedule.

⁶⁴ Paragraph 15(1) of the Fourth Schedule, read with section 22(2)(a) of the Tax Administration Act 28 of 2011.

⁶⁵ Section 3(4) of the Skills Development Levies Act.

8.5 Value-added tax

The definition of “person” in section 1(1) of the VAT Act includes any trust fund. A “trust fund” is defined in section 1(1) of the VAT Act as follows:

“ **‘[T]rust fund’** means any fund consisting of cash or other assets the administration and control of which is entrusted to any person acting in a fiduciary capacity by any person, whether under a deed of trust or by agreement, or by a deceased person under a will made by that person;”

VAT is levied under section 7(1) of the VAT Act at a rate of 15%⁶⁶ on the value of a supply of goods or services or the importation of goods, and in some instances, services. Certain exemptions, exceptions, deductions and adjustments are provided for in the VAT Act. Section 11 of the VAT Act provides for certain supplies of goods or services to be zero-rated (charged at 0%). Section 12 provides that the supply of certain goods or services is exempt from VAT.

A special trust that is registered for VAT that buys an asset which will form part of the enterprise of the trust will be entitled to claim input tax (that is, VAT paid on supplies made to the trust) on the asset. If a special trust is registered as a vendor and sells an asset that forms part of the trust’s enterprise, the sale would be subject to output tax (that is, VAT payable on taxable supplies made by the trust).

A special trust registered for VAT that distributes assets which form part of the enterprise of the trust to the beneficiaries of the trust, is liable for VAT on the distribution of the assets. The supply of services by the trust to the beneficiary would likewise be subject to VAT. Notwithstanding that no consideration may have been paid by the beneficiary for the assets, special time of supply and value of supply rules apply, since a trust and the beneficiary of a trust are “connected persons” for VAT purposes.

Thus, if a special trust distributes an enterprise asset to a beneficiary, the taxable supply is deemed to have been made when the supply is of –

- goods and the goods are to be removed, at the time of removal and when the goods are not to be removed, at the time they are made available to the beneficiary; and
- services, at the time the services are rendered.⁶⁷

The supply of the goods or services is deemed to be at market value when the beneficiary would not be entitled to a full input tax credit should VAT have been charged on the supply of the goods distributed to the beneficiary, or the services rendered to the beneficiary.⁶⁸

A special trust is required to register for VAT under section 23(1) of the VAT Act if it carries on an “enterprise” as defined in section 1(1) of the VAT Act and taxable supplies in excess of R1 million are made in any 12-month consecutive period. A special trust making taxable supplies with a value of less than R1 million may choose to register voluntarily under section 23(3) of the VAT Act. To qualify for voluntary VAT registration, the special trust must have made taxable supplies in excess of the minimum threshold of R50 000 in the past 12-month period. See the *VAT 404 – Guide for Vendors* for more information on VAT.

⁶⁶ The rate increased from 14% to 15% with effect from 1 April 2018.

⁶⁷ Section 9(2) of the VAT Act.

⁶⁸ Section 10(4) of the VAT Act.

8.6 Donations tax

8.6.1 Donations made to or by a trust

Donations tax is payable on the value of any gratuitous disposal of property by any person who is a resident to another person, including the disposal of property at less than market value.⁶⁹ The rate of donations tax is 20% of the value of the donation to the extent that the value of the donation and the value of previous donations by that donor do not exceed R30 million. Any excess above R30 million is subject to donations tax at the rate of 25%.⁷⁰ In determining whether the threshold of R30 million has been exceeded, the cumulative value of all property donated by the donor on or after 1 March 2018, which was not exempt from donations tax, is taken into account.⁷¹

Donations tax is payable by the donor under section 59. However, if the donor fails to pay the donations tax within the prescribed time, the donor and donee will be jointly and severally liable for donations tax.

Under section 56(1)(l) donations tax is not payable on property disposed of under a donation if it is disposed of under and in pursuance of any trust. The exemption applies to distributions of income or capital made by a trust to its beneficiaries in accordance with the trust deed. The word “capital” would include contributed capital as well as accumulated income and capital gains not distributed during the years of assessment in which they arose.

In *Abraham Krok Trust v C: SARS*⁷² Nugent JA referred to the observation by Marais J in *Welch's Estate v C: SARS*⁷³ in which he stated that the purpose of the exemption in section 56(1)(l) is to avoid donations tax being levied twice upon what was in essence one donation by the donor. Nugent JA went on to hold that the exemption, if properly construed, applies only to a donation that the trustees were authorised to make under the trust deed.⁷⁴

Donations tax is payable by a donor on donations of property to a special trust, subject to the exemptions under section 56. One of the exemptions that is likely to apply to a donor that is a natural person is section 56(2)(b). This section provides that the sum of donations by a natural person during a year of assessment is exempt from donations tax to the extent that it does not exceed R100 000.

8.6.2 Loan, advance or credit granted to a trust by a connected person (section 7C)

Section 7C was introduced to address the avoidance of donations tax and estate duty through the advance of a loan or credit to a trust.⁷⁵ The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017* provides the following explanation for the introduction of this section:⁷⁶

“An anti-avoidance measure aimed at curbing the tax-free transfer of wealth to trusts through the use of low interest or interest-free loans, advances or credit was introduced.... Under these

⁶⁹ Section 54 read with section 64.

⁷⁰ These rates apply with effect from 1 March 2018. See section 64.

⁷¹ See Draft Binding General Ruling (Donations Tax) “Determination of the Threshold for Applying the Higher Rate of Donations Tax”.

⁷² [2011] 2 All SA 591 (SCA), 73 SATC 105 at 110.

⁷³ 2005 (4) SA 173 (SCA), 66 SATC 303.

⁷⁴ At SATC 112.

⁷⁵ Section 7C applies to certain amounts owed by a trust on a loan, advance or credit provided to a trust before, on or after 1 March 2017 and to certain amounts owed by a company on a loan, advance or credit provided to a company before, on or after 19 July 2017.

⁷⁶ In paragraph 1.3.

tax avoidance schemes, a taxpayer transfers assets to a trust and the purchase price owed by the trust to the taxpayer in respect of the assets is left outstanding as a loan, advance or credit in favour of that taxpayer on which no interest or very low interest is charged. Alternatively, a taxpayer can advance a low interest or interest-free cash loan, advance or credit to a trust in order for the trust to use the money to acquire assets.

The use of low interest or interest-free loans in this manner means that donations tax is avoided when the assets are transferred in exchange for a low interest or interest-free loan, advance or credit because such transfers are treated as sale transactions and not donations. Furthermore, in some instances, the amount that is owed to the taxpayer (i.e. the loan claim) can remain outstanding indefinitely and the trust may have no real intention to pay it off. Coupled with the above, in some instances taxpayers reduce or waive the loan which is supposed to be paid back to him or her. This way, the waived amounts will not form part of his estate for purposes of estate duty. However, the taxpayer can make his children and/or spouse beneficiaries of the trust.”

Section 7C(1) provides that section 7C applies to any loan, advance or credit provided directly or indirectly to a trust by any of the following persons:

- A natural person that is a connected person in relation to the trust [section 7C(1)(a) read with section 7C(1)(i)(aa)].⁷⁷
- A natural person, if any connected person in relation to that natural person is a connected person in relation to the trust [section 7C(1)(a) read with section 7C(1)(i)(bb)].⁷⁸
- A company, if the loan, advance or credit is provided at the instance of a natural person that is a connected person in relation to the company under paragraph (d)(iv) of the definition of “connected person”, if the company or that natural person is a connected person in relation to the trust [section 7C(1)(b) read with section 7C(1)(i)(aa)].⁷⁹
- A company, if the loan, advance or credit is provided at the instance of a natural person that is a connected person in relation to the company under paragraph (d)(iv) of the definition of “connected person”, if any person that is a connected person in relation to that natural person or the company, is a connected person in relation to the trust [section 7C(1)(b) read with section 7C(1)(i)(bb)].⁸⁰

Section 7C(1) applies also to any loan, advance or credit provided directly or indirectly by any of the persons mentioned above to a company in which the trust alone or together with specified persons⁸¹ holds, directly or indirectly, at least 20% of the company's equity shares or can exercise at least 20% of the voting rights.

Section 7C(1A) provides that if a person acquires a claim to an amount owing by a trust or a company in respect of a loan, advance or credit referred to in section 7C(1), that person must for purposes of section 7C be treated as having provided a loan, advance or credit to that trust or company on the date on which that person acquired that claim, or if that person was not a connected person on that date in relation to that trust or the person who provided that loan, advance or credit to that trust or company, on the date on which that person became a connected person in relation to that trust or person. The person acquiring the claim will for

⁷⁷ Definition of “connected person” in section 1(1).

⁷⁸ See above.

⁷⁹ See above.

⁸⁰ See above.

⁸¹ Section 7C(1)(ii).

purposes of section 7C be treated as having provided a loan, advance or credit to that trust or company that is equal to the amount of the claim so acquired.

Under section 7C(3) an amount equal to the difference between the interest incurred by a trust or company on the loan, advance or credit referred to in section 7C(1) or (1A) during a year of assessment⁸² and the interest that would have been incurred had the interest been charged at the official rate of interest⁸³ is deemed, for purposes of donations tax,⁸⁴ to be a donation made by the natural person referred to in section 7C(1)(a) or (1A), on the last day of the trust's year of assessment.⁸⁵ The deemed donation occurs in every year of assessment when any loan, advance or credit meeting the requirements above is owed.

Section 7C(3) does not apply if any of the requirements in section 7C(5) are met. For example, an amount owing by a type-A trust is not subject to section 7C under section 7C(5)(c). Since section 7C does not contain a specific exemption for a type-B trust, an amount owing by a type-B trust may be subject to section 7C depending on the facts and circumstances.

8.7 Estate duty

Estate duty is levied on the dutiable amount of an estate under section 2(2) of the Estate Duty Act 45 of 1955. The rate on such dutiable amount is 20% if the dutiable amount of the estate does not exceed R30 million and 25% of the dutiable amount as exceeds R30 million.⁸⁶

While a trustee administers and owns the trust property, the property is held by the trustee for the benefit of the beneficiaries of the trust and is not owned by the trustee in the trustee's personal capacity. The property therefore does not form part of the trustee's personal estate for estate duty purposes and no estate duty would be payable on the value of the trust's property on the death of the trustee. Estate duty is also not levied on the value of the trust property held by a trustee for the benefit of the beneficiaries of the trust on the death of the beneficiaries, since the trust property similarly does not form part of their estates for estate duty purposes, assuming that they merely have contingent interests in the trust property on the date of death. Any outstanding loans advanced to the trust by the founder will form part of the founder's estate in the event of the founder's death.

If, however, the beneficiary of a special trust has a vested right to the assets of the trust and the beneficiary dies, the value of the vested right in the capital of the trust will be considered to be property⁸⁷ of the deceased beneficiary and dutiable in the estate of the beneficiary. The property administered by a *bewind* trust is owned by the beneficiary and its value must accordingly be taken into account in determining the estate duty liability of the beneficiary.

⁸² Assuming the interest incurred is incurred at a rate less than the official rate of interest. If interest is incurred at or above the official rate of interest, a deemed donation will not arise.

⁸³ Definition of "official rate of interest" in section 1(1).

⁸⁴ Part V of Chapter II of the Act.

⁸⁵ Section 7C(2), which contains income tax provisions, is not discussed for purposes of this part of the guide dealing with donations tax.

⁸⁶ The rate of 25% applies in respect of the estate of a person dying on or after 1 March 2018.

⁸⁷ As defined in section 3(2) of the Estate Duty Act.

8.8 Transfer duty

Transfer duty is levied under the Transfer Duty Act 40 of 1949 on the value of “property”, as defined in that Act, acquired by a person.

Transfer duty is payable under section 2(1)(b) of the Transfer Duty Act at the rates determined by parliament,⁸⁸ provided that the transaction is not exempt from transfer duty under section 9 of that Act. Transfer duty is payable when property is transferred to a trust or transferred from a trust to a beneficiary. However, trust property transferred by the trustee to persons entitled to it under the will or other written instrument (the trust deed) is exempt from transfer duty under section 9(4)(b) of the Transfer Duty Act. This exemption is restricted to transfers of property by –

- testamentary trusts; and
- *inter vivos* trusts if the beneficiaries are relatives of the founder of the trust and no consideration is paid directly or indirectly by such relatives⁸⁹ for the acquisition of the trust property.

A person cannot act as the trustee of a trust until the prescribed letters of authority are issued by the Master of the High Court. A “trust to be formed” may accordingly not be nominated as a purchaser for transfer duty purposes, not even when using the wording “*stipulatio alteri*”.⁹⁰

A person who acquires fixed property on behalf of a “trust to be formed” will have to pay transfer duty on the basis that the property had been acquired in that person’s own right on the date of the transaction. A further transaction must be entered into to transfer the property to the trust once the letters of authority have been issued. This further transaction results in a further dutiable transaction.⁹¹

In December 2002 the definition of “property” was broadened extensively by the insertion of paragraphs (d), (e) and (f) in the definition. These paragraphs are aimed at countering the widespread avoidance of transfer duty when residential property is acquired by companies, close corporations and trusts, after which the persons in control of these entities merely transfer the shares in the company, or member’s interest in the close corporation, or change the beneficiaries and trustees of the trust.⁹² By expanding the definition of property in this manner, it means the person acquiring the shares or member’s interest or obtaining control of the trust through a change in the beneficiaries and trustees is potentially liable for transfer duty. The definition of “property” in section 1(1) of the Transfer Duty Act reads as follows:

“**[P]roperty**’ means land in the Republic and any fixtures thereon, and includes—

- (a) any real right in land but excluding any right under a mortgage bond or a lease of property other than a lease referred to in paragraph (c);
- (b)
- (c) any right to minerals (including any right to mine for minerals) and a lease or sub-lease of such a right;
- (d) a share (other than a share contemplated in paragraph (g)) or member’s interest in a residential property company;

⁸⁸ See the relevant Rates and Monetary Amounts and Amendment of Revenue Laws Acts.

⁸⁹ Definition of “relative” in section 1(1) of the Estate Duty Act.

⁹⁰ See the Transfer Duty Guide.

⁹¹ As above.

⁹² See the Transfer Duty Guide.

- (e) a share (other than a share contemplated in paragraph (g)) or member's interest in a company which is a holding company (as defined in the Companies Act, 1973 (Act No. 61 of 1973), or as defined in the Close Corporations Act, 1984 (Act No. 69 of 1984), as the case may be), if that company and all of its subsidiary companies (as defined in the Companies Act, 1973, or Close Corporations Act, 1984), would be a residential property company if all such companies were regarded as a single entity;
- (f) a contingent right to any residential property or share or member's interest, contemplated in paragraph (d) or (e), held by a discretionary trust (other than a special trust as defined in section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962)), the acquisition of which is—
 - (i) a consequence of or attendant upon the conclusion of any agreement for consideration with regard to property held by that trust;
 - (ii) accompanied by the substitution or variation of that trust's loan creditors, or by the substitution or addition of any mortgage bond or mortgage bond creditor; or
 - (iii) accompanied by the change of any trustee of that trust; and
- (g) a share in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980);"

The substitution or addition of one or more beneficiaries with a contingent right to any property of a discretionary trust (excluding a type-A or type-B discretionary trust) which constitutes residential property or shares or member's interest referred to in paragraph (d) or (e) of the definition of "property" or a contingent right referred to in paragraph (f) of that definition, is a "transaction" as defined in section 1(1) of the Transfer Duty Act and is accordingly subject to transfer duty if no exemptions apply.⁹³

A contingent right to any residential property, or share or member's interest referred to in paragraph (d) or (e) of the definition of "property", held by a type-A or type-B discretionary trust, is excluded from paragraph (f) of the definition of "property". The substitution or addition of beneficiaries of a special trust may, however, trigger a liability for transfer duty if the substitution or addition of beneficiaries takes place during a year of assessment that a trust ceases to be a special trust (see 4.3.3 and 4.4.3), since the trust ceases to be a special trust from the beginning of that year of assessment.

8.9 Securities transfer tax

Securities transfer tax (STT) is levied on the transfer of a security⁹⁴ at the rate of 0,25% of the taxable amount of the security determined under section 2(1) of the Securities Transfer Tax Act 25 of 2007. STT is levied on the transfer of a security issued by –

- a close corporation or company incorporated, established or formed in the Republic; or
- a company incorporated, established or formed outside the Republic and listed on an exchange.

⁹³ Paragraph (c) of the definition of "transaction".

⁹⁴ The definition of "security" in section 1 of the Securities Transfer Tax Act means any share or depository receipt in a company or any member's interest in a close corporation.

Under section 8(1)(g) of the Securities Transfer Tax Act, STT is not payable on the transfer of a security if the security is transferred to a beneficiary entitled to it under a trust created in accordance with a will (testamentary trust).

Annexure – Whether a trust is regarded as a special trust for income tax and CGT purposes [definition of “special trust” in section 1(1)]

