SOUTH AFRICAN REVENUE SERVICE

DRAFT GUIDE ON THE TAXATION OF SPECIAL TRUSTS

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Draft Guide on 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 law as at the date of issue.

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 sent to **policycomments@sars.gov.za.**

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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;
- **“type-B trust”** means a special trust referred to in paragraph (*b*) of the definition of “special trust” in section 1(1);
- **“VAT Act”** means the Value-Added Tax Act 89 of 1991; and
- any 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.

2. Background

A single rate of tax of 40% for trusts was introduced[1] with effect from the 2003 year of assessment to combat the practice of income splitting through the use of multiple trust structures. This higher rate of tax does not, however, apply to special trusts which are taxed under the same rate structure as natural persons.

The definition of “special trust”, upon its initial introduction into section 1(1),[2] with effect from the 2002 year of assessment, only referred to a trust created solely for the benefit of “a person” who suffers from a defined mental illness or a serious physical disability. Applying a strict interpretation, the reference to “a person” arguably meant that a trust established for the benefit of more than one qualifying beneficiary would not have constituted a “special trust” as then defined. In addition, as is presently the case, to qualify as a “special trust” the beneficiary’s illness or disability must incapacitate that beneficiary from earning sufficient income for that person’s maintenance, or from managing that person’s own financial affairs. These trusts are referred to in this guide as **“type-A trusts”**.

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1 Introduced by section 8 of the Taxation Laws Amendment Act 30 of 2002.

2 The definition of “special trust” was inserted by section 5(*i*) of the Taxation Laws Amendment Act 5 of 2001. The definition of “special trust” for CGT purposes was inserted in paragraph 1 by section 63(1)(*d*) of the Revenue Laws Amendment Act 74 of 2002.

The definition of "special trust" in section 1 was extended[3] with effect from the 2003 year of assessment to also include certain trusts established by or under the will of a deceased person for the benefit of, amongst others, relatives of the deceased person when the youngest beneficiary is under the age of 21 years. These trusts are referred to in this guide as **"type-B trusts"**.

The definition of "special trust" in section 1(1) was amended[4] with effect from the 2013 year of assessment as follows:[5]

- In the case of a type-A trust,[6] the reference to "a person" was amended to refer to "one or more persons" to allow for more than one person with a disability, subject to the requirement that those persons should be relatives in relation to each other, and to restrict the concession to a person or persons with a "disability" as defined in section 18(3).
- In the case of a type-B trust,[7] the requirement that the youngest beneficiary had to be under the age of 21 was amended so that the youngest beneficiary must now be under the age of 18 years.[8]

The definition of "special trust" insofar as it relates to a type-A trust was again amended[9] with effect from the 2015 year of assessment to refer to a person or persons with a "disability" as defined in section 6B(1).

The distinction between a type-A trust and a type-B trust is important because a type-A trust qualifies for certain relief from CGT while a type-B trust does not qualify for such relief. The definition of "special trust" contained in paragraph 1 applies for CGT purposes only (see **6.4**).

3. Trusts under South African law

3.1 Trusts under South African common law

Under South African law there are three types of trust.

- An "ownership trust", under which the founder or settlor transfers ownership of assets or property to a trustee(s) 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 trustee(s).

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3 The definition of "special trust" was amended by section 9(*b*) of the Taxation Laws Amendment Act 30 of 2002.

4 The definition of "special trust" was substituted by section 2(1)(*z*A) of the Taxation Laws Amendment Act 22 of 2012.

5 A "year of assessment" is defined in section 1(1) (see **5.11**).

6 Paragraph (*a*) of the definition of "special trust" in section 1(1).

7 Paragraph (*b*) of the definition of "special trust" in section 1(1).

8 Section 17 of the Children's Act 38 of 2005 provides that a child becomes a major upon reaching the age of 18 years.

9 The definition of "special trust" was amended by section 4(1)(*zZh*) of the Taxation Laws Amendment Act 31 of 2013.

- A "curatorship trust", under which the trustee(s) administers 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.[10]

The Trust Property Control Act defines a "trust" in section 1 of that Act. The definition includes an ownership trust and a *bewind* trust:

> **"[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);

Trusts can be described in various ways, namely:

- 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.
- The rights they confer on beneficiaries (vesting and discretionary trusts). Under a vesting trust the income (both of a revenue and capital nature) or assets of the trust are vested in the beneficiaries and the beneficiaries are said to have vested rights to the income or assets of the trust. Under a discretionary trust the trustees usually have the discretion as to whether and how much of the income or capital of the trust to distribute to the beneficiaries. In these circumstances the beneficiaries merely have contingent rights to the income or capital of the trust.
- 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 both a type-A trust and a discretionary trust, and a testamentary trust can be both a type-B trust and a discretionary trust.

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. 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.[11]

[10] Section 72(1)(*d*) of the Administration of Estates Act 66 of 1965.

[11] P A Olivier, S Strydom & G P J van den Berg *Trust Law and Practice* 2 ed (2008) LexisNexis in paragraphs 2.5.1 and 2.5.2.

3.2 Trusts under the Income Tax Act

The definition of "person" in section 1(1) includes "any trust".[12] This definition was inserted following the decision in *CIR v Friedman & others NNO*[13] 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 term "trust" is defined in section 1(1) 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;

Two definitions of "special trust" are contained in the Act, 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) and who are 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 should be under the age of 18 years (a type-B trust) (paragraph (*b*) of the definition).

For CGT purposes a special trust means a trust contemplated in paragraph (*a*) of the definition of "special trust" in section 1(1). Therefore, only a trust created solely for the benefit of one or more persons who are persons with a disability (a type-A trust) will be a "special trust" for CGT purposes, unless stated otherwise.

The trustee is the representative taxpayer of a trust[14] and it therefore follows that the trustee of a special trust will be the representative taxpayer of the special trust and will act on behalf of the trust. 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 (ITR12TR) of the trust.

A "trustee" is defined in section 1(1) 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 trustee(s) (other than in the case of a *bewind* trust), a trustee is not the beneficial owner of the trust assets.[15]

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[12] Paragraph (*c*) of the definition of "person".

[13] 1993 (1) SA 353 (A), 55 SATC 39.

[14] Paragraph (*c*) of the definition of "representative taxpayer" in section 1(1).

[15] 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.

A "beneficiary" is defined in section 1(1) 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;

The authors of *Income Tax in South Africa* comment as follows on this definition:[16]

> "This definition is wide and includes capital and income beneficiaries with vested rights and discretionary beneficiaries, provided that these have been designated as such, irrespective of whether or not they have ever been in receipt of any distributions or have formally accepted benefits. The same would apply to members (named or unnamed) of a designated class of persons and where the class is specified as being a collection of persons from whom beneficiaries may be chosen by the trustees, even where this choice has not been made in respect of a particular person."[17]

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, a trust will qualify as a special trust for income tax purposes if it meets the requirements of a "special trust" as defined in section 1(1), and a special trust for CGT purposes if it meets the requirements of a "special trust" as defined in paragraph 1.

4. The characteristics of a special trust

4.1 The law

Section 1(1) – Definition of "special trust"[18]

> **"[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;

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16 D Clegg & R Stretch *Income Tax in South Africa* [online] (My LexisNexis: September 2013) in paragraph 24.1.1.

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

18 The definition of "special trust" was substituted by section 2(1)(*z*A) of the Taxation Laws Amendment Act 22 of 2012 with effect from years of assessment commencing on or after 1 March 2012.

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 only of relevance if in fact the income (whether revenue or capital in nature) falls to be taxed in the trust. Thus, when a beneficiary of a vesting trust has a vested right to the income (whether of a revenue or capital nature) derived by the trust, that income falls to be taxed in the beneficiary's hands and the provisions of the Act relating to special trusts are not of any application to such income. A *bewind* trust will similarly not benefit from being a special trust since the income and capital gains of the trust will be taxable in the hands of the beneficiary of the *bewind* trust. A vesting trust in which the beneficiary has a vested right in the **trust assets** will be in the same position as a *bewind* trust for CGT purposes and the income derived in consequence of the exploitation of the assets will be taxed in the hands of the beneficiary. See **5.1**, **6.1** and **6.5**.

4.3 Characteristics of a type-A trust

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).[19]

A "disability" is defined in section 6B(1) 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 means 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.[20]

4.3.3 The sole benefit requirement

The trust should 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).

[19] Section 6B was inserted by section 7(1) of the Taxation Laws Amendment Act 22 of 2012 with effect from 1 March 2014 and applies to years of assessment commencing on or after that date.

[20] See Part B of the "Confirmation of Diagnosis of Disability" (ITR-DD) on the SARS website.

The fact that the trust must be created for the benefit of beneficiaries having a disability does not mean that the beneficiaries should have a vested right to the income or capital of the trust. In fact, should the beneficiaries have such vested right, the income (whether of a revenue or capital nature) would fall to 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 in the beneficiaries' hands (see **5.1** for a discussion of "vested rights").

The trust deed or will should not make provision for, or grant, a discretion to the trustee(s) enabling 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 as long as a beneficiary or beneficiaries for whose sole benefit the trust was created is alive. If a person who does not have a disability has a vested right, or obtains a vested right, to the income or capital of a trust, the trust will not qualify as a type-A trust.

The beneficiary of a type-A trust can only be 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,[21] 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.[22]

Example 1 – Characteristics of a type-A trust

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 and 42 years of age. Does AB Trust qualify as a type-A trust?

Result:

AB Trust qualifies as a type-A trust 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 each other does not apply since C is the founder of AB Trust and not a beneficiary. The fact that B is over the age of 18 also does not result in the trust being disqualified as a type-A trust because there is no age restriction that applies to a type-A trust.

Example 2 – Characteristics of a type-A trust

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 as long as B is alive. C did not have any children at the time of drawing up the trust deed. Does AB Trust qualify as a type-A trust?

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21 In the case of a type-B trust, the beneficiaries of the trust should be relatives of the deceased person [paragraph (*b*) of the definition of "special trust" in section 1(1)].

22 In the case of a type-B trust however, the youngest of the beneficiaries of the trust should be under the age of 18 years (see **4.4.4**).

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 as long as B is alive disqualifies the trust from being classified as a type-A trust.

Note:

It does not matter that the trustees did not exercise their discretion to name the children of C as beneficiaries of AB Trust, nor does it matter that no children of C have as yet been born.

Example 3 – Characteristics of a type-A trust

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. Does EF Trust qualify as a type-A trust?

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 and financial management requirements

The beneficiaries of a type-A trust must be incapacitated as a result of a disability from –

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

A trust will not qualify as a type-A trust if a beneficiary of the trust is a person with a disability but is still able to earn sufficient income for that person's maintenance and is able to manage that person's own financial affairs. Whether or not a beneficiary derives sufficient income for that person's maintenance or is in a position to manage that person's affairs is a factual issue and will depend on the specific circumstances of the beneficiary concerned.

4.3.5 The living beneficiaries requirement

Even if a trust complies with the other requirements discussed in the preceding paragraphs, it is a further 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 cease to be a type-A trust from the commencement of the year of assessment during which all the beneficiaries for whose sole benefit the trust was created are deceased.

A trust deed may allow for other non-qualifying persons to become beneficiaries after the death of the last qualifying beneficiary, but such a trust will no longer be taxed as a special trust.

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

- A *bewind* 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 – Characteristics of a type-A trust

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 January 2014. Does GH Trust qualify as a type-A trust for the 2006 to 2014 years of assessment?

Result:

GH Trust qualified as a type-A trust for the 2006 to 2013 years of assessment. GH Trust does not qualify as a special trust for the 2014 year of assessment because H passed away during the 2014 year of assessment and the trust will accordingly be taxed at the rate of 40% for the 2014 year of assessment (see **5.10**).

4.3.6 The relatives requirement

A trust that is created solely for the benefit of more than one person 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 for purposes of paragraph (*a*) of the definition of "special trust" and accordingly has no impact on the question whether a trust qualifies as a "special trust".

A "relative" is defined in section 1(1) and 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.[23]

A "spouse" is defined in section 1(1) and 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 the Commissioner is satisfied is intended to be permanent.

[23] See Interpretation Note No. 67 (Issue 2) dated 14 February 2014 "Connected Persons" for a discussion of the definition of "relative".

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 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)).

Example 5 – Characteristics of a type-A trust

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 after the death of D solely for the benefit of B and C. Does the BC Trust qualify as a type-A trust?

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 qualifies as a type-A trust 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

4.4.1 Modes of formation

A type-B trust can only be created by or under the will of a deceased person. It follows that only a testamentary trust will 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 a discussion of the meaning of "relative". The beneficiaries need not be relatives in relation to each other.[24]

[24] 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)].

Example 6 – Characteristics of a type-B trust

Facts:

The JK Trust was created under L's will for the benefit of L's minor child J and cousin K. Does the JK Trust qualify as a type-B trust?

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 (L).

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 relative includes any beneficiary who has been conceived but not yet born on the date of death of the deceased person. It follows that a trust will not qualify as a type-B trust if it allows for the unborn and not conceived descendants of the testator to benefit under the trust formed after the testator's death. Substitution of beneficiaries will also disqualify a trust from being a type-B trust.

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 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 are related to the deceased person and the youngest beneficiary is under the age of 18.

Example 7 – Characteristics of a type-B trust

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. N was killed in a motor vehicle accident on 16 August 2013 and L passed away on 3 September 2013. The MN Trust was created on 15 October 2013. Does the MN Trust qualify as a type-B trust?

Result:

The MN Trust will qualify as a type-B trust for the benefit of M if N's estate will not benefit from the trust. Should N's estate benefit from the trust, the trust would not be 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 may include persons aged 18 years and older as long as 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 – Characteristics of a type-B trust

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 2014. P's children were respectively aged 18, 23 and 24 on 28 February 2014. Does Trust X qualify as a type-B trust for the 2014 year of assessment?

Result:

Trust X does not qualify as a type-B trust for the 2014 year of assessment because the youngest of the beneficiaries was not **under the age of 18** years on 28 February 2014.

4.5 Resident status of a special trust (type-A and type-B) and of the beneficiaries of a special trust

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.[25]

The tax residency of a special trust is of course only of any relevance if such special trust derives gross income or capital gains and is accordingly subject to South African tax.

This Guide focusses mainly on the tax implications for a special trust and not on the tax implications for the beneficiaries. 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 trust constituting a special trust (type-A and type-B trusts)

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.

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), be deemed to accrue to an ascertained beneficiary if the beneficiary has a vested right to the amount. A beneficiary may, for example, have a vested right to the relevant amount under the trust deed or acquire a vested right to the amount received by or accrued to the trust by the exercise of the trustees' discretion in the year of assessment to distribute the amount to the beneficiary. The amount will be treated as having accrued to the

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[25] A "resident" is defined in section 1(1) (see **5.2**).

trust itself if no beneficiary has a vested right to the amount in the year of assessment in which the amount accrues to, or is received by, the trust.

Thus, 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.

A "vested right" can have a different meaning depending on the context in which the words are used. This was highlighted in *Jewish Colonial Trust Ltd v Estate Nathan* in which Watermeyer JA stated the following:[26]

> "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:[27]

> "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."[28]

A contingent right is merely a *spes* – an expectation which might never be realised.[29] For example, a beneficiary will 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.

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) notwithstanding that 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

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26 1940 AD 163 at 175 – 6.

27 (1980) 43 SATC 56 (N) at 60.

28 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).

29 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).

- not actually been paid over to the taxpayer, but remains due and payable to the taxpayer.[30]

It follows, for example, that should income be vested by the trustees in a beneficiary but such income is retained by the trust, the income will still be regarded as having accrued to the beneficiary notwithstanding that the income has not been paid to the beneficiary.

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.[31] It was held in *Ovenstone v CIR*[32] that the phrase "any donation, settlement or other disposition" excludes any disposal of property made for adequate consideration but covers any disposal of property made wholly gratuitously out of liberality or generosity or made under a settlement or other disposition for some consideration but in which there is an appreciable element of gratuitousness and liberality or generosity.

In deciding whether income is attributable to a donation, settlement or other disposition,[33] the principle established in *CIR v Widan*[34] 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 efficient cause of the income being generated.

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.

The provisions of the Act relating to a special trust will only apply if income is taxable in the trust.

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

A resident special trust is taxable on its worldwide receipts or accruals.

The term "gross income", in the case of any resident, means the total amount in cash or otherwise received by or accrued to or in favour of such resident, excluding receipts or accruals of a capital nature.[35]

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[30] 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).

[31] 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.

[32] 1980 (2) SA 721 (A), 42 SATC 55.

[33] See **6.1** for an example of a disposition made by a donor to a trust.

[34] 1955 (1) SA 226 (A), 19 SATC 341.

[35] The term "gross income" is defined in section 1(1).

A “resident”, in the case of a person other than a natural person, is defined 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 management[36] in South Africa will accordingly be a “resident” for South African tax purposes.

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.

Should the special trust be regarded as tax resident in South Africa and another country with which South Africa has entered into a tax treaty,[37] the special trust will be regarded as tax resident in the country in which it is deemed to be exclusively resident under the tax treaty.[38]

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

A non-resident trust will only be subject to South African income tax on receipts or accruals from a South African source.

The term “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, excluding receipts or accruals of a capital nature.[39]

5.4 Gross income versus income of a capital nature [section 1(1)]

Amounts received by or accrued to a trust will be included in the gross income of the trust if the amounts are not of a capital nature. Receipts or accruals of a capital nature may be subject to CGT in the trust (see **6**).

5.5 The nature of income derived and distributed by a trust

Different types of income may be derived by a trust. If an amount of income of a trust is vested in a beneficiary during the same year of assessment in which it accrued to the trust, it will, subject to section 7, be deemed under section 25B(1) to be an amount of income that accrued to the beneficiary. Since it is the same amount of income which is deemed to accrue to the beneficiary, it follows that the income will retain its character in the beneficiary’s hands. Thus, for example, should a trust derive domestic dividend income that is vested in the beneficiaries before the end of the year of assessment, the beneficiaries will be treated

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[36] See Interpretation Note No. 6 dated 26 March 2002 “Resident: Place of Effective Management (Persons Other Than Natural Persons)” and the *Discussion Paper on Interpretation Note 6* for a discussion of the words “place of effective management”.

[37] An agreement for the avoidance of double taxation entered into between the Republic and another country.

[38] As above.

[39] The term “gross income” is defined in section 1(1).

as having received dividend income in that tax year and the exemption provided for in section 10(1)(*k*)(i) may apply to such income.

5.6 Dividend exemptions (sections 10(1)(*k*)(i), 10(2)(*b*) and 10B)

Domestic dividends received by or accrued to a trust which are distributed to 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 may be wholly or partially exempt under section 10B. Section 10(2)(*b*) provides that the exemption under section 10(1)(*k*)(i) will not apply if income is received in the form of an annuity. Section 10B(5) provides that the exemptions under section 10B shall not apply to any payments (such as annuities) 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)(*b*)(ii)(*aa*) for a natural person and a special trust is calculated at the ratio of 25 to 40 of the amount of foreign dividends received by or accrued to the natural person or special trust (see **Example 9**).

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

The income tax rate of a special trust is not the single rate of 40% that applies to a normal trust, but the sliding scale that varies from 18% to 40% that applies to a natural person.[40] For example, a special trust with a taxable income of R50 000 for the 2014 year of assessment will have a tax liability of R9 000 (R50 000 × 18%) instead of R20 000 (R50 000 × 40%).

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 2014 year of assessment.

	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	(15 000)				(15 000)
Net income	**45 000**	**25 000**	**12 000**	**100 000**	**182 000**

Calculate the tax liability of XYZ Trust for the 2014 year of assessment.

[40] Section 5(2) read with section 1(1) and paragraphs 1 and 2 of Appendix 1 of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 23 of 2013.

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 does not have a vested right to the income of the trust in the 2014 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 – R62 500 (R100 000 × 25 / 40)] (Note 2)	37 500
Taxable income	**107 500**
Tax liability @ 18%	19 350,00

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 40% had XYZ Trust not qualified as a special trust. The tax liability would have been R43 000 (R107 500 × 40%).
4. Should Y have 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 vests in Y would be 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 is only applicable to natural persons, for example, the primary, secondary and tertiary rebates under section 6 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. A "purchaser" is defined in section 10A(1) and 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*):

$$\frac{\text{Amount of the total cash consideration given by the purchaser under the annuity contract}^{41}}{\text{Total expected returns of all the annuities provided for in the annuity contract}} \times \text{Annuity amount}^{42}$$

A trust referred to above 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 further requirement of paragraph (*a*) of the definition of "special trust" in section 1(1) that the disabled person must be incapacitated "from managing their own financial affairs" would be met. It follows that while a trust established by order of court in the circumstances described above (a "purchaser" as defined for purposes of section 10A) 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), because, for example, the person's affliction (unsound mind) may not constitute a "disability" as defined.

Example 10 – Exemption of the capital amount of purchased annuities

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. The trustee 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 2013.

Calculate the amount of the annuity to be included in the gross income of Trust B for the 2014 year of assessment. Assume that C does not have a vested right to the annuity.

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.

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).

[41] The term "annuity contract" is defined in section 10A(1).

[42] 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:

Cash consideration / Total expected returns × Annuity amount

= R100 000 / R210 000 × R7 200

= R3 428.

The amount of the annuity included in the gross income of Trust B for the 2014 year of assessment is R3 772 (R7 200 – R3 428).

5.10 When a trust ceases to be a special trust for income tax purposes

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 either earn sufficient income for that person's own maintenance or to manage that person's own financial affairs.
- The beneficiaries for whose sole purpose a type-A trust was created are all deceased.
- The youngest of the beneficiaries of a type-B trust attains the age of 18 years during, or 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 enables or is varied to enable additional beneficiaries who are not disabled to obtain a vested right to any income or capital of the trust as long as the disabled beneficiary or beneficiaries for whose sole benefit the trust was created is or are alive.
- The provisions of the trust deed of the trust (type-A or type-B) are varied, added to, supplemented or amended in such a manner that the trust no longer complies with the requirements of a special trust.
- The trust (type-A or type-B) is involved in an impermissible tax avoidance arrangement under section 80A such that the existence of the trust may be ignored. When an impermissible tax avoidance arrangement is found to exist, 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. SARS is also granted other remedies to combat impermissible tax avoidance arrangements under section 80B(1)(*a*) to (*e*).

A trust that ceases to be a special trust (type-A or type-B) will be taxed at the rates of normal tax applicable to normal trusts (single rate of 40%) as from the year of assessment of the trust during which any of the abovementioned events occur.

5.11 Year of assessment

The year of assessment[43] of a special trust will always end on the last day of February.[44] 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

43 A "year of assessment" is defined in section 1(1).

44 Section 5(1)(*c*).

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. It follows that the last day of February will 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 No. 19 (Issue 3) dated 9 October 2013 "Year of Assessment of Natural Persons and Trusts: Accounts Accepted to a Date other than The Last Day of February".

6. CGT provisions relating to a special trust

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

The provisions of the Eighth Schedule that apply to a trust generally also apply to a special trust as contemplated in section 1(1) if a capital gain or capital loss is taxable in the trust.[45] However, certain provisions of the Eighth Schedule apply only to type-A trusts – these provisions are dealt with in **6.4**.

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 accounted for by another person. Two sets of attribution rules exist, namely –

- rules that attribute a capital gain to a 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 will, depending on the circumstances, be attributed to the donor under paragraphs 68 to 72 (see **5.1** 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 in the **capital gain but not in the asset**, the disposal of which gave rise to the capital gain. The capital gain must be disregarded in the trust and accounted for 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.[47]

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[45] Paragraph 6 of this Guide is largely based on the *Comprehensive Guide to Capital Gains Tax* (Issue 4).

[46] Paragraph 11(1)(*d*).

[47] See the commentary on this issue in paragraph 14.11.4 of the *Comprehensive Guide to Capital Gains Tax* (Issue 4).

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

Facts:

On 1 March 2013 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 the rate of 10% a year. ABC Trust used the funds to purchase South African-listed shares for R100 000. During the 2014 year of assessment dividends of R2 000 were received by ABC Trust. On 28 February 2014 the shares were sold for R111 000 and a capital gain of R11 000 (R111 000 – R100 000) was made.

Assume that the disposal is of a capital nature and that ABC Trust did not distribute the income of the trust or the capital gain to the beneficiary. Determine in whose hands the dividends and capital gain must be taxed.

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 2014 year of assessment from the interest-free loan is R10 000 (R100 000 × 10%). Dividends of R2 000 that accrued to ABC Trust are deemed to be the income of D under section 7(5).[48] The remaining benefit of R8 000 (R10 000 – R2 000) is attributed as a capital gain to D under paragraph 70. The remaining portion of the capital gain of R3 000 (R11 000 – R8 000) is taxed in ABC Trust.[49]

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

After determining a special trust's aggregate capital gain or aggregate capital loss (as explained in **6.4.1**), the special trust's assessed capital loss of the previous year of assessment, if any, must be deducted from the aggregate capital gain or added to the aggregate capital loss of the trust to determine the trust's net capital gain or assessed capital loss for the current year of assessment.

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 the trust's taxable income for the year of assessment. The inclusion rate of a net capital gain of a special trust (both type-A and a type-B) is 33,3% under paragraph 10(*a*), compared to the inclusion rate of a normal trust of 66,6% under paragraph 10(*c*).

A taxable capital gain attributed to a special trust from a controlled foreign company[50] is arrived at by multiplying the controlled foreign company's net capital gain by an inclusion rate of 33,3% under section 9D(2A)(*f*).

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48 The dividends of R2 000 will be exempt from normal tax under section 10(1)(*k*)(i).

49 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 (see paragraph 15.8 of the *Comprehensive Guide to Capital Gains Tax* (Issue 4) for a discussion of paragraph 73).

50 The term "controlled foreign company" is defined in section 1(1).

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

Facts:

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 to the capital gain. Trust X did not have any other taxable income for the 2014 year of assessment. The acquisition of the fixed property was not funded by a donation, settlement or other disposition.

Calculate the tax liability of Trust X for the 2014 year of assessment.

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 2014 year of assessment is calculated as follows, depending on the nature of the trust:

Type of trust	**Type-A trust**	**Type-B trust**	**Normal trust**
	R	R	R
Capital gain	1 250 000	1 250 000	1 250 000
Annual exclusion	(30 000)		
Aggregate capital gain	**1 220 000**	**1 250 000**	**1 250 000**
Inclusion rate	33,3%	33,3%	66,6%
Taxable capital gain	**406 260**	**416 250**	**832 500**
Tax rate	sliding scale	sliding scale	40%
Tax payable	99 756,50	103 253,00	333 000,00

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

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

An "asset" is defined in paragraph 1 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.
- Any asset which is attributable to a permanent establishment of the trust in South Africa.

A tax treaty[51] may, however, provide that a capital gain on disposal of certain assets is only taxable in the contracting state of which the seller is a resident.

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

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

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

A type-A “special trust” as defined in paragraph 1 is entitled to certain exclusions applicable to natural persons.

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

Unlike the position in regard to the taxation of 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 qualifying beneficiary or beneficiaries 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[52] (see **6.4.5**). Thus, for example, if a special trust ceases to be a “special trust” as defined in paragraph 1 (that is, a type-A trust) because all the qualifying 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 qualifying beneficiary.

6.4.1 The annual exclusion (paragraph 5)

A type-A trust is entitled to the annual exclusion provided for in paragraph 5. The purpose of the annual exclusion is to reduce compliance costs by keeping small capital gains and losses out of the CGT system.

Once all the capital gains and capital losses of a person have been calculated, the aggregate capital gain or aggregate capital loss is determined by adding together all capital gains and deducting all capital losses during the year of assessment to arrive at a net total. The net total, whether it is positive or negative, is then reduced by the annual exclusion. If the result is a positive figure it is an aggregate capital gain, and if it is negative it is an aggregate capital loss.

The annual exclusion for a type-A trust for the 2014 year of assessment is R30 000.

[51] An agreement for the avoidance of double taxation entered into between the Republic and another country.

[52] Paragraph 82.

6.4.2 The primary residence exclusion (paragraphs 44 to 50)

Under paragraph 45(1) a type-A trust that is a discretionary trust must disregard a capital gain or capital loss on the disposal of a primary residence –

- to the extent that the capital gain or capital loss does not exceed R2 million [paragraph 45(1)(*a*)]; or
- if the proceeds on disposal of the primary residence do not exceed R2 million [paragraph 45(1)(*b*)].[53]

A "primary residence" is defined in paragraph 44 and for purposes of a type-A trust 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 mainly for domestic purposes.[54]

The term "an interest" is defined in paragraph 44 and 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.

However, specifically excluded from "an interest" is 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. A beneficiary cannot therefore be said to have "an interest" in a residence owned by the special trust. The property owned by the special trust will nevertheless still be regarded as a "primary residence" of a special trust provided the beneficiary or a spouse of the beneficiary uses the property mainly (more than 50%) for domestic (that is, residential) purposes.

A beneficiary who holds an interest in a trust or an asset of a trust will not be able to claim the primary residence exclusion because of the exclusion of such a right or an interest from the definition of "an interest" in paragraph 44. Furthermore, if a beneficiary resides in a residence owned by the trust, the beneficiary will not be entitled to claim a primary residence exclusion as it cannot be said that such beneficiary has "an interest" in the residence which is owned by the trust. The trust will of course be entitled to claim the exclusion if the other requirements specified in paragraphs 45 to 50 are met since it holds "an interest" in the residence occupied by the beneficiary.

Vesting of a residence in a beneficiary and subsequent disposal to a third party

Once the trustees of a special trust vest an interest in a residence in a beneficiary, the trust will cease to be the owner of the residence for CGT purposes (that is, cease to have "an interest" in the residence) and the special trust will be unable to claim the primary residence exclusion.

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[53] As from the 2010 year of assessment.

[54] 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%.

Should the trustees of a type-A trust, therefore, distribute a residence to the beneficiary (that is, the beneficiary acquires a vested right to the residence by virtue of the *in specie* distribution), the trust will have disposed of an asset and a CGT liability arises. Since the trust and the beneficiary are regarded as "connected persons" in relation to one another, the disposal is deemed to be at market value under paragraph 38. Any capital gain arising in the special trust from the vesting of the residence must be disregarded by the trust and taken into account by the resident beneficiary under paragraph 80(1). Since the relevant capital gain is attributed to the beneficiary before the primary residence exclusion is taken into account, the beneficiary is taxable on the gross amount of the capital gain. The beneficiary may not take the primary residence exclusion into account in determining the aggregate capital gain or aggregate capital loss because it cannot be said that **the beneficiary** held "an interest" in the residence as contemplated in paragraph 44.

Should the type-A trust subsequently, acting on behalf of the beneficiary, dispose of the residence that is already vested in the beneficiary to a third party, neither the special trust nor the beneficiary will be entitled to claim the primary residence exclusion since neither holds an interest in the residence.

Bewind trust

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

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

Under paragraph 80(2), if a type-A trust disposes of the primary residence to a third party and a resident beneficiary of the trust obtains a vested right in the resultant capital gain (but not in the residence) the amount of the capital gain that vests in the beneficiary must be –

- disregarded in determining any aggregate capital gain or aggregate capital loss of the trust; and
- taken into account in determining the beneficiary's aggregate capital gain or aggregate capital loss.

Since the trust had "an interest" in the primary residence on the date of disposal of the residence to a third party, and not the beneficiary, the beneficiary will, notwithstanding that the beneficiary is liable for CGT on the attributed capital gain, not qualify for the primary residence exclusion under paragraph 45 (see **Example 13**).

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 R2 million proceeds exclusion under paragraph 45(1)(*b*) 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 thereof 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.

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. 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 the beneficiary's primary residence and at that time it was offered for sale and vacated because of the acquisition or intended acquisition of a new primary residence. This concession will 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 the beneficiary's primary residence [paragraph 48(*b*)].
- The residence is accidentally rendered uninhabitable, for example, when it is destroyed 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 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 used the residence for domestic purposes; and
- the part of the residence used by the beneficiary mainly for purposes other than the carrying on of a trade.

The portion of any capital gain or loss relating to trade usage by the beneficiary's spouse will also not qualify for the primary residence exclusion since it will not comprise domestic usage by the beneficiary.

Paragraph 50 allows a beneficiary of a special trust or the beneficiary's spouse to let the primary residence without that letting activity disqualifying that period of ownership as non-residential usage. 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*). The following conditions, however, apply:

- 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*)].[55]

Example 13 – Primary residence exclusion

Facts:

Trust C is a type-A trust and disposed of a residence owned by it. The beneficiary of Trust C ordinarily resided in the residence and used it mainly for domestic purposes. A capital gain of R2,5 million was made on disposal of the residence during the 2014 year of assessment. The beneficiary did not obtain a vested right to the capital gain. Trust C had no other taxable income for the 2014 year of assessment and its acquisition of the residence was not funded by a donation, settlement or other disposition. Calculate the tax liability of Trust C for the 2014 year of assessment.

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*)]	(2 000 000)
	500 000
Less: Annual exclusion (paragraph 5)	(30 000)
Aggregate capital gain	**470 000**
Inclusion rate [paragraph 10(*a*)]	**33,3%**
Taxable capital gain	**156 510**
Tax liability of Trust C (R156 510 × 18%)	28 171,80

Note:

The amount of the capital gain of R2,5 million would have been taxable in the hands of the beneficiary under paragraph 80(2) if the beneficiary had obtained a vested right to the full amount of the capital gain. If the trustees decided in the latter case to vest only R500 000 of the capital gain in the beneficiary and not the full amount of the capital gain of R2,5 million, Trust C would have qualified for the primary residence exclusion of R2 million and the excess of R500 000 would have been taxable in the beneficiary's hands.

[55] See Chapter 11 of the *Comprehensive Guide to Capital Gains Tax* (Issue 4) for a discussion of the primary residence exclusion.

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 February 2014 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. Calculate the tax liability of Trust X on the capital gain.

Result:

Trust X does not qualify for the primary residence exclusion under paragraph 45(1)(*b*) (proceeds less than R2 million) because a portion of the residence was used for purposes of carrying on a trade. However, a portion of the capital gain qualifies for the primary residence exclusion under paragraph 45(1)(*a*) read with paragraph 49 (capital gain or capital loss less than R2 million). 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*)]	(800 000)
	200 000
Less: Annual exclusion (paragraph 5)	(30 000)
Aggregate capital gain	**170 000**
Inclusion rate [paragraph 10(*a*)]	**33,3%**
Taxable capital gain	**56 610**
Tax liability of Trust X (R56 610 × 18%)	10 189,80

Example 15 – Primary residence exclusion

Facts:

D, the beneficiary of Trust C, passed away on 31 October 2013. Trust C qualified as a type-A trust. Trust C owned a residence that was used by D as a primary residence. Trust C sold the residence for R3 million on 15 January 2014 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. Does Trust C qualify for the primary residence exclusion?

Result:

The capital gain of R1,4 million is taxable in Trust C but must be disregarded 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.

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.

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).[56]

In order 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.[57]

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 resulting 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)(*g*B)(iv) with effect from 1 March 2012, 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 January 2014 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.

Are the proceeds of R12 million taxable in Trust X?

[56] Paragraph 53(3).

[57] See paragraph 12.2 of the *Comprehensive Guide to Capital Gains Tax* (Issue 4) for a discussion of paragraph 53.

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 on behalf of its beneficiary.

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 type-A trust will still apply, including the annual exclusion under paragraph 5. The inclusion rate of the net capital gain in taxable income will remain 33,3% 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 trust for whose sole benefit the trust was created.

The rate of tax at which a taxable capital gain will be taxed will, however, be the single rate of 40% that applies to trusts generally. The normal rates of tax applicable to a special trust can only be applied for the years of assessment of the trust during which the last living beneficiary of a type-A trust is alive (see **5.10**).

A capital gain arising after the disposal of all the assets held by the trust, or after 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 type-A trust. The inclusion rate of 66,6% on a net capital gain will apply instead of the more favourable inclusion rate of 33,3%.[58]

Example 18 – Death of the beneficiary of a type-A trust

Facts:

C was the beneficiary of Trust D, a discretionary type-A trust, and passed away on 15 January 2013. Trust D received taxable income of R300 000 for the 2013 year of assessment. All the assets of Trust D were disposed of by the trustees on 18 February 2014. 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 2014 year of assessment amounted to R50 000. Calculate the tax liability of Trust D for the 2013 and 2014 years of assessment. 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 during the 2013 and 2014 years of assessment.

[58] See paragraph 14.13.3 of the *Comprehensive Guide to Capital Gains Tax* (Issue 4) for a discussion of paragraph 82.

Result:

The tax liability of Trust D is calculated as follows:

	R
2013 year of assessment	
Taxable income	**300 000**
Tax payable @ 40%	120 000
2014 year of assessment	
Sum of capital gains	1 600 000
Annual exclusion (paragraph 5)	(30 000)
Aggregate capital gain	**1 570 000**
Inclusion rate [paragraph 10(*a*)]	**33,3%**
Taxable capital gain	522 810
Other taxable income	50 000
Taxable income	**572 810**
Tax payable @ 40%	229 124

Note:

The 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 CGT implications of a single beneficiary trust

The trust deed of a trust created for a single beneficiary must be examined to determine whether the beneficiary has a vested right to the assets of the special trust. Should the beneficiary have such a vested right, the special trust is essentially ignored for CGT purposes and any capital gains and losses must be determined in the beneficiary's hands with any actions of the trustees merely being actions on behalf of, and for the benefit of, the beneficiary.

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 the term "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 income 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, as the trust will of necessity have to be the owner of the assets in order 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. If the trust deed provides that the residue must be distributed to the beneficiary's deceased estate, it may indicate that the beneficiary has a vested right to the trust assets. By contrast, if the trust deed provides for the trust assets to be distributed to another person, such as the beneficiary's children or spouse, this would indicate that the beneficiary does not have a vested right to the trust assets.

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.

In all cases 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.

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

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 must be attached to the application for registration:

- The trust deed in the case of an *inter vivos* trust.
- The last will of the deceased person in the case of a testamentary trust.

The following additional documentation must be submitted in the case of 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 (ITR12TR).

8. Other taxes

No relief from other taxes applies to a special trust, unless specifically indicated below.

8.1 Provisional tax

A special trust that derives income, other than remuneration or an allowance or advance contemplated in section 8(1) must be registered as a provisional taxpayer.[61] 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] A special trust that becomes liable for the payment of provisional tax must apply in writing or via e-filing for registration within 21 business days of becoming liable.[63]

[59] See **5.2** for a discussion of when a trust starts to exist.

[60] A "Confirmation of Diagnosis of Disability ITR-DD" form that is available on the SARS website may be submitted in this regard.

[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] Paragraph 17(8) of the Fourth Schedule read with section 22(2)(*a*) of the Tax Administration Act 28 of 2011.

Application for a return for payment of provisional tax (IRP6) should be made at the nearest SARS branch office or via e-filing. See the *Reference Guide – Provisional Tax* on the SARS website.

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 remuneration[64] that exceeds the liability threshold for the deduction of employees' tax.[65] The term "employees' tax" is defined in paragraph 1 of the Fourth Schedule 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 publications available on the SARS website for more information on employees' tax.

8.3 Skills development levy (SDL)

A compulsory levy to fund education and training is imposed under section 3(1)(*b*) 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 its employees during any month.[66]

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* on the SARS website for more information on SDL.

8.4 Unemployment Insurance Fund (UIF) contributions

Employers paying remuneration to their employees will be liable for UIF at a rate of 1% of remuneration paid or payable during any month under section 6(1)(*b*) of the Unemployment Insurance Contributions Act 4 of 2002 unless they qualify for certain exemptions under section 4(1) of that Act. These contributions must be paid to the UIF office of the Department of Labour or to the SARS branch office where the special trust is liable for employees' tax or SDL. See the *Guide for Employers in respect of Unemployment Insurance Fund* on the SARS website for more information on UIF.

8.5 Value-added tax (VAT)

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;

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64 The term "remuneration" is defined in paragraph 1 of the Fourth Schedule.

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

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

VAT is levied under section 7(1) of the VAT Act at a rate of 14% 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 that 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 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 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 will 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 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
- when the supply is of services, at the time the services are rendered.[67]

In the event that 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, the supply of the goods or services is deemed to be at market value.[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 person making taxable supplies with a value of less than R1 million may choose to register voluntarily under section 23(3) of the VAT Act. In order to qualify for voluntary VAT registration, the person 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* on the SARS website for more information on VAT.

8.6 Donations tax

Donations tax is payable at the rate of 20% 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] 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.

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[67] Section 9(2) of the VAT Act.

[68] Section 10(4) of the VAT Act.

[69] Section 54 read with section 64.

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.

In *Abraham Krok Trust v C: SARS*[70] Nugent JA referred to the observation by Marais J in *Welch's Estate v C: SARS*[71] 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.[72]

Donations tax is accordingly 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 is section 56(2)(*b*). This section provides that the sum of donations by a natural person during a year of assessment, will be exempt from donations tax to the extent that it does not exceed R100 000.

8.7 Estate duty

Estate duty is levied at the rate of 20% on the dutiable amount of an estate under section 2(2) of the Estate Duty Act 45 of 1955.

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 that person's personal capacity. The property does not therefore 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.

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 a vested right in the capital of a trust will be considered to be property[73] of the deceased beneficiary and dutiable in the estate of the beneficiary. In the case of a *bewind* trust, the property vests in the beneficiary and its value will be taken into account for estate duty purposes for the beneficiary.

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70 [2011] 2 All SA 591 (SCA), 73 SATC 105 at 110.

71 2005 (4) SA 173 (SCA), 66 SATC 303.

72 At SATC 112.

73 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 acquired by a person.

Transfer duty is payable under section 2(1)(*b*) of the Transfer Duty Act at the following rates,[74] provided that the transaction is not exempt from transfer duty under section 9 of that Act:

Value of property (R)	Rate
0 – 600 000	0%
600 001 – 1 000 000	3% of the value above R600 000
1 000 001 – 1 500 000	R12 000 + 5% of the value above R1 000 000
1 500 001 and above	R37 000 + 8% of the value exceeding R1 500 000

Transfer duty is payable when property is transferred to a trust, or transferred from a trust to a beneficiary. 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 relatives[75] 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*".[76]

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 results in a further dutiable transaction.[77]

The substitution or addition of one or more beneficiaries with a contingent right to any property of a 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 subject to transfer duty.[78]

[74] Property acquired on or after 23 February 2011. Property acquired by a special trust before 23 February 2011 is subject to transfer duty at the rate of 8%.
[75] A "relative" as defined in section 1(1) of the Estate Duty Act.
[76] Paragraph 3.2.6 of the Transfer Duty Guide dated 13 March 2013.
[77] As above.
[78] Paragraph (*c*) of the definition of "transaction".

Paragraphs (*d*), (*e*) and (*f*) of the definition of "property" in section 1(1) of the Transfer Duty Act provide as follows:

> **"[P]roperty"** means land in the Republic and any fixtures thereon, and includes—
>
> (*d*) a share (other than a share contemplated in paragraph (*g*)) or member's interest in a residential property company;
>
> (*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

In December 2002 the definition of "property" was broadened extensively by the insertion of paragraphs (*d*), (*e*) and (*f*) in the definition.[79] 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.[80]

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 one or more beneficiaries with a contingent right to property of a discretionary special trust which constitutes a contingent right to any residential property or share or member's interest referred to in paragraph (*f*) of the definition of "property", is not a "transaction" as defined in section 1(1) of the Transfer Duty Act and is not subject to transfer duty. The substitution or addition of beneficiaries of a special trust is, however, only allowed after the death of the beneficiary or beneficiaries for whose sole benefit the trust was created (see **4.3.3** and **4.4.3**).

[79] Section 2(1)(*b*) of the Revenue Laws Amendment Act 74 of 2002.
[80] Paragraph 2.3.6 of the Transfer Duty Guide.

8.9 Securities Transfer Tax (STT)

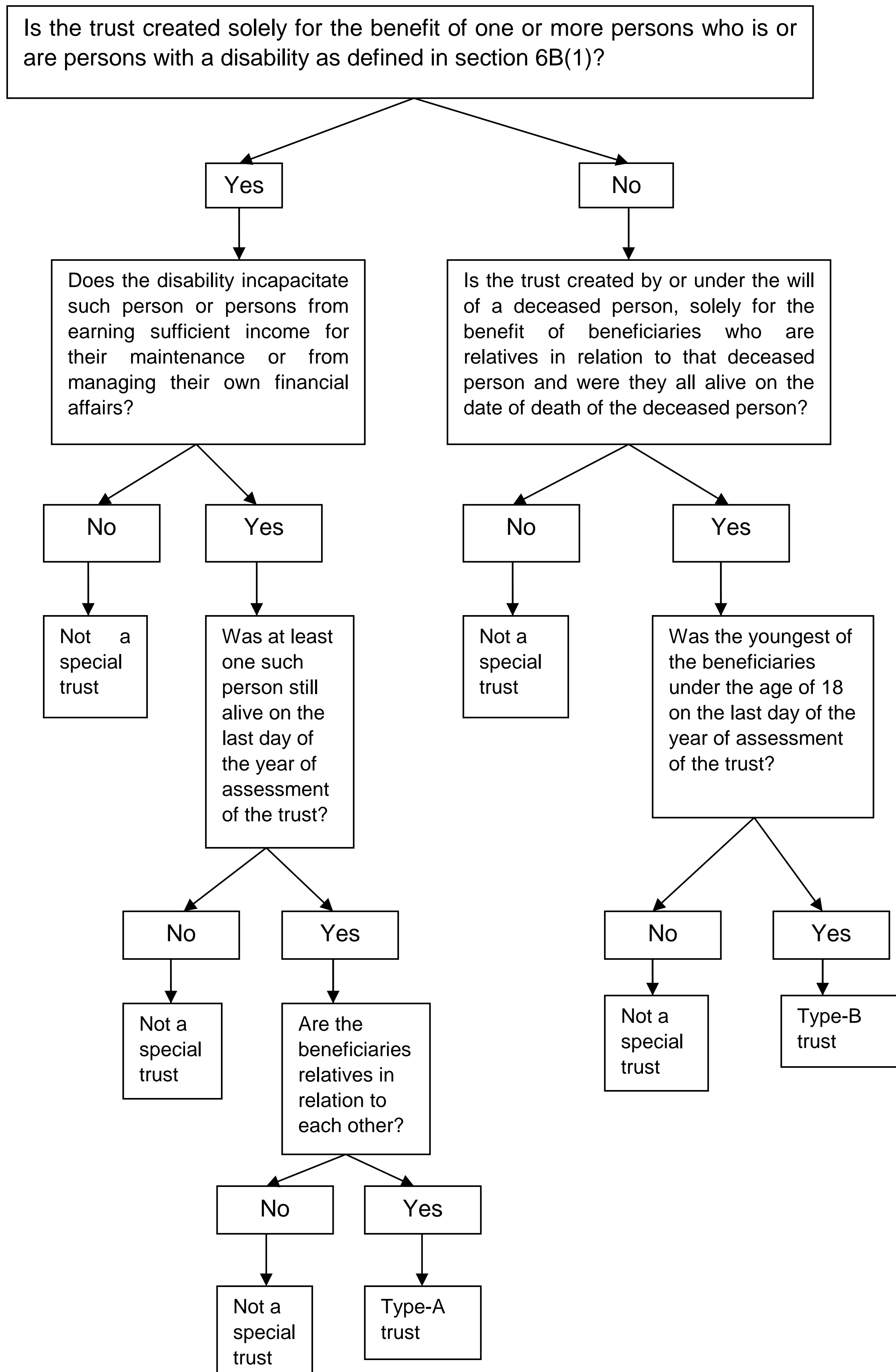
STT is levied on the transfer of a security[81] at the rate of 0,25% of the taxable amount of the security determined under section 2(1) of the Securities Transfer Tax Act 25 of 2007. STT is levied on the transfer of a security issued by –

- 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 the Johannesburg Stock Exchange.

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).

[81] A "security" is defined in section 1 of the Securities Transfer Tax Act and means any share or depository receipt in a company or any member's interest in a close corporation.

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



Annexure B – Scale of normal tax rates for the 2014 year of assessment

Statutory rates of tax for special trusts for the 2013 / 2014 year of assessment

TAXABLE INCOME			RATES OF TAX		
R		**R**	**R**		**R**
0	–	165 600			18% of taxable income
165 601	–	258 750	29 808	+	25% of taxable income above 165 600
258 751	–	358 110	53 096	+	30% of taxable income above 258 750
358 111	–	500 940	82 904	+	35% of taxable income above 358 110
500 941	–	638 600	132 894	+	38% of taxable income above 500 940
638 601	–	and above	185 205	+	40% of taxable income above 638 600

The rate of normal tax for trusts other than special trusts – 40%