



**THE SUPREME COURT OF APPEAL OF SOUTH AFRICA**  
**JUDGMENT**

**Reportable**

Case No: 516/2021

In the matter between:

**THE COMMISSIONER FOR THE SOUTH AFRICAN  
REVENUE SERVICE**

**APPELLANT**

and

**THE THISTLE TRUST**

**RESPONDENT**

**Neutral citation:** *CSARS v The Thistle Trust* (516/2021) [2022] ZASCA 153 (7 November 2022)

**Coram:** DAMBUZA ADP and VAN DER MERWE and HUGHES JJA and GOOSEN and DAFFUE AJJA

**Heard:** 2 September 2022

**Delivered:** 7 November 2022

**Summary:** Revenue – capital gains tax – Income Tax Act 58 of 1962 – capital gains determined in respect of trusts’ disposal of assets vested in a resident trust beneficiary, who in turn made a distribution to its beneficiaries in the same year of assessment – whether s 25B or para 80(2) of Schedule 8 is applicable – whether the appellant was correct in imposing an understatement penalty of 50% and interest.

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## ORDER

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**On appeal from:** The Tax Court, Gauteng (Wright J sitting as a court of appeal):

1 The appeal succeeds with costs.

2 The order of the Tax Court, Gauteng, is set aside and replaced with the following order:

(a) The appeal is upheld only to the extent that the understatement penalty is set aside.

(b) There is no order as to costs.'

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## JUDGMENT

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**Hughes JA (Dambuza ADP and Van der Merwe JA and Goosen and Daffue AJJA concurring):**

[1] This is an appeal against the decision of the Gauteng Tax Court (the tax court) upholding an appeal against an additional assessment raised by the appellant (SARS) against the respondent (the Thistle Trust). The appeal is with the leave of the tax court.

[2] The circumstances giving rise to the additional assessments are as follows. The Thistle Trust is a beneficiary of various trusts that comprised the Zenprop Group. The trusts, referred to as Tier 1 Trusts comprised a group of ten vesting trusts that conduct the business of the Zenprop Group, a group of property owners and developers. In the 2014, 2015 and 2016 tax periods, the Tier 1 Trusts disposed of certain capital assets. The capital gains so realised were distributed, *inter alia*, to the Thistle Trust in the same tax period. The Thistle Trust, in turn, in the same tax periods, distributed the amounts it received to its beneficiaries. It treated the proceeds received as taxable in the hands of its beneficiaries.

[3] SARS raised an additional assessment dated 21 September 2018 for the period 2014, 2015 and 2016, taxing the amounts received by the Thistle Trust as taxable in its hands. SARS also imposed an understatement penalty against the Thistle Trust and required it to pay interest on the assessed liability.

[4] The Thistle Trust filed an objection to the additional assessment. The main thrust of the objection was that:

'having regard to the provisions of section 25B of the ITA and paragraph 80(2) of the Eighth Schedule to the ITA ("the Eighth Schedule"), the capital gains . . . ought not to have been taxed as our client derived no taxable income in this regard, and such gains were properly taxable in the hands of our client's beneficiaries under those provisions of the ITA.'

[5] SARS disallowed the objection. In March 2021, the Thistle Trust appealed to the tax court. The tax court found that the vesting trusts (ie, the Tier 1 Trusts) had disposed of capital assets and made capital gains. It held that the capital gains distributed to the Thistle Trust and subsequently passed on to its beneficiaries, constituted 'amounts' that fell within the purview of ss 25B(1), 25B(2), and paragraph 80(2) of the Eighth Schedule of the Income Tax Act 58 of 1962 (the ITA). Accordingly, the distribution to the beneficiaries of the Thistle Trust was a distribution of capital gains taxable in the hands of its beneficiaries. The tax court, therefore, set aside the additional assessments.

### **The issues**

[6] Two crisp issues arise. The first is whether the capital gains accrued as a result of the disposal of capital assets by the Tier 1 Trusts are taxable in the hands of the Thistle Trust or in the hands of the beneficiaries of the Thistle Trust to whom those gains were distributed. The second concerns the imposition of an understatement penalty. It arises conditionally in the event that it is found that the gains are taxable in the hands of the Thistle Trust. In that event, the question is whether the circumstances giving rise to the tax treatment by the Thistle Trust of the further distribution to its beneficiaries, warrants the imposition of an understatement penalty.

### **The statutory framework**

[7] The taxation of trusts came about as a result of the decision of *CIR v Friedman (Friedman)*.<sup>1</sup> In *Friedman*, the court held that a trust was not a legal persona nor a taxable entity. The practice had been that the trustees, as representative taxpayers, were subject to the tax imposed on trust income that accrued to the trust. The court found that since a trust was not a legal person and not a taxpayer, the trustee could

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<sup>1</sup> *CIR v Friedman and Others NNO* 1993 (1) SA 353 (A) at 371D-F.

not be a representative taxpayer of the trust. Following this judgment, the ITA was amended to include a trust in the definition of a 'person' in s 1 of the ITA.

[8] Subsequently, s 25B was included in the ITA. The introduction of the section was to provide for the taxation of income accrued to trusts and their beneficiaries. The qualifier was that the trust or beneficiary concerned would only be taxed if it had a vested right in the 'amount' received or accrued. Put differently, in terms of s 25B, the trust or beneficiary had to have a vested right in the 'amount' received or acquired, otherwise the amount would be taxable in the hands of the trust.

[9] Section 25B of the ITA reads:

'(1) Any amount (other than an amount of a capital nature which is not included in gross income or an amount contemplated in paragraph 3B of the Second Schedule) received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.

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

[10] Capital gains tax was first introduced by s 26A of the ITA.<sup>2</sup> The section provided that taxable capital gains were to be determined in terms of the Eighth Schedule.<sup>3</sup> A capital gain is determined when the proceeds derived from the disposal of an asset exceed that of its base cost.<sup>4</sup>

[11] Paragraph 80 of the Eighth Schedule provides for capital gain attributed to a beneficiary as follows:

'80(1) Subject to paragraphs 68, 69 and 71, where a trust vests an asset in a beneficiary of that trust . . . *who is a resident*, and determines a capital gain in respect of that disposal or, if

<sup>2</sup> S 26A was inserted by s 14 of the Taxation Laws Amendment Act 5 of 2001.

<sup>3</sup> Section 26A provides that:

'There shall be included in the taxable income of a person for a year of assessment the taxable capital gain of that person for that year of assessment, as determined in terms of the Eighth Schedule.'

<sup>4</sup> Paragraph 3(a) of the Eighth Schedule.

that trust is not a resident, would have determined a capital gain in respect of that disposal had it been a resident—

*(a) that capital gain must be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust; and*

*(b) that capital gain or the amount that would have been determined as a capital gain must be taken into account as a capital gain for the purpose of calculating the aggregate capital gain or aggregate capital loss of the beneficiary to whom that asset was so disposed of.*

(2) Subject to paragraphs 64E, 68, 69 and 71, where a trust determines a capital gain in respect of the disposal of an asset in a year of assessment during which a beneficiary of that trust (other than any person contemplated in paragraph 62 (a) to (e)) *who is a resident has a vested right or acquires a vested right* (including a right created by the exercise of a discretion) to an amount derived from that capital gain but not to the asset disposed of, an amount that is equal to so much of the amount to which that beneficiary of that trust is entitled in terms of that right—

*(a) must be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust; and*

*(b) must be taken into account as a capital gain for the purpose of calculating the aggregate capital gain or aggregate capital loss of that beneficiary.* (Emphasis added.)

## **Submissions**

[12] SARS argued that paragraph 80(2) of the Eighth Schedule applies exclusively and that s 25B of the ITA does not apply. SARS argued that capital gains tax is expressly dealt with in the Eighth Schedule. These provisions were introduced subsequent to the amendments providing for the taxation of income accrued by trusts or their beneficiaries. Section 26A, read with the Eighth Schedule, provides for a specific form of tax and for the effect of the vesting of such capital gains as are realised in the hands of successive trusts.

[13] SARS further argued that the proceeds of the disposal of capital assets by the Tier 1 Trusts constituted capital gains in the hands of the Tier 1 Trusts. Those trusts, however, distributed the capital gains to the Thistle Trust. Paragraph 80(2), therefore, applies. The Thistle Trust acquired a vested right to the capital gains distributed to it but acquired no vested right to the disposed capital assets. The Thistle Trust distributed the amount it received to its beneficiaries. In doing so, it did not determine a capital gain in respect of the disposal of a capital asset as is required by paragraph 80(2) of the Schedule. Thus, insofar as the beneficiaries of the Thistle Trust are concerned, the provisions of 80(2) do not apply. Section 80(2) determines the tax position of the Thistle

Trust. The capital gains accrued upon the disposal of capital assets by the Tier 1 Trusts are, therefore, taxable in the hands of the Thistle Trust.

[14] In so far as s 25B of the ITA is concerned, SARS argued that the section does not apply as its provisions concern the taxation of income that accrues to trusts and their beneficiaries. It was argued that the reference to 'amounts' which accrues to trusts does not include amounts or proceeds of a capital nature. Those are dealt with in the Eighth Schedule.

[15] It was argued that the Tax Court had erred in finding that s 25B, when read in conjunction with paragraph 80(2) of the Schedule, had the effect that the distributions to the beneficiaries of the Thistle Trust were taxable in their hands.

[16] The Thistle Trust contended that both paragraphs 80(1) and 80(2) are applicable. Both support a 'see-through' approach when dealing with the taxation of capital gains which arises from the disposal of assets by a trust to or for the benefit of the resident beneficiaries. The gains attained are taxable in the hands of the resident beneficiaries. In making the argument, counsel for the Thistle Trust submitted that this is evident on a reading of paragraph 11(1)(d), which provides that a disposal for capital gains tax purposes includes the vesting of an interest in an asset of a trust in a beneficiary.

[17] The Thistle Trust argued that paragraph 80(2) ought to be read with s 25B. It submitted that 'an amount' in the said section is inclusive of capital gains.

## **Discussion**

[18] The first question involves the interpretation and application of the relevant provisions of the ITA and the Eighth Schedule to the ITA. Insofar as the interpretation exercise is concerned, it is apposite to call to mind what this Court said in *Commissioner, South African Revenue Service v United Manganese of Kalahari (Pty) Ltd*:<sup>5</sup>

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<sup>5</sup> See *C:SARS v United Manganese of Kalahari (Pty) Ltd* [2020] ZASCA 16; 2020 (4) SA 428 (SCA) para 8. See also *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] ZASCA 13; 2012 (4) SA 593 (SCA); [2012] 2 All SA 262 para 18; *Airports Company South Africa v Big Five Duty Free (Pty) Ltd and Others* [2018] ZACC 33; 2019 (5) SA 1 (CC) para 29; *Commissioner, South African Revenue Service v Bosch and Another* [2014] ZASCA 171; 2015 (2) SA 174 (SCA) para 9.

'It is unnecessary to rehearse the established approach to the interpretation of statutes set out in *Endumeni* and approved by the Constitutional Court in *Big Five Duty Free*. It is an objective unitary process where consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. The approach is as applicable to taxing statutes as to any other statute. The inevitable point of departure is the language used in the provision under consideration.' (Footnotes Omitted.)

[19] When examining ss 25B(1) and 25B(2) to determine what 'any amount' constitutes, the sections must be read as a whole. Section 25B(3) provides insight into the amount that the legislator was concerned with in the application of this section. That amount was the 'taxable income derived by way of any amount'. Section 25B, read in its entirety, demonstrates that the amount is of a taxable income nature and not of a capital gains nature – 'any amount' will thus not include capital gains.

[20] It bears mentioning that s 25B was introduced by the legislature in 1991, while capital gains tax came into existence in 2001. Logically, if capital gains did not exist, s 25B could not have been intended to apply to capital gains. Further, the insertion of 'other than an amount of a capital nature which is not included in gross income' in the section after any amount, which came about after capital gains was introduced, is yet another indicator that this section does not apply to an amount of the nature of a capital gains.

[21] Recently this Court in *Milnerton Estate Ltd v CSARS* stated that:<sup>6</sup>

'... capital gains, the determination of the amount of any capital gain falling to be included in the taxpayer's taxable income is a matter dealt with in the Eighth Schedule to the Act ... and on its face the Schedule seems to provide a self-contained method for determining whether a capital gain or loss has arisen.'

[22] When the provisions are read as a whole and in context, it is apparent that the legislature intended that s 25B be applied to the taxation of income that accrues to a trust or its beneficiaries. In contrast, the Eighth Schedule is to be applied to the taxation of capital gains that accrue to trusts or their beneficiaries. The tax court accordingly erred in finding that s 25B applied in this instance.

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<sup>6</sup> *Milnerton Estates Ltd v CSARS* [2018] ZASCA 155; 2019 (2) SA 386 (SCA) para 22.

[23] Counsel for the Thistle Trust argued that the ‘conduit-pipe principle’ was applicable in this case. He argued from the premise that the capital gains that the Tier 1 Trusts distributed to the Thistle Trust amounted to an asset which, in fact, vested in its beneficiaries. Therefore, so it was contended, the Thistle Trust was no more than a conduit for the gain that flowed through it and is accordingly not subject to be taxed on the gain.

[24] In *Armstrong v the Commissioner of Inland Revenue*,<sup>7</sup> the conduit-pipe principle was discussed for the first time. The principle became entrenched in our law in *Secretary for Inland Revenue v Rosen (Rosen)*.<sup>8</sup> *Rosen* established that an amount or dividend received by a trust and immediately passed on to a beneficiary in the same year in which it was received would be regarded as having accrued to such beneficiary as opposed to the trust that received it. The conduit-pipe would thus be open, and the trust would be no more than a conduit for the amount or dividend to flow through. Trollop JA cautioned in *Rosen* that while the principle was applicable for general application in our tax system, it ought only to be applied in appropriate circumstances to be determined on a case-by-case basis.

[25] The facts of this case do not support the application of the ‘conduit pipe principle’. The Tier 1 Trusts vested the capital gains in the Thistle Trust which accordingly held a vested right therein. The distribution to it of the accrued gains resulted in it receiving those gains as of right. The Thistle Trust did not dispose of any capital asset nor determine a capital gain that was distributed to its beneficiaries. Instead, it distributed monies that vested in it as of right. In these circumstances, the ‘conduit principle’ does not apply.

[26] Paragraph 80 (2) of the Schedule, properly interpreted and applied, requires that the capital gains accrued upon the disposal of assets by the Tier 1 Trusts are to be taxed in the hands of the Thistle Trust and not its beneficiaries to whom it distributed those gains. In the circumstances, SARS was correct to raise the additional assessment for the relevant tax periods.

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<sup>7</sup> *Armstrong v Commissioner of Inland Revenue* 1938 AD 343 at 348-349.

<sup>8</sup> *Secretary for Inland Revenue v Rosen* 1971 (1) SA 172 (A) at 190H-191A.



## **Understatement of penalties**

[27] As indicated earlier in this judgment, the second question arises in the event that it is found that the assessment was correctly raised. The imposition of an understatement penalty arises when a taxpayer submits a tax return that understates its taxable or deemed taxable income. In such circumstances, SARS is entitled to levy a penalty based upon the circumstances giving rise to the understatement. The Tax Administration Act 28 of 2011 (the TAA) provides that the penalty, as determined by the TAA, is payable unless the understatement arises from a *bona fide* inadvertent error.<sup>9</sup> Section 223 of the TAA sets the relevant percentages, in a table format, to be allocated for the different behavioural concerns of a taxpayer. These cover instances ranging from a taxpayer failing to take reasonable care to instances where the taxpayer is grossly negligent.

[28] In this matter, SARS imposed an understatement penalty of R1 460 092, which translated to a penalty of 50% levied against the Thistle Trust. As set out in the table, a penalty of 50% for a standard case relates to a taxpayer having 'no reasonable grounds for the "tax position" taken by the taxpayer'. It is common cause that the Thistle Trust had obtained a legal opinion which another entity within the Zenprop Group had sought.

[29] SARS initially adopted the position that, in the light of the legal opinion, it should be concluded that the Thistle Trust had consciously and deliberately adopted the position it took when it elected to distribute the amounts of the capital gains as it did. However, during the argument before us, counsel for SARS conceded, correctly, that the understatement by the Thistle Trust was a *bona fide* and inadvertent error as it had believed that s 25B was applicable to its case. Though the Thistle Trust erred, it did so in good faith and acted unintentionally. In the circumstances, it was conceded that SARS was not entitled to levy the understatement penalty.

## **Interest**

[30] Lastly, turning to the matter of interest, as the capital gains tax assessment favours SARS, the Thistle Trust would be liable for interest accrued, in terms of

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<sup>9</sup> Section 222 (1) of the TAA provides:

'In the event of an "understatement" by the taxpayer, the taxpayer must pay, in addition to the "tax" payable for the relevant tax period, the understatement penalty determined under subsection (2) unless the "understatement" results from a *bona fide* inadvertent error.'

s 89quat(2) of the ITA. If the taxable income exceeded, at the most, R50 000, and the normal tax payable exceeds the credit amount in that year, interest would be payable by the taxpayer at the prescribed rate on the amount by which normal tax exceeds the credit amount.<sup>10</sup> In argument before us, counsel for the Thistle Trust correctly conceded that SARS, if successful, would be entitled to the interest claimed.

[31] As a result, I make the following order:

1 The appeal succeeds with costs.

2 The order of the Tax Court, Gauteng, is set aside and replaced with the following order:

(a) The appeal is upheld only to the extent that the understatement penalty raised is set aside.

(b) There is no order as to costs.'

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W HUGHES  
JUDGE OF APPEAL

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<sup>10</sup> Section 89quat(2):

'(2) If the taxable income of any provisional taxpayer as finally determined for any year of assessment exceeds –

(a) R20 000 in the case of a company; or

(b) R50 000 in the case of any person other than a company, and the normal tax payable by him in respect of such taxable income exceeds the credit amount in relation to such year, interest shall, subject to the provisions of subsection (3), be payable by the taxpayer at the prescribed rate on the amount by which such normal tax exceeds the credit amount, such interest being calculated from the effective date in relation to the said year until the date of assessment of such normal tax.'

## APPEARANCES

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