

Trust distributions unpacked



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Is it only about taxes?

	Trust		Company/CC		Individual	
	Capital	Revenue	Capital	Revenue	Capital	Revenue
Income	R 100	R 100	R 100	R 100	R 100	R 100
Inclusion rate	80%	100%	80%	100%	40%	100%
Taxable income	R 80	R 100	R 80	R 100	R 40	R 100
Tax rate	45% (eff 36%)	45%	27% (eff 21.6%)	27%	45% (eff 18%)	45%
Taxation	(R 36.00)	(R 45.00)	(R 21.60)	(R 27.00)	(R 18.00)	(R 45.00)
After-tax	R 64.00	R 55.00	R 78.40	R 73.00	R 82.00	R 55.00
Dividends Tax @ 20%	-	-	(R 15.68)	(R 14.60)	-	-
Total tax	R 36.00	R 45.00	R 37.28	R 41.60	R 18.00	R 45.00

Actually, the trust is taxpayer of last resort; follow the rules

RULES:

1. Did you **donate or make loans** to trust at below-market interest rates? → Attribute income/capital gains to you and you pay tax (Section 7 of the Income Tax Act for income and Par 68 to 73 of the Eighth Schedule to the Income Tax Act for capital gains)
2. Did trustees use “**Conduit Principle**” to distribute income or capital gain to you as beneficiary (together with tax liability)? → You pay tax (Section 25B of the Income Tax Act for income and Par 80(2) of the Eighth Schedule to the Income Tax Act for capital gains (Armstrong and Rosen))
3. **Trust pays tax on rest**

R 218 987 tax BUT
retained R 1 024
391 value in trust

Donor/funder

Trust

Beneficiary

R 218 987 tax BUT
moved R 1 243 378
value out of trust

R 448 409 tax BUT
retained R 794 969
value in trust

Starting point - check the trust deed

Who can benefit?

From what can they benefit?



DEED OF TRUST

Signature

Signature

Any restrictions?

Process to follow?

Before you make distributions...
Apply the “Attribution rules”

Do you keep accounting records in such a way to apply Attribution Rules?

Sections 7(2) to 7(6) of the Income Tax Act

Paragraphs 68 to 72 of the Eighth Schedule to the Income Tax Act



Attribution rules – why do accountants not know about this?

- ✧ Anti-avoidance measures to **prevent tax avoidance**.
- ✧ Not concerned with who formed or created trust but rather person who **transferred assets** into trust at **favourable terms** or provided loan to trust to acquire assets.
- ✧ Not loan that is seen as gratuitous disposition (since a loan carries with it no inherent right to interest) but **non-charging of interest or charging of interest at below-market rates**. Therefore only income or capital gains attributable to charging of interest at less than market rates attributed to funder; not entire income and/or capital gains produced as result of loan.
- ✧ If, as result of funding, actual income and capital gain is less than calculated benefit that trust received by not charging interest at at least a market-related rate **‘unused’ portion of ‘benefit’ carried over** to following year - cumulative calculation performed annually until asset is disposed of or funding settled/death of funder.
- ✧ If asset disposed of for **less than market value**, difference between selling price and market value deemed a donation for purposes of Section 7 (Section 7(9) of the Income Tax Act). Difference applied.

History of attribution rules

- ✧ Although **Income Tax Act 28 of 1914** contained section equivalent to current **Section 7(2)**, equivalent of current **Sections 7(3) to 7(7)** only added later in attempt to close loopholes and combat further tax avoidance schemes used by taxpayers.
- ✧ Predecessor of **Section 7(3)** was added in **1925**, although no reference was yet made to “*donation, settlement or other disposition*”. Those words only added in 1932, resulting in section closely reflecting current version of **Section 7(3)**.
- ✧ Similar provisions to current **Sections 7(4) to 7(6)** part of South African Income Tax legislation since **1941**.
- ✧ **Section 7(7)** only added in **1983** to counter tax avoidance schemes whereby taxpayers attempted to transfer certain of their income to others without giving up control over income or over investments that generate income.

Attribution rules – What is meant by “income”?

- ✧ Some of opinion that ‘income’ used in Sections 7(2) to 7(7) should be interpreted as **‘taxable income’** (based on judgement in Simpson case). **Purpose** of Sections 7(3) to 7(6) not to punish taxpayer but to **prevent tax avoidance**. Not allowing relevant exemptions and deductions against income may lead to additional tax collected by SARS - Will place taxpayer in **worse** position than what they would have been normally; contrary to SARS’s intention.
- ✧ So, two schools of thought – **REQUIRE CLARITY:**
 - ✧ Where no specific deductions provision in section, reasonable that the ‘income’ referred to in the section should be interpreted as **‘taxable income’**. ‘Income’ means ‘gross income’ less related deductible expenses and losses.
 - ✧ **No deductions** allowed since no specific provision made. Specific provision made for Section 7(2B) deduction of expenses; if it were intention, SARS would have allowed similar deductions for Sections 7(3) to 7(6). Would be punitive, as neither funder nor trust will be able to deduct these direct expenses in their tax calculations.

Attribution rules – what about reinvestment?

- ✧ **General rule** - future income and capital gains on historical income and capital gains (income and capital gains that accrue from the **reinvestment** of the income and capital gains derived from a donation or loan) **not taxed in the hands of the donor/funder** through the application of attribution rules.
- ✧ Once income and capital gains accrued and **capitalised**, future income and capital gains arising from **new cause**; cannot be attributed to the original donation or loan (Kohler v CIR case of 1949).

Attribution rules – Now beneficial anti-avoidance provisions?

- ✧ **Historically** individuals paid more tax than trusts. People structured their affairs in multiple trusts to save tax, so SARS introduced these measures to **prevent** people from structuring their affairs in this way.
- ✧ **Currently**, individual may pay **IncomeTax** at **lower rate** – at sliding scale between 0% to 45% – than flat rate of 45% levied on trusts, and for **Capital Gains Tax**, only **40%** of capital gain will be included in their taxable income – and being taxed at sliding scale between 0% to 45% – (and they can deduct **R 40 000 annual exclusion**), compared to **80%** inclusion – and being taxed at flat rate of 45% – had it been taxed in trust (with no allowance for an annual exclusion in trust).
- ✧ No vesting of assets in name of beneficiary – no dilution of trust assets

Attribution rules – what must donor/funder do?

✧ Reporting:

- ✧ **Resident** who, at any time during year of assessment, makes a “*donation, settlement, or other disposition*” disclose to Commissioner in writing when submitting their Income Tax return for that year (Section 7(10) of Income Tax Act).

✧ Recover taxes payable from trust:

- ✧ Tax payable by the donor/funder “**may**” be recovered from the person entitled to receipt (Section 91(4) of the Income Tax Act) - “*So much of any tax payable by any person as is due to the inclusion in his income of any income deemed to have been received by him or to be his income, as the case may be, in terms of subsection (3), (4), (5) or (6) of section seven, may be recovered from the assets by which the income so included was produced.*”
- ✧ In the event that these taxes not recovered from trust - regarded as donation of such amount on which Donations Tax will be payable.

Attribution rules – what happens on death?

- ✧ Confusion - Section 7 (except for Section 7(5), which states that resultant future income may be taxed in hands of beneficiaries) and Paragraphs 68 to 72 do **not clearly stipulate** what tax implications are in relation to soft funding after funder's death.
- ✧ Views - **REQUIRE CLARITY:**
 - ✧ Resultant future income and capital gains taxed in **trust unless distributed** to SA resident beneficiaries in terms of Conduit Principle – in which instance taxed in their hands.
 - ✧ If loan **inherited** by another **SA resident natural person (same terms)** – assumed to be new funder. As long as capital remains unpaid, failure to charge interest represents a **continuing donation** (Commissioner for Inland Revenue v Berold case of 1962).

Only now can trustees distribute what is left in
the trust...

Requirements for distributions to flow through

- ✧ Clear from Section 7(1) - **not a requirement that cash should flow** - hence the reference to “**vest**”. A ‘vested right’ defined as “*right accrued to a possessor with no conditions*”, or legal definition being “*a right belonging completely and unconditionally to a person as a property interest which cannot be impaired or taken away without the consent of the owner.*” Vested right **cannot be conditional** - then it never existed in first place. Vested personal right to claim payment or transfer of benefit will form part of **estate** of beneficiary. It cannot just be taken away.
- ✧ Beneficiary with vested right has **right to claim** asset and/or income from trustees, depending on rights attaching to vested right.
- ✧ The conduit pipe remains open **whole year** and only closes at end of year if no vesting in beneficiary has taken place (Trustees of the Hull Trust Fund v CIR case of 1931 and SIR v Rosen case of 1971). It is, therefore, important for trustees to distribute income or capital gain **before end of financial year** (ending on last day of February each year) to take advantage of benefit.
- ✧ Income passing through trust retains identity (Armstrong v CIR case of 1938 and SIR v Rosen case of 1971), provided distributed in **same tax year** that trust received them; otherwise, taxable in trust.
- ✧ For income or capital gains to vest in beneficiary, **ALL following must be present:**
 - ✧ **Right to claim** income or capital gain.
 - ✧ Right should be **determinable**.
 - ✧ Right should **not be contingent**.

Deduction from income in trust

- ✧ **Section 23(f)** of Income Tax Act - “*any expenses incurred in respect of any amounts received or accrued which do **not constitute income as defined in section one**” of Income Tax are not deductible.*
- ✧ **Section 11** of Income Tax Act permits deduction of expenses from income in calculation of tax, but **Section 23(g)** of Income Tax Act **limits these expenses** to amounts incurred for **purpose of trade**; in other words, for **producing taxable income**. Trustees required to prove to SARS that expenditures deducted from taxable income incurred during production of such income.

Apportionment of expenses with distributions

- ✧ Where income of trust vests in beneficiary, any **deduction or allowance relating to income also vests** in beneficiary (Section 25B(3) of Income Tax Act).
- ✧ Any deduction is, however, **limited to income accruing to beneficiary from trust**. A trust is, therefore, prevented from distributing a loss. Any clause in trust instrument allowing trustees to distribute losses to beneficiaries therefore invalid.
- ✧ Deductions or allowances under Section 25B(3) must be **apportioned** between various amounts that accrue to **trust** or that are deemed to accrue to **beneficiary** under Section 25B(1) (beneficiary has a vested right in terms of trust instrument) and Section 25B(2) (beneficiary acquired vested right in consequence of trustees exercising their discretion in favour of beneficiary), **unless deduction or allowance is incurred directly in production of specific amount**, in which case deduction or allowance must be made against that specific amount that may have accrued to trust or be deemed to have accrued to beneficiary.

Apportionment of expenses with distributions (cont.)

- ✧ Although SARS not prescriptive as to how **expenses** should be **apportioned** between taxable income (for example, rental income) and exempt income (for example, income from dividends), **onus on trustees** to prove that they have applied their minds and that ultimate apportionments are **fair and reasonable**. Trustees to demonstrate sound basis for allocation and **not only attempt to achieve best tax position**. Judge confirmed in Local Investment Co v Commissioner of Taxes case of 2014 that *“It does not seem possible to me to lay down any general rules as to how the apportionment should be made, other than saying that the apportionment must be fair and reasonable, having regard to all the circumstances of the case”*. It does, however, appear that SARS favours apportionment on basis of **gross income** - expenses apportioned in the same proportion as taxable income to non-taxable income. The trustees to supply **proof** that the apportionment basis was fair and reasonable.
- ✧ Deductions and allowances must be allocated between trust and beneficiaries in **same proportion as amount**, which is received by trust, has been allocated. Should full deduction not be used by beneficiary, it **can be utilised by trust** but will be **limited to taxable income of trust before deduction of such expenditure** (so as to not create loss). If trust cannot absorb full deduction or allowance disallowed to beneficiary, **excess may be granted as deduction or allowance to beneficiary in next year of assessment**, subject to it being limited to income accruing to beneficiary from that trust (Section 25B(4) to (6) of Income Tax Act). Sections 25B(4) to (6) do not apply where the beneficiary is not subject to tax in South Africa on those distributions.

Can trustees distribute assets in stead?

- ✧ Asset can be **distributed** to (or vested in) South African resident beneficiary – **deemed a disposal** for Capital Gains Tax purposes (Paragraph 11(1) of Eighth Schedule to Income Tax Act)
 - ✧ Capital gain arises by virtue of operation of Paragraph 38 of Eighth Schedule to Income Tax Act - if asset transferred by way of donation or to 'connected person' at consideration that does not reflect arm's length price, **deemed to be disposed of at market value.**
 - ✧ Capital gain will be taxed in hands of **beneficiary** (Paragraph 80(1) of Eighth Schedule to Income Tax Act), subject to anti-avoidance provisions
- ✧ Asset **disposed of to third party**
 - ✧ Trust will make capital gain on transaction, and this gain will be taxable in hands of either **donor/funder, beneficiary, or trust.**
- ✧ Taxable portion of capital gain is included in trust's taxable income (as opposed to income) - deeming provisions of Sections 25B and 7 do not apply. Therefore, **Eighth Schedule has special attribution rules** (assignment or allocation rules) specifically dealing with capital gains arising in trust.
- ✧ A capital gain cannot be distributed to beneficiary for it to be taxed in their hands without this **power** (Paragraph 80(2) of the Eighth Schedule to Income Tax Act).

Global citizens



Where is your family and where are your structures?

All family in
SA; only SA
structures

SA
structures

Family in SA



International
family

International
structures

SA family trust with SA beneficiaries

Attribution rules

Attribution rules first: You made donation/loan at below-market interest rate to trust and trust:

- ✧ distributes related income/capital gain to **spouse** (OCOP) to avoid tax
- ✧ distributes related income/capital gain to **minor child**
- ✧ **retains** income/capital gain in discretionary trust/SA company held by trust
- ✧ distributes income/capital gain **BUT** you retain right to **revoke** the income or capital gain distribution, to **terminate** the trust, or to cancel or overrule **right** of beneficiary to receive distribution from trust

Then: distribution of income (Section 25B) and capital gains (Par 80(2)) - taxed in hands of SA beneficiaries

Foreign trust with SA beneficiaries

- ✧ A foreign trust distributing income or capital profit/gain in the **same** year to a SA beneficiary → SA beneficiary taxed (1 March 2019)
- ✧ A foreign trust distributing **prior** year capital gains to a SA beneficiary → SA beneficiary taxed

Foreign/SA trust with foreign beneficiaries

- ✧ Foreign/SA trust distributing income/capital gain resulting from a donation or loan at a below-market interest rate to a foreign beneficiary in the same year → SA donor/funder taxed
- ✧ For SA trusts: After Attribution rules applied, distribution of capital gains to foreign beneficiary - taxed in SA trust Par 80(2)
- ✧ For SA trusts: After Attribution rules applied, distribution of income to foreign beneficiary - taxed in SA trust (new from 1 March 2024 - aligned with existing Par 80(2))

Trust vests assets in beneficiary

- ✧ **Foreign trust vests asset in SA beneficiary = Disposal → Capital gains tax payable by beneficiary, subject to anti-avoidance provisions (donations/loans below market-related interest rates by SA donor/funder)**
- ✧ **SA trust vests asset in foreign beneficiary = Disposal → Capital gains tax payable by SA trust, subject to anti-avoidance provisions (donations/loans below market-related interest rates by SA donor/funder)**

Make distributions by end Feb and have data to submit IT3(t)



Do not
backdate
resolutions

IT3(t) - Government Gazette – 30 June 2023

RETURNS OF INFORMATION TO BE SUBMITTED BY THIRD PARTIES IN TERMS OF SECTION 26 OF THE TAX ADMINISTRATION ACT, 2011 (ACT NO. 28 OF 2011)

The following persons are required to submit a return as specified in paragraph 3:

A “trust” as defined in section 1 of the Income Tax Act, that is a “resident” as defined in that section, or a non-resident that is required to submit an annual income tax return,

Where two or more members of the public invest money, or other assets together - unit trusts, mutual funds, etc

excluding—

- ✧ a Collective Investment Scheme as defined in the Collective Investment Schemes Control Act, 2002, a “portfolio of a collective investment scheme” and any “portfolio of a hedge fund collective investment scheme”
- ✧ an Employment Share Incentive Scheme Trust

Dividends?/CG?

Government Gazette – 30 June 2023 (cont.)

RETURNS OF INFORMATION TO BE SUBMITTED BY THIRD PARTIES IN TERMS OF SECTION 26 OF THE TAX ADMINISTRATION ACT, 2011 (ACT NO. 28 OF 2011)

Due date for submitting a third party return:

- ✧ In respect of persons listed in paragraph 2.15:
 - ✧ The returns mentioned in the above Table, containing all prescribed information in respect of the period from 1 March to the end of February, must be submitted by 31 May of each year. [Now September 2024 - SARS communication 10 November 2023]

Manner of submitting a third party return:

- ✧ Declarations in respect of third party returns must be submitted electronically using the designated SARS electronic filing service.

Alternative arrangements with SARS:

- ✧ SARS may agree that a person, who is required to submit a return in accordance with this Schedule, may submit a return in respect of a different period, upon an alternative date and in an alternative manner, as the case may be.

Government Gazette - 30 June 2023 (cont.)

Column 1: Person mentioned in paragraph	Column 2: Information concerning	Column 3: Form
2.15	Any amount vested in a beneficiary: <ul style="list-style-type: none"> • Income (nett of Expenditure) • Capital gains • Capital amounts 	IT3(t); or Data compiled in accordance with SARS' Business Requirement Specification: IT3 Data Submission

Purpose: distributions;
not risk info requested
in tax return

Who pays provisional tax on trust income and capital gains?

Taxable in Donor hands –
Prov tax + submit tax return Jan

Taxable in trust – Prov tax + submit tax return Jan

Taxable in Ben. hands –
Prov tax + submit tax return Jan

Donor

Trust

Beneficiary

Not taxable in trust – Not Prov tax + submit tax return Oct

ITR12T form changes over the years...
“To promote efficiency and compliance”

Changes to the Income Tax Return for Trusts (ITR12T) - Information on donors/funders of the trust

Information on donors/funders of the trust:

- ✧ Additional questions added to the Income Tax Return Wizard to determine if amounts were deemed to have accrued to a donor/funder in terms of Section 7 during the relevant year of assessment.
- ✧ Donors or funders (where deeming provisions of Section 7 apply) must declare trust income and capital gains attributed to them. A proper trust administration/accounting system will be required to keep track of this very complicated calculation.



“Trust Filing Season: Form and System Changes to be Introduced from 23 June 2023” (cont)

- ✧ Some important changes to the Income Tax Return for Trusts (ITR12T), with effect from 23 June 2023(cont)
- ✧ A new requirement to upload mandatory supporting documents with the tax return
 - ✧ All mandatory supporting documents must be uploaded and submitted with the trust tax return, including the **trust instrument, annual financial statements and resolutions/minutes of trustee meetings.**

“Trust Filing Season: Form and System Changes to be Introduced from 23 June 2023” (cont)

✧ Beneficiaries of the trust

- ✧ Beneficiaries of a trust must declare income that was vested in them by the trust during the year of assessment in their respective income tax returns.
- ✧ This information will have to balance back to the new IT3(t)’s which trustees have to annually submit to SARS, based on distributions made to beneficiaries.
- ✧ The IT3(t)’s will have to be submitted before the trust tax returns are due - September 2024.
- ✧ Government Gazette 30 June 2023 - IT3(t)
 - ✧ Now September 2024 . [Now September 2024 - SARS communication 10 November 2023]

Changes to the Income Tax Return for Trusts (ITR12T) - distributions received from other trusts

- ✧ Additional questions added to the Income Tax Return Wizard to determine if any local or foreign amount(s) were vested in the trust as a beneficiary of another trust; and the number of trusts from where these amounts were received.
- ✧ Details to be provided per trust in the tax return - to be clearly provided in the financial records of the trust.

ITR12T – DECLARATION

- ✧ The representative taxpayer obliged to ensure that complete and accurate disclosure is made of all relevant information required on the Income Tax Return for Trusts.
- ✧ Misrepresentation, neglect, or omission to furnish such information or furnishing false information may result in penalties and/or additional tax assessments (together with interest) and/or prosecution.

After completion of the return, read the declaration on the front page of the return. I declare that:

- ✧ I am the duly appointed Representative of the Trust
- ✧ The information furnished in this return is to the best of my knowledge both true and correct
- ✧ I have disclosed the gross amounts of all income received and / or accrued to this Trust during the period covered by this return
- ✧ I have the necessary financial records and supporting schedules to support all declarations on this return which I will retain for audit purposes

Thank you!

For a free demo of our platform -
<https://lnkd.in/e4jvz2F3>

TRUST  EEZE
We guide you



DEMYSIFYING
TRUSTS
IN SOUTH AFRICA



TRUSTS IN PRACTICE
A REFERENCE GUIDE

- ARE TRUSTS STILL RELEVANT?
- MYTHS ABOUT TRUSTS
- TRUSTS AS PART OF YOUR ESTATE PLAN
- STRUCTURING A TRUST
- REQUIREMENTS FOR A VALID TRUST
- HOW TO GET ASSETS INTO A TRUST
- ROLE OF THE FOUNDER
- TRUSTEES' DUTIES
- BENEFICIARIES' RIGHTS
- TRUST ADMINISTRATION
- DIVORCE AND TRUSTS
- TAXATION

SECOND EDITION

PHIA VAN DER SPUY