ALL ABOUT TRUSTS

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INTRODUCTION

- Trusts were recognised as a entity by the Den Haag Convention on 10 January 1986 but only during 1991 was it included in the Tax Act.
- Sole purpose was to protect and manage assets
- Today the main purpose of trusts is:
  - To provide for dependants
  - Reduce estate duty
  - Manage financial risk exposure by protecting assets
  - BEE deals (for businesses)
- Trusts are the most expensive entity to do business in.
- Parties to a trust is trustees, beneficiaries, founder and donors

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CATEGORY OF TRUSTS

Each category of Trusts can be split into Special and Normal trust

- Intervivos Trust or normal trust– The trust is started while the founder is still alive
- Mortis Causa Trust (Testamentary Trust) or special trust – The trust is started by the founder's will

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CATEGORY OF TRUSTS

Accounting and Tax

- The accounting and management of both categories of Trust are the same.
- Difference is in the TAX and the PURPOSE!
- Special Trust – Taxed as at the individual tax tables without the primary and interest rebates
- Normal Trust – taxed at a tax rate of 45%
- Year end always February

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SPECIAL TRUST – DISABILITY

- Two Types – par (a) and par (b) special trust
- Par (a) Trust – Person with a disability that can't look after himself
- Characteristics:
  - All persons for whom the trust are created must be family
  - When the last person for whom the trust is created dies, the Trust must dissolve or continue as a normal trust
  - Gets more capital gains tax relief

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SPECIAL TRUST – MINORS

- Par (b) Trust – Created by a person's will for children younger than 18
- Characteristics:
  - All persons for whom the trust are created must be family of the person that died
  - Beneficiaries can be alive or conceived (unborn)
  - When the last person of the beneficiaries turns 18, the Trust must dissolve or continue as a normal trust

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NORMAL TRUST: INTERVIVOUS TRUST

- All other trust that are not a special trust
- Characteristics:
  - All persons for whom the trust are created do not need to be family
  - No special tax relief

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COMPARISON

	SPECIAL TRUST	NORMAL TRUST
Interest income	R 20 000	R 20 000
Rental income	R 30 000	R 30 000
Dividend income	R 10 000	R 10 000
Total income	R 60 000	R 60 000
Dividend income	(R 10 000)	(R 10 000)
Taxable income	R 50 000	R 50 000
Tax @ 18% / 45%	**R 9 000**	**R 22 500**

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DEFININITIONS

- Trust – Is a legal relationship created by a person (the founder), who places assets under the control of another (the trustee) for the benefit of specified persons (Beneficiaries)
- Trustee – The trustees manage the trust's income and assets.
- Beneficiaries – They are beneficiaries of the trust's income and under certain conditions, the capital
- Founder – The person started the Trust. The Founder appoints the first Trustees
- Donor – Donates assets to the trust
- Trust deed – House rules of the Trust
- Vested Right – Something that has substance, can be measured in money
- Contingent right – It is an expectation that will probably not realise

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DEFININITIONS (continue)

- Discretionary right – a discretionary right is held entirely by the Trustees where they decide whether or whether not to distribute income of the Trust to the beneficiaries.
- Trust fund – all sums of monies, property or assets subsequently acquired
- Official rate - This is the rate that SARS uses when they determine if market rates are used correctly and if they need to add additional taxes. The rates can be find on the SARS website
- Connected person - Connected person is any person or company with a relationship to the trust like a trustee, donor, founder, beneficiary or the trust holds more than 20% of the equity shares or voting rights in a company

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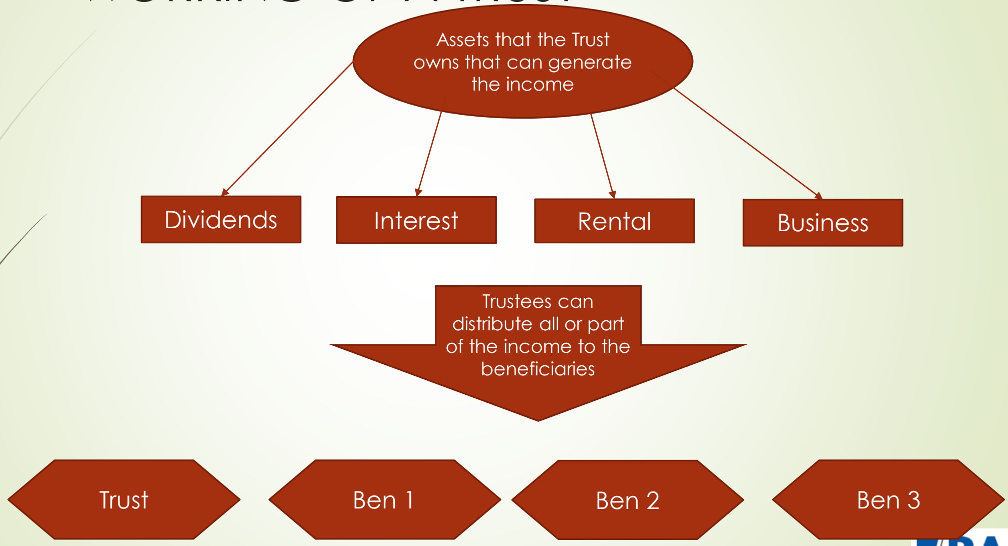
WORKING OF A TRUST



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THE LIABILITY OF THE TRUST INCOME

- Important to determine the nature of the income
- Trusts are taxed according to 2 sections in the Act
  - Section 7 (Anti-avoidance provision)
  - Section 25
- Order of tax:
  - Donor (Section 7(2) – 7(8)
  - Beneficiaries with a vested right (Section 25B)
  - Trust (Section 25B)

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ANTI-AVOIDANCE TAX PROVISIONS

- Anti-avoidance provisions exist in the income tax act to combat the use of trusts for income splitting and tax avoidance schemes
- These provisions will normally be applicable when income accrues to a person other than the donor as a result of the donor making a donation to the Trust, settlement or other disposition made (for example, the donor loans monies to the trust interest free or at a low interest rate).
- Section 7 is the anti-avoidance provision and may ONLY be invoked if a donation, settlement or other disposition has taken place.
- What is a donation, settlement or other disposition?
- Interest free loan or low interest loan is also considered to be a continuous donation thus included in section 7
- Section 7C may trigger donations tax as from 1 March 2017

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ANTI-AVOIDANCE TAX PROVISIONS

- Deemed inclusion in spouse's income (Section 7(2))
- Deemed inclusion in parent's income (Section 7(3) and (4))
- Retained income not vested due to stipulation or condition (Section 7(5))
- Amount vested that could have been revoked (Section 7(6))

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WHEN WILL THE DONAR BE LIABLE FOR TAX

ANTI-AVOIDANCE SECTION and 25B

- If a donor donates an income generating asset
- If a donor sells an income generating asset to the trust by way of a interest free loan (low interest loan)
- The beneficiaries are minors and parents are the donors
- Retained income not vested due to condition set by donor
- Amount vested that could have been revoked (Question 2 of Q&A)
- Donation to the right to income
- Distribution to a non-resident

- **SECTION 7 WILL ONLY APPLY IF THE DONOR IS ALIVE!!!**

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Example

Section 7(7)

- Ben created an inter vivos trust and donated a residential property to the trust. The trust deed stipulates that the rental income produced by the property must be paid to a specified charitable organisation. Ownership of the property must, however, be transferred back to Ben if he so notifies the trust in writing.
- Who will be liable for the tax?

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Example answer

- Ben is entitled to regain ownership of the property and the rental income produced by the property is therefore taxed in the hands of Ben, even though the charitable organisation receives all the rental income.

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LOAN ADVANCE OR CREDIT GRANTED TO TRUSTS

Loan granted to trust by connected person (Sec 7C)

- Applicable to interest free and low-interest loans by connected persons
- What is a low-interest loan? Interest rate below the official rate of SARS
- The lender is liable for the tax on the interest part
- The lender is liable for the donations tax on the difference between the actual interest charged and the official rate if any. (Sec 7C(3))
- Interest can be more than the capital amount

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Example (Interest free loan)

- Mark created an inter vivos discretionary trust on 29 Feb 2020 by selling a rent-producing property to the trust at its market value of R10 000 000. The purchase price was not paid by the trust but credited to an interest free loan account. Assume SARS considers that the market related interest of 5% should have been charged. The trust earned gross rental of R950 000 and incurred tax deductible expenditure of R250 000. Mark's minor stepdaughter and major son are the beneficiaries of the trust, but neither of them obtained a vested right to any amount during the 2021 year of assessment.
- Who will be liable for the tax?

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Example (Interest free loan)

- The net rental of R700 000 is taxable in Mark's hands.
- **BUT** limited to the interest that Mark should have charged
- Interest that should have been charged is R 500 000 (5% x R10 000 000)
- Mark is only liable for R 500 000
- Mark is allowed to donate R100 000 each year.
- Mark will pay donations tax on R 400 000 (R500 000 – R100 000)
- The leftover R200 000 will be taxed in the trust

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Example (low interest loan)

- Mark created an inter vivos discretionary trust on 29 Feb 2020 by selling a rent-producing property to the trust at its market value of R10 000 000. The purchase price was not paid by the trust but credited to a low interest loan account. The interest rate on the loan was 5%. The trust earned gross rental of R950 000 and incurred tax deductible expenditure of R250 000. Mark's minor stepdaughter and major son are the beneficiaries of the trust, but neither of them obtained a vested right to any amount during the 2021 year of assessment. Official rate is 7.5%
- Calculate the donations tax payable

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Example (donations tax)

- As from 1 March 2017 donations tax can apply
- Interest that should have been charged is R 750 000 (7.5% x R10 000 000)
- Donations tax will be charged on R150 000 (2.5% * R10 000 000 – R100 000)
- Donations tax will be R150 000 x 20% = R30 000
- Donations tax will only apply to natural persons and will never have any consequences for the trust as a debtor

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WHEN WILL THE BENEFICIARIES BE LIABLE

SECTION 7 and 25B

- When will the **beneficiaries** be liable for Tax?
- If the beneficiary has a vested right

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WHEN WILL THE TRUST BE LIABLE

SECTION 7 and 25B

- When will the **trust** be liable for Tax?
- If no beneficiary has a vested right
- The income is not deemed to accrue to the donor

- BUT please check the provisions of the Trust deed!!!

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Example 1 - MINOR

- Joseph donated a rent-producing asset to a trust. His two children (Mary and Margaret) are the beneficiaries of the trust. Mary is a minor and Margaret is a 22 year old student. During the 2020 year of assessment, the trust earned R50 000 net rental income. The trustees exercised their discretion and distributed R10 000 to each beneficiary. No beneficiary has a vested right to retained amount of R30 000.
- Who will be liable for the tax?

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Example answer

- 1. Look at the donor provisions
  - Income retained in the trust
  - Minor child
- Joseph will be taxed on:
  - R30 000 (retained in the trust) + R10 000 (minor child) = R40 000
- Margaret will be taxed on:
  - R10 000
- Mary will be taxed on:
  - R Nil
- The trust will be taxed on:
  - R Nil

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EXAMPLE 2 – Testamentary trust

- Scenario 1

In terms of a will, the assets of a deceased are vested in a resident trust to be administrated for and on behalf of the deceased's 6 minor children. The trustees must use their discretion to disburse the income of the trust necessary for the maintenance and education of the children. The balance of the income is to be accumulated for the benefit of the children and to be paid over to them if and when they reach the age of 25. In terms of the trust deed, a child is not entitled to his share of the accumulated income in the event of his death prior to reaching the age of 25.

During the year of assessment, the trust derived a net income of R40 000. In terms of the discretionary powers of the trustees, they spent R18 000 in total for the maintenance an education of the children whereby each child benefited equally .

Who will be taxed?

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EXAMPLE 2 answer – Testamentary trust

- Scenario 1 answer

Of the R18 000 expended by the trustees for the maintenance and education of the children, R3 000 is taxed in the hands of each minor (R18 000/6) because the children acquired a vested right.

The balance of R22 000 is being accumulated for the benefit of the minor children. A child will ONLY become entitled to the income if they reach the age of 25 and is still alive. This is a contingent right.

This means the beneficiaries is not presently entitled to the accumulated money. The R22 000 will be taxed in the trust.

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EXAMPLE 3 – Testamentary trust

- Scenario 2

In terms of her late father's will, Thandi was entitled to the balance of his estate. The will provided that his balance should be placed in a resident vested trust, to be administrated by trustees. The trustees have full discretion to determine how much of the trust income should be made available to Thandi and how much of the trust income should be reinvested. It was clear from the trust deed that Thandi had a vested right to both capital and income. Upon Thandi reaching the age of 30, the trust would terminate and she would receive all the accumulated income and assets of the trust

During the year of assessment, the trust derived a net income of R30 000. R6 000 was paid out to Thandi and R24 000 was reinvested .

Who will be taxed?

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EXAMPLE 3 answer – Testamentary trust

- Scenario 2 answer

The balance of Thandi's father's estate vested in her. The R24 000 not distributed to her was reinvested by the trustees for her benefit and is therefore to have accrued to her. The retained R24 000 as well as the R6 000 awarded to her are taxed in her hands.

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CAPITAL GAINS TAX AND TRUSTS

- Capital gains can be derived out of 2 sources:
  - Selling of assets to a third party
    - At market value normal capital gains calculation
  - Asset vesting in a beneficiary
    - Proceeds will deemed to be market value
    - Time of disposal will be the vesting date

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CAPITAL GAINS EXAMPLES

On 1 March 2020, Thandi gave R200 000 interest free to her discretionary family trust. The official SARS rate is 10%. The trust used the funds to purchase South African listed shares. During 2021 year of assessment dividends of R3 000 accrued to the trust. On 28 Feb 2021 the shares were sold for R222 000. This disposal resulted in a capital gain of R22 000 (R222 000 – R200 000) which did not vest in any beneficiary.

Explain the CGT consequences of the disposal of the shares

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CAPITAL GAINS EXAMPLES

1. Thandi is the donor – section 7(5) will apply
2. The "donation" is deemed to be R10 000 ((R200 000 – R100 000)*10%)
3. Dividends of R3 000 will be taxable in the Thandi's hands
4. R7 000 of the capital gains will also be taxed in the hands of Thandi.
5. Capital gain of R15 000 (R22 000 – R7 000) will be taxed in the trust

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OTHER CONSIDERATIONS

- You cannot distribute a loss
- Losses can be carried over to the next year of assessment
- If the trust receive dividends, the expenses for that dividends are not deductible
- Loan accounts

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TIPS TO REMEMBER

- If you are a party to a trust register for income tax.
- Make sure the trust deed in up to date
- Always have an independent trustee
- Keep non-taxable income in the trust, there is no tax payable on it
- Lenders can donate R100 000 every year to reduce credit loans

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CAPITAL GAINS TAX AND TRUSTS

Deemed donation event	Section in Act	Section in 8th Schedule
Spouse	s 7(2)	Par 68
Minor children	s 7(3) and s 7(4)	Par 69
Retained income not vested	s 7(5)	Par 70
Revocable vesting	s 7(6)	Par 71
Resident benefiting a non-resident	s 7(8)	Par 72
Donation of the right of income	s 7(7)	None

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QUESTIONS

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