

# Estate planning for people with special needs from a tax perspective

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## **ABSTRACT**

When planning an estate for a seriously mentally or physically disabled person, it is crucial to plan for the person's future financial security and care. The challenge that planning agents face when dealing with such a person is that the individual has the same wants and needs as someone without a disability, but cannot satisfy these needs without the financial and emotional support of a parent or guardian. This support is provided by using one of a variety of legal vehicles.

One such vehicle is a trust. A trust is a structure to which property is transferred, where it is administrated and controlled by trustees on behalf of beneficiaries, in accordance with a trust instrument. The *Income Tax Act* (ITA) expanded the trust and established a special trust, which caters especially for people with special needs. Apart from trusts and special trusts, there is also the options of non-profit organisations (NPOs) and public benefit organisations (PBOs). These organisations usually are exempt from tax liabilities and in certain cases the estate planner can employ such a strategy to help ensure a financial future for a person with special needs.

When planning an estate with a special-needs person in mind, there are, apart from the different types of applicable legal vehicles, certain other factors that should be taken into account. One such factor is the taxation of each legal vehicle. A trust, special trust, NPO, and PBO, all have different consequences regarding income tax as well as tax on capital gains. These factors can lead to advantages as well as disadvantages for agents planning an estate for a special-needs person. When deciding which legal vehicle will be best suited to a specific situation, the tax implications usually play a decisive role in the decision of the planner.

In light of the above-mentioned outline of the problem statement, it was deduced that the most suitable solution to the research question, is that of a special trust.

## **KEY WORDS**

Trusts; special trusts; Non-profit organisation (NPO); Public-benefit organisation (PBO); income tax; capital gains tax.

# TABLE OF CONTENTS

<b>ACKNOWLEDGEMENTS .....</b>	<b>I</b>
<b>ABSTRACT .....</b>	<b>II</b>
<b>KEY WORDS .....</b>	<b>II</b>
<b>LIST OF ABBREVIATIONS .....</b>	<b>IX</b>
<b>LIST OF TABLES .....</b>	<b>X</b>
<b>Chapter 1: Introduction .....</b>	<b>1</b>
<b>1.1        <i>Problem statement</i> .....</b>	<b>1</b>
<b>1.2        <i>Research question</i>.....</b>	<b>4</b>
<b>1.3        <i>Case study</i>.....</b>	<b>4</b>
<b>1.4        <i>Preview of study</i> .....</b>	<b>5</b>
<b>Chapter 2: Different legal vehicles .....</b>	<b>6</b>
<b>2.1        <i>Introduction</i>.....</b>	<b>6</b>
<b>2.2        <i>Trusts</i>.....</b>	<b>6</b>
2.2.1 <i>History of trusts</i> .....	6
2.2.1.1    The Germanic <i>Treuhand</i> .....	6
2.2.1.2    The English trust .....	7
2.2.1.3    The reception of the trust in SA Law .....	8
2.2.2 <i>Definition and legal nature of trusts</i> .....	9
<b>2.3        <i>Special trusts</i> .....</b>	<b>12</b>
2.3.1 <i>History of special trusts</i> .....	12

2.3.2	<i>Definition and legal nature of special trusts.....</i>	13
<b>2.4</b>	<b><i>Non-profit and Public Benefit Organisations (NPOs and PBOs) .....</i></b>	<b>16</b>
2.4.1	<i>History of NPOs.....</i>	16
2.4.2	<i>History of PBOs .....</i>	17
2.4.3	<i>Definition and legal nature of NPOs.....</i>	18
2.4.3.1	Voluntary association .....	19
2.4.3.2	Non-profit company .....	20
2.4.3.3	Non-profit trust .....	21
2.4.3.4	Requirements for the founding document of a NPO .....	21
2.4.4	<i>Definition and legal nature of PBOs.....</i>	23
<b>2.5</b>	<b><i>Conclusion.....</i></b>	<b>25</b>
<b>Chapter 3: Income Tax .....</b>		<b>26</b>
<b>3.1</b>	<b><i>Introduction.....</i></b>	<b>26</b>
<b>3.2</b>	<b><i>Definition and nature of income tax .....</i></b>	<b>26</b>
<b>3.3</b>	<b><i>Income tax implications of trusts .....</i></b>	<b>27</b>
3.3.1	<i>Section 25B.....</i>	28
3.3.1.1	Section 25B(3)–(4) .....	30
3.3.2	<i>Section 7 .....</i>	32
3.3.2.1	Section 7(2) .....	33
3.3.2.2	Section 7(3)–(4) .....	33

3.3.2.3	Section 7(5) .....	34
3.3.2.4	Section 7(6) .....	34
3.3.2.5	Section 7(7) .....	35
3.3.2.6	Section 7(8) .....	35
3.3.2.7	Section 7(9) and (10).....	36
3.3.3	<i>Application in terms of case study</i> .....	36
<b>3.4</b>	<b><i>Income tax implications of special trusts</i></b> .....	<b>37</b>
3.4.1	<i>Section 25B(1)</i> .....	37
3.4.2	<i>Section 7(1)</i> .....	38
3.4.3	<i>Section 7(2)-(8)</i> .....	39
3.4.4	<i>Section 25B(3)-(7)</i> .....	39
3.4.5	<i>Application to the case study</i> .....	40
<b>3.5</b>	<b><i>Income Tax implications of NPOs</i></b> .....	<b>41</b>
<b>3.6</b>	<b><i>Income Tax implications of PBOs</i></b> .....	<b>42</b>
3.6.1	<i>Section 10(1)(cN)</i> .....	42
3.6.1.1	Section 10(1)(cN)(ii)(aa) .....	43
3.6.1.2	Section 10(1)(cN)(ii)(bb) .....	43
3.6.1.3	Section 10(1)(cN)(ii)(cc).....	44
3.6.1.4	Section 10(1)(cN)(ii)(dd) .....	44
3.6.2	<i>Section 18A</i> .....	45
3.6.3	<i>Rates and provisional tax payments</i> .....	46

3.6.4	<i>Dissolution or termination of a PBO and its activities.....</i>	47
3.6.5	<i>Withdrawal of approval of a PBO.....</i>	47
3.6.6	<i>Application to the case study.....</i>	47
<b>3.7</b>	<b><i>Conclusion.....</i></b>	<b>48</b>
<b>Chapter 4: Capital Gains Tax .....</b>		<b>49</b>
<b>4.1</b>	<b><i>Introduction.....</i></b>	<b>49</b>
<b>4.2</b>	<b><i>Definition and nature of capital gains tax.....</i></b>	<b>49</b>
<b>4.3</b>	<b><i>Tax implications for capital gains of trusts .....</i></b>	<b>50</b>
4.3.1	<i>Vesting of an interest in a trust asset in a beneficiary .....</i>	51
4.3.2	<i>Discretionary trusts.....</i>	52
4.3.3	<i>Disposal by a trust.....</i>	52
4.3.4	<i>Application to the case study.....</i>	53
<b>4.4</b>	<b><i>Tax implications for capital gains of special trusts .....</i></b>	<b>53</b>
4.4.1	<i>Paragraphs 68–72 and 80.....</i>	54
4.4.2	<i>Section 9D(2A)(f) and paragraph 10.....</i>	55
4.4.3	<i>Provisions of the Eighth Schedule applicable .....</i>	55
4.4.3.1	<i>Paragraph 5 .....</i>	56
4.4.3.2	<i>Paragraphs 44–50.....</i>	56
4.4.3.3	<i>Paragraph 53 .....</i>	57
4.4.3.4	<i>Paragraph 59 .....</i>	58
4.4.3.5	<i>Paragraph 82 .....</i>	58

4.4.4	<i>Application to the case study</i> .....	59
<b>4.5</b>	<b><i>Tax implications for capital gains of NPOs</i></b> .....	<b>59</b>
<b>4.6</b>	<b><i>Tax implications for capital gains of PBOs</i></b> .....	<b>59</b>
4.6.1	<i>Non-trading assets (Paragraph 63A(a))</i> .....	60
4.6.2	<i>Minimal-trading assets (Paragraph 63A(b)(i))</i> .....	60
4.6.3	<i>Permissible trading assets (Paragraph 63A(b)(ii))</i> .....	61
4.6.4	<i>Application to the case study</i> .....	61
<b>4.7</b>	<b><i>Conclusion</i></b> .....	<b>61</b>
<b>Chapter 5: Conclusion</b> .....		<b>63</b>
<b>5.1</b>	<b><i>Introduction</i></b> .....	<b>63</b>
<b>5.2</b>	<b><i>Summary of different legal vehicles</i></b> .....	<b>63</b>
<b>5.3</b>	<b><i>Income tax implications</i></b> .....	<b>66</b>
5.3.1	<i>Trusts</i> .....	66
5.3.2	<i>Special trusts</i> .....	66
5.3.3	<i>NPOs</i> .....	67
5.3.4	<i>PBOs</i> .....	67
<b>5.4</b>	<b><i>Tax implications for capital gains</i></b> .....	<b>68</b>
5.4.1	<i>Trusts</i> .....	68
5.4.2	<i>Special trusts</i> .....	68
5.4.3	<i>NPOs</i> .....	69
5.4.4	<i>PBOs</i> .....	69



<b>5.5</b>	<b><i>Recommendations in terms of Mr and Mrs Maartens’ scenario.....</i></b>	<b>69</b>
	<b>BIBLIOGRAPHY.....</b>	<b>71</b>

## **LIST OF ABBREVIATIONS**

CGT	Capital Gains Tax
CIR	Commissioner of Inland Revenue
ITA	Income Tax Act 58 of 1962
NPO	Non-profit organisation
PBO	Public-benefit organisation
SARS	South African Revenue Service

**LIST OF TABLES**

Table 3.1 Beneficiary example of Section 25B(3) and (4).....31

Table 3.2: Trust example of Section 25B(3) and (4).....32

Table 4.1: Attribution rules that override paragraphs 80(1) and 80(2).....53

Table 5.1: Summary of legal vehicles.....64

# Chapter 1: Introduction

## 1.1 Problem statement

When observing a seriously mentally or physically disabled person in the care of their parents or guardian, people typically assumes the worst. The perception may be of a dismal future scenario, to the extent that they may be left to their own devices when their parents or guardians are no longer present.<sup>1</sup> One may query what will happen to these persons in the absence of other family members who are willing or able to take on the burden of care.<sup>2</sup> In this regard, estate planning becomes applicable for people with special needs, to provide for the future financial security and care of a disabled person.

In order to be regarded as a special-needs beneficiary,<sup>3</sup> such individuals must have a disability that causes a moderate to severe limitation on their ability to function or perform daily activities.<sup>4</sup> This limitation should already have lasted or is going to last longer than a year, and is the result of a mental, physical, intellectual, sensory or communication impairment. The impediment must furthermore be diagnosed by a registered medical practitioner.<sup>5</sup> Finally, such a disability should incapacitate these individuals from earning sufficient income for maintenance or from managing their own financial affairs.<sup>6</sup> The challenge when dealing with a person who suffers from a mental or physical disability is that such an individual has the same wants and needs of someone without such an impediment. However, the disabled person cannot satisfy these needs without the financial and emotional support of a parent or guardian. Most of these support figures are willing to provide in these wants and needs, but will not be present continually to do so. To assist in this predicament, the parent or guardian may use an estate planning tool to help secure the future of a person with special needs.

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<sup>1</sup> Nunns 2015 *Millers Inc* 5.

<sup>2</sup> Nunns 2015 *Millers Inc* 5.

<sup>3</sup> Beneficiary in terms of the *Income Tax Act* means: in relation to a trust 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.

<sup>4</sup> Section 6B of the *Income Tax Act* 58 of 1962. The *Income Tax Act* will hereafter be referred to as the ITA.

<sup>5</sup> Section 6B of the ITA.

<sup>6</sup> Stiglingh *et al Silke: South African Income Tax* 2016 837.

When planning an estate with the above-mentioned person in mind, a parent, guardian or estate planner may use various legal vehicles to meet their client's specific needs. One of the most prevalent estate planning tools is a trust. A trust is defined<sup>7</sup> in section 1 of the *Trust Property Control Act 57* of 1988 (the Trust Act).

A trust entails a structure to which property is transferred and is administrated. It is controlled by trustees on behalf of beneficiaries, in accordance with a trust instrument.<sup>8</sup> In terms of the common law, the court in *CIR v Friedmar*<sup>9</sup> held that it is important to note a trust is not a legal person in its own right. However, based on the amended definition in section 1(1) of the ITA, a trust has become a taxable entity. This amended definition of trusts includes a special trust, which is a vehicle created by the ITA to cater particularly for people with special needs. A special trust is an estate planning tool that parents or guardians of severely mentally or physically disabled children can utilise when considering the future financial support of these special-needs persons.<sup>10</sup> A special trust is defined in section 1 of the ITA to present of one of two forms.

In paragraph (a),<sup>11</sup> a special trust refers to one that is created for the benefit of mentally or physically disabled persons. This takes into account that their limitation incapacitates them from earning sufficient income to maintain themselves or to manage their own financial affairs.<sup>12</sup> Furthermore, according to paragraph (b), a trust is created in terms of a deceased person's will, specifically for the benefit of those who are alive on the date of death of the deceased person, with the youngest of those beneficiaries on the last day of the year of assessment of the trust, being under the age of 18 years.<sup>13</sup> A special trust can either be created during a trustee's lifetime (*inter vivos*), or in their will (testamentary trust).<sup>14</sup>

Apart from trusts and special trusts, this section discusses non-profit organisations (NPOs) as well as public benefit organisations (PBOs). NPOs and PBOs plays a significant

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<sup>7</sup> The definition of a trust will be given in full in Chapter 2 of this dissertation.

<sup>8</sup> A trust instrument is a document that creates a trust. Examples are a trust deed or a will.

<sup>9</sup> 1993 1 SA 333 (AD).

<sup>10</sup> Nunns 2015 *Millers Inc* 1-2.

<sup>11</sup> For purposes of this dissertation the focus will be on paragraph (a) of the definition (special needs persons), and not on paragraph (b) (minor children).

<sup>12</sup> Nunns 2015 *Millers Inc* 1-2.

<sup>13</sup> Nunns 2015 *Millers Inc* 5.

<sup>14</sup> Nunns 2015 *Millers Inc* 5.

role in any society, and even more significantly in Third World countries where the state is unable to take on the burden of all the needs the country's citizens may have. A NPO is defined in the *Non-profit Organisations Act*<sup>15</sup> as:

- a trust, company or other association of persons-
- (a) established for a public purpose; and
- (b) the income and property of which are not distributable to its members or office-bearers except as reasonable compensation for services rendered.

On the other hand, a PBO is defined in section 30(1) of the ITA as any organisation:

- that is a non-profit company as defined in section 1 of the Companies Act, or a trust or association of persons that has been incorporated, formed or established in South Africa, or
- a South African agency or branch of a non-resident company, association or a trust, that is exempt from tax in its country of residence.<sup>16</sup>

These organisations are usually exempt from tax liabilities and, in some cases, an estate planner can use them to plan for a person with special needs. The majority of NPOs and PBOs, however, have a broader objective than merely acting as legal vehicle for a single individual with special needs. These organisations usually are created for the benefit of a group of people or a community as a whole.

When planning an estate with a special-needs person in mind, certain other factors should be taken into account apart from the different types of legal vehicles to employ. One of these factors is the taxation of each legal vehicle.

It is crucial to acknowledge that the situation of individuals with special needs differ. Therefore, it is important to examine the different legal vehicles, in order to establish the correct solution for the particular situation. Typically, the following agents conduct estate planning for persons with special needs: the person's parent, guardian or an estate planner appointed by the parent or guardian. The purpose of these agents usually are to ensure that the person with the special needs are taken care of, when they, as supporting structures, are no longer present to provide the service themselves.

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<sup>15</sup> 71 of 1997.

<sup>16</sup> Section 30(1) of the ITA.

A trust, special trust, NPO and PBO, have different tax consequences. This can result in different advantages as well as disadvantages for an agent planning an estate with a special-needs person in mind. When deciding on the most appropriate legal vehicle for a specific situation, the tax implications usually are of the highest significance. It is, therefore, important to examine the tax obligations of the different legal vehicles before making a decision.

### ***1.2 Research question***

On the basis of the above-mentioned problem statement, the following research question was posed: How does the tax treatment of trusts, special trusts, NPOs and PBOs compare when planning an estate with a special-needs person in mind?

In order to answer the research question, the different legal vehicles as well as their tax obligations from both perspectives of income and capital gain, will be explained, interpreted and analysed. For this purpose, these advantages and disadvantages will be applied to a case study below of Mr and Mrs Maartens, after which a conclusion will be drawn and recommendations made.

The main objective of the study, is to find the most suitable legal vehicle for a person planning an estate with a special-needs person in mind, as viewed from a tax perspective.

### ***1.3 Case study***

The following case study is presented to operationalise the research question within the context of estate planning for special-needs persons.

Mr and Mrs Maartens have been happily married in community of property for the past 25 years, and have been blessed with three wonderful children. Mr and Mrs Maartens youngest son, Richard, however, has since birth been diagnosed with a severe case of Down's syndrome, which incapacitates his daily activities. Richard (currently 16 years old) lives with Mr and Mrs Maartens, and is unable to take care of himself physically or mentally. His parents attend to his daily needs such as feeding and clothing. Richard also will not be able to earn income of his own. If Richard's parents were to pass before him, someone would have to take on the burden of care, seeing that he would not be able to do so himself. Mr and Mrs Maartens are deeply concerned about Richard's future.

Mr and Mrs Maartens are currently busy planning their estate and have decided to draft a joint will. In this joint will they endeavour to include an estate planning tool that would ensure that Richard is taken care of in case of one or both of them are deceased. Mr and Mrs Maartens' other two children Kate (22 years old) and Peter (20 years old) are both willing and able to act as Richard's guardians and to take care of him if their parents were to pass before Richard does. Mr and Mrs Maartens have heard of a few different estate planning tools, namely trusts, special trusts, NPOs and PBOs, and wants to know what each of these tools entails. This insight will help them make an informed decision about the tool most suitable for Richard's situation. Mr and Mrs Maartens would further specifically like to know how these different legal vehicles compare in terms of income as well as capital gains tax obligations.

#### ***1.4 Preview of study***

The present study investigates the tax obligations of different legal vehicles when planning an estate with special-needs person's in mind. This topic was chosen because of the difficulties encountered in situations when an agent plans for a person with special needs, or on behalf of his/her family.

This dissertation is divided into five chapters. Chapter 2 presents a brief definition (according to statutes), an explanation as well as the history (according to literature) of each of the different legal vehicles. Thereafter, in chapters 3 and 4, both tax obligations regarding income and capital gains of each above-mentioned legal vehicle will be discussed. Chapter 5 provides the conclusion of the study as well as the recommendations that will be given to Mr and Mrs Maartens in terms of their current situation regarding Richard.



## Chapter 2: Different legal vehicles

### 2.1 Introduction

For numerous years, the creation of a trust has been a highly popular estate planning tool, particularly in terms of the tax advantages it held and the protection it provided. Together with a trust, a special trust, NPO and PBO can also be used as an estate planning instrument. Effectively, the use of these vehicles can provide various tax and other financial and non-financial advantages. In this chapter each of the identified vehicles will be discussed by referring to their history, definition and legal nature. When choosing the most appropriate legal vehicle for a specific situation, such as Mr and Mrs Maartens' scenario with Richard, it is important to know the requirements and elements that each vehicle entails. Such vehicles each offers a different solution to the same 'problem', therefore, it is important to choose the vehicle that provides the most suitable solution for each individual case.

### 2.2 Trusts

When elaborating on trusts, it is appropriate to discuss the creation and history thereof:

#### 2.2.1 History of trusts

##### 2.2.1.1 The Germanic *Treuhand*

Presently, most jurists are of the opinion that the modern trust developed from the Germanic *Treuhand*.<sup>17</sup> The *Treuhand* allowed A to transfer ownership in property to B, who had to exercise the ownership of the property for the benefit of the nominated beneficiaries. One of the main duties was to transfer the property to the nominated beneficiaries after the death of A.<sup>18</sup> The *Treuhand* began as a proposed exception to the strict Germanic rules of succession, and was codified in the *Lex Salica*.<sup>19</sup> Title 46 of this codification allows property to be transferred to an intermediary. This is accompanied by instructions about the disposal of the property in favour of the nominated beneficiaries

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<sup>17</sup> Du Toit *South African Trust Law Principles and Practice* 3.

<sup>18</sup> Grundman "The evolution of trust and Treuhand in the 20<sup>th</sup> century" 469-470.

<sup>19</sup> Du Toit *South African Trust Law Principles and Practice* 3.

after the transferor's death.<sup>20</sup> An important feature of the *Treuhand* was that the intermediary (*Treuhander*) enjoyed no beneficial interest in the property, and had to declare an oath that he/she at all times would honour his undertaking to transfer the property entrusted to him/her to the nominated beneficiaries.<sup>21</sup> Traces of the *Treuhand* are recognisable in the English institution of the *use*, which is the precursor to the modern English trust.<sup>22</sup>

### 2.2.1.2 The English trust

As early as the 11th, and common by the 13th century in England, the institution took place of granting specific land to an intermediary for various *uses*.<sup>23</sup> *Use* allowed A (the *feoffor*) to transfer property in ownership to B (the *feoffee*) for the *use* of C (the *cestui que use*).<sup>24</sup> The *feoffee* had vested ownership in the property, but was bound by an oath to abide by the wishes of the *feoffor* and to provide the benefit stipulated by the *feoffor* on the *cestui que use*.<sup>25</sup> The *feoffee* was recognised as the legal owner of the property. The common law did not grant the *cestui que use* a remedy against the *feoffee*, which means that it failed to provide successfully for the interests of the *cestui que use* in the property held to *use*. The reason was that the *feoffee* was recognised as the legal owner of such property, and the common law did not grant the *cestui que use* a remedy against the *feoffee*.<sup>26</sup> Despite the *feoffee's* legal right to use the property in terms of the common law, it was readily recognised in equity that the *feoffee* held the property for the benefit of the *cestui que use*. Due to the fact that the *feoffee* was obliged to hold the property to *use* in good faith, this person could be forced to adhere to the terms of the *use*.<sup>27</sup> Initially, the interest of the *cestui que use* was a mere claim against the *feoffee*, but from the 15th century, onwards it came to be recognised as a proprietary interest.<sup>28</sup> The concept of dual ownership, divided between the legal estate of the *feoffee* and the

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<sup>20</sup> Du Toit *South African Trust Law Principles and Practice* 3.

<sup>21</sup> Grundman "The evolution of trust and *Treuhand* in the 20<sup>th</sup> century" 469-470.

<sup>22</sup> Du Toit *South African Trust Law Principles and Practice* 3.

<sup>23</sup> Cameron *et al Honore's South African Law of Trusts* 24.

<sup>24</sup> Cameron *et al Honore's South African Law of Trusts* 25.

<sup>25</sup> Du Toit *South African Trust Law Principles and Practice* 4.

<sup>26</sup> Du Toit *South African Trust Law Principles and Practice* 5.

<sup>27</sup> Essays UK 2013 <http://www.lawteacher.net/free-law-essays/equity-law/historical-development-of-trust-modern-property-equity-law-essay.php?cref=1>.

<sup>28</sup> Essays UK 2013 <http://www.lawteacher.net/free-law-essays/equity-law/historical-development-of-trust-modern-property-equity-law-essay.php?cref=1>.

equitable estate of the *cestui que use*, soon became a feature of the English law.<sup>29</sup> The large-scale exploitation of the *use* promoted the passing of the *Statute of Uses* in 1535. The aim was putting an end to the abuse of the *use*. In due time and through sustained legal development, the *use* was transformed into the trust.<sup>30</sup>

### 2.2.1.3 The reception of the trust in SA Law

In 1806, the British occupied the Cape for a second time, after a brief occupation from 1795 until 1803.<sup>31</sup> Despite the preservation of Roman-Dutch law, a steady absorption of English legal principles and institutions was unavoidable.<sup>32</sup> The trust as a form of *uses* was one of these institutions. The British settlers incorporated the trust institution as well as the use of the terms “trust” and “trustee” in wills, deeds of gift, ante-nuptial contracts and land transfers.<sup>33</sup>

It was, however, not until 1915, in *Estate Kemp v McDonald’s Trustee*,<sup>34</sup> that a South African court had to decide whether South African law could, and indeed should, give legal effect to the trust. In the mentioned case, the Appellate Division was faced with a trust created in a will, drawn up in England. The Court commenced with the notion that the English law of trusts was not yet received in South African law and, therefore, does not form part of the South African law.<sup>35</sup> The Court, however, further found that the trust institution is not incompatible with the general principles of South African law and the use of trusts was becoming rooted firmly in legal and commercial practice. Therefore, it would be all but impossible to eradicate it.<sup>36</sup>

A testamentary disposition expressed in the form of a trust was thus met with the judicial acceptance of South Africa’s highest court. This prompted the Appellate Division to accommodate and give legal effect to the trust.<sup>37</sup> Even though the English trust as an institution was incorporated into South African law, this does not apply to English law of

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<sup>29</sup> Du Toit *South African Trust Law Principles and Practice* 5.

<sup>30</sup> Du Toit *South African Trust Law Principles and Practice* 5.

<sup>31</sup> Trustguru 2011 [https://trustguru.co.za/Trust\\_Historical\\_development.html](https://trustguru.co.za/Trust_Historical_development.html).

<sup>32</sup> Du Toit *South African Trust Law Principles and Practice* 6.

<sup>33</sup> Trustguru 2011 [https://trustguru.co.za/Trust\\_Historical\\_development.html](https://trustguru.co.za/Trust_Historical_development.html).

<sup>34</sup> 1915 AD 491.

<sup>35</sup> 1915 AD 507.

<sup>36</sup> 1915 AD 519.

<sup>37</sup> Du Toit *South African Trust Law Principles and Practice* 6.

trust as a whole. As a result, some of the South African trust principles differs from those in the English law.<sup>38</sup> The creation and revocation of trusts is governed by South African common-law rules. This means that a trust must be set up according to the common-law rules about testamentary dispositions, donations and contracts. These legal tools include a contract for the benefit of a third person, which unlike English law, do not recognise the effectiveness of unilateral dispositions of property by a living person.<sup>39</sup>

Over the years, the courts have created a uniquely South African trust law which shows minimal resemblance to its English counterpart.<sup>40</sup> The rules of the South African trust law are thus a mixture of English, Roman-Dutch and distinctively South African rules, with the latter continually growing in relative importance.<sup>41</sup> Presently, a trust in terms of South African law is not regarded as a legal person, but rather as a legal institution *sui generis*,<sup>42</sup> and is thus governed by a unique legislation.<sup>43</sup> The *Trust Act* currently regulates the trust law in South Africa.

### 2.2.2 Definition and legal nature of trusts

A trust is defined in section 1 of the *Trust Act* as:

Trust 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* 66 of 1965.<sup>44</sup>

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<sup>38</sup> Marais *The taxation of income and expenditure of trusts in South Africa* 5.

<sup>39</sup> Cameron *et al Honore's South African Law of Trusts* 22-23.

<sup>40</sup> Marais *The taxation of income and expenditure of trusts in South Africa* 5.

<sup>41</sup> Cameron *et al Honore's South African Law of Trusts* 22-23.

<sup>42</sup> *Sui generis* means: the only one of its kind; peculiar.

<sup>43</sup> Kenny 2015 *Without Prejudice* 70.

<sup>44</sup> Section 1 of the *Trust Act*.

In the context of estate planning, a trust is defined as a legal relationship created by a person (founder) through the placement of assets under the control of another (trustee) during his lifetime or on his death, for the benefit of third persons (beneficiaries).<sup>45</sup> Even though a trust is regarded as a relationship between parties, it was specifically included in the definition of "person"<sup>46</sup> in section 1 of the ITA. This inclusion puts it beyond doubt that a trust could be subject to normal taxation.<sup>47</sup> A trust as described in section 1, can consist of either ready money (cash), or any other assets administered and controlled by trustees. In this case, such a person is appointed under a deed of trust, by agreement, or under the will of a deceased person, with the objective to control and administer the assets to the benefit of the beneficiaries.<sup>48</sup> Thus, to state the objective of the trustees simply, it can be said that the trustees must take care of the assets on behalf of the beneficiaries until a certain unknown future event occurs.

It is clear from the definition of a trust that the law makes provision for both the strict and the wide interpretation of trusts. A trust is an entity that is created by a trust instrument also known as the trust document.<sup>49</sup> This instrument implies that both testamentary (created by a will) and *inter vivos* (created by a contract) trusts are included in the definition but oral trusts are excluded, because no trust document is created.<sup>50</sup> In other words, a trust must have a trust instrument, which means it has to be in some form of writing. The legal nature of the two types of trusts also differs.

As stated above, an *inter vivos* trust is created through a contract. This was confirmed in the decision of *Crookes v Watson*,<sup>51</sup> where the court found that a trust *inter vivos* is a contract for the benefit of a third person,<sup>52</sup> a so-called *stipulatio alteri*.<sup>53</sup> This means that

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<sup>45</sup> Rabenowitz *et al* *The South African Financial Planning Handbook* 822.

<sup>46</sup> Person in section 1 of the ITA: includes-

(a) an insolvent estate;

(b) the estate of a deceased person;

(c) any trust; and

(d) any portfolio of a collective investment scheme, but does not include a foreign partnership.

<sup>47</sup> Stiglingh *et al* *Silke: South African Income Tax 2016* 837.

<sup>48</sup> Stiglingh *et al* *Silke: South African Income Tax 2016* 837.

<sup>49</sup> Business News 2009 <http://www.iol.co.za>.

<sup>50</sup> Rabenowitz *et al* *The South African Financial Planning Handbook* 824.

<sup>51</sup> 1956 1 ALL SA 227 (A).

<sup>52</sup> Rabenowitz *et al* *The South African Financial Planning Handbook* 825.

<sup>53</sup> This right, known as an *ius quaesitum tertio*, arises where the third party is the intended beneficiary of the contract, as opposed to a mere incidental beneficiary.

if a trust is created *inter vivos*, the formalities,<sup>54</sup> prescribed for a valid contract must also be adhered to, for the trust to be valid.

On the other hand, a testamentary trust is officially created on the death of the testator by his last will and testament.<sup>55</sup> In *Braun v Blann and Botha*,<sup>56</sup> the court found that a testamentary trust is not the same as a *fideicommissum*,<sup>57</sup> and that this document has its own unique legal nature and characteristics.<sup>58</sup> The fact that a testamentary trust is formed by a will implies compliance to the formalities<sup>59</sup> of the *Wills Act*<sup>60</sup>.

For a trust to be valid, certain general requirements must be adhered to. The following are the essential aspects of a valid trust:

For a trust to be created (a) the founder must intend to create one, (b) the founder's intention must be expressed in a mode appropriate to create an obligation, (c) the property subject to the trust must be defined with reasonable certainty, (d) the trust object, which may either be personal or impersonal, must be defined with reasonable certainty, and (e) the trust object must be lawful.<sup>61</sup>

In terms of the *Trust Act*, a copy of the trust deed must be lodged with the Master of the High Court. Furthermore, a trustee is not allowed to perform a valid act unless authorised

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<sup>54</sup> The formalities for a valid contract are as follows:  
Consensus: the parties' intent in their minds must match (or at least appear to match) on all material aspects of their agreement;  
Capacity: the parties must have the necessary legal capacity to contract;  
Formalities: where in exceptional cases, require that the agreement should be in a certain format (for example, in writing and signed), these formalities must be respected.  
Legality: the agreement must be lawful - in other words it cannot be prohibited by law or common law;  
Possibility: the undertaken commitments must be performed when the agreement is entered, and  
Security: the agreement must have definite or determinate content, so that the commitments can be enforced.

<sup>55</sup> Rabenowitz *et al The South African Financial Planning Handbook* 825.

<sup>56</sup> 1984 2 ALL SA 197 (AD).

<sup>57</sup> *Fideicommissum* is a form of substitution where a testator leaves his estate, part thereof or a specific asset, to an heir or legatee and directs that the property so bequeathed is to go to another heir or legatee after the expiry of a certain period or the occurrence of an uncertain event.

<sup>58</sup> Rabenowitz *et al The South African Financial Planning Handbook* 825.

<sup>59</sup> The formalities for a valid will are as follows:

- 1) All wills must be in writing. They can be written by hand, typed or printed.
- 2) The testator must sign the will in the presence of two or more competent witnesses.
- 3) The witnesses must attest and sign the will in the presence of the testator and of each other.

<sup>60</sup> 7 of 1953.

<sup>61</sup> Cameron *et al Honore's South African Law of Trusts* 169.

by the Master to act as trustee by issuing a letter of authority.<sup>62</sup> When these above-mentioned essentials are adhered to, a valid trust will come into existence.

As explained previously, a trust can be used as an estate planning tool. Trusts represent relatively easy and effective methods of estate planning and have been highly popular in the past. As stated above, a third person will benefit from a trust. Therefore, applied to the case study: Mr and Mrs Maartens' can utilise a trust to the advantage of Richard and his special needs.

In the early 2000's, SARS created a new kind of trust, referred to as a special trust. This form of trust has certain tax advantages that is not available to a usual trust, and will be discussed in the following paragraphs.

### **2.3 Special trusts**

When elaborating on special trust, it is appropriate to discuss the creation and history thereof:

#### *2.3.1 History of special trusts*

A definition for special trusts was first introduced in 2002<sup>63</sup> in the ITA. This definition refers to a trust created solely for the benefit of a person who suffered from a defined mental or serious physical disability.<sup>64</sup> The precondition is that the limitation should hinder these individuals from earning sufficient income to maintain themselves (the so-called type-A trusts<sup>65</sup>).<sup>66</sup> When the first definition of a special trust is applied strictly, "a person" arguably means that a trust created for the benefit of more than one qualifying beneficiary would not have constituted a special trust.<sup>67</sup> In addition, to qualify as a special trust, beneficiary's illness or disability should incapacitate this individual from earning sufficient income for his/her own maintenance, or from managing his/her own financial

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<sup>62</sup> Marais *The taxation of income and expenditure of trusts in South Africa* 10.

<sup>63</sup> The special trust definition was inserted into the ITA by means of section 5(i) of the *Taxation Laws Amendment Act 5 of 2001*.

<sup>64</sup> Pace and van der Westhuizen *Wills and Trusts* 235.

<sup>65</sup> Commonly referred to in literature as a type-A trust, even though the legislation refers to it as subsection (a) special trusts.

<sup>66</sup> Section 1 of the ITA.

<sup>67</sup> Pace and van der Westhuizen *Wills and Trusts* 235; SARS *Draft Guide on the taxation of special trusts* 1-2.

affairs.<sup>68</sup> This initial definition was extended in the 2003 year of assessment to include certain trusts created by the will of a deceased person for the benefit of relatives who are under the age of 21 years<sup>69</sup> (the so-called type-B trusts).<sup>70</sup>

The current definition of special trust in section 1(1) of the ITA was amended with effect from the 2013 year of assessment. The amended definition regulates the situation as follows:<sup>71</sup>

In the case of a type-A trust, 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).<sup>72</sup>

The definition of special trust in terms of a type-A trust was again amended<sup>73</sup> with effect from the 2015 year of assessment, thereafter referring to a person or persons with a "disability" as defined in section 6B(1). This amended definition is currently still in use. A special trust is created especially for the benefit of individuals who suffer from a severe disability, or who are under-age when the trust comes into existence.

### *2.3.2 Definition and legal nature of special trusts*

A special trust is defined in section 1 of the ITA as 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

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<sup>68</sup> Section 6B of the ITA.

<sup>69</sup> Pace and van der Westhuizen *Wills and Trusts* 237; SARS *Draft Guide on the taxation of special trusts* 1-2.

<sup>70</sup> Section 1 of the ITA.

<sup>71</sup> The substituted definition of a special trust was inserted into the ITA by section 2(1)(zA) of the *Taxation Laws Amendment Act* 22 of 2012.

<sup>72</sup> SARS *Comprehensive Guide to Capital Gains Tax* 49; Pace and van der Westhuizen *Wills and Trusts* 236; SARS *Draft Guide on the taxation of special trusts* 1-2.

<sup>73</sup> The definition of special trust was amended by section 4(1)(zZh) of the *Taxation Laws Amendment Act* 31 of 2013.



(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.

A type-A special trust, therefore, refers to an *inter vivos* trust, a testamentary trust or a trust created as a result of a court order. This legal document is created solely for the benefit of a person who suffers from a defined mental illness or a serious physical disability. The beneficiary of a type-A trust can only be a natural person because only such an individual can have a disability.<sup>74</sup> For an illness or disability to qualify as a special need, as stated above, it must incapacitate the beneficiaries from earning sufficient income for their own maintenance, or from managing their own financial affairs.<sup>75</sup> The disability must be defined in terms of section 6B(1),<sup>76</sup> which states the following:

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.<sup>77</sup>

A trust will not qualify as type-A if the beneficiary is a person with a disability but still able to earn sufficient income for personal and financial capacity.<sup>78</sup> It is a factual issue whether or not a beneficiary earns sufficient income to ensure such a personal and financial capacity, and naturally will depend on the specific circumstances of each case.<sup>79</sup> This disability proviso as explained above, leads to the following requirement, namely that the trust has to be created solely for the benefit of one or more persons with a disability as defined in section 6B(1) of the ITA, and no one else.<sup>80</sup> This means that the trust deed should not make provision for, or grant, a discretion to the trustees enabling

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<sup>74</sup> SARS *Draft Guide on the taxation of special trusts* 7.

<sup>75</sup> Section 1 of the ITA.

<sup>76</sup> Section 6B of the ITA.

<sup>77</sup> Section 6B(1) of the ITA states: Firstly that an ITR-DD form must be completed by the person with the disability/or on behalf of the person with the disability (part A of the form) and a registered medical practitioner qualified to express an opinion on the disability (part B and C of the form). The medical practitioner will have to answer various questions and confirm whether a 'moderate to severe' disability in accordance with the criteria as stated in the ITR-DD form are present. The form only needs to be completed every five years for taxpayers who or whose spouse or child has a permanent disability.

<sup>78</sup> Stiglingh *et al Silke: South African Income Tax 2016* 837.

<sup>79</sup> Stiglingh *et al Silke: South African Income Tax 2016* 837.

<sup>80</sup> SARS *Draft Guide on the taxation of special trusts* 12.

any individual who is not a person with a disability (according to the preconditions). Such a person should not be offered the chance to obtain a vested or a discretionary right to any income or capital of the trust as long as the beneficiary or beneficiaries for whose sole benefit the trust was created is alive.<sup>81</sup>

Another factor that can emerge when creating a type-A special trust is the requirement regarding relatives.<sup>82</sup> This requirement entails that if a type-A trust is created for the sole benefit of more than one disabled person, these individuals have to be relatives of each other. The relationship between the founder of the trust and the beneficiaries is of no consequence for purposes of a type-A trust. This implies that the founder of the trust and its beneficiaries do not have to be relatives.<sup>83</sup>

Even if a trust complies with the other requirements as outlined above, a further requirement is 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. This means that a trust will cease to be a type-A trust from the start of the year of assessment, during which all the designated beneficiaries of the trust are deceased.<sup>84</sup> A type-A special trust will thus only exist if all the above-mentioned requirements are met, SARS approved and the trust registered as a type-A special trust.

Since the amendment of the definition in 2003, special trusts have become increasingly popular as estate planning tools, and has provided significant tax advantages. These factors should be considered when deciding on the most effective legal vehicle for a specific situation. Special trusts are avenues that SARS provide to assist special-needs persons to lessen the financial burden they carry throughout their life.

Other legal vehicles that can be employed for this purpose, are a Non-profit Organisation or, Public Benefit Organisation. These legal vehicles have a different approach to situations such as that of Mr and Mrs Maartens in the presented case study.

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<sup>81</sup> SARS *Draft Guide on the taxation of special trusts* 7.

<sup>82</sup> A relative is defined in section 1(1) of the ITA and means in relation to any person –  
(a) The spouse of that person;  
(b) Anybody related to that person within the third degree of consanguinity;  
(c) Anybody related to the spouse of that person within the third degree of consanguinity, and  
(d) The spouse of anybody related within the third degree of consanguinity to that person or that person's spouse.

<sup>83</sup> SARS *Draft Guide on the taxation of special trusts* 9.

<sup>84</sup> SARS *Draft Guide on the taxation of special trusts* 8.

## **2.4 Non-profit and Public Benefit Organisations (NPOs and PBOs)**

When elaborating on NPOs and PBOs it is appropriate to discuss the creation and history thereof:

### *2.4.1 History of NPOs*

NPOs play a significant role in society by taking shared responsibility for the social and development needs of the country, thus relieving the financial burden that would otherwise be assigned to the state.<sup>85</sup> Since 1994, the environment in which non-profit organisations operate underwent a fundamental transformation.<sup>86</sup> The previous dispensation (apartheid era) was characterised by major deficiencies in the legislative framework applicable to non-profit organisations. Of these shortcomings were: the mandatory registration necessary to raise funds for the organisations, extremely limited tax benefits, for which very few NGOs qualified, and the failure to recognise the legal existence of associations whose objectives were declared unlawful by the State.<sup>87</sup> In the early 1990s, various initiatives were set in motion to promote socio-political reform. These interventions created an environment where legislation was developed to assist with the constitutional change that was taking place in South Africa.<sup>88</sup>

The *Non-Profit Organisations Act*<sup>89</sup> (hereafter: the *NPO Act*), finally came into operation on 1 September 1998. This was the outcome of an extensive process of policy and legislative reform negotiated between the state and civil society organisations.<sup>90</sup> Historically, the *Fundraising Act*<sup>91</sup> which has largely been repealed by the *NPO Act* and which regulated public fundraising by NPOs, was misused by the apartheid state to monitor and constrain the activities of NPOs opposing the dispensation.<sup>92</sup> Primarily, the *NPO Act* strives to achieve its objectives of creating an enabling environment for NPOs and setting and maintaining adequate standards of governance, accountability and

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<sup>85</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 2.

<sup>86</sup> Anon "Laws and regulations governing non-profit organisations in South Africa" 1.

<sup>87</sup> Bamford *The Law of Partnership and Voluntary Association in South Africa* 121.

<sup>88</sup> Anon "Laws and regulations governing non-profit organisations in South Africa" 1.

<sup>89</sup> 71 of 1997.

<sup>90</sup> Honey M 2012 *NPO Legal Support Project* 1.

<sup>91</sup> 107 of 1978.

<sup>92</sup> Honey M 2012 *NPO Legal Support Project* 1.

transparency, by creating a voluntary registration facility.<sup>93</sup> Essentially, the *NPO Act* provides a registration facility for the existing South African NPOs, provided that certain minimum establishment and annual reporting requirements are met.<sup>94</sup>

South Africa currently boasts a wide-spread NPO sector, which consist of approximately 100 000 registered NPOs and an estimated 50 000 unregistered ones.<sup>95</sup> This is the product of a civilisation based on a rich history with diverse ethnical groups that has formed the way in which the South African society operates as a whole, and the strategic processes according to which the non-profit sector conducts its operations.<sup>96</sup> The South African NPO sector currently consist of two types of organisations.<sup>97</sup> The first is service driven, and the second entail organisations that focus on human rights and advocacy.<sup>98</sup> The first type provides much needed social services to underprivileged communities, and the latter operates as a social watchdog.<sup>99</sup> Without these NPOs, the citizens of South Africa would be worst off, as the NPOs strive to create an improved social situation, higher standards of living, and helps the state fulfil its duties to the citizens.<sup>100</sup>

#### *2.4.2 History of PBOs*

Historically, non-profit organisations were granted a certain degree of preferential tax treatment and donor incentives.<sup>101</sup> Particularly religious, charitable and educational institutions were exempt from income taxes.<sup>102</sup> Following recommendations by the Katz Commission, the Minister of Finance, in his 2000 Budget Speech, announced wide-ranging changes to the legislation regulating the tax exemption of NPOs.<sup>103</sup> Henceforth, tax exemptions would only be granted to organisations that qualify as a PBO.

A PBO entails any organization with the sole objective of providing one or more of the public benefit activities in a non-profit manner as defined by the Minister.<sup>104</sup> All PBOs thus

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<sup>93</sup> Section 2 of the *NPO Act*; Honey M 2012 *NPO Legal Support Project 1*.

<sup>94</sup> Honey M 2012 *NPO Legal Support Project 1*.

<sup>95</sup> Stuart 2013 *SANGO Pulse 2*.

<sup>96</sup> Stuart 2013 *SANGO Pulse 3*.

<sup>97</sup> Honey M 2012 *NPO Legal Support Project 1*.

<sup>98</sup> Stuart 2013 *SANGO Pulse 4*.

<sup>99</sup> Stuart 2013 *SANGO Pulse 4*.

<sup>100</sup> Honey M 2012 *NPO Legal Support Project 2*.

<sup>101</sup> Anon 2012 <http://www.tcn.co.za/site/wp-content/uploads/2012/07/5-what-is-a-PBO-and-NPO.pdt>.

<sup>102</sup> Anon 2012 <http://www.tcn.co.za/site/wp-content/uploads/2012/07/5-what-is-a-PBO-and-NPO.pdt>.

<sup>103</sup> Anon 2012 <http://www.tcn.co.za/site/wp-content/uploads/2012/07/5-what-is-a-PBO-and-NPO.pdt>.

<sup>104</sup> Stuart 2013 *SANGO Pulse 4*.

can be considered as NPOs, but not all NPOs function as PBOs. An organisation as NPO firstly has to be registered in terms of section 30 of the ITA to qualify as a PBO.<sup>105</sup> Section 30 stipulates the following requirements:

The ITA requires that the PBO conducts its activities in a non-profit manner and with an altruistic or philanthropic intent. Furthermore, the activities conducted by the PBO cannot directly or indirectly enhance the economic self-interest of any person acting in a fiduciary capacity for the PBO or for an employee thereof, except in the form of reasonable remuneration payable to that fiduciary or employee for services rendered. In addition, at least 85% of the activities conducted by the PBO, measured either as the cost related to the activities or the time expended relating thereto must be carried out for the benefit of persons in the country, unless the Minister having reference to the circumstances of the PBO directs otherwise. Where the PBO conducts activities both within and outside South Africa, the cost incurred for the benefit of persons outside the country shall be disregarded to the extent that donations are received from persons who are not resident in the country.<sup>106</sup>

#### *2.4.3 Definition and legal nature of NPOs*

When a person or a group of people observe a need in their surrounding society, and decides on interventions to address that need, they start an action.<sup>107</sup> Should these person/people organised their efforts to sustain this action and continue to deliver a solution for the need, they start an organisation. Most of these community organisations remain in this phase, driven entirely by the resources and energies of the founders and members.<sup>108</sup> However, when a community organisation seeks recognition from the state, or requires resources outside of the organisation and has to establish a formal institution, another sector opens up.<sup>109</sup> After this formal institution is created, one of the options available to it, is the creation of a so-called non-profit organisation (NPO). A NPO is defined in the *NPO Act* as follows:

a trust, company or other association of persons-

- (a) established for a public purpose; and
- (b) the income and property of which are not distributable to its members or office-bearers except as reasonable compensation for services rendered.

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<sup>105</sup> Section 30 of the ITA.

<sup>106</sup> SAICA 2006  
[https://www.saica.co.za/integritax/2006/1457\\_The\\_current\\_rules\\_governing\\_public\\_benefit\\_organisations.htm](https://www.saica.co.za/integritax/2006/1457_The_current_rules_governing_public_benefit_organisations.htm).

<sup>107</sup> Department of Social Development 2001 *NPOs* 7.

<sup>108</sup> Department of Social Development 2001 *NPOs* 7.

<sup>109</sup> Department of Social Development 2001 *NPOs* 7.

This definition implies that any organisation, which is not for profit and is not part of the government, can apply to register as a NPO. The following organisations can all thus register as a NPO:

- Non-governmental organisations (NGO);
- Community-based organisations (CBO);
- Faith-based organisations (FBO);
- organisations that have registered as a non-profit company (NPC) in terms of the *Companies Act* 71 of 2008;
- trusts that have registered with Master of the Supreme Court under the *Trust Property Control Act* 57 of 1988; and
- any other voluntary association that is not for profit.<sup>110</sup>

A NPO can, therefore, be considered as a group of people that collaborate for a shared purpose, and who agrees to cooperate in order to fulfil the purpose agreed upon.<sup>111</sup> They direct their actions towards this purpose, and should they gain profit after their expenses are processed, this profit is allocated for the benefit of the purpose.<sup>112</sup> Such a purpose or objective is known as a public benefit activity. A public benefit activity is any activity listed in Part 1 of the 9th Schedule of the Act, or any other activity determined by the Minister of Finance.<sup>113</sup> These activities should have a benevolent nature focused on the needs, interest and wellbeing of the general public.<sup>114</sup> There are in essence three kinds of legal entities available when launching a NPO, namely a voluntary association, non-profit trust and non-profit company.<sup>115</sup>

#### 2.4.3.1 Voluntary association

A voluntary association is the most frequently used legal entity when establishing a NPO since it is simple, fast and inexpensive.<sup>116</sup> The NPO Directorate<sup>117</sup> recently reported that voluntary associations represent approximately 95% of all the NPOs that are registered

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<sup>110</sup> Department of Social Development 2014 [https://www.westerncape.gov.za/general-publication/all-you-need-know-about-registration-non-profit-organisations?toc\\_page=1](https://www.westerncape.gov.za/general-publication/all-you-need-know-about-registration-non-profit-organisations?toc_page=1).

<sup>111</sup> Department of Social Development 2001 *NPOs* 5.

<sup>112</sup> Department of Social Development 2001 *NPOs* 5.

<sup>113</sup> Section 30 of the *PBO Act*.

<sup>114</sup> Pretorius 2016 *TaxTalk* 21.

<sup>115</sup> Wyngaard 2012 *SANGO Pulse* 1.

<sup>116</sup> Wyngaard 2012 *SANGO Pulse* 1.

<sup>117</sup> The NPO Directorate is a panel of members of Arbitration in Terms of the NPO Act.

in terms of the *NPO Act*.<sup>118</sup> A voluntary association is established when three or more individuals enter into an agreement to create an organisation to achieve a common non-profit objective.<sup>119</sup> Voluntary associations can be used for small community-based organisations that do not have or manage extensive amounts of money, valuable property or equipment while carrying out their activities.<sup>120</sup> To create an incorporated voluntary association with an independent legal personality, the common law stipulates provisions for the constitution of the voluntary association. These provisions specify that the organisation will continue to exist despite changes in its membership; and that its assets and liabilities will be held separately from those of its members.<sup>121</sup>

#### 2.4.3.2 Non-profit company

Section 21 of the previous *Companies Act*<sup>122</sup> made provision for a “not-for-profit company” or an association incorporated “not for gain.” These types of entities resemble profit-oriented companies in their legal structure, but have no share capital and thus are not allowed to distribute shares or pay dividends to their members.<sup>123</sup> As of 1 May 2011, with the introduction of the new *Companies Act*,<sup>124</sup> the name “non-profit company” (NPC) is allocated to entities previously known as Section 21 companies. NPCs are founded on a Memorandum of Incorporation, which sets out its objectives, and is signed by a minimum of three people known as incorporators.<sup>125</sup> NPCs are registered with the Companies and Intellectual Properties Commission, either by an accountant, company secretary or statutory service, or by following the steps outlined on the Commission’s website.<sup>126</sup>

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<sup>118</sup> Wyngaard 2012 *SANGO Pulse* 1.

<sup>119</sup> Honey M 2012 *NPO Legal Support Project* 5.

<sup>120</sup> Honey M 2012 *NPO Legal Support Project* 5.

<sup>121</sup> Honey M 2012 *NPO Legal Support Project* 5.

<sup>122</sup> 61 of 1973.

<sup>123</sup> Honey M 2012 *NPO Legal Support Project* 9.

<sup>124</sup> 71 of 2008.

<sup>125</sup> Tshikululu Social Investments 2012 *Tshikhulu* 3.

<sup>126</sup> Requirements for forming a NPC:

- They are incorporated for a “public benefit purpose”.
- Income and property may not be distributed to the incorporators, members, directors or officers of a non-profit company, except for reasonable compensation for services rendered by them.
- The name of a non-profit company will end with “NPC”.
- A minimum of three persons, called incorporators, must complete and sign the MOI.
- A minimum of three directors must be appointed.
- All of a non-profit company’s assets and income must be used to advance its stated objectives, as set out in its MOI.

Section 21 companies existing prior to 1 May 2011, are thereafter recognised as NPCs.<sup>127</sup> All NPCs are required to submit annual returns and are expected to comply with the *Companies Act*.

In terms of the *Companies Act*, a non-profit company is formed for a public benefit object, or an object relating to a cultural or social activity for a communal or group interest. Part of the essence of a non-profit company is the provision that its income and property are not to be distributed among its members, directors, incorporators, offices or people related to any of them, except to the extent permitted Schedule 1 of the *Companies Act*. Non-profit companies are subject to a modified application of the Act and to a distinct set of essential rules, as set out in Schedule 1 to the *Companies Act*, which governs matters unique to non-profit companies.<sup>128</sup>

#### 2.4.3.3 Non-profit trust

A non-profit trust, still resorts under the scope of a trust and has to be registered in terms of the *Trust Act*. The Master of the High Court is responsible for the registration of such trusts.<sup>129</sup> A Board of Trustees (similar to a Board of Directors in a company) governs the trust. Their powers are usually defined as wide as possible to help them achieve the objectives of the trust.<sup>130</sup> Trustees must exercise their duties with the care, diligence and skill that are reasonably expected of a person who manages the affairs of another. A trust also registered as an NPO (in addition to being registered with the Master of the High Court) is recognised by law as a body corporate. In this sense, it has acquired an independent legal personality through the mentioned registration.<sup>131</sup>

#### 2.4.3.4 Requirements for the founding document of a NPO

The founding document or constitution of each of the abovementioned legal entities, must comply with a number of requirements in order to be registered.<sup>132</sup> These funding documents should state the objectives of the organisation, how the organisation will be

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<sup>127</sup> Tshikululu Social Investments 2012 *Tshikululu* 3.

<sup>128</sup> Honey M 2012 *NPO Legal Support Project* 7.

<sup>129</sup> Wyngaard 2012 *SANGO Pulse* 1.

<sup>130</sup> Honey M 2012 *NPO Legal Support Project* 7.

<sup>131</sup> Honey M 2012 *NPO Legal Support Project* 8.

<sup>132</sup> Honey M 2012 *NPO Legal Support Project* 1.



managed, its structure, and the duties of its directors.<sup>133</sup> The nature of the founding document will depend on the type of organisation, which is as follows:

- non-profit company, as defined in section 1 of the *Companies Act* - a memorandum of incorporation;
- trust - a trust deed or, if established as a testamentary trust, a will; and
- voluntary association - a constitution adopted by all of its members.<sup>134</sup>

All of these above-mentioned founding documents have certain mandatory requirements that should be adhere to. These requirements are set out as follows:

Unless the laws in terms of which a non-profit organisation is established or incorporated make provision for the matters in this sub-section, the constitution of a non-profit organisation that intends to register must:

- a. State the organisation's name, as well as their main and ancillary objectives;
- b. State that the organisation's income and property are not distributable to its members or office-bearers, except as reasonable compensation for services rendered;
- c. Make provision for the organisation to be a body corporate and have an identity and existence distinct from its members or office-bearers;
- d. Make provision for the organisation's continued existence notwithstanding changes in the composition of its membership or office-bearers;
- e. Ensure that the members or office-bearers have no rights in the property or other assets of the organisation solely by virtue of their being members or office-bearers;
- f. Specify the powers of the organisation as well as their organisational structures and mechanisms for its governance;
- g. Set out the rules for convening and conducting meetings, including quorums required for and the minutes to be kept of those meetings;
- h. Determine the manner in which decisions are to be made;
- i. Provide that the organisation's financial transactions must be conducted by means of a banking account;
- j. Determine a date for the end of the organisation's financial year;
- k. Set out a procedures for changing the constitution as well as a procedure by which the organisation may be wound up or dissolved;

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<sup>133</sup> Tshikululu Social Investments 2012 *Tshihikulu* 4.

<sup>134</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 4.

- I. Provide that, when the organisation is being wound up or dissolved, any asset remaining after all its liabilities have been met, must be transferred to another non-profit organisation having similar objectives.<sup>135</sup>

If these requirements mentioned above are met, then a valid NPO will be created. These NPOs may campaign for funds from individuals, organisations and the government outside their organisation to help with their cause. If not registered as a NPO, then restrictions tend to burden the organisations ability to grow and succeed in its cause.

#### *2.4.4 Definition and legal nature of PBOs*

The mere fact that an organisation has a non-profit motive, is established, or registered as an NPO under the *NPO Act*, or is established as a non-profit company under the *Companies Act*, does not mean that it *ipso facto* qualifies as a PBO.<sup>136</sup> All non-profit organisations are encouraged to register as public benefit organisations. For an organisation to be approved as a PBO, it must apply to SARS. The conditions and requirements for an organisation to be approved as a PBO are contained in section 30 of the ITA.<sup>137</sup> A PBO can be a trust, a company (a not-for-profit company in terms of the new *Companies Act*) or another association registered with SARS in terms of section 30(1) of the ITA. To receive PBO status, an organisation must be involved in one or more public benefit activities as defined by the ITA. These activities must resort under the following categories to be considered as valid: Welfare and Humanitarian; Health Care; Land and Housing; Education; Religion and Belief and Philosophy; Conservation, Environment and Animal Welfare; Research and Consumer Rights; Sports; and providing of funds to an association carrying on public benefit activities.<sup>138</sup>

Section 30(3) of the ITA prescribes that the Commissioner will approve a PBO that adheres to the following requirements:

- All conditions prescribed by the Minister must be complied with by the PBO, to ensure that both the resources and activities of the PBO's resources and activities are in-line with its object.<sup>139</sup>

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<sup>135</sup> Section 12 of the *NPO Act*; Honey M 2012 *NPO Legal Support Project* 1.

<sup>136</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 2.

<sup>137</sup> Section 30(3) of the ITA.

<sup>138</sup> Tshikululu Social Investments 2012 *Tshihikulu* 5.

<sup>139</sup> Section 30(3) of the ITA.

- To apply for exemption, the PBO must submit a copy of its founding document or constitution under which it was created to the Commissioner. This document should have at least three non-connected persons, who can accept fiduciary responsibility on behalf of the PBO. It is important to note that no single person may be directly or indirectly in control of the decision-making within the PBO.<sup>140</sup>
- No funds of the PBO may be distributed to any person, except if it's while this individual is undertaking PBO activities. The funds must be used solely for the objectives of the PBO. The PBO is required to invest its funds with a financial institution as set out in section 1 of the *Financial Services Board Act 97* of 1990, or in any shares listed on the JSE, or in such "other prudent investments in financial instruments and assets."<sup>141</sup>
- In the case were a PBO has to dissolve, their management must transfer all their assets to another PBO with similar objectives, and which has been approved in terms of section 30 of the ITA or to any other institution or board. These legal entities, under section 10(1)(cA)(i) of the ITA, should be exempt from tax. Furthermore, these entities must have the sole objective to carry on for the benefit of the public or for one of the spheres of the Government.<sup>142</sup>
- A PBO is not allowed to accept any donations, which are revocable by a donor, for reasons other than a material failure. A donation made by a donor may not impose conditions on the PBO, which could result in the direct or indirect deriving of the benefit.<sup>143</sup>
- To amend the constitution or founding document of a PBO, a copy of the proposed amendments should be submitted to the Commissioner for approval.<sup>144</sup>

A PBO is thus a further registration than a NPO. All PBO are NPOs but not all NPOs are PBOs. If a party registers a NPO as a PBO, certain tax advantages will be created for the organisation.

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<sup>140</sup> Section 30(3) of the ITA.

<sup>141</sup> Section 30(3) of the ITA.

<sup>142</sup> Section 30(3) of the ITA.

<sup>143</sup> Section 30(3) of the ITA.

<sup>144</sup> Section 30(3) of the ITA.

## ***2.5 Conclusion***

When considering the most suitable legal vehicle for a specific scenario, is it important to understand the legal nature of each vehicle. In this chapter the different legal vehicles were explained in terms of their definition, legal nature as well as the difference in their requirements, structure and their unique solution for a specific scenario. When measuring the vehicles according to the above-mentioned factors, seemingly there still are no clear standout vehicle suitable for Mr and Mrs Maartens' scenario with their special needs son, Richard. Other elements from the legal framework such as income and capital gains tax should thus also be explained.

The taxation of each of the vehicles differ significantly. In the following chapters the tax obligations regarding income as well as capital gains of each of the above-mentioned legal vehicles will be analysed and discussed. The aim will be to find the most suitable solution for the presented case study of Mr and Mrs Maartens' scenario.

## Chapter 3: Income Tax

### 3.1 Introduction

In this chapter the income tax treatment of each of the above-mentioned legal vehicles is analysed and discussed. In this discussion, the focus is on the different circumstances under which income tax is payable by each of the legal vehicles. Thereafter follows an explanation how income tax can be used most positively to the benefit of a person with a special need. When planning an estate with a special-needs person in mind, the income tax payable should be kept to a minimum. If this is the case, the bulk of the estate's income can be used to address the physical needs of the person. The care of a special person should not be burdened by income tax obligations, and thus it is important to understand these obligations fully.

### 3.2 Definition and nature of income tax

Taxes are part of everyday life, and is payable by almost all persons.<sup>145</sup> Normal tax (also commonly known as income tax) consists of both income as well as capital gains tax. The tax rates are fixed annually by Parliament in table format according to the year of assessment or financial year.<sup>146</sup> A liability<sup>147</sup> usually arises for normal tax to be paid when a taxpayer has a taxable income at the end of the year of assessment.<sup>148</sup> The year of assessment for individuals usually ends on the last day of February, but for companies, it ends on the last day of the financial year of the company during the calendar year in question. In the case of the death or insolvency of a natural person, the year of

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<sup>145</sup> A person for the purposes of tax in South Africa can be defined as:

- An individual;
- A company or close corporation;
- A micro business;
- A small business corporation;
- A trust;
- An insolvent estate;
- A deceased estate;
- A non-resident company; and
- A portfolio of a collective investment scheme.

<sup>146</sup> Rabenowitz *et al* *The South African Financial Planning Handbook* 605; Section 5(2) of the ITA.

<sup>147</sup> Section 5(1) of the ITA established the liability.

<sup>148</sup> SARS 2016 <http://www.sars.gov.za/Pages/Glossary-Y.aspx>.

assessment will end on the day the death or insolvency occurs.<sup>149</sup> Taxable income is calculated in the manner and in accordance with the rules of the ITA, and is defined as:

- (a) the amount remaining after deducting from the income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income; and
- (b) all amounts to be included or deemed to be included in the taxable income of any person in terms of this Act.<sup>150</sup>

Income tax is payable by most persons and the tax rates differ for each type of taxpayer. It is important to examine and compare the different income tax implications of each of the discussed legal vehicles to establish the impact that income tax has on each of them. By comparing the income tax implications, the correct legal vehicle may be found for the presented case study of Mr and Mrs Maartens' scenario.

### **3.3 Income tax implications of trusts**

The definition of a person in section 1(1) of the ITA was amended after the decision in *CIR v Friedman*<sup>151</sup> to include any trust.<sup>152</sup> The reason for the amendment was that the court held that under common law a trust is not a person, and since the ITA used the criteria of a "person" to obligate income tax, a trust did not have to pay income tax.<sup>153</sup> Since the amendment, a trust has become a taxable entity in its own right but is still treated differently from companies or close corporations.<sup>154</sup> Even though amounts may be received by a trust, these receipts are not allowed to be taxed in the trust, but rather in the hands of the beneficiaries or the creator of the trust.<sup>155</sup> As stated above, a trust is not a natural person and, therefore, does not qualify for the primary, secondary or tertiary rebates in terms of section 6 or section 10(1)(i) of the ITA.<sup>156</sup> An ordinary trust is taxed at a fixed rate of 41%, but will only have a taxable income if no other person has a vested

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<sup>149</sup> SARS Interpretation Note 19.

<sup>150</sup> Paragraph 1 of the Eight Schedule of the ITA.

<sup>151</sup> 1993 1 SA 333 (AD).

<sup>152</sup> A trust defined in section 1(1) means any 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.

<sup>153</sup> 1993 1 SA 333 (AD).

<sup>154</sup> Rabenowitz *et al* *The South African Financial Planning Handbook* 839.

<sup>155</sup> Farrand 2015 *ENSight* 10.

<sup>156</sup> Stiglingh *et al* *Silke: South African Income Tax 2016* 837.

right to the income and this income is not deemed to accrue to another person.<sup>157</sup> When considering the income tax implications of a trust, the provisions expounded below are the most important ones for this discussion.

### 3.3.1 Section 25B

Section 25B of the ITA regulates how a trust or its beneficiaries are to be taxed as far as income tax is concerned.<sup>158</sup> It further provides that where a beneficiary has acquired a vested right<sup>159</sup> to income in a trust, such income is deemed to have accrued to that beneficiary.<sup>160</sup> This is known as the conduit principle,<sup>161</sup> and means that income received by or accrued to the beneficiary will be taxed in the beneficiary's hands<sup>162</sup> and will retain its nature, even though it had passed through the trust.<sup>163</sup> If however, there is no vesting in a beneficiary, the income will be taxed in the hands of the trust.<sup>164</sup> When the income accrues to the beneficiary, any exemption from tax applicable to the income will be available to that beneficiary.<sup>165</sup> The problem is that this principle can be used for splitting<sup>166</sup> income and deductions.<sup>167</sup> Section 25B of the ITA is, however, subject to section 7, which means that sometimes a person is deemed to have received income for tax purposes even though:

- the income was received or accrued to a beneficiary; or

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<sup>157</sup> Pace and van der Westhuizen *Wills and Trusts* 240; SARS 2016 <http://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Companies-Trusts-and-Small-Business-Corporations.aspx>.

<sup>158</sup> Pace and van der Westhuizen *Wills and Trusts* 250; Honiball and Olivier *The Taxation of Trusts in South Africa* 73; Section 25B of the ITA.

<sup>159</sup> A vested right means a right to income that the beneficiary will definitely receive or income that falls into the estate of the beneficiary should he die before the payment of the income.

<sup>160</sup> Vogelmann and Coetzee 2007 *ENSight* 20.

<sup>161</sup> This principle is codified in section 25B of the ITA and paragraph 80 of the Eighth Schedule of the ITA.

<sup>162</sup> *Armstrong v CIR* 1938 AD 343.

<sup>163</sup> Retaining its nature means that if for example interest is received by the trust and is paid over to a beneficiary, the income will retain its nature as interest and be treated as such in the hands of the beneficiary for tax purposes; Farrand 2015 *ENSight* 10.

<sup>164</sup> Pace and van der Westhuizen *Wills and Trusts* 251; SAICA 2007 [https://www.saica.co.za/integritax/2007/1587\\_Time\\_of\\_vesting\\_of\\_benefits.htm](https://www.saica.co.za/integritax/2007/1587_Time_of_vesting_of_benefits.htm).

<sup>165</sup> SAICA 2007 [https://www.saica.co.za/integritax/2007/1587\\_Time\\_of\\_vesting\\_of\\_benefits.htm](https://www.saica.co.za/integritax/2007/1587_Time_of_vesting_of_benefits.htm).

<sup>166</sup> Section 25B of the ITA codifies the conduit principle and provides that if income accruing to a trust is distributed in the same tax year it retains its nature and is taxed at the individual's tax rate, as opposed to the Trust's. Based on this principle, trusts have been used as a means to effect so-called income splitting, where an initial amount that would have been taxed at the higher tax rate of the trust, is split and paid to natural persons at a lower income rate (or at worst the same rate), while also enjoying the benefits of rebates, which are limited to natural persons; SAICA 2013 [https://www.saica.co.za/integritax/2013/2239.\\_Conduit\\_Principle.htm](https://www.saica.co.za/integritax/2013/2239._Conduit_Principle.htm).

<sup>167</sup> SAICA 2013 [https://www.saica.co.za/integritax/2013/2239.\\_Conduit\\_Principle.htm](https://www.saica.co.za/integritax/2013/2239._Conduit_Principle.htm).

- the income was retained in the trust.<sup>168</sup>

Thus, when using the provisions in section 25B it is important to take note of section 7 that limits section 25B's power. To illustrate the workings of section 25B the following example is applicable:

If there are three natural-person beneficiaries in a trust, that earns R 75 000 interest in the current year of assessment, and if the interest remains in the trust and tax is payable on it, the trust will get no exemption, because it is not considered a natural person. The tax liability at the rate of 41% will thus be R 30 750.

However, if the trustees award the interest equally to the beneficiaries, the tax liability will be as follows: income of each beneficiary R 25 000, of which R 23 800 is exempt. The taxable balance is thus R 1 200 on which, even at the maximum marginal rate of 41% of a natural person, the tax will be R 492. The total tax payable on the interest will thus be  $R 492 \times 3 = R 1 476$  and not the R 30 750 that will be payable by the trust.

Section 25B, as can be seen from the forgoing example, is a useful tool to limit the income tax payable by a trust, if used correctly. As stated above, the conduit principle relates to a unique way of applying income tax to trusts by giving the persons an option under the anti-avoidance provisions in the ITA. According to these provisions, income must be taxed, either in the trust, or in the hands of the beneficiaries.<sup>169</sup> The option relates to the tax rates applicable to trusts (41%) compared to tax rates applicable to individuals (0–41%).<sup>170</sup> Individuals enjoy various tax exclusions and exemptions, which a trust does not have.

Section 25B, if applied correctly, is an extremely tax-efficient structure, but has been miss-used by taxpayers and tax advisors for numerous years, leading to the tax authorities' threat of eliminating the conduit-principle altogether.<sup>171</sup> If this principle is

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<sup>168</sup> Rabenowitz *et al* *The South African Financial Planning Handbook* 841.

<sup>169</sup> Pace and van der Westhuizen *Wills and Trusts* 256; Dryden 2015 *Real Estate Investor* 3.

<sup>170</sup> SARS 2016 <http://www.sars.gov.za/Tax-Rates/Pages/default.aspx>.

<sup>171</sup> Dryden 2015 *Real Estate Investor* 3.



abolished completely, the income arising from the trust will be taxed in the trust at a rate of 41%, with no annual allowances and exemptions that are applicable to an individual.<sup>172</sup>

The Davis Tax Committee mentioned in their first report in 2015 that adjustments should be made for sections 7 and 25B of the ITA. In their second report the committee stated the following:

There can be no doubt that current legislation allows the taxpayer to reduce estate duty. Furthermore, the “conduit pipe/ flow-through principle” embodied in section 25B and paragraph 80 of the Eighth Schedule creates the potential situation in which income and capital gains are taxed at a lower rate in the hands of taxpayers other than in the trusts to which these accrued. At the very least, there should be strict enforcement measures in place to ensure that all income of trusts is ultimately subjected to tax at some point. However, the very fundamentals of the legislation should also be considered.<sup>173</sup>

It was reported that the Minister is currently attending to these suggested adjustments.<sup>174</sup>

### 3.3.1.1 Section 25B(3)–(4)

Section 25B(3) regulates the deductions in respect of trust income, and determines that allowable deductions and allowances follow the amount to which they relate.<sup>175</sup> To the extent to which an amount is deemed to be that of a beneficiary or of the trust, the deduction or allowance will be considered as a deduction or allowance in determining the taxable income derived by the beneficiary or trust.<sup>176</sup> If no income accrued to a beneficiary, the trust will be able to claim the allowance or deduction. Section 25B(4), on

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<sup>172</sup> Anon <https://www.citadel.co.za/Insights/view/852/proposed-changes-to-trust-taxation>.

<sup>173</sup> Davis Tax Committee 2016 *Minister of Finance* 42.

<sup>174</sup> The suggestions are as follows:

The flat rate of tax for trusts should be maintained at its existing levels.

The deeming provisions of section 7 and 25B should be repealed, insofar as they apply to RSA resident trust arrangements.

The deeming provisions of section 7 and 25B should be retained, insofar as they apply to non-resident trust arrangements.

Trusts should be taxed as separate taxpayers.

The only relief to the rule should be the “special trust definition” contained in section 1 to the Income Tax Act which allows a trust to be taxed at personal income tax rates in limited special circumstances.

The definition should be revisited by National Treasury.

No attempt should be made to implement transfer pricing adjustments in the event of financial assistance or interest-free loans being advanced to trusts; Anon <https://www.citadel.co.za/Insights/view/852/proposed-changes-to-trust-taxation>.

<sup>175</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 79; Rabenowitz *et al The South African Financial Planning Handbook* 841.

<sup>176</sup> Stiglingh *et al Silke: South African Income Tax 2016* 850.

the other hand, makes it clear that the deduction or allowance will be limited to the amount of the income that has accrued to the beneficiary in terms of section 25B(1) and cannot exceed that amount.<sup>177</sup>

It is important to note whether the deductions and allowances in terms of section 25B(3) and (4) will form part of the beneficiary’s income tax, or that of the trust. These deductions and allowances can be plied to the advantage of the trust and its beneficiaries when used correctly. The example below explains this case.

A trust has rentals of R 100 and interest of R 50. Its deductions and allowances amount to R 125, of which R 120 relates to its rentals and R 5 to its interest. A beneficiary has a vested right to the rentals. Nobody, however, has a vested right to the interest.

Table 3.1: Beneficiary example of Section 25B(3) and (4)

Gross income (rentals) in terms of section 25B(1)	100
Allowances and deductions in terms of section 25B(3), but limited in terms of section 25(4)	<u>(100)</u>
Taxable income	=
Allowances and deductions total in terms of section 25B(3)	120
Deductions allowed (see above)	<u>(100)</u>
Carried forward to the trust (see below) in terms of section 25B(5)	<u>20</u>

Table 3.2: Trust example of Section 25B(3) and (4)

Gross income (interest)		50
Allowance and deductions		
– actual (in terms of Practice Note 31)	(5)	

<sup>177</sup> Goebel *The Taxation of trusts: An Analysis of S25B and the Anti-Avoidance Provisions contained in S7 of the Income Tax Act No 58 of 1962* 25.

– deemed in terms of section 25B(5) (see above)	(20)	(25)
Taxable income		25

The example above shows the mechanism of section 25B(3) and (4).

Section 25B is thus applicable to all testamentary trusts as well as those *inter vivos* trusts where section 7 is not applicable. Section 7 will only apply if “a donation, settlement or other disposition” has been made to the trust.<sup>178</sup>

### 3.3.2 Section 7

As stated previously, the provisions of section 7 overrules section 25B, which means that even though income was distributed to a beneficiary, it can be deemed to be the income of someone else. Therefore, this income has major implications for income tax on the trust and its beneficiaries.<sup>179</sup> Section 7 provisions will apply if income has been received through any “donation, settlement or disposition”<sup>180</sup> made, and the donor of this income will be liable for the tax.<sup>181</sup> Section 7 has an anti-avoidance theme. Its aim is ensuring that if a person divests him-/herself of an asset, any income from that asset will be taxed in the hands of the donor, and not of the trust.<sup>182</sup> Section 7 is thus a tool to regulate individuals who use a trust as their *alter ego* with the aim to avoid income tax.<sup>183</sup> The following provisions of section 7 will shed some more light on the different implications for income tax stipulated by the section.

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<sup>178</sup> Pace and van der Westhuizen *Wills and Trusts* 260.

<sup>179</sup> Goebel *The Taxation of trusts: An Analysis of S25B and the Anti-Avoidance Provisions contained in S7 of the Income Tax Act No 58 of 1962* 2.

<sup>180</sup> SARS states in their *Draft Guide on the Taxation of Special Trusts* that “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.” It thus means that in some situations deemed income will also be seen as income on which income tax may be payable even if the income has vested in a beneficiary and not in the trust.

<sup>181</sup> Jeaven *South African Trusts: Eroding the Tax Base?* 29.

<sup>182</sup> 1980 2 SA 721 (A).

<sup>183</sup> Jeaven *South African Trusts: Eroding the Tax Base?* 29.

### 3.3.2.1 Section 7(2)

This section entails an anti-avoidance provision aimed at preventing spouses from reducing their liabilities for normal tax by arranging for taxable income to be split between them. The section is applied when excessive amounts are paid out of trade income between spouses with the sole purpose of reducing a tax liability.<sup>184</sup> In other words, it is a measure to pay less income tax by "donating" taxable income to a spouse. SARS uses section 7(2) to prevent this form of "donation", and the spouse "donating" the income will be taxed, and not the trust to which the donation was made.<sup>185</sup>

### 3.3.2.2 Section 7(3)–(4)

Section 7(3) applies when income is donated directly or indirectly from a parent (donor) to minor<sup>186</sup> children. The application of section 7(3) can be found in *Ovenstone v Secretary for Inland Revenue*<sup>187</sup> where the court stated:

These sections are aimed at transactions in which the taxpayer seeks to achieve tax avoidance by donating, or disposing of income producing property to or in favour of another under the therein specified conditions or circumstances, thereby diverting its income from himself without his replacing or being able to replace it.

The income will be considered as that of the donor, and will be taxed in his/her hands, even if the income is accumulated for the children in the trust and not paid over to them immediately.<sup>188</sup> This section applies where income is received, accrued or accumulated "by reason of"<sup>189</sup> any donation, settlement or other disposition by the parent.<sup>190</sup> The test of "real efficient cause"<sup>191</sup> is used to prove section 7(3), and was applied by the court in

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<sup>184</sup> Badenhorst 2011 *Exceed* 5.

<sup>185</sup> Section 7(2) of the ITA.

<sup>186</sup> A person is a minor if he is unmarried and has not yet attained the age of 18.

<sup>187</sup> 1980 2 SA 721 A.

<sup>188</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 85; Stiglingh *et al Silke: South African Income Tax 2016* 844.

<sup>189</sup> In *Kohler v CIR*, the court found that "by reason of" refers to the immediate cause and not the remote cause.

<sup>190</sup> Jeaven *South African Trusts: Eroding the Tax Base?* 31.

<sup>191</sup> The Chief Justice in *Widan* found that it was "out of the question" to treat the proximate cause as the cause which is proximate in time only, and that the proximate cause need not be the immediate cause. The court found that it was necessary to establish the "real and efficient cause" of the income accruing to the minor child, and if that "real and efficient cause" was the donation made by the parent, then section 9(3) applied.

*CIR v Widan*.<sup>192</sup> The object of section 7(3) is thus to prevent income-splitting between the parent and minor in order to take advantage of the lower tax rate of the child.<sup>193</sup>

Section 7(4) prevents the evasion of section 7(3) through the use of a third party and considers income to be that of the parent of a minor child.<sup>194</sup> Section 7(3) and (4) thus applies when a parent donates income to a minor through the use of a trust. The parent will still be liable for the income tax, and not the trust itself.

### 3.3.2.3 Section 7(5)

Before section 7(5) can apply, a donation with an attached condition or a stipulation<sup>195</sup> which is embodied in the trust, must be made. The effect is that the beneficiaries do not receive any income until the happening of such a condition.<sup>196</sup> In other words, where a trust deed provides that income can be retained in a trust until certain events occur, this accumulated income will be considered as that of the donor.<sup>197</sup> However, if a beneficiary has a vested right in the income, even if the income is delayed, section 7(5) will not apply. In this case the beneficiary will be liable for the income tax.<sup>198</sup> Again, this means that the trust itself will not be liable for the income tax, but rather the donor.

### 3.3.2.4 Section 7(6)

In terms of section 7(6), the donor will be taxed where a beneficiary has received the income or it has been accrued to a beneficiary of the trust, but the donor has the power to revoke the right to the income through a specific provision.<sup>199</sup> In other words, this provision implies that when an individual donates income but has the power to revoke this income at any time, the donor will be liable for the payable income tax, and not the

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<sup>192</sup> *CIR v Widan* 1955 1 SA 226 (A) 234, *Commissioner for South African Revenue Services v Woulidge* 1999 4 SA 519 (C), Carroll *SARS Ability to Attribute Trust Income and Capital Gains to a Donor-Parent* 6.

<sup>193</sup> Du Toit *SA Trust Law* 135.

<sup>194</sup> Goebel *The Taxation of trusts: An Analysis of S25B and the Anti-Avoidance Provisions contained in S7 of the Income Tax Act No 58 of 1962* 37.

<sup>195</sup> This may mean that a certain age should be reached, or that the beneficiary must marry, or that the trustees must exercise a discretionary power to pay income to the beneficiaries. In other words anything that prevents a person from receiving a vested right until an uncertain future event happens.

<sup>196</sup> *Estate Dempers v SIR Corbett* 1977 3 SA 410 (A).

<sup>197</sup> Section 7(5) of the ITA.

<sup>198</sup> Jeaven *South African Trusts: Eroding the Tax Base?* 31.

<sup>199</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 92; Rabenowitz *et al The South African Financial Planning Handbook* 845.

beneficiary.<sup>200</sup> This is understandable when considering that if the donor revokes the income and the beneficiary has already paid the income tax, the beneficiary gains no advantage from the transaction. The donor thus has to be liable for the income tax that is payable.

### 3.3.2.5 Section 7(7)

Section 7(7) provides for a case where there has been a donation, settlement or other disposition, and investment income has, as a result of a cession by the donor, been received by another person. In such a case, the one making the donation will be taxed on that investment income if the donor has retained the right to regain the property in the future.<sup>201</sup> An example would be where donors cede their right to income for a limited period, after which the right would revert back to them.<sup>202</sup> If the taxpayer cedes the right to income before accrual, this person's taxable income is decreased by the amount that he/she ceded. Thus, the donor will be taxed even if the income would have been exempt from tax in the hands of the actual recipient.<sup>203</sup>

### 3.3.2.6 Section 7(8)

Section 7(8) ensures that any income which has been received by, or accrued to, any non-South African resident as a result of a donation, settlement or disposition by a South African (SA) resident, is deemed to be that of the SA resident.<sup>204</sup> This, however, does not apply to a SA resident making a donation to a non-resident public benefit organisation (i.e. outside of SA) or to a controlled foreign company.<sup>205</sup> To invoke, provision, it requires a donation, settlement or disposition, and the status of a resident by one person and the

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<sup>200</sup> *ITC 543* 1942 13 SATC 118.

<sup>201</sup> Section 7(7) of the ITA; Goebel *The Taxation of trusts: An Analysis of S25B and the Anti-Avoidance Provisions contained in S7 of the Income Tax Act No 58 of 1962* 53.

<sup>202</sup> *ITC 1378* 1983 45 SATC 230; Goebel *The Taxation of trusts: An Analysis of S25B and the Anti-Avoidance Provisions contained in S7 of the Income Tax Act No 58 of 1962* 53.

<sup>203</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 93; Stiglingh *et al Silke: South African Income Tax 2016* 847.

<sup>204</sup> Jeaven *South African Trusts: Eroding the Tax Base?* 31.

<sup>205</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 94; Stiglingh *et al Silke: South African Income Tax 2016* 848.

status of a non-resident by another.<sup>206</sup> SARS applies this provision to prevent losing income tax to a foreign entity through a donation by a SA resident.

### 3.3.2.7 Section 7(9) and (10)

Section 7(9) states that, the disposal of an asset for a consideration which is below its market value will be a donation to the extent of the amount which is below its market value.<sup>207</sup> This means that the donor will be liable for the income tax that is payable between the market value and the donation made. Section 7(10) states that a resident is obliged, during any year of assessment to disclose to SARS any donation, settlement or other disposition that has been made. This is to help SARS not losing track of the donations a person has made in the specific year of assessment.<sup>208</sup>

### 3.3.3 Application in terms of case study

The above-mentioned sections entails the most important income tax implications in terms of a trust. These implications must be taken into account when deciding whether a trust should be employed for a special-needs person's estate planning.

Regarding the case study: When taking Mr and Mrs Maartens' scenario into account, section 7(3) and (4) especially applies. This means that when income is donated directly or indirectly from a parent to his/her minor children, the income will be deemed to be that of the donor, and will be taxed in the parent's hands.<sup>209</sup> This will be so, even if the income is accumulated for these minors in the trust and is not paid over to them immediately, as is the case in Mr and Mrs Maartens' scenario. The mentioned section applies where the parent has received, accrued, or accumulated income through any donation, settlement or other disposition.<sup>210</sup> The parent will still be liable for the income tax and not the trust itself. Applied to the case study, this means that when Mr and Mrs Maartens donate money to the trust they would be liable to pay the income tax, and not

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<sup>206</sup> SAIT 2015 <http://www.thesait.org.za/news/239159/Does-section-78-apply-where-a-resident-lends-to-a-foreign-trust-at-an-interest-rate-below-prime-.htm>.

<sup>207</sup> Jeaven *South African Trusts: Eroding the Tax Base?* 32.

<sup>208</sup> Section 7(10) of the ITA, Rabenowitz *et al The South African Financial Planning Handbook* 846.

<sup>209</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 85; Section 7(3) of the ITA.

<sup>210</sup> Section 7(4) of the ITA.

Richard. This provision is, however, only applicable if Richard is still a minor at the time of the donation.

If Richard should not be a minor anymore, the normal tax implications of trusts will be applicable, implying that the income of the trust will be taxed at a rate of 41%. This will have a negative impact because valuable income will be taken that could be used to acquire the needed treatment and care for Richard when his parents are deceased.

### **3.4 Income tax implications of special trusts**

A special trust is taxed on a sliding scale applicable to natural persons, and not at the flat rate of 41% that applies to a conventional trust.<sup>211</sup> Even though a special trust is taxable on a natural person's scale, it is not a natural person, and as such the prescribed rebates and exemptions do not apply.<sup>212</sup> Sections 7 and 25B are the provisions in the ITA that generally apply to trusts as well as special trusts.<sup>213</sup>

#### **3.4.1 Section 25B(1)**

Section 25B(1) contains the provisions that apply in the case where amounts received or accrued are taxable either in the trust, or in the hands of a beneficiary.<sup>214</sup> This section provides that during a year of assessment any amount that a person has received or was accrued to him/her in that person's capacity as the trustee, will be taken as the amount which has accrued to the trust beneficiary, and not to the trust itself.<sup>215</sup>

A beneficiary may have a vested right to the amount, or may acquire such a right. This takes place through the discretion of the trustees to distribute the amount to the beneficiary in the same year of assessment in which the amount was received by or accrued to the trust.<sup>216</sup> This amount will be treated as having accrued to the trust itself if no beneficiary has a vested right to the amount or if the amount has been received by the trust. Any exercise by the trustees of their discretion to vest income must be made

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<sup>211</sup> Pace and van der Westhuizen *Wills and Trusts* 241; Human 2012 *FANews* 4.

<sup>212</sup> Van Deventer 2009 *SARS* 4.

<sup>213</sup> These sections were fully explained in paragraph 3.3.1 and thus will there only be briefly referred to them now.

<sup>214</sup> Stiglingh *et al Silke: South African Income Tax 2016* 855.

<sup>215</sup> Jacobs 2015 *CDH* 2.

<sup>216</sup> SAICA 2007 [https://www.saica.co.za/integritax/2007/1587\\_Time\\_of\\_vesting\\_of\\_benefits.htm](https://www.saica.co.za/integritax/2007/1587_Time_of_vesting_of_benefits.htm).



during the year of assessment in which the income arises.<sup>217</sup> Should the trustees exercise their discretion retrospectively after the end of the year of assessment, it will be deemed that the income has been received by or accrued to the trust, unless it is attributed to a donor under section 7.<sup>218</sup>

A special trust created for a single beneficiary must be examined to determine whether the beneficiary has a vested right to the income of the special trust.<sup>219</sup> Such a vested right may exist if there is only a single beneficiary: if it is clear under the trust deed that the income derived by the trust is for the immediate benefit of the single beneficiary, the discretion granted to the trustees may be a nullity.<sup>220</sup>

If a single beneficiary has a vested right to the income, the trust is ignored essentially under section 25B(1). As a result, any income derived by the trust is deemed to accrue to the single beneficiary, with any actions of the trustees merely being on behalf of or for the benefit of the beneficiary.<sup>221</sup> Since the beneficiary of a special trust does not qualify for any special tax treatment, this individual will be taxed on the income derived by the trust. This will be done on the same basis as all other individual taxpayers.<sup>222</sup> Section 25B is subject to the section 7 provisions as expounded below.

### 3.4.2 Section 7(1)

Section 7(1) states that income will be understood to have accrued to a taxpayer and gives subject to section 25B(1). The income will be deemed to have accrued even though:

- it has been invested, accumulated or otherwise capitalised by the taxpayer;
- it has been credited in the account or reinvested or accumulate or capitalised or otherwise dealt with in the taxpayer's name or on the taxpayer's behalf; or
- it has not actually been paid over to the taxpayer, but remains due and payable to the taxpayer.<sup>223</sup>

Thus, income vested by the trustees in a beneficiary and retained by the trust, will still be regarded as having accrued to the beneficiary. This would be the case, even though

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<sup>217</sup> Vogelmann and Coetzee 2007 *ENSight* 20.

<sup>218</sup> Section 25B of the ITA.

<sup>219</sup> SARS *Draft Guide on the taxation of special trusts* 14.

<sup>220</sup> 1980 2 SA 721 (A).

<sup>221</sup> SARS *Draft Guide on the taxation of special trusts* 14.

<sup>222</sup> Section 25B(1) of the ITA.

<sup>223</sup> *ITC 919* 1959 24 SATC 263 (T); *Collard v Findlay's Executors* 1907; *ITC 417* 1938 10 SATC 264 (U).

the income has not been paid to the beneficiary.<sup>224</sup> The beneficiary will thus be liable for the payable income tax.

### 3.4.3 Section 7(2)-(8)

The income of a trust may be taxable in the hands of the person who made a “donation, settlement or other disposition” in terms of section 7(2)-(8).<sup>225</sup> These provisions have created various judicial questions. In *Ovenstone v CIR*<sup>226</sup> the court found firstly, that the phrase “donation, settlement or other disposition” excludes any disposal of property made for adequate consideration. However, secondly, it covers any disposals of property made fully gratuitously out of liberality or generosity, or under a settlement, or other disposition for some consideration.<sup>227</sup> The court also found in *CIR v Widar*<sup>228</sup> that when deciding whether income is attributable to a “donation, settlement or other disposition”, there must be some causal relation between the income and the donation.<sup>229</sup>

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

- the hands of the donor;
- the hands of the beneficiary of a trust; or
- the trust itself.<sup>230</sup>

### 3.4.4 Section 25B(3)-(7)

Section 25B(3)–(7) regulates the deductions and allowances of special trusts. Section 25B(3) addresses these deductions between the trust and its beneficiaries on the basis of the income allocated to those parties under section 25B(1).<sup>231</sup> Sections 25B(4)-(7) contains rules to limit losses when deductions and allowances exceed the amount of income that is deemed to accrue to a trust or beneficiary under section 25B(1).<sup>232</sup> Thus,

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<sup>224</sup> Goebel *The Taxation of trusts: An Analysis of S25B and the Anti-Avoidance Provisions contained in S7 of the Income Tax Act No 58 of 1962* 2.

<sup>225</sup> Referred to footnote 185 in terms of “donation, settlement or other disposition”.

<sup>226</sup> 1980 2 SA 721 (A).

<sup>227</sup> Jeaven *South African Trusts: Eroding the Tax Base?* 29.

<sup>228</sup> 1955 1 SA 226 (A).

<sup>229</sup> 1955 1 SA 226 (A).

<sup>230</sup> The conduit principle as explained above.

<sup>231</sup> Section 25B(1) and 25B(3) of the ITA.

<sup>232</sup> Section 25B(4)-(7); SARS *Draft Guide on the taxation of special trusts* 16.

if a donation falls within the provisions of section 25B(4)-(7), the section will regulate the deductions and allowances in terms of a special trust.

Should these tax implications be taken into account it is evident that a special trust has clear advantages with regard to the liability for income tax, even though the exemption for medical expenses<sup>233</sup> does not apply to a special trust. Below is an example of how the income tax advantages of a special trust will be regarded against a normal trust's income tax liability.

As stated above, the income tax rate of a special trust is not the single rate that applies to a normal trust, but the sliding scale applicable to a natural person.<sup>234</sup> For the 2016 year of assessment, the rate will vary from 18% to 41%.<sup>235</sup> Thus, a special trust with a taxable income of R 50 000 will have a tax liability of R 9 000 ( $R\ 50\ 000 \times 18\%$ ) instead of R 20 500 ( $R\ 50\ 000 \times 41\%$ ), that a normal trust would have to pay.

#### *3.4.5 Application to the case study*

The provisions regulating a special trust does not differ significantly from a normal trust as stated in paragraph 3.3.1, since sections 25B and 7 are still applicable. A special trust is, however, taxed at a different rate than that of a normal one. A normal trust is taxed at a fixed rate of 41% while a special trust is taxed at the rates of an individual, in other words between 18%-41%. A special trust, although taxed on the natural-person scale, does not entail a natural person. Therefore, the exemptions and rebates that the ITA offers a natural person will not apply in the case of a special trust.

When this is taken into account, a special trust will be a more suitable legal vehicle for Mr and Mrs Maartens in the case study, due to the lesser tax rate and the specific deductions under section 25B(4)-(7) that may be claimed. These provisions contain the rules to limited losses that regulate the income and deductions of a special trust.

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<sup>233</sup> A taxpayer who has or whose spouse or child has a disability in accordance with the criteria set out in the ITR-DD form and confirmed by the medical practitioner, can claim 33,3% of the qualifying out-of-pocket medical expenses, which include disability related expenses, paid during the relevant year of assessment. This exemption is only applicable to natural persons and thus will a special trust not be liable.

<sup>234</sup> SARS 2016 <http://www.sars.gov.za/Tax-Rates/Pages/default.aspx>.

<sup>235</sup> Section 5(2) read with section 3(1) and paragraphs 1 and 2 of Appendix I to the *Rates and Monetary Amounts and Amendment of Revenue Laws Bill*, 2015.

### ***3.5 Income Tax implications of NPOs***

South Africa's educational, charitable and religious NPOs used to be exempt fully from income and other taxes. Furthermore, there was no comprehensive case law or statutory definitions to outline these exemptions. Therefore, the Commissioner had the responsibility to interpret and implement the exemption provisions on a case-to-case basis.<sup>236</sup> However, in his 2000 Budget Speech, the Minister of Finance followed the Katz Commission's recommendations and announced wide-ranging changes<sup>237</sup> to the legislation of the income tax exemptions for NPOs.<sup>238</sup> These changes introduced sections 10(1)(dN) and 30 of the ITA, which both deal with previously exempt entities, and introduced the concept of a PBO conducting an activity that entails an approved public benefit.<sup>239</sup>

In 2006, a system of partial taxation was created through legislation which states that the receipts and accruals from trading activities in excess of permissible tax-free limits must be subject to normal tax without the PBO losing the exemption for its underlying public benefit activities.<sup>240</sup> An organisation operating with a non-profit motive, or is established or registered<sup>241</sup> as an NPO, does not qualify automatically for preferential tax treatment. The reason is that this registration is a voluntary commitment and not a condition for approval as a PBO under section 30.<sup>242</sup> An organisation will only enjoy preferential tax treatment after it has applied for and been granted approval as a PBO by the Tax Exemption Unit.<sup>243</sup> This means that an NPO does not have any specific tax advantages and will be taxed in accordance with the type of legal entity it entails, for example, a company or trust. Regarding the case study: It would thus be advisable that Mr and Mrs Maartens not use an NPO in the case of Richard, due to the lack of income tax advantages it holds.

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<sup>236</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 2.

<sup>237</sup> The objective of these changes was to group certain entities together so that they can be treated uniformly, and to provide for more certainty for both the taxpayers and the Commissioner.

<sup>238</sup> Brewis 2006 *ICNL* 4.

<sup>239</sup> Section 10(1)(dN) and Section 30 of the *NPO Act*; Brewis 2006 *ICNL* 19.

<sup>240</sup> Katz 1999 *Fiscal Issues Affecting Non-Profit Organisations* 19.

<sup>241</sup> Registered under the terms of the *Non-Profit Organisations Act* 71 of 1997.

<sup>242</sup> Section 30 of the ITA; SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 7.

<sup>243</sup> The Tax Exemption Unit is a dedicated office within SARS which deals with all applications by non-profit organisations for approval as PBOs.

### **3.6 Income Tax implications of PBOs**

The ITA created tax benefits to assist NPOs by expanding their financial resources and providing them with an empowering environment in which to achieve their set objectives.<sup>244</sup> The ITA contains various provisions regarding the tax treatment of PBOs as well as the requirements for the entity to be exempt from tax obligations.<sup>245</sup> These approved entities have the privilege of spending public funds<sup>246</sup> and should thus take on the responsibility of handling the funds with the necessary care.<sup>247</sup> These funds are either received from the public directly, or indirectly from the State and should be used in the public interest to achieve the PBO's stated objective.<sup>248</sup> In order for an entity to qualify for these exemptions it must be approved as a PBO in terms of section 30 of the ITA, which contains the conditions and requirements for a valid PBO.<sup>249</sup> The rules governing the preferential tax treatment of PBOs are contained in section 10(1)(cN) of the ITA. These rules provide for the exemption from normal tax of certain receipts and accruals of approved PBOs.<sup>250</sup> Not all tax-exempt PBOs can issue tax deduction certificates to donors.<sup>251</sup> In the following paragraphs the most important provisions for PBOs are examined and explicated.<sup>252</sup>

#### **3.6.1 Section 10(1)(cN)**

Section 10(1)(cN) exempts the receipts and accruals of any PBO that is approved by the Commissioner in terms of section 30(3) of the ITA.<sup>253</sup> This section states that the total receipts and accruals<sup>254</sup> of a PBO, which arise from something else than any business

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<sup>244</sup> Davis and Mogatle 1992 *Development Resources Centre* 10.

<sup>245</sup> Pretorius 2016 *TaxTalk* 21; Section 30 of the ITA is explained in Chapter 2.

<sup>246</sup> They derive the funds from donations or grants from either private individuals, companies or the State in public interest on a tax-free basis.

<sup>247</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 1.

<sup>248</sup> Katz 1999 *Fiscal Issues Affecting Non-Profit Organisations* 30.

<sup>249</sup> Section 30 of the ITA, Pretorius 2016 *TaxTalk* 21.

<sup>250</sup> Section 10(1)(cN) of the ITA.

<sup>251</sup> Steenkamp 2014 *TaxTalk* 10.

<sup>252</sup> Only a few of the provisions will be taken into account, and not all of them. To have a comprehensive exposition of the tax treatment of PBOs; see the *Tax Exemption Guide for Public Benefit Organisations in South Africa*.

<sup>253</sup> SAICA 2006  
[https://www.saica.co.za/integritax/2006/1457\\_The\\_current\\_rules\\_governing\\_public\\_benefit\\_organisations.htm](https://www.saica.co.za/integritax/2006/1457_The_current_rules_governing_public_benefit_organisations.htm).

<sup>254</sup> Total receipts and accruals includes the total sum of all receipts and accruals from any source within or outside South Africa, irrespective of whether on capital or revenue account.

undertaking or trading activity, are exempt from income tax. This is the case if the trading activity falls under one of the four exemptions as outlined below.<sup>255</sup>

#### 3.6.1.1 Section 10(1)(dN)(ii)(aa)

For a PBO to be exempt in terms of the integral and directly related trade provision, the following requirements should be met:

- The trading activity must be integral and directly related to the sole object of the PBO.
- Substantially the whole<sup>256</sup> of the trading activity must be conducted on a cost-recovery basis.
- The trading activity should not result in unfair competition<sup>257</sup> with other taxable entities.<sup>258</sup>

For a PBO to claim an exemption under this subparagraph, it must provide a detailed letter of motivation with the necessary supporting material to confirm the fact that its trading activity complies with all three conditions.<sup>259</sup> The use of assets to generate income will not be regarded as a related trading activity, but rather as income from a taxable trading activity, which means income tax will be payable.<sup>260</sup>

#### 3.6.1.2 Section 10(1)(dN)(ii)(bb)

This section described the occasional nature of a PBO, and has the following two requirements for the trading activity:

- It must take place on an occasional/infrequent basis.<sup>261</sup>

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<sup>255</sup> Section 10(1)(dN) of the ITA.

<sup>256</sup> The concept "substantially the whole" is regarded by SARS as 90% or more. However, in order to overcome certain practical difficulties, SARS will accept a percentage of not less than 85%. This % may be motivated by taking into account time or cost.

<sup>257</sup> A PBO should not be in a more favourable position or have an unfair advantage over a taxable entity conducting the same trading activity.

<sup>258</sup> Section 10(1)(dN)(ii)(aa) of the ITA.

<sup>259</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 9.

<sup>260</sup> Paulsen 2015 *Tax Alert* 1-4.

<sup>261</sup> Occasional basis is one conducted on an irregular, infrequent basis or as a special event.

- It must be undertaken substantially with assistance on a voluntary basis without compensation.<sup>262</sup>

As in the case of section 10(1)(cN)(ii)(aa), the PBO must provide detailed motivation and support that its trading activity complies with both stated conditions.<sup>263</sup> If a PBO can prove that its trading activity complies with these requirements, it will not be liable for income tax on these activities.

### 3.6.1.3 Section 10(1)(cN)(ii)(cc)

For a trading activity to be exempt, the Minister's approval must be given in terms of a notice in the *Government Gazette*. The Minister will take the following factors into account:

- the nature and scope of the trading activity;
- the direct connection between the trading activity and the objective of the PBO;
- the profitability of the trading activity; and
- the level of economic distortion that will be caused by the tax-exempt status of the PBO carrying out the trading activity.<sup>264</sup>

Furthermore, the following provisions should be demonstrated in detail to the Minister: the general public benefits of the trading activity, together with reasons why it will not result in unfair competition with other taxpayers. Then the Minister will decide if income tax will be payable. To date, no such activities have been approved.<sup>265</sup>

### 3.6.1.4 Section 10(1)(cN)(ii)(dd)

According to section 10(1)(cN)(ii)(dd), a PBO that carries on with trading activities which do not fall within the ambit of the above-mentioned exemptions, will be taxed on the receipts and accruals derived from those trading activities above the basic exemption

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<sup>262</sup> Section 10(1)(cN)(ii)(bb) of the ITA.

<sup>263</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 9.

<sup>264</sup> Section 10(1)(cN)(ii)(cc) of the ITA.

<sup>265</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 9.

amount.<sup>266</sup> This means that the value of the basic exemption threshold must be applied collectively to the total receipts and accruals from all trading activities and not individually.<sup>267</sup> The basic exemption is calculated as the greater of 5% of the total receipts and accruals of the PBO or R 200 000.<sup>268</sup> If a PBO thus has accruals that do not fall into the above-mentioned sections, the basic exemption amount will apply to those accruals and will be exempt from the payable income tax. This is to ensure some form of advantage is still given to the PBO in a case where the normal advantages does not apply.

### 3.6.2 Section 18A

The South African Government acknowledges that certain organisations do depend on the generosity of the public. Therefore, to encourage the public to donate to these organisations the government has provided a tax deduction for these taxpayers.<sup>269</sup> This applies to an approved PBO that conducts a public-benefit activity listed in Part II of the Ninth Schedule.<sup>270</sup> Such an entity must apply to the Tax Exemption Unit for permission to issue a section 18A receipts for a donation received from any person in the public sphere.<sup>271</sup> This entails that a section 18A receipt creates a tax deduction in favour of a taxpayer who makes a *bona fide* donation<sup>272</sup> to a PBO, not exceeding 10% of the taxable income in the circumstances set out in the section.<sup>273</sup> The PBO will have to provide a receipt to the taxpayer in order for the latter to claim a deduction.<sup>274</sup> The following payments do not qualify for a tax deduction:

- an amount paid for attending a fundraising dinner and dance;
- memorabilia and other assets donated to be auctioned to raise funds;
- the amount paid for the successful bid of goods auctioned to raise funds;
- amounts paid for raffle or lottery tickets;
- amounts paid for school fees, school entrance fees or compulsory school levies;

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<sup>266</sup> Section 10(1)(cN)(ii)(dd) of the ITA.

<sup>267</sup> Paulsen 2015 *Tax Alert* 1-4.

<sup>268</sup> Section 10(1)(cN)(ii)(dd) of the ITA; SARS *Basic Guide to Income Tax for Public Benefit Organisations* 9.

<sup>269</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 22.

<sup>270</sup> A PBO may only issue a section 18A receipts for a donation from the date the Tax Exemption Unit confirmed that the PBO qualifies for section 18A approval and has issued a reference number.

<sup>271</sup> Thusanang 2004 *NGpulse* 1.

<sup>272</sup> A donation is a gratuitous disposal by the donor out of generosity, under which the donee is enriched and the donor impoverished.

<sup>273</sup> Pretorius 2016 *TaxTalk* 21.

<sup>274</sup> Thusanang 2004 *NGpulse* 1; Pretorius 2016 *TaxTalk* 21.



- the value of free rent, water and electricity provided by a lessor to the lessee which is a PBO;
- the payment of debt owed by an organisation approved under section 18A;
- prizes and sponsorships donated for a fundraising event such as a charity golf day;
- tithes and offerings to churches or other faith-based organisations for religious activities;
- membership fees.<sup>275</sup>

In 2013 the *Taxation Laws Amendment Act*<sup>276</sup> introduced relief for the above-mentioned scenario by allowing the above excess donation to be rolled over as a deductible donation in the subsequent year of assessment, starting on or after 1 March 2014.<sup>277</sup> Section 18(2A) requires that the donation be utilised solely to carry on activities contemplated in Part II of the Ninth Schedule.<sup>278</sup>

If a PBO is registered to give a section 18A deduction certificate, persons or institutions will be more likely to make donations due to the tax advantage that the donation holds.

### *3.6.3 Rates and provisional tax payments*

An approved PBO that is liable for tax on its trading income will be taxed at a flat rate of 28%, irrespective of the type of entity the PBO entails.<sup>279</sup> Therefore, for example, if a PBO is a trust, it will be taxed at 28% and not the usual 41%. These exemptions may be applied retrospectively, if the Tax Exemption Unit is of the opinion that the requirements of section 30 had been complied with at an earlier stage.<sup>280</sup> Furthermore, if the PBO is approved by the Commissioner, it will be exempt from making provisional tax payments and submitting provisional tax returns.<sup>281</sup> This will imply a significant tax as well as liquidity benefit for a PBO, as it can use its capital/income to further its cause and not to pay provisional tax.

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<sup>275</sup> SARS *Basic Guide to Income Tax for Public Benefit Organisations* 10.

<sup>276</sup> 31 of 2013.

<sup>277</sup> Steenkamp 2014 *TaxTalk* 11.

<sup>278</sup> Grieve 2010 *ChangeLives 2*; Steenkamp 2014 *TaxTalk* 10.

<sup>279</sup> Musviba 2015 *Satax* 5.

<sup>280</sup> Section 30 of the ITA.

<sup>281</sup> Paragraph (aa) of the exclusion to the definition of "provisional taxpayer" in paragraph 1 of the Fourth Schedule.

### 3.6.4 Dissolution or termination of a PBO and its activities

It may happen that a PBO fails to transfer or take reasonable steps to transfer its remaining assets after its decision to dissolve.<sup>282</sup> This will result in the amount of the market value of the not transferred assets *less* the amount of the *bona fide* liabilities of the PBO, considered as taxable income accrued to the PBO during the year of assessment in which the dissolution took place.<sup>283</sup> If, however, the PBO transfers the assets to a PBO with the same nature, no income tax will be payable on those assets.

### 3.6.5 Withdrawal of approval of a PBO

Should the Tax Exemption Unit have found that a PBO has in any material respect, or on a continuous basis in any year of assessment, failed to adhere to section 30, the approval of the PBO may be withdrawn, in that year of assessment, after due notice is given<sup>284</sup> to the PBO.<sup>285</sup> The consequences of such a withdrawal is that the PBO must, within three months (unless the Commissioner allows a longer period), transfer or take reasonable steps to transfer its remaining assets to another approved PBO, an institution, board or body in terms of section 10(1)(cA)(i), or the government of South Africa.<sup>286</sup> If the PBO fails to transfer the remaining assets as stated above, the entity will be liable for the amount of the market value of the not-transferred assets *less* the amount of the *bona fide* liabilities of the PBO, being deemed to be taxable income which accrued to the PBO during the year of assessment in which the approval was withdrawn.<sup>287</sup>

### 3.6.6 Application to the case study

When applying an NPO and a PBO to Mr and Mrs Maartens' scenario for the case study, it is evident that an NPO offers no tax advantages, and would thus not be suitable for

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<sup>282</sup> The PBO has 3 months after the date of dissolution to transfer the assets.

<sup>283</sup> Section 30 of the ITA; SAICA 2006 [https://www.saica.co.za/integritax/2006/1457\\_The\\_current\\_rules\\_governing\\_public\\_benefit\\_organisations.htm](https://www.saica.co.za/integritax/2006/1457_The_current_rules_governing_public_benefit_organisations.htm).

<sup>284</sup> Due notice means that the Tax Exemption Unit must send the NPO a warning that they are considering revoking their NPO status. This may only happen if the NPO continuously didn't adhere to the requirements in section 30 of the *NPO Act*.

<sup>285</sup> Section 30 of the ITA.

<sup>286</sup> SAICA 2006 [https://www.saica.co.za/integritax/2006/1457\\_The\\_current\\_rules\\_governing\\_public\\_benefit\\_organisations.htm](https://www.saica.co.za/integritax/2006/1457_The_current_rules_governing_public_benefit_organisations.htm).

<sup>287</sup> SARS *Basic Guide to Income Tax for Public Benefit Organisations* 12.

Richard. A PBO on the other hand, although it has numerous income tax advantages, is much more difficult to create and adhere to than a trust or a special trust. A PBO is much more suitable for situations where multiple individuals create an organisation with a wider and more defined mission, and not for the benefit of a single person with a disability.

### ***3.7 Conclusion***

This chapter focused on the income tax implications of the different legal vehicles, and offered an insightful investigation into the vehicle best suited for Mr and Mrs Maartens' scenario. When considering the options of a trust, a special trust, an NPO and a PBO, a special trust in terms of income tax will be best suited for Richard because of the above-mentioned advantages. These advantages are noted most in the income tax rate that is applicable when using a special trust, as well as the deductions that is applicable to a special trust.

In the following chapter the tax implications for capital gain of these different legal vehicles will be discussed.

## **Chapter 4: Capital Gains Tax**

### ***4.1 Introduction***

In this chapter the tax obligations for capital gains of each of the above-mentioned legal vehicles are analysed and discussed. In the discussion the focus is on the different circumstances in which capital gains tax is payable by each of the legal vehicles. This is followed by an explanation as to how capital gains tax can be used most effectively for a person with a special need. When planning an estate with a special-needs person in mind, the capital gains tax obligation should entail the smallest amount payable. The financial position of a special-needs person should not be affected negatively because of the payable capital gains tax. Therefore, it is important to understand the obligations for capital gains tax in terms of the different legal vehicles. In the following paragraphs the tax implications for capital gains of each of the legal vehicles are discussed.

### ***4.2 Definition and nature of capital gains tax***

The idea of capital gains tax is not new to South Africa. In 1969, the Franzsen Commission proposed a limited form of capital gains tax (CGT) on immovable property and marketable securities, while in 1986 the Margo Commission recommended that capital gains should not be taxed.<sup>288</sup> In 1994, the Katz Commission in its third report considered the merits and demerits of a CGT in South Africa. However, the Commission declined to make firm recommendations due to the complexity of the CGT administration and the lack of capacity of SARS at that time.<sup>289</sup> The Minister of Finance announced in his Budget Speech on 23 February 2000 that CGT was to be introduced with effect from 1 April 2001, but this date was later postponed to 1 October 2001, and was applicable to capital gains made after that date.<sup>290</sup> This implementation was part of a wider tax reform effort aimed at enhancing the integrity, efficiency and equity of the South African income tax regime.<sup>291</sup>

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<sup>288</sup> McAllister 2015 *Legal Policy* 37.

<sup>289</sup> Katz "Katz Commission 3<sup>rd</sup> Report" 2.

<sup>290</sup> CGT was introduced into South African law by the *Taxation Laws Amendment Act* 5 of 2001, which was promulgated on 20 June 2001.

<sup>291</sup> National Treasury's Tax Policy Chief Directorate "Capital Gains Tax in South Africa" 2.

At the time of its introduction, CGT was incorporated into the ITA because it was, and still is, regarded as a tax on income, and not as a transaction tax.<sup>292</sup> Section 26A of the ITA provides that any net taxable capital gain must be included in a taxpayer's taxable income, but that any net capital loss should not be included in such income. The net capital loss, should be carried forward to the following year, where it can be deducted from the capital gain in that year of assessment.<sup>293</sup> Section 26A forms the link between the ITA and the Eighth Schedule where the CGT provisions are contained.<sup>294</sup>

A person's taxable income must be determined at the end of every tax year. This means that individual's total capital gains and capital losses for the year must be established.<sup>295</sup> In the following paragraphs the CGT implications of the different legal vehicles are discussed, with the objective to decide which legal vehicle will be the best suited for Mr and Mrs Maartens' scenario in the case study.

### **4.3 Tax implications for capital gains of trusts**

The CGT liability differs depending on the residence of the trust, the trust beneficiaries, and whether or not the anti-avoidance rules are applicable. Generally, the provisions in the ITA that govern the taxation of trust income are mirrored by the provisions in the Eighth Schedule governing the capital gains.<sup>296</sup>

The calculation of CGT is set out in steps, which are known as the core rules.<sup>297</sup> These rules indicate the gain to be included in a taxpayer's taxable income in terms of section 26A of the ITA.<sup>298</sup> However, section 25B of the ITA states that trusts and trust beneficiaries should enjoy special treatment regarding the calculation of certain taxes. This special treatment is referred to as the attribution rules.<sup>299</sup> If one of the attribution rules does apply, the capital gain will be taxed in the hands of the person to whom it is

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<sup>292</sup> McAllister 2015 *Legal Policy* 28.

<sup>293</sup> Rabenowitz *et al The South African Financial Planning Handbook* 691.

<sup>294</sup> McAllister 2015 *Legal Policy* 28.

<sup>295</sup> Rabenowitz *et al The South African Financial Planning Handbook* 691.

<sup>296</sup> Davis *et al Estate Planning* 60.

<sup>297</sup> Carroll *SARS Ability to Attribute Trust Income and Capital Gains to a Donor-Parent* 41.

<sup>298</sup> Section 26A of the ITA reads "[i]nclusion of taxable capital gain in taxable income.—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 Eight Schedule."

<sup>299</sup> Paragraph 68, 69, 71 and 72 of the Eight Schedule of the ITA.

attributed to, and not in the hands of the trust.<sup>300</sup> Furthermore, if one or more of the attribution rules do not apply, and a capital gain is made by a trust on the vesting of an asset in a beneficiary who is a resident, the trust must disregard that gain. In such a case, the gain must be taken into account by the beneficiary when calculating their aggregate capital gain.<sup>301</sup> Finally, if no attribution rules apply and no beneficiary has a vested right regarding a capital gain made by the trust, the trust itself will be liable for the capital gain.<sup>302</sup> These attribution rules regulate who is liable for the CGT payment: the trust itself, the beneficiary or a donor. These rules will be elucidated below.

#### *4.3.1 Vesting of an interest in a trust asset in a beneficiary*

In terms of paragraph 11(1)(d), the vesting of an interest in an asset of a trust constitutes a disposal.<sup>303</sup> If a beneficiary receives a right in a trust asset through vesting, the asset is still held by the trust on behalf of that beneficiary. Then the normal CGT rules apply, which means that any disposal of the asset will be regarded as done by the beneficiary.<sup>304</sup> The vesting of the right in the asset can occur before or after distribution. This means that the value of the asset at the time of vesting will be accepted as the market value of the asset at that time. The reason why the asset's value is the market value is that the beneficiary and the trust are connected persons.<sup>305</sup> Paragraph 13(1)(a)(iiA) of the Eight Schedule of the ITA states that the time of the disposal of the asset when a beneficiary has a vested right, is the date on which the interest is vested in the beneficiary.<sup>306</sup> This means that the trust itself will not be liable for CGT purposes but the beneficiary will be from the date that the vesting in the beneficiary has occurred.

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<sup>300</sup> SARS *Comprehensive Guide to Capital Gains Tax* 538; Rabenowitz *et al The South African Financial Planning Handbook* 840.

<sup>301</sup> Par 80 (1) of the Eight Schedule to the ITA.

<sup>302</sup> Farrand 2015 *ENSight* 10.

<sup>303</sup> Williams *Capital Gains Tax: A Practitioner's Manual* 38.

<sup>304</sup> Farrand 2015 *ENSight* 10.

<sup>305</sup> Connected persons means

(a) In relation to a natural persons –

(i) Any relative, and

(ii) Any trust (other than a portfolio of a collection investment scheme in securities or a portfolio of a collective investment scheme in property) of which such natural person or such relative is a beneficiary;

*Interpretation Note* 67 of 2002; Stiglingh *et al Silke: South African Income Tax 2016* 853; Clegg *Concise Guide to Capital Gains Tax* 108.

<sup>306</sup> Paragraph 13(1)(a)(iiA) of the Eight Schedule of the ITA; Davis *et al Estate Planning* 55.

### 4.3.2 Discretionary trusts

A beneficiary's interest in terms of paragraph 81 will be treated as having a base cost of Rnil if no trust asset has been vested in that beneficiary. A trust whose terms provide that no gains will vest in the beneficiary until the happening of some future event, will be accounted for in the hands of that person for setting off losses against gains.<sup>307</sup> If beneficiaries dispose of their discretionary interest to a third party, full proceeds from the disposal of that interest will be treated as a capital gain in the hands of the beneficiary.<sup>308</sup> The capital gain determined in respect of that disposal will, under paragraph 80, be taxed in the hands of the resident beneficiary in whom that right vests, unless that gain is attributed to another person under paragraphs 68, 69, 71 or 72.<sup>309</sup>

### 4.3.3 Disposal by a trust

When a trust disposes of an asset, the trust is liable for CGT unless a special rule applies to divert the tax liability of the capital gains to another person.<sup>310</sup> These scenarios are regulated by paragraph 80(1), which states that a capital gain, which is determined in a trust on vesting of an asset in a resident beneficiary, must be disregarded by the trust and should be accounted for by the resident beneficiary.<sup>311</sup> Paragraph 80(2) applies when the beneficiary receives the capital gain and not the asset.<sup>312</sup> Both these paragraphs<sup>313</sup> provide that the gain will be disregarded by the trust and added to the aggregated capital gain of the beneficiary, which means that a beneficiary will be liable for the tax.

Paragraph 80(1) and 80(2) does not apply if the beneficiary is a person as regulated in paragraph 62(a)–(e). This paragraph states that a taxpayer is to disregard a capital gain determined for a donation of an asset to a PBO or any other exempt person.<sup>314</sup> This

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<sup>307</sup> Clegg *Concise Guide to Capital Gains Tax* 73.

<sup>308</sup> Farrand 2015 *ENSight* 10.

<sup>309</sup> SARS *Comprehensive Guide to Capital Gains Tax* 538.

<sup>310</sup> PricewaterhouseCoopers 2001 *SAICA* 1.

<sup>311</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 128; Paragraph 80(1) of the Eight Schedule of the ITA; Davis *et al Estate Planning* 56.

<sup>312</sup> SARS *Comprehensive Guide to Capital Gains Tax* 538; Paragraph 80(2) of the Eight Schedule of the ITA.

<sup>313</sup> Paragraph 80(1) and 80(2) are subject to paragraphs 68, 69, 71 and 72 of the Eight Schedule of the ITA that will effectively shift the liability for capital gains tax to a person who made a "donation, settlement or disposition".

<sup>314</sup> Honiball and Olivier *The Taxation of Trusts in South Africa* 128; Paragraph 62 (a)-(e) of the Eight Schedule of the ITA, Stiglingh *et al Silke: South African Income Tax 2016* 854.

exclusion states that the capital gain will remain in the trust and will be disregarded in terms of paragraph 62.<sup>315</sup>

Table 4.1: Attribution rules that override paragraph 80(1) and 80(2)<sup>316</sup>

Paragraph	Attribution rules
68	Capital gain attributed to spouse (donation motivated by tax avoidance)
69	Capital gain attributed to parent of minor child
71	Capital gain subject to revocable vesting
72	Capital gain vesting in non-resident

*4.3.4 Application to the case study*

When considering the CGT implications of a trust, it can be seen that a trust will be liable for the CGT, except when one of the special rules for the exemptions applies. Thus, applied to the case study: When the CGT is payable by the beneficiary, the trust will have a CGT advantage, but if it is payable by the trust, it will be payable at a higher rate and will have a negative impact on the funds available for the future financial care of Richard. The inclusion rate of a normal trust is 80%, while the inclusion rate of an individual is 40%. The attribution rules contained in paragraphs 68, 69, 71 and 72 will thus determine whether or not the trust will be liable for the CGT.

Capital gains in the trust attract CGT at a higher rate in the hands of a trust than for a natural person, or a special trust, although this can be avoided by vesting the capital gains in the beneficiaries.<sup>317</sup>

**4.4 Tax implications for capital gains of special trusts**

For CGT purposes, a special trust is viewed according to paragraph (a) of the definition of special trust in section 1(1). This implies that only a trust created for the benefit of one or more persons with a disability will be a special trust for purposes of capital gains

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<sup>315</sup> Davis *et al Estate Planning* 57.  
<sup>316</sup> SARS *Comprehensive Guide to Capital Gains Tax* 539.  
<sup>317</sup> Davis *et al Estate Planning* 105.



tax.<sup>318</sup> Special trusts qualify for the same reduction of capital gains as individuals.<sup>319</sup> The provisions of the Eighth Schedule as stated above apply to a special trust.<sup>320</sup>

#### 4.4.1 Paragraphs 68–72 and 80

The attribution rules are codified in these paragraphs, and states that a capital gain or loss that was created in a trust must be accounted for by the trust. This applies unless there is a specific rule which directs the capital gain to another person.<sup>321</sup> There are two sets of attribution rules, namely:

- rules that attribute a capital gain to a donor (paragraphs 68-72); and
- rules that attribute to a capital gain to a resident beneficiary (paragraph 80).<sup>322</sup>

These rules are aimed at countering specific tax-planning scenarios and are also applicable when a capital gain occurs through a donation, settlement or other disposition:

- (a) by a person's spouse mainly for the purpose of reducing, postponing or avoiding that spouse's liability for any tax, duty or levy administered by the Commissioner (par. 68);
- (b) by a parent to his/her minor child (par. 69);
- (c) subject to the condition that the capital gain (or portion thereof) will not vest in the beneficiary of the donation, settlement or other disposition until the occurrence of a fixed or contingent event (par. 71);
- (d) subject to the condition imposed by that person that the gain may be revoked and may vest in another person (par. 72); and
- (e) by a resident to any other person and as a result of which a capital gain is derived by a non-resident (par. 72).<sup>323</sup>

Paragraphs 68-72 serve the same purpose as section 7 of the ITA. This means that the amount of the capital gain that is attributed in terms of paragraphs 68-72 can only be the portion that is attributable to the donation, settlement or other disposition.<sup>324</sup>

Paragraph 80(1) states that 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 be accounted for by

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<sup>318</sup> PricewaterhouseCoopers 2001 *SAICA* 1.

<sup>319</sup> Clegg *Concise Guide to Capital Gains Tax* 113.

<sup>320</sup> Paragraph (c) of the definition of representative taxpayer in section 1(1) of the ITA.

<sup>321</sup> West and Roeleveld 2003 *Meditari Accountancy Research* 221.

<sup>322</sup> SARS *Guide to Taxation of Special Trusts* 22.

<sup>323</sup> Olivier 2007 *Meditari Accountancy Research* 46.

<sup>324</sup> West and Roeleveld 2003 *Meditari Accountancy Research* 234.

the resident beneficiary.<sup>325</sup> 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 or acquires a vested interest in the capital gain but not in the asset, the disposal of which gave rise to the capital gain. Then the capital gain must be disregarded in the trust and accounted for by the resident beneficiary.<sup>326</sup>

#### *4.4.2 Section 9D(2A)(f) and paragraph 10*

Section 9D(2A)(f) regulates the inclusion rate for net capital gain of a special trust. This gain is multiplied by the inclusion rate applicable to the special trust to arrive at the trust's taxable capital gain, which must be included in the trust's taxable income for the year of assessment.<sup>327</sup> Under paragraph 10(a) the inclusion rate of a special trust is 40% compared to that of a normal trust of 80%, which offers a significant advantage to a special trust.<sup>328</sup> These two provisions should be aligned throughout.

#### *4.4.3 Provisions of the Eighth Schedule applicable*

For CGT purposes, reference to a beneficiary of a special trust means a person who has a disability and for whose sole benefit the trust is created. This does not include any substitute beneficiary or individual who does not have a disability, and obtain a vested right to the income or capital of the trust subsequent to the death of the person with a disability for whose benefit the trust was created.<sup>329</sup> Unlike the treatment of the taxation of gross income, these trusts will continue to be treated as a special trust for CGT purposes, notwithstanding the death of the beneficiary with a disability. The treatment of these trusts as special trusts will continue until all the assets held by the trust have been disposed of, or until two years after the death of the last living beneficiary with a disability, depending on the earlier date.<sup>330</sup> This provides the trustees time to close the

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<sup>325</sup> Paragraph 80(1) of the Eight Schedule of the ITA; West and Roeleveld 2003 *Meditari Accountancy Research* 221; SARS *Guide to Taxation of Special Trusts* 23.

<sup>326</sup> Paragraph 80(2) of the Eight Schedule of the ITA; SARS *Guide to Taxation of Special Trusts* 23.

<sup>327</sup> Paragraph 10 of the Eight Schedule of the ITA; Engel 2002 *National Treasury* 6.

<sup>328</sup> De Abreu *A suggested Interpretation Note for section 9D of the Income Tax Act* 136; Paragraph 10(a) of the Eight Schedule of the ITA.

<sup>329</sup> Olivier 2007 *Meditari Accountancy Research* 48.

<sup>330</sup> Williams *Capital Gains Tax: A Practitioner's Manual* 19; SARS *Guide to Taxation of Special Trusts* 25.

trust and sell the assets after the death of the special-needs person. The proceeds of the trust will then be distributed as stipulated in the trust deed.

#### 4.4.3.1 Paragraph 5

The annual exclusion paragraph states that a special trust must take into account an annual exclusion, which is currently R 40 000, when determining the trust's aggregate capital gain or loss.<sup>331</sup> This means that the R 40 000 annual exclusion amount must be deducted from the aggregate capital gain to calculate the payable CGT. The annual exclusion remains available to a special trust only until the earlier of the date when all the assets have been disposed of, or two years after the death of the special-needs person.<sup>332</sup>

#### 4.4.3.2 Paragraphs 44–50

A special trust can under paragraph 45(1) disregard an aggregate capital gain or loss under the following provisions:

- when a capital gain or loss determined in respect of the disposal of the primary residence<sup>333</sup> of that trust does not exceed R 2 million; or
- when a capital gain is determined regarding the disposal of the primary residence of that trust, and if the proceeds from the disposal of that primary residence do not exceed R 2 million.<sup>334</sup>

However, this exclusion is subject to certain conditions. Firstly, the capital gain or loss 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 simultaneously.<sup>335</sup> Under paragraph 45(3) only one residence may be regarded a primary

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<sup>331</sup> *Taxation Laws Amendment Act 25 of 2015*; Paragraph 5 of the Eight Schedule of the ITA; Davis *et al Estate Planning* 55; Anon <http://www.werksmans.com/legal-briefs-view/20162017-budget-proposals-tax-overview/>.

<sup>332</sup> SARS *Comprehensive Guide to Capital Gains Tax* 539.

<sup>333</sup> A primary residence is defined in paragraph 44 and means a residence:

- In which the special trust holds an interest, and
- In which the beneficiary of a 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.

<sup>334</sup> Williams *Capital Gains Tax: A Practitioner's Manual* 73; Davis *et al Estate Planning* 45; Paragraph 45(1) of the Eight Schedule of the ITA.

<sup>335</sup> Brettenny and Strauss *'n Studentegids tot Kapitaalwinstbelasting* 41; Paragraphs 45(1) and 45(2) of the Eight Schedule of the ITA.

residence of a special trust. This applies to the period during which the special trust holds an interest in more than one residence, subject to the exceptions provided for in paragraph 48.<sup>336</sup>

Secondly, the R 2 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 of it for the purposes of carrying on a trade for any portion of the period commencing on or after 1 October 2001 during which the special trust held an interest in the residence.<sup>337</sup>

Thirdly, paragraph 47<sup>338</sup> provides that the portion of the capital gain or capital loss to be disregarded under paragraph 45(1)(a) must be determined by referring to the portion of the period during which the beneficiary of the special trust or the spouse of the beneficiary was ordinarily stayed in the residence from 1 October 2001.<sup>339</sup>

#### 4.4.3.3 Paragraph 53

The personal-use asset exclusion means that a capital gain or loss determined on the disposal of an asset for personal use must be disregarded under this paragraph.<sup>340</sup> In order to qualify as a personal-use asset the asset must be used mainly for purposes other than the carrying on of a trade.<sup>341</sup>

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<sup>336</sup> Brettenny and Strauss *'n Studentegids tot Kapitaalwinstbelasting* 41; Paragraph 45(3) of the Eight Schedule of the ITA.

<sup>337</sup> Paragraph 45(1)(b) and paragraph 45(4) of the Eight Schedule of the ITA; SARS *Guide to Taxation of Special Trusts* 28.

<sup>338</sup> Paragraph 47 of the Eight Schedule of the ITA states the following:  
Subject to paragraphs 48, where-

(a) a natural person or special trust disposes of an interest in a residence which is or was a primary residence; and

(b) that person or a beneficiary of that special trust or a spouse of that person or beneficiary, was not ordinarily resident in that residence throughout the period on or after the valuation date during which that person or special trust held that interest,

then the portion of the capital gain or capital loss to be disregarded in terms of paragraph 45 must be determined with reference to the portion of that period during which that person, beneficiary or spouse was so ordinarily resident.

<sup>339</sup> Paragraph 47 of the Eight Schedule of the ITA.

<sup>340</sup> Brettenny and Strauss *'n Studentegids tot Kapitaalwinstbelasting* 46.

<sup>341</sup> Paragraph 53 of the Eight Schedule of the ITA; Davis *et al Estate Planning* 50; SARS *Guide to Taxation of Special Trusts* 31.

Personal-use assets exclude the following items:

- (a) a coin made mainly from gold or platinum of which the market value is mainly attributable to the material from which it is minted or cast;
- (b) immovable property;
- (c) an aircraft, the empty mass of which exceeds 450 kilograms;
- (d) a boat exceeding ten metres in length;
- (e) a financial instrument;
- (f) any fiduciary, usufructuary or other like interest, the value of which decreases over time;
- (g) any contract in terms of which a person, in return for payment of a premium, is entitled to policy benefits upon the happening of a certain event and includes a reinsurance policy in respect of such a contract, but excludes any short-term policy contemplated in the Short-term Insurance Act;
- (h) any short-term policy contemplated in the Short-term Insurance Act to the extent that it relates to any asset which is not a personal-use asset; and
- (i) a right or interest of whatever nature to or in an asset envisaged in items (a) to (h).<sup>342</sup>

No CGT will thus be payable by the special trust or the beneficiary of the trust when there is a disposal of any items for personal use.

#### 4.4.3.4 Paragraph 59

A special trust must disregard a capital gain or loss on the disposal of a claim that resulted in this trust receiving compensation for personal injury, illness or defamation of the beneficiary.<sup>343</sup> Compensation as a revenue paid to a person under section 17 of the *Road Accident Fund Act*<sup>344</sup> is exempt from normal tax under section 10(1)(gB)(iv) with effect from 1 March 2012. This is regardless of whether the payment is in the form of a lump sum or annuity, and will thus not be subject to CGT, either by the special trust or the beneficiary.<sup>345</sup>

#### 4.4.3.5 Paragraph 82

This paragraph is aimed at preserving the status of a special trust for purposes of CGT, regardless of the death of the beneficiary for whose sole benefit the trust was created.<sup>346</sup> The trust will continue to be treated as a special trust for purposes of CGT until the earlier of, the disposal of all the assets held by the trust, or two years after the date of death of

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<sup>342</sup> Williams *Capital Gains Tax: A Practitioner's Manual* 75; Paragraph 53 of the Eight Schedule of the ITA.

<sup>343</sup> Paragraph 59 of the Eight Schedule of the ITA; SARS *Guide to Taxation of Special Trusts* 32.

<sup>344</sup> 56 of 1996.

<sup>345</sup> Davis *et al Estate Planning* 53; Section 10(1)(gB)(iv) of the ITA.

<sup>346</sup> Brettenny and Strauss *'n Studentegids tot Kapitaalwinstbelasting* 67.

the last living beneficiary of the trust for whom it was created.<sup>347</sup> Thus, the special trust's tax advantages for capital gains will still apply to the trust, even though the special-needs person is deceased.

#### *4.4.4 Application to the case study*

As in the case of a normal trust, paragraphs 68-72 are still the most important provisions regarding the CGT implications of a special trust. However, the inclusion rate of a special trust differs substantially from that of a normal trust. Section 9D(2A)(f) and paragraph 10 regulates the inclusion rate of a special trust, and states that the inclusion rate of such a trust is 40% compared to that of a normal trust at 80%.<sup>348</sup> Paragraph 82 further provides that a special trust will still be regarded as such for CGT purposes even if the special-needs person dies. Applied to the case study: From a CGT perspective, it will thus be a better solution for Mr and Mrs Maartens to use a special trust for Richard's estate planning instead of a normal trust due to the applicable advantages explained above.

#### **4.5 Tax implications for capital gains of NPOs**

As stated above the implications for the income tax of an NPO applies as follows: an organisation that has a non-profit motive or is established or registered<sup>349</sup> as an NPO does not automatically qualify for preferential tax treatment. The reason is that this registration is a voluntary commitment and not a condition for approval such as a PBO under section 30.<sup>350</sup> An organisation will only enjoy preferential tax treatment after it has applied for and been granted approval as a PBO by the Tax Exemption Unit. This implies that an NPO does not have any specific tax advantages, and will be taxed depending on the type of entity the organisation has chosen.

#### **4.6 Tax implications for capital gains of PBOs**

PBOs enjoyed complete exemption from income as well as capital gains tax up and until 1 April 2006. Thereafter, a partial taxation system<sup>351</sup> was introduced which led to PBOs

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<sup>347</sup> Brettenny and Strauss *'n Studentegids tot Kapitaalwinstbelasting* 49; Paragraph 82 of the Eight Schedule of the ITA; SARS *Guide to Taxation of Special Trusts* 32.

<sup>348</sup> Section 9D(2A)(f) of the ITA.

<sup>349</sup> Registered under the terms of the *Non-Profit Organisations Act* 71 of 1997.

<sup>350</sup> Section 30 of the ITA, SARS *Basic Guide to Income Tax for Public Benefit Organisations* 7.

<sup>351</sup> *Revenue Laws Amendment Act* 31 of 2005.

becoming taxable on their trading activities.<sup>352</sup> This means that PBOs no longer qualify for full exemption from capital gains tax. Furthermore, any capital gain or loss made by a PBO on the disposal of an asset, which has been used for a trading activity, or substantially the whole of which has been used in such an undertaking, will not be disregarded any longer.<sup>353</sup> Any capital gain or loss made by a PBO approved by the Commissioner under section 30(3) on the disposal of an asset falling into one of the following three categories must be disregarded, for CGT purposes.<sup>354</sup> These three categories are:

- non-trading assets;
- minimal-trading assets; and
- permissible trading assets.

#### *4.6.1 Non-trading assets (Paragraph 63A(a))*

This category makes provision for assets that have not been used by the PBO on or after the valuation date<sup>355</sup> for any trading activity, including assets that have been used exclusively for public benefit activities. These mentioned assets should be excluded when calculating the capital gains tax.<sup>356</sup> Only assets that have been used on or after the valuation date should be taken into account.<sup>357</sup> Also included in this category are assets that are not used but held by the PBO, such as investments in the nature of shares and participatory interests in collective investment schemes.<sup>358</sup>

#### *4.6.2 Minimal-trading assets (Paragraph 63A(b)(i))*

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<sup>352</sup> Brewis 2006 *ICNL* 4.

<sup>353</sup> Pretorius 2016 *TaxTalk* 21; SARS *Basic Guide to Income Tax for Public Benefit Organisations* 7.

<sup>354</sup> Paragraph 63A of the Eight Schedule of the ITA; Pretorius 2016 *TaxTalk* 21; SARS *Comprehensive Guide to Capital Gains Tax* 460.

<sup>355</sup> The valuation date of a PBO in existence on 1 April 2006 is the first day of its first year of assessment commencing on or after 1 April 2006. A PBO with a June year-end will have a valuation date of 1 July 2006, which is the commencement of its 2007 year of assessment.

<sup>356</sup> Daya 2007 *Without Prejudice* 20-21.

<sup>357</sup> Daya 2007 *Without Prejudice* 20-21.

<sup>358</sup> SA Institute of Tax Practitioners *SAIT Compendium of Tax Legislation* 720; SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 38.

This category applies when substantially the whole of the use of the asset by the PBO on or after the valuation date was directed at a purpose other than the trading activity.<sup>359</sup> As an example, if an asset is used 20% for trading activity and 80% for a public benefit activity, it will be considered as a minimal-trading asset. The assets referred to in this category are excluded from the first category since they are used in the trading activity, but are included in terms of this category.<sup>360</sup>

#### *4.6.3 Permissible trading assets (Paragraph 63A(b)(ii))*

The permissible trading category applies when substantially the whole of the use of the asset by the PBO on or after the valuation date was directed at the trading activity, which qualifies for exemption under section 10(1)(cN)(ii)(aa)-(cc).<sup>361</sup> Any capital gain or loss made on the disposal of an asset used in a trading activity will thus not be disregarded, except if it falls under one of these three categories discussed here.<sup>362</sup>

#### *4.6.4 Application to the case study*

When applying an NPO and a PBO to Mr and Mrs Maartens' scenario, it is evident that an NPO offers no tax advantages, and would thus not be suitable for Richard. As for a PBO, although it has many CGT advantages, it is significantly more difficult to create and adhere to than a trust or a special trust. A PBO is notably more suitable for situations where multiple persons create an organisation with a wider and more defined mission, and not for the benefit of a single person with a disability.

### **4.7 Conclusion**

This chapter examined which legal vehicle will be best suited for Mr and Mrs Maartens' scenario by focussing on the CGT implications of the different legal vehicles. When considering a trust, a special trust, an NPO and a PBO, a special trust in terms of CGT will be best suited for Richard because of the mentioned advantages. These advantages

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<sup>359</sup> Daya 2007 *Without Prejudice* 20-21.

<sup>360</sup> SARS *Comprehensive Guide to Capital Gains Tax* 436; SA Institute of Tax Practitioners *SAIT Compendium of Tax Legislation* 721; SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 38.

<sup>361</sup> Section 10(1)(cN)(ii)(aa)-(cc) of the ITA; SA Institute of Tax Practitioners *SAIT Compendium of Tax Legislation* 722.

<sup>362</sup> Daya 2007 *Without Prejudice* 20-21.



are most noted in the CGT inclusion rate that is applicable when using a special trust, as well as in the deductions applied to a special trust.

In the following chapter a conclusion will be drawn and recommendations made to inform the presented case study of Mr and Mrs Maartens.

## **Chapter 5: Conclusion**

### ***5.1 Introduction***

When planning for a special-needs person it is important to follow a different, more careful approach, seeing that these individuals are unable to take care of themselves financially. This is where estate planning for people with special needs is applicable, to provide for the future financial security and care of such a disabled person. Securing the future for a person with a special need differs significantly from planning for someone without disabilities. Therefore, a planning agent should not only consider the different income as well as tax obligations for capital gains, but also the type and nature of the legal vehicle that is employed.

This lead to the research question that was posed and discussed in Chapter 1. The research question read as follows: How does the tax treatment of trusts, special trusts, NPOs and PBOs compare when planning an estate with a special-needs person in mind?

To answer the above-mentioned research question, it was necessary beforehand to examine and explain a trust, special trust, NPO and PBO based on their definition, legal nature and requirements.

### ***5.2 Summary of different legal vehicles***

In Chapter 2 the four different legal vehicles were identified and discussed in terms of their definition and legal nature. Each of these vehicles was elucidated by focusing on its requirements, duties and legislation, as well as the steps needed to be followed to create such a vehicle. The following table summarises the different legal vehicles investigated in the present study.<sup>363</sup>

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<sup>363</sup> The contents of the table are derived from Chapter 2 of this dissertation. There is no footnote's in the table, for layout purposes. The sources reviewed in Chapter 2, also apply to this table.

Table 5.1: Summary of legal vehicles

Element	Trust	Special Trust	NPO	PBO
Legislation	<i>Trust Property Control Act</i> 57 of 1988	<i>Income Tax Act</i> 58 of 1962	<i>Non-profit Organisations Act</i> 71 of 1997	<i>Income Tax Act</i> 58 of 1962
Definition	A trust is an arrangement in a trust document whereby a person, a trustee, holds property as its nominal owner for the good of one or more persons, the beneficiaries.	A special trust is created 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.	A NPO is a trust, company or other association of persons established for a public purpose; and the income and property of which may not be distributed to its members or office-bearers except as reasonable compensation for services rendered.	A PBO is a non-profit company as defined in section 1 of the <i>Companies Act</i> , or a trust or association of persons that has been incorporated, formed or established in South Africa, or a South African agency or branch of a non-resident company, association or a trust, which is exempt from tax in its country of residence.
Legal nature	Not a legal person in its own right.  Some statutes, however, recognise a trust as a person for a specific purpose, such as the <i>Income Tax Act</i> .	Not a legal person in its own right.  Some statutes, however, recognise a special trust as a person for a specific purpose, such as the <i>Income Tax Act</i> .	A NPO is in most cases a legal person, depending on the type of entity it entails.  It can either be a voluntary association, a non-profit trust, or a non-profit company, and will take on the legal nature of the entity chosen.	A PBO is in most cases a legal person depending on the type of entity it entails.  It can either be a voluntary association, a non-profit trust, or a non-profit company, and will take on the legal nature of the entity chosen.
Requirements	(a) Founder must intend to create a trust.  (b) The intention must create an obligation.	The same requirements as for a trust are needed, as well as the fact that the special trust has to be created solely for the benefit of a person who suffers from	An NPO has to adhere to the requirements of the entity it entails, which is either a company, trust or association, and needs a	Section 30(3) of the ITA prescribes that all conditions prescribed by the Minister have to be complied with. The requirements are as follows:

	<p>(c) The trust property must be defined with reasonable certainty.</p> <p>(d) The trust object, must be defined with reasonable certainty.</p> <p>(e) The trust object must be lawful.</p>	<p>a defined mental illness or a serious physical disability.</p>	<p>public-benefit activity as its objection.</p>	<p>(a) Must submit a copy of its founding document to the Commissioner.</p> <p>(b) No funds of the PBO may be distributed to any person, except if it is in the course of the person undertaking PBO activities.</p> <p>(c) If a PBO dissolve, it must transfer its assets to another PBO with similar objectives and which has been approved in terms of section 30 of the ITA.</p> <p>(d) A PBO may not accept any donations, which are revocable by a donor, for reasons other than material failure.</p>
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Diverse legal vehicles have different requirements that have to be met for the entity to be recognised as such. Each specific scenario will link to the most suitable legal vehicle. Regarding the case study: In Mr and Mrs Maartens' scenario a special trust will be the best suitable option since such a trust is easy to establish and easily meet the requirements stated by the ITA. It is furthermore possible to change the provisions of a special trust and it is not expensive to establish. Such a trust offers a wide range of advantages to a person with special needs that the other legal vehicles do not provide.

### **5.3 Income tax implications**

When dealing with any legal vehicle, there is always income tax obligations applicable:

#### *5.3.1 Trusts*

A trust is not a natural person, and therefore, does not qualify for the primary, secondary or tertiary rebates in terms of section 6 or section 10(1)(i) of the ITA.<sup>364</sup> An ordinary trust is taxed at a fixed rate of 41%, but will only have a taxable income if no other person has a vested right to the income and this income is not deemed to accrue to another person.<sup>365</sup> Sections 25B and 7 regulate the obligations for income tax of a trust as well as its beneficiaries. These sections state in which cases the trust, and the beneficiaries are liable for the income tax. The conduit principle plays an important role in regulating the income tax payable by trusts, but is currently under inspection by SARS. In terms of Mr and Mrs Maartens' scenario a trust seems a viable option.

#### *5.3.2 Special trusts*

The main difference between a special and a normal trust is the rate at which income tax is payable. A special trust is taxed on a sliding scale applicable to natural persons, and not according to the flat rate of 41% that applies to a normal trust.<sup>366</sup> Even though a special trust is taxable on a natural person's scale, this trust is not a natural person and as a result, the rebates and exemptions do not apply. Sections 7 and 25B are the provisions in the ITA that generally apply to trusts as well as special trusts, and thus the

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<sup>364</sup> Stiglingh *et al Silke: South African Income Tax 2016* 837.

<sup>365</sup> Stiglingh *et al Silke: South African Income Tax 2016* 843.

<sup>366</sup> SARS *Guide to Taxation of Special Trusts* 1.

attribution rules will apply to a special trust. However, when a special-needs person is deceased, the trust does not dissolve automatically, and will still be considered as a special trust. Thus to conclude, it can be stated that if a single beneficiary has a vested right to the income, the special trust is essentially ignored under section 25B(1). Furthermore, any income derived by the trust is deemed to accrue to the beneficiary with any actions of the trustees merely conducted on behalf of, and for the benefit of, the beneficiary.

### 5.3.3 NPOs

NPOs used to be fully exempt from tax, but the position of its taxation changed in 2006 when a partial taxation system was created. An organisation that has a non-profit motive or is established or registered<sup>367</sup> as a NPO, does not qualify automatically for preferential tax treatment. The reason is that this registration is a voluntary commitment, not a condition for approval as a PBO under section 30.<sup>368</sup> An organisation will only enjoy preferential tax treatment after it has applied for and has been granted approval as a PBO by the Tax Exemption Unit.<sup>369</sup> This implies that a NPO does not have specific tax advantages and will thus be taxed according to the type of legal entity it entails, for example, a company or trust.

### 5.3.4 PBOs

In order for an NPO to qualify as a PBO, and thus receive the exemptions that the ITA offers, it must be approved in terms of section 30 of the ITA, which contains the conditions and requirements for a valid PBO.<sup>370</sup> The rules governing the preferential tax treatment of PBOs are stipulated in section 10(1)(cN) of the ITA.<sup>371</sup> These rules provides for the exemption from normal tax of certain receipts and accruals of approved PBOs in terms of their trading activities.<sup>372</sup> These exemptions have a positive effect on the PBO.

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<sup>367</sup> Registered under the terms of the *Non-Profit Organisations Act* 71 of 1997.

<sup>368</sup> SARS *Basic Guide to Income Tax for Public Benefit Organisations* 7.

<sup>369</sup> The Tax Exemption Unit is a dedicated office within SARS which deals with all applications by non-profit organisations for approval as PBOs.

<sup>370</sup> Section 30 of the ITA.

<sup>371</sup> Section 10(1)(cN) of the ITA.

<sup>372</sup> SARS *Basic Guide to Income Tax for Public Benefit Organisations* 1.

Therefore, applied to the case study, a PBO is a better option than an NPO, but not as effective as a trust or special trust, for Mr and Mrs Maartens' scenario.

#### **5.4 Tax implications for capital gains**

When dealing with any legal vehicle, there is always capital gains tax obligations applicable:

##### *5.4.1 Trusts*

Section 26A of the ITA provides that any net capital gain that is taxable must be included in a taxpayer's taxable income. However, any net capital loss should not be included in a taxable income, but should be carried forward to be deducted from the aggregate capital gain the following year.<sup>373</sup> Section 26A forms the link between the ITA and the Eight Schedule, which contains most of the CGT provisions.<sup>374</sup> Trusts and trust beneficiaries enjoy special treatment, known as attribution rules. These rules are contained in paragraphs 68, 69, 71 and 72 of the Eight Schedule of the ITA with regard to calculating CGT. This special treatment, known as the conduit principle, provides that the trust is not always liable for the CGT and that the tax may also be payable by a donor or beneficiary. The case may be where income accrues to a trust and the trustees award it to one or more beneficiaries in the same year of assessment. In such a case, the income retains its nature in the hands of the beneficiary, and the trust will not be liable for the CGT. The conduit principle is, however, currently under administration by SARS.

##### *5.4.2 Special trusts*

For CGT purposes, a special trust is considered an entity described in paragraph (a) of the definition of special trust in section 1(1). In other words, only a trust created for the benefit of one or more persons with a disability will be considered a special trust for purposes of capital gains tax. The provisions of the Eighth Schedule as well as sections 25B and 7 apply to a special trust.<sup>375</sup> Under paragraph 10(a) the inclusion rate of a special trust is 40% compared to that of a normal trust at 80%. The annual exclusion of R 40

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<sup>373</sup> SARS *Comprehensive Guide to Capital Gains Tax* 71; Rabenowitz *et al The South African Financial Planning Handbook* 691.

<sup>374</sup> McAllister 2015 *Legal Policy* 28; SARS *Comprehensive Guide to Capital Gains Tax* 71.

<sup>375</sup> Paragraph (c) of the definition of representative taxpayer in section 1(1) of the ITA.

000 offers a significant advantage to a special trust. Furthermore, such a trust will still exist and enjoy the advantage of a special trust even if the special-needs person is deceased. A further advantage of a special trust is that it is easy to establish as well as to change.

#### *5.4.3 NPOs*

Regarding the CGT of an NPO, the same applies as for the income tax. An organisation will only enjoy preferential tax treatment after it has applied for and has been granted approval as a PBO by the Tax Exemption Unit.<sup>376</sup> This implies that a NPO does not have any specific tax advantages and will be taxed according to the type of legal entity it entails, for example a company or trust.

#### *5.4.4 PBOs*

PBOs no longer qualify for full exemption from CGT. Therefore, any capital gain or loss a PBO makes when disposing an asset which has been used for trading activity or substantially the whole employed in such an undertaking, will not be disregarded any longer.<sup>377</sup> For CGT purposes, the following must be disregarded: any capital gain or loss by a PBO on the disposal of an asset falling into either non-trading, minimal-trading, or permissible trading assets. Paragraph 63A of the Eighth Schedule regulates these CGT provisions for PBOs.<sup>378</sup>

### ***5.5 Recommendations in terms of Mr and Mrs Maartens' scenario***

In light of the discussions above, it is thus strongly recommended that Mr and Mrs Maartens in the case study, should use a special trust in their planning for Richard's future.

The special trust has the most suitable structure for a scenario that depicts a person with a special need who has to be taken care of financially. A special trust is easy to establish

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<sup>376</sup> The Tax Exemption Unit is a dedicated office within SARS which deals with all applications by non-profit organisations for approval as PBOs.

<sup>377</sup> SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* 37.

<sup>378</sup> Pretorius 2016 *TaxTalk* 21.



and is applicable for people with a mentally or serious physical disability which limits them from earning sufficient income to maintain themselves.

Regarding a special trust's income tax advantages, it should be stated beforehand that such a special trust is taxed on a sliding scale applied to natural persons and not on the flat rate of 41% as in the case of a conventional trust. Sections 25B and 7 regulate the conduit principle that currently applies to special trusts that limits the amount of income tax payable by the trust itself. Section 25B(3)-(7) also stipulates the deductions available in terms of a special trust.

A special trust holds several tax advantages for capital gains. Firstly, the attribution rules provided in paragraph 68-72 and 80 state that the trust is liable for the CGT unless there is a specific rule that directs the capital gain to another person. Secondly, under paragraph 10(a) for the CGT, the inclusion rate of a special trust, is 40% compared to the 80% of a normal trust. Thirdly, there is an annual exclusion of R 40 000 for a special trust regarding CGT. Fourthly, normal CGT provisions do also apply to a special trust and thus no CGT will be payable on the first R 2 million of a primary residence or on items of personal use.

To conclude: From the examination and discussions above, it can be stated that for Mr and Mrs Maartens' scenario a special trust is the best suited legal instrument.

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