TRUST TAXES

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The South African Revenue Service (Sars) will not tax amounts in excess of the total income or capital gains received by the trustees, nor will Sars tax more than one person on the same amount. Where income or capital gains is taxed in the hands of the trust, any subsequent distribution thereof will not attract tax in the hands of the beneficiary. Depending on the circumstances, trust income and capital gains can be taxed in the hands of the donor/funder, the beneficiary, or the trust.

The following sequence should be followed in determining who will be liable for the payment of tax on trust assets:

- Firstly, Sars introduced anti-avoidance provisions to prohibit people from moving income or capital gains away from themselves by donating assets to a trust or selling them to the trust on an interest-free or soft loan basis. In this instance, income or capital gains generated on assets donated to the trust or financed via an interest-free or soft loan by a connected person in relation to the trust is deemed to be accruing to the donor/funder. These provisions override any other provisions that aim to tax trust income or capital gains.
- Secondly, if no deeming provisions can be applied to an income or capital gain that is vested in a beneficiary—resulting in it being taxed in the hands of the donor/funder—the beneficiary will, if decided by the trustees in terms of the Conduit Principle, a mechanism that allows trustees to shift the tax burden from a trust to its beneficiaries, allowing them to pay tax at the respective individuals' marginal tax rates on the income or capital gain vested in them, excluding distributions to non-South African resident beneficiaries.

Trustees can use the Conduit Principle and pay beneficiaries who are earning an income that falls below the tax threshold, resulting in no tax payable on such amounts. Trustees can also utilise the Conduit Principle to split income and capital gains amongst a number of beneficiaries who earn up to the thresholds, thereby ensuring that little or no tax is paid on trust income and capital gains. This is referred to as "income splitting" and is a benefit available exclusively to trusts. Income splitting ensures that tax payable is reduced to an amount less than had the income been taxed from one source. Should a distribution of interest be made to a number of beneficiaries, each beneficiary is permitted to utilise the annual interest exemption to reduce their taxes. This is contrary to the interest exemption that can only be used once by an individual who earns the same combined interest.

Similarly, a capital gain distributed to a number of beneficiaries—rather than an individual making the capital gain in his/her own hands—can benefit from multiple annual exclusions. This exclusion currently stands at R 40 000 per natural person, per year. It is important to note that any such distributions must be made before the end of February—otherwise the income or capital gain will be taxed in the trust.

- Finally, the trust will pay tax on any trust income or capital gains that has not been taxed, including distributions to non-South African resident beneficiaries. The trust is, therefore, the taxpayer of last resort.

The above makes it clear that a blanket statement that the most tax is paid on income generated or capital gain realised in a trust is simply not true. One needs to actively manage a trust and consider the various options in order to minimise taxes paid. Be mindful though not to register a trust only for a tax advantage.