TRUST EXAMPLES

TRUST EXAMPLE 1: INCOME TAX
Peter donated a townhouse complex to a trust that produces rental income for the trust. His two children (Jackie and Mikey) are the beneficiaries of the trust. Jackie is a minor and Mikey is 22-years old and working as a candidate attorney. During the 2013 year of assessment the trust earned R300 000 net rental income. The trustees exercised their discretion and distributed R100 000 to each beneficiary. No beneficiary has a vested right to the retained amount.

Determine who will be liable for income tax on the rentals earned by the trust. [5]

Firstly: Apply relevant s 7 provisions. The donor will be taxed on the income that accrues to his minor child by reason of his donation (s 7(3)), as well as the retained income of the trust (s 7(5)). Peter is therefore taxed on R200 000 (R100 000 + R100 000).

Secondly: Apply s 25B(1) to include the income in the beneficiary’s tax calculation who has a vested right to it. Mikey will thus be taxed on her R100 000.

Lastly, the trust will be taxed on any amount to which no beneficiary has a vested right. Because the retained amount was subject to s 7(5), there is no amount to be included in the taxable income of the trust.

TRUST EXAMPLE 2: INCOME TAX
Mr. McLaren creates a discretionary inter vivos trust called the McLaren trust. His wife and 3 minor children are the beneficiaries of this trust. Mr. McLaren donated a business building to this trust. The business building earns rental income of R4,000,000 per year. The trustees use their discretion and transfer 1/3 of the rental income to Mr McLaren’s spouse, 1/3 of the rental income to the children and the remaining 1/3 of the rental income is retained in the trust for the year of assessment ending 28 February 2013.

Explain who will be liable for the payment of the income tax. Refer to relevant authority. [5]

ANSWER:
Mr. McLaren [1]will be liable for the payment of the income tax payable on the full R4, 000,000. [1]

1) Sec. 7(2): Where a spouse (husband or wife) creates a trust and the other spouse is entitled to the trust income, such income will be deemed to be the income of the first-mentioned spouse if the trust was created with the sole or main purpose to reduce, postpone or avoid the liability for any tax of the first mentioned spouse. [1]

2) Sec. 7(3): If a parent founds a trust for the benefit of his minor child by a donation of assets to the trust, the parent will be liable for any tax payable on the income from such assets. [1]

3) Sec. 7(5): Where a person donates or otherwise transfers assets to a trust subject to a stipulation or condition, which makes the beneficiary’s receipt of the income or a portion thereof contingent on the occurrence of a specified event. [1]This section basically applies if someone has made a donation, settlement, interest free loan, or similar gratuitous disposition to a trust. The income arising out of such a gratuitous disposition is taxed in the
hands of the person who made the disposition (if the income is retained in the trust due to a stipulation in the trust deed which stated that the income shall not be distributed until the happening of some event). If income can be retained in the trust, some stipulation must have provided for this.

**Trust Example 3: Income Tax**
Simon Powell created a trust by donating assets to trustees to be administered for the benefit of his minor grandson, Taylor, his major grandson, Tom, and his married granddaughter, Celia. The trust deed provides that the trustees have discretionary powers with regard to distributing income to the beneficiaries as they deem necessary. The deed provides further that the remaining amount from the annual income is to be accumulated for the beneficiaries, but that they will be entitled to receive it only on Simon’s death or when the beneficiaries reach the age of 30, whichever happens first. If a beneficiary should die before attaining the age of 30, the other beneficiaries will proportionally be entitled to that amount.

During the year of assessment the trustees received a taxable income of R10 000 from the trust assets. In terms of the discretion as per the trust deed they distributed R1 000 to each beneficiary and retained the balance in the trust. Determine who is liable for tax on the R10 000 taxable income.

**ANSWER:**
As far as s 7(5) is concerned, there is clearly a stipulation in the trust deed which prevents the beneficiaries from acquiring a vested right until the happening of an event. The events contemplated by the trust deed are the death of the donor or the attainment of the age of 30 by the beneficiaries, whichever takes place first, of the exercise by the trustees of their discretionary power whether or distribute any income. Section 7(5) can apply only to retained amounts, and the R1 000 distributed to each beneficiary will be taxable in the hands of the beneficiaries in terms of s 25B(1). The retained amount of R7 000 (R10 000 – R1 000 – R1 000 – R1 000) is deemed to be Simon’s in terms of s 7(5), as the condition prohibits the beneficiaries from receiving the money or attaining a vested right to it. Section 7(3) does not apply to a donor-grandparent that benefits his minor grandchildren.

**Trust Example 4: Loan Account and Capital Gains Tax**
Mr Brown made an interest free loan of R1 000 000 to the Brown Trust in 2006. The market related interest rate on this loan would have been 10%. The Brown Trust is a discretionary South African *inter vivos* trust. The beneficiaries of this trust are Mr Brown’s wife and children, Steven Brown (aged 17) and David Brown (aged 25). David Brown has immigrated to Australia and is an Australian resident. The trust invested the money in South African shares. In 2012 year of assessment, the trust sold the shares and made a capital gain of R300 000. The capital gain was distributed to the beneficiaries in equal shares. In the 2013 tax year of assessment the trust received dividends of R100 000 and also sold the remainder of the shares and made a capital gain of R200 000. The income as well as the capital gain was distributed to the beneficiaries in the 2013 year of assessment.

Who will be liable for the payment of the capital gains tax and or income in the 2013 year of assessment?
The trust has ‘benefited’ by the interest not paid of R100 000 [1 mil at 10%] since 2006 – the first time that the trust generated income and or capital. A total of R600 000 [6 YEARS].

In the 2012 tax year Mr. Brown would have been liable for the payment of the CGT on R300,000 – because by 2012 a full amount of R600 000 can be reverted to the donor.

Because only R300 000 was utilised, the remainder of R300 000 is carried over to the 2013 tax year.

In 2013, the trust benefit by an additional R100 000 as the loan account has still not been paid off. So, R100 000 for the current year plus the R300 000 carried over – in the 2013 tax year a full amount of R400 000 can be attributed to the donor.

In 2013, the trust makes a gain of R200 000 and dividend income of R100 000. These amounts were distributed to the beneficiaries:

Capital Gain and income that vest in the spouse will be taxed in Mr Brown’s hands – par 68 and 7(2).
Capital gain and income that vest in minor will be taxed in Mr Brown’s hands – par. 69 and s7(2)
Capital gain and income that vests in David Brown’s hands will be taxed in Mr Brown’s hands – par 72 and S7(8). Capital gains distributed by a trust to a non resident. The gain can be attributed to a gratuitous disposition made by a South African resident then the SA resident donor is taxed on the gain instead of the non resident or the trust.

Remember in 2013 a total of R400 000 could be attributed to the donor – trust income was only R300 000 – so an amount of R100 000 will be carried over to the next years of assessment.

**TRUST EXAMPLE 5: LOAN ACCOUNT AND CAPITAL GAINS TAX**

The assets of Zeeman trust consist of townhouses to the value of R5 million. The shares were sold to the trust by way of an interest-free loan that Mr. Zeeman made to the trust on 1 March 2008. Mr Zeeman’s 3 minor children are the beneficiaries of this discretionary trust. A market-related interest rate on a similar loan is 10%. The trust received no income before the current year of assessment. The trust sells the property and realises a Capital Gain of R2 000 000. They distribute this gain in equal shares to the beneficiaries.

Explain who will be liable for the payment of the Capital Gains tax. Refer to relevant authority and show the relevant calculations, if any.

**Answer**

The interest-free loan is deemed to be a “donation, settlement or other disposition” and it activates section 7. Of the R2 000, 000 only R500, 000 will be attributable to the interest free loan (R5, 000,000 x 10 % = R500, 000). Therefore R500, 000 will be taxed in the hands of Mr.Zeeman and the R1,500, 000 will be taxed in equal share in the hands of the children (R500, 000 for each child) [1]

Mr. Zeeman R500, 000[1]
Minor Child R500, 000
Minor Child R500, 000
Minor Child R500, 000[1]

**Paragraph 69: attribution of capital gain to parent of minor child. [1]**

This rule mirrors the rules in section 7(3) and (4).
Where a minor child’s CG or a CG that has vested in or is treated as having vested in, or that has been used for the benefit of that child during the year of assessment in which it arose can be attributed wholly or partly to any donation, settlement or other disposition:

- Made by a parent of that child, or
- Made by another person in return for any donation, settlement or other disposition or some other consideration made or given by a parent of that child in favour, directly or indirectly, of that person or his/her family.

So much of that gain as can be so attributed must be disregarded when determining that child’s aggregate CG or aggregate capital loss, and must be taken into account in determining the aggregate CG or aggregate capital loss of that parent. [1]

**Trust Example 6: Interest Free Loan**

Mr Petriangi made an interest free loan of R1 000 000 to the Petriangi Trust in 2012. The market related interest rate on this loan would have been 10%. The Petriangi Trust is a discretionary South African trust. The beneficiaries of this trust are Mr Petriangi’s children, Tony Petriangi (aged 17) and Luigi Petriangi (aged 25). Luigi Petriangi immigrated to Italy and is an Italian resident. The trust invested the money in South African shares. In 2013 year of assessment the trust sold the shares and made a capital gain of R100 000. This capital gain was distributed to the beneficiaries in equal shares.

Who will be liable for the payment of the capital gains tax? [5]

**ANSWER**

Mr. Petriangi will be liable for the payment of the CGT on the Full R100,000

The 10% interest free loan would have amounted to R100,000 over one year, so the full amount of R100,000 will be used for calculation purposes

R50 000 that vest in minor will be taxed in Mr Petriangi’s hands – par. 69. Minors

R50,000 that vest in Luigi Petriangi’s hands will be taxed in Mr Petriangi’d hands – par 72.

Capital gains distributed by a trust to a non resident. The gain can be attributed to a gratuitous disposition made by a South African resident then the SA resident donor is taxed on the gain instead of the non resident or the trust.

**Trust Example 7: Donations Tax**

Max wants to donate R2,000,000 to his trust in order to make his personal estate smaller for estate duty purposes. The trust is to buy property with the money. Define and explain the concept of donations tax. [2]

**ANSWER:**

Donations Tax is levied in terms of the Income Tax Act on the value of any property disposed of by any resident of the Republic under a donation, whether such disposition occurred directly or indirectly and whether in trust or not. [1] For this purpose “donation” is defined in section 55 (1) of the Act as any gratuitous disposal of property including any gratuitous waiver or renunciation of a right. Section 58 of the Act furthermore deems it a donation of any property is disposed of for a consideration. [1]