TAX & EXCHANGE CONTROL
ALERT

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CDH
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A sensible outcome: SARS' ruling regarding special trusts

While the provisions in the Income Tax Act 58 of 1962 (ITA) that apply to ordinary trusts are often the subject of disputes in the Tax Court or of binding private rulings issued by the South African Revenue Service (SARS), the same cannot be said for special trusts. We briefly discussed the ITA's dispensation applicable to special trusts in our Tax and Exchange Control Alert of 18 January 2019 and explained that it may apply in instances where a person is unable to look after their own affairs and where the special trust is then created for the benefit of such person.

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In Binding Private Ruling 384 (BPR 384) a question arose regarding the donations and capital gains tax (CGT) consequences resulting from the beneficiary (applicant) of a special trust ceding his loan account against the trust, to that trust.

Facts

The applicant is a resident person with a disability who suffered a traumatic brain injury as a result of which he is unable to work, talk or maintain himself independently but is still able to make decisions. His wife takes care of his physical needs and manages his financial affairs under power of attorney. The co-applicant in BPR 384 is a special trust for the sole benefit and maintenance of the applicant for the duration of his lifetime, due to his mental and physical disabilities.

The secondary beneficiaries of the special trust are the applicant's spouse and children who may only benefit as discretionary beneficiaries from the trust after the death of the applicant.

The special trust formerly served as a family trust for the benefit of the applicant, his spouse and children but became a special trust pursuant to the trust deed being amended.

The applicant has a loan account against the special trust due to funds made available to the co-applicant. The applicant proposed ceding this loan account to the special trust with the objective of reducing the trust's liabilities and ensuring that more funds are available to take care of the applicant's maintenance needs during his lifetime should something happen to his wife.

Ruling

Firstly, it is important to note that SARS' ruling is subject to the additional condition and assumption that the cession of the loan account does not result in an amount being transferred to the special trust which, for purposes of the applicant's maintenance, is excessive.

A sensible outcome: SARS' ruling regarding special trusts

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Pursuant to this, SARS ruled as follows:

- That the cession by the applicant of his loan account to the special trust does not constitute a donation in terms of section 54 of the ITA.
- That the proceeds in respect of the cession of the loan account will be equal to the face value of the loan account, under paragraph 38 of the Eighth Schedule to the ITA. Consequently, no capital gain or loss will be realised by the applicant from the cession of the loan account and paragraph 39 is not applicable.

Analysis

SARS' finding that the cession of the loan account does not constitute a donation, is unsurprising. In Binding Private Ruling 309 (discussed in our Tax and Exchange Control Alert of 18 January 2019), the facts were similar and SARS ruled that where the primary beneficiary (who suffered from early onset dementia) intended to transfer an amount to a special trust to provide for her future upkeep and well-being, it did not constitute a donation in terms of section 54 of the ITA. It is possible that SARS' view, in the case of BPR 384, was also that the cession of the loan account was not motivated by *"pure liberality or disinterested benevolence"* (the key requirement for a donation in addition to the definition in section 54 of the ITA) as the cession will only benefit the applicant during his lifetime. It is also possible that the condition to which the ruling was subject, that the cession of the loan account does not result in the transfer of an amount that is excessive for purposes of the applicant's maintenance, played a role in SARS' decision.

In respect of the CGT issue, SARS' ruling on the application of paragraphs 38 and 39 of the Eighth Schedule of the ITA, is sensible. These paragraphs were likely considered as the applicant, being a beneficiary of the special trust, is a connected person in relation to the trust. The purpose of these provisions is to prevent tax avoidance where assets are disposed of in the context of connected persons, by stating that disposals between connected persons -

- are deemed to take place for a consideration that is arm's length (if the consideration is less than an arm's length price) (see paragraph 38); and
- resulting in a capital loss, must be treated so that the capital loss is ring-fenced and can only be set-off against capital gains realised as a result of disposals between the same connected persons.

Given that the consideration for the asset, the applicant's loan account against the trust, was equal to the face value of the loan, it is clear that no capital gain or capital loss arose as a result of the cession.

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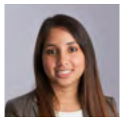

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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