

# TAX & EXCHANGE CONTROL ALERT

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### A SPECIAL DISPENSATION: SARS RULING ABOUT SPECIAL TRUSTS

In recent times, the issue of mental health and the importance of caring for vulnerable persons with mental illnesses has become more prominent. Of course, the effect of mental illness on persons may differ depending on the nature of the illness. In the case of very serious forms of mental illness, a person may not be able to look after their own affairs any longer. From a tax perspective, the Income Tax Act, No 58 of 1962 (Act), makes provision for the creation of so-called special trusts, where the trust is created for the benefit of a person who cannot take care of his own affairs due to a disability (Beneficiary), including as a result of a serious mental illness.

# A SPECIAL DISPENSATION: SARS RULING ABOUT SPECIAL TRUSTS

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*A special trust is not taxed on income at the rate of 45%, as is the case with ordinary trusts. It also pays capital gains tax on disposals at the same rate as individuals, where the maximum effective rate is currently 18%.*



In recent times, the issue of mental health and the importance of caring for vulnerable persons with mental illnesses has become more prominent. Of course, the effect of mental illness on persons may differ depending on the nature of the illness. In the case of very serious forms of mental illness, a person may not be able to look after their own affairs any longer. From a tax perspective, the Income Tax Act, No 58 of 1962 (Act), makes provision for the creation of so-called special trusts, where the trust is created for the benefit of a person who cannot take care of his own affairs due to a disability (Beneficiary), including as a result of a serious mental illness.

The trustees of such a trust would then have to administer the assets of the trust in favour of the Beneficiary. In order for a trust to become a special trust, it would have to register with SARS as a special trust. Without delving into detail, the benefit of the special trust dispensation is that in some respects the tax considerations for a special trust, are similar to the tax considerations for an individual, as opposed to the tax considerations that apply to ordinary trusts. For example, the income that accrues to or is received by a special trust during a year of assessment, is calculated with reference to the tax tables applicable to individuals. A special trust is not taxed on income at the rate of 45%, as is the case with ordinary trusts. It also pays capital gains tax on disposals at the same rate as individuals, where the maximum effective rate is currently 18%.

On 28 June 2018, SARS released Binding Private Ruling 306 (BPR 306), which deals with the donation of funds to a special trust.

## Facts of BPR 306

The facts of BPR306 are as follows:

- The applicant, described as a resident adult suffering from a debilitating malady (Applicant), suffers from an early onset of dementia, but is currently still lucid and has the capacity to contract.
- The Applicant will transfer an amount to the trust in order to provide for her future upkeep and wellbeing, which amount transferred does not represent the applicant's entire estate.
- The trust, described as a discretionary *inter vivos* trust, created by the Applicant and registered as a special trust (Trust), provides for primary and secondary beneficiaries.
- The Applicant is the primary beneficiary and her descendants are the secondary beneficiaries.



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# A SPECIAL DISPENSATION: SARS RULING ABOUT SPECIAL TRUSTS

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*SARS ruled that the amount to be contributed by the Applicant will not constitute a donation as contemplated in s54 and s55 of the Act, and, as a result, no donations tax will be levied.*



- Both the primary and the secondary beneficiaries are contingent beneficiaries as their rights to receive income or assets are subject to the exercise of the discretion of the Trust's trustees.
- The trustees may only exercise their discretion in respect of the secondary beneficiaries on the passing of the primary beneficiary.
- The purpose of the Trust is to take care of the Applicant when she becomes debilitated by her medical condition, by providing for her care and maintenance.

#### SARS's decision in BPR 306

SARS ruled that the amount to be contributed by the Applicant will not constitute a donation as contemplated in s54 and s55 of the Act, and, as a result, no donations tax will be levied.

#### Comment

In the matter of *Welch's Estate v C*: SARS 2005 (4) SA 173, the Supreme Court of Appeal held that the legislature did not eliminate from the statutory definition of "donation" the common law requirement that the disposition be motivated by pure liberality or disinterested benevolence and not by self-interest or the expectation of a *quid pro quo* of some kind from whatever source it may come. SARS may, due to its finding in BPR 306, hold the view that the Applicant made the transfer of assets for her own interest and that it was not motivated by pure liberality or disinterested benevolence because, during her lifetime, the Trust will only benefit the Applicant.

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*Louis Botha*



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Gerhard Badenhorst ranked by CHAMBERS GLOBAL 2014 - 2018 in Band 1: Tax: Indirect Tax.

Emil Brincker ranked by CHAMBERS GLOBAL 2003 - 2018 in Band 1: Tax.

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Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

Ludwig Smith has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

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