

Capital gains and multiple trust structures

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In March 2021, the Tax Court¹ determined whether a trust acted as a 'conduit pipe' when it received capital gains from various vesting trusts as a beneficiary, and in turn distributed the same capital gains to its own beneficiaries. The court determined the trust's tax liability in accordance with section 25B(1) of the Income Tax Act, 58 of 1962 (the Act) prior to its recent amendment.

Facts

The Appellant is ABC Trust, a South African resident trust. Throughout the 2014, 2015 and 2016 years of assessment, the Appellant had beneficiaries who were also South African residents, and the Appellant was similarly a vested beneficiary of various vesting South African resident trusts.

During the years under consideration, the various vesting trusts had disposed of certain capital assets. The Appellant, by virtue of it being a vested beneficiary of these trusts, became entitled to the various capital gains derived from the disposal of the capital assets.

The Appellant, in turn, distributed the capital gain to its beneficiaries during the same years of assessment, with the beneficiaries paying Capital Gains Tax (CGT) on these capital gains.

¹ Case citation: *SARS TC ITC 24918 (IT) [2021]*

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The Appellant's stance was that it acted as a 'conduit pipe' as the capital gain from the various trusts moved through it and eventually vested in its own beneficiaries. As a result, no capital gain had been received or accrued to the Appellant and as such, it was not subject to any tax liability. Instead, the Appellant argued that any receipts or accruals of the capital gain took place in the hands of its beneficiaries, and it is therefore the Appellant's beneficiaries who should bear the tax liability.

Contrastingly, SARS' stance was that the Appellant should be liable for CGT on the capital gain and accordingly raised additional assessments for the 2014, 2015 and 2016 years of assessment wherein SARS assessed the Appellant for capital gains, understatement penalties and interest.

Issue

The issue is the correct treatment of the capital gains and the consequent taxability or otherwise of these gains in the hands of the Appellant.

Judgment

The relevant law used in this judgment were sections 25B(1), 25B(2) and 26A of the Act and sub-paragraphs 80(1) and 80(2) of the Eighth Schedule of the Act.

It is important to note that an amendment to section 25B(1) of the Act was promulgated in January 2021. However, despite this matter being heard in March 2021, the years under consideration were prior to 2021 therefore section 25B(1) as amended was not applied retrospectively.

In terms of section 25B(1) of the Act (prior to the 2021 amendment which specifically excludes capital gains), any amount received by or accrued to a person in their capacity as trustee of a trust, shall be deemed to be an amount which has been received by or accrued to a beneficiary who has a vested right to that amount, to the extent that the amount has been derived for the immediate or future benefit of that beneficiary. Section 25B(2) of the Act goes on further to state that the above principle applies where a beneficiary has acquired a vested right to an amount as a consequence of the exercise of discretion by the trustees of the trust.

The court applied a broad meaning to the definition of 'any amount' in section 25B(1) and sought to include capital gains within this definition.

The court found that the various vesting trusts awarded the Appellant realised proceeds of capital gains from the disposal of capital assets. These proceeds were deemed to be 'amounts' in terms of section 25B(1) of the Act which were then awarded from the Appellant to the Appellant's beneficiaries.

Taking into account section 26A of the Act, which states that the taxable capital gain of a person should be included in their taxable income in accordance with the Eighth Schedule of the Act, the court delved into the Eighth Schedule to determine the taxability of the capital gains amount.

The court discussed the provisions of sub-paragraphs 80(1) and 80(2) of the Eighth Schedule. Sub-paragraph 80(1) deals with the application of a capital gain where an asset has been vested in a trust beneficiary whereas sub-paragraph 80(2) deals with the application of a capital gain where an asset has been disposed of and the trust beneficiary has a vested interest in the capital gain but not the asset. Where the requirements are met for either of the sub-paragraphs, the capital gain must be accounted for in the trust beneficiary in whom the gain vests.

The court determined that the capital gain passed from the vesting trusts to the Appellant and then to the Appellant's beneficiaries constituted a 'capital gain but not an asset' within the scope of sub-paragraph 80(2) rather than an 'asset' in terms of sub-paragraph 80(1) of the Eighth Schedule.

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On the facts, the court held that the capital gain in question fell within the purview of sections 25B(1) and 25B(2) of the Act and sub-paragraph 80(2) of the Eighth Schedule for the years under consideration. The appeal was upheld and the additional assessments were set aside.

SARS is currently appealing the judgment directly to the Supreme Court of Appeal.

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