



DAVEY'S Locker



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Multiple-trust structures

A capital gains tax pitfall

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I am not a fan of multiple discretionary trusts in a pyramid structure. Although I concede that there are circumstances in which such structures can ring-fence trust assets, generally speaking, a well-drafted, single discretionary trust will suffice. In fact, a danger of the multiple-discretionary-trust structure is SARS's approach to the CGT implications.

Conduit principle

The effective rate of CGT for natural persons is 6,5 to 13,3%, while a trust's effective rate is 26,7%.

Nevertheless, courtesy of para 80(2) of the Eighth Schedule to the Income Tax Act, a capital gain realized by a trust may be attributed to a beneficiary who is a natural person. In other words, the conduit principle results in the application of the lower rate relevant to natural persons.

CGT pitfall

The SARS interpretation (as evidenced by *Comprehensive Guide to Capital Gains Tax—Issue 4*) is such that, within a multiple-trust structure, a second attribution is not recognized for CGT purposes. To quote:

Example—Consecutive vesting of capital gain by multiple trusts

Facts:

Trust B is a beneficiary of Trust A and Walter is a beneficiary of Trust B. Trust A and Trust B are discretionary trusts.

Trust A disposes of an asset in year 1 resulting in a capital gain which the trustee vests in Trust B in the same year of assessment. The trustee of Trust B then vests the same capital gain in Walter in year 1. All parties are residents.

Result:

Under paragraph 80(2) the capital gain must be disregarded by Trust A and accounted for by Trust B. The attributed gain in Trust B is not one that arises from the disposal of an asset by Trust B. It cannot therefore be on-attributed to Walter.

A band-aid CGT solution would be to add the ultimate natural person beneficiaries to all the trusts in the structure, thereby ensuring the ability to attribute such gains directly.

[This topic, of a 'dead trust bounce', was also covered in 54 *TSH* 2007, 63 *TSH* 2008 and 79 *TSH* 2009.—Ed]

