



**15 November 2022**

**7.2022**

**Editors Note:**

In this seventh newsletter for 2022 we consider the following:

C.SARS v The Thistle Trust Judgement – CGT downside for multiple trust structures

First Tax Ombud's Term of Office Expires

SARS BCR 080 Revisited: Foreign Pension Trust and Estate Duty

SARS vs Airports Company (SA) – SCA confirms Objection Grounds amendments limitations

Two-Pot Retirement System & Tax - Update

SARS Interpretation Notes (INs), Draft INs, Guides, BCRs, BPRs Noter-Up

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**C: SARS v THE THISTLE TRUST – THE SCA CONFIRMS THAT  
CAPITAL GAINS CANNOT FLOW THROUGH MULTIPLE  
DISCRETIONARY TRUSTS**

The question whether a capital gain can flow through multiple discretionary trusts has finally been settled by the Supreme Court of Appeal (SCA).

Why is this important? Assume discretionary Trust 1 sells an asset, realises a capital gain of R100 and vests it in discretionary Trust 2 in the same tax year. Trust 2 vests the

R100 in John, one of its beneficiaries, in the same tax year. John is on the maximum marginal rate of 45%. If the gain could flow to John, he would pay tax of R18 ( $R100 \times 40\%$  inclusion rate  $\times 45\%$  marginal tax rate) (ignoring the annual exclusion of R40 000). But if the gain could travel only as far as Trust 2, it would be taxed at an effective rate of 36% (80% inclusion rate)  $\times$  45% flat rate) and the tax would be R36.

The facts of *C: SARS v The Thistle Trust* Case No. 516/2021 7 November 2022 were that 10 vesting trusts, collectively the 'Zenprop Group', carried on business as property owners and developers. In the 2014 to 2016 years of assessment, these 'tier 1' trusts disposed of capital assets which gave rise to capital gains which vested in The Thistle Trust in the same year of assessment. The Thistle Trust in turn vested the capital gains in its natural person beneficiaries in the same year of assessment, and they declared the capital gains. SARS raised additional assessments for the years in question on the Thistle Trust as well as an understatement penalty of 50% plus *s 89quat* interest. In the tax court (ITC 1941 (2021) 83 SATC 387 (G)) Wright J found in favour of the taxpayer, holding that the capital gains were correctly taxed in the hands of the natural person beneficiaries of the Thistle Trust under *s 25B*, para 80(2) and the conduit principle.

On appeal, the SCA held that *s 25B* did not apply because the Eighth Schedule had a self-contained rule for dealing with capital gains in the form of para 80(2). Paragraph 80(2) required the capital gains to be disregarded by the tier 1 trusts and to be taken into account by the Thistle Trust. What was vested in the natural person beneficiaries of the Thistle Trust was simply a sum of money that did not give rise to a capital gain capable of attribution. The conduit-pipe principle formulated in the *Armstrong* and *Rosen* cases found no application.

The lesson to be taken from the case is that multiple discretionary trust structures are CGT inefficient because they prevent gains from being taxed in the hands of natural person beneficiaries at the lower 0% to 18% CGT effective rate, and result in the capital gains being taxed in the tier 2 trust at 36%.

By implication, the case also puts paid to the argument that capital gains can be distributed to non-resident beneficiaries by resident trusts through the conduit principle.

It would be interesting to know whether the assessments of the natural person beneficiaries will be reduced or whether they have prescribed.

The taxpayer at least enjoyed success in one area. The court found that it was not liable for the understatement penalty of 50% because it had relied on a legal opinion. But the trust still had to pay the interest on the underpayment of provisional tax.

### **FIRST TAX OMBUD'S TERM OF OFFICE EXPIRES**

The first Tax Ombud, Judge BM Mgoepe, whose third term of office has now expired, will be temporarily replaced by Professor T Lejwail, who is currently the CEO at the Tax Ombud Office. Achievements of the first Tax Ombud included an automated complaints management system, systematic investigations, for example, SARS delayed refunds and a compilation albeit unenforceable, of a Report on Taxpayer's Rights, Entitlements and Obligations.

The Ombud also strived for financial independence from SARS in order to strengthen the Tax Ombud's Office in achieving good governance in its oversight role and this is currently being considered by Parliament's finance committee.

### **SARS BCR 080, REVISITED: ESTATE DUTY**

In Davey's Locker 15 September (6.2022) we addressed SARS Binding Class Ruling (BCR) 080 dated 12 August 2022 pertaining to a specific foreign pension trust (FPT) structure. Simply put, SARS BCR states that this specific FPT has none of the purported favourable tax attributes including no effective estate duty exemption. This article focuses on the purported estate duty exemption.

The rate of estate duty and donations tax is 20% for dutiable estate amounts of R30 million or less and increases to 25% for dutiable estate amounts over R30 million.

Section 3(2)(i) of the Estate Duty Act exempts from estate duty –

“so much of any benefit which is due and payable by, or in consequence of membership or past membership of, any pension fund, pension preservation fund, provident fund,

provident preservation fund or retirement annuity fund as defined in the Income Tax Act, 1962 (Act No. 58 of 1962), on or as a result of the death of the deceased.”

The above exemption specifically cross-references to the various retirement funds as defined in the Income Tax Act. The Income Tax Act, in turn refers to a fund – “which is approved by the Commissioner (my underlining) in respect of the year of assessment in question and, in the case of any such fund established on or after 1 July 1986, is registered under the provisions of the Pension funds Act.”

It is common cause that a foreign retirement fund would not be approved by SARS, which has jurisdiction only over approved RSA funds, and thus foreign funds do not fall within the definitions of the various retirement funds referred to in the Estate Duty exemption.

Our view is in accordance with SARS BCR, which although not fully furnishing its rationale, rules as follows under para 7:

- ‘(a) The FPT is not a “pension fund”, “provident fund” or “retirement annuity fund” as defined in section 1(1).’
  
- ‘(g) When an Investor dies prior to normal retirement date, the vested personal right will constitute “property” in terms of section 3 of the Estate Duty Act. The right will form part of the deceased Investor’s dutiable estate.’
  
- ‘(j) On the death of an Investor after normal retirement date, the right to an annuity will constitute “property” as defined in paragraph (b) of the definition of “property” in section 3 of the Estate Duty Act. The right to an annuity will fall within the dutiable estate of the deceased Investor.’

The only other rationale for an estate duty exemption, in our view, would be that the monies invested and housed in the FPT, belong to such foreign trust, not the RSA resident investor, and thus are not ‘property’ as defined in the Estate Duty Act, and hence are not dutiable.

SARS BCR rules as follows under para 7:

'(c) A contribution made by an Investor will not constitute a "donation" as defined in section 55. Sections 54 and 58(1) will not apply to Investors in respect of contributions made to the FPT.'

'(d) An Investor will, upon becoming a beneficiary/member of the FPT, acquire a personal right against the trustees of the FPT to administer the trust appropriately, and a vested personal right to the income and capital of the FPT (my underlining), subject to the time-based restrictions stipulated in the scheme rules.'

Thus, SARS BCR finding, as we interpret it, is that given that there is a vested right, this constitutes 'property' for purposes of the Estate Duty Act and hence is dutiable.

Since SARS issue of this BCR, FPT promoters of other FPT structures, have sought to differentiate their structures primarily on the basis that the RSA resident investor does not acquire any vested right to the foreign trust fund monies. Thus, they argue that no attribution of income/capital gains arise, nor is the trust fund 'property' for estate duty purposes as ownership vests with the trustees of the non-resident trust.

Binary logic however, suggests to us that if this is indeed the position that the RSA resident investor has divested himself/herself from the invested monies, then surely this *prima facie* constitutes firstly, an immediate donation to the FPT subject to donations tax and secondly, the attribution of income/capital gains still arise?

More of this in our next Newsletter in which we shall, *inter alia*, consider the limitations of the *Welch* SCA case, pertaining to estate planning and donations tax in the context of FPTs.

**SARS VS AIRPORTS COMPANY (SA) (2022 ZASCA, 132)**  
**– SCA CONFIRMS OBJECTION GROUNDS AMENDMENTS LIMITATIONS**

The substance of the SCA appeal by SARS is whether it is permissible to amend Grounds of Objection against an additional assessment after the expiry of the time periods prescribed in the Tax Administration Act (TAA) and Tax Court Rules. (SARS had refused to allow such objection on the basis that S104 of the TAA read with rule 7 of the Tax Court Rules on time limitations, precluded such).

The Tax Court held that the taxpayer is permitted under Tax Court, rule 42(1) read with Uniform Rules of Court rule 28 to amend its objection.

On Appeal, the SCA held at paragraphs 23 and 24 of the judgement that –  
‘The effect of the amendment sought by the taxpayer will be to extend the period for the filing of an objection (or the filing of new grounds of objection) long after the peremptory periods prescribed in section 104 of the TAA, read with rule 7, have expired. The prescribed time periods provided for in the TAA, read with rule 7, taken together with the ability of a taxpayer to secure an extension of time within the permitted parameters, achieves a fair balance between SARS and the taxpayer. To permit amendments to an objection would unjustifiably undermine the principles of certainty and finality referred to in *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd and Others*, which underpin a revenue authority’s duty to collect taxes.

It would also permit the taxpayer to impermissibly introduce new grounds of objection to the additional assessment.’

The critical lesson here is that a taxpayer is bound by both the contents of an Objection and the time periods, unless an extension is timeously requested for the latter. The contents (grounds) for an Objection thus circumscribe any Appeal grounds and although an Appeal can amplify and augment the Objection, the taxpayer cannot introduce any additional new grounds.

Thus, it is critical that a taxpayer, at the inception of a dispute, obtains advice and correctly drafts the Grounds of Objection, as there is no *post facto* remedy.

## **TWO-POT RETIREMENT SYSTEM & TAX - UPDATE**

Three subsequent proposals since our Newsletter 6.2022, as per Treasury’s presentation to Parliament’s standing committee on finance on 20 September 2022, are–

The Revenue Laws Amendment Bill draft legislation for public comment which proposes a so-termed 'two-pot retirement system', will be effective 1 March 2024, previously 2023.

The section 11F tax-deductible contributions are limited to 27,5% of taxable income with a maximum of R350 000 per tax year. Any excess contributions (which can be carried forward for deduction in a subsequent tax year) could in terms of the original proposal be allocated only to the 'retirement' pot. These excess contributions can now be allocated to either the 'retirement' or 'savings' pots.

A portion of a members' accumulated retirement fund benefit as at 1 March 2024 may be transferred to the savings pot and hence be accessible, subject to further negotiations, taking into account retirement fund liquidity issues.

### INTERPRETATION NOTES

Date of issue	IN	Tax	Section	Description
14.11.2022	125	IT	30B(2)(b)(ix)	Associations: Funding requirement
29.09.2022	124	IT	Paragraph 3(c) in Part I of the Ninth Schedule	Public benefit organisations: Provision of residential care for retired persons
26.09.2022	123	It	8E	Effect on the date of issue of a share arising from a change in the redemption features
22.09.2022	22 (Issue 5)	TD	9(1)© and (1A)	Transfer Duty Exemption: Public Benefit Organisations and Statutory Bodies

#### Draft Interpretation Notes

Date of issue	IN	Tax	Section	Description
31.10.2022	-	IT	12Q	Exemption of income relating to South African ships used in international shipping
14.10.2022	-	IT	31	Definition of 'associated enterprise'
13.09.2022	112 (Issue 2)	IT	18A	Audit certificate

**DRAFT BINDING GENERAL RULINGS**

Date of issue	BGR	Tax	Section	Description
04.11.2022	-	VAT		Value-Added Tax treatment of rounding difference in cash transactions

**BINDING PRIVATE RULINGS**

Date of issue	BPR	Tax	Section	Description
31.10.2022	386	IT	1(1) – Definition of ‘connected person’, 54, 58(1) and PARA 38 of the Eighth Schedule	Share disposal between two employee share incentive trusts
31.10.2022	385	IT	1(1) – Definition of “gross income”, 8E, 8EA, 10(1)(Kk)(i), 24J(1) – Definition of “instrument”, 54, 58, 64F(1)(a), 64G(2) and paras 19, 20(1)(a), 38, 39, 43A AND 80(2) of the Eighth Schedule	Use of preference share proceeds to fund employee share ownership plan
28.10.2022	384	IT	54, 55 and paras 38 and 39 of Eighth Schedule	Cession to special trust of the beneficiary’s loan
27.10.2022	383	IT	9D(2A) and (9)	Transfer of profits for group tax purposes between controlled foreign companies
05.10.2022	382	IT	6quat and paras 2 and 35 of Eighth Schedule	Rebate in respect of foreign taxes
04.10.2022	381	STT	1, 2(1) and 8(1)(q)	Beneficial ownership in respect of back-to-back share transfers
04.10.2022	380	IT/STT	9D, 64E, paras 38, 39 and 76B of Eighth Schedule 1, 2(1), 6(2) and 7(2)	Transfer of shares in resident company to non-resident holding company
03.10.2022	379	IT	8E and 8EA	Qualifying purpose
15.09.2022	378	IT/STT	9C, 42 and para 61(3) of Eighth Schedule 8(1)(a)(i)	Transfer of listed financial instruments to collective investment schemes in exchange for participatory interests

**BINDING CLASS RULINGS**

Date of issue	BCR	Tax	Section	Description
31.10.2022	083	IT	46 and paragraphs 75 and 31(1)(a) of Eighth Schedule	Simultaneous unbundling of shares held in more than one listed company
27.10.2022	082	IT	8(4)(a), 11(a), 23(c), 23(g), 23H AND 23L	Deductibility of mining rehabilitation +insurance
08.09.2022	081	IT	8E and 8EA	Hybrid Equity Interest or Third-Party Backed Share
12.08.2022	080	IT	1(1) – Definitions of ‘gross income’, ‘pension fund’, ‘provident fund’, ‘retirement annuity fund’ AND ‘trust’, 7(1), 9HA, 11F, 25B, 54, 55 – definitions of ‘donation’ and ‘property’, 58 and PARAs 1 – Definition of ‘asset’, 20(1), 35(1), 54, 80 and 81 of the Eighth Schedule to the ITA; section 3 of the Estate Duty Act	Tax Implications for Resident Beneficiaries of a Foreign Pension Trust

**GUIDES**

Date	Description
18.10.2022	Tax Guide for Share Owners (Issue 8)
17.10.2022	VAT Quick Reference Guide for Non-Executive Directors (Issue 3)
05.10.2022	Tax Guide for Small Businesses (2021/2022)
22.09.2022	Taxation in South Africa 2022

**Draft guides**

Date	Description
22.09.2022	Draft Guide on the Taxation of Farming Operations