Trusts play important role and are here to stay

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LAW MATTERS

THE Davis Tax Committee report on estate duty includes recommendations regarding the taxation of trusts. Trusts are creatures both of statute and common law and have developed over many decades.

Trusts have various uses including protection of assets from creditors, continuity of ownership on death of the estate planner, preservation of wealth, control of financial support for descendants and tax efficiency.

In respect of income and capital gains, trusts are taxed at the rate of 41% for income and effectively 27.3% on capital gains. If the deed allows it, trustees can distribute income and capital gains to beneficiaries who will enjoy a lower marginal tax rate.

One of the far-reaching proposals by the Davis Commission is that this discretion, referred to as the "conduit principle", should not be used to lower the rate at which trusts would be taxed. This would have far-reaching effects. It will greatly affect beneficiaries and persons who have established trusts for their retirement planning. The Davis Commission's view is that trusts are used to avoid estate duty and this prejudices the government in its collection of taxes.

There are other uses for trusts, for example, employee share ownership and Broad Based Black Economic Empowerment. The financial services industry also uses trusts to separate a fund vehicle from the beneficiaries of a fund. The Commission proposes that interest free loans to trusts are being abused and under scrutiny. It also recommends that distributions from foreign trusts be taxed as income, even if the offshore trust is distributing capital and not income. The Commission has overacted with regard to the potential loss to the fiscus with regard to the taxation of trusts. The Income Tax Act No 58 of 1962 already contains provisions in Section 7 which allow Sars to enforce compliance when it comes to avoidance of tax, particularly with regard to family income splitting and using trusts to do so. The newly published trust income tax return assists greatly in this regard, but it seems that Sars is not enforcing the powers it has under the Act.

If one has an existing trust, now is not the time to panic and terminate it. Time will tell whether these recommendations will be implemented. Perhaps the Minister of Finance will enlighten us in the Budget speech. Even if an announcement is made, it remains to be seen exactly what the changes will be. It is therefore prudent to obtain professional advice before making decisions. Trusts are here to stay and will continue to play an important role in the economic life of the country and should not be discarded before careful analysis and planning.

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