Call for review of foreign trusts bill

By Hanna Ziady

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Proposals contained in a draft bill to change the tax treatment of foreign trusts held by South Africans are aggressive and should be reconsidered, says Andrew Wellsted, director at Norton Rose Fulbright.

"The continued attack on trusts by the revenue authority is disappointing because they serve a useful commercial purpose and are not solely used as tax-avoidance structures," Wellsted said this week.

Trusts could ring-fence assets owned by entrepreneurs so that creditors could not attach them or protect assets for children not old enough to manage their parents' estates in the event of death, he said.

Revenue authorities globally are scrutinising trusts, which are perceived as tax-avoidance vehicles. The Davis Tax Committee, an advisory panel to the Treasury chaired by Judge Dennis Davis, has proposed that the South African Revenue Service establish an investigations unit to examine foreign discretionary trusts.

Johan van Zyl, partner and CEO in SA of international family office Stonehage Fleming, said trusts were becoming less popular because tax benefits had been eroded over time.

In respect of foreign trusts that house their assets in foreign companies, the Draft Taxation Laws Amendment Bill has proposed to treat the companies as controlled foreign companies. This would mean income earned by these companies would be taxable in the hands of resident beneficiaries.

A second proposed amendment would subject all distributions made to local beneficiaries by these types of trusts to income tax. This could result in double taxation of trust income, said Wellsted.

Currently, distributions from foreign trusts were taxed according to their nature, which was more equitable, he said.

A further proposed change seeks to address the tax-free transfer of wealth to trusts by tightening a loophole in section 7(c) of the Income Tax Act.

Section 7(c) was introduced to penalise individuals making interest-free loans to trusts of which they were beneficiaries, said Tertius Troost, tax consultant at Mazars. The provision treats the difference between the interest charged on the loan and the official rate of interest for trusts - 7.75% a year - as a donation, subject to donations tax.

To avoid paying this tax, individuals would shift the investments originally held by the trust to a company of which the trust was a shareholder, said Troost.

The Treasury has now proposed that section 7(c) should also apply to loans made to companies held by trusts.

This would hurt entrepreneurs, who commonly loaned interest-free funds to a newly established company held in a trust to keep it outside that person's estate, said Troost.

Trusts would need to be independently evaluated to determine what action should be taken to deal with the implications of the amendment, said Elana Nel, senior associate in tax advisory at Stonehage Fleming.

Aggressive first-draft proposals were often eased in the second draft, said Wellsted.

Source: Business Day