

## WHO IS TAXED WHEN A TRUST DISTRIBUTES GAIN TO BENEFICIARIES

### CSARS v The Thistle Trust (516/2021) [2022] ZASCA 153 (7 November 2022)

*A group of trusts, conducting business under a single umbrella, disposed of capital assets and then distributed the capital gains to, amongst others, Trust X. The latter Trust distributed the amounts it received to its beneficiaries and treated this distribution as taxable in the hands of its beneficiaries.*

*A dispute arose with SARS as to whether Trust X's disposition to its beneficiaries was to be assessed under section 25B of the Income Tax Act, or in terms of paragraph 80 of the Schedule to the Act. The relevance is that section 25B applies to the taxation of income that accrued to a trust or its beneficiaries, while paragraph 80 applied to the taxation of capital gains that accrue to trusts or their beneficiaries. In this instance, the Court held that paragraph 80 applied and that the capital gains accrued upon the disposal to Trust X, are to be taxed in the hands of Trust X, not its beneficiaries.*

The Judgment can be viewed [here](#).

### FACTS

The Thistle Trust is a beneficiary of various trusts that comprised the Zenprop Group. These trusts, referred to as Tier 1 Trusts, comprised a group of 10 vesting trusts that conduct the business of the Zenprop Group, a group of property owners and developers.

In the 2014, 2015 and 2016 tax periods, the Tier 1 Trusts disposed of certain capital assets. The capital gains so realised were distributed, amongst others, to the Thistle Trust in the same tax period. The Thistle Trust, in turn and in the same tax periods, distributed the amounts it received to its beneficiaries. It treated the proceeds received as taxable in the hands of its beneficiaries.

In September 2018, SARS raised an additional assessment in respect of the Thistle Trust for the periods 2014, 2015 and 2016, taxing the amounts received by the Thistle Trust as taxable in its hands. SARS also imposed an understatement penalty against the Thistle Trust and required it to pay interest on the assessed liability.

The Thistle Trust filed an objection to the additional assessment. It argued that, having regard to the provisions of the Income tax Act, the Thistle Trust did not derive a taxable income in this instance and that the gains were properly taxable in the hands of the beneficiaries. SARS disallowed the objection.

In March 2021, the Thistle Trust appealed to the tax court. The tax court found that the vesting trusts (i.e. the Tier 1 Trusts) had disposed of capital assets and made capital gains. It held that the capital gains distributed to the Thistle Trust and subsequently passed on to its beneficiaries, constituted 'amounts' that fell within the purview of sections 25B(1), 25B(2), and paragraph 80(2) of the Eighth Schedule of the Income Tax Act. Accordingly, the distribution to the beneficiaries of the Thistle Trust was a distribution of capital gains taxable in the hands of its beneficiaries. The tax court, therefore, set aside the additional assessments.

SARS appealed to the Supreme Court of Appeal.

### HELD

- Two issues arose in this matter: The first is whether the capital gains accrued (as a result of the disposal of capital assets by the Tier 1 Trusts) were taxable in the hands of the Thistle Trust or in the hands of its

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beneficiaries to whom those gains were distributed. SARS argued that para 80(2) applied exclusively, so that when the Thistle Trust distributed the amount it received to its beneficiaries without determining a capital gain in respect of the disposal of a capital asset as required by para 80(2), as far as the beneficiaries of the Thistle Trust were concerned, para 80(2) did not apply. The Thistle Trust argued that the 'conduit-pipe principle' applied since it was no more than a conduit for the gain that flowed through it, and it accordingly was not subject to be taxed on the gain.

- The second concerned the imposition of an understatement penalty. It arises conditionally in the event that it is found that the gains are taxable in the hands of the Thistle Trust. In that event, the question is whether the circumstances giving rise to the tax treatment by the Thistle Trust of the further distribution to its beneficiaries, warrants the imposition of an understatement penalty.

### ***The first issue: In whose hands must the disposition be taxed?***

#### ***The law***

- Section 25B of the Income Tax Act 58 provides that '(a)ny amount . . . received by or accrued to . . . any person during any year of assessment . . . as the trustee of a trust, shall . . . to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.
- Para 80 (2) of schedule 8 to the Income Tax Act provides for the determination of a capital gain attributed to a trust beneficiary, and provides that a trust must 'determine a capital gain in respect of the disposal of an asset in a year of assessment during which a beneficiary of that trust . . . has a vested right or acquires a vested right . . . to an amount derived from that capital gain . . . equal to so much of the amount to which that beneficiary of that trust is entitled in terms of that right'. Such amount must 'be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust' and 'be taken into account as a capital gain . . . of that beneficiary'.

#### ***The law applied***

- When the provisions are read as a whole and in context, it was apparent that the legislature intended that section 25B be applied to the taxation of income that accrues to a trust or its beneficiaries, while schedule 8 was to be applied to the taxation of capital gains that accrue to trusts or their beneficiaries.
- The tax court accordingly erred in finding that section 25B applied in this instance.
- Paragraph 80 (2) of the schedule, properly interpreted and applied, requires that the capital gains accrued upon the disposal of assets by the Tier 1 Trusts are to be taxed in the hands of the Thistle Trust and not its beneficiaries to whom it distributed those gains. In the circumstances, SARS was correct to raise the additional assessment for the relevant tax periods.
- In addition, the facts of this case do not support the application of the 'conduit pipe principle'. The Tier 1 Trusts vested the capital gains in the Thistle Trust which accordingly held a vested right therein. The distribution to it of the accrued gains resulted in it receiving those gains as of right. The Thistle Trust did not dispose of any capital asset nor determine a capital gain that was distributed to its beneficiaries. Instead, it distributed monies that vested in it as of right. In these circumstances, the 'conduit principle' did not apply.

### ***The second issue: Was the imposition of an understatement penalty warranted?***

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- Thistle Trust's error was a *bona fide* and inadvertent error as it had believed that section 25B was applicable to its case. Though the Thistle Trust erred, it did so in good faith and acted unintentionally.

## CONCLUSION

In the circumstances, it was conceded that SARS was not entitled to levy the understatement penalty.