

TAX

Changes to the tax treatment of trust income awarded to foreign beneficiaries on the horizon

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Currently, income that arises in a South African trust which is awarded to a foreign beneficiary during the same tax year is disregarded in the South African trust. It is being proposed that such income be taxed in the hands of the South African trust, even if awarded to a foreign beneficiary during the same tax year.

Current Legal Position

Currently, income that arises in a South African trust and that is awarded to a trust beneficiary during the same tax year in which the income arose is not taxed in the trust, but in the hands of the beneficiary, irrespective of whether the trust beneficiary is a South African tax resident or a non-South African tax resident.

This contrasts with SARS's view of the tax treatment of capital gains that are derived by a South African trust, and which are awarded to a trust beneficiary during the same tax year. According to SARS in Annexure C of the 2023 Budget Review, if a capital gain is awarded to a trust beneficiary, the gain will only flow through to, and be taxable in the hands of, that beneficiary if the beneficiary is a South African tax resident. Where the trust beneficiary is a non-South African tax resident, the capital gain will be "trapped", and SARS will seek to tax the gain in the hands of the South African trust. This view of SARS has been challenged and the jury is still out on the correct position. Should the SARS view prevail, capital gains awarded to foreign beneficiaries are subject to a tax rate of 36%, compared to capital gains awarded to South African tax resident beneficiaries who are natural persons and who are subject to tax at a maximum rate of 18%.

Proposed Amendments

National Treasury has grown concerned with the perceived different tax treatment of income amounts and capital gains awarded to foreign beneficiaries.

National Treasury in Annexure C of the Budget Review states that *"the [flow-through] of amounts from South African tax resident trusts to non-resident beneficiaries makes it difficult for SARS to collect income tax from those non-resident beneficiaries as it is more complicated to enforce recovery actions against non-residents."*

Consequently, it is proposed that the provisions relating to income be aligned with those applicable to capital gains (as interpreted by SARS) so that income that is awarded to a South African tax resident beneficiary in the same tax year will continue to be taxable in the beneficiary's hands on the flow-through basis, but that any income that is awarded to a foreign beneficiary will be "trapped", and taxed, in the hands of the South African trust.

The effect of the proposed amendment would be that any income that accrues to or is received by a South African trust, and that is awarded to a foreign beneficiary during the same tax year will be taxed in the hands of the South African trust at a flat rate of 45%.

The potential implications of the proposed amendment will be far-reaching for South African tax resident trusts and their foreign beneficiaries, and the impact thereof will have to be considered in more detail once the final legislation has been introduced in future legislative cycles. Considering National Treasury's rationale for the proposal, in our view, the proposed amendment is drastic, especially since

the foreign beneficiary may be subject to tax in the foreign jurisdiction where he or she is tax resident, without the benefit of a foreign tax credit for the tax paid by the South African trust.

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