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The application of the reportable arrangement provisions to contributions to offshore discretionary trusts

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Offshore discretionary trusts

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The reportable arrangement provisions in Part B of Chapter 4 of the Tax Administration Act, No 28 of 2011 ("**TAA**") contain mandatory disclosure rules that require taxpayers to report certain arrangements to the South African Revenue Service ("**SARS**") on an upfront basis to enable it to investigate such arrangements for possible tax avoidance purposes.

Arrangements falling within the ambit of these provisions should be reported by the "participants" thereto within 45 business days of them being entered into. A "participant" includes the taxpayer, the person who is principally responsible for organizing, designing, selling, financing or managing the arrangement (referred to as the "promoter") and any other party to an arrangement that is listed in a public notice ("**Public Notice**").

It follows that a single reportable arrangement can have multiple participants, with each having its own individual reporting obligation. It is a common practice for participants to nominate a single party to do the reporting as the non-reporting parties are exempted from having to do so if they obtain a written statement from the reporting party confirming that it reported the reportable arrangement to SARS.

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Participants who fail to report their reportable arrangements to SARS within the 45 business days are subject to hefty penalties which recur on a monthly basis for each month that the failure continues, for up to 12 months. The penalty is R50,000 per month for the taxpayer and R100,000 per month for the promoter, and it is doubled if the anticipated tax benefits flowing from the arrangement exceed R5 million and tripled if they exceed R10 million. Any other person who is a party to the arrangement listed in the Public Notice is only subject to a once-off penalty of R50,000 in the event of such person's failure to report the arrangement within the 45 business days.

This article is concerned solely with paragraph 2.3 of the Public Notice which lists the following as a reportable arrangement:

> *"An arrangement in terms of which-*
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> *(a) a person that is a resident makes any contribution or payment on or after 16 March 2015 to a trust that is not a resident* ***and has or acquires a beneficial interest in that trust****; and*
>
> *(b) the amount of* ***all*** *contributions or payments, whether made before or after 16 March 2015,* ***or*** *the value of* ***that*** *interest exceeds or is reasonably expected to exceed R10 million …" (emphasis added)*

Paragraph 2.3 of the Public Notice

Broken down into its individual components, paragraph 2.3 of the Public Notice has the following requirements, all of which should be satisfied for a reporting obligation to arise:

1. A resident must make a "contribution" or "payment" on or after 16 March 2015 to a non-resident trust (it is considered that these terms envisage a settlement or donation, and would not include a loan);
2. The resident must have or obtains a "beneficial interest" in the trust; and
3. Either the amount of all contributions or payments made by the resident to the trust or the value of the resident's beneficial interest in the trust exceeds or is reasonably expected to exceed R10 million.

A question that frequently arises is exactly when a resident obtains a "beneficial interest" in a fully discretionary and irrevocable trust? The answer to this question is important as it dictates when the contributions to such trust should be reported under the reportable arrangement provisions.

It is well-settled that the beneficiaries of a fully discretionary and irrevocable trust only have contingent rights to the trust assets. A contingent right is merely a *spes* – a hope that might never be realised. Such beneficiaries merely have a personal right against the trustees to administer the trust in accordance with the trust deed. This right should be distinguished from a real right which is a right that is enforceable against all persons and is the badge of ownership.

Beneficial interest

South African case law on the meaning of "beneficial interest" can be found mainly in the context of estate duty disputes. These cases equate a beneficial interest to a vested right in property and hold that it does not include a beneficiary's contingent right to receive benefits from a trust or estate. In this regard, the following was held by Schreiner JA in *CIR and Others v Sive's Estate*:[1]

> *"**It is clear that what was held by A and ceases on his death must be a beneficial interest and not the merely legal or nominal interest held by a person occupying the position of an 'administrative peg'**. The Legislature was taxing the passing of or the succession to beneficial interests in property, not changes consequent upon the death of a person holding property as a trustee or similar representative.*
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> ***It is, I think, also clear that what is deemed to be property passing on death, and what is the subject of a succession on death, does not include a chance or hope that the deceased might have had of receiving an interest in property in circumstances which, though they might have arisen, did not in fact arise**. **Such a chance or hope is not an 'interest held' by the deceased within the meaning of the provisions that I have quoted** ...*
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> *In regard to the income, clause 45 has provisions of much the same shape as clause 44. The testator directs that the income shall belong to his children in equal shares and shall be paid over to them subject to certain provisions. **Again the child gets no vested right to any of the income of the residue unless and until he or she reaches a certain age or unless and until the administrators exercise their discretion in his or her favour.** Who will become entitled to the income is dependent upon the same kinds of uncertain events as those that govern the devolution of the capital. **No one holds any beneficial interest in anything coming from the residue of the estate unless and until one or more of the uncertainties is resolved in his favour**." (Emphasis added)*

The following remarks of Kubushi J in *M v M and Others*[2] are also instructive:

> *"[57] During the duration of the trial, I took the liberty to request counsel to provide me with authorities explaining the term 'beneficial interest'. Both counsel furnished me with judgments wherein the concept of beneficial interest was discussed in relation to trusts. Counsel informed me that even after diligent search, they did not come across a judgment where the term 'beneficial interest' was especially defined.*
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> *[58] I also could not find any judgment wherein the term 'beneficial interest' is defined. I looked up the term in the internet search engine in the Free Dictionary (Legal dictionary) by Farflex. The term is explained as: **'the right to receive benefits on assets held by another party'**; **'Beneficial interest in a trust is whereby one has vested interest in the trust assets'**; and 'A beneficiary of a trust has a beneficial interest in the trust property, the legal title of which is held by the trustee.' ..." (emphasis added)*

Even if one is to accept that a beneficiary's contingent right to the assets of a fully discretionary trust constitutes a "beneficial interest", it will still be impossible to value such right for purposes of determining whether the R10 million reporting threshold is exceeded. In this regard, in distinguishing between vested and contingent rights, the following was held in *ITC76*:[3]

> *"Vesting implied the transfer of dominium … A vested right was something substantial; something which could be measured in money; something which had a present value and could be attached.* ***A contingent interest was merely a spes – an expectation which might never be realised. From its very nature it could not have a definite present value****. In the income tax sense, therefore, a vested right was an accrued right." (Emphasis added)*

This bolsters the interpretation that a beneficiary's contingent right to a trust's assets does not fall within the ambit of paragraph 2.3 of the Public Notice as the notice clearly requires the taxpayer to value his or her "beneficial interest" in the trust. What is envisaged by the expression "beneficial interest" would, accordingly, seem to be a vested right to either the capital or the income of a trust, or both, for only in this situation is there anything that is capable of valuation.

Definition of "beneficiary" in section 1(1) of the Income Tax Act, No 58 of 1962

If the Commissioner had intended the position to be otherwise, he could have made this in the Public Notice by using appropriate language. For example, the definition of "beneficiary" in section 1(1) of the Income Tax Act, No 58 of 1962 ("Act") means "*in relation to a trust any person who has a vested or contingent interest in all or a portion of the receipts, accruals or the assets of that trust*" (emphasis added).

This definition clearly includes both vested and contingent interests in a trust. If it was the intention that contributions and payments to discretionary trusts should be reported, the provision should have arguably required a reporting obligation where any resident "beneficiary", as defined in section 1(1) of the Act, makes a contribution to a non-resident trust and the gross value of the trust's assets exceed or is reasonably likely to exceed R10 million. This he has not done, and the language used suggests the opposite.

It is understood that SARS equates the term "beneficial interest" with a "contingent right" and that, according to its interpretation, residents are required to report their contributions to fully discretionary and irrevocable non-resident trusts if the aggregate contributions and payments or value of the trust's assets exceed or is reasonably likely to exceed the R10 million threshold.

The views expressed in this article do, however, point in the opposite direction and resident beneficiaries of fully discretionary and irrevocable non-resident trusts should take note of these views should they ever be challenged by SARS for not reporting their trust contributions under the paragraph 2.3 of the Public Notice.

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[1] 1955 (1) SA 249 (A), 20 SATC 66 at 86 and 88. Also see *Colonel v CIR* 1938 TPD 530, 10 SATC 158.

[2] (559/2007) [2015] ZAGPPHC 66 (4 February 2015).

[3] 3 SATC 68(U) at 70.



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