

Trust Taxation and Non-Residents



In March 2023, we issued a Budget Snapshot dealing with this subject.

Treasury has now published draft legislation to bring about their budget proposal. For clarity, the term “non-resident” means a natural person or entity not resident in South Africa for tax purposes.

The use of South African tax resident trusts to award income to non-resident beneficiaries will need to be carefully reconsidered.

The draft legislation provides that even though such a trust awards taxable income to its non-resident beneficiary, it is the trust itself that will be taxed on such income. It is essential therefore that such awards take into account the tax payable by the trust before determining the amount of the award.

What this proposal does is to turn off for non-residents the “conduit principle” which has for many years existed in our tax system in regard to trusts. In other words, if a trust awards an amount of taxable income to a South African tax resident person (natural person or entity), such income is not taxed in the hands of the trust but instead, in the hands of the beneficiary at the rates of tax applicable to such beneficiary.

A few years ago, this principle ceased to apply in the case of capital gains awarded to a non-resident beneficiary. The effect is that such gains are taxed in the hands of the trust at the flat rate of 36% instead of at the beneficiary's rate which, if a natural person, would be not greater than 18%.

By extending this principle to all taxable income, the effect is as follows –

- Trust derives bank interest and awards such income to a non-resident. In the past, such income would be tax free as bank interest is exempt from tax in the hands of a non-resident taxpayer. In future, such income would be taxed in the hands of the trust itself at the flat rate of 45%.
- Same example as above, but the nature of the income is rent from a property owned by the trust. In the past, the award would not have been taxed in South Africa in the hands of the trust but in the hands of the non-resident beneficiary at the tax rate applicable to the beneficiary. If such beneficiary had no other South African taxable income and the award is say R100 000 and he is over 65 years old, there would have been no South African tax payable. His income would be below the tax threshold. In future, the tax in the hands of the trust would be R45 000.
- If the non-resident is taxed in his home country on income awards from a South African trust, would his home tax authority grant him a tax credit or tax relief for tax paid in South Africa on such income even though not paid in his name but in the name of the trust? The answer may be dependent on the terms of an applicable double tax treaty.

The viability of some trust structures with non-resident beneficiaries may need to be carefully re-examined if this draft legislation is promulgated without change.

These new rules are proposed to apply for trusts in respect of any years of assessment ending on or after 31 July 2023.

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