No wealth tax, but trustees beware

By Elzahne Henn

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Despite speculations that government has revived plans to introduce a wealth tax, the South African Revenue Service's (Sars) focus has instead shifted to compliance of wealthy taxpayers with complex financial structures as well as trusts.

Source: Supplied. Elzahne Henn, director and head of private clients at Mazars in South Africa.

Sars has made its intentions clear by re-establishing the High Wealth Individual (HWI) segment in 2021 to focus on the tax affairs of the wealthy, while strengthening its investigative capabilities.

In September 2022, Sars warned that it was increasing its focus on trusts following SARS' analysis of tax compliance by trusts and beneficiaries.

Through this process, Sars has identified significant non-compliance, in particular the number of beneficiaries of trusts that are not declaring distributions; and trusts not registered as taxpayers.

Various measures have been introduced to address these concerns, including the enhancement of the registration function.

Registration of beneficial owners

All trusts must be registered as taxpayers and file tax returns, but the registration function on Efiling for trusts has been challenging.

Sars is now addressing the issue through the online query functionality. The system was enhanced in February 2023 to allow for capturing beneficial owner's details to comply with the requirements of the Financial Action Task Force (FATF) - an intergovernmental organisation geared towards combating money laundering - for beneficial owner transparency. The aim is to record all beneficial owners of newly registered trusts.

Beneficial owner is not defined in our tax law, but per the guidance issued by Sars (and following international norms) the representative taxpayer of the trustee (main trustee) is required to record the information of the founder, trustees, donor (a person who donates assets, income, or any other property to the trust through a deed of donation or by any other means), protector and beneficiaries (person with a vested or contingent interest) on the online query system.

It should be noted that the ultimate beneficial owner will always be a natural person. Therefore, if the trust has legal entities as beneficial owners, the ultimate natural person that will benefit from the assets or income of a trust must be identified and the detail of the natural person must be disclosed.

Where the trust has more than 10 individuals (natural persons) as beneficial owners, an organogram must be uploaded.

The registration of beneficial owners' details is therefore far-reaching and requires an extensive recording of dates. The Sars system has effectively established an ultimate beneficial ownership (Ubo) register for trusts in South Africa similar to Ubo register requirements already in place in Europe.

Third party data reporting

Sars currently requires third-party declarations of taxpayer activity from banks, financial institutions, medical-aid schemes, attorneys, and estate agents. This declaration process ensures that the information relevant to the taxpayer is pre-populated on the taxpayer's annual income tax return.

The significant differences between distributions declared in the tax returns of beneficiaries, and trust distributions declared in the trust tax returns have initiated Sars' decision to introduce third-party data reporting by trustees. The first reporting date is still to be promulgated, but Sars has indicated that the first reporting date will be September 2023.

The objective is that third-party data will eventually be reported in auto-assessments of individuals who are beneficiaries, and will potentially be used to generate effective tax rates for employers who would then be able to withhold employee tax on trust distributions from individuals who are employees.

Stakeholders have raised concerns that the reporting of beneficial owner information and distributions to beneficiaries by way of the third-party declarations will place a huge administrative burden on the representative taxpayer of the Trust (the main trustee) and have significant cost implications.

Many of these taxpayers may not have the financial means to develop the systems or employ tax practitioners to enable this kind of data submission.

Budget proposal – distribution

Consistent with Sars' warning in September 2022 to focus on trusts, the Budget Review released on 22 February 2023 notes that government is concerned about the difference between the rules covering the normal tax treatment of income attributed to non-resident beneficiaries of trusts and the rules covering the tax treatment of capital gains in relation to non-resident beneficiaries.

Non-resident beneficiaries are treated differently to resident beneficiaries when capital gains are distributed. Capital gains distributed to South African tax resident beneficiaries (during the same year of assessment) are not subject to tax in the trust but are attributed to beneficiaries.

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22 Feb 2023

However, capital gains distributed to non-resident beneficiaries do not flow through to the beneficiaries and remain taxable in the trust and the trust is liable for the payment of the tax (currently at an effective rate of 36% compared to a maximum effective rate 18% when the capital gain is distributed to a resident beneficiary).

In contrast, for income distributions, the flow through principle applies irrespective of whether the beneficiary is a resident or non-resident beneficiary.

Sars is of the view that it is complicated to enforce recovery actions against non-residents. To address this, it is proposed that changes be made to align the rules governing the tax implications of income distributions to non-residents with the rules governing the tax implications of the distributions of capital gains.

It is important to understand that the trustees or the non-resident beneficiaries may also have a reporting obligation in the foreign jurisdiction where the beneficiary is resident.

Trustees must ensure that a proper assessment of beneficiaries is performed to understand and plan for any possible adverse South African and international tax consequences, should a distribution be made.

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