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INTERNATIONAL TAX CASE SUMMARY

THISTLE TRUST vs C.SARS

OCTOBER 2024

ACADEMY OF TAX LAW

PUBLISHING SERVICES

First Edition Published on 01 November 2024

Published by Academy Of Tax Law

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HEAD OF ACADEMICS

Welcome to the Academy of Tax Law's case and judgment summaries. These documents have been carefully curated to support professionals, students, and researchers navigating the complex landscape of international tax and transfer pricing. At the Academy, we understand that tax law is ever-evolving, with key rulings continuously shaping its practice.

Each summary you'll find here is designed to provide not just the facts, but the context and implications of pivotal legal decisions. These case summaries are created to serve as a valuable resource for legal teams, multinationals, revenue authorities, and academics, offering insights that go beyond the surface. Our goal is to ensure you remain informed and prepared, whether you are dealing with tax planning, dispute resolution, or risk management.

We believe that knowledge is the foundation of sound decision-making, and with these resources, we hope to empower you in your professional journey. As you delve into the analysis, remember that staying ahead in tax law requires not just understanding the rules but how to apply them in a dynamic, global environment.

Thank you for choosing the Academy of Tax Law as your partner in this ongoing learning experience.

Sincerely,
Dr. Daniel N Erasmus

PART 1

SUMMARY

JUDGEMENT SUMMARY

CASE OVERVIEW

Court:	Constitutional Court of South Africa
Case No:	CCT 337/22
Applicant:	The Thistle Trust
Defendant:	Commissioner for the South African Revenue Service
Judgment Date:	2 October 2024
Full Judgment:	https://academyoftaxlaw.com/document/the-thistle-trust-vs-c-south-african-revenue-service-judgment/
View Online:	https://academyoftaxlaw.com/conduit-principle-multi-tiered-trusts/

JUDGMENT SUMMARY

In the landmark case of The Thistle Trust v Commissioner for the South African Revenue Service, the Constitutional Court of South Africa was tasked with examining the application of the conduit principle in the taxation of trusts, particularly focusing on how capital gains are treated within a multi-tiered trust structure. The court assessed whether capital gains realized by Zenprop, a group of trusts engaged in property development, which were distributed to The Thistle Trust and then further distributed to individual beneficiaries, were taxable in the hands of Thistle or the ultimate beneficiaries.

The case revolved around sections 25B and 26A of the Income Tax Act 58 of 1962 and paragraph 80(2) of the Eighth Schedule. The Tax Court initially ruled in favor of Thistle, applying the conduit principle to conclude that capital gains should be taxed at the beneficiary level. However, the Supreme Court of Appeal (SCA) overturned this decision, stating that capital gains tax liability rested with Thistle, not the individual beneficiaries, based on the interpretation that paragraph 80(2) did not extend the conduit principle beyond the first-tier trust. SARS, having conducted an audit, argued that Thistle was liable for capital gains tax, as the distributed amounts were not passed further for tax purposes in the eyes of the law.

The Constitutional Court ultimately upheld the SCA's decision, agreeing that paragraph 80(2) of the Eighth Schedule limited the application of the conduit principle in multi-tiered structures. This meant that Thistle, as a direct beneficiary of Zenprop, could not pass capital gains tax liability further to individual beneficiaries. The court also found that the understatement penalties initially imposed by SARS should be waived, as the error was bona fide and inadvertent, as conceded by SARS during the appeal process.

KEY POINTS

OF THE JUDGMENT

BACKGROUND

The Thistle Trust is a registered inter vivos discretionary trust that received capital gains distributions from Zenprop, a group of property development trusts. In the tax years 2014 to 2016, Zenprop realized capital gains from the disposal of properties and distributed these gains to Thistle. Thistle, in turn, distributed the capital gains to its natural person beneficiaries, who declared and paid taxes on the gains. Relying on the common law conduit principle and legal advice, Thistle and Zenprop did not report these gains in their tax returns. However, during a tax audit, SARS contended that Thistle should be liable for the tax, as paragraph 80(2) did not allow the conduit principle to apply beyond the first-tier trust.

Subsequently, SARS issued additional tax assessments, including understatement penalties. Thistle objected, claiming that the capital gains were properly taxed in the hands of the ultimate beneficiaries, and that the imposition of penalties was unwarranted. The Tax Court sided with Thistle, but SARS appealed to the SCA, which reversed the decision, leading to Thistle seeking redress in the Constitutional Court.

KEY POINTS

OF THE JUDGMENT

CORE DISPUTE

The central issue was whether the capital gains distributed through a multi-tiered trust structure were subject to the conduit principle, thus shifting tax liability from Thistle to the ultimate beneficiaries. The key legal provisions under scrutiny were section 25B, which deals with income of trusts and beneficiaries, section 26A concerning the inclusion of capital gains in taxable income, and paragraph 80(2) of the Eighth Schedule, which addresses capital gains tax in trust structures. Thistle argued that the capital gains should be taxed in the hands of the beneficiaries, based on a broad application of the conduit principle. Conversely, SARS maintained that Thistle bore the tax liability, as the conduit principle did not extend beyond the first-tier trust.

KEY POINTS

OF THE JUDGMENT

COURT FINDINGS

The Constitutional Court found that paragraph 80(2) clearly limited the conduit principle's application, preventing it from being extended through multiple discretionary trusts. The court noted that the 2008 amendment to paragraph 80(2) specifically aimed to block the transfer of capital gains tax liability beyond the first beneficiary trust in a tiered structure. The justices emphasized that section 25B, though dealing with income distribution, did not override paragraph 80(2) when it came to capital gains. The court reasoned that, since Thistle did not directly dispose of any assets to generate the capital gains, it could not further pass on tax liability.

Furthermore, the court acknowledged SARS' argument that the interpretation of section 25B should be confined to non-capital income, as capital gains tax was introduced separately, and the wording in paragraph 80(2) provided a comprehensive framework for taxing such gains. Thus, the court upheld the SCA's decision that Thistle was liable for the capital gains tax. However, the court dismissed the understatement penalties, agreeing that Thistle had made a bona fide error.

KEY POINTS
OF THE JUDGMENT

OUTCOME

The Constitutional Court dismissed Thistle's appeal, confirming that the tax liability for the capital gains rested with The Thistle Trust. It ruled that the conduit principle could not apply beyond the first-tier trust in a multi-tiered trust structure, as articulated in paragraph 80(2) of the Eighth Schedule. As a result, Thistle was liable for the capital gains tax on amounts distributed to it by Zenprop for the tax years 2014 to 2016. The court emphasized that the amendment to paragraph 80(2) in 2008 was specifically designed to prevent trusts from avoiding tax liability through multiple tiers.

However, the court did not impose any costs on Thistle and waived the understatement penalties. This was because SARS conceded that Thistle's failure to declare the capital gains was a bona fide inadvertent error. The ruling thus clarified the legal position on the application of the conduit principle in multi-tiered trust structures, providing significant guidance on how capital gains should be treated for tax purposes.

PART 2

SIGNIFICANCE

MAJOR ISSUES

AREAS OF CONTENTION

The main points of contention included the proper interpretation and application of the conduit principle concerning capital gains in a multi-tiered trust structure and the retrospective application of amendments to section 25B. Thistle argued that the principle should allow for the transfer of tax liability to the ultimate beneficiaries, asserting that the nature of the gains should not change during distribution. SARS, however, maintained that paragraph 80(2) explicitly limited this transfer and that Thistle should be taxed on the capital gains.

Another contentious issue was whether section 25B, introduced before the concept of capital gains tax, should extend to capital gains or be restricted to ordinary income. Thistle contended that the phrase "any amount" in section 25B was broad enough to include capital gains, while SARS argued for a narrower interpretation. Additionally, the imposition of understatement penalties was disputed, with Thistle claiming good faith in its tax reporting, ultimately convincing the court to waive these penalties.

The interpretation of tax statutes and the limits of the conduit principle in South African law were central to the case, setting a precedent for future disputes involving complex trust structures.

EXPECTED
OR CONTROVERSIAL?

The decision was somewhat expected but also controversial due to the high stakes involved and the nuanced interpretation of tax laws. The controversy lay in the court's rejection of a long-standing application of the conduit principle, which trusts and tax practitioners had relied upon for structuring multi-tiered trust arrangements. The court's emphasis on the limitations imposed by paragraph 80(2) disrupted common tax planning strategies, leading to significant implications for the taxation of capital gains.

Moreover, the ruling was anticipated in light of the SCA's earlier judgment, which had already narrowed the scope of the conduit principle. Tax experts expected the Constitutional Court to uphold this interpretation, especially given the clear legislative intent behind the 2008 amendment to paragraph 80(2). However, some viewed the decision as controversial because it seemed to contradict the broader application of the conduit principle in other tax contexts, potentially complicating the tax landscape for trusts.

The waiver of understatement penalties, though more agreeable, also sparked debate. While it was a relief for Thistle, it raised questions about how SARS applies penalties, with critics arguing that the concession indicated inconsistencies in enforcement. Overall, the case's outcome underscored the complexity of tax law and the challenges of balancing legislative intent with established principles.

SIGNIFICANCE
FOR MULTINATIONALS

The judgment has substantial implications for multinationals that use trusts as part of their tax planning and asset management strategies. The court's decision to restrict the application of the conduit principle in multi-tiered trust structures highlights the need for multinationals to reassess their use of discretionary trusts. Trusts that are integral to holding and distributing capital gains may now be exposed to higher tax liabilities if they cannot pass these gains to lower-taxed beneficiaries.

Multinationals must also be wary of structuring trusts in a way that appears to contravene legislative amendments designed to curb tax avoidance. The ruling emphasizes that even established practices like the conduit principle are subject to statutory limitations. Therefore, multinational corporations need to consider the potential for legislative changes that could impact their tax liability and compliance obligations.

Additionally, the case highlights the importance of clear documentation and justification of tax positions, as the waiver of penalties hinged on proving a bona fide error. Multinationals must work closely with tax advisors to ensure that all tax planning structures are compliant and that any risk of understatement is mitigated.

SIGNIFICANCE

FOR REVENUE SERVICES

For revenue services, the ruling reinforces the authority to impose tax liability at the trust level, even in complex multi-tiered structures. This case sets a precedent that can be used to challenge trusts attempting to distribute capital gains to individual beneficiaries to minimize tax obligations. It highlights the importance of legislative amendments in addressing tax avoidance and provides SARS with a robust framework to counter similar tax structures.

The decision also emphasizes the necessity for revenue authorities to clarify tax statutes and ensure that amendments are effectively communicated to the taxpaying community. SARS's success in this case was partly due to the clear legislative intent behind the 2008 amendment, showcasing the value of proactive legislative updates to prevent tax avoidance. However, the case also underlines the need for fairness and consistency, as seen in the waiver of penalties due to a bona fide error.

This balance between enforcement and fairness may guide future audits and assessments, encouraging a more nuanced approach to penalties and taxpayer errors. It also sends a message to revenue services worldwide about the importance of monitoring trust structures and being vigilant against tax minimization schemes.

RELEVANT CASES

ARMSTRONG VS CIR (1938 AD 343)

In this case, the Appellate Division ruled that dividends distributed from a trust to a beneficiary retained their character as dividends and were not taxable income in the hands of the beneficiary. The judgment established the conduit principle in South African tax law, where a trust acts as a "conduit pipe" for income, ensuring it is taxed according to its nature. The court emphasized that the true beneficial owner of the income should bear the tax burden.

Relevance: This case serves as a foundational precedent for the conduit principle, which was a key point of contention in The Thistle Trust case.

SIR VS ROSEN (1971 (1) SA 172 (A))

The Appellate Division in Rosen expanded on the conduit principle, clarifying that it applied to trusts where income is distributed to beneficiaries. The court stated that the principle rested on "robust common sense" and aimed to ensure income retained its nature when distributed. However, the court also emphasized that this principle was subject to the specific provisions of tax statutes.

Relevance: The judgment in Rosen was cited in The Thistle Trust case to argue for the conduit principle, but the limitations imposed by paragraph 80(2) were ultimately upheld.

MILNERTON ESTATES VS C.SARS

The Supreme Court of Appeal ruled on the interpretation of the Eighth Schedule of the ITA, emphasizing that capital gains tax provisions were self-contained. The court held that the calculation and allocation of capital gains must adhere strictly to the Eighth Schedule's rules, independent of common law principles.

Relevance: This case supports the court's decision in The Thistle Trust, affirming that statutory provisions on capital gains tax take precedence over common law principles like the conduit principle.

PART 3

PREVENTION

ENGAGING EXPERTS

Engaging with tax lawyers is crucial for multinational enterprises (MNEs) to navigate the complex landscape of international tax compliance and minimize exposure to risks. Tax laws and regulations vary significantly across jurisdictions, and tax authorities are increasingly collaborating globally to enforce compliance. Tax lawyers provide MNEs with strategic guidance tailored to specific jurisdictions, ensuring that transactions and tax structures align with both local and international tax laws.

One of the primary advantages of consulting tax lawyers is their expertise in safeguarding sensitive information under legal professional privilege, especially in cross-border contexts. This confidentiality is essential for MNEs, as it allows open communication with legal counsel, protecting strategic tax planning discussions from disclosure to tax authorities. Tax lawyers are also well-versed in complex anti-avoidance laws, transfer pricing regulations, and disclosure obligations, which vary across jurisdictions but significantly impact MNEs.

Moreover, tax lawyers play a vital role in risk management, advising MNEs on compliance strategies and helping establish robust tax governance frameworks. With proactive legal advice, MNEs can adopt preventative measures—such as setting up a tax steering committee or implementing a tax risk management process—that help in identifying, managing, and mitigating tax risks before they escalate into costly disputes or reputational issues.

In an environment where global tax regulations are continually evolving, engaging tax lawyers allows MNEs to stay compliant and responsive to regulatory changes, reducing potential risks while upholding best practices in tax transparency and governance.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX RISK MANAGEMENT PROCESS

Implementing a comprehensive tax risk management process is essential to identify, assess, and mitigate tax risks associated with cross-border transactions. This process should involve:

- Regular reviews of intra-group transactions to ensure they have genuine economic substance.
- Proactive engagement with tax authorities to seek clarity on the application of anti-abuse rules.
- Thorough documentation of the business rationale for each transaction to support

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TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES

Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies" by Dr. Daniel N. Erasmus is a must-read for businesses seeking to navigate the intricate world of tax compliance and risk management. By highlighting common pitfalls and offering strategic solutions, Erasmus equips companies with the knowledge to improve their tax practices and secure financial stability.

https://support.academyoftaxlaw.com/product/tax-intelligence-by-prof-dr-daniel-n-erasmus/

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like the X BV case.

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DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE

The eBook "Driving Tax Compliance: The Essential Role of a Tax Steering Committee" by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

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