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Trust Taxation Reform in South Africa: Striking a Balance Between Tax Neutrality and Effective Compliance (Lessons from the United Kingdom and the United States of America)

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Declaration

I, Sanjiv Dhanpat, declare that this research report is my own, unaided work. It is being submitted for the degree of Master of Commerce (specialising in Taxation) at the University of Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination at any other university.

Signature of Candidate (Sanjiv Dhanpat)

......07. ......day of.... November 2024...........in……. Johannesburg.....................

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Abstract

South Africa's trust legislation revisions under the General Laws Amendment Act, 22 of 2022, intend to address international concerns highlighted by the Financial Action Task Force (FATF), most notably concerns affecting tax evasion and a lack of transparency around beneficial ownership. This research report examines trust legislative amendments, particularly the Trust Property Control Act (TPCA) 57 of 1988, as well as various other legislative acts in the trust sector.

This research report further provides a comparative assessment of South Africa's trust legislative amendments against legislative measures utilized in the United Kingdom and the United States of America. This comparison is relevant given the diverse but well-established frameworks for dealing with trusts within these jurisdictions. The objective of this comparison is to find similarities and significant variances in how each nation taxes and regulates trusts.

Aligned with the FATF's focus on addressing deficiencies in beneficial ownership transparency, this research report also examines the growing emphasis on beneficial ownership transparency from a worldwide context. In the broader context of this research, the comparison between the United Kingdom and the United States of America is relevant to highlight their regulatory procedures for ensuring tax neutrality and effective compliance in the trust landscape.

South Africa's amendments to the Trust Property Control Act (TPCA) aim to enhance transparency around beneficial ownership. However, administrative and enforcement challenges may affect the overall effectiveness of these reforms. This research, through comparative analysis of the United Kingdom's Trust Registration Service (TRS) and the United States' Corporate Transparency Act (CTA), provides valuable insights for improving trust oversight in South Africa. The findings suggest that while adopting similar measures could strengthen South Africa's regulatory framework, adequate resource allocation for enforcement and ensuring trustee compliance are essential for achieving effective regulation.

This research report contributes to the critical discussion on trust regulation mechanisms by analysing the delicate balance between overregulation and the need to implement appropriate safeguards against trust abuse.

Keywords: *Tax Neutrality, Base Erosion and Profit Shifting, Beneficial Ownership, Ultimate Ownership, Transparency, Impermissible Tax Avoidance, Tax Evasion, Registered Ownership*

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Abbreviations

Acronym	Meaning
AIT	Approval for International Transfers
AML	Anti-Money Laundering
BOT	Beneficial Ownership Transparency
CDD	Customer Due Diligence
CFT	Combating Financing of Terrorism
CIPC	Companies and Intellectual Property Commission
CJEU	Court of Justice of the European Union
CRS	Common Reporting Standard
CTA	Corporate Transparency Act
DNFBPs	Designated Non-Financial Businesses and Professions
DNI	Distributable Net Income
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FICA	Financial Intelligence Centre Act
FSRA	Financial Sector Regulation Act
IRC	Internal Revenue Code
IT3(t)	IT3 Trust Tax Certificate
ITA	Income Tax Act
MER	Mutual Evaluation Report
NPO	Nonprofit Organisations
OECD	Organisation for Economic Co-operation and Development
PBO	Public Beneficial Ownership
POPIA	Protection of Personal Information Act
SARB	South African Reserve Bank
SARS	South African Revenue Service
SDA	Single Discretionary Allowance
TAA	Tax Administration Act
TCS	Tax Compliance Status
TPCA	Trust Property Control Act
TRS	Trust Registration Service
UK	United Kingdom
USA	United States of America
USC	United States Code
UTC	Uniform Trust Code

Definitions of Key Terms

Tax Neutrality:

Tax neutrality refers to the principle that the tax system should not influence individuals' or businesses' economic decisions. In a tax-neutral environment, taxation does not favour one type of investment, business activity, or economic behaviour over another, allowing market forces to operate without distortion.

Base Erosion and Profit Shifting (BEPS):

Base Erosion and Profit Shifting (BEPS) encompasses tax planning strategies used by multinational enterprises to exploit gaps and mismatches in tax rules. These strategies artificially shift profits to low or no-tax jurisdictions, eroding the tax base of higher-tax countries.

Beneficial Ownership:

Beneficial ownership refers to the natural person(s) who ultimately own or control an entity or asset, even if the asset is legally held by another entity. The beneficial owner enjoys the benefits of ownership, such as profits, dividends, and decision-making authority.

Ultimate Ownership:

Ultimate ownership denotes the highest level of ownership or control over an asset or entity, typically representing the final individual(s) or entity that holds significant influence or decision-making power, regardless of intermediate layers of ownership.

Transparency:

Transparency in taxation and trust regulation refers to the clarity, openness, and accessibility of information related to financial transactions, ownership structures, and compliance with legal and regulatory requirements.

Impermissible Tax Avoidance:

Impermissible tax avoidance involves strategies and practices that, while not explicitly illegal, contravene the spirit and intent of tax laws. These practices exploit loopholes or ambiguities in tax legislation to significantly reduce tax liabilities in ways that are considered unethical or contrary to regulatory objectives.

Tax Evasion:

Tax evasion is the illegal act of deliberately misrepresenting or concealing information to reduce tax liabilities. This includes underreporting income, inflating deductions, hiding money and interest in offshore accounts, and other fraudulent activities.

Registered Ownership:

Registered ownership refers to the legal ownership of an asset as recorded in official registers or registries. The registered owner is the individual or entity listed in these records and holds the title to the asset.

Trust Transparency:

The openness and clarity with which information about trust operations, ownership, financial activities, and decision-making processes is disclosed to stakeholders, including regulators, beneficiaries, and the public.

Taxation Governance:

The frameworks, policies, and institutional mechanisms that govern the collection, administration, and enforcement of taxes within a jurisdiction. It involves the roles of governmental agencies, legislative bodies, and regulatory institutions in ensuring fair and efficient tax systems.

Regulatory Systems:

Structured sets of rules, standards, and enforcement mechanisms established by governmental and non-governmental bodies to oversee and control activities within specific sectors. These systems aim to ensure compliance, protect public interests, and promote ethical practices.

Effectiveness and Fairness:

- **Effectiveness:** The degree to which regulatory measures achieve their intended outcomes, such as compliance rates, reduction in illicit activities, and enhancement of transparency within the trust sector.
- **Fairness:** The equitable application of laws and regulations, ensuring that all stakeholders are treated justly without undue bias or discrimination.

Trust Sector:

Entities and professionals involved in the creation, management, and administration of trusts. This also includes trust companies, trustees, legal advisors, financial planners, and other stakeholders who facilitate trust services for individuals, families, and organizations.

1. Introduction

Trusts have long been an important part of the South African financial landscape, providing a legislative mechanism for estate planning, asset protection, and wealth management. Concerns regarding the possible use of trusts for illicit purposes have lately risen in South Africa due to the countless fraud and bribery allegations faced within the country. These concerns of illicit trust use were further escalated after the Financial Action Task Force (FATF) grey listed South Africa on 24 February 2023.[1]

Understanding Grey listing and the FATF's Role

The FATF, an international agency founded in 1989 to combat financial crime, establishes global standards and regulations to support countries in their efforts to address these crimes.[2] South Africa has been a full member of the FATF since 2003 and is actively involved in the organisation's operations.[3]

The FATF grey lists nations that have strategic faults and shortcomings in their Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT) frameworks.[4] The FATF identifies nations with strategic AML/CFT inadequacies using its mutual evaluation process, which compares a country's laws, regulations, and institutional structures to international norms. If flaws are discovered, the FATF may suggest grey listing, a decision that is voted on by the FATF Plenary (which includes all member nations). Grey listing encourages governments to take swift action to correct weaknesses identified in their AML/CFT frameworks, however successful remediation of these weaknesses identified by the FATF may lead to the removal of a country from the grey list.

In response to the weaknesses identified by FATF, the South African government has initiated a major revamp in the financial sector to address these weaknesses. These comprehensive changes intend to improve accountability and transparency in the financial sector, especially in the trust sector an area identified with several weaknesses.

As part of this major revamp initiated by the South African government, the General Laws Amendment Act of 2022[5] was a key legislative initiative to enact amendments to various pieces of legislation in the country that had known weaknesses.

Notable changes to the Trust Property Control Act (TPCA) 57 of 1988 have been introduced to improve the governance of trusts in South Africa. The fundamental goal of these trust

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[1] Financial Action Task Force, 2023, 'Jurisdictions under increased monitoring'.
[2] Financial Action Task Force, 2024, 'Who we are'.
[3] Financial Action Task Force,2024, 'South Africa'.
[4] Financial Action Task Force,2024, 'Black and grey' lists.
[5] Government Gazette, No. 47815, General Notice No. 1532 of 2022, General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, No. 22 of 2022.

amendments is to bring transparency into the beneficial ownership of trusts, an area previously shrouded in opacity in South Africa.

Furthermore, the South African Revenue Service (SARS) has also initiated a host of strategic measures to strengthen trust compliance in the country. Most notably SARS has implemented the IT3 Trust Tax Certificate (IT3(t)) Data Submission Process to provide accurate insights into trust distributions. SARS further implemented significant legislative improvements in the 2023 year, in the form of amendments to taxation legislation proposed by the Tax Administration Laws Amendment Act (TALAA) 18 of 2023 and the Tax Laws Amendment Act (TLAA) 17 of 2023.The key amendments proposed by these acts with regards to trusts aim to provide a more precise definition of beneficial ownership and further address issues affecting non-resident trust beneficiaries. These amendments ultimately aim to align trust taxation laws with legal principles, creating a consolidated framework for the South African trust sector. This convergence and implementation of cross-regulatory procedures is intended to improve compliance, increase financial transparency, and prevent money laundering within the trust sector.

The broad consequences of these amendments in the trust sector by the South African government warrant an in-depth examination, which is the major focus of this research report.

Adam Smith's Maxims[6]

To further evaluate the changes introduced by the General Laws Amendment Act, 22 of 2022[7] as well as proposed changes in South Africa's trust taxation and regulation laws, this research will employ Adam Smith's maxims as a theoretical framework. Smith's principles, particularly those related to economic fairness, transparency, and efficiency, provide a foundational lens through which to assess the effectiveness and equity of legislative reforms. In Chapter 9, this analysis will measure the trust changes against these maxims to determine how well the reforms align with foundational economic and ethical principles.

Global Taxation Perspective

Trusts have been severely scrutinised for their suspected involvement in tax evasion, money laundering, and financial secrecy. This worldwide scrutiny encourages a global analysis, which will compare South Africa's regulatory approach to trusts to that of the United Kingdom (UK) and the United States of America (USA). The grey listing-driven legislative shift in South Africa comes against a context of increased worldwide concern regarding trust transparency. As

[6] Smith, Adam, 1776, An Enquiry into the Nature and Causes of the Wealth of Nations, Chicago: University of Chicago Press.

[7] Government Gazette, No. 47815, General Notice No. 1532 of 2022, General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, No. 22 of 2022.

countries throughout the globe contend with preventing the exploitation of trusts for illicit objectives, South Africa's actions cannot be viewed in isolation.

1.1 The Research Question

How do the recent and proposed changes in South Africa's trust taxation and regulation laws, in response to the FATF grey listing, impact trust beneficiaries and transparency compared to the United Kingdom and the United States of America?

1.1.1 Research Sub-Questions

1. **Impact of Legislative Amendments on Transparency:** How have the amendments to the Trust Property Control Act (TPCA) 57 of 1988 and the Tax Administration Laws Amendment Act (TALAA) 18 of 2023 enhance transparency in the trust sector in South Africa?
2. **Compliance Improvements Post-Amendments:** In what ways have the 2022 and 2023 legislative changes to South Africa's trust taxation laws improved compliance mechanisms within the trust sector compared to the United Kingdom's Trust Registration Service (TRS) and the United States' Corporate Transparency Act (CTA)?
3. **Influence of Global Trust Regulation Environment:** How does the global environment of trust regulation, particularly the FATF's standards and grey listing criteria, impact South Africa's domestic policies and practices in the trust sector?
4. **Comparative Analysis of Regulatory Frameworks:** What specific elements from the United Kingdom's Trust Registration Service (TRS) and the United States' Corporate Transparency Act (CTA) can South Africa adopt to further strengthen its trust regulation and taxation compliance?
5. **Challenges and Opportunities in Implementation:** What are the primary challenges faced by South Africa in implementing the amended TPCA and TALAA, and how do these challenges compare to those encountered in the United Kingdom and the United States during the adoption of their respective trust transparency regulations?
6. **Alignment with Adam Smith's Maxims:**
   How do the 2022 and 2023 legislative changes in South Africa's trust legislation align with Adam Smith's maxims related to economic fairness, transparency, and efficiency, and what implications does this alignment have for trust beneficiaries and the broader financial landscape?
7. **Balancing Scrutiny and Trust Preservation***:* Does the increased scrutiny of trusts in South Africa balance the advantages of preserving trusts in the modern South African financial landscape, particularly in terms of taxation governance and beneficiary interests?

1.1.2 Research Methodology

This research will be conducted in the form of a literature review, with the following sources being analysed:

- The Income Tax Act No. 58 of 1962 (Income Tax Act)
- Trust Property Control Act 57 of 1988(Trust Property Act)
- Tax Administration Act 28 of 2011(Tax Admin Act)
- Organisation for Economic Co-operation and Development (OECD) publications
- Reputable websites
- Journal articles

2 South Africa's Trust System

2.1.1 Trust Administration Framework in South Africa

2.1.1.1 Foundation and Legal Basis of Trusts

Trusts in South Africa are fundamental instruments for estate planning, wealth management, and asset protection. The legal foundation of trusts is primarily governed by the Trust Property Control Act No. 57 of 1988 (TPCA), which establishes the framework within which trusts operate (TPCA, 1988).

Historical Context

The concept of trusts in South Africa is deeply rooted in the country's legal history, drawing influence from both Roman-Dutch law and English law. Despite the retention of Roman-Dutch law during the second British occupation of the Cape in 1806, English legal principles and institutions, including the concept of trusts, inevitably made their way into the South African legal system[8]. Trusts became a readily accepted feature of legal and commercial practice, and their validity was firmly established in cases such as *Estate Kemp v McDonald's Trustee* (1915), where the court recognized the trust as an integral part of South African law[9]

The South African law of trusts has evolved uniquely through court cases over the years, diverging significantly from its early foundations and bearing little resemblance to its English origins.

Definition of a Trust

According to section 1 of TPCA, a trust is defined as: "The arrangement through which ownership in property of one person is, by virtue of a trust instrument, made over or bequeathed to another person".

Similarly, the ITA defines a trust as: "Any trust fund consisting of cash or other assets, including assets transferred to the trust upon the death of the founder, which are administered and controlled by a person acting in a fiduciary capacity".

While a trust is considered a legal entity for certain purposes, it is not a juristic person under South African law. This means that a trust lacks legal personality and cannot sue or be sued in its own name; instead, actions are brought by or against the trustees in their representative capacity.[10]

[8] Du Toit, F., 2007:13
[9] Du Toit, F., 2007:14
[10]BDO Wealth Advisory,2016, p.3

Types of Trusts[11]

In South Africa, trusts can be categorized based on their formation and purpose:

- Inter Vivo Trusts (Living Trusts): Established during the lifetime of the founder through a trust deed. These trusts are commonly used for estate planning and asset protection.
- Testamentary Trusts (Mortis Causa Trusts): Created upon the death of the founder, as stipulated in their will. These trusts often serve to manage and distribute assets to heirs according to the deceased's wishes.
- Special Trusts: Established for specific purposes, such as benefiting individuals with disabilities or minor children[12].

Trusts are also classified based on beneficiary rights[13]:

- Vesting Trusts: Beneficiaries have vested rights to the income or capital of the trust. Distribution is not subject to the trustees' discretion.
- Discretionary Trusts: Trustees have discretion over distributing income and capital to beneficiaries. Beneficiaries have no automatic right to the trust assets.

Legal Nature of Trusts

In the South African trust system, trustees hold two separate estates: the trust estate and their personal estate. This separation ensures the:

- Protection of Beneficiaries: Trust assets are protected from claims by the trustees' personal creditors in cases of insolvency[14].
- Fiduciary Duty: Trustees are required to act in the best interests of the beneficiaries, adhering to the terms of the trust deed and legal obligations[15].

While the South African trust differs functionally from the English trust, it shares core elements such as duality of interests, the fiduciary capacity of trustees, and the application of real subrogation[16].

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[11] BDO Wealth Advisory,2016, p.7
[12]'Special trust' as defined S1 of ITA
[13] BDO Wealth Advisory,2016, p.9
[14] BDO Wealth Advisory,2016, p.11
[15] S9 of TPCA
[16] Du Toit, F., 2007:16

2.1.1.2 Roles of Trustees and Beneficiaries

Parties to a Trust[17]

1. Founder (Settlor/Donor): The individual who creates the trust and transfers assets into the trust.

2. Trustees: Appointed by the founder to manage and administer the trust assets in accordance with the trust deed and legal requirements.

3. Beneficiaries: Persons or entities entitled to benefit from the trust assets.

2.1.2 Legislative Framework for Trust Taxation

The Income Tax Act No. 58 of 1962 (ITA) serves as the cornerstone for the taxation of trusts in South Africa. Under the ITA, a trust is classified as a "person" for tax purposes, making it subject to income tax obligations[18].

2.1.2.1 Residency Rules

South Africa employs a residency-based taxation system, making the residency status of a trust crucial:

- Resident Trusts:

A trust is resident if it is established or formed in South Africa or has its place of effective management in the country[19].A resident trust is taxed on worldwide income, including both South African and foreign sources.

- Non-Resident Trusts:

These types of trusts are taxed only on income sourced within South Africa and may be subject to withholding taxes on certain types of income.

- Double Taxation Agreements (DTAs):

South Africa has DTAs with various countries to prevent double taxation and allocate taxing rights[20].DTAs can influence the residency status and tax obligations of trusts.

[17] BDO Wealth Advisory,2016, p.5
[18] “person” as defined s1 of ITA
[19] “resident” as defined in s1 of ITA
[20] S108 of ITA

2.1.2.2 Types of Trusts and Tax Treatment

Different trusts receive specific tax treatments:

- Special Trusts:
  - Type A: Created solely for the benefit of a person with a mental or physical disability[21].
  - Type B: Testamentary trusts established for relatives alive at the time of death, where the youngest beneficiary is under 18.
  - Tax Rates: Taxed according to the sliding scale applicable to individuals, not at the flat trust rate.
- Charitable Trusts (Public Benefit Organisations - PBOs): Charitable trusts may be exempt from income taxation if approved by SARS and engaged in public benefit activities[22].
- Employee Share Trusts: Facilitate employee ownership in a company structure. specific taxation rules apply to prevent tax avoidance and ensure appropriate taxation of benefits.
- Family Trusts: These types of trusts are commonly used for estate planning and asset protection. These types of trusts are subject to general trust taxation rules unless qualifying as a special trust per the ITA.

2.1.2.3 Trust Income Attribution Mechanisms

Income attribution rules determine who is taxed on trust income:

- Vesting Trusts: In South Africa, if a trust beneficiary is ascertained and has a vested right to the income derived for their benefit, the income is deemed to have accrued to the beneficiary. Consequently, the beneficiary is liable for tax on that income, while the trust is not taxed on the income.
- Discretionary Trusts: For discretionary trusts, where trustees exercise discretion in favour of a beneficiary, the beneficiary has a vested right to the income for that year of assessment. This results in the beneficiary being taxed on the income and the trust is not taxed on the amount distributed. [23]Trustees decide if and how much income or capital to vest in beneficiaries.

[21] S1 of ITA
[22] S10(1)(cN)) of ITA.
[23] S 25B (2) of ITA.

- Income Attribution: If there is no ascertained beneficiary with a vested right to the income, the trust is taxed on the income. This applies to situations where the trustee has not exercised discretion, or the rights of the beneficiaries are not yet vested.[24]

2.1.2.4 Key ITA Provisions Include:

Section 25B: Taxation of Trust Income

Section 25B of the ITA outlines how income received by or accrued to a trust is taxed:

- **Income Retained in the Trust**: If the trust retains the income, it is taxed at the trust's flat rate, currently 45%.
- **Income Distributed to Beneficiaries**: When income is distributed to beneficiaries, it is taxed in their hands at their applicable personal tax rates. This is stipulated in Section 25B (1) of the ITA.

Section 7: Anti-Avoidance Provisions

Section 7 contains anti-avoidance measures to prevent tax evasion through schemes where income is diverted to beneficiaries taxed at lower rates. It attributes income back to the donor in certain circumstances, such as when income accrues to minor children, spouses, or non-resident beneficiaries. Relevant subsections include Sections 7(2) to 7(8) of the ITA.

Section 7C: Loans to Trusts

Section 7C addresses interest-free or low-interest loans made to trusts by connected persons, aiming to prevent the avoidance of estate duty and donations tax. It deems the interest forgone as a donation, subject to donations tax. This provision applies to loans made by natural persons or companies at the instance of natural persons to trusts where the lender is a connected person in relation to the trust.

Capital Gains Tax (CGT) and Trusts

Trusts are subject to CGT on the disposal of assets. The Eighth Schedule to the ITA outlines how capital gains are calculated and attributed between the trust and beneficiaries. Key points include:

[24] S 25B (1) of ITA.

- Paragraph 80 of the Eighth Schedule: This paragraph of the ITA, deals with the attribution of capital gains to beneficiaries. If a trust vests an asset in a beneficiary, the capital gain is attributed to the beneficiary and taxed in their hands. However, if the beneficiary is a non-resident, the gain may be taxed in the trust's hands.
- CGT Inclusion Rates: For trusts, 80% of the net capital gain is included in taxable income, whereas for individuals and special trusts, the inclusion rate is 40%. This results in a higher effective CGT rate for trusts compared to individual taxpayers.

2.1.3 Tax Administration Act

The Tax Administration Act No. 28 of 2011 (TAA) consolidates the administrative aspects of tax laws in South Africa, affecting trusts in several ways:

- Registration and Compliance:
  - Trusts must register with SARS and obtain a tax reference number[25].
  - Trustees are responsible for filing annual income tax returns on behalf of the trust[26].
- Record-Keeping:
  - Trustees must maintain accurate records of all transactions, income, and distributions for at least five years[27].
- Enforcement and Penalties:
  - SARS has the authority to audit trusts, issue assessments, and impose penalties for non-compliance[28].
  - Trustees can be held personally liable for certain tax debts of the trust[29].

[25] S22 of TAA
[26] S25 to 27 of TAA
[27] S29 of TAA
[28] S40 to 49 of TAA
[29] S155 of TAA

This chapter has provided a foundational overview of South Africa's trust system, including the legal basis, types of trusts, roles of trustees and beneficiaries, and the legislative framework governing trust taxation. While not exhaustive, this chapter highlights key aspects of the Trust Property Control Act (TPCA) and the Income Tax Act (ITA). Understanding the foundational landscape of South African trust legislation better enables the analysis of the changes brought by the General Laws Amendment Act of 2022[30] as explained in the preceding chapter. This will then provide a basis for a comparative examination of international trust regulation frameworks in subsequent chapters, where these changes will be analysed in relation to the legislative approaches adopted by the United Kingdom and the United States.

[30] Government Gazette, No. 47815, General Notice No. 1532 of 2022, General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, No. 22 of 2022

3 South Africa's Trust Legislation Reform

The inclusion of South Africa on the FATF grey list on 24 February 2023 marked a significant change in the domestic trust management landscape. This chapter explores and draws on regulatory responses to this predicament, focusing on the necessary TPCA amendments.[31]

3.1 Key Deficiencies in the Mutual Evaluation Report (MER)

The 2021 Mutual Evaluation Report (MER) by the FATF found significant weaknesses in South Africa's AML/CFT framework. [32] While the full MER outlines numerous areas of concern, relevant to trusts the following key deficiencies have been identified:

1. Lack of Transparency in Beneficial Ownership

One of the most prominent deficiencies identified in the MER report was the inadequate transparency surrounding the beneficial ownership of legal entities, particularly trusts. The report highlighted the lack of legislative mechanisms to effectively identify and record the individuals who ultimately control or benefit from trusts.

2. Insufficient Supervision of Designated Non-Financial Businesses and Professions (DNFBPs)

The MER report also emphasised the need for more supervision of DNFBPs, these are specific sectors and professions that aren’t regarded as financial institutions but are key for facilitating financial transactions. Examples of DNFBPs in the trust sector are lawyers, real estate agents or trust service providers. These occupations are especially susceptible to money laundering threats due to their frequent handling of substantial amounts of money and sensitive financial data.

3. Ineffective Customer Due Diligence (CDD) Measures

The MER report further identified weaknesses in CDD measures implemented by accountable institutions. CDD measures are processes in place by accountable institutions to verify the identities of clients and their various financial activities.

4. Inefficiencies in Reporting Suspicious Transactions

The mechanisms in place by financial institutions to report suspicious transactions were seen as another key deficiency in the MER report. The report highlighted the cumbersome reporting procedures and the need for effective feedback mechanisms for financial institutions to report suspicious transactions.

[31] Trust Property Control Act 57 of 1988
[32] Financial Action Task Force, 2021, Anti-money laundering and counter-terrorist financing measures – South Africa, Fourth Round Mutual Evaluation Report.

5. Limited International Cooperation and Information Exchange

Finally, the MER emphasised the need for enhanced international cooperation and information exchange in combating cross-border financial crime. While South Africa does participate in information-sharing initiatives, the report identified opportunities to strengthen collaboration with other countries to track and disrupt transnational money laundering activities effectively.

3.2 Restoring Global Trust: South Africa's Post-Grey listing Strategy

Following its placement on the FATF grey list on 24 February 2023, the South African government has initiated a series of measures to address the identified deficiencies in its AML/CFT framework. These actions demonstrate a commitment to fortifying its regulatory environment and aligning with international standards. The most significant legislative amendment in this regard is as follows:

The passing of the General Laws Amendment Act 22 of 2022[33]. This amendment act provides legislative changes to five critical acts in South Africa, namely:

- Trust Property Control Act 57 of 1988 (sections 1 to 8 of the General Laws Amendment Act)
- Nonprofit Organisations Act 71 of 1997 (sections 9 to 17 of the General Laws Amendment Act)
- Financial Intelligence Centre Act (FICA) 38 of 2001 (sections 18 to 54 of the General Laws Amendment Act)
- Companies Act 71 of 2008 (sections 55 to 61 of the General Laws Amendment Act)
- Financial Sector Regulation Act (FSRA) 9 of 2017 (sections 62 to 65 of the General Laws Amendment Act)

This concerted effort amongst other initiatives by the South African government signifies a proactive approach in addressing the deficiencies identified by the FATF.

3.2.1 Amendments Introduced to the TPCA

The FATF grey listing has resulted in significant changes to South Africa's financial regulations, particularly impacting trust legislation. This discussion focuses on the amendments introduced to the TPCA through sections 1 to 8 of the General Laws Amendment Act 22 of 2022. [34] Table 1 below, outlines the specific legislative changes.

[33] Government Gazette, Notice 47815, R.1535,2022.
[34] Government Gazette, Notice 47815, R.1535,2022.

Table 1: General Laws Amendment Act Changes

The General Laws Amendment Act, 22 of 2022, Section Number	Trust Property Control 57 of 1988, Section Number	Purpose of the amendments
1.	1. Added definitions of "Accountable Institution" and "Beneficial Owner"	These added definitions align the TPCA with other notable acts above and ensure that trusts are subject to the same AML/CFT requirements as other financial institutions.
2.	6. Added Subsection (1A) to Section 6	The addition of Subsection (1A) to the TPCA aims to disqualify specific individuals from being authorised as trustees.
3.	8. Substituted Section 8	The substitution of Section (8) in the TPCA requires foreign trustees to obtain authorisation from the Master's office before administering or disposing of trust property assets within the country.
4.	10. Added subsection (2) to Section 10	The addition of Subsection (2) to the TPCA mandates trustees to disclose their roles to accountable institutions and articulate the nature of their involvement with trust property assets.
5.	11. Added Subsection (1A) to Section 11	Subsection (1A) of the TPCA requires trustees to record the details of the accountable institutions used as agents on behalf of trustees to fulfil trust services.
6.	11.Added Section 11A	Section (11A) of the TPCA introduces stringent regulations for trustees concerning handling beneficial ownership information. It obliges trustees to accurately establish, document, update, and lodge beneficial ownership details with the Master's Office, creating a centralised and up-to-date repository of trust ownership information. Additionally, both trustees and the Master are required to make this information accessible to authorised parties.
7.	19. Added subsection (2) to Section 19	The inclusion of Subsection (2) in the TPCA introduces legal consequences for trustees who fail to comply with specified obligations outlined in the Act.
8.	20. Amended Subsection (2) of Section 20	The amendment to Subsection (2) in the TPCA revises the criteria for removing a trustee. This revision aims to broaden the grounds for removing a trustee beyond the disqualifications listed in Section 6(1A) of the TPCA.

3.3 How the Amended TPCA Addresses the FATF's Key Deficiencies

To better understand how the amended TPCA[35] addresses the critical FATF deficiencies stated above, this analysis will examine the identified deficiencies, and the specific amendments designed to rectify them.

3.3.1 Addressing the Opacity of Beneficial Ownership (Deficiency 1)

The lack of transparency surrounding beneficial ownership information in trusts was a significant concern for the FATF.

[35] Government Gazette, Notice 47815, R.1535,2022.

The amended TPCA addresses these deficiencies through the following provisions:

- Addition of the definition of 'beneficial ownership' (TPCA Section 1): The addition of this definition aims to ensure consistency and clarity in South African AML/CFT regulations across the various legislative acts. Furthermore, this inclusion of the definition of "Beneficial ownership" is not limited to the TPCA but also extends to other legislative frameworks, such as the TALA [36] which will be examined in the next chapter.
- Enhanced Disclosure Requirements (TPCA Section 10): Trustees are now mandated to disclose their roles and connections to trust assets. These enhanced disclosure requirements are a form of beneficial ownership transparency as it aims to ensure transparency in the trust structure.
- Stringent Recordkeeping (TPCA Section 11): This amendment mandates recordkeeping of all agents and services utilised in trust administration. This comprehensive recordkeeping provides the Masters Office with valuable information for effective oversight of trusts, allowing for the identification of potential vulnerabilities that could be exploited for illicit purposes.
- Centralised Beneficial Ownership Information (TPCA Section 11A): This amendment establishes a framework for collecting, maintaining, and updating beneficial ownership information, making this crucial information readily available to authorised parties. This increased transparency significantly reduces the opportunities for trust misuse and facilitates detecting suspicious activity in trusts.

3.3.2 Strengthening Oversight and Control of DNFBPs (Deficiency 2)

The FATF Mutual Evaluation report identified insufficient supervision of non-financial institutions.[37] The amended TPCA[38] addresses this concern, specifically regarding instances of these institutions being part of the trustee structure, by introducing measures to strengthen the Master's oversight and control over this sector:

- Disqualification of Unsuitable Individuals (TPCA Section 6): Recognising the potential risks posed by individuals with unsuitable backgrounds assuming trustee roles, the act introduces a mechanism for disqualifying such individuals. This proactive measure pre-emptively mitigates risks by barring individuals with questionable credentials or those deemed unfit for trust administration.
- Authorisation for Foreign Trustees (TPCA Section 8): The amended act mandates that foreign trustees obtain authorisation from the Masters office before assuming trustee duties. This allows the Masters office greater oversight powers by ensuring foreign

[36] Tax Administration Laws Amendment Act,18 of 2023.
[37] FATF, Mutual Evaluation Report,2021.
[38] Government Gazette, Notice 47815, R.1535,2022

trustees are assessed for their suitability according to local regulations. This enhanced oversight significantly reduces the risk of foreign trustees being used to circumvent South Africa's AML/CFT framework and fosters international cooperation in combating financial crime involving trusts.

- Broadened Grounds for Trustee Removal (TPCA Section 20): The amended act empowers the Masters office to remove trustees on grounds of misconduct or incompetence and further in cases of failure to comply with the new TPCA amendments. These expanded authority mechanisms allow for a more swift and decisive action against non-compliant trustees which safeguards the trust administration's integrity and in turn protects the interests of beneficiaries.

3.3.3 Strengthening Transparency and Addressing Ineffective CDD Measures (Deficiency 3)

The FATF Mutual Evaluation report identified weaknesses in CDD measures by accountable institutions. Through several key amendments, the TPCA addresses this vulnerability indirectly through the following:[39]

Transparency as a Foundation for Enhanced CDD:

- Definitions and Disclosures (Sections 1 & 10 of TPCA): Aligning the new definitions with other financial regulations and mandating disclosures by trustees creates consistent communication and information sharing with the trust sector. These amendments further facilitate a comprehensive understanding of trust structures and beneficial ownership, enabling accountable institutions to tailor CDD efforts to specific risks.
- Beneficial Ownership Registry (Section 11A of TPCA): Establishing a centralised beneficial ownership registry removes obstacles to identifying individuals ultimately benefiting from trusts, a key element in effective CDD measures and suspicious activity detection. This central registry empowers accountable institutions to effectively scrutinise transactions involving potentially high-risk individuals.

Increased Oversight and Control, Reduced Customer Due Diligence CDD Burden:

- Disqualification of Unsuitable Trustees (Section 6 of TPCA): Proactively barring unsuitable trustees from trust administration minimises the risk of deliberate misuse of trusts for illicit purposes. These requirements will lower the CDD burden for accountable institutions interacting with trusts.

[39] FATF, Mutual Evaluation Report,2021

- Authorisation for Foreign Trustees (Section 8 of TPCA): This authorisation process by the Master's office enhances oversight of foreign trustees, reducing the risk of circumventing AML/CFT regulations. This in turn aids in CDD mechanisms by accountable institutions regarding interaction with foreign trustees however effective collaboration efforts by the Master office and accountable institutions is key for these advancements.
- Broadened Grounds for Trustee Removal (Section 20 of TPCA): Empowering the Master's office to address irregularities and hold trustees accountable discourages non-compliance with CDD requirements. This amendment by the TPCA is only effective with collaboration and information sharing between the Masters office and accountable institutions.

CDD measures effectiveness hinges on collaboration between the Master office and accountable institutions in the trust sector. The deficiencies identified by the FATF is regarding weaknesses in CDD measures specifically regarding beneficial ownership transparency. Based on the improvements and initiatives by the South African government a proactive change has been initiated only time will tell if these initiatives will be effective in addressing the key deficiencies by the FATF.

3.3.4 Inefficiencies in Reporting Suspicious Transactions and Limited International Cooperation and Information Exchange (Deficiency 4 and 5)

While the amended TPCA[40] primarily focuses on strengthening transparency and accountability within the trust sector, it also indirectly addresses the last two critical deficiencies: Suspicious transaction reporting and international cooperation.

4. **Inefficiencies in Reporting Suspicious Transactions:**
   - Increased Transparency (Sections 1, 10, & 11A of TPCA): By making beneficial ownership and trust structure information readily available, the TPCA empowers accountable institutions to better identify potential suspicious activity within trust transactions. This increased transparency can result in timely and accurate reporting of suspicious activity by removing obstacles to recognising suspicious patterns, even in low-value transactions.
   - Enhanced Oversight (Section 20 of TPCA): The Master's office increased regulatory oversite to address irregularities and hold trustees accountable can deter non-compliance with reporting requirements. These enhanced oversight measures foster a culture of responsible trust administration, encouraging accountable Institutions to report suspicious activity without fear of reprisal.

[40] Government Gazette, Notice 47815, R.1535,2022.

5. **Limited International Cooperation and Information Exchange:**
   - Centralized Beneficial Ownership Information (Section 11A of TPCA): Domestic beneficial ownership can be integrated with international beneficial ownership information, facilitating information sharing and cross-border investigations involving trusts. This centralised system could significantly enhance cooperation and information exchange in combating transnational money laundering activities.
   - Meticulous Recordkeeping (Section 11 of TPCA): Detailed records maintained by trustees, if accessible to authorised parties, can support international investigations by providing valuable information on trust activities and potential financial crime networks.

While the act amendments do not directly address international cooperation agreements or information exchange protocols, it lays the groundwork for improved collaboration by creating a more transparent and accountable trust sector with readily available information.

3.4 Amended TPCA: Progress & Challenges

The amendments to the TPCA[41] represent a significant step forward in enhancing the country's AML and CFT compliance. These changes aim to mitigate the risks associated with the misuse of trusts for money laundering and terrorist financing by increasing transparency, improving regulatory oversight, and ensuring accountability within the trust sector. Key anticipated impacts include:

1. Mitigation of Misuse Risks: The amendments enhance transparency around beneficial ownership and trust structures, thereby reducing the likelihood of trusts being exploited for illicit activities and strengthening the overall integrity of the trust sector.
2. Enhanced AML/CFT Effectiveness: By providing authorities with better legislative mechanisms and enhanced disclosure of information to identify and investigate suspicious activities, the amendments bolster the effectiveness of AML/CFT measures.
3. Increased Accountability: The amendments place greater responsibility on trustees, enhancing the accountability mechanisms within the trust administration framework.

However, the successful implementation of these amendments will demand concerted efforts, including adequate resourcing of the Master's office for oversight, continuous training for trustees, and a collaborative approach among all stakeholders involved in trust administration.

[41] Government Gazette, Notice 47815, R.1535,2022.

In summary, while the TPCA amendments[42] lay a solid foundation for strengthening South Africa's AML/CFT framework within the trust sector, ongoing commitment, and collaboration across all levels of trust administration and oversight are crucial for realising the full potential of the act amendments and ensuring a safer, more compliant financial environment.

[42] Government Gazette, Notice 47815, R.1535,2022.

4 Strengthening Trust Taxation: SARS's Response to Grey listing

Given the legislative amendments to the TPCA[43] in the preceding chapter. This chapter will focus on the supplementary strategic initiatives implemented by SARS in response to South Africa's grey listing.

SARS has implemented a comprehensive reform strategy to rebuild trust and improve governance throughout its operations to address increasing international scrutiny. While these reforms have a broad implication for the taxation system, this discussion will focus specifically on trust taxation. This reform narrative centres on several key initiatives, metaphorically termed "pillars," in the discussion below. These pillars symbolise specific areas of attention in SARS's strategy to enhance transparency and accountability in trust taxation.

- Pillar 1: The Approval for International Transfers (AIT) Process: The amendments to this compliance mechanism address substantial cross-border illicit financial flows linked to trusts and other entities. [44]
- Pillar 2: The IT3(t) Data Submission Process: SARS utilises this new process to obtain detailed information regarding trust distributions.[45]
- Pillar 3: The Tax Administration Laws Amendment Act: This legislation amends key governance issues across various entities in the tax system. A specific focus will be on the changes affecting trusts taxation. [46]
- Pillar 4: The Tax Laws Amendment Act: This legislative act aims to provide amendments to address potential loopholes and resolve ambiguities within the tax system. With relevance to trust taxation, a key focus will be on the 2023 changes to s25B[47] regarding non-resident beneficiaries for trusts.[48]

This subsequent analysis will offer a detailed examination of these pillars and their far-reaching implications for trust governance in South Africa.

4.1 Pillar 1: The AIT Process

In response to the FATF's concerns regarding the risk of illicit funds flowing through trusts in South Africa, SARS and the Reserve Bank implemented significant changes to the Tax Compliance Status (TCS) system on the 24th of April 2023. This section will provide a more detailed discussion of these new requirements and their impact on trusts. [49]

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[43] Government Gazette, Notice 47815, R.1535,2022.
[44] *SARS, 'How SARS has changed tax compliance status reporting for transferring funds abroad',* 2023.
[45] Government Gazette, No. 48867, General Notice No. 3631 of 2023, Returns of information to be submitted by third parties regarding section 26.
[46] Tax Administration Laws Amendment Act,18 of 2023.
[47] S25B of ITA
[48] Tax Laws Amendment Act,17 of 2023.
[49] *SARS,*2023.

4.1.1 TCS

Before April 2023, the TCS system was crucial for overseeing cross-border financial transfers. When financial transfers exceeded the 1-million-rand Single Discretionary Allowance (SDA) by a taxable entity, the TCS was used to verify the tax compliance status of these taxable entities.[50]

However, the TCS had limitations. Its primary focus on entities' overall tax compliance status rather than scrutinising individual transactions was a significant concern for cross-border financial transfers.

TCS Simplification and the New Approval for International Transfer (AIT) System

SARS has taken a significant step towards simplifying the TCS process by consolidating various TCS compliance pins into a single, more streamlined system called the "Approval for International Transfer" system. This change combines previously separate processes such as the "Emigration" and "Foreign Investment Allowance" compliance pins into one unified procedure for cross-border transfers.[51]

An essential aspect of the AIT system is its strong emphasis on transparency and scrutiny, especially concerning the activities of trusts and other entities involved in cross-border transactions. These enhanced transparency measures include the requirement for detailed information regarding the source and destination of funds, the purpose behind the transactions, and the identification of all beneficiaries involved. Such detailed reporting is essential for SARS and the South African Reserve Bank (SARB) to monitor and evaluate the legitimacy of cross-border financial activities.[52]

Triggering the AIT Process

The process for triggering the AIT process is similar to the process that was in place under the previous TCS model. Specifically, the AIT process is initiated when a trust intends to facilitate a cross-border financial transfer exceeding the SDA of 1-million-rand per annum. The AIT process however is now much more stringent requiring more disclosure of specified information for the cross-border financial transfer.

The AIT Process as a Key Measure in Cross-Border Financial Management

The AIT process is a significant strategic measure in response to the FATF deficiencies, signifying a crucial amendment in South Africa's approach to managing cross-border financial transactions.

[50] *SARS,*2023.
[51] *SARS, 'Manage your Tax Compliance Status',* 2023.
[52] *SARS, 'Supporting Documents for Approval of International Transfers',* 2023.

The AIT process is fundamentally much more than a cross-border financial management initiative. The effectiveness of the AIT process depends on its integration with the overall tax system and newer taxation mechanisms in trust sector. New mechanisms being the IT3(t) trust submissions process, which will be discussed further below.

4.2 Pillar 2: The IT3(t) Certificates

In the intricate landscape of trust governance in South Africa, the implementation of the IT3(t) process forms the second pillar of transparency and accountability in the SARS metaphorical framework. This strategic mechanism, initiated in June 2023, directly addresses the pervasive concerns of tax evasion and the previously insufficient oversight within the trust sector. [53] The following section will further explore the IT3(t) mandate and its overall impact on financial transparency and accountability in South Africa.

4.2.1 What are IT3(t) certificates?

As a designated authority under section 11A of the Amended TPCA, SARS can access beneficial ownership information, as outlined in Chapter 3.[54] However despite this authority, SARS faces persistent challenges such as non-compliance in trust registration, inadequate trust tax return submissions, and insufficient trust taxation disclosures. As such SARS has issued requirements mandating that trusts submit IT3(t) certificates to counter these non-compliance challenges. [55]

The implementation of the IT3(t) certificate requirement signifies a significant shift towards bolstering transparency and accountability in trust management by SARS. Trustees are now responsible for directly reporting comprehensive financial information to SARS based on the IT3(t) submission process. This increased disclosure requirement includes detailed accounts of attributions, income, gains, and distributions to trust beneficiaries. This disclosure mandate aims to enhance the accuracy of financial reporting by trusts and ensure all distributions from trusts to beneficiaries are thoroughly documented well before the deadlines for traditional trust tax returns.

Combating Financial Crime and Ensuring Fair Tax Collection

One of the most significant contributions of the IT3(t) certificate disclosure mandate lies in its ability to empower SARS to combat trust tax evasion effectively. This transparency disclosure enables SARS to:

- Strengthen Enforcement Capabilities: With comprehensive trust information, SARS is better equipped to enforce tax regulations and combat tax evasion strategies often

[53] SARS, Government Gazette Notice 48867, R.3631,2023.
[54] Government Gazette, Notice 47815, R.1535,2022.
[55] SARS, Government Gazette Notice 48867, R.3631,2023.

associated with trusts. The detailed information on income and distributions provided through the IT3(t) process facilitates accurate assessment of tax liabilities, reducing opportunities for manipulation and ensuring fair and consistent tax collection across the trust sector.

- Enhance Risk Management: The comprehensive information provided by the IT3(t) certificates allows SARS to develop a more risk-based approach to monitoring trusts. In identifying similarities and indicators of potential trust tax abuses, SARS can prioritise its resources and investigations, thereby targeting high-risk trusts and maximising its effectiveness in combating tax evasion through these trusts.

IT3(t) Compliance Requirements

All trusts registered in South Africa must submit IT3(t) certificates, and where applicable where non-resident trusts submit an annual income tax return to SARS they must also comply with these requirements.[56]

The following types of trusts are excluded from the new requirements:

- Collective Investment Schemes
- Employment Share Incentive Scheme Trusts

Deadlines and Key Dates: For the 2023 tax year, the deadline for submitting IT3(t) certificates is 30 September 2024, per the latest extension by SARS. [57]

4.3 Pillar 3: Legislative Amendments by the Tax Administration Laws Amendment Act of 2023

The TALA[58] is a critical component of SARS's extensive strategy to tighten its compliance mechanisms with regards to taxation governance.

In this section, the discussion is narrowed down to the specific amendments made by the Tax Administration Laws Amendment Act of 2023(Amendment Act) to the Income Tax Act (ITA)[59] and the Tax Administration Act (TAA)[60], focusing on their implications for trust governance. It is essential to acknowledge that the revisions to the TPCA, as outlined by the General Amendment Act 22 of 2022[61], have already been detailed in Chapter 3.

[56] SARS, Government Gazette Notice 48867, R.3631,2023.
[57] Government Gazette, No. 49646, General Notice No. 4051 of 2023, amendment to Third Party Notice to Submit Returns for periods commencing on or after 1 March 2023.
[58] Tax Administration Laws Amendment Act 18 of 2023.
[59] Income Tax Act, 58 of 1962, as amended by the Taxation Laws Amendment Bill, 2023.
[60] Tax Admin Act, 11 of 2011, as amended by the Taxation Laws Amendment Bill, 2023.
[61] Government Gazette Notice, R.1535,2022.

4.3.1 Amendments to the Income Tax Act (ITA) 58 of 1962:

The Amendment Act sets out more stringent standards for disqualifying individuals considered unsuitable for managing public funds or serving as trustees. This critical step is multi-layered, directly aligning with amendments to Section 6 of the TPCA, which disqualifies specific individuals from being appointed as trustees.

- Section 10 of the ITA has been amended to bring it in line with the TPCA, introducing specific disqualification criteria for individuals tasked with managing collective interests. Essentially, the ITA now includes a new provision, subsection (5)(a), which stipulates that a person is barred from managing the shared interests of members, as outlined in subsection (1)(e)(i)(cc)(A) if they are disqualified under section 6 of the TPCA, section 25A of the Nonprofit Organisations Act of 1997, or section 69 of the Companies Act. This amendment ensures a cohesive approach across different legislative frameworks to disqualify individuals from positions of financial management or trusteeship based on established criteria, reinforcing the integrity of collective interest management in South Africa.
- The ITA's sections 30, 30A, 30B, and 30C have also been amended to broaden the scope of disqualification criteria, for individuals involved with public benefit organisations, recreational clubs, and small business funding entities. This amendment aims to safeguard the various entities from the risks posed by individuals deemed unfit for fiduciary roles. Specifically, these amendments now require such entities to have at least three natural persons, not closely related to each other, to undertake fiduciary responsibilities, ensuring no single person holds undue control over the entity's decision-making processes. These amendments align with the TPCA disqualification provisions, ensuring a consistent approach across different types of entities to maintain integrity and accountability in financial management and governance.

4.3.2 Amendments to the Tax Administration Act (TAA) 28 of 2011:

Standardising Beneficial Ownership

The TAA has been amended to include a more precise and uniform definition of "beneficial owner" within its first section. This amendment strategically aligns the TAA with the TPCA, which also added the definition of "beneficial ownership". This strategic alignment was closely examined in Chapter 3, highlighting the significance of these amendments. For a more comprehensive discussion on beneficial ownership within the broader context of global financial transparency and governance, please refer to Chapter 7.

This seemingly technical change carries significant weight in the fight against financial crime and illicit activities. This amendment fosters clarity and consistency across regulatory frameworks. This in turn facilitates the effective implementation of AML/CFT measures in the country.

Enhanced Information Sharing

Section 70 of the TAA was amended; this amendment introduces an approach to sharing beneficial ownership information among South Africa's regulatory bodies.

The amendment to Section 70 further enhances the legal mandate for information disclosure, enabling the Companies and Intellectual Property Commission (CIPC), the Master of the High Court, and the Nonprofit Organisations (NPO) Directorate to receive taxpayer information relevant to their regulatory duties under the Companies Act of 2008, the Trust Property Control Act of 1988, and the Nonprofit Organisations Act of 1997, respectively. This aligns with the broader objectives of South Africa's AML/CFT framework by supporting the cross-verification of beneficial ownership information, similar to disclosures already permitted by the SARB, Financial Intelligence Centre, and the Financial Sector Conduct Authority.

Guarding Against Disqualified Public Officers

Lastly, the amendment to Section 246 of the TAA establishes a critical link to the revised Section 6 of the TPCA, a point thoroughly examined in Chapter 3. This revision explicitly bars individuals disqualified under the TPCA, the Nonprofit Organisations Act, or the Companies Act from being appointed public officers for taxation purposes.

Effective Date: The Tax Administration Laws Amendment Act was officially signed into law on 22 December 2023.[62]

The Tax Administration Laws Amendment Act, the third legislative pillar, is crucial in refining the administrative framework surrounding tax regulation. Introducing measures to disqualify unsuitable trustees and enhancing information sharing across various legislative acts presents a foundation for a more robust and interconnected regulatory environment. This pillar, focusing on administrative enhancements rather than direct tax legislation changes, paves the way for the seamless integration with the last pillar: the Tax Laws Amendment Act of 2023.

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[62] Tax Administration Laws Amendment Act 18 of 2023.

4.4 Pillar 4: Tax Laws Amendment Act of 2023.

As we reach the final pillar of our analysis, we examine the transformative impact of the Tax Laws Amendment Act of 2023 on trust taxation in South Africa. This Act introduces significant amendments to key provisions within the Income Tax Act, specifically Sections 25B and 7C, addressing critical issues surrounding the taxation of trust distributions to non-resident beneficiaries and the anti-avoidance measures for low-interest or interest-free loans to trusts.

4.4.1 Amendments to Section 25B

The easing of exchange control regulations by the SARB has resulted in an increase in cross-border financial transactions, particularly regarding distributions from trusts to non-resident beneficiaries.[63]This increased activity has highlighted the discrepancies between the tax treatment of income attributed to foreign beneficiaries under section 25B of the ITA and the tax treatment of capital gains in paragraph 80 of the Eighth Schedule ITA to foreign beneficiaries. Such discrepancies have raised concerns over possible tax avoidance and highlighted the need for a uniform tax treatment of trust distributions.

Current Tax Treatment of Trust Capital Gains

Paragraph 80 of the Eighth Schedule ITA addresses capital gains that can be attributed to beneficiaries of trusts. When a trust vests an asset to a South African resident beneficiary, the resulting capital gain is often assigned to the beneficiary. The capital gain is then disregarded in the hands of the trust for purposes of calculating the taxable income of the trust. However, suppose an asset is vested in a non-resident beneficiary. In that case, the capital gain flowing from the vesting is generally not attributed to the non-resident beneficiary but is taxed in the trust.

Current Tax Treatment of Trust Income

Since paragraph 80 expressly only deals with capital gains, income distributed through trusts is dealt with in section 25B of the ITA. In section 25 of the ITA, as it currently stands, income vested in a beneficiary during a tax year is generally deemed to accrue to a beneficiary. However, it is worth noting that while paragraph 80 refers to the tax residence of trust beneficiaries, sections 25B (1) and (2) of the ITA contain no distinction based on the beneficiary's residence. Notably, the application of section 25B of the ITA is subject to section 7 of the ITA (Trust taxation attribution rules), which further allows an alternative taxpayer to be liable for taxation in certain circumstances.

[63] Tax Laws Amendment Act 17 of 2023 'Explanatory memorandum on the taxation laws amendment bill'.

Need for Integration

To address these concerns and ensure consistency in the tax treatment of trust distributions, the Tax laws Amendment Act[64] attempts to align the tax treatment of income and capital gains derived from trusts. This alignment aims to prevent potential tax avoidance strategies and promote a more cohesive framework for offshore transfers. This amendment act accordingly amends section 25B of the ITA to align with the provisions of paragraph 80 of the Eighth Schedule of the ITA by limiting the flow through principle only to resident beneficiaries.

Effective Date: The Tax Laws Amendment Act was officially passed into law on 22 December 2023.[65]

4.4.2 Amendments to Section 7C

Section 7C was introduced as an anti-avoidance measure to prevent tax-free wealth transfers to trusts using low-interest or interest-free loans, advances, or credit[66]. Initially focusing on individuals and companies providing such loans, variations emerged involving companies owned by trusts.

Issues Addressed

1. Foreign Currency Loans:
   - Lack of Clarity: There was no specific guidance on translating foreign currency loans to South African rands when calculating deemed donations arising from low-interest or interest-free loans to trusts.
2. Primary Residence Exclusion:
   - Ambiguity in Definition: The definition of "primary residence" in the Eighth Schedule was not fully aligned with the intended meaning in Section 7C, leading to potential gaps where certain expenses, like improvements, were not covered by the exclusion.

Amendments Introduced

1. Transparent Translation of Foreign Currency Loans:
   - Specific Methodology Provided: The amendments introduce a clear method for translating foreign currency loans to South African rands using the spot rate on the last day of the year of assessment.

[64] Tax Laws Amendment Act 17 of 2023.
[65] Tax Laws Amendment Act 17 of 2023.
[66] S7C of ITA

2. Expanded Primary Residence Exclusion:
    - Inclusion of Improvements:
        - The exclusion for the acquisition of a primary residence now explicitly includes funding for improvements to the property.
    - Alignment with Limitations:
        - Applies the limitations relating to the land on which the primary residence is situated to the residence itself.[67]

Effective Date: The Tax Laws Amendment Act was officially passed into law on 22 December 2023.[68]

4.4.3 Overall Impact on Trust Taxation

The amendments to Sections 25B and 7C of the ITA signify a pivotal shift in South Africa's approach to trust taxation. By addressing discrepancies and closing potential loopholes, these changes enhance transparency, promote fairness, and align with international standards. As South Africa navigates this new landscape, collaboration among stakeholders will be crucial to ensure a resilient, compliant, and trustworthy financial ecosystem.

4.5 Shift in South Africa's Trust Sector Governance

The South African trust sector is experiencing a substantial change precipitated by the 2023 legislative reforms enacted by SARS. These reforms, integrated with international standards, endeavour to combat financial crime, and ensure the equitable taxation of trusts in South Africa. This emerging regulatory framework necessitates close collaboration among SARS, the trust industry, and other key stakeholders. The successful implementation of this framework hinges upon a comprehensive understanding of these specified amendments and a strict adherence to these regulations by all involved parties in the trust sector.

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[67] Paragraph 46 of 8th Schedule of ITA

[68] Tax Laws Amendment Act 17 of 2023.

5 Global Trust Taxation Frameworks

5.1.1 Trust Income Attribution Mechanisms

A global analysis of trust taxation frameworks, as outlined by (Du Plessis,2018)[69], reveals a complex landscape shaped by three primary considerations: the mechanism used for taxation, the focus on the individual taxed, and the distinction between viewing the trust as a separate entity or adopting a flow-through system. These approaches yield diverse implications for the taxation of trusts across jurisdictions, reflecting a blend of administrative efficiency, equitable tax treatment, and the prevention of double taxation.

1. Mechanisms of taxation are further detailed into the following classifications[70]:

Initial Choice System: This taxation system offers flexibility by allowing a choice between taxing the trust or the beneficiary as income arises. Therefore, income is taxed in the hands of the beneficiary if the beneficiary is entitled to the trust income. Where the income is retained in the trust for circumstances where no beneficiary is entitled to the trust income, the trust will be liable for income taxation.

Credit System: This taxation system, the trust and the beneficiaries are taxed. Beneficiaries are taxed on any distributions from the trust and the trustees are taxed on the trust income. A key distinction in this taxation mechanism is that beneficiaries are granted a credit for tax paid by the trustee.

Deduction System: This taxation system follows the same principle of the credit system in that the beneficiary and trust are both taxed. The difference in this method of taxation lies in the deduction that is allowed for the trust for any distributions to the beneficiaries.

2. Taxation based on residence:[71]

This method of trust taxation is based on the residence of the settlor, trustee, or beneficiary of the trust.

3. Entity System or the Flow-Through System:[72]

In this last classification method for taxation of trusts, a distinction is made whether the trust is taxed as an entity system or whether through a hybrid flow-through system.

Entity System: This taxation system taxes the trust only. The key difference in this method of taxation is distributions to beneficiaries are not considered in determining the amount that is

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[69] Du Plessis, I,2018,'The Taxation of Trusts in SADC Member States,' Stellenbosch Law Review, (Volume 29 Issue 2), p.270-294
[70] Du Plessis, I,2018, p.273-274
[71] Du Plessis, I,2018, p.273-274
[72] Du Plessis, I,2018, p.275

taxed in the trust and further no tax liability will arise for the beneficiary when the trust income is distributed.

Flow-Through System: This system of taxation entails that beneficiaries are taxed on income distributed and the trust will be liable for tax on the retained income in the trust.

This chapter has provided a comprehensive overview of the global landscape of trust taxation frameworks, elucidating the various mechanisms employed by different jurisdictions to tax trusts. By examining the Initial Choice System, Credit System, and Deduction System, this analysis has briefly highlighted how each approach offers distinct advantages and poses unique challenges in terms of administrative efficiency, equitable tax treatment, and the prevention of double taxation. Additionally, the discussion on taxation based on residence and the distinction between Entity and Flow-Through Systems has underscored the diverse strategies nations adopt to align trust taxation with their broader financial transparency and governance objectives.

From this foundational understanding of global trust taxation mechanisms, the analysis will proceed to explore the specific tax systems of the United Kingdom and the United States in the subsequent chapters. These sections will delve into the nuances of each country's approach, examining the benefits and disadvantages inherent in their respective trust systems. Lastly in chapter 9 (Discussion and analysis), we will analyse South Africa's trust taxation framework, comparing it against the established practices of the UK and USA.

6 The United Kingdom's Trust System

The progression of trust law in the United Kingdom, from mediaeval beginnings to the current legal system used today, showcases a progression in inheritance law and property administration. The beginnings of early trust law in the United Kingdom can be described in a legal concept known as "uses." This foundational law principle has enabled the landowners to differentiate between what is the legal ownership of their property and what is the right to derive benefits from this property.[73] This fundamental law principle has allowed for the distribution of property to move beyond the direct ownership constraints, with trustees being able to manage land on behalf of beneficiaries.

The widespread application of the fundamental principle of "uses" led to the Statute of Uses in 1535 under Henry VIII, this Statute aimed to curb the avoidance of traditional duties and taxes in the United Kingdom. The establishment of the Statute of Uses, led to the legal principles of "uses" being incorporated into developing trust law, which was facilitated by the Court of Chancery.[74] This critical development in early trust law is seen as the foundation of modern trust law, which emphasising the roles of trustees and beneficiaries.

Trust law in the United Kingdom has since evolved from its early uses to a more defined legal framework which governs asset management and distribution with clearly defined trustee duties and beneficiary protections. This development in trust law reflects the dynamic nature of legal systems in addressing societal needs, modernising historical practices into cornerstone legal mechanisms for contemporary asset management and inheritance practices used today.

6.1 Trust Administration Framework

The administrative framework governing trusts within the United Kingdom is defined by a body of statutory laws, with the Trustee Act of 2000 serving as a foundational legislative instrument.[75] The Trustee Act proclaims the trustees' fiduciary duties, mandating the requirements and adherence to the trust deed. This legislative act is essential for ensuring that trustees prioritise the beneficiaries' interests, thereby upholding the integrity and objectives of the trust.

6.2 Legislative Framework for Trust Taxation

The taxation of trusts in the United Kingdom is shaped by a comprehensive legislative framework that includes crucial statutes such as the Inheritance Tax Act of 1984, the Income

[73] Ames, J. B,1908, The Origin of Uses and Trusts. Harvard Law Review, 21(4), 261-274.
[74] Scott, A. W,1922, The Trust as an Instrument of Law Reform. Yale Law Journal, 31(5), 457-468.
[75] Great Britain,2000, Trustee Act of 2000 (c. 29).

Tax Act of 2007, and the Taxation of Chargeable Gains Act of 1992. These legislative acts form the primary legislation used to determine the taxation obligations and systems that impact trusts, trustees, and beneficiaries in the United Kingdom.

The United Kingdom's taxation of trusts incorporates a dual approach that initially recognises the distinct legal nature of trusts followed by the pass-through nature of trusts for specific distribution purposes. This two-tier taxation system, initially levying taxes at the trustee level and then potentially at the beneficiary level, depending on the distribution of trust income or capital gain. The residence-based and trust income attribution rules will be discussed further below in the chapter.

The United Kingdom's Diverse Trust Landscape

This discussion below explores the complexity of trusts in the United Kingdom, examining the various types and their unique tax implications. It briefly analyses the taxation of trust income and capital gains, highlighting the variations based on the specific trust structure[76].

Taxable Trusts

- Bare trusts stand out in the United Kingdom taxation landscape for their simplicity and transparency, offering a straightforward mechanism for asset transfers. Beneficiaries have a direct entitlement to the trust's income and capital in these types of trusts. [77]This direct entitlement entails that the trust is treated as transparent for tax purposes, taxing all income and gains in the hands of the beneficiaries as if they directly owned the assets.
- Interest in Possession Trusts is distinguished from other types of trusts by allowing the beneficiary an immediate entitlement to the trust's income as it arises, following the deduction of any expenses that align with the income. These types of trusts entail, trustees the discretion to distribute all net income to the beneficiaries, who in turn are responsible for the tax liability.[78]
- Discretionary and Accumulation Trusts distinctive difference from other types of trusts is the flexibility it allows trustees to make decisions about the distribution of income and capital in the trust. Further specific taxation rules with regards to taxation of income received in the trust is unique to these types of trusts.[79] Additionally, income accumulated within the trust is taxed at a specific trust rate which emphasises strategic trust accumulations which can be leveraged for future distributions to beneficiaries.

[76] GOV.UK, n.d. '*Types of Trusts',2024*
[77] Her Majesty's Revenue and Customs,2024, Trusts, Settlements and Estates Manual - TSEM1563 - Introduction to trusts: types of trust: bare or straightforward trust.
[78] Her Majesty's Revenue and Customs,2024, Trusts, Settlements and Estates Manual - TSEM1564 - Introduction to trusts: types of trust: interest in possession trust.
[79] Her Majesty's Revenue and Customs,2024, Trusts, Settlements and Estates Manual - TSEM1565 - Introduction to trusts: types of trust: accumulation/discretionary trust.

- Settlor-interested trusts are structured to ensure the taxation liability of the trust falls on the settlor.[80]This approach to trust taxation underscores the principle that if the settlor retains an interest or potential benefit in the trust's assets or income, they are considered to have an ongoing economic ownership of these assets for tax purposes.

Tax-exempt Trusts

While various tax-exempt trusts exist in the United Kingdom each serving societal, charitable, or employee welfare purposes, charitable trusts stand out for their significant tax benefits. Further in the chapter, a more detailed analysis of charitable trusts will be discussed, examining how their tax-exempt status influences their ability to address tax neutrality and equity principles within the United Kingdom's trust taxation landscape.

The diversity of trusts mentioned above highlights the complexities of the United Kingdom's trust framework. Each trust type is subject to specific tax legislation and regulatory norms, reflecting the trust's main purposes and benefits. While this discussion provides insight into the common types of trusts, it is important to understand that it does not include more specialised or complex trust structures used in the United Kingdom.

Capital Gains Tax Rules for Trusts

Capital Gains Tax (CGT) legislation rules for trusts in the United Kingdom vary depending on the type of trust, with distinct implications for beneficiaries, trustees, and settlors.[81]

- Bare Trusts: Beneficiaries are considered direct owners of the trust assets. Therefore, CGT applies to the beneficiaries upon the disposal of trust assets.
- Interest in Possession Trusts: Trustees are responsible for CGT on gains from asset disposals, with beneficiaries of these types of trusts not directly liable for CGT on these gains.
- Discretionary and Accumulation Trust: These types of trusts assign the responsibility of CGT on gains to trustees, with these trusts benefiting from an annual CGT exemption that is half that available to individuals.
- Settlor-Interested Trusts: CGT implications might affect the settlor significantly if they benefit from the trust's assets.

The general CGT exemption for trusts, for the 2023 tax year of assessment, reflects a tailored approach to different trust structures, with £6,000 for disabled persons' trusts and £3,000 for all other trusts.[82] The specific trust CGT reliefs, such as Private Residence Relief and Business Asset Disposal Relief, can reduce CGT tax liabilities where possible.

[80] Her Majesty's Revenue and Customs,2024, HS270 Trusts and settlements — income treated as the settlor's.
[81] Her Majesty's Revenue and Customs,2024, Trusts and taxes - Trusts and Capital Gains Tax.
[82] Her Majesty's Revenue and Customs,2024, Trusts and taxes - Trusts and Income Tax.

These general taxation laws briefly demonstrate the specific approach to capital gains taxation in the complex environment of trusts in the United Kingdom.

Trust taxation rates

The United Kingdom's trust tax system subject's specific income tax rates tailored to the nature and amount of trust income of the trust. The trust taxation is further defined in a tiered taxation structure to address the diverse types of trust and various incomes.[83] These taxation rates are briefly classified as follows:

- Standard Rate Band: Trusts benefit from a standard rate band on the first £1,000 of trust income. This income is taxed at 20% for non-dividend income and 8.75% for dividend income. This taxation rate band is particularly relevant for accumulation or discretionary trusts and is further divided if the settlor has established multiple trusts.
- Interest in possession trustees: These types of trusts particularly pay income tax at 8.75% (dividends) or 20% (all other income). Trust income that is mandated to the trust beneficiary is taxed in the beneficiaries' hands and is included on the beneficiaries' tax return.
- Above Standard Rate Band: Higher taxation rates apply for trust income that exceeds the standard rate taxation band. Non-dividend trust income above this standard threshold is taxed at 45%, while dividend income is taxed at 39.35%. These taxation rates reflect the progressive nature of the United Kingdom's trust tax system, aiming to tax higher income levels at higher rates.

This structured approach to trust taxation ensures a balanced taxation mechanism, considering the trust's various income types and distributions. It highlights the division of tax obligations between trustees and beneficiaries, embodying the transparency principle in trust taxation by aligning tax liabilities with the economic benefits derived from the trust assets.

6.3 Trust Taxation Mechanisms in the United Kingdom

This analysis below will examine the complexities of trust taxation in the United Kingdom, particularly the residency rules and income attribution mechanisms. Lastly, this analysis will examine how charitable trusts facilitate wealth redistribution and promote social goodwill in the United Kingdom.

[83] HMRC, n.d. Trusts Settlements and Estates Manual: TSEM1002.

6.3.1 Residence Source Regulations

In the United Kingdom, determining a trust's tax residency is primarily governed by the Income Tax Act of 2007.[84] These legislative provisions broadly state that the residency status of a trust is based on the residency of its trustees:

- A trust is deemed a resident of the United Kingdom if all its trustees are residents of the United Kingdom for tax purposes. Conversely, the trust is considered non-resident if all trustees reside outside the United Kingdom. In cases where the trustees' residency is mixed, the residency and domicile status of the settlor at the time the trust was established or when assets were included as ownership by the trust, play a crucial role in determining the trust's residency.
- Corporate Trustees: The residency status of a trust with corporate trustees may also be influenced by the presence of a branch, agency, or permanent establishment within the United Kingdom.

6.3.2 Trust Income Attribution Mechanisms

As discussed in Chapter 5: Global Trust Taxation Frameworks, the global analysis of trust taxation frameworks reveals a complex landscape shaped by three primary considerations: the mechanism used for taxation, the focus on the individual taxed, and the distinction between viewing the trust as a separate entity or adopting a flow-through system[85]. These approaches yield diverse implications for the taxation of trusts across jurisdictions, reflecting a blend of administrative efficiency, equitable tax treatment, and the prevention of double taxation.

Building on this foundational understanding, this section delves into the specific trust income attribution mechanisms employed by the United Kingdom. By examining the UK's approach, we can illustrate how global taxation considerations are tailored to meet national objectives, regulatory standards, and societal demands. This analysis will highlight the benefits and disadvantages of the UK's system, providing a basis for comparing it with the trust taxation frameworks of the United States and South Africa in subsequent chapters.

United Kingdom’s Trust taxation rules

The United Kingdom's taxation of trusts demonstrates a complex interaction between residence regulations with entity and flow-through principles. The United Kingdom uses a Credit System to avoid double taxation in trust structures[86].

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[84] As defined in sections 475 and 476, Chapter 2, Part 9 of the Income Tax Act, 2007.
[85] Du Plessis, I,2018, p.273-274
[86] Du Plessis, I,2018, p.273-274

The Credit System functions on two main aspects:

Trustee Taxation: The trustee is first taxed on the income produced by the trust's assets. This stage of taxation treats the trust as a separate entity, liable for its tax obligations, thereby establishing the trust's tax contribution at this primary level.

Beneficiary Taxation with Credit: When a trust distributes funds to beneficiaries, these distributions are subject to taxation for the beneficiaries. The United Kingdom's Credit System addresses the problem of double taxation by providing beneficiaries with a credit for the tax paid by the trustee at the trust level. This critical step ensures that the income is taxed only once, effectively preventing the economic burden of double taxation.

Hybrid Trust Taxation System

As stated by Easson and Thuronyi, the United Kingdom’s treatment of trusts deviates from strict adherence to either the separate entity or flow-through taxation system[87]. Instead, it embraces a hybrid approach characterised by:

Separate Entity Taxation: The trust acts as independent entity for taxation purposes, with income initially taxed at the trust level, regardless of future distributions.

Distribution Considerations: While the initial trust taxation disregards distributions, a crucial element – the credit system – addresses potential inequities, especially for beneficiaries in lower tax brackets. This credit compensates beneficiaries for taxes already paid by the trust, blurring the lines between a pure separate entity system and a flow-through approach.

Analysing the United Kingdom's trust taxation structure provides valuable insights into balancing equality, efficiency, and anti-avoidance. The essential features of the United Kingdom's tax system are as follows:

Credit System: The United Kingdom implements a complex credit system that reduces the possibility of double taxation and ensures equal tax treatment of beneficiaries for trusts. This approach permits taxes paid at the trust level to be reimbursed to beneficiaries, ensuring that income is taxed transparently and fairly at the beneficiary level.

Progressive Taxation to Enhance Equity: The United Kingdom’s use of progressive taxation rates and credits within its trust taxation system ensures a more equitable distribution of tax burdens. By considering the varying financial circumstances of beneficiaries, the taxation system aims to achieve a progressive tax outcome that fairly allocates tax liabilities.

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[87] Easson, A and Thuronyi, V (1998) “Chapter 21: Fiscal Transparency” in Tax Law Design and Drafting, International Monetary Fund, pages 26-27.

Consistency and Transparency in Tax Laws: The United Kingdom's trust taxation framework benefits from the consistent application of tax laws and clear, transparent guidelines for both trusts and beneficiaries.

The United Kingdom's approach, focusing on fairness, efficiency, and the prevention of avoidance, provides a valuable model for other countries seeking to optimise their trust taxation systems.

6.3.3 Charity Trusts

The charity trust landscape in the United Kingdom is intrinsically connected to the country's history, reflecting a long heritage of philanthropy and wealth redistribution to uplift the socio-economic circumstances of its people. The United Kingdom's commitment to philanthropy is evidenced by its third-place ranking in the Charities Aid Foundation (CAF) World Giving Index for 2023. [88]

This long history of generosity, which is motivated by active social participation and supported by a strong regulatory framework, demonstrates how philanthropy benefits communities and social welfare in the United Kingdom. The United Kingdom’s strategic use of legislative support combined with charity initiatives provides a model for other countries seeking to expand their charity sectors and address social issues.

Legal Framework for Charitable Trusts

The Charities Act of 2011 is a crucial legislation for the governance of charitable trusts in the United Kingdom.[89] This legislative framework establishes the criteria for what qualifies as a charitable trust and details the different charitable activities a charitable trust should undertake. Charitable trusts in the United Kingdom must ensure that their aims and activities comply with the principles of the relevant law to address social concerns effectively.

Integral to this legal architecture for charitable trusts is the oversight provided by the Charity Commission for England and Wales.[90] The Commission's role transcends mere regulatory oversight; it ensures that charitable trusts adhere to the legal requirements, safeguarding the sector's integrity and effectiveness. The Commission instils public confidence through its vigilant monitoring and enforcement, ensuring that charitable activities are transparent and aligned with their stated missions.

[88] Charities Aid Foundation,2023, Comparative Philanthropy Report 2023.
[89] Great Britain,2011, Charities Act 2011 (c. 25).
[90] Charity Commission for England and Wales,2024, About the Charity Commission.

Charitable Trusts: Tax Benefits and Considerations

The United Kingdom strategically uses tax incentives to stimulate philanthropic activity, benefiting donors and charitable trusts.

These initiatives encourage individual generosity and ensure charitable trusts have a robust financial means to execute their missions, ultimately promoting more significant social equity.

Once a charitable trust is established and recognised as having a charitable status, it becomes eligible for significant tax advantages. One of the primary taxation benefits is that charitable trusts do not pay tax on most types of income and capital gains, provided that this income is used for charitable purposes.[91] This exemption includes but is not limited to, income from donations, sales, and investments. The concept of "charitable expenditure" is central to these tax advantages, ensuring that the funds align with the trust's charitable objectives and not for private benefit or commercial purposes.[92]

To maintain these tax advantages, charitable trusts must comply with strict regulations and reporting requirements set by the Charity Commission in England and Wales. These requirements include submitting annual tax returns and accounts, which allow the regulatory bodies to ensure that the charity continues to operate for the public benefit and its charitable purposes.[93]

The United Kingdom's governance of charitable trusts serves as a valuable model for organised, purposeful philanthropy. The United Kingdom’s charitable trusts framework shows how charitable trusts may significantly enhance social progress via its solid legal framework, diverse trust forms, and advantageous tax incentives. This framework for charitable causes facilitates the efficient channelling of resources to various causes and encourages philanthropic giving through financial incentives, thereby maximising the impact on societal well-being. The effectiveness of the charity trust sector in the United Kingdom highlights the significance of a methodical and planned philanthropic strategy in tackling inequality and poverty. It serves as a compelling demonstration of how organised philanthropy can drive beneficial societal change in a country.

6.4 Framework for Trust Transparency

The United Kingdom's strategy of improving trust transparency by disclosing beneficial ownership information sets a high standard for dealing with the lack of clarity in trust arrangements in the country. This section examines the United Kingdom's beneficial ownership transparency measures regarding trusts in the country.

[91] Her Majesty’s Revenue and Customs,2024, Charities and tax.
[92] Her Majesty’s Revenue and Customs,2024, Charities and tax
[93] Charity Commission for England and Wales, 2024

6.4.1 Public Beneficial Ownership (PBO) Register

The United Kingdom pioneered the implementation of the PBO Register for the financial sector, marking a significant shift in the global financial transparency landscape. The United Kingdom's PBO registry was established in June 2016, making it one of the first nations to do so, thereby setting a precedence for nations worldwide.[94]

The Significance of the PBO Register

The PBO Register represents a crucial step in addressing the longstanding issue of hidden ownership in the United Kingdom. This public accessibility of PBO registers in the United Kingdom is a crucial differentiator from similar registers in other jurisdictions, which may impose stricter access measures to law enforcement or specific regulatory bodies. The United Kingdom’s legislative approach to transparency in the financial sector facilitates a wider scrutiny by authorised parties and the public to investigate and uncover potential illicit activities through beneficiation ownership transparency. [95]This complex issue of varying access levels regarding beneficial ownership will be further analysed in Chapter 8.

6.4.2 Trust Registration Service (TRS)

The United Kingdom’s TRS system was first introduced in 2017 under the European Union’s Fourth Money Laundering Directive to improve transparency surrounding the beneficial ownership of assets held in trusts within the United Kingdom.[96] This initiative aligned with the European Union’s (EU) broader anti-money laundering directives, which aimed to combat money laundering and terrorist financing in EU nations.

The EU’s Fifth Money Laundering Directive regulation, effective from October 2020, significantly extended the TRS's scope in the United Kingdom. This extended legislative scope of the TRS system led to most trusts in the United Kingdom needing to register with the TRS system, with only certain exemptions available for specific trusts.[97] All trustees are required to maintain accurate and up-to-date beneficial ownership records regardless of the trust’s registration status. The TRS system provides a centralised system for trustees and personal representatives of complex estates to comply with their reporting and registration obligations regarding beneficial ownership transparency in the United Kingdom.

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[94] Shalchi, A and Mor, F,2022, Registers of beneficial ownership. Commons Library Research Briefing.
[95] Robinson, T.R. and Loft, P.L,2023, Registers of beneficial ownership - House of Commons Library.
[96] Fenley. A ,2022, What is the Trust Registration Service TRS, and do you need to register your trust, Mercers Solicitors.
[97] Howe.C. and Emmerson.D,2024, Key changes to the UK trust registration service since 1 September 2022. Farrer & Co: Independent Lawyers in London, UK.

The United Kingdom's pioneering approach to enhancing trust transparency, focusing on the transparency of beneficial ownership, sets a benchmark for addressing trust-related opacity within complex legal structures. This initiative is rooted in a comprehensive framework designed to identify and register the actual beneficiaries behind trust assets.

The TRS system, which plays a pivotal role in collecting and safeguarding critical information regarding beneficial ownership, is central to this effort by the United Kingdom.

6.5 United Kingdom's Trusts: A Framework of Transparency

The exploration of the United Kingdom's trust system reveals a sophisticated blend of historical evolution, legal framework development, and commitment to transparency and tax compliance. From its roots in medieval "uses" to establishing the TRS system and participation in global transparency initiatives, the United Kingdom has consistently led by example in the realm of trust law and administration. Adopting digital solutions for trust registration, implementing public beneficial ownership registers, and active engagement in international information exchange networks underline the United Kingdom's proactive approach to combating financial opacity and enhancing trust transparency. This comprehensive approach addresses the inherent challenges of trust structures and sets a precedent for global best practices in trust oversight, beneficial ownership disclosure, and tax compliance. By prioritising clarity, accountability, and technological innovation, the United Kingdom's trust system offers valuable insights and models for jurisdictions worldwide, aiming to strengthen their financial regulatory frameworks and foster an environment of equitable wealth management and philanthropy. The United Kingdom's refined trust system, shaped by centuries of tradition and modernisation for the current era, stands as a global benchmark for legal and financial trust structures. The United Kingdom's continued emphasis on transparency, accountability, and prioritising public interest offers a compelling blueprint for nations seeking ethical and enduring governance in the trust sector.

7 The United States of America’s Trust System

The United States of America's approach to trust taxation, with its extensive legislative framework and various trust structures, provides an established foundation for asset management and estate planning techniques in the country’s financial landscape. This chapter provides an overview of the United States Trust Taxation System as well as examining the relationship between the United States Trust System and Wealth Inequality, specifically how the structural and legal specifics of the American system influence wealth distribution.

7.1 Foundation of Trusts

The evolution of trust legislation in the United States demonstrates the legal framework's adaptability, to continuously respond to the nation's shifting social and economic needs. Trusts, which originated in English common law, have seen a substantial transition in the United States, from an approach to administer estates and safeguard assets to becoming an intricate instrument for financial planning, crucial to the American legal framework.[98]

A trust as defined in the American landscape, is defined legally as a fiduciary arrangement in which a trustee administers assets for the benefit of beneficiaries within a framework governed by State and Federal laws. This framework incorporates individual State legislation and case law as well as national laws which apply to most states in the United States of America.

The Uniform Trust Code (UTC), established in 2000, has played a critical role in standardising trust legislation throughout the United States of America. The UTC attempts to offer a consistent framework to govern trusts under the United States federal law system which thereby goes against the current system of trust law under individual State regulation. The UTC legislation's enactment by thirty-six states in the United States of America exemplifies a major change in the legislative direction in the trust sector.[99] This legislative approach, shown by the UTC and state-specific regulations, demonstrates the American legal system's responsiveness to the intricacies of contemporary trust structures.

The transition from common law foundations to a modern statutory framework demonstrates the United States' dynamic legal adaptability to shifts in society. It highlights the value of trusts in wealth management and protection throughout generations, highlighting the legal system's role in promoting trust and dependability in fiduciary relationships. This transition demonstrates a profound understanding of the trust's position in the fabric of American society, demonstrating the legal system's continual commitment to adapting and responding to changing demands.

[98] Langbein, J.H,2006-2007, Why Did Trust Law Become Statute Law in the United States? Alabama Law Review, 58(5), 1069-1082.
[99] Uniform Law Commission,2024, Trust Code - Uniform Law Commission.

Legislative Foundations: Exploring the Complexities and Details

The United States Code (USC) is the official consolidation and codification of the general and permanent federal laws of the United States.[100] Title 26 of the USC, known as the Internal Revenue Code (IRC), contains all the federal tax laws. Subchapter J of the IRC provides the framework for trust taxation in the United States.

Defining Trusts for Tax Purposes

For federal income tax purposes in the United States, a trust is a distinct taxable entity. The IRC further describes a trust as an arrangement established through a will (upon death) or a trust instrument (during life), where a trustee holds the legal title to property to protect and conserve it for the trust's designated beneficiaries. [101]

7.2 Residency and Source Rules in Trust Taxation

In the field of trust taxation, the Internal Revenue Service (IRS) classifies trusts into two main categories: domestic (US residents) and foreign (non-US residents). The IRS uses two primary factors to determine a trust's residency status[102]:

1. The Court Test

This legislative requirement mandates if a United States federal or state court has the authority to supervise the trust's administration, then in these circumstances the trust will be seen as resident for tax purposes in the United States of America.[103] However, a trust's eligibility under the Court Test requirement is jeopardised if its governing documents permit a migration that evades a United States court jurisdiction, this may result in automatic disqualification of this legislative requirement.[104]

2. The Control Test

This legislative requirement provides that the capacity to make all substantial decisions affecting the trust must reside with a United States resident trustee.[105] This legislative requirement essentially is used to determine where the trust is effectively managed.

Further Source rules for determination of taxation of Foreign Trusts:

- Grantor Trusts: The grantor remains responsible for the taxation liability of the trust in the United States of America. This responsibility remains even if the grantor does not

[100] Office of the Law Revision Counsel,2024, Title 26 - Internal Revenue Code, S674-679
[101] United States Treasury Department. (2024). Code of Federal Regulations, Title 26, Part 301.7701-4 – Trusts.
[102] US Treas.Reg.§ 301.7701-7(a)(1)).
[103] US Treas.Reg.§ 301.7701-7(c)(1)).
[104] US Treas.Reg.§ 301.7701-7(c)(4)(ii)).
[105] US Treas.Reg.§ 301.7701-7(d)(1)(ii)).

personally receive earnings from the trust, with certain exceptions based on the circumstances.[106]

- Non-Grantor Trusts: These types of trusts may defer the income taxation until distributions reach the United States beneficiaries of the trust. If the trust accrues income or profits from the United States of America and opts to retain this income, the trust will be responsible for tax purposes from a United States perspective.[107]

To effectively qualify as a domestic trust within the United States of America, a trust must successfully meet both the Court and Control Tests.[108] This process is further complicated based on the various state legislation and foreign trust rules that could affect the residence of the trust. This intricate framework of trust residence rules underscores the meticulous balance sought between equitable taxation and discouraging the undue use of trusts for tax avoidance in the United States of America.

7.3 Trust Taxation Mechanisms in the United States

As outlined in Chapter 5: Global Trust Taxation Frameworks, the global analysis of trust taxation frameworks reveals a complex landscape shaped by three primary considerations: the mechanism used for taxation, the focus on the individual taxed, and the distinction between viewing the trust as a separate entity or adopting a flow-through system[109]. These approaches yield diverse implications for the taxation of trusts across jurisdictions, reflecting a blend of administrative efficiency, equitable tax treatment, and the prevention of double taxation.

Assessing the effectiveness and efficiency of the U.S. trust taxation system and comparing it with those of the United Kingdom and South Africa, allows for the identification of best practices and areas for potential improvement. This examination explores the critical approaches utilized in the U.S., including mechanisms for assigning tax liability, the application of specific residence rules within the trust structure, and the distinction between treating the trust as a separate entity or as a conduit for trust income distribution. Building upon this foundational understanding, attention is now turned to the trust taxation mechanisms employed by the United States.

The Deduction System Model

The United States of America uses a deduction system for the taxation of trusts.[110] In a deduction system, the trust and the beneficiaries are taxed for income tax purposes.

[106] US Treas.Reg.§ 301.7701-7(a)(2)(i)).
[107] US Treas.Reg.§ 301.7701-7(a)(2)(ii)).
[108] US Treas.Reg.§ 301.7701-7(d)(1)).
[109] Du Plessis, I,2018, p.273-274
[110] Du Plessis, 2018, p.275

Where this taxation system differentiates is concerning distributions to beneficiaries, in this regard, the trust is allowed a deduction for distributions to beneficiaries[111].

The Grantor Trust Regime

The "grantor trust" framework encapsulates a noteworthy variant within the United States taxation framework.[112] Under this arrangement, if a grantor (or settlor) maintains significant control over, or stands to benefit from, the trust, the tax liability for the trust's income is directly imputed to the grantor.

This approach effectively aligns with the grantor residency rules as explained above, underscoring the tax implications of the grantor's retained interests or powers within the trust structure. This specific framework of taxing trusts based on the residence of the settlor is perceived as unfair for the settlor in circumstances where the settlor has a small contribution to the trust with the greatest part of the trust income arising from other sources. This taxation method effectively highlights the significance of control and benefit retention in determining trust tax responsibilities in the United States of America.

Entity vs. Flow-Through Similarities[113]

The United States tax treatment of trusts isn't purely flow-through or entity-based. It creates a balanced trust taxation system with the following notable distinctions:

- Flow-through for Distributions: When a trust distributes income to its beneficiaries, it acts like a flow-through entity. The beneficiaries report that income on their tax returns.
- Entity-based for Retained Income: If the trust retains income instead of distributing it to the specified beneficiaries, the trust itself is taxed on that retained income at trust taxation rates. Here, the trust acts more like a separate entity responsible for its tax burden.

The United States trust taxation system, through its implementation of the deduction system and the grantor trust regime, alongside hybrid elements of the distribution mechanisms, exemplifies a complex yet coherent taxation structure. This framework is designed to allocate tax liabilities to minimise double Taxation while reflecting the dynamic interplay between trusts and their beneficiaries. It underscores the intricate considerations inherent in the Taxation of trusts, balancing the principles of autonomy, control, and equitable tax distribution in the United States of America.

[111]Du Plessis, 2018, p.275
[112]Du Plessis, 2018, p.275
[113]Du Plessis, 2018, p.275

7.4 Classification of Trusts for Taxation Purposes

Trusts are essential estate planning instruments that establish a fiduciary relationship among three primary parties: the grantor (or settlor), who contributes the property to the trust; the trustee, who is tasked with managing the trust's assets; and the beneficiary, who is designated to benefit from the trust.[114] This arrangement is designed to fulfil a specific purpose as outlined by the grantor, facilitating the management and distribution of assets of the trust according to predetermined terms(Trust Deed).

There are two primary tax categories of trusts: Grantor Trusts and Non-Grantor Trusts.

Grantor Trusts

Grantor trusts are defined by the grantor's significant control over the trust's assets and decisions regarding income distribution, asset reallocation, and revocability. The grantor's retention of power over the trust translates into specific tax responsibilities; notably, the income generated by a grantor trust is taxed directly to the grantor[115].

Non-Grantor Trusts

Non-grantor trusts, on the other hand, signify a transfer of control from the grantor to the trust. This transition of control establishes the trust as an independent entity from the grantor for tax purposes. Assets placed into a non-grantor trust are removed from the grantor's estate, offering protection from the grantor's creditors and estate taxes, thereby securing benefits for the beneficiaries. Taxation of distributed income from non-grantor trusts is carried out differently; the trust deducts distributions made to beneficiaries, thus reducing its taxable income[116]. The income retains its character (e.g., ordinary income, capital gains) when passed on to beneficiaries, who then assume the tax liability[117].

In summary, the choice between a grantor and a non-grantor trust is based on the grantor's objectives regarding control, tax efficiency, and protection of assets. Grantor trusts offer the grantor continued influence over the trust's direction with direct tax implications. In contrast, non-grantor trusts separate the trust's assets from the grantor, with distinct beneficiary tax advantages.

[114] Internal Revenue Service,2024, Abusive Trust Tax Evasion Schemes - Questions and Answers.
[115] Office of the Law Revision Counsel,2024, Title 26 - Internal Revenue Code, S674-679
[116] Office of the Law Revision Counsel,2024, Title 26 - Internal Revenue Code, S661
[117] Office of the Law Revision Counsel,2024, Title 26 - Internal Revenue Code, S662

7.4.1 Fiduciary Income Taxation

A "Fiduciary" is the person or entity holding legal title to the assets in the entity and responsible for its management and care. A fiduciary is also referred to as a "trustee" in a trust arrangement.[118]

The principle underlying fiduciary income taxation in the United States of America is that non-grantor trusts and estates function similarly to partnerships regarding how taxable income is passed through to beneficiaries. This system ensures that income generated by these fiduciary entities is ultimately taxed at the level of the beneficiaries. Unlike partnerships, however, trusts and estates have a dual capacity – they can act as separate tax-paying entities or as conduits for income distribution[119].

Taxation of fiduciary Entities

For purposes of trust taxation, fiduciary entities are further categorized into simple trusts, complex trusts, and estates. This categorization aims to ensure equitable taxation based on the varying distribution mechanisms used by these entities.

For this discussion, the focus will be on simple and complex trusts.[120]

Distributable Net Income (DNI)

To comprehensively understand the distinctions between simple and complex trusts within the United States taxation framework, it is imperative to first examine the fundamental concept of Distributable Net Income (DNI).[121] DNI serves as a cornerstone in the Taxation of trusts and estates in the United States of America. This concept establishes the income from a trust or estate taxable to the beneficiaries, distinguishing the income taxable at the entity level from that taxable to the individuals receiving distributions from the trust[122].

Calculation of DNI

The calculation of DNI in broad terms, is the trust's distributable gross income minus allowable deductions with further adjustments as specified by the tax regulations.[123]

Impact on Beneficiaries

For beneficiaries, the portion of any distribution they receive from a trust or estate considered DNI is taxable. This income retains its character as it flows through to the beneficiaries, meaning that if the DNI consists of interest, dividends, or capital gains, the beneficiaries will

[118] 26 U.S.C. § 7701(a)(6))
[119] 26 U.S.C. §§ 641-692
[120] Title 26 - Internal Revenue Code § 643
[121] Title 26, I.R.C § 643
[122] 26 U.S.C. § 643(a))
[123] 26 U.S.C. § 643(a))

be taxed accordingly. This ensures that income is taxed in a manner consistent with its source[124].

In summary, DNI is a critical concept in the Taxation of trusts and estates, acting as a bridge to allocate tax responsibilities between the fiduciary entity and its beneficiaries. Its calculation and application are integral to equitable and efficient income taxation as it moves from the entity to the individuals who benefit from it.

Simple Trusts

A simple trust calculates its fiduciary income for tax purposes and distributes this income to the beneficiaries as a mandatory provision regardless of the income being distributed or not to the beneficiary.[125] The distribution deduction for the simple trust is limited to the distributable net income DNI, ensuring that the trust can only deduct the amount of income it is obliged to distribute currently. [126]Another key requirement of a simple trust is that no charitable contributions are allowed to be made or deducted from the trust.

Complex Trusts

In contrast to simple trusts, a complex trust does not require the current distribution of all trust income and charitable contributions are allowed in complex trusts.[127] As seen with a simple trust a complex trust's deduction on distribution is also limited by its DNI.[128]

When it comes to the distribution mechanism for complex trusts it is further differentiated to that of simple trusts. The distributions of complex trusts are divided into a tier system which consists of two tiers. Tier, one acts like a mechanism seen where all income of the trust is required to be distributed as seen with simple trusts. Whereas tier two is seen as all other income that does not fall under the tier one distribution. [129]The purpose of this tier system is to ensure that all distributed income that falls under the DNI will be allocated to the first tier which will be regarded as taxable income and the other income that does not fall under the tier one will be seen as non-taxable income.

The primary difference between simple and complex trusts lies in the mandatory distribution of income and how it impacts their deductions for trust tax purposes.

[124] 26 U.S.C. §§ 652(b), 662(b))
[125] US Treas.Reg.§ 1.651(a)-1
[126] I.R.C § 651(a)
[127] US Treas.Reg.§ 1.651(a)-1
[128]I.R.C §661(a)(2)
[129]I.R.C §662(a)(2)

Income tax rates applicable to trusts

Trusts have a distinct tax bracket structure with the highest marginal rate (37%) applied to income over $14,450 in 2023[130].This structure is significantly more compressed than that for individuals, where the highest rate applies at much higher income levels. The result is a potentially higher tax burden for trusts, particularly those generating modest income. The rationale behind this system is to encourage the distribution of trust income to beneficiaries, who might be taxed at lower rates.

The United States of America trust legislation system is pivotal in estate and wealth management, showcasing a complex interplay of laws and regulations designed to facilitate asset management, protection, and transfer across generations. The UTC and specific state laws offer a standardised approach to trust creation, operation, and termination, reflecting the dynamic legal adaptation to societal and financial complexities. Trust taxation in the United States of America governed by Subchapter J of the Internal Revenue Code, outlines the tax obligations and roles of trusts, trustees, and beneficiaries, distinguishing between grantor and non-grantor trusts for tax purposes. This framework ensures that trusts are taxed equitably, whether as separate entities or conduits for income distribution, with specific provisions to prevent double Taxation and maintain the financial system's integrity.

The distinction between simple and complex trusts, based on their distribution mechanisms and the ability to make deductions, further shows the intricacies of trust Taxation in the United States of America. DNI plays a crucial role in determining how income is taxed to beneficiaries, ensuring that income distribution is taxed at the recipient level to align with the principle of equitable Taxation. As this discussion transitions from understanding the intricacies of the United States Trust Taxation System, the next part of this chapter will examine the United States Trust System and Wealth Inequality. This analysis will explore how the United States trust system's structural and regulatory nuances contribute to wealth distribution, potentially exacerbating economic disparities.

7.5 U.S. Trust System and Wealth Inequality

Following the brief exploration of the United States trust taxation system at the beginning of this chapter, this last section of the chapter will critically examine the United States trust system in the context of wealth inequality and tax equity. While offering intricate mechanisms for tax minimisation, asset protection, and intergenerational wealth transfer, the United States trust framework has been critiqued for its role in perpetuating wealth disparities. Such structures, mainly accessible to those of considerable wealth, facilitate the sequestration and

[130] I.R.C § 1e)

growth of wealth in ways that often evade equitable Taxation, contributing to a widening economic divide.

In this context, this discussion seeks to unravel how the United States of America's trust system exacerbates wealth concentration among the affluent through specific legislative mechanisms. The section of the chapter examines the broader implications for societal equity and tax justice by dissecting the economic ramifications and legislative frameworks underpinning such wealth consolidation.

The Influence of Trusts on Wealth Concentration in the United States

The global landscape of financial secrecy, traditionally dominated by offshore tax havens, has seen a significant shift towards the United States. This transition was highlighted by the fallout from Russia's invasion of Ukraine, as the world's attention turned to the hidden assets of Russian elites.[131] Such scrutiny revealed the international and domestic elites' preference for the United States of America as a sanctuary for their fortunes. This expanding wealth, speculated to be concealed within trusts, underscores a deepening chasm of wealth inequality in the United States.

Trusts and the Escalation of Wealth

At the heart of this escalating wealth concentration are trusts, sophisticated legal frameworks that have evolved from simple estate planning tools to potent wealth accumulation and tax avoidance instruments. The United States harbours an estimated $5.6 trillion in trust and estate assets, predominantly owned by the wealthy.[132] These assets, often obscured within states that have tailored their laws to accommodate such wealth, contribute to the United States's emerging reputation as a global tax haven.

Trusts have become vital for the rich to transform their wealth into enduring dynasties. Dynasty Trusts, a key to the American trust sector, is designed to protect family assets while minimising oversight and taxation. Dynasty trusts exploit the concept of "ownership limbo" – where trust assets legally belong to neither the grantor, beneficiary, nor trustee.[133] These trusts can exist for centuries or indefinitely, allowing assets to grow virtually untaxed across generations while being shielded from creditors and tax authorities.

States in America Facilitating Wealth Accumulation through Trusts

The United States of America has witnessed a significant transformation in how wealth is protected and increased among certain individuals. This increase in wealth is primarily

[131]Thomhave, K. and Collins, C,2021, Dynasty Trusts: How the Wealthy Shield Trillions from Taxation Onshore. Institute for Policy Studies.
[132] Thomhave and Collins, 2021.
[133] Knobel, A. (2017), Trusts: Weapons of Mass Injustice, tax justice network.

attributed to the strategic use of trusts facilitated by specific states in America.[134] These states have tailored their laws over decades to attract trust businesses by offering low or no taxes and the added benefit of high levels of secrecy within these states. A key example of how these states have attracted wealthy individuals is through repealing or weakening the Rule Against Perpetuities which has allowed dynasty trusts to protect assets across generations.[135]

Impact on Wealth Inequality and State Policy

The strategic use of trusts in the United States of America has profound implications for wealth inequality among its citizens. The abuse of trusts by the wealthy to avoid federal and state taxes deprives the government of essential revenue. This directly limits the government's ability to fund programs that aim to reduce inequality among Americans. At a state level, this inequality is further emphasised in states with a high concentration of trusts whose sole endeavour is to limit or avoid taxation for wealthy individuals from a state level as well as a federal level. This then leads to a regressive tax system in these States, where the burden of taxation disproportionately falls on lower-income residents. These dynamic underscores a troubling correlation between states that cater to the trust industry and those with the most inequitable tax systems.

Implications for South Africa's Trust Taxation Framework

The examination of wealth inequality facilitated by trusts in the United States underscores the potential risks and societal impacts inherent in complex trust taxation systems. South Africa, in its efforts to reform and enhance its trust taxation framework, can draw critical lessons from the U.S. experience:

1. Preventing Wealth Concentration:
   South Africa must consider how its trust taxation mechanisms can prevent the excessive concentration of wealth among the affluent, ensuring that trusts serve their intended purpose without exacerbating economic disparities.
2. Enhancing Transparency:
   The U.S. example highlights the necessity of comprehensive transparency measures. South Africa should prioritize the adoption of standardized trust registration and disclosure requirements to mitigate the risks of tax evasion and illicit financial flows.
3. Balancing Flexibility and Equity:
   While the flexibility of the U.S. system allows for tailored tax strategies, it also

[134] Thomhave and Collins, 2021.
[135] Thomhave and Collins, 2021.

introduces complexities that can lead to inequitable tax burdens. South Africa should strive to balance flexibility with clear guidelines to promote both administrative efficiency and tax equity.

4. International Cooperation:
   The global nature of trust abuses in the U.S. emphasizes the importance of international cooperation in combating tax evasion. South Africa should engage with international standards and frameworks, such as FATF recommendations, to bolster its regulatory measures.

By integrating these lessons, South Africa can refine its trust taxation framework to promote a more equitable and transparent financial system, thereby enhancing its standing relative to global counterparts like the United Kingdom and the United States.

7.5.1 Global Tax Haven through Trust Abuses

The transformation of the United States into a global tax haven represents a notable contradiction within the global context. The United States of America once hailed as a leader in combating offshore tax evasion has emerged as a refuge for the wealthy seeking to evade taxation and regulatory scrutiny. As evidenced by the latest Tax Justice Network's Financial Secrecy Index (2022), the United States has been named as the number one country concerning financial secrecy in the world. [136]This yearly index assesses the degree to which national financial systems enable the laundering of money and the hiding of assets.

A pivotal moment in the United States of America’s effort to combat tax evasion was the enactment of the Foreign Account Tax Compliance Act (FATCA), which was explicitly aimed at addressing tax evasion associated with foreign bank accounts. However, the positive enactment of the FATCA was overshadowed by the United States' reluctance to adopt the OECD Common Reporting Standard (CRS). This reluctance can be seen as one of the main reasons behind the United States of America becoming the number one country for financial secrecy as stated above.

The following section will offer a brief analysis of these contrasting approaches—FATCA and CRS—highlighting their strengths, weaknesses, and overall impact on global financial transparency, providing a clearer understanding of this complex landscape.

Foreign Account Tax Compliance Act

FATCA was introduced by the United States Congress in 2010 and became effective in 2014, this act targets tax evasion by Americans using foreign financial accounts.[137]

[136] Financial Secrecy Index,2024, Financial Secrecy Index.
[137] United States Department of the Treasury,2024, Foreign Account Tax Compliance Act.

FATCA compels foreign financial institutions to report details about accounts held by United States taxpayers or foreign entities with significant ownership in the United States of America to the IRS.

OECD Common Reporting Standard (CRS)

The CRS developed by the OECD and implemented in 2014, establishes a global framework for automatically exchanging financial account information between governments.[138]

The Impact of FATCA and CRS on Trusts

The contrast between FATCA's enactment within the United States and the United States' non-engagement in the CRS framework creates a conducive environment for the abuse of trusts within the United States.[139] This conflict manifests through the following:

- Global Isolation Through Non-Reciprocation: The United States' decision not to participate in CRS while still benefiting from information received through FATCA, effectively isolates it from the global movement towards financial transparency. This isolation makes the United States an appealing destination for foreign individuals seeking to evade taxes in their home countries.
- Utilization of Trusts as a Secrecy Loophole: Trusts in the United States., particularly those established in states with advantageous trust laws, offer significant privacy and asset protection. The lack of an automatic exchange framework like the CRS allows individuals to utilise specific states in America to obscure asset ownership from foreign tax authorities, exacerbating tax evasion and illicit financial flows.
- Compromised Transparency and Compliance: The United States' stance on CRS and its financial secrecy laws in certain states challenges global tax compliance efforts. This conflict attracts foreign wealth in search of secrecy and hampers the global community's ability to effectively combat tax evasion and money laundering.

FATCA represented a pioneering effort by the United States of America to mitigate offshore tax evasion. However, its impact is significantly diluted by the United States' non-participation in the CRS framework, which has inadvertently positioned the United States as a refuge for global wealth seeking to exploit trust mechanisms for tax evasion purposes. This development poses a formidable challenge to international tax regulation efforts, necessitating a cooperative approach that includes United States engagement in the CRS framework to increase trust transparency globally.

[138] Organisation for Economic Co-operation and Development,2024, Common reporting standard.
[139] Mansour, M.B,2024, US tops financial secrecy ranking as G7 countries upend global progress on transparency, Tax Justice Network.

The Unified Trust Code

There is a pressing need for government measures to address practices that facilitate the concealment of illicit wealth and to promote a more equitable tax landscape across the United States of America.

In this context, the UTC, as mentioned at the beginning of the chapter, emerges as a significant government intervention aimed at standardising trust law across the United States of America. [140]Although the UTC represents a step in the right direction toward mitigating the disparities introduced by state-level legislation, its effectiveness currently needs to be improved by complete adoption amongst all states in America. Full implementation of the UTC across all states would constitute a critical government measure to harmonise trust legislation, thereby reducing tax evasion and wealth concealment opportunities. Such a standardised legal framework would ensure trusts are used consistently with national economic equity and uphold the tax system's integrity.

7.6 Federal Mandate for Trust Transparency

This analysis of the United States trust system reveals its troubling role in perpetuating wealth inequality and undermining tax equity. While trusts offer legitimate asset management tools, their strategic exploitation exacerbates economic disparities and positions the United States as an unwitting global tax haven.

The federal enactment of the United States Corporate Transparency Act (CTA) of 2021 marks a significant step forward for beneficial ownership transparency in the United States of America, yet its constrained scope focusing on corporate entities highlights an immediate necessity for expanded regulations. As its reporting requirements are set to commence on the 1st of January 2024, there is a pressing imperative for the United States of America to promptly broaden its applicability to encompass all trusts, ensuring a more comprehensive oversight.[141]

Further Adopting the UTC and a federal mandate for comprehensive trust registration and disclosure would significantly curtail the anonymity that facilitates tax evasion and illicit activities. However, the United States' conflicting stance towards global transparency standards like FATCA and the CRS hinders progress. True reform necessitates alignment with these international efforts.

[140] Uniform Law Commission, 2024
[141] United States Treasury,2024, U.S. Beneficial Ownership Information Registry Now Accepting Reports.

Addressing the complexities of the United States trust system demands a balance between legitimate wealth preservation and tax equity imperatives. This calls for robust international cooperation, meaningful legal reforms, and a widespread embrace of transparency. Society can only create a more equitable global financial system that prioritises fairness and societal well-being by curtailing trust abuse.

8 Beneficial Ownership

In the broader context of global financial transparency and governance, beneficial ownership has gained significant prominence, particularly in its application to trust structures. This chapter examines South Africa’s 2022 and 2023 legislation amendments in beneficial ownership transparency, situating these reforms within the broader international context towards greater financial transparency, particularly in the trust sector.

Trust Abuse and Beneficial Ownership

The concept of Beneficial ownership is to identify the true owners and controllers of assets and income, as opposed to those who hold legal ownership. John D. Rockefeller's quote, "Own nothing, but control everything,"[142] perfectly illustrates this principle, underscoring the distinction between legal and actual control over assets. In the domain of trust law, the term' beneficial owner' refers to the individual who enjoys the benefits and exercises control over the trust’s assets without holding legal ownership. This concept finds relevance in scenarios such as dividend distribution, where the emphasis shifts from nominal ownership to the actual economic benefits derived[143].

Trusts, commonly utilised for asset protection, have become vehicles for illicit activities, highlighting the necessity of a comprehensive understanding of beneficial ownership due to the lack of stringent ownership guidelines in legislative frameworks. The call for transparency in the trust sector is paramount for combating money laundering and ensuring trust taxation transparency, which in turn will facilitate the detection and prevention of financial crimes in the trust sector.[144]

Beneficial Ownership Transparency (BOT) has become integral to contemporary financial systems, mandating the disclosure of the actual individuals behind asset control or entity management. This transparency is essential for enhancing due diligence and compliance in governmental functions, law enforcement agencies, and the private sector.

The importance of BOT in combating financial crimes has gained recognition globally, with the FATF pinpointing the lack of transparency as a critical issue in the global landscape. In response to this pressing issue around BOT, over 200 countries, including South Africa, have enacted reforms in line with the FATF's anti-corruption guidelines. [145]The Grey listing of South Africa by the FATF underscores the urgency for robust BOT frameworks to ensure corporate

[142] This has been attributed to Nelson Rockefeller, a former governor of New York and vice president of the United States.
[143] 'Dividend' as defined in section 1 of Income Tax Act 58 of 1962.
[144] Organisation for Economic Co-operation and Development (OECD) and Inter-American Development Bank (IDB), 2021, Building Effective Beneficial Ownership Frameworks: A joint Global Forum and IDB Toolkit.
[145] Financial Action Task Force,2024, FATF Global Network.

accountability and curb illicit financial flows in the country. South Africa is advancing its BOT policies through amendments in legislation like the General Laws Amendment Act[146], aiming to bolster financial transparency and enhance the effectiveness of its legislative framework.

Challenges in Identifying Beneficial Ownership Information

Identifying and verifying beneficial owners in the financial system is challenging, primarily due to varying interpretations of "beneficial ownership" across different legal frameworks and jurisdictions. This complexity arises from the multifaceted nature of beneficial ownership, which encompasses legal ownership, control, and economic benefit. The lack of a consistent global definition and varying legislative criteria for determining beneficial ownership contributes to an unclear and inconsistent identification and verification process in the financial sector.

One significant challenge in BOT is the presence of opaque and complex ownership structures, often involving intermediaries between various entities including trust. These various ownership structures obscure the identities of the ultimate beneficiaries, making it difficult to trace the real owners behind legal entities. This ambiguity is aggravated by legal loopholes and weak regulatory frameworks in most jurisdictions, allowing for hidden ownership structures that can be exploited for illicit activities such as tax evasion and money laundering.

The introduction of Beneficial ownership registries is a welcomed step in many jurisdictions, but the lack of effective verification processes compromises the reliability of these registries. The historical difficulty in accessing and verifying beneficial ownership information has opened avenues for misuse and fraud in the financial sector.[147]

In the case of trusts that do not possess legal personality, identifying the beneficial owner presents unique challenges. Trusts involve a settlor transferring ownership rights to a trustee for the benefit of a trust beneficiary, creating ambiguities in establishing who exercises the ultimate control. The FATF beneficial ownership recommendations specifically sections 24 and 25, while helpful from a legal standpoint, do not fully resolve the practical difficulties in pinpointing control in entities.[148]

Moreover, identifying and verifying beneficial ownership requires handling of sensitive personal information, necessitating compliance with data protection laws. Balancing the

[146] Government Gazette, Notice 47815, R.1535,2022.
[147] Open Ownership, 2023, Open Ownership Principles.
[148] Financial Action Task Force, 2023, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation.

objectives of BOT with protecting individual privacy rights is crucial for an effective transparency framework.

Importance of Beneficial Ownership Transparency for Combating Tax Evasion, Money Laundering, and Corruption

Transparency in beneficial ownership is crucial for combating tax evasion and money laundering. Key global institutions advocating for transparent beneficial ownership structures are the FATF and the European Union. The efforts by these institutions aim to establish clear criteria and policies for identifying beneficial owners, as well as enhancing the authorities' ability to monitor and scrutinise financial transactions in the respective jurisdiction. However, ensuring that beneficial ownership information is accurate, up-to-date, and readily accessible to regulatory and enforcement agencies is key for an effective framework.

8.1 South Africa's Regulatory Framework for Beneficial Ownership

South Africa's grey listing by the FATF was pivotal in highlighting the need for improved transparency in beneficial ownership, particularly in trust structures. This led to crucial amendments to the TPCA [149] marking a new era of transparency and accountability in the trust sector.

The amended TPCA [150] introduced several significant changes to enhance beneficial ownership transparency, as mentioned in Chapter 3. Below is a brief highlight of the key amendments:

- Definition of Beneficial Ownership: The Act now provides a precise definition, including individuals who directly or indirectly control the trust, such as those with voting rights, significant influence, or economic benefits.
- Recordkeeping and Reporting: Trustees must maintain a detailed and current register of beneficial ownership for each trust and electronically submit this information to the Master of the High Court.
- Enhanced Verification and Due Diligence: The Act emphasises verifying beneficial ownership information and imposes more stringent due diligence requirements on trustees when introducing new beneficiaries.
- Increased Penalties and Sanctions: Non-compliance with the Act may lead to fines or imprisonment, emphasising the importance of these transparency measures.

[149] Government Gazette, Notice 47815, R.1535,2022.
[150] Government Gazette, Notice 47815, R.1535,2022.

8.2 Trust Beneficial Ownership Registry.

In line with the recommendations by FATF, South Africa has also established an online Beneficial Ownership Trust Register with oversight from the Master's Office. The Chief Master's Directive 8 of 2023[151], effective from 16 October 2023, mandates that all trusts comply with the beneficial ownership register requirements regardless of their registration time or purpose, marking a pivotal step in operationalising the beneficial ownership register. The Companies and Intellectual Property Commission has also launched a beneficial ownership register for companies and closed corporations which is effective from 1 April 2023, which further demonstrates South Africa's commitment to complying with international standards regarding beneficial ownership registries.[152]

Alignment with International Standards

South Africa's commitment to enhancing its BOT framework aligns with several international benchmarks, notably those established by the FATF as previously mentioned. South Africa's dedication to Beneficial Ownership Transparency BOT is further bolstered by its active role in the Group of Twenty (G20).[153] As the only African nation besides the African Union to hold membership in this influential intergovernmental organization, South Africa plays a key role in advocating for BOT on the continent. In addition, South Africa's adherence to the regulations set by the Organization for Economic Co-operation and Development (OECD) underscores its commitment to upholding international standards in financial transparency and governance. [154] South Africa’s participation and support to the international bodies above, demonstrates South Africa's role as a leader in promoting transparency and combating financial crimes not only within its borders but also across the African continent and globally.

Issues with beneficial ownership registers in the European Union (EU)

The unfolding discrepancies of beneficial ownership registers in the EU and the United Kingdom captures the intricate conflict between enhancing financial transparency and safeguarding individual privacy. The landmark decision by the Court of Justice of the European Union (CJEU) has resulted in a significant shift in how member states of the EU approach the accessibility of beneficial ownership information, contrasting with the United Kingdom’s commitment to public access of beneficial ownership.

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[151] Department of Justice and Constitutional Development, 2023, CHIEF MASTERS DIRECTIVE 8 OF 2023, Beneficial Ownership Register.
[152] Companies and Intellectual Property Commission, 2023, User Guidelines Beneficial Ownership.
[153] Group of Twenty, 2024, About the Group of Twenty.
[154] Organisation for Economic Co-operation and Development, (2024), South Africa and the OECD.

On 22 November 2022, the CJEU ruled that granting the public access to beneficial ownership registers contradicts EU law, explicitly infringing on privacy and data protection rights. This court decision highlights that beneficial ownership access excessively interferes with this fundamental right and further exceeds what is necessary and proportionate for the intended aim of transparency. This ruling to privacy challenges the EUs 5th Money Laundering Directive's mandate for public accessibility of corporate beneficial ownership information in EU Member States[155].

After the CJEU's ruling EU member states have diverged in their responses to BOT. Several EU countries have changed public access to beneficial ownership registries, limiting it to individuals or entities demonstrating a 'legitimate interest'—a term that has seen varied interpretations across the EU. Notably some EU countries have went as far as retracting beneficial ownership registries completely in their countries after the court ruling.[156]

In contrast to EU member countries, the United Kingdom's approach to beneficial ownership transparency showcases a different approach. Despite the CJEU's concerns and after carefully considering the European Convention on Human Rights, the United Kingdom has chosen to keep open access to its beneficial ownership registers. [157]This decision underscores the United Kingdom's focus on prioritising transparency over privacy concerns, although with mechanisms in place to suppress sensitive information under certain conditions.

Access to the United Kingdom's trust register is not available to everyone; it is limited and needs proof of 'legitimate interest,' notably for individuals or entities attempting to combat money laundering or terrorist financing. When access is requested, specific details and reasons must be provided before access is granted.[158]

The United Kingdom's approach to beneficial ownership access has been carefully considered, striking a balance between promoting transparency as a weapon against financial crimes and recognising the need to protect privacy. This balancing act is part of a larger, global conversation about navigating the delicate framework of privacy rights and transparency in rooting out illegal financial activities.

[155] Robinson, T.R. and Loft, P.L,2023, Registers of beneficial ownership - House of Commons Library.
[156] Robinson&Loft,2023.
[157] Robinson&Loft,2023.
[158] Neuman, T, 2023, Understanding the UK beneficial ownership registers: What information is publicly accessible.

South Africa’s Beneficial Ownership Register

South Africa's efforts to enhance its BOT framework are part of a broader, global movement towards financial transparency. This global trend is underscored by significant legal developments such as the CJEU landmark decision, alongside the United Kingdom's strong commitment to public access to beneficial ownership information, as highlighted above. These international shifts provide a backdrop against which South Africa's endeavours to adhere to the FATF standards can be understood, especially in the delicate balance between promoting transparency and protecting individual privacy rights as enshrined in local laws.

South Africa's commitment to privacy protection is deeply rooted in Section 14 of the Constitution, which enshrines the values of autonomy, dignity, and security[159]. The Protection of Personal Information Act (POPIA) gives this foundational constitutional right practical effect, establishing guidelines for public and private entities' lawful processing of personal information in the country. The enactment of POPIA underscores South Africa's dedication to safeguarding individuals from the unlawful handling of their personal information. This commitment reflects a growing global concern about the privacy implications of publicly accessible beneficial ownership information.

The need for greater financial transparency while safeguarding privacy has shaped South Africa's evolving legal framework. The TPCA’s new Section 11A, highlighted in Chapter 3, plays a crucial role in this framework by requiring the Master's Office to make beneficial ownership information accessible to authorised parties[160]. This stipulation aims to enhance accountability by ensuring that entities with legitimate needs, such as law enforcement and regulatory bodies, can access this information. These entities must undergo a formal process, submitting requests to the Chief Master and proving their eligibility to access the beneficial ownership register. This process, detailed in the Chief Master Directive 8 of 2023, specifically Section 3.4, ensures that access is granted solely to designated officials, with the Master holding the authority to grant or revoke access as necessary.[161]

Challenges and Enhancing the Beneficial Ownership Framework

To navigate these challenges, future enhancements to South Africa's BOT framework may involve introducing legislative mechanisms to identify exceptions with regards to accessing specific types of trust information in conjunction with specific detailed risk

[159] Section 14 of the Constitution of the Republic of South Africa, 1996.
[160] Government Gazette, Notice 47815, R.1535,2022.
[161] Department of Justice and Constitutional Development, 2023.

assessments.[162]These targeted legislative mechanisms would allow competent authorities to access critical information efficiently, enhancing efforts to combat illegal financial activities. Moreover, ensuring that any access to beneficial ownership information strictly adheres to POPIA is essential to prevent misuse.

Implementing stringent sanctions for any violations is crucial in maintaining the framework's integrity and further requires continued analysis for any future possible violations to ensure relevance.

South Africa's Commitment to Transparency and Privacy

In summary, South Africa's ongoing BOT refinements reflect a concerted effort to align with international transparency standards while learning from global practices. These concerted efforts aim to strike a balance between promoting public interest in BOT and safeguard the privacy of individuals the country. Through careful consideration of access regimes and strong privacy legislation, South Africa undoubtably demonstrates its commitment to enhancing the efficacy of its BOT framework. Ultimately, this exemplifies the country's resolve to uphold global standards, protect personal privacy, and navigate the complexities of financial transparency in the modern age. The key to these BOT reforms rests on various trust sector stakeholders to apply these amendments effectively and efficiently to achieve the overarching objectives of these reforms.

[162] Open Ownership, 2022, Beneficial Ownership Transparency and Data Protection in South Africa: Policy Briefing.

9 Discussion and Analysis

This research report has documented South Africa's evolving trust legislation landscape in response to increasing global compliance pressures. These findings offer an essential context for critically examining South Africa's 2022 and 2023 trust legislation reforms. This discussion chapter will examine key findings in the previous chapters with regards to addressing tax neutrality and compliance in the trust sector from a South African context.

Revisiting Neutrality and Effective Compliance

The basis of effective taxation is not merely the pursuit of revenue collection, but also the principles that drive the taxation system. In this regard, classical economist Adam Smith's theories in "The Wealth of Nations"(1776)[163] had an indelible impact on taxation theory and practice. Smith's four fundamental taxation concepts—equity, clarity, convenience, and economy in administration—are still relevant today as guiding principles for developing fair and efficient tax systems.

Addressing tax neutrality in South Africa, especially in the context of 2022 and 2023 legislative developments that coincide with Adam Smith's ideas, requires a comprehensive approach. This discussion aims to examine these changes through the perspective of Smith's canons of taxation. Chapters 2 and 3 outlined specific tax and regulatory changes affecting trusts, particularly amendments within the TPCA and measures implemented by SARS. This discussion will explore areas where South Africa's tax neutrality in trust taxation might be compromised, potentially challenging Smith's fundamental principles.

9.1 Tax Neutrality in the South African Context

Achieving tax neutrality in South Africa requires that tax policies do not unduly influence economic decisions. Tax neutrality fosters an environment where decisions are made based on their economic merits rather than their tax implications, aligning with principles of fairness and flexibility.

[163] Smith, Adam, 1776, An Enquiry into the Nature and Causes of the Wealth of Nations, Chicago: University of Chicago Press.

Adam Smith's Principles of Taxation and the TPCA Amendments

- Equity Principle

  Section 11A (Beneficial Ownership Information)[164]: Mandating trustees to adequately record and submit beneficial ownership information aligns with the Equity Principle by ensuring that trust entities contribute proportionately to the country's tax base. This effective transparency ensures that trusts are not excluded from their fair share of regulatory oversight, resulting in a more equitable financial climate.
- Certainty Principle

  Sections 1 and 6 (Definitions and Disqualifications)[165]: The inclusion of clear definitions for "Accountable Institution" and "Beneficial Owner" aligns with the certainty principle. These definitions remove uncertainty and offer a transparent framework by precisely defining the entities and individuals engaged in trust administration, as well as the characteristics of beneficial ownership. This clarity ensures all parties involved in trust administration understand their roles, responsibilities, and the legal context of their actions, fostering a predictable and secure regulatory environment.
- Convenience Principle

  Section 10 (Disclosure to Accountable Institutions)[166]: Requiring trustees to disclose their roles and ties to trust property upon request embraces the Convenience Principle. This requirement ensures that the administration of trusts is conducted in a manner that is convenient for both the trustees and the regulatory bodies, facilitating easier compliance and monitoring.
- Economy Principle

  Sections 19 and 20 (Legal Consequences and Criteria for Trustee Removal), and lastly Section 6 (Disqualification Criteria for Trustees)[167]: these amendments collectively streamline the trust regulatory framework in accordance with the Economy Principle. These amendments detail legal repercussions for non-compliance, expanding grounds for trustee removal, and establishing strict disqualification standards. These amendments aim to facilitate efficient enforcement while minimizing compliance costs. This targeted approach reduces the risk of financial mismanagement and fraud, thereby lessening the economic burden on the trust system and enhancing overall financial integrity.

[164] Government Gazette, Notice 47815, R.1535,2022.
[165] Government Gazette, Notice 47815, R.1535,2022.
[166] Government Gazette, Notice 47815, R.1535,2022.
[167] Government Gazette, Notice 47815, R.1535,2022.

The amendments to the TPCA motivated by the FATF's evaluation and subsequent grey listing of South Africa, represent a targeted overhaul of trust legislation. These reforms not only align with Adam Smith's timeless principles but also directly tackle the identified gaps in South Africa's AML/CFT framework, demonstrating a strategic and thorough response to enhance financial integrity in the trust sector.

9.2 Examining SARS Trust Taxation Reforms

SARS implemented strategic changes in response to the FATF grey listing, which have been discussed based on the four separate legislative pillars, each addressing unique difficulties and goals within the trust taxation and compliance framework. This intricate approach taken by SARS in these reforms resonates with the economic philosophies of Adam Smith, particularly his advocacy for a transparent, equitable tax system that underpins the integrity and fairness of fiscal governance.

Pillar 1: AIT Process

The AIT process represents a foundational shift towards stringent compliance and transparency in managing cross-border financial transactions. The AIT process directly addresses the FATF's concerns about the possible exploitation of trusts for illicit financial flows. SARS's AIT process intends to improve the monitoring of international financial transactions by requiring trustees to disclose specific details about the sources and beneficiaries of funding. This approach intends not just to mitigate money laundering and terrorist funding, but also to instil trust in South Africa's financial system among international stakeholders.

Pillar 2: IT3(t) Certificates

Through the introduction of IT3(t) certificates, SARS aims to ensure adequate compliance and transparency in the reporting and taxation of trust income. The IT3(t) certificates assist in clarifying the flow of income within trusts, ensuring that all income distributions and capital gains are accurately documented and taxed. This pillar reflects a strategic alignment with the principles of fair taxation, where the detailed tracking of trust income aims to ensure that all entities contribute equitably to the tax base.

Pillar 3: Tax Administration Laws Amendment Act[168]

The Tax Administration Laws Amendment Act is an essential legislative act towards strengthening trust taxation governance and monitoring in South Africa.

This legislative act addresses the underlying financial mismanagement in trusts by introducing stringent criteria for disqualifying individuals from managing or holding fiduciary positions within trusts for tax administration purposes. Furthermore, the act facilitates information sharing amongst regulatory bodies and standardises the definition of "beneficial ownership" across the financial sector. These amendments foster a collaborative approach to combating financial crimes by accountable institutions, aligning with international efforts to enhance transparency and accountability in financial transactions and governance.

Pillar 4: Tax Laws Amendment Act[169]

The section 25B[170] amendment introduced by the Tax Laws Amendments Act, with regards to trust taxation aims to align the income taxation of non-resident beneficiaries with the tax treatment of capital gains under paragraph 80 of the Eighth Schedule. The section 25B amendment limits the conduit principle to resident beneficiaries, which has an important implication for trust tax neutrality and equity, both from a resident and a non-resident perspective.

The amendment to section 25B in pursuit of tax neutrality and equity addresses the need for a balanced approach that safeguards South Africa's fiscal interests while aligning with international tax norms. By limiting the application of the conduit principle to resident beneficiaries, the amendment aims to prevent tax avoidance strategies that exploit discrepancies in the tax treatment of income and capital gains. While this may increase the tax burden on non-resident beneficiaries, it is a necessary step towards ensuring that all beneficiaries of South African trusts contribute equitably to the tax base. This approach strikes a balance between protecting the integrity of South Africa's trust tax system and adhering to principles of tax neutrality and equity on a global scale.

SARS Trust Taxation Compliance

In integrating the detailed analysis of SARS's reformative pillars, it becomes evident that the overarching strategy is deeply rooted in enhancing compliance, transparency, and equitable tax administration. Each pillar addresses specific facets of trust taxation and compliance, collectively advancing a comprehensive framework designed to meet international standards

[168] Tax Administration Laws Amendment Act ,18 of 2023.
[169] Tax Laws Amendment Act,17 of 2023.
[170] Income Tax Act No. 58 of 1962.

and rectify the issues highlighted by the FATF grey listing. Through these reforms, SARS embodies the economic philosophies of Adam Smith, advancing a tax system that is fair, transparent, and conducive to the integrity of the financial sector.

The meticulous approach taken in these reforms reflects a commitment to addressing immediate regulatory challenges and establishing a robust foundation for the sustainable governance of South Africa's trust sector.

9.3 Trust taxation across jurisdictions

In exploring trust taxation frameworks, we have previously examined the intricate mechanisms employed in the United Kingdom and the United States of America, as outlined in Chapters 5 and 6. This discourse now extends to South Africa, where the Income Tax Act (ITA) adopts a distinct yet intricate approach.

Based on the taxation of trusts in South Africa as discussed in Chapter 2, it can be established that South Africa's trust tax system integrates elements of the Initial Choice System intricately within its taxation framework, as well as positioning trusts as hybrid entities that blend characteristics of separate legal entities and flow-through mechanisms.

This taxation system offers flexibility by allowing a choice between taxing the trust or the beneficiary as income arises. This aligns taxation with where the most significant economic benefit is realized, ensuring income is taxed once.

The Initial Choice Mechanism empowers the trust or the beneficiaries to be the primary focus of taxation, depending on where the economic benefits are most pronounced. This ensures that income is taxed to align with the actual realization of benefits, thereby preventing undue tax burdens and double taxation.

Moreover, from a hybrid taxation mechanism point of view, trusts under South African tax law facilitate an intricate approach to income distributions. Trusts can operate with the transparency of a flow-through entity, where income is passed directly to beneficiaries and taxed according to their tax circumstances. This method acknowledges the ultimate beneficiaries of the trust's income, allowing their tax situations to be duly considered. Alternatively, a trust can be treated as a separate entity when it lacks an identified beneficiary with a vested interest in its income, and the trust is taxed in these circumstances.

This strategic implementation of trust taxation in South Africa showcases a deliberate effort to balance administrative efficiency with equitable tax treatment. This trust taxation measure ensures that trusts are taxed to reflect their economic realities and provides a framework capable of accommodating the diverse needs of trusts and their beneficiaries.

South Africa’s approach stands out for its Initial Choice System and hybrid entity model, which blends aspects of separate legal entity treatment with flow-through taxation. This model aims to balance administrative efficiency with tax equity by taxing income where the most significant economic benefits are realized.

However, the reliance on this dual mechanism may introduce complexity, particularly in distinguishing scenarios where the trust, rather than beneficiaries, is taxed.

The flexibility in South Africa’s model allows for adaptable tax alignment, but it may also create uncertainties around tax liabilities, particularly for beneficiaries and trustees. While this hybrid approach provides nuanced options, it may benefit from further refinement to clarify when and how specific tax obligations should apply.

Comparative Analysis of Trust Taxation Across Jurisdictions

The table below will compare trust taxation across South Africa, the United Kingdom, and the United States of America, highlighting essential residency rules, income attribution practices, and the balance between tax neutrality and compliance in each jurisdiction.

Table 2: Trust Taxation Across Jurisdictions

Jurisdiction	**Residency Rules for Trusts**	**Trust Tax System Approach**	**Compliance vs. Neutrality**
South Africa (SA)	Trust residency is based on the location of effective management; trusts managed within SA are considered tax residents.	**Initial Choice System & Hybrid Entity**: Integrates elements of the initial choice system, allowing flexibility between taxing the trust or the beneficiary. Trusts can operate as hybrid entities, blending characteristics of separate legal entities and flow-through mechanisms.	There is a balancing act between FATF compliance and maintaining attractiveness for trusts. While there is pressure to tighten regulations, there is also caution against over-restriction to avoid diminishing the jurisdiction's appeal.
United Kingdom (UK), (Chapter 4)	A trust is considered a UK resident if all its trustees are UK residents. Non-resident, if all trustees are outside the UK with certain exceptions.	**Credit System & Hybrid Approach**: Employs a credit system to prevent double taxation. Trust initially treated as a separate entity but where beneficiaries are taxed, a credit is given for taxes paid at the trust level for beneficiaries.	Trust taxation approach has evolved to prioritise transparency and compliance, with stringent disclosure requirements to enhance compliance without sacrificing the jurisdiction’s attractiveness.

United States (US) (Chapter 5)	Trust residency is based on the court test (where the trust is subject to judicial oversight) and the control test (where the decisions are made).	**Deduction System & Grantor Trust Regime**: Uses a deduction system, treating trusts as separate entities but allowing deductions for distributions to beneficiaries. The grantor trust regime aligns tax liabilities with the grantor when significant control or benefits are retained.	Trust taxation system is perceived as complex, often favouring wealthy individuals. Compliance is challenging due to the intricate nature of the regulations (State vs Federal laws), which may impact neutrality and fairness.

Integrating the insights from the comparative analysis of trust taxation across South Africa, the United Kingdom, and the United States of America, the table underscores the intricate consequences of each jurisdiction's approach to trust legislation and its impact on the use and administration of trusts.

Unintended Consequences of Overly Rigid or Complex Provisions

- South Africa: The 2022 and 2023 legislation amendments aim to align with global standards which could impose burdensome reporting and compliance costs, potentially making trusts less attractive for legitimate estate planning purposes.
- United Kingdom: The stringent transparency and reporting requirements, while combating money laundering and tax evasion, may have initially deterred some legitimate use of trusts in the country. Legislative amendments have the added benefits of historical significance as well as increased monetary backing due to the United Kingdom’s standing in the global community.
- United States of America: The complexity of trust taxation, especially around grantor trusts, has made trusts a tool predominantly for the wealthy, capable of navigating or affording professional guidance through these intricacies. Different State and Federal legislative requirements have also increased the complexity and ambiguity in the United States of Americas trust taxation framework.

9.4 Beneficial Ownership: Transparency Limits & the Global Context

South Africa's 2022 and 2023 legislative focus on beneficial ownership transparency stems from concerns raised in the FATF grey listing announcement. A key challenge in the legislative amendments in the South African trust sector is balancing beneficial ownership transparency with privacy rights, as highlighted in Chapter 8.

Further, the varied global approaches to beneficial ownership offer key insights for South Africa regarding beneficial ownership transparency issues. The European Union, the United

Kingdom, and the United States of America, each have different legislative frameworks for beneficial ownership transparency.

Analysing these frameworks can assist South Africa in further refining its strategy towards beneficial ownership transparency. This discussion below aims to extract insights from these global experiences, considering how South Africa can improve its respective beneficial ownership transparency legislations given its recent implementation.

Global Privacy Concerns and Beneficial Ownership

The global drive to combat financial crimes such as money laundering, tax evasion, and corruption has fuelled a growing emphasis on beneficial ownership transparency. While beneficial ownership transparency disclosure is undoubtedly crucial for countering illicit activities, it also raises a critical and complex issue – the potential infringement on the privacy rights of individuals listed as beneficial owners.

This tension between transparency and privacy is exemplified by the judgment of the CJEU.[171]The CJEU, while acknowledging the importance of transparency in beneficial ownership, ruled against unrestricted public access to beneficial ownership information. This landmark ruling underscores the need to strike a delicate balance between the public interest in financial accountability and the legitimate privacy concerns of individuals.

Insights from the United Kingdom

The United Kingdom has positioned itself as a world leader in driving beneficial ownership transparency as a key tool in the fight against financial crime. The United Kingdom's pioneering approach is marked by the creation of public registers like the Persons with Significant Control register and the Register of Overseas Entities. These registries underscore a strong stance which favours transparency over strict privacy restrictions in the public domain. This contrasts with the CJEU ruling that limits public access to beneficial ownership registers in EU member states as mentioned above.

Key Highlights of beneficial ownership in the United Kingdom (discussed in Chapters 6 and 8).

- Public Registers as a Core Principle: The United Kingdom's beneficial ownership registers are publicly accessible to authorised parties with certain restrictions to curb

[171] Robinson&Loft,2023

privacy concerns. This ease of access facilitates investigations into potential illicit activities and fosters corporate accountability.

- Trust Registration for Enhanced Oversight: The Trust Registration Service (TRS) mandates the registration of most eligible trusts in the United Kingdom. This further enhances transparency around the beneficial ownership of assets held in trusts, often used in complex financial structures.

- International Cooperation: The United Kingdom actively participates in global initiatives like the Automatic Exchange of Information and Public Country-by-Country Reporting frameworks. These collaborations facilitate cross-border tracking of financial flows and combat tax evasion and money laundering from a global context.

Key Highlights of beneficial ownership in the United States of America (discussed in Chapters 7).

The United States of America presents a complex landscape regarding beneficial ownership transparency in the country. Unlike the UK's emphasis on public beneficial ownership registries, the US adopts a more fragmented approach, resulting in a patchwork of state-level regulations and a marked lack of transparency around trusts. Key aspects include:

- Limited Federal Measures: The Corporate Transparency Act[172], which came into effect in January 2024, focuses on beneficial ownership in corporate entities which leaves a significant regulatory gap regarding trusts from a federal legislation point of view.

- State-Level Disparities: Trust laws vary widely between states, with some becoming domestic tax havens due to their favourable trust legislation and lack of beneficial ownership transparency requirements. These disparities further exacerbate wealth inequality in the country.

Lessons for South Africa

Drawing insights from the trust taxation systems of the United Kingdom (UK) and the United States of America (USA), South Africa can adopt strategic reforms to enhance its own trust legislation framework. This section outlines key lessons and potential reforms, supported by empirical evidence and authoritative references.

[172] United States Treasury,2024.

United Kingdom as a Model

The UK aims to achieve a balance between transparency and compliance, striving to make trusts attractive while upholding regulatory standards.

This balance is evident through the implementation of the Trust Registration Service (TRS) and the Persons with Significant Control (PSC) Register, which have significantly enhanced transparency in the trust sector.

- The Trust Registration Service (TRS) mandates that most trusts in the UK register with HM Revenue and Customs (HMRC), requiring detailed information about the trust's beneficiaries and settlors. Since its inception, the TRS has seen over 633,000 trusts and estates registered by March 31, 2023.[173] This initiative has significantly enhanced accountability and reduced the potential for misuse.

- Persons with Significant Control (PSC) Register: The PSC register mandates the disclosure of individuals who have significant control over a company or trust. This measure has been instrumental in combating financial crimes by ensuring that the true beneficial owners are identifiable[174].

By adopting similar phased, clear, and manageable trust compliance requirements, South Africa could improve its international standing and effectively address FATF concerns based on the UK Trust System.

United States of America as a Cautionary Tale

The complexity observed in the United States' trust system serves as a warning against establishing a legal framework that primarily benefits those with significant resources. As detailed in Section 7.5 (U.S. Trust System and Wealth Inequality), the intricate trust taxation mechanisms in the U.S. have led to the concentration of wealth among the affluent, thereby exacerbating economic disparities.

- Trust Taxation ComplexityThe U.S. tax system for trusts, governed by Subchapter J of the Internal Revenue Code (IRC), is notably complex. Non-grantor trusts in the U.S. face higher tax rates at lower income thresholds compared to individual tax rates, leading to higher effective tax rates for trusts. This complexity not only imposes significant compliance burdens but also contributes to economic inequality by enabling wealth concentration among those who can navigate or exploit these intricate tax

[173] Her Majesty's Revenue and Customs,2024, Statistics on trusts in the UK October 2023
[174] Kenney, M,2024, Can the UK Teach the US How to Manage Beneficial Ownership Registers?

structures. The Tax Foundation highlights that the federal tax code's complexity results in substantial compliance costs, with businesses and individuals spending billions annually to comply with tax regulations.[175].

- Wealth Concentration: The concentration of wealth in the United States is significantly influenced using trusts, particularly among the wealthiest households. According to a letter from several U.S. Senators to the Treasury Department, trusts are frequently utilized by ultra-wealthy individuals to transfer substantial wealth to their heirs while minimizing tax liabilities. This practice allows for the accumulation and preservation of wealth within a select segment of the population, thereby exacerbating economic inequality[176]

- State-Level Disparities: The lack of uniform trust regulations across states creates favourable conditions for wealth accumulation among the affluent. States like Delaware and South Dakota have become popular jurisdictions for trusts due to favourable tax laws and high levels of secrecy, which facilitate wealth concentration and tax avoidance[177].

Given South Africa's already high levels of wealth inequality, it is crucial to avoid such complexity. Instead, South Africa should ensure that the 2022 and 2023 legislative amendments do not further fragment the use of trusts by wealthy individuals, maintaining the system's accessibility for legitimate estate planning purposes.

- Intricate, Middle-ground Reforms

Drawing from both examples, South Africa can enact reforms that enhance transparency and compliance while preserving the benefits of trusts. This balanced approach ensures that trusts remain a viable tool for legitimate estate planning and asset protection without being exploited for illicit purposes.

Proposed Reforms:

- Simplified Reporting for Lower-risk Trusts: Implementing tiered reporting requirements based on the risk profile of trusts. Lower-risk trusts could benefit from simplified reporting, reducing compliance burdens while maintaining oversight.

[175] Tax Foundation. (2023). *Federal Tax Complexity: Costs and Reform*.
[176] Senators' Letter to Treasury,2022, *Senators Urge Treasury to Crack Down on Abusive Trusts*.
[177] Thomhave and Collins, 2021.

- Clear Guidelines on Beneficial Ownership: Establishing precise definitions and guidelines for beneficial ownership to prevent ambiguity and ensure consistent application across the trust sector.

- Support for Legitimate Estate Planning: Introducing measures that support trustees and beneficiaries in complying with regulations, such as providing accessible resources and training on trust governance and compliance.

By carefully considering the lessons from the United Kingdom and the United States of America, South Africa can implement its legislative amendments effectively. South Africa's goal would be to implement reforms that strengthen compliance with international standards, addressing the FATF grey listing concerns, and maintaining the functional attractiveness of trusts for legitimate purposes. These reforms should be guided by Adam Smith's maxims, ensuring that the balance between economic efficiency, transparency, and fairness is maintained, thereby fostering a trustworthy and equitable financial environment.

10 Conclusion

The 2022 and 2023 amendments to trust legislation in South Africa, initiated by the FATF grey listing, underscores a pivotal moment in the country's financial regulatory sector. These amendments are not just about responding to international pressures but also about taking the opportunity to refine the framework governing trusts in South Africa. The overarching objective of these reforms is to establish a trust legislation framework for trusts that embodies tax neutrality while ensuring effective compliance. In examining these reforms, it becomes clear that to fully gauge the scope and intricacies of these amendments it is key to consider these amendments from an international perspective. The international viewpoint taken in this research paper was from the established trust legislative frameworks of both the United Kingdom and the United States of America.

The United Kingdoms, approach to trust legislation has been characterised by a commitment to transparency and compliance, achieved without imposing undue administrative burdens on the respective taxpayer. The United Kingdom's extensive trust transparency measures in the form of the establishment of beneficial ownership registers together with the establishment of a world-renowned trust registration system, serves as a model of how trust transparency measures should work. The key to these transparency measures is the convenience they bring to the taxpayer by not becoming an excessive burden to the taxpayer while ensuring additional compliance mechanisms. In the case of South Africa, the United Kingdom's experience suggests that enhancing transparency does not necessitate a sacrifice in efficiency or the imposition of onerous obligations on trustees and beneficiaries. Instead, it points towards a pathway where tax neutrality and compliance can coexist, promoting a fair and equitable taxation system that deters misuse while supporting legitimate trust activities.

South Africa can further draw significant insights from the United Kingdom's extensive use of charity trusts. The United Kingdom's diverse trust system stands as a beacon, highlighting the profound social and financial benefits trusts can offer, especially in the realm of philanthropy. By emphasizing educational initiatives that bring these advantages to the forefront, South Africa can cultivate a dynamic culture of giving. This effort can be greatly enhanced through the introduction of strategic tax incentives. These taxation incentives, carefully designed to promote mass involvement and align with national development objectives, may have a significant impact on encouraging charitable trusts.

The complex trust legislation framework of the United States of America on the other hand serves as a cautionary note, providing insight into specific challenges that South Africa must address in the amendments to its trust framework.

The intricate and extensive laws and regulations in the United States, although intended to eliminate loopholes and ensure equity in the trust framework, have further led to unintentional opportunities for tax evasion. This issue underscores the crucial significance for South Africa to give priority to simplicity and clarity in its trust taxation changes. Striving for regulations that are straightforward to understand will help South Africa steer clear of the overcomplexity trap, ensuring that the trust taxation system is accessible to all respective parties involved. This strategy not only simplifies adherence to regulations but also successfully combats tax avoidance without discouraging the utilisation of trusts.

Furthermore, the difficulties encountered by the United States of America regarding international transparency and compliance, particularly its refusal to participate in the CRS framework by the OECD, emphasise the need for South Africa to take a proactive stance in implementing and adhering to rules that promote global financial integrity. This commitment must be carefully weighed against ensuring the continuation of the nation's development aspirations. South Africa can create policies that discourage abuse and promote genuine trust operations by analysing the constraints seen in the United States of America's trust system. Regulations should prioritise simplicity, encourage true trust utilisation, and create an atmosphere where compliance is the standard and tax fairness is a tangible result.

The challenge for South Africa, then, lies in synthesizing these international lessons into a coherent approach that resonates with its unique socio-economic context. The delicate task of balancing tax neutrality with effective compliance involves navigating the fine line between aligning with global standards and nurturing a conducive environment for economic growth and investment. This entails careful consideration of domestic priorities, such as economic development, social upliftment, and the protection of individual rights within the framework of existing legislation like POPIA in consideration of beneficial ownership transparency mechanisms.

Moreover, enhancing collaboration with neighbouring African countries and fostering a network for information sharing within the African continent are critical components of this reformative endeavour. Such regional cooperation not only bolsters the collective capacity to address financial crimes but also provides a platform for challenging the double standards often applied by international regulatory bodies. In doing so, South Africa and its African counterparts can advocate for a more equitable global financial system that acknowledges the diverse challenges faced by developing nations.

The FATF grey listing, while a significant motivator for change, marks just the beginning of South Africa's journey towards a reformed trust taxation system. This journey requires a proactive stance, characterised by ongoing regulatory adaptability and a commitment to selfevaluation. By drawing on the lessons from the United Kingdom and the United States of America, South Africa can craft a trust legislation framework that strikes an optimal balance between tax neutrality and effective compliance. Such a framework would not only address the immediate concerns highlighted by the FATF but also lay the groundwork for a robust, equitable, and dynamic financial system capable of adapting to future challenges.

In conclusion, as South Africa endeavours to reform its trust system, the experiences of the United Kingdom and the United States of America offer invaluable insights. By carefully considering these international examples, South Africa can navigate the complexities of trust taxation reform, aiming for a system that integrates tax neutrality with effective compliance. This balanced approach, informed by global best practices, and tailored to local conditions, will ensure that South Africa not only meets international standards but also fosters an environment conducive to economic growth and development, thereby strengthening its position in the global financial landscape.

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