

The legal nature of a foundation under SA law

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AFRICA

questions

🍷 case study

- do we have an institution of foundation as distinct from a trust?
- what law would a SA court apply (outside of tax) to a foreign foundation?
- how would such a foundation be construed for tax purposes? Trust or company?

Case study

Facts:

Foundation established in Liechtenstein

! Mr F = founder of the foundation; SA tax and exchange control resident

Statutes of the Foundation stated the following:

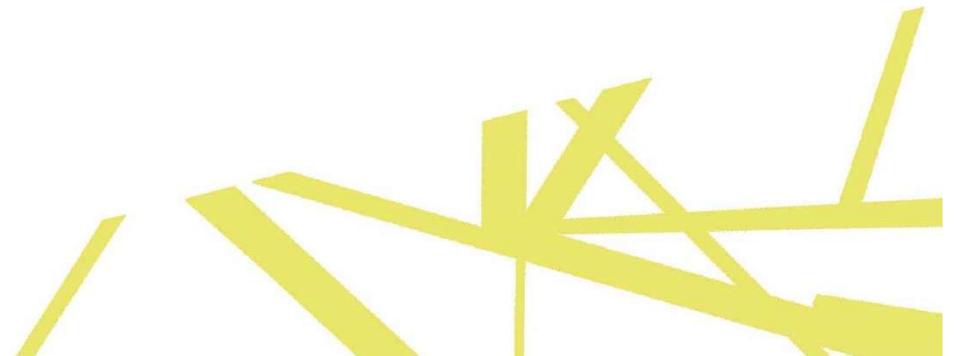
- Foundation has its own legal personality and operates in accordance with Liechtenstein law
- Foundation comprises an endowment fund
- Purpose of foundation is to administer the endowment fund as well as to establish the policy of bestowals to persons that were named in the relevant Regulation to the foundation
- Foundation is to be administered by a Board of Trustees, which duties include
 - Issuing the regulation regarding the beneficiaries and the bestowals they are to receive;
 - Determining the amounts and the manner in which the bestowals are to be rendered to the beneficiaries

Case study continued...

- Regulations of foundation stated
 - Mr F and his wife Mrs F (both of whom were SA tax and exchange control residents during their lifetimes) will be entitled to claim during their lifetimes the foundation's net assets and its income
 - In the event of the death of Mr F and Mrs F, their children will have all rights to the foundation's net assets and net income in equal shares

Question:

- Whether, and to what extent, were Mr F and Mrs F had a duty to report their rights to the assets of the foundation for exchange control purposes and pay tax on these assets during their lifetimes



Case study continued

- Nature of the rights of the beneficiaries with respect to the assets of the foundation is clear from the provisions of the Statute of the Foundation:
 - Ownership of the assets vests in the foundation – fact that foundation has own legal personality, as per the Statutes, indicates its ability to hold rights of ownership in assets
 - Mr F and his wife had vested rights to the assets, which would be vested personal rights to the assets which are owned by the foundation – similar to the vested rights to capital and income of a trust
 - After death of Mr F, Mrs F continued to hold vested rights to the assets of the foundation, and such rights constituted an asset in her estate

features of a foundation

- ✦ juristic person
- ✦ consisting of a collection of assets/funds
- ✦ devoted to a defined purpose
- ✦ managed by administrators/board of trustees
- ✦ ownership of assets vests in foundation itself

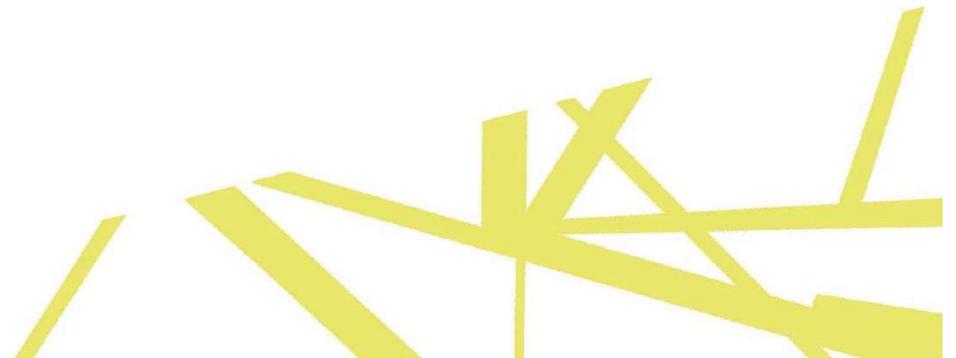


compare SA trust

- ✔ trust is an accumulation of assets and liabilities
- ✔ but trust not a legal person (except by statute, for tax purposes)
- ✔ ownership vests in trustees or beneficiaries (if vested)
- ✔ created by will (testamentary) or by agreement with trustees (*inter vivos*)

Foreign law governs

- ✔ offshore foundation intended to be governed by law of that jurisdiction
- ✔ SA court would almost certainly apply that law to a dispute
- ✔ but tax consequences determined by application of SA tax law

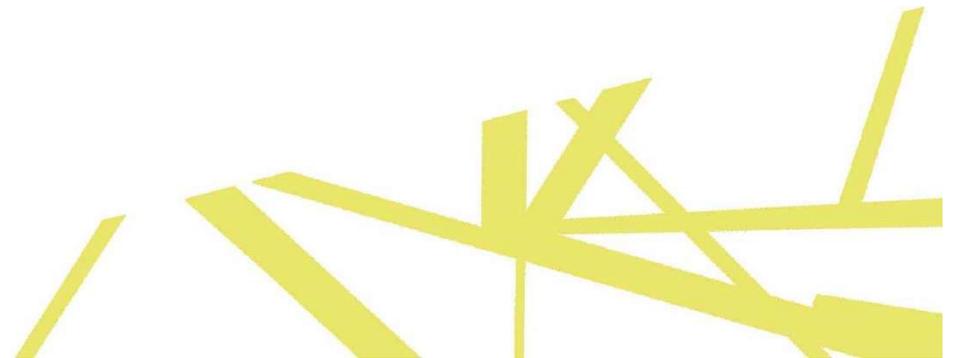


Income Tax Act

- ✔ wide definitions of both 'trust' and 'company'
- ✔ foundation seems to fall within both definitions
- ✔ giving SARS a choice of which provision to apply?
- ✔ uncertainty creates tax risks

definition of trust covers foundation

- ✔ covers all forms of SA trusts
- ✔ but no mention of legal personality
- ✔ so covers foundation too
- ✔ definition of trustee very wide; includes executors, administrator, curator etc



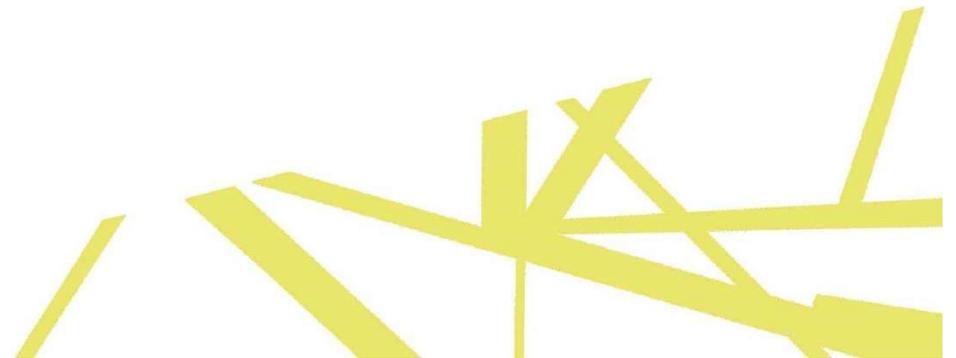
this definition too covers foundation

if:

- the foundation has legal personality
- and is incorporated offshore

could also be a company

therefore possibility that foundation constitutes both a company and a trust for SA tax purposes



conclusion

- ✦ when drafting founding documents, be clear which entity you would like to use
- ✦ if prefer to have a trust, delete references to 'body corporate', 'dividend'
- ✦ foundation could under certain circumstances make sense
 - CFC rules would apply
 - proposed amendments to participation exemption for underlying companies could make use of foundations more attractive

Important disclosure considerations

- ✦ board of trustees must make correct disclosures for CRS purposes to ensure tax treatment follows planning
- ✦ financial statements must be clear
- ✦ disclosure of beneficiaries in local tax returns must correspond with chosen entity

