WITHOUT PREJUDICE
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The taxation of interest earned in a trust

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It is imperative for the founders of trusts to be fully conversant with the tax implications of interest earned on funds donated to a trust.

I will analyse one common trend in South Africa to clarify the position. Quite often, a parent will set up an education trust by donating an interest earning investment of considerable value to the education trust.

For example Mr X donates R1 million to his daughter's education trust that earns an interest of 10% a year. In terms of the provisions of the trust deed, the trustees are required to pay the daughter an amount sufficient to cover all her university education costs and supply her with a reasonable monthly allowance to cover her university accommodation and living expenses. The trust deed also provides that interest in the trust will be capitalised and reinvested and when the daughter completes her studies, the trust will be dissolved and the capital and capitalised interest will be awarded to the her.

In whose income will the interest earned by the education trust be included for taxation purposes?

The distributions made by the trustees to the daughter for purposes of covering her university tuition, accommodation and allowance, **if the daughter is a minor**, will be taxed in the hands of the parent (aka trust founder Mr X). s7(3) of the Income Tax Act (58 of 1962) states that if, by reason