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Application of the conduit principle to foreign trusts and beneficiaries

The recent Taxation Laws Amendment Bill (B30 – 2025, the TLAB) will, once promulgated, amend section 25B of the Income Tax Act No 58 of 1962 (the Act). The amendments are intended to ensure that the “conduit principle” only applies to South African resident beneficiaries and donors. However, the amendments will result in the conduit principle applying to foreign trusts and foreign beneficiaries.

Section 25B of the Act, the conduit principle

Section 25B of the Act enshrines the “conduit principle” in relation to trust distributions. The conduit principle was well established in South African case law, including in *Secretary for Inland Revenue v Rosen* whereby income retained in a trust may lose its “identity and character”.

Section 25B was introduced to codify the conduit principle, confirming that:

- Income retains its character when vested in a beneficiary in the same year of assessment as it is received by or accrued to the trust, and therefore is taxable in the hands of the beneficiary, and
- Income otherwise retained in the trust is taxable in the trust.

The 2025 Taxation Law Amendment Bill and clarifications regarding South African residents

Per both National Treasury’s draft explanatory memorandum and its draft response document regarding the 2025 TLAB, the amendments to section 25B of the Act seek to clarify the application of the conduit principle “*only ... to income received by or accrued to resident beneficiaries and resident donors.*” However, section 25B, once amended, will apply the conduit principle to:

- Distributions by **South African** resident trusts to **South African** resident beneficiaries; and
- Distributions by **foreign** trusts to **any** beneficiaries (i.e. both South African and foreign beneficiaries).

Once the TLAB is successfully promulgated, these amendments are to have affect for tax years beginning on or after 1 March 2026.

Impact of application of conduit principle to foreign trusts and residents

The amendments to section 25B do clarify that the conduit principle applies in respect of South African resident beneficiaries as intended by National Treasury. However, confirming the application of the conduit principle between non-South African tax resident trusts and beneficiaries may have an unintended impact regarding South African sourced income.

Currently in terms of South African domestic law, the **foreign trust would ordinarily constitute the taxable person** for any South African sourced income it receives, without reference to any of its beneficiaries. For example, at a domestic level generally and before application of any applicable double taxation agreements (DTAs):

- Rental income from South African situated immovable property would be subject to a **flat** South African income tax rate of 45%; and
- Proceeds on disposal of South African situated immovable property would be subject to an effective South African income tax rate of 36%.

Determining the application of any DTA's would be relatively straightforward, as only two jurisdictions would need to be considered (South Africa and the country of tax residence of the trust).

Applying the conduit principle to foreign trust / beneficiary distributions would result in the **beneficiaries of the foreign trust being the relevant taxable person** in respect of South African sourced income vested and distributed to them in the same year it was received by or accrued to the trust. Assuming the *foreign* beneficiaries of such foreign trust are natural persons, domestic taxation of the aforementioned income streams would be as follows:

- Rental income from South African situated immovable property would be subject to a **maximum marginal** South African income tax rate of 45%; and
- Proceeds on disposal of immovable property would be subject to an effective South African income tax rate of 18%.

The proposed expansion of the conduit principle may therefore result in possible lost revenue for SARS.

In addition, DTA application may be further complicated where the foreign trust and beneficiary are resident in different foreign jurisdictions, especially where one of the jurisdictions does not have a DTA with South Africa. Finally, both foreign trustees and beneficiaries will have additional administrative burdens (where foreign trustees will have to track South African sourced income and when it is distributed to beneficiaries, and beneficiaries may have to register as a South African taxpayer).

Key takeaways

The amendments to section 25B contained in the 2025 TLAB would result in the conduit principle applying in respect of South African beneficiaries, as intended. There may however be additional unintended consequences for foreign trusts and beneficiaries, including:

Possible loss of South African income tax revenue;

- Difficult application of DTA relief; and
- An administrative burden for both foreign trustees and beneficiaries.

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