SECTION 7C AND ITS **EFFECT ON TRUSTS**

Effective 1 March 2017, section 7C puts a stop to the well-used technique of shifting value to trusts using interest-free or low interest loan accounts, which pegged the value of the asset transferred, thus avoiding estate duty on future asset growth.

Section 7C deems interest to accumulate on the difference between the interest charged and the official rate (currently 7.5%) during the year of assessment, and treats this deemed amount as a donation back to the trust during each year of assessment. This effectively erodes the donations tax exemption available to natural persons (currently R100 000) and limits the extent to which an individual can reduce the loan he or she made to the trust by donating back to the trust each year an amount equal to the exempt amount.

It is important to note that section 7C only applies to resident natural persons if they are connected persons to the trust, or to a company that makes a loan to a trust if the loan is at the instance of such resident connected person.

EXAMPLE

An individual loans to his family trust the sum of R10 000 000 (ten million rand) as part of an estate planning exercise to purchase a share portfolio. The loan is interest free and payable on demand. The resultant donations tax liability is illustrated below:

Step 1: Calculate the deemed interest: R10 000 000 x 7.5% (current official rate) = R750 000

Step 2: Deduct the annual donations tax allowance available to resident natural persons, currently R100 000: R750 000 – R100 000 = R650 000

Step 3: Calculate the donations tax payable: R650 000 x 20% (current rate of donations tax) = R130 000

The donations tax liability, payable at the end of the tax year and every subsequent year in which the interest rate on such loan remains 0% and the official rate remains 7.5%, will therefore be **R130 000.**

SECTION 7C DOES NOT APPLY IN ALL CIRCUMSTANCES

There are several instances where section 7C will not apply to interest-free or low interest loans to trusts or companies ("affected entities"). These exemptions are summarised as follows:

1. Any loan to an affected entity which is an approved Public Benefit Organisation or Small Business Funding Entity;
2. Any loan to a trust by a person by reason of or in return for a vested interest held by that person in the receipts and accruals and assets of the trust;
3. Any loan to a trust which qualifies as a Special Trust;
4. Any loan to an affected entity where the loan, wholly or in part, was used to fund the acquisition of a primary residence as defined in the Act;
5. Any loan to an affected entity in terms of an arrangement that would have qualified as a Sharia-compliant financing arrangement as defined; and
6. Any loan which is caught under the deemed dividend provisions or which qualifies as an affected transaction, i.e transfer pricing.

FURTHER REFINEMENTS TO SECTION 7C

As with most anti-avoidance measures, taxpayers try and restructure their affairs to avoid the effects of the new measures – in this respect, SARS identified two schemes employed and brought in new measures towards the end of 2017, effective 19 July 2017.

LOANS MADE TO COMPANIES

Prior to the amendment, section 7C only applied to loans made to trusts. This provision was overcome by restructuring the trust's assets into a company whose shares were held by a trust and extending a low interest or interest-free loan to the company. From the effective date, the provisions of section 7C now extend to loans made by individuals to companies in which the trust (or a beneficiary of the trust) holds at least 20% of the shares or 20% of the voting rights in the company.

TRANSFER OF LOANS

Section 7C only dealt with the initial lender, and it was argued that where the loan claim was transferred to another person, usually a beneficiary of the trust, section 7C no longer applied. This argument has now been shut down by making it clear that the recipient of such claim will also be subject to the provisions of section 7C where they are a connected person in relation to the trust or company receiving the low interest or interest-free loan.

The reach of section 7C is wide and has put an end to the popular value-shifting arrangement so effectively employed using interest-free loan accounts. Structuring your estate utilising a trust still has many advantages, but it is crucial to obtain professional advice before proceeding.

Should you require any assistance with your estate, please contact your financial planner who will assist you in contacting a Lighthouse Trust & Corporate Attorney.