

"Whether you think you can or you can't, you're right" –

Henry Ford

TAXATION LAWS AMENDMENT BILL, 2016 (the "TLAB") – INDIVIDUALS, LOANS AND TRUSTS

Our newsletter remitted in August 2016 and titled "Closing the Gap on Trusts" has reference. The article dealt with the new rules proposed by the TLAB expected to come into operation on 01 March 2017.

The first draft TLAB proposed to include to the Income Tax Act (per the new section 7C) the following - should a person sell assets to a trust on loan account and charge no interest or charge interest below market related, an amount equal to the difference between:

1. the interest that would arise as determined with reference to the official rate of interest (as determined in terms of the Seventh Schedule to the Income Tax Act and calculated to be 8% at this stage) (hereinafter the "Official Rate"); and
2. the actual applicable rate of interest on the loan below market rate made to a trust (hereinafter the "Actual Rate");

will be regarded as an amount of income accrued or received by the lender.

AMENDMENTS TO THE PROPOSED SECTION 7C

Since August, the draft TLAB was made available for commentary and section 7C was substantially altered from its initial mechanics proposed in the first draft TLAB.

Section 7C is still applicable to situations where: a loan, advance or credit is advanced by a natural person to a trust; or where such a person is a 'connected person' of a company that provides a loan, advance or credit to a trust; and which loan, advance or credit bears no interest (i.e. no interest is incurred by the trust); or bears interest at a rate lower than the Official Rate.

Law & Laughter

Joke: What did the lawyer name his daughter?
Answer: Sue

For purposes of section 7C, a 'connected person' is any person who individually or jointly with any connected person in relation to himself, holds directly or indirectly at least 20% of the company's equity share capital.

Where section 7C previously stated that an amount equal to the difference between the Official Rate and the Actual Rate will be regarded as an amount of income accrued or received by the lender, it is now stated that the difference between the Official Rate and the Actual Rate will be treated as a donation made to the trust, on the last day of the year of assessment, by the person who made the loan to the trust.

For example, should Mr. X advance R20'000'000.00 at an interest rate of 2% annum (i.e. the Actual Rate which is 6% below the Official Rate in this example) on loan account to his trust, the implications of the new section 7C would result in Mr. X being liable for R220'000.00 in donations tax. For avoidance of doubt: R20'000'000.00 multiplied by the difference between the Actual Rate and the Official Rate (in this instance 6%) – which equals R1'200'000.00.

R1'200'000.00 will therefore be regarded as a donation by Mr. X to the trust and subject to donations tax. Donations tax is calculated at a rate of 20% of the donated value amount. Therefore, 20% of R1'200'000.00 (less that annual exemption of R100'000.00 for individuals in the example of Mr. X) equals R220'000.00 donations tax payable by Mr. X.

Exemptions:

The proposed provisions of section 7C will not apply –

1. If the relevant trust is a Public Benefit Organisation;
2. If the loan, advance or credit was made in return for a vested interest in receipts, accruals and assets of the trust;
3. If the loan, advance or credit was made in terms of the Sharia Compliant Financing Arrangements as described in section 24JA of the Income Tax Act;
4. Where a loan was made to a trust by a company, which loan is regarded as a dividend to the trust;
5. If the trust is a 'special trust' – i.e. a trust established for the benefit of a person with a disability who, due to such disability, cannot earn sufficient income or is incapable of managing his / her financial affairs;
6. If a trust utilised the loan, advance or credit for purposes of funding (either partly or wholly) the acquisition of an asset, which asset was used (throughout the year of assessment), by the person (or his / her spouse) who granted the loan, etc.

Shareholders of companies:

It is important for shareholders of companies to note the provisions of the draft section 7C(4) which states that if a loan, advance or credit was advanced by a company to a trust at the instance of more than one person that is a connected person in relation to that company, the amount so advanced must be treated as having been donated to the trust by each of those persons.

The amount donated by each such person (i.e. the respective shareholders) to that trust will be equal to that amount that bears the same ratio as the equity shares or voting rights held by that person in the company in relation to the total aggregate equity shares or voting rights in that company held by such persons (i.e. the shareholders).

No deductions or capital losses

The draft section 7C(2) states that no deduction, loss, allowance or capital loss may be claimed in respect of a disposal, including by way of a reduction or waiver; or as the failure, wholly or partly, of a claim for the payment, of any amount owing in respect of a loan, advance or credit mentioned in section 7C.

CONCLUSION

A loan by individuals to their trust is a widely accepted estate planning tool utilised to avoid estate duty and donations tax. However, despite the Davis Tax Committee's recommendation that "No attempt should be made to implement transfer pricing adjustments in the event of financial assistance or interest-free loans being advanced to trusts", it would appear that section 7C is the National Treasury's preferred measure aimed at curbing the avoidance of estate duty and donations tax.

Although the provisions of section 7C are not final and pending further comments, it is prudent to acknowledge and recognise the possible implication of the proposed amendments on one's personal affairs.

Pending the public consultation process to be finalised before introducing the newly proposed measures, we encourage our clients to contact us well in advance to assess whether a restructure of their personal affairs may be required.

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