STRATEGIQ CAPITAL

REGULATION UPDATE:
Taxation Laws – Impacting Local Trusts

Taxation Laws Amendment Bill, 2016, Section 7C

- **What is it?**

  - The National Treasury and SARS published the 2016 Draft Taxation Laws Amendment Bill on the 8 July 2016. The Bill introduces a new section - Section 7C - to the Income Tax Act ('the Act') which provides detail and measures to prevent Estate Duty and Donations Tax avoidance through the transfer of assets to a Trust on interest-free loan account.

  - The section applies where any natural person, or a company in relation to which that person is a connected person provides any loan, advance or credit to any Trust. If the loan is interest-free or if the interest rate charged is less than the official rate (currently 8%), the shortfall will be taxable in the hands of the lender but it will not be deductible by the Trust.

  - President Jacob Zuma signed the Taxation Laws Amendment Bill into law on January 11th 2017. As a result of the new regulations, it could soon become far less favourable from a tax perspective to move assets to a trust and extend an interest-free or low-interest loan to the vehicle to finance the transaction.

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- **Currently:**

  - Currently, the sale of assets to a trust which is financed by way of an interest-free loan does not trigger any adverse tax consequences for the seller or the trust.
  - According to the Explanatory Memorandum, the benefit of this is that a seller who is a natural person can extinguish the loan by making use of the annual R100,000 exemption from donations tax, in terms of s56(2)(b) of the Act (persons other than natural persons enjoy an annual exemption of R10,000 in terms of s56(2)(a)).
  - The financing of the asset in this manner is also beneficial from an estate duty perspective as the seller's asset base is reduced tax-free through the use of the annual exemption from donations tax.
  - As no interest is payable in terms of the loan, the tax base is further reduced

- **Practical example 1:**

  - If the founder of a trust extended an interest-free loan of R2 million to the trust ten years ago and donated R100 000 per annum to the trust to reduce the loan (the loan would have reduced to R1 million by now).

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➢ **Impact of the section 7C on the tax treatment of interest-free loans to a trust :**

The two most likely scenarios that may apply to you, in line with this legislation are as follows:

1. You have sold an asset to the trust on an interest-free loan basis or interest rate lower than the SARS official rate;
2. The trustees of a trust made a distribution to trust beneficiaries and the beneficiaries loaned it back to the trust

The new provisions will make people think twice before moving assets into a trust, except in cases where trusts are explicitly excluded from the regulations.

- Excluded trusts includes: Investment trusts (where the lender holds a vested right in the trust assets corresponding pro rata with the loan), public benefit organisation trusts, special trusts for mentally or physically handicapped people as well as trusts where a primary residence was transferred by way of an interest-free loan are exempt from the Section 7C provisions. Some technical areas are also explicitly excluded.

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- **Practical example 1:** **(going back to our original example)**

Depending on the size of the loan, planners won't be able to reduce the outstanding balance of the loan without paying donations tax.

- If the founder of a trust extended an interest-free loan of R2 million to the trust ten years ago and donated R100 000 per annum to the trust to reduce the loan (the loan would have reduced to R1 million by now), ***from 01 March 2017, the founder will be deemed to have made a donation of R80 000 (R1m x 8%p.a.) to the trust on the last day of the tax year, leaving only R20 000 of the R100 000 annual donations tax exemption to donate to the trust without having to pay donations tax.***

- **Practical example 2:**
  - Interest free loan to a trust: R10 000 000
  - Donation: R10 000 000 x 8% (SARS official rate) = R800 000
  - Donation tax: (R800 000 – R100 000 'annual exemption') * 20% = R140 000

- Due to the annual donations tax exemption of R100 000, the lender won't be liable for donations tax unless the loan **exceeds R1.25 million** (official rate = 8%pa), provided the person didn't make any other donations during the year.

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- **Why should you be concerned**

  - If you have made a loan to a South African trust, we recommend that you evaluate your position and the impact of this legislation on you before 28 February 2017 (if any).

  - Your specific circumstances would dictate the best tax efficient advice for you. In some cases the best solution would be for you either to pay interest on the loan, or to repay the loan, or to make loans to a company, or to restructure your trust.

Trust Benefits

Trusts offer many benefits for wealth management, either alone or in conjunction with companies or foundations. They can hold a diverse range of asset classes including private company shares, residential and commercial property, managed investment portfolios, bank deposits, insurance or assurance policies and intellectual property.

The main benefits and reasons why clients set up trusts include:

- Wealth preservation of family wealth or a family business;
- Asset protection (political, economic and social Instability);
- Protecting the interests of minors;
- Smooth transfer of assets to future generations;
- Consolidation and efficient management of assets;
- Legitimate confidentiality of ownership; and
- Maximise tax efficiencies

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END | THANK YOU

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