

Trusts and loan accounts

What is section 7C?

This section of the Act stipulates measures designed to prevent the avoidance of estate duty and donations tax through, amongst other things, the transfer of assets to a trust on an interest-free or a low interest-bearing loan account.

How will it work?

This new amendment to the Act will only have an effect if a person or a company has made a loan to the trust. Up until now, such a loan could be interest free or bear interest lower than a market-related rate.

- From 1 March 2017, in terms of this new section, the lender may be required to charge interest on the loan at a market-related rate.
- If interest is not charged, the lender could be deemed to have made a donation to the trust, which could be taxable depending on the amount.
- The law stipulates a minimum interest rate of the repo rate + 1% (which currently equates to 8%) but SARS has indicated that 8% is not a fixed rate, as they expect the lender to charge an interest rate that is market related in the particular circumstances.
- The declaration for tax purposes arising from the interest charged or the donation made, is the responsibility of the lender, but it will impact the trust's tax return and financial statements.
- Effectively, this will only be relevant for the 2017/2018 tax year, but provisional taxpayers should take this into consideration from July 2017 already.
- The interest on the loan account must be paid by the trust itself.

Exclusions from the obligation to charge interest:

- Loans to public benefit organisations, 'special trusts' as defined by law, and so-called vesting trusts. (Typically, most testamentary trusts are 'vesting'.)
- Where the loan to the trust was used to purchase a primary residence for the lender or his/her spouse.
- Where the loan is a Shari'ah compliant financing arrangement.

In the case of companies: If a loan was made by the company and the company elects not to charge interest, the donation can be deemed to have been made by shareholders pro rata to their shareholding, in certain circumstances.

How to proceed

- The lender must make a decision on whether interest will be charged on the loan at all, and at what interest rate. The best course of action for the lender is to consult with the trustees on this.
- If the lender is not charging interest, the taxable value of the donation will be equal to the market-related interest that he/she has elected not to charge.
- Sanlam Trust recommends that the lender consult his/her own tax specialist for the appropriate advice, since we are not in a position to provide specific tax advice.

A simple example

- If a lender lends R1 250 000 to a qualifying trust, and charges no interest, the loan is deemed to be a taxable donation to the trust. The official rate as stipulated by law will then come into effect. On this amount, the 8% p.a. interest not charged equals a donation of
- R100 000 ($8/100 \times 1\,250\,000$). In this example the lender will therefore pay NO tax, as the annual tax-exempt donation permitted by law is R100 000.
- If the lender charges 8% p.a. he/she can still make tax-exempt donations to a maximum of R100 000 per annum.