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TAX & EXCHANGE CONTROL **ALERT**

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Trusts to be subject to further anti-avoidance provisions: The proposed amendment to section 7C

Section 7C of the Income Tax Act 58 of 1962 (ITA) contains various anti-avoidance provisions in respect of loans or credit advanced to trusts. These provisions were introduced to curb the abuse of trusts by taxpayers who transfer their wealth to trusts, tax-free, by means of low interest or interest-free loans or credit.

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Section 7C of the Income Tax Act 58 of 1962 (ITA) contains various anti-avoidance provisions in respect of loans or credit advanced to trusts. These provisions were introduced to curb the abuse of trusts by taxpayers who transfer their wealth to trusts, tax-free, by means of low interest or interest-free loans or credit.

At present, the anti-avoidance provisions apply to schemes in terms of which natural persons or companies, at the instance of a natural person:

1. Transfer assets to a trust and allow for the purchase price that the trust owes in respect thereof to remain outstanding as a low interest or interest-free loan or credit in favour of the natural person or company;
2. Advance low interest or interest-free loans or credit to a trust to enable the trust to use the money to acquire assets; and
3. Advance low interest or interest-free loans to companies that are connected persons in relation to a trust.

In many of these schemes, the loan or credit would remain outstanding with no real intention of settlement, with the natural person writing off the loan or credit over time by making use of their annual donations tax allowance of R100,000. By applying the R100,000 annual allowance towards reducing the amount owing by the trust, the outstanding loan amount at the death of the natural person is reduced, thereby reducing the deceased estate's liability for estate duty. As such, by implementing these schemes, taxpayers previously avoided incurring a donations tax liability and reduced their estate duty liability at death.

The anti-avoidance provisions contained in section 7C, however, provide for an annual donation to be triggered in the hands of the natural person who advances the loan, or at whose instance the loan is advanced by a company. The amount of the deemed donation is the difference between the interest that is actually charged on the loan or credit, and the interest that would have been payable by the trust had the interest been charged at the prevailing *"official rate of interest"*, as defined in the Seventh Schedule of the ITA.

The 2020 Draft Taxation Laws Amendment Bill (Draft TLAB), that was published for public comment on 31 July 2020, proposed the insertion of a new anti-avoidance measure in section 7C in order to curb the use of schemes involving preference share funding to circumvent the application of the current section 7C provisions. These schemes have become increasingly popular and involve the subscription by a natural person for preference shares (with no or a low rate of return) in a company that is owned by a trust that is a connected person to that natural person.

It has been proposed that where a natural person, or a company at the instance of a natural person in respect of whom that company is a connected person, subscribes for preference shares in a company with a particular shareholding (NewCo), then:

1. the consideration received by NewCo for the issue of the preference shares will be deemed to be a loan in terms of section 7C(3); and
2. any dividend that is declared in respect of those preference shares will be deemed to be interest in respect of the deemed loan as contemplated in section 7C(1).

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This amendment is intended to come into operation on 1 January 2021 and will apply in respect of years of assessment commencing on or after that date.

The NewCo envisioned in this new anti-avoidance measure is a company in which 20% or more of the equity shares are held (whether directly or indirectly), or of which the voting rights can be exercised, by a trust (whether alone or together with any person who is a beneficiary of that trust) that is a connected person in relation to the natural person or company subscribing for the preference shares in the NewCo.

This amendment is intended to come into operation on 1 January 2021 and will apply in respect of years of assessment commencing on or after that date.

Comment

The proposed amendment appears to be aimed at avoiding tax leakage and undue tax benefits accruing to taxpayers who implement schemes purely for purposes of unduly avoiding the payment of taxes, in this case, donations tax and the future payment of estate duty.

The public had an opportunity to submit written comments on the proposed amendments to the Draft TLAB and other tax Acts. National Treasury will be hosting virtual public workshops in respect of the proposed amendments and public comments during the week of 7 to 11 September 2020.

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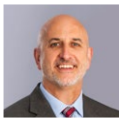

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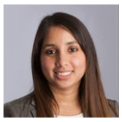

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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