TALARIA WEALTH

s7C
Complexities aside, it looks here to stay

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s7C – How we got here

- The taxation of trusts has long been on the radar of National Treasury as evidenced by past commissions such as Franzen, Smith, Margo, Katz …
- More recently the Davis Tax Committee ("DTC") published its First Interim Report on Estate Duty incorporating a number of proposals on trusts. However, the DTC did recommend 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.

  The justification for this position was:

  … There would be numerous complexities associated with implementing a form of transfer pricing adjustment to deem a return on interest-free loans between SA registered trusts and SA registered taxpayers. The DTC concurs with the recommendations of the Katz Commission that this be avoided.

Chapter 4 Trusts, pg. 40

s7C – How we got here continued

- Complexities aside the recommendations of the DTC would appear to have been ignored if the 2016 National Budget Review is anything to go by:

… To limit taxpayers' ability to transfer wealth without being taxed, government proposes to ensure that the assets transferred through a loan to a trust are included in the estate of the founder at death, and to categorise interest-free loans to trusts as donations. Further measures to limit the use of discretionary trusts for income-splitting and other tax benefits will also be considered.

Chapter 4: Revenue Trends and Tax Proposals, pg. 49

- According to The Draft Explanatory Memorandum to the Draft Taxation Laws Amendment Bill, 2016 at issue is the

… avoidance of estate duty and donations tax when a person sells assets to a trust and the sale of those assets is financed by way of an interest free loan or a loan with interest below market rates.

Paragraph 1.6, pg. 8

s7C – What does it say

- Applies to
  - Natural persons where that person and a trust are connected persons.
  - Companies who are connected persons in relation to such natural persons or to the trust.
- The natural person or company, or connected persons in relation to them must directly or indirectly provide a loan, advance or credit to the trust.
  - A person is connected to the trust if they or any relative is a beneficiary of the trust.
  - A company is connected if any person individually or jointly with another connected person holds directly or indirectly at least 20% of the company's equity share capital or voting rights.
- Included in the income of the natural person is interest calculated at either
  - The official rate of interest (para 1 7th Sch) where no interest is incurred by the trust, or
  - The difference between the official rate of interest and the actual (lower) rate of interest incurred by the trust.

s7C – What does it say continued

- The natural person cannot apply the s10(1)(i) interest exemption.
- The natural person may recover the additional tax payable on the imputed interest from the trust. Where this additional tax is not recovered within a period of three years the additional tax will be treated as a donation by the natural person to the trust.
- The annual donations tax exemption granted in terms of s56(2) will not apply in respect of any loan contemplated in terms of the section owing to the donor.
- On promulgation the section will come into operation on 1 March 2017 and will be applicable to years of assessment commencing on or after that date.

s7C – Concerns

- Double taxation

  It begs the question as to whether the application of the deemed income provisions of s7 and their mirror image in paragraphs 68 – 72 of the 8th Schedule will also apply if interest is imputed in terms of s7C.

- Distributions to beneficiaries

  How are distributions to beneficiaries, the payment of which is often held back until a later date, to be treated. The accounting treatment is to invariably credit the distribution to a "beneficiary loan account". While the accountants may record the obligation of the trust as a loan there may be a case to be made that this is not the case.

  It is the trustees that decide to withhold payment of the distribution, their power being derived from the trust deed. Nor is the consent of the beneficiary a requirement for withholding the payment of the distribution.

- Retrospectivity

  It is not clear as to whether the provisions apply to loans made prior to 1 March 2017. In its present form the section comes into operation on 1 March 2017 and refers to "… directly or indirectly makes or provides any loan, …"- wording in the present tense.

s7C – Concerns continued

- Offshore trusts

  The right of recovery granted to the lender in this instance, cannot be imposed in an offshore jurisdiction. Trustees of a foreign trust may therefore not pay the lender, subjecting the lender in turn to donations tax.

- Official rate of interest

  The official rate of interest may prove to be excessive. Loans of the nature in question will invariably be backed by an underlying asset and will in essence be fully secured. To impart the same return requirements and cost structure as a conventional lender to an individual seems unfair. A discount to the repurchase rate may be more appropriate.

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s7C – Workshop - National Treasury 16 August

- The primary motivation in support of the proposed legislation would appear to be the perceived avoidance of Estate Duty through the use of interest free loans.
- The intention is to include all loans, existing and future. It is however recognised that trust structures other than those adopted for the perceived avoidance of Estate Duty are in place and cognisance will be taken thereof. To this end the exclusion of employee share trusts, PBOs, special trusts and the like is being considered.
- It is not intended to effectively double tax the benefits flowing from trusts funded in this manner. Either the new s7C or the existing attribution rules will be applied to the case in point, not both.
- Concern on the part of National Treasury that CGT is not a replacement for Estate Duty and to this end "growth assets" fall outside the attribution rules. Proposed legislation is a way of addressing this rather than placing reliance on the common law and the debate around the nature of interest free loans and the foregoing of interest that can be challenged in court.

s7C – Workshop - National Treasury 16 August continued

- Constitutional issues such as the application of Sharia Law and the imposition of interest are recognised and will be considered.
- National Treasury is willing to work with industry representatives, hears the concerns being raised and is not dismissive of the importance of trusts in our law.
- However the view remains within National Treasury that the proposed legislation is required. To this end the normal legislative process will be followed and s7C, in a workable form due recognition being given to the representations and input received from interested parties, will be adopted.

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Questions

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