

*Introducing measures  
to prevent Estate Duty  
and Donations Tax  
avoidance – Section 7C*

*... Additional Anti Avoidance*

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# *Death And Taxes*

Benjamin Franklin (1706 – 1790) in a letter to Jean-Baptiste Leroy, 1789, reprinted in *The Works of Benjamin Franklin*, 1817 he said:

*“In this world nothing can be said to be certain, except death and taxes.”*



# *Why wealth taxes?*

## **Comprehensive Tax System**



Wealth Taxes

Direct Taxes  
Income Tax

Indirect Taxes  
Tax on Consumption / Expenditure

# ***Background***

Using *Inter Vivos* Trusts to minimise Estate Duty in the event of death

Funding of the Trust by means of Interest Free Loans

Funding by means of Interest Free Loans not subject to donations tax

Pegging of the Estate Planner's estate for Estate Duty purposes

Growth within the Trust, thus no Estate Duty

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## *History of Section 7C*

### *DTC's First Interim Report on Estate Duty recommended that:*

- **no attempt** should be made to implement **transfer pricing adjustments** in the event of financial assistance or **interest free loans** being advanced to a Trust.
- 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.
- **concurred with** the recommendation of the **Katz Commission** that this be avoided – page 40, DTC First Interim Report, January 2015.

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## *History of Section 7C*

***The Minister of Finance** proposed during his Budget Speech held on **24 February 2016**, that 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** (yet to be tabled)
- and to categorise **interest free loans** to Trusts **as donations**.  
– Chapter 4, Revenue Trends and Tax Proposals, Additional Measures to Protect the Tax Base, Tax Treatment of Trusts, on page 49

# *History of Section 7C*

Then came the DTC's *Second Interim Report*:

- National Treasury should consider the possibility of extending the provisions of section 3(3)(d) of the Estate Duty Act
- to include deeming provisions that identify “deemed control” of a Trust through a loan account between a Trust and a “connected person(s)”, where the loan is not subject to interest or is subject to interest at below the official rate.
- In these circumstances, the loan provides the lender with **de facto** control over the Trust (my emphasis) - page 7, DTC Second Interim Report, on Estate Duty August 2016.

## Old position – An example (ED & DT)



### **Year 1**

Founder's NAV = R10m (pegged)

Trust's NAV R0

### **Year 20**

Founder's NAV = R10m

Trust's NAV R29m

Founder's ED = R1,3m

Founder's DT = R0

Loss to the *fiscus* : ED = R5,800,000

: DT = R1,980,000



# *The mechanism of Section 7C*

*Applies in respect of any **loan, advance** or **credit** that:*

- a **natural person**; or
- at the instance of that person, a **company in relation** to which that person is a **connected person**,
- **directly or indirectly** provides to a Trust in relation to which that person or company, or **any person** that is a connected person in relation to that person or company, is a connected person.
- If a Trust incurs **no interest or interest** at a rate **lower than the official rate** as per the Seventh Schedule
- Loan by **company at the instance** of more than one person

## *The mechanism of Section 7C*

- an **amount equal** to the **difference** between the amount incurred by that Trust, during a year of assessment as interest in respect of that loan, advance or credit **and** the amount that would have been incurred by that Trust at the official rate of interest must be **treated as a donation made to** that Trust by the person on the last day of that year of assessment of that Trust
- **1 March 2017** - and applies to amounts owed by a Trust before, on or after that date.

## *The mechanism of Section 7C*

- Section 59 - **Persons liable for the tax** The person liable for donations tax shall be the **donor**: Provided that if the donor fails to pay the tax **within the period prescribed** in subsection (1) of **section sixty** the **donor and the donee** shall be **jointly and severally liable** for the tax.
- Section 60 - **Payment and assessment of the tax.**—  
(1) Donations tax shall be paid to the Commissioner **by the end of the month following the month during which a donation takes effect** or such longer period as the Commissioner may allow from the date upon which the donation in question takes effect.

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## ***The mechanism of Section 7C – Vested, but not distributed*** (EM on the Taxation Laws Amendment Bill 17B of 2016 - 15 December 2016 )

- Amount **vested irrevocably** by a trustee in a beneficiary **and**
- Is used or administered for the benefit of **that beneficiary** without distributing or paying it to that beneficiary
- **Will not** qualify as a loan made by that beneficiary to that Trust if:
  - the vested amount **may not be distributed** to that beneficiary, e.g. before that beneficiary reaches a specific age; **or**
  - trustee has a **discretion** regarding the **timing of and the extent of any distribution** to that beneficiary.

## *The mechanism of Section 7C – Vested, but not distributed*

- A vested non- distributed amount to a beneficiary will qualify as a loan or credit:
  - if that non-distribution results from an **election exercised** by that beneficiary **or** a **request** by that beneficiary that the amount **not be distributed or paid over**; and
  - the trustee **accedes** to a request by that beneficiary that this not be done; **or**
  - the beneficiary enters into an **agreement** with the trustee in terms of which the amount may be retained in the Trust.
- **Financial statements....**

# *The mechanism of Section 7C*

## *What about exemptions?*

PBO Trusts

Sec 30C  
Trusts

Vesting Trusts

Special Trusts

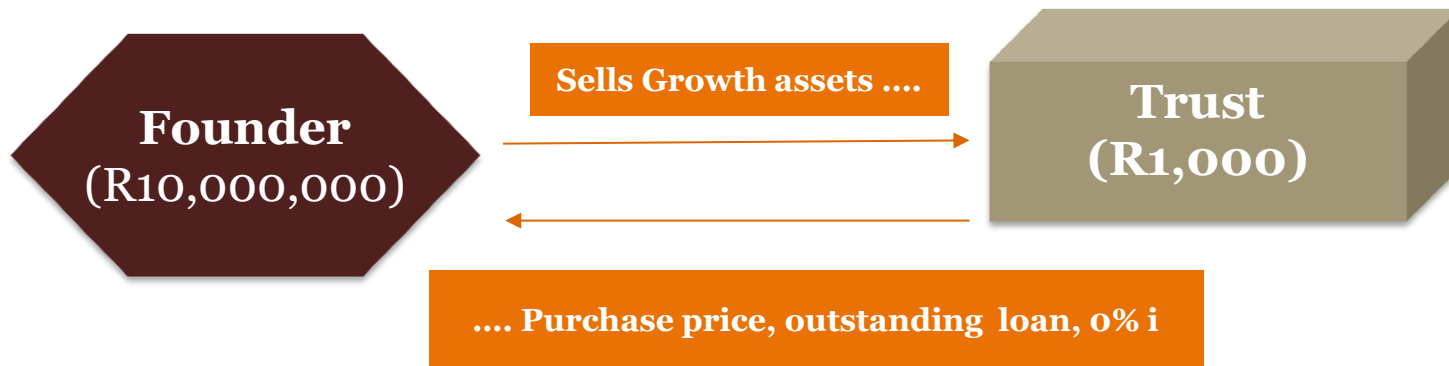
Primary  
resident  
Trusts

Transfer  
pricing –  
Sec 31

Shariah  
financing

Deemed  
dividend –  
Sec 64E(4)

# 1 March 2017 – An example (ED & DT)



## Year 1

Founder's NAV = R10m (pegged)

Trust's NAV R0

## Year 20

Founder's NAV = R10m

Trust's NAV R29m

Founder's ED = R1,3m

**Founder's DT = R2,8m**

Loss to the *fiscus* : ED = R5,800,000

: DT = no loss, actual gain of R820,000

# *Additional Anti Avoidance*

*The Minister of Finance* proposed during his Budget Speech held on **22 February 2017 (Annexure C, p. 138)**

- **Refining measures** to prevent tax avoidance through the use of Trusts
  - .....taxpayers have already attempted to **circumvent the anti-avoidance** measure by making low-interest or interest-free loans **to companies** owned by a Trust.
  - To **counter abuse**, ..... be extended to cover these avoidance schemes
  - .....new rule should not apply to Trusts that are **not used** for estate planning, i.e. employee share scheme Trusts and trading Trusts.



## ***Reason for Additional Anti Avoidance -***

*(EM on the Taxation Laws Amendment Bill, 2017 (Draft) 19 July 2017)*

- Interest-free loans or low interest loans, advances or credit made to companies **owned** by Trusts
- fiscus forgoes ongoing donations tax
- Companies benefit and tax can only be collected later
- Transfer of loans to current or future beneficiaries under arrangements
- Argues to break the link and the transferee does not account for the deemed donation –didn't make the original donation

## ***Draft Amendments to Section 7C – The Net Effect***

This section applies in respect of any loan, advance or credit that:

- (a) a natural person; **or**
- (b) at the instance of that person, a company..... connected person, directly or indirectly provides **to**:
  - (i) a **Trust** in relation to which—
    - (aa) that person or company, or
    - (bb) any person that is a connected person in relation to the person or company referred to in item (aa), is a connected person; **or**
  - (ii) a **Company** that is a connected person in relation to the Trust referred to in subparagraph (i).

## ***Draft Amendments to Section 7C – The Net Effect***

(1A) If a **natural person acquires** a claim to an amount owing by a Trust or a company in respect of a loan, advance or credit referred to in subsection (1), that person must for purposes of this section be **treated as having provided** a loan, advance or credit to that **Trust or company**:

(a) on the date on which that person acquired that claim; or

(b) if that person was not a connected person on that date in relation to

(i) that Trust; or

(ii) the person who provided that loan, advance or credit to that Trust or company, on the date on which that person became a connected person in relation to that Trust or person, that is equal to the amount of the claim so acquired.

# ***Draft Amendments to Section 7C – A New Section 7D***

## ***Calculation of amount of interest at official rate of interest***

**7D** “..... that amount must be determined without regard to any rule of the common law or provision of any act in terms of which—

- (a) the amount of any interest, fee or similar finance charge that accrues or is incurred in respect of a debt may not in aggregate exceed the amount of that debt; or
- (b) no interest may accrue or be incurred in respect of a debt once the amount that has accrued or been incurred as interest is equal to the amount of that debt”

**Why 7D?** = *in duplum* - rule

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# *Draft Amendments to Section 7C –*

*What about exemptions?*

**As per above**

**Employee Share  
Incentive Scheme**

# Way forward



Implementation of new Sec 7 C will have negative consequences for interest free loan-funders of Trusts



We strongly advise that clients seek advice before making any hasty decisions



Each case must be judged on own merits and facts to establish appropriate plan of action



Trusts are still valuable Estate Planning Vehicles



Careful consideration on how to “Fund” Trusts

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