Is the Granting of an Interest-free Loan for Tax Planning Purposes from the Lender's Perspective Under Threat?

1 Introduction

This paper investigates the possibility of whether the free "use of property", consisting of money in the context of interest-free loans, can also be included as the gratuitous disposal of "property" for donations tax purposes as it stands in the light of the developments in the United States of America (hereinafter "US").

The following topics are discussed and covered in this note: The definition of a "donation" in section 55 of the Income Tax Act (58 of 1968) (hereafter "the Act") is analysed to determine whether the granting of an interest-free loan constitutes a donation subject to donations tax. Discussions relating to interest-free loans and donations tax are considered; the judicial process followed in the US that subjected the "use of property" to gift tax is summarised (the summary is based on an article of Caron "Taxing opportunity" 1994 *Virginia Tax Review Charlottesville Fall* 2 347–423); and, based on current South African tax legislation compared with the warning signals from the US, a conclusion is drawn whether South African taxpayers are at risk when granting interest-free loans.

The granting of interest-free loans is widely used in South Africa and is recommended by practitioners to their clients, particularly for estate planning purposes. There will be a saving in estate duty where the property increases in value and the amount of the loan stays fixed. The increase in value will take place in the beneficiary's hands.

Most practitioners advise their clients, based on the current practice of the South African Revenue Service (SARS), that the interest-free loan is not subject to donations tax and that the income tax provisions can be avoided if the transaction is carefully planned taking the relevant specific anti-avoidance provisions into account.

This note will explore whether the tax benefits of diverting growth assets to a trust by selling the asset at market value on an interest-free loan are at risk. The possible additional tax implications relating to the granting of interest-free loans for South African taxpayers based on developments in the US will be highlighted.

The Supreme Court of Appeal of South Africa delivered a judgment on 2007-09-13 in *Commissioner, SARS v Brummeria Renaissance (Pty) Ltd* [2007] SCA 99 (RSA) whereby the right to use loans interest-free was treated as gross income which accrued to the taxpayer. The focus of this note is, however, on the lender in respect of possible donations tax implications and not on the tax effects on the borrower. Where necessary, the possible consequences to a borrower will be indicated.

2 Background and Historical Overview of Interest-free Loans and Taxation Thereof

A loan can be defined as "[m]oney lent on condition that it is repaid, either in instalments or all at once, on agreed dates and usually that the borrower pays the lender an agreed rate of interest (unless it is an interest-free loan)" (*A Dictionary of Finance and Banking* (1997) online at www.oxfordreference.com).

The implementation of specific legislation was considered when the Margo Commission (Margo Commission *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (1987) par 20 56) recommended that interest-free or low-interest loans and other means of financing to transfer real wealth for inadequate consideration should be subject to the capital transfer tax. Nothing was however done about it at that point. Another tax reform team, the Katz Commission (Katz Commission *Fourth Interim Report of the Commission of Inquiry: Capital Transfer Tax* (1997) par 7 2) continued the work of the Margo Commission. The Katz Commission (par 7 2) stated in its Fourth Report on the issue of a capital transfer tax, that the position in foreign jurisdictions had been researched. It was found that effective action against interest-free loans was relatively rare. According to the Katz Commission "[t]he United States has made endeavours in this regard, which have resulted in horrendous complexity, with questionable effectiveness".

The Katz Commission's review of countries that do recognise and who seek to counter the avoidance advantages inherent in interest-free loans revealed that they split the problem into two parts, namely:

- interest-free demand loans, and
- interest-free term loans.

An extract from Appendix A of the Katz Commission's Fourth Report revealed the following comparative information that applied in 1996:

	United States of America	Canada	United Kingdom	Austra-lia	New Zealand
Death duty	Yes	No	Yes	No	No
Donations tax	Yes	No	Yes	No	Yes
Death duty top rate	55% at $3 million	N/A	40% at £154 000	N/A	N/A
Flat or progressive rate	Progressive (average rate rises with duti-able amount)	N/A	Flat	N/A	N/A
Tax interest-free loans	Yes, term and demand loans	N/A	Yes, only term loans	N/A	Yes, only term loans

continued

Even though some of the rates and threshholds of the death duty and donations tax in the different countries have changed since 1996, the legal position is still the same in 2007 and it is clear that the US has the most comprehensive legislation for death duty, donations tax and taxes relating to the granting of interest-free loans, both term and demand.

Katz commented further in its Fourth Report (par 7 5) that "[a]n attempt to follow this precedent can encourage the use of a range of derivative instruments designed to circumvent the legislation, hence necessitating complex legislation".

It states further "[f]or these reasons, the commission has decided against a recommendation of specific legislation to remedy the problem of interest-free loans" (par 7 7).

An article by Croome ("Interest free loans made available to trusts – the fiscal consequences" November 2003 *SAICA Integritax Newsletter* 28) stated that when the capital gains tax legislation was being drafted, the legislature proposed introducing specific provisions into the Act to the effect that the person granting an interest-free loan would be liable to donations tax on the value of the interest-free loan made available. At that stage it was proposed that having regard to the official rate of interest and increasing this rate by 3% would determine the value of the donation. The proposed legislation was not introduced. It would seem, however, that the matter is still on the agenda and it remains to be seen if it will be enacted.

In South Africa, the Act contains some anti-avoidance provisions to deal with the possible tax benefits that might be achieved by granting certain interest-free loans. For example,

- section 7 deals with deemed accrual of income caused by a donation, settlement or other disposition;
- section 31 provides the Commissioner with the power to adjust the consideration for an international agreement between certain connected parties that do not reflect an arm's length price; and
- section 103(1) is a general anti-avoidance provision.

The Seventh Schedule to the Act deals with interest-free or low-interest loans granted by employers to employees. The Eighth Schedule has provisions similar to section 7 dealing with the attribution of capital gains (refer to Appendix A for a summary of the current South African normal tax (including capital gains tax (CGT)) implications in respect of the deeming provisions that might be applicable in respect of the granting of interest-free loans). Sections 54 to 64 are not anti-avoidance provisions, but they determine the levying of donations tax on the transfer of property by donation.

3 Potential Donations Tax Consequences in Respect of Granting of Interest-free Loans

Donations tax is dealt with in Part V of the Act in sections 54 to 64. It was introduced in March 1955 by the then Minister of Finance in his Budget speech given on 1955-03-24, as follows:

> "A method also employed for avoiding taxation is by distribution of gifts – a practice which has, during recent years, been employed on a large scale. It serves a double purpose. In the first place the donor reduces the assets on which estate duty would be payable at death, and in addition whilst he is still alive, he reduces his income tax, because by means of these donations the assets, and hence also the income derived there from, are spread over a great number of taxpayers."

Section 54 requires that donations tax must be paid (subject to certain exemptions provided for in s 56) "… on the value of any property disposed of (whether directly or indirectly and whether in trust or not) under any donation by any resident …"

As this research investigates the potential tax risks for South African taxpayers, it can therefore be assumed that they are residents, leaving only two requirements that need to be met for donations tax to be applicable, namely

- "property"; and
- a disposal under a "donation".

Both the words "donation" and "property" are defined in section 55, but they need to be analysed to establish whether they are wide enough to include the granting of an interest-free loan in their scope and thus subjecting it to donations tax.

"Property" is defined in section 55 as "any right in or to property movable or immovable, corporeal or incorporeal . . ."

According to Meyerowitz (*Meyerowitz on Income Tax* (2003) 31–32) this definition is all-embracing and unlimited.

The English word "property" derives from the Latin noun *proprietas*, the adjective of which, *proprius*, means one's own. Farms, motor vehicles and jewels are corporeal (or material) objects and real rights (ownership, servitudes and leases), shares in a company and patent rights are incorporeal (or immaterial) property (Kuhne *LAWSA* (ed Joubert) 27 (2004) par 195). Property therefore includes personal and real rights, as long as they are rights in or to property, for example, usufructuary and fiduciary interests, a right to an annuity, an option and goodwill (Meyerowitz 31–33).

A "donation" is defined in section 55 as meaning "…any gratuitous disposal of property including any gratuitous waiver or renunciation of a right".

This definition does not refer to a contract, but to a disposal which would appear to have a wider meaning than its common law meaning. It follows that any form of disposal which is motivated by liberality at the expense of the donor, an act whereby the donee is enriched and the donor correspondingly is impoverished will fall within the ambit of the definition of a "donation" as contained in section 55 (Davis, Beneke and Jooste *Estate Planning* (2004) par 2 9 2).

The relevant question that needs to be examined is whether the fact that the lender in terms of an interest-free loan receives no interest, can be seen as a gratuitous waiver or renunciation of a right.

An interest-free loan can arise in one of two ways:

- The sale of an asset, allowing the purchase price to remain outstanding on an interest-free loan account (Davis *et al* par 2 9 2); or
- an outright loan with which the borrower can, for example, purchase an asset.

It has been suggested that when an asset is sold for at least its fair market value at the date of its sale, it seems doubtful whether the sale of the asset *per se* can attract donations tax. A sale at full market value is not a gratuitous disposal as no element of liberality is present.

The question, however, is whether by not charging interest on the loan and allowing it to remain outstanding, a potential liability for donations tax could arise.

The following statement by Divaris (Spring, Editor of Personal Finance Newletter *Business Times* 1988 quoted the statement made by the well known tax adviser Divaris) is relevant in his regard: "The general principle of taxation is that there is no obligation resting upon a lender to charge interest or, if he . . . does so, to charge a market-related rate of interest."

Divaris also states (*supra*) that a family transaction will often be financed by means of an interest-free loan representing either the purchase price of some transferred asset, or moneys advanced for the independent acquisition of an asset. In terms of the income tax law there is no provision deeming interest to accrue on a loan of this nature. He also states that a loan of this nature does not constitute a donation for donations tax purposes. Divaris concludes that specific legislation would be required to change this position, "whose validity is widely accepted".

Ware and Roper ("The impact of residence-based tax on offshore trusts" 2001 *Insurance and Tax Journal* 21) agree with the above view and state that when assets are sold at market value, a correctly structured interest-free loan should not be a donation under South Africa's Roman-Dutch legal heritage . . . and hence should not be subject to donations tax.

Yet according to Davis (Davis *et al* par 13 6), it would appear necessary to distinguish between

- a loan when no interest is charged and the lender cannot alter the interest conditions, and
- a loan when no interest is charged but the lender is entitled to charge interest.

If the lender can charge interest but refrains from doing so, it is submitted that there may well be a donation, as a donation for donations tax purposes includes any "gratuitous waiver or renunciation of a right".

When money is lent, however, no inherent right to interest arises so by not stipulating for interest in the loan agreement there is no "waiver or renunciation of a right" within the meaning of the definition of a "donation" for donations tax purposes.

Davis (Davis *et al*) continues this argument by stating that it must follow that if refraining from charging interest constitutes a continuing donation of the interest that could have been charged, no donation of capital has taken place.

If, by way of example, the capital value of an asset is R100 000, the seller of that asset would normally expect to receive that amount in cash. It could then be invested, by agreement with some other party, in a way that generates an annual income. The right to this annual income then arises from the contract concerned. If the seller, however, elects not to receive cash, but an asset of another sort, namely, a loan account, and has no right in terms of the contract to charge interest, this does not in itself mean that some sort of capital donation has taken place (Davis *et al* par 136).

Silke (De Koker *Silke on the South African Income Tax* (2004) par 23 3) states that it is doubtful whether the making of an interest-free loan constitutes a "gratuitous disposal of property", and says that it is not general practice of SARS to levy donations tax on interest-free loans.

When property is disposed of for a consideration, which, in the opinion of the Commissioner, is not an adequate consideration for that property, section 58 deems the property to have been disposed of under a donation for the purposes of Part V (the part dealing with donations tax). It does provide, however, that a reduction must be made of an amount equal to the value of the actual consideration. Davis *et al* (par 13 6) propose the argument that when a lender makes a loan of money, the lender is disposing of ownership (*commixtio operates*) of the money in return for a right to recover the face value of the loan at some future date (for example a term loan). It could therefore be argued, according to Davis, that the right on the repayment date has a value that is less than the face value, the difference between this "present" value and the face value would constitute a deemed donation in terms of section 58.

The arguments of Davis (Davis *et al* par 13.6) for and against subjecting interest-free loans to donations tax can be summarised as follows:

Provisions in Income Tax Act	**Arguments for**	**Arguments against**
Subjecting the interest that should have been charged to donations tax in terms of section 54.	If the lender has the right to charge interest, but does not, then the "waiver or renunciation of a right" constitutes a donation for donations tax purposes.	If the lender has no right to charge interest, then no inherent right arises that could be waived to subject the interest-free loan to donations tax.

continued

Provisions in Income Tax Act	Arguments for	Arguments against
Subjecting the interest that should have been charged to donations tax in terms of section 58.	Term loan. The lender is disposing of ownership of the money in return for a right to recover the face value of the loan at some future date. The difference between the "present" value and the face value constitutes a deemed donation.	Demand loan. Valuation of the continuing donation is problematical and it is not the current SARS practice to subject the mere provision of an interest-free loan to donations tax.

The arguments for subjecting term loans to donations tax are stronger than for demand loans, when the lender has no right to charge interest.

Davis (Davis *et al* par 13 6) provide the following three recommendations to taxpayers on how to reduce any risk of donations tax when significant assets are sold by way of interest-free loans as part of an estate plan:

- Obtain independent valuations of the assets sold.
- Obtain approval from SARS, if possible, for the transfer values.
- The loan must be repayable on demand.

Even though the risk of donations tax may be reduced, the tax treatment in the US is now evaluated to establish whether the risk is a real threat to a South African taxpayer, because the wording of the South African and the American legislations are similar.

4 Tax Treatment of Interest-free Loans in the US

This note will only consider Federal tax law based on the Internal Revenue Code (hereinafter "Code") enacted by Congress in Title 26 of the United States Code (26 USC) and possible tax consequences by a specific state will not be addressed.

4 1 *Term Loans*

Since the decision in *Blackburn v Commissioner* (1953 20 TC 204 207) an interest-free term loan is treated as a taxable gift from a parent to a child based on the difference between the fair market value of the property and its face value (Caron 1994 *Virginia Tax Review* 360).

4 2 *Demand Loans*

An individual may, without incurring the gift tax, squander money, conceal it under a mattress, or otherwise waste its use value by failing to invest it. But, if the taxpayer chooses not to waste the use value of money, and transfers the use to someone else, a taxable event has occurred (*Dickman v Commissioner* 1984 465 US 330 340). Certain tax consequences will inevitably flow from a decision to make a "transfer of property by gift" in terms of section 2501(*a*)(1) of the Code.

In the US the transfer of a property by gift is subject to gift tax in terms of section 2501(*a*) of the Code, applicable "whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible" (s 2511(*a*)).

In *Dickman v Commissioner* (344–345) it was stated that an interest-free demand loan resulted in a taxable gift of the reasonable value of the use of the money lent. The Commissioner need not establish that funds lent did produce a particular amount of revenue, but only that a certain yield could readily be secured and that the reasonable value of the funds can be reliably ascertained.

The broad reach of the gift tax is confirmed in the Treasury Regulations (25 2511–1(*c*)) by including "any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed".

According to the Department of Treasury

> "[y]ou make a gift if you give property (including money), or the use of or income from property, without expecting to receive something of at least equal value in return. If you ... make an interest-free or reduced interest loan, you may be making a gift". (Department of Treasury *Publication 950: Introduction to Estate and Gift Taxes* (2007) 5 available online at www.irs.gov/publications/p950 accessed 2008-01-31.)

The Internal Revenue Service's (IRS) attempts to subject foregone opportunities to an evolving arm's length standard, highlight the wisdom of the dissenting view in the *Dickman* (348–353) case that the courts should defer to Congress in deciding whether and to what extent the gift tax should be extended beyond transfers of traditional types of property.

Subsequent to the *Dickman* case and the enactment of section 7872 of the Code, the granting of an interest-free gift loan in the US has two separate tax implications:

- The first is for income tax purposes. It is treated as if the lender received interest.
- the second is gift tax. It is treated as if the lender donated the deemed interest to the borrower (resulting in a gift for gift tax purposes).

A separate annual exemption from gift tax in the US applies to each person to whom you make a gift which might effectively lead to no gift tax being payable. The exemption was $10 000 for 1998 through 2001 and for 2002 through 2005 the exemption was $11 000. For 2006 and 2007 the amount is $12 000. (Department of Treasury *Publication 950: Introduction to Estate and Gift Taxes* (2007) 6 (available online at www.irs.gov/publications/p950.) Annexure B provides a summary of the income tax and gift tax treatment in respect of the granting of interest-free loans in the US.

5 Comparison Between South African and US Tax Legislation

The potential warning signal for a South African taxpayer is derived from the long judicial process since the arguments that were raised against the imposition of gift tax in the US are similar to the current arguments of

South African taxpayers as to why interest-free loans should not be subject to donations tax. The wording of the gift tax legislation in the US is, however, similar to the current South African wording in sections 54 and 58 of the Act.

In the US the transfer of a property by gift is subject to gift tax in terms of section 2501(*a*) of the Code, applicable "whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible" (s 2511(*a*)).

Section 2512(*b*) of the Code further defines the phrase "transfer of property by gift" as follows:

> "[w]here the property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift".

In South Africa section 54 of the Act requires that donations tax must be paid (subject to certain exemptions provided for in section 56) "on the value of any property disposed of (whether directly or indirectly and whether in trust or not) under any donation by any resident".

When property is disposed of for a consideration, which, in the opinion of the Commissioner, is not an adequate consideration for that property, section 58 of the Act deems the property to have been disposed of under a donation for donations tax purposes. It does provide, however, that a reduction must be made of an amount equal to the value of actual consideration.

Although the wording of the South African and American legislation is similar, the following difference must be noted before any conclusion can be drawn, namely, that the common law (Roman-Dutch heritage of law) must be taken into account to establish whether a donation has taken place. In his judgment Marais JA (*Estate Welch v Commissioner for SARS* 2004 2 All SA 586 (SCA) 591) stated that the test to be applied at common law to determine whether the disposition of an asset amounts to a donation is so well-settled that it hardly needs repetition. The test is of course, he said, that the disposition must have been motivated by "pure liberality" or "disinterested benevolence" (quoting from *Avis v Verseput* 1943 AD 331 345 377). Marais JA added in *Estate Welch v Commissioner for SARS* (2004 2 All SA 586 (SCA) 592) that there is a presumption against donations in our law.

The South African income tax legislation has specific imputation rules in place where income of one person is deemed to be that of another person (refer to s 7 and the attribution rules in the 8th Sch to the Act). These provisions do not deal with a deemed interest imputation to the donor. They deal with the imputation of income or of a capital gain attributable to the donor. It appears that specific legislation is needed to change the current situation.

The fact that SARS does not presently levy donations tax does not mean that it could not start to levy donations tax and follow the same arguments that were raised by the Supreme Court of Appeal in the *Dickman* case. A South African taxpayer may argue on the basis of

legitimate expectations that on the practice prevailing donations tax should not be levied on interest-free loans.

In the *ITC* case (*ITC* 1682 62 SATC 380) a list of qualities are provided to qualify for protection under the legitimate expectation doctrine. One of the qualities listed is that the expectation must be induced by the decision maker either expressly or implicitly by means of settled past conduct or practice.

In the *ITC* case (*ITC* 1751 65 SATC 294) reference was made to *Administrator, Transvaal v Traub* (1989 4 SA 731 (A)) where it was noted that the doctrine of legitimate expectation has been part of the South African law since its decision. The Commissioner is not obliged, however, to follow a policy which is in violation of the tax law as set out in any Act of Parliament. The Commissioner is not entitled to change his mind when there is no factual justification for the change by making assumptions that cannot be sustained after vigorous examination of the facts before a court.

The judgment by the Supreme Court of Appeal of South Africa in *Commissioner, SARS v Brummeria Renaissance (Pty) Ltd* ([2007] SCA 99 (RSA)) went against expectations when they ruled that the right to use loans interest-free is gross income which accrued to the taxpayer. Even though this ruling affected the borrower and not the lender, it is significant because it changed a generally prevailing practice.

The sale of an asset at market value on interest-free loan is still beneficial for estate planning purposes. The loan should be a demand loan to discourage the levying of donations tax as it is difficult to value. A further benefit also arises when the attribution rules apply and the taxpayer does not invoke his/her right to recover the normal tax from the donee as provided for in sections 90 and 91 of the Act. The following example shows the benefit for estate planning purposes: Taxpayer A sells an income-producing asset to a trust at market value on an interest-free demand loan account. It is a discretionary trust and the beneficiaries are his two major children. All the parties are residents. Taxpayer A and both his children already pay normal income tax at the maximum marginal tax rate of 40%. The growth of the asset takes place in the trust. None of the income received or accrued is distributed to the beneficiaries during the year of assessment. Section 7(5) applies and Taxpayer A will be taxed on the undistributed income. Let’s assume that the income generated amounts to R500 000. Taxpayer A does not invoke his right to recover the tax from the trust or beneficiaries. In the following year the accumulated income is distributed to the beneficiaries. The beneficiaries’ estates grow with income of R500 000 while Taxpayer A’s estate reduces by R200 000 (normal tax payable at 40% on R500 000).

Both sections 90 and 91 of the Act provide for the recovery of tax and state that the taxpayer *may* recover the taxation paid by him under this Act. A further question arises, namely, can the decision not to exercise the right to recover the tax be regarded as a donation? It is submitted that it may consist of a gratuitous disposition as the donor has the right to recover the tax but decides not to do so.

6 Conclusion

The Margo and Katz Commissions considered the implementation of specific legislation to subject interest-free loans to donations tax. This indicates that there is uncertainty how to subject interest-free loans to donations tax under the current wording of the legislation.

Where an asset is sold at market value on an interest-free term loan one has to consider the possible application of section 58 of the Act (Davis *et al*). The difference between the present value and the face value of the loan may constitute a deemed donation. In the case of a term loan, the present value can be calculated, whereas with a demand loan, the present value of the loan is not possible to calculate for the application of section 58 of the Act.

It is the current general practice of SARS not to levy donations tax on interest-free loans (De Koker). Taxpayers may therefore argue on the basis of legitimate expectation that interest-free loans are not subject to donations tax. Clarity is needed in legislation to remove any uncertainty whether or not interest-free loans are subject to donations tax. It is however important to remember that where the practice of SARS is in violation of the tax law then the Commissioner is not obliged to follow its own practice (See *ITC* 1751 65 SATC 294).

South African taxpayers should take note of the developments in the US where the granting of an interest-free loan was regarded as a gratuitous disposition and the deemed interest subjected to both income tax and gift tax in the hands of the lender.

It appears that the current practice to divert growth assets to a trust by selling the asset at market value and settling the amount owing out of the proceeds of an interest-free loan is still beneficial for estate planning purposes. A further benefit to divert oneself from one's assets arises when the attribution rules apply and the taxpayer does not invoke his right in terms of sections 90 or 91 of the Income Tax Act to recover the normal tax from the trust. The donee is enriched and the donor correspondingly is impoverished. It is, however, submitted that there may be a hidden donations tax implication when the taxpayer does not invoke his/her right to recover the normal tax from the donee.

The current South African normal tax (including CGT) implications in respect of the deeming provisions that might be applicable in respect of the granting of interest-free loans can be summarised as follows:

Parties involved	Normal tax treatment	Penalty on lender
Lender: Parent **Borrower:** Child (minor)	No inclusion of notional interest in the hands of the lender. Deemed inclusion in parent's income of actual income accruing to minor by reason of not paying interest on loan (s 7(3)).	Yes, indirectly (ie not the notional interest, but "deemed income" or "deemed" capital gain is included).

continued

Parties involved	Normal tax treatment	Penalty on lender
	The actual capital gain realised by minor from asset acquired by way of an interest-free loan is attributed to parent (par 69 of the 8th Sch). Limit on deemed amounts (not exceeding the amount of the benefit, ie the foregone interest) (par 73 of the 8th Sch).	
Lender: Parent **Borrower:** Child (major and RSA resident)	No inclusion of notional interest in the hands of the lender. No deemed inclusion in parent's income of actual income generated by major child or attribution of actual capital gain realised by major from asset acquired by way of an interest-free loan.	No.
Lender: Parent **Borrower:** Child (major and not RSA resident)	SARS may include notional interest in terms of s 31 in the hands of the lender; and/or deemed inclusion in parent's income of actual income accruing to non-resident by reason of not paying interest on loan (s 7(8)). The actual capital gain realised by non-resident in respect of disposal of asset acquired by way of an interest-free loan is attributed to parent (par 72 of the 8th Sch). Limit on deemed amounts (not exceeding the amount of the benefit, ie the foregone interest) (par 73 of the 8th Sch).	Yes, directly and/or indirectly.
Lender: RSA resident **Borrower:** Unconnected non-RSA resident	No inclusion of notional interest in the hands of the lender. Deemed inclusion to resident of accrual to non-resident by reason of not paying interest on loan (s 7(8)). The actual capital gain realised by non-resident in respect of disposal of asset acquired by way of an interest-free loan is attributed to lender (par 72 of the 8th Sch).	Yes, indirectly.

continued

Parties involved	Normal tax treatment	Penalty on lender
	Limit on deemed amounts (not exceeding the amount of the benefit, ie the foregone interest) (par 73 of the 8th Sch).	
Lender: Employer **Borrower:**	No inclusion of notional interest in the hands of the lender (employer). Inclusion of interest that should	No.

Employee	have been paid in the gross income of the borrower (employee) (Gross income par (i), valued in terms of the 7th Sch). Exception to the inclusion is if the loan is a casual loan < R3 000 or if it is in respect of the employee's studies (par 11 of the 7th Sch).	
Lender: Company **Borrower:** Shareholder (RSA resident)	No inclusion of notional interest in the hands of the lender (company). Deemed dividends and temporary STC liability (12.5%) for the lender, as the company may receive the STC credit once the loan is repaid. Exception to STC liability: If shareholder is also an employee and similar loans are available to other employees as well (s 64C(4)(*e*)). If lender and borrower are part of the same group of companies (s 64C(4)(*l*)).	Yes, indirectly.
Lender: Company **Borrower:** Shareholder (non-RSA resident)	SARS may include notional interest in terms of section 31(2) in the hands of the lender only if the parties are connected, which will depend on the percentage shareholding of the shareholder in the company STC liability as discussed above.	Yes, directly.

continued

A summary of the income tax and gift tax treatment in respect of the granting of interest-free loans in the US during 2007:

Type of interest-free loan	**Inclusion of notional interest (income tax)**	**Gift tax on interest not charged**
Gift loans ($12 000 or less)	No.	No.
Gift loans ($100 000 or less) Borrower earns $1 000 or less in investment income	No.	No.
Gift loans (<$100 000) Borrower earns more than $1 000 in investment income	Yes, but limited to borrower's net investment income.	Yes, but annual gift tax exemption may be utilised.
Gift loans (>$100 000)	Yes, include interest at applicable federal rate.	Yes, but annual gift tax exemption may be utilised.
Pay-related loans (<$10 000) (ie loan between an employer and an employee or between an independent contractor and a person for whom the contractor provides services)	No.	No.
Pay-related loans (>$10 000)	Yes.	No, amount given = payment for services.
Corporation-shareholder loans (<$10 000)	No.	No.
Corporation-shareholder loans (>$10 000)	Yes.	No, amount given = dividend.
Tax avoidance loans, being any below-market loan where the avoidance of federal tax is one of the main purposes of the interest arrangement.	Yes.	Yes, could be seen as a gift.
Between businesses under common ownership	Yes.	Yes, could be seen as a gift.

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