A CRITICAL ANALYSIS OF THE PROVISIONS CONTAINED IN THE INCOME TAX ACT 58 OF 1962 RELATING TO THE TAXATION OF INTEREST FREE LOANS MADE TO TRUSTS OR COMPANIES

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LIST OF ACRONYMS

CGT	Capital Gains Tax
CTT	Capital Transfer Tax
DTC	Davis Tax Committee
DIN	Draft Interpretation Note
EDA	Estate Duty Act, Act 45 of 1955
GAAR	General Anti-Avoidance Regulations
ITA	Income Tax Act, Act 58 of 1962
JSCOF	Joint Standing Committee on Finance
KTC	Katz Tax Commission
OECD	Organisation for Economic Co-operation and Development
Para	Paragraph
Pg	Page
RSA	Republic of South Africa
SARS	South African Revenue Service
TPCA	Trust Property Control Act
TDA	Transfer Duty Act

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CHAPTER 1: INTRODUCTION

1.1. INTRODUCTION AND BACKGROUND

In the Art of War,[1] the Chinese general Sun Tzu makes the following statement –

> "Know the enemy and know yourself; in a hundred battles, you will never be defeated. When you are ignorant of the enemy but know yourself, your chances of winning or losing are equal. If ignorant of both the enemy and of yourself, you are sure to be defeated in every battle."[2]

As a result of the complexity inherent therein, the same can be said of the interpretation of legislation, so much so that legislation, the Interpretation Act,[3] has been drafted in this regard. This can be illustrated in a number of cases[4] and it must be borne in mind that every word is used in legislation for a specific purpose as the wording reflects the purpose of the legislature.[5]

Even the Joint Standing Committee on Finance (hereinafter the "JSCOF") in its report on the Katz Tax Commission's Third Interim Report alluded to the need for simplified language to be used.[6] Due to the complicated nature of tax law, the wording used must be chosen meticulously during the course of drafting process in order to ensure that there are no unintended loopholes which are created. This is particularly important in the case where a new section is introduced into legislation which has the potential to have a profound effect on the current status of practice.

The insertion of section 7C into the Income Tax Act (hereinafter the "ITA") has had a profound impact on financial planning as well as on the use of trusts and serves as a perfect example of how the wording used in a section which is inserted into existing legislation should be drafted

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[1] Sun Tzu's Art of War, The Modern Chinese Interpretation, General Tao Hanzhang, 2007.
[2] Hanzhang, Pg 36.
[3] Interpretation Act, Act 33 of 1957.
[4] See for example *V v V* (A5021/12) [2016] ZAGPJHC 311 (24 November 2016) which specifically related to the interpretation of wording used in a settlement agreement.
[5] *Principal Immigration Officer v Hawabu* 1936 AD 26 30 and Venter v R 1907 TS 910 914 which dealt with the situation where the wording used in an Act are clear or where the wording was vague and ambiguous respectively. See also the Interpretation Act, Act 33 of 1967 to illustrate the complexity of legal interpretation.
[6] Final Report of the Joint Standing Committee on Finance on the Third Interim Report Pg 5.

with every potential consequence borne in mind as far as possible. Essentially it is a wealth tax which has been implemented in order to ensure that individuals cannot transfer assets into a trust by way of making use of an interest free loan made to the trust.[7]

1.2. HISTORICAL BACKGROUND

Historically, the Republic of South Africa (hereinafter "RSA") has made use of various bodies to assist with reviews into the potential reform of tax systems in RSA. The three bodies which are of particular interest for this dissertation are –

- The Margo Tax Commission (hereinafter the "MTC");
- The Katz Tax Commission (hereinafter the "KTC"); and
- The Davis Tax Committee (hereinafter the "DTC").

It must be noted that these bodies do not make policies, but rather recommendations to the JSCOF.[8]

1.3. THE MARGO AND KATZ TAX COMMISSION REPORTS

The MTC and KTC were the predecessors to the DTC and were tasked with a review of the tax system as part of a formalised process of tax reform.[9] These bodies relied on the views of experts from a wide range of disciplines in order to advise them on various technical considerations.[10]

Although neither the MTC nor the KTC directly addressed the technicalities surrounding the insertion of a transfer pricing[11] mechanism, they did put forward that the usage of a Capital

---

[7] Section 7C of the Income Tax Act 58 of 1962.

[8] See in this regard page 3 of the Third Katz Report where the following was illustrated – "When attempting to follow the issues the Commission deals with arising from its mandate to their becoming legislated and implemented, the JSCOF notes that a number are not acted upon."

[9] Final Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission: Pg 2.

[10] Final Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission: Pg 1.

[11] Transfer pricing relates to the guidelines imposed on certain transactions to be done at arms-length which are contained in section 31 of the ITA which places strong emphasis on the concept of who is considered to be a connected person for the purposes of certain transactions in order to try and curb tax abuse.

Transfer Tax (hereinafter "CTT"), which could be used as wealth tax,[12] which would find application in terms of estate duty and donations tax.[13]

As additional justification for the introduction of a wealth tax, the KTC made reference to Sandford and uses the following quote[14] –

> "There is a strong case in principle for including some sort of wealth tax as part of the tax structure of a country…
>
>> (2) taxing wealth when it is transferred from one person to another by gift or as a result of death – a wealth transfer tax (WTT). Although a capital gains tax, which taxes the appreciation of wealth, has similar purposes and some similar problems to the other two forms, it is not strictly a wealth tax but…it is more akin to income tax. Our concern is therefore with the other two…"

Only limited comments were received from their expert panel and the KTC suggested that further comments should be called for in order to conclusively deal with the discussion on whether a CTT, or some other wealth tax, would be desirable in RSA.[15]

It must be noted that the KTC did favour the introduction of CTT notwithstanding the potential complications which surrounded the introduction of such provisions.[16] Although some research was conducted, both locally and outside of RSA,[17] the KTC did concede that their recommendation was made without having completed all of the necessary research into the feasibility of wealth taxes.[18]

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[12] Third Interim Report of the Katz Commission: 7.1.4 and 7.1.5.
[13] Final Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission: Pg 15.
[14] Third Interim Report of the Katz Commission: 7.1.6.
[15] Final Report of the Joint Standing Committee on Finance on theThird Interim Report of the Katz Commission: Pg 15.
[16] Third Interim Report of the Katz Commission: 7.1.12 and 7.1.13.
[17] Fourth Report of the Katz Commission: 1.6.
[18] Third Interim Report of the Katz Commission: 7.1.12 and 7.1.14.

1.4. DAVIS TAX COMMITTEE REPORTS

The DTC headed up by Judge Davis, which forms the primary body for the purpose of this study, was established to investigate potential to reform the tax system in the RSA. The terms of reference of the DTC were to investigate[19] –

> "The progressivity of the tax system and the role and continued relevance of estate duty to support a more equitable and progressive tax system. In this inquiry, the interaction between CGT and estate duty should be considered."

The DTC released their First Interim Report on Estate Duty (hereinafter the "First Report") which contained their recommendations on matters relating to Estate Duty.[20] After taking cognisance of public commentary, the Second Report on Estate Duty (hereinafter referred to as the "Second Report") was published. In both the First Report, and the Second Report, the DTC made recommendations in respect of the taxation of trusts especially insofar as they used it in the postponement of estate duty was concerned. In this regard the DTC made the following statement[21] –

> "In absence of specific anti-avoidance provisions within the Estate Duty Act, there is little to prevent South Africans from using trusts as effective estate duty saving mechanisms."

The use of a trust is often done as part of an estate planning exercise, due to the benefits which are afforded by the use of a trust structure.[22] Any assets held in trust are, subject to some exceptions, not subject to Estate Duty.[23] This creates the situation where the transfer of assets from the personal estate of an individual ("the estate planner") to a trust would be desirable. This would however entail that the South African Revenue Service (hereinafter "SARS") should closely monitor trusts as well as their registration processes in order to ensure that tax abuses are curbed as far as possible.

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[19] First Report: Executive Summary. Pg 5.
[20] January 2015.
[21] First Report: Chapter 4: Trusts. Pg 37. See also Second Report, Chapter 2, Pg 25.
[22] First Report: Chapter 3: Estate Duty Avoidance. Pg 35. See also First Report: Chapter 4: Trusts. Pg 40.
[23] Section 3 of the Estate Duty Act, Act 45 of 1955. See also First Report: Chapter 4: Trusts. Pg 37.

It must be noted however that a trust is a *sui generis* legal entity[24] and as such the transfer of assets from an estate planner to the trust would require conduct to affect the transfer. The methods available to dispose of assets to a trust in order to obtain an Estate Duty benefit are the sale of the assets to the trust or the donation of the assets to the trust.

The donation of the assets would result in Donations Tax,[25] which would defeat the purpose as this tax rate is equivalent to that of Estate Duty[26] and the sale of the assets to a trust would require cash, or cash equivalents, which would not always be readily available by estate planners to accomplish their desired purposes.

However, the donation aspect, as well as the lack of cashflow, could be circumvented by making use of an interest-free loan which is made to the trust.[27] This method became even more attractive as from 1 March 2013, after which the loan accounts owing to an estate planner could be bequeathed to the relevant debtor without incurring any Capital Gains Tax implications.[28]

The DTC was of the opinion that the ITA is currently not effective at deterring the implementation of estate duty saving mechanisms,[29] which finding was also in line with those of the KTC.[30]

To combat the aforementioned practice, the DTC made the recommendation that the provisions contained in section 3(3)(d) of the Estate Duty Act[31] should be amended to provide for "deemed control"[32] of the trust as long as a loan exists between a connected person[33] and the trust, as

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[24] Olivier Chapter 1. Pg 1-22.
[25] Section 56 of the ITA.
[26] Currently levied at a rate of 20% of the value of the assets in an estate.
[27] First Report: Executive Summary. Pg 5.
[28] Para 12 of the Eighth Schedule to the ITA.
[29] First Report: Chapter 3: Estate Duty Avoidance. Pg 35. See also section 80 of the ITA.
[30] Third Report on the Katz Commission: Pg 19.
[31] Act 45 of 1955
[32] The term "Deemed Control" is not defined in the ITA and as such an ordinary dictionary meaning should be afforded to same, which effectively would translate into any perceived influence which can be indirectly exerted over a specific object in order to ensure that the object acts in line with a specific desire.
[33] As defined in section 1 of the ITA. The term connected person is incredibly wide and includes a multitude of potential persons, both natural and juristic, and will be more fully discussed in Chapter 3 of this thesis.

opposed to making use of transfer pricing legislation,[34] which would have the effect of extending the General Anti-Avoidance Regulations (hereinafter "GAAR") already contained in the Estate Duty Act.[35] Should there be a situation where there is "deemed control" by a taxpayer, then tax consequences will arise.

Despite this, the DTC conceded that taxpayers must be allowed to make use of trusts where it would make sense to do so.[36] This is also in line with the findings of courts which held that taxpayers are allowed to arrange their affairs in a tax efficient manner.[37]

1.5. COMPARISON WITH INTERNATIONAL STANDARDS

The recommendations by the DTC were made with cognisance of similar provisions which were suggested in foreign jurisdictions.[38]

Notwithstanding the above, the DTC found as follows[39] -

> "The implementation of CTT in South Africa would place an enormous burden on the resources of both SARS and the taxpayer, as was evident, for example, when CGT was implemented in 2001."

Accordingly, the recommendation of the DTC amounted to suggesting that the avoidance or postponement of the implementation of CTT should be considered as opposed to the implementation thereof.[40] The postponement was largely due to the complex nature of CTT provisions and their comparatively low yield.[41] It was suggested that the amendment of the Estate Duty system could accomplish the same goals without implementing CTT.[42]

---

[34] Second Report, Chapter 2, Pg 30. See Also First Report: Executive Summary. Pg 7: "…No attempt should be made to implement transfer pricing adjustments in the event of financial assistance or interest-free loans being advanced to trusts".

[35] Act 45 of 1955. Note that the majority of the GAAR are contained in section 80A to 80L of the ITA. Prior to the insertion of these provisions, the GAAR provisions were contained in section 103(1) of the ITA.

[36] First Report: Executive Summary. Pg 7. See also First Report: Chapter 4: Trusts. Pg 40.

[37] *Ayshire Pullman Motor Services and Richie v IRC* (1929), *Levene v IRC* (1928) 5, *IRC v Duke of Westrninister*, (1936) and *CIR v Estate Kohler* 1953 (2) SA 584 (A).

[38] First Report: Executive Summary. Pg 7.

[39] First Report: Executive Summary. Pg 8.

[40] First Report: Executive Summary, Pg 8.

[41] Second Report, Chapter 2, Pg 30.

[42] First Report: Executive Summary. Pg 8.

With CTT not being an appropriate method to deal with estate duty, an alternative had to be found that could have the result of curbing the use of trusts to postpone estate duty while also not imposing an undue burden on SARS. The DTC made several suggestions in this regard.[43] It would seem that these suggestions were mostly disregard in favour of the implementation of CTT in the form of section 7C of the ITA which came into force in 2017.

1.6. INTRODUCTION OF SECTION 7C

1.6.1. PROVISIONS CONTAINED IN SECTION 7C OF THE ITA

Notwithstanding that the DTC advised that the implementation of CTT or transfer pricing adjustments should be avoided,[44] the provisions relating to the taxation of interest free loans made to a trust by taxpayers were inserted into the ITA.[45] These effectively constitute a CTT in the sense that a taxpayer will be taxed in the event where they transfer assets from their personal name to another connected entity.

These provisions contained in the ITA came into force on 1 March 2017 and were aimed at combatting the practice of using trusts in the method as described in this dissertation.[46] These provisions apply to all interest free loans made to trusts by taxpayers which are in existence at the end of a given financial year.

It is of interest to note that the JSCOF specifically made the following comment when the KTC suggested that further commentary should be obtained in respect of the implementation of a CTT or any other "wealth tax" –

> "…any capital transfer or other 'wealth' tax should be set at a rate that would not be perceived of as 'punitive'"[47]

Although not punitive as such, the implementation of section 7C is retrospective in nature and applies to loans which were made in the past which are in existence at the end of a financial

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[43] First Report: Chapter 4: Trusts. Pg 44.
[44] First Report: Chapter 4: Trusts. Pg 40.
[45] Section 7C of the ITA introduced with effect from 1 March 2017.
[46] Section 7C(1) of the ITA.
[47] Section 7C(1) of the ITA.

year and as such effectively punishes a taxpayer for exercising their rights to structure their tax affairs in an efficient way, which was permissible at the time of implementation.[48]

The charging provision of this tax which is contained in the ITA[49] reads as follows –

> "(1) 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 in relation to which that person is a connected person in terms of paragraph (d)(iv) of the definition of 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.
>
> 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."

Thus, it can be established that in essence this section can be broken down to deal with any transactions which involve –

- A loan, advance or credit;

[48] Section 7C(3) provides that interest will be charged on any loan, advance or credit which is in existence at the end of a financial year and does not refer in any way to the date of the creation of the loan.

[49] Section 7C(1) contains the charging provisions.

- which is made by a natural person, or at the instance of that person a company which is a connected person[50] in relation to that person;
- to a trust;[51] and
- without levying interest on same,[52] or by levying interest which is less than the prescribed rate of interest[53] as determined by the Minister of Finance from time to time to time.[54]

A typical section 7C transaction can be schematically illustrated as follows –

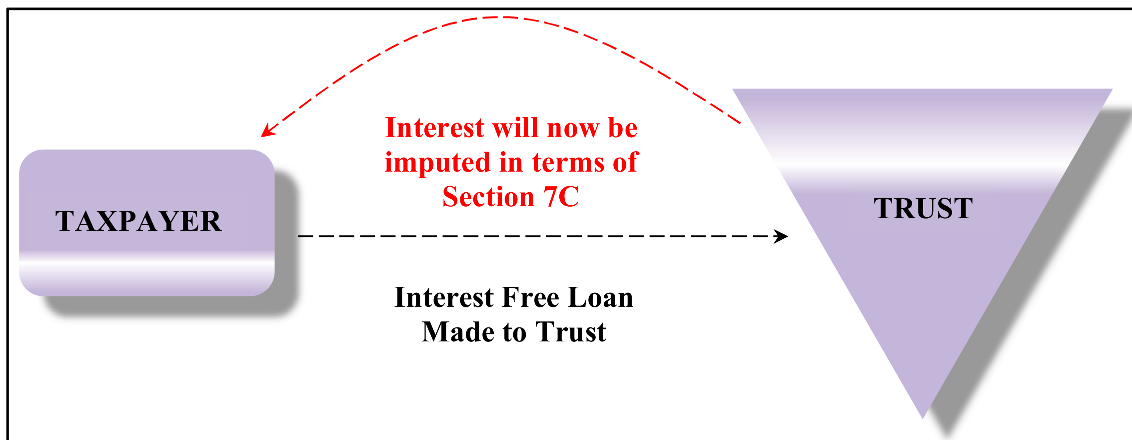

Figure 1: Basic Section 7C Transaction Prior to Amendment

1.6.2. RECEPTION OF SECTION 7C AND SUBSEQUENT AMENDMENT

Both the DTC and the KTC advised that the implementation of transfer pricing adjustments should be avoided.[55] Notwithstanding this the provisions relating to the taxation of interest free loans were inserted into the ITA.[56]

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[50] Definition of "connected person" as contained in section 1 of the ITA.
[51] Definition of "trust" as contained in section 1 of the ITA. See also section 1 of the Trust Property Control Act.
[52] Section 7C(1) read with section 7C(3) of the ITA.
[53] Part V of Chapter 2 of the ITA.
[54] Section 7C(3) of the ITA.
[55] First Report: Chapter 4: Trusts. Pg 40. See also Third Report on the Katz Commission: Pg 16.
[56] Section 7C of the ITA introduced with effect from 1 March 2017.

The reaction to section 7C was largely negative from practice, as the introduction thereof stifled the preferred existing method to transfer wealth to a trust, i.e. making use of interest free loans, and soon methods were devised by practitioners to circumvent the application thereof.[57] The original method to circumvent the application of section 7C can be illustrated as follows –

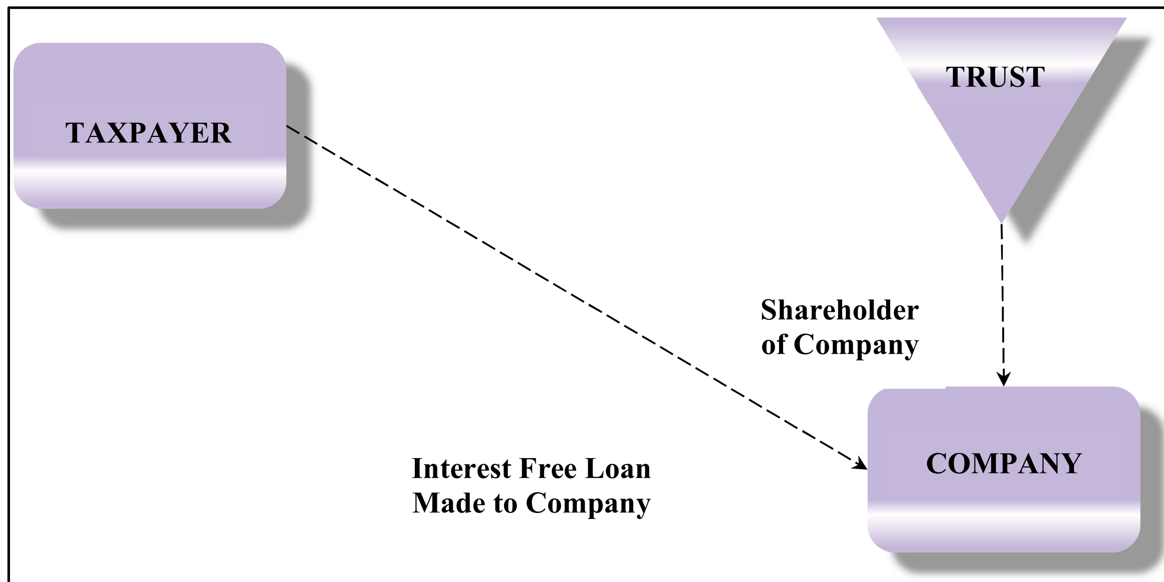

Figure 2: Original Method to Circumvent Section 7C

Using a company as an intermediary, the same benefit could be obtained without triggering the application of section 7C.

This resulted in the first amendment of these provisions[58] to include any loan advance or credit, as envisaged in the ITA,[59] which was made to a company by a person who is a connected person in respect of a company or a trust, subject to the provisions contained in section 7C.

The new wording of section 7C after the amendment included the following –

---

[57] In its original form, section 7C did not apply to loans, advances or credit given to companies, which then became the launching point for financial service providers. See in this regard PWC Tax Alert – National Tax Technical 29 August 2017: Anti-avoidance rules for trusts: Refinement of section 7C.

[58] Introduced with effect from 19 July 2017 in the 2017 Draft Taxation Laws Amendment Bill.

[59] Section 7C. This amendment also had the effect that certain employee share schemes were excluded from the application of section 7C. See PWC Tax Alert, National Tax Technical, Anti-avoidance rules for trusts: Refinement of section 7C, dated 29 August 2017.

(ii) a company, if at least 20 per cent of -

(aa) the equity shares in that company are held, directly or indirectly; or

(bb) the voting rights in the company can be exercised,

by the trust referred to in subparagraph (i) or by a beneficiary of that trust."

Section 7C contained further amendments to ensure that interest free or low interest loans to companies were included. The purpose of this amendment was to ensure that the provisions contained in section 7C could not be circumvented by using a company as an intermediary between the trust and the taxpayer transferring the wealth as illustrated in Figure 2 as it appears above.

1.7. PRACTICAL CONSIDERATIONS RELATED TO SECTION 7C

It is trite that any study into the inner workings of a provisions which is aimed at combating a specific practice will have to include a myriad of different legal concepts. It is submitted that the primary concepts which should be taken into account in the analysis of the provisions of Section 7C will be –

- Income Tax;[60]
- Donations Tax;[61]
- The definition of "person";[62]
- The definition of "connected person";[63]
- The exact meaning of "loan, advance or credit";

[60] As contemplated by the ITA.
[61] As contemplated in section 56 of the ITA.
[62] Definition of "person" as it appears in section 1 of the ITA.
[63] Definition of "connected person" as it appears in section 1 of the ITA.

- The meaning of "trust", both in terms of the ITA[64] as well as in terms of the Trust Property Control Act;[65]
- The meaning of "trust", both in terms of the ITA[66] as well as in terms of the Trust Property Control Act;[67]
- The nature and role of all individuals involved with a trust;[68] and
- An analysis and review of the basic principles of financial planning and how they would relate to Section 7C.[69]

1.8. PROBLEM STATEMENT

Due to the fact that the provisions contained in section 7C have only recently been inserted into the ITA, the provisions have not yet been tested in a court of law, nor have there been a plethora of other countries which can be used as sources which have implemented a similar system in order for a comparison to be drawn. Until some time has passed and these provisions have been tested in a court of law, both SARS and the taxpayers require additional clarity with regards to the application of the provisions and how to deal with any potential loopholes or anomalies which may be present.

Accordingly, the problem is as follows – without an in-depth understanding of the exact meaning of the provisions contained in section 7C, as well as how they would apply when tested in a court of law, there can be no legal certainty as to how to deal with any anomalies which may arise as a result of the application of section 7C.

[64] Definition of "person" as it appears in section 1 of the ITA. See also the discussion in this regard in Chapter 4, Para 4.1.2, Pg 38 - 40.

[65] Section 1 of the Trust Property Control Act, Act 57 of 1988. See also the discussion by Olivier, Strydom and Van Den Berg, Trust Law and Practice (2nd Edition), Service Issue 4 (LexisNexis Durban, 2017) in Chapter 1 in this regard.

[66] Definition of "person" as it appears in section 1 of the ITA. See also the discussion in this regard in Chapter 4, Para 4.1.2, Pg 38 - 40.

[67] Section 1 of the Trust Property Control Act, Act 57 of 1988. See also the discussion by Olivier, Strydom and Van Den Berg, Trust Law and Practice (2nd Edition), Service Issue 4 (LexisNexis Durban, 2017) in Chapter 1 in this regard.

[68] Olivier Chapter 1 and Chapter 3. See also the definition of "trust" as contained in section 1 of the Trust Property Control Act, Act 57 of 1988.

[69] Olivier Chapter 3, Chapter 4 and Chapter 9.

1.9. AIM OF STUDY

The aim of this study is to conduct a critical analysis of the provisions of section 7C, after consideration of the historical development thereof, as well as a review of the ancillary provisions contained in the ITA, in order to identify potential weaknesses, inconsistencies and/or anomalies contained therein and to provide workable solutions to address them.

1.10. RESEARCH QUESTIONS POSED

The following research topics and questions will be dealt with in this study -

(a) An investigation into the evolution of section 7C as well as the historical and international development of CTT insofar as it relates to section 7C;

(b) The identification of any weaknesses, inconsistencies and/or anomalies which may arise where the working of Section 7C in respect of a given transaction will be either impossible or inappropriate. This will include a study into –

- the "soft threshold"[70] for the application of section 7C;
- how loans of this nature will be dealt with in a deceased estate;
- loans made to beneficiaries of trusts as opposed to trust funds which have vested in beneficiaries but have not been distributed by the trustees;
- donation of loans to spouses to mitigate or completely eliminate the effect of section 7C;
- the absence of business trusts from the exclusions listed in section 7(5);
- loans made between trusts;
- how a loan as envisioned in section 7C is dealt with in a deceased estate.

(c) The determination of whether section 7C, in its current form, achieves the purpose for which it was created and suggestions in relation with how to deal with the weaknesses identified above.

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[70] See Chapter 4, Para 4.3.3, Pg 50 - 52.

1.11. RESEARCH METHODOLOGY

The research involved in this study will follow a historical approach combined with a comprehensive qualitative literature review on the relevant sections of the ITA, articles written on the subject, the recommendations of the DTC and its predecessors as well as comparable case law in order to draw analogies where applicable.

The questions which have been identified above will be answered through the collection and study of research literature available. A comparative analysis of any sources from other countries will also be conducted to make a recommendation or provide a solution where it is possible to do so.

1.12. CHAPTER EXPOSITION

The following chapter exposition is suggested for this thesis is as follows -

Chapter One: Introduction and Overview of the Study

The first chapter provides the general outline of the study as well as the rationale for undertaking the study. It will include the research questions posed as well as the methodology selected for the study. This chapter then gives an outline for the remaining chapters for the dissertation.

Chapter Two: Historical Background and development of section 7C

Chapter Two serves as the basis of the dissertation where the foundational aspects of section 7C, which will mostly be derived from foreign jurisdictions due to the fact that the concept has been largely conceived based on attempts by foreign jurisdictions to make use of capital transfer taxes of this nature.

Accordingly, this chapter considers sources from foreign jurisdictions that serve as the basis from which section 7C was conceptualised, a look at the commentary from the KTC and the DTC in respect of the introduction of provisions of this nature being inserted into the Income Tax Act and finally, explore the commentaries and suggestions prior to the introduction of the provisions into the Act.

Chapter Three: The iterations and contents of section 7C of the Income Tax Act and their connection to estate planning

Chapter Three will build upon the previous chapter by dealing with the reception of the initial version of section 7C when it came into force. The chapter will initially look at the original version of section 7C as well as the various comments which were received in respect thereof as well as the reasons for the subsequent amendment of the provisions to address the evolving practices to avoid the application thereof.

The final version of section 7C will then be discussed and analysed in detail in order to determine the purpose and working thereof in theory as well as taking cognisance of the way it is treated in practice.

At the date of writing hereof, an additional amendment of section 7C has been suggested and will accordingly also be dealt with in this chapter.

Chapter Four: The practical effect of section 7C of the Income Tax Act

Chapter four will then proceed to look at the interaction between the final provisions of section 7C and other legislation, including the provisions contained in the Income Tax Act itself. This chapter will attempt to focus on the identification of the primary aspects to take into account, i.e. the interaction between section 7C and the concept of a "connected person" as well as confirming the importance for such identification.

Furthermore, this chapter will attempt to identify weaknesses (i.e. where it fails to accomplish the stated goals for which section 7C was created) as well as inconsistencies (i.e. any situations where the provisions contained in section 7C may contradict existing legislation) contained in section 7C as well as any legal anomalies (i.e. those situations which result in scenarios which are not dealt with, or which are not dealt with to any substantial degree, by existing legislation or practice) which may arise as a result of section 7C will be identified.

Once identified, proposed solutions to these aspects will be considered.

Due to the nature of section 7C, this will involve a look at fiscal legislation such as the Income Tax Act as well as non-fiscal legislation such as the Trust Property Control Act.

Chapter Five: Concluding remarks on section 7C of the Income Tax Act

Finally, Chapter five will look at whether section 7C has accomplished the goals for which it was created as well as sum up the successes and failures thereof, including both theoretical and practical failures, as well as well providing meaningful suggestions for dealing with any weaknesses, inconsistencies or anomalies which may arise in order to provide some guidance to achieve legal certainty should any such aspects arise in future.

CHAPTER 2: HISTORICAL DEVELOPMENT OF SECTION 7C OF THE INCOME TAX ACT

2.1. INTRODUCTION AND BACKGROUND

Johnson once said the following –

> "The study of history is a powerful antidote to contemporary arrogance. It is humbling to discover how many of our glib assumptions, which seem to us novel and plausible, have been tested before, not once but many times and in innumerable guises; and discovered to be, at great human cost, wholly false."[71]

This principle should serve as a warning to those with the power to implement change to ensure that the decisions of the past are taken into account when exercising their authority. Furthermore, this functionally serves as the rationale behind the establishment of committees which are tasked with the analysis of existing structures to find ways of improving them.[72]

It has long been a common estate planning practice to make use of trusts and this has drawn the attention of the South African Revenue Service (hereinafter "SARS"). The use of trusts have often been in the crosshairs of committees,[73] especially since any assets held in a trust are, except for some exceptions, not subject to Estate Duty.[74] This creates the situation where the transfer of assets from the personal estate of an individual ("the estate planner") to a trust would be desirable for estate planners from a tax perspective.

SARS closely monitors trusts as well as their registration processes.[75] However a trust is a *sui generis* legal entity[76] and as such the transfer of assets from an estate planner to the trust would still require a separate *causa* to effect such a transfer. The methods available to dispose of

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[71] If Ignorance is Bliss, Why Aren't There More Happy People, Quotes for Interesting Times, John Lloyd and John Mitchinson, Pg 146.
[72] Third Interim Report of the Katz Commission: Para 2 at Pg 2.
[73] See Chapter 1, Para 1.3 and Para 1.4, Pg 2 - 3 and Pg 4 - 6.
[74] Section 3 of the Estate Duty Act, Act 45 of 1955. See also First Report: Chapter 4: Trusts. Pg 37.
[75] It must be noted that although a trust need not be registered in order to be a validly created trust, practically an unregistered trust will find contracting with third parties extremely difficult as a duly issued Letter of Authority is often requested. See Chapter 4, Para 4.4.2, Pg 54 - 55 for a discussion on the registration of trusts with the Master of the High Court.
[76] Olivier Chapter 1. Pg 1-22.

assets to a trust to obtain an estate duty benefit are the sale of the assets to the trust or the donation of the assets to the trust, which each have their own drawbacks.

A new method was required to transfer assets into trust without incurring unnecessary tax consequences, which initially entailed the use of interest-free or low-interest loan accounts which resulted in assets being transferred whilst incurring virtually no tax obligations unless the taxpayer passed away with an outstanding loan account to his name.[77]

Section 7C of the Income Tax Act is a Capital Transfer Tax ("CTT") relating specifically to interest-free or low interest loans, and was introduced into legislation with an effective date of 1 March 2017.[78] This section was inserted in an attempt to curb the use of interest-free or low interest loans to shift assets into trusts. As stated above, the use of a trust is often done as part of an estate planning exercise, due to the benefits which are afforded by the use of a trust structure.[79]

The provisions of section 7C, despite being relatively new, have a storied history which dates back some years and it is necessary to take cognisance of this history in order to fully understand how section 7C was ultimately introduced into legislation.[80]As stated in the previous chapter, for the purposes of this dissertation, the three primary committees that are relevant for the purposes of the discussion surrounding the introduction of section 7C into legislation are –

- The MTC;
- The KTC; and
- The DTC.

To fully comprehend the development and introduction of section 7C, it is necessary to consider the findings of these bodies, as well as define some terms which are relevant to this discussion. The following concepts will be briefly discussed below –

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[77] Section 3 of the EDA.
[78] South African National Budget Speech, 22 February 2017.
[79] First Report: Chapter 3: Estate Duty Avoidance. Pg 35. See also First Report: Chapter 4: Trusts. Pg 40.
[80] See the Margo, Katz and David Tax Commissions in this regard.

- Wealth;
- Wealth Tax; and
- Capital Transfer Tax.

2.1.1. WEALTH

The DTC defined "wealth", through referring to Trotman-Dickenson, as "all forms of accumulated marketable assets by individuals (or households) through savings or the preservation of inherited wealth".[81]

The term "net wealth" was defined as the difference between gross wealth and total debt.[82]

2.1.2. WEALTH TAXES

As each of the bodies referred to in paragraph 2.1 above dealt with whether a wealth tax should be introduced in Republic of South Africa (hereinafter "RSA"), it becomes clear that it must be determined what exactly is meant with the term "wealth tax" as it appears in this dissertation.

As such a wealth tax is a tax which is generally seen as being more equitable in society as a person is taxed on the level of his/her wealth.[83] Another perceived benefit of the introduction of a wealth tax is that it would cause relatively little distortion. This is opposed to the introduction of more invasive taxes due to the relative simplicity of the alterations to the existing tax administration system, which would be required in order to accommodate such a tax.[84]

It must be noted that although wealth taxes may be used as a means of affording some degree of equity between taxpayers, it may also have the result of encouraging taxpayers to leave a country as occurred in France.[85]

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[81] DTC; Feasibility of A Wealth Tax in South Africa. Pg 12.
[82] *Ibid*.
[83] Third Interim Report of the Katz Commission: Para 7.1.4.
[84] Third Interim Report of the Katz Commission: Para 7.1.7 and 7.1.8.
[85] https://www.france24.com/en/20150808-france-wealthy-flee-high-taxes-les-echos-figures accessed on 30 August 2019 where it was stated that there has been an increase in the amount of people who are leaving France due to the high tax rates in the country. Among the reasons for these individuals leaving was the Solidarity Tax on Wealth and perceived emphasis on wealth taxing in general. See

RSA makes use of wealth taxes in the following forms –

- Transfer Duty;[86]
- Estate Duty;[87]
- Donations Tax;[88] and
- CTT in terms of section 7C as of 1 March 2017.

2.1.3. CAPITAL TRANSFER TAXES

CTT may essentially be seen as a sub-species of wealth tax in that the goal of such a tax is to tax the transfer of wealth and may even be referred to as a wealth transfer tax.[89]

Initially CTT was defined as "an inheritance tax levied in the United Kingdom on estates exceeding a certain value".[90] Although this definition refers to the United Kingdom, this is not restricted only to that country. This definition is no longer completely accurate as the modern concept of CTT encapsulates more than just inheritance taxes.[91]

2.2. DISCUSSION OF THE TAX COMMISSIONS

2.2.1. THE MARGO AND KATZ TAX COMMISSION REPORTS

Due to the relative uniformity between the viewpoints of the MTC and KTC on CTT, which is the subject of discussion in this dissertation, only the findings of the KTC will be discussed further in this dissertation.

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also https://www.ensafrica.com/news/A-wealth-tax-for-South-Africa?Id=2626 accessed on 27 February 2019 and the DTC; Feasibility of A Wealth Tax in South Africa. Pg 5.

[86] Which is taxed on a sliding scale based on the value of the property being transferred starting from R900 000 and incrementally increasing in value. See the South African National Budget Speech 2016, 24 February 2016 for the full details.

[87] Which is currently levied at 20% of the value of an estate under R30 000 000 and 25% on any amount which exceeds R30 000 000 in accordance with the First Schedule to the EDA. See section 2(2) of the EDA in this regard as well as the South African National Budget Speech 2018, 21 February 2018 in this regard as well.

[88] Currently set at 20% of the value of the property which is donated in terms of section 64 of the ITA.

[89] Third Interim Report of the Katz Commission: Para 7.1.6.

[90] https://www.investopedia.com/terms/c/capital-transfer-tax.asp accessed on 27 February 2019.

[91] https://www.investopedia.com/terms/c/capital-transfer-tax.asp accessed on 27 February 2019. See also Third Interim Report of the Katz Commission: 7.1.6.

The views of the KTC must be interpreted in light of a changing political and social climate in the RSA. The findings of the KTC must be read bearing in mind that the Constitution[92] had just been implemented and concepts such as Capital Gains Tax (hereinafter "CGT") were deemed to be undesirable at that stage due to a lack of capacity by the tax administration authorities.[93]

The KTC did however advocate that it was in favour of the introduction of a Capital Transfer Tax (hereinafter "CTT") which would then constitute wealth tax.[94] The type of CTT envisioned by the KTC would encompass the estate duty and donations tax systems at the time. It must be noted that the JSCOF advised that further investigation would be required in respect of various aspects, including the administrative costs relating to the introduction of a CTT as well as an investigation into the micro-and macro-economic consequences surrounding the potential introduction of such a tax.[95]

Having concluded that there was a strong case to be made for the introduction of a wealth tax, three options were suggested, to wit[96] –

- An annual wealth tax, or possibly a once-off wealth tax;
- A transfer tax, imposed on wealth when it is transferred from one person to another, either as a gift or as a result of death; and
- A national land or other property tax.[97]

The Commission, due to the arguments against an annual or once-off wealth tax, favoured the introduction of a CTT.[98]

Only limited comments were received from the panel of experts which provided their input to the KTC and it was suggested that further comments should be called for in order to

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[92] Constitution of the Republic of South Africa, 1996.
[93] Third Interim Report of the Katz Commission: Para 6.7.1.
[94] Third Interim Report of the Katz Commission: 7.1.4 and 7.1.5.
[95] Final Report of the Joint Standing Committee on Finance on theThird Interim Report of the Katz Commission: Pg 15.
[96] Third Interim Report of the Katz Commission: 7.1.9
[97] Third Interim Report of the Katz Commission: 18.13. RSA already has property tax in respect of the transfer of properties as well as property taxes paid by the owners of land, however this would be an additional tax imposed on top of any existing taxes in respect of agricultural land.
[98] Third Interim Report of the Katz Commission: 7.1.12

conclusively deal with the discussion on whether a CTT, or some other wealth tax, would be desirable in RSA.[99] As alluded to in the previous chapter,[100] it was conceded that this recommendation was made without having completed all of the necessary research into the feasibility of the introduction of such a tax.[101]

After the third report of the KTC was complied, further research was undertaken and the following conclusions were derived[102] –

- CTT are prone to be extremely complex;
- These complexities result in administrative problems and higher collection costs;
- Anti-avoidance measures must aim to result in the taxation of transactions which should be subject to taxes but should aim not to include transactions which have legitimate commercial and other justifications;
- CTT generally have a low yield; and
- The introduction of CTT tends to give rise to an unproductive estate planning industry.

Furthermore, the KTC specifically mentioned that if countries that have more sophisticated tax systems are not entirely successful in their implementation of CTT systems, then RSA may not be in any position to implement such a system as it may be an over ambitious plan of action for such a young democracy.[103]

Research into foreign jurisdictions found that situations where action was being taken against interest-free loans, which include low interest loans for the purposes of this document, were extremely rare due to the complexity of the legislation required.[104]

With regards to the United States specifically, this complexity was illustrated in *American Jurisprudence*[105] which was quoted by the KTC and which reads as follows[106] –

[99] Final Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission: Pg 15.
[100] Chapter 1: Para 1.3, Pg 2 - 3.
[101] Third Interim Report of the Katz Commission: 7.1.12 and 7.1.14.
[102] Fourth Report of the Katz Commission: 1.7.
[103] Third Interim Report of the Katz Commission: 1.9.
[104] Third Interim Report of the Katz Commission: Para 7.2.
[105] 1996, Volume 34A, paragraph 147, 351.
[106] Third Interim Report of the Katz Commission: Para 7.3.

> "Certain interest-free and below-market interest rate loans result in a gift from the lender to the borrower for gift tax purposes. Generally, the amount of the gift is determined by comparing, for a demand loan, the interest payable on the loan to the Applicable Federal Rate (AFR), or for a term loan, the amount loaned to the present value of all payments due under the loan. For a demand loan, the lender is treated as transferring to the borrower an amount equal to the foregone interest, generally on the last day of the year. For a term loan, the lender is treated as transferring cash in an amount equal to the excess of the amount loaned over the present value of all required payments, generally on the day the loan is made. There is an exception provided for certain de minimise loans – generally gift loans directly between the individuals where the aggregate outstanding loans between individuals doesn't exceed $10 000. But this exception doesn't apply to loans directly attributable to buying or carrying income-producing assets."

The research conducted by the KTC also showed that some countries, such as the United Kingdom and New Zealand chose not to take any action against interest-free loans.[107]

Ultimately, the KTC recommended, despite favouring the implementation of CTT, that no specific legislative measures should be taken in order to address the use of interest-free or low interest loans by estate planners due to the complexity inherent in the required legislation.[108]

2.2.2. DAVIS TAX COMMITTEE REPORTS

Having taken cognisance of the findings of its predecessors, the MTC and the KTC, the DTC was tasked with a review of the existing tax system with the intention to consider the possibility of a potential reform of the existing tax system.[109]

The DTC was of the opinion that the ITA currently is not effective at deterring the implementation of estate duty saving mechanisms,[110] which finding was also in line with the those of the KTC.[111]

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[107] Third Interim Report of the Katz Commission: Para 7.4.
[108] Third Interim Report of the Katz Commission: Para 7.6 and 14.7.
[109] Chapter 1: Para 1.3. Pg 2 - 3.
[110] First Report: Chapter 3: Estate Duty Avoidance. Pg 35. See also section 80 of the ITA.
[111] *Ibid*.

Specific emphasis was placed on the use of interest-free or low interest loans which were made to trusts by estate planners and the potential of such loans to provide tax benefits to the estate planner in respect of the following[112] –

- The elimination of donations tax as an interest-free loan is seen as a settlement or a disposition and does not qualify as a "donation"[113]; and
- The estate of the holder of the interest-free loan account is effectively frozen at its current value on the date of transfer of the asset.

This of course gives the holder of the loan a measure of control over the trust, which the DTC refers to as the "trump card of control".[114]

In light of this, the DTC recommended that the SARS should ensure that any such transactions should be comprehensively examined but specifically stated that no transfer pricing regulations should be implemented in respect of domestic trust arrangements.[115] Instead, the recommendation of the DTC was to extend the definition of section 3(3)(d) of the Estate Duty Act, Act 45 of 1955, to specifically target interest-free loan accounts made to trusts.[116] This recommendation entails that a section 3(3)(d) investigation, revolving around the identification of whether an estate planner does in fact have control or *de facto* control over assets which are not in this name for estate duty purposes, should be triggered upon the transfer of assets into a trust.[117]

With regards to CTT, the DTC concurred with the problems which were identified by the KTC and recommended that CTT should ideally not be introduced and suggested that the amendment of the existing estate duty system could accomplish many of the same goals.[118]

In March 2018 the DTC released a report on wealth tax in RSA. In this document, the DTC provides and in-depth investigation into the rationale behind the use of a wealth tax in RSA.[119]

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[112] DTC Final Report on Estate Duty, Chapter 2, Pg 29.
[113] As defined in section 55(1) of the Income Tax Act, Act 58 of 1962.
[114] DTC Final Report on Estate Duty, Chapter 2, Pg 29.
[115] DTC Final Report on Estate Duty, Chapter 2, Pg 30.
[116] DTC Final Report on Estate Duty, Chapter 2, Pg 32.
[117] *Ibid*.
[118] Para 2.1.
[119] DTC; Feasibility of A Wealth Tax in South Africa, March 2018.

2.3. FEASIBILITY OF WEALTH TAXES

As discussed previously, the question of whether it is in fact feasible to introduce wealth taxes in RSA was considered by the DTC in a document released in 2018.[120] In this document the DTC examines the nature and implications of wealth taxes as well as providing a comparison with our contemporaries internationally.[121] The recommendations by the DTC were made with cognisance of similar provisions in foreign jurisdictions.[122]

In the DTC's review of the feasibility of wealth taxes, it was noted that the following three principles of wealth taxation need to be borne in mind[123] –

- Tax efficiency can become challenging when introducing a wealth tax;
- Administrative costs can become excessive; and
- Tax reform will have both winners and losers.

The state of wealth taxes in other jurisdictions were considered.[124] The DTC notes that over the course of the last 20 years that some countries, such as Germany, Finland and India have abandoned wealth taxes due to the rising costs of classifying and measuring assets, restructuring the tax collection system and accounting for global assets.[125]

In the DTC report, it also stated that in 2017 there were only 4 (four) Organisation for Economic Co-operation and Development ("OECD") countries which still made use of wealth taxes. This shows a clear decline from the 12 which collected wealth taxes in 1990.[126] An additional consideration raised was the increased burden on taxpayers, which is generally negatively received.[127]

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[120] DTC; Feasibility of A Wealth Tax in South Africa, March 2018.
[121] *Ibid*.
[122] First Report: Executive Summary. Pg 7. See also the discussion in Para 2.1.
[123] DTC; Feasibility of A Wealth Tax in South Africa. Pg 4.
[124] DTC; Feasibility of A Wealth Tax in South Africa. Pg 5.
[125] *Ibid*.
[126] DTC; Feasibility of A Wealth Tax in South Africa. Pg 10.
[127] *Ibid*.

2.4. CONCLUSION

Ultimately, the DTC found that the implementation of a new wealth tax cannot be implemented in the short term and emphasised that the focus should be placed on the improvement of the existing measures in place to collect estate duty, especially in light of the fact that the necessary administrative framework in respect of such collections is already in place.[128]

It would seem that these suggestions were mostly disregarded in favour of the implementation of CTT in the form of section 7C of the ITA, which provisions came into force in March 2017.[129]

[128] DTC; Feasibility of A Wealth Tax in South Africa. Pg 68.
[129] Para 2.1.

CHAPTER 3: THE ITERATIONS AND CONTENTS OF SECTION 7C OF THE INCOME TAX ACT AND THEIR CONNECTION TO ESTATE PLANNING

3.1. INTRODUCTION

Notwithstanding the advice of the DTC to avoid the introduction of legislative measures in respect of CTT or any kind of transfer pricing, government introduced section 7C into the ITA.[130] Section 7C was introduced to specifically combat the practice of making use of interest-free or low interest loans made to trusts by taxpayers as part of estate planning practices.

Section 7C was specifically designed to ensure that taxpayers could not avoid taxes by way of transferring assets into a trust through using interest-free or low interest loans. The use of trusts as part of estate planning exercises and the introduction, application and effect of section 7C will be discussed in greater detail below. Lastly, this chapter deals with the transactions exempted from section 7C before this chapter concludes.

3.2. ESTATE PLANNING AND TRUSTS

Estate planning is a broad field which incorporates a variety of legal disciplines. For the purposes of determining the link between the provisions of section 7C and estate planning exercises, it is necessary to broadly understand the following concepts –

- the Estate Duty Act and how it relates to trusts;
- an understanding of what qualifies as Estate Planning;
- a brief look at the nature of trusts;
- an understanding of what parties are involved with trusts;
- the legal nature of trusts;
- how assets may be transferred to trusts given their separate legal personality; and
- how interest-free loans are used in conjunction with estate planning exercises to reduce potential estate duty.

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[130] With effect from 1 March 2017.

3.2.1. ESTATE DUTY ACT

The general principle of estate planning revolves around the determination of how to structure the affairs of the taxpayer in such a way as to ensure that the wishes of the individual are carried out by the eventual executors of their estate while at the same time attempting to limit the amount of tax which will be payable by their estate.[131] In the majority of cases this will either relate to Estate Duty[132] or CGT.[133] Whilst Estate Duty is levied on the property or deemed property of an individual after their demise,[134] CGT is levied on the disposal of an asset by a person in accordance with the provisions contained in the ITA.[135]

By making use of trusts these provisions can effectively be circumvented as a trust is not a natural person and is therefore functionally immortal.

3.2.2. ESTATE PLANNING

It has been a common practice for taxpayers to make use of trusts as part of their general estate planning due to their flexible nature and *sui generis*[136] status. When using a trust in connection with the provisions contained in the EDA relating to what constitutes either property[137] or deemed property[138] it is possible to remove certain assets from estate duty calculations.

3.2.3. NATURE AND USE OF TRUSTS

Although the legal nature of trusts has not been definitively confirmed,[139] it has been stated that trusts are akin to a *stipulatio alteri*[140] in the sense that they are essentially contracts which have been entered into between two parties for the benefit of a third party.[141]

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[131] Olivier Chapter 1. Para 1.1, Pg 1-2 and Para 1.7. Pg 1-23. See also section 3 of the EDA in this regard which illustrates that only assets which are either the property or deemed property of the deceased are included for Estate Duty purposes.
[132] As envisaged in the EDA.
[133] As envisaged in the Eighth Schedule to the ITA.
[134] Section 3((1) of the EDA.
[135] See the para 3 of the Eighth Schedule to the ITA.
[136] Olivier Chapter 1. Para 1.6.3, Pg 1-20, Para 1.6.3, Pg 1-22 and Para 1.7, Pg 1-23. See also *Braun v Blann & Botha* 1984 (2) SA 850 (A).
[137] Section 3(2) of the EDA.
[138] Section 3(3) of the EDA.
[139] Olivier Chapter 2. Para 2.10, Pg 2-29 – Pg 2-30.
[140] *CIR v Estate Crewe* 1943 AD 656. See also Olivier Chapter 1. Para 1.6.3, Pg 1-20 – Pg 1-21.
[141] *Crookes v Watson* 1956 (1) SA 277 (A). See also Olivier Chapter 2. Para 2.10, Pg 2-29 – Pg 2-30.

3.2.4. PARTIES INVOLVED WITH TRUSTS

There are three parties involved with trusts –

- The founder of the trust, the creator of the trust;[142]
- The trustees of the trust, the individuals or entities which are responsible for the effective management of the trust;[143] and
- The beneficiaries of the trust, the individuals or entities which are to draw the eventual benefit of the trust.[144]

3.2.5. LEGAL PERSONALITY OF TRUSTS

As mentioned above, trusts are *sui generis*[145] legal entities which do not inherently possess a separate legal personality[146] from the parties involved with the creation and administration of the trust. However trusts are included in the definition of "person" in the ITA for tax purposes.[147] Furthermore the beneficiaries of trusts will often not have a claim to the assets held in trust but will only have a chance to be benefitted, known as a '*spes*'.[148] The existence of a s*pes* allows for a situation where the assets held in trust do not form part of the estates of discretionary beneficiaries of a trust when they pass away as it is neither property nor deemed property.[149] Accordingly, the beneficiaries have the potential to obtain a benefit, but do not obtain any vested rights to trust property. An illustration of this can be found in one of the cornerstones of Trust Law, which relates to the separation of control and enjoyment of the trust assets by the beneficiaries of the trust.[150]

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[142] Olivier Chapter 2. Para 2.2.1, Pg 2-3.
[143] Olivier Chapter 2. Para 2.2.2, Pg 2-3 – Pg 2-4.
[144] Olivier Chapter 2. Para 2.2.3, Pg 2-4.
[145] Olivier Chapter 1. Para 1.6.3, Pg 1-20, Para 1.6.3, Pg 1-22 and Para 1.7, Pg 1-23. See also *Braun v Blann & Botha* 1984 (2) SA 850 (A). See also Para 3.2.2.
[146] See the definition of "trust" in section 1 of the TPCA.
[147] See the definition of "person" as it appears in section 1 of the ITA.
[148] Olivier Chapter 2. Para 2.9.2.1.1 (VII). See also *PPS Insurance Company Ltd and Others v Nkhabela* 2012 (3) SA 292 ZASCA.
[149] Section 3(3) of the EDA.
[150] Olivier Chapter 2. Para 2.11.3.6. See also *Raath v Nel* (473/2011) [2012] ZASCA 86, 2012 (5) SA 273 (SCA).

Since it is a separate legal entity,[151] existing assets in the name of a taxpayer would need to be transferred to the trust subject to an underlying cause, which could lead to their own tax consequences.[152]

3.2.6. METHODS TO TRANSFER WEALTH TO TRUSTS

The primary methods by which assets could be transferred to a trust are the following –

1) A direct sale to the trust, which would require that funds should flow into the bank account of the trust;
2) The donation of the asset to the trust; or
3) Transferring the asset to the trust in exchange for an interest-free or low interest loan account.

The most popular method was to use interest-free or low-interest loan accounts to transfer assets to a trust due to cutting out potential donations tax[153] as well as ensuring that there need not be any actual cashflow.

3.2.7. INTEREST-FREE OR LOW-INTEREST LOANS MADE TO TRUSTS

Based on the above discussion, estate planners made use of the flexibility of trusts[154] and often used interest-free or low-interest loans to trusts in order to transfer growth assets into a trust. The reasons for doing so include –

1) The value of the asset, determined at its market value, would be transferred to a trust in order to "peg" the value of the asset in the estate of the estate planner. The loan account owing to the estate planner would still be an asset in their estate, but any future growth would be in the hands of the trust;[155]

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[151] Olivier, Chapter 1, Para 1.2 Pg 1-4 and Chapter 1 in general provide a overview of the nature and classification of trusts.
[152] For example, CGT in the event of a direct disposal of the asset or donations tax in the event where the asset was donated to the trust, both in terms of the ITA.
[153] See section 56 of the ITA in this regard.
[154] See Olivier Chapter 7, Para 7.1, Pg 7-3.
[155] Section 3 of the EDA. The removal of future growth from the estate of an individual taxpayer is particularly important to reduce future CGT as well as the value of the estate of such a taxpayer as all future growth would be in the name of the trust, which is a separate legal entity and accordingly could reduce either his own tax burden by delaying the sale of assets indefinitely while at the same time

2) There would be no donations tax that arises as there was a *quid pro quo;*[156]
3) Should an asset be disposed of by the trust in future, provided that the trust deed caters for such disposals, the capital gain could be distributed down to a beneficiary and taxed at a lower effective CGT rate;[157]
4) If the asset is not sold but rather retained in trust, there would also be no future estate duty payable in respect of the asset, as a trust is not a natural person and is not subject to estate duty; or
5) The outstanding loan account owing to the taxpayer could be whittled down over time by using the annual donations tax exemption available to natural persons, currently set at R100 000, to remove portions of the loan annually.[158] When used in conjunction with spousal donations,[159] this greatly assists in the elimination of loan account.[160]

3.3. SECTION 7C OF THE ITA

3.3.1. INTRODUCTION OF SECTION 7C

As discussed in Chapter 2,[161] both the DTC and the KTC advised that implementing transfer pricing adjustments should be avoided,[162] nevertheless this government inserted the provisions relating to the taxation of interest free loans were into the ITA.[163]

At present there have been two iterations of section 7C, namely –

- The deficiency of the initial iteration of section 7C as at 1 March 2017; and
- The amended version of section 7C which came into force on 19 July 2017.[164]

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removing the asset from his estate for the purposes of estate duty. Although trusts have a higher rate for CGT, the conduit principle allows for this drawback to be circumvented. See Oliver Chapter 7, Para 7.2.2, Pg 7-9 in this regard as well.

[156] Section 56 of the ITA.

[157] Olivier Chapter 7. Para 7.2.2 Pg 7-9.

[158] Section 56(2) of the ITA.

[159] This refers to donations made between two individuals who are "spouses" as contemplated in section 56 of the ITA.

[160] See section 56(1)(b) of the ITA.

[161] Chapter 2: Para 2.2, Pg 20 - 24.

[162] First Report: Chapter 4: Trusts. Pg 40. See also Third Report on the Katz Commission: Pg 16.

[163] Section 7C of the ITA introduced with effect from 1 March 2017. These provisions were inserted to combat the misuse of interest free or low interest loans to trusts as discussed in this dissertation.

[164] The legislation was promulgated on 18 December 2017.

Each of these iterations will be discussed below.

3.3.2. THE DEFICIENCY OF THE INITIAL ITERATION OF SECTION 7C

The initial iteration of section 7C of the ITA read as illustrated in paragraph 1.6.1 as it appears above,[165] was largely negatively received by practice,[166] as the introduction thereof stifled the preferred existing method to transfer wealth to a trust, i.e. making use of interest-free or low-interest loans to the trust, and soon methods were devised by practitioners to circumvent the application thereof.[167]

In order to avoid the application of section 7C, a company was introduced into the existing structure as an intermediary between the trust and the estate planner and a loan was then made to this company, whose shares were held by the trust. This removed the threat of section 7C becoming applicable while accomplishing the same goal.[168]

Having realised that this iteration of section 7C could easily be circumvented, an amendment of these provisions followed shortly after the introduction of the provisions into the ITA.

3.3.3. CURRENT ITERATION OF SECTION 7C

The first amendment of these provisions[169] ensured that the provisions also catered for situations where any loan advance or credit, as envisaged in the ITA,[170] was made to a company by a person who is a connected person in respect of a company or a trust, subject to the provisions contained in section 7C.

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[165] Chapter 1: Para 1.6.1, Pg 7 - 9.

[166] See for example https://www.grantthornton.co.za/insights/articles/the-unintended-consequences-of-the-trust-clawback-provision--section-7c// and https://blog.delportvandenberg.co.za/2018/02/26/budget-2018-influence-on-estate-planning-section-7c-revisited-yet-again/.

[167] In its original form, section 7C did not apply to loans, advances or credit given to companies, which then became the launching point for financial service providers. See in this regard PWC Tax Alert – National Tax Technical 29 August 2017: Anti-avoidance rules for trusts: Refinement of section 7C.

[168] Chapter 1: Para 1.6.2., Pg 9 – 11. See also para 3.3.2.

[169] Introduced with effect from 19 July 2017 in the 2017 Draft Taxation Laws Amendment Bill.

[170] Section 7C(1).

After the amendment, the new wording of Section 7C reads as illustrated in paragraph 1.6.2 as it appears above.[171]

Accordingly, this amendment ensures that the provisions contained in section 7C could not be circumvented by way of making use of a company as an intermediary between the trust and the taxpayer, unless the taxpayer or the relevant trust would hold less than 20% of the either the equity shares or voting rights.[172]

3.4. APPLICATION OF SECTION 7C

In its current form, it can be established that section 7C will apply to any transaction which consists of –

- any loan, advance or credit;
- which is made by a natural person, or at the instance of that person a company which is a connected person[173] in relation to that person;
- to a trust or to a company;[174]
- in respect of which that person is a connected person;[175] and
- without levying interest on such loan, advance or credit,[176] or by levying interest which is less than the prescribed rate of interest[177] as determined by the Minister of Finance from time to time.[178]

From the above it is clear that the definition of a connected person is critical to the application of section 7C.[179] This aspect will be discussed further in the next chapter.

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[171] Chapter 1, Para 1.6.2, Pg 9 - 11.
[172] See the definition of "connected person" as it appears in section 1 of the ITA.
[173] *Ibid*.
[174] Definition of "trust" as contained in section 1 of the ITA. See also section 1 of the Trust Property Control Act.
[175] Section 7C(1) of the ITA read with the definition of "connected person" as it appears in section 1 of the ITA.
[176] Section 7C(1) read with section 7C(3) of the ITA.
[177] Part V of Chapter 2 of the ITA.
[178] Section 7C(3) of the ITA.
[179] See https://www.iol.co.za/business-report/opinion/opinion-why-sars-targets-connected-persons-in-relation-to-a-trust-15004783 accessed on 9 October 2019.

3.5. CONSEQUENCES OF SECTION 7C

Should any interest-free or low interest loan account, as envisioned for the purposes of this chapter, exist at the end of a given financial year end, irrespective of whether this loan account was created prior to the introduction of section 7C, then such a loan will be deemed to have charged interest at the prescribed rate of interest notwithstanding that no interest was levied. In the event where this interest has not been paid by the trust, it is deemed to be a donation from the estate planner to the trust[180] and is subsequently subject to Donations Tax.[181]

Due to the widespread use of interest-free or low interest loans in the past, it has created a significant concern for many taxpayers who may now be liable for Donations Tax on an annual basis.[182] This could lead to a cashflow problem for taxpayers, particularly where the asset in question does not generate income for the trust and the Donations Tax must now be covered out of pocket by the relevant taxpayer.

3.6. TRANSACTIONS EXEMPTED FROM SECTION 7C

There are however some exceptional circumstances which are specifically excluded from the application of section 7C.[183] These are the following –

- Any loan, advance or credit made to a public benefit organisation as approved by the Commissioner of SARS;[184]
- Any loan, advance or credit made to a trust in return for which the individual receives a vested interest in a trust;[185]
- Any loan, advance or credit made to a special trust as contemplated in the ITA;[186]
- Any loan, advance or credit, or any portion thereof, which is used to fund the acquisition of a primary residence;[187]

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[180] Section 7C(3).
[181] Section 56 of the ITA.
[182] Para 3.2.6.
[183] Section 7C(5) of the ITA.
[184] Section 7C(5)(a) of the ITA.
[185] Section 7C(5)(b) of the ITA.
[186] Section 7C(5)(c) of the ITA.
[187] Section 7C(5)(d) of the ITA.

- Where any loan, advance or credit constitutes an affected transaction as defined in section 31(1) of the ITA;[188]
- Where any loan, advance or credit qualifies as a sharia compliant financing arrangement as contemplated in section 24J of the ITA;[189] and
- Where any loan, advance or credit would be subject to section 64E(4) of the ITA.[190]

3.7. CONCLUSION

The provisions of section 7C have been drafted in such a manner as to curb the practice of making interest-free or low interest loans to either companies or trusts as part of estate planning to thwart or completely curb avoidance of estate duty in respect of growth assets, subject to some exclusions as referred to in paragraph 3.6 above.

Although these provisions at face value seem to curb the practice of making such loans there are still methods which exist to either mitigate, or in some cases eliminate, the application of section 7C. This evasion calls into question the effectiveness of the provisions which were inserted into the ITA[191] in respect of addressing the concerns which are raised when using interest free or low-interest loans, advances or credit.

It must be noted that although the intention is to curb the use of trusts due to perceived tax avoidance, there are various legitimate reasons to make use of trusts in estate planning which may now have been penalised due to the far reaching implications of the definition of "connected person" as it appears in the ITA.[192]

The next chapter will examine the practical application, potential mitigation or elimination and shortcomings of section 7C.

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[188] Section 7C(5)(e) of the ITA.
[189] Section 7C(5)(f) of the ITA.
[190] Section 7C(5)(g) of the ITA.
[191] Section 7C of the ITA.
[192] Section 1 of the ITA.

CHAPTER 4: THE PRACTICAL EFFECT OF SECTION 7C OF THE INCOME TAX ACT

4.1. INTRODUCTION

With the content of the previous chapters taken into account, the current iteration[193] of section 7C now makes provision for any loan, advance or credit made to a company in addition to trusts.[194] Accordingly once a transaction has complied with the application criteria illustrated above,[195] the provisions of section 7C will become applicable to the transaction and tax consequences will arise, unless an exception is applicable.[196] These requirements will be discussed in further detail below.

4.1.1. LOAN, ADVANCE OR CREDIT

4.1.1.1. DEFINITION OF LOAN, ADVANCE OR CREDIT

The term "loan, advance or credit" is not defined in the ITA, and as such we must give the term its ordinary dictionary meaning, unless such interpretation would lead to an interpretation which is not in line with the values and principles which are enshrined in our Constitution.[197]

In this case of *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism*[198] Ngcobo J made the following statement:

> "The technique of paying attention to context in statutory construction is now required by the Constitution, in particular s 39(2). As pointed out above, that provision introduces a mandatory requirement to construe every piece of legislation in a manner that promotes the 'spirit, purport and objects of the Bill of Rights'."[199]

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[193] As at the date of writing hereof.
[194] Chapter 1, Para 1.6.2, Pg 9 - 11.
[195] Chapter 3, Para 3.4, Pg 33.
[196] Section 7C(5).
[197] The Constitution of the Republic of South Africa, 1996.
[198] [2004] ZACC 15; 2004 (4) SA 490 (CC); 2004 (7) BCLR 687 (CC).
[199] *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* [2004] ZACC 15; 2004 (4) SA 490 (CC); 2004 (7) BCLR 687 (CC) at para 89.

The dissenting judgement of Schreiner JA in *Jaga v Dönges, NO*[200] is cited with approval in *Bato Star Fishing* and reads as follows –

> "Certainly no less important that the oft repeated statement that the words and expressions used in a statute must be interpreted according to their ordinary meaning is that statement that they must be interpreted in light of their context. But it may be useful to stress two points in relation to the application of this principle. The first is that 'the context' as here used, is not limited to the language of the rest of the statute regarded as throwing the light of a dictionary kind on the part to be interpreted. Often of more importance is the matter of the statute, its apparent scope and purpose, and within limits, its background."[201]

This makes it clear that the context of the wording used should be taken into account. However the interpretation must also remain faithful to the actual wording used.[202]

Accordingly, the ordinary definitions of the wording used is critical in order to correctly interpret the provisions contained in section 7C and as such, the ordinary dictionary definitions of the following terms will need to be obtained –

- Loan;
- Advance; and
- Credit.

The Online Cambridge Dictionary defines these terms as follows[203] –

"Loan"

> "an amount of money that is borrowed, often from a bank, and has to be paid back, usually together with an extra amount of money that you have to pay as a charge for borrowing."[204]

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[200] 1950 (4) SA 653 (A) at 662-3.
[201] *Jaga v Dönges, NO and Another* 1950 (4) SA 653 (A) at 662-3 *supra* at 662G-H.
[202] *Bertie Van Zyl (Pty) Ltd and Another v Minister for Safety and Security and Others* [2009] ZACC 11 at para 22.
[203] https://dictionary.cambridge.org/dictionary/english accessed on 04 06 2019.
[204] https://dictionary.cambridge.org/dictionary/english/loan accessed on 04 06 2019.

"Advance"

> "to pay someone some money before the regular time"[205]

"Credit"

> "a method of paying for goods or services at a later time, usually paying interest as well as the original money"[206]

4.1.1.2. PRACTICAL EFFECT OF THE DEFINITION OF LOAN, ADVANCE OR CREDIT

Any transaction which has elements which qualify in respect of any of the definitions contained above may fall within the ambit of section 7C provided that the remaining requirements contained in the ITA have been met.[207] It should also be noted that the provisions of section 7C are retrospective and as such it does not matter when the loan, advance or credit took place, only that such loan, advance or credit is in existence at the end of a financial year.[208]

4.1.2. MADE BY A NATURAL PERSON

4.1.2.1. DEFINITION OF "NATURAL PERSON"

It is trite that the provisions of section 7C of the Act will only become applicable where there is a loan, advance or credit that is made by a natural person, or at the instance of a natural person by a company, to a trust or a company.[209]

What requires some clarification is exactly what is meant with "natural person" as there is no definition of natural person contained in the ITA.

The ordinary dictionary definition of "person" is -

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[205] https://dictionary.cambridge.org/dictionary/english/advance accessed on 04 06 2019.
[206] https://dictionary.cambridge.org/dictionary/english/credit?q=CREDIT accessed on 04 06 2019.
[207] See Chapter 1, Para 1.6.1, Pg 7 - 9.
[208] Section 7C(3) of the ITA.
[209] Section 7C(1) of the ITA.

"a man, woman, or child"[210]

Whereas the ordinary dictionary definition of "natural" is -

"as found in nature and not involving anything made or done by people"

or

A natural ability or characteristic is one that you were born with"

or

from nature; not artificial or involving anything made or caused by people"[211]

These definitions already provide a clear understanding of what is meant with "natural person", however some additional guidance may be obtained from LAWSA[212] which is referred to in the SARS Draft Interpretation Note ("DIN").[213] The following section was quoted when dealing with the definition of a person –

> "Modern law distinguishes between two classes of persons: (a) natural persons; and (b) juristic or artificial persons…All human beings, irrespective of their age, mental condition or intellectual ability, are recognised as legal subjects. Every human being therefore can have rights, duties and capacities although the content of these rights, duties and capacities may vary depending on factors such as the person's mental condition and age. To distinguish them from other juristic persons humans are referred to as 'natural persons'."[214]

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[210] https://dictionary.cambridge.org/dictionary/english/person accessed on 11 06 2019.
[211] https://dictionary.cambridge.org/dictionary/english/natural?q=Natural accessed on 11 06 2019.
[212] DSP Cronje (updated by M Carnelley) "Different Kinds of Person" 20(1) (Second Edition Volume) LAWSA (online) in paragraph 439."
[213] SARS Draft Interpretation Note 67 (Issue 3).
[214] Draft Interpretation Note 67 (Issue 3), Pg 4, Para 3.1.2.

4.1.2.2. PRACTICAL EFFECT IN RESPECT OF NATURAL PERSONS REQUIREMENT

Accordingly, the provisions of section 7C can only apply when the transaction is initiated by a natural person and it must be noted that since there is no definition contained in the ITA, additional guidance is required.

There are some bodies which may fall outside the scope of this section as they technically do not qualify as "natural persons" despite effectively being guided by natural persons and not qualifying as "juristic persons" either.[215]

A notable exception to this is contained in section 7C(1) where a loan is made "at the instance of"[216] a natural person by a company in respect of which such a person is a connected person.[217]

Such a loan made at the instance of a natural person shall be attributed to the person in proportion to their shareholding in the company.[218]

4.1.3. TO A TRUST OR COMPANY

4.1.3.1. DEFINITION OF TRUSTS

In terms of section 1 of the ITA, a trust is defined as follows –

> "…means any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person."[219]

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[215] Such as a trust. See para 4.1.3.1.

[216] As this is not a defined term, this can only refer to a transaction which is made at the direction or under the auspices of a natural person.

[217] Section 7C(1)(b) read with section 7C(4) of the ITA.

[218] Section 7C(4) of the ITA.

[219] See also Draft Interpretation Note 67 (Issue 3), Pg 8, Para 3.1.4 in this regard.

4.1.3.2. DEFINITION OF BENEFICIARIES OF A TRUST

Due to the nature of trusts, and the wording contained in the definition of connected person as it appears in the ITA,[220] it is also necessary to consider the definition of "beneficiaries", which reads as follows –

> "in relation to a trust means a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust."[221]

SARS is of the view that this definition also includes discretionary beneficiaries who have been identified as such in terms of the provisions contained in the trust deed.[222] Notwithstanding the fact that the beneficiaries with discretionary rights technically have no entitlement to any assets held in trust as they are only in possessions of a potential or wish to be benefitted, colloquially known as a '*spes*',[223] and do not have any ability in order to enforce distributions to themselves if the principles of trust law applicable to discretionary trusts are adhered to. Typically trusts afford discretionary rights to the trustees, which are the individuals which direct the management of the trust,[224] to decide which beneficiaries, and in which proportions such beneficiaries are to receive any benefits from the trust funds.

4.1.3.3. DEFINITION OF COMPANIES

In terms of section 1 of the ITA, a company is defined as follows –

> "'company' includes -
>
> (a) an association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate

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[220] Section 1(1) of the Income Tax Act, Definition of "Connected Person".
[221] Draft Interpretation Note 67 (Issue 3), Pg 8, Para 3.1.4. See also their reference to D Clegg and R Stretch – Income Tax in South Africa [online] in paragraph 24.1.1 as it is contained in the Draft Interpretation Note.
[222] *Ibid*.
[223] Olivier, Para 3.4.2.1.17, Pg 3-36.
[224] See Olivier, Para 4.3.5.1, Pg 4-16 in this regard.

formed or established or deemed to be formed or established by or under any such law; or

(b) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or

(c) any co-operative; or

(d) any association (not being an association referred to in paragraph (a) or (f) formed in the Republic to serve a specific purpose, beneficial to the public or a section of the republic; or

(e) any –

(i) …..

(ii) portfolio comprised in any investment scheme carried on outside the Republic …; or

(iii) portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(x) of the JSE Listings Requirements; or

(f) A close corporation,

but does not include a foreign partnership;[225]"

4.1.3.4. PRACTICAL EFFECT IN RESPECT OF TRUSTS AND COMPANIES REQUIREMENT

It is commonplace that any loan, advance or credit which is made by a natural person, or at the instance of such person by a company in respect of whom such a person is a connected person,[226] to either a company or a trust will fall within the ambit of section 7C and require that interest must be levied.[227]

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[225] Section 1(1) of the ITA, Definition of "Company".
[226] Section 7C(1)(b) read with the definition of "Connected Person" as contained in section 1 of the ITA.
[227] Section 7C(3) of the ITA. See also para 4.1.5.

4.1.4. WHO IS A CONNECTED PERSON

4.1.4.1. DEFINITION OF CONNECTED PERSON

The definition of "connected person" was introduced into section 1 of the ITA and became effective on 21 June 1993. It replaced the previous definition of "connected person" which was contained in section 12C(6).[228]

As it stands, the relevant sections of the definition for the purposes of section 7C read as follows[229] –

"'connected person' means -

(a) in relation to a natural person -

(i) any relative; and

(ii) any trust (other than a portfolio of a collective investment scheme) of which a natural person or such relative is a beneficiary;

4.1.4.2. SCOPE OF THE DEFINITION OF CONNECTED PERSON

As can be seen from the above, the definition contains a number of facets to take into account when determining whether an individual is connected, which can become a complicated investigation for the purposes of this section, to another person. The definition is exceptionally wide and could lead to litigation,[230] especially when viewed in the context of a provision like section 7C which has yet to be tested in a court of law.

In order to simply matters somewhat, the definition can be broken down into a classification of which persons may qualify as persons which are regarded as being too closely involved in

[228] Draft Interpretation Note 67 (Issue 3), Para 2, Pg 3.
[229] Section 1(1) of the ITA, Definition of "Connected Person".
[230] Croome, B J "Taxpayers Rights in South Africa", Pg 89. See *ITC 1741* (2003) 65 SATC 106. Although this case did not deal with section 7C, it serves to illustrate the complications which may arise in the course of the interpretation of wording.

relation to the other individuals involved in a transaction, which in the case of section 7C may include[231] –

- Natural persons;[232]
- Trusts;[233]
- Connected persons in relation to trusts;[234]
- Members of partnerships or foreign partnerships;[235] and
- Companies and close corporations.[236]

4.1.4.3. THE EFFECT OF THE WIDE-RANGING DEFINITION OF CONNECTED PERSON IN RESPECT OF SECTION 7C

Once it has been established that a party involved in a transaction is not a person which is excluded by section 7C and is a connected person, as defined above, then the final step of the investigation is to determine whether section 7C applies.

The sheer scope of the definition of connected person could also lead to additional issues in respect of interpretation of the term, which has occurred in other jurisdictions as is illustrated by Seun Ado from PWC Africa in respect of the definition of "connected taxable persons" in terms of Nigerian Law.[237] This article illustrated that there are serious complications which may arise from a definition which is too wide, and it is submitted that this is a risk which may carry over to any matters relating to the interpretation of tax matters in RSA, specifically in respect of section 7C as our definition is just as far reaching. As this is an article which originates from a foreign jurisdiction, this will likely only have persuasive value, if any, in respect of any matters which may arise within RSA.

[231] Draft Interpretation Note 67 (Issue 3), Para 3, Pg 3. See also Section 1(1) of the ITA.
[232] Section 1(1) of the ITA, Definition of "Connected Person" para (a)(i) and (a)(ii).
[233] Section 1(1) of the ITA, Definition of "Connected Person" para (b)(i) and (b)(ii).
[234] Section 1(1) of the ITA, Definition of "Connected Person" para (bA).
[235] Section 1(1) of the ITA, Definition of "Connected Person" para (c)(i) and (c)(ii).
[236] Section 1(1) of the ITA, Definition of "Connected Person" para (d)(i) to (d(v).
[237] PWC Transfer Pricing Series Ado, S – What the definition of connected taxable persons can teach us about definitional fallacies, 2017.

4.1.5. WITHOUT LEVYING INTEREST

4.1.5.1. REQUIRED RATE OF INTEREST

Accordingly, should all of the factors mentioned in 4.1.1 to 4.1.4 above be complied with, the provisions contained in section 7C(3) will become applicable and require that interest be levied.

Section 7C(3) reads as follows –

> "If a trust or company incurs -
>
> (a) no interest in respect of a loan, advance or credit as referred to in subsection (1); or
> (b) interest at a lower rate than the official rate of interest as defined in paragraph 1 of the Seventh Schedule,
>
> an amount equal to the difference between the amount incurred by that trust or company, 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, for the purposes of Part V of Chapter II, be treated as a donation made to that trust by the person referred to in subsection 1(a) on the last day of that year of assessment of that trust or company."

At the time of writing hereof, the official rate of interest is 7,75% and accordingly any loan, advance or credit that falls within the ambit of the provisions contained in section 7C will require that interest must be levied which is at least equivalent to the official interest rate.[238]

This section will also have the effect of making the provisions of section 7C applicable retrospectively. This is because the wording which has been used is not limited to only a loan, advance or credit made after the implementation of section 7C. The only requirement is that the loan, advance or credit must be in existence at the end of a financial year.[239]

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[238] Section 7C(3) of the ITA.
[239] *Ibid*.

4.1.5.2. PRACTICAL EFFECT OF THE NON-COMPLIANCE WITH LEVYING OF INTEREST

Should any person involved in a transaction which falls within the ambit of section 7C fail to levy interest, or levy interest at a rate lower than the official rate of interest, the difference between the amount of interest which has been charged and the official rate of interest will be imputed by SARS and the failure to collect such interest will be seen as donation from the person who has loaned, advanced or made a credit to the trust or company at the end of the relevant year of assessment.

Any amount donated during a given year of assessment, in excess of the annual donations tax rebate afforded to natural persons,[240] shall be subjected to Donations Tax at 20% of the value of the amount which has been donated.[241]

Due to the retrospective nature of section 7C, this could lead to significant cash flow problems for individuals who made use of interest free loans to transfer assets into trusts in the past as part of an estate planning exercise due to the flexible nature of trusts for these purposes.[242]

4.2. PRACTICAL METHODS TO ADDRESS SECTION 7C

Once section 7C applies to a transaction, and not subject to any of the exclusions listed in section 7C(5), interest will be imputed and the arising tax consequences will need to be addressed.

4.2.1. GENERATION OF INCOME IN THE TRUST

One of the methods to address the interest which must now be levied on the loan is to ensure that sufficient cash is available to ensure that the interest can be repaid to the taxpayer who has loaned the cash to the trust or the company. This will put the taxpayer into the position to avoid the payment of any Donations Tax obligation but would of course result in additional income in his personal capacity for income tax purposes.[243]

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[240] Section 56(2)(b) of the ITA.
[241] Section 54 of the ITA read with section 64 of the ITA.
[242] Olivier, Para 1.1, Pg 1-1.
[243] Section 8 of the ITA.

Furthermore, in order to ensure that the interest that has been paid out is deductible for income tax purposes, the interest paid will need to be shown as the payment of an expense in the production of income.[244]

The abovementioned results in a weighing of interests in order to ensure that the interest payable,[245] or subsequent Donations Tax liability if no interest is payable,[246] would not outweigh the potential tax implications resulting from the increase in the taxable income of the taxpayer.[247]

4.2.2. REPAYMENT OF THE LOAN ACCOUNT

Where sufficient funds or assets are available, the repayment of the loan account may be taken into account. The same considerations as alluded to in 4.2.1 are relevant in this regard.[248]

4.2.3. WAIVER OR CONVERSION OF LOAN ACCOUNT

In the event where the interest emanating from the outstanding loan account would result in an undue burden on the taxpayer, it is possible to unilaterally waive the loan account owing to the taxpayer.[249] Waiving a loan account would however constitute a donation and would result in the creation of a corresponding Donations Tax consequence.[250]

It is therefore necessary to determine whether the tax consequence from the donation would outweigh the burden which will be created by section 7C. Another consideration is whether there will be sufficient cash or alternatively whether the waiver would result in future cash flow problems.

Where a loan, advance or credit made to a company falls within the ambit of section 7C(1), another possible solution is potentially to convert the loan account to equity shares in the

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[244] In this case, SARS Practice Note 31 (Dated 3 October 1994) would become relevant and would assist with the deductibility of the interest.
[245] Section 7C(3) of the ITA.
[246] Section 54 of the ITA.
[247] An equation will need to be made in order to determine which would be the most efficient route for the taxpayer to take in this regard. See section 7C read with section 56.
[248] Para 4.1.2.
[249] RH Christie, The Law of Contract in South Africa, Fifth Edition (2006), Chapter 12, Pg 437.
[250] *Ibid*. See also section 56 of the ITA.

company as opposed to requiring the repayment of the loan. This would allow for the existing loan account to be extinguished, although this action would increase the estate of the estate planner, which would have implications for their financial planning.[251] It would also have some potential CGT consequences. Some relief from CGT consequences may also be found in Paragraph 12A of the Eighth Schedule to the ITA.

4.2.4. MAKING USE OF THE DONATIONS TAX REBATE TO ELIMINATE THE OUTSTANDING LOAN

Each natural person is afforded the ability to make a donation up to an amount of R100 000 without incurring Donations Tax.[252]

4.2.5. MAINTENANCE DONATIONS

Another consideration which may be applicable, and which may be applicable in certain circumstances, can be found in section 56(2)(7) of the ITA. It relates to donations which were made for the maintenance of any person.

Any donations made for such purposes would be exempted from Donations Tax. The relevant wording is as follows –

> "so much of any bona fide contribution made by the donor towards the maintenance of any person as the Commissioner considers to be reasonable."[253]

As there is no limit attached to the wording used in this section, it is possible for a taxpayer to donate a substantial amount to a trust for the benefit of his family, provided that he can show that it is for the maintenance of an individual and the Commissioner finds it reasonable to do so.

Of course, the exact meaning and scope of these terms in light of section 7C remains to be tested in practice and until it has occurred, it would be difficult to say what amount the Commissioner would deem to be reasonable for maintenance purposes.

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[251] As the loan account which has been converted to shares will now be an asset in the name of the taxpayer. See also section 3 of the EDA and Chapter 3, Para 3.2.1, Pg 28 in this regard.
[252] Section 56(2)(b) of the ITA.
[253] Section 56(2)(7) of the ITA.

4.3. METHODS TO CIRCUMVENT OR MITIGATE THE APPLICATION OF SECTION 7C

Where 4.2 above relates to the scenario where section 7C already applies to a transaction, the following paragraphs relates to the planning practices aimed at assisting a taxpayer to avoid falling foul of the provisions of section 7C.

4.3.1. TESTAMENTARY BEQUESTS

Although estate planning does not afford a direct benefit to the taxpayer during the course of his lifetime, a comprehensive estate planning exercise could lead to the complete circumvention of the provisions of section 7C by ensuring that assets are not disposed of by the taxpayer to a trust.[254]

This is accomplished by ensuring that the Last Will and Testament of the taxpayer is drafted in such a manner as to allow for the bequest of all relevant assets to a trust while minimising the resulting Estate Duty burden.

Once an asset has been bequeathed to a trust, which is a *sui generis* legal entity and as such theoretically can continue existing in perpetuity,[255] the trust will become the owner of the asset and will ensure that such assets are then used for the benefit of the defined group of beneficiaries.[256]

In this manner the same goal is accomplished as was intended by making use of the loan account, albeit that the effective date is delayed until the death of the taxpayer and there will be an initial Estate Duty consideration which may be somewhat higher as the asset would likely have grown in value since it was obtained by the taxpayer.

One must exercise extreme caution in respect of loans when considering succession, as natural persons who receive a loan account as a bequest or as part of the residue of an estate, will be

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[254] This may include either *inter vivos* or *mortis causa (testamentary)* trusts – See Olivier Chapter 1, Para 1.6, Pg 1-18 for a discussion on the distinction between an *inter vivos* and a *mortis causa* trust. Assets bequeathed to a trust will not qualify as a loan, advance or credit and in future will not form part of the estate of a taxpayer for purposes of section 3 of the EDA.

[255] Olivier, Para 1.6.3, Pg 1-22. See also *Braun v Blann & Botha* 1984 (2) SA 850 (A).

[256] Olivier, Para 1.6.4, Pg 1-22. See also *Braun v Blann & Botha* 1984 (2) SA 850 (A).

deemed to be a connected person to the trust or company from the date on which the loan was received. It could have adverse consequences which may arise.[257]

This extends the concept of "connected person" to include persons who may not previously have qualified as such and adds additional impetus to the consideration that loans must be bequeathed back to the trust and not to another individual.[258]

4.3.2. TRANSFERRING ASSETS FROM EXISTING TRUSTS

As referred to in 4.1.2 above,[259] the provisions contained in section 7C will only come into effect where the loan, advance or credit has been made by a natural person, or in certain instances by a company at the instance of a natural person.[260]

However, since a trust is not a natural person, nor does it fall within the definition of a company as contained in the ITA,[261] any loan, advance or credit which has been made by an existing trust will not be subject to the provisions contained in section 7C.[262] Accordingly, where an estate plan was already in place in the past which transferred assets into trust, these trusts can now effectively avoid section 7C while still accomplishing the same goals.[263]

As trusts are generation skipping devices, which may be seen as financial vehicles which are used to build wealth for future family members in a tax efficient manner, effectively existing in perpetuity, most tax consequences can be delayed indefinitely in this regard.[264]

4.3.3. "SOFT THRESHOLD" PLANNING

The provisions contained in section 7C(3) will result in the imposition of donations tax on the difference between the amount of interest which should have been charged in terms of section 7C and the interest, if any, which was charged in reality.

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[257] Section 7C(1A) of the ITA.
[258] Definition of "person" as it appears in section 1 of the ITA.
[259] Pg 38 - 40.
[260] Section 7C(1)(b) of the ITA.
[261] Para 4.1.3.3.
[262] Irrespective of whether such a trust is an *inter vivos* or a *mortis causa* trust. See Olivier Chapter 1, Para 1.6, Pg 1-18 for a discussion on the distinction between an *inter vivos* and a *mortis causa* trust.
[263] Para 4.3.1.
[264] Chapter 2: Para 2.1, Pg 17 - 20.

However, there is a method to make use of a calculation to determine the maximum value of a loan, advance or credit which can be made to a trust and still avoid the physical payment of any taxes by making use of the annual tax rebate available to natural persons.[265]

This can be achieved by ensuing interest deemed to be donation is less than the rebate, one can effectively still make a loan, advance or credit without incurring any negative consequences.

The "soft-threshold" formula may be illustrated as follows –

> **X (the current official rate of interest) x Y (the value of the loan account)**
> **< Z (current Donations Tax rebate available to natural persons)**

At this stage, any loan, advance or credit which does not exceed R1 290 000 will fall within the ambit of this formula and thus effectively circumvent section 7C.[266]

This planning can be taken even further to make maximum use of this strategy by way of the taxpayer making an additional donation to their spouse[267] and subsequently making an interest-free loan to their other close family members.[268]

The "soft-threshold" strategy referred to above works as follows –

> The taxpayer donates an amount which is equal to the "soft-threshold" to his spouse. This does not incur Donations Tax.[269]
>
> **THEN**

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[265] Section 56(2)(b) of the ITA.
[266] Calculated in line with the formula laid down in this paragraph and based on the relevant exemptions and required rate of return at the time of writing.
[267] In terms of section 56(1)(a) and section 56(1)(b) of the ITA donations made to spouses are exempted from donations tax.
[268] As these loans are made to natural persons, they do not fall within the ambit of section 7C. Also see section 7C(1) and the discussion in Chapter 3, Para 3.4, Pg 33 in this regard.
[269] Section 56(1)(b) of the ITA.

> The taxpayer loans an amount equal to the "soft-threshold" to one or more of his children or family members who are willing to assist. This will not fall foul of section 7C as the loan is made to a natural person.[270]

The above strategy can be illustrated in terms of the following scenario –

> X has a loan account which was made to his trust to the value of R5 000 000 which falls directly in the ambit of section 7C and would result in a tax obligation of R57 500 at the end of the financial year should he fail to levy interest on same.
>
> **SO**
>
> X now donates R1 290 000 to his spouse, Y, which leaves an amount of R3 710 000 and has reduced the potential tax obligation to R37 505.
>
> **THEN**
>
> X loans an amount of R1 290 000 to each of his two sons, which now leaves an amount of R1 130 000 and has completely eliminated the need to pay tax as the total value now falls below the soft planning threshold.

Of course, this strategic planning still leaves an Estate Duty concern but can drastically improve the situation where there would be a potential cash flow problem.[271] In the event where the trust generates income, the outstanding loan accounts can be diminished over time. The eventual goal being to ensure that the loans are bequeathed back to the trust in the Last Will and Testament of each of the relevant individuals without incurring any CGT.[272]

4.4. ANOMALIES AND ISSUES ARISING FROM SECTION 7C

The final consideration for the purposes of this chapter relates to certain legal anomalies arising as result of the provisions contained in section 7C which may lead to some legal uncertainty.

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[270] Section 7C(1) requires that a loan, advance or credit must be made to a trust or juristic person. See the the discussion in Chapter 3, Para 3.4, Pg 33 in this regard.
[271] Section 3 of the EDA will still qualify the outstanding loan accounts as assets for the purposes of Estate Duty.
[272] Para 12A of the Eighth Schedule to the ITA.

4.4.1. LEGAL STATUS OF EXECUTORS FOR THE PURPOSES OF SECTION 7C

Although conventionally an executor steps into the shoes of a deceased individual, it must be noted that an executor is not necessarily a natural person nor does an executor have to be a juristic person.[273]

An executor is defined as follows in the EDA –[274]

> "…means any person to whom letters of administration or of executorship have been granted by a Master in respect of the estate of a deceased person under any law relating to the administration of estates, or whose appointment as assumed executor of such an estate has been endorsed by a Master under such law, or who liquidates or distributes such an estate in pursuance of a direction of a Master, and includes a person acting or authorized to act under letters of administration or of executorship granted outside the Republic but signed and sealed by a Master for use within the Republic and, in any case where the estate is not required to be administered under the supervision of the Master, the person administering the estate;"

The term "person" is not defined in the EDA and as such must be given its ordinary dictionary meaning and as such includes both natural and juristic persons.[275]

Due to the fact that an executor could be either a natural or juristic person acting in the interests of the estate, there may be an issue which arises in respect of the application of section 7C. If an executor is a natural person which steps into the shoes of the deceased, one can assume that the identity of natural person is retained and the position which applies to a natural person where a loan, advance or credit is made in terms of section 7C(1)[276] will prevail.

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[273] Section 1 definition of "executor" in the EDA.
[274] *Ibid*.
[275] See para 4.1.1.1 *supra* for a discussion on how words which are not defined are to be interpreted.
[276] See *Booysen and Others v Booysen and Others* 2012 (2) SA (GSJ) (25 March 2011) where the following statement was made – "In regard to the legal status of both the deceased estate and the executor, the deceased estate is not a separate persona, but the executor is such person for the purposes of the estate and in whom the assets and liabilities temporarily reside in a representative capacity…""

In the event where the executor is a juristic person however, the same situation would apply due to the executor simply stepping into the shoes of the deceased,[277] which would result in an additional exception where a loan made from a juristic person may also trigger the application of section 7C(1).[278]

This could also require that any advances made by executors to heirs or legatees must be made subject to interest being charged on them, since such an advance does not form part of the exemptions listed in section 7C(5) and could accordingly result in Donations Tax obligations arising.[279]

4.4.2. UNREGISTERED TRUSTS AND SECTION 7C

The common practice is to ensure that trusts are reduced to writing in the form of a deed of trust and subsequently submitted to the Master of the High Court in order to obtain a letter of authority showing that these trusts have been duly registered in terms of the Trust Property Control Act, Act 57 of 1988 ("TPCA").[280] This allows for the trustees of the trust to engage with third parties as duly authorised representatives of the trust. Such a registration is only required where trustees wish to acquire the benefits afforded by the TCPA.

Cognisance must be given to the definition of "trust" as it is contained in the TPCA, which reads as follows –

> "…means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed –
>
> (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

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[277] See *Booysen and Others v Booysen and Others* 2012 (2) SA (GSJ) (25 March 2011) where the following statement was made – "In regard to the legal status of both the deceased estate and the executor, the deceased estate is not a separate persona, but the executor is such person for the purposes of the estate and in whom the assets and liabilities temporarily reside in a representative capacity…""
[278] Also see para 4.1.2.2. where other examples are provided.
[279] Section 7C(3) of the ITA.
[280] Section 6(1) of the TPCA.

(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act…"[281]

This must be read with the definition of "trust instrument" which reads as follows –

> "…means a written agreement or a testamentary writing or court order according to which a trust was created"[282]

What stands out is that neither of these definitions require that the trust needs to be registered with the Master of the High Court. Should the trust not be registered with the Master of the High Court, the trust will not be regulated by the TPCA, however this would not affect the validity of the trust and rather will only effect whether it is governed by the TPCA.[283]

Due to the definition of trust contained in the ITA,[284] unregistered trusts, which is to say trusts which fall outside of the scope of the TPCA, could fall within the ambit of section 7C and could lead to unforeseen tax consequences.

4.5. CONCLUSION

The provisions of section 7C were originally aimed at curbing tax abuse by targeting interest-free or low interest loans which were made to trusts and then extended to loans which were made to companies. However, it is clear from the above arguments that there are methods to circumvent these provisions and although there are some transactions which will be directly impacted by section 7C that there are methods to either mitigate or circumvent section 7C.

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281 Section 1(1) definition of "trust" in terms of the TPCA.
282 Section 1(1) definition of "trust instrument" in terms of the TPCA.
283 Olivier Para 1.2.2.5, Pg 1-7.
284 Para 4.1.3.1.

CHAPTER 5: CONCLUDING REMARKS ON SECTION 7C OF THE INCOME TAX ACT

5.1. INTRODUCTION

The previous chapters showed how the provisions contained in section 7C interact with the ITA and other pieces of legislation in practice as well as expanding upon the areas in which section 7C has created unnecessary grey areas. It is still necessary to determine whether the provisions contained therein have in fact served the purpose for which they were created in the first place.

Additionally, it needs to be determined whether any of these provisions could be refined in order to ensure that they function properly and provide legal certainty in the event of any disputes arising.

In order to determine whether this is the case, the following aspects are discussed in this chapter –

- What is the goal behind the insertion of section 7C in the ITA;
- What are the shortcomings of section 7C and how do such shortcomings impact the effectiveness of section 7C; and
- Concluding remarks on the provisions of section 7C as they appear in the ITA.

5.2. THE GOAL OF SECTION 7C

When it was first introduced, SARS issued an explanatory memorandum which accompanied the Tax Act Amendment Bill 2016[285] in order to explain the reasoning and functionality of the provisions which were to be amended or inserted by this document.

This was the first explanatory memorandum issued that directly addressed section 7C and specifically dealt with the reason for the inserting the provisions contained therein. The primary rationale, which was put forward, was that the tax base was being reduced by the practice of

[285] Explanatory Memorandum on the Taxation Laws Amendment Bill 17B of 2016, 15 December 2016.

using interest-free or low interest loans as a result of the loss of Estate Duty and / or potentially Donations Tax.[286]

Concerns were also raised in respect of cancellation or waiver of low interest-free or low interest loans, which lead to the inclusion of provisions which state that no deduction, loss, allowance or capital loss may be claimed in respect of such loans.[287] These prohibitive provisions referred to above are contained in section 7C(2) of the ITA.

Accordingly, it may be surmised that the provisions of section 7C were inserted into legislation in order to ensure that there would be no further reduction in the erosion of the tax base. This goal must however be read in line with the current socio-economic climate in which RSA finds itself that requires SARS to find as many avenues for the collection of revenue as possible.[288]

5.3. THE SHORTCOMINGS AND EFFECTIVENESS OF SECTION 7C

5.3.1. GENERAL SHORTCOMINGS OF SECTION 7C

With the goal of section 7C having been confirmed by SARS it becomes necessary to weigh the shortcomings of the provisions contained therein with this stated goal.

One of the initial shortcomings related to the fact that only interest-free or low interest loans made by natural persons to trusts,[289] with some exceptions,[290] were encompassed by these provisions which lead to a substantial obstacle for section 7C as loans could simply be made to companies where the trust was the sole shareholder of the trust, effectively accomplishing the same goal while not falling foul of the section 7C. Of course, this occurrence was quickly addressed by the first amendment to the existing provisions of section 7C which included interest-free or low interest loans made to companies as well.[291]

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[286] Explanatory Memorandum on the Taxation Laws Amendment Bill 17B of 2016, 15 December 2016, Paragraph II, Pg 10. See also https://www.moneyweb.co.za/in-depth/fisa/concern-about-practical-challenges-with-new-trust-legislation/ accessed on 22 July 2019.

[287] Explanatory Memorandum on the Taxation Laws Amendment Bill 17B of 2016, 15 December 2016, Paragraph III(D), Pg 12.

[288] South African Budget Speech, 20 February 2019.

[289] Section 7C(1)(a) of the ITA.

[290] Section 7C(1)(b) of the ITA.

[291] See Chapter 3, Para 3.3.3, Pg 32 - 33.

The exceptionally wide definition of "connected person" could complicate investigations surrounding an interest-free or low interest loan made to a trust or a company by an individual may in fact trigger the application of section 7C in certain circumstances.

In addition to the above, and as referred to in the previous chapter of this dissertation,[292] there are several aspects where the provisions contained in section 7C either do not provide sufficient guidance,[293] or where the consequences contained therein could be either mitigated or potentially completely avoided.[294] The existence of these method serves to dilute the effectiveness of the provisions contained in section 7C significantly.

5.3.2. DEEMED LOANS IN TERMS SECTION 7C

There are also concerns which arise in respect of distributions which are made to trust beneficiaries which are then borrowed back by the trustees. Although this does not technically qualify as a loan in the strictest sense of the word as it is usually not a bilateral action, it will be sufficient to fall within the ambit of section 7C in the event where the trust deed has not been correctly drafted.

In order to ensure that the trustees do not fall foul of the provisions contained in section 7C, the trust deed should make it clear that the discretion to make actual payment to the beneficiaries should at all times be in the absolute discretion of the trustees. In addition, the trust deed must not afford the beneficiaries any discretion to consent to this action, thus removing its bilateral nature, thus not complying with the definition of a loan.[295]

Should the event arise where there is a dispute in this regard, an additional administrative burden will arise in order to prove that the trust deed has been correctly drafted and as such will not fall within the ambit of the provisions contained in section 7C.

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[292] Chapter 4.
[293] Chapter 4, Para 4.4, Pg 52 - 55.
[294] Chapter 4, Para 4.3.3, Pg 50 - 52.
[295] See the Explanatory Memorandum on the Taxation Laws Amendment Bill 17B of 2016, 15 December 2016 in this regard. Also see Section 7C(1) of the ITA and the discussion of the definition of the terms "loan, advance or credit" as they appear in Chapter 4.

Accordingly, it could become quite complicated to determine whether there is in fact a loan, advance or credit present.[296] Conversely, where the trust deed is not correctly drafted, beneficiaries could find themselves falling foul of section 7C without even realising it.[297]

5.3.3. SECTION 7C AND THE RIGHT OF TAXPAYERS

An additional consideration, as was illustrated in the cases of *Ayshire Pullman Motor Services and Richie v IRC (1929)*,[298] *Levene v IRC* (1928) *5*,[299] *IRC v Duke of Westminster*, (1936)[300] and *CIR v Estate Kohler* (1953),[301] is that taxpayers have the right to structure their affairs in such a manner as to ensure that such affairs afford the relevant taxpayer the most efficient tax consequences.

This does not mean that the legislator does not have the ability to restrict certain tax practices nor that any abuse of existing provisions may not be addressed. However, the comparatively low impact of Estate Duty in comparison with other taxes,[302] as well as the recommendations of the both the DTC and the KTC in respect of the implementation of a wealth tax of this nature,[303] would seem to show an increased focus on a relatively low impact tax, which could well constitute a contradiction of this view that taxpayers are allowed to arrange their affairs in such a manner.

This could also be compared with the findings in *Hicklin v SIR* (1980)[304] where the court was of the opinion that shareholders were entitled to avoid a tax liability by adopting some other legitimate course. In order to obtain any legal certainty in this regard, the input of the courts

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[296] See https://www.moneyweb.co.za/in-depth/fisa/concern-about-practical-challenges-with-new-trust-legislation/ accessed on 22 July 2019.
[297] For example, where the trust deed does not clearly afford the trustees the ability to make use of the funds without the consent of the beneficiaries, it would still be capable of being construed as a loan and therefore fall within the ambit of section 7C of the ITA. See https://www.moneyweb.co.za/in-depth/fisa/concern-about-practical-challenges-with-new-trust-legislation/ accessed on 22 July 2019.
[298] [1928-29] 14 TC 754.
[299] [1928 AC 217], [1928] UKHL 1.
[300] [1936] AC 1, [1935] All ER 259, (1935) 19 Tax Cas 490, (1935) 104 LJKB 383, [1935] UKHL TC – 19 – 490, [1935] UKHL
[301] 1953 (2) SA 584 (A).
[302] https://stats.oecd.org/Index.aspx?DataSetCode=REVNLD# accessed on 31 July 2019.
[303] See Chapter 2 of this dissertation for a discussion in this regard.
[304] 1980 (1) SA 481 (A), 41 SATC 179.

will be required in order to be completely ventilate any legal aspects in order to determine whether it would in fact have any fundamental impact on the provisions contained therein.

In addition to the shortcomings illustrated above, it must be noted that the current circumstances in which SARS finds itself[305] must also be taken into account to determine whether these provisions are effective in accomplishing their goals, specifically when considering the increased administrative burden which will be placed on SARS in order to ensure compliance.[306]

5.3.4. EFFECTIVENESS OF SECTION 7C

What remains is to determine whether the provisions of section 7C, when weighed against the shortcomings and concerns surrounding section 7C illustrated in this dissertation,[307] are effective in providing protection against the reduction of the tax base.

Although the provisions contained in section 7C would discourage the use of an interest-free or low interest loan account by those who are not versed in the provisions of section 7C, it is submitted that the usage of trusts as a flexible estate planning vehicle would likely not be greatly affected by this.[308]

In respect of the primary issue raised, which relates to the reduction of the tax base for Estate Duty purposes, the Estate Duty is only reduced to the extent to which the loan account has been reduced during the lifetime of the taxpayer.[309] Where the estate planner has not, or could not, reduce the value of the loan account the value of the loan account still forms part of the estate of the taxpayer for Estate Duty purposes.[310]

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[305] https://www.fin24.com/Companies/Financial-Services/timeline-sars-in-disarray-all-you-need-to-know-ahead-of-the-final-commission-report-20181214 accessed on 31 July 2019. See also https://www.fin24.com/Opinion/sars-zumas-man-tom-moyane-leaves-behind-a-broken-tax-man-20181101 accessed on 31 July 2019.

[306] https://www.moneyweb.co.za/in-depth/fisa/concern-about-practical-challenges-with-new-trust-legislation/ accessed on 22 July 2019. See also the IT144 SARS Donation's form.

[307] See Chapter 4 of this dissertation for a discussion in this regard.

[308] Chapter 3, Para 3.2.5, Pg 29 - 30. See also the general discussion of trusts as contained in chapter 3 of this dissertation read with the stratagems suggested to deal with section 7C as contained in chapter 4 of this dissertation.

[309] Section 3(3) of the EDA.

[310] *Ibid*.

Section 7C could be completely avoided by way of using long-term estate planning tactics such as simply bequeathing the relevant assets to an existing trust, thus accomplishing essentially the same goal without any effect arising from the provisions which are contained in section 7C as there was no loan, advance or credit.[311] Once the assets are in trust, future generations can simply on-loan from the trust to fund other trusts, since trusts which make interest-free or low interest loans will not fall foul of section 7C.[312]

Furthermore, the effect of section 7C on new acquisitions of assets would only be effective insofar as the acquisition does not fall within the ambit of the exclusions illustrated in section 7C(5) or is not mitigated by the use of the stratagems which are referred to in Chapter 4 of this dissertation.

Accordingly, despite the exceptionally wide application of section 7C and the complicated nature of considerations to take into account when determining whether section 7C may find application or not, it is submitted that the provisions as the exist in their current form will likely not be effective in accomplishing their stated goal. Moreover, it is submitted that technically speaking there was no real reason to include the provisions of section 7C at all, as the existing anti-avoidance provisions contained in section 7 of the ITA would be have been capable of being invoked to curb abuse by taxpayers.[313] These provisions include the accrual and attribution rules, which would have the effect of attributing a tax consequence back to a specific individual involved in a transaction.[314]

5.4. CONCLUSION

There can be no doubt that SARS has found itself in circumstances where they are required to ensure that taxes are collected from as many sources as possible. However, in light of the information referred to above, there is no doubt that many of these provisions can simply be circumvented. For example, the taxes can potentially be deferred or dealt with as part of an

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[311] Section 7C(1) of the ITA.
[312] Section 7C(1) of the ITA.
[313]Section 7 of the ITA. See also http://www.mondaq.com/southafrica/x/565738/Income+Tax/Introduction+Of+Section+7C+To+The+Income+Tax+Act+And+Its+Effect+On+Estate+Planning accessed on 22 July 2019.
[314] See Olivier Chapter 7, Para 7.2, 7.3 and 7.4, Pg 7 – 11 to Pg 7 – 39 for a discussion on how these provisions apply in respect of trusts.

estate planning exercise to completely nullify section 7C. As such the desired goal of section 7C would inevitably fail to be accomplished, with only interest-free or low interest loan accounts which were in existence prior to the implementation of section 7C,[315] which are simply too large or too cumbersome to be dealt with in terms of the stratagems laid out in Chapter 4 of this dissertation, truly becoming problematic for taxpayers.[316]

It is submitted that the insertion of section 7C of the ITA may in fact result in accomplishing the exact opposite of its stated goal, instead encouraging individuals to attend to making preparations to simply the bequeath assets to a trust at their demise, which would ensure that Estate Duty is not lost by SARS. This will also potentially allow for the complete postponement of any future Capital Gains Tax for an indefinite time as there is no need to transfer assets from a trust. In turn this could potentially eliminate any future Transfer Duty[317] or Estate Duty completely,[318] which could in the long term reduce revenue collections even further.

Although the primary purpose of this dissertation is to find any potential weaknesses and anomalies which may arise from the provisions contained in section 7C, there are some suggested amendments which may need to be taken in account in order to allow for more clarity in this regard –

1) To include a restricted definition of "connected person" in order to ensure that there will not be any unnecessary dispute which may emanate from the existing, exceptionally wide, definition contained in the ITA;[319] and
2) To clarify the provisions surrounding the position of an executor of a deceased estate when considering section 7C.[320]

With regards to the provisions relating to the "soft-threshold" as illustrated in this dissertation, it is submitted that these provisions should remain unaltered, as this affords taxpayers some freedom in structuring their affairs in line with established case law while still allowing for

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[315] 1 March 2017.
[316] Chapter 4.
[317] Section 9 of the Transfer Duty Act, Act 40 of 1949.
[318] Chapter 3, Para 3.2.5. Pg 29 - 30.
[319] Chapter 4, Para 4.1.4 , Pg 43 - 44.
[320] As discussed in Chapter 4, Para 4.4.1, Pg 53 - 54.

SARS to obtain some benefit. This would allow for SARS to take the current fiscal and economic climate into account, while still allowing for some leeway for taxpayers.

The complication which arises in respect of the proposed amendments lies in the inherent complexity of section 7C, as was illustrated by the KTC.[321] Where an advanced legal system such as that of the United States of America fails to adequately address a situation, it would be the height of hubris to assume that our current provision, or any of the amendments suggested herein, would succeed where they have failed.[322]

Nonetheless, we find ourselves in a situation where this clause has already been inserted into the existing legislation and as such must now find ways to ensure that it functions as close as possible to its intended goal. As a closing thought in this regard, I wish to quote General Tao Hanzhang who translated Sun Tzu's Art of War –[323]

> "…a skilled commander seeks victory from the situation and does not demand it of his subordinates. He selects suitable men and exploits the situation."

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[321] Chapter 2: Para 2.2.1, Pg 20 - 23.
[322] Third Interim Report of the Katz Commission: Para 7.2.
[323] Sun Tzu's Art of War, The Modern Chinese Interpretation, General Tao Hanzhang, 2007, Pg 46.

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