

## Section 7C of the Income Tax Act

This document is not intended to be tax or financial advice.  
It is intended to provide the user with sufficient information to answer the most common questions incurred in the market in respect of this technical topic.

### Introduction

Section 7C was introduced in March 2017 to prevent trusts from being used to avoid or reduce estate duty and/or donations tax.

The main factors of this section, insofar it impacts the use of trusts as an estate planning vehicle, are as follows:

- A loan/advance/credit is made to a trust (directly or indirectly):
  - o By a natural person, that is a connected person in relation of the trust, or
  - o By a company at the instance of a natural person, where that natural person is a connected person in relation to that company and the trust.
- A loan/advance/credit is made to a company:
  - o Where at least 20% of the shares/voting rights is held by the trust or by the trust and a beneficiary of the trust including a spouse of that beneficiary or a relative of that beneficiary or spouse to the second degree, and that loan/advance/credit is made:
    - By a natural person, that is a connected person in relation of the trust, or
    - By a company at the instance of a natural person, where that natural person is a connected person in relation to that company and the trust.
    - This section is relevant from 19 July 2017.
- Where a person acquires a claim in respect of a loan/advance/credit referred to above, that person shall be treated to have made the loan/advance/credit on the date they acquired the claim or on the date they became a connected person in relation to that trust, if they were not a connected person on date of acquiring that claim (this section is relevant from 19 July 2017).
- No interest is charged on that loan, or
  - o Interest is charged at a rate below the official rate (currently 7.75% per annum).
- There is a deemed donation made by the natural person to the trust:
  - o That is equal to interest at 7.75% per annum, or
  - o The difference between the actual interest rate being charged and the official rate of 7.75% per annum.
- The donation is deemed to take place on the last day of the year of assessment of that trust.
- If more than one natural person made the loan to the trust, the donation will split proportionately between them.

The section stipulates that certain trust structures are excluded from the consequences of section 7C. A detailed list will follow.

**Note:**

- This section will apply irrespective of when the loan was made – whether it was made prior to, on or after the effective date is irrelevant. It applies retrospectively to loans made prior to 1 March 2017, however, the actual donation will be deemed to take place on the last day of any given tax year. For this 2017/18 tax year it will be on 28 February 2018. (This means that any donations tax payable in respect of this year of assessment will be payable by 31 March 2018.)
- When determining the deemed interest that is donated, the actual official interest rate/s will be applied during that year for the specific period that the loan existed and the specific time the rate was applicable. It is therefore not the official rate on the last day of the tax year that applies.

The official rate is determined by taking the repo rate at any given time plus one percent. When there is a change in the repo rate, the official rate changes on the first day of the following month. The official rates since the inception of section 7C is as follows:

<b>Date</b>	<b>Official rate</b>
1 April 2016 to 31 July 2017	8.00%
1 August 2017 to 31 March 2018	7.75%
1 April 2018 to 30 November 2018	7.50%
1 December 2018 to currently	7.75%

**Practical implications****Is this section relevant?**

The following questions should be answered to determine if section 7C will be relevant:

1. If the loan is made by a natural person, is that natural person a connected person in relation to that trust?
2. If the loan is made by a company at the instance of a natural person, is that natural person a connected person in relation to that trust and that company?
3. If the loan is made to a company, are at least 20% of that company's shares or voting rights held by a trust or by a trust and a beneficiary of that trust (including a spouse of that beneficiary or a relative of the beneficiary or spouse to the second degree)?
  - If the loan is made to a company (that fulfil the requirement in point 3) by a natural person, is that natural person a connected person in relation to that trust (that holds 20% of the shares or voting rights of that company)?
  - If the loan is made to a company (that fulfils the requirement in point 3) by a company at the instance of a natural person, is that natural person a connected person in relation to that trust (that holds 20% of the shares or voting rights of that company) and that company?
4. If the loan is owed to a person other than the person who originally made the loan to the trust, is that person that acquired that loan a connected person in relation to that trust?
5. Is there interest being charged on the loan?
6. If yes, is the interest being charged less than 7.75% per annum?
7. Does one of the exclusions apply?

Once all the questions are answered, it will be clear whether the natural person in question is liable for donations tax or not. The following information can assist to answer the questions:

### Who is a connected person in relation to a trust?

The Income Tax Act defines a connected person. A connected person in relation to a trust includes:

- A beneficiary of that trust, and
- A connected person in relation to that beneficiary.

A beneficiary as defined as follows:

**“[B]eneficiary”** 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;<sup>1</sup>

This definition is very wide and has the effect that a beneficiary will include income and capital beneficiaries in relation to vested/’bewind’ trusts and a discretionary trusts. A person can also be widely defined to include, natural persons, companies, close corporations, etc.

Note:

- In the context of this guide ‘trust/s’ will refer to discretionary trusts, unless stated otherwise.
- Beneficiary will generally be viewed as a natural person, unless stated otherwise.

A connected person in relation to a beneficiary, that is a natural person, will include any relative. A relative is defined as follows:

**“[R]elative”** in relation to any person, means the spouse of such person or anybody related to him or his spouse within the third degree of consanguinity, or any spouse of anybody so related, and for the purpose of determining the relationship between any child referred to in the definition of “child” in this section and any other person, such child shall be deemed to be related to its adoptive parent within the first degree of consanguinity;<sup>2</sup>

Therefore it will include the following:

- that person’s spouse;
- anybody related to that person within the third degree of consanguinity;
- anybody related to that person’s spouse within the third degree of consanguinity; and
- the spouse of anybody related within the third degree of consanguinity to that person or to that person’s spouse.

A spouse is defined as:

**“[S]pouse”**, in relation to any person, means a person who is the partner of such person—  
 (a) in a marriage or customary union recognised in terms of the laws of the Republic;  
 (b) in a union recognised as a marriage in accordance with the tenets of any religion; or  
 (c) in a same-sex or heterosexual union which is intended to be permanent,

<sup>1</sup> Section 1 of the Income Tax Act

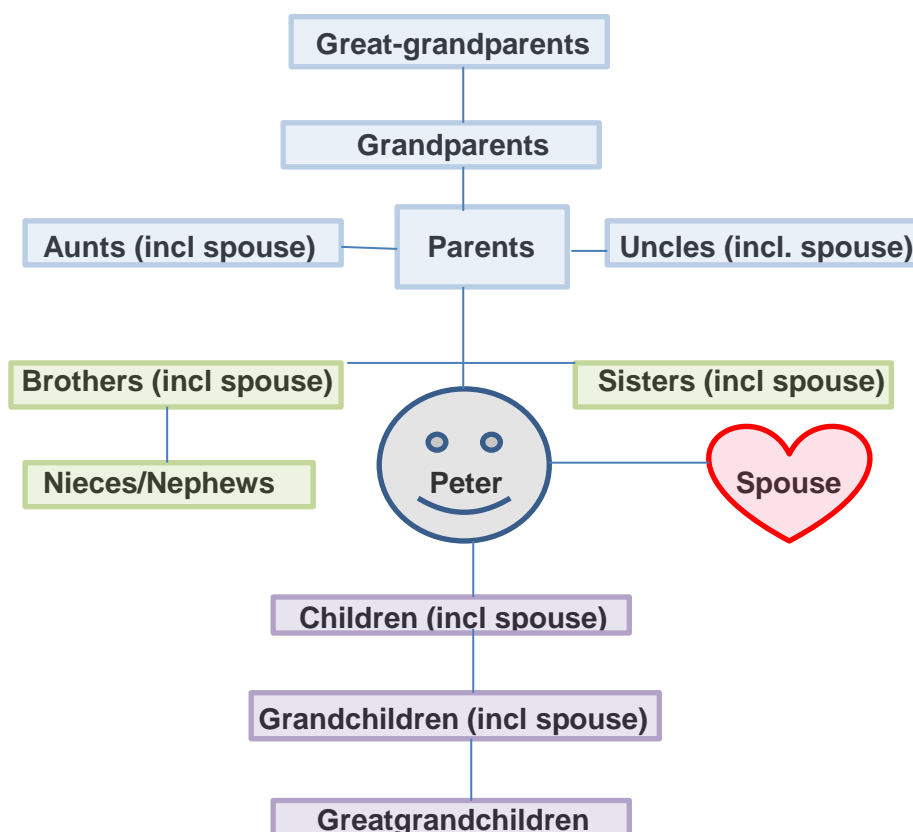
<sup>2</sup> See 1 above.

and “**married**”, “**husband**” or “**wife**” shall be construed accordingly: Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union out of community of property;<sup>3</sup>

Based on this definition the following will include connected persons in relation to a natural person:

- Children (first degree of consanguinity)
- Grandchildren (second degree of consanguinity)
- Great-grandchildren (third degree of consanguinity)
- Parents (first degree of consanguinity)
- Grandparents (second degree of consanguinity)
- Great-grandparents (third degree of consanguinity)
- Brothers and sisters (second degree of consanguinity)
- Nephews and nieces (third degree of consanguinity)
- Uncles and aunts (third degree of consanguinity)

**Example:** Peter is a beneficiary of the Rabbit Family Trust. If one of the following persons lent money to the trust, either in their personal capacity or via a company or acquired a claim in respect of a loan made to a trust, the transaction will be affected by section 7C:



<sup>3</sup> See 1 above.

**Note** – All persons related to the spouse to the third degree is also included in this application and will also be seen as a connected person in relation to Peter and therefore the trust.

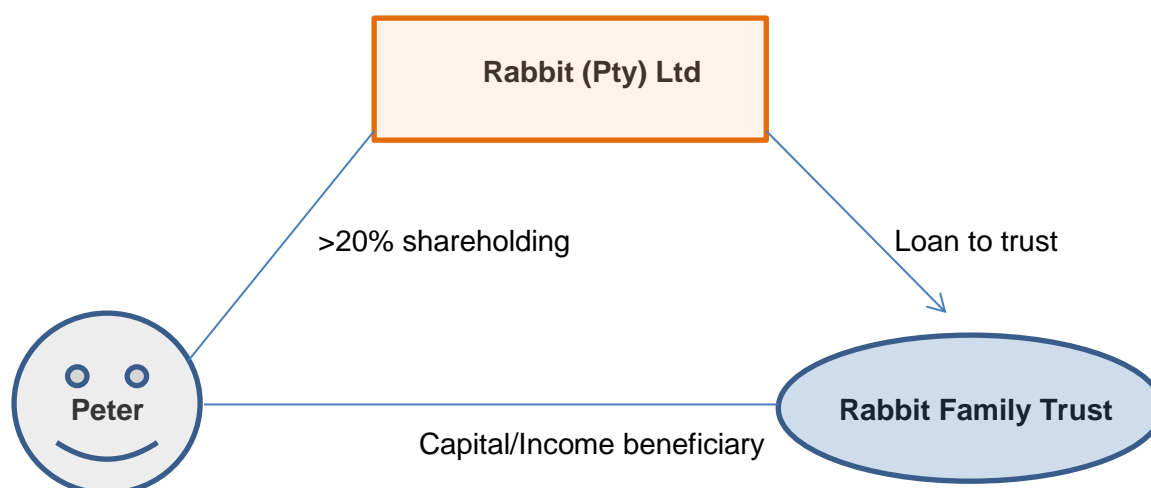
### Who is a connected person in relation to a company?

It will essentially include any person that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20% of the shares or voting rights in that company. In relation to a trust, it will be where the trust or the trust's beneficiary holds 20% shares or voting rights in the company.

Therefore, where that person holds less than 20% shares or voting rights in that company, that person is not a connected person in relation to the company and the provisions of section 7C will not apply.

Therefore, the following structure will also fall within the ambit of section 7C:

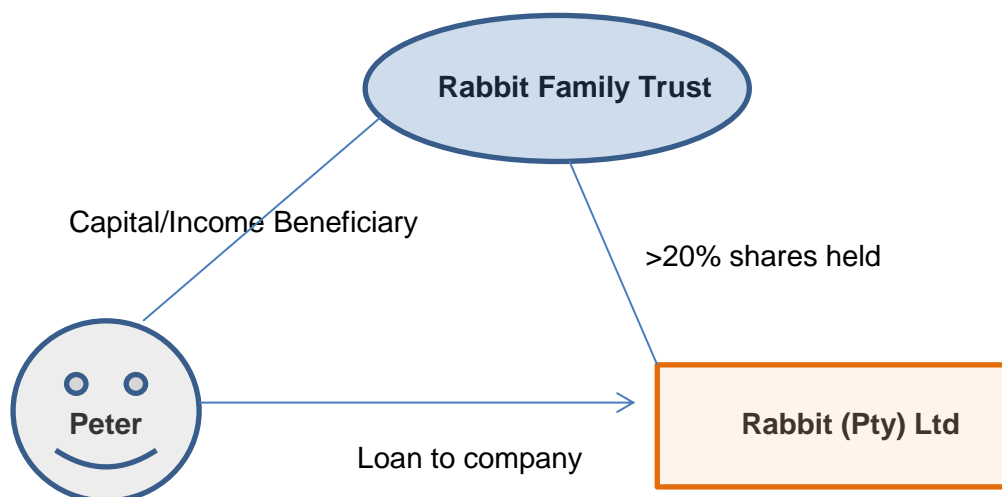
**Example:** Rabbit (Pty) Ltd is owned by Peter. The company has made a loan to Rabbit family trust of which Peter is a capital and an income beneficiary.



If all the requirements of section 7C are met, Peter may be liable for donations tax on the deemed donation triggered by the loan made to the trust.

Where the company is owned by the trust and a loan is made to the trust by this company, section 7C will also apply if the trust or a beneficiary of the trust holds 20% of the shares or voting rights in that company. The following example will illustrate this point:

**Example:** Rabbit Family Trust owns Rabbit (Pty) Ltd. Peter has made a loan to Rabbit (Pty) Ltd.



### What is an indirect loan?

An example of an indirect loan to a trust is where the connected person lends money to a third party with the understanding that that third party on-lends the funds to the trust – to overcome the connected person requirement – where the third party is required to cede the rights in terms of the loan to the connected person as security for the loan.

In this instance the connected person will still be viewed as the lender for purposes of applying section 7C.

**Example:** Peter and his spouse and children are beneficiaries of the Rabbit Trust.

Peter enters into a loan with a business partner, Paddington, who is not a connected person in relation to any of the trusts. He lends him R1 500 000. It is an interest-free loan that is payable on demand and subject to the condition that Paddington lends the R1 500 000 to the Rabbit Trust on the same basis (no interest and payable on demand). In addition Paddington has to cede the loan to Peter as security for the loan made between them.

In this instance the loan will still fall into the ambit of section 7C and Peter will still be viewed as the lender and he will still be liable for donations tax, as if he made the loan to the Rabbit Trust in his personal capacity.

### The deemed donation and donations tax payable

Once it is determined that a loan was made to a trust by a connected person in relation to that trust (or by a company that meets the requirements), one will determine if any interest is being charged on that loan. If no interest is charged, or if interest is charged at a rate less than 7.75% per annum (the current official interest rate), there will be a deemed donation.

If interest is charged at 7.75% per annum or in excess of 7.75% per annum, there will not be a deemed donation and section 7C will not apply.

The value of this deemed donation will be equal to either 7.75% per annum on the outstanding loan amount (in the case of a no interest loan), or the difference between 7.75% per annum and the actual interest rate being charged (in the case of the rate being less than 7.75% per annum).

Once the deemed donation is determined on the last day of the year of assessment, the lender will have to declare the donation to SARS.

Natural persons are entitled to a donations tax exemption of up to R100 000 per annum. Therefore the lender will only pay donations tax on the deemed donation insofar it exceeds R100 000. The result is that donations tax will only be payable on interest-free loans in excess of R1 290 322.50 ( $R1\ 290\ 322.50 \times 7.75\% = R100\ 000$ ).

Donations tax is levied at 20%.

**Example 1:**

Peter, a beneficiary of the Rabbit Family Trust (as indicated in the example above), lent R5 000 000 to the trust, charging no interest.

The deemed donation for that year of assessment will be equal to  $R5\ 000\ 000 \times 7.75\% = R387\ 500$ . Assuming Peter made no additional donations during the tax year, donations tax will be payable on R287 500 ( $R387\ 500 - R100\ 000$ ).

Therefore Peter will have to pay R57 500 donations tax.

**Example 2:**

Peter lent the trust R5 000 000 at an interest rate of 5% per annum.

The deemed donation for the year of assessment will be equal to:

$$\begin{aligned} &= (R5\ 000\ 000 \times 7.75\%) - (R5\ 000\ 000 \times 5\%) \\ &= R387\ 500 - R250\ 000 \\ &= R137\ 500 \end{aligned}$$

Assuming Peter made no other donations during the year, he will be liable for 20% donations tax on R37 500 ( $R137\ 500 - R100\ 000$ ). Therefore he will have to pay R7 500 donations tax.

**Example 3:**

Peter's great-grandmother lent money to the Rabbit Family Trust in 1987. The loan was for an amount of R1 000 000 and it was interest free. In her will she bequeathed the loan to Peter's mother, Angela, and therefore the trust now owes Angela R1 000 000. There is still no interest being charged on the loan.

Angela is a connected person in relation to Peter who is a beneficiary of the Rabbit Family Trust and therefore the loan will fall within the ambit of section 7C.

The deemed donation made by Angela to the trust is  $R1\ 000\ 000 \times 7.75\%$  per annum = R75 000. Assuming Angela made no other donations during the year, she will not have to pay any donations tax, as the total donation is less than the R100 000 annual limit.

**Example 4:**

Rabbit (Pty) Ltd lent R14 500 000 to the Rabbit Family Trust for investment purposes. The shareholders of Rabbit (Pty) Ltd are Peter's father (Pete) and his uncle (Andrew) and Peter himself. They each own 10% respectively. The remaining 70% is held by unrelated third person.

Rabbit company charges 4% per annum interest on the loan.

There will be deemed donation of R580 000 which is calculated as follows:  
 $= (R14\,500\,000 \times 7.75\%) - (R14\,500\,000 \times 4\%)$   
 $= R543\,750.$

As Peter, Pete and Andrew own 30% of the shares in Rabbit (Pty) Ltd, only 30% of the deemed donation is attributed to them in equal shares. Therefore R163 125 of the deemed donation will be attributed to them, which is equal to R54 375.

Assuming no other donations are made by any one of them during that tax year, no donations tax will be payable.

**Example 5:**

Peter lent R2 000 000 to Rabbit (Pty) Ltd. No interest is charged on the loan. Rabbit (Pty) Ltd is wholly owned by the Peter Rabbit Family Trust. Peter is a capital and income beneficiary in relation to the trust.

As Peter is a connected person in relation to the trust and the trust owns the company, the deemed interest of R155 000 is a deemed donation ( $R2\,000\,000 \times 7.75\%$ ). Donations tax will be payable by Peter on R55 000 ( $R155\,000 - R100\,000$ ) amounting to R11 000 ( $R55\,000 \times 20\%$ ).

**Example 6:**

Peter lent R12 000 000 to the Rabbit Family Trust. He got married to Sue on 1 August 2017. After they got married he donated the R12 000 000 loan to Sue to avoid the consequences of section 7C.

As Sue is a connected person in relation to Peter the consequences of section 7C will apply from the date of marriage, which is when she became a connected person in relation to Peter and the trust.

The deemed donation that Sue will be taxed on will be equal to  $R12\,000\,000 \times 7.75\% \times 7/12$ , which is R542 500 less R100 000 = R442 500. The donations tax on this amount will be equal to R88 500.



## The denial of tax losses or deductions

Section 7C(2) determines that:

- no deduction, loss, allowance or capital loss,
- can be claimed by the trust in respect of a disposal, including a way of a reduction or waiver, or the failure to claim for the payment,
- of any amount owing,
- in respect of a loan/advance/credit provided to the trust by a connected person.

Often lenders of no or low interest loans will cancel or waive a loan – effectively write the loan off – which results in the reduction of that lender’s asset base for estate duty purposes. To counter this method from being used to reduce estate duty, no deduction of this nature may be claimed in respect of interest-free or low interest loans made by connected persons to a trust.

## Excluded trusts

In terms of section 7(2)(5), the following trusts will not be affected by the provisions of section 7C:

- The trust is a public benefit organization as approved by the Commissioner in terms of section 30(3). Therefore, it includes all registered charities operated in trust that is approved by SARS.
- The trust is a small business funding entity approved by the Commissioner in terms of section 30C.
  - This is a trust that is approved by SARS and the main purpose of the trust is to provide funding to small and medium sized entities.
  - The Act contains all the requirements that the trust must meet to be approved as a small business funding entity and when in doubt it will be required to confirm approval with the auditor and tax practitioner of the trust.
- Employee share scheme trusts where all the requirements as set out in the Act are met. The requirements are as follows:
  - The trust that is created solely for purposes of giving effect to an employee share incentive scheme in terms of which that loan, advance or credit was provided by a company to that trust for purposes of funding the acquisition, by that trust, of shares in that company or in any other company forming part of the same group of companies as that company.
  - Shares may only be offered by that trust to someone by virtue of that person being in the full-time employment of a company or holding the office of director of a company.
  - A person that is a connected person in terms of paragraph (d)(iv) of the definition of “connected person” in relation to a company or any other company forming part of the same group of companies as that company (i.e. a person that holds at least a 20 per cent interest either individually or collectively with connected persons) may not participate in that scheme.

- The trust is a special trust as defined in paragraph (a) of the definition contained in the Act.
  - This is therefore limited to apply in respect of special trusts set up for disabled beneficiaries.

In addition, the following loans will also be excluded from the consequences of section 7C:

- The loan was provided to the trust by a person with a vested interest in the trust or in return for a vested interest in the trust, and
  - the beneficiaries of the trust hold a vested interest in all the income and assets of the trust, and
  - no beneficiary of the trust can hold or acquire an interest in the trust other than a vested interest in all income and assets of that trust, and
  - the vested interest of each beneficiary is determined solely by reference to and in proportion to the assets, services or funding contributed by that beneficiary to that trust, and
  - none of the vested interests held is subject to a discretionary power of the trustees.

Note that the trust envisaged above does not necessarily include all vested trusts and is specifically aimed at trusts where the beneficiary's interest is determined by their contribution made to the trust. This would typically be a business trust where the beneficiary is also generally the trustee and all the beneficiaries share in the profits and losses of the trust based on the vested right they hold.

The exclusion will also apply in respect of *bewind* trusts where the beneficiary of that trust makes a loan to the trust that is interest-free or a low interest loan.

- The loan was wholly or partly used to fund the acquisition of a property used as a primary residence by that person (the lender) or that person's spouse and the loan relates to part of that loan that funded the acquisition of the property.

**Example:** Peter lends money to his family trust and the trust uses the loan to purchase a property and Peter (or his spouse) uses the property as their primary residence.

Peter lent the trust R3 000 000 and the trust acquired a property for R2 000 000, that is used as a primary residence, and applied the remaining R1 000 000 for other investments.

The exclusion will only apply towards the R2 000 000 applied to acquire the property. The normal consequences of section 7C will apply in respect of the R1 000 000 applied for other purposes.

- The loan is an affected transaction as defined in section 31(1) of the ITA (transfer pricing provisions);
- The loan was provided to the trust in terms of an arrangement that is a Sharia compliant finance arrangement as contemplated in section 24JA, had the trust been a bank;

- The loan is subject to the provisions of section 64E(4). This is where a loan is made to a trust by a company and this section deems that loan as a dividend.

Therefore, any loan made by a connected person to any of the trusts listed above or for the purposes listed above will not result in a deemed donation and no donations tax will be payable. Therefore no-interest or low-interest loans can be used to fund these trust structures without any donations tax implications.

### **Distributions to beneficiaries**

Where income or capital is irrevocably vested in a beneficiary but not physically paid to that beneficiary will not be regarded as a loan account for the purposes of section 7C.

#### **Example:**

The trustees of Rabbit Family Trust decides to vest R1 000 000 of the trust's income in Peter during the tax year. However, instead of paying Peter the amount of money, they retain it in the trust. So effectively the trust holds the funds on behalf of Peter.

To ensure that this vested amount does not constitute a loan for the purposes of section 7C, the following factors should be present:

- The vested amount may not be paid to that beneficiary until the happening of a certain event or certain age as provided for in the trust deed, or
- The trustees must have the full discretion to determine when payment is eventually made to the beneficiary, and
- The retention of the vested amount in the trust was not at the instance of the beneficiary, and
- The trustees will manage and administer the vested amount for the benefit of that beneficiary.

The circumstances should support the fact that there was no intention by either party's to enter into a loan agreement.

It is important that estate planners and their trust administrators review their financial statements to ensure they clearly indicate that such amounts owing to beneficiaries are not loans but in fact vested income/capital not yet paid. In certain instances corrective measures may be necessary to change the wording on the financial statements. Such amounts should not be noted as loans but rather as vested amount retained for the benefit of a specific beneficiary.

The trust deeds should also be reviewed to determine whether the deed gives the trustees the power to distribute income and/or capital to beneficiaries without paying it to them and the discretion to determine when such payment is made. Where possible, trust deeds that do not include this power should be amended.

### **What are the options to counter the consequences of section 7C?**

There are no 'one-size fits all' solutions that will eliminate the consequences of section 7C and each client's circumstances will have to be assessed to determine which of the following alternatives will be best suited.

Please involve the client's accountant/auditor and attorney in the process of investigating the alternatives and obtain the services of a fiduciary specialist (Momentum Trust) to ensure that all the consequences of each action are known upfront.

### **1. Repay the loan account/reduce the loan**

The trust can repay the loan account to the lender in full or to the extent that the loan amount remains at R1 290 322.50. In most cases this will require that the trust liquidates some of its assets to obtain the funds necessary to repay the loan. The trust can also consider transferring assets to the lender as repayment of the loan

One should be aware of the possible costs associated with the disposal/transfer of assets – capital gains tax, transfer duty, conveyancing costs, etc.

Where the loan is relatively small in relation to the trust's assets, this can be a viable alternative, as the benefits associated with the trust will still apply in respect of the remaining assets.

### **2. Donation between spouses**

Donations tax is only payable where the loan is in excess of R1 290 322.50 (assuming the lender does not use the R100 000 annual donation exemption for other purposes). Where the loan is in excess of this amount, the lender can donate a portion of the loan to their spouse – limited to an amount of R1 290 322.50.

There is no donations tax payable where donations are made between spouses.

The result will be that the spouse can use their annual R100 000 tax-free donation in respect of this portion of the loan, effectively reducing the donations tax payable by the lender by maximum of R20 000.

Example: Jack and Jill are married. Jack lent R2 500 000 to the Jack Family Trust, interest free. Based on an official rate of 7.75%, the deemed interest on the loan that will be treated as a donation, is R193 750. Jack will pay donations tax on the amount in excess of R100 000 which will amount to R18 750.

If Jack donates 50% of the loan amount to his wife, Jill, both will have a loan to the trust of R1 250 000. The donation made by Jack to Jill will not be subject to donations tax due to the exemption applicable between spouses. Jack and Jill will both be deemed to have donated R96 875 to the trust. As this amount is less than R100 000, the annual donation exemption, no donations tax will be payable.

When the portion of the loan is donated to the spouse, it is an asset in the estate of that spouse and that spouse's creditor will be able to lay claim to that asset in the event of sequestration. It remains an asset in the estate of that spouse in the event of divorce as well. In the event of death it will also be part of that spouse's deceased estate. In general the will should determine that the loan account is bequeathed back to the trust. This bequest should not trigger estate duty due to the R3 500 000 abatement available to that spouse and will not trigger capital gains tax either.

### **3. Charge interest on the loan**

The lender can prevent the application of section 7C by levying interest on the loan of 7.75% per annum.

The trust will have to pay the interest to the lender, which will require positive cash flow. It is unlikely that the trust will enjoy a tax deduction for the interest paid, unless the trust applied the loan to generate taxable income – section 11(a) determines that expenses made in the production of income will be tax deductible.

The cost comparison of the two alternatives, assuming a loan of R5 000 000, is as follows:

**Section 7C deemed donation on a zero interest loan:**

The deemed interest (@7.75%) on the loan is R387 500. If one takes the annual exemption iro donations into account (R100 000), it will result in R287 500 being subject to donations tax. Therefore the lender will be liable for R57 500.

**Interest charged @ 7.75% per annum:**

The trust will have to pay the lender R387 500 per annum. This will be gross income in the hands of the lender and the annual interest exemption will apply. Therefore the taxable interest is R363 700 (assuming the lender is under 65 and the interest exemption is R23 800). The income tax payable will be as follows:

@ marginal rate of 18%	-	R 65 466
@ marginal rate of 30%	-	R109 110
@ marginal rate of 45%	-	R163 665.

To determine which option is the most viable, the size of the loan and the marginal tax rate of the lender will be the deciding factors. However, in most cases the application of section 7C will be the most cost-effective.

#### 4. Outright donation vs deemed donations when making new loans

Instead of 'selling' assets to the trust or lending funds to the trust to acquire assets, the estate planner can consider donating the asset/cash amount to the trust from the outset. Therefore pay the donations tax on the full value transferred to the trust upfront rather than setting up the interest-free loan.

The following table will compare the actual cost associated with both options.

It is assumed that the estate planner wishes to transfer R5 000 000 to the trust.

Outright donation		Interest-free loan triggering section 7C	
Donated amount	R5 000 000	Deemed interest @ 7.75%	R387 500
Less tax-free donation	<b>R100 000</b>	Less tax-free donation	<b>R100 000</b>
Taxable donation	R4 900 000	Taxable donation	R287 500
<b>Donations tax @ 20%</b>	<b>R980 000</b>	<b>Donations tax @ 20%</b>	<b>R57 500</b>
<b>It will take 17 years before the deemed interest donations tax amount equals the donations tax payable when doing the outright donation.</b>			

To determine which option is more viable, the size of the asset/loan and the age of the estate planner will play a role in deciding which option will be more viable.

#### The relevance of section 7D on loans to trusts

There is a rule of law referred to as the *in duplum* rule. This rule provides for interest and finance costs to stop accruing in respect of a loan when the total of these amounts equal the

capital portion of the debt – so the total interest charged on the debt cannot exceed that actual capital amount owing.

The introduction of section 7D (effective 1 March 2018) results in this rule not being relevant in respect of various anti-avoidance provisions (which includes section 7C) regarding the use of low or zero-interest loans.

When applying section 7C and calculating the deemed interest, the *in duplum* rule will result in the total (deemed) interest calculated to be capped at an amount equal to the actual capital amount that was lent. This would result in the deemed interest amount being limited over the lifetime of the lender and render section 7C ineffective at some point in the future. Therefore this rule cannot apply in instances where section 7C applies – to prevent this ‘cap’ from applying.

The following example will highlight the point:

Mr. T Rust has lent his trust R10 000 000 on an interest-free basis. For the purposes of section 7C, the annual deemed interest amounts to R775 000 per annum (at 7.75%). The *in duplum* rule will cap the maximum deemed interest amount to R10 000 000. The result would be that section 7C will no longer be effective after 12.9 years (which is when the deemed interest is equal to the capital sum lent) and there will no longer be any deemed donation.

The introduction of section 7D prevents this rule applying in this instance, and therefore donations tax will be levied on the deemed donation until such time as the debt is cleared or the loan is bequeathed to a person that is not a connected person in relation to the trust.

### **Is there a future for the discretionary trust as an estate planning tool?**

It is very important to have a clear vision of why a trust was/is being introduced into a client’s financial plan. If it is merely to save taxes, the trust might not serve that purpose.

However, if the client requires:

- asset protection against creditors and beneficiaries alike,
- estate planning for future generations,
- continuity and unhindered continuity of business assets,
- ease of estate administration upon the death of the estate planner, and
- the limitation of estate duty that will come with long term planning,

then the trust is still a viable estate planning tool.

The unbundling of trust structures should not be considered without careful consideration, ensuring that the impact on the overall estate planning objectives are clearly set out and the cost of this unbundling be weighed up with the long terms benefits thereof. It can be a costly exercise that might result in unwanted consequences.

Momentum Trust provides the services of Senior Fiduciary Specialists that can assist in advising the clients.

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