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New rules on loans to trusts

Amendment bill proposes further tax liability extensions

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Section 7C of the Income Tax Act 58 of 1962 was introduced earlier in 2017 and applies to loans made to trusts interest-free or at a rate lower than the official rate of interest as defined in paragraph 1 of the seventh schedule to the act.

In terms of section 7C, with effect from March 1, an amount equal to the difference between the interest charged by the lender or holder of the loan and the official interest rate will be treated as a donation made to the trust by the lender or holder of the loan. The interest forgone will be treated as an ongoing and annual donation made to the trust on the last day of the trust's year of assessment and taxed as such at the rate of 20%.

On July 19, the National Treasury published the Draft Taxation Laws Amendment Bill 2017. The bill proposed that section 7C be extended so as also to apply to interest-free or low-interest loans, advances or credit that are made by a natural person or a company to a company that is a connected person in relation to a trust.

In addition, where the initial loan claim to the trust is transferred to another natural person, the transferee of the loan claim is deemed to have made a loan to the trust or company on the date the loan claim was acquired from the transferor. Important to note is that the abovementioned proposals will not apply to loans provided to trusts used in employee share schemes, provided that:

- The trust was created solely to give effect to an employee share scheme in terms of which the loan was provided by a company to the trust to enable the trust to acquire shares in the lending company or any other company in the same group as the lending company (scheme company);
- Shares or other equity instruments that relate to or derive their value from shares in a company may only be offered by that trust to someone by virtue of that person being a full-time employee or being a director of a company; and
- If a person is a connected person in terms of paragraph (d)(iv) of the act's definition of "connected person", in relation to a company, or any other company forming part of the same group of companies, such person may not participate in the scheme.

As it currently reads, employee share schemes will not be negatively affected by the proposed amendments. The bill, proposes measures to curb the use of trusts in anti-avoidance schemes. It seeks to close the loophole of using a company as a vehicle through which interest-free or low-interest loans are made to trusts which, in certain instances, leads to the avoidance of tax.

As the bill currently reads, the proposed amendments were set to be effective from July 19 2017 in respect of any amount owed by a trust or a company in respect of a loan, advance or credit provided to that trust before, on or after that date.

CLOSING A LOOPHOLE

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EMPLOYEE SHARE SCHEMES WILL NOT BE NEGATIVELY AFFECTED BY THE PROPOSED AMENDMENTS