Davey's Locker

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Section 7C of the Income Tax Act revisited

by Tony Davey

I covered the new s 7C of the Income Tax Act, effective as from 1 March 2017, in 162 *TSH* 2016.

In essence, donations tax is levied annually on the provision of an interest-free or soft loan by a natural person (or such a person's connected person) to a domestic trust, if the interest rate charge is less than the 'official rate of interest', currently 8% a year (160 *TSH* 2016).

The effective maximum rate is thus 1,6% a year of the outstanding loan capital, being 20% (donations tax rate) of 8% (official rate).

Bequest of an existing loan

Section 7C(1) refers to circumstances in which a person 'directly or indirectly provides to a trust' 'any loan, advance or credit'.

In my view, it is couched in sufficiently broad terms to include an inherited loan, since an heir, in either not calling up the loan or not charging interest, will be providing finance.

But there would be no liability if a lender bequeaths such a loan to the trust, thus extinguishing the debt.

Repayment by the trust

A full cash repayment extinguishes the s 7C charge but payment by way of the cession of trust property could create other tax consequences.

First, a cession of trust property as security only, being in law merely a pledge, does not transfer ownership and thus does not amount to repayment. The cession must therefore be absolute (or outright).

If the property ceded is an endowment policy, an effective repayment for purposes of s 7C, will be achieved. Moreover, para 55 of the Eighth Schedule to the act exempts the disposal of qualifying life policies from the CGT. But the lender will acquire a so-called second-hand policy, which is tax-inefficient, since para 55 applies (subject to some exceptions) only to the original policy-owner. Thus the lender will suffer both the underlying normal tax paid by the insurer (under the four-fund tax principle) and CGT upon the eventual surrender or maturity of the policy.

Calculation basis

Section 7C(3) refers to the interest difference as 'a donation made to that trust…on the last day of that year of assessment of that trust'. Under s 24J, [targeted] interest accrues on a day by day basis. In my view, this reference to the last day of the year of assessment merely sets the last day for purposes of the year, of the daily computation.

On this basis, the repayment of the

loan on the last day of the year of assessment does not obviate the accumulated daily interest charge.

(Some colleagues have a more generous view, to the effect that, if repayment is made before the last day of year of assessment, there is no donation.)

R100 000 exemption

Fortunately, this exemption, under s 56(2)(*b*), is no longer excluded, as it was under previous drafts of s 7C. Thus R100 000 of the value of such a donation might be exempted.

On an interest-free loan, the exemption translates to a capital value threshold-level of R1,25 million, since 8% of this amount equates to R100 000.

[My views on s 7C differ dramatically, although not necessarily on all the issues raised here.—Ed]

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