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Loans between trusts

Yet more on s 7C of the Income Tax Act

by Tony Davey

In essence, s 7C of the Income Tax Act subjects to an annual donations tax, effective as from 1 March 2017, an interest-free or low-interest loan to a resident trust. The effect of applying the 20% donations tax rate to the 8% 'official rate' (less the interest paid), is a maximum annual donations tax of 1,6% of the loan.

Nature of lender

Section 7C applies to a loan provided by either a natural person or a company, if the natural person is the company's 'connected person', as defined for this particular purpose.

It follows that, if a trust lends monies to another trust, *prima facie*, s 7C(1)(*a*) and (*b*) do not apply, since the lender is not a natural person or a company.

Directly or Indirectly

But s 7C refers to a loan made by a natural person or company 'directly or indirectly'.

Thus, according to the relevant *Explanatory Memorandum*, if a natural person provides a loan to Trust A, which in turn provides a loan to Trust B, the loan, being an indirect loan, is subject to the application of s 7C.

On the other hand, if Trust A uses its own capital and reserves (capitalized investment earnings and trade income), I see no indirect loan being advanced.

Conclusion

Inter-trust loans are unaffected by s 7C, provided the lender trust uses its own capital and reserves. To the extent the capital and reserves are insufficient to fund such loans, SARS might challenge the loan as being indirect and subject to the application of s 7C.

Given the facts that this is new legislation and that there is currently no decided tax case law or any published rulings illustrating the approach of SARS to inter-trust loans, I would adopt a prudent, cautious approach by confining such loans to an amount equal to a trust's own capital and reserves.

[And I would be questioning why and at whose instance Trust A has come to be lending money to Trust B.—Ed]