BAKER TILLY
MORRISON MURRAY

Registered Auditors
Chartered Accountants (SA)

NEWSFLASH!

Dear Client

Trusts are currently in a state of change. Over the last few years, much has been written about what should be changed and how it should be done. Up until now, it has just been proposals. With the release of the Taxation Amendment Act of 2016, we no longer just have proposals and have moved into the realm of concrete legislative change.

Amendment as contained in the legislation

The focus of these amendments is with regards to loans, specifically interest free loans or loans where the interest charged is below the official rate of interest. These loans are ones granted by natural persons to trusts, or where the loan is from a company that is a connected person to either the trust or the beneficiaries.

The effective date for these changes is 1 March 2017 for all loans that are paid or become due and payable after this date. From that date, interest must be charged on the loan at the official rate of interest (currently 8%). If interest is not charged then a deemed interest donation will be calculated at a rate equal to the official rate of interest less any interest actually paid on the loan. This excess interest is then subject to Donations Tax at 20%.

The net result of these changes will be quite far reaching. A calculation has been attached below to illustrate the impact where no interest is charged on the loan :

Loan amount	R16 000 000.00	R16 000 000.00
Donation		
Deemed Interest @ 8%	R1 280 000.00	R1 280 000.00
Less annual exemption	R100 000.00	R0.00
Dutiable amount	**R1 180 000.00**	**R1 280 000.00**
Donations Tax @ 20%	R236 000.00	R256 000.00
Effective tax rate	1.48%	1.60%

This is an annual charge. Fortunately we are not yet required to compound this on a monthly basis, although that may change. In addition, some loans are exempt from s 7C. This exemption applies where:

- the trust is a public benefit organisation approved by the Commissioner;
- the loan, advance or credit was provided to that trust by a person by reason of or in return for a vested interest held by that person in the receipts and accruals and assets of that trust
    - The legislation is very specific - everything must be vested and absolutely no discretion allowed;
- the trust is a special trust for the benefit of someone with a disability;
- the trust used that loan, advance or credit wholly or partly for purposes of funding the acquisition of a primary residence;
- the loan, advance or credit is subject to the transfer pricing provisions of s 31;
- that loan, advance or credit was provided to that trust in terms of an arrangement that would have qualified as a sharia compliant financing arrangement as contemplated in section 24JA, had that trust been a bank as defined in that section; or
- that loan, advance or credit is subject to the deemed dividends rules of section 64E (4).

What does this mean for your trust?

All beneficiaries and trustees should review the loans in their trusts and come up with an action plan for how they are going to deal with the additional tax charge.

PO Box 1098, Westville, 3630, South Africa

T: +27 (0)31 267 5300 F: +27 (0)31 267 1838

mail@bakertillymm.co.za
www.bakertillymm.co.za
An independent member of Baker Tilly International

Matters to be considered

- Repayment of the loans.
- Setting off credit and debit loans in the Trust.
- Reorganisation of the loans so that a company loans the money to the Trust rather than an individual. Dividends Tax at 15% is still cheaper than Donations Tax at 20%.
- Charging of interest on the loans at the official rate of interest, where appropriate.
- Changes to your trust deed to provide the trustees with the discretion to vest amounts and to determine the date of payment for discretionary trusts. Please see below for more detail.

What about unpaid distributions?

Amounts owing to beneficiaries as a result of unpaid distributions are currently an area of significant uncertainty. Please note that an Explanatory Memorandum carries no legal weight when it comes to the interpretation of statute. It merely provides insight into the thinking of National Treasury when the legislation was written. SARS are in the process of drafting an Interpretation Note that deals with this new provision which should provide greater clarity on the treatment of unpaid beneficiary distributions in the future.

The Explanatory Memorandum does however provide some clues on how these distributions could be moved out of the ambit of s 7C. Please refer to the following extract on Section 7C:

> The proposed rules will apply only in respect of loans advanced or provided by a natural person or, at that person's instance, by a connected company. An amount that is vested irrevocably by a trustee in a trust beneficiary and that is used or administered for the benefit of that beneficiary without distributing or paying it to that beneficiary will not qualify as a loan or credit provided by that beneficiary to that trust if
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> - the vested amount may in terms of the trust deed governing that trust not be distributed to that beneficiary, e.g. before that beneficiary reaches a specific age ; or
> - that trustee has the sole discretion in terms of that trust deed regarding the timing of and the extent of any distribution to that beneficiary of such vested amount.
>
> An amount vested by a trust in a trust beneficiary that is not distributed to that beneficiary will, however, qualify as a loan or credit provided by that beneficiary to that trust if that non-distribution results from an election exercised by that beneficiary or a request by that beneficiary that the amount not be distributed or paid over, e.g. if the beneficiary has reached the age at which a vested amount must be paid over or distributed to him or her and
>
> - the trustee accedes to a request by that beneficiary that this not be done ; or
> - the beneficiary enters into an agreement with the trustee in terms of which the amount may be retained in the trust.

The gist of this is that s 7C will apply wherever a beneficiary has a right to claim or demand payment from the Trust. Where the beneficiary has no such right, then no loan or credit exists, therefore s 7C should not apply.

Please review your Trust Deed to see what clauses are included regarding the payment of distributions to beneficiaries. It may be that the unpaid distributions will not attract s 7C.

Disclaimer:
The content of this leaflet is intended as information only and does not constitute tax advice. Please contact the relevant partner if specialist advice relating to your specific circumstances is needed.

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