PROPOSED CHANGES TO TAX LAW IN SOUTH AFRICA: INTEREST-FREE LOANS AS A TOOL IN ESTATE PLANNING?

M. J. Preston
North-West University (Vaal Campus), South Africa
E-mail: marie.preston@nwu.ac.za

H. Kloppers
North-West University (Potchefstroom Campus), South Africa
E-mail: Henk.Kloppers@nwu.ac.za

─Abstract ─

Estate planning often involves the sale of an asset by an estate planner (the owner of the asset) to an *inter vivos* trust, as a related family trust. It also often happens that the buying trust does not have the necessary funds to pay the purchase price. In this situation it is common practice to finance the sale by means of an interest-free loan agreement. The buying trust becomes the owner of the property, while the purchase price remains due and payable to the seller, without the loan amount accruing interest. The result achieved by the estate planner is that potential further growth of the asset soldis shifted to the trust, resulting in an estate duty benefit for the seller. The debate surrounding the use of the interest-free loan as an estate planning tool has been polarised for years with most researchers concluding that the interest-free loan remains a useful estate planning tool. Doubts regarding the use of such agreements and the trust for estate planning have recently neem renewed. Since 2013, several statements by the different Ministers of Finance, in their respective budget speeches, indicated that government will propose tax avoidance legislation that will directly impact the taxation of trusts and connected parties to a trust. This study will focus on the effect which the recent proposed changes to the Income Tax Act (58 of 1962) might have on the use of interest-free loans as an estate planning tool. The study is qualitative in nature with document analysis at its core. The main aim is to provide more clarity to estate planners in this regard. The research concludes that the interest-free loan still has some advantage as an estate planning tool, but if estate planning is done with only tax planning and tax savings as motivation, that advantage may disappear.

Key Words: *Trusts, interest-free loans, income tax, taxation, estate duty, Wealth tax*

JEL Classification: H21, H24, K34

1. INTRODUCTION

When referring to estate planning, many estate planners mainly have tax planning and more specifically the minimisation of estate duty in mind (Burger, 2011).

One of the estate planning vehicles often used in the drafting and later execution of an estate plan, is the trust. Assets are transferred by the estate planner, which can be either the creator of the trust or another donor (usually a person connected to the beneficiaries of the trust), to the family trust. The transfer of ownership of these assets would normally have been done by way of a donation agreement or a sale agreement. The agreement of sale would usually link with a loan agreement, since the purchasing trust often does not have the financial means to pay for these assets (Carrol, 2010; Olivier, Strydom and Van den Berg, 2011; Preston 2014). It can be expected that the loan agreement will stipulate that no interest is payable on the outstanding capital, or that interest at a lower than market related rate is levied. In this way the estate planner has managed to remove the assets, which could potentially increase in value, from his estate and replaced them with a loan account with little or no growth potential. (Carrol, 2010; Olivier *et al,* 2011; Ostler, 2013)

The ease with which assets could be removed from the estate planner's estate, as explained above, made the interest-free loan agreement, the "most frequently used estate planning tool" for many years (Preston, 2014:1). It was also generally accepted that this arrangement will not have any tax consequences for the recipient of the interest-free loan (West and Surtees, 2002; Preston, 2014). However, the Government was of the opinion that these estate planning tools were abused so as to avoid the paying of tax (2013 Budget Speech). Financial planners have thus been expecting for the past nine years that such planning methods might not remain a viable tax-saving option for long. That expectation may be realised on 1 March 2017 if the new proposed section 7C of the Income Tax Act (58 of 1962, hereafter referred to as ITA) (Second Draft Bill, 2016) is accepted in its current form.

In the light of the above, the following research question is raised: Can the interest-free loan still be used as an estate planning tool? The aim of this study is thus to clarify some of the uncertainties that exist with regards to the current and future taxation of trusts and the future of the interest-free loan, as estate planning tool, for financial and estate planners.

In the following sections the use of the interest-free loan in estate planning, as well as the events that lead to the proposed changes to the ITA are explored.

2. LITERATURE REVIEW

In the past ten years, several events have shaken the foundations of financial and tax planners[1], and forced a rethink of estate planning strategies - especially the use of interest-free loans. One such event was the Supreme Court of Appeal's ruling in the case of the Commissioner for the South African Revenue Service v Brummeria Renaissance (Pty) Ltd (2007) (Brummeria case) (Preston, 2014). The court was confronted with the question whether the benefit of an interest-free loan had a taxable value for the lender. Since then, but especially since the 2013 annual Budget Speech delivered by Minister Gordhan, financial planners and writers have widely speculated that the use of trusts and the interest-free loan, as estate planning tools, was coming to an end. Minister Gordhan stated that "the Budget Review outlines various measures proposed to protect the tax base and limit the scope for tax leakage and avoidance. The taxation of trusts will come under review to control abuse" (2013:21). Press and academia were sceptical as (apart from the brief statements in the Budget Speeches) no draft legislation, outlining possible changes to related tax legislation, had been promulgated. Opinions were based on the words of Minister Gordhan quoted above as well as his comments in the 2016/2017 Budget Speech, with the emphasis on the fact that wealth taxes are under review and that Government will "continue to act aggressively against the evasion of tax" (2016:16). The opinions were also based to some extend on comments by the Davis Tax Committee (DTC) (DTC: 2014 & 2015).

In July 2016 the Government, with the release of the draft on the new section 7C of the Income Tax Act (58 of 1962) (ITA), indicated how the use of interest-free loans as an estate planning tool will be impacted (Draft Bill, 2016).

Before the importance of the Brummeria case and current and proposed legislation is considered, it is necessary to highlight the nature and main aim of estate planning.

Estate planning has been defined as "the arrangement, management, securement and disposition of a person's estate so that he, his family and beneficiaries can enjoy and continue to enjoy the maximum benefits from his assets or estate during his lifetime and after his death" (Olivier *et al*, 2011:8-4; Rabenowitz, 2013:851). If estate planning is done with the emphasis on succession planning, the aim will be to ensure that "succession take place in a way that minimises taxes and costs,

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[1] *If referred to hereafter to only financial planners it will include by implication also tax- and estate planners.*

and adequately protects the inherited assets" (Rabenowitz, 2013:851). Hence, the main objective of estate planning is rather to provide for future maintenance of the estate planner and his[2] family as well as the protection of assets. In this regard Jurinski and Zwick (2013:53) cautioned that estate planning cannot be seen as an action to minimise tax, because "tax laws, financial conditions, or family dynamics" might have changed by the time that the estate plan is executed.

Apart from a valid will, several estate planning vehicles (e.g. the trust and a company) might form part of the estate plan to enable the planner to reach the main objective mentioned above. As was explained previously, an interest-free loan is often used to move assets from the planner (hereafter referred to as the donor) to for example the trust. For many years financial planners believed that the use of the interest-free loan as estate planning tool would not have any tax consequences for the recipient of the loan (Smit, 2008). With the judgement delivered in the Brummeria case, this was not true for all situations anymore, and many financial planners had to reconsider these plans. This ruling sparked much research into the potential impact of this judgement on the use of interest-free loans. (Dachs (2008), *Brummeria prompts talk*; Jansen van Rensburg (2008); *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd and Other: Does the judgement benefit an understanding of the concept 'amount'?* Cohen (2009); *Does Brummeria Sweep Clean?*, etc.)

The Brummeria group of companies were involved in the development and running of retirement villages. In order to get finance for the development of the residential units, the companies entered into an interest-free loan agreement with a potential occupant. As *quid pro quo* (in exchange) for the right to use the money free of an interest charge, the lender (potential occupant) would acquire the life-long right of "occupation of the unit, whilst ownership remained with the company" (Brummeria 2007:603; Interpretation note no. 58: 2010).

The Supreme Court of Appeal (SCA) was faced with the question of whether the right to use the loan capital free of any interest obligation could be valued and therefore could be taxable in the hands of the borrower (Brummeria 2007). Judge Cloete remarked: "Indeed, it can hardly be doubted that, in the modern commercial world, a right to retain and use loan capital for a period of time, interest-free, is a valuable right. The basis, upon which the Commissioner valued that right in each particular year of assessment in the further revised assessments,

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[2] *The words 'him' or 'his' will include not only the male form, but also includes by implication the feminine form.*

was not challenged on appeal." (Brummeria 2007:609). The result was that the SCA concluded that this right had indeed "an ascertainable value that accrued to the taxpayer and must be included in the gross income of the taxpayer (the Brummeria companies)" (Brummeria 2007:614).

The judges in the Brummeria case (Brummeria 2007:607) referred to Judge Hoexter's comments in the case of Commissioner for Inland Revenue v Berold (1962:753): "[The] making of an interest-free loan constitutes a continuing donation to the borrower which confers a benefit upon such borrower". This statement was apparently taken seriously by the tax authorities.

Before the influence of the Brummeria case, and the new proposed section 7C of the ITA can be considered, the current taxation law as well as the draft section 7C of the ITA must be outlined.

3. CURRENT AND PROPOSED LEGISLATION

3.1 Current legislation

Due to the limitations of the study the author is not able to address the workings of the current law as contained in sections 7 and 25B of the ITA, in detail. A quick overview is given on how income received by a trust is taxed in the hands of the donor.

Section 25B(1) of the ITA stipulates: "Any amount received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust"

In the current legislation sections 7(2) up to 7(8) (ITA) will only apply if income received by a taxpayer (beneficiary of a trust) "was derived by the recipient in consequence of a donation, settlement or other disposition made by the donor" of an asset in favour of the trust. The meanings of these words are wide enough to include the sale of an asset on an interest-free loan account (Carrol, 2010; Peterson, 2013). It is also important that there should be "a causal connection" between the donation, settlement or other disposition of an asset and the income received by a taxpayer (beneficiary of a trust). The income so derived by the trust

and distributed to the beneficiary (depending on the nature of the beneficiary (as specified under each of the applicable sections 7(2) up to 7(8) of the ITA), will only then be deemed to be the donor's income and therefore be taxed in the hands of the donor (Commissioner for Inland Revenue v Widan 1955; Olivier *et al,* 2011). This implies that the income in question should have been generated by the asset sold on an interest-free loan account to a trust. If for example the beneficiary of the trust, who has a vested right in this income, is the minor child of the seller/donor, section 7(3) of the ITA will deem this income so derived (because of the causal connection) to be that of the donor parent. This income will then be taxed in the hands of the donor and not the minor beneficiary (Carrol, 2010).

In addition to the current sections 7 and 25B of the ITA, the legislator published a draft of section 7C of the ITA which will be reviewed in the next paragraph.

3.2 Proposed legislation

On 8 July 2016 the Minister of Finance published the "Draft Taxation Amendment Bill" (Draft Bill 2016) for 2016. After comment was received from the public, a new draft was published on 23 September 2016 (Draft Taxation Laws Amendment Bill, 2016 (Second Batch) (Second Draft Bill, 2016). On page 2 of the Second Draft Bill (2016) a new section 7C, which reads as follows, is proposed[3]:

"**7C.** (1) This section applies in respect of any loan, advance or credit that—

(a) a natural person; or

(b) at the instance of that person, a company in relation to which that person is a connected person in terms of paragraph *(d)*(iv) of the definition of connected person,

directly or indirectly provides to a trust in relation to which that person or company, or any person that is a connected person in relation to that person or company, is a connected person. ....

(3) If a trust incurs—

[3] *It should be noted that only the relevant subsections of section 7C of the ITA are quoted here. The complete section 7C can be retrieved from:* http://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2016-84%20-%20Draft%20TLAB%20revisions%20and%20additions%20for%20public%20comment%2025%20September%202016.pdf

(a) no interest in respect of a loan, advance or credit referred to in subsection (1); or

(b) interest at a rate lower than the official rate of interest as defined in paragraph 1 of the Seventh Schedule,

an amount equal to the difference between the amount incurred by that trust as interest in respect of a year of assessment and the amount that would have been incurred by that trust at the official rate of interest must, for purposes of Part V of Chapter II, be treated as a donation made to that trust on the last day of that year of assessment by the person referred to in paragraph *(a)* of subsection (1).

(4) If—

(a) a loan, advance or credit was provided by a company to a trust at the instance of more than one person that is a connected person in relation to that company as referred to in paragraph *(b)* of subsection (1); and

(b) an amount must in terms of subsection (3) be treated as having been donated to that trust on the last day of a year of assessment of that trust,

each of those persons must be treated as having donated, to that trust, the part of that amount that bears to that amount the same ratio as the equity shares or voting rights in that company that were held by that person during that year of assessment bears to the equity shares or voting rights in that company held in aggregate by those persons during that year of assessment."

Subsection 5 contains the provisions with regards to certain types of trusts and loans that would be excluded from the stipulations of sections 7C(1) to (4).

The influence of the new proposed section 7C of the ITA, on estate planning and the use of the interest-free loan as estate planning tool, will be discussed in paragraph 5 below.

4. METHODOLOGY AND BACKGROUND OF THE STUDY

This study is qualitative in nature and utilises document analysis to analyse and interpret results. Document analysis (Bowen, 2009) involves the evaluation of documents, in all forms. The method requires that documents be analysed and interpreted in order to gain deeper understanding and elicit meaning from their content. The document analysis strategy employed by this study is textual analysis, which emphasises the meaning that one can extract from documents (De Vos, Strydom, Fouche and Delport, 2011).

The literature reviewed was used to analyse and interpret, in conjunction with this study's title, the influence of the findings in the Brummeria case as well as legislation, on the future use of the interest-free loan as estate planning tool.

The findings of the document analysis are discussed accordingly.

5. INTERPRETATION AND FINDINGS

The definition of the loan and the origin of the loan agreement fall outside the scope of this study. It is however important to note that the type of loan that will be discussed does not fall within the scope of, and is therefore not governed by, the National Credit Act (34 of 2005) (NCA). This opinion is founded on, amongst others, the provisions of sections 1 "instalment agreements", 8(3)(b), 8(4), 92(2) and (3), 103 and 105 of the NCA (Preston, 2014). The same opinion was expressed by Tennant (Tennant, 2010).

It is also important to note that the interest-free loan under review in the Brummeria case differs from the interest-free loan agreement normally used for estate planning. This difference stems from the fact that the loan agreements pertaining to this case were granted as *quid pro quo* for the life right of occupation (refer to the facts of the case set out in paragraph 2 above). As mentioned above the SCA remarked that "... the basis, upon which the Commissioner valued that right in each particular year of assessment in the further revised assessments, was not challenged on appeal." (Brummeria 2007:609). Two other very important aspects that were not addressed by the Court, are the facts that the lender of the money did not receive any interest and also did not pay any rental amount for the right of occupation. The question can be asked whether a value should not have been placed on these rights too. (Spearman, 2011; Preston, 2014)

The importance of this case for estate planning must be judged in that light. The SCA regarded the "right to retain and use loan capital for a period of time, interest-free" to be a "valuable right" (Brummeria 2007:602). The fact that the judges in the Brummeria case referred to Judge Hoexter's opinion that "[The] making of an interest-free loan constitutes a continuing donation to the borrower which confers a benefit upon such borrower" (Brummeria 2007:607), could also have been an indication that the trust, for example, would at some stage become liable to pay tax on this benefit.

It is also notable that the SCA in fact did not explain exactly how the benefit that accrued to the Brummeria companies, did in fact constitute an amount in terms of

the gross income definition. However, since this fact has not been challenged in court, the rule was set (Jansen van Rensburg, 2008).

As explained above, the interest-free loan could be effectively employed to help a family trust, who does not have the necessary funds available, to acquire an asset. Apart from a means to enable the family trust to acquire an asset, it is also a very effective tool to remove a growth asset from the planner's estate. The asset will be replaced with a loan account of which the value will be pegged at the original capital amount of the asset sold, if the loan agreement is a so-called interest-free agreement. As time advances and the trust does repay the loan, the loan account will decrease. If the estate planner, who sold the assets to the trust (from now on referred to as the donor), makes use of the provisions of section 56(2) (b) of the ITA, by donating an amount of R100 000 per year tax free to the trust, the capital repaid on the loan account can again be moved out of the donor's estate.

To avoid the payment of donations tax on the original sale transaction, the asset would have been sold at a market related price (Stiglingh, 2015). At the stage when the asset is sold to the family trust, the only tax payable by the seller will be capital gains tax, because the sale transaction will be regarded as a disposal for capital gains tax purposes. It should be noted that this is true for current tax law. The whole situation is bound to change if the draft section 7C of the ITA is accepted by Parliament.

The following case study, taken from Olivier *et al* (Olivier *et al,* 2011) and adjusted by Preston (Preston, 2014:17-18), illustrates the use of an interest-free loan agreement in estate planning as well as the effectiveness of this estate planning tool.

"The donor is a forty-five-year-old South African resident farmer. He is married out of community of property and has two sons, aged 17 and 21 respectively. Both of his sons would like to continue with the farming operation after completion of their studies. The planner is the proud owner of two farms. An estate planner illustrated to the farmer what the effect of inflation can be on the value of the property. At an inflation rate of 6% the value of the farming property will grow from R3 000 000 in 2002 to an estimated R6 400 000 in 2015 and an estimated R12 000 000 in 2026. If the R3 500 000, as found in section 4A of the Estate Duty

Act (45 of 1955) (EDA), is taken into account, estate duty of R980 000[4] will be payable on the estimated estate value of R12 000 000.

Should the donor pass away during 2016, the whole problem of estate duty can be minimized if his sons inherit the farms subject to a *usufruct* in favour of their mother. This calculation is dependent on the value of her inheritance (the *usufruct*) and will be a result of the provisions of sections 4A and 4(q) of the EDA. However the estate duty problem is just postponed up to the date that his wife dies."

"The estate planner suggested that the following steps be taken:

1. Two trusts, one with each son as beneficiary, must be created.
2. The farms must be appraised to determine the fair value with a view to selling the farm property to the two trusts.
3. Sale agreements between the donor and the trustees of the trusts must be drawn up and executed, with the terms that the farms will be individually sold to the respective trusts, at a fair value as determined. The purchase price will be financed by way of an interest-free loan between the donor and the trustees of the trusts.
4. The donor can then carry on with his farming operation through a lease agreement, paying a nominal rental amount.
5. The result will be that future value increase of the farms will take place in the trusts and is therefore effectively removed from the donor's estate.
6. Should either son in future want to join his father in the farming operation, he can either farm with him in a partnership, or take over the lease agreements (on the respective farms earmarked for him) from his father and farm for his own account.
7. At this stage the donor can start to levy interest on the outstanding loan account, and the trusts will be able to pay the interest out of the rental income."

The only assets in the donor's estate relating to the original farming property will therefore be the outstanding loan account.

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[4] *The amount was calculated: R12 000 000 x 70% = the value to be included for estate duty purposes as property. Refer to section 5(1A) of the EDA. From this value R3 500 000 the section 4A abatement was deducted. The current estate duty tax percentage is 20% to be calculated on the net amount.*

The authors mentioned above have expressed the opinion that the interest-free loan was a very useful (and up to now a tax free) estate planning tool. However after each successive Budget Speech of the Minister of Finance, several authors have speculated on how long this will remain true.

Section 7 of the ITA was originally implemented at a time when the tax rate of a trust was much lower than the maximum marginal tax rate of individuals. The idea behind the implementation of section 7 and the attribution rules (also known as the conduit pipe principles), was at that stage to serve as anti-avoidance measure "aimed at preventing a trust from being used as an income-splitting device" (DTC, 2015:7). With both maximum tax rates for individuals as well as trusts currently at 41%, the opposite result is achieved. The DTC recommended in 2015, amongst other recommendations, that the deeming provisions of sections 7 and 25B should be repealed and that taxing the trust as a separate tax payer should be considered (DTC, 2015). The Commission recommended that these changes to the ITA should be announced in the 2015 Budget Speech for implementation with effect from 1 March 2016. None of these recommendations were announced in the 2015 or 2016 Budget Speeches.

The DTC also acknowledged that the interest-free loan is indeed used "in the gradual dissipation of a taxpayer's estate over a prolonged period, in turn ultimately dissipating the taxpayer's estate prior to death" (DTC, 2015:38). The Commission however did not make any specific recommendations with regards to the taxation of the interest-free loan.

In July 2016 the Treasury tabled new legislation in the form of the new section 7C of the ITA, for public comment. As stated; "at issue is the avoidance of estate duty and donations tax when a person sells assets to a trust and the sale of those assets is financed by way of an interest free loan or a loan with interest below market rates" (Draft Response Document, 2016, hereafter referred to as DRD, 2016). The original draft was drafted very aggressively and would have widespread consequences.

The main consequences of the July 2016 draft can be summarised as follows:

1. The donor (being a natural person) would have been taxed on an amount (notional amount) equal to the difference between the interest rate stipulated in the loan agreement and the official rate of interest (as determined in terms of the Seventh Schedule to the ITA). (Draft Bill, 2016; Van Wyk, 2016; Warneke, 2016).

2. The donor would also be taxed, as explained in 1 above, even if the interest-free loan (or low-interest loan) was granted by a legal person to which the donor is a connected person. (Warneke, 2016)
3. "Such amount attributed as income in the hands of the seller will not qualify for the section 10(1)(*i*) exemption in respect of interest" (Draft Bill 2016:9; Loubser, 2016; Van Wyk, 2016).
4. Since the trust did not actually pay the interest now to be taxed in the hands of the donor, no deduction of this 'deemed' interest will be allowed against taxable income of the trust (Draft Bill, 2016; Van Wyk, 2016).
5. As explained above, the donor often reduced the outstanding loan account, by donating R100 000 to the trust. The implication of sub-section (5) is that if the loan account is reduced in this way, the R100 000 annual exemption of donations tax will not be available against this donation and the whole amount with which the loan is reduced will be subject to donations tax of 20% (Draft Bill, 2016).
6. The provisions of the first sub-section 4(b) are particularly interesting. It seems as if the words of Judge Hoexter are influential here. If the donor did not recover that additional amount of assessed tax from the trust, he will also be liable for donations tax on this tax amount, suggesting repeated taxation.

The draft section 7C, as discussed above, was written extremely broadly, and in many respects the application thereof was unclear. Much criticism and commentary were received by Treasury from the public. The second note above was especially troublesome. If the connected person to the company had a 20 percent interest, the implication would have been that the shareholder would have been taxed proportionately, whether or not the shareholder indeed had influence in the granting of the loan to the trust. (Warneke, 2016)

Following the public's reaction, the second proposed draft was published in September 2016 for public comment. The implications of the highlighted sub-sections of the second draft section 7C of the ITA, are as follows:

a) The central aim of the newly drafted section 7C is the same as that of its predecessor: to ensure that the lender will be taxed on interest not levied, "as to compensate for perceived avoidance of tax" (Warneke, 2016).

b) Like the first draft, the current draft will apply to all existing loans, advances and credit provided to the trust. The provisions will however not be retrospectively implemented. (DRD, 2016; Warneke, 2016)

c) The notional amount is still to be calculated as explained in note 1 above.

d) The main difference between the first draft and the second relates to the form in which the notional interest amount will be taxed. In the first draft, the notional amount would have been included in the lender's / donor's gross income. In the second draft this is no longer the case, as the notional amount will now be treated as an amount donated by the natural person to the trust, for donation tax purposes. For obvious reasons the notional amount will be calculated on the last day of the donor's year of assessment. (Warneke, 2016)

e) In the first draft the annual donations tax exemption available in terms of section 56(2)(b) of the ITA, would not have been available as a deduction in the calculation of the taxable amount for donations tax purposes. (Refer to notes 5 and 6 above.) This provision was deleted from the most recent draft of section 7C. The deemed donation could therefore be 'reduced' by the annual exemption available. (DRD, 2016)

f) Subsection 5 as well as page 8 of the DRD (DRD, 2016) specifies the type of loans and trusts that will be excluded from the above applications. Of importance is to take note of the following three:

   a. Under certain circumstances loans to vesting trusts will be excluded.

   b. In the case of a special trust, created solely for the benefit of persons with disabilities and/or minor children, the above will not be applicable.

   c. One of the most important exclusions will be in the case where the loan was granted to a trust in order to acquire a primary residence that is used by the donor and/or the donor's spouse.

g) The original interest-free loan to the trust, in order to acquire the asset, will still not fall in the donations tax net (Stiglingh, 2015; also refer to Loubser, 2016; Van Wyk, 2016).

h) The current provisions of section 7 and 25B were not changed. It is uncertain as to how the new section 7C will be integrated into the 'old' provisions. (Loubser, 2016)

If the above views and interpretations are applied to the above case study[5], the donor will annually have to declare R28 000[6] in the form of donations tax.

There are still some uncertainties, especially where the loan was granted by a company, and it is now regarded as having been made by the natural person who is a connected person of the company. (Warneke, 2016) Hopefully Treasury will at some stage give more clarity in this regards.

If the two drafts of section 7C are compared, the current draft is more taxpayer-friendly as it is better to "suffer donations tax at the rate of 20 percent than income tax on interest at a rate of 41 percent" (Warneke, 2016). In most cases the previous version would have had the implication that the donor would have paid 41 percent tax yearly on the notional amount and if the donor did not recover the additional tax (resulting from the inclusions of the notional amount in gross income) from the trust, an additional 20 percent donations tax would have been payable. The result would be that in a period of four tax years, the donations tax saved, would have been paid by the taxpayer.

6. CONCLUSION

It was clear since 2007 that the tax authorities intended to prohibit the use of interest-free loans to avoid the payment of taxes that would have been payable under normal circumstances. The ministers of finance, in their respective budget speeches, repeatedly warned that legislation was being considered to stop the use of interest-free loans and trusts to avoid paying donations tax and / or estate duty.

From the discussion above it can be concluded that it might have been better for the donor to pay the once-off donations tax, if the full or greater portion of the loan capital is still outstanding on a loan account. If the draft taxation in its original form was accepted, it would be advisable for donors to consider the amounts still due to them in terms of interest-free loan agreements. If the trust does have the financial means, it may have been beneficial to settle such amounts. With the proposed section 7C, in its current form, it will take approximately 14 years to equal the amount that would have been payable if the asset sold on an

[5] *The following assumptions are applicable: The current official interest rate is 8%. The farms were sold in 2002 for R3 000 000 to the trusts and the full R3 000 000 is still outstanding on a loan account.*

[6] *R3 000 000 x 8% = R240 000; R240 000 – R100 000 (Section 56(2)(b) annual exemption) = R140 000; R140 000 x 20% (donations tax rate) = R28 000.*

interest-free loan account had originally been donated to the trust. The advantage is still that the growth asset is part of the assets of the trust and not of the donor's estate. It might even be (depending on when the sale transaction took place) that the loan capital due is much less than the original loan amount.

In conclusion, the interest-free loan still has its place in estate planning, but the trust should aim to pay back this loan as soon as possible to avoid the payment of more tax by the donor than the amount of donations tax or estate duty the planner had tried to save.

If estate planning strategy's main aim had been to save on estate duty in the past, that strategy may no longer work. It is advised that estate plans based on prior legislation be revised promptly. To draw up an estate plan requires, as it did in the past also, careful consideration of the needs of the donor as well as current and future tax legislation.

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