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1. Definition and Technical Breakdown of Section 7C

1.1 Background

Section 7C of the Income Tax Act was introduced to combat the avoidance of Donations Tax through interest-free or low-interest loans to trusts or certain companies by connected persons. These types of structures were commonly used in estate planning to transfer wealth without triggering tax consequences.

1.2 Applicability

Section 7C applies to:

- Any **loan, advance, or credit** provided directly or indirectly by:
  - A **natural person**, or
  - A **company at the instance of a natural person** who is a connected person in relation to that company,
- To a **trust**, where the trust is connected to the person or company as described.

1.3 Connected Persons

A trust is regarded as connected to a person if:

- The person or company, or
- Any connected person in relation to them, is a beneficiary of the trust.

It also applies where a trust holds at least 20% of the equity shares or voting rights in a company, alone or with its beneficiaries and their close relatives.

1.4 Deemed Donation

Where interest is charged below the **official rate** (currently repo rate + 1%), the difference between the actual interest charged and what should have been charged is deemed to be a **donation** by the lender on the last day of the trust's year of assessment.

2. Section 7C(1A): Transfer of Claims

Section 7C(1A) was introduced to prevent taxpayers from circumventing the anti-avoidance rules in Section 7C by transferring existing loan claims into their own name.

Core Provision

If a natural person **acquires a claim** to a loan, advance, or credit originally provided to a trust or a qualifying company by someone else, **they are deemed to have provided that loan themselves on:**

- The date they acquired the claim; or
- If they were not a connected person at the time, then from the date they **became connected** to the trust or the lender.

This applies **regardless of how the loan was acquired** — by sale, donation, or even inheritance.

Purpose

The intention is to maintain the **tax implications** attached to interest-free or low-interest loans, even after those loans are transferred.

Example

Let's say:

- John made an interest-free loan of R2 million to a family trust.
- A year later, his sister Jane **buys the loan account** from John for R2 million.
- Jane does **not charge interest** on the loan going forward.

Implication:

- Jane is deemed to have made a R2 million loan to the trust on the date she acquired the loan.
- If the official rate is 8%, and she charges no interest, a **deemed donation of R160,000** (R2,000,000 × 8%) is made on the last day of the trust's year of assessment.
- If Jane was not connected to the trust at the time of acquisition but later becomes connected, the deemed loan starts from the date she **becomes connected.**

3. Section 7D: Nullification of the In Duplum Rule

Section 7D was introduced to override the **common law "in duplum" rule**, which limited recoverable interest to the original loan amount. It requires calculation of deemed interest (for tax purposes) **as if** interest accrued beyond the capital amount, which is especially important in long-term, interest-free loans.

The In Duplum Rule Explained

Under the **common law**, the in duplum rule limits interest recoverable on a debt to the original **capital amount**. That means once interest accrued equals the original debt, no more interest can accrue.

This created a tax avoidance opportunity: if a loan was interest-free and left unpaid long enough, the **donation value could be capped** under the in duplum rule.

Section 7D Overrides This

Section 7D mandates that, for tax purposes, the official rate of interest **must still be applied** annually to determine the deemed donation, even if the deemed interest **exceeds the capital** of the loan.

Effect

- Ensures that the deemed donation **continues to accrue indefinitely** for as long as the loan is outstanding and interest charged is below the official rate.
- Prevents long-term interest-free loans from **escaping tax simply due to duration.**

Example

Sarah makes an interest-free loan of R5 million to her family trust.

- **Year 1**: Deemed donation = R5,000,000 × 7.5% = R375,000
- **Year 2–N**: Even if cumulative deemed interest > R5 million, **the same R375,000 continues** to be calculated and taxed annually.

This keeps the **donation tax exposure continuous**, ensuring estate planning via long-term interest-free loans remains fully taxable.

4. Exemptions from Section 7C

Section 7C does **not apply** if:

4.1 Public Benefit or Special Entities

- The borrower is a **Public Benefit Organisation** (section 30(3)) or **Small Business Funding Entity** (section 30C).

4.2 Vested Interests

- The loan is made **by a person with a vested interest** in the trust's receipts/assets.
- The trust must be fully **vested** (no discretionary powers allowed).
- Interests must be **proportional to each beneficiary's contribution.**

4.3 Bewind Trusts

- Where the trust is a **bewind trust**, which administers assets **owned by the beneficiary**, the exemption may apply.

4.4 Special Trusts

- Trusts for **disabled persons** as defined in section

4.5 Primary Residence

- The loan funds the acquisition of a **primary residence** used by the lender or their spouse.

4.6 Transfer Pricing

- The loan is an **affected transaction** governed by **section 31 (transfer pricing).**

4.7 Sharia Compliant Loans

- The loan qualifies as a **Sharia compliant financing arrangement** under section 24JA.

4.8 Deemed Dividends

- Loans deemed to be **dividends in terms of section 64E(4).**

4.9 Employee Share Incentive Trusts

- Loans to a trust formed **solely** for implementing an employee share incentive scheme, where:
  - The trust buys shares in the employer or related company.
  - Only employees/directors benefit.
  - **Connected persons** to the scheme company are excluded.

5. Tax Consequences

5.1 Donations

- The **deemed donation** equals the difference between actual and official interest.
- Donations tax is calculated annually on 28 February.
- **R100,000 annual exemption** still applies.

Example:

Loan: R10 million
Interest charged: 5%
Official rate: 7.5%
Difference = 2.5% → Deemed donation = R250,000
Donations Tax (after exemption): 20% of R150,000 = R30,000

5.2 No Capital Loss or Deduction

You **cannot deduct:**

- Any capital loss,
- Any waiver of the loan,
- Even if it becomes irrecoverable.

5.3 Multiple Connected Persons

Where more than one person is involved (e.g. multiple shareholders of lending company), each is taxed proportionally.

6. Loan Accounts vs Distributions

6.1 When Not Treated as a Loan

- If trustees credit distributions to a beneficiary **at their sole discretion**, and
- No contract of loan exists, then it's **not a loan** under Section 7C.

6.2 When Treated as a Loan

- If the beneficiary **has a say** in timing or amount,
- Or enters into an agreement with trustees, then the vested distribution **is treated as a loan**.

7. Companies Owned by Trusts

Section 7C applies **mutatis mutandis** to loans to companies **where shares are held by a trust**, except for exemptions unique to trusts.

8. Effective Dates

- Section 7C: Effective **1 March 2017**.
- Amendments to include acquired claims: **19 July 2017**.

9. Planning Tips

- **Each case is unique**. Tailored advice is essential.
- For loans ≤ R1,333,335, no donations tax due to exemption.
- Use of **spouse** for splitting loans.
- Consider **donating the loan** outright if it will save tax in the long term.
- Ensure the trust **pays deductible interest,** where applicable.

10. Estate Planning Impact

When the lender dies:

- The interest till death is still a deemed donation.
- The **estate may pay donations tax** and can claim it against estate duty.
- Issues:
  - Executor is not a connected person.
  - **Section 9HA** triggers CGT at death on assets transferred to heirs.
  - Beware the **matrimonial accrual system**.

11. Debt Reductions for Less Than Full Consideration

Relevant when:

- Debt is waived,
- Converted into shares,
- Settled indirectly.

11.1 Section 19 and Paragraph 12A (Eighth Schedule)

Applies to **capital assets**, not trading stock or allowances.

Exemptions:

- **Estate waives debt:** Exempt if property still forms part of the estate (whether estate duty applies or not).
- **Debt forgiven as a donation:** Exempt if **donations tax is paid**.

Note:

- If the **R100,000 exemption** is used, it reduces the **base cost** of the asset.
- Foreign lenders → **No donations tax**, so full value triggers **capital gains tax.**

Conclusion

Section 7C remains a **powerful anti-avoidance tool**, particularly targeting **estate planning** using trusts. It creates substantial complexity but also contains several **critical exemptions** and **planning opportunities**. Professional advice is crucial when dealing with:

- Interest-free or low-interest loans,
- Vesting arrangements,
- Trust structuring, and
- Estate planning with trusts and companies.

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