KPMG
Private Enterprise

Family Office & Private Client

Introduction

There is a significant amount of focus on tax planning around Trusts, in particular with the introduction of section 7C of the Income Tax Act, No 58 of 1962 (**the Act**) in 2016. We believe that there is some uncertainty as to the transactions which may be caught within the ambit of section 7C of the Act, specifically loans between companies which form part of a group of family businesses and are ultimately owned by a family trust(s).

This uncertainty is a function of the extension of the ambit of the provisions of section 7C of the Act, in July 2019, to include an interest-free or low interest loan made by, or at the instance of, an individual to a company where the aforementioned trust holds at least 20% of the equity shares or exercises voting rights in that company

Interest free loans within a group of family businesses

In order for section 7C of the Act to apply, the following criteria must be met:

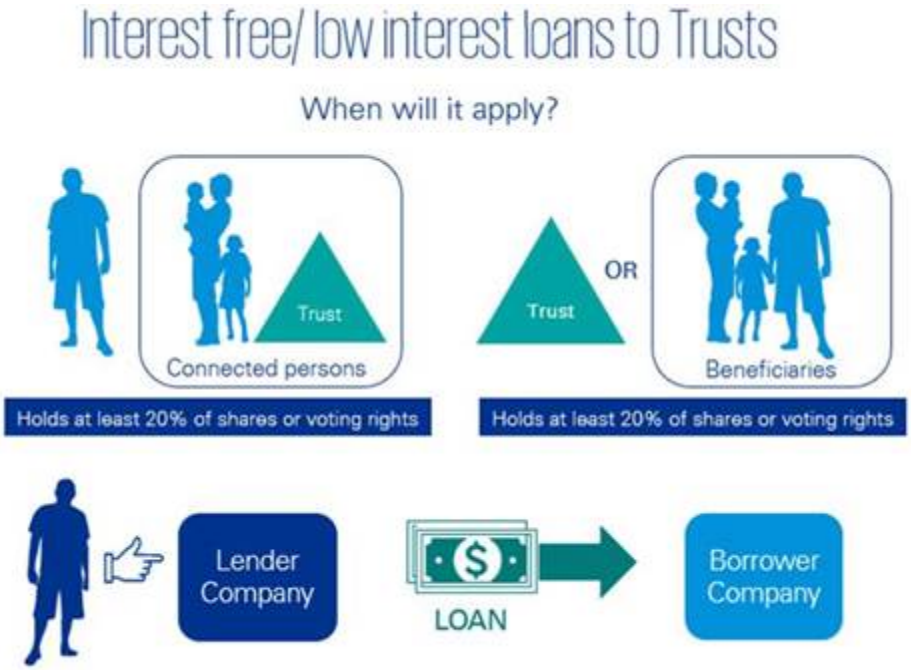
- there must have been a loan, credit or advance made by -
  - a natural person or a company, where that natural person is a connected person ***and*** the loan, credit or advance was made at the instance of that natural person;
- to a trust or a company in which the trust has at least 20% shareholding or voting rights; and
- the loan, credit or advance was made at an interest rate which is below the official rate (repo + 1%, currently 4.5%).

In order to ascertain whether the above apply, the term 'connected person' (as defined in the Act) is crucial. The Act sets out a detailed explanation of who or what constitutes a 'connected person'. For purposes of this alert we will focus on only the relevant parts of the definition, with reference to the application of section 7C. In this regard, dependent on the nature of the 'person', a connected person is:

- *Natural person*, is any relative (within the third degree of consanguinity), as well as any trust where that natural person or relative is a beneficiary.
- *Trust*, is any beneficiary of the trust and any connected person in relation to such beneficiary.
- *Company*, is any person other than a company that:
  - individually or jointly, with any connected person in relation to that person holds, directly or indirectly 20% of the equity shares or the voting rights in the company;

- or any other company where there is common management or control by the individual who is a connected person in relation to such company or any other person who is a connected person in relation to the individual.

Many group company structures (without a trust in the structure), provide intra-group financing (within South Africa) interest-free, and there are generally no adverse tax implications. However, for family enterprise structures, which include a trust(s), the interest-free financing may be at risk of triggering section 7C of the Act. Below provides a simple example family structure to illustrate.



In order to provide some clarity

In order to provide some clarity, in our view, the purpose of section 7C of the Act is an important starting point. The purpose of section 7C simply put is to combat the avoidance of donations tax and estate duty by taxpayers transferring assets into a trust on either an interest free or low interest loan account. While there may be instances where section 7C of the Act could justifiably be triggered, there are other instances, where there is a true commercial/business intention to the intra-family enterprise financing, to which section 7C of the Act should not apply.

As the burden of proof rests on the taxpayer to justify the true intention of the transaction, company/trust documentation (ie company/trust resolutions, minutes of meetings) are crucial. They must clearly indicate what the purpose of the interest-free / low-interest intra-family enterprise loan is, and should also be very clear at whose instance, and in what capacity, the loan is provided, in order to mitigate the risk of the loan falling within the ambit of section 7C of the Act. Considering the purpose of section 7C of the Act, the documentation should justify in form and substance that the purpose of the loan was not for estate planning purposes.

This is where those charged with governance of the family trusts and companies, need to also ensure that all the required documentation is in place, to ensure that there are no unnecessary risks in respect of the commercial intra-family enterprise loans.

In conclusion

In parting, as noted in the many media articles, SARS has restructured its High Wealth Individual Taxpayers (**HWI**) unit. Governance structures (corporate and family) within a group of family enterprises are important, as SARS has identified the family members and associated enterprise structures. Accordingly, all relevant documentation should to be in place to respond to any questions SARS's HWI unit raise.

Should you require any further information, please do not hesitate to contact the team members below.

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Key links

- KPMG SA FO&PC Homepage
- Mastering a Comeback: COVID-19 report
- Post-Budget 2021 insights

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If you have any questions, please send an email to taxandlegal@kpmg.co.za .

Designed by Evalueserve.

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