KPMG
Private Enterprise

Family Office & Private Client

Introduction

Over the last few months we have shared a number of tax alerts relating to trust structures and also shared some insights around the wealth tax discussion. This refresher alert serves as a reminder of the most recent tax legislation changes implemented regarding the anti-avoidance rules put into place to curb the misuse of trust structures and an update on the wealth tax discussion.

Trust Structures and anti-avoidance: Section 7C deemed donations

The following points are imperative to remember:

- Section 7C of the Income Tax Act, No. 58 of 1962 (the **Act**) was introduced to curb situations where a loan is made interest free or at a lower interest rate than the official rate of interest (repo rate plus 1%, currently 4.5%).
- For Section 7C of the Act to apply, the following requirements have to be fulfilled:
  - There must be a loan, advance or credit made by an individual taxpayer or, at the instance of the individual taxpayer, by a company which is a connected person to that individual taxpayer;
  - The loan, advance or credit must be made to:
    - A trust in relation to which that individual taxpayer/company is a connected person;
    - A trust in relation to which a connected person that is connected to the individual taxpayer/company who/which provided the loan is a connected person;
    - A company where 20% of the equity shares/voting rights is held by a trust; or
    - A company where 20% of the equity shares/voting rights is held by the beneficiary of a trust; and
  - The loan, advance or credit is provided interest free or a rate that is lower than the official rate of interest.

Should the above be met, there is a deemed annual donation of the amount of interest below the official rate of interest, in terms of which donations tax at 20%/25% may be due to SARS.

The most recent amendment, effective January 2021 looks to curb the preference share funding structures which have effectively avoided the deemed donation provisions noted above. The amendment brings into the anti-avoidance provision structures where a natural person or a company (at the instance of the natural person, who is a connected person) subscribes for

preference shares in a company, where at least 20% of the equity shares/voting rights are held by a trust that is a connected person in relation to either the natural person or the company subscribing for the preference shares. Effectively the donations tax implication is that an annual donations tax liability will be triggered on the difference between the official rate of interest and the preference dividend rate.

Equity investments in non-South African companies

In terms of the proposed legislation set out in the 2020 DTLAB, preference share funding is brought into the scope of section 7C of the Act. Specifically where a natural person or a company (at the instance of the natural person, which is a connected person) subscribes for preference shares in a company where at least 20% of the equity/voting rights are held by a trust that is a connected person in relation to the natural person or the company subscribing to the preference shares. The deemed donation mechanism will apply where the preference dividends which will be deemed to amount to interest for purpose of the anti-avoidance mechanism, equates to an interest rate which is below the official rate of interest. In this instance the deemed donation liability will be triggered on the difference between the official rate of interest and the preference dividend rate.

Wealth Tax discussion

In addition to the above, there has also been a lot of discussion around the introduction of a wealth tax to alleviate the country's tax deficit, as well as possibly to fund the rollout of the Covid-19 vaccinations.

There are views for and against the introduction of a wealth tax, noting that it may not be effective and may in fact cost more to administer than the additional revenues collected, and there is evidence of other jurisdictions removing the wealth tax regime for such reasons, amongst others. One other reason being the potential flight of wealth out of the respective jurisdictions, which was then invested for the benefit of another economy.

Research performed by both the Katz Commission (in 1994) and the Davis Tax Committee (**DTC**) (since 2013), which included assessing the viability of introducing a wealth tax in South Africa, concluded at the time of the respective reports that a wealth tax was not viable for the South African economy. The DTC did note that focussing on the current tax types/mechanisms and enhancing the effectiveness of these, together with ensuring compliance by taxpayers, will assist with increasing the tax collections. This even led to the increase in the Donations Tax and Estate Duty rates to 25% (from 20%) for donations/dutiable estates above R30 million.

To ensure compliance of taxpayers, in turn to reduce the country's tax deficit, there is also reference to routine lifestyle audits (of those above a specified wealth threshold). The South African Revenue Service (**SARS**) already has a unit tasked with ensuring that the high net worth taxpayers are compliant. It is this unit that the DTC recommends also be enhanced to drive the lifestyle audits.

Another solution, which in our view should be high on the agenda, is how to incentivise the wealthy to reinvest into the South African economy, which in turn will broaden the tax base and increase tax revenues organically and creates annuity tax revenue for the long term.

We are stating the obvious that there is a lot of trepidation leading up to the budget speech on 24 February 2021, and one has to acknowledge it is a difficult task National Treasury and SARS have.

Should you require any further information, please do not hesitate to contact the team members below. Alternatively, please visit the KPMG Family Office and Private Client website (click here).
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Key links

- Budget 2021 – A new tax reality
- 2020 Personal Perspectives
- KPMG SA FO&PC Homepage
- KPMG SA Tax Homepage

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