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Possible revenue windfalls from section 7C

In the Medium Term Budget Policy Statement 2016 (Medium Term Budget Speech) it was noted that without policy adjustments, gross tax revenue is projected to fall short of February 2016 estimates by R36 billion in 2017/18 and R52 billion in 2018/19. Section 7C of the Income Tax Act may just curb such deficit by the additional revenue streams flowing from the anti-avoidance provisions. An argument can be made that the introduction of the taxation on interest-free or low interest rate loan, advance or credit to a trust by a connected person, may entitle the South African Revenue Service (SARS) to an unexpected windfall of revenue streams in cases where trusts have distributed, but not yet paid or transferred the awards to beneficiaries.

Section 7C of the Income Tax Act promulgated on 19 January 2017 will come into full strike on 1 March 2017 and apply to any amount owed by a trust in respect of a loan, advance or credit provided to that trust by a connected person before, on or after that date. The anti-avoidance section was introduced to address the issue of estate duty and donations tax avoidance, when a person transfers wealth through an interest-free loan, or a loan with interest below market rates.

In the instance where loans are created by the distribution of an award to a beneficiary without payment of the whole or portion of such award to such beneficiary, section 7C may be applicable: the forgone interest may be considered as a donation where the distribution constitutes an interest-free loan, or a loan with interest below market rates.

To the extent that the above interpretation is followed, and considering that there are currently 333 465 active trusts registered with SARS per the Davis Tax Committee Second Interim Report on Estate Duty report (DTC Estate Duty report), SARS may just experience a surprising gust of windfall revenue.

In addition to the above argument on a strict interpretation of the law, the Final Explanatory Memorandum on the Taxation Laws Amendment Bill 2016 (Explanatory Memorandum) also sheds some light on the issue. It notes that where an amount is vested in a beneficiary by a trust, but not distributed by election or request of the beneficiary, such distribution would qualify as a loan or credit provided by that beneficiary to the trust. Effectively, the tax implications would be that the beneficiary would be liable for donations tax per section 7C, where such loan or credit provided is interest free or provided at a lower interest rate.

The *vice versa* should also then apply: where the trust does not have the funds to distribute to a beneficiary, such distribution would have to constitute an advance or credit to the trust for the beneficiary's benefit. Where such advance or credit is interest free or at a lower interest rate, the beneficiary would not only be prejudiced by not receiving his or her distribution award, but possibly also be liable for donation tax.

The gust of windfall revenue for SARS may be welcomed with open arms, given the limited space available to increase taxation in the upcoming 2017 Budget. As things stand at the moment, it cannot accommodate all the proposals that have been tabled for a substantial expansion in health, education, defence, social development and infrastructure during the Medium Term Budget Speech.

It is not clear whether this effect of section 7C was the intention of National Treasury. More clarity or answers could possibly be forthcoming in the upcoming 2017 Budget Speech by the Minister of Finance.

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