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TAX ALERT

SECTION 7C DONATIONS TAX CALCULATIONS

1 March 2018

Introduction

Section 7C of the Income Tax Act, 1962 (the Act), promulgated on 19 January 2017, came into effect on 1 March 2017 applying 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 1 March 2017.

The anti-avoidance section was introduced to address the issue of estate duty and donations tax avoidance, which arises when a person transfers wealth (tax-free) to a trust through the use of an interest free loan or a loan with interest below market rates.

Most trusts' years of assessment runs from 1 March 2017 to 28 February 2018 (unless the trust applied to the Commissioner to draw up accounts to a date other than February in terms of section 66(13A) of the Act).

Section 7C(3) of the Act specifically provides that the donation will be regarded as having been made to the trust on the last day of the year of assessment of the trust. Given that section 7C tax implications will become a reality when donations tax is due on 31 March 2018 (i.e. by the end of the month following the month the donation was made), we have addressed some practical issues that have arisen in this regard.

Calculation of donations tax

Section 7C of the Act only prescribes the rate that needs to be used to determine the deemed amount of interest during the year of assessment when taking the amount that has been incurred or would have been incurred.

The official rate of interest as defined in section 1 of the Act (previously defined under paragraph 1 of the Seventh Schedule to the Act) which currently amounts to 7.75% per annum, should be used to determine if section 7C is applicable.

Section 7C does not, however, expressly prescribe the calculation methodology for the deemed donation, i.e. the deemed amount of interest during the year of assessment. An interpretation of the law, though it may not have been intended, may be that the same methodology used to calculate the actual interest (i.e. where a low interest rate applies) should be used to determine the deemed interest at the official rate, less the lower interest rate actually charged.

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Accordingly, if the capital amount of the outstanding loan changes during the year of assessment, it should also be taken into consideration. Furthermore, if the methodology used before determining the deemed amount per section 7C, was compounded monthly, the same methodology should be used when determining the deemed amount per section 7C. However, this does create an anomaly for zero rate loans.

The South African Revenue Service (SARS) practice as far as it relates to dividend withholding tax, which also has no calculation methodology, seems to be daily simple interest on the daily balance outstanding. Although various methodologies are used, it seems that the SARS practice (as applied to deemed dividends) is the most prevalent method used by practitioners.

SAICA is of the view that whichever methodology is used to calculate interest, it must be done consistently and furthermore, should be reasonable.

SAICA has proposed to National Treasury and SARS that the methodology using simple interest calculated on the daily balance outstanding should be incorporated into legislation. Once feedback is received, communication will be provided to members via Integritax Weekly and the Integritax Facebook Page.

Person liable to pay donations tax

Section 7C of the Act prescribes that the low interest or interest free loan will be treated as a deemed donation made to the trust by a natural person.

Section 59 of the Act provides that the donor will be liable for donations tax. Hence the natural person would be liable for the 20% donations tax.

Section 59 of the Act further prescribes that where the person liable for the tax fails to pay the tax within the prescribed period, the donor and donee are jointly and severally liable for the debt. Accordingly, the trust to whom the section 7C loan was made could also be liable if the natural person does not pay the tax by the due date.

Due date when donations tax is payable and return (IT144) submitted

As noted above, section 7C(3) prescribes that the donation will be deemed to have been made on the last day of the year of assessment of the trust.

Section 60(1) of the Act in turn provides that donations tax will be payable by the end of the month following the month during which the donation takes effect. Thus, the donations tax will be payable a month after the last day of the year of assessment of the trust.

A practical issue that arises is that donations tax payments done through internet banking alone is not recognisable by SARS given that there is no PRN reference number and Beneficiary ID. The SARS South African Payment Rules External Guide, however, provides for a solution in that donations tax can be paid via eFiling as a non-core tax utilising the credit push option. The donations tax payment transaction will therefore be initiated on eFiling, but only processed once the payer provided the necessary authorisation through his/her banking product (i.e. internet banking profile).

In addition, section 60(4) of the Act provides that the payment of the donations tax should be accompanied by a return (i.e. IT144). Accordingly, per the SARS website, the completed IT144 return should be sent to SARS with the payment. It seems like another practical issue that arises is the manual submission of the IT144 return at the nearest SARS Branch.

It was noted in an article SARS responds to concern about process for donations tax payment, that:

"At this stage, SARS is not in a position to provide a short-term commitment with regards [to] payment of donations tax through platforms other than eFiling. It says plans are in the pipeline to modernise the eFiling system to reduce the paperwork related to Section 7C donations tax payments and returns, but no date has been set."

Extension of section 7C

Taxpayers have discovered ways to avoid the deemed annual donation triggered by the anti-avoidance measure, since the introduction of section 7C, through:

- Interest-free loans, advances or credit and low interest loans, advances or credit made to companies owned by trusts; and
- Transfers of loan claims to current or future beneficiaries of trusts.

In order to curb the abovementioned avoidance, National Treasury amended section 7C to include interest free or low interest loans, advances or credit that are made by a natural person or a company (at the instance of a natural person) to a company, whose equity shares are held, directly or indirectly or whose voting rights in that company may be exercised by the trust or by a trust beneficiary.

National Treasury furthermore introduced section 7C(1A) in instances where current or future trust beneficiaries acquire a loan claim to an amount owing by that trust in respect of a loan that was originally advanced by a natural person or a company to that trust. The application of section 7C will take affect from the date of acquisition of such loan claim in the beneficiary's or future trust beneficiary's name.

The amendments to section 7C of the Act is effective from 19 July 2017 and applies in respect of any amount owed by a trust or company in respect of a loan, advance or credit provided to that trust before, on or after that date.