

Proposed changes to the taxation of trusts, in terms of the draft Taxation Laws Amendment Bill 2016

One of the most popular means of settling assets into a trust in South Africa is by way of an interest free loan. The growth in the value of the assets then takes place in the trust, while the loan remains an asset in the settlor's estate. The value of the growth is thus ring-fenced from Estate Duty while the value of the loan at the time of the settlor's death will be subject to Estate Duty (depending on the manner in which it is bequeathed).

This perceived loophole for the transfer of wealth without having to incur donations tax or income tax has resulted in an attempt by Treasury to capture these revenues by focusing on the treatment of loans to trusts.

The draft Taxation Laws Amendment Bill 2016 has proposed the following treatment of interest free or below market rate loans to trusts:

- The difference between the market rate and the actual interest applied to the loan will be regarded as income in the hands of the seller.
- The trust will only be able to claim a deduction against the interest that has actually been paid (not the interest amount included in the settlor's tax returns).
- The annual donations tax exemption will no longer apply to loans to trusts, such that attempts to reduce these loans will now attract donations tax.
- If the settlor does not recover the tax from the trust within three years, the amount will be treated as a donation to the trust, attracting donations tax.

The amendment is to come into effect on 1 March 2017 and although it is not specifically stated, it is expected that the changes will be applicable to both existing and new loans in place as such date.

The proposed legislation contains much uncertainty and commentary is being provided to Treasury in this regard. It is therefore too soon to start assessing existing trusts to establish the merits of maintaining or unwinding, but the final legislation once promulgated, may well demand a scrutiny of existing trusts and consideration of restructuring.