Interest-free loans or low-interest loans and estate planning: Life after Brummeria

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SUMMARY AND KEY TERMS

From time to time the court delivers a judgment that has a ripple effect beyond what was expected, resulting in estate planners reconsidering their planning strategies. Such a judgment was the judgment delivered by the Supreme Court of Appeal (SCA) in the case of the *Commissioner for the South African Revenue Services v Brummeria Renaissance* 2007 6 SA 601 (SCA) (*Brummeria* case). In this case the interest-free loan and the right to use loan capital free of any interest obligation were under scrutiny. The SCA had to rule on whether or not this right had a determinable value and whether or not this value could be taxable in the hands of the borrower. The SCA ruled that the right under an interest-free loan should be included in the gross income of the borrower.

Since estate planning often involves the use of an interest-free loan, as estate planning tool, to remove a growth asset from the estate of a planner, it could not be generally accepted any more that the granting of such loan would not have any tax implications. Although the interest-free loans used in the *Brummeria* case, did not relate to an estate planning exercise, the ruling resulted in much speculation regarding the future of the interest-free loan as estate planning tool. SARS tried to ease the uncertainty by issuing Interpretation Note 58, but there is still uncertainty to some extent.

The focus of this mini-dissertation is to explain when and to what extend the provisions of the *Income Tax Act* 58 of 1962 (ITA) as well as the *Estate Duty Act* 45 of 1955 (EDA) will apply to the granting of an interest-free loan as part of an estate planning exercise. The provisions of the gross income definition, sections 7 and 64E, the provisions of donations tax as well as paragraph 12(5) and 12A of the Eighth Schedule to the ITA, were explored. Sections 3(3) and 3(5) of the EDA are discussed with the use of these loans for estate planning in mind. The question whether or not the interest-free loan is still a useful estate planning tool is also answered.

Keywords:

Interest-free loan / low-interest loan / Brummeria case / income tax / gross income / received by or accrued to / *quid pro quo* / not of a capital nature / donations tax / capital gains tax / estate planning / estate duty

OPSOMMING EN SLEUTELWOORDE

Rentevrye lenings of lae-rente lenings en boedelbeplanning: Die lewe na Brummeria

Van tyd tot tyd lewer die hof 'n uitspraak wat 'n baie groter uitwerking het as wat verwag is, en wat daartoe lei dat boedelbeplanners hul beplanningstrategieë heroorweeg. Só 'n uitspraak was die vonnis van die Appèlhof in die saak van die *Kommissaris vir die Suid-Afrikaanse Inkomstediens v Brummeria Renaissance* 2007 6 SA 601 (SCA) (*Brummeria* hofsaak). In hierdie hofsaak was die rentevrye lening en die reg om leningskapitaal vry van enige rente verpligtinge te gebruik, onder die soeklig. Die Appèlhof moes beslis of die reg 'n bepaalbare waarde het en of hierdie waarde belasbaar in die hande van die lener kan wees. Die Appèlhof het beslis dat die reg onder 'n rentevrye lening wel in die bruto inkomste van die lener ingesluit moet word.

Boedelbeplanning behels dikwels dat rentevrye lenings as boedelbeplanningsinstrumente gebruik word om 'n waarde groeiende bate uit die boedel van 'n beplanner te verwyder. Sedert die *Brummeria* hofsaak kan daar egter nie summier aanvaar word dat die toestaan van sodanige lenings geen belasting implikasies sal inhou nie. Alhoewel die rentevrye lenings in die *Brummeria* hofsaak glad nie met boedelbeplanning verband gehou het nie, het die beslissing tot heelwat spekulasie oor die toekoms van die rentevrye lening as boedelbeplanningsinstrument gelei. SARS het probeer om die onsekerheid meegebring deur die hof se uitspraak uit te klaar deur *Interpretation Note 58* uit te reik, maar daar is steeds ’n mate van onsekerheid.

Die fokus van hierdie mini-verhandeling is om aan te dui wanneer en tot watter mate die bepalings van die *Inkomstebelastingwet* 58 van 1962 (IB-Wet) sowel as die *Boedelbelastingwet* 45 van 1955 op die gebruik van rentevrye lenings, in die geval van boedelbeplanning, van toepassing sal wees. Die bepalings van die bruto inkomste definisie, artikels 7 en 64E, die bepalings van skenkingsbelasting asook paragraaf 12(5) en 12A van die Agtste Bylae tot die IB-Wet, is ondersoek. Met die gebruik van hierdie lenings vir boedelbeplanning in gedagte, word artikels 3(3) en 3(5) van die *Boedelbelastingwet* spesifiek bespreek. Die vraag of die rentevrye lening steeds 'n nuttige boedelbeplanningsinstrument is, word ook beantwoord.

Sleutelwoorde:

Rentevrye lening / lae-rente lening / Brummeria hofsaak / inkomstebelasting / bruto inkomste / ontvang deur of toegeval aan / *quid pro quo* / nie van 'n kapitale aard / skenkingsbelasting / kapitaalwinsbelasting / boedelbelasting / boedelbeplanning

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LIST OF ABBREVIATIONS

EDA	Estate Duty Act 45 of 1955
ITA	Income Tax Act 58 of 1962
NCA	National Credit Act 34 of 2005
S.African L.J.	South African Law Journal
SARS	South African Revenue Service
SCA	Supreme Court of Appeal
STC	Secondary Tax on Companies
Stell LR	Stellenbosh Law Review

Chapter 1

1 Introduction

1.1 Background and problem statement

An estate plan often involves the transfer of assets by way of a donation or the selling of assets to a connected person such as a family trust.[1] However, just as often the purchaser does not have the means to pay the purchase price. On agreement between the seller and the buyer, which will mostly be between the founder[2] of the family trust (or any other person connected to the trust) and the trust,[3] the purchase price due will remain outstanding on a loan account.[4] In all likelihood no interest will be levied or an interest rate lower than the market-related interest rate[5] will be agreed upon. For many years the interest-free loan was therefore the most frequently used estate planning tool.[6]

It was generally accepted (and the tax law has been applied accordingly) that the recipient of such a loan would not incur any income tax consequences.[7] On 13 September 2007 the decision of the Supreme Court of Appeal (SCA) in the case of *Commissioner for the South African Revenue Service v Brummeria Renaissance*[8] (hereafter referred to as the *Brummeria case*), seemingly pulled the rug from under

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1 Olivier, Strydom and Van den Berg *Trust Law* 8–18, also see Ostler 2013 http://www.schoemanlaw.co.za/wp-content/uploads/2013/06/Interest-Free-Loans-The-Situation-Post-March-2013.pdf., as well as Carroll *Income to a Donor-Parent* 16.

2 In this mini-dissertation where reference is made to the founder, the person referred to will be the estate owner for whom estate planning is being done. The founder can also be a trustee of the trust or even a beneficiary. In the rest of the document where the term planner is found, it will refer to the estate owner.

3 In this mini-dissertation a trust will mainly be used as example. In practice it is also found that assets are sold to a family business in the form of a private company (or close corporation) and that the planner's shares in this company is then at the same time transferred/sold to the family trust. (Example *C:SARS v Airworld CC* 2007 SCA 147 (RSA)).

4 Olivier, Strydom and Van den Berg *Trust Law* 8-21. Also refer to Carroll *Income to a Donor-Parent* 16.

5 The words 'low-interest loan' will refer to a loan agreement where the interest charged on the outstanding loan capital will be at a rate lower than a market-related interest rate. In this mini-dissertation references to 'interest-free loans' will also include 'low-interest loans', unless the context indicates otherwise.

6 West and Surtees 2002 *Meditari Accountancy Research* 260.

7 Smit *The impact of the Brummeria Renaissance case* 1.

8 2007 6 SA 601 (SCA).

those who used the interest-free loan in estate plans as an estate planning tool. The court was confronted with the of question of whether or not the right to use loan capital free of charge, and therefore without any interest obligation for the borrower, has an ascertainable taxable value and would be taxable in the hands of the borrowers.

An amount is taxable in the hands of a taxpayer when the amount is included in the gross income of that taxpayer. All the elements of the gross income definition, as found in section 1 of the *Income Tax Act* 58 of 1962[9] (hereafter referred to as the ITA), must be met before an amount would qualify as taxable. Unfortunately, the individual elements of the definition are not expressly defined in the ITA and it often occurs that the courts are called upon to determine the definition. The *Brummeria* case was but one of the many cases that dealt with the interpretation of the definition.

The conclusion drawn by the court in the *Brummeria* case resulted in much speculation regarding the future use of the interest-free loan as an estate planning tool. Despite the fact that SARS tried to clarify the reasoning behind the ruling, with the issue of Interpretation Note 58[10] (hereafter referred to as IN58), there is still uncertainty regarding the taxability of the right to use loan capital interest-free. This conclusion can be drawn from the large number of academic publications and articles written by academics, lawyers, and auditors on the topic of the *Brummeria* case since 2007.[11] Hence, the following remark by Spearman[12] is of great relevance:

> It is submitted that in order for a tax system to function effectively, it is vital that taxpayers have reasonable certainty as to whether, in terms of the applicable

9 *Income Tax Act* 58 of 1962; Gross income is defined in section 1 of the ITA as "in relation to any year or period of assessment means –
(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature...".

10 Interpretation Note 58 of 30 June 2010.

11 See Smit *The impact of the Brummeria Renaissance case*, Spearman *Valuation of amounts*, Tennant *Interest-free loans*, West and Surtees 2002 *Meditari Accountancy Research* 259-294, Jansen van Rensburg 2008 *Stell LR* 30-50, Cliffe Dekker Hofmeyer 2010 http://www.auditpartners.co.za/a/8111/interest-free-loans--interpretation-note-on-the-...2013/05/11, et cetera.

12 Spearman *Valuation of amounts* 13.

law, they are or are not liable for income tax, or will or will not be liable for income tax if they adopt a contemplated course of action... Deak (1997) is of the opinion that, in South Africa, as in many other tax jurisdictions, such certainty is an ideal that is often removed from reality.

This principle of certainty was one of the minimum standards for an effective tax system, coined as early as 1769 by Adam Smith. In his book, *The Wealth of Nations,* Smith[13] stated that:

> The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gathered, which can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself.

Shortly after the *Brummeria* case, and still to some extent today, the taxpayer using an interest-free loan as an estate planning tool, are still not certain as to what amount is payable for taxation purposes.

1.2 Research question

Based on the problem statement, as defined above, the research question for this study was:

> In light of the *Brummeria* case, to what extent does the taxation of interest-free or low-interest loans influence the usefulness of these loans as estate planning tools?

Previous studies on the effect of the *Brummeria* case judgement on the taxation of interest-free loans did not address the question of how these types of loans can still be used to the best advantage of the taxpayer in compiling an estate plan. This issue was researched and addressed in this study.

In order to address the above-mentioned in more detail the following secondary research questions were asked:

1.2.1 What is the nature and extent of interest-free loan agreements and to what extent are they used in estate planning?

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13 Smith *The Wealth of Nations* chapter II 1.

1.2.2 To what extent are interest-free loans taxable if one takes into account the provisions of the ITA with regard to income tax?

1.2.3 To what extent are interest-free loans taxable, if one takes into account the provisions of the ITA with regard to donations tax?

1.2.4 To what extent are interest-free loans taxable, if one takes into account the provisions of the ITA with regard to capital gains?

1.2.5 To what extent are interest-free loans taxable, if one takes into account the provisions of the *Estate Duty Act* 45 of 1955[14] (hereafter referred to as the EDA)?

1.3 Aim of the study

The contribution this study made lies in the explanation of what the tax implications of the use of an interest-free loan in estate planning are. The study also made some recommendations on how to make use of interest-free loans in estate planning without incurring a tax liability. With the characteristics of loan agreements in mind, these interest-free loans were defined. The tax implications for the use of interest-free loans for an individual were explored on the basis of the following tax types:

- income tax;
- donations tax;
- capital gains tax (hereafter referred to as CGT);
- estate duty.

On the basis of the research question, the following research objectives were identified:

- To understand the nature of an interest-free loan in the context of estate planning.
- To investigate tax law with reference to IT, donations tax, CGT and estate duty.
- To determine what the *Brummeria* case and other case law dictate with regard to the nature and taxation of interest-free or low-interest loans.

14 *Estate Duty Act* 45 of 1955.

1.4 Overview of the chapters to follow

The research is structured under the following headings in the chapters to follow: Chapter 2: The research on the legal background of loans is discussed and, in particular, the essential elements of loan agreements. A short explanation is given of what estate planning constitutes and what the main objectives are when an estate plan is compiled for a client.[15] The use of loans in estate planning is illustrated by way of a case study. Chapters 3 and 4: The tax implications with regard to income tax, donations tax, capital gains tax, and estate duty on the use of these loans are analysed. Chapter 5: In this chapter the final conclusions are discussed with specific emphasis on whether or not interest-free loans still play a role as an estate planning tool.

1.5 Methods, procedures and research techniques

A qualitative research methodology, through a literature study, was adopted in this study. The literature study involved the use of research already conducted on the taxation of interest-free loans, literature on estate planning and current tax legislation and applicable case law.

The next chapter explores the characteristics of a loan and the use of a loan, especially with regard to the use of interest-free loans in estate planning.

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15 In the chapters to follow the client for whom estate planning is done, will be referred to as the planner.

Chapter 2: The use of a loan as estate planning tool

2.1 Introduction

Estate planning is a specialised field that cannot be researched and explored to its full extent in this study. The purpose of this study was not to serve as a tax planning or estate planning tool, but to research the use of interest-free loans in estate and tax planning and identify what the tax implications will be, taking into consideration the current state of tax legislation.

In the previous chapter the aim and importance of this study were addressed. The following chapters focus on the taxation of interest-free loans when used in estate planning. However, with the research question in mind, in order to discuss the taxation of interest-free loans it was necessary to first establish what constitutes a loan and how it is used in the process of estate planning. The legal nature of loans is therefore discussed in this chapter. Whether or not interest is an essential element of a loan agreement is addressed in particular. The use of interest-free loans in estate planning is linked to the main objectives of estate planning.

2.2. Loans: a historical analysis

The controversy of whether or not interest may be levied on a loan dates back to the time when the books of the Old Testament were written.[16] According to Tennant,[17] in the Old Testament the Bible prohibited the lender from charging interest on a loan. Watson[18] holds the view that the reason for not charging interest is that "friends do not demand interest from friends". This view changed over time and in the sixteenth century it became acceptable for the lender to charge interest on a loan.[19]

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16 Tennant *Interest-free loans* 12. Watson claims that the loan for consumption appeared in the third century BC (Watson *Law and History Review* 3).
17 Tennant *Interest-free loans* 12.
18 Watson *Law and History Review* 6.
19 Tennant *Interest-free loans* 12.

The South African loan agreement originates from the Roman-Dutch common law.[20] In time legislation was promulgated that regulated credit agreements.[21] Currently in South Africa the main legislation regulating credit-providing arrangements, and which replaced a number of credit-related laws, is the *National Credit Act* 34 of 2005[22] (hereafter referred to as the NCA).

The following discussions explore the applicability of the NCA to interest-free and low-interest loans.

2.3 Definition of a loan

In the previous paragraph it was stated that the NCA is the main regulatory legislation with regard to credit agreements et cetera. In this paragraph the 'loan' concept is defined in the light of the provisions of the NCA.

Tennant[23] defines a loan as:

> Something, generally a sum of money, that would be borrowed to someone and in return they are expected to repay the amount borrowed.

The NCA defines credit[24] (when used as a noun) as:

> (a) a deferral of payment of money owed to a person, or a promise to defer such a payment; or
> (b) a promise to advance or pay money to or at the direction of another person.

Section 4(1) of the NCA states that the Act will apply to all credit agreements concluded or 'having an effect within' the Republic, between parties dealing at arm's length.[25] It is therefore of great importance to evaluate the agreement against the

20 Tennant *Interest-free loans* 17. According to Thomas it is no exaggeration to say that the Roman law of property contains the essence of the modern South African property law. (Thomas, Van der Merwe and Stoop *Die Suid-Afrikaanse Privaatreg* 7 and 145).
21 Tennant *Interest-free loans* 13.
22 *National Credit Act* 34 of 2005.
23 Tennant *Interest-free loans* 12.
24 S1 NCA.
25 An arm's length transaction will typically be a transaction for a price that will be similar to a price "that may be fetched on the open market between a willing buyer and willing seller."(Tennant *Interest-free loans* 14). Judge Trolip's definition if an arm's length transaction (found in *Hicklin v Secretary for Inland Revenue* 1980 1 SA 481 (A) at 495), is: "It connotes that each party is

'arm’s length' requirement to establish whether or not the NCA will be applicable to the specific loan agreement. Section 4 of the NCA continues to list the exceptions to this general rule. The opinion is held that it is in these exceptions, especially those described in section 4(2)(b) of the NCA that the definition of the typical loan used in estate planning is to be found. Section 4(2)(b) of the NCA specifically excludes the following loans from the principles enforced by the NCA:

> In any of the following agreements, the parties are not dealing at arm’s length:
> (i) a shareholder loan or other credit agreement between a juristic person, as consumer, and a person who has a controlling interest in that juristic person, as credit provider;
> (ii) a loan to a shareholder or other credit agreement between a juristic person, as a credit provider, and a person who has a controlling interest in that juristic person, as consumer;
> (iii) a credit agreement between natural persons who are in a familial relationship and –
> (aa) are co-dependent on each other;
> (bb) one is dependent upon the other; and
> (iv) any other arrangement –
> (aa) in which each party is not independent of the other and consequently **does not necessarily strive to obtain the utmost possible advantage out of the transaction**; or
> (bb) that is of a type that has been held in law to be between parties who are **not dealing at arm’s length**.
> (Own emphasis)

It is evident from the above discussions that loans, or transactions involving a loan between connected parties,[26] will not be regarded as a transaction (loan agreement) that took place at arm’s length due to the fact that the lender will not normally "strive to obtain the utmost possible advantage from the transaction."[27] These last statements are very important for two reasons: firstly to determine whether or not the NCA will be applicable to the transaction, and lastly, whether or not interest must be

independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself.".

26 A connected person is defined in section 1 of the ITA. According to the definition a natural person will be a connected person to any relative as well as a trust "(other than a portfolio of a collective investment scheme in securities or a portfolio of a collective investment scheme in property)", usually a family trust, of whom that person or his relative is a beneficiary. A relative will include adopted children and adoptive parents. It is not stipulated as such in the ITA, but in practice any relative will be any person within the third degree of consanguinity from the connected natural person. See Wilcocks "Capital allowances" 220.

27 S4(2)(b)(iv)(aa) of the NCA.

charged by the connected lender. In paragraph 2.4.3 the question whether or not interest is an essential element of a loan agreement, is specifically addressed.[28]

The following discussion outlines the nature of a loan and its essential elements.

2.4 *The nature of a loan*

In this paragraph the nature of a loan and the essential elements of a loan agreement are considered in terms of the common law as well as the NCA. This part of the research was aimed at clarifying whether or not interest is an integrated part of any loan. This is important, because if it can be proved that the charging of interest is one of the essential elements of a loan agreement, then the question arises whether or not the interest-free loan agreements, used in estate planning, are legal and enforceable.

2.4.1 *The nature of a loan in terms of the common law*

The South African loan agreement originates from the Roman-Dutch common law.[29] There are two types of loan agreements in South Africa, namely the *commodatum,* or loan for use, and the *mutuum*, the loan for consumption. These two loan agreements can be differentiated from each other in that the 'loan for use' expects of the borrower to return the exact item to the lender.[30] In the case of the loan for

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28 Basson and Blackburn 2011 http://www.bassonblackburn.com/news-attorneys-2011jan3.html: In this article the authors discussed an unreported case before the High Court (*Beets v Swanepoel* (2150/09) [2010] ZANCHC 55 (05/10/2010)). The mother advanced a loan to her major daughter to enable the daughter to buy a property. The agreements had very favourable terms (assumedly for the daughter). A bond was registered as security. The daughter defaulted on the terms of repayment and the mother went to court to try and recover her money. What is important for this study is that the Court found that the NCA was applicable to the specific loan agreement. The loan between relatives must be tested against the principles of 'arm's length' as well as whether or not the parties involved are "dependent of each other." On page 7 of paragraph 7 of this case Judge Trollip expressed the opinion that the parties "strove to gain the utmost advantage from the agreement." It will therefore be important to consider each and every transaction taking place under an estate plan in terms of the NCA as well. Refer to s4(2)(b)(iv)(aa) of the NCA.

29 Tennant *Interest-free loans* 17, and Thomas, Van der Merwe and Stoop *Die Suid-Afrikaanse Privaatreg* 285.

30 Thomas, Van der Merwe and Stoop *Die Suid-Afrikaanse Privaatreg* 290.

consumption the borrower is merely expected to return a similar object of same value to the lender.[31]

This mini-dissertation focussed on the latter of the two. The loan for consumption generally entitles the borrower to take ownership of the thing or amount and use it as he or she pleases. The repayment of this loan will take place over a period of time and interest may be charged as agreed upon by the parties involved. Originally these types of loans were used between natural persons and in a non-commercial sense.[32] In general no interest was charged as it was not part of the agreement. In time these types of loans became applicable in the commercial world and interest was generally part of the agreement. The contract would be concluded verbally and the payment of interest would have been a *stipulatio* and would be independent from the *mutuum* (the loan).[33]

The following discussion explored the 'modern loan'agreement used in South Africa as well as the statutes regulating loan agreements.

2.4.2 *The nature of a loan in terms of the NCA*

As mentioned above, the modern loan in South Africa, as it is used today, originated in the Roman-Dutch common law. Over time the common law was supplemented by legislation. As was seen in paragraph 2.4.1 above, these laws were largely replaced by the NCA.

Sections 103 and 104 of the NCA outline the rules regarding the charging of fees, charges and interest on loans or credit agreements. It is evident from the wording of these sections that the credit provider (the party granting the loan, or the lender) may charge interest on the principal debt. The author could not find any indication in the NCA that a credit provider has to charge interest. Section 5(3)(b) of the NCA states

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31 Tennant *Interest-free loans* 17, also refer to Watson *Law and History Review* 2 and Thomas, Van der Merwe and Stoop *Die Suid-Afrikaanse Privaatreg* 287. Thomas explains that if the loan was for wine, for example, that the borrower had to give back wine of the same quantity and quality.

32 Jansen van Rensburg 2008 *Stell LR* 42, also refer to Watson *Law and History Review* 2 - 6.

33 Jansen van Rensburg 2008 *Stell LR* 43, also refer to Watson *Law and History Review* 2 - 6.

that a person may charge interest with respect to the unpaid amount, relating to an incidental credit agreement,[34] if:

> The credit provider has disclosed, and the consumer has accepted, the amount of such a fee, charge or interest, or the basis on which it may become payable...

If the definition of an incidental credit agreement is considered, it is evident that this type of credit agreement will generally not be a credit or loan agreement that will be applicable in estate planning. The importance of the above statement is the fact that interest will be payable in terms of an agreement between the lender and the borrower. Other sections in the NCA[35] also indicate that an agreement with regard to interest must exist.

The opinion is held that the main objective, if one takes into account the above and in particular the provisions of sections 103 to 105 of the NCA, is to protect the consumer and not to lay down rules and regulations as to the essential elements of loan or credit agreements.[36]

According to Tennant[37] the provisions of the NCA do not apply to juristic persons and this means:

> That juristic parties are free to negotiate the amount of interest and fees charged on credit agreements they enter into. However, this does not mean that those parties are not required to adhere to public policy. Our courts are able to declare those provisions unenforceable by way of Constitutional Law.

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34 S1 NCA "'incidental credit agreement' means an agreement, irrespective of its form, in terms of which an account was tendered for goods or services that have been provided to the consumer, or goods or services that are to be provided to a consumer over a period of time and either or both of the following conditions apply:
(a) a fee, charge or interest became payable when payment of an amount charged in terms of that account was not made on or before a determined period or date; or
(b) two prices were quoted for settlement of the account, the lower price being applicable if the account is paid on or before a determined date, and the higher price being applicable due to the account not having been paid by that date.".

35 Refer to s1 'instalment agreements' "(d) interest, fees or other charges are payable to the credit provider in respect of the agreement." as well as 'lease'; s8(3)(b) and (4), and s92(2) and (3).

36 The opinion is confirmed by Tennant. See Tennant *Interest-free loans* at 16.

37 Tennant *Interest-free loans* 16. If a juristic person's "asset value or annual turnover, together with the combined asset value or annual turnover of all related juristic persons, at the time the agreement is made, equals or exceeds R1 000 000," the NCA will not be applicable to credit agreements entered into by the juristic person. See Deloitte https://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Content/Articles/Insights%20into%20aspects%20of%20the%20National%20Credit%20Act.pdf 2.

The conclusion can then be drawn that interest is therefore an amount charged on a loan or advance under an agreement and "*in lieu* of being provided the right to use that advance over a period of time."[38]

The essential elements of a loan agreement are discussed below.

2.4.3 The essential elements of a loan agreement

As mentioned in paragraph 2.4.1 the loan for consumption is typically the loan agreement that is more applicable in today's context. Under the common law the *mutuum* or loan for consumption only becomes enforceable once the borrower has received the object of the loan in a transfer of ownership.[39] One of the essential elements of the loan agreement is therefore that the lender must transfer ownership of the object, either money or an item, to the borrower.

According to Jansen van Rensburg[40] a loan for consumption under the modern South African law "is arguably not a real contract anymore, but rather a consensual one." Once the contract has been concluded between the parties (and they therefore reached an agreement as to the content of the contract), both parties will incur obligations under the contract. Once the transfer of the loan capital has taken place, the lender has fulfilled his obligation.[41] A continuous contractual obligation rests on the borrower to repay the loan capital at a certain point in time. Jansen van Rensburg furthermore states that the modern loan agreement will give rise to a third obligation if an amount of interest is charged. The third obligation will therefore be on the borrower to pay the interest and on the lender to receive the interest paid. The author also emphasises that despite the fact that it is often found that the modern loan agreement makes provision for the payment of interest, that interest is not one of the essential elements of a loan contract.[42] Confirmation of this statement is to be

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38 Tennant *Interest-free loans* 16.
39 Jansen van Rensburg 2008 *Stell LR* 42.
40 Jansen van Rensburg 2008 *Stell LR* 43.
41 In this mini-dissertation references to the masculine gender will also include the feminine gender, unless the context indicates otherwise.
42 Jansen van Rensburg 2008 *Stell LR* 43.

found in the case of *NBS Boland Bank v One Berg River Drive and Others, Deeb and Another v ABSA Bank Ltd; Friedman v Standard Bank of South Africa Ltd.*[43]

The conclusion can be drawn that the agreement between two parties where the lender agrees to transfer ownership of loan capital to the borrower, who in turn agrees to repay the loan capital at a later stage, will be a separate agreement from the agreement where the parties agree that the borrower will pay an amount of interest over and above the repayment of loan capital. Interest is therefore not an essential element of a loan agreement or loan contract. It can furthermore be concluded that a loan agreement between connected parties may be concluded without an element of interest, or at a lower than market-related[44] interest rate.

Now that the origin and the nature of a loan have been established, the purpose of a loan, especially for estate planning purposes, is discussed.

2.5 Interest-free or low-interest loan and estate planning

It is important to discuss estate planning briefly as the use of interest-free loans and low-interest loans in estate planning and the taxability of these loans are the main focus of this study.

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43 1999 4 All SA 183 A at 194. Judge van Heerden made the following comment: " [A] term relating to the payment of interest is not an *essentialé*, as opposed to a material term, of a contract of loan. There can after all be a perfectly good contract of loan even if it makes no provision for the payment of interest.".

44 According to Tennant it will all depend on the nature of the person/taxpayer as to what will be regarded as a market-related rate. (Tennant Interest-free loans 16) In the case of a natural person or a trust the 'official rate of interest' will be determined in accordance with the definition to be found in paragraph 1 of the Seventh Schedule to the ITA. It states that the 'official rate of interest' means

"(a) in the case of a loan which is dominated in the currency of the Republic, a rate of interest equal to the South African repurchase rate plus 100 basis points; or

(b) in the case of a loan which is dominated in any other currency, a rate of interest that is the equivalent of the South African repurchase rate applicable in the currency plus 100 basis points."

2.5.1 *What is estate planning?*

While estate planning is not the main topic of this research study it is believed that a few general remarks on the subject of estate planning will be in order, merely to serve as a link with the use of the loan in estate planning.

Meyerowitz, as quoted by Olivier,[45] defines estate planning as:

> The arrangement, management, securement and disposition of a person's estate so that he, his family and beneficiaries can enjoy and continue to enjoy the maximum benefits from his assets or estate during his lifetime and after his death.

Firstly it is important to understand that estate planning and tax planning is not the same thing. Estate planning will certainly contain a large component of tax planning, but tax planning is not, and should not be the only consideration. Unfortunately tax planning, and more specifically the minimisation of estate duty, normally is the main motivation behind estate planning, and many of the tools and techniques used in the estate plan are aimed at reducing or avoiding estate duty.[46] The objectives of estate planning[47] are certainly different from those of tax planning and also embrace succession planning.

Several authors[48] on this topic are in agreement that the objectives of the planner[49] play an important role and that estate planning is an on-going process. As the

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45 Meyerowitz 1965 *The Taxpayer CC,* as quoted by Olivier *Trust Law* 8-4; Viktor *et al Estate Planning* 195; Burger *Trusts as Estate Planning Tool* 5.

46 Burger *Trusts as Estate Planning Tool* 1. Jurinski and Zwick warn that advisers as well as the client must not confuse estate planning with tax minimisation. The main reason for this is that the plan may fail because "tax laws, financial conditions, or family dynamics" may have changed by the time the estate plan comes into operation. They also warn that an estate plan may cause "resentment and split the family apart" if the planner and the client resent dealing with family issues in the plan. (Jurinski and Zwick *Journal of Financial Services Professionals* 53).

47 Victor *et al Estate Planning* are of the opinion that "the primary objective of estate planning is to produce a cost-effective plan that is in accordance with what a client, after consultation, wants to achieve." (Victor *et al Estate Planning* 196). For more information on the primary objectives and the purpose of estate planning refer to Victor *et al Estate Planning* 195-196, Rabenowitz (ed) *Financial Planning* (LexisNexis Durban 2012) 484-486, as well as De Swardt "Estate Planning" 1030.

48 Olivier, Strydom and Van den Berg *Trust Law* 8-4, also see Rabenowitz (ed) *Financial Planning* (LexisNexis Durban 2012) 483, Victor *et al Estate Planning* 201 and Burger *Trusts as Estate Planning Tool* 10.

planner's circumstances, financial situation and wishes change, the plan must be revisited and if necessary revised. Timeous planning will ensure that problems are anticipated and dealt with in a manner that will conserve assets and minimise taxes as far as legally possible.[50] To reach the objectives of the planner, estate planning would generally, among other things, involve the transfer or disposal of the assets during the owner's lifetime in such a way that it makes economic sense, and at the same time limit the erosion of the value of the assets. This is usually where the planner makes use of interest-free loans to enable the acquiring party financing for the transaction.

Now that estate planning has been defined, the use of interest-free and low-interest loans in the estate planning process will be discussed.

2.5.2 The use of interest-free and low-interest loans in estate planning

The general purpose of a loan is normally to obtain finance in order to satisfy a need in a business.[51] Victor[52] and Olivier[53] discussed the use of a loan as a method of assisting in estate planning and saving on estate duty. In general the use of a loan and the use of a trust or another legal entity go hand-in-hand in an estate plan. The trust can be used effectively to remove the growth assets from the estate of the planner. This is done by selling the asset to the trust on a loan account.[54] The growth asset is therefore effectively replaced by a loan account. Depending on whether or not the loan is an interest-bearing loan or interest-free loan, the value of the loan will be pegged at the original value of the asset when it was sold to the trust. Over time the loan account will decrease as the loan is repaid by the trust (or other legal entity) or by making use of the permissible R100 000 free of donations tax amount.[55] In chapters 4 to 6 the tax implications of the use of the R100 000 yearly tax-free donation, are discussed.

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49 In this paragraph as well as the rest of the mini-dissertation: Where reference is made to the planner it will be the client for whom an estate plan is compiled as well as the person whom may be ending up paying tax when executing the estate plan.
50 The opinion is supported by Olivier, Strydom and Van den Berg *Trust Law* 8-4.
51 Tennant *Interest-free loans* 19.
52 Victor *et al Estate Planning* 202.
53 Olivier, Strydom and Van den Berg *Trust Law* 8-21.
54 Olivier, Strydom and Van den Berg *Trust Law* 8-21.
55 S56(2)(b) of the ITA.

2.6 Conclusion

In this chapter the loan agreement in terms of the common law as well as the NCA were analysed. The conclusion was drawn that interest is not an essential element of a loan agreement and that a loan agreement may be concluded without any stipulation to payable interest. In fact, if the parties do reach an agreement relating to interest payable on the outstanding loan account, the interest agreement will be a separate agreement with its own obligations.

In the last instance estate planning was defined in short as an on-going process that will take into account the particular circumstances, wishes and assets of a specific person to ensure that the person as well as his family and beneficiaries can enjoy and continue to enjoy the maximum benefits from his assets or estate during his lifetime and after his death.

It must be emphasised that the process and purpose of estate planning as discussed above can never serve as a detailed reference source on the topic of estate planning, since the main objective of this study was to research the tax implications if a low-interest or interest-free loan is used in the estate planning process.

It can therefore be concluded that estate planning will only be effective if one first and foremost takes the client's wishes into account. Then the estate planner will need in-depth knowledge of estate duty, income tax, capital gains tax, donations tax, transfer duty and the laws relating to matrimonial regimes and the establishment of wills and trusts to construct a cost-effective and flexible estate plan.[56]

In the next section the use of an interest-free loan in an estate plan, is illustrated by way of a case study.

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56 Victor *et al Estate Planning* 195.

2.7 Case study

This case study[57] practically illustrates the tax implications relating to interest-free and low-interest loans in the following chapters. The example also serves as a good summarised illustration of what estate planning, as defined above, is about.

The planner[58] is a forty-five-year-old South African resident farmer. He is married out of community of property and has two sons, aged 17 and 21 respectively. Both of his sons would like to continue with the farming operation after completion of their studies. The planner is the proud owner of two farms with a total area of 2 000 hectares that were valued at R375 per hectare in 1990. An estate planner illustrated to the planner what the effect of inflation can be on the value of the property. At an inflation rate of 6% the value of the farming property will grow from R3 000 000 in 2002 to an estimated R12 000 000 in 2026. If the R3 500 000, as found in section 4A of the EDA,[59] is taken into account, estate duty of R980 000[60] will be payable on the estimated estate value of R12 000 000.

Should the estate owner pass away during 2014, and his sons inherit the farms subject to a *usufruct* in favour of their mother, estate duty can be less than R500 000 or even zero. This calculation is dependent on the value of her inheritance (the *usufruct*) and will be a result of the provisions of sections 4A and 4(q) of the EDA. Suppose that a few years later the surviving spouse of the deceased also passes away. The *usufruct* could by then increased considerably in value. The full net value (after taking into account/consideration the section 4A R3 500 000 rebate) will be subject to estate duty.

The estate planner suggested that the following steps be taken:

- Two trusts, one with each son as beneficiary, must be created.

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57 The case study was adjusted from the one to be found in Olivier, Strydom and Van den Berg *Trust Law* 8-19.
58 The planner is the estate owner or client for whom estate planning is done.
59 *Estate Duty Act* 45 of 1955.
60 The amount was calculated: R12 000 000 x 70% = the value to be included for estate duty purposes as property. Refer to s5(1A) of the EDA.

- The farms must be evaluated to determine the fair value with a view to selling the farm property to the two trusts.
- Sale agreements between the trustees of the trusts must be drawn up and executed, with the terms that the farms will be individually sold to the respective trusts, at a fair value as determined. The purchase price will be financed by way of an interest-free loan between the estate owner and the trustees of the trusts.
- The estate owner can then carry on with his farming operation through a lease agreement, paying a nominal rental amount.
- The result will be that future value increase of the farms will take place in the trusts and is therefore effectively removed from the planner's estate.
- Should the sons in future want to join their farther in the farming operation, they can either farm with him in a partnership, or they can take over the lease agreements "on the respective farm earmarked for him"[61] from their father and farm for his own account.
- At this stage the planner can start to levy interest on the outstanding loan account, and the trusts will be able to pay the interest out of the rental income.
- The only assets in the planner's estate relating to the original farming property will therefore be the outstanding loan account.

In the chapters to follow the taxation of interest-free loans is explored. Firstly, the effects of income tax are discussed.

61 Olivier, Strydom and Van den Berg *Trust Law* 8-19.

Chapter 3: Income tax consequences for the use of interest-free loans

In chapter 2 the process of estate planning and the use of an interest-free loan as an estate planning tool, were discussed. Burger[62] states:

> It is important that tax legislation be observed and that the anti-avoidance provisions are not contravened when these tools and structures are implemented.

The taxation of an interest-free loan in the hands of the lender, as well as the borrower, is discussed in terms of the provisions of the ITA as well as the related case law in this chapter.

3.1 Introduction

In chapter 1, under paragraph 1.1, it was mentioned that the use of interest-free loans in estate planning was common practice. It was commonly believed that the recipient of such a loan would generally not incur any income tax consequences,[63] but the *Brummeria* case proved this conception by, among others, tax- and financial planners to be incorrect. In the *Brummeria* case the court was confronted with the question as to whether or not the right to use loan capital free of charge,[64]has an ascertainable taxable value and would be taxable in the hands of the borrower. It must be noted that a benefit or an amount can only be taxable if the amount was received by or accrued to the borrower (to his benefit) and met all the requirements of the gross income definition.[65] It is therefore important to first establish a clear understanding of the different elements of the gross income definition.

This chapter is divided into three parts. In the first part, three of the elements of the gross income definition as well as the term *quid pro quo* are discussed with

62 Burger *Trusts as Estate Planning Tool* 11.
63 Smit *The impact of the Brummeria*-case 1.
64 The right received by the borrower under an interest-free loan is the right to use loan capital free of charge. It means that the borrower did not incur any corresponding interest obligation. In the following paragraphs there will only be referred to as the right.
65 This opinion is supported by authors such as Stiglingh "Gross Income" 18. Also refer to paragraph 1.1 and the applicable footnote for the wording of the definition of gross income.

reference to case law, IN 58,[66] and the opinions of authors with regard to these topics. This discussion is important as a right can only be taxable if it meets the requirements of the gross income definition. It is therefore necessary to assess whether or not the interest-free or low-interest loan used in estate planning will be regarded as a benefit, capable of being valued and therefore taxable in terms of the gross income definition. The three elements of the gross income definition to be discussed are the meaning of:

- An amount
- Received by and accrued to
- Not of a capital nature.

In the second part of this chapter the discussion involves some of the anti-avoidance sections to be found in the ITA, namely section 64 and section 7.

Lastly, the findings in this chapter are applied to the case study as stated in chapter 2.

3.2 Gross income definition

3.2.1 Introduction

On 13 September 2007 the Supreme Court of Appeal (the SCA) delivered judgment in the *Brummeria* case on whether or not the right constituted a right capable of being valued and therefore taxable in the hands of the borrower.[67] The Court indeed

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66 Interpretation Note 58 of 30 June 2010.

67 *Brummeria* case at 602-604. The facts of the case in short were: The respondents in this case were three companies that had been involved in the development of retirement villages. In order to finance these developments, the companies entered into agreements with potential occupants of the planned units of the retirement village. The typical standard terms of these agreements were:

- The company contracted with potential occupants and would have obtained an interest-free loan from them.
- As acknowledgement of the loan a debenture would have been issued to the lender. As further security, the title deed of the particular property, forming the subject of the matter, was endorsed and a covering bond was registered in favour of the lender.
- In the event of cancellation of the agreement, or upon the death of the lender (the occupant), the company would have been obliged to repay the loan.
- The occupant lender was granted the lifelong right of occupation of the unit, while the ownership of the unit remained with the company.

concluded[68] that this right can be regarded as an amount with an ascertainable value that accrued to the taxpayer (the *Brummeria* companies) and must be included in the gross income of the taxpayer.

In the next paragraphs the meaning of the words amount, received by or accrued to and *quid pro quo* as defined by case law, and in particular the *Brummeria* case, is discussed. The views of some authors on these concepts were also explored.

3.2.2 Defining amount

The word amount in the definition of gross income is a term that is not defined in the ITA itself. The result is that taxpayers turned to the courts over the years to give clarity as to the meaning of the word.

The case *Lategan W v Commissioner for Inland Revenue*[69] (hereafter referred to as the *Lategan* case) is the most pertinent case that dealt with the meaning of the word amount. Judge Watermeyer[70] concluded that the word amount must be interpreted in a wide sense and will include not only cash or money, but also the value of property and goods received and earned by the taxpayer.[71] The property can be corporeal or incorporeal, as long as it can be expressed in a monetary value.[72] When interpreting

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- The standard agreement stipulated that the interest-free loan constituted the consideration for the lifelong right of occupation.
- SARS issued revised assessments and taxed the value of the right to use loan capital free of any interest obligation, on the grounds (among others things) that the benefit was received as *quid pro quo* for the provision of occupation "and had an ascertainable money value and accordingly falls within the gross income definition.".
- The Tax Court (presided over by Judge Goldblatt) upheld the companies' appeal. SARS then appealed to the SCA.
- The companies raised, inter alia, the following ground of appeal: They contended that the right received did not constitute an amount received by them as contemplated in the gross income definition.

68 *Brummeria* case at 607 and at 612.

69 2 SATC 16; the facts of the *Lategan* case at 17-18: The taxpayer was a wine farmer who sold the wine produced to third parties. The buyers would settle the purchase price in instalments, with a portion of the amount only payable after the taxpayer's (Lategan) tax yearend. The Commissioner included the amount only receivable after yearend, in the taxpayer's gross income in the year that the sale was concluded, "as they believed that a right, being a personal right, was created in respect of the future payment and that that right could be turned into money in that first year." (Tennant *Interest-free loans* 23 as well as Williams *Cases and Materials* 91).

70 *Lategan* case at 19, also refer to Stiglingh "Gross Income" 16 and 18.

71 Stiglingh "Gross Income" 16 and 18.

72 Stiglingh "Gross Income" 16 and 18.

the word amount Judge Cloete[73] in the *Brummeria* case turned to this interpretation of the word as well as to the cases of *Commissioner for Inland Revenue v People's Stores (Walvis Bay)(Pty) Ltd*[74] (hereafter referred to as the *People's Stores* case) and the judgement of Judge Hefer in *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue*[75] (hereafter referred to as the *Cactus* case). Judge Cloete added that the words corporeal and incorporeal will also include "debts and rights of action". [76] Cloete elaborates that he does agree with the view of the Commissioner that:

> The right to retain and use the borrowed funds without paying interest had a money value, and accordingly that the value of such right must be included in the companies' gross incomes for the years that such rights accrued to the companies.[77]

In reaction to the Commissioner's argument the respondents contended that the rights received and valued by the Commissioner could not be turned into money and therefore did not have a money value and did not fall within the ambit of the definition of gross income.[78] The counsel for the companies relied on the decision of the Cape Provincial Division in the case *Stander v Commissioner for Inland Revenue*[79]

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73 *Brummeria* case at 606.
74 1990 2 SA 353 (A).
75 1999 1 SA 315 (SCA).
76 *Brummeria* case at 611.
77 *Brummeria* case at 607.
78 Their argument was based on the principle of convertibility. This principle had its place in our 'tax interpretation' rules (tax jurisprudence) since the late 1800's. This principle had its origin in the 1892 judgement of the House of Lords in the case of Tennant v Smith 1892 AC 1150 (HL). The convertibility principle was applied in several South African cases, such as the *Stander* case, the *People's Stores* case and the *Lategan* case. It was therefore also widely believed that the convertibility principle was part of our law, except where the provision of a statute proved otherwise. However, the *Brummeria* case came to change that.
79 59 SATC 212 – Facts of the *Stander* case: Mr Stander, the taxpayer, received an award in the form of an overseas holiday for himself and his wife for "achieving excellent standards of performance in financial management." What is very interesting is that he received this award from the franchise dealer who organised the competition (Delta). It was stated that "whatever it cost Delta, or whatever a person who wished to go on such a trip would have had to pay for it, does not constitute an amount which can be said to have money's worth in Stander's hands. In regard to the question whether the trip could be said to have been given 'in respect of services rendered' the court a quo found that the award clearly 'stands in a direct causal relationship to the services rendered by him'." (at 220) Judge Foxcroft, however, ruled that "ordinarily the phrase (and this was common cause between counsel) means 'by force of', 'by authority of', 'by reason of', 'because of', 'through' or 'in pursuance of'. (See Black's Law Dictionary 4 ed 252.) Each of these definitions suggests there must be a direct link between the cause and the result. The presence of the words 'by virtue of' in par (c) consequently does not require any separate consideration. For these reasons the trip in question was on no basis subject to tax and should not have been included by the Commissioner as part of Stander's income." (at 220).

(hereafter referred to as the *Stander* case) as authority for their reasoning. Judge Cloete[80] responded in the following way:

> It is clear from the passage quoted from the judgment of Hefer JA, as well as the passage quoted by him from the judgment of the Chief Justice in the *Delfos*[81] case, that the question whether a receipt or accrual in a form other than money has a money value is the primary question and the question whether such receipt or accrual can be turned into money is but one of the ways in which it can be determined whether or not this is the case; in other words, it does not follow that if a receipt or accrual cannot be turned into money, it has no money value. The test is objective, not subjective. It is for that reason that the passages quoted from the *Stander* case incorrectly reflect the law and the reasoning of Conradie J in ITC 701 was correct.

The SCA (in the *Brummeria* case) never explained how the benefit that accrued to or was acquired by the taxpayers could constitute an amount in terms of the gross income definition.[82] As a result of the facts of the *Brummeria* case being very specific and the loans pertaining in this case were not granted under an estate plan, the views of authors are explored to establish when a loan used in an estate plan will be regarded as a right, capable of being included as a taxable amount in the hands of the borrower.

Jansen van Rensburg[83] focussed on the issue of whether or not all receipts "that have an objective monetary value" should be included in the gross income. With reference to the *Lategan* case Jansen van Rensburg agreed with the conclusion that receipts and accruals in any form of property will constitute an amount in terms of the gross income definition.[84] Jansen van Rensburg emphasised, by referring to the judgment of Jansen in *ITC 1810*[85] that

> the concepts of "amount" and "accrued to" are linked in that both require the existence of a subjective right as represented by the concept of *property.* As explained above, it has been held that an accrual can only take place if a

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80 *Brummeria* case at 609-610.
81 1933 AD 242.
82 Jansen van Rensburg 2008 *Stell LR* 47.
83 Jansen van Rensburg 2008 *Stell LR* 37.
84 Jansen van Rensburg 2008 *Stell LR* 38. Also refer to *Lategan* case as discussed above where Watermeyer held as follows: "In his Lordship's opinion the word 'amount' had to be given a wider meaning and must include not only money but the value of every form of **property** earned by the taxpayer whether corporeal or incorporeal which has a money value". (Own emphasis).
85 68 SATC 189.

> taxpayer acquires a *right:* If the taxpayer acquires, for example, a mere *spes,* there is neither an accrual nor an amount...[86]

Jansen van Rensburg also holds the opinion that property in the context of income tax will bear the traditional meaning of subjective rights with a patrimonial value attached to it.[87] In the case of a loan contract, the borrower only receives a contractual right to receive possession and title to the money lent.[88] This will be a personal right, and as soon as the money is received, the borrower "becomes the holder of the real right of ownership which is also property."[89] However it must be remembered that a simultaneous duty to repay the money received arises as soon as the agreement is concluded.[90] The result of receiving the loan capital as well as the obligation to repay the amount, is that an amount was received that will not qualify as a taxable amount in terms of the gross income definition. This was confirmed in the case *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd*[91] (hereafter referred to as the *Genn* case), and again by Judge Cloete in the *Brummeria* case.[92]

Jansen van Rensburg[93] highlighted the fact that:

> The SCA never dealt with the issue as to how the 'right' to retain and use the loan capital can be regarded as *property* that was *acquired by* the taxpayers after receipt of the loan capital in any great depth. Instead, once the Court concluded that this 'right' had objective monetary value, it simply accepted that it was an *amount* that accrued to the taxpayers on a seemingly continuous basis.[94]

Smit[95] and Tennant[96] agreed with the above arguments of Jansen van Rensburg. The discussion as to whether or not Judge Cloete indeed made a mistake by dismissing the respondent's argument, that the right could not be turned into money,

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86 Jansen van Rensburg 2008 *Stell LR* 39.
87 Jansen van Rensburg 2008 *Stell LR* 42-43.
88 Jansen van Rensburg 2008 *Stell LR* 44-49.
89 Jansen van Rensburg 2008 *Stell LR* 44.
90 Jansen van Rensburg 2008 *Stell LR* 45. Jansen van Rensburg based her opinion on the ruling in the *Genn* case at 301. The principles of the *Genn* case were accepted in the *Brummeria* case and it can therefore be accepted that the principle of the *Genn* case is still applicable.
91 1955 3 SA 293 (A) at 301.
92 *Brummeria* case at 605.
93 Jansen van Rensburg 2008 *Stell LR* 47.
94 Jansen van Rensburg 2008 *Stell LR* 47: "Based on the fact that an amount was included in the taxpayer's gross income on a yearly basis, it must be accepted that the 'right' to retain and use the loan capital, accrued (and would carry on accruing) on a continuous basis throughout the term of the loan.".
95 Smit *The impact of the Brummeria Renaissance case* 38.
96 Tennant *Interest-free loans* 33.

as well as the ruling of the court a quo, will remain of academic value until another judgment overrules the *Brummeria* judgement. However, the author is still of the opinion that Jansen van Rensburg is correct in her conclusion. In terms of the gross income definition as found in the ITA, a borrower cannot be taxed on having acquired a benefit under an interest-free loan, since the borrower did not acquire property that can be seen as an amount received by or accrued to the taxpayer in terms of the gross income definition.[97]

In the next paragraphs the meaning of 'received by or accrued to' and what is meant by '*quid pro quo*' are explored.

3.2.3 Defining 'received by or accrued to' and 'quid pro quo'

As was mentioned above in paragraph 3.1, an amount will only be included in the gross income of a taxpayer if it has an ascertainable value and if the amount was received by or did accrue to the taxpayer for his own benefit.[98] It is widely accepted that the *Brummeria* case brought forward another concept namely, '*quid pro quo*'. In this discussion the concepts 'received by or accrued to' as well as '*quid pro quo*' are analysed.

Like the word amount the words received by or accrued to have come under judicial scrutiny in numerous cases[99], including the *Lategan* case, the *People's Stores* case

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97 As was seen above the opinion is supported by the opinion of Jansen van Rensburg 2008 *Stell LR* 34, Smit *The impact of the Brummeria* case 38, as well as Tennant *Interest-free loans* 33.

98 The gross income definition refers to 'in favour' and not for the 'benefit' of the taxpayer. But if the word is used as a verb benefit will be a synonym for favour. Refer to paragraph 1.1 and the footnote quoting the gross income definition.

99 In the case *Geldenhuys v CIR* 1947 3 SA 256 (C) the Court ruled that if an amount was received in the form of money, it should have been received by the taxpayer for his own benefit (at 260). It was also ruled that this meant that the taxpayer should have been entitled to the amount (at 269). In the following cases the amount was in a non-monetary consideration. In the *Lategan* case (at 251) it was ruled that the words accrued to meant that the taxpayer must be entitled to the amount, irrespective of when he will receive it. The words entitled to implies that the taxpayer acquired a vested right to future payment. This ruling was echoed by the ruling in the *People's Stores* case. For more information refer to Williams *Cases and Materials* at 84, 91 and 92 as well as Stiglingh "Gross Income" 22-23. In the unreported case of *Van Heerden & Others v S* (A63/08) 2010 ZAWCHC 227 at 247 the Court ruled that where a taxpayer waives a conditional right to receive future income, prior to the execution of that condition, the income that the taxpayer would have received but waived, would not constitute an amount that accrued to him and would not be included in his gross income.

and the case *Mooi v Secretary for Inland Revenue.*[100] Again it was left to the courts to give clarity on these words and over the years the meaning of these words were shaped by interpretations of judges.

The conclusion can then be drawn from a summary of the different rulings that the amount should have been unconditionally received by the taxpayer for his favour, benefit or use in order to be included in his gross income. It is also a fact that the amount will be taxed only once; with accrual or receipt – whichever of the two events occurred first.[101] The latest case, *MP Finance Group CC (in liquidation) v Commissioner for the South African Revenue Service*[102] (hereafter referred to as the *MP Finance* case) to a large extent resolved most of the uncertainties with regard to the concept of 'received by'. In the *MP Finance* case the court came to a conclusion[103] that the amounts received by the scheme was received "with the intention of retaining them for their own benefit." The intention of the receiving party with regard to the use of the amount for his own benefit therefore plays an important role. IN58[104] also stated that the intention of the taxpayer should be taken into consideration when considering the taxability of an interest-free loan.

The last concept to be defined here is the concept of '*quid pro quo*'*.* This concept was referred to in the *Brummeria* case as a reason for including the value of a certain right obtained in the taxpayer's gross income. In an effort to give a definition, relating to income tax, of this concept, the statement of Judge Watermeyer in the case *Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd*[105] can be referred to. Judge Watermeyer said:

> [The] originating cause is the work which the taxpayer does to earn them [the income], the *quid pro quo* which he gives in return, for which he undertakes, or an activity in which he engages.... [106]

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100 1972 1 SA 675 (AD): In this case the Court took the ruling in the *Lategan* and *People's Store*s cases one step further and ruled that if there is a condition the condition must first be fulfilled. The taxpayer should therefore be **unconditionally entitled to the amount** before it can accrue to him. For more information refer to Williams *Cases and Materials* 101 as well as Stiglingh "Gross Income" 22.

101 Stiglingh "Gross Income" 24. Also refer to Jiyane *Received by and accrued to* 59-60.

102 2007 5 SA 521 (SCA).

103 2007 5 SA 521 (SCA) at 527.

104 IN58 5.

105 14 SATC 1.

106 14 SATC 1 at 8-9.

In the *Brummeria* case the Commissioner argued that the companies received as *quid pro quo* from the units built either the selling price, in the case where the unit was disposed of, or the benefit to use loan capital free of any interest obligation. The companies therefore received only the *bare dominium* of the unit until an obligation to repay the loan arises and the *usufruct* is again united with the *bare dominium*. This will be when the lender died or when the lender is no longer occupying the unit for example because of ill health.

In an effort to clarify some of the uncertainties with regard to the gross income definition resulting from the *Brummeria* judgement, SARS issued IN58. In the note they specifically addressed the meaning of the word amount[107] and when the granting of an interest-free loan might qualify as the granting of a benefit as *quid pro quo* for something else. IN58[108] concluded that in "all other cases", where a "benefit in a form other than money" is granted in exchange for something else, for example goods or services, the *Brummeria* judgement might be applicable. Under paragraph 6.2 of IN58[109] the interest-free loan between a shareholder and a company was discussed. In this document SARS acknowledges the fact that the loan may have been granted with the "intention of providing long-term working capital to the company" et cetera. SARS also acknowledges the fact that the granting of an interest-free loan by a shareholder to a company is not necessarily an indication that the right received by the company was received as *quid pro quo* for "services rendered or some other benefit granted by the borrowing company." It is therefore clear that the *Brummeria* case will not necessarily be applicable to all interest-free loans granted, since the benefit can be of a capital nature. However, it is also clear from the note that when goods, services or any other benefit was received by the lender in exchange for the use of loan capital free of any interest obligation, the right must be valued and included in the borrower's gross income as a taxable amount. In

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107 IN58 2; It must be noted that IN58 was specifically published as a result of the *Brummeria* case and with the purpose of explaining the gross income definition.
108 IN58 3.
109 IN58 4.

all other cases the right would most probably be of a capital nature and will therefore not be included in the gross income of the receiver of the right.[110]

From the above, and especially the words of Judge Watermeyer[111], four elements were identified to assess whether or not a right or an amount is *quid pro quo,* namely:

- the originating cause/work
- undertaking given
- activities engaged in
- the intention of the parties.

The Court (in the *Brummeria* case) did not pay much attention in its ruling to the argument of SARS that the right constituted *quid pro quo* because it was not a point in dispute. The opinion is held that the Court should have paid more attention to the intention of the parties and the nature of their business. From the court document[112] it is clear that the *Brummeria* companies' ultimate intention with the loans was to acquire the necessary financial means to build the units. Their ultimate intention with the units was to sell it. As *quid pro quo* for the loan capital received, the companies undertook to provide the lender with a life right of occupation. It was therefore wrong to assess the interest amount not paid. The court should have considered the option of assessing the life right. The author's opinion is supported by that of Spearman. Spearman[113] strongly criticised the SCA's acceptance of the Commissioner's argument. He held the opinion that the Court only took into account

> the right to use the loan capital, disregarding the fact that the retirees had a right to rent-free occupation.[114]

110 IN58 5.
111 Refer to page 26.
112 *Brummeria* case at 603.
113 Spearman *Valuation of amounts* 5.
114 Spearman *Valuation of amounts* 3.

The opinion was expressed that this indicates that double taxation occurred in that the court taxed the

> 'notional income' received by the taxpayers [but] allowed no deduction for 'notional rent expenses' (the loss of rental income on the units as a result of the contract providing for a life-right to occupy the units interest-free.[115]

In his article Cohen[116] expressed the same opinion. Cohen drew a comparison between the granting of similar loans for tax purposes in the United States of America and in the RSA. Cohen[117] explained that if the court (in the *Brummeria* case) did in fact "re-characterizes the loan as involving reciprocal transfers", the court would have recognised the fact that the lender and company are also tenant and landlord. This would imply that the company accrued the rental income (not received) and should have included this amount in the gross income, but that they also would have paid interest equal to the rental income. If this interest relates to an asset already brought into use or property ready for letting, the interest would have been fully deductible under section 24J of the ITA. However, if that was the case, the lender would have had a corresponding income in the form of interest that should be included in the gross income.[118] Unfortunately, unlike the companies, the lender would not have a corresponding deductible expense (like rent paid) that could be offset against the income accrued. The net income effect will solely depend on the interest exemption available under section 10(1)(i) of the ITA. Cohen[119] concluded that:

> The court's failure to treat the company as paying interest on the loan may obscure the tax consequences for the other party to the transaction, the lender.

Smit[120] considered the views of a number of authors on this topic as well as the view of SARS as expressed in IN58. Smit[121] is of the opinion that the judgment in the *Brummeria* case is wide enough to apply to all types of interest-free loan

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115 Spearman *Valuation of amounts* 3.
116 Cohen 2009 *S. African L.J.* 498. Cohen expressed the opinion that the loan agreements under scrutiny (and also those used in estate planning) were "demand loans" because there is no fixed payback period or date.
117 Cohen 2009 *S. African L.J.* 494 and 498.
118 Spearman agreed with Cohen on this statement. (Spearman *Valuation of amounts* 64).
119 Cohen 2009 *S. African L.J.* 499.
120 Smit *The impact of the Brummeria Renaissance case* 54-58.
121 Smit *The impact of the Brummeria Renaissance case* 59.

agreements. He based his opinion on the words of the judgment as found in paragraph 12:

> Indeed, it can hardly be doubted that in the modern commercial world, a right to retain and use loan capital for a period of time, interest-free, is a valuable right.[122]

The effect of this statement will depend on whether or not it is part of the *ratio decidendi* (decided binding principles) of the court or merely a passing comment by the judge. Smit[123] stressed that in order to prove that the right to use loan capital free of any interest obligation, has no taxable value, it should be proven that the right was not received as *quid pro quo* and/or that the right received is of a capital nature.

Judge Hefer made an interesting ruling in the *Cactus* case117.[124] Judge Hefer remarked that in the *Lever Brothers* case the loans were "in the form of credit given to the 'borrowers'"[125] and that the lender therefore rendered a service to the borrower. In return and therefore as *quid pro quo* the lender will receive interest for the services rendered. In the *Cactus* case the loan entered into was a loan for consumption,[126] agreed upon between connected persons, and the interest levied could not be compensation for services rendered (*quid pro quo*).

The opinion is therefore held that the ordinary loan entered into between connected persons as part of an estate plan will be a normal loan for consumption and that the interest obligation (or the lack thereof) would not be compensation (*quid pro quo)* for services rendered. Despite the opinion of Smit, if the intention of the parties to an estate plan is considered, and whether or not any undertakings were given, the conclusion can be drawn that the main intention with estate planning (and the sale of an asset under an interest-free loan) will be to stop the growth of an asset in the planner’s estate. It can also be that the main intention is to provide for his family should he pass away. A second intention might be to make available, to the purchaser/borrower, long-term capital to finance operations. In these cases it can be concluded that the right to use loan capital free of any interest obligation is not *quid*

122 *Brummeria* case at 607.
123 Smit *The impact of the Brummeria Renaissance case* 61.
124 *Cactus* case at 5-6.
125 *Cactus* case at 5.
126 Refer to paragraph 2.4.1.

pro quo for any services rendered. It cannot constitute an amount received by or that accrued to the borrower and cannot be taxable in terms of the gross income definition of the ITA.

In the next paragraph the last element of the gross income definition, that need to be addressed, namely 'of a capital nature', is considered.

3.2.4 Defining 'of a capital nature'

In the previous paragraphs the elements of 'amount', 'received by or accrued to', and 'in favour of' as included in the gross income definition, were defined and explored. The meaning of the term *quid pro quo* was also addressed.

In this paragraph the last concept that will determine whether or not an amount or right, capable of valuation, will be included in the gross income of a taxpayer, namely 'of a capital nature', is explored.

The gross income definition in section 1 of the ITA[127] specifically excludes "receipts or accruals of a capital nature". The concept of capital nature is once again not defined in the ITA and again it was left to the courts to interpret the words. The interpretation note issued by SARS[128] on Capital Gains Tax (hereafter referred to as CGT), also assists with interpreting the words in a specific context. This study did not aim to go into the detail of all the court rulings. The purpose of this paragraph is to establish whether or not the right to use loan capital free of an interest obligation can be of a capital nature and if so, under what circumstances will it qualify as being of a capital nature.

Judge Corbett noted in *Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste*[129] that the first question to be asked in determining the taxability of the sale of an asset for gross income purposes, is whether or not

127 Paragraph 1.1 footnote on the definition of gross income.
128 GN LAPD-CGT-G01 22 December 2011 chapter 2.
129 1978 1 SA 101 (A); also see Tennant *Interest-free loans* 34.

> the sale of an asset that generated the income was a realisation of a capital asset or whether it was in pursuant of carrying on his trade and had the intention to make a profit.[130]

This statement indicates that the intention of the taxpayer, both at the time of acquiring the asset as well as at the time of sale, will most definitely play an important role in the pursuit of an answer.[131]

Over time the courts formulated the subjective test as well as the objective test to assist in determining the taxability of an asset disposed of.[132] The subjective test will test the intention of the taxpayer relating to the asset sold or disposed of. In the case of a loan for consumption, as was discussed in chapter 2 as well as in paragraph 3.2.3, the intention of the taxpayer would not be to derive income from the asset (the loan) but rather to help a connected person to finance the purchase of an asset. The objective test will consider the facts of the case and in what manner the asset sold was used.[133] Examples[134] of the objective test questions that can be asked are:

- What is the nature of the asset?
- For what period of time was the asset used before it was disposed of?
- What is the nature of the taxpayer's business?
- What is the frequency of similar transactions?
- What is the financial position of the taxpayer?

In general it can be concluded that a receipt from the sale of an asset would be of a capital nature if the "asset was held as fixed capital"[135] and used as the tree (the

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130 Tennant *Interest-free loans* 34.

131 Stiglingh "Income and capital" 32. Also refer to GN LAPD-CGT-G01 22 December 2011 10.

132 For further information with regards to the applicable case law as well as interpretation please refer to Williams *Cases and Materials* chapter 6, Stiglingh "Income and capital" (chapter 3) as well as GN LAPD-CGT-G01 22 December 2011 chapter 2.

133 Stiglingh "Income and capital" 33-34.

134 The examples can be linked to estate planning and interest-free loans in the following way: Question: For what period of time was the asset used before it was disposed of? In the case of a loan used in estate planning the loan would only be repayable on the death of the lender, and therefore the period will in most cases not be determinable at the conclusion of the loan and will depend on how long the lender had lived to the conclusion of the loan. Question: What is the nature of the taxpayer's business? As was pointed out in par. 3.2.3 the lender will in general not be a money lender. Question: What is the financial position of the taxpayer? The financial position of the lender would normally be very good, but the borrower would normally not be in a position to finance a purchase of an asset, and would normally not be in a position to pay any interest on a loan. For an example refer to *C:SARS v Woulidge* 2002 2 All SA 199 (A).

135 Phasha *A critical analysis* 34. According to Phasha the following type of receipts would constitute a receipt of a capital nature: (1) "generated through realising an asset which was held to derive

income producing structure) that would generate the fruit[136] or income and there was no change in the intention of the taxpayer with regard to the use of the asset.[137]

It must be noted that the Court did not consider the question whether or not the right received under an interest-free loan constituted the receipt of a capital nature.[138] The reason for this was that the issue of whether or not the right was of a capital nature was never before the Tax Court and they did not bring an application for the amendment of the "statement of the grounds of appeal."[139] The *Brummeria* case therefore does not impact "nor alter" any previous rulings on the term "of a capital nature".[140]

In order to analyse the nature of a loan as capital in nature or not, the physical receipt of the loan capital is considered first. In referring to the *Genn* case in the *Brummeria* judgment, Judge Cloete[141] expressed the opinion that the "receipt of loan capital is not a receipt" in terms of the gross income definition. Jansen van Rensburg[142] commented on this statement by Judge Cloete. The author agrees with Judge Cloete (contrary to the opinion of the Tax Court) that it is not a receipt as such of a capital nature but rather "that the borrower did not 'receive' it."[143] The reasoning behind this opinion could lie in the fact that the borrower immediately on receipt of the loan capital incurred the obligation to repay the loan capital.

3.2.5 Conclusion

With the above in mind the following conclusions can be drawn with regard to loans (including interest-free and low-interest loans) and the taxation thereof in terms of the gross income definition:

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income through use of the asset" and (2) "obtained in the sale of fixed capital (an asset that remained intact through the production process)." (Phasha *A critical analysis* 33-34).

136 *Commissioner for Inland Revenue v Visser* 1937 (TPD) 77.

137 Stiglingh "Income and capital" 33-34.

138 IN58 3.

139 *Brummeria* case at 605 and at 606. Judge Cloete referred to the *Genn* case. Please refer to the *Genn* case at 301.

140 Phasha *A critical analysis* 32.

141 *Brummeria*-case at 605.

142 Jansen van Rensburg 2008 *Stell LR* 46.

143 Jansen van Rensburg 2008 *Stell LR* 45.

All the elements of the gross income definition must be present before a right to an amount received can be included in the taxpayer's gross income.[144]

The judges of the *Brummeria* case ruled that the right is a valuable right capable of being evaluated and will therefore constitute an amount that can be included in the gross income of a taxpayer. Although any opinion to the contrary is only of academic value, the opinion is still expressed that interest is not an essential element of a loan.[145] The opinion is also expressed that the right to use loan capital free of any interest obligation is not property and therefore cannot qualify as being seen as an amount in terms of the gross income definition and cannot be taxed in the borrower's hands.[146]

The intention of the taxpayer plays an important role in determining whether or not an amount was received by or accrued to the taxpayer for his own benefit. In the case of loans utilised as estate planning tools the intention will be to stop growth of an asset in the estate owner's estate, to provide for family should the taxpayer pass away, and/or to provide capital to a trust or company related to him.[147]

Perhaps the most important qualifying 'element' might be that the right to use an interest-free loan should be *quid pro quo* for services rendered or a right granted to the lender, such as the right to stay in a unit at no cost.

It can also be concluded that loan capital received by the borrower in terms of a loan for consumption is not of capital nature, but that it also does not constitute a 'receipt' in terms of the gross income definition. Should the loan agreement, entered into under an estate plan provide for interest payable to the lender, it should be noted that the interest amount was not received as *quid pro quo* for any services rendered by the lender to the borrower.

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144 Refer to paragraph 1.1 for the full definition. It was also mentioned on page 2, of this mini-dissertation, that all elements must be present in order for an amount to be taxable.
145 Refer to paragraphs 2.4.3 and 2.6.
146 Refer to paragraph 3.2.2.
147 Refer to paragraph 3.2.3.

The opinion is therefore held that the typical loan agreement to be found in estate planning is a loan for consumption and is therefore not 'received' in terms of the gross income definition, not of a capital nature[148], nor of a revenue nature, nor *quid pro quo* for services rendered.

As estate planning most definitely involves the transfer of assets from the client's estate to a connected entity, as was suggested in paragraph 2.5.1 and 2.7, it would therefore be logical to explore what other provision of the of the ITA would impact the taxation of income in the hands of the lender as well as the borrower. The issue of anti-avoidance provisions is addressed in the next paragraph.

3.3 Anti-avoidance and interest-free loans

3.3.1 Introduction

When drafting an estate plan the planner must be very cautious of the anti-avoidance measures contained in the ITA. In the next paragraphs the provisions of sections 64E and 7 of the ITA with regard to low-interest and interest-free loans are explored. [149]

3.3.2 The taxability of loan debt in terms of section 64E of the ITA

Section 64 of the ITA contains the provisions with regard to dividend tax and came into operation on 1 April 2012.[150] Section 64E(4)(a)[151] specifically states that where

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148 Refer to paragraph 3.2.4 as well as Jansen van Rensburg 2008 *Stell LR* 45.

149 An estate planner must also be aware of the provisions of sections 80A up to 80L and 103 of the ITA. These sections contain the definitions of what will be regarded as tax avoidance schemes and the taxation of income relating to these schemes. Since the use of interest-free loans does not really fall within the scope of these sections, no further discussion will be led on these sections. For further information on this topic, please refer to Olivier, Strydom and Van den Berg *Trust Law* 7-40 as well as Van Schalkwyk "Tax Avoidance" 811.

150 S64E(1) of the ITA.

151 "Where during any year of assessment, any amount is owing to a company by-

(i) a person that is –

(aa) not a company;

(bb) a resident, and

(cc) a connected person in relation to that company; or

(ii) a person that is –

(aa) not a company;

at the end of a tax year a person is indebted to a company, and that debt relates to shares held by the person in the company, it shall be deemed that the person has received a dividend from the company. The amount of the dividend will be the greater of the difference between a market-related interest rate levied on the debt less any amount of interest paid by the debtor on the loan.[152]

The *Commissioner for South African Revenue Service v Airworld CC*[153] (hereafter referred to as the *Airworld* case) is a good example of an instance where a loan in an estate planning exercise being taxed as an *in specie* dividend distributed. The ruling in the *Airworld* case is mainly of academic value because of the amendments to the act. However, it is not going to make any difference to the current discussion whether Secondary Tax on Companies (STC) was payable (as was the situation in the *Airworld* case) or whether Dividend tax is payable as per current legislation. The court had to rule in terms of section 64C of the ITA[154] whether or not a dividend was indeed distributed, whether the family trust was a 'recipient' as defined and whether any exemption was applicable to the trust. In a majority judgement (two out of three) it was ruled that the intention of the legislator was clearly to bring in anti-tax avoidance measures. The term beneficiaries would include all potential beneficiaries, whether they would have had a vested or only a contingent right to capital or income from the trust.[155]

While the *Airworld* case was on-going, the concept recipient was defined in section 64C of the ITA as "any trust of which such shareholder or relative is a beneficiary."[156]

(bb) a resident; and

(cc) a connected person in relation to a person contemplated in subparagraph (i) in respect of debt, that company must, for the purposes of this Part, be deemed to have paid a dividend if that debt arises by virtue of any share held in that company by a person contemplated in subparagraph (i)."

152 S64E(1)(b)(ii) of the ITA.

153 2007 SCA 147 (RSA): The facts in short: Mr Retief was the sole shareholder of two CC that fared financially very well. Mr Retief, his wife and children were the beneficiaries (both capital and income) of a family trust. During 1995 and 1996 it was decided, as an estate planning exercise, to move/buy growth investments to/in the family trust. In order to finance these transactions the cash was lent by the CC to the trust. SARS issued assessments on the grounds that a 'recipient' of a loan in terms of section 64C(3)(a) received a dividend and therefore the CC is liable for STC. (*Airworld* case at 151-152).

154 S's 64C(1), 64C(4)(c) and 64C(4)(d) of the ITA; *Airworld* case at 152.

155 Olivier, Strydom and Van den Berg *Trust Law* 2-39; *Airworld* case at 168-170.

156 S64C(1)(c) of the ITA before the amendment enacted in 2000. In 2000 section 64C(1) of the ITA was amended and a recipient was defined as:

The word recipient was replaced in the new section 64E with the word person. Currently, in section 1 of the ITA under the subparagraph (c) of the definition of a person, it is clear that a person includes any trust.[157] The definition of a connected person, also to be found in section 1 of the ITA,[158] includes in relation to a trust "any beneficiary of such trust, and any connected person in relation to such beneficiary."

It can therefore be concluded that where a family trust, as part of an estate planning exercise, acquires the taxpayer's shares in a company and the company (also including a close corporation) finances the sale of the shares by way of a loan account, the outstanding loan will still qualify as a distribution of a dividend *in specie* under section 64E of the ITA. Dividend tax will be paid (in this case by the company) at 15% on the interest amount not paid by the trust on the outstanding loan capital.

3.3.3 The influence of section 7 on the taxation of the planner

Section 7 is only one of a number of anti-avoidance sections in the ITA. In estate planning sections 7(3) up to 7(10) will most definitely play a role when assets are transferred as part of an estate plan, from the 'donor'[159] (the taxpayer for whom estate planning is done) to, for example a family trust.

In *Ovenstone v Secretary for Inland Revenue*[160] (hereafter referred to as the *Ovenstone* case) Judge Trollip described the purpose of sections 7(2) up to 7(8) to be to capture transactions aimed at tax avoidance. These transactions are based on an agreement of some sort, resulting in the diversion of income away from the taxpayer.[161] In the case *Estate Dempers v Secretary for Inland Revenue*[162] (hereafter referred to as the *Dempers* case) Judge Corbett expressed the opinion that in general:

(a) Any shareholder of such company;
(b) Any connected person (as defined) in relation to such shareholder.

157 S1 'person' par(c) of the ITA.
158 S1 'connected person' par (b) of the ITA.
159 The term 'donor' used in the text will also refer to any "person who makes a donation, settlement or other disposition." (Olivier, Strydom and Van den Berg *Trust Law* 7-16). In the context of this mini-dissertation the word donor will refer to the planner.
160 1980 2 721 (A).
161 *Ovenstone* case at 736.
162 1977 3 SA 410 (A). Also see Olivier, Strydom and Van den Berg *Trust Law* at 7-16.

> A taxpayer is perfectly entitled to reduce the amount of his income, and thereby the income tax payable, by giving away income producing assets owned by him....[H]owever (as in the case of the corresponding South African legislation[163]), certain limitations are placed upon the right to avoid in this way liability for the payment of tax.

In order for sections 7(2) up to 7(8) to apply, there should have been a "donation, settlement or other disposition"[164] that would include a sale of assets on an interest-free or low-interest loan account.[165] Section 7(9) of the ITA also stipulates:

> Where any asset has been disposed of for a consideration which is less than the market value of such asset, the amount by which such market value exceeds such consideration shall for the purpose of this section be deemed to be a donation.

Olivier[166] referred to the court cases of *Commissioner for Inland Revenue v Widan*[167] and *P v COT*[168] For section 7 to be applicable there should be:

> [A] causal connection between the donation, settlement or other disposition and the income which is deemed to be the donor's income. [169]

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163 At the time of the hearing of the *Dempers* case section 9 contained the same principles to be found in section 7 of the current ITA.

164 See S's 7(2)(a), 7(3), 7(4), 7(5), 7(6), 7(7), and 7(8) of the ITA. A detailed discussion on the meaning of "donation, settlement and disposition" falls outside the scope of this study. Due to the fact that these words appear in all of the above sections, it can be assumed that they will carry the same meaning wherever they are used (refer to Olivier, Strydom and Van den Berg *Trust Law* 7-19). The word 'donation' bears the general meaning and implies that there will be an element of gratuitousness present (refer to Judge Trollip *Ovenstone* case at 736). If any amount of consideration was paid by the donee, the disposition will no longer qualify as a donation and would most probably be as a result of a commercial transaction (refer to Carroll *Income to a Donor-Parent* 13-14). The word settlement implies that transfer of property would take place in accordance with the provisions of a deed of settlement, and that the consideration paid was not the "full value in money or money's worth" (refer to Olivier, Strydom and Van den Berg *Trust Law* 7-19 and 7-20). Carroll held the opinion that the type of settlement referred to in section 7 of the ITA, would definitely be made out of generosity or gratuitously out of liberty (refer to Carroll *Income to a Donor-Parent* 13). The words 'or other disposition' would not include any business related disposal of property (refer to *Ovenstone* case at 740). It will relate to "dispositions of a gratuitous nature." Carroll expressed the opinion that the interest-free loan is the "most widely used form of 'other disposition'" (refer to Carroll *Income to a Donor-Parent* 14 and 16). The resources mentioned in this note can be consulted for further detailed information on these definitions.

165 Carroll *Income to a Donor-Parent* 16. Also refer to Petersen *Taxation of a trust* 62.

166 Olivier, Strydom and Van den Berg *Trust Law* 7-19.

167 1955 1 SA 226 (A).

168 24 SATC 518.

169 Olivier, Strydom and Van den Berg *Trust Law* 7-19.

Olivier further stated that the donor should have had the intention to transfer the income benefit to another. An example would be that an income-producing asset is transferred to a minor child or a trust of which the minor child is a beneficiary. The income generated by the donated asset would then be paid out for the benefit of that child. Section 7(3) of the ITA will for example deem income received by the minor that can be directly linked to such a donation, settlement or disposition, to be received by or accrued to the donor.

The question that remains to be answered is how these sections affect the taxability of income derived from assets transferred as part of an estate planning exercise to, for example, a family trust.

As was mentioned before, the interest-free loan is one of the most widely used estate planning tools. In order to avoid or minimise the effect of donations tax, the asset is sold at a market-related value to, for example, a family trust. The purchase price would be left due and payable by the trust to the seller on a loan account. The term disposition would include such a transaction.[170] In this case the income derived by the trust from the asset acquired on an interest-free loan may be deemed to have accrued to or have been received by the donor, depending on whether or not the provisions of one or more of sections 7(2) up to 7(8) are applicable.[171] The most relevant sections for this study are sections 7(2), 7(3), 7(5) and 7(8) of the ITA.[172] It is very important to take note of the fact that these sections may only be applied if the donor is still alive. It is also important to take note:

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170 Carroll *Income to a Donor-Parent* 16. Carroll also refers to the *Woulidge* case. Apparently the Cape High Court (1999 4 SA 519 (C) at 527) ruled that in the case where no interest is charged, it normally would be an indication that the transaction did not took place in a business or commercial environment. Section 7(3) was therefore applied in this case to the income received by a minor beneficiary of a trust (Carroll *Income to a Donor-Parent* 17). In this case the assets were sold on a loan account but no terms as to when and how the loan capital would be repaid existed. The "books merely reflected the credit for this as one for an indefinite period." (*Woulidge* case at 539-540) The Court also had to consider whether or not the interest not paid represented an annual donation. SARS wanted to enter a plea that the whole transaction was a sham, but could not do so because it did not form part of their original grounds for appeal.

171 In the case *Commissioner for Inland Revenue v Berold* 1962 3 SA 748 (AD) at 753 (hereafter referred to as the *Berold* case) the court ruled that the granting of an interest-free loan will constitute a "continuing donation" of interest. According to Carroll this means that as long as the loan capital is still due to the lender (in the *Berold* case the parent of a minor beneficiary), the "the non-charging of interest will be attributable to the donor-parent." (Carroll *Income to a Donor-Parent* 17).

172 For a detailed discussion of section 7 refer to Olivier, Strydom and Van den Berg *Trust Law* 7-16 – 7-36. Also refer to Stark "Trusts" paragraph 27.6 849-856.

> The failure to demand payment of a market related rate of interest, where interest is chargeable is a disposition of a valuable right containing an element of gratuitousness sufficiently to prompt the operation of section 7.[173]

Section 7(2) of the ITA will apply if the beneficiary is the spouse of the donor and has a vested right to the trust income. Section 7(3) of the ITA will apply if the beneficiary is the minor child of the donor. Section 7(8) of the ITA will apply in all cases where the beneficiary is a non-resident. In order for the donor to be taxed on the income received by or accrued to the beneficiary under the sections just mentioned, the beneficiaries should have acquired a vested right in the trust income by way of a stipulation in the trust deed or by way of a distribution done by the trustees. A direct link between the income vesting in the beneficiary and the asset donated or sold on an interest-free or low-interest loan account should exist. If this is true, the donor will be taxed on the income (relating to his disposition) that were received by or accrued to the particular beneficiary.[174]

In addition to the above-mentioned requirements contained in section 7(2), 7(3) and 7(8), the following requirement should be present to make section 7(5) of the ITA applicable:

> The donation, settlement or other disposition [should be] subject to a stipulation or condition to the effect that the beneficiaries or some of them shall not receive the income or portion thereof until the happening of some event, whether fixed or contingent.[175]

A section 7(5) event will, for example be when a beneficiary acquires a vested right in the trust income, relating to the specific asset sold on a loan account to the trust, at a specific date or because of the fact that he attained a specific age. In the case where the trustees of a discretionary trust decide not to make any distributions and

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173 Carroll *Income to a Donor-Parent* 17.

174 In the *Woulidge*- as well as *Ovenstone* cases the courts ruled that apportionment may take place, to calculate the "annual limit [of] the income that may be attributed to the donor-parent." (Carroll *Income to a Donor-Parent* 18). Also refer to Olivier, Strydom and Van den Berg *Trust Law* 7-16, 7-22, and 7-36, as well as Stark "Trusts" 850 and 853.

175 Olivier, Strydom and Van den Berg *Trust Law* 7-24.

to retain the income in the trust, the exercise of their discretion is also seen as an event and section 7(5) will apply.[176]

The following example illustrates how the sections discussed above find application in real life. The family trust was created as a *mortis causa* trust by way of a deceased grandparent's will. The trust inherited a rent-producing property. The beneficiary of the trust is the minor grandson of the deceased. A few years later, as part of an estate planning exercise, the planner (who was also the parent of the minor beneficiary) sold at a market-related price shares in a listed company to the trust. The purchase price was left outstanding on an interest-free loan account. During the 2014 year of assessment, the trust received R100 000 in the form of rental income and R50 000 in the form of dividend income. The trustees exercised their discretion and distributed R60 000 of the trust income to the beneficiary. It must be noted that one third of the trust income relates to the disposition of the donor (whom is still alive and well). The income will be taxed as follows:

Section applicable	Reason	Donor (R)	Beneficiary (R)	Trust (R)
	Total income received by the trust			150 000
	Distribution by trustees:		60 000	-60 000
	Rental income		40 000	
	Dividend income		20 000	
			60 000	**90 000**
	Income attributed in terms of section 7 and 25B to:			
S7(3)	Minor child of donor	20 000	-20 000	
S7(5)	Retained in trust	30 000		-30 000
	Income to be included in gross income of the different parties	**50 000**	**40 000**	**60 000**

The above table illustrated that the R20 000 income received by the beneficiary as distribution, will accrue to the planner in terms of the provisions of section 7(3). The

176 Olivier, Strydom and Van den Berg *Trust Law* 7-32.

planner will also accrue R30 000 in terms of section 7(5). In total R50 000 of the R150 000 2014 trust income will be taxable in the planner's hands.

3.3.4 Conclusion

It can be concluded from the above that the planner (estate owner) and estate planner should be aware of the fact that there are anti-avoidance sections, such as sections 64E and 7 of the ITA, that may result in the buyer (for example the family trust) being taxable on deemed dividend income or the planner on income received by others. It will basically only be in the case where the trust beneficiary is a major resident, and no rights were reserved by the planner for himself, that the trust income will not be taxed in the planner's hands.

In the next paragraph the conclusions drawn above, with regard to the taxability of interest-free loans with specific reference to income tax, are applied to the case study to be found in paragraph 2.7.

3.4 Application to the case study

As was discussed in paragraph 2.7 the estate planner suggested that the two farms should be sold to two different trusts where the two sons would be the income as well as capital beneficiaries of the trusts. The result would be that the farms would now fall outside the planner (estate owner's) estate and that the only asset in his estate, relating to the farms, in his estate would be the outstanding amount of the loan account. The estate owner will then lease the farm property from the trusts.

The following tax consequences may be a result of the implementation of the estate plan.

3.4.1 Lease income/rental expense

At first glance it seems fairly easy to answer the question of what the tax consequences in relation to the rental income paid and received would be for the planner and the family trust. The fact that section 7 of the ITA may result in the trust income being taxed in the hands of the planner will, however, result in the answer being more complicated.

As in the past the planner will in the first instance include the operational farming income in his gross income. He will, however, now have an additional expense in the form of a rental expense that is deductible against his income in terms of section 11(a) of the ITA. Should the trusts use the rental income to repay the loan capital owed to the planner, the instalments received from the trusts will be of a capital nature and would therefore not constitute income in the hands of the planner. The result will be that the asset in the planner's estate, namely the loan account, will diminish over time. The instalments paid by the trusts are also of a capital nature and no deduction would be available against trust income for the amounts repaid to the estate owner.

The rental income retained in the trusts or distributed to the minor children of the estate owner or in the case where the planner's wife is a beneficiary, will be taxed in the planner's hands in terms of the provisions in sections 7(2), 7(3) and 7(5) as was explained in paragraph 3.3.3 above. The tax effect for the planner will be zero because of the application of section 11(a) of the ITA (as explained above).[177]

3.4.2 Quid pro quo v of a capital nature

The applicability of the *Brummeria* judgement to the use of interest-free loans in the process of implementing an estate plan was discussed in detail under paragraph 3.2. The opinion was expressed that the wording of the loan agreement as well as the intention of the parties to the sale and loan agreements will determine whether or not any right will be taxable as *quid pro quo* for services rendered or rights granted.

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177 It must be noted that the trust deed should not contain any stipulation whereby the estate owner reserves the right to revoke a distribution in favour of one of the beneficiaries to benefit another person. This will result in section 7(6) of the ITA being applicable to the rental income received and the planner will be taxed on rental income. The trust deed, for the same reason, should also not contain any stipulation whereby the planner reserves the right to at any stage repossess the assets sold to the trust. If this is the case, section 7(7) of the ITA will be applicable and the rental income will be taxable in the hands of the planner. Refer to Olivier, Strydom and Van den Berg *Trust Law* 8-19.

SARS admitted in IN58[178] that the intention behind a loan agreement between a connected person to a company and the company itself could be to provide the company with long term working capital. For the same reason the planner could enter into a loan agreement with the family trusts. In this case one can reason that the trusts did not receive the loan capital as *quid pro quo* for services rendered, but to acquire assets that can generate income for the trust in the long term.

Care should be taken not to make provision in the loan or sale agreement for the planner to receive a lifelong right to the primary residence situated on and being part of the farming property sold to the trust on a loan account. This will result in a situation very similar to that of the *Brummeria* case. The result might be that SARS will regard the right as having been received as *quid pro quo* for the right to use the loan capital free of any interest obligation. The right might then be valued and the trust may be taxed on the amount, as was the case with the developers in the *Brummeria* case. It may even result in the seller being taxed on the value of the right to occupy the house free of any obligation to pay a lease amount.

The best option would be to sell the property free of any rights reserved and to grant a loan to the trusts without any accompanying obligation. The trustees of the trust, if permitted in terms of the trust deed, may then grant the right to the beneficiaries, who could be the seller (the planner) and his family, to occupy the house free of charge. This decision will fall within the ambit of the discretionary powers granted to the trustees. Hence, the decision made by the trustees in this regard, the beneficiaries will receive a vested right that will allow them to occupy the house free of charge.

The opinion is held that the loan agreements entered into between the planner and the trusts, that enabled the trusts to acquire the farm property, were neither *quid pro quo* nor of a capital nature, because these loans were loans of consumption and were not received by the trusts in terms of the gross income definition.[179]

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178 IN58 4.
179 Refer to paragraph 3.2.5 above.

3.5 Conclusion

It can be concluded that as was illustrated in paragraph 3.4 above, the loans granted under an estate planning exercise, will most probably not constitute a valuable right capable of being valued and taxable in the hands of the borrower. The provisions contained in section 7 of the ITA may possibly still have implications for the seller/planner and may result in income being taxed in his hands. Depending on the facts of the case, section 64E might also result in the interest not levied on the outstanding loan account, owned by a company, being regarded as the distribution of a dividend and subject to withholding tax of 15%.In chapter 4 the influence of donations tax, capital gains tax and estate duty on the use of interest-free loans in estate planning are explored.

Chapter 4: Other taxes: The influence thereof on the use of interest-free loans

In chapter 3 the influence of the ITA on the use of interest-free loans as an estate planning tool was discussed. It was concluded that the right to use loan capital under these circumstances will not constitute a taxable right in terms of the gross income definition as found in the ITA. It was also concluded that some of the anti-avoidance sections, such as section 7 of the ITA, may be applicable to income received by, for example, a family trust.

In this chapter the taxation of the granting of an interest-free loan in terms of donations tax[180] is explored. Furthermore, the tax effect on loan capital owed to the deceased in terms of the provisions of the Estate Duty Act[181] and CGT[182] is discussed. When compiling an estate plan the planner should always be mindful of the provisions of these taxes.

4.1 Donations Tax

As was mentioned in chapter 1, interest-free loans are one of the most regularly used estate planning tools. Estate planning practitioners in particular use this tool because such transactions (where the asset is sold for its fair market value on a loan account) are currently not taxed for donations tax purposes.[183]

Donations tax will be levied in terms of sections 54 and 58(1) of the ITA if property was disposed of by a resident of the Republic for a consideration that "is in the opinion of the Commissioner" inadequate. The amount of donations tax payable will

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180 S's 54 to 64 of the ITA.
181 45 of 1955 (also in the text referred to as EDA).
182 The Eighth Schedule to the ITA.
183 Refer to Oosthuizen "Donations tax" 826, as well as Stark 2008 http://repository.up.ac.za/bitstream/handle/2263/14485/Stark_ls%282008%29.pdf?sequence=3 145 (hereafter only referred to as Stark 2008).

be calculated as 20% of the difference between the value of the property[184] and the consideration received by the person deemed to have disposed of the property.[185]

The following definitions relating to donations tax are of importance when considering whether or not the granting of an interest-free loan could be taxable in terms of the provisions of donations tax. These definitions are to be found in section 55(1) of the ITA:

> 'donation' means any gratuitous disposal of property including any gratuitous waiver or renunciation of a right.
>
> 'property' means any right in or to property movable or immovable, corporeal or incorporeal, wheresoever situated.
>
> 'fair market value' means
> (a) the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm's length in an open market; or
> (b) in relation to immovable property on which a *bona fide* farming undertaking is being carried on in the Republic, the amount determined by reducing the price which could be obtained upon a sale of the property between a willing buyer and willing seller dealing at arm's length in an open market by 30 per cent.

If the meaning of 'donation' is kept in mind, it is clear that there can only be a donation if the donor disposes of property to a donee, or abandons a right in favour of a donee, out of "pure liberality".[186] A broad interpretation of the word disposal includes any act that results in the transfer of ownership of the property, such as "dealing with, bestowal, sale"[187] and, of course, the donation of that property. Any act whereby the donor is impoverished and the donee enriched to the same extent

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184 Refer to the definition of 'fair market value'. It must be noted that the taxable amount, on which donations tax will be calculated is subject to the exemptions as provided for in section 56 of the ITA.

185 S58(1) and s64 of the ITA. Also refer to Olivier, Strydom and Van den Berg *Trust Law* 7-43, Honoré and Cameron *The taxation of trusts* 384, and Oosthuizen "Donations tax" 826. Take note that there are some exceptions and exemptions available (s56 of the ITA). A discussion of these exemptions however falls outside the ambit of this mini-dissertation.

186 The test for a disposal as a donation is whether or not it "was motivated by 'pure liberality' or 'disinterested benevolence'." Refer to *Welch v Commissioner for the South African Revenue Service* 2004 2 All SA 586 (SCA) at 597 (and at 591) where Judge Cloete referred to the case *Avis v Verseput* 1943 AD 331 at 345 and at 377. Olivier, Strydom and Van den Berg *Trust Law* 7-41. For further discussion on the legal principles of donations, please refer to Honoré and Cameron *The taxation of trusts* 27-28, 32-33, 112 and 116-118.

187 Olivier, Strydom and Van den Berg *Trust Law* 7-42. Also refer to par 11 of the Eighth Schedule to the ITA, as well as Stark 2008 148.

would therefore fall within the ambit of this definition.[188] Generally in the case of a donation no consideration is given by the donee for receiving the benefit or asset.[189] Section 58(1) of the ITA, however, makes provision for a deemed donation where the donor did receive consideration, "which, in the opinion of the Commissioner, is not adequate consideration." The consideration will not be regarded as adequate if it is less than the fair market value, as defined above, of the property.[190] The difference between the fair market value of the property and the consideration given by the donee is regarded as the value of the deemed donation.

The relevant question to be answered is how the consideration given by the donee can influence the use of loan accounts, and in particular interest-free loans, in estate planning. Some academics speculate that the granting of an interest-free loan could be taxable in terms of section 54 as well as section 58(1) of the ITA.[191] It should be kept in mind that SARS does not currently "treat interest-free loans as donations for donations tax purposes",[192] but that does not mean the situation may not change in future.

As the definition of property (as found in section 55(1) of the ITA) is so broad[193] and includes "any right in or to property" it should be considered whether the loan agreement entitles the lender to interest on the outstanding loan capital. If the loan agreement entitles the lender to interest on the outstanding capital, and the lender does not enforce his right or in fact waives his right, it can be argued that the right has been gratuitously waived, that could result in donation tax being levied on the interest not received in terms of section 54 of the ITA.[194] The terms and conditions of the specific loan agreement would therefore be of importance in this case.[195]

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188 Stark 2008 148.
189 Oosthuizen "Donations tax" 827.
190 Olivier, Strydom and Van den Berg *Trust Law* 7-49 – 7-50. Also refer to Oosthuizen "Donations tax" 828 as well as to Honoré and Cameron *The taxation of trusts* 385.
191 Refer to Oosthuizen "Donations tax" 827, as well as Olivier, Strydom and Van den Berg *Trust Law* 7-46.
192 Tennant *Interest-free loans* 57. Also refer to Oosthuizen "Donations tax" 828, Olivier, Strydom and Van den Berg *Trust Law* 7-46, as well as Stark 2008 145 and 149.
193 Stark quoted Meyerowitz as being of the opinion that the definition of property is "all-embracing and unlimited" (Stark 2008 148).
194 This opinion is supported by among others Stark 2008 149 and Oosthuizen "Donations tax" 827.
195 Tennant *Interest-free loans* 57. Jansen van Rensburg is of the opinion that a contractual right and not a legal right was waived in this case (Jansen van Rensburg 2008 *Stell LR* 34-50).

What, however, would be the taxability of an interest-free loan in terms of section 54 and 58(1) of the ITA? As was discussed in paragraph 2.4.3 above, interest is not an essential element of a loan agreement. Notional interest can therefore not be property or 'a right in or to property', because no personal right in property was created by the interest-free loan agreement.[196] In considering whether or not the provisions of section 58(1) may result in the granting of an interest-free loan being regarded as a donation, the meaning of adequate consideration must be considered. Oosthuizen[197] is of the opinion that SARS may regard the sale of property (for assumingly the fair market value of the property) on an interest-free loan account not to be an adequate consideration for the property. The author further suggests that the agreement has to provide for the repayment of the loan on demand, because that will make it impossible to determine the lost value.[198] As was seen with the *Brummeria* case, SARS did find a means to determine the value, regardless of the fact that the date of repayment of the loan was unknown. The opinion is held that since interest is not an essential element of a loan agreement, and since the agreement of sale and the loan agreement are two separate agreements, as was explained in paragraph 2.4.3 above, section 58(1) cannot be applicable in the case of an interest-free loan. There can be no question of a "waiver or renunciation of a right".[199]

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196 Also refer to paragraph 3.2.2 above. It was concluded that the right to use loan capital free of any interest obligation cannot be regarded as property or a personal right in property.

197 Oosthuizen "Donations tax" 827. Olivier did not pay much attention to the possibility that the granting of an interest-free loan might be taxable in terms of section 58(1). He did not express any opinion in this regard. He just referred to the 'White Paper of the tax structure of the Republic' by the Margo Commission (1988) and stated that the commission recommended that this question should be considered again (Olivier, Strydom and Van den Berg *Trust Law* 7-46). According to Stark the commission indeed recommended that this transaction should be subjected to "capital transfer tax". Stark also point out that the Katz Commission found that "effective action against interest-free loans was relatively rare" (Stark 2008 146).

198 Stark referred to Davis. Davis is of the opinion that in the case where the loan is a fixed-term loan (the amount must be paid back in a certain manner at a specific point in time) "the lender is disposing of ownership of the money in return to recover the face value of the loan at some future date. The difference between the 'present' value and the face value constitutes a deemed donation." Davis' opinion therefore corresponds (also with regard to a demand loan) with that of Oosthuizen (Stark 2008 151).

199 Tennant went so far as to state that the "interest-free element on the loan capital is not a real or personal right, and therefore is not regarded as property (Tennant *Interest-free loans* 57). Also refer to Stark 2008 150.

In the *Brummeria* case the judge referred to the *Commissioner for Inland Revenue v Berold*[200] (hereafter referred to as the *Berold* case) and stated that:

> [The] making of an interest-free loan constitutes a continuing donation to the borrower which confers a benefit upon such borrower.

It must be noted that in the *Berold* case[201] the question was whether or not the income that accrued to family trusts could be regarded as the income of the lender in terms of section 7(3) (at that time section 9(3)) of the ITA.[202] The question was therefore not whether or not the interest-free loan could be taxed as a donation for donation tax purposes. These cases (the *Brummeria* case and the *Berold* case) can therefore not be used as authority for interest-free loans, or the benefit received under this loan, being taxed as donations in terms of the provisions of sections 51 up to 58 of the ITA.[203]

Stark[204] conducted research on the tax treatment of interest-free loans in the United States of America (USA). It was found that the arguments currently raised against the taxing of an interest-free loan for donation tax purposes were also raised in the USA. The wording of the gift tax legislation in the USA is very similar to the wording of sections 54 and 58 of the ITA. Stark is of the opinion that specific legislation would be needed to change the current situation.

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200 1962 3 SA 748 (AD) at 753. *Brummeria* case at 607.

201 1962 3 SA 748 (AD) at 753. The following summary of the facts of the *Berold* case and Judge Hoexter's judgement is to be found at 753-754: "When the taxpayer sold and transferred a large number of valuable assets to Luzen, he did so on credit and without charging interest on the purchase price. In effect he lent a substantial sum of money to Luzen, [F] and as long as he refrained from compelling Luzen to repay that sum, there was a continuing donation by him to Luzen of the interest on that loan. This donation benefited the shareholders of Luzen, but initially the taxpayer was the sole shareholder and the donation did not alter his financial position. When, however, he donated his shares in Luzen to the [G] five trusts which he had created, those trusts obtained the benefit of his continuing donation to Luzen, and it was, of course, for this very purpose that he donated the Luzen shares to the trusts. One glance at the relevant balance sheets and profit and loss accounts will show that no interest was paid by Luzen to the taxpayer in respect of the balance owing to him and that probably Luzen would otherwise not have been able [H] to declare any dividends. If the taxpayer had charged interest, his income would have been increased thereby. His object, however, was to give his children the benefit of that interest in the guise of Luzen dividends. The question now arises whether the incorporation of Zenlu, the donation of Zenlu shares by the grandmother to the trusts, and the purchase by Zenlu of the Luzen shares in any way altered the effect of the taxpayer's donation. It seems clear that the income accumulated for the benefit of the taxpayer's children can be derived from no source other than the donations made by the taxpayer and the grandmother.".

202 Tennant *Interest-free loans* 56. Also refer to Jansen van Rensburg 2008 *Stell LR* 43.

203 Also refer to Tennant *Interest-free loans* 56, as well as Olivier, Strydom and Van den Berg *Trust Law* 7-46.

204 Stark 2008 151-153.

The following conclusions can be drawn with regard to the case study in paragraph 2.7. In the first instance, in this point in time the granting of interest-free loans to the two trusts under the estate plan will not be taxable in terms of sections 54 up to 58 for donations tax purposes. The outstanding amounts due on the two loan accounts will, however, still be assets in the estate of the planner. One way to reduce the debt due under the loan accounts is to donate a total amount of R100 000 to the trusts annually. The trusts will then use this donated amount to pay off the outstanding debt. The reason for using R100 000 is because the first R100 000 in value of all donations made by a taxpayer in a particular tax year is exempt from donations tax.[205] It must be noted that due to the fact that spouses can donate assets or money to each other free of any donations tax,[206] the amount could be increased to R200 000. The planner could therefore donate R100 000 (or more) to his wife and she again will donate the R100 000 to the trusts.[207] Over time the loan account might be erased in this way. There will be no donations tax implications for the planner. Burger[208] warns that although this practice is currently not perceived as a donation, that taxpayers should be careful not to give the impression that "the real nature of the loan was in fact to make a donation". Hoon[209] suggests for this transaction not to be perceived as a donation it should not be done by merely recording these transactions by way of journal entries. It would be necessary for the money to physically change hands.

In the next paragraph the influence of CGT on the use of interest-free loans as estate planning tools is explored.

4.2 Capital Gains Tax

As was seen in chapter 3 (paragraph 3.2.4) only income that is not of a capital nature, is taxable in terms of the definition of gross income. On 20 June 2001 CGT

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205 S56(2)(b) of the ITA.
206 S's 56(1)(a) and 56(1)(b) of the ITA.
207 Hoon *CGT and loan accounts* 3 and 44. Also refer to Ostler 2013 3.
208 Burger *Trusts as Estate Planning Tool* 41. Also refer to GN LAPD-CGT-G01-Comprehensive guide to Capital Gains Tax 22 December 2011 (hereafter referred to as the CGT guide) 94, as well as Carroll *Income to a Donor-Parent* 37.
209 Hoon *CGT and loan accounts* 45.

was incorporated into South African tax law with the effective date of 1 October 2001.[210] One of the many reasons for incorporating CGT was to prevent taxpayers from characterising income as capital.[211] The provisions of CGT are to be found in the Eighth Schedule to the ITA. The essence of the Eighth Schedule is that the amount of taxable capital gain resulting from the sale of an asset or assets (that will be of a capital nature and not revenue of nature) would be included in the taxable income of the disposing taxpayer. CGT is therefore not a separate tax, as it forms part of the taxable income of the taxpayer. It is not within the ambit of this mini-dissertation to go into detail on the amount of taxable capital gain is calculated, all the exemptions and roll-overs available, et cetera. The aim of this section is rather to explain under what circumstances a loan account is taxable in terms of the provisions of CGT.

When an asset is disposed[212] of (sold or donated) as part of an estate plan to, for example, a family trust, the capital gain or loss of that asset will have to be determined.[213] This implies that the planner of the case study (see paragraph 2.7) will have to determine the taxable capital gain for the farms sold on loan accounts, and will have to include the amount in his taxable income. The loan accounts replaced the assets (farms) in the estate. Since the granting of the loan is the 'giving of money or currency',[214] it will have no CGT implications. There will be no CGT consequences with regard to this debt[215] unless the planner reduces the debt or discharges the borrower from paying part of or all of the outstanding debt. In such an instance paragraph 12A[216] will trigger a deemed disposal of an asset and in this case

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210 CGT guide 4. Unless otherwise indicated the use of paragraph numbers in paragraph 4.2 of this document will imply that it refers to the Eight Schedule of the ITA.

211 CGT guide 2.

212 Refer par 11 for the to the definition of disposal. Also refer to paragraph 4.1 of the CGT guide (32-45) for the definitions relating to CGT.

213 Par 2. Olivier stressed that in such a transaction between connected persons it will be very important to sell the property at a market-related price. If this is not the case, SARS will use the open market value to calculated the capital gain or loss. In case of a loss, the loss will be ring-fenced and will only be deductible in future against capital gain generated by transactions between the same connected persons. Olivier, Strydom and Van den Berg *Trust Law* 7-63. Also refer to Koekemoer "Capital gains tax (CGT)" 925.

214 The definition of an 'asset', as found in the Eight Schedule to the ITA, excludes currency/money (being a medium of exchange). Refer to CGT guide 40.

215 According to the CGT guide the meaning of debt is "amounts in respect of which there is an unconditional liability to pay" (CGT guide 88).

216 Par 12(5) was replaced by par 12A, and all deemed disposal rules applicable to the reduction of debt were affected as from the 1st of January 2013 (Koekemoer "Capital gains tax (CGT)" 885).

the debt owed to him. This deemed disposal will have CGT consequences for the debtor and depending on the amount renounced or reduced, it may have a serious impact on the debtor's taxable income.[217]

As was explained in paragraph 4.1, it is common practice to reduce the outstanding loan amount in the estate of the lender by letting him make a donation of R100 000 to the borrower (usually the family trust), and in return the borrower would then use the R100 000 to pay off part of the loan.[218] In this way no liability is incurred for donations tax or CGT purposes, in particular paragraph 12A. The reason for this statement is that the lender did not reduce the outstanding debt – the trust repaid part of or the full outstanding debt.[219] Another practice is to bequeath the outstanding debt to the debtor in the will of the estate owner.[220] Prior to 1 January 2013 paragraph 12(5) would have triggered CGT and would have had a tax implication for the debtor (the family trusts if the case study is referred to).[221] This led to innovative schemes in an effort to try and avoid paying CGT.[222] However, as was pointed out above, paragraph 12(5) was repealed and replaced with paragraph 12A[223] for all tax assessment years commencing on or after 1 January 2013. In general the provisions of paragraph 12A incorporated the provisions of the repealed paragraph 12(5), but

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Par 12(5) had the effect that where debt owed "has been reduced or discharged by [the] creditor for no consideration or for a consideration which is less than the amount by which the face value of the debt has been reduced or discharged", the debt would have been "subject to CGT on a capital gain equal to the amount discharged" (CGT guide 88). There are some exceptions to this rule, for example where one spouse writes off debt owed by the other spouse, but a discussion on these exception falls outside the scope of this mini-dissertation. For further discussion refer to Koekemoer "CGT 2013" 847.

217 Also refer to Louw (date unknown) Debt reduction http://taxcentre.saipa.co.za/sites/default/files/budget_reaction_from_cliffe_dekker_hofmeyr.pdf 5.

218 For an example and an in-depth discussion refer to CGT guide page 94-97. Also refer to Strydom and Van den Berg 2013 http://www.fidsa.org.za/wp-content/uploads/2013/05/Money-Marketing-31-May-2013.pdf (hereafter referred to as Strydom and Van den Berg 2013) 1.

219 SARS warned that this type of practice will not pull the wool over the court's eyes, especially where the trust had the means to repay the loan amount. It just might be that the court exercises the provisions of the act and taxed the lender accordingly. (CGT guide 95). Also refer to Hoon *CGT and loan accounts* 45.

220 Ostler 2013 2. Strydom and Van den Berg had the opinion that these transactions were normally only book entries without money actually passing from one party to another (Strydom and Van den Berg 2013 1).

221 CGT guide 96.

222 For more information in this regard refer to Hoon *CGT and loan accounts* 45-49.

223 Par 12A must be read together with par 19.

the original paragraph 12(5) was expanded up to seven subparagraphs. Paragraph 12A[224] is subject to subparagraph (6) and will apply

> where a debt that is owed by a person is reduced by any amount and-
> (a) the amount of that debt was used, directly or indirectly, to fund any expenditure [not already deducted in terms of the ITA[225]], and
> (b) the amount of that reduction exceeds any amount applied by that person as consideration for that reduction.

Should the transaction described above not take place, and the lender simply write off or reduce the debt of the debtor, the provisions of paragraph 12A will apply.

One of the main differences between the repealed paragraph 12(5) and the new paragraph 12A is the new subparagraph 12A(6)[226] that was introduced. Subparagraph (6) provides that paragraph 12A will not apply where debt is owed to a deceased estate and the outstanding debt was written off by way of a provision in the will of the creditor. In this case, estate duty will be paid on the debt that will constitute property in the estate of the deceased.[227] Strydom and Van den Berg[228] are of the opinion that paragraph 12A will still apply even if no estate duty is payable by the estate because of the fact that the dutiable estate is less than the R3 500 000 abatement available in terms of the provisions of section 4A.[229]

It can therefore be concluded that on the granting of the interest-free loan no GCT will be due and payable. Furthermore, depending on the actions of the trusts and the planner in the years following the granting of the loan, the application of paragraph 12A may be triggered. This will be at the instance where the outstanding loan amount was reduced or written off by the planner and no (or less than the amount written off) consideration was paid over by the trusts.

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224 Par 12A(2)(a).
225 Own words summarising par 12A(a)(i) and 12A(a)(ii).
226 "(6) This paragraph must not apply to any debt owed by a person-
(a) that is an heir or legatee of a deceased estate, to the extent that-
(i) the debt is owed to that deceased estate;
(ii) the debt is reduced by the deceased; and
(iii) the amount by which the debt is reduced by the deceased estate forms part of the property of the deceased estate for the purposes of the Estate Duty Act, 1955."
227 Refer to Ostler 2013 2-3. Also refer to Stein 2013 http://www.thesait.org.za/news/115672/Debt-Forgiveness--CGT.htm 1.
228 Strydom and Van den Berg 2013 1.
229 S4A of the EDA.

In the last paragraph of this chapter the effects of the Estate Duty Act on the use of interest-free loans in estate planning is considered.

4.3 Estate duty

The last of the taxes that may have an influence on the decision to make use of interest-free loans in estate planning, namely estate duty, is considered in this paragraph.

The EDA repealed the *Death Duties Act* 29 of 1922[230] and was applicable as from 1 April 1955. It is not within the ambit of this mini-dissertation to discuss the subject of estate duty in detail. For a detailed discussion of the subject the reader is referred to the well-known works of (among others) Meyerowitz[231] and Stein.[232] In this paragraph the treatment of a loan account in the estate of the deceased for estate duty purposes is explored.

In order for the value of an asset to be included in the net value of the estate, and eventually in the dutiable amount of the estate, the asset should fit the definition of property[233] or deemed property.[234] The EDA refers to property as "a right in or to property, movable or immovable, corporeal and incorporeal". The EDA also specifically lists a few examples in section 3, but also excludes certain rights. Debt is not specifically listed as a type of property. It is, however, a well-known fact that property will include patrimonial rights. Patrimonial rights do form part of a person's estate,[235] and the loan account in a trust will therefore form part of the dutiable assets of the estate of the planner.[236] It is important to note that it is not going to make any difference whether or not the loan account is interest free or interest bearing. Depending on the amount still owed by the trust in terms of an interest-free

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230 *Death Duties Act* 29 of 1922.
231 Meyerowitz *Administration of estates*.
232 Stein *Estate Duty*.
233 S3(2) of the EDA. In all cases where reference in this paragraph is made to a particular section, the section will relate to the EDA.
234 S3(3).
235 "Patrimonial rights are rights having patrimonial value." It can also be said that "patrimonial objects have economic or material value." (Badenhorst, Pienaar and Mostert *Law of Property* 9, 23-24). Also refer to Stein *Estate Duty* 13-15.
236 Olivier, Strydom and Van den Berg *Trust Law* 7-51.

loan agreement, the debt may have a significant impact on the dutiable amount, especially if the total debt and/or the net value of the estate is greater than the section 4A R3 500 000 abatement. The opinion is held, however, that it is still preferable to have a loan account (of which the book value will be equal to or less than the original selling price of the property) as an asset in your estate than the property itself that could have escalated in value since the date of sale.

The last question to be answered in this paragraph is what the influence of the definition of deemed property, and in particular the provisions of sections 3(3)(d) as well as 3(5), will be on the use of loan accounts as part of an estate planning process. According to Stein[237] there are four classes of deemed property. The last class of deemed property relates to

> property that the deceased was, immediately prior to his death, competent to dispose of for his or her own benefit or for the benefit of his or her estate.

These sections will therefore have to be considered if the assets were sold on a loan account to the trusts by the planner, and the planner reserved rights for himself as conditions to the sale. It is very important to note that the planner should have been able to dispose of the property of the trusts for his own benefit. If the planner or his estate could not benefit from the disposal of this property "without the consent of at least one other person, section 3(3)(d) can never apply."[238] In such a case it would not be necessary to test in detail whether or not the deeming provisions of section 3(5) would apply. Section 3(5) only defines what is meant by "component to dispose of". It must be noted that the property referred to in section 3(5) does not include normal property already included in the net value of the estate by way of the definition of property or because of the fact that it is exempted for some reason.[239] For an in-depth discussion on when a deceased would be regarded as being competent to dispose of property, the reader is referred to the work of Meyerowitz[240] as well as Stein.[241] For the purpose of this study sections 3(5)(b)[242] and 3(5)(c)[243]

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237 Stein *Estate Duty* 45. Also refer to s3(3)(d).
238 Olivier, Strydom and Van den Berg *Trust Law* 7-52. Also refer to Meyerowitz *Administration of estates* 27-31.
239 Meyerowitz *Administration of estates* 27-30 – 27-31.
240 Meyerowitz *Administration of estates* 27-20 – 27-32.
241 Stein Estate Duty 128-130.

are of particular importance. For section 3(5)(b) to apply the mere right of disposal (held by the deceased) should have existed on the date of the planner's death. According to Meyerowitz:

> [T]he circumstances in which a deceased is deemed competent to dispose of property are so widely framed that probably no case can be conceived where the deceased in substance was competent to dispose of property as he was fit but is not covered by these deeming provisions.[244]

Smit again stresses that both the requirements of sections 3(3)(d) as well as 3(5) must be met before the property will be deemed to be that of the deceased's estate. He gave the following example to illustrate when this will be the case. If the trust deed provides for the trustees to distribute property to the planner (who is now deceased) and the planner was the sole trustee or had the final say (had a veto right) of all trustees, and lastly he would receive the property for his own benefit, the requirements of both the above stated sections will be met, and the property will be deemed to be that of the deceased estate. If it is, however, clear that where there is more than one trustee, of whom the planner is but one, and the planner "could not act without the consent of the other trustees, the provisions may not be evoked".[245]

Olivier[246] emphasised that it would be futile just to consider a few of the provisions of a trust deed in order to determine whether or not section 3(3)(d) will be applicable or not. The trust deed as a whole should be analysed. Olivier[247] gave some practical examples of how a trust deed must be executed to prevent the application of section 3(3)(b), namely:

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242 S3(5)(b) provides: "[A] person shall be deemed to have been competent to dispose of any property –
(i) if he had such power as would have enabled him, if he was *sui juris*, to appropriate or dispose of such property as he saw fit whether exercisable by will, power of appointment or in any other manner;
(ii) if under any deed of donation, settlement, trust or other disposition made by him he retained the power to revoke or vary the provisions thereof relating to such property;"
The words *sui juris* means 'In his full legal capacity'. Refer to Meyerowitz *Administration of estates* 27-32, as well as Stein *Estate Duty* 129.

243 S3(5)(c) "[T]he power to appropriate, dispose, revoke or vary contemplated in paragraph (b) shall be deemed to exist if the deceased could have obtained such power directly or indirectly by the exercise , either with or without notice, of power exercisable by him or with his consent."

244 Refer to Meyerowitz *Administration of estates* 27-31 – 27-32, as well as Stein *Estate Duty* 129.

245 Stein *Estate Duty* 130.

246 Olivier, Strydom and Van den Berg *Trust Law* 7-52.

247 Olivier, Strydom and Van den Berg *Trust Law* 7-52.

(i) Where veto rights were reserved for the planner. (It will, however, be important that the planner is not the only trustee, and will only exercise the right if no consensus could be reached among the other trustees).[248]

(ii) Where the planner has a right to appoint or dismiss a trustee. It is, however, important that the deed must provide that a minimum of two trustees had to approve the resolution for it to be passed as valid.

(iii) If the trust deed provides for the alteration thereof, it must be clear that the planner does not have the sole right to alter the trust deed.

(iv) If the planner "has a right to determine the ultimate division of trust assets between capital beneficiaries" he must just ensure that when this right is exercised it should not benefit himself or his estate.[249]

In general it can be concluded that for estate duty purposes it will make no difference whether or not the loan account in favour of the planner bears interest or not. The fact that there is a loan account will result in the outstanding amount, still due and payable, being an asset in his estate and forming part of the dutiable estate on which 20% estate duty might be payable. As was stressed above, it is still better than to have an asset in your estate that by the date of death could have escalated to a value way above the original acquiring cost.

The provisions of section 3(3)(d) and 3(5) are of great importance. In order to prevent assets of the trust being deemed to be those of the deceased, the provisions of these two sections must be borne in mind when compiling an estate plan.

248 Own opinion.
249 Olivier, Strydom and Van den Berg *Trust Law* 7-52.

Chapter 5: Conclusion

In chapter 1, paragraph 1.2, the research question for this mini-dissertation was stated as: In light of the *Brummeria* case, to what extent does the taxation of interest-free or low-interest loans influence the usefulness of these loans as estate planning tools? In order to answer this question, the following secondary questions were formulated:

1. What are the nature and extent of interest-free loan agreements and to what extent are they used in estate planning?
2. To what extent are interest-free loans taxable if the provisions of the ITA with regard to income tax are taken into account?
3. To what extent are interest-free loans taxable, if the provisions of the ITA with regard to donations tax are taken into account?
4. To what extent are interest-free loans taxable if the provisions of the ITA with regard to capital gains are taken into account?
5. To what extent are interest-free loans taxable if the provisions of the *Estate Duty Act* 45 of 1955[250] are taken into account?

In this chapter, the conclusions drawn throughout this study are summarised.

Over time well-known practices and schemes were established by tax and estate planners. Many of these schemes were formulated with a tax saving in mind. One of these schemes to safely remove a valuable growing asset from a planner's estate was to sell the asset to a private company or family trust[251] on a loan account. The general opinion was that the recipient of the loan would not incur any income tax consequences. Then came the case that estate planners feared would come, the *Brummeria* case. Numerous opinions were expressed in articles such as "Interest-free loan and Tax: Decision in Brummeria provokes controversy among tax planners",[252] "Death of interest-free loans – recent court case shakes the foundation

250 *Estate Duty Act* 45 of 1955.
251 For the purpose of this study only the trust was used as example.
252 Ger (date unknown) http://beta.mylexisnexis.co.za/Index.aspx.

of business world",[253] and many more. As a consequence of the confusion caused by the *Brummeria* case SARS also issued IN58 in an effort to clarify when the right to use loan capital free of an interest obligation would constitute gross income. Notwithstanding the many articles written on the *Brummeria* case and its influence on the use of interest-free loans, the opinion was that in-depth research is necessary to determine whether or not the interest-free loan still has a place as estate planning tool.

In order to determine what the influence of the *Brummeria* case and other case law could be on the use of interest-free loans as estate planning tools, it was first necessary to determine the nature of an interest-free loan as well as how it is used in an estate plan. It was found that the interest-free loan as we know it today originated from the Roman-Dutch common law and related to the loan for consumption (the *mutuum*) as it was used then.[254] Jansen van Rensburg[255] held the opinion that a loan for consumption under the modern South African law "is arguably not a real contract anymore, but rather a consensual one." It was also concluded that interest was not an essential element of a loan agreement, and that even the NCA stipulated that interest may be charged, but there is no provision stating that the lender has no choice in this regard.[256] Connected persons would therefore be able to conclude a loan agreement without any reference or agreement relating to interest. The opinion was expressed that if parties to a loan contract came to an agreement that interest would be paid on the outstanding loan capital, it would have been a separate agreement apart from the loan agreement.[257]

The next step was to determine why interest-free loans are used in estate planning. It was emphasised that tax savings should never be the main motivation for doing estate planning. It was found that at least the following two reasons might be motivations for the use of interest-free loans in the execution of an estate plan. The

253 Deneys Reitz Tax 2007 http://www.fanews.co.za/article/tax/16/tax/1016/death-of-interest-free-loans-recent-court-case-shakes-the-foundation-of-business-world/892. Also refer to "Brummeria prompts talk" (Dachs *International Tax Review* 83-84), as well as Pretorius 2010 http://www.thesait.org.za/news/97605/Brummeria--Finally-Put-To-Rest-.htm.
254 Refer to paragraph 2.2.
255 Jansen van Rensburg 2008 *Stell LR* 43.
256 Refer to paragraph 2.4.2.
257 Refer to paragraph 2.4.3.

first is that it enables the planner to effectively remove a growth asset from his estate and at the same time provide the means for the family trust to acquire that asset at a market-related price. The transaction will therefore meet the requirements of an arms-length transaction. The second reason will be to provide finance to the trust to enable it to acquire other assets from independent third parties.[258]

The study thereafter proceeded to determine whether the family trust could be taxed, in terms of the ITA, on the benefit of acquiring loan capital without the obligation to pay interest.[259] The meanings of 'amount', 'received by and accrued to', as well as 'not of a capital nature', as found in the gross income definition of the ITA, were discussed in detail.[260] The focus was on whether or not the right to use loan capital without an interest obligation could be included in the gross income of the borrower. The judgments in cases such as *Brummeria* and *Geldenhuys* were examined for applicability to the specific use of loans in estate planning. It was concluded that the right acquired by the borrower is in the first instance not property and therefore could not constitute an amount that could be included in the gross income of the trust. It was also concluded that the right, which was under scrutiny in the *Brummeria* case, was received as *quid pro quo* for a life right of occupation.[261] The conclusion was drawn in the *MP Finance* case that the intention of the parties would also play an important role when considering whether or not the amount or right was received or accrued by the taxpayer. It was concluded that the typical loan agreement used in the execution of an estate plan is a loan for consumption and is not granted as *quid pro quo* for services rendered or any other benefit. It was found that loan capital cannot be regarded as being 'of a capital nature' because it was not really received. An obligation to repay the money will come into existence the minute the amount is received by the borrower. Overall it was found that the interest-free loan used in the execution of an estate plan will supply the necessary capital to a trust to acquire assets, and will not be taxable in terms of the gross income definition of the ITA.

258 Refer to paragraphs 2.5.2, 2.6 as well as 3.2.3.
259 Refer to chapter 3.
260 Refer to paragraphs 3.2.2, 3.2.3 and 3.2.4.
261 Refer to paragraph 3.2.4 as well as 3.4.2.

Unfortunately the ITA and its provisions which might impact the use of an interest-free loan do not stop with the above. There are numerous anti-avoidance provisions in the ITA, of which section 64E and section 7 were discussed in this mini-dissertation. The conclusion drawn under paragraph 3.3.2 was that where a family trust acquires a planner's shares in a company (or close corporation) and the sale is financed by way of a loan account in favour of the company, the interest not paid on the outstanding debt would be regarded as a dividend *in specie* and dividend tax would be levied. With regard to section 7[262] the main theme to be found in most of the subsections is that there should have been a donation, settlement or disposition. It was found that where assets were disposed of to a family trust by way of a bona fide sale agreement and financed by way of an interest-free or low-interest loan agreement, the transaction would be regarded as a disposition. Section 7 then may be applicable in that the income received by the trust, which relates to the asset sold in this way, will be deemed to have accrued to the planner and will be taxed in his hands. Depending on the percentage of interest levied, the amount received by the trust that relates to this asset received from the planner would either be taxed as a whole in his hands or a portion thereof will be taxed in his hands.

In chapter 4 the influence that other taxes may have on the use of interest-free loans was considered. The different applicable sections of donations tax, CGT as well as the EDA were considered.

It was concluded that currently the granting of an interest-free or low-interest loan in terms of an estate plan will not be taxed as a donation with regard to donations tax.[263] Two reasons were given to support this statement. The first was the fact that it is not current practice for SARS to tax this type of transaction as a donation. The second was that the transfer of assets took place under a legal arm's-length sale transaction, which was only financed by way of an interest-free loan. Since interest is not an essential element of a loan agreement, there could be no "waiver or renunciation of a right".[264] A warning was raised that, like in the USA, the ITA may be altered to make these types of transactions taxable.

262 Refer to paragraph 3.3.3.
263 S's 54 to 58 of the ITA. Refer to paragraph 4.1.
264 Refer to section 55(1) meaning of 'donation' as well as paragraph 4.1 above.

When considering the effect of CGT,[265] it was found that there is currently only one paragraph that may influence the use of loans in estate planning, and that is paragraph 12A. It must be understood that it is not the fact that an interest-free loan or low-interest loan is granted which will trigger the provisions of paragraph 12A, but rather the situation where outstanding debt is reduced or written off by the planner. In such a case it will be deemed to be a disposal and the trust owing the planner money will incur a CGT liability. In paragraphs 4.1 as well as 4.2 it was explained that if the planner makes use of the R100 000[266] exemption to donate R100 000 to the trust, and the trust in turn uses the R100 000 to repay loan capital, paragraph 12A of the Eighth Schedule to the ITA will not be applicable. It was accentuated that it is important that the R100 000 repayment of loan debt by the trust should not be only a book entry, but should physically take place in order not to create the idea that the transaction was in fact a donation. The provisions of paragraph 12A currently allow debt to be written off in terms of a provision in the planner's will, without any CGT being payable on the stipulation.

The last tax act that was considered was the EDA.[267] It was concluded that it is common knowledge that the outstanding debt amount owed by the trust in terms of an interest-free loan agreement would still be an asset in the planner's estate at the date of his death. In effect, without taking into account the deductions available in terms of section 4 and 4A of the EDA, 20% estate duty will be payable on the face value of the debt. The effect of sections 3(3)(d) as well as 3(5) were also considered. It was found that unless the planner could be regarded as being able to dispose of trust property for his own benefit (just before his death), the provisions of these sections would not be applicable. The mere fact that assets were sold by the planner to the trust in terms of an interest-free loan agreement could not be regarded as a provision implicating the existence of a right to dispose of property for his own benefit.

265 The Eighth Schedule to the ITA. Refer to paragraph 4.2.
266 S56(2)(b) of the ITA.
267 Refer to paragraph 4.3.

It can therefore finally be concluded that the interest-free loan is still an excellent estate planning tool to safely remove assets from a planner's estate and in this way stop the growth of that asset in his hands. There will always be tax considerations with the execution of an estate plan, but if the applicable tax provisions are taken into consideration, for the time being there will be no tax consequences; neither for the planner nor for the trust acquiring the assets.

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