Taxation of interest-free loans to trusts in estate planning

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ABSTRACT

Interest-free loans to trusts have emerged as an essential tool in South African estate planning, allowing individuals to reduce estate duty and efficiently transfer wealth to beneficiaries. These loans offer substantial tax advantages, yet they are fraught with complex legal and tax implications. While they are widely used to preserve family wealth and mitigate the financial impact of taxes, they also raise significant concerns, such as exposure to donations tax, capital gains tax (CGT), income tax, and the potential application of the General Anti-Avoidance Rules (GAAR).

Through a combination of detailed theoretical analysis and a practical case study, this research investigates the implications of interest-free loans on estate planning strategies. It provides an exploration of the relevant tax laws, particularly focusing on provisions such as section 7C of the *Income Tax Act*, and GAAR, to determine whether these loans should be considered legitimate estate planning tools or if they may be classified as impermissible tax avoidance arrangements.

The findings of this dissertation reveal that, while interest-free loans can be an effective means of reducing estate duty and preserving wealth, their potential to trigger unintended tax consequences cannot be overlooked. If not structured correctly, interest-free loans may fall foul of the tax laws, leading to donations tax liabilities. In particular, section 7C of the *Income Tax Act* could deem such loans to be donations if the loan is not charged at a market-related interest rate or, if the loan lacks commercial substance.

This dissertation concludes by asserting that interest-free loans can continue to be a valuable estate planning tool, but their use must be carefully managed to avoid the risks of unintended tax liabilities. Estate planners must ensure that such loans are properly documented, structured in accordance with the law, and clearly demonstrate their purpose as a legitimate estate planning strategy. The research also highlights the importance of ongoing legal and tax advice in the context of an ever-evolving regulatory landscape.

OPSOMMING

Rentevrye lenings aan trusts het 'n belangrike hulpmiddel geword in Suid-Afrikaanse boedelbeplanning, wat individue in staat stel om boedelbelasting te verminder en rykdom doeltreffend na begunstigdes oor te dra. Hierdie lenings bied aansienlike belastingvoordele, maar dit kom met ingewikkelde regs- en belastingimplikasies. Alhoewel dit wyd gebruik word om familierykdom te bewaar en die finansiële impak van belasting te verminder, roep dit ook beduidende bekommernisse op, soos blootstelling aan skenkingsbelasting, kapitaalwinsbelasting, inkomstebelasting, en die moontlike toepassing van die Algemene Teenvermydingsreëls.

Deur 'n kombinasie van gedetailleerde teoretiese analise en 'n praktiese gevallestudie, ondersoek hierdie navorsing die implikasies van rentevrye lenings op boedelbeplanningstrategieë. Dit verken die relevante belastingwette, met spesifieke fokus op bepalings soos artikel 7C van die *Inkomstebelastingwet* en die Algemene Teenvermydingsreëls, om vas te stel of hierdie lenings as wettige boedelbeplanningsinstrumente beskou moet word of as onaanvaarbare belastingvermydingsreëlings geklassifiseer kan word.

Die bevindinge van hierdie proefskrif toon dat, alhoewel rentevrye lenings 'n effektiewe manier kan wees om boedelbelasting te verminder en rykdom te bewaar, die potensiaal vir onbedoelde belastinggevolge nie oor die hoof gesien kan word nie. As dit nie korrek gestruktureer word nie, kan rentevrye lenings moontlik in stryd wees met die belastingwette, wat kan lei tot skenkingsbelastingverpligtinge. In die besonder kan artikel 7C van die *Inkomstebelastingwet* sodanige lenings as skenkings beskou as die lening nie teen 'n markverwante rentekoers gehef word nie, of as die lening nie kommersiële substansie het nie.

Hierdie proefskrif kom tot die gevolgtrekking dat rentevrye lenings 'n waardevolle hulpmiddel vir boedelbeplanning kan bly, maar die gebruik daarvan moet noukeurig bestuur word om die risiko's van onbedoelde belastingverpligtinge te vermy. Boedelbeplanners moet verseker dat sulke lenings behoorlik gedokumenteer is, gestruktureer is in ooreenstemming met die wet, en hul doel as 'n wettige

boedelbeplanningsstrategie duidelik aandui. Die navorsing beklemtoon ook die belangrikheid van deurlopende regs- en belastingadvies in die konteks van 'n voortdurend ontwikkelende regulatoriese landskap.

Keywords:

interest-free loans, low-interest loans, estate planning, trusts, tax avoidance, GAAR, section 7C

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LIST OF ABBREVIATIONS AND ACRONYMS

AD - Appellate Division

CGT - Capital Gains Tax

FMV - Fair Market Value

GAARs - General Anti-Avoidance Rules

JSAL - Journal of South Africa Law

IRC - Inland Revenue Commissioners

NCA - National Credit Act 34 of 2005

S - section

SALJ - South African Law Journal

SARS - South African Revenue Service

SCA - Supreme Court of Appeal

Ss - sections

STELL LR - Stellenbosch Law Review

VAT - Value-Added Tax

Chapter 1 Introduction

1. 1 Background and problem statement

Estate planning traditionally centred on planning for one's eventual passing, with the objective of minimising taxes and costs, akin to what may be understood as "putting one's affairs in order" before death.[1] However, upon closer inspection, it becomes evident that estate planning transcends mere preparation for death. It involves addressing an individual's needs during their lifetime and ensuring the well-being of their beneficiaries after their passing.[2] Meyerowitz[3] aptly describes estate planning as:

> The arrangement, management and securement and disposition of a person's estate so that he, his family and other beneficiaries may enjoy and continue to enjoy the maximum from his estate and his assets during his lifetime and after his death, no matter when death may occur.

Implicit within this all-encompassing definition is that estate planning is a continuum. It starts with the accumulation of an estate and concludes with its disposition upon the estate owner's death. Olivier's commentary on estate planning further captures this:[4]

> Dit wil voorkom asof 'n mens met reg kan sê dat boedelbeplanning betrekking het op die bymekaarmaak, die benutting en die verdeling van bates na dood.[5]

Individuals, confronted with the inevitability of both tax and death,[6] often seek ways to minimise their tax liability, especially with respect to the 'inevitable death tax': estate duty.[7] This has prompted the utilisation of various estate planning tools, with trusts the most prevalent.

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1 Victor and King *Estate Planning & Fiduciary Services Guide* 195.

2 Victor and King *Estate Planning & Fiduciary Services Guide* 196.

3 Meyerowitz and Spiro *On Income Tax* 1.

4 Olivier and Van den Berg *Pracktiese boedelbeplanning* 14.

5 The English translation is as follows: It would seem that one can rightly say that estate planning is concerned with the accumulation, utilisation and distribution of assets after death.

6 "Nothing is certain except for death and taxes" is an expression that succinctly captures the unavoidable realities of human life. Attributed to Benjamin Franklin, this phrase has endured through the centuries as a reminder of two inevitable truths: the inevitability of death and the necessity of paying taxes.

7 The term estate duty describes the "duty" charged and collected for every deceased person's estate. See s 2(1) of the *Estate Duty Act* 45 of 1955. (hereafter the *Estate Duty Act*). The object of estate duty is to levy a tax on wealth transfer between the estate of a deceased and their beneficiaries. Estate duty resembles donations tax, with one distinction, that being that estate duty

A trust is a legal arrangement wherein a trustee manages property separate from their own, in the interests of others or some other impersonal purpose.[8] Estate owners commonly use trusts to divert property (disposing thereof) from themselves, to reduce the value of their estate. This diverting or disposing of property "pegs" the value of an asset and prevents its further growth in the owner's estate, and in so doing also saves on estate duty.[9]

A common way to dispose of growth assets is either by way of a donation or by selling them at their market value to a trust. When immediate payment of the purchase price is unfeasible, the proceeds in favour of the sale are typically left as an outstanding balance on a loan account.[10] This loan would ordinarily be structured to be interest-free or low-interest.[11]

This raises critical questions: Does the disposal of assets to a trust, interest-free or at a low-interest rate, represent an avoidance arrangement by the estate owner to avoid a liability for tax? Further, perhaps more pertinent, does the disposal of assets on a loan account successfully bypasses a trigger for donations tax given that it may not meet the "gratuitous disposal" criteria of a donation.[12]

The current legal position regarding tax avoidance arrangements can be traced to the "Westminster doctrine" constructed from the case in *Inland Revenue Commissioners v Duke of Westminster*[13] in that

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taxes the transfer of wealth at death. Meanwhile, donations tax is the tax charged on transfer of wealth while a person is still alive. See Stiglingh et al SILKE: South African Income Tax 1057.

8 Cameron, De Waal and Solomon *Honoré's South African Law of Trusts* 6th ed 2.

9 Estate pegging has to do with the transferring of assets to a trust (typically an inter vivos trust). The mere transfer of the asset pegs/freezes its value in your own name, any growth of the asset after its transfer then takes place in the trust and not in your personal estate. See Botha *et al SA Financial Planning Handbook* 911; Honiball and Olivier *The Taxation of Trusts in South Africa* 198; Victor and King *Law & Estate Planning* 339.

10 Reference to the "amount owing in favour of a loan account" in this mini-dissertation, save where the contrary is expressed, describes the capital amount which is outstanding in respect of the sale of an asset.

11 Reference to "interest-free loans" throughout this mini-dissertation means that no interest at all is charged on the loan. "Low-interest loans" means that interest is charged at a rate which is below the market-related rate of interest.

12 See discussion and application in Chapter 4.5.2.

13 [1936] AC 1 (hereafter *IRC v Duke of Westminster*) at 19. Trust law in South Africa has its roots in English law, which was adopted into South African jurisprudence. The South African trust law is materially different to the trust in Enland, although English case law on trusts, such as the one

> [e]very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

From this, one can deduce that an individual may order his affairs in a way that reduces his applicable tax, as long as it remains within the law. However, while Lord Tomlin's principle permits the minimisation of tax, it does not extend to an avoidance of the law altogether, which may be the goal of some ambitious taxpayers. In a South African case, some 16 years earlier to Lord Tomlin's judgement, Solomon JA held in *Dadoo Ltd Appellants v Krugersdorp Municipal Council Respondents*:[14]

> It is perfectly legitimate; however, for persons to evade a statute by deliberately keeping outside of its provisions and by doing something which effects their purpose equally well; but without bringing themselves within the scope of the law.

In relation to the second question, it is now trite law that a loan (interest-free or low-interest) advanced by an individual to a trust will constitute a deemed donation to the trust, subject to donations tax.[15] Section 58(1) of the *Income Tax Act*,[16] sets out that the disposal of any property for a consideration that is inadequate, "must be deemed to have been disposed of under a donation".

These two questions form the basis of this mini-dissertation's theoretical exploration of the law, alongside the analysis of the viability of interest-free loans as an estate planning tool. A forthcoming case study offers further insights into the practical application of interest-free (or low-interest) loans in estate planning, complementing the theoretical discussion.

1. 2 Research question

From the above problem statement, it follows that the research question for this study is:

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before Lord Tomlin continue to play an important part in common law and remains a benchmark for the development of the South African law of trust. See Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 17-32

14 1920 AD 530 at 560 (hereafter *Dadoo v Krugersdorp Municipal Council*).

15 Stiglingh *et al SILKE: South African Income Tax* 1022.

16 58 of 1962 (hereafter the *Income Tax Act*).

To what degree does the use of interest-free (or low-interest) loans remain an advantageous tool for estate planning ?

1. 3 Research aims and objectives

To attend to the research question with the attentiveness it demands, the following case study serves as an example to illustrate how interest-free (or low-interest) loans to trusts are handled.[17]

David Clark, a 44-year-old successful entrepreneur, is married to Olivia Clark (41), out of community of property with an antenuptial contract that excludes the accrual system. David has amassed a substantial estate valued at R16 million, while Olivia stays home to care for their two minor sons; Michael (16) and James (14).

Among the assets in David's portfolio is a 40% shareholding in a mineral transport company, TrueNorth Logistics (Pty) Ltd, which he purchased in 2014 from his father, Henry, for R1,1 million. The shares are currently worth R4 million per a stockbroker's valuation. The shares are further expected to increase in value in the foreseeable future.

David is concerned that his family will be unable to maintain their lifestyle, should something happen to him. To help him structure his affairs, he solicits the advice of a financial planner. He mentions to the planner that he wants to guarantee that his family is looked after in the event of something henceforward happening to him and rendering him unable to care for them. He further mentions that he "nearly pays half his worth over in tax" and wishes to reduce his tax liability. He further wants to ensure that upon death, his taxes remain low.

On the advice of his financial planner, David created the Clark Family Trust, a discretionary *inter vivos* trust,[18] to hold and manage certain assets.

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17 This case study serves to show an example of estate planning in practice, this case study is reformulated by the author from a similar set of facts set out in Botha *et al SA Financial Planning Case Studies* 148-151.

18 A discretionary inter vivos trust is a trust created in the lifetime of its founder through a contractual agreement with the trustee aimed at benefitting third parties. The trust instrument grants the

David sold his 40% shareholding in TrueNorth Logistics (Pty) Ltd to the trust for R2,5 million.[19] The sale was structured through a low-interest loan to the trust, with the loan carrying an annual interest rate of 4%.

David and Olivia are co-trustees. The beneficiaries of the trust are David, Olivia, Michael, and James.

Assumptions:

- The official rate of interest is 9,25% per annum;[20] and
- David's marginal rate for income tax through the period was 41%.[21]
- Local dividends (in respect of the shares) accrued to the trust for the current year of assessment in the amount of R244 000.

The following secondary objectives are a supplement to the above case study and present the theme for each of the forthcoming chapters of this mini-dissertation.

trustees the discretion to select beneficiaries and determine their benefit level from the trust. See Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 8-9.

19 It is important to take notice from the outset, that in this transaction the sale price is much lower, to the tune of R2 million, of the value of the asset. This is an example of "inadequate consideration" as provided for in s 58(1) which will have the effect of this transacting being deemed as a donation – even though there is a sale of an asset. Furthermore, this transaction is also likely to trigger capital gains tax given that the alienation of the shares to the trust is at a capital gain (it was sold for 4 million (Proceeds) and was bought for 1.1 million (base cost)).

20 The Income Tax Act sets out in s 1 that the "official rate of interest" means the South African repo rate plus 100 basis points (1%). Currently, the repo rate is 8.25%, hence the official rate of interest is 9.25%.

21 South African residents' taxable income is determined on a sliding scale and are is referred to as their marginal rate of tax. See South African Revenue Services 1997 https://www.sars.gov.za/types-of-tax/personal-income-tax/.

1.3.1 Secondary objectives

1.3.1.1 Consider the nature of loans (specifically interest free loans) and their use in estate planning (Chapter 2);

1.3.1.2 Define the nature of trusts as a tool for estate planning (Chapter 3);

1.3.1.3 Examine the influence that taxation has on the use of trusts as an estate planning tool within the legal framework of South Africa (Chapter 4);

1.3.1.4 Distinguish when a taxpayer's arrangement of their affairs are likely to constitute impermissible tax avoidance arrangements, (Chapter 5); and

1.3.1.5 Determine the anti-avoidance provisions specifically befitting trusts, with specific reference to the decision in *Commissioner for the South African Revenue Services v Brummeria Renaissance (Pty) Ltd*[22] (Chapter 6).

1. 4 Research methods

This dissertation employs a qualitative research approach, primarily rooted in a literature review. The review encompasses existing research on the taxation of trusts and the impact of interest-free loans on trust taxation. Relevant literature on estate planning, legislative materials, and case law is incorporated.

1. 5 Framework

This dissertation comprises of six chapters.

Chapter 1 introduces the research, outlining the problem statement, motivation, aims, objectives, and proposed research methods.

Chapter 2 considers the fundamental nature of a loan according to the common law and the NCA and explores whether interest-free loans resorts under either of these categories.

[22] [2007] 4 All SA 1338 (SCA) (hereafter *CSARS v Brummeria Renaissance*).

Chapter 3 examines the trust. This chapter only establishes the fundamental elements of a trust with certain specific points incidental to trusts in estate planning.

Chapter 4 focuses on the tax ramifications that goes along with trusts and aims to provide a compendium of the influence of taxation on the continued suitability of trusts in South Africa.

Chapter 5 considers tax avoidance arrangements. An application of the General Anti-Avoidance Rules (GAAR) is given in light of what the Commissioner (or court) may consider to be impermissible tax avoidance arrangements.

Chapter 6 gives an account of the specific anti-avoidance rules that were introduced to curb the tax avoidance through trusts.

Finally, Chapter 7 consolidates the key findings, summarising the research outcomes comprehensively and reiterating the main implications of interest-free loans for estate planning practitioners.

Chapter 2 The concept of a loan in estate planning

2.1 Introduction

This Chapter examines loan agreements, with a particular focus on the distinctions and applications of loans under the common law and the *National Credit Act*.[23] It aims to clarify how loan agreements, as credit transactions, are governed by exploring both the definitions and the regulatory frameworks applicable. The chapter culminates in a discussion on the nature of interest-free loans in the context of estate planning.

2.2 Defining a loan

A loan typically involves lending something, often money, to someone expecting repayment at a future date.[24] This postponement of the borrower's obligation to pay the lender embodies one of the fundamental elements of credit: the deferral of payment. The *NCA* describes credit[25] 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.

A typical credit transaction includes an additional component — interest, fee, or charge on the deferred amount.[26] The borrower incurs these fees in exchange for access to resources (money), while the lender is compensated for the risk undertaken to part with their money.

However, not all forms of indebtedness constitute a loan.[27] For instance, purchasing goods on credit and repaying over time is considered an advance or credit rather than

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23 34 of 2005 (hereafter the *NCA*).

24 Hornby *et al Oxford Advanced Learner's Dictionary* 872; Black, Hashimzade and Myles *Oxford Dictionary of Economics* 242.

25 Section 1 of the *NCA*. The credit provider is the one who undertakes to defer the consumer's obligation.

26 The credit provider's deferral of the credit consumer's obligation to repay the utilised credit typically comes at a cost to the consumer in the form of some sort of fee, which in most cases is interest. See Nagel *et al Commercial Law* 296.

27 *Western Bank Ltd v Registrar of Financial Institutions and Another* [1975] 4 All SA 155 (T) (hereafter *Western Bank*) at 164.

a loan.[28] Notwithstanding the above, loans, advances or credit are sometimes aggregated to refer to "loans" in the broader context of credit agreements involving trusts or company structures, where individuals may be "connected persons" to these entities.[29]

To understand the role of loans in estate planning, it is essential to assess which credit transactions constitutes the loans used to facilitate estate planning strategies. In South Africa, two principal types of loan agreements exist:[30] *commodatum* (loan for use); and *mutuum* (loan for consumption).[31]

2.3 Loans under the common law

In South Africa, our common law is rooted in Roman-Dutch law. Accordingly, the modern use of loans has significantly been shaped by 17th and 18th-century Roman-Dutch principles. At common law, the traditional loan for money is a "*verbruiklening*", a contract of *mutuum* (or loan for consumption).[32] In a *mutuum* agreement, the lender delivers a tangible item together with his ownership in the item/goods to the borrower who endeavours to return an item/goods similar in quality and quantity at a later time.[33] This transfer of ownership is essential; without it, a contract of *mutuum* cannot be enforced. A *datio* (transfer of ownership) must thus follow a *pactum de mutuo dando* (an agreement to lend).[34]

Historically, *mutuum* contracts were informal and short-term financing instruments between friends, with no interest payable.[35] After all — "friends do not demand interest

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28 *Western Bank* at 164. See below at 3.3.1.1 for a further explanation of why debt can be understood to be broader than merely a loan.

29 Loans, advances, or credit, as the case may be, means that an agreement of credit of some sort was undertaken between the parties involved.

30 Both these loans are derived from Roman-Dutch Law principles of contract. Contemporary South African law is a modernised version of the Roman-Dutch Law, which is known as our common law. While many of the principles of the common law remain, not only relevant but practised, particularly in contracts, they also remain subject to the Constitution of the Republic of South Africa, 1996 from which all law in the Republic derives its validity. See Hutchison *et al The Law of Contract in South Africa* 11.

31 Preston *Interest-free loans or low-interest loans and estate planning* 9.

32 *Western Bank* at 162; Jansen van Rensburg 2008 *STELL LR* 42.

33 *Western Bank* at 162.

34 Jansen van Rensburg 2008 *STELL LR* 42.

35 Jansen van Rensburg 2008 *STELL LR* 42.

from friends".[36] Over time, *mutuum* was introduced into commerce which led to the charge of interest on these loans.[37] Interest became a common, though not necessary condition, to *mutuum* contracts. This additional component to *mutuum* contracts had to be agreed upon between the parties.[38]

A *mutuum* agreement in commercial dealings can be seen in the bank-customer relationship. When a customer deposits money into their bank account, they effectively loan their money to the bank. Conversely, when a customer overdraws their account, the bank loans money to them.[39] In both cases, the borrower receives possession and title to the borrowed funds. While interest is often associated with these loans, it is not a prerequisite for a contract of *mutuum* between the parties.

2.4 Loans in terms of the NCA

The *NCA* serves as the primary legislative framework regulating credit agreements in the Republic. Its object is to ensure a fair marketplace for consumer credit access as well as fostering a consistent enforcement framework for credit agreements.[40]

The *NCA* has application to all credit agreements conducted at arm's length,[41] where the agreement is made within or is effective within the Republic.[42] Section 4(2)(b) of the *NCA* excludes certain credit agreements from its purview for want of being at arm's length. Hereafter are examples of parties whom the NCA deems not to be dealing at an arm's length:[43]

(i) a loan or credit agreement between a legal entity and an individual with a controlling

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36 Watson 1984 *Law & Hist Rev* 6.

37 Potgieter *The prescription of interest-free loans and the tax implications thereof* 26.

38 This additional component was referred to as a stipulatio – a verbal agreement undertaken between the parties to make interest a part of their loan agreement. See further Jansen van Rensburg 2008 *STELL LR* 42.

39 Sharrock *The Law of Banking and Payment in South Africa* 116–117.

40 Long-title to the *NCA*.

41 Section 4(1) of the NCA. See also Trollip JA's interpretation of an arm's length transaction in *Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A) 311: "[I]t connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself".

42 Section 4(1) of the *NCA*.

43 Section 4 of the *NCA* focuses on the Act's application. S 4(2)(b) specifically focuses on what the Act deems to be agreements not at an arm's length.

interest in that entity;

(ii) a loan to a shareholder or a credit agreement where the legal entity is the lender and the individual with a controlling interest in the entity is the borrower;

(iii) a credit agreement between individuals who are family members and either depend on each other or one is reliant on the other;

(iv) any other agreements where:

(aa) the parties are not independent from each other and thus may not aim for the maximum possible benefit from the transaction.

(bb) it is legally recognised that the parties are not dealing at arm's length.

The rationale that underscores these exclusions is that such transactions lack the independence typically associated with commercial dealings.[44] Consequently, they fall beyond the scope of the *NCA*, by dint of not exhibiting the independence and financial motivations that characterise typical commercial credit agreements.

The following section examines the applicability of common law principles and the *NCA* to interest-free loans, particularly in the context of estate planning.

2.5 The nature of interest-free loans in estate planning

Loans, particularly when employed in estate planning, represent a significant departure from traditional loans that characterize modern commercial transactions.[45] The essence of traditional loan agreements lies in a contractual relationship at arm's length, where the borrower consumes the loaned item and has an obligation to return its equivalent later with interest, however, loans in estate planning function quite differently.[46]

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44 Independence between parties would entail a transaction at arm's length – this would generally mean a transaction conducted for a price comparable to what would be obtained in an open market where there is an acquiescent buyer and seller. See *Tennant The nature of interest-free loans and the tax implications thereof* 14; Preston *Interest-free loans or low-interest loans and estate planning* 7.

45 In estate planning loans are generally used to facilitate the disposal of assets to a family trust or a company, that does not have the funds on hand to pay for these assets. The loan replaces the asset in an individual's estate and becomes an asset in the estate of the individual for as long as the loan amount remains outstanding. These loans may be interest-free or interest-bearing. Since the loan is not associated with the generation of profit, if interest is charged it would be below the market-related rate of interest. See the above discussion from notes 12–14.

46 To reiterate, interest is not a necessary concomitant of a loan, but is often agreed to as an additional component between contracting parties.

At common law, *mutuum*, typically operates within a framework where both the lender and borrower seek to maximise their individual benefit. In estate planning, interest-free loans bear little resemblance to the commercial motives of a *mutuum*. These loans are often employed within close familial relationships, where the primary objective is not financial gain for the lender but rather the facilitation of asset preservation, and the minimization of tax.[47]

The *NCA* does not explicitly mention that loans used in estate planning are excluded from its scope, although it is opined that these types of transactions embody the characteristics the Act excludes in section 4(2)(b).[48]

Section 4(2)(b)(iii) explicitly excludes agreements between persons who have familial relations from the scope of the *NCA*. In the case study, the position of David makes this clear — his beneficiaries are those persons with whom he shares kinship. Though he does in fact deal with them, he does not do so to derive a benefit for himself.

To liken interest-free loans (used for estate planning) to their counterparts under the common law, it can be said that it likely resembles *commodatum*, in some respect. However, categorising interest-free loans in estate planning as a form of *commodatum* would be an oversimplification that cannot be entertained. A *commodatum* requires the return of the exact same item in its original form. In estate planning, the borrowed item is consumed, often with little expectation to be returned in its original form. Interest-free loans, as can be seen, neither fit the structure nor purpose of loans in the common law or the *NCA*, it is in a category of its own — a loan *sui generis*.

2.6 Conclusion

This Chapter has outlined the distinctions between loans under the common law and the *NCA* while shedding light on the unique nature of interest-free loans as an instrument of estate planning. It is concluded that, traditional loans in commercial settings operate on an arm's length basis with an expectation of *quid pro quo* (a degree of reciprocity). Interest-free loans, on the other hand, lack these commercial

47 Victor and King *Law & Estate Planning* 3-4.
48 Preston *Interest-free loans or low-interest loans and estate planning* 8.

incentives. It follows that they function as instruments of asset management and tax planning, closely resembling *commodatum* in spirit but ultimately being a loan of its own kind.

Chapter 3, hereafter, explores the fundamental principles of trust law.

Chapter 3 The legal nature of a trust in South Africa

3.1 Introduction

The English jurist and historian Frederic Maitland once recounted the trust as being "the greatest and most distinctive achievement performed by the Englishmen in the field of jurisprudence".[49] It is undeniable that the trust is rooted in English law.[50] The concept was introduced to the Batavian Republic (modern-day Cape Town) following the British occupation and the subsequent defeat of the Dutch.[51] After the British colonisation of the Cape, which area adhered to Roman-Dutch law, the British continued the familiar practice (to them) of using trusts.[52] Over time, and through customary usage, trusts became embedded in South African law.

In the course of the first judicial consideration of trusts in the context of South African jurisprudence, the courts recognised the institution but consciously chose not to adopt English trust law in its entirety.[53] While the semblance of the trust was accepted, its nucleus underwent significant remoulding.[54] What is today known as South African trust law has evolved over time into a "uniquely homegrown product", distinct from the English trust that originally washed up on South Africa's shores.[55]

3.2 The definition of a trust

Section 1 of the *Trust Property Control Act*[56] defines a trust in the following way:

> Trust means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed –
>
> (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of a person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

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49 Gallanis "The Contribution of Fiduciary Law" 388.
50 Maitland *The Collected Papers of Frederic William Maitland* 474.
51 Cameron, De Waal and Solomon *Honoré's South African Law of Trusts* 6th ed 2-3.
52 Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 21.
53 *Estate Kemp v McDonald's Trustee* 1915 AD 491 at 499.
54 De Waal 2000 *SALJ* 548 at 555.
55 Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 17.
56 57 of 1988 (hereafter the *Trust Property Control Act*).

(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument.

The statutory definition differentiates between two types of trusts and delineates in each case the trustee's role. The terms "trust" and "trustee" can be understood in both a wide and a narrow (strict) sense.[57] In its wide sense, as contemplated by paragraph (a), ownership of property is "made over" or "bequeath" to a trustee who administers the property in the interests of a beneficiary.[58] Conversely, in a narrow sense, outlined in paragraph (b), property is made over or bequeathed directly to the beneficiaries, with the trustee merely overseeing the management thereof.[59]

The etymology of the word "trust" inherently implies a fiduciary relationship.[60] It follows that a trustee is beholden to a fiduciary duty in respect to the trust beneficiaries. According to section 9(1) of the *Trust Property Control Act*, a trustee must dispense their duty with "care, diligence and skill which can reasonably be expected of a person who manages the affairs of another". That is to say, it is incumbent on a trustee to act as a *bonus et diligens paterfamilias* (a shrewd and vigilant person)[61] with *uberrimae fidei* (utmost good faith).[62] While contracts in contemporary South Africa are generally contracts of good faith,[63] trusteeship

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57 *Goodricke and Son (Pty) Ltd v Registrar of Deeds, Natal* [1974] 1 All SA 364 (N) at 368; *Conze v Masterbond Participation Trust Managers (Pty) Ltd* [1996] 1 All SA 521 (C) at 521; Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 1.

58 Section 1, "trust", para (a). Scholars concur that what para (a) of the definition of "trust" refers to is an ownership trust, also known as a "trust in the strict sense" or an "ordinary" trust. In this type of trust the ownership of property vests in the trustee, but is to be exercised for an interest other than their own. See Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 8; Geach *Trust Law in South Africa* 3. Geach contends that the ownership trust is commonly employed in practice and is particularly prevalent in estate planning.

59 Section 1, "trust", para (b). Scholars further agree that para (b) of the definition pertains to a bewind trust, where the term bewind denotes an administrator (or *bewindhebber*) who manages another's property. See Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 8; Geach *Trust Law in South Africa* 3.

60 Palmer "Trusts" in LAWSA 177.

61 *Sackville West Appellant v Nourse and Another Respondent* 1925 AD 516 at 534 (hereafter *Sackville West v Nourse*).

62 *Doyle v Board of Executors* [1999] 1 All SA 309 (C) at 315.

63 Good faith is a cornerstone of modern contracts and places a positive duty on parties to contract, to act honestly and fairly towards one another in their dealings with each other. See Hutchison *et al The Law of Contract in South Africa* 46.

demands a higher standard of conduct – to such extent that can be described as exceptional in "care, diligence and skill" and of a degree better than "good".[64]

3.3 The core idea of a trust

A central tenet of South African trust law is the separation of control from enjoyment.[65] In *Land and Agricultural Development Bank of South Africa v Parker,*[66] the court elucidated:

> The core idea of the trust is the separation of ownership (or control) from enjoyment. Though a trustee can also be a beneficiary, the central notion is that the person entrusted with control exercises it on behalf of and in the interests of another.

This principle implies that a trustee administers property in the interests of beneficiaries, in trust, separate from their personal estate. The statutory phrases "to be administered..." and "for the benefit of *another*" emphasises the trustee's role first and foremost as an administrator (and then)[67] rather than owner. Thus in both an ownership and a *bewind* trust the trustee should maintain this "core idea" of trust,

> Namely the functional separation of the trustee's ownership (or control) over trust property from the enjoyment derived from such ownership (or control) through the bestowal of trust benefits on the trust's beneficiaries or through the achievement of the trust's object.[68]

Trusteeship enables the simultaneous holding of two estates: the personal estate of the trustee and the holding of (in official capacity) the trust estate.[69] Notwithstanding,

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64 The degree of a man's exercise of his affairs is measured against that of a reasonable man. The anomaly with a trustee is that a man ought to be better in his exercise of another's affairs, for "[he] may act as he pleases with his own property" but does not have the same liberties with the property of another - *Sackville West v Nourse* at 534.

65 Du Toit, Smith and Van der Linde *Fundamentals of South African Trust Law* 2.

66 [2004] 4 All SA 261 (SCA) (hereafter *Land and Agricultural Bank of SA v Parker*).

67 Even when a trustee has been conferred ownership of the trust assets, their duty is primarily that of administering the assets of the trust for an impersonal purpose.

68 Du Toit 2007 *STELL LR* 469.

69 De Waal 2000 *SALJ* 560-562. De Waal points out that there is in fact no actual owner of the trust estate, there is however, a holder of this estate (the trustee) with the authority to deal with the estate. What De Waal is (in the author's opinion) getting at is that while paragraph (a) of the definition of trust implies that ownership vests in the trustee, what the trustee in fact has is not so much the dominium of the property, but rather a right which his office confers on him – to deal with the trust property as though owner thereof in the interests of others (beneficiaries). To deal (as a verb is to: treat, handle, or use) is axiomatic to what an owner would in the ordinary sense do with property that belongs to them. Thus, the qualification "for the benefit of" implies that if there was, on the part of the trustee dominium in the property, such dominium is bare, because it can only be exercised for an impersonal interest.

the separation of estates, the trustee is not precluded from also being a trust beneficiary.[70] Importantly, while a trustee may also be a beneficiary, he cannot be a sole trustee and sole beneficiary.[71] This would be tantamount to a conflation of administrative and beneficial interests, instead of a sunder thereof – a practice incompatible with the South African trust.[72]

3.4 The discretionary family trust

It may be contentious to assert that the discretionary (family) trust is invariably the default structure for estate planning, but in the least it has become a key implement in the estate planner's toolkit.

The challenge that arises with the family trust is when the property is treated as though belonging to the founder.[73] In such case the founder, acting as a trustee or their appointed proxies, are derelict in their fiduciary duties and administers trust property in their own interests rather than the interests of the beneficiaries.[74] Although a trustee may also be a beneficiary, it is specifically emphasised that it is the trustee who administers the property (in official capacity) to put beyond doubt the "separation in ownership and enjoyment"[75] of the trust estate.

The idea of a family trust has seemingly been less about having a separation in ownership and control, and more about protecting the interests of persons with familial ties. The object of a family trust is first and foremost to –

> secure the interests and protect the property of a group of family members, usually identified in the trust deed by name or by descent or by degree of kinship to the founder.[76]

In *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*,[77] Harms JA pointed out that these "newer type of trusts" — often employed in estate planning — as falling short of the central

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[70] See above at note 69.
[71] *Land and Agricultural Bank of SA v Parker* para 19.
[72] *Land and Agricultural Bank of SA v Parker* para 19.
[73] Marumoagae 2017 *Obiter* 37.
[74] *Badenhorst v Badenhorst* [2006] 2 All SA 363 (SCA) para 9.
[75] *Thorpe v Trittenwein* [2006] 4 All SA 129 (SCA) para 17.
[76] *Rees v Harris* [2011] JOL 28014 (GSJ) (hereafter *Rees v Harris*) para 25.
[77] [2004] 1 All SA 396 (SCA) (hereafter *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*) para 17.

idea of trust. These (new) trusts purport to separate ownership from control, when in fact "everything else remain [sic] as before".[78]

Family trusts are increasingly employed as the *alter ego* of its founder. The courts have defined the meaning of *alter ego* as some subterfuge of the "fiction of legal personality".[79] Family discretionary trusts are particularly vulnerable to the whim of the trustees, who often treat property held in trust as still belonging to them.[80]

There is, in principle, nothing objectionable about the family trust or its object of safeguarding the interests of family members.[81] However, the trust's legitimacy is undermined when securing these interests devolves into a situation where trustees are merely at the beck and call of the founder (own emphasis). In these situations, the trust may be classified as a sham.[82]

When the substance of the trust no longer aligns with its intended purpose under the law, what remains is a hollow shell — retaining the outward form of a trust while concealing an entirely different arrangement. That said, if the trust serves merely as a façade to mask the true nature of affairs and *de facto* control of trust property remains with the founder, then there never existed an arrangement by which "ownership in property of one person is by virtue of a trust instrument made over or bequeathed *to another*" as the statutory definition delineates.[83] In such case, the courts may go beyond the form and uncover the true substance of the trust. Cameron JA asserted in *Land and Agricultural Bank of SA v Parker*:[84]

> It may be necessary to go further and extend well-established principles to trusts by holding in a suitable case that the trustees' conduct invites the inference that the trust form was a mere cover for the conduct of business 'as before', and that the assets

78 *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* para 17.

79 *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* [1993] 3 All SA 685 (C) at 714-717. See also generally *Ebrahim v Airport Cold Storage (Pty) Ltd* (2008) 6 SA 585 SCA paras 15, and 21-22; *Rees v Harris* paras 13, 15, and 18-19. In neither of these cases has the courts defined an alter ego but has used it as an umbrella term for a cloak, mask, façade or sham and pointed out that in such instances the court will lift or "pierce the veil" of such alter ego. In the case of trusts, piercing of the corporate veil has been referred to as the "piercing of the trust veneer".

80 *Van Zyl v Kaye* (2014) 4 SA (WCC) para 21.

81 Geach *Trust Law in South Africa* 23-24.

82 Geach *Trust Law in South Africa* 24.

83 *MJ K v II K* [2002] JOL 54724 (SCA) para 31.

84 Para 37.3.

> allegedly vesting in trustees, in fact, belong to one or more of the trustees and so may be used in satisfaction of debts to the repayment of which the trustees purported to bind the trust. Where trustees of a family trust, including the founder, act in breach of the duties imposed by the trust deed and purport on their sole authority to enter into contracts binding the trust, that may provide evidence that the trust form is a veneer that in justice should be pierced in the interests of creditors.

3.4.1 The family trust in practice

The reputation of trusts as an estate planning tool precedes itself. Its enduring appeal stems from the array of advantages it offers, making it a highly versatile and favourable tool. These advantages include, but are not limited to:

3.4.1.1 Asset protection

One of the key justifications for employing a trust is for the purpose of protecting assets. This protection hinges on the trust's foundational principle: the separation of ownership and enjoyment.[85] This separation in ownership and enjoyment, enables the trust to insulate its assets from the reach of the creditors of the founder, trustees and beneficiaries, the financial fallout of insolvency of the trustees and founder, or the personal indebtedness of the founder.[86] That said, it should be advised that the protective (or spendthrift) trust should not be wielded as a means merely to deny creditors their rightful claims.[87] This would be inimical to the spirit and purport of the *Insolvency Act*.[88]

3.4.1.2 Estate freezing

A hallmark feature of a trust is its ability to facilitate an estate duty saving, by pegging the value of the estate.[89] Typically, an estate owner will transfer growth assets to a trust, with growth thereafter occurring within the trust rather than in the founder's hands.[90] There will be a substitution of the growth asset for debt in the owner's estate.[91] A case in point is the sale of an asset to a trust on loan account (as in the

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85 See para 3.3 above.
86 Geach *Trust Law in South Africa* 433.
87 Stander 1999 *JJS* 158.
88 24 of 1936.
89 Deloitte *Pay Less Tax* 19th ed 243.
90 Du Plessis 2024 *Trust & Trustees* 522.
91 Victor and King *Law & Estate Planning* 339.

case study of David), often interest-free or low-interest. It should be noted that section 7C of the *Income Tax Act* deems the foregone interest as a donation.

> Section 7C imposes an annual donations tax liability for, essentially, notional uncharged interest on 'loans, advances or credits' made by an individual and certain companies, to a 'connected person' trust.[92]

The amount deemed to be a donation will be determined as the difference between the interest calculated at the official rate and the actual interest paid by the trust or company, if any.[93] Even so, the payment of tax under section 7C will, in itself, still dissipate the estate of the founder.[94]

3.4.1.3 Perpetual succession

Trusts enjoy perpetual succession, ensuring continuity beyond the founder's death. Moreover, a trust enables the uninterrupted enjoyment of trust benefits.[95] While a deceased person's estate undergoes administration during the winding up process, a trust continues "business as usual", save where the trust deed provides for its termination upon the founder's death – an unlikely provision from (especially) an estate planning perspective though not impossible.

3.4.2 In trusts we trust: the preferred technique for estate planning

When compared to some other estate planning tools, i.e., such as inter-spousal transactions, the R3,5 million section 4A abatement, the use of limited rights, and domestic life policies – the trust consistently emerges as the preferred tool for estate planning. Despite legislative interventions over the past decade aimed at curtailing the use of trusts as anti-avoidance vehicles,[96] the trust retains enduring appeal due to its multifaceted advantages.

It is important to take cognisance that no estate plan should primarily be contingent on a tax benefit because tax legislation changes over time. It follows that many estate

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92 Clegg 2024 LexisNexis 1.
93 Section 7C (3) of the Income Tax Act.
94 Botha *et al SA Financial Planning Handbook* 951.
95 Honiball and Olivier *The Taxation of Trusts in South Africa* 11.
96 Du Plessis 2024 *Trust & Trustees* 516.

planning tools offer a singular and specific advantage, while trusts yield several benefits that make them important for estate planning. A trust is for many a "one stop shop". Pierre le Paulle succinctly captured this in a comment, explaining:

> Trusts have now pervaded all fields of social institutions in common law countries. They are like those extraordinary drugs curing at the same time toothache, sprained ankles and baldness, sold by peddlers on the Paris boulevards; they solve equally well family troubles, business difficulties, religious and charitable problems. What amazes the sceptical civilians is that they really solve them.

3. 5 Is a trust a person? The conundrum unravelled

It has long been a legal conundrum whether the trust has autonomous identity. In South African law, a trust is not considered to be a person.[97] In *Braun v Blann and Botha*,[98] Joubert JA expressed that "in its strictly technical sense the trust is a legal institution *sui generis*". This interpretation was confirmed in *Commissioner for Inland Revenue v Friedman*,[99] where Joubert JA further asserted that

> 'Trust' is not defined in the 1962 Act. It must therefore be given its common law meaning, viz an entity whose assets and liabilities vest in its trustee for purposes of administration,[100]

From this, Joubert JA concluded that trusts are non-taxable entities.[101] The trustee (as resorting under the definition of person) was designated as the representative taxpayer on behalf of the trust.[102] The conundrum: if a trustee is a representative taxpayer, and a taxpayer must be a person, whom exactly is the trustee a representative for if the trust is not a person?

This conspicuous inconsistency prompted legislative amendment to the *Income Tax Act*, which accordingly expanded the definition of "person" to incorporate any trust.[103]

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[97] The categories of persons constitute natural and juristic. Declaring that a trust is not a person thus means it is neither a juristic nor a natural person.
[98] [1984] 2 All SA 197 (AD) at 201. (hereafter *Braun v Blann*).
[99] [1993] 1 All SA 306 (A) 308. (hereafter *CIR v Friedman*).
[100] *CIR v Friedman* 312.
[101] At 318.
[102] At 325(2) – 325(3).
[103] *Friedman v Commissioner for Inland Revenue: In re Phillip Frame Will Trust v Commissioner for Inland Revenue* 1991 (2) SA 340 (W) and confirmed on appeal in *CIR v Friedman*. See further *Commissioner for South African Revenue Service v The Thirstle Trust* [2023] (2) SA 120 (SCA) para 7.

Hence, under the *Income Tax Act* — a trust is a person. Beyond tax, the trust remains not a person. Under the common law it is an aggregate of assets and liabilities, and in terms of the *Trust Property Control Act*, an "arrangement"[104] A trust therefore retains the character (save for statutory purposes) as described by Cameron JA in *Land and Agricultural Bank of SA v Parker* as;

> an accumulation of assets and liabilities. These constitute the trust estate, which is a separate entity. But though separate, the accumulation of rights and obligations comprising the trust estate does not have legal personality.[105]

The position was reinforced in *Lupacchini v Minister of Safety and Security*[106] that:

> A trust that is established by a trust deed is not a legal person – it is a legal relationship of a special kind that is described by the authors of Honoré's *South African Law of Trusts* as 'a legal institution in which a person, the trustee, subject to public supervision, holds or administers property separately from his or her own, for the benefit of another person or persons or for the furtherance of a charitable or other purpose'.

Thus, to put it plainly – for tax purposes a trust is a person, but in a context otherwise than for tax, a trust lacks juristic personality.[107] It is merely a legal relationship *sui generis*.

3. 6 Conclusion

The trust, while undeniably rooted in English law, has undergone significant adaptation to become a uniquely South African institution. This evolution highlights its flexibility and enduring relevance in estate planning. The defining characteristic of the South African trust — the separation of control from enjoyment — remains central to its legitimacy, ensuring that trustees administer trust property for the benefit of others rather than their own.

The family trust, despite its utility, is increasingly vulnerable to abuse. When founders manipulate the trust for their own benefit, disregarding the division between ownership

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[104] See definition of "Trust" in s 1.

[105] At para 10. It should be noted, even if only for further clarification, that the sentence preceding this extract read as follows: "Except where statute provide otherwise, a trust is not a legal person". The elevation of a trust to the status of a person in terms of the Income Tax Act is thus justified, given that the *Income Tax Act*, is in fact a statute.

[106] [2011] 2 All SA 138 (SCA) para 1.

[107] Davis, Beneke and Jooste "Chapter 5: The law of trusts" at 5-8.

and control, the trust ceases to function as intended and devolves into a sham. In such cases, courts have rightly pierced the trust veneer, looking beyond its outward form to expose arrangements that contravene the tenets of South African trust law.

The dual nature of the trust in South African law is a distinct feature. A trust is deemed a "person" for tax purposes, it is otherwise recognised as a *sui generis* legal relationship, neither constituting a legal entity nor having a personality in law.

In summary, the trust continues to be a powerful tool for estate planning, providing asset protection, perpetual succession, and estate duty savings. However, its legitimacy depends often squarely on the strict adherence of a trustee to the duties incumbent on their office.

Chapter 4 The impact of taxation on the use of trusts in estate planning

4.1 Introduction

Trusts in estate planning, particularly discretionary *inter vivos* trusts, have long been valued for managing and preserving family wealth. Their popularity as a legal institution is primarily due to their versatility, flexibility, and autonomy.[108] "A further reason for the trust's popularity in rebut decades has been for tax reasons".[109] However, the tax implications associated with using trusts — especially when interest-free (or low-interest) loans are involved require careful consideration.

Trusts in South Africa are subject to several taxes, including income tax, donations tax, and capital gains tax (CGT), amongst others, all of which can materially impact their utility in estate planning. This chapter examines the tax consequences of employing trusts, with a particular focus on the use of interest-free (or low-interest) loans. The discussion is framed within the context of the case study presented in chapter 1, providing a practical overview of the taxation of the trust.

4.2 The tax principles applicable to trusts

As noted above at paragraph 3.5, a trust[110] is deemed a "person" under the *Income Tax Act.*[111] Following the judgement in *Friedman v Commissioner for Inland Revenue: In re Phillip Frame Will Trust v Commissioner for Inland Revenue*[112] the definition in section 1 of the *Income Tax Act* were revised to explicitly include trusts. This inclusion

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108 Dlodlo J in *Meijer v Firstrand Bank Limited (Formerly Known as First National Bank of Southern Africa) In re Firstrand Bank Limited (Formerly Known as First National Bank of Southern Africa) v Meijer* [2013] JOL 30560 (WCC) para 2 (hereafter *Meijer v Firstrand Bank*).

109 *Meijer v Firstrand Bank* para 2.

110 "Trust" for purposes of the Income Tax Act means – any trust fund, comprising cash or other assets, that is administered and controlled by a fiduciary, so appointed under a deed of trust, agreement, or the will of a deceased person.

111 A person can be considered either a natural or juristic person; resident or non-resident. For purposes of this dissertation, the term "person" as descriptive for a trust means neither of the aforementioned but rather a person (otherwise than a natural person) incorporated, formed or having been established in the Republic.

112 1991 (2) SA 340 (W). (hereafter *Friedman v CIR: In re Phillip Frame Trust*). It should be noted that in para 3.5 above, it may suggest that the decision of *CIR v Friedman* is the case that prompted the inclusion of a trust in the definition of "person" in s 1 of the Income Tax Act, however, the correct position is that this occurred subsequent to the decision in *Friedman v CIR: In re Phillip Frame Trust* and only confirmed on appeal in *CIR v Friedman*.

recognizes a trust as an autonomous entity.[113] This has the effect that normal income tax is applicable to trusts.[114]

The determination of a person's liability for tax in South Africa commences with the computation of their gross income, in light of the fact that only amounts included in gross income are subject to tax.[115]

> "Gross income"[116] in relation to any year or period of assessment means –
>
> (a) 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
>
> (b) 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,
>
> ... excluding receipts of a capital nature.

As part of the preliminary enquiry in determining a person's tax liability, it is also necessary to establish their residence status. Residents are subject to tax on their worldwide receipts and accruals, while non-residents are taxed solely on income sourced within the Republic.[117] In the context of trusts, a resident *trust* is one whose formation, establishment or area of effective management is within the country.[118]

4.3 Treatment of trusts: income and beneficiaries

Although the gross income definition has been provided in paragraph 4.2 above, further clarification is required on three (3) constituent elements: "received by," "accrued to," and "year or period of assessment". Additionally, a clear distinction between a beneficiary's vested and discretionary rights is necessary before ensuing with a consideration of the taxation of a trust.

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113 Geach *Trust Law in South Africa* 464.
114 Honiball and Olivier *The Taxation of Trusts in South Africa* 65.
115 Coetzee "Gross Income" 160.
116 Section 1 of the *Income Tax Act*: "Gross Income" definition.
117 Wilcocks "Gross Income" 26.
118 Paragraph (b) of the definition of "resident" in s 1 of the Income Tax Act.

4.3. 1 "Received by" and "accrued to" in a "year or period of assessment"

In *Geldenhuys v Commissioner for Inland Revenue*,[119] Steyn J clarified that "received by" in the gross income definition means a receipt by the taxpayer "on his own behalf for his own benefit".[120] Thus, the mere fact of having received an amount does not warrant an inclusion in the taxpayers gross income, if not receiving it for his own benefit.

In *Lategan v Commissioner for Inland Revenue*, Watermeyer J expressed view that "accrued to" must mean "to which *a person* has become entitled".[121] In this case, a wine farmer sold wine, and only part of the purchase price was paid upon delivery, with the balance payable in a subsequent year. The court noted, however, that although part of the payment was deferred, the taxpayer had not become entitled to payment of the amount but has acquired a future right to payment. The right to claim payment in future is a *spes* or conditional right, one which does not give rise to an accrual.[122] *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty)*,[123] affirmed the decision in *Lategan v CIR* and concluded that an amount accrues to a person upon his becoming entitled thereto. It follows that an amount only accrues when a person becomes unconditionally entitled to it — that is to say, without impending conditions.[124]

The prefatory phrase "in any year or period of assessment" introduces a temporal boundary, ensuring that only amounts received or accrued within a specific tax year are considered for inclusion in gross income. This expression safeguards the proper allocation of income to the correct year of assessment.

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119 14 SATC 419 and 430.
120 In *Geldenhuys v Commissioner for Inland Revenue* 14 SATC 419 at 430.
121 1926 CPD 203 at 209 (hereafter *Lategan v CIR*).
122 *Ochberg v Commissioner for Inland Revenue* 1933 CPD 256 at 263–264.
123 52 SATC 9 (hereafter *CIR v People's Stores*).
124 See *Mooi v Secretary for Inland Revenue* 34 SATC 1 at 6.

4.3. 2 Discretionary and vested rights of beneficiaries

The *Trust Property Control Act*[125] recognises two types of trusts: one in which ownership vests in the trustee and another where ownership vests in the beneficiary, subject to the trustee's control. In both instances, beneficiaries wield a personal right against the trustee, obliging the trustee to administer the trust property in the utmost good faith, for the benefit of the beneficiaries. This personal right is enjoyed by beneficiaries for "the proper administration of the trust in accordance with the aforementioned demands of his fiduciary office".[126]

The aforementioned personal right contrasts fundamentally with a real right, which is enforceable against the world at large. Ownership, as a real right, encapsulates the full suite of entitlements associated with a thing.

Beneficiaries invariably have, at minimum, a personal right which may be either discretionary or vested. A discretionary right is inherently contingent – a *spes* or mere expectation. Such a right (or hope) materialises only if the trustee's exercise a discretion. Conversely, a vested right offers greater certainty. A beneficiary with a vested right has a determinable claim and their claim hinges not on the trustee's discretion.[127] A beneficiary with a vested right holds an immediate entitlement to the trust benefits. This entitlement establishes a personal right in respect of the trustee, enabling the beneficiary to claim those benefits as soon as they become distributable.[128]

In a trust, there are invariably three parties involved: the donor/the person who generates the income (through a donation, settlement, or other disposition), the trust beneficiary, and the trust itself. The landmark decision in *Friedman v CIR: In re Phillip Frame Trust* did more than expand the definition of "person" to include trusts; it paved the way for the introduction of section 25B of the *Income Tax Act*.[129] This section addresses the taxation of income generated by a trust. It sets out that if the trust

[125] Section 1 "Trust" definition.
[126] Du Toit 2007 *STELL LR* 477.
[127] Olivier 2002 *JSAL* 222.
[128] Du Toit 2007 *STELL LR* 476.
[129] Du Plessis 2024 *Trust & Trustees* 516.

distributes income to a beneficiary during the same year of its accrual, the tax burden is borne by the beneficiary in whose favour the income so accrues. In such cases, the trust is merely a "conduit pipe" through which income flows through to a beneficiary.[130]

Notwithstanding, under certain circumstances the receipts or accruals of a trust may create a liability for tax in the hands of someone other than a beneficiary.[131] This would be an instance in which the "conduit pipe" is interrupted – income that would flow directly to a beneficiary is instead attributed to some party other than the beneficiary.[132]

4.3.3 Donation, settlement, or other disposition

Sections 7(2)–(8) outline the circumstances in which income as a concomitant of a donation, settlement or other disposition is taxable in the donor's hands. The expression 'donation, settlement, or other disposition', entails a "disposal of property to another otherwise than for due consideration" — "the disposal is therefore gratuitous to an appreciable extent".[133] Where the donor makes a direct donation or disposes of an asset to a person for a consideration below the market value of the asset, section 7(9) will be applicable.

Accordingly the donor will be liable for income tax if the income derives from a donation, settlement or disposition and made to a trust to which they are a connected person.

An interest-free loan has at its core a considerable degree of generosity, therefore, the interest portion of the loan can be viewed as a gratuitous disposition.

A disposition may be two-fold, in which one part is commercial and the other gratuitous (a loan at low-interest as opposed to interest-free), in which case an apportionment is

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130 Botha *et al SA Financial Planning Handbook* 914.

131 The beneficiary will be liable for tax, "only to the extent that it is not deemed to accrue to the donor" under s 25B read with s 7 of the Income Tax Act. See Cucciolillo "Taxation of trusts" 687–689; Stark and Stiglingh "Trusts" 988–989.

132 Davis, Beneke and Jooste "Chapter 1: Introduction to estate planning" at 2.

133 *Ovenstone v Secretary for Inland Revenue* [1980] 2 All SA 25 (A) at 38. (hereafter *Ovenstone v SIR*).

possible. This would entail that a calculation follows to determine the gratuitous part of the loan, treating that part as a disposal deemed to be made under a donation.

4.4 I heard it through the grapevine: The link between trusts, section 25B and section 7

4.4.1 Section 25B

Section 25B(1) of the *Income Tax Act* provides the framework for determining how income earned by a trust is treated. Under this provision, the beneficiary's liability for tax on income is premised on the basis that they receive directly what flows to them through the medium of the trust.[134] The principle established in *Armstrong v CIR*, that income retains its nature until it reaches the designated beneficiary attaches to it a suspensive condition: the income must be distributed within the year in which it accrues or is received by the trust. The position when income is distributed in subsequent years of assessment seems to suggest that income in that sense does not retain its value. The court in *Secretary for Inland Revenue v Rosen*[135] implied this when it held the view that

> the trust deed may itself entitle or oblige the trustee to administer the dividends in such a way that he is not a mere conduit-pipe for passing them on to the beneficiary, that in his hands their source as dividends can no longer be identified or they otherwise lose their character and identity as dividends, and that the beneficiary is thus entitled to receive mere trust income in contradistinction to the benefit of the dividend rights in terms of the above crucial phrase. Thus, a trust deed may endow the trustee with a discretion to pass on dividends to the beneficiary or to retain and accumulate them. If he decides on the latter, I think (but express no firm view) that the dividends might then lose their identity and character as dividends, so that, if they are subsequently paid out to the beneficiary, they might possibly no longer be dividends in his hands, for the conduit-pipe had turned itself off at the relevant time. But if he decides on the former, i.e. to pass the dividends on to the beneficiary, the condition suspending the beneficiary's entitlement thereto is fulfilled, and they would constitute dividends in his hands in the same way as if he had been originally entitled to them unconditionally under the trust deed, i.e. as if the conduit-pipe had always been open.

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134 *Armstrong v Commissioner for Inland Revenue* 10 SATC 1 at 7 (hereafter *Armstrong v CIR*).
135 [1971] 1 All SA 180 (A).

4.4.2 Section 7

Section 7 of the *Income Tax Act* is referred to as the attribution rules and serves as an anti-avoidance provision designed to curtail tax avoidance through the diverting of income to trusts through 'donations or other gratuitous dispositions'.[136] Under section 7, the conduit pipe can be assumed to have turned itself off, since income does not flow through to a beneficiary but is attributed back to a donor.

4.5 Application to the case study

4.5.1 Income tax

Having already mentioned that a trust is a person as defined in section 1 of the *Income Tax Act*, it follows that a person is liable for tax on their gross income which comprises "the total amount, in cash or otherwise, received by or accrued to or in favour of *such resident person*" (own emphasis added).[137]

The assumption was that dividend income of R244 000 accrued to the trust for the current year. Since a trust is a conduit pipe, the income retains its identity, dividend income received thus remains dividend income when distributed to the beneficiaries.[138] Given that this is a discretionary trust, income and capital are distributed to beneficiaries at the trustees' discretion.

No beneficiary has a vested right to income,[139] but should the discretion of the trustee's be exercised in favour of each beneficiary in equal share then the following would be the effect [R61 000 (R244 000÷4)]; Olivia would be taxed at her marginal rate (we will assume for purposes to show a calculation that to be 18%). Olivia would thus be liable for income tax of R10 980 (18% of R61 000). Michael and James, both minors, would be taxed in David's hands, according to the attribution rules of section 7(3) of the

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136 Davis, Beneke & Jooste "Chapter 6: The taxation of trust income" para 6.1.

137 Section 1 of the Income Tax Act – "gross income" is defined in para (i). A trust in this mini-dissertation means a resident trust, save where otherwise stated. See s 1, "resident", para (b) of the Income Tax Act.

138 Stark and Stiglingh "Trusts" 986.

139 A vested right means having a complete and unconditional title to something. In the case of income, it would entail unconditional entitlement to such income. In the absence of such right, vesting happens at the exercise of the trustees' discretion. See Stark and Stiglingh "Trusts" 989.

Income Tax Act. In terms of section 7(3), income is deemed that of the parent of any minor child or stepchild, if it is received by or accrues to such minor child by reason of any donation, settlement or other disposition made by that parent of that child.[140]

David would thus be liable for tax as follows: R75 030 [41% of (R61 000 x 3)].

4.5.2 Donations tax

Donations tax is levied on the transfer of wealth during an individual's lifetime.[141] In South Africa, two instances give rise to the transfer of wealth: donations tax, and estate duty.[142] When a person dies, estate duty is payable on the dutiable amount of their estate.[143] Persons would, therefore, be able to circumvent estate duty liability if they donated all or some of their property before their death.[144] Donations tax was introduced to curb this tax avoidance strategy.[145]

Donations tax, levied at the same rate as estate duty,[146] would thus be paid by someone if they knew they would die the following day and such knowledge prompts them to donate their assets before their death.

Section 54 of the *Income Tax Act*, imposes donations tax on the value of any property transferred through a donation, whether direct or indirectly. A donation is defined in section 55 as a "gratuitous disposal of property including any gratuitous waiver or renunciation of a right".[147]

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140 See above at para 4.3.3.

141 See note 6 above.

142 Coetzee "Donations tax" 738.

143 Stedall "Estate Duty" 761.

144 In this instance it should be noted that in terms of s 4A of the *Estate Duty Act* an amount of R3,5 million is deducted from the net value of an estate as an abatement to determine the dutiable amount of such estate, on which 20% estate duty is levied. So technically, a taxpayer need not strip their estate of all its value, only as far as such value exceeds R3,5 million.

145 Botha *et al SA Financial Planning Handbook* 753; Coetzee "Donations tax" 738; Honiball and Olivier *The Taxation of Trusts in South Africa* 175.

146 Donations tax is levied at a rate of 20% on all property donated not exceeding R30 million in aggregate value. For any amounts exceeding this threshold, donations tax is levied at 25%. Donations tax are only payable on property disposed of by donors who are resident in the Republic.

147 Section 55(1) of the Income Tax Act.

In this context, "gratuitous" conveys a disposition free from the expectation of *quid pro quo* and motivated by pure liberality.[148]

4.5.2.1 The question of whether interest-free (or low-interest) loans are a donation?

An interest-free loan does not constitute a donation as defined in section 55(1) of the *Income Tax Act*.[149] In *Estate Welch v C:SARS*,[150] Marais JA observed that the determination of whether a disposition of an asset qualifies as a donation lies in the intention of the donor, which must be driven by "pure liberality" or "disinterested benevolence". This is the test that is applied under the common law definition of a donation.

Marais JA further explains that the common law definition of donation aligns with what the statutory definition postulates in section 55(1) of the *Income Tax Act*.[151] In this case, where a donor transfers property without receiving adequate consideration, they relinquish their own self-interest and any expectation of reciprocal benefit, thereby making the disposition a gratuitous one.[152]

An interest-free loan does not satisfy the criteria of a donation as outlined in section 55(1). The reasoning is that though the loan is given for value, no right to interest is established, and without such a right, there is nothing to waive or relinquish — as the definition in section 55(1) requires.

In David's case, while the loan bears interest, the sale of the shares to the Clark Family trust at a discounted price will be a trigger for section 7C of the *Income Tax Act* and will be a deemed donation.[153]

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148 *Estate Welch v Commissioner for SARS* [2004] 2 All SA 586 (SCA) (hereafter *Estate Welch v C:SARS*) para 31.

149 See Victor and King *Law & Estate Planning* 297.

150 *Estate Welch v C:SARS* para 22.

151 *Estate Welch v C:SARS* para 30.

152 Although interest-free (or low-interest) loans are not as a matter of its attributed definition a donation per se, by exhausting its interpretation, it surely seems congruous with what the legislators intended to charge as a donation.

153 It is a deemed donation in the sense that the consideration is inadequate. It triggers s 7C as a specific anti-avoidance provision imposed on transactions between parties not dealing at an arm's length.

4.5.2.2 The donations tax implications for David

The fair market value (FMV) of the shares was R4 million, but David sold them to the trust for R2,5 million. The difference (shortfall) of R1,5 million will in terms of section 58(1) of the *Income Tax Act* be regarded as a deemed donation. David will not be taxed on the full R4 million, but rather on the portion deemed to be a donation — R1,5 million less the annual exemption of R100 000.[154] Therefore, the taxable donation is R1,4 million, and at a rate of 20%, David's deemed donations tax liability amounts to R280 000.

David incurs a liability for donations tax on his disposal of shares to the Clark Family Trust of the above R280 000 (resulting from the once-off disposal) as well as R6 250 annually (calculation below at 4.5.2.3). Although both these amounts represent a liability for donations tax, there is a distinction between the sale itself and the inadequate consideration on the loan. The R280 000 is payable only at the time when the sale takes place, whereas the R6 250 will be charged every year for as long as the loan amount remains outstanding.

4.5.2.3 Donations tax payable as a result of the loan interest being less than the "official rate of interest" (section 7C)

Section 7C applies to interest-free or low-interest loans, advances or credit extended to a trust by connected persons, such as David. If a loan, advance or credit[155] is made to a trust and no interest is charged, or the interest charged is below the official rate, the difference between the interest calculated at the official rate and the interest actually charged is deemed to be a donation.[156]

For David, the imposition of section 7C will look as follows:

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154 Section 56(2)(b) of the Income Tax Act.

155 The terms "loan, credit, or advance" in s 7C are deliberately broad to cover situations that may not be covered by a loan proper. An "advance" or "credit" encompasses a wider range of transactions than a formal loan. For example, if a trust owes a debt in respect of an "accounts payable", but the creditor chooses not to enforce payment, s 7C will apply, even though no loan agreement exists. The waiver of an amount owing by the trust will thus be accommodated by an advance or credit.

156 Geach *Trust Law in South Africa* 470.

The interest at the official rate (9.25% of R2,5 million) is R231 250, while the interest charged by David is only R100 000 (4% of R2,5 million). The difference of R131 250 is the deemed donation, less the annual exemption of R100 000.[157] Consequently, the taxable portion is R31 250, and the resulting donations tax liability is R6 250 (20% of R31 250).

David would incur this R6 250 donations tax liability annually for as long as the loan remains outstanding, assuming he makes no other donations during the relevant future tax year(s) of assessment.[158]

4.5.3 Capital Gains Tax

CGT is payable when a gain is realised on the disposal of an asset that is capital in nature.[159] At the outset of any enquiry for capital gains tax, it is necessary to determine whether the asset disposed of is capital or revenue in nature. Revenue assets are included in gross income and therefore not subject to capital gains tax. On the other hand, if an asset is capital in nature, the gain or loss will be subject to capital gains tax in terms of the Eighth Schedule of the *Income Tax Act*.[160]

In *Commissioner for Inland Revenue v Visser*,[161] Maritz J contemplated the economic meaning of capital and income and evinced that "the one excludes the other".[162] This case formulated what is known today as the "fruit and tree" principle. It can be explained by the following example:

> Now, although a man's education, his energy, his personality, or his eloquence may have a potential value, such [as] education etc., only becomes a factor in the economic or income tax sense when it acquires a real value. His education becomes of real value when he puts it to use, for example, by adopting a profession. His profession may then be likened to a tree, and his earnings from his profession to the fruit of the tree.[163]

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157 In terms of s 56(2)(b) of the *Income Tax Act*, a R100 000 exemption, which will be free from donations tax, applies to all donors who are natural persons, for every year of assessment.

158 The effect of s 7C(2) of the Income Tax Act, in respect of interest-free or low-interest loans, is that the donation is treated as a continuous annual donation to the trust.

159 Koekemoer "Capital gains tax" 401.

160 Koekemoer "Capital gains tax" 401.

161 8 SATC 271 (hereafter *CIR v Visser*) at 276.

162 *CIR v Visser* at 276.

163 *CIR v Visser* at 276.

This explanation gives some guide for determining whether an asset is capital or revenue in nature for capital gains tax purposes, but it should be borne in mind that a subjective interpretation is necessary — a pen in the hands of a student may be a capital asset, that same pen is a revenue (income) producing asset to a stationary shop. Hence, it should be noted that "what is a tree to one man is fruits to another".[164]

Capital gains tax is not a transactional tax, arising only when a disposal is made. Every person's taxable capital gains and losses are established at the end of a financial year, taking into account each capital asset disposed of during the year.[165]

> A person is deemed to have disposed of an asset for an amount equal to its market value as at the date of the disposal if a person disposing of an asset:
>
> (a) by means of a donation to anyone; or
>
> (b) for a consideration not measurable in money; or
>
> (c) to a connected person for a consideration that does not equal an arm's length price.[166]

In the case study, the FMV of the shares was R4 million, thus this is the value at which it will be deemed to have been disposed of under paragraph 38(1)(a) of the Eighth Schedule to the *Income Tax Act*.

Since David sold his shares at below market value, the deemed proceeds are the FMV of R4 million, not the R2,5 million received. The base cost of the shares, which David initially purchased for R1,1 million, is deducted from the FMV, resulting in a capital gain of R2,9 million.

David has an annual exclusion of R40 000 in respect of CGT. The remaining taxable capital gain is R2,86 million. At a rate of inclusion of 40%, the taxable gain is R1,144 million, and at David's marginal rate of 41%, the CGT liability is an estimated R469 040.

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164 *CIR v Visser* at 276.

165 Botha *et al SA Financial Planning Handbook* 763.

166 Paragraph 38 of the *Eighth Schedule of the Income Tax Act*. See also Koekemoer "Capital gains tax" 414.

4.5.4 Estate duty

Estate duty is levied on the dutiable amount of a deceased person's estate.[167] The duty applies to all assets, or "property", along with property that may be "deemed to be property" upon death.[168] Estate duty is levied at 20% on the first R30 million and 25% on amounts exceeding this threshold.[169]

Since David sold the shares to the trust, they no longer form part of his estate. Effectively, what this means is that David has "pegged" or frozen his estate by the sale of the shares to the trust. The effect of the estate pegging will be that subsequent to the sale of the shares, future growth of the asset will accrue to the trust and not in the estate of the owner, thereby reducing his estate duty liability upon death.[170]

Although the shares were pegged and no longer a part of David's estate, the outstanding (low-interest) loan is now an asset in his estate. At death, the value of this loan will be subject to estate duty.

4.5.5 Concluding remarks on the application of the case study

Does the means justify the end? This is a critical question for David and estate planners when assessing whether transferring assets to trusts achieves the intended tax efficiency.

For the current year of assessment, based solely on his transaction involving the sale of shares to the trust, David incurs an estimated liability for tax of approximately R824 070: comprising R75 030 in income tax, R280 000 in donations tax, and R429 040 in capital gains tax. These amounts represent the cost of transferring an asset valued at R4 million.

On the other hand, retaining the shares in his personal estate would expose David to estate duty on their full value upon his death (which as stated is expected to increase),

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167 Section 2(2) of the *Estate Duty Act*.
168 See respectively ss 3(2)–(3) of the *Estate Duty Act*.
169 See para 1 of the First Schedule of the *Estate Duty Act*.
170 Victor and King *Law & Estate Planning* 339.

creating a liability he is actively seeking to minimise. If the shares remained in his estate, he would be liable for the estate duty of R2,5 million.

The normal estate duty liability in David's estate:	R
GROSS VALUE OF ESTATE	16 000 000
Less: Liabilities	Nil
NET VALUE OF ESTATE	16 000 000
Less: Section 4A abatement	(3 500 000)
DUTIABLE AMOUNT OF ESTATE	12 500 000
Estate duty at 20%	2 500 000

The above calculation reveals that by transferring the shares to the trust during his lifetime, David could make a substantial tax saving of roughly R1 675 930. Of course, additional factors may affect the estate duty on David's death, including domestic life insurance policies; an accrual claim; property over which David held disposal rights prior to death; *etcetera*. These would all be deemed to be property in his estate in terms of section 3(3) of the *Estate Duty Act*.

However, based solely on the provided facts, David's decision to transfer his shares to the trust results in a potential tax advantage (the saving of estate duty) not achievable if he retains the shares in his estate, especially since the shares are expected to appreciate in value — the dutiable estate would not be impacted by such appreciation in the shares' value.

4.6 Conclusion

Ultimately, it remains the responsibility of each estate planner to determine whether an estate planning strategy justifies its costs. Taxes are inevitable, and while they cannot be evaded, they can certainly be avoided, in as far as the law allows. A well-structured estate plan not only ensures the estate owner's wishes are fulfilled but also minimises tax liabilities so that their beneficiaries are adequately provided for after their passing.

Chapter 5 Interest-free Loans, a Tax Avoidance Arrangement: Unpacking the GAAR

5.1 Introduction

In estate planning, the goal of minimising taxes often prompts taxpayers to dabble in arrangements aimed at tax mitigation. The utilisation of certain arrangements as part of mitigating tax is countenanced as "permissible tax avoidance".[171] This concept is encapsulated by Lord Tomlin's dictum in *IRC v Duke of Westminster*[172] that

> [e]very man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.

On the other hand, and often differentiated by a fine line, is "impermissible avoidance arrangements" or worse, the outright exploits of the law in the form of tax evasion.[173] These impermissible arrangements undermine the tax system's integrity and impair its innate revenue collection function.[174] General Anti-Avoidance Rules (GAARs) are specifically designed to prevent impermissible tax avoidance arrangements and impose limits on what the law is willing to tolerate concerning the "ordering of affairs". GAARs play a key role in distinguishing between tax planning and impermissible tax avoidance.[175]

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171 Permissible tax avoidance arrangements suggest that a taxpayer has structured his affairs in a manner that enables him to reduce his tax burden. Tax planning and tax avoidance are sometimes used to refer to the same thing. However, tax avoidance has been reviled for the repulsiveness the taxpayers' ingenuity brings about. Tax planning, seemingly the same thing, has not been flatlined with the same sentiment. Perhaps what creates a distaste for tax avoidance schemes instead of tax planning mechanisms is the aggressiveness involved with tax avoidance and the fine line that splits tax planning from tax avoidance. Nevertheless, tax avoidance is legitimate irrespective of how unappreciative the taxpayer's actions may be deemed.

172 [1936] AC 1 at 19.

173 It cannot be gainsaid that tax evasion is the illegal and unscrupulous act of a taxpayer to rid himself of a tax encumbrance that would otherwise be owed but for the perfidious behaviour of the taxpayer. From an income tax perspective, tax evasion involves the non-disclosure or misrepresentation of income and/or allowable deductions to pay less tax than would be payable had the income and allowable deductions been disclosed accurately. See Wiesener and Van Heerden "Tax avoidance" 1204. Tax evasion as defined here is sufficient for a basic understanding; a deeper analysis is neither necessary to elucidate the crux of the matter (the distinction between permissible and impermissible tax avoidance arrangements) nor does the scope of this dissertation permit.

174 SARS *Discussion Paper on Tax Avoidance and Section 103 of Income Tax Act* 1.

175 SARS *Discussion Paper on Tax Avoidance and Section 103 of Income Tax Act* 5.

This Chapter explores the general principles of avoidance arrangements, looking at where interest-free or low-interest loans fit into the spectrum between what would be permissible and/or impermissible.

5.2 Tax avoidance arrangements

Tax avoidance entails the purposeful structuring of one's affairs to minimise taxable income in a way that is both legitimate and within the bounds of the law.[176] A tax avoidance arrangement is permissible if the taxpayer's "ordering of affairs" can be considered appropriate,[177] taking advantage of the fiscally more appealing option when a commercial outcome is obtainable in multiple ways.[178] However, an arrangement crosses the Rubicon and becomes impermissible when its sole or main purpose is obtaining a tax benefit.[179]

For an avoidance arrangement to be classified as impermissible under the GAAR, the following four requirements must be satisfied:[180]

(a) There must be an arrangement;

(b) It must result in a tax benefit;

(c) Its sole or main purpose must be to obtain a tax benefit;

(d) The arrangement must be abnormal or lack commercial substance.

Below, each of these components is discussed for better understanding.

5.2.1 An arrangement

Section 80L of the *Income Tax Act* defines an arrangement as

> any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof...

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176 Wiesener and Van Heerden "Tax avoidance" 1204.

177 *Commissioner for the South African Revenue Services v Absa Bank Ltd* [2023] JOL 61177 (SCA) para 12.

178 *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd* [1999] JOL 5363 (A) para 1.

179 In such case, the provisions of ss 80A–L will be applicable to the arrangement.

180 Wiesener and Van Heerden "Tax Avoidance" 1206.

Determining whether there is an arrangement is the first step in the enquiry under GAAR. It goes without saying that for an arrangement to be considered impermissible, the presence of an arrangement must first be established.

The term "arrangement" can be described as an act

> requiring a conscious involvement of two or more participants who arrive at an understanding. It cannot exist in a vacuum and presupposes a meeting of minds, which embodies an expectation as to future conduct between the parties, that is, an expectation by each that the other will act in a particular way.[181]

To establish that an arrangement has taken place, there must be consensus by the parties on the terms of their agreement. It would seem that no actual agreement needs to have taken place, but there ought (at minimum) to be a plan, "something in the nature of an understanding between two or more persons *to bring about a consequence, whether enforceable or not*" (own emphasis added).[182]

5.2.2 The arrangement results in a tax benefit

Not only should there be an arrangement as defined, but the direct and main purpose of such an arrangement should be to bring about a tax benefit. A tax benefit encompasses any "avoidance, postponement or reduction of any liability for tax".[183] Steyn CJ succinctly described an avoidance of a liability for tax as "getting out of the way of, escaping or preventing an anticipated liability for tax".[184]

Naturally, if there is no anticipated liability for tax, no tax benefit can arise from entering an arrangement. Similarly, if a tax benefit results from a transaction but the main purpose is not to secure such benefit, the transaction cannot be deemed an avoidance arrangement, at least not an impermissible one.[185]

The above principle was illustrated in *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*[186] where the court recognised that although the

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181 De Koker and Williams "Chapter 19: Tax Avoidance" 19.36.
182 See generally *Newton v Federal Commissioner of Taxation* [1958] 2 All ER 759 (PC) at 7.
183 Section 1 of the Income Tax Act: "tax benefit" as defined.
184 *Smith v Commissioner for Inland Revenue* [1964] 2 All SA 83 (A) at 89.
185 *Income Tax Case* 1940 83 SATC 202 at 228.
186 [1999] JOL 5363 (A).

transaction served a dual purpose, its primary aim was not to obtain a tax benefit; rather, the tax benefit was a welcomed by-product of the taxpayer choosing the most tax-efficient method for their transaction.

5.2.3 Sole or main purpose was to obtain a tax benefit

Section 80G introduces a refutable presumption that the transaction has a tainted element — if its main purpose is the achievement of a tax benefit.[187] Section 80A, which describes impermissible tax avoidance arrangements, opens with the following lines:

> An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit…

The wording clearly indicates that the characterisation of an avoidance arrangement as impermissible hinges on the subjective nature of the arrangement. The "sole or main purpose" of obtaining a tax benefit is thus a *conditio sine qua non* for an impermissible arrangement. Accordingly, even if a tax benefit is realised as a subsidiary of securing the commercial benefit (main purpose) if it was not the arrangement's "sole or main purpose", the GAAR cannot be invoked.

The interpretation of the word "purpose" must be subjective rather than objective.[188] In *SIR v Gallagher,* Corbett JA expounded on the difference between an objective and subjective test:

> By an objective test in this context is evidently meant a test which has regard rather to the effect of the scheme, objectively viewed, as opposed to a "subjective" test which takes as its criterion the purpose which those carrying out the scheme intend to achieve by means of the scheme.[189]

Moreover, the wording of section 80A, specifically the insertion of the word "and" (at the end), implies that when the requisite main purpose of a tax benefit is established,

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187 In terms of the provisions of s 80G, the party who has obtained a tax benefit bears the onus to disprove the presumption.

188 Before explaining the distinction between an objective and subjective interpretation of the word "purpose", Corbett JA said the test is "undoubtedly a subjective one". See *Secretary for Inland Revenue v Gallagher* [1978] 3 All SA 1(A) (hereafter *SIR v Gallagher*) at 5.

189 *SIR v Gallagher* at 5.

the presence of any one of the other elements is sufficient to bring the arrangement within the scope of the GAAR.

5.2.4 The arrangement is abnormal/ lacks commercial substance

The first part of section 80A(a)(i) focuses on "abnormality". It calls for an objective evaluation whether the arrangement can be said to have been entered into or executed in a way that deviates from what would typically be used for legitimate business purposes aside from securing a tax benefit. The qualification "not normally employed for *bona fide* business purposes" applies to both the method ("by means") and the manner ("in a manner") under which the arrangement was executed.

If the method used would usually be applied for *bona fide* business purposes, the fact that a tax benefit arises is irrelevant. The GAAR will only be triggered if the arrangement also involves one of the additional elements listed in section 80A(a)–(c) and if the main purpose is the securement of a tax benefit.

Section 80A(a)(ii) addresses avoidance arrangements that "lack commercial substance". An arrangement is absent of commercial substance –

> if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained…

It follows that an arrangement is an impermissible avoidance arrangement if it lacks commercial substance, either in whole or in part, and its sole purpose is to obtain a tax benefit. Even if only a portion of a larger arrangement lacks commercial substance, this flaw — when paired with the main purpose of a tax benefit requirement — taints and renders the entire arrangement impermissible.[190]

[190] The commissioner will, in this case, have the prerogative to "show his hand" as his discretion allows under s 80B.

5.3 Interest-free loans viewed through the lens of GAAR

Tax avoidance, although lawful may be as undesirably awful in the eyes of SARS because, when successful, it negatively affects the revenue stream to the fiscus, something for which a taxpayer would

> incur no legal penalties and, strictly, speaking, no moral censure if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside of them.[191]

As celebrated a feature of tax jurisprudence as tax avoidance is, it has also been met with acute disdain, referred to as a "mischief" that needs to be suppressed.[192]

To determine whether the GAAR applies to interest-free loans, it is crucial to be cognisant of the fact that GAAR is perhaps the most significant anti-avoidance provision, invariably considered in cases of tax avoidance. Having established that GAAR could apply universally, it follows that an interest-free loan would not pass muster with GAAR if the substantive requirements of section 80A are satisfied. An overview of GAAR's application is provided in paragraphs 5.2.1 to 5.2.4 above.

Yet, an important question arises: although GAAR is a comprehensive provision designed to counter tax avoidance arrangements, is it the most effective at addressing loans to trusts as an estate planning tool? The short answer is no. Section 7C was introduced to prevent (as an estate planning tool) the disposal of assets to trusts and leaving the purchase price outstanding by extending an interest-free loan to the trust.[193] In fact, the Davis Tax Committee found that section 80 does not, as an anti-avoidance provision, "act as effective deterrent against a wide range of estate planning mechanisms that are presently implemented."[194]

Section 7C, as a specific anti-avoidance provision, directly targets scenarios involving interest-free or low-interest loans. The natural person advancing the loan, or under whose direction a company advances the loan, is deemed to have made a donation to

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[191] *Levene v Inland Revenue Commissioners* [1928] AC 217 at 227.
[192] *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* [1975] 4 All SA 620 (A) at 626-627.
[193] Bdk Auditors 2000 https://bdkauditors.co.za/2020/03/04/section-7c-a-practical-explanation/.
[194] Davis, Beneke and Jooste "18A Reports on Estate Duty: Davis Tax Committee" 18A-3.

the trust, and thereby constituting a trigger for donations tax.[195] It can be said, in the context of interest-free or low-interest loans to trusts, section 7C as the rule of greater specificity (in terms of the doctrine of subsidiarity) will apply and GAAR will operate as a safeguard to address transactions that elude the scope of the specific anti-avoidance provisions of section 7C.[196]

Suffice it to say that the lens of the GAAR does no longer fit the examining of interest-free loans as anti-avoidance arrangements.

Section 7C(1) sets the ambit of section 7C and can be broken down as follows:

- the section applies in respect of any loan, advance or credit;
- granted, directly or indirectly, by a natural person, or at the instance of a natural person, a company in relation to which that person is a connected person;
- to a trust in relation to which that person or company is a connected person; or
- to any person that is a connected person in relation to the person referred to in the last bullet; or
- to a company if at least 20 per cent of its equity shares are held, directly or indirectly, or 20 per cent of the voting rights in the company can be exercised by, a trust referred to in the last two bullets whether alone or together with any person who is a beneficiary of that trust or the spouse of a beneficiary of that trust or any person related to that beneficiary or that spouse within the second degree of consanguinity.[197]

5.4 Conclusion

GAAR distinguishes between permissible and impermissible tax avoidance, targeting arrangements that lack commercial substance or have the sole purpose of securing a tax benefit. While interest-free loans may, in some cases, fall within GAAR's ambit, section 7C now serves as the primary anti-avoidance measure for such transactions. As a result, GAAR functions as a safeguard, addressing avoidance schemes beyond section 7C's scope, reinforcing that tax planning must align with legal and commercial substance.

[195] Cucciolillo "Taxation of trusts" 703.
[196] Wiesener and Van Heerden "Tax avoidance" 1205.
[197] Davis, Beneke and Jooste "Chapter 6: The taxation of trust income" 6-26(6A).

Chapter 6 Interest-free Loans to Trusts: Specific Anti-Avoidance Provisions

6.1 Introduction

Family trusts are commonly employed to hold the assets of a family and safeguard their interests. The benefits of trusts for this purpose are indisputable — they allow, *inter alia*, asset protection, estate planning, and perpetuity in succession. One key tool in funding these purposes is the interest-free loan, which enables an estate owner to transfer assets into the trust on a loan account. This loan would ordinarily not have interest charged on it or be subject to a low interest rate.

CSARS v Brummeria Renaissance is in many respects a forerunner for the introduction of section 7C. The court had to determine whether the receipt of a right (in this case, an interest-free loan) has a monetary value that is taxable. Put differently, whether the "financial benefit" of not paying interest on a loan could be subject to tax.

Unlike GAAR, which addresses a broad range of impermissible avoidance arrangements, section 7C specifically targets trust-related arrangements involving interest-free or below-market related loans.

6.2 The Brummeria case and the right to use loans interest-free

6.2.1 A summary of the facts[198]

In *Brummeria*, three companies carrying on the trade of developing retirement villages offered life occupancy rights to residents in exchange for interest-free loans to a company, which then issued debentures as an acknowledgement of these loans. To further secure these arrangements, title deeds and properties were endorsed, with a covering bond in favour of the lenders.

The residents received lifelong occupancy rights, while the companies retained ownership of the units. The companies, in turn, were obliged to repay the loans upon the termination of the occupancy agreements or upon the occupant's death.

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[198] See generally *C:SARS v Brummeria Renaissance* at 206-208.

The Commissioner included, in the companies' gross income, amounts equivalent to the value of their right of use of the loans, free from interest. The value of these rights were calculated using the weighted prime overdraft rate applied to the average amount of the loans held by each company during the relevant assessment year.

The taxpayer companies contended that these loans did not constitute "amounts" that were "received by" or "accrued to" them under section 1. They cited *Stander v Commissioner for Inland Revenue*,[199] which established that determining the monetary value of a receipt or accrual should be based rather on an objective test as opposed to a test which is subjective.[200]

However, the court concluded that even non-monetary receipts qualify as "amounts" that accrued to the companies. [201] Therefore, these values had to be included in the companies' gross income for the years in which the right was received or accrued.[202]

6.3 Interest-free loans are no longer free

As discussed in paragraph 2.3 above, a monetary loan is regarded as *mutuum*, or a contract of consumption, transferring ownership in an asset to the borrower, who must later return an asset of similar quality and quantity.

Under South African common law, a *mutuum* is a real contract,[203] meaning that for the contract to be enforceable, the thing (which is the subject of the agreement) must be transferred — it is not enough for the parties to merely agree thereon. Interest was, in terms of a *mutuum*, an additional feature, established by verbal agreement, known as a *stipulatio*. That said, the imposition of interest was not an essential feature

199 59 SATC 212 (hereafter *Stander v CIR*).

200 The decision in *Stander v CIR* was, on this point, found to reflect the law incorrectly.

201 The definition of gross income – specifically with reference to "amount", is not limited to the receipt of money but extends to any property acquired by a taxpayer that holds a monetary value. This principle was articulated by Watermeyer J in *Lategan v Commissioner for Inland Revenue* 1926 CPD 203 at 209–210 and later affirmed by Hefer JA in *Commissioner for Inland Revenue v People's Stores (Walvis Bay)* [1990] 4 All SA 594 (AD) at 598.

202 *C:SARS v Brummeria Renaissance* para 12.

203 A real contract is one that is established by agreement, but requires some further element, in this case delivery of the thing so agreed upon (own emphasis added). See Hutchison *et al The Law of Contract in South Africa* 38.

of *mutuum*. The question then is, if interest is not an essential feature of a loan for money, why is the non-charging of interest a taxable event?

Under section 7C, interest-free loans are treated as ongoing donations. However, if the parties did not agree to charge interest, no right to interest exists, and without such a right the lender cannot waiver or relinquish it.

Today, loans for money in South Africa appear to be consensual contracts rather than real contracts,[204] enforceable upon the agreement alone without requiring anything further.

In *Commissioner, South African Revenue Services v Woulidge*,[205] the court noted that in an imagined commercial transaction involving interest, a lender would typically demand the payment of interest and a borrower capable of meeting that obligation. The forbearance of interest in interest-free loans does, therefore, not reflect the current position of loans for money in South Africa anymore.

Interest, albeit not an *essentialia* of a loan for money, seems indeed to be a *naturalia* thereof. The *naturalia* of a contract are those parts which form a part of the contract by operation of law and the parties need not specifically agree thereto, or even be aware thereof.[206] Interest is to loan for money contracts what the liability of a seller for latent defects is to agreements of sale — they are accepted as trade usage in their respective industries.[207]

6.4 The aftermath of Brummeria: Section 7C of the Income Tax Act

In *CSARS v Brummeria Renaissance* the court held that the use of loan capital, interest-free (a non-money receipt) is a right that has value in money's worth. Thus, this benefit

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204 A consensual contract is one that is created by mere agreement. See Hutchison *et al The Law of Contract in South* Africa 38.

205 [2002] 2 All SA 199 (A) (hereafter *Commissioner, SARS V Woulidge*) para 12.

206 Nagel *et al Commercial Law* 45.

207 The concept of "trade usage" was first formulated in *Crook v Pedersen Ltd* 1927 WLD 62 at 71 and further elaborated on in *Golden Fruits (Pty) Ltd v Fotoplate* (Pty) Ltd [1973] 3 All SA 118 (C) at 122.

should be included in gross income — being "an amount in cash or otherwise, received by or accrued to or in favour of" the taxpayer companies.

Section 7C seeks to ensure that when loan capital is used, appropriate consideration is given to the lender, to replace in the lender's estate the value removed by the granting of the loan. Section 7C thus prevents an attempt on the part of a donor/planner to dissipate their estate by diverting property from themselves without their replacing of such property in part or in full, or their ability to do same.

Section 7C applies when a "connected person" to a trust, provides a loan, advance or credit to the trust and charges no interest on the loan, or the interest that is charged is below the official rate of interest.[208] The donation is the amount equal to the difference between the interest actually charged and the interest incurred (if any) by the trust.

Section 7C does not apply in all instances where trusts receive loans, advances, or credit from connected persons. Section 7C(5) provides for some exemptions from the imposition of the charging provisions of the section. On face value, the exemptions offered by section 7C(5) seem not to be of relief to financial and tax planners in an estate or tax planning exercise since the relief given is not typically what is sought by persons making use of trusts in estate planning.

6.5 The in-duplum rule

The *in-duplum* rule can simply be described as 'double the amount'.[209] Under the rule, the accumulation of interest on a loan stops running when the total arrears and the

[208] There is a situation too where due to the charging provisions on trusts, taxpayers have opted to make such loans to a company in which they hold 20% of equity shares. This practice was later also clamped down under s 7C. Taxpayers have also, in further attempts to stay clear of s 7C, transferred assets/resources to companies and opted for preference shares with no or low return rate. This scheme has also been counteracted by s 7C(1B). a further discussion of all the ways in which taxpayers sought to circumvent s 7C falls outside the scope of this study, however, knowing that there has been attempts to "outsmart" s 7C and staying outside the ambit of its charging provisions suffices. The seriousness is evident in the attitude of SARS in counteracting any arrangement that seeks to bypass s 7C and if further schemes were employed with this intention – SARS will not hinder in showing its hand.

[209] Elliot 2013 https://assets.kpmg.com/content/dam/kpmg/pdf/2016/05/In-duplum-factsheet.pdf.

outstanding debt are in equilibrium.[210] The purpose of the *in duplum* rule is to act as a shield for borrowers against predatory lenders.[211]

This rule, contrary to the purpose it was introduced to serve, has for some time been a device of anti-avoidance arrangements by taxpayers in offsetting the foregone interest in interest-free loans to trusts.[212] This was specifically the case in *Commissioner, SARS V Woulidge*, in which Mr. Woulidge set up two trusts which he financed with interest-free loans. The court held that the in-duplum rule cannot apply in the instance of a transaction that deals with the forbearance of interest. Froneman AJA explained this as follows

> It is clear that the *in duplum* rule can only be applied in the real world of commerce and economic activity where it serves considerations of public policy in the protection of borrowers against exploitation by lenders.[213]

He went further saying that reason does not allow him to see that the application of the in-duplum rule can be invoked by elements of gratuity.[214]

The court noted that in an imagined commercial transaction involving interest, a lender would typically demand interest payment and a borrower capable of meeting that obligation. However, in an interest-free loan, neither such party exists, resulting in a transaction which is merely a "gratuitous disposition".[215] It follows that in the case of an interest-free loan, which by its nature is gratuitous, will not draw on the application of the *in-duplum* rule.

6.6 Conclusion

Trusts continue to be a valuable estate planning tool, despite the findings of the court in *CSARS v Brummeria* or the introduction of section 7C. Traditionally, taxpayers could benefit from transferring wealth to trusts without the burden of interest, making this a favourable planning strategy. However, the days when interest-free loans are used

[210] Elliot 2013 https://assets.kpmg.com/content/dam/kpmg/pdf/2016/05/In-duplum-factsheet.pdf.
[211] *Paulsen and Another v Slip Knot Investments 777 (Pty) Limited* [2015] ZACC 5 para 80.
[212] Herbst *A Comparative Evaluation of the South African Income Tax Regime for Investments Using Trusts* 349.
[213] Para 12.
[214] Para 12.
[215] Commissioner, SARS v Woulidge para 12.

for tax benefits are long over. If section 7C is anything to go by, the court will continue to close gaps that allow taxpayers to exploit the use of trusts through loan accounts as an estate planning tool.

The future of interest-free loans to trusts remains to be seen but the intention of the courts and revenue authorities are clear — where taxpayers seek to bypass the tax system through arrangements that erode their estate, measures will be put in place to deal with them.

Chapter 7 Conclusion and recommendations

7. 1 Introduction

This Chapter consolidates the findings from the previous chapters and presents a series of recommendations aimed at answering the research question.

The idea that estate planning is merely an exercise in anticipation of death is overly narrow. Suffice it to say that estate planning is about putting a plan in place that benefits the planner during their lifetime, while ensuring that their successors reap the rewards after their passing. While estate planning is not solely a strategy to save on estate duty, its role in minimising estate duty cannot be understated.

It is trite that death and tax have a common denominator: they are both inevitable. While it is incumbent on everyone to pay tax, there is no law that requires the leaving of a tip. This reflects the notion that paying taxes is an obligation, but arranging one's affairs to minimise this obligation is perfectly fine. Viscount Sumner expresses that it is perfectly normal to "make it *your* business to walk outside the *lines of taxes*".[216]

One common manner of saving on estate duty involves trusts. Trusts are valued for their perpetuity, which rules out a likelihood of incurring what may be termed the death tax: estate duty. Today, trusts are, really as Pierre la Paulle described — the pill that solves it all.

Individuals typically employ the use of a trust to which they make interest-free or low-interest loans and so divest themselves of assets that would otherwise form part of their estate at death, while retaining the value as a loan (debt). This ensures that the growth of assets occurs outside the planner's personal estate. However, SARS has continually taken issue with trusts used as tax avoidance tools. The Davis Tax Committee second report puts this at centre stage, revealing that of 333 465 active trusts, a meagre 33% of them are tax compliant. This of course poses a threat to the ability of SARS to collect revenue.

[216] See above at note 218.

7. 2 Findings

Chapters 2 to 6 of this dissertation provide a comprehensive examination of the role of interest-free loans in South African estate planning. Chapter 2 established that while interest-free loans are legally valid under South African law, they face challenges related to their commercial substance, especially when used in the context of estate planning. The lack of interest on the loans raises questions about its legitimacy, particularly in terms of how it fits within the common law definition of a loan and the regulatory framework of the *NCA*. The loans used in estate planning was concluded to fall beyond the scope of both; the common law and the NCA – it expresses itself to be a loan *sui generis*.

Chapter 3 can for all intent and purpose be seen as the link between the theory and the practical. A lot can be said for the importance of trusts in contemporary times and most certainly, its advantages cannot be overlooked. Not all the advantages of trusts were addressed in this chapter since the scope thereof did not accommodate a discussion at length on what the advantages are, but the author will recall a few of the non-mentioned advantages as by listing them *obiter dictum* here;

i. the administration of trust assets can be placed in the hands of a competent trustee;
ii. it is simple to form and is an unregulated environment;
iii. there is no prescription and/or limitation of the parties who should be either trustee's or beneficiaries;
iv. beneficiaries can benefit in a variety of ways from the use of trusts.[217]

The chapters that ensue from chapter 3 were focused on the tax treatment of trusts, especially how the use of interest-free (or low-interest) loans to trusts gives rise to tax consequences. Chapter 3 was thus the launching pad for these discussions because, without the foundational principles of trusts and their prevalence in estate planning, little is to be said of the tax treatment thereof.

[217] Geach *Trust Law in South Africa* 433-439.

Chapter 4 explored the tax implications associated with using trusts as an estate planning tool. While it can be said that trusts offer various tax advantages, particularly in terms of estate duty minimisation, it also comes with significant complexities. What was particularly interesting is the financial resource it takes to put an estate plan with a trust in motion, begging the question — does the reward justify the effort?

What was noted is that for David to implement a plan in which he disposed of an asset to a trust, the tax liability incurred in rolling out of the plan would amount to approximately R824 070. This is no doubt a big expense and tax liability, for a plan that was specifically put in place to reduce an inflated tax liability. Nevertheless, in light of the bigger scheme of things, he would make a saving on estate duty to the amount of roughly R 1 675 930.

For David, this long term plan achieved his goal of stabilizing his estate and ensures that the growth of his assets will take place outside his personal estate. Without inferring that the R244 000 yield to the trust will take place every year, it is a safe assumption that there is a reasonable expectation that the dividend income will accrue to the trust, *albeit* that this amount is undeterminable.

Not everyone may stand in the shoes that David filled when he undertook this transaction, but it should be borne in mind that if the goal is the gradual dissipation of an estate (without the incurring of donations tax), then one should ensure that at all material time in a particular year of assessment that the loan account is less than or equal to R 1 250 000 with a loan having an 8% interest rate. This will entail that the donations tax payable on a yearly basis will be R 100 000 (R 1 250 000 x 8%). A person would thus be able to offset this yearly donations tax with their R 100 000 annual donations tax exemption in terms of section 56(2)(b) of the *Income Tax Act*.

If a couple wishes to undertake a similar transaction, they would need to ensure that at an 8% interest rate, the loan account does not exceed R 2 500 000 per year of assessment. Since every person has the donations tax exemption, it would allow them each to donate R 100 000 per year to the trust.

What is important to remember and as the above example makes clear, not everyone will be in the same position but may also want to structure their estates. It is imperative to take account of your own situation, and not basing an estate plan on the position occupied by another person. Estate planning remains an individual exercise, and should be tailored to the set of facts that is prevalent and likely to play out in each person's life.

In Chapter 5, the focus shifted to the application of the GAAR and interest-free loans. As celebrated a feature of tax jurisprudence as tax avoidance is, it has also been met with acute disdain, referred to in some cases as a "mischief" that needs to be suppressed.[218] The use of interest-free loans to trusts is a longstanding practice in domestic estate planning, but also, infamously so, a vehicle facilitating tax avoidance. This chapter went on to show that although interest-free loans can serve legitimate estate planning purposes, they risk scrutiny under GAAR and accordingly may be classified as impermissible tax avoidance arrangements.

For these loans to be viewed as legitimate, they must possess commercial substance and must be part of a broader estate planning strategy that is not solely motivated by an avoidance for tax. This highlights the need for careful structuring of these loans to meet both the legal and tax objectives of the estate owner.

For all the great that GAAR does, it is not the most suitable in curtailing the avoidance arrangements undertaken with trusts to which the estate planner is a connected person. For this, section 7C plays a better role.

Chapter 6 builds on the anti-avoidance provisions, but focuses on the specific anti-avoidance provisions, particularly section 7C of the *Income Tax Act*, which regulates the treatment of interest-free loans. The chapter also looked at section 7C which is a crucial measure for preventing the tax avoidance arrangements associated with such loans.

[218] *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* [1975] 4 All SA 620 (A) at 626-627.

The landmark case *CSARS v Brummeria Renaissance* solidified the interpretation of section 7C and set precedence for the treatment of interest-free loans. The Chapter underscores the importance of ensuring that interest-free loans are structured with clear terms and are properly documented to avoid them being classified as donations, which could trigger donations tax.

So to answer the research question: to what extent does the use of interest-free (low-interest) loans remain an advantageous tool for estate planning?

Interest-free (or low-interest) loans are an important tool in domestic estate planning. Trusts also remain a key part of estate planning, however, it is invariably the case that the trust has insufficient funds to acquire assets. In which case, the use of loans from either the owner or some other person who is a connected person to the trust may be a good financing instrument to enable the trust to acquire assets. It is true that loans (interest-free or low-interest) has come under significant scrutiny and has been noted to comprise a significant degree of gratuity. This gratuitousness brings interest-free and low-interest loans within the ambit of section 55(1) and section 58(1) of the *Income Tax Act,* respectively.

Despite the fact that interest-free loans have been met with harsh realities, it may continue to be useful in estate planning. The economic state of affairs will of course inform the use of interest-free loans, since an economic climate in which low interest loans prevail – a taxpayer might opt for low-interest loans as opposed to interest-free loans. On the other hand, when interest rates are higher, it may be wiser to outright donate an asset because the cost of it being a donation will be less than its yield, had the loan been free of interest. So, yes! Interest-free and low-interest loans will continue to play an important role in estate planning. The decision between the two, will however, be contingent on the situations of each individual taxpayer, coupled with an understanding of the prevailing environment.

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