



TAX

Section 7C: Sars's Draft Interpretation Note Signals Assertive Approach to Wealth Transfers

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On 26 November 2025, SARS published a Draft Interpretation Note titled "Loan, advance, or credit granted to a trust by a connected natural person" ("Draft IN"). The Draft IN clarifies the meaning and scope of section 7C of the Income Tax Act No. 58 of 1962 ("the Act").

Overview Of Section 7C

Section 7C is an anti-avoidance provision that targets the use of low-interest and interest-free loans provided by resident persons to trusts as a means of transferring wealth free of tax. The policy rationale is to compensate the *fiscus* for the estate duty that would otherwise be forgone, as the assets transferred to the trust would fall outside the lender's estate at the date of death.

Prior to the introduction of section 7C, wealthy individuals used interest-free or low-interest loans to fund the shift of assets out of their personal estates into trust structures, either by advancing cash or selling assets to trusts on loan account. This practice eroded South Africa's tax base by facilitating the transfer of growth assets to local and offshore trusts, thereby freezing the value of the

lender's estate at the loan amount, avoiding income tax on forgone interest, and circumventing donations tax, as the transfers were structured as loans rather than outright dispositions.

Section 7C applies when a resident natural person, or a company connected to that natural person, provides a loan, advance, or credit — directly or indirectly — to a local or foreign trust that is connected to that natural person. It also applies where such funding is provided to a company in which that trust, alone or together with its connected persons, holds at least 20% of the equity shares or voting rights.

If no interest, or interest below the “official rate of interest”, is charged on the loan, the difference between the actual amount of interest incurred by that trust or company in respect of that loan and the amount that would have been incurred if the “official rate of interest” were applied is treated as a donation made to that trust or company by the lender. The forgone interest is deemed to be an annual donation for so long as the loan remains outstanding.

The “official rate of interest” for loans denominated in Rands is the Reserve Bank’s repo rate plus 100 basis points (currently 7.75%), while for loans denominated in foreign currency, it is the equivalent of the South African repo rate in that foreign currency plus 100 basis points.

Donations tax is payable only by South African tax residents. The donor is liable for donations tax at a rate of 20% on cumulative donations of up to R30 million, calculated from 1 March 2018, and at 25% thereafter. However, the taxpayer may use his or her R200,000 (previously R100,000) annual donations tax exemption to reduce the amount of the deemed donation under section 7C.

Loans, advances, or credit are excluded from section 7C in the following circumstances: the funding is used by the trust to purchase or improve the primary residence of the lender or the lender’s spouse, provided that the residence is used mainly for domestic purposes; the loan is interest-free in accordance with Sharia-compliant financing; or the funding is provided in exchange for a vested interest in the trust’s assets that the trustees cannot vary.

Draft Interpretation Note

Although SARS’s Interpretation Notes are not binding on taxpayers or the courts, the Draft IN provides insight into SARS’s planned interpretation and application of section 7C, as it defines certain key terms that are not defined in the Act. Moreover, once published, the Draft IN will give rise to a “practice generally prevailing” as contemplated in section 5 of the Tax Administration Act No. 28 of 2011, which means that if a taxpayer is assessed in accordance with that practice, the assessment cannot be reopened should SARS subsequently change its view.

“Loan, advance or credit”

The Draft IN broadly interprets the phrase “loan, advance or credit” to mean any form of financial assistance provided by a connected person to a trust on an interest-free or low-interest basis. Whether a donation has been made is determined objectively by comparing the charged interest rate to the “official rate of interest”. Whether the person subjectively intended to make a donation is irrelevant.

“Connected person”

In terms of section 1 of the Act, a natural person’s relatives, and any trust that the person is a beneficiary of, are “connected persons” to that natural person. The Draft IN reiterates that only a natural person’s parents, children, grandparents or siblings will be “connected persons” to that natural person for purposes of section 7C.

“At the instance of”

The loan is not limited to one made by the taxpayer personally but extends to a company that is a connected person and that makes a loan at the instance of the taxpayer. The Draft IN states that the phrase “at the instance of” requires that the funding must (i) be made at the request or under the influence of a connected person to the trust, and (ii) result in a transfer of wealth from that connected person to the trust.

The Draft IN is clear that the person who initiates the loan must also be the one to extend it. The question arises, however, as to the consequences where more than one person has instigated the funding.

Section 7C(4) clarifies the consequences for multiple initiators in the context of companies. If a loan, advance or credit is provided by a company at the instance of more than one connected person, each connected person is deemed to donate an amount in proportion

to each of their shareholding in the company relative to the total shareholding of those connected persons.

“Provide”

The Draft IN states that the word “provide” implies a conscious decision rather than mere acquiescence. This interpretation is important in the context of discretionary trusts.

If a beneficiary of a trust provides a low-interest or interest-free loan to the trust that is payable on demand, the beneficiary's decision not to demand repayment is obviously a conscious decision, and this amount will constitute a loan, advance or a credit for purposes of section 7C.

However, the trustees of a discretionary trust may unanimously elect either to retain undistributed income and capital in the trust or to make distributions to a beneficiary. When the trustees decide to allocate amounts to a beneficiary, those amounts vest in the beneficiary and are credited to the beneficiary's loan account.

If the trust deed goes on to state that those vested amounts may not, at the trustees' discretion, be distributed to the beneficiary but must rather be retained in the trust and administered on the beneficiary's behalf until the trustees decide to release the funds, such amounts will not qualify as a loan, advance, or credit, and section 7C will not apply.

Likewise, if the trustees, at their sole discretion as provided for by the terms of the trust deed, refrain from paying the vested amounts to the beneficiary, such amounts will not constitute loans, advances, or credit, and section 7C will not find application.

A beneficiary of a discretionary trust cannot be said to have made a conscious decision to provide a loan to the trust if the trust deed provides, or the trustees unanimously decided that certain amounts must vest in the beneficiary but not be paid. The Draft IN confirms that it is only where a beneficiary decides or instructs the trustees to refrain from paying the vested amounts that the beneficiary will be deemed to have made a conscious decision to loan the trust an amount.

Calculation of interest

The Draft IN clarifies that the amount of forgone interest is calculated daily on the basis of simple interest. Furthermore, as the *in duplum* rule does not apply, the total amount of interest that may accumulate on the loan is not limited to the outstanding principal debt.

When a new repo rate or equivalent rate is determined, the new rate of interest will apply from the first day of the month following the date on which the new repo rate or equivalent rate came into operation.

The aggregate of the daily interest differential calculated during the year of assessment is deemed to be a donation on the last day of the year of assessment of the trust or company that is the borrower. In the case of trusts, this will typically be the last day of February of each year, which means that the lender must pay the donations tax by the end of March.

Affected transaction in terms of section 31

Section 7C does not apply to a low-interest or interest-free loan to the extent that the loan is subject to the transfer pricing rules contained in section 31 of the Act.

Under these rules, a lender to a non-resident connected person is deemed to earn interest charged at a market-related rate. In addition, there is the so-called secondary adjustment, so that a lender who is a natural person will also be deemed to have made a donation equal to the amount of the interest not charged. This means the amount could be subject to an effective tax rate of as much as 65% or 70% when both income tax and donations tax are taken into account.

In terms of the example contained in SARS Interpretation Note No. 127, titled *‘Determination of the taxable income of certain persons from international transactions: intra-group loans’* (issued on 17 January 2023), an arm's length interest rate means the rate of interest that a financial institution would have charged on the loan. It is therefore possible that the “official rate of interest” and the arm's length interest rate will not be equal.

As this could result in the same loan triggering a deemed donation under both provisions, section 7C provides that, to the extent a donation arises under section 31, no donation will be deemed to arise under section 7C.

Section 7(8) attribution rules

Although the Draft IN clarifies the relationship between section 7C and the transfer pricing rules, it is silent on its interaction with so-called attribution rules contained in section 7(8) of the Act.

Section 7(8) provides that any amount of income received by a non-resident as a result of any donation, settlement, or other similar disposition made by a resident will be attributed to, and taxed in the hands of, that resident. A similar provision in relation to capital gains is contained in paragraph 72 of the Eighth Schedule to the Act.

As the forgone interest on a low-interest or interest-free loan constitutes a donation, section 7(8) and paragraph 72 are triggered by a loan, advance, or credit provided as contemplated in section 7C. Accordingly, any income received by or accrued to, or any capital gain realised by, the non-resident borrower will be taxed in the lender's hands at the lender's marginal rate of tax — notwithstanding the fact that donations tax has already been charged on the forgone interest in terms of section 7C.

The Draft IN therefore confirms that if a resident extends low-interest or interest-free funding to an offshore trust or company, that loan will trigger both donations tax and income tax in terms of section 7C and section 7(8) of the Act. (As an aside, the Act does not specify what an acceptable interest rate would be to avoid attribution under section 7(8) and paragraph 72; SARS merely asserts that it must be a market-related rate. If a taxpayer were to apply the "official rate of interest" for attribution purposes as well, it seems difficult to see how a court would not agree with the taxpayer. After all, if the official interest rate multiplied by the loan constitutes a donation under section 7C, it is hard to conceive on what basis SARS could argue that a higher rate should be used for the attribution rules.)

Redeemable Preference Shares

There was previously a gap in the legislation, and taxpayers accordingly ceased funding trusts or underlying companies with interest-free loans, opting instead to finance them with zero-coupon or low-coupon preference shares. Section 7C was subsequently amended so that a preference share is now deemed to be a loan for the purposes of section 7C. Consequently, where relevant, the principles stated above apply equally to such preference shares.

Conclusion

The Draft IN foreshadows SARS's broad interpretation of the meaning and scope of section 7C. It reduces the financial advantages of discretionary trusts, excludes the application of the *in duplum* rule, and confirms that a single transaction may trigger double or even triple tax consequences in terms of sections 7(8), 7C, and 31 of the Act.



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