The Section 7C Net Tightens: An Analysis of the Draft Interpretation Note

Introduction

On 26 November 2025, the South African Revenue Service (SARS) issued a Draft Interpretation Note titled '*Loan, advance, or credit granted to a trust by a connected natural person*' (hereinafter, 'the Draft IN'). This document represents an unambiguous signal of direction in the ongoing legislative efforts against the tax-free transfer of wealth to trusts.

Section 7C of the Income Tax Act 58 of 1962 (the Act) was introduced in 2017 to counter the specific 'mischief' of so-called 'estate freezing'. After years of legislative amendments which expanded the ambit of the section to include certain loans by companies, preference shares, and transfer pricing adjustments, the Draft IN now consolidates SARS's enforcement philosophy into a comprehensive guide. The guidance provided confirms that section 7C effectively operates as a wealth tax mechanism. This aligns with the observations of the Davis Tax Committee ('DTC'), which, in its reports on estate duty and wealth tax, categorised estate duty and donations tax as forms of wealth tax. The DTC acknowledged that section 7C effectively functions as a capital transfer tax ('CTT'), introduced specifically to plug the gap where wealth was being shifted to trusts tax-free. By taxing the notional yield of the capital annually, section 7C acts as a proxy wealth tax on the structure, overriding common law defences and piercing the corporate veil where necessary.

The Draft IN is open for public comment until 16 January 2026. This deadline is critical for tax and legal practitioners, as the finalisation of the Draft IN will cement SARS's interpretation on contentious issues such as the 'conscious decision' test for vested rights and the extraterritorial reach to non-resident trusts.

The legislative context: countering the 'mischief' of estate freezing

To contextualise discussion of the Draft IN, one must revisit the specific 'mischief' section 7C was enacted to counteract. Historically, estate planners utilised 'estate freezing' or 'estate pegging' structures to bypass estate duty and donations tax.

The mechanics of estate freezing

A natural person would dispose of high-growth assets to a discretionary trust on an interest-free loan account. As a result, the natural person's estate value would then be 'frozen' at the face value of the loan. Future growth would accrue to the trust, thereby ultimately escaping the 20% (or 25%) estate duty levy upon death of that natural person on such future growth. The interest-free nature of the loan would mean that no income tax liability would arise for the lender, and additionally, no donations tax liability would arise on the basis that the disposal transaction would legally have been a sale and not a donation.

The legislative response

Section 7C changes the above position by identifying the economic benefit of the interest-free funding, namely, the foregone interest, and subjecting this benefit to donations tax. In other words, section 7C deems the difference between the interest actually charged and the official rate of interest to be a continuing annual donation made by the lender to the trust.

Crucially, the Draft IN confirms that section 7C applies to loans advanced prior to the effective date (1 March 2017) if they remain outstanding. While this does not constitute a retrospective tax in the strict sense (as it does not tax interest foregone in years prior to 2017), it brings legacy loan structures into the current tax net, potentially eroding their fiscal efficiency going forward.

Critical clarifications: the gateway definitions

The application of section 7C hinges on the existence of a 'loan, advance or credit'. These terms serve as the gateway to the provision; if a transaction does not fit these definitions, section 7C cannot apply. The Draft IN provides extensive guidance on these definitions, adopting an expansive interpretation to capture any form of financial assistance.

'Loan, advance or credit': the ejusdem generis approach

The Act does not define the terms 'loan, advance or credit'. In the absence of statutory definitions, the Draft IN relies on the *ejusdem generis* rule ('of the same kind') and the related maxim *noscitur a sociis* (by which the meaning of a word may be determined by reference to associated terms) to interpret the terms 'loan', 'advance' and 'credit' as a single genus of financial assistance. SARS cites specific dictionary definitions to broaden the scope:

- A loan is typically interpreted in the context of the Roman-Dutch contract of *mutuum*, implying money lent for temporary use with an obligation to repay an equivalent amount. The Draft IN cites the Merriam-Webster definition: 'money lent at interest; something lent usually for the borrower's temporary use.'
- In respect of the term 'advance', the Draft IN quotes a CollinsDictionary.com example which states that '[i]f you advance someone a sum of money, you lend it to them, or pay it to them earlier than arranged.'
- In relation to 'credit', the Draft IN refers to the Cambridge English Dictionary thereof, namely 'a method of paying for goods or services at a later time, usually paying interest as well as the original money'. This is the critical catch-all for sale agreements where the purchase price is left outstanding on a loan account. The mere granting of time to pay a debt constitutes 'credit'.

The Draft IN concludes that 'section 7C may apply broadly to any form of financial assistance provided by a connected person to a trust on an interest-free or low-interest basis.' Whether the financial assistance is structured as a loan, a sale on credit, or an advance against future distributions, if it results objectively in the trust holding funds owed to a connected person without paying market-related interest, it falls within the net of section 7C. The lender's subjective motivation, whether benevolent family support or aggressive tax avoidance, is explicitly deemed irrelevant.

The 'conscious decision' test: vested rights versus loans

Perhaps the most significant clarification in the Draft IN concerns the treatment of vested rights. This resolves (at least from SARS's perspective) a long-standing academic debate: if a trust beneficiary has a vested right to a distribution but the funds are retained in the trust, does this retention constitute a 'loan' provided by the beneficiary?

SARS resolves this question by analysing the word 'provide', arguing that it implies a positive action or a choice.

Trustees frequently exercise discretion under a trust deed to vest certain income or capital in a beneficiary. Instead of distributing this income or capital, the trustee may credit the amount to a loan account in the beneficiary's name without their knowledge. In this scenario, although the beneficiary obtains a personal right against the trustees, they have not 'provided' a loan because the retention was a unilateral act by the trustees.

Conversely, an amount vested by a trust in a beneficiary that is not distributed will be considered a loan provided by that beneficiary if the non-distribution results from an election made by that beneficiary or a request by the beneficiary that the amount not be distributed.

The distinction therefore lies in whether the beneficiary has performed a positive act of "providing" the assistance. Where trustees unilaterally decide to retain vested funds – even where the beneficiary has a vested right – no loan exists if the beneficiary has not elected or requested such retention.

This distinction places a heavy burden on trust administration. Trustee minutes must meticulously record that retentions are an exercise of unilateral trustee discretion. Minutes that record 'beneficiary agreement' or 'requests' for retention are fatal, as they evidence the positive act required to trigger section 7C.

Extraterritorial reach: non-resident trusts

The Draft IN explicitly confirms that the 'trust' referred to in section 7C(1) includes both domestic and foreign trusts. Since the legislation does not stipulate residence requirements for the borrower, offshore trusts are fully within the ambit of the section if the relevant requirements are met.

'At the instance of' and piercing the corporate veil

Section 7C(1)(b) captures loans made by companies 'at the instance of' a connected natural person. The Draft IN interprets this phrase to mean 'at the suggestion of or instigation of', or stated differently, 'at the request or under the influence of' the connected natural person.

This implies a causal link: but for the influence of the natural person, the company would not have extended the credit which resulted in an effective transfer of wealth from the natural person to the trust. This interpretation effectively pierces the corporate veil, treating the company's loan as if it were made by the shareholder directly.

The calculation mechanics and the *in duplum* override

The Draft IN provides precise instructions on the calculation of the deemed donation. The deemed donation is the aggregate of daily calculations of the interest differential and is based on simple interest, not compound interest. Section 7D, as highlighted in the Draft IN, specifically overrides the common law *in duplum* rule. The deemed donation liability is perpetual. Even if the notional interest exceeds the capital of the loan, the section 7C liability continues annually as long as the loan remains outstanding.

The 'double sanction' risk: interaction with section 31

A critical question addressed in the Draft IN and recent legislative amendments is the interaction between section 7C and section 31 (transfer pricing) regarding cross-border loans.

Previously, there had been ambiguity regarding whether section 31 completely ousted the application of section 7C. The 2024 amendments to section 7C(5)(e) as clarified by the Draft IN, however, establish a 'top-up' mechanism in that the exemption from section 7C applies only 'to the extent of an adjustment made in terms of section 31(2)'. For example, if the arm's length rate (in terms of section 31) is 6%, but the official rate (in terms of section 7C) is 9%, the taxpayer faces a double adjustment. The lender pays income tax on the 6% imputed interest (section 31) as well as donations tax on the 3% differential (section 7C).

This ensures that taxpayers cannot use lower offshore arm's length rates to escape the minimum tax threshold set by the official rate for domestic trusts.

The 'double sanction' dilemma: the unresolved interaction with section 7

While the Draft IN clarifies the interplay with section 31, it remains conspicuously silent on a far more common overlap: the interaction with the attribution rules of section 7 (specifically sections 7(3), 7(5), and 7(8)).

The jurisprudence on 'disposition'

To understand the overlap, one must consider the established jurisprudence regarding what constitutes a 'donation, settlement or other disposition'.

- In *CIR v Berold* (1962)[i], the court definitively held that an interest-free loan constitutes a 'continuing donation'. The gratuitous element is the lender's failure to charge market-related interest, which enriches the trust.
- In *Ovenstone v SIR* (1980)[ii], the court construed 'donation, settlement or other disposition' *ejusdem generis*, holding that all three terms target disposals that are wholly or to an appreciable extent gratuitous, but exclude *bona fide* commercial transactions for due consideration. 'Other disposition' was included to capture similar gratuitous arrangements not strictly amounting to donations or settlements.
- In *SARS v Woulidge* (2002)[iii], the court reaffirmed that loans to trusts not bearing interest at market-related rates constitute a disposition for purposes of section 7, emphasising the gratuitous nature of the interest forbearance.

The concurrent application and the lack of exemption

Because an interest-free loan is jurisprudentially a 'disposition' (triggering section 7) and statutorily a 'loan' (triggering section 7C), a single transaction results in two distinct tax liabilities:

1. Income tax (section 7) – the actual income (the fruit) generated by the trust with respect to the interest-free portion is attributed to the lender and taxed at their marginal rate.
2. Donations tax (section 7C) – the foregone interest is deemed a donation and taxed at 20% or 25% in the hands of the lender.

It is regrettable that no exemption is afforded in section 7C(5) similar to the specific exemption provided for section 31 adjustments. Taxpayers might attempt to rely on the principle in *Isaacs v CIR* (1949)[iv], where the court held that there is a presumption against double taxation. However, this defense is likely to fail in this context, as the principle in *Isaacs* generally applies to imposing the same tax twice on the same amount. Here, we have two distinct types of tax (income tax and donations tax) levied on two different amounts (the actual fruit and the deemed funding benefit respectively).

Consequently, in the absence of a specific legislative exemption, sections 7 and 7C apply concurrently. The Draft IN offers no commentary on this point. By remaining silent, SARS effectively confirms the double sanction, namely that the taxpayer pays income tax on the trust's relevant earnings and donations tax on the loan's notional interest simultaneously.

The safe harbours

While the net cast by section 7C is wide, the Draft IN details specific safe harbours provided for in section 7C(5) that can be utilised by taxpayers.

Primary residence (section 7C(5)(d))

Loans used to fund the acquisition or improvement of a primary residence for the lender or their spouse are exempt. The Draft IN clarifies the interpretation of the requirement that the residence be used 'mainly' for domestic purposes. Relying on the precedent set in *SBI v Lourens Erasmus (Edms) Bpk*[v], SARS interprets 'mainly' as a strict quantitative standard of more than 50%. The implication is that this is not a subjective 'intent' test. For example, if a trust property, as a matter of fact, is 40% residentially used and 60% commercially used, the entire exemption is inapplicable.

Sharia compliant financing (section 7C(5)(f))

Arrangements compliant with section 24JA are exempt. This exemption acknowledges the prohibition on interest in Islamic finance, preventing section 7C from penalising non-interest-based financial products that are functionally equivalent to loans.

Vested interest trusts (section 7C(5)(b))

Loans to trusts where the loan is in return for a vested interest in the trust's assets are exempt. This typically applies to 'bewind' trusts. As per the legislation, no trustee discretion may exist to vary these rights. If trustees have the power to shift benefits between beneficiaries, this exemption fails.

Conclusion: action items for practitioners

The release of the Draft IN requires action from practitioners to mitigate risk before the guidance is finalised.

1. Submit comments by 16 January 2026: Practitioners should scrutinise the 'conscious decision' test and the potential double taxation anomalies regarding section 7.
2. Audit vested rights: Review all client trusts with retained vested benefits. Insofar as clarification is necessary, ensure that relevant minutes reflect trustee discretion rather than beneficiary requests to avoid the 'conscious decision' trap.
3. Review cross-border funding: Re-evaluate offshore loans. Calculate the potential 'top-up' liability where the arm's length rate is below the official rate.
4. Quantify the risk: With the *in duplum* rule explicitly overridden, the tax liability on legacy loans is perpetual. Clients must be advised on the long-term cost of maintaining these structures versus capitalising the relevant loan or winding up the relevant trust.

The era of unrestricted estate freezing has come to an end. In the final analysis, the Draft IN indicates that section 7C is intended as a comprehensive regime designed to erode the fiscal benefits of the discretionary trust in South African law.

[i] *Commissioner for Inland Revenue v Berold* 1962 (3) SA 748 (A).
[ii] *Ovenstone v Secretary for Inland Revenue* 1980 (2) SA 721 (A).
[iii] *Commissioner for South African Revenue Service v Woulidge* 2002 (1) SA 68 (SCA).
[iv] *Isaacs v Commissioner for Inland Revenue* 1949 (4) SA 561 (A).
[v] *Sekretaris van Binnelandse Inkomste v Lourens Erasmus (Edms) Bpk* 28 SATC 233.

Disclaimer

Author

Dr Hendri Herbst
hherbst@renmere.co.za | T +27 83 784 8040

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