Tax On Property Loans In Trusts

The sale of property to a trust remains a popular method of accumulating assets, particularly in families. However, trusts cannot always afford to pay a seller immediately. The future payment to a seller is then facilitated through a loan account within a trust, making the property held in a loan an asset within the estate. Should the seller become deceased, this loan is administered according to the last will and testament of the individual.

Fiduciary Specialist at Nedbank Private Wealth Graham Patrick says there are several reasons why trusts simplify the planning for tax efficiency. “Trusts minimise estate value and allow the long-term preservation of assets, such as when property has been held in families for generations.” The structure of the holding of individual property, such as a trust, determines how SARS deals with a range of applicable taxes, including CGT.

Before CGT became applicable, the cancellation of outstanding loans in trusts took place relatively conveniently, when the wills of most individual specified that such loans are bequeathed back to the trust. However, since implementation of CGT in 2001, “debt forgiveness” came into play. Up to February this year, SARS deemed a bequest of an outstanding loan within a trust as a disposal which was subject to CGT. Debt owed by a person to a creditor, was either reduced or discharged by the creditor at no charge or, for less than market value of that property.

However, as of March 2014, a bequest of such a loan account in the last will and testament of the creditor, will no longer attract CGT. This change says Patrick, facilitates benefits to trusts used for property ownership in terms of estate duty, donations tax or fringe benefit tax.

An example is when a person lends money to a family trust to purchase investment properties, and then bequeaths the outstanding loan amount to the family trust in his will. Because the loan is part of his estate, which is potentially subject to estate duty, no CGT will now be payable on the writing off of the loan amount. When an individual’s will has not been updated since the introduction of CGT, it removes the potential for an estate to be subjected to additional tax.

Certain conditions are stipulated however, says Marteen Michau of Sanlam Private Investments. This debt as it relates to an outstanding loan on a property, has to be reduced by the deceased estate, and the debt amount has to qualify as “property” as defined in the Estate Duty Act.

She says the amendment offers constructive planning opportunities when structuring loan accounts within trusts, such as the cancellation of the loan debt on death. An alternative is to bequeath the loan account to the entity or person owing it to the deceased estate in the will of the deceased person. However, a lack of funds to repay such debt, may not render this is a “fit all” plan.

In some cases it might cause an unintended liquidity problem in the estate of the deceased person to cover unintended estate duty. An example is when the loan amount exceeds the abatement – or reduction of taxation amount – for estate duty purposes of R3.5-million. This also applies when the abatement amount, when added together with other bequests to persons or entities other than the surviving spouse, is more than the loan amount.

Depending on individual circumstances, or the need to access necessary funds, it would make sense to bequeath the loan account or asset to the surviving spouse or another family member.

Thoughtful estate planning is an invaluable commodity to all families, including property owners.