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Part 13
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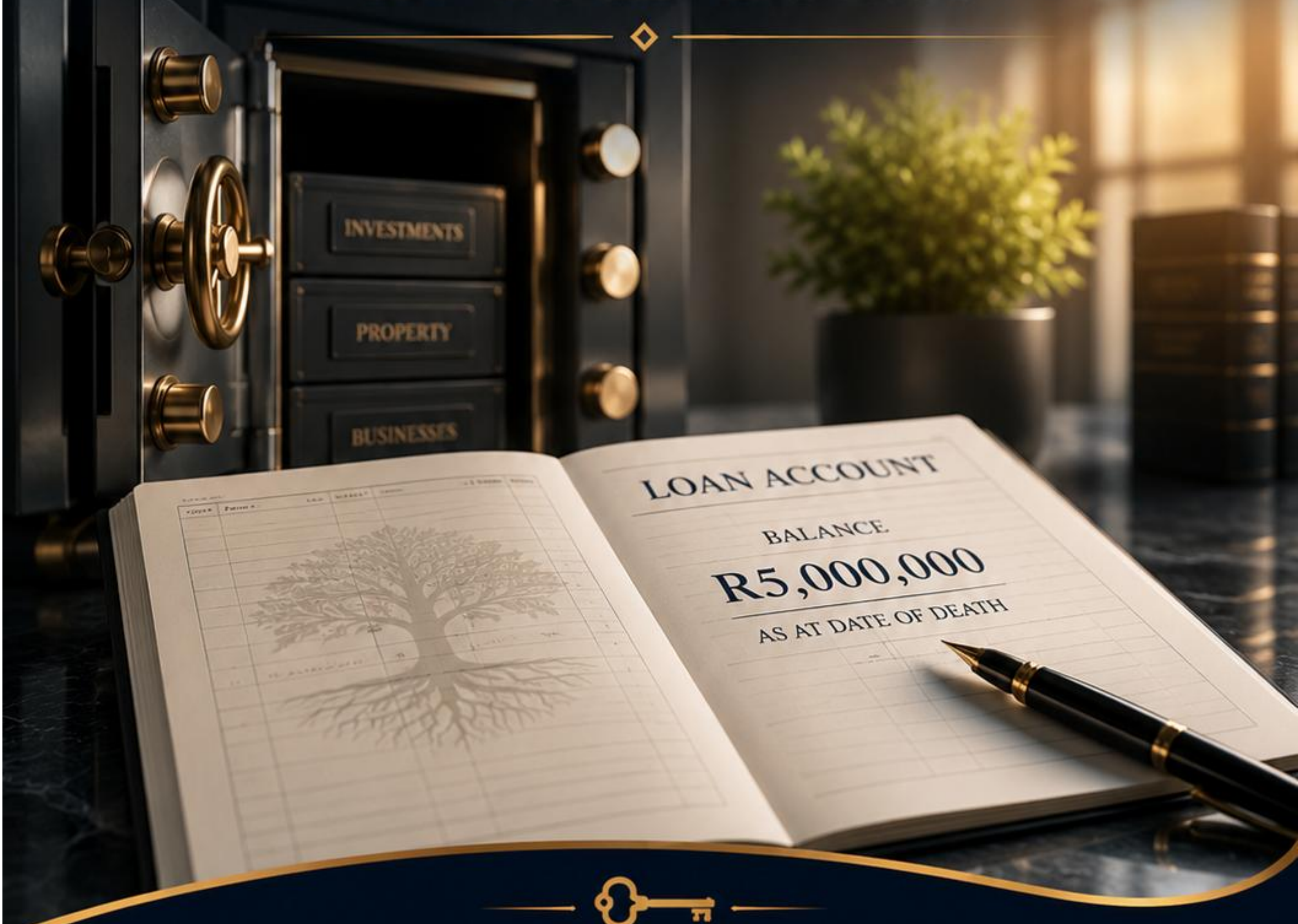
Loan Accounts – The Hidden Asset in Your Estate



Some assets are easy to see.
Some are easy to overlook.

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Loan Accounts – The Hidden Asset in Your Estate

When people think about the assets that form part of their estate, they typically think of:

- Property
- Investments
- Retirement savings
- Businesses
- Vehicles

Very few people consider loan accounts.

Yet for many business owners, investors, and individuals who have established family trusts, loan accounts may represent one of the largest assets in their estate.

In some cases, these loan accounts can create substantial Estate Duty exposure and significantly increase the costs payable upon death.

Understanding how loan accounts work is therefore an essential part of effective estate planning.

What Is a Loan Account?

A loan account arises when one party lends money to another.

Common examples include:

- A shareholder lending money to their company.
- A founder lending money to a trust.
- A director funding business operations.
- A family member advancing money to a business entity.

In each case, the lender has a legal right to recover the amount owed.

This right to repayment has value.

As a result, the loan account itself becomes an asset.

Why Loan Accounts Matter

Many people focus on the assets held by a trust or company and overlook the corresponding loan account.

Consider the following example:

Mr Smith transfers an investment property worth R5 million to a family trust.

Instead of paying cash, the trust records a loan payable to Mr Smith.

The trust now owns the property.

Mr Smith owns a loan account worth R5 million.

While the property has moved out of his personal ownership, the loan account remains an asset in his estate.

This is where many estate plans unintentionally fall short.

The Estate Duty Problem

For Estate Duty purposes, a credit loan account generally forms part of the lender's estate.

Using the previous example:

Trust Assets

Property: R5,000,000

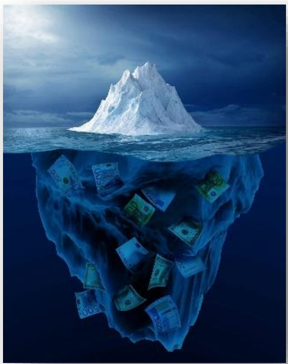
Personal Estate

Loan Account: R5,000,000

Although the property no longer belongs to Mr Smith personally, the loan account still does.

If the loan account remains outstanding at the date of death, it may increase the value of the estate and potentially attract Estate Duty.

In many cases, the loan account becomes one of the largest assets in the estate.



How Loan Accounts Grow

Loan accounts often arise when:

- Assets are transferred to a trust.
- Cash is advanced to a company.
- Additional funding is provided over time.

As years pass, the balance can become substantial.

Many individuals establish trusts specifically to reduce estate growth, only to discover that the resulting loan account continues to increase their estate value.

This is why loan account planning is such an important component of long-term estate planning.

The Family Trust Example

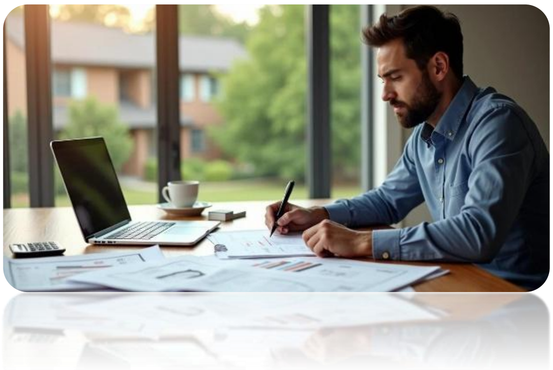
Consider the following scenario:

Year 1

Mr and Mrs Smith transfer assets worth R10 million to a family trust.

The trust owes them:

- Mr Smith Loan Account: R5 million
- Mrs Smith Loan Account: R5 million



Twenty Years Later

Trust Assets:
R25 million

Personal Loan Accounts:
Still R10 million

Although the future growth of R15 million has occurred within the trust, the outstanding loan accounts still form part of the founders' estates.

This creates an opportunity for further estate planning.

Reducing Loan Accounts Over Time

One of the most effective estate planning strategies involves gradually reducing trust loan accounts during your lifetime.

The objective is simple:

Reduce the value of the asset sitting in your estate.

This can often be achieved through:

- Repayment of the loan
- Donations
- Estate planning strategies
- Structured wealth transfers

The earlier the planning begins, the more effective the strategy can become.

Understanding the Annual Donations Exemption

South African tax legislation currently provides an annual donations tax exemption for natural persons.

At present, an individual may donate up to:

R100,000 Per Year

without attracting Donations Tax.

For married couples:

R200,000 Per Year

may potentially be transferred collectively.

Many estate planners use this exemption to gradually reduce trust loan accounts.

Example

Outstanding Loan Account:
R5,000,000

Annual Reduction:
R100,000

Each year, the loan account is reduced by the annual exemption amount.

Over time, this progressively reduces the size of the founder's estate.

While the annual reduction may appear small, the cumulative effect over many years can be significant.

Understanding Section 7C

Section 7C of the Income Tax Act has become one of the most important considerations when dealing with trust loan accounts.

The legislation was introduced to prevent individuals from transferring wealth to trusts through interest-free or low-interest loans without tax consequences.

In simple terms:

Where a loan is advanced to a trust at less than the official rate of interest, the foregone interest may be treated as a donation.

This deemed donation may attract Donations Tax consequences.

The objective of the legislation is to prevent the artificial transfer of wealth to trusts without appropriate tax treatment.

Does Section 7C Make Trusts Ineffective?

Absolutely not.

Section 7C changed the rules, but it did not eliminate the estate planning benefits of trusts.

Trusts remain valuable tools for:

- Wealth preservation
- Succession planning
- Asset protection
- Estate growth management

The key is ensuring that trust structures are managed correctly and reviewed regularly.

Loan Accounts in Family Companies

Loan accounts are not limited to trusts.

Many business owners have substantial shareholder loan accounts in private companies.

These loan accounts often arise when:

- Profits are retained in the business.
- Directors fund growth.
- Assets are transferred into company structures.

These balances can also form part of an individual's estate.

As a result, they should be reviewed as part of every estate planning exercise.

The Importance of Regular Reviews

Many loan accounts are created years before any estate planning review takes place.

As a result, balances can accumulate unnoticed.

Questions worth considering include:

- Do I have loan accounts in trusts?
- Do I have shareholder loan accounts in companies?
- What is the current value of these loan accounts?
- What impact would they have on my estate?
- Have I considered a strategy to reduce them over time?

The answers often reveal opportunities for meaningful estate planning improvements.

The Bigger Picture

One of the primary objectives of estate planning is reducing the value of assets held personally while preserving family wealth.

Trusts and family companies can help achieve this objective.

However, if significant loan accounts remain outstanding, part of the estate planning objective may remain incomplete.

Understanding and managing loan accounts is therefore an essential component of any comprehensive estate plan.

Final Thoughts

Loan accounts are often referred to as the hidden asset in an estate because many individuals do not realise their significance.

While trusts and family companies can be highly effective wealth preservation tools, the associated loan accounts frequently remain personal assets and may continue to attract Estate Duty.

By understanding how loan accounts work, reviewing them regularly, and implementing appropriate reduction strategies over time, individuals can significantly improve the efficiency of their estate plan.

The goal is not simply to move assets out of your estate.

The goal is to progressively reduce the value of your estate while ensuring that family wealth remains protected for future generations.

In the next article, we will bring together many of the concepts discussed throughout this series and explore:

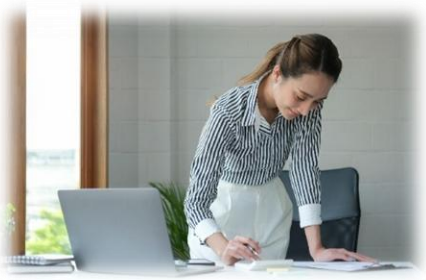
Part 14: How to Transfer Wealth to the Next Generation Without Losing Control

Professional Note

This article provides a natural transition into Part 14, where you can combine:

- Family Trusts
- Family Companies
- Section 42 Transactions
- Loan Account Reductions
- Annual Donations
- Succession Planning

into a single intergenerational wealth transfer strategy. This is often where clients begin to understand how all the individual estate planning tools fit together into one cohesive long-term plan.



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