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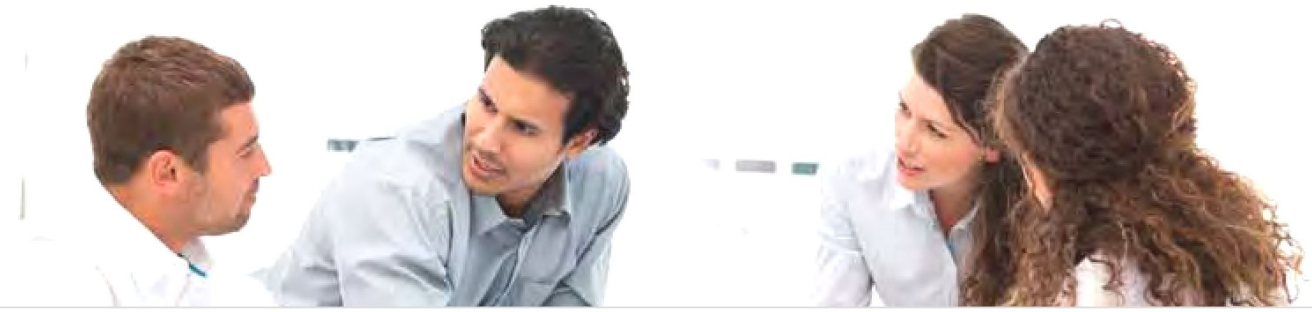

CONSIDER ALL POSSIBILITIES WHEN BEQUEATHING A LOAN ACCOUNT

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In the wake of the proposed repeal of paragraph 12(5) of the Eighth Schedule to the Income Tax Act, 58 of 1962, estate planners will do well to carefully consider all options available when dealing with an outstanding loan account to a trust in the planning and drafting of a will for the creditor to the trust.

In one of the popular estate planning structures, estate owners were advised over the years (in appropriate circumstances) to sell growth assets to an inter vivos trust on outstanding loan account. Prior to the ABC case mentioned below, the outstanding amount of the loan on date of death of the seller was then bequeathed in his/her will to the trust, thereby completing the transfer of the full value of the asset(s) to the trust.

Anybody who has been active in or keeping an eye on estate planning since 2006 will be aware of the absurd situation created by certain interpretations of par 12(5). This will now be a thing of the past for years of assessment ending after 1 January 2013.

The notorious case of the ABC Trust v the Commissioner for the South African Revenue Service has been discussed in numerous articles and on numerous occasions at conferences and seminars over the years. In short, the Gauteng Tax Court (Bertelsman J) found for SARS that a bequest of "… Any amount that the ABC Family Trust may owe me, to the mentioned trust …" (my translation) was a reduction or discharge of a debt for no consideration as envisaged by the mentioned sub-paragraph.

The mental gymnastics to get to this was mind-boggling enough. According to the judgement, the estate's asset (the loan) was "… extinguished by the operation of law, namely the set-off, which in turn was created by a disposition by the testatrix(the bequest) …". Forget the fact that all other bequests dispose of value from the estate for no consideration. The absurd situation arising from this interpretation and application of par 12(5) was even worse as it created a special class of bequest from a deceased estate – special in the sense that it was the only type of bequest causing capital gains tax in the hands of the heir or legatee.

"In our law, interest on a loan is not assumed. If the loan agreement is silent on the issue of interest on the loan, the common law position is that no interest is payable, i.e. an interest-free loan. This has been almost the automatic option in typical estate structuring situations."

Various ways of avoiding this sprang up, the most popular being a bequest of an amount of cash equal to the outstanding balance of the loan, with an instruction to the executor to collect all debts and not award any debt to a legatee or heir. More absurdity to cover the original one.