



Loans to children – what you need to know in advance

Loren Godet, Trust Officer, provides practical tips on what to consider when funds are loaned to family members.

Parents often want to assist their children, even when they are adults and financially independent. Your adult children may have approached you rather than securing a loan from a bank, or you feel responsible to assist them when times are tough. Whatever the case may be, there could be unintentional consequences when the documentation is missing or there is no documentation to prove that it was a loan that was made. A written agreement is always preferred above an oral agreement – remember that memories fade as time passes!

- Both parties must sign the agreement.
- The agreement must be dated.
- Both parties should keep a copy of the signed agreement.

Records of loan repayments should be kept by **both** parties and final acknowledgement of the full repayment must be signed by both parties, and dated.

You may ask why it is necessary for all the documentation? The main reason is that we need to understand what happens if either party passes away before the loan is repaid.

A record of loan repayments may be requested by the executor of the deceased estate, should there be any outstanding loans and/or interest at the date of death of either party. Again, think of your family situation and your Will here. If you as parent and loan provider pass away suddenly, and you have had no signed loan agreement, will one child be prejudiced above the other children where your Will stipulates an equal inheritance to all children and no collation? Or will your heirs (read children) be negatively affected when there is no proof of a loan to be repaid to your estate late account, when you made a loan to a friend? The documentation is key!

You may request an amendment to your Will where substantial amounts are provided for loans. This will alert the executor, but it remains important to keep records of repayments, and an additional loan agreement is still advisable. The executor will need proof.

Another reason why it is better to have a written loan agreement is to protect yourself from potential SARS queries, especially where the loan amount exceeds the annual donation limit. As per current tax legislation, the tax-free donation amount is R100,000 per tax year. Donations above the limit will be taxed at 20%. You don't want a loan to be interpreted as a donation, which could potentially be the case without proof.

Drafting a loan agreement between you and family members may feel uncomfortable, and you may (silently) not expect full repayment, but be sure to take your family circumstances into account if you want to avoid an uncomfortable family situation later.

The main purpose of this article is to focus on loans between parents and adult children, but many of the principles apply to loans between you and non-family members, partners and extended family members. My advice is to consider your family circumstances **before** agreeing to a loan. Will your other children or step-children feel that they have been treated unfairly if you provide a loan to one child only? Will you inform your other children or keep this information private?

What if your child can't repay the loan – will it affect your own financial situation negatively? The latter point is often overlooked and it is therefore advisable to ask your Trust Officer whether a loan will affect your own financial situation, either from an income or capital perspective, should the loan not be repaid. For example, providing a loan for your son/daughter's start-up business is risky and you must consider the worst case scenario.

This brings us to a few practical points for consideration when drafting your loan agreement:

- Full names and surnames of the two parties entering the agreement, including their ID numbers, must be stated.
- Terms of the loan agreement must be specified:
 1. loan amount (also in words)
 2. repayment term (how many months or years?) or indefinite until paid up fully?
 3. repayment frequency (monthly?)
 4. will interest be charged and at what rate?

