Trust Guide

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Important note and disclaimer

INTRODUCTION

In spite of the ongoing uncertainty about how trusts will be taxed in South Africa in the future, trusts remain a very useful estate planning tool and are widely used for a number of purposes.

However, if a trust is not formed or administered correctly, it can create a nightmare that acts against the very reason for forming it in the first place.

Anyone thinking of setting up a trust needs not only to make sure that they are creating a valid legal structure, but also to understand the nature of the trust, the duties of trustees, and the rights of beneficiaries.

This guide is designed to help anyone involved with a trust understand the key elements of forming and administering a trust in South Africa.

Some points to consider when setting up a trust:

The most important thing to consider is whether the founder/donor is willing to relinquish direct control over assets transferred to the trust. If not, the trust may be regarded as a front (sham) and the protection and planning opportunities afforded by trust ownership will be lost.

Other considerations are:

- Whether the trust fits into the overall estate plan
- The trust should not primarily be used to mitigate paying taxes
- Whether the benefit of the trust justifies the costs and administration involved in keeping the trust compliant
- Whether to appoint an independent trustee to ensure the trust is properly administered

GENERAL INFORMATION ON TRUSTS

The rules of South African trust law are a mixture of English, Roman-Dutch and South African law.

The Trust Property Control Act No. 57 of 1988 (TPCA) forms the framework in which trusts operate. All decisions and actions taken by the trustees must be made with reference to the trust deed and the TPCA.

A trust is a legal entity which is created to hold assets for the benefit of certain persons or entities.

It is not a juristic (legal) person but there are times when, in terms of certain statutes, a trust is regarded as having a separate legal identity (for example for tax purposes in terms of the Income Tax Act).

Without legal personality, it does not have legal standing and therefore the trust itself cannot sue or be sued.

The trustees act on behalf of the trust and in this capacity can bring and defend actions concerning the trust.

Assets can be transferred into a trust by sale (via a loan granted to the trust), donation or on death in terms of will.

If assets are sold to a trust, there must be loan agreement or a sale agreement. Without an agreement, SARS will regard the transaction as a donation.

The loan agreement does not necessarily have to include an interest rate but must include a repayment date.

Trust property may be movable, immovable, including contingent interests in property, which are to be administered or disposed of by a trustee in terms of the deed.

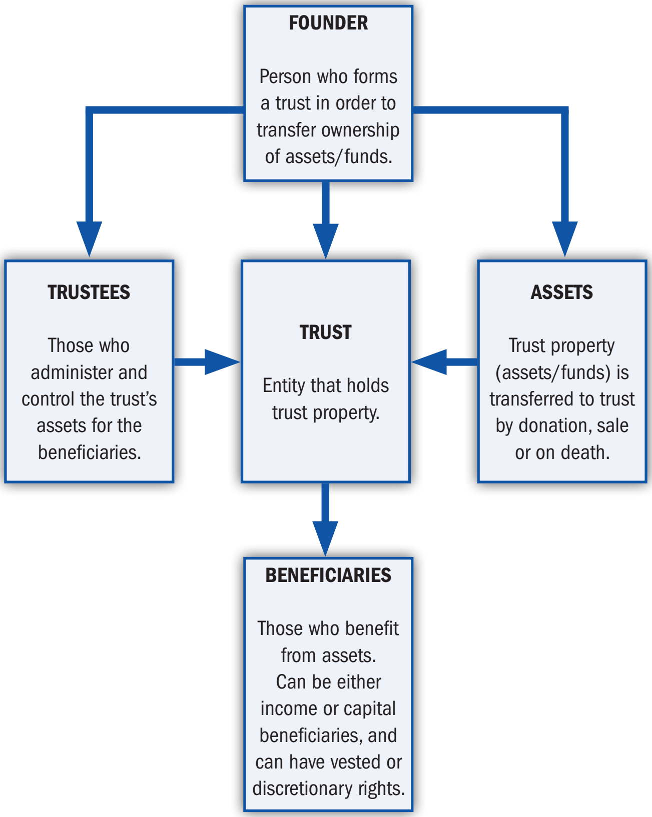
ESSENTIAL REQUIREMENTS FOR A VALID TRUST

- The founder must have a serious intention to create a trust and transfer control
- The trust must set up in writing in the trust instrument
- Trust property must be clearly identified
- Trust object must be clearly stated and lawful
- There must be binding obligation on the trustee(s) to administer the trust property
- Trustees must be authorised and have capacity
- There must be at least one beneficiary
- Trust beneficiaries must be must clearly identified

Some Important Points to Check When Contracting With a Trust:

- Obtain evidence of the written letters of authority granted by the Master to make sure that those who are representing themselves as acting on behalf of the trust are in fact capable of binding the trust
- Make sure that trustees are qualified to act - if a trustee becomes disqualified, that person cannot validly represent the trust and any agreement will be void
- Make sure that the required minimum number of trustees as stipulated in the trust deed is in place – without this, an agreement will not be binding
- Make sure that the 'Joint Action Rule' is adhered to - co-trustees must always act jointly in regard to trust administration

STRUCTURE OF A TRUST



TRUST INSTRUMENT

The founder of a trust may prepare a guideline for the administration of trust assets in a "letter of wishes". This document is not legally binding on the trustees.

The trust instrument formalises these wishes and is an essential requirement of a valid trust.

A trust's constitutional document is a trust instrument which defines the framework in which the trust must operate, including its powers and limitations.

The trust instrument must clearly establish a separation between the right to control the trust assets, which is held by the trustees, and the right (whether vested or contingent) to benefit from the trust assets, which is held by the beneficiaries.

The trust instrument is either the:

- Trust deed - creates an inter vivos/living trust, or
- Will - creates a testamentary trust

The main things specified in the trust instrument include:

- Aims and objectives of the trust
- Names of the beneficiaries and whether they are to be income or capital beneficiaries (or both)
- Rights and obligations of the trustees, including their powers, remuneration and requirements for meetings
- Rules and restrictions regarding the distribution of income and capital
- The duration and procedure on termination of the trust
- The procedure to be followed if the trust needs to be amended

TYPES OF TRUST

South African law recognises three types of trust

Ownership Trust: Created when the trust founder transfers ownership of assets or property to a trustee(s) to be held for the benefit of defined or determinable beneficiaries of the trust. This is the most common form of trust and is also known as an ‘ordinary trust’.

- The trustees are the actual owners of the trust assets.
- The rights of the beneficiaries in respect of the trust assets are usually determined by the trust deed.

Bewind Trust: Created when the founder makes a bequest to the beneficiaries and vests the administration of the assets in the trustees.

- The beneficiary is the actual owner of the trust assets.
- The trustees only have administrative control of the trust assets which they manage for the benefit of the beneficiaries.

Curatorship Trust: Similar in structure to a bewind trust, except that the assets are administered on behalf of a beneficiary who does not have the capacity to manage his/her own affairs.

Trusts are described according to when they are created

Inter Vivos (Living) Trust: This is a trust created during the founder’s lifetime. It is established by a trust deed which sets out who the founder, trustees and beneficiaries are, defines powers and duties of trustees and how and when the trust is to be wound up. The founder may also be co-beneficiary and /or trustee. The founder usually donates assets to the trust.

There are various kinds of inter vivos trusts that can be set up, depending on their purpose, for example, charity trusts (formed with an impersonal object), empowerment or employee trusts and business trusts.

Testamentary (Mortis Causa) Trust: This type of trust is the most commonly used form of trust in South Africa.

Testamentary (will) trusts are created by a trust clause in a will, in which the testator bequeaths assets to the trust and stipulates the terms and conditions which will apply to the trust.

A testamentary trust only comes into existence upon death of the testator. If for any reason the will is invalid, the trust will not come into effect.

Testamentary trusts are geared towards protecting the interests of minors and other dependants who cannot look after their own affairs. Assets that form part of an estate may be moved to the testamentary trust and sometimes include limited rights such as usufruct (temporary right to use/benefit from trust assets).

The appointed trustees administer the trust in terms of the will until the trust terminates, usually after a predetermined period or at a determined event, such as a minor turning eighteen or the death of an income beneficiary.

Generally, the terms of a will trust cannot be amended but the TPCA gives the Court certain powers to amend a trust deed.

A testamentary trust may be a discretionary or a vested trust.

Main Differences Between Inter Vivos and Testamentary Trusts		
	Inter Vivos Trust	**Testamentary Trust**
Formation	During life time	After death by Executor(s)
Instrument	Trust deed	Will
Flexibility for amendments	Flexible	Less flexible
Assets transferred into trust (trust capitalised)	During life time	After death in terms of will

Trusts are described according to the rights given to beneficiaries

Discretionary Trust: This type of trust gives the trustee(s) discretionary powers as to how and when to allocate the income or capital of the trust to the beneficiaries.

The beneficiary does not have a vested right to the income until the trustees have exercised their discretion, and paid over the benefit to the trust beneficiary.

The trustees may also be given discretion to nominate income and /or capital beneficiaries from a group, as long as a "class" of potential beneficiaries has been named, as well as how and when and the ratio of any such award is given.

Because the beneficiary has no rights whatsoever, in the event of his death (or insolvency), nothing can be held in his estate or pass to his heirs or creditors.

This is an effective structure from the point of view of estate planning – for estate duty savings as well as protection of assets from creditors, on the basis that the trust assets do not form part of the estate planner's estate.

Vested (Vesting) Trust: Here the trustees are not given any discretion in the deed, and the beneficiaries and their benefit(s) are fixed and predetermined.

Any income earned by the trust vests in the beneficiary. The beneficiaries have a personal right to claim their portion of the trust benefits from the trustee upon the happening of a certain event (e.g. upon reaching the age of eighteen).

The beneficiary has a vested right to the income and capital, which cannot be contested by anyone else.

In the event of the death of the beneficiary prior to payment, the deceased beneficiary's interests (i.e. his personal rights) are transmissible to his heirs, and these must be included in his estate for estate duty purposes.

Trusts can be described according to the purpose for which they are formed

Asset-Protection Trusts: Asset-protection trusts include a wide range of legal structures which are set up in an attempt to mitigate the effects of taxation, divorce and bankruptcy on the beneficiary.

Any form of trust which provides for trust property to be held on a discretionary basis falls within this category, e.g. a family trust which is designed to secure the interests and protect the property of a group of family members.

- **Family (Private) Trusts:** These can be testamentary or inter vivos trusts. Their main objective is the protection & maintenance of trust property, for the benefit of minor children, or family relations of the founder.

- **Empowerment/Employee Trusts:** These are inter vivos trusts formed to empower staff and give them the chance of meaningful participation and "ownership" in the business venture.

- **Offshore Trusts:** The term offshore trust describe a trust which is set up in a tax haven jurisdiction. In South Africa the term includes any non-South African or non-residence trust that has its place of effective management outside the Republic. There are both tax advantages and disadvantages with regards to offshore trusts and in South Africa there are both general and specific anti-avoidance provisions that can negatively impact the use of offshore trusts.

- **Business/Trading Trusts:** These are inter vivos trusts formed to carry on the business with a profit incentive. The trustees should be independent of the beneficiaries. Business Trusts:
  - may be either public or private
  - beneficiaries enjoy limited liability trading
  - administration is less complex and less expensive than a company or close corporation
  - trustees may each individually face personal liability in the event of recklessness or failure to exercise reasonable care and skill

Charitable Trust: This is a trust set up for charitable purposes and may qualify for exemption from income tax and Capital Gains Tax provided that:

- It carries on an approved public benefit entity
- It is registered as a Public Benefit Organisation by the SARS Tax Exemption Unit

Donations to a charitable trust which fulfils the regulatory requirements will also be exempted from donations tax.

Special Trust: Unlike conventional trusts which are taxed at a flat rate of tax, a special trust is taxed on the same sliding scale applicable to natural persons.

For tax purposes the following types of special trusts are recognised:

Special Trust Type A: A trust created solely for the maintenance and care of a person with a mental illness (as defined in the Mental Health Care Act) or any serious physical disability which precludes him from earning income or managing his own affairs.

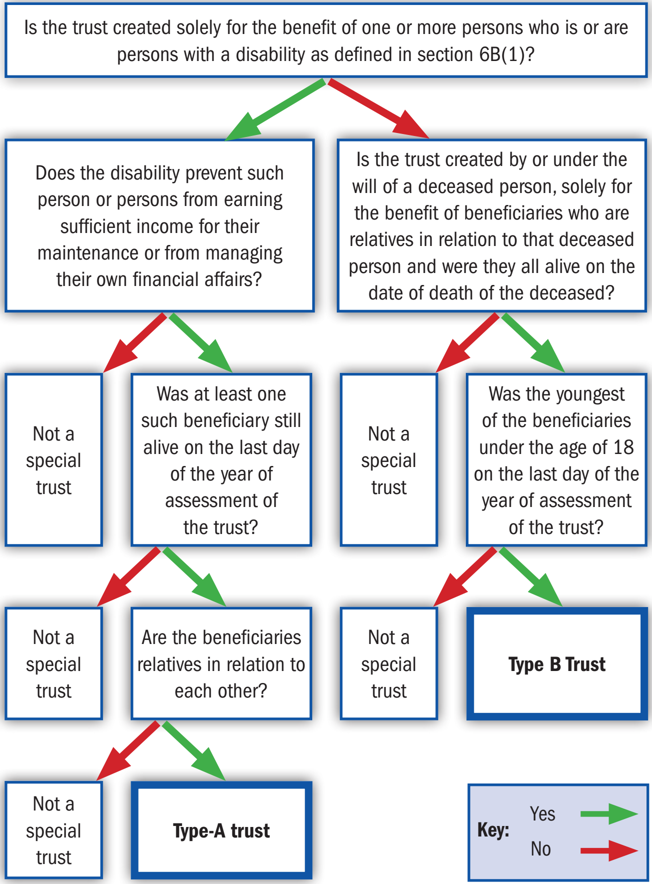
Special Trust Type-A trusts can be testamentary or inter vivos trusts and are sometimes created as a result of a court order in favour of a specified natural person.

Special Trust Type B: This is a testamentary trust created by a testator by or in terms of his will solely for the maintenance and care of his relatives who are alive on the date of death of the deceased (including any beneficiary who has been conceived but not yet born on that date).

The youngest of the relatives should be under the age of eighteen years. A trust will cease to be a Type-B trust as from the beginning of a year of assessment in which the youngest of its beneficiaries turns eighteen.

The distinction between a Type-A trust and a Type-B trust is important because a Type-A trust qualifies for certain relief from Capital Gains Tax while a Type-B trust does not qualify for such relief.

IDENTIFYING SPECIAL TRUSTS



ADVANTAGES AND DISADVANTAGES OF A TRUST

Advantages of a trust

- Continuity - a trust survives the life of an individual (donor / trustee / beneficiary) and can span multiple generations
- Can protect an individual's assets from creditors and / or matrimonial and relationship disputes
- Utilisation of services, knowledge and abilities of trustees
- Custodianship of assets, preventing assets from being squandered
- Management and control of trust assets - e.g. where there may be several owners of the same asset who cannot agree on how to manage the asset
- Administration of asset for charitable purposes
- Tax benefits can be created by the correct distribution of income and capital gains
- Estate duty can be minimised or capped because the growth of an asset is no longer in the hands of mortal person

Disadvantages of a trust

- Formation and administration of a trust is costly
- Higher rate of income and capital gains taxes on distributions, if retained in the trust
- Possibility of future legislative amendments which may adversely affect the benefit of the trust
- Administrative and Taxation requirements such as:
  - Annual financial statements
  - Annual income tax return
  - Bi-annual provisional tax returns
  - Onerous duties of trustees
- Must be relinquishment of control (SARS may deem income back to the donor of the asset if there is not adequate relinquishment of control over the asset)

BENEFICIARIES OF A TRUST

The beneficiaries are named in the trust instrument and can be:

- Income beneficiaries (benefit from income derived from trust assets or the use of trust assets)
- Capital beneficiaries (benefit from distribution of a portion or the whole of the capital assets)

The qualifications of beneficiaries

- Any person (unborn or alive) can be a beneficiary of the trust
- There is no limit to the number of beneficiaries of a trust
- Persons other than natural persons can be beneficiaries (e.g. duly registered trusts, juristic persons, associations etc.)
- The founder of a trust may also be a trustee or a beneficiary of the trust or both, but he may not be the only trustee

Rights of beneficiaries

- A personal right against the trustee for the trustee's compliance with his duties.
- Rights in respect of the trust assets/income as stipulated in the trust instrument which can be:
  - Vested rights - assets and / or benefits vest in the beneficiaries, but are administered by the trustees
  - Discretionary rights - trustees have full discretion to determine benefits of beneficiaries

A beneficiary must accept the benefits conferred by the trust deed. Once the beneficiary has accepted these benefits, the trust deed can only be varied with the beneficiary's consent.

- The trustee acts in an official capacity, which is fiduciary in nature, meaning that the trustee must honour the trust placed in him, and always act in the best interests of the trust beneficiaries and the trust.
- A natural person or a corporate person may be a trustee.
- The trustee is not personally liable for the debts of the trust and trust assets do not form part of the trustee's estate in the event of his sequestration.
- At least one independent outsider trustee should be co-appointed as trustee to every trust in which (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to each other.
- A trustee can be a beneficiary of a trust, but a sole trustee may not also be a sole beneficiary of a trust, as a trustee by definition holds and administers property for some person other than himself.
- A trust may be properly established with only one trustee, there is generally no upper limit to the number of trustees who may be appointed.
- The trust instrument usually specifies the required minimum/maximum number of trustees.

Disqualification from appointment as a trustee

A person cannot be appointed as a trustee if he/she is:

- Disqualified from being a trustee in terms of the TPCA
- An unrehabilitated insolvent
- Removed from an office of trust on account of misconduct
- Convicted of a crime involving dishonesty
- Disqualified in terms of the trust deed

Rights of Trustees

Right to Remuneration

A trustee is entitled to remuneration as provided for in the trust deed. If no remuneration is provided for in the trust deed, the trustee will still be entitled to reasonable remuneration for the services to be rendered by the trustee. In the event of a dispute, the Master may fix the trustee's remuneration.

Right to Make Representation

A trustee who is affected by a proposed removal of office by the other trustees, has the right to make representations with regard to his/her removal from office. The trustee is entitled to have his/her representations heard at the meeting which is convened for the purposes of proposing a resolution for the trustee's removal.

Powers of Trustees

The trust deed normally awards wide powers to the trustee in order to ensure proper administration of the trust.

Some examples of powers awarded to trustees include:

- Buying and selling trust property
- Determining distributions to beneficiaries
- Hiring and firing professional advisors, tradesmen and contractors
- Opening/operating bank or building society accounts or facilities

Trustees are required to exercise their powers independently and objectively. Trustees hold a fiduciary position and therefore must always exercise their powers to the advantage of the beneficiaries and act within these powers. When trustees act contrary to the provisions of the trust deed, their acts are ultra vires ("beyond the powers") and are therefore invalid.

With the exception of a bewind trust, the trustees are generally the legal owners of trust property.

DUTIES, RESPONSIBILITIES AND OBLIGATIONS OF TRUSTEES

The duties of a trustee can be divided into the following categories:

Obligations in relation to the trust deed

Trustee(s) have an obligation to:

- Lodge initial trust deeds with the Master
- Pay the Master's fees
- Be familiar with the trust instructions including the nature and extent of their powers and duties
- Lodge amendments to the deed with the Master

Obligations in relation to the trustees

Authority to act – can only act as trustee once authorised to do so in writing by the Master.

Notice of address – a trustee must inform the Master of his/her postal and physical address. Master must be notified of any change of address by registered mail within 14 days of the change.

Exercising discretion – a trustee may delegate tasks, but must make decisions and exercise discretionary powers personally and independently. The trustee is responsible to the beneficiaries for any appointed agent's actions. Where a trustee relies upon a dominant co-trustee and approves of his/her (wrongful) conduct, he/she may be removed from office by a court.

Avoid a conflict of interests – a trustee must act in good faith, and at all times avoid any conflict of interests between personal interests and official and fiduciary duties to the trust and to the beneficiaries. A trustee may not gain personally from the trust fund (other than reasonable remuneration).

Declare a personal "interest"- a trustee who in any way acquires an interest in an agreement or proposed agreement which has been or is to be entered into with the trust, must immediately declare the nature and extent of this interest in writing to the other trustees. (This includes having any relationship, either by blood or by marriage with a person who has such an interest.)

Duty of care & negligence – trustee must act with "the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another". Any provision in a trust deed which exempts a trustee from liability for negligence is void and a trustee may be held liable for any losses suffered by beneficiaries if it is found that the trustee did not act with the required degree of care and skill in the administration of the trust assets.

Accountability - a trustee is accountable at all times to the Master and to the beneficiaries. If requested in writing to do so, the trustee must give an account of administration and disposal of trust property, provide any relevant book, record, account or document and honestly and truthfully answer any relevant questions by the Master. If a trustee becomes aware of any acts or occurrences that may be prejudicial to the rights of the beneficiaries, action must be taken.

Obligations in relation to the trust property

Obtain control of trust property - the trustee must obtain effective control over the trust property as soon as possible after the issue of the Master's Letters of Authority.

Registration and identification of trust property - the trustee must identify the trust property and keep it separate from any personal property. Property (including immovable property and any account or investment at a financial institution) should be registered in the name of the trust.

Treatment of trust property - a trustee must notify all trustees so that a decision may be made in regard to a proposed sale of immovable property held by the trust. A trustee may not withhold information from co-trustees.

Collect debts due to the trust - trustees must collect debts owed in respect of trust property.

Distribute trust income & capital - a trustee must distribute trust income and capital to the appropriate beneficiaries at the time(s) stipulated in the trust deed.

Custody of documents - a trustee must keep all documentation relating to the administration of the trust for FIVE YEARS after the termination of the trust. Such documents may not be destroyed without the written consent of the Master.

Obligations in relation to the finances of the trust

Trust bank account - a trustee must deposit trust monies in a separate account with a financial institution without delay.

Administration and investment - the trustee must administer the trust in terms of the law and the provisions of the trust deed and act with the highest degree of diligence and caution. It is improper for a trustee to borrow trust money.

Reasonable return on trust capital – a trustee must ensure that a reasonable return is obtained on the trust capital

Bookkeeping, accounting and financial statements – a trustee must keep, at the office of the trust, accounting records that fairly represent the trust's state of affairs and business and explain its transactions and financial position. These records must be available for inspection by any trustee or beneficiary. The trustees are responsible for producing annual financial statements.

Compliance with legislation

The trustee must ensure that the trust complies with the TPCA and all other applicable legislation, including, but not limited to, the following:

- The Income Tax Act, 1962 as amended
- The Banks Act, 1990
- The Value-Added Tax Act, 1991
- The Financial Institutions Act, 2001
- The Prevention & Combating of Corruption Act, 2004
- The Financial Intelligence Centre Act, 2001
- The Tax Administration Act, 2011

SUMMARY: DUTIES OF TRUSTEES

Fiduciary Duties	Statutory Duties in Terms of Trust Property Control Act	Other Common Law Duties
Always exercise powers In good faith, acting independently and objectively	Act with Care, Diligence and Skill (Sect.9)	Act within limits of authority
Always avoid a conflict between personal interests official fiduciary duties	Lodge trust instrument with Master (Sect.4)	Know and obey terms of the trust instrument
Act exclusively in the best interests of all trust beneficiaries	Provide Master with trustee's address/ change of address (Sect.5)	Properly identify the beneficiaries of the trust
Fulfil duties impartially and in good faith	Provide Master with security/exemption from security (Sect.6)	Make sure required number of trustees is in place
Do not make a profit (directly/indirectly) from trust administration	Obtain written authorisation to act as trustee (Sect.6)	Act unanimously with other trustees
	Open separate bank account for trust (Sect.10)	Make proper distributions to identified beneficiaries and distinguish between income and capital

Fiduciary Duties	Statutory Duties in Terms of Trust Property Control Act	Other Common Law Duties
	Register and identify trust property (trust property must be clearly designated) (Sect.11)	Hold regular meetings and keep proper records of meetings
	Take control of the trust assets and keep these clearly separate from personal property (Sect.12)	Keep proper accounting records and prepare financial statements and tax returns
	Protect trust's documents - do not destroy before 5 years after trust is ended (Sect.17)	Comply with all applicable legislation e.g. Income Tax Act, Banks Act etc
	Keep proper records and accounts of administration/disposal (Sect.16)	Implement proper systems of internal control
		Invest productively, wisely and in accordance with sound government principals
		Preserve the trust property and keep it free from burdens such as mortgages, pledges and liens

LIABILITY OF TRUSTEES

Although a trustee may not act in the capacity of trustee until he has received a letter of appointment from the Master, he is still liable for any unlawful act committed in the handling of trust affairs prior to the issue of the letters.

Once a trustee has accepted the position and is authorised to act, the trustee must act at all times in the best interests of the trust's beneficiaries and fulfil all duties in terms of the trust deed and the law. A trustee may not be negligent when performing his duties.

A trust itself cannot be sued as it is not recognised as a legal person in South Africa (unless a statute defines it as such). It is the trustees in their official capacity who can be sued.

An indemnity clause in the trust deed which exempts trustees from liability for breach of trust is void and does not exempt a trustee from actions involving ordinary or gross negligence or intentional wrongdoing.

Criminal liability may be imposed on a trustee who commits a crime in the course of the trust administration e.g. theft or fraud.

Trustees are jointly and severally liable for damages (delict). Beneficiaries or third parties (e.g. creditors) who have suffered a loss as a result of breach of trust are entitled to bring a damages claim against the trustees.

Trustees can be sued for damages by beneficiaries if they act negligently (even if they act in good faith) and/or if they intentionally act wrongfully.

A co-trustee who was not involved with a breach of trust may nevertheless be liable for any wrongful action of another trustee if the "innocent" trustee's ignorance and/or inactivity is causally connected to the damage incurred. For example: where the "innocent trustee" is aware of a breach of trust by co-trustees but does not report it, or where the "innocent trustee" improperly allows trust funds to remain in the sole control of co-trustees.

REMOVAL & TERMINATION OF OFFICE OF A TRUSTEE

Removal from office

A trustee may be removed from office by the Master under the following circumstances:

- convicted of any offence involving dishonesty/sentenced without option of a fine
- failed to give security/additional security within two months of Master's request
- his estate is sequestrated/ liquidated/ placed under judicial management
- declared mentally ill/ incapable of managing own affairs
- fails to perform satisfactorily any duty required by law or by the Master
- breach of trust by the trustee
- decided by Court that removal is best interests of trust and beneficiaries

Termination of office

A trustee can also stop being a trustee in one of the following ways:

- Death (the trusteeship does not pass to the executor of the trustee's estate)
- Resignation
- Dissolution of the trust
- Any other way the trust deed may authorise

Should a trustee die or resign, the Master requires the Letter of Authority plus death certificate or resignation letter from the outgoing trustee as well as a resolution by the remaining trustees accepting the resignation.

Any change of trustees, for whatever reason, is only of legal force and effect once the original Letters of Authority/Master's Certificate have been amended by the Master to reflect that change.

Steps must then be taken to appoint a new trustee - until the minimum required number of trustees have been formally appointed by the Master and amended Letters of Authority/Master's Certificate issued reflecting their names, the trust cannot transact.

ADMINISTRATION OF TRUSTS

An inter vivos trust must be registered at the office of the Master in whose area of jurisdiction the greatest portion of the trust assets is situated. If more than one Master has jurisdiction over the trust assets, final jurisdiction will rest with the Master of the office where the trust was first registered.

Documents Required by Master to Register the Trust	Inter Vivos Trust	Testamentary Trust
Original trust deed or notarial certified copy thereof	✔	Deceased's last will
Payment of R100 fee (either revenue stamps affixed to the trust document or a stamp impressed with a franking machine approved by the Commissioner for Inland Revenue)	✔	No fees involved
Completed Acceptance of Trusteeship (J417) for each Trustee	✔	✔
Acceptance of Auditor Application (J405) forms	✔	✔
Bond of security by the trustees - form J344 (if required by the Master)	✔	✔

The Master will deregister a trust under the following circumstances:

- By statute
- Trust objective has been realised
- Failure of the beneficiary
- Renunciation or repudiation of rights by the beneficiary
- Trust assets have been destroyed without fault on the part of the trustee
- Operation of a resolutive condition
- Sequestration of the trust

TRUSTS AS A FINANCIAL AND ESTATE PLANNING TOOL

Trusts can serve a dual function of protecting assets as well as creating certain taxation benefits.

To protect minor beneficiaries and incapacitated persons

- Setting up a special trust for a mentally disabled or incapacitated person allows for the safe custody of assets while at the same time benefitting from lenient tax treatment from an income tax and capital gains tax perspective.
- Setting up a testamentary trust for the benefit of minor children provides some income tax benefits as well as preventing any funds being held by the Guardian’s fund on behalf of the minor.

Protection against creditors

- A discretionary trust may enjoy creditor protection in the case insolvency (subject to insolvency rules).
- Where the asset was transferred to the trust while the founder was solvent it would be difficult for creditors to set aside the trust transaction.
- Where there are vested rights – the protection is only afforded to those assets in which the insolvent has no vested rights. (A bewind trust provides no protection in these circumstances.)

Capital gains tax and trusts

With the introduction of capital gains tax, the effectiveness of the use of trusts in estate planning has been slightly negated, but with careful planning the impact of capital gains tax can be reduced and even completely avoided.

Capital gains tax is payable by any trust in South Africa on any gains made as a result of a disposal of assets after 1 October 2001.

Estate duties and donations tax

- If properly planned, managed and controlled, a trust can act as a significant shelter against future estate duties.
- The founder may transfer assets with growth potential into a trust, preferably a discretionary trust, with his children and grandchildren as beneficiaries.
- The growth in the assets from the date of transfer to date of his death accrues to the trust, and at most, only the value of the asset at the date of the transfer (usually in the form of a loan account) is retained in his estate.
- The loan account is usually gradually reduced during the founder's lifetime by loan repayments, further reducing estate duty liability.
- Actual cash must exchange hands, as a writing off of a loan constitutes a capital gains tax event whereupon capital gains tax is payable.
- Any growth in the asset(s) will take place in the trust and not in the founder's hands. The increase in value will not be included in the founder's estate and the value of his estate (and therefore estate duty) is reduced accordingly.

In this way, estate duty may be by-passed for one or more generations. (These benefits are only applicable to a discretionary inter vivos trust and not vested or bewind trusts.)

Methods of transferring assets into a trust

See page 29 for a summary of the proposed changes to the taxation of trusts that were announced in a draft bill in July 2016.

By donation: The founder will pay donations tax on the value of the assets donated to the trust. The first R100,000 per annum per natural person is exempt from donations tax.

By sale: Assets can be sold to the trust at fair market value against a loan account. The sale must be at fair market value, otherwise the founder will probably have to pay donations tax.

In order to gradually reduce the loan account, the founder may then donate up to R100,000 each year to the trust without attracting any donations tax liability. The balance of the loan account will be included in his estate when he dies.

IMPORTANT POINTS TO CONSIDER REGARDING TAXATION AND ADMINISTRATION OF TRUSTS

Tax considerations

Trustees may create tax efficiencies based on the timing and amounts of distributions made to beneficiaries.

Where income received by the trust is paid out to the beneficiaries within the same tax year, it is treated, for tax purposes, as if it had never been received by the trust, but rather directly by the beneficiaries. It is therefore advisable for distributions to be made to the beneficiaries in the same year as income is received.

The trust acts as a conduit through which income flows. Income flowing through a trust to beneficiaries retains its identity. Therefore, interest received by the trust is also treated as interest received by the beneficiary and is thus taxed in the beneficiary's hands.

Where income is taxed in the hands of the trust, any subsequent distribution thereof will not again attract tax in the hands of the beneficiary.

General points to consider

The way in which the trust deed is drafted is important, and also the way in which the trust and the trust assets are administered.

It is an abuse of a trust where a person creates a trust, transfers assets to the trust, and then simply treats the trust assets as though they were his own.

It is advisable to appoint at least three trustees, one of whom is completely independent, to act as such so that the founder (who may be a trustee and a beneficiary) will have a minority vote.

TAXATION OF TRUSTS

For tax purposes a trust is considered to be a separate "person".

A trust will be considered to be resident for tax purposes if it is incorporated, established, formed or has its place of effective management in South Africa.

Depending on the circumstances, trust income can be taxed in the hands of the donor, beneficiary or the trust.

A grey area exists where a trust distributes a capital gain to a non-resident beneficiary. Trustees should therefore seek advice before making capital distributions to non-resident beneficiaries.

Anti-avoidance provisions

Various anti-avoidance provisions exist to combat the use of trusts for income-splitting and tax avoidance schemes.

Income-splitting occurs where the marginal rate of tax is reduced to an amount less than if the income had been taxed from one source.

Section 103(2) of the Income Tax Act includes trusts and prevents the utilisation of any loss in a trust, solely for the purposes of avoiding tax.

The Section 7 deeming provisions of the Income Tax Act work mainly on the basis whereby any income earned by the trust as a result of a donation, settlement, or other disposition made by a person ("the donor") which is not distributed, is deemed to be the income of that donor and taxed in his/her hands. If income is distributed to beneficiaries who are minor children of the donor, the income is also taxed in the hands of the donor.

Similar provisions exist in respect of capital gains made by or accrued to a trust.

Type of Trust	Income Tax Rates	Capital Gains Tax Inclusion Rate
Normal Trust	41%	80%
Special Trust	Same as those applicable to natural persons, except that the rebates and interest exemptions do not apply	40%

Capital gains tax rates

Type of Trust	2017*	2016	2015	2014	2013
Individuals and Special Trusts	16.4%	13.65%	13.32%	13.32%	13.32%
Other Trusts	32.8%	27.31%	26.64%	26.64%	26.64%

*Proposed rates as announced by the Minister of Finance in the 2016/2017 Budget.

Proposed Changes Affecting Taxation of Trusts (July 2016)

- The difference between the official interest rate and the below-market rate of the loan to a trust will be regarded as income accrued or received by the seller.
- Where there is no actual payment of interest by the trust to the seller, no deduction may be claimed by the trust.
- Below-market interest loans: only the amount of interest that is actually paid by the trust to the seller can be claimed as a deduction.
- Interest free loans or below-market interest loans to trusts will not qualify for the current R100,000 annual donations tax exemption.
- Normal tax attributable to income included in the income received or accrued to the seller may be recoverable by the seller from the trust within a period of three years after the end of the year of assessment. After this period, such income will be treated as a donation by the seller.

If approved, these amendments will come into effect from 1 March 2017.

PROPOSED CHANGES TO THE TAX TREATMENT OF TRUSTS

In July 2015, the Davis Tax Committee (DTC) released an interim report on Estate Duty for public comment. This report proposes significant changes to the taxation of trusts which will have important implications for estate planning and the taxation of trusts if adopted by Treasury.

The DTC Report recommends that taxpayers should be allowed to make use of trusts when it makes sense to do so in the pursuit of a commercial benefit. However, in order to prevent the use of trusts to avoid or defer estate duty, the DTC has recommended the following:

- The flat rate of taxation for a trust should remain at 41%
- Trusts to be taxed as separate taxpayers
- The only relief for trusts should be the "special trust definition", which allows a trust to be taxed at personal income tax rates in limited special circumstances
- The definition of a "special trust" should be reviewed to possibly include selected trusts used in Broad Based Black Economic Empowerment Structures
- The current attribution provisions for taxation of trusts and beneficiaries should either be repealed for South African resident trust arrangements, or retained for non-resident (offshore) trust arrangements.
- No attempt should be made to implement transfer pricing adjustments in the event of financial assistance or interest-free loans being advanced to trusts
- All distributions from foreign trusts should be taxed as income in the hands of beneficiaries
- Spousal relief for estate duty should be removed and spousal relief for donations tax should be limited
- Criminal charges should be brought against taxpayers who fail to disclose their direct or indirect interests in foreign trust arrangements

Irrespective of the outcome of the DTC recommendations, trusts are still an important estate planning tool.

More than ever before, good planning and careful structuring of trusts is essential.

EXAMPLES OF RECENT CASE LAW

Case	Court Decision	Relevance
Land and Agricultural Bank of South Africa v Parker 2005	Contracts were void because they were not signed by the stipulated number of trustees.	A sub-minimum of trustees cannot bind a trust.
Jordaan vs Jordaan 2001	Trust was the founder's alter ego (founder treated trust assets as his own), assets were subject to division.	Separation of ownership (or control) from enjoyment is fundamental in creating a valid trust.
Doyle v Board of Executors 1999	Beneficiaries are entitled to have access to the books of account of the trust.	Trustees must keep accurate records and act in good faith.
Potgieter v Potgieter NO 2012	Beneficiary had not agreed to amendment of trust deed so agreement was invalid.	Once a beneficiary has accepted his rights, any change to the trust deed must be agreed by the beneficiary.
Simplex (Pty) Ltd v van der Merwe and Others 1996	Trustees had acted before being authorised to do so by the Master and agreements were null and void.	Trustees have no authority to act until Letters of Authority had been issued by the Master.
Steyn and Others NNO v Blockpave (Pty) Ltd 2011	Transactions are not valid if all the trustees have not agreed to them.	All trustees must act together when making decisions affecting the trust.

USEFUL LINKS

The Master of the High Court

- http://www.justice.gov.za

Trust Property Control Act 57 of 1988

- http://www.justice.gov.za

S.A. Legal Information Institute (Case Law)

- http://www.saflii.org

SARS Guide to Taxation of Special Trusts

- http://www.sars.gov.za

Income Tax Return For Trusts (ITR12T)

- http://www.sars.gov.za

Tax Registration of a Trust

- http://www.sars.gov.za

Department of Justice: Trust Forms

- http://www.justice.gov.za

Davis Tax Committee Estates Discussion Document

- http://www.taxcom.org.za

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