Introduction

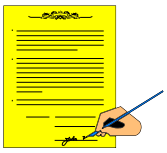
The law on trusts originates from English Law and the words “trust” and “trustees” were, in the beginning, foreign to our Roman-Dutch Law. However, with British rule at the Cape Colony, came the introduction of the trust concept to our shores. Over time the South African Law on Trusts has been developed by legislature, the courts and legal practitioners into what we have today. But the story does not end there. Given the changing world we live in, new requirements continually emerge, not least of which are driven by the South African Revenue Services (SARS), for which the trust may need to be refined. And so the Law of Trusts is developing and will continue to develop both in its principles of place and in its application.

Trusts are often encountered in estate planning and it is therefore essential that any estate planner has a working knowledge of trusts, in order to affect proper estate planning. This document serves to provide the reader with a broad view on the use of trusts.

There are a number of different categories and types of trusts, but for purposes of this document we will look at the two basic types of trusts, being *testamentary trusts* and *inter-vivos trusts.*

Testamentary Trusts

A *testamentary trust* is what it says, a trust that is created on the death of the testator in terms of specified provisions as set out in terms of the testator’s Last Will and Testament. The first distinction between the testamentary trust and the inter-vivos trust is that the testamentary trust, by virtue of it being created in terms of a Will, is the result of a unilateral juristic act.



Any number of assets may be bequeathed to the trust in terms of the Will. However, for practical reasons, some assets are better than others. For example, it serves no purpose for trustees to hold items of furniture in trust and these asset types may be distributed to the trust beneficiary (or his guardian where he is a minor).

Popular reasons for creating a testamentary trust are to allow for the adequate management and control of the assets, protection of a spouse or minor children or providing for a charitable institution in perpetuity. The trust may be designed to continue until a minor child attains majority or another preferred age or until the happening of a certain event.

It has been said by some estate planning authors; that the testamentary trust cannot be used for estate duty saving purposes. However, this is not entirely correct, since while it does not help in the estate of the first dying, it certainly may be used to reduce the possible duty that may become payable upon the surviving spouse’s demise.

Inter-Vivos Trusts

An *inter-vivos trust* is created by means of agreement (a contract) between the founder and the trustees, during the lifetime of the founder. And so the second distinction between this and the testamentary trust appears, being that it is created during the creator's lifetime, as opposed to after his death. The agreement is called the trust instrument (or Trust Deed) and is signed in accordance with the Law of Contracts and registered with the Master of the High Court. The Trust Deed is a specialised legal document, which requires proper expertise for the drawing up thereof.

The parties to the trust are:

- **The Founder:** The person who creates the trust and makes the initial funds available to the trust. Also referred to as the settlor or donor.
- **The Trustees:** Appointed in terms of the Trust Deed to administer the assets of the trust in accordance with the provisions as set out in the Deed.
- **The beneficiaries:** These are the persons who are to benefit either now or in the future from the trust and can be named or otherwise indicated by class.

There are a number of requirements that must be in existence in order for the trust deed to be determined as valid. These requirements may be listed as follows:

1. Founder must have an intention to create a trust
2. The Trust Deed by its wording must create a binding obligation
3. Trust assets must be easily identifiable
4. Trust objectives must be clearly and concisely stated
5. Trust objectives must be lawful

It should be noted here that should the trust objective not exist or should the trust objective no longer be attainable or applicable, the validity of the trust's existence may be called to question with immediate effect.

Reasons for using Trusts

1. Estate "pegging" or freezing of asset values

This is one of the cornerstone features of using an Inter-Vivos Trust for estate planning purposes. Once the asset is moved into the Trust, either by way of a loan account or by means of donation, then any future growth in the asset that takes place during the donor's lifetime, will take place in the Trust. This means that the value of the donor's estate at his death is significantly less than if the growth had taken place in his estate and as a result, his estate duty liability will be limited.

2. Limited financial skills of surviving spouse

Protecting the interests of a surviving spouse who may have limited skills in financial matters. This is especially popular where a spouse is concerned about the survivor being taken advantage of by unscrupulous investors or indeed by their own children.

3. Protection of minor children

Protecting the interests of children until they are old enough to handle their own financial affairs. The trust can be managed separately for each individual child and thus not unfairly favour one child over another in respect of the application of the funds.
In fact, where a child is handicapped, the only means of protection and planning for that child is to set up a trust for him.

4. Continuity/perpetual succession

The trust can continue for future generations and this adds continuity to the estate planning of the family. When a person dies, their estate is frozen and only once the Executor is in possession of Letters of Executorship, will he be able to make provision for the surviving spouse and/or children. The Trust, however, is a separate vehicle and will not be affected by the death of the Founder, but instead will continue to operate as before. Furthermore, the Will of a deceased becomes a public document upon his death, whereas the Trust remains a private affair and is not open to public scrutiny.

5. Insolvency of beneficiaries/claims by creditors

As stated before, the trust property does not form part of the personal estate of the beneficiaries until vesting takes place, which in a discretionary trust only occurs when the trustees exercise this option, thus these assets are beyond reach of the trust beneficiaries' creditors.

The assets transferred into the trust are also subject to protection from creditors, provided the founder was solvent at the time of settling the assets into trust. However, if the creditors can show that the result of such settlement was to make the founder insolvent and jeopardise the creditors' successful claims, then such protection falls away. The Insolvency Act will provide more guidance on this aspect.

6. Tax implications

(a) Income tax

Under certain circumstances, income from a trust can be split between spouses and further beneficiaries, thereby reducing tax liability. However, it should be noted that where income is accrued to minor beneficiaries, such income will be taxed in the hands of the minor beneficiary's parent (guardian) in accordance with section 7 of the Income Tax Act.

(b) Estate duty

Where a person has assets in excess of R5 million when he dies, then he should consider establishing a trust. The reason being that only the first R3.5 million of the estate is free of estate duty. His estate will pay estate duty at a rate of either 20% or 25% on an amount over this.
However, any amount left for the benefit of a spouse will be free of any duty and hence a cornerstone of reducing estate duty is planning with trusts and using the joint estates in doing so.

(c) Donations tax

Settlement of assets to trust can take place either by means of donation or by means of selling the assets to the trust. However, the trust has no money to start and therefore a loan account is created in favour of the seller (usually the founder). If a donation is made, then any amount over R100,000 (R200,000 between married couples) will be subject to donations tax at 20%, although the assets would then be completely out of the donor's estate.

An alternative is to have a loan account in the trust and for the so called "seller" to donate his allowable amount back to the trust on an annual basis, effectively reducing the loan account over time. The allowable donation per year is R100, 000 per spouse, while donations between spouses are free of any donations tax. Section 7C of the Income Tax Act may become applicable where this loan account is interest free.

7. Estates of spouse and/or children

The founder may be assisting his spouse and/or children in reducing the possibility of them having their own estate duty problem. The eventual distribution may rather take place at a much later time when there are a larger number of beneficiaries, resulting in smaller amounts being added to each beneficiary's estate.

8. Indivisibility of assets

Certain assets, such as farm property, mineral rights or some businesses are sometimes not suitable for dividing between beneficiaries. The trust is an ideal vehicle for taking ownership of such assets, keeping the assets intact and allowing the beneficiaries to fully appreciate the benefit of the assets concerned.

9. Business interests

The trust may often be more suitable as a vehicle for holding business interests for a number of reasons:

(a) Separating risk between business and personal assets
(b) Pegging growth in personal estate
(c) Flexibility in tax planning

Disadvantages of a Trust

1. Control by settlor

This is one of the most important issues to deal with for the settlor. When the assets are made over to the trustees, ownership thereof passes in its entirety to the trust. The settlor therefore has to accept that he is no longer the legal owner of the assets and is therefore not entitled to effect control thereon.

The settlor, as founder, can however, retain some control over the assets by means of the wording of the trust deed. Here there are essentially two aspects which are of the utmost importance. Firstly, no decision may be made without the affirmative vote of the founder. Secondly, the founder has the right to appoint additional trustees as and when he deems fit (while any trustee may be removed from office as trustee by majority decision of the trustees).

As long as it is made clear to the settlor that he will lose control over the relevant assets and as long as he is happy to do this, the trust will be an effective tool.

2. Choice of trustees

If the trustees are rival heirs, there could be problems with certain decisions made by the trustees and this could ultimately jeopardise the whole objective with which the trust was originally created.

Furthermore, the trustees must be persons of trust; hence care should be taken to know the person whom is appointed. For this reason, it is often better to appoint a professional trustee (who can be seen as the impartial party), if not during a person's lifetime, then certainly after his death to take on the actual administration and management of the trust and to be part of the decision making process. A professional trustee would be a person or entity experienced with dealing in trust administration, giving the person peace of mind that the trustee is backed by corporate governance and funding.

Too often one sees how the family friend, accountant or lawyer, who is appointed alone to act for the family, teams up with one family member or benefits himself only.

3. Future legislative changes

Unfortunately trusts have been identified as problem vehicles by SARS where not correctly administered and will no doubt continue to be scrutinised in the future, much the same as has been done in the past. Such changes as the introduction of Capital Gains Tax and the raising of the income tax rates applicable to trusts, is an example of this.

4. Costs

Depending on who is commissioned to attend to the drawing up of the trust deed and also to attend to the administration of the trust, the costs can vary.

Generally the costs in the market place are as follows:

- An initial fee of about R5 000 plus VAT, for setting up the trust. Costs can go up to R15,000 depending on the complexity of the estate. Some companies are offering trusts for less than R5,000 but these are often off-the-shelf trusts and should be carefully considered;
- Registration costs of R250;
- Annual administration fees. If you have appointed a professional administrator or trustee, of between 1% and 2% per annum on the value of the assets, subject to negotiation;
- Accounting fees to have financial statements drawn up (please note that an audit is not required by law); and
- Transfer costs. If you transfer fixed property into a trust, such as your home, you will pay transfer fees on a sliding scale. There will also be conveyancing fees and possible capital gains tax applicable.

Frequently Asked Questions

1. When can one only use two trustees and what is the purpose of using more than two trustees?

Any number of trustees may be appointed to administer a Trust, however when creating a Trust for purposes of estate planning one must take care to show due separation between the donor and the assets he has donated to the Trust. By separation it is meant that it must be clear that he no longer has ownership or control of the asset. The reason for this lies in the wording of section 3(3)(d) of the Estate Duty Act.

Section 3(1) of the Act reads as follows: *For the purposes of this Act the estate of any person shall consist of all property of that person as at the date of his death and of all property, which in accordance with this Act is deemed to be property of that person at that date.*

Section 3(3)(d) of the Act reads as follows: *Property which is deemed to be property of the deceased includes property (being property not otherwise chargeable under this Act or the full value of which is not otherwise required to be taken into account in the determination of the dutiable amount of the estate) of which the deceased was immediately prior to his death competent to dispose for his own benefit or for the benefit of his estate.*

Normally in a Family Trust situation the assets held in Trust do not amount to more than a couple of significant holdings and may be easily managed by the donor. However, because of Section 3(3)(d) he cannot perform on his own. So too he cannot perform only with his wife as they would be seen to be retaining control by collusion with each other. For that reason it is common practice that a 3rd (or more) trustee(s) be appointed as trustee(s) to bring about impartiality to the decision making in the Trust. This effectively satisfies SARS that the donor has not fallen foul of Section 3(3)(d).

As a last word here it should be noted that the founder of the Trust cannot act alone as trustee, since this would be in contravention of contract law as he would be seen to be contracting with themselves and it is a basic principle of contract law that there should always be more than one party to a valid contract.

2. What are the benefits of appointing a professional trustee?

A professional trustee is able to offer full service bookkeeping (amongst other things) thereby ensuring that proper accounting and tax records are maintained. The professional trustee also serves as an impartial trustee, thereby immediately putting to rest the concerns of Section 3(3)(d). Whereas family members would not usually be paid a fee for their services as trustees, the professional trustee will charge a fee. These charges vary and may be negotiated at the time of appointment.

3. What are implications of having a 3rd, independent trustee?

The concern for most founders is that they have to give up control over the assets being placed in Trust and are concerned as to how they may protect their interests. This "protection" may be achieved through the wording of the Trust Deed. Where a 3rd trustee dies the remaining trustees have the power to appoint a new trustee in his stead. The founder may appoint additional trustees as and when he needs to and a 3rd trustee may be fired by majority vote of the trustees holding office from time to time. Furthermore should the founder come to die; he has the power to appoint a substitute trustee in terms of his will.

4. Is it necessary to dissolve a trust (family trust) where spouses are getting divorced?

Not necessarily, but it will depend on the circumstances. Unless the Trust is to continue for the sole benefit of the children from the marriage, a situation will more than likely arise where one of the parties would like to continue with the Trust for their own benefit. As long as the other party is in agreement thereto such may be done by making a variation to the Trust Deed. This would not usually be a problem as the power of variation is usually granted in the Trust Deed.

5. Quorums

This is determined from the outset in terms of the Trust Deed. Its importance lies in the need firstly to ensure that sufficient trustees are present at a meeting for decision-making purposes and secondly it can be worded in such a manner as to ensure that the founder is always present at such meetings.

6. Financial statements

The financial statements can take any form as long as there is some form of balance sheet reflecting the assets and liabilities in the Trust and either an income statement or a transaction statement.

There should also be a clear distinction made between that part of the Trust, which is considered to be income and that part of the Trust that is seen as capital. Both the assets and the cash flows must have a distinction in terms of capital or income.

Effective rate of Capital Gains Tax in the case of a Trust will be 36%, whereas the effective rate for an individual will be 18% (maximum possible rate) therefore it can be considered (depending on the circumstances) for the capital gain in a Trust asset to be vested in the beneficiaries of the Trust at the time of disposal of the asset.

7. Is there protection against creditors?

The Trust Deed may be worded in such a way that any insolvent beneficiary will not receive benefits from the Trust in terms of the discretionary powers granted to the Trustees.

The Trust serves as a separate vehicle and the trustees, as long as they act with due care and diligence and meet all the requirements of someone who is acting in a fiduciary capacity, cannot be held accountable or liable for losses in the Trust.

8. What discretion should be given to the trustees for purposes of distributing income and/or capital?

It is common practice and the preferred option to provide the trustees with wide discretionary powers for the distribution of income and/or capital from the Trust. This allows the Trust to be versatile and control to be placed in the hands of the trustees. However, the trustees are limited in the application of their discretion to only provide distributions to or for the benefit of those beneficiaries or class of beneficiaries listed in the Trust Deed.

9. Are separate trusts created?

It is advisable to give the trustees the power to create further trusts for any beneficiaries of the Trust who may be under a certain age (which age may be determined by the client) at the termination of the Trust. The benefit is that the Trust does not have to continue until such beneficiary has attained such required age, but may instead terminate and place only such child's share in trust for him and pay the other beneficiaries their share of the capital of the Trust directly.

Duties and Responsibilities of a Trustee

The trustee's duties are determined by:

- **The trust instrument**
- **Common Law**
- **The Trust Property Control Act 57 of 1988**

The trustee's duties are made up as follows:

- Lodgement of trust instrument
- Payment of Master's fees
- Notice of change of address
- Acquaintance with trust instrument, which will *inter alia* also involve the interpretation thereof by the trustee
- Control of trust property
- Risk management
- Administration
  - Investment of assets
  - Disposal of assets
  - Maintenance of assets
  - Investment reviews/analyses
  - Capital transactions
  - Income transactions
  - Collection of income
  - Determine extent of benefits to beneficiaries
  - Distributions to beneficiaries
  - Preparation and submission of income tax return
  - Including CGT
  - Furnish statement of account on regular basis
- Avoid conflict of interests
- Act with due care and diligence
- Exercise discretion
- Maintain a trust bank account
- Registration and identification of trust property
- Accountability
- Custody of security and other important documentation
- Keeping abreast of legislative changes
- Keeping abreast of economic developments

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Conserve & Preserve

TESTAMENTARY TRUST	INTER-VIVOS TRUST
• A *testamentary trust* is created only at the death of the testator in terms of his/her Last Will and Testament. In most cases the purposes of creating such a trust evolve from a need to protect the ultimate beneficiaries, to skip a generation or generations and to a lesser extent for purposes of estate planning.	• An *inter-vivos trust* is created by means of a Trust Deed during the lifetime of the Founder. The Trust is usually funded by means of a donation or loan. In most cases the purposes of creating such a trust are for purposes of estate planning and tax efficient structuring and to a lesser degree for protection purposes.
• The provisions of the Trust are set out in the Will of the deceased and for all intents and purposes the trustee is legally obliged to enforce these provisions. The provisions will usually provide for the termination of the Trust upon fulfilment of a certain condition.	• The provisions of the Trust are set out in the Trust Deed and any addendums thereto. The Trustees usually have full discretion to apply funds for the benefit of beneficiaries. Provisions may be amended, provided such powers are provided in the Trust Deed. Letter of wishes used to guide the Trustees, but as such is not legally binding. Termination at the discretion of the Trustees.
• Capital Gains Tax (CGT) will have an effect on a Testamentary Trust. CGT will be payable at an effective rate of 18% (where registered as a Special Trust) on the capital gain realised upon the disposal of a Trust asset. Estate Duty will not be applied, except for ceasing value purposes.	• Capital Gains Tax (CGT) will have an effect on an Inter-Vivos Trust. CGT will be payable at an effective rate of 20% on the capital gain realised upon the disposal of a Trust asset, except during the lifetime of the Founder, when the effective rate could be 10% in terms of section 7 of the Income Tax Act. Furthermore Trustee will have discretion to vest capital gains in beneficiary, thereby changing the effective rate from 20% to 10% in respect of the disposal vested.
• Offshore assets may be bequeathed to a trust and the decision then lies with the trustees as to whether or not to repatriate the funds or to continue to hold the assets offshore.	• Offshore assets cannot be placed in a trust directly from an individual and a trust may not place any of its funds into offshore investments.

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