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Categorisation of trusts

Trusts

Apart from the conventional family trust, advisers may need to advise on matters pertaining to other types of trusts, including bewind, special and business trusts. It is important to identify the type of trust you are dealing with as this may impact on:

- ownership of the trust property
- the rights of beneficiaries
- the powers and obligations of trustees
- how the trust is to be taxed.

The primary consideration when attempting to categorise a trust is to determine where ownership of the trust assets lie.

In "ownership trusts" as they are understood in the conventional sense, the trustee is the owner and administrator of the trust property.

Where there is more than one trustee, the trustees are co-owners of the trust property. Ownership is confined to the administration of the trust property, and the trustee does not acquire any beneficial rights in respect of the trust property.

At the other end of the scale, ownership as used in this narrow sense does not have to vest in the trustee for a valid trust to come into existence. In the case of a "bewind trust", ownership of the trust property vests in the beneficiaries. The rights of ownership enjoyed by the beneficiaries are only limited to the extent that the control and administration of the trust property is transferred to the trustee.

This article provides a brief overview of the bewind, special and business trusts.

Bewind trust

Bewind trusts are most commonly used:

- as part of a private equity fund structure in terms of which the investors are beneficiaries of a trust that is managed and controlled by the trustees;
- as part of the investment structure of a linked investment service provider which is required to separate money received from customers from the assets of the linked investment service provider itself.
- as an alternative to the appointment of a curator bonis appointed by the High Court to manage the affairs of a person whose mental faculties are seriously diminishing.

Ownership of the asset, however, is a double edged sword and the beneficiary may find the asset concerned the subject of a claim by creditors in the case of insolvency or a similar event.

As a general principle, income generated by the assets of the bewind trust will flow through to the beneficiary concerned and be taxed in accordance with the conduit principle.

Special trust

A special trust is a creature of statute and is defined in the Income Tax Act as a trust formed for the benefit of a person with serious mental or physical disabilities, as well as a trust established in terms of the will of a deceased person solely for the benefit of relatives, the youngest of which is under the age of 21.

A special trust benefits not only from all the advantages that a trust has to offer in the conventional sense but is also subject to tax on the same sliding scale applicable to individuals.

The taxation of capital gains is treated on a similar basis with the special trust subject to an effective rate of 10% as opposed to the effective rate of 20% levied on conventional trusts.

Given the favourable tax treatment available to special trusts, advisers engaged in the estate planning process, especially with young families, would be well advised to include the formation of a special trust as a standard review item.

As a general principle, income generated by the assets of the bewind trust will flow through to the beneficiary concerned and be taxed in accordance with the conduit principle

Business trust

A business trust in its simplest form is a regular trust, the trust deed of which has been extended to enable the trust to transact commercially in the widest sense of the meaning eg raise capital or loan finance, invest in financial assets or plant and equipment, buy and sell trust assets, in essence do everything one would expect of a business housed in a conventional business entity such as a company.

To operate in this manner the powers of the trustees need to be extended to enable them to trade and make everyday business decisions.

Similarly, the rights of the beneficiaries have to be extended to enable them, inter alia, to dispose of their commercial interest in the trust, or pledge their interest in the trust as security for the raising of loans.

While the appeal of a business trust lies in the absence of regulation, one may find that in configuring the trust deed to suit the business objectives of the trust the added complexity outweighs the benefits to be had from trading in a more conventional format. An additional consideration is the flat tax rate of 40% as opposed to the more favourable corporate tax rate of 28%.

Advisers must therefore consider carefully the reason and motivation for adopting a business trust as a commercial trading vehicle before advising favourably on the matter.

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