Trust & Estate Planning Feature

The fact that trusts are receiving more scrutiny from SARS should not deter advisors from recommending this useful estate planning tool. It is imperative, however, that the trust be set up properly with the founder and trustees understanding and adhering to the legislation.

We have collected a variety of views from various contributors from different sectors in the industry.

Trusts and estate planning

Trinette Burger, Estate Planning Specialist, Sanlam Glacier Fiduciary Services

In recent years, trusts have received a lot of attention – some admire and others criticize. One moment your brother tells you to set up a trust and the next your friend at the gym tells you to stay away from trusts. This might be due to the scrutiny of trusts by the courts, announcements by the Finance Minister regarding the abuse of trusts and tax amendments affecting the taxation of trusts.

In the first twelve years of this century, there have already been just as many court cases regarding trusts as there have been in the whole of the previous century. It is clear that the courts aren't taking the abuse of trusts lightly and neither are the tax authorities. Finance Minister, Pravin Gordhan, recently announced that SARS will focus more of its attention on the abuse of trusts and that trusts by wealthy individuals can expect substantially more compliance checks and integrated audits.

These developments should not prevent one from setting up a trust for appropriate and legitimate estate planning purposes. Rather, they should serve as valuable lessons and useful guidelines when dealing with trusts. These lessons (or guidelines) for a well-managed trust include, amongst others, the following:

- The number of trustees prescribed in the trust deed must be properly authorised to represent the trust.
- Decisions by trustees must be valid. Trustees should study the trust deed and confirm whether a majority or unanimous vote is required for a particular decision. Where the trust deed is silent on decision-making, all decisions must be taken unanimously. Where a majority is required, the minority cannot merely be excluded from the decision. Although physical presence is not required, all the trustees should be aware of meetings and participate in decisions.
- The trustees must study the trust deed and confirm their rights, duties and powers as trustees and ensure that they properly administer the trust's assets and affairs.
- Always separate ownership from enjoyment. Beware of retaining control over the trust assets. The trustees should review the provisions of the trust deed in order to ensure that a single trustee with a beneficial interest in the trust does not have the power to control the trust assets (*de jure* control). The trustees should also take care that there isn't a trustee who (despite the provisions of the trust deed) in reality, controls the trust assets (*de facto* control).

Despite all the attention from the courts and SARS, trusts still remain very useful estate planning tools in many circumstances. It is up to the trustees whether this will affect them or not. If the trust was set up for the right reasons and the trustees administer the trust assets properly and respect the tax authorities, many (or all) of the benefits of trusts, such as asset protection, estate pegging for estate duty purposes, continuity and avoiding the administration process at death, will still apply.

The price of being too conservative

Henry van Deventer, financial planning coach at acsis

While the volatile markets that characterised most of 2011 are most likely to continue into this year, retirement fund investors should be wary of opting for the 'safe', cash investment options, as this is often one of the greatest mistakes investors make.

The closer investors get to retirement, the more stressful the decision becomes because the consequences of making the 'wrong' decision could seriously affect their quality of life in retirement. Because of this concern, the natural instinct before retirement is to put money where it is 'safe'. This often means a more conservative investment strategy, and in most cases, it entails being heavily invested in cash. The reasoning is that if the market falls during the year that an individual retires, he or she should be safe. If it does not, the individual will still be able to sleep at night.

This mistake is often made by investors who do not understand what they are potentially sacrificing by seeking safety in cash. As a starting point, consider that, as a rule of thumb, investors can draw a monthly income of about R5 000 before tax for every million rand invested at retirement. They

erefore need to give themselves the best possible chance to accumulate as much as possible before retirement with as much certainty as possible. The five years prior to retirement are especially crucial in achieving this.

Investors need to know how to grow their funds before retirement age and what to expect. For the best possible growth, investors should mainly be exposed to shares. Between 1925 and 2011, the average annual return on South African shares was approximately 14,4%. This means that a responsibly managed, share-focused strategy would have doubled roughly every five years. In cash, over the same period, the average return was approximately 6,7% per annum.

Therefore, by applying the above, investors with R1 million five years before retirement and a share portfolio could, on average, result in about R1,96m at retirement. A cash portfolio, on the other hand, could result in just over R1,38m – about two-thirds less. In terms of difference to monthly standard of living, a share portfolio would have produced about R3 000 more per month. If we apply the same argument to ten years before retirement instead of five, the difference becomes quite staggering - an additional R10 000 per month.

One concern with the above argument is that share market returns are not guaranteed. Investors will most probably lose some money during one of the five years before retirement as historically, South African shares produce a negative return 32% of the time, or roughly once every three years. However, over a five-year period, they have a 95% chance of achieving a positive return.

Over longer terms, chances of a positive return become even better. By investing in a responsibly managed and diversified share portfolio, the chances of getting a high positive return become better yet. We also need to remember that the investment term does not stop when one retires. It stops when the investors stops – which should be more than 25 years after retirement age.

Investors should consider that the more time they have available and the more responsible they are by not gambling on the share market (it is best to stick to a fund that will consistently follow the markets), the less the risk becomes and the better their retirement lifestyles could be. However, investors need to remember that an objective, expert financial planner needs to play a vital role in this regard. Do not be afraid of paying a fee to get sound advice – it may well turn out to be the most valuable item ever bought.

Why regular estate planning reviews are vital

Koos Rossouw, director at Stonehage

While some may argue that uncertainty is the only certainty there is, others would contend that when it comes to one's financial affairs, certainty is the only option.

It is surprising to see, however, how often accomplished people fail to adequately plan when it comes to their estate and succession planning. Local and global markets and economies exist in a permanent state of flux, therefore having spent a lifetime building a fortune and overcoming that volatility, it could be detrimental to expose it to the constant unpredictability associated with fate.

In South Africa, there are various types of trusts – inter vivos, testamentary, charitable and bewind. The tax and legal considerations for each type of trust vary, which is why an in-depth knowledge of each type is vital if one is to maximise the benefits and options that exist.

Unlike foreign trusts, natural persons mostly act as trustees for South African trusts. The trustees often include the trust's founder and/or his or her spouse, but it is of critical importance that an independent professional person is also appointed as trustee.

Trustees must be aware of what fiduciary duties are involved in this capacity to ensure that the trust is properly administered. Events like changes in personal, financial or legal circumstances, such as death, divorce, senility, insolvency or a dispute with beneficiaries may expose a trust that is not properly formed and or administered.

Some of the responsibilities of trustees include attending regular trustee meetings, minuting all meetings, recording every decision, and ensuring that the trust's accounting and tax affairs are appropriate and up to date.

It is important that estate planning is undertaken or reviewed when significant changes in personal circumstances such as emigration, divorce, remarriage or death of a potential beneficiary occur. Further complications may arise and require careful consideration specifically in instances of multi-

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generational families, multiple marriages, and or beneficiaries who reside in different jurisdictions.

Although laws affecting estate planning do not change regularly, when changes are made it is vital that your legal advisor makes the necessary amendments to your estate plan. By keeping clients up-to-date, we ensure that they do not open themselves and their beneficiaries to unnecessary tax liabilities, potential litigation or needless disputes.

Trusting Trusts can be scary, but worth it

Wim Visser, Manager Fiduciary services FedGroup, Member of the Fiduciary Institute of South Africa, and Ettiene Hugo, FedGroup Branch Manager: Eastern Cape

Considered an essential tool for many clients, a trust plays a meaningful role in a variety of estate planning disciplines. In addition to asset protection, a trust can function as an asset value pegging mechanism for estate duty, a means to support and maintain families and as a vehicle to house business interests. However, in recent years, many financial advisors and high net worth individuals have formed a negative perception about the use of trusts as an estate planning tool. What formed this perception? More importantly, does the appropriateness of trusts prevail amidst the pressure? How should financial advisors approach trusts in today's environment?

The negative perception of trusts came about partly as a result of legislation – legislation that was fuelled by a trust feeding frenzy. Seemingly, interest was only placed in the instant gratification of having a trust and saving tax. Popularity instead of relevance thus characterised the reasoning behind setting up a trust. Subsequently, the feeding frenzy raised the interest of the fiscal authorities whose response included raised regulation aimed at aligning trusts with general tax compliance.

To add to this, the South African Revenue Service recently revealed that it intends to focus more of its attention on the abuse of trusts by wealthy South Africans. According to Commissioner, Oupa Magashule, the trusts of wealthy South Africans can expect a substantial increase in compliance checks and audits. This revelation, coupled with an increase in Trust Capital Gains Tax, as revealed in the 2012 Budget Speech, has added to the negative perception about the use of trusts as an estate planning tool.

Despite Government targeting wealthy individuals in general, with specific focus on trusts, a trust as a financial planning tool is as important as ever.

Appropriateness prevails - fiscal benefits combined with asset protection

If a trust is set up for the right reasons and is used correctly, it is able to unlock specific benefits for the estate owner. In essence, a trust combines fiscal benefits with asset protection. Whether in a personal or business capacity, it is a useful vehicle that offers total asset protection as well as asset continuation. This is achieved by virtue of the fact that a trust is not owned by anyone and the death of a natural person will not influence or affect the continuation thereof.

Additional advantages of using a trust vehicle in estate and financial planning include savings on Estate Duty and Executor's fees due to the so-called "pinning" or "freezing" of the value of estate assets.

A holistic approach in today's environment

Due to increased legislation and vigilance, the trust arena has become a highly specialist playing ground. Ideally, advisors should be equipped to deal with this area of the law and similarly, be aware of the latest regulatory and legislative trends concerning trusts.

The primary objective of any estate planning structure should be based on the specific personal circumstances of the estate owner. It therefore makes sense to suggest that a holistic approach should be adopted by financial planners when administering clients' estate and financial planning. Advisors acting in the best interest of their clients will ensure that a trust is never created for the wrong reasons.

Considering the right trust

Afzal Seedat, Head of Absa Trust

When considering a trust as an estate planning tool, it is important to remember that a best advice and best practice approach should be followed, ensuring that a trust is structured with the primary objective of providing certainty for the succession and protection of assets. Factors such as a reduction in estate duty and executor's fees as a result of the pegging of estate asset values should be utilised as subsequent planning benefits and not as the primary or sole objective of the use of a trust.

Advisors should keep in mind that a trust is not a quick fix, savings are limited to inflationary growth. Furthermore, if an estate is not substantial today, it will most probably exceed the basic deduction over a period of time and could therefore need consideration. Consider the following: R 7 000 000 capitalised at a rate of only 6% over a period of 15 years will be worth R16, 7 million, while R7 000 000 capitalised at a rate

of 8% over the same period will be worth R 22, 2 million.

The cost of setting up a trust and the administration thereof should be weighed against the future benefits and savings through the trust.

The only downfall of a trust in the current environment is where one is structured in a silo to provide only one single function or solution rather than being keystone to a well conceptualised and implemented estate plan taking into account an individual's assets, lifestyle and obligations together with the needs, both currently and in the future, of the individual and his or her family.

It is recommended that advisors revise their client's financial and estate plan on a regular basis, taking changes in the client's financial and personal situation, as well as changes in legislation into account.

Trust administration

Ronel Williams, Legal and Technical Manager, Old Mutual Trust

Certain benefits of a trust

Property registered in the name of a trust does not increase the value of the founder/beneficiary's estate, facilitating a saving in estate duty. If the founder, however, lent money to the trust to purchase property or sold the property to the trust on loan account, the loan account will be an asset in his estate at his death. The trust should repay the loan account over a period of time. The idea is that any growth in the value of the asset will take place in the trust, whereas the value of the loan account will (at worst) be pegged at the initial amount.

If the beneficiaries have discretionary rights to income, it means they do not have a vested right to income or assets from the trust, that is, they cannot lay claim to any income or assets. Such a discretionary right will therefore not form an asset in their estate and no estate duty is payable thereon.

Protection in the event of insolvency of the founder or beneficiary, as the property will not be in his/her/their name(s) and will therefore not be fit for attachment by creditors. (If the founder sold assets to the trust on loan account and he becomes insolvent, the loan account will have to be recalled, as it is an asset in his estate. If the trust does not have the money to repay it, creditors could attach assets of the trust).

A trust can be used to ensure that incapacitated beneficiaries (for example, minor children) do not inherit directly. It can protect an heir from a bad marriage, creditors or bad business decisions.

The principles of trust law have not changed, but it appears that our courts are looking at trusts more closely to make sure that the principles are not contravened. This was illustrated in Land and Agricultural Development Bank of SA v Parker and Others 2004 (4) All SA 261 (SCA), where the court criticised the founder of a trust for treating it as his alter ego.

The major tax changes affecting trusts over the last few years are:

Transfer duty

Where a trust acquires immovable property, transfer duty is calculated using the same sliding scale that is used when a natural person acquires property. (Prior to 1 March 2011, a trust paid transfer duty on a flat rate of 8% of the value of the property.)

Capital Gains Tax

With effect from 1 March 2012, a trust that disposes of an asset has to include 66,6% of the net gain (after deduction of the annual exclusion) in its income for purposes of income tax. (Prior to 1 March 2012, only 50% of the gain had to be included.) As a trust is taxed at a fixed rate of 40% on income, this means the effective rate has increased from 20% to 26,7%.

Last year's advice concerning trust structuring and arrangement is still quite relevant for the current situation. In order for a trust to be effective, it must be formed and administered in such a way that it is clear that the founder is not in sole control of the assets of the trust. Our courts have stressed that the underlying principle of a trust is the

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separation between control of the trust assets and enjoyment thereof.

It is therefore important for advisors to revisit their clients' trust arrangements on at least an annual basis.

It is also very important for the founder to understand that the trust assets are no longer individually owned and that they cannot be dealt with as they were before they were sold or donated to the trust. If this happens, there is a very real danger that the courts will look through the trust and regard the assets held by it as being personal assets. If this is the case, these assets could become subject to attachment by the founder's creditors in the event of insolvency or be taken into consideration in the calculation of maintenance in divorce proceedings. The assets could also be regarded as part of the founder's personal estate for estate duty purposes on death.

More often than not, a founder will give the trustees a 'letter of wishes' in which guidelines are set out for the trustees to apply during the administration process. It is very important that the founder understand that the letter is just that – it is a list of his wishes which is intended to assist the trustees when they make decisions and cannot detract from the trustees' discretion.

We have, over the last few years, seen an increased focus from SARS on wealthy individuals and the application of using trusts in financial planning is under pressure. If a trust is, however, set up properly, the founder and trustees adhere to the general principles of trust law and act in terms of the provisions of the trust deed, there is no basis for an attack on the trust.

Reasons to set up a trust (even if we had no estate duty)

By Clive Hill, Estate Planning Specialist, Glacier by Sanlam

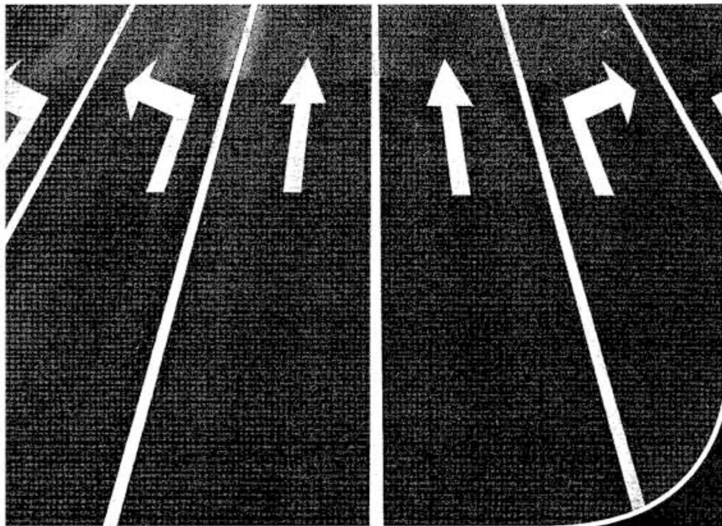
Trusts are commonly used to 'freeze' the value of assets, so that when the person who transferred them to the trust dies, they won't form part of his/her deceased estate.

Usually, an owner will sell his/her assets to a trust. The amount of the purchase price payable by the trust might continue to appear as a liability (debt) in the books of the trust and a corresponding asset in the seller's books, but any growth in the asset belongs to the trust. The effect is to reduce the dutiable estate of the seller over time, and hence the estate duty arising upon his/her death. If estate duty is reduced, the heirs will receive a larger inheritance.

There are several important reasons for the ongoing use of trusts as part of holistic financial planning:

1. Trusts offer protection against other types of tax

Even if estate duty were to be abolished, trusts still offer tax advantages, though usually not in the short term, owing to the deeming provisions of the Income Tax Act.



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Once the deeming provisions no longer apply, tax savings might be available. For example, income can be distributed to trust beneficiaries who might well be in lower tax brackets than the original owner of the assets. Capital gains can likewise be distributed to such beneficiaries.

Furthermore, if the trustees do not wish that the beneficiaries use the cash immediately (for various reasons), income and gains can be vested in such beneficiaries and physical payment made later, for example, at a time when they reach an age of understanding, or the monies are needed to fund education.

2. Trusts can reduce the costs of winding up a deceased estate

Executor's fees and other winding up costs can eat into the limited pool of available cash in an estate. Since trusts do not die, such costs simply do not arise.

3. Trusts offer protection against the uncertainties of life

Trusts not only offer protection against certain taxes levied at the time of death, but more importantly, against claims arising against a personal owner of assets during his/her lifetime.

At death, compensation in the form of life assurance proceeds is usually available, but during life, a large claim against one's estate, possibly leading to personal sequestration, results in no such assurance compensation.

It is bad enough to lose one's business, but to reward one's creditors with one's house, motor vehicles and investments shows a poor appreciation of risk management. It is also the sad result of an obstinate disregard of the benefits of available professional services. Many people are so busy working to create wealth that they fail to use such services and end up losing much of the fruit of their labours. Often a simple action can result in substantial benefits.

4. Trusts offer protection against the uncertainties of death

During one's lifetime one can try to educate family members about good financial practices and discipline. Premature death would frustrate such efforts. Even educated people can come under the sway of others, who may be well-meaning, but do not have an understanding of the bigger picture or the longer term horizon.

Trustees who are skilled in such matters can materially enhance the long-term financial well-being of current and future generations.

5. Trusts can buy time

Most business people and investors wish to make commercial decisions in their own time and not according to the timescale of the Master of the High Court. The Master is tasked under the Administration of Estates Act with overseeing the winding up process of deceased estates in his area of jurisdiction.

An executor's sole aim is to achieve the 100% pass mark required by the law in the submission of the prescribed accounts to the Master. The executor has to attend to a host of administrative requirements, all on a strict timetable, deviations from which require prior written permission, given only upon cogent reasons submitted.

During this winding up process, which can take 6-8 months (or longer), a business owned personally by the deceased, or a company of which he was the sole director, is at risk. In such circumstances, normal commercial decision-making is suspended, which can lead to customer shrinkage and a drop in the value of business assets.

Indeed, if the executor has good reason to think that by allowing such a business to continue running after the death of the owner, its value might shrink by a significant amount, he is obliged to liquidate the business sooner rather than later. His risk profile is different from that of a business person who is used to taking commercial risk. It is better for such a business to be owned by a company, which is in turn owned by a trust. Decisions are then made by the director(s). Should all directors die, or become unable to run the company, the shareholder, that is, the trust, represented by the trustees, has the responsibility to appoint alternative directors to ensure continuity of commercial decision making.

6. Trusts can mitigate or avoid the common shortfalls in cash in a deceased estate

Certain people are said to be "worth more dead than alive" (usually due to life assurance proceeds). It is equally true that many people "owe more dead than alive".

Most estates have more debts than cash (often due to taxes which arise only at point of death) and usually the executor has to sell assets to raise cash. The timing of a sale is not a luxury available to the executor and so, quite often, valuable assets realise far less on a forced sale than they would under normal circumstances. This means that even more assets have to be sold (again at lower prices) to make up the shortfall, leading to a vicious circle.

It makes more sense to reduce one's personal assets and liabilities to manageable proportions, while building up trust assets which the trustees can continue to manage after one's death, unconstrained by legislated timetables.

7. Trusts permit 'one owner, many users'

Certain assets intended to be used by different family members, especially those needing constant upkeep such as holiday houses or large boats, lend themselves to trust ownership. Management, registration, accounting, expense and financial records can be centralised, thus saving costs, while trust beneficiaries can enjoy the pleasures of ownership on an equitable basis.

Since a trust is a contract between the founder and the trustees for the benefit of beneficiaries, it is necessary to tailor make it to one's particular financial and domestic circumstances. Trustees need to understand their fiduciary responsibilities and have a comprehensive appreciation of the deeming provisions of the Income Tax Act. Professional consultation is, in this regard, not a luxury, but a necessity to ensure that one's affairs are properly structured to avoid any attacks by creditors or others. Surely this is a small price to pay for the satisfaction of knowing that one is leaving a legacy for which future generations will thank you.