TRUSTS: THE LULL BEFORE THE STORM?

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The hardest thing to understand in the world is the income tax. *Albert Einstein*

You are clearly in illustrious company if you are somewhat confused and uncertain as to the possible outcome of the renewal of the South African Revenue Service's (SARS) focus on the avoidance of tax through the use of trusts.

The 2013 Budget Review published by the National Treasury provides an indication of where this focus will lie. In summary:

- The income and capital gains (as well as losses) of a discretionary trust will be calculated and taxed at trust level. Trusts are taxed at a flat rate of 40%. Distributions to beneficiaries would be treated as deductible payments to the extent of current taxable income in the trust. Distributions to beneficiaries would be tax free except where they give rise to deductible payments.
- The income and capital gains of a trading trust will also be taxed at trust level. A trust will be viewed as a trading trust if the trust conducts a trade or the beneficial ownership interest in the trust is freely transferable.
- Distributions from offshore foundations will be treated as ordinary revenue.

The proposals will not apply to trusts established to attend to the legitimate needs of minor children and people with disabilities.

There has been an abundance of commentary in the press, professional journals and newsletters to clients analysing the potential impact of the proposals, specifically the additional tax that could (will?) be paid. Most pundits conclude with a cautious wait and see, all will be revealed when the draft legislation is published and more informed decisions can be made.

Francois van Gijsen in a recent article in Accountancy SA of April 2013 has perhaps identified the source of our confusion and uncertainty when he says:

> *Many people associate good financial planning and estate planning with obtaining a tax saving. What a great pity that the trust concept is being 'bastardised' to the extent that many people only consider its tax treatment when deciding whether a trust is a viable financial planning tool.*

If your motivation for establishing a trust was anchored predominantly in saving tax through whatever tax planning opportunities the tax law of the day presented, it is fairly safe to say you will be disappointed. Many if not all of these opportunities will be removed if not immediately then over time.

At an international level the taxation of trusts, in all their variations, is present on the agenda of most governments in countries having a legal tradition not dissimilar to our own. It is a sign of the times driven by a stagnant global economy, declining tax revenues at a national level coupled with the perception that the rich are conspiring to short change the local fiscus of its fair share of one's wealth. South Africa is merely playing catch-up.

It is against this backdrop that the question has arisen of the continued role of "my trust". Should I create a trust, or what other planning opportunities are available instead of the trust?

The minimisation of tax will always be a legitimate component of an estate plan. However, it does not follow that the role of the trust in such a plan should change or even be eliminated merely because the tax savings one enjoyed through its use are reduced or no longer available. The trust remains a relevant and useful tool in the estate planning process, adding value well beyond the tax savings that are currently available.

If you are considering creating a trust as part of a current estate planning process, the discussion with your advisor will no doubt include what I consider five of the main reasons, tax considerations aside, for creating a trust:

- The protection of assets from creditors and other claimants.

  Trust assets exist independently of the founder, who may have endowed the trust from his personal estate, and the beneficiaries.
- A trust, due regard being had to the continuation of trustees to administer and control the trust, can exist indefinitely.

  Orderly, intergenerational wealth management and transfer is a key component of any estate plan. A trust is an ideal mechanism to facilitate such a process.
- The protection of beneficiaries from themselves.

  The separation of the enjoyment of trust assets from their ownership, management and control enables a founder to protect beneficiaries such as minors, and those with special needs or limited capacity from their own indiscretions or limitations. Trustees with the appropriate knowledge and experience, and who will act at all times in the best interests of the beneficiaries, should be appointed to administer the trust assets.
- Privacy.

  Whereas the winding up of a deceased estate requires the liquidation and distribution accounts to lie open for public inspection at the office of the Master of the High Court, no such requirement is imposed upon a trust. The financial statements of the trust are private and not open to public scrutiny.
- Ease of administration.

  A trust is not only simple to form, its continued administration is generally not subject to the extensive regulation and oversight that is associated with the formation and administration of a company or similar entity.

Detractors of the trust mechanism may argue that our laws governing succession provide adequate and alternative methods for achieving similar outcomes. The granting of a *usufruct* over an asset to one person with the attendant bare *dominium* vesting in another comes to mind. The legal concept of the *fideicommissum* whereby a person referred to as the *fiduciary* acquires ownership of an asset with all its attendant benefits (except the right of disposal), subject to the condition that upon the death of the *fiduciary* or after a fixed period the asset must be given to another person called the *fideicommissary* is another example of a well-established estate planning tool. The savings in estate duty that are possible as a consequence of the valuation rules pertaining to *usufructs*, bare *dominium* and *fideicommissum* are well documented.

It is not disputed that these estate planning tools have their place in a well-designed estate plan. My reservations are harboured not only in their relative complexity, but also the absence of oversight that comes with having appropriately qualified trustees administer and control trust assets in the interest of those that should benefit from such assets, alive or yet to be born.

The announcement of the members of the Tax Review Committee, to be chaired by Judge Dennis Davis, along with its terms of reference has also added to the uncertainty. The committee's mandate encompasses all taxes and to that end wealthy individuals and the tax they pay will come under scrutiny. National Treasury has already been engaged by a number of professional bodies as part of a process to understand and inform the debate around the nature and extent of the changes to be made.

The creation and preservation of wealth in the modern economy is no longer confined to the privileged few, nor is the desire to protect a more modest asset base for the benefit of future generations. The trust is a mechanism that has evolved and adapted successfully to the modern world. It has been used to protect the interests of rich and those less fortunate alike. I am of the opinion that after the consultation process is complete, those entrusted with formulating the impending changes to the taxation of trusts will be mindful of the greater role played by trusts than merely a vehicle to reduce tax. I am certain that legislation, no more or less equitable than that in other jurisdictions where trusts are prevalent, will be implemented. It should not follow therefore, that the trust as an estate planning vehicle is rendered obsolete.

If you are in the process of formulating an estate plan incorporating the use of a trust, continue. If you have already created a trust for the reasons discussed earlier, I see no reason to abandon it.

At worst we can all wait for the recommendations of "The Davis Commission" ….

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Membership is drawn from trust companies and banks, as well as the legal, accounting and financial planning professions.

Activities of FISA members include but are not restricted to the drafting of wills, administration of trusts and estates, beneficiary funds, tax and financial advice and the management of client funds.

FISA has over 700 individual members, who collectively manage in excess of R260 billion. They draft several thousand wills each year and administer around 50 percent of deceased estates reported to the Master's Office.

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