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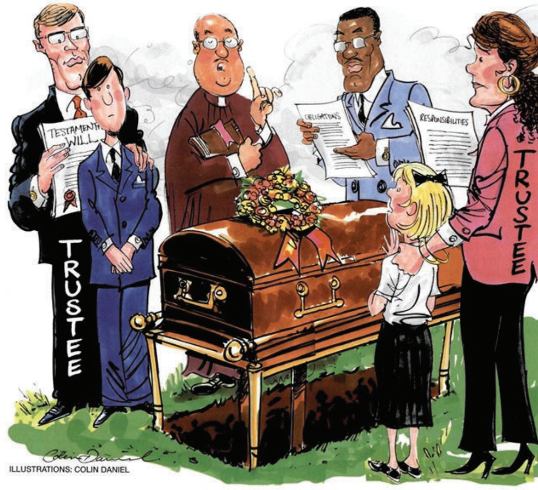
Taken on trust

If your will makes provision for minor children or builds in protection for certain beneficiaries, it's very likely to include a testamentary trust. That means appointing trustees to carry out your wishes, a task that should not be undertaken lightly. **Roz Wrottesley** reports



ILLUSTRATIONS: COLIN DANIEL

A TESTAMENTARY TRUST (ALSO KNOWN AS a will trust) comes into being after the death of the testator, because the trust clauses are contained in the will. The main purpose of such a trust is to protect the assets in the estate for (and sometimes from) the beneficiaries. As with all trusts, a testamentary trust is a means of transferring assets into a separate protective "vehicle" (a trust is not a separate legal entity, except for tax purposes) that is administered by trustees for the benefit of one or more beneficiaries.

You might have minor children who require financial support until they are old enough to inherit assets in their own right; or adult beneficiaries who lack the mental capacity to look after their affairs, or whose lifestyles make you doubt their competence to manage assets left to them. In an era of multiple marriages and partners, you might want to give your present partner access to your assets in his or her lifetime but ensure that, ultimately, they are preserved for your children from a previous relationship.

The will itself acts as the trust deed, so it is likely to be a longer, more complex document than an ordinary will, spelling out your wishes and naming the people appointed to act on your behalf in the interests of your beneficiaries. They are the trustees – distinct from the executor(s) of your estate and with a much longer and potentially more complicated commitment. Appointing trustees is often done lightly, like bestowing an honour on a relative or friend, with no real appreciation of how onerous the responsibilities can be.

According to the Trust Property Control Act 57 of 1988, "a trustee shall, in the performance of his duties and the exercise of his powers, act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another". And there is no way of reducing that responsibility. As the Act puts it sternly: "Any provision contained in a trust instrument shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust where he fails to show the degree of care, diligence and skill as required [above]."

So you might appoint as trustees your brother, who lives in another city, is an accountant and has a good relationship with your children; your partner of the past 10 years who knows you best; and – if you follow best practice – someone who knows the law – possibly, but not necessarily, the legal adviser who helped you to draw up your will. Three trustees who bring three different perspectives to the table is the generally recommended number, Laurianne Hollings, a wills and estates specialist with Hollings Attorneys, says.

Many people do not appoint as many as three trustees and do not include anyone with an understanding of the role, because they never fully appreciate how unpredictable and complicated life can be, Hollings says.

The trustees should generally be granted very wide powers, to ensure that they have the freedom to act in the interests of the beneficiaries in all circumstances. But the task of balancing conflicting interests and taking tough decisions can be too much for a single trustee, or trustees without a thorough grasp of the trust's purpose and their precise duties.

On the other hand, Johann Jacobs, the national practice head of the trusts and estates department at law firm DLA Cliffe Decker Hofmeyr, says he recommends as few trustees as possible, for practical reasons, and puts the emphasis on choosing wisely. Dealing with regulatory requirements and government departments can become very cumbersome when there are a number of trustees and they are not located in the same place, he says.

"Government departments are less and less likely to accept that one trustee has been authorised by other trustees to, for example, sign documents on their behalf. That can cause complications and delays. You have to balance that with the fact that you may not want to put all the power in one person's hands. So you could appoint a layperson – who would be someone who knows the family well – and a professional person who understands the responsibilities of trustees," Jacobs says.

Whatever the intention of the deceased, the trustees' powers are only as far-reaching as they are allowed to be by the wording of the will – and the wording cannot be changed without a costly court application.

Whereas an inter vivos trust (a trust that comes into existence during the life of the founder – see "Definitions" on **page 62**) can be amended or terminated, a testamentary trust is cast in stone at the moment of the founder's death, when it comes into being, and everyone has to live with the consequences. It terminates when the founder intended it to and no sooner – which might be once all the assets have been distributed, or upon the death of a spouse, partner or other beneficiary.

Purposes of a testamentary trust

■ For protection

A testamentary trust is a valuable tool when you need to look after people who are not ready or able to look after themselves.

❑ **Minor children (under the age of 18).** Any money inherited by a minor must be paid into the Guardian's Fund, under the jurisdiction of the Master of the High Court, until the beneficiary >>

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>> turns 18 (or a later age specified in the will). The money is invested by the Public Investment Commission, and interest is paid on it, but claiming money for the beneficiary's expenses can be cumbersome.

You can leave property to a minor, but cash would be required to maintain the property. A minor can also not sell a property should it become necessary to do so.

By setting up a trust, you can avoid having money for a minor paid into the Guardian's Fund and instead assign the responsibility for property and for managing your money and any other assets according to your wishes to the trustee(s). The trustees are guided by the terms of the will; for example, it might specify that the child's guardian be paid an income for the benefit of the child every year, increasing at the rate of inflation, and that the trust pays all education and medical expenses, plus any unforeseen expenses within reason, until the beneficiary is aged 25, when he or she should receive the remaining income and all the capital.

Chris Murphy, a director at Legacy Fiduciary Services & Estate Planning and the chairperson of the Fiduciary Institute of Southern Africa (Fisa) in the Western Cape, believes the roles of guardian and trustee should be separated, with the guardian looking after the day-to-day care of a minor child and the trustee(s) taking care of the finances.

"If you are responsible for a child's everyday well-being, you probably don't have time to make sure the capital in the trust provides for the child properly and remains 100-percent secure. The task of a trustee is to keep everything in abeyance until the child reaches the right age, ensuring that the wishes of the testator and the terms of the trust are adhered to formally, financially and correctly," Murphy says.

The age at which a minor beneficiary should receive the capital and any accumulated income could be 18, 21, or anything else, but the current trend is to choose 25.

He says: "The theory is that you leave school at 18, then you go into some form of further tertiary education or training. You get your degree or diploma – hopefully, after only a couple of failures – at 23. You've then got two years to do articles or an internship, and by age 25 you've done what you are going to do, learned what you need to learn, and receiving the capital at the more mature age will help you set up in business or buy a home. And away you go.

"Although," he laughs, "we have seen a case where the client wanted her daughter to receive the capital from the trust at age 85. She said that, by that age, her daughter's 'bloody husband' would be dead, and she would be happy for her to have the money only once he was gone."

If your assets do not include a home and are confined mainly to cash from a retirement fund, there is an alternative to a setting up a trust – you can ask the trustees of your retirement fund to consider putting the money in a beneficiary fund that is regulated under the Pension Funds Act. The trustees of these umbrella funds manage the benefits of many fund members, but your money will be in an sub-account for the benefit of your beneficiaries and the trustees can pay a guardian for costs, such as the education of a child. When the child turns 18, the money can be paid out to the child.

❑ **An adult beneficiary who is incapacitated in some way.** If the beneficiary of a will is not able to manage his or her own affairs and there is no provision in the will for a trust or guardian, the Guardian's Fund will administer the inheritance.

❑ **An adult beneficiary whose lifestyle is risky.** If the beneficiary is unable to manage his or her affairs because of a profligate lifestyle (for example, addiction to drugs or gambling, or a record of criminal associations or reckless spending), a trust will protect inherited assets and give the trustees the right and duty to provide the benefits at their own discretion in the best interests of the beneficiary.

However, Jacobs warns against testators trying to control lifestyles of which they don't approve.

"What seems to be reckless spending, for example, might just be a different spending style. It's a question of degree. But even if the person really is a prodigal, at what stage do you stop protecting an adult?"

Hollings points out that attempts by testators to "rule from the grave" can expose trustees to a lot of pressure from beneficiaries, particularly if they are not professional people and are known to the beneficiary.

"Family members or friends may be vulnerable to being manipulated or bullied into releasing funds. A trustee who is a professional accountant or lawyer, and who is experienced and detached, can be very useful as someone the family can hide behind when a beneficiary is difficult," she says.

■ For preservation

A trust creates a separate entity with control over the assets, so it is invaluable as a means of preventing the assets from becoming the target of creditors or falling into the wrong hands – for example, if the surviving partner is exploited, dies intestate, or becomes incapable of managing his or her own affairs.

"It is also very useful in reconstituted families," Jacobs says. "For example, take a male testator who had a late second marriage, is much wealthier than his spouse and is confronted by the competing interests of his children and her children. He wants to take care of his wife and her children, but once she dies, he would like the remaining assets to go to his children. In that situation a trust can really work: the trustees will see that his wife's interests are looked after until the final stage of the trust plays out and the assets are transferred to the testator's children."

Another reason for placing property in a testamentary trust is to keep it in the family, Murphy says.

"If you have a holiday house and you leave it to the kids, there is always the fear that one of them will persuade the others to sell. In a trust, it can be preserved for generations to come.

"The only problem is that you have to leave sufficient liquidity to look after it (rates and taxes, insurance and maintenance), at least for the first few years. Otherwise, that's the simplest way for a beneficiary to attempt to pierce the armour of the trust: they can say, 'we can't pay the maintenance costs, the rates, the insurance ... there's no money in the trust, so it has to be sold before we are forced into a sale in execution by the municipality'."

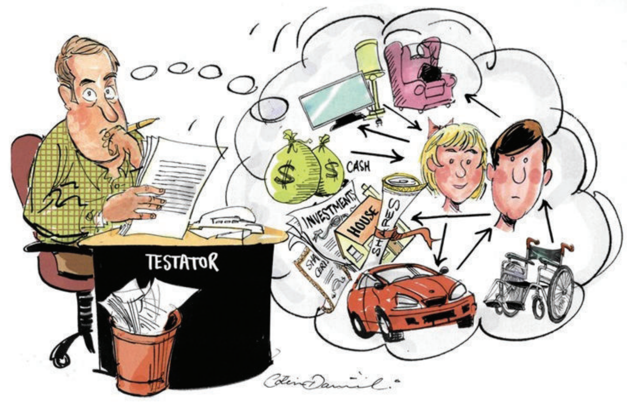
Murphy says testators usually have good reason to want to control the distribution of assets, and it is the job of fiduciary practitioners and planners to listen to their concerns and find solutions via wills and trusts.

"The overriding reason for setting up a testamentary trust is protection of some kind, before tax benefits, and if it is done on that basis, with the right clauses, you may have a will of many pages setting out everything you want to happen.

"For example, you can say: 'I want my son to go to UCT, but if, by the age of 30, he doesn't have a degree, then such-and-such should happen'. You can't say 'my daughter can inherit only if she marries royalty and speaks Lithuanian by the age of 25' – that would be ultra vires, or beyond the legal power of the testator – but you can be quite prescriptive. You certainly don't want to rule from the grave, but I know that if I had inherited a lot of money at age 18, I'd have been off on the next plane and had nothing left by 22," Murphy says.

The risk of being prescriptive, however, is that life is unpredictable, whereas testamentary trusts are fixed at the time of death. So you can express your wishes, but it is essential to give the trustees wide-ranging powers to deal with the unexpected.

"You can put in clauses that provide flexibility," Murphy says, "but changing the terms means a costly application to court, which may not succeed. If something is looming that will have a major effect on the trust, such as a change in law or >>



DEFINITIONS

Testamentary trust: A trust set up in terms of a will. The will serves as the trust deed and names the trustees in a unilateral act.

Inter vivos trust: A trust set up during the lifetime of the founder as a contract of sorts with the trustees. The founder hands over assets to the trustees and they accept them, making this a bilateral act.

Special trust: A trust with a special purpose, which qualifies it for a lower rate of taxation. There are two kinds:

❑ Type A, which is set up in the lifetime of the donor for the benefit of a person, child or adult, who cannot look after his or her own financial affairs; or

❑ Type B, which is a testamentary trust that benefits relatives of the deceased exclusively, including minor children.

Both kinds of special trust are taxed at the rate applicable to individuals (between 18 and 40 percent), instead of the rate applicable to trusts (40 percent).