>> tax policy, or a change in the circumstances of a beneficiary, you're stuck. With an inter vivos trust, you can adapt it to changing circumstances, change the trustees or even dissolve the trust. So you have to imagine what might happen. I have to ask some really tricky questions to prompt clients to think 'what would happen if ...?'"

The tax implications

A TESTAMENTARY TRUST OR AN INTER vivos trust set up for minors or for adults who are incapable of managing their own affairs is regarded as a special trust and is taxed at less punitive tax rates than those that apply to an ordinary inter vivos trust.

A trust is regarded as a special trust if the youngest beneficiary of the trust (person who receives benefits) is still under the age of 21 on the last day of the tax year; or the beneficiary suffers from a serious physical disability or mental illness, as defined in the Mental Health Act, that prevents him or her from earning sufficient income for his or her maintenance or from managing his or her own financial affairs.

If you set up a testamentary trust for minor children, and you want the assets in the trust to be passed on to them only after the age of 21 (for example, at the age of 25), the trust can continue after the youngest child turns 21, but from then until the trust is terminated it will be taxed as a normal trust.

Tax on income earned by a special trust is levied at the same rate that would apply to an individual – that is, the marginal tax rate that is applicable to income at that level. Similarly, a special trust, like an individual, pays capital gains tax (CGT) at a maximum effective rate of 13.3 percent of the gain (where the trust's marginal tax rate is 40 percent). A special trust enjoys the annual CGT exemption (currently R30 000 a year) and the R2-million exemption for gains made on a primary residence. These concessions are also allowed for two years after the beneficiary of a special trust dies, while the assets are disposed of.

A special trust does not pay transfer duty on the first R600 000 of the value of a property. On the value between R600 000 and R1 million, transfer duty is levied at three percent and between R1 million and R1.5 million at five percent. Only that part of the value of a property that exceeds R1.5 million attracts transfer duty at eight percent.

A normal trust pays income tax at a flat rate of 40 percent and CGT at an effective rate of 26.66 percent of the gain. It does not enjoy the annual CGT exemption an individual enjoys, or the R2-million CGT exemption on a primary residence. It pays transfer duty at a flat rate of eight percent on any property that is transferred to the trust, regardless of the property's value.

If you need to leave assets to minor beneficiaries or beneficiaries who have physical or mental disabilities, you don't need to worry about trust tax rates, because the rates are essentially the same as they are for an individual.

If you need to set up a trust for reasons other than providing for beneficiaries who cannot manage their own finances, you will probably find an inter vivos trust better suited to your needs. You must then consider the reasons you need a trust – for example, to keep the growth of your estate in a trust and reduce your estate duty liability or to protect your assets from exposure to your business risks. Then you need to assess the benefits of the trust to you relative to the tax disadvantages.

Remember that an estate needs to be quite large before you need to set up a trust to minimise estate duty.

After permitted deductions (the deceased's liabilities, bequests to public benefit organisations, property accruing to a surviving spouse and estate administration costs) individuals enjoy an abatement of R3.5 million before estate duty tax is charged at 20 percent. The abatement was only R1.5 million as recently as 2005.

In 2010, the concept of the "portable" estate duty rebate for couples was introduced, which means that any portion of the R3.5-million abatement not used by the spouse or partner who dies first may be transferred to the surviving spouse or partner, so that, together, they can leave R7 million in assets without paying estate duty. In this era of long lives, large estates are less and less common.

Chris Murphy: Changing the terms of a will requires a costly application to court

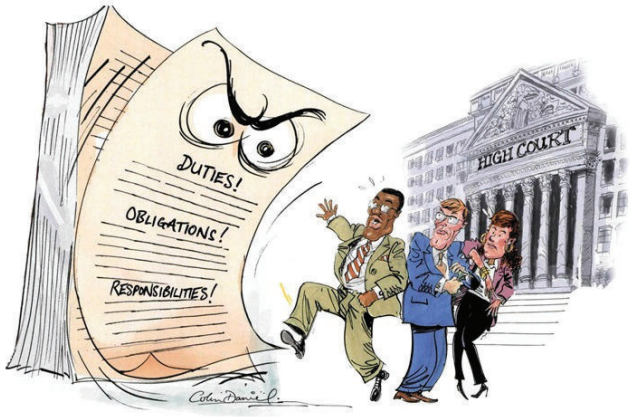
Laurianne Hollings: One benefit that falls away can make a trust unviable

Johann Jacobs: A trustee may not abdicate his power to another person

Appointment of trustees

TRUSTEES ARE NAMED IN THE WILL AND have usually agreed in principle to be trustees well before the will is executed and the trust comes into being. When that time comes, the appointment is not automatic. The executor of the estate approaches the nominated trustees, and at that point they can accept or reject the role. The very first thing to do, Murphy says, is to read the trust deed, or will.

Jacobs agrees that accepting the role of trustee must be an informed decision, based on the contents of the will and a thorough understanding of what the role entails.



"You must have a clear idea of the depth and breadth of your responsibilities, how much time you'll have to give to the task and whether you have the aptitude. If you are a layperson, you might want to make sure there is a professional person among your co-trustees," he says.

The will might or might not stipulate how the trustees should be remunerated for their pains, but if there is no such stipulation, "reasonable" fees can be set by the Master of the High Court.

Jacobs says that, typically, fees are charged as a percentage of the annual income generated by the trust, or a smaller percentage of the value of the capital in the trust, or both.

"If the capital consists of, say, a share portfolio worth R1 million, the fee might be 0.25 percent. It depends whether or not it is labour intensive to look after the capital."

Fees charged in this way, particularly if the capital sum is large, may be disproportionate to the work involved in running the trust.

Angelique Visser, the chairperson of Fisa, says you can negotiate professional trustee fees with the trust company or law firm that you want to use. These could be updated annually in your will, but the work involved and the fee required need to be assessed with each update.

Fees are another important consideration when it comes to the number of trustees you appoint, Jacobs says. "Too many fees might dilute the value of the trust. On the other hand, if remuneration is set by the will and must be divided among the trustees, it will dilute their fees. They might divide up the work, so one [trustee] is responsible for liaising with the family, another draws up the annual accounts, and another looks after the investments, but in the end they are all entitled to a fee. And, of course, a professional trustee – your accountant or lawyer – will not do the job for nothing."

He points out another danger: "You save money by appointing a relative, make no provision for remuneration, and the relative feels bad asking for any. Then the general principle that you get what you pay for in life applies, and he or she starts to neglect the trust. Although, technically at least, trustees can't renege on their responsibilities because they're not being paid, or not being paid adequately. So, once they have accepted the role, you have them over a barrel."

Powers of trustees

THE SCOPE OF TRUSTEES' POWERS IS SET BY THE trust deed – in the case of testamentary trusts, the will. *The Estate Planning and Fiduciary Services Guide 2013*, published by LexisNexis (authors: R King, B Victor, L van Vuren and L Rossini) sums up the general principles as follows.

"The powers that are given to the trustees are usually wide and differ from one trust deed to another. It is important to provide for wide discretionary powers, since the inference may validly be made that the founder intended not to include a power that was not included.

"A trustee may delegate his powers, provided that he does not thereby free himself from liability for the conduct of the person appointed by him or the general body of trustees, and that he could at any time freely revoke the appointment. The trustee chosen by virtue of some special quality may >>

>> not delegate powers, authority and duties to anyone else.

"A trustee may not abdicate his power to another person and remains in office until he has been removed by the Master, and such other person does not obtain any powers before he has been authorised as such by the Master."

If the responsibility sounds onerous, it very often is, Jacobs says. "You can't say: 'I left that task to so-and-so and I trusted him ...', or opt out when you think you've had enough. You must realise that it's a very responsible position that can last a long time. Sometimes things go wrong, but the responsibility remains with you.

"For example, you come to me to set up a trust for your son, who is a tik addict. That's a classic example of why you'd create a testamentary trust: he's irresponsible, at risk. But now the trustees have to face this guy and his irrational behaviour and threats. If it gets too much, you can't say to somebody: 'I've got a nice job; do you want to take it over from me?'"

Even under more benign circumstances, protecting the interests of a number of beneficiaries of different ages and personalities can call for the wisdom of Solomon, Murphy says.

He cites the example of a young beneficiary who wants the trust to buy him an expensive Italian sports car. He believes that would be to his benefit, but there is no doubt that it would be disadvantageous to the other beneficiaries by reducing the capital in the trust, and thus the income earned.

"So the trustees can say: 'We can't buy you an expensive sports car, but we can buy you a compact runabout, because one of the conditions of the trust is that you be supplied with a vehicle.' It doesn't say what kind of vehicle, and it doesn't say it has to be an expensive vehicle. Sonny may be very upset about it, but that's just the way it is. You get to understand why people set up trusts the way they do."

Duties and obligations of trustees

TRUSTEES NEED TO LOOK TO TWO SOURCES FOR the full scope of their duties and obligations: statute (the Trust Property Control Act) and common law.

Their statutory duties are:

- To act with care, diligence and skill.
- To perform all the duties imposed by the trust instrument (deed).
- To bank monies in a dedicated trust account and ensure that any account or investment is identifiable as belonging to the trust.
- To lodge the trust instrument with the Master of the High Court.
- To furnish their addresses to the Master and keep them up to date.
- To obtain written authorisation from the Master and lodge security if required in the form of a signed document undertaking to compensate the trust for any loss due to negligence or maladministration. In most cases, the trust deed exempts trustees from the obligation to furnish security (J344 "Undertaking and bond of security" form), but the Master may override that, if it is considered necessary.
- To register trust property, and to ensure that it is always identifiable as trust property.
- To protect the trust's documents and make sure nothing is destroyed within five years of the termination of the trust.
- To take only reasonable remuneration. The trust deed usually leaves the level of remuneration to the trustees' discretion, but in the event of a dispute, the Master may decide what remuneration is appropriate.
- To account to the Master when requested to do so. If the accounting is unsatisfactory, the Master may authorise an independent investigation into the administration of the trust.

The common law duties of trustees are:

- To act jointly and find unanimity in making decisions.
- To act independently and in good faith.
- To be impartial and treat all beneficiaries equally (unless the trust deed gives discretion to treat them differently). Impartiality also extends to any conflict of interest, if, for example, the trustee is also a beneficiary of the trust, or would benefit in any way from decisions by the trustees.
- To exercise active management, including investing the trust's assets productively, because passive management could be construed as negligence.
- To avoid risk and preserve the trust property as far as possible. While keeping assets intact is the first principle, trustees may sell assets if this is necessary to provide necessary income.
- To account to beneficiaries and co-trustees.
- To act within given powers and not to exceed them.
- To make proper distributions to beneficiaries and to distinguish between income and capital.
- To appoint the stipulated number of trustees.
- To ensure that proper controls are in place.
- To obtain expert advice when necessary.
- To comply with all laws.

Rights of beneficiaries

BENEFICIARIES MAY BE INCOME BENEFICIARIES and/or capital beneficiaries, and they may have vested rights or discretionary rights, depending on how the trust is set up. Vested rights are immediate and clearly defined, with no need for the trustees to exercise their discretion. For example, the trust might stipulate that a teenage child should receive a set monthly allowance until he or she is 25, and then the balance of the income and all the capital in the trust in stages by the age of 30.

A trust that transfers the ownership of property to the beneficiaries, with only the control of the assets residing with the trustees until a given time or event, is known as a "bewind trust".

Discretionary rights are in the discretion of the trustees, and a beneficiary has no definite or defined entitlement. Where this is the case, the trustees are the actual owners of the assets, but only in so far as they are required to look after the assets and distribute them at their discretion; they have no right of enjoyment of the assets. In this kind of trust, known as an "ownership trust", it is left to the trustees to decide what the beneficiaries should receive and when, acting in accordance with the instructions in the trust deed, or will.

Discretionary powers usually apply to income, with the capital in the trust vesting in one or more beneficiaries, although discretion can also apply to the capital.

Beneficiaries have the right to expect the administration of the trust to be transparent, efficient and well documented, but they have no right to know the reasoning behind every decision, or "the inner workings", as Jacobs puts it.

"Aggrieved beneficiaries have some recourse to the Master of the High Court, but it is very limited. The court cannot interfere with the trustees' discretion or second-guess their decisions. It can bring an action against the trustees only if they are clearly failing in their duties. Trustees may make mistakes – such as investment decisions that, in hindsight, turn out to be poor – as long as they can demonstrate that they applied their minds and acted in what they believed was the best interests of the beneficiaries," he says.

Given how difficult and thankless the job of a trustee can be, few people would take it on knowingly if they were at risk of being constantly second-guessed in their decision-making by beneficiaries or the court.

Forward planning

THE ONLY COST OF SETTING UP A TESTAMENTARY trust is the cost of drawing up the will, which may be done years before the will is acted upon and the trust comes into existence. Because of the time lag, there is a danger of inflation, the stock market or other factors eroding the value of the assets in the trust to the extent that the trust is no longer commercially viable when it is needed. "That is a perennial problem with will trusts," Jacobs says.

"It is essential to make sure a trust will be viable, not just when it comes into being, but for the expected lifetime of the trust. Of course, it can be reviewed and amended until the death of the testator, but not after that. Also, if you created the trust 20 years ago for your minor children and they're not minor any longer, the trust will, effectively, never come into existence," he says.

"Review, review, review ... your will and your trust," Hollings urges.

"Between the signing of a will and the time when it is needed, laws can change, and one benefit that falls away can make a trust unviable. Then you can revise your will and cancel the trust if necessary.

"For example, the introduction of CGT in 2001 – which affects estates, with certain deferments and abatements – changed everything. Yet there are certainly still people who have wills that were drawn up before 2001 and take no account of one of the two major taxes on estates," Hollings says. ❑