

## SHORTREPORT

>> maintenance, when payable in terms of a divorce order, are exempt from income tax in terms of section 10(1)(u) of the Income Tax Act.

The tax implications of amounts distributed to children in terms of a maintenance order are less clear. As the transfer of a cash lump sum to a trust with the intention of discharging a maintenance obligation is not seen as a donation in terms of the Income Tax Act, it is uncertain whether section 7(3) – which attempts to prevent tax evasion by regulating when a sum of money donated to a minor child must be taxed in the hands of the parent or donor – applies where a minor child is concerned. It appears that maintenance payments received by both minor and major children are taxable in the hands of the child, as maintenance orders for child support are specifically included in gross income without any exemption applying. A trust is also not able to claim the maintenance payments as a tax deduction.

Another consideration when you contemplate an inter vivos trust is the annual administration costs during the lifetime of the person ordered to pay the maintenance. These include, among others, the costs of registering the trust with the Master of the High Court and the South African Revenue Service, and, annually, the costs of keeping proper account of the trust's books, preparing and filing income tax returns for the trust, having trustees' meetings with prepared agendas and minutes, and remunerating the trustees.

Furthermore, when you transfer funds to an inter vivos trust to pay maintenance, you lose control of the funds and the opportunity to invest the funds for your own benefit during your lifetime. On the other hand, there is no estate duty or executor's fee to pay on this amount when you die, as the amount distributed to the trust falls outside the dutiable estate. This might also expedite finalisation of the estate, as there would be no testamentary trust to set up. However, should the obligation to pay maintenance end before you die – because your ex-spouse remarries, for example – you would have incurred the additional costs of setting up an inter vivos trust (as opposed to a testamentary trust) for no benefit.

### Testamentary trust

If you opt for a testamentary trust, the cash lump sum is bequeathed to the trust in your will with your ex-spouse or child as the beneficiary. As the lump sum is transferred to the testamentary trust after

your death and in terms of your will, it forms part of your deceased estate and is, therefore, subject to executor's fees and estate duty at a rate of 20 percent (if your estate is subject to estate duty). Before your death, the maintenance payments would be made in your personal capacity and would be exempt from tax in the hands of an ex-spouse receiving them in terms of a divorce order, but would probably be taxable in the hands of a child receiving them.

After your death, the payments would be continued by the testamentary trust. The tax consequences of distributions made to the child or ex-spouse, as beneficiaries, are the same as they would be with an inter vivos trust. (It should be

noted that there is some doubt as to whether or not maintenance payments received from a former spouse's deceased estate – or any vehicle used to make such payments, such as a trust – do qualify for the exemption in terms of section 10(1)(u). However, my interpretation of the law is that the exemption does apply in these circumstances.)

As mentioned before, a further consequence of using a testamentary trust is that it takes time to set up, so it might delay finalisation of the estate, whereas an inter vivos trust would already exist. Although the cash lump sum

forms part of the deceased estate and might increase the estate duty and executor's fees payable at death, the testator does have the advantage of controlling the money during his or her lifetime, since the cash lump sum is not allocated until the trust is created in terms of the will.

### Conclusion

IT IS EASY TO FORGET THAT AN OBLIGATION TO provide maintenance for an ex-spouse or a child does not end with death. A claim against your estate could cause serious delays and, possibly, a reduction in the assets available to the beneficiaries of your will. Obtaining expert advice when you draft your will is critical to achieving the effect you want and ensuring your executor has the tools to carry out your wishes efficiently. This article focuses on trusts as effective and well-used planning tools, but whether you choose one of them as your solution depends, of course, on your specific circumstances and preferences.

■ *Carien Strauss is a fiduciary and tax specialist at Sanlam Private Wealth and a member of the Fiduciary Institute of Southern Africa.*

