

Trusts set to lose their allure as a tax haven

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TRUSTS may still offer certain benefits, but if the Davis tax committee has its way, registrations of new trust structures are likely to slow to a trickle.

Loopholes that have allowed individuals to create complex structures to reduce their tax burden — particularly in transferring wealth from one generation to the next — are being closed, with a revamp of the taxation of trusts on the way.

New legislation will almost certainly make trusts unattractive places to stash assets, from a tax perspective.

By way of definition, Ronel Williams, chairwoman of the Fiduciary Institute of Southern Africa, said a discretionary trust allowed a person to “freeze” their estate during their lifetime by selling growth assets to the trust. All future growth then takes place in the trust and the loan account is a substitute for the assets in the founder’s estate.

Williams said the most common reasons for setting up a trust were to take care of beneficiaries such as minors who could not manage their own affairs adequately, protection from creditors or divorce, continuity after the death of the founder, business succession and confidentiality.

The South African Revenue Service is “deeply concerned” with the compliance record of trusts, including the historically low levels of registration for tax, submission of income tax returns and accuracy of those returns that have been submitted.

In future, SARS says, enforced registration of existing and new trust structures with the Master’s Office and greater information sharing will allow it to police compliance with the submission of tax returns. Penalties for the non-submission of annual income returns for trusts are also being considered.

SARS cites “inequality” as a reason for acting, with the rich — who tend to dominate trust structure formation — being able to exploit tax-advantageous structures to avoid tax such as estate duty and to shift income and capital gains tax rates to beneficiaries with lower applicable rates.

David Hurford, director of marketing and consulting at Fairheads Benefit Services, said looming legislative changes based on the recommendations of the Davis committee would mean that the highest income tax and capital gains tax rates applied, with no rebates, while outlawing the use of interest-free loan accounts and preventing the “conduit principle” whereby income is shifted to beneficiaries with lower tax rates.

“The question of what the legislation will look like hasn’t been answered definitively yet, but the gaps will be closed. Setting up a family trust may involve no significant cost, but now the question is long-term

usefulness.” He believes beneficiary funds offer a tax advantage. “There’s no better structure for death benefits.”

Grant Thornton director and tax leader Eugene du Plessis said the final legislation would guide would-be trust users to alternatives, but that many trusts would become ineffective if all the proposals are enacted.

“It’s relatively simple to restructure an existing trust, like creating a company under the trust and deferring some of the consequences. There are provisions allowing you to do that tax-free. But the ability to manoeuvre will depend on trust complexity, level of assets, whether you’re realising profits when you change,” he said.

Sanlam Trust’s head of trust operations, Tanya Lochner, said the affluent market would always have a use for trusts because they provided liquidity and protection from creditors at death that was difficult to replicate with other structures. But, she added, many wealthy South Africans had set up trust structures on bad advice and would end up paying the price.

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“I think the industry will push back against some legislation because trusts with the right intention can be useful. But part of the problem is that trust law in South Africa is still fairly young and not so clear-cut. There is still a lot of case law and setting of precedents. There has been abuse.”

She said typical abusive structures might entail setting up elaborate trust structures owing each other loans in an attempt to make an individual appear technically insolvent.

“A trust can be onerous in terms of administration and tax returns, and some people are sitting with trusts they should not have had. I foresee a substantial drop in the number of trusts being set up, but because there’s a good and valid reason for using one as a planning tool, some people will be willing to pay the tax premium for the protection offered.

“Trusts will not be useful for average-value clients who might have a single asset to place in it. It is too expensive for that level of assets.”

However, a lot of legislation would have to change for trusts to disappear, she said.

SARS’s attempt to manage trust abuse had arrived in the form of a complicated tax return and filing system for trusts, she said. “It’s not very user-friendly, although they’ve tried to streamline it and provide training. But a lot is slipping through the cracks and if trust abuse still proves to be difficult to monitor, we can expect further legislation.”