DEMYSTIFYING TRUSTS

IN SOUTH AFRICA

TRUSTS IN PRACTICE

A REFERENCE GUIDE

- ARE TRUSTS STILL RELEVANT?
- MYTHS ABOUT TRUSTS
- TRUSTS AS PART OF YOUR ESTATE PLAN
- STRUCTURING YOUR TRUST
- REQUIREMENTS FOR A VALID TRUST
- TRUSTEES' DUTIES
- BENEFICIARIES' RIGHTS
- TRUST ADMINISTRATION
- DIVORCE AND TRUSTS
- TAXATION

TRUST EEZE

We guide you

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DEMYSTIFYING TRUSTS

IN SOUTH AFRICA

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"If a man empties his purse into his head, no man can take it away from him. An investment in knowledge always pays the best interest" ~Benjamin Franklin

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SPILLING THE BEANS

What made me write this book?

Many years ago, I was approached by a client who was going through a divorce. He required guidance in terms of handling his various trusts.

Despite the fact that I was a qualified chartered accountant with many years' experience in financial affairs, my knowledge on trust matters, at the time, was limited.

Determined to help my client, I reached out to my network of attorneys, estate planners, accountants, and other professionals for guidance, only to discover that their knowledge was equally limited. It soon became clear to me that people who owned trusts were relying on the expertise of "professionals" who were as in the dark as I was.

I decided to make it my personal mission to empower myself with as much knowledge about trusts as possible. My client's complex divorce case became a training ground for me to become an expert on trusts in South Africa.

With years of wisdom and experience – and one exceptionally happy client who set me on this path in the first place - I decided to compile and publish a practical book, written in understandable language, to demystify the issues surrounding trusts.

I would love to hear from you. If you have any questions around trusts, please contact me by email at phia@trusteeze.co.za, by telephone on +27 (11) 888 9088, or visit the Trusteeze web site at www.trusteeze.co.za.

Phia Van der Spuy

The following chapters are a selection of key chapters from the full book, and are my gift to you.

The full book is available both in paperback and e-book (Kindle) format.

CHAPTER 7

WHY SHOULD YOU CONSIDER A TRUST?

Trusts are relevant today *if* they are used correctly. They are the only vehicles with the following advantages:

7.1 Protect your assets while you are alive

- **Separate your personal assets from your business or property holding**

The number one wealth preservation rule is to protect your assets.

If you have your own business, sizeable investments and/or other assets, then you might want to pay attention. One of the most important reasons why you should consider a trust is because it will help you to separate your assets from your property investment debt, your business interests and/or your other financial risks.

Assets owned by a trust do not form part of the insolvent's estate, and therefore cannot be attached by his/her creditors. Section 12 of the Trust Property Control Act states that "Trust property shall not form part of the personal estate of the trustee *except* in so far as he/she as trust beneficiary is *entitled* to trust property". This would be the case with a discretionary trust where beneficiaries became entitled to trust property when the trustees *vest* trust property in such beneficiaries. Take note that the definition of vesting specifically refers to the right of *absolute ownership*, which means that it cannot have any conditions attached to it. This is often undone by trust instruments which state that the trustees can make a distribution to beneficiaries, *but* may pay it when they so decide. Refer to Chapter 22 (Taxation of trusts) for the possible adverse tax consequences in this case.

This should however not be seen as a form of blanket protection because there are a number of sections in the Insolvency Act that will allow the trustee of the insolvent estate to claw these assets back into the insolvent estate. Where the assets were transferred to the trust while the estate planner was solvent, it would however be difficult for creditors to set aside the trust's actions.

- **Why is this separation so important?**

Some of the risks that business owners experience include potential claims for financial damages from creditors, employees, tenants, customers, and even competitors. Even though you might not be directly responsible for the incident that led to the claim against your business or property investment, your personal assets could be used to settle the claim against your property investment or business.

This principle not only applies to business owners, but also to anyone with a relatively large asset base, who is also exposed to any financial risk, such as claims, debt, sureties, and so on.

With today's high rates of divorce and relationship breakups, a trust may also protect your assets from claims arising from matrimonial or relationship disputes. Refer to Chapter 21 (Trust and asset protection in divorce) for more information.

- **The *way* you transfer assets is also important**

The manner in which assets are transferred is relevant when it comes to the extent of their protection. For example, if you transfer an asset on loan account, the amount of such loan account will remain an asset in your estate until the trust fully repays the loan. The implication is that the loan will not be protected from creditors. The loan is considered to be an asset in your own hands, and it can be attached. Creditors can - if your loan is repayable on demand as per your loan agreement - demand repayment from the trust, and they can then liquidate assets in the trust to ensure that this loan is repaid to them if the trust has no available cash.

Be mindful of possible attacks from SARS in future, where interest-free loans are repayable on demand. The Davis Tax Committee proposed in its Second Interim Report that it recommends the inclusion of all trust assets in the estate of the founder, due to the funders *"control"* over the trust. This is a far-fetched proposal. Refer to Chapter 10 (Are trusts still relevant?) for more information.

Over a period of time, as the loan decreases – provided there are repayments - and the asset value increases in the trust, the benefit of asset protection will be established.

Take note that there are new tax consequences if you create an interest-free loan account, instead of charging the official interest rate (*repo rate plus 1%*) on such loans. Refer to Chapter 22 (Taxation of trusts) for more information.

Correct financial planning will involve assets being bought into the trust from the outset, rather than being purchased in your personal name and *then* transferred to the trust. This is why it is so important to set up a trust *before* large assets are accumulated.

- **Protection of your assets for future generations**

It is important to remember that upon your death, the assets that the trust owns will *not* be transferred into your beneficiaries' personal estates, as would be the case in terms of their inheritance upon your death. Such assets will therefore also be protected from your beneficiaries' creditors.

7.2 Enjoy the fruits of your work while you are alive

The advantages of proper tax planning in a well-structured trust are clearly defined in the tax legislation. Even minor beneficiaries can enjoy tax-friendly distributions. Refer to the concept of *income splitting* discussed below.

The following principles can be applied in structuring your financial affairs to enjoy maximum benefit:

- **Conduit Principle, but subject to anti-avoidance provisions**

Unlike companies or close corporations, the trustees can decide to pay the Income Tax (45% for the 2018 tax year) or Capital Gains Tax (36% for the 2018 tax year) in the hands of the trust or distribute the tax liability to the beneficiaries at their marginal rate of tax (Income Tax 18% to 45% or Capital Gains Tax 7.2% to 18% for the 2018 tax year), thereby paying much less tax.

Income and capital gains generated within the trust can be distributed to the beneficiaries where they will be paying tax based on their own personal income tax rates. Any income or capital gain *paid* to or *vesting in* a beneficiary will be taxed in the hands of that beneficiary. Take note that the definition of vesting specifically refers to the right of *absolute ownership*, which means it cannot have any conditions attached to it (which is often undone by trust instruments which state that the trustees can make a distribution to beneficiaries, *but* may pay it when they so decide. Refer to Chapter 22 (Taxation of trusts) for possible adverse tax consequences.

The Income Tax Act goes even further, giving trustees the power to vest purely *capital growth* in a beneficiary, without awarding any assets to the beneficiary. The caveat is that the growth awarded then becomes part of the estate of the beneficiary.

The Conduit Principle also applies to the *source* of income from a trust. Dividends, which are tax-free, remain tax-free as they pass through the trust to a beneficiary. Distributions therefore retain their nature for tax purposes, provided they are distributed in the same tax year that the trust received them; otherwise they will be taxable in the trust. Refer to Chapter 22 (Taxation of trusts) for more information.

Many trusts empower the trustees to award income and capital gains from different sources to different beneficiaries, which creates good planning opportunities. So for example, dividend income can be awarded to one beneficiary and interest income can be awarded to another. For example consider the opportunity to award interest income (which are taxable) to children with no other source of income (and are not yet paying any taxes) and the dividend income (on which no further taxes are payable) to parents with other sources of income (and already paying tax at the 45% marginal tax rate (for the 2018 tax year)).

There may be circumstances where it is necessary to create a trust that retains all of its income, resulting in it paying tax at punitively high rates. In these circumstances, it is best to rather invest the trust capital in equities and preference shares which pay tax free dividends to make the income non-taxable in the trust.

Also keep in mind that once the trustees distribute large amounts of income and/or capital gains to beneficiaries to save tax, it will then inflate the estates of those beneficiaries and estate duty will become payable on their death on the amounts so distributed plus any *growth* thereof.

Take note that the Income Tax Act contains specific *anti-avoidance* provisions, which will tax such distributions in the *donor's/funder's* hands if a donation or a soft loan was made to the trust by him/her and income was generated as a *result* of this donation or soft loan. Also be careful if the beneficiaries are *resident* outside of South Africa. Refer to Chapter 22 (Taxation of trusts) for a detailed description of the provisions of Section 7 of the Income Tax Act for *income* distributed, and then to Paragraph 68 to 73 of the Eighth Schedule of the Income Tax Act for *capital gains* distributed.

A summary of the anti-avoidance provisions to be mindful of, all in relation to the donor or funder (the person who makes a donation or soft loan to the trust):

Type	Income Tax (Section)	Capital Gains Tax (Paragraph of the Eighth Schedule)
Spouses	7(2)	68
Minor Children	7(3) and 7(4)	69
Conditional vesting (all discretionary trusts) – For retained monies in trust	7(5)	70
Revocable vesting (founder can terminate trust or veto decisions) – For distributed monies	7(6)	71
Cession of investment income	7(7)	N/A
Resident benefiting a non-resident	7(8)	72
Capital gain attributable to the donor/funder if already taxed on income	N/A	73
Assets transferred at *less* than market value, difference between transfer value and market value apply Section 7(2) to 7(8)	7(9)	N/A

As per the anti-avoidance provisions, capital gains made by the trust are attributable to the person who made a donation or interest-free loan to the trust. This means that during the donor's/funder's lifetime, the capital gain is taxable in his/her hands at his/her rate of tax and not at the higher rate attributed to trusts. This is actually a beneficial provision, as it saves tax!

However, take note that this amount has to be claimed back from the trust by the donor/funder, otherwise it will be *deemed* a donation to the trust, on which Donations Tax will be payable (20% for the 2018 tax year). Section 91(4) of the Income Tax Act states that "So much of any tax payable by any person as is due to the inclusion in his income of any income deemed to have been received by him or to be his income, as the case may be, in terms of subsection (3), (4), (5) or (6) of section seven, may be recovered from the assets by which the income so included was produced".

If *after* the death of the donor/funder of the trust the higher Capital Gains Tax cannot be avoided (as the trust may become liable for tax), the trustees must ensure that they *delay* the payment of Capital Gains Tax until they are able to make an *award* to a beneficiary in terms of the Conduit Principle.

Alternatively, by investing in unit trusts rather than a bespoke portfolio of shares, trustees can delay Capital Gains Tax until they sell the units, leaving the unit trust manager to switch the underlying shares at will without attracting Capital Gains Tax on each sale.

- **Income Splitting:**

Trustees can use the Conduit Principle and distribute income to *various* beneficiaries who do not earn enough to pay tax. Individuals who earn up to R 75 750 (for the 2018 tax year) income per year, do *not* pay tax. Trust income can therefore be split among a number of beneficiaries who earn up to this threshold and end up paying no or very little tax on trust income.

By using the trust as a conduit, the trustees can pay the school fees of the grandchildren (not children, which will trigger the anti-avoidance provision discussed above) of the donor/funder (the person who made a donation or soft loan to the trust) and have the income taxed in their hands. Each grandchild will not be liable for tax until his/her income exceeds R 75 750 (for the 2018 tax year).

The same is true for the major children of the donor/funder and for the minor children of a *deceased* donor. For *each* child receiving R 75 750 per annum, a tax saving of R 34 087.50 (R 75 750 x 45%) will be achieved (for the 2018 tax year). So if you distribute R 75 750 to 5 of these qualifying people, you will save R 170 437.50 (R 34 087.50 x 5) in tax.

Refer to more information on the anti-avoidance measures (and therefore the specific reference here to grandchildren, major children and the life of the donor/funder) in Chapter 22 (Taxation of trusts).

- **Donations tax:**

Assets in the trust can be distributed to the trust beneficiaries without incurring Donations Tax. If during your lifetime you wish to assist a child in purchasing a property, the trust can distribute *trust capital* (the assets that the trust owns and any retained income on which the trust already paid tax) to the child without having to pay Donations Tax.

If you used your own funds to contribute towards the house, you would be liable for Donations Tax (at 20% for the 2018 tax year) on so much of the grant as exceeds R 100 000 (the annual Donations Tax exemption applicable to individuals) for that tax year. So if *you* donate R 1m rand to your child to purchase a house, you will be liable for R 180 000 Donations Tax {(R 1m – R 100k) x 20%}.

7.3 Flexibility to cater for varying circumstances and events

A discretionary trust is extremely flexible and can be administered so as to take into account any family, financial and legislative circumstances. This means that the trustees can manage the trust's assets in the best interests of the beneficiaries at any particular time by taking into account all the relevant factors at that time. This flexibility caters for uncertainties such as divorce, insolvency, increase in family size or fortunes, and changes to tax legislation, provided the beneficiaries are defined, and the rest of the trust deed is drafted in such a way as to anticipate these uncertainties.

A trust also provides assistance for those tricky situations where people marry for a second or third time and there are children from the previous marriage(s). A significant concern is that if the one party bequeaths his/her estate to the new spouse, then this spouse may disinherit the first dying's children in order to benefit his/her own children. A trust often provides a workable solution to this potential problem so that the current spouse can still enjoy the quality of life that he/she has become accustomed to while the capital is protected for the first dying's children. This is done by defining the spouse as the income beneficiary only, and the children as both income and capital beneficiaries. In this case, a trust should be registered for each spouse (and his/her family) to make this arrangement work on a practical level.

7.4 Family asset management

A trust can provide a centralised asset management structure, as well as controlled distributions for beneficiaries who are not in a position to manage assets themselves due to prodigality (excessive or extravagant spending).

A trust can also provide for *joint ownership of indivisible assets,* such as holiday homes and farms.

7.5 "Insurance" should something go wrong with your mental health

Trusts can also be used to avoid the need to place a person under curatorship. This is especially true for people who suffer from Alzheimer's Disease or simple senile dementia.

If you have created a trust during your lifetime and become afflicted by one of these dreadful conditions, your financial affairs would continue as before, with persons that you entrusted as trustees of your trust. The appointment of trustees should be carefully considered in the anticipation of these circumstances.

7.6 Preserve your wealth for future generations

People who have accumulated wealth in their lifetime, or who have inherited wealth, prefer to see their wealth spread beyond the next generation. A trust is still the most effective vehicle for the preservation of wealth. A well run trust allows succeeding generations to participate in, and benefit from, the wealth created in one generation. One only has to consider the large numbers of students that still benefit from bursaries created by people like Cecil John Rhodes.

If you bequeath your estate to individuals, it may become a case of *easy come, easy go.* For example, people and/or their spouses who inherit, may not attach sentimental value towards the inheritance and may put pressure on their spouses to liquidate the assets in order to go on an expensive holiday.

There is also no tax on the accumulation of wealth within a trust, unlike Estate Duty which is applicable in an individual's hands upon his/her death. The combined tax rate of Capital Gains Tax (7.2% to 18% for the 2018 tax year) and Estate Duty (20% for the 2018 tax year) for an individual is still higher than the Capital Gains Tax rate (36% for the 2018 tax year) within trusts, *and* no death triggers Capital Gains Tax in a trust; it only gets paid once an asset is physically *sold* by the trustees, or distributed to beneficiaries (a *deemed* disposal in terms of Paragraph 13(1)(a) of the Eighth Schedule of the Income Tax Act).

There are practical benefits to preserving family wealth across successive generations. A large farm being transferred from one generation to another will not be liable for the intervening estate duties when it is held in a trust. Capital Gains Tax is also delayed until the farm is eventually sold by the family a number of generations later. If the farm was held by the family, the Estate Duty and Capital Gains Tax due on the death of each successive family member creates a huge financial drain on the business, which could eventually force the family to sell the farm if they run into liquidity problems.

People often decide that they do not want their wealth to become a disincentive for the success of the next generation. For this reason trusts are created so that the next generation can improve their lifestyle and explore their talents without being entirely dependent on inherited wealth for their daily living. So much talent has been thrown to the wayside by generations who choose to live from the trust's assets, rather than explore their abilities and build careers of their own. A well-managed trust aims to prevent this from happening.

7.7 Protect other people

Often particular family members (such as people with disabilities) need special attention and trusts are used to provide funds to look after those family members. Sometimes children have special challenges which inhibit their ability to manage their own financial affairs. A trust is the perfect solution for people like this. This is also true for minors. Trusts for minors and disabled persons may enjoy special tax treatment. Refer to Special Trusts in Chapter 22 (Taxation of trusts) for further information.

In the fifties and sixties there was a tendency to treat widows in this way. It allowed husbands to continue to rule from the grave. This is becoming less so today but there are still cases where testators bequeath money in trust to have a hold over spouses or children. Today this is more likely to occur when a parent has little faith in or does not trust a son- or daughter-in-law.

7.8 Life continues for your family after death; no estate freezing

It is wise to arrange your affairs in such a way that when you are no longer here your personal and financial affairs will continue with minimal disruption. Our heirs are usually traumatised by our departure and are then doubly traumatised by having to make decisions on matters that they have little or no knowledge of.

An estate is frozen upon the death of an individual. It may take two or more years to finalise an estate, which could lead to hardship when the family cannot access any cash or assets until the estate has been wound up.

In contrast, death does not interrupt the operation of a trust.

7.9 Protect your family from liquidity issues resulting from your death

Trusts provide tax liquidity solutions on death.

On death, Estate Duty (20% for the 2018 tax year) is payable on the value of the assets *and* Capital Gains Tax (7.2% to 18% for the 2018 tax year) is payable on the growth of assets held in an individual's hands, whether the asset is disposed of or held in the family.

Executor's Fees of 3.5% plus VAT of the *gross* asset value of the estate may also become payable then.

In a trust, Capital Gains Tax is only triggered on distribution or sale of the asset, hence matching tax liability to cash flow.

For example, a family holiday home intended to be held for multiple generations would be better held in trust. Capital Gains Tax on the growth of the asset would only apply when the asset is actually sold by the trust.

Conversely, if the holiday home is held in a parent's name and transferred to the children upon death of the parent, Capital Gains Tax would apply to the growth of the property, without any cash flow being available from the property to fund the Capital Gains Tax liability when the property is transferred to the children. In many cases, assets will have to be *sold* out of the estate to foot the tax bill due to the lack of liquidity in the estate. These taxes will be triggered *multiple* times, upon the death of each legatee/heir. This can be avoided by placing the assets that you want to preserve for generations in a trust.

CHAPTER 9

HOW DOES A TRUST FIT INTO YOUR ESTATE PLAN?

9.1 What exactly is estate planning?

- If you knew you were going to die tonight, would you know what the estate duty implications would be in your estate?
- Do you know what Capital Gains Tax your estate would pay?
- Would there be enough cash or liquidity in your estate to pay the different costs that would arise?
- Would your loved ones have enough money in cash to keep going until your estate is wound up?
- Would your family receive what you had intended them to receive?

Finding answers to these questions is what estate planning is all about.

Many people believe that estate planning is having a will. Having a will is just one part of the plan.

You must always ensure that there is sufficient *liquidity* in your estate to meet any liabilities without compromising your dependants. A trust is one way to deal with this issue.

It is estimated that the average person spends 76 800 hours to build his/her estate, yet very few people spend any time ensuring that their estates are not diluted by more than 30% upon death through death taxes.

Estate planning is often overlooked when more emphasis is placed on investment strategies and the creation of wealth than on estate planning. Estate planning forms one of the key supporting pillars of a sound financial plan.

The following example illustrates the implications of a lack of planning:

Facts:

- You bequeath certain assets to your children or a trust to the value of R 3.5m (the Estate Duty abatement).
- You also have a life policy of R 2m, payable to a child or somebody else upon your death.
- Your remaining estate goes to your spouse, of which the main portion is the family home. Your pension will provide your spouse with an income upon your death.

Effect upon your death:

- Estate Duty will only be payable on the amount of the "deemed asset", being the life policy of R 2m, as the first R 3.5m bequeathed is exempt from Estate Duty. The inter-spousal transfer is also exempt from Estate Duty.

- R 400k (R 2m x 20%) Estate Duty on the life policy becomes payable, and is to be paid as follows:
    - The *children* (referred to as the legatees) who received the R 3.5m in assets as a *direct bequest* pay *nothing*.
    - The *beneficiary* of the life policy pays R 145 455 (R 400k x R 2m/(R 2m + R 3.5m).
    - *Your estate* (the amount that should have gone to your spouse) pays the remaining R 254 545 (R 400 000 – R 145 455). As your spouse only inherits the house and your pension, the house will either have to be sold, or the pension will have to be liquidated (and the proceeds taxed by SARS) to pay for the Estate Duty. This is not a position that we would want to leave our loved ones in!

The Wikipedia definition of estate planning is deceptively simple – "*the process of disposing of your estate*". This definition implies that you can arrange your financial affairs while you are alive for your own benefit as well as for the benefit of those who you favour after your death, called the legacy that you leave.

Proper estate planning is otherwise widely defined as the arrangement, securement, management and disposition of your estate so that you, your family and other beneficiaries may enjoy and continue to enjoy the maximum benefits from your estate and your assets *during* your lifetime and *after your death*, no matter *when* death may occur.

This is therefore a great deal more than just the retirement planning performed by most financial advisors. What would happen if you died a few months before retirement? You would certainly defeat the whole object of proper estate planning.

Proper estate planning involves structuring your estate in such a way that you can benefit from it while you are still alive. You simply need to make sure that your estate is secured at all times in order to ensure current and future maximum enjoyment.

Estate planning involves the arrangement of your assets so that they may be moved – in the most efficient way possible – to people whom you wish to inherit your assets. It also involves ensuring that no unnecessary taxes or estate duty are payable.

An estate plan should also be *flexible* enough to ensure that future adjustments resulting from factors such as changing laws, financial situation and/or family needs can be made. It is wise to review your estate plan every year to cater for any changes, before it is too late.

➢ **Estate planning can be divided into five elements:**

- Protect the value of growth assets in your estate
- Protect assets from forced sale by assessing the availability of liquidity in your estate
- Reduce exposure to taxes such as Capital Gains Tax and Estate Duty
- Limit estate expenses
- Ensure the smooth transition of your estate on death

➢ **Your estate plan should take the following into account:**

- Your will
- Your trust
- All your assets and liabilities

- "Deemed property", such as your life policies
- Liquidity to fund Capital Gains Tax, Estate Duty and Executor's Fees (where applicable)

9.2 Start with a will

Children as young as *sixteen* are allowed to have a will in terms of the Wills Act. Most people delay addressing their will because it is an emotional document to prepare. However, proper estate planning begins with your will. Your will should always be up to date and reflect your current wishes in terms of how you would like your assets to be distributed upon your death.

Your will is a living document and should be reviewed whenever your circumstances change, but at least *once a year*.

➢ **Requirements of a will**

- Always draft a will that clearly demonstrates your *intentions*.
- Although a will does not have to be dated, *dating* it makes it easy to identify which is the most recent will.
- Always have a revocation clause in your will to replace previous wills (where relevant).
- For a will to be valid, it has to be signed by *two independent, competent witnesses* who do *not* stand to inherit from the will and who will not exercise any undue influence. A child as young as *fourteen* can witness a will in terms of the Wills Act.
- Include special instructions in your will such as whether you would like to be buried or cremated.
- Name an *executor*. The executor is the person who will be responsible for administering your estate. By nominating

this person in your will you will avoid any unnecessary delays in the administration of the estate. The executor's role is to control the estate's assets, pay debts and to distribute what is left. Appointing your spouse (or anybody else) as the executor does not mean that he/she has to wind up your estate; he/she can appoint an agent to handle this, and he/she can negotiate the fee for this service.

It is a good idea to name an alternative person as executor just in case the person you nominate is unable to take on the task or is no longer around. If no executor is appointed, the Master of the High Court must appoint an executor. Such appointment will take place with the involvement of the estate's beneficiaries and creditors. This will delay the finalisation of the estate.

Banks often offer to draw up your will for free, but it may end up costing you much more due to the fees they charge. The Administration of Estates Act prescribes a tariff equal to 3.5% (plus VAT) of the value of the *gross* assets of the estate being administered as Executor's Fees as well as a commission of 6% on all income collected by the executor from date of death to date of finalisation of the administration process. This fee may be negotiable in certain circumstances.

- Ensure that your will contains a clause that any assets left to your child would not form part of that child's matrimonial regime. If, for example, you leave a property to your daughter who marries in community of property, including this clause in your will ensures that the property will not form part of your daughter and her spouse's joint estate.

- If you have minor children, specifically state that *no* money will be paid into the Guardian's Fund.

- If you have a trust, remember to name follow-up trustees in your will and also ensure your trust deed allows for that.

- If you are married, it is preferable to have individual wills rather than a joint will. The problem with a joint will is that when the surviving spouse dies it can take a long time to locate the original will at the Master of the High Court's office. If the original joint will cannot be found, the surviving spouse will die intestate. Intestate succession is based primarily on blood relationship, whereby the estate will be distributed amongst family members in a certain order. The assets will therefore be divided in terms of the Intestate Succession Act, and this may not be how you wanted your assets to be split.

- If you have assets abroad, you may require a separate will for your offshore estate.

- Perform an Estate Duty calculation for the various options that you may consider to ensure that your will wording supports the most tax efficient option. This is especially true where you need to decide who (your spouse or others) should receive the residue of your estate. In many cases, it may be more efficient to nominate your spouse to inherit the residue of the estate, rather than others, should you bequeath similar amounts to them.

➢ **Do you need a living will?**

A living will is a document that you sign to ensure that you do not wish to be kept alive by artificial means, or by the use of life prolonging drugs, in the event that your state of health is such that there is no reasonable hope of your recovery and the condition from which you are suffering is causing you severe pain and distress or making you incapable of rational life. There is a standard format that is used for this purpose and it is recommended that you use this format. There are however no prescribed legal formalities which must be complied with in order for it to be valid.

9.3 Letter of Wishes

A letter of wishes is a way for you to inform others of matters to be taken into account after your death. It may, for example, contain guidance to the guardians of minor children detailing how you might want your children brought up in terms of education, religion or residence.

A letter of wishes is a separate document to your will, but it accompanies your will. It is *not legally binding* but can guide your executors and trustees to ensure that your personal wishes are carried out.

You should take care that a letter of wishes does not contain anything that could conflict with your will. It is usually better to keep these specific requests in a separate document from the will so that they can easily be amended should the need arise.

The letter of wishes can advise on anything but most common uses include:

- Who to notify of your death, or in some cases, who not to tell.
- The style of funeral you want, whether you want a burial or a cremation, any specific instructions regarding the service, and where you would like to be buried or have your ashes scattered.
- Listing your main assets - including bank accounts, life insurance policies, expensive items or jewellery and their location - will help your executors in the administration of your estate. These items should also be included in your will because the letter of wishes is *not* legally binding.

- Guiding your executors or trustees in terms of how you would like any money managed or trusts to be run. Be careful not to be prescriptive to the extent that the discretion of the trustees is questioned. This is not advisable, as it may invalidate the trust, as it may affect the discretionary powers of the trustees.

- Advising guardians on how you would like your children to be raised, their religious upbringing, education, and where they live. These details should be reviewed as the children grow up.

- Giving more detailed information to assist your executors in identifying specific items that you are bequeathing in terms of your will.

- Providing explanations as to why you have excluded someone from the will, if you think that it may be a controversial decision or challenged later.

A letter of wishes should be written in plain English, signed and dated, but *not* witnessed, so as to avoid any claim that it has become a legal will or codicil (an addition or supplement that explains, modifies, or revokes a will or part of one).

There is an ongoing debate as to the role of a letter of wishes and whether a letter of wishes should be seen as part of the trust deed. A letter of wishes is *not* legally binding on the trustees, but could be taken into account by them.

Where trustees have been given wide discretion in a trust instrument, it is important for them to have an understanding of what the founder had in mind when he/she created the trust, and exercise their discretion accordingly. The trustees should certainly be influenced, but *never* dictated to, by a letter of wishes.

If the trustees only follow the letter of wishes and do not apply their discretion, they risk being attacked by beneficiaries and creditors.

Typically, letters of wishes are concerned with the exercise of discretions in relation to the distribution of the trust fund, wholly or in part. Occasionally letters of wishes may include comments in relation to the exercise of powers of investment, or other purely administrative powers.

Letters of wishes should be reviewed regularly. It would be helpful if the trustees took the initiative in this and asked the founder, from time to time if he/she had any changes in mind.

Letters of wishes should be kept by the trustees.

9.4 Which assets are not included in the estate?

Certain assets are not included in the deceased's estate, for the calculation of Estate Duty, and may be distributed to the beneficiaries independently. Such assets include:

- **Life assurance benefits**

If beneficiaries have been *nominated* in a life assurance policy, the proceeds of that policy are not included in the estate, but are paid out directly to the beneficiaries. Such policies are the ideal vehicles for providing cash for dependents while the estate is being wound up. Where the assets under life policies are included in the estate (in other words, no beneficiaries are named), they count in the calculation of the Executor's Fee.

Refer to Chapter 14 (How to move assets into a trust), point 14.4 for more information on life policies.

- **Retirement assets**

Compulsory retirement assets are excluded from the estate. When it comes to pension funds, it is important to note that the assets are not necessarily distributed according to the wishes of the deceased fund member as expressed in a will or on the pension fund beneficiary nomination form. The trustees of a pension fund are obliged under the Pension Funds Act to distribute the assets to a member's dependents.

For the distribution of death benefits, the following persons qualify as dependents in terms of the Pension Funds Act:

- *Spouses* (including customary and religious unions, civil marriages and civil partnerships).
- *Children* (biological, stepchildren and legally adopted).
- Anyone proven to be *dependent* on the deceased for maintenance/financial support, or legally liable for maintenance/financial support (e.g. in terms of divorce agreements and maintenance orders), or would have become legally liable for maintenance, had the deceased not died (e.g. engaged to be married, unborn children).

- **Assets held in trust**

Assets held in an inter-vivos trust are not included in the estate.

9.5 What is your estate's executor required to do when you die?

Although you may have appointed an executor in your will, it does not necessarily mean that this person will automatically become the executor. The Master of the High Court has to officially appoint the executor and this can take anything from one week to three months. Once appointed, the executor takes control of the administration of your estate, settles any liabilities in your estate, and distributes the remainder of your assets in terms of your will.

The executor will start acting on behalf of your estate when your death has been reported to the Master of the High Court and Letters of Executorship have been granted by the Master of the High Court in the executor's favour.

A Letter of Executorship is a formal document which states that the executor named therein has been formally appointed by the Master of the High Court and from the date on which it is issued the executor is legally empowered to act.

The executor could also go to the Master of the High Court's Office to report the estate but with certain fairly limited exceptions the Master of the High Court will require, before issuing Letters of Executorship, that the executor nominates a professional estate administrator to attend to the administration of the estate on his/her behalf.

Once all the necessary documentation and information has been approved to the Master of the High Court's satisfaction, he/she will issue the Letters of Executorship confirming the executor's appointment as the executor of the estate.

South African law, in the form of the Administration of Estates Act, prescribes a formal process which must be followed in so far as the administration of a deceased estate is concerned, the main purpose of which is to protect the rights of heirs and of creditors, including SARS.

Among other things, an executor has to place statutory advertisements in the newspaper and to lodge an account with the Master of the High Court in a certain format containing specific information. The estate administrator will attend to this on your behalf and in an average uncomplicated estate the process should be completed in six to eight months. For more complex estates it can take up to three years to complete this process.

Should you be able to structure your assets effectively in a trust, leaving your estate at a value of lower than R 250 000 (for the 2018 tax year) (Section 18(3) of the Estate Duty Act), there is a simpler procedure prescribed in the Administration of Estates Act, but the death of the deceased still has to be reported to the Master of the High Court, together with the same documentation, as required for larger estates.

In these smaller estates the Master of the High Court issues Letters of Authority (as opposed to Letters of Executorship) in favour of the nominated executor who can then administer the estate without having to comply with any of the formal requirements applicable to larger estates, such as placing advertisements in the newspaper and submitting accounts to the Master of the High Court. It is not necessary or required that an executor of such an estate utilises the services of a professional estate administrator although he/she is always free to do so.

9.6 Why a trust is the most comprehensive estate planning vehicle in the world

Trusts have an important role to play in estate planning and will affect your decision in terms of how much risk and investment life assurance you require. This is because setting up a trust will affect how much Estate Duty and Capital Gains Tax your estate will pay and the provision you make for your dependants after your death.

- **The benefits of having a trust as part of your estate plan**

- **Freeze the value of your estate**

If you transfer an asset to a trust, the asset's value does not grow in your hands, but in the trust. Had you retained ownership of the asset, it would have increased the amount of Estate Duty that would have been payable on your death.

If you have made use of a loan to the trust to move assets and the loan is not settled at the time of your death, only the value of the assets as at the date of transfer remains an asset in your hands through the loan and not the market value of the assets on death. However, be mindful of the new tax provisions relating to interest-free loans Refer to Section 7C description in Chapter 22 (Taxation of trusts) for more information.

- **A trust provides total continuity**

Trusts continue to pay benefits to dependants (beneficiaries) after you die. Bank accounts and cash reserves of a trust will not be frozen during the winding up of your estate. A trust will ensure rapid access to capital and income after death. This may not be the case with assets in your estate as your estate is frozen during the winding up process. This may result in your dependants not receiving an income until after your estate is finalised, which may take two years or longer.

Remember that your estate cannot be wound up if there is any debt in the estate. It may mean that properties may have to be sold, which would in turn mean that extra transfer costs will have to be paid to cancel bonds, transfer properties, and so forth. Because a trust stands as its own separate instrument, your death will not affect any assets in the trust. All that will happen is that follow-up trustees will be appointed to manage and administer the trust assets.

- **A trust provides succession planning**

If the intention is to retain an asset in a family in perpetuity for the benefit of generations to come, then a trust, in particular, could be the ideal vehicle for achieving this goal. Consider a holiday home in a prime location which could be used by the family well into the future and never disposed of, or certainly not disposed of in the near future. Not only would the trust facilitate perpetual succession, it would also allow the beneficiaries to have fair access to the property in the long term.

- **A trust provides liquidity**

If an individual has not structured and properly planned their assets, cash, property portfolio, insurance portfolio and their business interests, all their assets may have to be liquidated to compensate for any taxes and outstanding debt upon their death. This could be potentially detrimental to your family and their financial wellbeing and can be avoided through proper planning and structuring.

- **Taxes and costs of over 30% can be saved upon your death**

If you do not have a trust, more than 30% of your life assets will go to SARS and others when you die. This is based on assets that you have acquired with money that you paid tax on while you were alive!

Although it should never be the primary motivation for setting up a trust, a trust, if properly planned, managed and controlled, can act as a significant shelter against future estate duties. The founder may transfer assets with growth potential into a trust, preferably a discretionary trust, with his/her children and grandchildren as beneficiaries. The growth in the assets from the date of transfer to date of his/her death accrues to the trust, and at most, only the value of the assets at the date of the transfer (usually in the form of a loan account) is retained in his/her estate.

The loan account is usually gradually reduced during the founder's lifetime through loan repayments, further reducing the Estate Duty liability. However, be mindful of the new provisions (Section 7C of the Income Tax Act) impacting interest-free loans, as discussed in Chapter 22 (Taxation of trusts).

Any growth in the assets will take place in the trust and not in the founder's hands. The increase in value will not be included in the founder's estate and the value of his/her estate (and therefore estate duty) is reduced accordingly. In this way, estate duty may be bypassed for one or more generations. These benefits are however only applicable to a discretionary inter-vivos trust, and not to vested or bewind trusts.

➢ **A trust therefore ensures the following upon death:**

- **No Estate Duty** (20% for 2018 tax year) as the trust will continue to exist after death.

- **No Capital Gains Tax** (7.2% to 18% for 2018 tax year) on growth assets. Death is deemed as a disposal and will trigger if you hold these assets in your own name upon death.

- **No Executor's Fees** (at 3.5% plus VAT of the Gross Estate). This is an unnecessary and avoidable cost. Executor's Fees are calculated on the gross value of an estate and deducted before any other expenses, meaning that the executor can receive up to 10% of a net estate.

- **No transfer costs and bond cancellation costs** are payable on immovable property and other assets which are already registered in or held by the trust. This is because ownership does not transfer to anyone after death.

- **Your minors are protected**

  Under South African law, a minor, in general, cannot inherit because they do not have contractual capacity. Therefore upon the death of a parent (or other person who the child inherits from) the assets held in the parent's personal name are liquidated and the proceeds invested in the Guardian's Fund at 3% interest with limited access thereto until the minor turns eighteen.

It therefore makes sense to proactively structure assets in a trust as part of your estate planning in when minors may inherit. A testamentary trust or inter-vivos trust can be used for this purpose. It is important to do a proper evaluation of your individual circumstances before you make a decision regarding the type of trust to be used. The main difference is that if you only create a testamentary trust upon your death, Capital Gains Tax, Estate Duty and Executor's Fees will be payable *before* the assets are transferred into the trust, whereas assets accumulated in an inter-vivos trust will not attract *any* taxes upon your death.

Assets are also protected against spendthrift children, who will not be able to reduce the assets to zero.

- **Incapacitated persons are protected**

  Setting up a Special Trust for a mentally disabled or incapacitated person allows for the safe custody of assets, while at the same time benefitting from lenient tax treatment from an Income Tax and Capital Gains Tax perspective.

- **Ring-fence maintenance obligations post death**

  Many maintenance obligations continue after death in terms of the Maintenance of the Surviving Spouses Act, in so far as the surviving spouse is unable to provide therefore from his/her own means or earnings, until the ex-spouse dies or remarries.

However, when you are divorced, the Divorce Act and *not* the Maintenance of the Surviving Spouses Act applies, whereby maintenance does *not* extend beyond death of the maintenance payer, unless the divorce order states that it applies.

In a marriage, the surviving spouse will have the same order of preference as a claim for maintenance of a dependent child of the deceased spouse, and if these claims compete, the claims shall be reduced proportionally. This claim arises regardless of the matrimonial property system which operated in the marriage. The surviving spouse shall not, however, have a right of recourse against any person to whom money or property has already been paid.

On the death of the spouse who has the maintenance obligation, his/her former spouse will lodge a claim against the estate for the maintenance obligation, and this can delay the winding up of the estate and result in conflict with the beneficiaries.

The following factors must be taken into account when considering the surviving spouse's reasonable maintenance needs:

- The amount in the deceased estate available for distribution amongst the heirs and legatees

- The existing and expected means, earning capacity, financial needs and obligations of the surviving spouse and the subsistence of the marriage

- The standard of living of the surviving spouse during the subsistence of the marriage

- The duration of the marriage
- The surviving spouse's age at the time of the deceased's death

The solution is to create a trust on the death of the spouse who has the maintenance obligation so that the trust takes over the maintenance obligation and continues paying income to the ex-spouse. When the maintenance obligation expires, the balance of the capital in the trust can be distributed to the deceased's heirs.

A claim against the deceased's estate for maintenance is deductible for Estate Duty purposes, provided it is reasonable.

- **Multi-ownership of assets**

Some assets cannot be divided (for example businesses, farms and other property). By placing these types of assets in trust, the heirs can be the beneficiaries of the income generated by the assets. The heirs are also protected from each other's creditors, as well as potential claims by spouses upon divorce, or potential claims of creditors upon sequestration of an heir.

- **Confidentiality**

A will and the Liquidation and Distribution Account in a deceased estate become a public document on death. A trust does not form part of an estate, and therefore the list of assets held in a trust remain confidential.

9.7 Some important tips to remember when you do estate planning

- **Roll-over and the use thereof**

Each person's estate is entitled to an exemption or abatement from estate duty on assets up to R 3.5 million (for the 2018 tax year). Estate duty of 20% (for the 2018 tax year) is charged on assets that exceed this amount, with the exception of any assets that you leave to your spouse.

Legislation allows the estate of the second-dying spouse to use any portion of the exemption that the estate of the first-dying spouse did not utilise. This means that if the first-dying spouse left all his/her assets to his/her spouse, and therefore did not use any portion of the R 3.5 million exemption, the exemption will roll over to the surviving spouse, and his/her estate will enjoy an exemption of R 7 million on his/her death (for the 2018 tax year).

Rolling over the exemption has its pros and cons. If the surviving spouse lives for a further twenty years, the executor of his/her estate will have to track down the liquidation and distribution account of the first-dying spouse and prove to SARS that the exemption was not used in his/her estate. If you do not have the liquidation and distribution account, it will be quite a headache for your executor to prove that the exemption was not used.

Where applicable, always keep a copy of this with your will.

If you have a fairly large estate and you have set up a trust during your lifetime (an inter-vivos trust), rather leave the exempt amount to your trust. The exempt amount can be invested in the name of the trust for the benefit of the surviving spouse. It will also grow within the trust and not in the hands of the surviving spouse. This can save you money in terms of Estate Duty.

➢ Spouses should keep their assets separate

Married couples should split their assets between themselves to ensure that the surviving spouse will not be left without any cash after the other spouse has died. If the spouse in whose name all the assets are registered dies first, the surviving spouse may have no cash assets on which to survive while the estate is wound up.

➢ Minor children cannot inherit from you directly

If you want to leave any assets to your minor children, you should rather leave the assets to them in a trust so that the trustees can look after the assets until the children can do so themselves. Children under the age of *eighteen* cannot inherit cash from you directly.

If you have not set up an inter-vivos trust while you are alive, you can stipulate in your will that you want a testamentary trust to be established upon your death. In this case, make sure that your will deals comprehensively with the establishment of the testamentary trust. Your will serves as the trust instrument in the case of a testamentary trust. Your will should spell out who the trustees will be, who the beneficiaries will be, the responsibility of the trustees, and any other conditions. These provisions should be detailed enough to protect your assets for your heirs. Often wills do not provide sufficient measures to ensure that trusts are executed properly.

It remains the best option to set up an inter-vivos trust while you are alive, as upon your death you will pay unnecessary taxes and transfer costs to move assets to a testamentary trust.

If you do not set up a trust for your minor children, your executor will be obliged to hand their cash inheritance to the Guardian's Fund. Money managed by the Guardian's Fund is invested very conservatively. Investing too conservatively can negatively impact the value of the inheritance, especially over the long term.

- **Fund trustees will decide who receives your retirement savings**

Savings in your occupational retirement fund, retirement annuity fund and preservation fund, as well as any group life assurance, become payable upon your death, but you cannot always expect the savings to be paid out as you have stipulated on a beneficiary nomination form. The beneficiary nomination form is only an indication to the trustees of the fund of how you would like your retirement savings to be distributed.

The trustees will determine how to distribute the savings according to Section 37C of the Pension Funds Act. In terms of this section, the trustees have to trace your dependants, and then any persons who are financially dependent on you, for example an aged parent, and distribute your retirement savings equitably among them. You should bear in mind that a family member such as your daughter who lives rent-free with her boyfriend in a cottage in your garden may be able to prove dependency.

Only if your dependants have sufficient funds would the trustees consider anyone else that you have nominated as a beneficiary.

Your retirement fund savings can be paid out to your dependants either as an income or as a lump sum (after Income Tax has been deducted). Your assets in a tax-incentivised retirement-savings fund do *not* attract Estate Duty in your estate.

If you have any specific wishes that you would like the trustees to take into account, record these on your beneficiary nomination form. For example, if your daughter is irresponsible with money, ask the trustees to allocate her a monthly income rather than pay her a lump sum.

- **You can choose beneficiaries of a living annuity**

Living annuity investments fall outside of the Pension Funds Act, so you can nominate the beneficiaries that you would like to inherit your living annuity investments. These investments can be drawn either as an income or a lump sum (after tax).

Legislation stipulates that it is not possible for one beneficiary to draw an income and for another to take a lump sum: all the beneficiaries must make the same choice. This was obviously not the intention of those who drafted the legislation.

If the beneficiary/ies elect to take the benefit as a lump sum, the taxable lump sum will be taxed in the deceased's hands in accordance with the retirement tax table.

If the beneficiary/ies elect to receive an annuity instead of a lump sum, the benefit will be transferred tax free into an annuity contract in the beneficiary's name. The income received from this annuity will attract income tax, which will be deducted by the administrator and the after tax income will be paid to the beneficiary.

- **Be mindful of who funds the Estate Duty**

Where a direct investment bequest is made that is estate dutiable, the Estate Duty will be paid out of the residue of the estate, leaving the residuary heirs with less funds. Refer to the example in the beginning of this chapter.

If the investment is classified as a *policy*, in other words a life is insured in terms of the investment contract, the proportionate Estate Duty payable will be collected from the beneficiary. It is therefore important to determine the nature of the investment and whether the Estate Duty payable on the investment will be collected from the legatee or the residuary heir.

- **Buy life cover to pay off liabilities**

If your estate will not have enough liquidity to pay off your liabilities, it is advisable to take out life cover that will pay out when you die to cover these liabilities.

Remember that life policies, with some exceptions – most notably those that pay out to your spouse – are dutiable in your estate. This means that you should take out more life cover than you will require to pay the liabilities. You should therefore increase this amount to take into account any Estate Duty that may be payable, leaving you with the amount you require.

Refer to Chapter 14 (How to move assets into a trust), point 14.4 for more information on life policies.

- **Make use of donations**

Another tool that you can use in estate planning is donations. Donations between spouses and partners are *not* subject to Donations Tax. Donations to anyone else are taxed at 20% (for the 2018 tax year).

You can however donate R 100 000 a year without paying Donations Tax. In effect, the exemption allows a couple to donate R 200 000 a year to a trust or to other beneficiaries without incurring any taxes. However, you *cannot* accumulate this exemption. If the exemption is not used in one tax year, it *cannot* be carried through to the next tax year. It is therefore very important to make use of the exemption *every year* and to submit the necessary returns to SARS. Remember to reflect this donation in your personal Income Tax return.

Donations made to the trust can be invested in a growth investment, such as an endowment (investment) policy. Do *not* take out an endowment with a life assured (an endowment wrapper), as the policy proceeds upon your death will be *included* as *deemed* property in your estate in terms of Section 3(3)(a) of the Estate Duty Act, on which Estate Duty (20% for the 2018 tax year) will be payable.

Note that the trust must take out the policy from inception, to avoid second hand policy problems. No policy should be ceded to the trust, or else there will be double Capital Gains Tax - in the portfolio, and again when it pays out.

The amounts should be physically paid to the trust to enable the trust to pay the premiums. If both spouses want to make use of this mechanism, each spouse should physically pay out of his/her bank account.

If the trust invests money in a 5-year endowment policy, the following benefits will be achieved:

- Avoid tax on interest earned, or the application of the Section 7 anti-avoidance measures. Refer to Chapter 22 (Taxation of trusts) for more information.

- Avoid any Capital Gains Tax in the trust's hands if the units are sold

- Avoid any consequences if the proposed changes to the Taxation of trusts as per the Davis Tax Committee recommendations are ever implemented. Refer to Chapter 10 (Are trusts still relevant?) for more information on the recommendations.

When the investment matures, the trust can loan the money back to you, the donor, should you require cash. You can use the money as you please, but not for the acquisition of new assets in your personal name. Should you acquire additional assets, you risk growing your estate and having to pay Estate Duty upon your death. When you die, your estate will have to pay the loan back to the trust. This liability reduces the size of your estate and the Estate Duty payable.

You can also use the R 100 000 annual Donations Tax exemption to reduce your loan to a trust, which is an asset in your estate.

Refer to Chapter 14 (How to move assets into a trust) for more information on donations to trusts.

➢ Make provision for cash for living expenses

Assets are frozen when estate administration begins, and this can have serious implications for dependants. A spouse married in community of property will have no access to funds in the combined estate until the executor is certain that the estate is solvent, so it may take some time before that spouse can access any cash.

If you have young children, your family may require additional funds, because, without your income, your surviving spouse will most probably struggle to support your children from a financial perspective.

To avoid these situations, you can:

- Set up a discretionary inter-vivos trust. Any assets transferred into the trust fall outside the estate.

- Take out a life assurance policy in favour of the trust. Such policies pay out directly to the beneficiaries named in the policies, often within days of the insurance company receiving the necessary information.

  Carefully review the beneficiaries of your life policies. While a policy to support your surviving spouse and children should probably name your trust or spouse as the beneficiary, a policy that you take out to provide liquidity in your estate should name your estate as the beneficiary.

  Refer to Chapter 14 (How to move assets into a trust), point 14.4 for more information on life policies.

- Transfer a sum of money to your trust, your spouse or your dependants if death is foreseeable because of ill-health or frailty.

CHAPTER 11

REQUIREMENTS FOR A TRUST TO EXIST

The Trust Property Control Act does not specify the requirements or procedures required for the formation of a valid trust.

The Master of the High Court may have issued Letters of Authority and may have assigned a registration number to the trust, but this does not make the trust valid. It is *not* the Master of the High Court's duty to test and investigate the validity of a trust. The validity of a trust is usually only challenged by creditors, SARS, a soon-to-be-ex-spouse, and so forth, at a time when it may seem beneficial to such persons or creditors to disregard the trust.

Many family trusts in South Africa are designed to be controlled by the founder, the beneficiaries, or one or more trustees, which is not allowed.

In terms of business trusts, there are many cases where the parties believe that they have created a trust, whereas by law and in reality they have created something else, such as a partnership.

A founder may also have transferred property to another individual without imposing any trust obligations on that person.

In order to prevent the trust from being torn apart in a dispute, the requirements described in this chapter should be met.

11.1 Requirements for a valid contract – inter-vivos trusts

The creation of an inter-vivos trust is regulated by the Law of Contracts as opposed to a testamentary trust, which is governed by the Law of Succession. Therefore the principles that apply to the execution of a valid contract also apply to the execution of a valid trust deed.

For a contract to be considered valid and binding in South Africa, the following requirements must be met:

- There must be consensus between the contracting parties;
- The parties must have seriously intended the agreement to result in terms which can be enforced. This requirement is similar to the requirement explained in point 11.2 below;
- The parties must have the capacity to contract. In terms of South African law, when you turn eighteen you are free to contract and conduct your own affairs without your parent or guardian's assistance;
- The agreement must have certain and definite terms. It is therefore important to ensure that the terms covered in the trust deed should be explicit;
- The agreement must be lawful. Refer to point 11.2 below, which discusses the fact that the object defined in the trust instrument should be lawful. This requirement therefore ensures that the trust can only exist if it is lawful;
- It must be possible to perform the contractual obligations; and
- The content of the agreement must be certain. All aspects

that you need to cover, and which you can enforce, should be contained in the trust deed.

The main attributes typically stipulated in a trust instrument include:

- The aims and objectives of the trust
- Names of the beneficiaries and whether they are to be income and/or capital beneficiaries
- Rights and obligations of the trustees, including their powers, remuneration and requirements for meetings and decision-making
- Rules and restrictions regarding the distribution of income and capital
- The procedure to be followed should the trust require amendments
- The duration and procedures on termination of the trust

The trustees are bound by law to act in terms of the trust deed. If the terms are such that the trustees are hindered from acting independently, it may indicate that there was no effective transfer of trust property, and therefore that no trust exists.

11.2 Essential elements for a trust to exist

In the Estate Richards v Nichol case of 1996, the Court confirmed the essential elements for the creation of a valid trust. If any one of these elements are missing, it is important to understand that a trust has *not* been created. Although the parties may have termed what they created a "trust", it does not infer that it is a trust in the legal sense of the word.

The following requirements must be met in order for a valid trust to exist:

11.3 A clear and unambiguous intention on the part of the founder to create a trust

Often when a service provider (usually a lawyer, an accountant or other person unrelated to the trust) sets up a trust for a client, they will choose an arbitrary founder for the trust, completely disregarding this critical requirement.

Clients are often advised that the founder cannot, or should not, simultaneously hold the role of trustee and/or beneficiary. This is simply not true. The Trust Property Control Act acknowledges the fact that the founder can also be a trustee through the definition of a trustee as "any person (*including the founder of a trust*) who acts as trustee…"

The intention to create a trust is manifested by the handing over of assets to the trustees by the founder by virtue of a trust instrument to be administered by the trustees in accordance with the terms of the trust instrument for the benefit of the beneficiaries. This intention is generally what comes into question when determining whether the founder created the trust to administer his/her property, or whether he/she is merely using the trust as a means through which to conduct his/her personal affairs.

Because a trust is regarded as a contract, the courts will look at the substance of the *arrangement* rather than simply looking at the trust *instrument*. If it is clear from the substance of the arrangement that the founder did not intend to give up control over the assets, the trust may be disregarded.

The proposed founder of a trust should always be asked whether he/she has a true *intention* to create a trust for the benefit of the beneficiaries, as well as whether this person will be making the initial donation to the trust. Failure to do so could affect the potential validity of the trust.

The founder of a trust will also enjoy a Transfer Duty concession if he/she is related to the beneficiaries of the trust. No Transfer Duty is payable when fixed property is transferred to a beneficiary, who is related to the founder by blood, within three degrees of consanguinity. This concession applies when *no* consideration is paid directly or indirectly by this particular relative in respect of the acquisition of such trust property (Section 9(4)(b) of the Transfer Duty Act).

11.4 The founder expresses his/her intention in the creation of the trust instrument in such a way as to create an obligation

This takes place when the founder expresses his/her intention in the trust instrument to transfer property to the trustees for them to manage on behalf of the beneficiaries. Because a trust is a contract, the trust instrument will create a legal obligation on the part of the founder to execute his/her intention as stipulated in the trust instrument.

If the founder typically reserved the following rights and powers in the trust instrument in an attempt to retain control over the trust's assets, it may be indicative that the founder did not really intend to create a trust, thereby invalidating the trust:

- The sole right of the founder to amend the trust instrument, without deferring to the trustees
- Decisions reserved for the founder to deal with trust assets
- A testamentary reservation clause in terms of which a right is retained by the founder to dispose of trust

assets in his/her will

If the trust instrument does not specify any legal obligation for the founder to unconditionally hand over trust assets to the trustees, and the trustees are subject to the control of the founder, it is not a trust. It is, instead, referred to as an *agency*.

11.5 Trust property should be clearly and certainly defined so that it can easily be identified

Trust property is defined as movable or immovable property and should be clearly defined as such in the trust instrument. This includes the founder's initial donation, as well as any subsequent donations. The property, in terms of the trust instrument, is placed under the control of the trustees for the benefit of the beneficiaries, whether acquired by, or donated to, the trust.

The Trust Property Control Act requires a maintained asset register for the trust stipulating the description, value and location of each asset.

The financial records should also clearly indicate which property is held by trustees.

Trust property is used to determine which Master of the High Court's office has jurisdiction over the trust and where it should be submitted.

11.6 Beneficiaries (or object) must be clearly and certainly defined to be identifiable

The objects (beneficiaries) of the trust must be clearly identified or readily ascertainable.

The Trust Property Control Act defines a trust as "the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed:

- to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

- to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument…".

The first part of the definition deals with typical discretionary family trusts, and the second part refers to vested trusts.

Although the term "beneficiaries" is not defined in the Trust Property Control Act, the definition of a trust in this act sets out the requirements for a valid trust in terms of this act. The essence of a trust is that trustees hold trust assets *on behalf of* beneficiaries, or on behalf of some object, such as a charity.

A trust is therefore formed to benefit some persons or some object. As such, there should be a "person", identified by name and preferably an identity number, or "class of persons", identifiable through the description of such a class, such as "the descendants of".

The Trust Property Control Act does *not* allow for a vague definition of beneficiaries, something that is problematic for many trusts currently in existence. A trust without *identified* or *identifiable* beneficiaries is invalid.

The test for identifiable beneficiaries in the trust instrument:

- In the case of a personal trust (such as a family trust) the trust object relates to how the benefits of the beneficiaries are defined. In order to meet this requirement, it should be possible to *identify* the beneficiaries in the trust instrument. Beneficiaries should therefore be listed by name, or consist of a class of persons such as "*the descendants of…"*

  The trustees should *not* have the power to appoint any beneficiaries. The trust object (the beneficiaries) in such a trust should be defined with reasonable certainty and be determined or determinable from objective criteria such as "The children of X". The trust object cannot be vague. Phrases such as *"those beneficiaries which the trustees will select as they see fit from no defined class"* are not permitted.

- In the case of an impersonal trust (such as a charitable trust), the trust object relates to the way in which persons who are to benefit from such a trust (the beneficiaries) are typically described as a class of persons in such a way that they can be objectively determinable, such as "*students meeting the following criteria…"*

Under certain circumstances - such as when the founder has died – it may be impossible to change these provisions in the trust instrument. It is therefore important to review your current trust instrument to ensure that this requirement is met and make the changes if necessary. However be mindful to be caught by the provisions of Section 1 of the Transfer Duty Act that includes the *addition* or *substitution* of beneficiaries in the definition of transaction, which will trigger Transfer Duty in trusts holding *residential property*.

11.7 The trust object (not purpose) must be lawful

The object of a trust must be lawful. There is a misconception that the legality of an inter-vivos trust is determined by the Master of the High Court. Although the trust deed must be registered with the Master of the High Court in terms of Section 4 of the Trust Property Control Act, the Master of the High Court does not censor its object. Instead, this is left to those interested in the trust to establish if the trust object is unlawful.

In the case of a testamentary trust, the Master of the High Court has the power to refuse or accept a will for the purposes of the Administration of Estates Act, until the validity of the will has been determined by the Court. In this way the testamentary trust falls under the Master of the High Court's scrutiny for validity. As such, any trust created in a will *can*, therefore, also be declared invalid.

In the Peterson v Claassen case of 2006, an important distinction was made between the *object* and the *purpose* of a trust. It was held that while it is correct that one of the requirements for the creation of a valid trust is that the trust object must be lawful, it does *not* follow, however, that a trust is void if it is created with a fraudulent, illegal or immoral purpose.

There seems to be a material difference between the object of a trust and the purpose of a trust. The object is generally openly stated in the trust instrument, and all parties who have dealings with that trust will be able to establish the object from the trust instrument. An example of this would be *"To hold trust assets for the benefit of the beneficiaries"*. Provided the stated object of the trust is lawful, it will pass this test.

However, where a trust is formed for an illegal or unlawful purpose, this fact will not be known by any party dealing with the trust. Only the founder and possibly some of the trustees who set the trust up for an illegal or unlawful purpose (even though the trust instrument may contain a legal object), will be aware of it. The trust's purpose is *not* stated in the trust instrument and as such it can be said that the object of the trust is not the same as the actual purpose for which the trust was created.

If a trust is created for an unlawful purpose, the law does not automatically render it void. Where a trust is created for an illegal purpose, agreements which it "concludes" may be void or voidable, in accordance with ordinary contractual principles and depending on the circumstances surrounding the conclusion of each agreement.

It also follows that the ordinary rules, be it the rules of the law of contract in the case of an inter-vivos trust, or the rules relating to the drafting and signing of wills for a testamentary trust, must be complied with.

11.8 Property must be transferred to the trustees (discretionary trust) or beneficiaries (vested trust)

While a company or close corporation can exist without assets, it is *not* possible for a trust to exist without assets.

The trust property defined in the trust instrument should be physically transferred by the founder to the trustees in order to establish a valid trust. A founder's failure to relinquish control over the trust property to the trustees may *delay* the trust from coming into operation.

Although some people interpret the principle established in the Deedat v The Master case of 1994 to mean that you do *not* have to make the physical initial donation to establish a trust, as long as there is an *obligation* to make such initial donation in the trust deed, which is then made at a *later* date, it is recommended to rather make the initial donation as soon as the trust is registered to avoid attacks from SARS and creditors. The judge found that "It may well be that the definition of a trust in the 1988 Act is wide enough to encompass property, duly identifiable, which is only to be acquired by the trustees in future from outside sources".

In the application of the Substance Over Form Principle in South Africa, the trust should not only legally own the trust property, but it should be clear from the *actions and behaviour* of the trustees and the founder that the assets in substance are managed by the trustees, and not by the founder or only one of the trustees.

If the treatment of the trust assets does not reflect the *true* intention of the founder, the legal form of the trust will be ignored, the trust will be disregarded and the assets will be regarded as belonging to the founder, thereby negating the benefits sought when first establishing the trust.

The First National Bank v Britz case heard in 2011 was the first case where the courts have expressly permitted creditors to attach trust assets. This was due to the fact that the founder did not physically hand over the trust assets. The husband and wife, for example, lived in the house without a rental contract with the trust and did not physically hand over the house contents that they made use of. Estate planners should take heed and not disregard the trust form.

What about other factors?

11.9 Should there be an appointed trustee?

The designation of a trustee as well as the acceptance by the designated trustee is *not* essential to the existence of a trust. However, case law states that there should be a duly appointed trustee for a trust to operate and he/she should have accepted the appointment.

As decided in the Committee of the Johannesburg Public Library v

Spence case, provided the *obligation* exists to create or administer a trust, the Master of the High Court, or the Court, will, if necessary, ensure that the trust is formed through the appointment of a trustee.

Legal precedent further determines - as per the Deedat v The Master case of 1994 - that it is not necessary for property belonging to the trust to be transferred to the trustee or its beneficiary. All that is necessary for the existence of a valid trust is that the founder should be under an *obligation* to hand over control of the property to a *trustee*, whether named or not.

The Master of the High Court may be approached to appoint a trustee in the absence of a provision that governs the appointment of a trustee in the trust instrument (Section 7 of the Trust Property Control Act). The Master of the High Court will appoint a trustee after consultation with as many interested parties as he/she may deem necessary. The Master of the High Court may also appoint a co-trustee if he/she considers it desirable.

11.10 Is it a requirement to have a bank account in order to have a valid trust?

Section 10 of the Trust Property Control Act specifically provides that "whenever a person receives money in his/her capacity as trustee, he/she shall deposit such money in a separate trust account at a banking institution…"

For a trust to be validly formed, the founder is required to make a donation to the trust. In most cases, the founder stipulates an amount of money as the initial donation. Even if the amount is small (sometimes as little as R 100), it must be deposited into the trust's bank account by law. Although a trust bank account is *not* an essential requirement for the formation of a valid trust, the absence of a trust bank account could serve as evidence of a lack of the requisite intention to create a trust in the first place.