



THE POWER
OF INDEPENDENT ADVICE

IN THIS ISSUE

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SHOULD PERSONAL ASSETS BE OWNED THROUGH A TRUST?

By Desmond Benecke Certified Financial Planner® at Brenthurst Wealth

Including a trust in an overall financial plan has for decades been a popular choice for investors, but over time the legislation relating to, and tax benefits offered by trusts have changed. Including a trust in a financial strategy, as with most investment and personal finance decisions, depends on each investor’s objectives, personal circumstances, and investment goals. It has benefits and disadvantages and these should be considered with care to make an informed decision.

THE ASSETS NO LONGER BELONG TO THE FOUNDER/DONOR AND CONTROL MUST BE RELINQUISHED

Different trusts are available for various purposes, but a family trust remains the most widely used as an investment vehicle. [A trust](#) is effectively a legal relationship between the founder of the trust, who places the assets in the trust for the benefit of a third person, called a beneficiary. The Trust Property Control Act No. 57 of 1988 (TFCA) forms the framework in which trusts operate. A trust is not a juristic (legal) person, but it is sometimes regarded as having a separate legal identity for example for tax purposes in terms of the Income Tax Act.

The trust assets are placed under the control of a third party who is known as a trustee. Trusts are an effective instrument to transfer assets on through multiple generations for the benefit of beneficiaries. The assets are therefore mostly meant to be long lasting in nature with a long-term investment horizon.

Once assets have been transferred to a trust, they no longer belong to the founder or donor. The assets now belong to the trustees of the trust in their capacities as trustees and are to be managed for the benefit of the trust beneficiaries.

THE ORIGINAL DONOR NO LONGER HAS ANY DISCRETIONARY DECISION-MAKING AUTHORITY OVER THE ASSETS. If not, the trust may be regarded as a front (sham) and the protection and planning opportunities afforded by trust ownership will be lost. In the case of *Jordaan vs. Jordaan* it was ruled that the trust was the founder's alter ego (founder treated trust assets as his own) and determined that the separation of ownership or control from enjoyment is fundamental in creating a valid trust.

TRUSTEES NEED TO BE INDEPENDENT. One of the most important examples in case law in this regard is the case of *Landbank vs. Parker* where the Court of Appeals ruled that the Master of the Supreme Court must ensure that where the trustees of trusts and all the beneficiaries are related to each other, an independent trustee must be appointed. The purpose of a trust is to separate the enjoyment and control of the assets.

THE BENEFITS OF A TRUST

If trust assets are managed correctly, they will not form part of the founder's estate, but the founder could still enjoy the benefits thereof. Because the assets fall outside of the founder's personal estate, it will not attract estate duty or capital gains tax upon death. Assets can also be held for the benefit of next of kin while they will not form part of their estates.

ASSETS BELONGING TO A TRUST ARE PROTECTED FROM THE FOUNDER'S CREDITORS AND/OR MATRIMONIAL DISPUTES.

Should a founder wish to transfer assets that are already personally owned to a trust, the assets have to be sold or donated to the trust. The value of the sale price will remain an asset in founder's personal estate, but the growth in the value of the assets will take place within the trust. This approach is broadly referred to as 'estate freezing'.

Should the founder decide to donate the assets to the trust, such founder will be responsible for donations tax at a rate of 20% on all amounts above R100,000. If the asset to be donated is of a capital nature, capital gains tax will also be payable. The assets may be sold to the trust by way of a loan account, but the extent of the trust's indebtedness to the founder will remain an asset in his/her estate. Where no loan or sale agreement exists, SARS will consider the transaction as a donation. The loan account is usually gradually reduced during the founder's lifetime by loan repayments, further reducing estate duty liability.



When trusts are considered as part of [estate planning](#) cognisance must also be taken of the fact that individuals enjoy estate duty exemption to the value of R3,500,000, and if spouses bequeath their respective estates to each other, the total exemption amounts to R7 000 000. Estate duty only becomes relevant on estates above this value.

TAXATION AND COSTS TO BE CONSIDERED

Cognisance must be taken of anti-avoidance measures that have been introduced to prevent the abuse of trusts for tax avoidance purposes. Should assets be sold to a trust by way of a loan account, interest has to be charged by the founder, payable by the trust. Section 7C of the Income Tax Act (58 of 1962) states that interest not charged, and which is less than the official rate of interest (currently 4,5%) will be deemed to be a donation to the trust and donations tax will be payable.

Trusts are subject to income tax at a fixed rate of 45% and a sliding scale is not applied as with individuals. Income tax is paid at a rate of 45% regardless of the amount. Trusts also do not enjoy interest rate exemptions as individuals do.

The inclusion rate for trusts regarding capital gains tax is 80%, which is taxed at 45%. The effective rate is thus 36%. Trusts also do not enjoy the R40 000 per annum capital gains exemption which individuals do. This is much higher than the 40% inclusion rate applicable to individuals which is taxed according to the normal tax tables, resulting in effective rates ranging between 0% and 18% maximum.

If fixed property is registered in an individual's name and is a primary residence, the individual will be allowed an exemption for capital gains tax up to an amount of R2 million, which is a benefit that will not be available if the property was registered in the name of a trust.

The formation and administration of a trust is costly, and the costs must justify the potential benefits of having a trust.

TAX EFFICIENT INVESTMENT PRODUCTS

Given the high rate of taxation applicable to trusts, **endowments are ideally suited** for the placement of investment portfolios in the name of a trust. There are many benefits to an endowment, but they also have some disadvantages. Often the benefits of endowments outweigh the disadvantages.

Endowments are tax efficient and are taxed at a flat rate of 30% which is lower than the 45% that trusts are taxed at. The effective rate on capital gains tax is as low as 12% compared to 36% for trusts.



CONCLUSION

- ⇒ Before proceeding with setting up a trust make sure you are fully informed about the pros and cons of owning or transferring assets to trusts.
- ⇒ There must be a proper understanding that trusts should ideally house and grow wealth across multiple generations.
- ⇒ The deed of trust is critical in terms of specifying how the assets are to be administered and managed and should be prepared by a trust specialist.
- ⇒ When a trust is considered it should fit into the founder/donor's overall estate plan.
- ⇒ The intention should not primarily be to mitigate the payment of taxes.
- ⇒ The benefits of the trust should justify the costs and administration involved in keeping the trust compliant.
- ⇒ As with all decisions related to a personal financial plan, it is highly advisable to consult with a qualified Certified Financial Planner on the investment vehicle structure best suited to the individual's requirements – which may or may not include trusts.

INTRODUCING WEALTH MANAGER: DESMOND BENECKE, CERTIFIED FINANCIAL PLANNER®

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Desmond started his career as a Commercial Banker in 1983, and later became involved with Private Banking and Wealth Management in 1999.

He gained extensive experience in managing relationships with High-Net-Worth Families, Financial Planning and Fiduciary matters while with the Absa Group and Standard Bank.

Desmond is head of the Fourways office, Johannesburg. He is a CERTIFIED FINANCIAL PLANNER® professional and Tax Practitioner and is fully qualified to give advice on all investment matters.

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