Changes in our tax legislation and the outcomes of court cases have affected the administration and cost-effectiveness of trusts. Read about the different types of trusts to find out if a trust is necessary for you and if so, which type of trust will best serve your needs.

Testamentary trusts

Testamentary trusts remain the most valuable tool in estate planning when there are minor children involved. These trusts are stipulated in a will and only come into effect on death. They also dissolve when the child reaches a specified age.

Benefits of testamentary trusts

Without a testamentary trust, assets left to minors could be reduced to cash and paid into the Guardian‟s Fund with no growth and little flexibility. A testamentary trust only comes into effect on your death, as stated in your will.

Important things to know

Make sure you have a financial plan that provides for executor costs and taxes without putting the assets or capital in the estate at risk. This will ensure that there is enough capital to provide an income for the benefit of the minor children (or the spouse or adult dependents who lack the financial savvy to deal with an inheritance effectively).

Living trusts

Inter vivos trusts, or living trusts, are created while you are still alive. Your assets are transferred into the living trust and the value of these assets is capped at the value when they were transferred into the trust.

Benefits of living trusts

Because the growth on these assets does not fall into your estate, there is no estate duty or capital gains tax (CGT) paid on these assets when you die.

As the assets are not included in the estate there are also no executor‟s fees.

This means potential savings of 3.5% on executor‟s fees (plus VAT, if applicable), 20% on estate duty and capital gains tax on 25% of the gain, taxed at the planner‟s marginal rate of tax. This could amount to a considerable saving.

Important things to know

While this looks good on paper there are several negatives to consider and opting for a trust simply to avoid tax may not be as cost effective as it appears.

Loss of control

By transferring assets to the trust, you effectively give up ownership and control over them. If you continue to treat the trust‟s assets as your own, it will be seen as a “sham” trust, which SARS (and creditors) will investigate and all the taxes may be levied in the event of death as if you had actually held the assets in your own name.

Higher taxes

Tax charged to the trust can be at a higher rate than tax charged to an individual. All income retained by the trust will be taxed at a flat rate of 40%, and all capital gains made and retained by the trust will be taxed at an effective rate of 20%.

Costs and fees

The cost of transferring assets into a trust can be high. You will need to pay:

Costs for establishing the trust.

CGT when you dispose of assets to the trust.

Transfer duty on transferring immovable property to the trust.

Donations tax if you donate the assets to the trust instead of selling them to the trust.

Choosing the right trustee

It is essential to have a third-party, arms-length trustee who acts for the beneficiaries of the trust. The trustee should keep proper records of all meetings to show that he or she has acted for the beneficiaries rather than „rubber stamping‟ decisions made by the planner of the trust.

Trustee fees and responsibilities

A trustee will normally charge a fee for professional services, and rightly so. Trustees are personally liable to SARS if the trust does not account for its taxes correctly, so the independent trustee could potentially be exposing himself to risk. This fee can amount to a sizeable sum of money over time.

Alternatives to setting up a trust

If the only reason for establishing a trust is to save taxes on death, it is best to weigh up all the additional costs incurred in setting up and maintaining a trust. You could just as easily take out life insurance to cover the costs of taxes and executor‟s fees and it may work out a great deal less expensive than a trust.
If, however, the growth asset is something that will never be realised, but kept in the family for generations to come, such as a game farm or holiday home at the coast, then transferring it to a trust may still make good financial planning sense.