

# IT'S A MATTER OF



## What is a Trust?

In the most basic terms a Trust is an arrangement by which assets are held and administered by persons who do not actually own the assets, for the benefit of trust beneficiaries.

A fundamental element to the Trust arrangement is the relinquishment of ownership and control of Trust assets from the donor/founder to Trustees who administer the Trust assets on behalf of Trust beneficiaries.

## How is a Trust formed?

### 1. **Inter Vivos Trust:**

- Created during the lifetime of the donor/founder;
- Useful for asset protection and estate planning.

### 2. **Testamentary Trust**

- Created in Will - The Trust is formed on the death of the donor/founder;
- Vehicle to protect assets following death of donor/founder and a mechanism for the donor/founder to direct how assets are vested in beneficiaries.

## 3 Fundamental elements of a Trust:

### 1. The Trust Deed

The Trust Deed is a Trust's constitutional document which sets out the framework within which a Trust must operate, including its powers and limitations. It is noteworthy that the Trust will not be entitled to act in a manner not specifically authorised by its Trust Deed.

### 2. The Trustees

The Trustees are appointed to administer the Trust assets for the benefit of the beneficiaries. The Trustees are appointed through the office of the Master of the High Court and have no capacity to act as a Trustee until such time as he/she has been appointed as a Trustee in terms of letters of authority issued by the Master of the High Court.

The Trustees have, in terms of the common law and in terms of statute, a fiduciary duty to the beneficiaries of the Trust.

Although not a strict legal requirement, when considering the appointment of Trustees, the appointment of an independent Trustee should be considered, especially in the case of a Family Trust.

The following should be noted when considering the appointment of an **independent Trustee**:

- an independent Trustee is not a beneficiary of the trust nor is he/she related to the beneficiaries, Trustees and/or founder of the Trust;
- the Master of the High Court has previously refused to register a Trust or amend Trustees where there is not an independent Trustee appointed;
- the case of *Land and Agricultural Development Bank of South Africa v J L Parker* ("the Parker case") is the landmark case relating to the issue of an independent Trustee. Justice Cameron held that there must be a clear differentiation between beneficiaries and Trustees of a Trust. He held further that it was the responsibility of the Master to ensure that Family Trusts are not controlled solely by family members who are beneficiaries;
- it is important that a donor/founder understands that assets which are owned by the Trust are no longer his to administer as he sees fit. If ownership of assets is transferred to a Trust and the donor/founder continues to administer assets as if they were his own there is a risk that these assets will be vulnerable to his personal creditors. It can be argued that the Trust is simply being used as an "alter ego" and the protection afforded by the Trust can be pierced.

### 3. The Beneficiaries

The beneficiaries of a trust are the individuals / entities entitled to benefit from the Trust assets or income.



## 2 Benefits of holding assets in a Trust

There are two main benefits to the transfer of assets into a Trust:

### **1. Protection of assets against creditors:**

The transfer by a donor/founder of assets into a Trust offers protection against creditors as neither the donor/founder, Trustees or the Beneficiaries own the assets. The donor/founder has effectively relinquished ownership of the assets and as such Trust assets are not as vulnerable to the outcomes of liquidation, sequestration and divorce;

## 2. Estate and succession planning:

Trusts provide for the creation of flexible succession arrangements.

The assets owned by the Trust will not be subject to cumbersome and often lengthy legal procedures after the death of the founder/donor nor will they be subject to estate duty. Trust assets will not be “frozen” during the winding up of the donor/founder’s personal estate.



### Concerns for those contracting with Trusts

There are certain concerns which warrant consideration by third parties when concluding agreements with a Trust. The following is worthy of consideration:

A Trustee acting without requisite authority:

- 1.1 A Trustee may not act on behalf of a Trust, even if appointed in accordance with the Trust Deed, without the prior authorisation of the Master (in the form of letters of authority). Any action taken by an appointed Trustee prior to receiving letters of authority will be null and void and incapable of ratification;
- 1.2 A Trustee may not bind a Trust without acquiring the necessary authority from the remaining Trustees, as provided for in the Trust Deed. An agreement concluded by a Trustee without the necessary authority may in certain instances be null and void.

Take heed of this extract from Justice Scott’s judgment in the case of *Nieuwoudt and another NNO v Vrystaat Mielies* – “It is moreover trite that unless the Trust Deed provides otherwise, Trustees must act jointly. In the absence of a contrary provision in the Deed they may, however, authorize someone to act on their behalf and that person may be one of the Trustees”.

- 1.3 A Trustee will have no authority to act on behalf of the Trust where the Trust Deed does not explicitly or implicitly empower the Trustee to act and any action taken by Trustees outside the scope of their power is null and void

It is prudent for third parties, in the protection of their own interests, to have sight of both the letters of authority and the Trust Deed prior to the conclusion of agreements with a Trust. This will assist third parties in determining the identity of the Trustees, the limitations on their powers, the capacity of the Trust to conclude certain agreements and the minimum number of Trustees required to enable the Trust to act. At the very least, a Resolution should be obtained *prior* to signing.

### The Conduit Principle & Basic Taxation

A well-established principle in relation to the taxation of Trusts is the conduit principle in terms whereof Trust income or capital that has become vested in the beneficiaries is not taxed in the hands of the Trust, but rather in the hands of the beneficiaries.

Currently the rate for income tax in a trust is **41%** from the first rand, with no rebates. This is as opposed to an incremental marginal rate starting at 18% and going up to 41% with various exemptions and rebates (where applicable), available to individuals.

Therefore it is beneficial, for tax saving purposes, for a Trust to distribute Trust income to the beneficiaries in whose hands Trust income will be taxed.

#### **IMPORTANT NOTICE**

The information contained in this document is a summary. You are strongly cautioned not to act solely on material contained in this document as the nature of the information contained herein is general and may in certain circumstances be subject to misinterpretation. In addition, laws and the application thereof change over time. Consequently, it is recommended that you seek advice when dealing with Trust and tax issues for specific situations. While every care has been taken in the compilation of this document, no responsibility of any nature whatsoever shall be accepted for any inaccuracies, errors or omissions.