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THE USE OF SOUTH AFRICAN TRUSTS AS ESTATE PLANNING AND WEALTH PRESERVATION TOOLS

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To my

loving and supportive husband,

my brave superhero son

and new born angel baby boy

I will forever be grateful for your love,

understanding and patience during the writing of this research report.

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Chapter 2: Abstract

Much focus has been placed on the ability of trusts in achieving the function of serving as estate planning and wealth preservation tools. Throughout the years, trusts have held a primary function to provide asset protection and continuity of ownership, and in certain circumstances trusts have been seen to also provide tax advantages.

Various committees, legislation and Acts have played an integral part in providing guidance and recommendations to the use of trusts to ensure its proper use through policies and laws that disincentivise the ill-use and abuse from the time a trust is set up, throughout its course of existence.

This research will investigate whether trusts are a viable estate planning and wealth preservation vehicle where Chapter 3 focuses on understanding the different types of trusts and their uses highlighting the need and practicality of use for each type. Chapter 4 unpacks the elements and importance of estate planning as well as how estate planning marries into other principles such as wills, taxation, donations, and estate administration. Chapter 5 will illustrate five wealth preservation principles and recommendations within the South African context. Chapter 6 identifies how trusts can be utilized as asset protection mechanisms by expanding and detailing on the areas of insolvency of the different trust role-players, attachment of debt by creditors, the look into how unsuccessful marriages and divorce may impact trust assets, the value and of business trusts as well as various applicable case law that complement this chapter. Lastly, Chapter 7 details the different types of taxation on trusts and the impact these taxes have, along with anti-avoidance provisions that have been promulgated overtime into the *Income Tax Act 58 of 1962.*

Key Words: SARS, interest-free and low interest loans, Types of Trusts, Estate Planning, Wealth Preservation, Donations tax, Creditors, Davis Tax Committee, Protection Mechanism for Assets, Estate Duty, Anti-Avoidance Provisions, Donor attribution rules(s 7), Trust Income (s 25B)

Chapter 3: Introduction

The topic chosen for this research report is titled '***THE USE OF SOUTH AFRICAN TRUSTS AS ESTATE PLANNING AND WEALTH PRESERVATION TOOLS'***

This topic has specifically been chosen as it is one of particular interest and importance from past personal experiences as well as the scope of work many have been exposed to and currently doing. Many professionals who are involved in financial advice, financial planning, and tax consultancy throughout their work life, have experienced different variations and applications of trusts to individual and/or entity solutions.

In many instances, there has been great debates on misuse, abuse, and unviability of trusts as estate planning tools.

The use and purpose of trusts can be extremely wide and broad. The aim of this report is not to explore and find solutions to a problem, but rather analyse ways in which a trust can be considered an estate planning and wealth preservation tool looking at current legislation and recommendations as well as expressed possible future practices.

The context of the research report states how this is a practice that can work successfully and can be feasible and useful within its context. The efficiency of the use of a trust as an estate planning and wealth preservation tool will be explored deeper and ultimately making a conclusion on its viability or lack thereof.

Chapter 4

3.1 Different types of South African Trusts

It is very important to understand why a *'person(s)'* would want to create a Trust and what purpose or need it has to meet. Through having insight into this, one can appropriately advise and identify the most suitable type of Trust as part of estate and wealth preservation planning.

Trust Property Control Act 57 of 1988 defines only two types of Trust Instruments para (a) where ownership in property is made over or bequeathed to the Trustees, to be dealt with in terms of the Trust Instrument (Deed) and;

Para (b) where ownership of assets is passed to beneficiaries, but the administration thereof is done by the trustees.

Para (a) is commonly called a *'discretionary trust',* although the Deed might determine a future date when beneficiaries must receive income or capital (which gives them a vested right to receive a future distribution)
Para (b) is a '*vesting or bewind trust*' - where ownership passes immediately to the beneficiaries

The fiduciary industry has, over the years, used various unofficial names to describe a trust, based on the purpose for which it was created. Commonly used names for Trusts are:

- Special Trust (a classification under the Income Tax Act)
- Family Trust (a term for a TPCA para (a) trust)
- Vesting or Bewind Trust (TPCA para (b) trust)
- Business Trust

3.2 The Importance of Estate Planning

During our lives, we have the opportunity of putting together a protective plan that benefits 'our loved ones', when we are no longer around.

The objective of estate planning is to ensure that loved ones are taken care of as per a person's specific wishes. This planning can be defined as the process of creating documentation and managing applicable assets and liabilities with the purpose to preserve and legally protect assets, during a person's lifetime, so that the subsequent distribution of these assets to succeeding generation is effective.

In this chapter, we will look at how to define an 'estate' in this context, who should consider developing an estate plan, when should one possibly start with the plan and areas to consider, different role players and parties to an estate plan and how often this plan should be reviewed.

3.3 Wealth Preservation in South African context

Wealth preservation can come in various forms and needs to be applied accurately. This is a strategy that ensures your assets grow while providing a legacy for your family. As can be spotted, wealth preservation does somewhat overlap with estate planning, but the essence of this involves management of assets in such a way that it ensures the value of these assets does not decrease or erode – to preserve the wealth. Trusts can be seen as efficient and successful in this regard and, in this chapter, we will be exploring in greater detail how this can be made possible.

3.4 Trusts as a protection mechanism for assets

One can confidently argue that one of the biggest motivators behind creating trusts as protection mechanism of assets, is the protection one inherits after the transfer of these assets from their personal capacity into the trust entity. This protection can vary from creditors, businesses, legal claims or consequences of unsuccessful marriages (divorce) or a fall out in business relationships.

Another benefit of having assets transferred into a trust is the protection of these assets from trustees who in their personal capacity could become insolvent. The same advantages would apply to the beneficiaries of a trust, but this would need to be investigated further depending on the type of trust.

Should the founder of the trust be declared insolvent or sequestrated, once again, all assets transferred into the trust prior to this will be protected as they no longer form part of their personal estate.

Based on the summary above, there are numerous asset protection benefits that can be derived from the transfer of assets into the applicable trust type along with proper administration as per basic trust principles. In this research report, we will be exploring more detail into these.

3.5 Impact of taxation on the use of trusts as an estate planning and wealth preservation tool

A trust is a separate (legal entity) taxpayer and the trust itself might be taxed on undistributed trust income and trust capital gains.

When it comes to taxation of Trusts, many different types of taxes are applicable, but the most important thing is how one (within the boundaries of the law) can minimise or even avoid payment of these taxes. In this section we will also explore some measures put in place that make it illegal to transact or to structure trusts in a specific way which encourages tax evasion – the applicable anti-tax avoidance measures.

Impact of the following taxes on the use of trusts as estate planning and wealth preservation tool will be applied and discussed:

Income Tax is a tax that is charged on Income received or accrued to a South African registered Trust on both local income and worldwide income in that specific tax year and this is either at a flat rate or sliding scale applicable to natural persons depending on the type of trust definition.

Capital gains tax is a tax which is charged on the disposal of capital assets. This tax is only triggered through disposing a list of specific assets, assets which fall into the definition of capital assets under the Eighth Schedule of the Income Tax Act.

Donation tax is a tax charged on the disposal of an asset to another party. The person making the donation is called the donor (the giver of the donation) and they are responsible for paying donations tax and the person receiving the donation is called a donee (the receiver of the donation).

Lastly, the implications of the introduced of section 7C will need to be discussed in greater detail as this piece of legislation forms an integral part of this chapter.

Conclusion

The planning and execution of a trust for desired goals and wishes can be done in a way that aims to both preserve wealth and ensure effective succession. Understanding the various pieces of legislation that overlap is paramount to achieving this goal.

Research Methodology

As we know, research is the gathering of information (knowledge and facts) to be used as a solution to a particular question or particular problem.

The research methodology that will be used in this particular research report is the *qualitative method/methodology* which explores available literature around the chosen topic by reviewing and applying a host of academically acceptable source material written in publications, interpretation notes, guidance notes, acts, journals, books, court judgements etc.

Chapter 4 : Different types of South African Trusts

4.1 Introduction

Trusts are one of several tools which form an integral part of holistic financial planning. Each person's life circumstance, and the ownership status of his/her assets is unique. Estate planning will involve the structuring of your assets in such a manner that you and your loved ones are best protected. For some individuals and under certain circumstances, a trust can provide a viable solution during one's lifetime and even after death.

Trusts are established for various reasons and can be created in various ways. The way in which a trust is created might impact the rights that beneficiaries have, the way in which the trust and beneficiaries are taxed as well as limitations and powers available to the different role players within the trust.

The starting point to creating a trust is understanding *'why'* an individual would want to set up a trust and what purpose or need it must meet. Through having insight into this, one can appropriately identify and advise the most suitable type of trust as part of estate and wealth preservation planning.

A trust under the South African law is a contract whereby a donor (who is also known as the settler, founder or creator of the trust) transfers assets to a trustee or trustees. In terms of the founding document of the trust (the 'trust deed'), the trustees will have no beneficial interest in the assets but are bound to hold them and apply them for the benefit of the beneficiaries or for some other special purpose.[1]

Section 1 of the Income Tax Act describes a 'beneficiary' in relation to a trust

> 'as a person who has a vested or contingent interest in all or a portion of the receipts, the accruals, or the assets of a trust.'[2]

The Trust Property Control Act 57 of 1988 (TPCA) defines a trust as:

"trust" means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed-

[1] Burman, K (2009) *A Logical Approach to South African Tax*: 11th Ed, Edge Learning Media
[2] S1 Income Tax Act 58 of 1962

(a) 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

(b) 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,

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965 (Act No. 66 of 1965)[3]

Para (a) defines where ownership in of the trust property is made over or bequeathed to the trustees, to be dealt with in terms of the trust instrument (deed); and

Para (b) where ownership of assets is passed to beneficiaries, but the administration thereof is done by the trustees.

Para (a) is commonly called a *discretionary trust, ownership trust or ordinary trust,* although the deed might determine a future date when beneficiaries must receive income or capital (which gives them a vested right to receive a future distribution).

Para (b) is a *vesting or bewind trust* - where ownership passes immediately to the beneficiaries.

Trusts can also be described according to when they are created namely, *Inter Vivos Trust (Living)*[4] and *Testamentary Trust (Mortis Causa)*[5].

4.1.1 Inter Vivos Trust

An inter vivos Trust (meaning 'between the living') is created during the founder's lifetime through the conclusion of a legal binding contract. This contract is called a Trust Deed which sets out who the various role players (founder, trustees, and beneficiaries) to the trust are, as well as how and when the trust is to be wound up.

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[3] Trust Property Control Act 57 of 1988; see definitions under section 1

[4] SARS, (2022) *'Types of Trusts'* available at https://www.sars.gov.za/business-and-employers/trusts/types-of-trust/ [accessed 2 February 2022]

[5] BDO, '*Trusts'* *https://www.google.com/search?q=BDO+trusts&sxsrf=ALiCzsaM1P7ROKvHwlXsFz-d_yvGCmBJ9Q%3A1655766553286&source=hp&ei=Gf6wYpbSD5G0gQadgo9I&iflsig=AJiK0e8AAAAAYrEMKX0N0ZrbGu7VkcdY4wBzc8ooN6G5&ved=0ahUKEwjWwvOJk734AhURWsAKHR3BAwkQ4dUDCAc&uact=5&oq=BDO+trusts&gs_lcp=Cgdnd3Mtd2l6EAMyBQgAEIAEMgYIABAeEBYyBggAEB4QFjoECCMQJzoLCAAQgAQQsQMQgwE6CAgAELEDEIMBOg4ILhCxAxCDARDHARCjAjoFCC4QgAQ6FAguEIAEELEDEIMBEMcBENEDENQCOhEILhCABBCxAxCDARDHARCjAjoLCC4QgAQQxwEQrwE6EQguEIAEELEDEIMBEMcBENEDOggIABCABBCxAzoLCC4QgAQQxwEQ0QM6CAgAEIAEEMkDUABYgWZg6nFoAHAAeACAAecCiAHsFpIBBTItNy4zmAEAoAEB&sclient=gws-wiz* [accessed 2 February 2022]

An inter vivos Trust becomes operational when the creator of the Trust (founder) makes transfer of assets, capital, or money into the Trust.

There are various kinds of inter vivos trusts that can be set up, depending on their purpose.

4.1.2 Testamentary Trust

A testamentary trust (through the provisions of a Will) is created by a trust clause in a Will, where the testator bequeaths assets to the trust and stipulates the terms and conditions which will apply to the trust. This is the most used form of a trust in South Africa.

The most common use of a testamentary trust is to protect minor children and those who cannot look after their own affairs. Assets that form part of a deceased estate may be moved to the testamentary trust for the intended use for the beneficiaries and sometimes include limited rights such as usufructs.

The will outlines how the trustee is to administer the trust as well as under what circumstances the trust should terminate once which can be triggered by certain events. For example, a minor beneficiary turns 18 years of age or the death of an income beneficiary.

Under normal circumstances a testamentary trust cannot be amended but the TPCA may give the court certain powers to amend.

Another differentiating factor to the type of trusts is the rights given to beneficiaries namely, – Discretionary Trust and Vested (Vesting) Trust.

4.1.3 Discretionary Trust

This type of trust gives the trustee(s) discretionary powers outlined in the trust deed or will on how manage the allocation of income or capital of the trust to the beneficiaries. The beneficiaries have no control, power, or ownership in anyway and in the event of death or insolvency, nothing can be held in their estate or have it passed to their heirs or even creditors.[6]

Part of the S1 definition of a trust beneficiary makes reference to 'contingent interest' to the beneficiary, where *Silke ON* South African Income Tax authors, *AP de Koker* and *RC Williams* highlight that this contingent interest 'encompasses in the definition the beneficiary of a discretionary trust in whom the trustees have not yet vested any amount of trust property.'[7]

4.1.4 Vested Trust

The trust deed or will outlines how the trust benefits are to be distributed or shared among the beneficiaries. In this type of trust, the trustees have no power and discretion over how the trust capital and income should be managed as these are fixed and predetermined.

The beneficiaries have a vested right to the income and capital, which cannot be contested by anyone else.

Any income earned by the trust vests in the beneficiary. The beneficiaries have a personal right to claim their portion of the trust benefits from the trustee upon the happening of a certain event (e.g., upon reaching the age of eighteen).

In the event of the death of the beneficiary prior to payment, the deceased beneficiary's interests (i.e., his personal rights) are transmissible to his heirs, and these must be included in his estate for *estate duty*[8] purposes. This in turn has is one of the disadvantages from an estate planning and wealth preservation point of view.

[6] BDO, '*Trusts*' https://www.google.com/search?q=BDO+trusts&sxsrf=ALiCzsaM1P7ROKvHwlXsFz-d_yvGCmBJ9Q%3A1655766553286&source=hp&ei=Gf6wYpbSD5G0gQadgo9I&iflsig=AJiK0e8AAAAAYrEMKX0N0ZrbGu7VkcdY4wBzc8ooN6G5&ved=0ahUKEwjWwvOJk734AhURWsAKHR3BAwkQ4dUDCAc&uact=5&oq=BDO+trusts&gs_lcp=Cgdnd3Mtd2l6EAMyBQgAEIAEMgYIABAeEBYyBggAEB4QFjoECCMQJzoLCAAQgAQQsQMQgwE6CAgAELEDEIMBOg4ILhCxAxCDARDHARCjAjoFCC4QgAQ6FAguEIAEELEDEIMBEMcBENEDENQCOhEILhCABBCxAxCDARDHARCjAjoLCC4QgAQQxwEQrwE6EQguEIAEELEDEIMBEMcBENEDOggIABCABBCxAzoLCC4QgAQQxwEQ0QM6CAgAEIAEEMkDUABYgWZg6nFoAHAAeACAAecCiAHsFpIBBTItNy4zmAEAoAEB&sclient=gws-wiz [accessed 2 February 2022]

[7] AP de Koker, RC Williams, March 2022, Silke On South African Income Tax, Lexi Nexis Durban, Available at https://mylexisnexis.co.za/Index.aspx [accessed 6 September 2022]

[8] Estate Duty Act 45 of 1955

4.1.5 Hybrid Trust

The majority of trusts in South Africa will have vested and contingent rights provided for in the trust instrument. In other words, a combination of the vesting trust and the discretionary trust mentioned above[9].

The fiduciary industry has, over the years, used various unofficial names to describe a trust based on the purpose for which it is created. Trusts may be classified as different types based on the application of the trust namely, -

- Special Trusts
- Asset-Protection trusts
    a) Family (Private) trusts
    b) Empowerment/Employee trusts
    c) Trading (Business) trusts
    d) Offshore/Foreign trusts
- Charitable trusts
- BEE trusts

4.1.6 Special Trust

A further type of trust is a special trust. The Act describes a special trust to be:

''special trust' means a trust created –

(a) *solely for the benefit of one or more persons who is or are persons with a disability as defined in section 6B(1) where such disability incapacitates such person or persons from earning sufficient income for their maintenance, or from managing their own financial affairs:*

Provided that-

(aa) such trust shall be deemed not to be a special trust in respect of years of assessment ending on or after the date on which all such persons are deceased; and

(bb) where such trust is created for the benefit of more than one person, all persons for whose benefit the trust is created must be relatives in relation to each other; or

(b) *by or in terms of the will of a deceased person, solely for the benefit of beneficiaries who are relatives in relation to that deceased person and who are alive on the date of death of that deceased person (including any beneficiary who has been conceived but not yet born*

[9] SARS, (2022) *'Types of Trusts'* available at https://www.sars.gov.za/business-and-employers/trusts/types-of-trust/ (accessed 2 February 2022)

on that date), where the youngest of those beneficiaries is on the last day of the year of assessment of that trust under the age of 18 years' [10]

As seen above, there are therefore two types of special trusts and are set up either inter vivos (during the life of the founder) or in a will - special trust Type A and special trust Type B. Special Trust Type A is specifically for a person who suffers from a *mental illness*[11] as defined in Section 1 if the Mental Health Act 18 of 1973; or any *physical disability*[12] where such an illness or disability incapacitates such a person from earning sufficient income to maintain themselves and Special Type B - if at least one or all the beneficiaries of a testamentary trust is/are under the age of 18 at the date of the founder's death.

A beneficiary of a special trust may be granted a vested right to income and/or capital or may not enjoy any such vested right depending on the provisions of the trust instrument.

Type A trusts[13] can be testamentary or inter vivos trusts depending on the objectives of the founder and are at times set up as a result of a court order in favour of a specified natural person.
A beneficiary of this trust must have a disability which limits their ability to function or perform activities of daily living which include physical, sensory, communicative, intellectual, or mental impairments which have been diagnosed as permanent and non-reversable. The impairments/disability needs to have affected the beneficiary for at least 12 months.

Type B trusts[14] are testamentary trusts created via a will to ensure maintenance and care of beneficiaries (both dead and alive and those who have been conceived but not yet born) who are relatives and or children of the testator of which the youngest of the testator's relatives should be under the age of 18 at the time of their death for the testamentary trust to be formed.

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[10] The Income Tax Act 58 of 1962
[11] Mental Health Act 18 of 1973
[12] S6B(1) Income Tax Act 58 of 1962
[13] Burman, K (2009) *A Logical Approach to South African Tax*: 11th Ed, Edge Learning Media
[14] Burman, K (2009) *A Logical Approach to South African Tax*: 11th Ed, Edge Learning Media

4.1.7 Family Trust

A Family Trust is a type of inter vivos or testamentary trust which is created by or between living persons through a contractual agreement or via a will. There is a *connected person*[15] relationships between the different role players in a family trust and/or one person takes on one or more roles. For example – where all the trustees are also beneficiaries, and the beneficiaries are all related to one another. But in such an instance, the Master of the High Court can insist on the appointment of an independent outsider as one of the Trustees. A typical example of a family trust is where the founder of the trust is the husband, and he nominates himself as well as his wife as the trustee and their two children are the beneficiaries.

4.1.8 Employee Trust

Empowerment trusts, or Employee trusts, are inter vivos trusts that are set up to give employees an opportunity to meaningfully participate in, and co-own, a business venture, while they are in the employ of the entity. The trust will be one of the shareholders in the business, and as such will share in the profits of the business[16].

4.1.9 Business Trust

This is a type of trust is used to hold and protect business assets which is especially beneficial under undesirable events of subsequent liquidation, sequestration, or divorce. A business trust may also be used to hold shares in businesses and to ensure the continuity of ownership of assets. It is usually a TPCA para (b) trust where the beneficiaries have vested rights to a defined percentage of the income and capital (similar to the rights of a shareholder of a company). These are inter vivos trusts formed to carry on the business with a profit incentive and may be public or private with administration less complex and less expensive than a company or close corporation. Trustees may be held personally liable in the event of failure to exercise reasonable due care, skill, and diligence.

[15] S1 Income Tax Act 58 of 1962

[16] Trust Eeze *'Empowerment/Employee Trust'* 2022, https://trusteeze.co.za/empowerment-employee-trust (accessed 8 February 2022)

4.1.10 Foreign Trust

A foreign/offshore trust is one that is set up in various jurisdictions outside of South Africa with its place of effective management being outside the republic. This type of trust is non-South African and non-resident. In general, a foreign trust is typically set up in a tax haven jurisdiction not to say that there perhaps aren't any tax disadvantages and specific anti-avoidance provisions which can deter interest in this type of trust set up.

4.1.11 Charitable Trust

This type of trust is set up for charitable purposes and may benefit from certain tax exemptions should it meet the applicable criteria.

4.1.12 BEE Trust

This trust is set up with the primary purpose of providing an opportunity to previously disadvantaged (black) persons through a change of regaining economic agency they were deprived of during the South African apartheid regime. The BEE trust is governed under the Broad-based Black Economic Empowerment Act 53 of 2003 and is used to hold rights of ownership by employees, communities, or other similar collective groups where the trust instrument/deed specifies the proportion of entitlement in receiving any distributions.

The trust deed must be implemented as a living document and upon it's ceasing, all accumulated economic interest must accrue to the participants or to an entity with similar objectives.

4.2 Conclusion

As can be seen from the above discussion, there are clear benefits as to how the different trust structures can be used as a viable wealth and estate planning tool. This is evident in that trusts serve as an excellent mechanism for the safeguarding of assets and ensuring that disabled and minor beneficiaries are not taken advantage of when the founder is no longer around as well as trusts are used to hold and protect assets (as well as business assets) which is especially beneficial in the event of subsequent liquidation, sequestration, or divorce. This is an effective structure from the point of view of estate planning – for estate duty savings as well as protection of assets from creditors, on the basis that the trust assets do not form part of the estate planner's estate. The one disadvantage as mentioned, is upon the death of a vested trust beneficiary their vested rights/assets will form part of their deceased estate and ultimately contribute towards their estate duty.

Chapter 5 : The Importance of Estate Planning

5.1 Introduction

During our lives, we have the opportunity of putting together a protective plan that benefits our loved ones when we are no longer around.

The objective of estate planning is to ensure that loved ones are taken care of as per a person’s specific wishes with provisions in place during the person’s lifetime and thereafter. This planning can be defined as the process of creating documentation and managing applicable assets and liabilities with the purpose to preserve and legally protect assets, during a person’s lifetime, so that the subsequent distribution of these assets to succeeding generation is effective.

This chapter will illustrate how to define an estate planning in this context, who should consider developing an estate plan, when should one possibly start with the plan and other important arears of consideration.

5.2 Defining Estate Planning

Many South African authors defined estate planning over the years.

Meyerowitz – ‘*the father of estate planning’* has defined estate planning in the following terms:

Meyerowitz (1965:1):

‘The arrangement management and securement and disposition of a person’s estate so that he, his family and other beneficiaries may enjoy and continue to enjoy the maximum from his estate and his assets during his lifetime and after his death, no matter when death occurs’

Bobbert (1976:15):

‘Estate planning is the process whereby a person acquires property, ensuring that he derives the maximum benefits from his ownership and the enjoyment thereof during his lifetime and that as much as possible and in the most economical manner with the minimum erosion thereof shall devolve upon his heirs when he dies.’

Van der Westhuizen (1988:46):

'The deciding in advance by an estate owner of what to do with his assets and liabilities during his lifetime and upon his death, how to do it, when to do it and who to do it.'[17]

5.3 The importance of Estate Planning

Estate planning involves the structuring of wealth optimally during one's lifetime and to also be carried out after their death. This is done through planning for all life events such as a marriage, birth of a child, divorce, and death through the set-up of various financial planning and legal provisions in place such as; an up-to-date will, recommended insurance products and/or the creation and set up of wealth preservation structures such as trusts.

Estate planning is important to the estate planner, their loved ones and relatives as it provides confidence that their wishes are clear and will be acted on through the protection of beneficiaries and children. Properly set up estate plans can avoid unnecessary delay in pay-outs of assets and inheritances by ensuring the administration of the estate is as efficient as possible and thus preventing loved ones from being forced to sell assets to cover costs. Having peace of mind that the way one's wealth is structured allows for changes over time and that it provides protection against risk such as creditor risk.

Estate planning extensively involves the understanding of financial impact of death, the costs that will apply and measures that can be put in place to mitigate these costs such as taxes for example estate duty.

The 2015 first interim report on estate duty published by the Davis Tax Committee looked at how the progressivity of the tax system and the role and continued relevance of estate duty to support a more equitable and progressive tax system, with this inquiry specifically focusing on the interaction between the then workings of various sections of act that interlink with estate duty.

[17] Burger, T. 2011. *The future of trusts as an estate planning tool.* North-West Universuty. (Dissertation – Mcom)

The report referred to there being no ‘silver bullet’[18] which could make a substantial difference to the overall revenue from tax in South Africa.

This report was to highlight areas within the various legislation that prohibit successful and large amounts of estate duty collection. It stated in the report that in the absence of specific anti-avoidance provisions within the Estate Duty Act, there was little to prevent South Africans from using trusts as effective estate duty saving mechanisms[19].

This of course is the question at hand in relation to this specific research report. The above finding conquers with the notion that trusts do form a solid estate planning tool.

Olivier and van den Berg (1991:14) considered the abovementioned definitions and stated that estate planning involves the accumulation, utilisation and distribution of assets and that it consists of the following three aspects:

(a) The evaluation of the existing state of affairs

Evaluating the existing state of affairs will ensure the organised and responsible creation of wealth and the accumulation of assets during a person’s lifetime. This involves an investigation of a person’s existing economic position, business history, background and family circumstances. (Olivier & van den Berg,1991:14)

(b) The evaluation of the future

The evaluation of the future aims to ensure that the future accumulation of assets take place in an orderly manner. This involves an investigation of a person’s objectives, needs and prospects (Olivier & van den Berg,1991:14).

Because a person’s needs and personal circumstances are continually changing, an estate plan should be flexible and capable of being adapted to changed circumstances.

(c) The evaluation of the position as it will be after death

[18] Davis Tax Committee, (2015) *‘First Interim Report on Estate Planning For The Minister Of Finance’* Chapter 2, available at https://www.taxcom.org.za/docs/20150723%20DTC%20First%20Interim%20Report%20on%20Estate%20Duty%20-%20website.pdf

[19] Davis Tax Committee, (2015) *‘First Interim Report on Estate Planning For The Minister Of Finance’* Chapter 2, available at https://www.taxcom.org.za/docs/20150723%20DTC%20First%20Interim%20Report%20on%20Estate%20Duty%20-%20website.pdf

This part of the planning process involves the final distribution of assets and the preparation of a succession plan that will meet a person's objectives in a manner that is both practically efficient and fiscally beneficial (Olivier & van den Berg,1991:14).[20]

5.4 Wills and Estate Planning

The *law of succession*[21] determines what will happen to a person's estate when they die. On death a person's estate can devolve in one of three ways:

(i) Testate – when a person disposes of his estate by means of a valid Will
(ii) Intestate – a person's estate is not dealt with in a Will, or the Will is invalid, or the Will is partially invalid

Drafting and executing a Will in accordance with the provisions of the Act[22] is one of the most important tools in estate planning and one that should promote a feeling of security and peace of mind.

A Will can help a person control how his estate is to be divided and it removes the uncertainty about how his assets should be distributed.

It records the wishes to ensure the well-being of the estate owners' family and dependants when they are no longer around. Also, if the estate owner decided to pass their estate to personal friends or charity a valid Will is the primary means of fulfilling these wishes.

Once a person dies without a Will, they automatically forfeit the freedom of deciding what should happen to their estate which means it will be administered in terms of the *Intestate Succession Act*.

The matter between *Khuzwayo v Tshinavhe*[23] serves as common and very true reflection of the challenges and feuds that can arise in the instance of an estate devolving intestate.

In this case, Mrs Khuzwayo dies with a valid Will[24]in place and is survived by her mother and siblings. She and her husband who had pre-deceased her had no children

[20] Burger, T. 2011. *The future of trusts as an estate planning tool.* North-West University. (Dissertation – MCom)
[21] Intestate Succession Act 81 of 1987
[22] Wills Act 7 of 1953
[23] *Khuzwayo v Tshinavhe NO and Others* (2018) ZAGPJHC 514
[24] Wills Act 7 of 1953 ; Section 2 (formalities required in the execution of a Will) and Section 4 (competency to make a Will)

and both of them had no children. In her Will she bequeathed her estate to one of her survivors. The nephew of her husband who predeceased her applied to the high court to have Mrs Khuzwayo's last Will and testament declared null, and void and it be ordered that she dies intestate, and the disillusion of her estate is administered in terms of the Act[25]. This application was on the grounds that it was verbally agreed that Mr and Mrs Khuzwayo would leave the house to him upon death and not to anyone else. During the proceedings, it was also mentioned that the applicant neither never stayed at the premises nor lived in the premises during the time Mrs Khuzwayo fell ill before her death.

The courts ordered the application to be dismissed as the Will was considered valid along with no provision in is bequeathing the applicant any of the deceased estate or part thereof. The applicant was also neither the deceased child nor adopted child.

If the deceased failed to consider estate planning and not draft a will to execute their wishes upon death, the outcome of this case could have played out differently.

5.5 Administration of Estates

The administration of deceased estates is governed and legislated by the Administration of Estates Act [26] which specifies the process of *winding up an estate* [27] and financial affairs of the deceased, as well as the protection of the financial interest of the heirs.

When a person has been declared deceased, a deceased estate then originates. Once the post-mortem is concluded and the death has been reported; a death certificate is issued. The process of administering the estate will then incorporate various aspects to it such as reporting the estate of the deceased person to the Master of the High Court, the appointment of the estate executor which is someone that was either nominated in the deceased persons Will or is appointed by the Master of the High Court. The executor will register the account of the administration of the estate with the Master within the area of jurisdiction the deceased was living in prior to their death. Another aspect to the administration is providing notice to the creditors of the death

[25] Intestate Succession Act 81 of 1987

[26] Administration Of Estates Act 66 of 1965

[27] The Department of Justice and Constitutional Development. Republic of South Africa (2022) *'The Master of the High Court – Deceased Estates'* available at https://www.justice.gov.za/master/deceased.html (accessed 20 April 2022)

and request them to institute their claims within a certain period. The executor will initiate the freezing accounts and prepare the liquidation and distribution account. This is typically an important point to consider especially for couples married in community of property. When one of the spouses dies, the entire estate is frozen; this can cause much inconvenience to the surviving spouse and with thorough and effective financial planning, these areas can be considered to eliminate the strain upon death.

The executor of the estate will file an income tax return from the first date of the current year of assessment to the date of death of the deceased. An attorney will be appointed and meet the family to read out the provisions of the Will.

Once correspondence with third parties, estate fees and taxes have been paid and the residue of the estate has been bequeathed; the estate shall be wound up and administration completed.

The administration of a deceased estate can be quite a lengthy and rigorous. The importance of estate planning cannot be further emphasised in preparation for such an exercise and should be considered a priority. One can incorporate a provision in their Will for the use and creation of trusts upon death as part of the estate planning phase to further simplify the process. This trust type would be a testamentary trust.

5.6 Estate Planning, Estate Fees and Taxes

Ben Franklin recorded in a letter, *'In this world nothing can be said to be certain, except death and taxes.'* The costs involved in the administration of an estate cannot be denied nor escaped. From the time a deceased estate is logged, certain estate taxes and fees become due.

The remuneration of an Executor is payable according to the structure prescribed in the Act below -

> *'Every executor (including an executor liquidating and distributing an estate under sub-section (4) of section thirty-four) shall, subject to the provisions of sub-sections (3) and (4), be entitled to receive out of the assets of the estate –*
>
> *(a) such remuneration as may have been fixed by the deceased by will; or*
>
> *(b) if no such remuneration has been fixed, a remuneration which shall be assessed according to a prescribed tariff and shall be taxed by the Master'*[28]

[28] S51(1) Administration Of Deceased Estates Act 66 of 1965

The current Executor fee chargeable is 3.5% of the gross value of an estate plus 15% Value Added Tax (if the executor is a Vat Vendor); limiting the fee at 4.025%

> *'An executor shall not be entitled to receive any remuneration before the estate has been distributed as provided in section 34(11) or 35(12), as the case may be, unless payment of such remuneration has been approved in writing by the Master.'*[29]

The applicable taxes charged during the administration of a deceased estate are:

(i) Capital Gains tax
(ii) Income tax
(iii) Income Tax
(iv) Value Added Tax
(v) Estate duty

Other fees that may be applicable include:

Accrual claims, settlement of liabilities, property conveyancing fees, bond cancellation costs, masters fee, postage and petties and advertising costs, insurance costs, licencing fees.

5.7 Estate Planning and Trusts

A testamentary trust is a trust that is created upon the death of the testator through the inclusion of a trust clause in a Will. A testamentary trust can be used as means of wealth preservation and succession planning and is often referred to as means of *living beyond the grave* in that one can direct and instruct what should happen to their estates at death as they would if they were alive.

Determining which type of trust is an important tool of estate planning and needs to be considered both during the person's lifetime and after death and consider the most suitable one.

5.8 Donations and Estate Planning

A *donation*[30] is defined as a 'gratuitous disposal of property or any gratuitous waiver or renunciation of a right' as in section 55 of the Act. Philanthropical gestures when incorporated effectively in estate planning can provide much desired tax benefits through the use of exemptions and deductions.

[29] S51(1) Administration Of Deceased Estates Act 66 of 1965
[30] S55 Income Tax Act

5.9 Documents used in an Estate Analysis

5.9.1 AGREEMENTS/CONTRACTS AND OTHER DOCUMENTS

5.9.1.1 Current Wills (South African and international)

A will serves vital importance. It not only reflects the person's wishes, but also determines how assets devolve on that person's death. The provisions of the will have an impact on the actual estate calculations.

5.9.1.2 Antenuptial Contract (ANC)

Should the person be married out of community of property with or without the application of the accrual system[31], generally a copy of the ANC is required in order to have sight of the provisions governing the marriage. The person's matrimonial property regime plays a huge part in the estate analysis with an impact on estate calculations during their lifetime as well as upon death.

It has happened in the past that individuals are under the impression that they are married without accrual for example, however once there is a look at the actual ANC, to their dismay, they are in fact married with the application of the accrual system. (Remember that marriage out of community of property with the application of the accrual system is the default ANC option and one would need to opt into marriage out of community of property without the application of the accrual system).

In addition to this, with a marriage subject to the accrual system, the ANC contains the commencement value of each spouse's estate and could contain a list of excluded assets. All of which is required to perform the estate calculations.

5.9.1.3 Divorce Order

A copy of the divorce order is required in order to account for any funds which need to be paid by the estate or any obligations which need to be fulfilled by the executor.

5.9.1.4 Amnesty application and approval (where applicable).

[31] Matrimonial Property Act 88 of 1984

In the event that the person has international funds which have been regularised (for South African exchange control and/or tax purposes) through an amnesty application process and approval to retain such funds abroad has been granted by the Reserve Bank, the actual application and approval would need to be reviewed to ascertain the legal impact of such approval.

Generally, such approvals contain certain conditions which could limit what a person can do with the regularised funds.

5.9.1.5 Guardian Details

Should a person have minor children, a supply of the details of the guardian(s) the person wishes to appoint is needed, failing the natural guardians. This information allows to ensure that a person's Will is updated accordingly. There may be undesirable consequences in the event of a minor child not having a guardian nominated in a Will with both natural parents of the child having been deceased. In this instance, the Guardian's Fund[32] will administer and manage the funds of the child with a chosen guardian through other avenues of law such as the Children's Court.

5.9.1.6 Shareholder Agreements

Although a comprehensive review of these agreements Will not be performed, these agreements generally contain provisions which could impact a person's shareholding and ability to dispose thereof.

5.9.2. STATEMENTS RELATING TO REQUIRED DOCUMENTATION

(a) Assurance policy schedule

(b) Details of retirement savings (such as retirement annuities/pension/provident/preservation fund(s)) and employer group benefits

(c) Unit trust and other investment statements

(d) Any share scheme policies/documents

[32] S86-93 Administration Of Deceased Estates Act 66 of 1965

This information is needed in order to determine the treatment and impact of the assets/policies on the death of the person. The above information is also useful when determining the individual's liquidity position.

Beneficiary nominations are of specific importance as more often than not, the estate planner is under the impression that they have nominated a specific beneficiary when in fact there could be no beneficiary nominated on a policy. This therefore impacts the estate calculations to be performed.

5.9.3 DOCUMENTS RELATING TO TRUSTS (SOUTH AFRICAN AND INTERNATIONAL)

(a) Trust deed/s
(b) Latest financial statement
(c) Letters of authority
(d) Letters of wishes (South African and international)

A trust review may not be typically performed as part of this estate analysis, but it should be noted that information on existing trusts and trust structures is important for estate planning purposes. There could be loans owing to a person by a trust or due by a person to a trust. Distributions vested in the estate planner but not paid (withheld distributions) are assets in the estate.
This information could have an impact on the estate calculations and the advice given to person.

5.9.3 (a) Entities (South African and international)

(i) Founding documents
(ii) Surety details
(iii) Buy-and-sell agreements
(iv) Latest financial statements
(v) Keyperson agreements

As with trusts, although a review will not be performed as part of a typical estate analysis, information on existing structures is important for estate planning purposes.

This information could have an impact on the calculations and the advice given to a person.

5.9.3 (b) Loans

Details of any loan accounts (debit/credit) in companies/businesses/trusts or with individuals .

Loans owing to the estate planner are assets in the estate and loans owing by the estate planner are liabilities in the estate. Both have an impact on the calculations to be performed and the advice given to person.

5.9.3 (c) Donations

Philanthropical endeavours can be beneficial to givers as they can provide certain income tax benefits and deductions. Documentation pertaining to donations made to trusts or by trusts are important in this regard.

5.10 Conclusion

Estate planning provides a set structure to the succession plan of the estate owner. Should the estate owner wish to incorporate and structure a trust upon death, the most suitable time to list these wishes is during the estate planning phase. After consideration of estate duty costs, a trust in this context can be one of many ways to ensure that it can serves the function of a wealth preservation and estate planning tool.

Chapter 6 : Wealth Preservation in South African context

6.1 Introduction

Wealth preservation can come in various forms and needs to be applied accurately. This is a strategy that ensures your assets grow while providing a legacy for your family. As can be spotted, wealth preservation does somewhat overlap with estate planning, but the essence of this involves management of assets in such a way that it ensures that the value of these assets does not decrease or erode – to preserve the wealth. Trusts can be seen as efficient and successful in this regard and, in this chapter, we will be exploring in greater detail how this can be made possible.

Proactive and effective financial planning can be one of the best ways to kick start a journey towards successful wealth preservation. While focussing on financial planning principles of saving money, buying a house, funding a child's education and retirement etc. at some stage in our financial journey, the focus often turns to growing the wealth that has now begun to accumulate. Once enough money has been accumulated, wealth preservation becomes an important part of financial planning that need not be overlooked.

There are many wealth preservation strategies that can be implemented and are best suited and personalised to individual situations and circumstances. For example, one could be approaching the end of their working years and nearing their retirement life stage and therefore needs a strategy that is more conservative in order to preserve their wealth to last throughout their retirement years and pass it down to future generations or meet both needs.

On the other side, one could be in need of a more aggressive strategy which provides the opportunity of accelerated wealth accumulation as they are at a life stage that can handle and buffer the volatility as they have many years ahead of them to play out this particular wealth preservation strategy by maximising their investments for the future.

There are several wealth preservation strategies that can be applied within the South African context, below are a few illustrations:

6.2 Incorporate risk management into the financial plan

Personal insurance is a vital aspect in ensuring peace of mind and financial access to any emergencies that may arise. It is critical to protect yourself again the loss of benefits and avoid having to tap into investments and savings to cater for unexpected financial events.

The purchase of a life insurance policy may serve as means to replace original source of income and preserve wealth. Retrenchment or the dependence on a spouse's pension income and social benefits may cause financial distress and devastation if there is no type of insurance in place to cater such expenses.

Another common risk management wealth preservation strategy is to obtain long-term care insurance. Sudden life changing events such medical diagnosis, disability or severe illness could cause financial constraints, significantly increase expenses, and deplete hard earned savings. With the provision of long-term care insurance, such situations can be mitigated.

Certain risk insurance policies may also be used to minimise estate taxes through setting in place financial provision for those specific taxes as well as creating a life insurance trust in which the policies live outside the estate and therefore not taxable[33].

6.3 Implement an investment strategy that protects assets

Establishing a sound investment strategy is essential as it can reduce the chances of substantial loss. It is said that the best investments to preserve wealth are those that create a balanced portfolio. Including the right amount of low-risk investments in a portfolio based on your personal financial circumstances is a smart way to soften the blow of any major market fluctuations. This investment strategy can be applied across all types of assets.[34]

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[33] BayPoint Wealth, *'Wealth Preservation: 5 Key Strategies'* 2022, https://blog.baypointwealth.com/wealth-preservation (accessed on 11 April 2022)

[34] BayPoint Wealth, *'Wealth Preservation: 5 Key Strategies'* 2022, https://blog.baypointwealth.com/wealth-preservation (accessed on 11 April 2022)

6.4 Develop a philanthropic strategy

After effecting strong risk management and investment strategies, another proposed way to continue preserving wealth is by implementing a philanthropical strategy within your financial plan. This will enable you to reduce your tax burden and make a positive impact in an area near and dear to your heart.[35]

6.5 Plan to pass wealth down to future generations

As mentioned before, a trust serves as a great vehicle in preserving wealth and ensuring it is saved and passes down the lineage. Trusts are an important part of family and wealth preservation. By transferring assets into a trust, this can eliminate heavy estate tax that would've otherwise been imposed to an individual with a high net worth and subsequently deplete the inheritance children and grandchildren would receive as stipulated in the estate plan upon the death of the planner.

Individuals in their later years of life (post-retirement) who have enough retirement funding that will outlive them, may use trusts as instruments that will preserve the left-over funds by transferring their wealth and passed on to identified heirs for their benefit while potentially minimising both their income and estate taxes.

Besides estate taxes, one can have peace of mind that minor children and disabled children/relatives will continue to receive their inheritance upon the death of the planner should a special trust be created. Establishing a trust can be helpful for children who do not have a positive track record in dealing with money, or who are married and later on might get a divorce. Upon creating the trust, the founder can impose certain restrictions to around when and how the beneficiaries can access the funds. [36]

6.6 Create a business succession plan

It is vital that business owners do not overlook the importance of planning on how their wealth will be taken out of the business and how the company will pass it to another party if something unexpected happens to them. This is an integral part of wealth

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[35] BayPoint Wealth, *'Wealth Preservation: 5 Key Strategies'* 2022, https://blog.baypointwealth.com/wealth-preservation (accessed on 11 April 2022)

[36] BayPoint Wealth, *'Wealth Preservation: 5 Key Strategies'* 2022, https://blog.baypointwealth.com/wealth-preservation (accessed on 11 April 2022)

preservation planning. A good business succession plan should stipulate what should happen with the distribution of proceeds of the company for example, if the business owner wants the business to continue operating in the event of death, they can consider purchasing a life insurance policy to fund the business or if the business owner has a business partner, it would be advisable to structure a buy and sell agreement in place with life insurance policies taken out on one another.

From a tax efficiency perspective, passing down wealth to (children who are majors and not minors) in a lower tax bracket will insure that they receive the income taxed at a lower rate and subsequently reducing any possible estate tax burden for the planner in the future. This can also be aided through structuring a trust instrument and ensuring the succession of the business trust.[37]

6.7 Conclusion

Based on the above discussions on the various ways to preserve wealth, it has been evident that a trust can be used as a vehicle to promote the preservation of wealth and ensure it passes from generation to generation.

[37]BayPoint Wealth, *'Wealth Preservation: 5 Key Strategies'* 2022, https://blog.baypointwealth.com/wealth-preservation (accessed on 11 April 2022)

Chapter 7 : Trusts as a protection mechanism for assets

7.1 Introduction

One can confidently argue that one of the biggest motivators behind creating trusts as a protection mechanism for assets, is the protection inherited after the transfer of these assets from a personal capacity into the trust entity. This protection can vary from creditors, businesses, legal claims, consequences of unsuccessful marriages (divorce) or a fall out in business relationships and protect heirs through providing guarantee of inheritance.

Another benefit of having assets transferred into a trust is the protection of these assets from trustees who in their personal capacity could become insolvent. The same advantages would apply to the beneficiaries of a trust, (this would be depending on the type of trust) as well as the insolvency/sequestration of the estate founder/owner.

Should the founder of the trust be declared insolvent or sequestrated, once again, all assets transferred into the trust prior to this will be protected as they no longer form part of their personal estate.

Based on the summary above, there are numerous asset protection benefits that can be derived from the transfer of assets into the appropriate trust type along with proper administration as per basic trust principles. This section of the research report will be exploring more detail into the areas mentioned above.

7.2 Insolvency

The Insolvency Act 24 of 1936[38] is the legislation that relates to and governs insolvent 'persons' and relates to their estates.

persons [39] in this regard can refer to the following definitions:

- *(i)* *"debtor", in connection with the sequestration of the debtor's estate, means a person or a partnership or the estate of a person or partnership which is a debtor in the usual sense of the word, except a body corporate or a company or other association of persons which may be placed in liquidation under the law relating to Companies;*
- *(ii)* *"insolvent estate" means an estate under sequestration*
- (iii) *"trustee" means the trustee of an estate under sequestration and includes a provisional trustee."*

[38] Insolvency Act 24 of 1936

[39] S2 Insolvency Act 24 of 1936

7.2.1 Insolvency of trust role-players

a) Insolvency of Trustees

A 'trustee' as defined by the act means:

- *'any person (including the founder of a trust) who acts as trustee by virtue of an authorization under section 6 and includes any person whose appointment as trustee is already of force and effect at the commencement of this Ac'*[40]

Governs 'trust property' or 'property' meaning:

- *'movable or immovable property, and includes contingent interests in property, which in accordance with the provisions of a trust instrument are to be administered or disposed of by a trustee'*[41]

The trustee holds a fiduciary role to own and administer the trust assets in his/her capacity as a trustee. Therefore, a trustee in his/her official capacity as a trustee is actually the owner of trust assets. This is not the case in their personal capacity except in so far as he/she as a trust beneficiary is entitled to the trust property[42]. This portion of act provides protection of trust assets for the trust and the beneficiaries from the trustee should the trustee become insolvent. This is in so far as the trustee administers the trust in accordance with the requirements[43] set out in legislation and does not abuse their power of being trustees and abuse of the trust form.

b) Insolvency of beneficiaries

In chapter 3 of the report, we looked into the different kinds of South African trust structures that can be set up.

In a discretionary trust set up, the beneficiaries have no control, power, or ownership in anyway and in the event of death or insolvency, nothing can be held in their estate or have it passed to their heirs or even creditors. This then translates to beneficiaries' protection of trust assets from the beneficiaries in the event of insolvency. However, vested trusts operate in the opposite manner. As per the trust instrument, the beneficiary has a vested right to the income and capital, which cannot be contested

40 S1 Trust Property Control Act 57 of 1988
41 S1 Trust Property Control Act 57 of 1988
42 S12 Trust Property Control Act 57 of 1988
43 S9 Trust Property Control Act 57 of 1988

by anyone else. As can be seen, this then means that assets can be attached to the beneficiary in the case of insolvency.

c) Insolvency of trust founder

Once the trust founder transfers, donates or sells his/her property to the trust, this property then belongs to the trust (depending on the trust structure mentioned above) and is administered by the trustees. Creditors do not have a claim on trust property transferred by the founder in the face of insolvency.

The Insolvency Act[44] also references instances where creditors may attach assets in the instance of insolvency of the founder considering the aspects around disposition.

7.3 Creditors

Protecting trust assets from potential creditors for distribution to heirs/beneficiaries can be said to be one of the most important goals of creating virtually every irrevocable trust. One type of trust set up that will protect assets from creditors is called an irrevocable trust. Once this trust is established, the trust founder no longer legally owns the assets transferred into the trust and can no longer control how those assets are handled beyond the scope of what was initially set out in the trust instrument as with an irrevocable trust one surrenders re ability to later modify the trust instrument.

Part of effective estate planning is to ensure that income/capital and assets ultimately pass to the selected beneficiaries rather than to creditors. This asset protection mechanism starts at estate planning stage and can become an excellent vehicle for protecting trust assets from the creditors of the founder, the trustees and the beneficiaries.

As much as a trust can provide protection and relief from the creditors of the different role players; it is also of paramount importance to keep a trust itself debt free. As soon as a trust incurs debt, it is in the same position as an individual who cannot pay his/her debt because then the assets of the trust can in this instance be attached by creditors. A trust needs to maintain a debt free position so that it can fulfil its intended purpose

[44] S26 Insolvency Act 24 of 1936

However, it is vital that we understand the legalities when it comes to the 'intention' of making asset transfers into a trust. Should the founder create and/or transfer assets into a trust for the purposes of avoiding attachment and listing by existing creditors; these transfers are considered fraudulent in the eyes of the law and therefore making this protection null and void. This of course, is only applicable if the founder already faces creditor problems before the trust is established and there is probably little that can be done to shield assets from those creditors.

The protection from creditors extends to other role-players within a trust such as the trustees and beneficiaries. Assets cannot be attached by creditors should they become sequestrated, as upon initial asset transfer, the ownership had moved from the personal capacity of the founder, into the ownership and capacity of the trust. At this point, the trust entity owns the assets. However, should the trustee not act within their fiduciary capacity and demonstrate skill, due-diligence, and care (among other duties) in the management of the trust assets; they can be charged and held personally liable in their individual capacity for the mismanagement of the trust assets. In this instance, if the founder is also a trustee and/or a beneficiary and happen to make a fraudulent transfer; the same legal outcome would apply for the fraudulent act.

7.3.1 A case study: *Nedbank v Trustees for the time being of The Mdwaba Family Trust and Others*[45].

For the intent of this discussion an in depth analysis will be made on this case:

On 20 November Nedbank Ltd entered into a long-term loan agreement contract with Trustees for the time being of The Mthunzi Mdwaba Family Trust and Others for the purchase of immoveable property. The loan amount was for R2 500 000, repayable over monthly instalments of R21 934 over a 240 month period.

The second respondent, Perry-Mason Mdwaba signed surety over the loan and lived in the property with his family.

The issue arose when Nedbank submitted a claim of non-payment and breaking of contractual agreement by the trust. Nedbank's application to the courts was to enforce a payment of a lump sum amount, interest on the capital amount at a rate of 8.65%.

[45] *Nedbank v Trustees for the time being of The Mthunzi Mdwaba Family Trust and Others* (2019) ZAGPPHC 336

An order to have Perry-Mason Mdwaba and family executed from the property and lastly an order for the payment of all legal costs.

The legal position of the court was to deal with the question on whether a trust is a juristic person for the applicability of Rule 46A. The ruling on the case was decided on various factors. The court held that except where statute provides otherwise, a trust is not a legal person. In the case between the *Land and Agricultural Bank of South Africa v Parker Cameron*[46], JA elaborated that a trust should be seen as a vehicle where the accumulation of assets and liabilities are housed. This then constitutes a trust estate, which is a separate entity and does not have a legal personality. The legal personality vests in the trustees; and through the trustees specifies in the trust instrument can that trust act.

Applying the above to the case in question, this then meant that the accumulation of rights and obligations vested in the individual trustees of the Mthunzi Mdwaba Trust and the applicant should serve all court processes on all the trustees from the onset. This includes all the Rule 46A procedures. Lastly, The Mthunzi Mdwaba Trusts cannot be regarded as a juristic person due to the lack of legislation in support of this notion and subsequently it was ruled that the trust is not a juristic person for the purpose of this enquiry.[47]

The fact that the trust is not considered a juristic entity in this regard is vital for the case. This will be discussed in detail further down.

Rule 46A looks at the procedural rules for executing a judgement debt against residential immovable property in terms of the high court and serves as a layer of protection for a debtor facing the loss of his or her home. As per the government notice *Rules Board For Courts Of Law Act, 1985 (Act No. 107 Of 1985),* the results of Rule 46A came into operation on 22 December 2017 and states :

The following is hereby inserted in the Rules after rule 46:

‘46A Execution against residential immovable property

(1) This rule applies whenever an execution creditor seeks to execute against the residential immovable property of a judgement debtor.

[46] *Land and Agricultural Bank of South Africa v Parker and Others* 2004 (ZASCA 56)

[47] [2019] ZAGPPHC 336 para 10

(2)(a) A court considering an application under this rule must –

(i) establish whether the immovable property which the execution creditor intends to execute against is the primary residence of the judgement debtor

(ii) consider alternative means by the judgement debtor of satisfying the judgement debt, other than execution against the judgement debtor's primary residence.

(b) Court shall not authorise execution against immovable property which is the primary residence of a judgement debtor unless the court, having considered all relevant factors, considered that execution against such property is warranted.

(c) The registrar shall not issue a writ of execution against te residential immovable property of any judgement debtor unless a court has ordered execution against such property.' [48]

Part of Rule 46A states that immoveable property registered in the name of a trust and not of a natural person will benefit from the protection of non-attachment offered in the Rules.

As per the initial decision that The Mthunzi Mdwaba Family Trust was regarded as a non-juristic person and thus seen as not clothed by any legislation, is in favour of the trustees as stated in the Rules of 46A. However, Nedbank attempted to dismiss and challenge the protection offered by the Rule 46 A in saying that the immovable property was registered in the name of the trust and not in the name of a natural person and therefore protection offered to the primary residence is not applicable. Nedbank further quoted a scenario in favour of their submission that was said in the *Absa v Mokebe case*[49] paragraph 50 which reads:

'We cannot stress enough that this matter concerns and applies only to those properties which are primary homes of debtors who are individual consumers and natural persons'[50]

This submission was not considered based on the aforementioned reasons.

In the analysis of the case, it was further stated that section 26 of the Constitution accords every individual the right to access adequate housing.

[48] Department of Justice and Constitutional Development (2017), *'Amendment of the rules regulating the conduct of the proceedings of the several provincial and local divisions of the high court of South Africa'* available at : http://sassoc.co.za/wp-content/uploads/2018/04/Rule-46-of-the-Uniform-Rules-Supreme-Courts-Act.pdf (accessed on 12 May 2022)

[49] *Absa Bank Limited v Mokebe; Absa Bank Limited v Kobe; Absa Bank Limited v Vokwani; Standard Bank of South Africa Limited v Colombick and Another* (2018) (6) SA 492 (GJ)

[50] ZAGPJHC 485 para 50

The Constitutional Court in *Jaftha v Schoeman and Others, Van Rooyen v Stoltz and Others* [51] made reference to Section 26 which introduces a decisive break from the past and emphasises the importance of adequate housing and in particular the security of tenure. It further mentions that this piece of legislation aims to refrain from permitting people to be removed unless it can be justified and will prohibit the indignity suffered as a result of evictions from homes, forced removals and relocation.[52]

In conclusion, the court ordered Nedbank's application to be dismissed with costs on attorney and own client scale.

As can be derived from the above case, the attachment of creditors to trust property has many facets to it. Even though the trust was not considered a juristic person, and the immovable property served as a dwelling for the trustee and their children, legislation as per Rule 46A and section 26 of the Constitution were in favour of the respondent. This serves true to this section of the report.

7.4 Unsuccessful marriages (divorce)

In the recent years, Statistics South Africa[53] revealed that the total number of people getting married has gradually fallen from 2011 to 2022 and almost one in five South African marriages end in divorce. This number has been steadily climbing. It is always advisable that before you get married, take advice on the best matrimonial property regime [54]for your circumstances. If a regime with an anti-nuptial contract has been selected, this should record the respective rights to any assets, including any interests in or potential benefits from trusts.

Often, during a divorce litigation, the issue arises of whether trust assets should be included or excluded to determine the estate of a party. It is imperative that a trust is correctly drafted with the proper intention by the founder in order to operate separately from his/her own estate. Once the trust is established in good faith, proper governance and maintenance should remain a priority. The position of South African law is that the

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[51] *Jaftha v Schoeman and Others, Van Rooyen v Stoltz and Others* (2005) (1) BCLR 78 (CC)

[52] BCLR 78 para 7

[53] Department of Statistics South Africa (2022), *' Is marriage an old-fashioned institution'* available at https://www.statssa.gov.za/?p=15247 (accessed 22 May 2022)

[54] Matrimonial Property Act 88 of 1984

trustee does not become the owner of the trust property but merely holds such property or the benefit of third parties (beneficiaries). For this reason, the trust property cannot be considered as part of a person's estate for purposes of determining the value of an estate in divorce cases.

In many instances, courts have considered trust founders and trustees to have dealt with the assets of the trust as if there had been no trust for the purpose of divorce proceedings and thus can be regarded as part of the founder's estate. An 'intention test' exercise will need to be demonstrated in determining the founder's true intention in establishing the trust is crucial, and one of the major indicators. If the founder did not have the intention to establish a trust for the benefit of the beneficiaries, but rather to keep assets outside of the estate to avoid legal consequences of the matrimonial property regime; the courts will rule in favour of attaching the assets to his/her personal capacity.

The Section 26 of the Insolvency Act [55] protects against trusts that are set up with the specific purpose of cheating or prejudicing (in this instance a spouse), particularly to avoid the legal workings of their matrimonial property system.

7.4.1 Alter-ego trust v Sham trust

Another instance in which the courts could rule in favour of attaching trust assets to an individual's personal capacity is when one of the parties used the trust as his/her *'alter ego'*[56].

'An alter-ego trust is when all the necessary requirements for a valid trust are present and the trust is established, but the trustees act as puppets, mainly under the instruction of the creator or another trustee. It is also present when the trust property is treated by the creator or a trustee as if it is personally owned by him, instead of belonging to the trust, where a trust is created without the genuine intention of creating a trust, it is probable that the trust can be attacked and labelled a sham trust which never actually comes into existence as a trust, where a trust, however was created with the intention of actually creatin a trust, but the assets are dealt with as if they are a trustee's persona; property, creditors of the trust, as well as SARS and soon-to-be ex-spouses of trustees, can attack the trust and have it labelled an alter-ego trust. The results of this can be that the courts disregard the trust and treat the trust assets as assets of the trustee in his or her personal capacity' [57]

[55] S26 Insolvency Act 24 of 1936

[56] *Rees v Harris* 2012 (1) SA 583 (SGHC) – a case whereby the courts treated trust assets as personal property of the trustee

[57] Anica Theunissen, 'An alter-ego trust – What is it and its risks' 4 July 2020, available at https://sstlaw.co.za/2020/07/04/an-alter-ego-trust-what-it-is-and-its-risks/#:~:text=An%20alter%2Dego%20trust%20is,the%20creator%20or%20another%20trustee. (accessed 22 May 2022)

There is a clear distinction between a *sham trust* and an *alter ego trust*. Although there are currently only two applicable case laws[58] that have thus far dealt with *sham trust* in practice; there has been ground-breaking judgement that has elevated the 'sham trust' concept from theoretical possibility to practical reality[59].

An *alter ego trust* refers to the instance where the trustee uses his/her alter ego by regarding the trust assets as his/her own[60].

7.4.2 A Case study : *Badenhorst v Badenhorst*

A 2005 court case held of *Badenhorst v Badenhorst* [61] where the former husband sued his former wife for a decree of divorce and ancillary relief and the former wife in turn claimed that 50 per cent of the total value of the former husband's estate should be transferred to her as per sec 7(3) of the Divorce Act. Moreover, she further accused the former husband of managing alter ego trust and requested a claim from the assets held in the trust to be included in the determination of the matter.

In this case the court held that while it appeared to be that the assets were held in trust, they were in fact under the control of Mr Badenhorst, who was also one of the trustees (along with his brother) and who made all the decisions concerning the trust, despite the appointment of co-trustees.
The court set out two vital elements that are required to be proved by a spouse who claims that a trust is being used as an 'alter ego' of his/her spouse:

- that such spouse controlled the trust, irrespective of the terms of the trust deed, and to consider the evidence of how the affairs of the trust were steered during the marriage;
- that 'without' the trust, such spouse would still have acquired and owned assets in his/her own name.

[58] *Humansdorp Co-op v Wait ; Land and Agricultural Bank of SA v Parker* 2005 (2) SA 77 (SCA)
[59] Bradley S Smith, *'Sham trusts in South Africa: times change and we change with them'* Juta Journals, South African Law Journal, p550-580
[60] SAIT, *'Trust assets may be treated as the personal asset of a trustee who used the trust as alter ego'* 2012, available at https://www.thesait.org.za/news/87399/Trust-assets-may-be-treated-as-the-personal-assets-of-a-trustee-who-has-used-the-trust-as-alter-ego.htm (accessed 22 May 2022)
[61] *Badenhorst v Badenhorst* 2005 (2) All SA 363 (SCA)

The Court held that all the assets were deemed to be owned by Mr Badenhorst personally and had to be shared with his wife in their divorce. The plaintiff was ordered to pay a sum of R1 250 000 to the defendant within six months of the order.

7.4.3. A Case Study : *WT and Others v KT*

In another matter around the claim of alter ego, a Supreme Court of Appeal case of '*WT and Others v KT'*[62]a husband and a wife who had married in community of property. Upon their divorce, the wife claimed 50 per cent share of their primary residence which they moved and lived in for some two years. A year after moving in, they got married and officially bought the property and lived in it for nine years before they divorced.

The husband transferred this primary residence into a Discretionary Family Trust where he was one of the trustees along his brother as a co-trustee and his children as beneficiaries.

Upon transfer, the wife claimed that the husband falsely represented that the transfer of the property into the trust was solely to protect the asset against his businesses and any future possible claims from creditors. The former husband proceeded to exclude the former wife from the trust as a beneficiary and any other role player to the trust, and subsequently from her 50 per cent entitlement of the property which should fall in the joint estate based on their marital regime – in community of property[63].

Contrary to the accusations of the husband having managed the trust as his alter ego; various sections of act and case facts concluded why the trust was instead not viewed as an alter ego trust. One of the main reasons was that the courts believed that it was common cause that the former husband had procured the establishment of the trust as well as the purchase of the property prior to his marriage, without her participation and without and significant financial contribution from her.

Subsequently, the end result was that the trust could keep the house, leaving the former wife to pay the husband's legal costs.

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[62] *WT and Others v KT* (2015) SA 574 (SCA)
[63] Matrimonial Property Act 88 of 1984

As stated in the matter, assessing the proprietary consequences of a divorce following a marriage in community of property, as in the present case, the court is generally confined merely to directing that the assets of the joint estate be divided in equal shares. The court concerned with a marriage in community of property accordingly has no discretion to include the assets of a third party in the joint estate. In any event the Divorce Act specifically recognizes in this context that trust assets held by a trustee in trust, do not form part of the personal property of such trustee as a matter of law.

7.4.4 Conclusion

As can be seen from the above discussion, a trust can serve as a great asset protection mechanism even in instances of unsuccessful marriages, but it is imperative that the trust was initially set up with the correct intention and furthermore, managed in a way that keeps it as a separate entity and not that of an alter ego.

7.5 Business Trust

A business trust is a special legal instrument for holding and running a business. Many business owners use this model to protect their assets and safeguard the business against liability and certain taxes. A business trust caters for continuance in the event of undesirable future events such as death or insolvency.

A business trust in South Africa is generally used as a way to protect individuals. Just like certain business insurance can help add protection against, trust models can safeguard individual business owners against liability, creditors, taxes, and lawsuits[64]

Many people don’t realise that they can protect business assets by holding them in a trust-owned company, which in turn owns the business. Trusts provide protection and advantages those other legal entities do not. They therefore provide a solution for many sticky estate-planning problems associated with owning a business.

The major advantage to housing assets within any trust is that the assets of a trust are usually (depending on the trust set up as well as other pertinent information) protected from being held personally liable. Creditors, former spouses and other relevant

[64] SME South Africa, ‘What is a Business Trust?’ available at https://smesouthafrica.co.za/what-is-a-business-trust/ (accessed on 22 May 2022)

persons cannot lay claim to the trust assets, including the shares held by the trust in the company owing the business. This is especially important when you are in business where there is a possibility of sequestration of your estate should something go wrong. This also prevents legal cases where relations turn sour within business co-owners and/or company shareholders.

A business trust can also serve means for preservation of wealth by keeping that specific business within the family lineage passed on from generation to generation. People who have amassed wealth in their lifetime, or who have inherited wealth, want it to benefit succeeding generations. A Business trust may be the most effective vehicle for that purpose as it allows succeeding generations to participate in and benefit from the wealth created in one generation.

Business trusts can serve as means of continuity. As business owners get more involved in their business, their personal affairs can suffer from benign neglect. This is mainly because many business owners simply do not have the time to attend to strategic personal planning, and because families are often focused on their own goals and successes. Rather than waiting until you are no longer around and leaving your family or business partner(s) to sort things out, you can set up a trust to ensure that your personal and business affairs will continue with a minimum of disruption.

While trusts can provide solutions for many situations, they are not necessarily the solution to all problems. It's vital to understand the workings of a trust before you set up one. Firstly, a trust is an agreement between the owner of the assets and the trustees of the trust who will manage the assets with due diligence, care and skill for the benefit of the beneficiaries of the trust. That means the founder loses legal control over the assets transferred to the trust.

7.6 Conclusion

As discussed above, the value of trusts being used as a protection mechanism for estate planning and wealth preservation are strongly identified and illustrated. A trust can provide practical avenues of ensuring protection through different life events one might find themself.

Chapter 8 : Impact of taxation on the use of trusts as an estate planning and wealth preservation tool

8.1 Introduction

When it comes to the taxation of trusts, many different types of taxes are applicable, but the most important thing is how one (within the boundaries of the law) can minimise or even avoid payment of these taxes. Remember, avoidance is legal, evasion is illegal. A trust is a separate taxpayer and the trust itself might be taxed on undistributed trust income and trust capital gains.

This section will explore the impact of the below taxes on the use of trusts as estate planning and wealth preservation tool and will be applied and discussed.

Income Tax is a tax that is charged according to the provisions of the *Income Tax Act 58 of 1963*[65] on income received or accrued to a South African registered trust on both local income and worldwide income in that specific tax year and this is either at a flat rate or sliding scale applicable to natural persons depending on the type of trust definition.

Capital gains tax is a tax levied on the trigger and *disposal*[66] of *assets*[67] under the *Eighth Schedule of the Income Tax Act*[68].

Donations tax[69] is charged on the disposal of an asset to another party. The person making the donation is called the donor (the giver of the donation) and they are responsible for paying donations tax and the person receiving the donation is called a donee (the receiver of the donation).

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[65] Income Tax Act 58 of 1962

[66] Para 1 Eighth Schedule Income Tax Act

[67] S1 Income Tax Act ; Cloete, S; Muller, C; Starling, S; Britz, M; Du Toit, L; Chirkoot, J.2021 *Premiums and Problems* available from VitalSource eTextbook: https://bookshelf.vitalsource.com/reader/books/9781485138686/pages/recent (Date of access 29 May 2022) pA43 "*The term 'asset' is defined as widely as possible and basically includes any property of whatever nature and any interest in such property – including Shares; unit trusts; land; property and rights to property; large boats (more than 10 m) and aircraft (more than 450 kg); plant and machinery; mineral rights; coins made mainly from gold or platinum, e.g. Krugerrands and all other assets except those specifically excluded. The definition of asset specifically excludes any currency, and the distribution of money can therefore never be subject to CGT. CGT applies to all assets disposed of after 1 October 2001, whether or not the asset was acquired before, on, or after that date*"

[68] Income Tax Act 58 of 1962

[69] Income Tax Act 58 of 1962

The *Income Tax Act 58 of 1962* caters for measures put in place that make it illegal to transact or to structure trusts in a specific way which encourages tax evasion – this section will illustrate the applicable section 7 anti-tax avoidance measures.

Lastly, the implications of the introduction of section 7C will need to be discussed in great detail as this piece of legislation forms an interregnal part of this chapter. Section 7C covers how any loan, credit or advance made to a trust is paid back by the trust at the official interest rate and if not, the interest saving portion will constitute a donation.

8.2 Taxation of Trusts (section 25B)

Trusts are included in the definition of a *'person'* [70] in Section 1 of the Income Tax Act and income earned by the trust is taxable.

A trust will be considered to be a resident if it is incorporated, established, formed, or has its place of effective management in South Africa for the purposes of tax.

Depending on the circumstances, trust income can be taxed in the hands of the donor, beneficiary, or the trust.

Section 25B of the Income Tax Act is the main section which regulates who will be taxed on trust income and under which circumstances.

Section 25B determines that, subject to Section 7 (which we will look into extensively below), the income of the trust will be taxed either in the trust or in the hands of the beneficiary.

Authors AP de Koker and RC Williams describes Section 25B as follows;

'Section 25B does for trusts and their beneficiaries what s 25 (see § 12.8) does for the estates of deceased persons and the heirs or legatees under an estate. It constitutes what for convenience may be labelled a 'deemed-income rule', and the income it affects is identified as 'any amount' (other than of a capital nature which is not included in gross income or an amount contemplated in paragraph 3B of the Second Schedule) received by or accrued to or in favour of a person during any year of assessment in his capacity as the trustee of such a trust.'[71]

They further go on to explain that this 'deemed-income rule' establishes that the 'vesting' of a 'right' to an amount towards a beneficiary may occur even though the

[70] *Friedman NO v CIR* 1993 (1) SA 353

[71] AP de Koker, RC Williams, March 2022, Silke On South African Income Tax, Lexi Nexis Durban, Available at https://mylexisnexis.co.za/Index.aspx [accessed 6 September 2022]

distribution of that amount is deferred and that vesting and distribution may occur simultaneously.

The deemed-income rule is subject to section 7 of the act which focuses on the anti-avoidance provisions towards trust income.

The above sections of the act highlight that any amount received by or accrued to any person during the year of assessment in their fiduciary capacity as a trustee will be taxed in the hands of the trust as it is deemed to be an amount which has accrued to the trust. Any amount that accrues and vests in the resident beneficiary (vested right trust structure) during the year of assessment will therefore be included in the resident beneficiary's gross income. Any amount that accrues and vests in the resident beneficiary upon the discretion of the trustees (discretionary trust structure) during the year of assessment will therefore be included in the resident beneficiary's gross income.

To summarise the sections under 25B of the Income Tax Act[72]

8.2.1 Section 25B(1)

This section provides that any income received by, or accrued to, or in favour of a trustee of a trust within the year of assessment, shall, subject to provisions of section 7, accrue to the beneficiary provided that the beneficiary has vested rights (vested trust structure) to the income. If no vested rights (discretionary trust structure) to the income, the income is then deemed to accrue to the trust.

8.2.2 Section 25B(2)

Should trust income accrue to the beneficiary due to the discretion of the trustee (discretionary trust) as instructed in the trust deed; the income will accrue to the beneficiary and be taxable in their hands.

8.2.3 Section 25B(3)

All deductions and allowances available under the Act towards the calculation of taxable income; is deemed to be a deduction or allowance in the hand of the 'person'

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[72] Burman, K (2009) *A Logical Approach to South African Tax*: 11th Ed, Edge Learning Media

who received the income - either the beneficiary or the trust. Also, an apportionment will apply should the income vest and be split between the beneficiary and the trust.

An example is section 11(e) wear and tear allowance : If 60% income was vested in the beneficiary and 40% in the trust, the allowance will be apportioned 60/40 based on the portion of income received.

8.2.4 Section 25B(4)

This section limits the deduction or allowance claimable to the amount of income accrued and received by the beneficiary from the trust.

8.2.5 Section 25B(5)(a)

Provides that the excess of expenditure over income that arises from S25B(4) shall be deducted by the trust in that year but still limited to taxable income that is prior to the deduction of such an expense

8.2.6 Section 25B(5)(b)

Where the trust is not subject to tax in South Africa, the excess of expenditure can be carried forward and treated as a deduction which the beneficiary may claim in the next year from income which he receives from the trust.

8.2.7 Section 25B(6)

Where the trust cannot absorb access expenditure (as per 25B(5)(a) and 25B(5)(b)) this excess expenditure may be granted as a deduction or allowance to the beneficiary in the next year of assessment subject to same imitations as S35B(4).

The real effect of provisions S25B(4)-(6) is to act as a deterrence and prevent trusts from distributing losses to beneficiaries. This applies to new trusts created on 11 March 1998 and existing trusts from the year of assessment commencing on or after January 1999.

8.2.8 Section 25B(7)

The ‘ring-fencing’ and ‘carry-forward’ rules of S25B(4)-(6) do not apply in respect to income that accrues to a beneficiary where the beneficiary is not subject to tax in South Africa on such income. Where deductions and allowances exceed the trust income, the beneficiary would be able to offset this tax loss again other income.

8.3 Income Tax

The payment of tax at the specified income tax rate will be paid either by the trust (via the trustees or the vested or discretionarily selected trust beneficiaries.

Trust Income in relation to the applicable trust classification types and is charged income tax at a flat rate of 45 per cent (45%) per year of assessment. This income tax rate is specific to all trust types apart from special trusts.

The '*conduit pipe principle'* [73] is where a trust displays a flow through vehicle in which income and gains flow through to beneficiaries. The conduit principle with regard to trusts is important to take note of. The principle provides that income received by or accrued on behalf of a beneficiary who has a vested right to such an amount during each year shall be deemed to be an amount which has accrued to the beneficiary and shall be taxed in the hands of the beneficiary. Income or gains that are realised inside a trust, can *'flow through',* or be distributed to the beneficiaries of the trust, while retaining the nature of the income. This in essence means that whatever form of income is received by the trust (in some instances from one trust to the next) gets distributed to the beneficiaries and taxed in the hands of the beneficiaries in its current form and not taxed within the trust. Dividends, interest earned, capital gains etc. will pass on to the beneficiaries and taxed while retaining the nature of the income.

Depending on the trust type, assets held, and the trust beneficiary's effective estate planning would be demonstrated in determining which role-player between the trust itself and the beneficiary is best suited to suffer the knock of paying the taxes. Of course, one needs to be cognisant of the wishes of the founder, but efficient and effective advice would cover the impact that taxation would have on the trust versus the beneficiaries and perhaps the most economical and financially viable option can be explored.

Special Trusts are set up in terms of the Income Tax Act and enjoys special tax benefits that are not available to ordinary trusts.

Special Trust Type A must be set up solely for the benefit of persons with a disability[74], and there can be no benefit in it for the trustees. The trust must be registered with Sars

[73] *ABC Trust v CSARS* (2021) IT 24918

[74] S6B(1) Income Tax Act 58 of 1962; S1 Income Tax Act 58 of 1962

as a Type A trust to enjoy the tax benefits afforded to such vehicles. While ordinary trusts pay income tax at the highest tax rate of 45%, tax rates applicable to natural persons ranging from 18% to 45% apply to Type A trusts.

Type B trusts are trust structures where the youngest of the trust beneficiaries on the last day of assessment is under the age of 18 years. The income tax rates for Type B trusts are the same as those applicable to natural persons ranging from 18% to 45% and is also not set at the highest tax rate of 45%.

Special trust Type A and Type B form an important estate planning and wealth preservation tool when considering the income tax advantages derived. With proper expertise in handling the financial affairs of the trust; the potential tax breaks may be used to create further wealth for the trust and ultimately the beneficiaries while preserving the current wealth.
This would be one way to ensuring the impact of taxation can be used as an estate planning and wealth preservation tool.

Lastly, the Type A trust is an excellent mechanism for the safeguarding of assets and ensuring that disabled beneficiaries/relatives are not taken advantage of when the founder is deceased.
And Type B trust is ideal for those who have minor children and want to avoid their children's inheritance from being administered by the Guardians Fund in the event of death with the inheritance distributed to the minors as per wishes.

8.4 Capital Gains Tax

The Eighth Schedule of the Income Tax Act governs Capital Gains Tax which is a tax charged on the gains of the disposal of capital assets. When an asset is disposed of, Capital Gains Tax (CGT) may apply. In an instance where a trust disposes of the asset held in the trust, the full capital gain or loss values are not taxable, only part thereof. The capital gain is multiplied by the inclusion rate. In certain circumstances the beneficiaries may be liable for CGT in terms of the conduit principle.

A capital gain is the proceeds (or deemed proceeds) from the disposal (or deemed disposal) of an asset less the base cost. The proceeds from the disposal will generally be the price at which the asset is sold. In certain cases, when it is not possible to determine the selling price of the asset (for example in the case of death, donations, disposal of an asset at less than market value, emigration or immigrations), the market value of the asset will be the price that could have been obtained upon the sale of the asset between a willing buyer and a willing seller dealing at arm's length in the open market. The base cost of the asset is deducted from the proceeds to arrive at the capital gain. The capital gain is then multiplied by the inclusion rate to determine the taxable capital gain.

8.4.1 What is a disposal?

The term *'disposal'* has a very wide definition that covers almost every situation where there is a change of ownership of an asset. A disposal for capital gains tax purposes is regarded as any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset. [75] There are a number of situations that trigger capital gains.

The most important aspect to remember is that - where capital gain is vested in a beneficiary of the trust, the trust will not have that gain included in its own tax calculation, but it will be taxed in the hands of the beneficiary.

Paragraph 80(1) and 80(2) between capital gains determined in respect of the vesting by a trust of an asset in a beneficiary, and capital gains determined in respect of the disposal of an asset by a trust, where the beneficiary has a vested interest in the capital gain but not in the asset in respect of which the capital gain was derived.

In either of the aforementioned circumstances the capital gain must be disregarded for the purpose of calculating the trust's taxable income and must be taken into account when calculating the taxable income of the trust beneficiary in whom the capital gain vests.

A trust instrument may authorise the trustees to vest assets to the beneficiaries and subsequently distribute the above-mentioned instances of capital gains tax liability to them. It is also possible to distribute the gains to multiple beneficiaries and a huge tax break would be where each beneficiary pays at their assumed lower marginal tax rate and each having their own annual exclusion amount.

Substantial capital gains savings can be achieved if the applicable individual marginal tax rates of between 18% - 45% was applied as opposed to the marginal tax flat rate

[75] S, C., C, M., S, S., M, B., L, D. and J, C. (2021). *Premiums and Problems* 2021. 123rd Edition: Juta Law. pA44

of 45% for trusts (except for special trusts). Secondly, each beneficiary would qualify for the full individual annual exclusion amount of R40 000 (paragraph 5 (1) of the 8th Schedule) and a primary residence exclusion amount of R2 000 000 (Paragraph 5 (2) of the 8th Schedule).

From section 26B of the Income Tax Act, taxable capital gains – which are to be included in a taxpayer's – are to be determined as per the Eight Schedule to the Act. In order to reach the capital gain liability; the formula takes the net capital gain multiplied by the inclusion rate of either 80% or 40%; 80% for all trust types and 40% for special trust and individuals which brings the taxable capital gain amount. Lastly, the taxable capital gain value will be multiplied by the statutory (marginal) tax rate of 45% for all trust types or between 0%-45% for special trusts. The inclusion rates and statutory tax rates bring about an effective rate of either 36% (80% x 45%) for all trust types and between 0%-18% (40% x 18%-45%) for special trusts.

Taking into consideration the individual annual exclusions (should the tax liability vest to the beneficiaries), reduced inclusion rates and reduced statutory tax rates for special trusts and individuals; this is another way that taxation on the use of trusts can be utilized as an effective estate planning and wealth preservation tool. The tax savings can once again be used as means of increasing wealth.

In order to achieve savings of this nature, capital gain has to be allocated to a resident natural person in the year in which it was realised by the trust, many trusts have beneficiaries that include another trust. If the gain passes to another trust first and then an ultimate beneficiary of the second trust the higher tax rate will be applied.

8.5 Donations Tax

Another very important tax that needs to be considered when looking at creating and essentially managing a trust is donations tax. Donations tax is a tax charged on the disposal of an asset to another party.

According to sections 56 of the Income Tax Act of 1962 a donation is defined as-

'Any gratuitous disposal of property including any gratuitous waiver or renunciation of a right'[76].

Also, in terms of section 58 of the Act,

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[76] S56 Income Tax Act 58 of 1962

‘The disposal of any property for an inadequate consideration can be deemed to be a donation’.[77]

Donations tax applies to any *‘person’* – individual, company or trust that is a resident. Non-residents are not liable to pay donations tax.

The word donate means giving away / disposing of an asset at a value below what is considered to be its reasonable value (fair market value)

donation can also be illustrated where the donor lends capital to a trust without interest or charges interest below the official interest rate. The difference between the reasonable value and the actual consideration will be a deemed donation, just like the difference between the actual interest rate and the lower interest rate charged will be a deemed donation of the amount of interest which the lender could have charged but didn’t. This form of donation relating to Section 7C of the Act will be covered broader in the next chapter.

A donation is a transaction between the donor and the donee. The donor can be described as the individual making the donation and responsible for the payment of donations tax, while the done meane the beneficiary under the donation.

The donor is liable for the payment of the tax. Should the donor fail to adhere to the payment, both the donor and the donee will then be jointly and severally liable[78] for the tax as per section 59 of the income tax act.

Section 54 of the Act specifies the rate chargeable for donations tax in respect of the value of any property disposed of under a donation. This rate is currently 20 per cent of that value if the aggregate of that value and the value of any other property disposed of under a taxable donation on or after 1 March 2018 until the date of that donation does not exceed R30 million; and 25 per cent of that value to the extent that that value is not taxed under the forementioned expressed value before.

The Act caters for instances where donations tax is not applicable and not payable. These instances are:

[77] S58 Income Tax Act 58 of 1962
[78] S59 Income Tax Act 58 of 1962

- When the sum of the values of all casual gifts made by a donor who is a non-natural person (companies and trusts) during any year of assessment as does not exceed R10 000 within a 12-month period
- Where the sum of the values of all property disposed of under donations by a donor who is a natural person as does not during any year of assessment
- so much of any bona fide contribution made by the donor towards the maintenance of any person as the Commissioner considers to be reasonable.[79]

The list of exemptions further includes payments or donations made between spouses, as well as payments made to approved public benefit organisation as per section 56(1).

When setting up a trust, it is most common for the founder to move/transfer and sell assets from his/her personal estate into that of the trust entity. The founder and trust normally have a *'connected person'*[80] relationship, and this is an important aspect in the taxation of the transferred assets.

The connected persons relationship implies a non-arms-length commercial relationship with its crux being the application of anti-avoidance legislation.

Transferring assets into a trust can happen in one of two ways; the assets can either be donated to the trust by the founder or connected person donor, in which case donations tax liability of 20 per cent on the value of the donated asset (exceeding an aggregate of R100 000 within the tax year) will arise or the founder can sell the asset to the trust on a loan account, in which case the trust will owe the founder the sale price plus interest on the asset.

In both illustrations above, there is some fee/payment liability upon the transfer of assets into the trust as this ensures that trusts are set up for legitimate purposes and tax avoidance measures have been adhered to.

[79] S56 Income Tax Act 58 of 1962
[80] S1 Income Tax Act 58 of 1962

8.6 Anti-Avoidance Provisions

8.6.1 Introduction

In an effort to curb tax evasion by utilising trusts, section 7 of the Income Tax Act provides several anti-avoidance measures, which deem someone other than the person who receives income or to whom income accrues, to be entitled to the income and subsequently the tax thereof as well.

In the case of *Overstone v SIR*[81], it was stated that section 7 provisions are in light of transactions –

> 'in which a taxpayer seeks to achieve tax avoidance by donating or disposing of income-producing property to or in favour of another under the specified conditions or circumstances, thereby diverting its income from himself without his replacing or being able to replace it.'

The provisions of section 7 explicitly relate to acts of generosity whereby a person has made a donation, settlement, or other disposition between connected persons. 'The donee needs to be enriched and the donor correspondingly impoverished' (*Overstone v SIR* 1980 (2) SA 721).

8.6.2 Section 7(2)

Transactions between spouses' section 7(2) is common in most marriages. An example of this section would be where one spouse makes a donation, settlement or gratuitous disposal which results in the accrual of income via a trust to the second spouse. Because natural persons are taxed based on a sliding scale, this scheme will be beneficial if the spouse receiving the income is taxed at a rate that is lower than that of the spouse who made this donation. To address this abuse, an anti-avoidance rule was introduced to attribute the income back to the original spouse who made the donation and to deem the income to be received by that spouse.

It is important to note that this anti-avoidance principle will be applied if the sole and main purpose of making the donation, settlement or other disposition is to avoid, postpone or reduce the tax liability.

This section of the act is applicable to all donations, settlements or other dispositions made by one spouse to another spouse, regardless of whether a trust is involved. In the context of a trust, section 7(2) could be applicable if one spouse donates an asset

[81] *Overstone v SIR* 1980 (2) SA 721

to a trust and the other spouse is a beneficiary of the trust to whom trust income is attributed or distributed.

The matrimonial property regime needs to be considered especially for the spouses married in community of property. The considerations are where spouses are married in community of property and an asset is donated out of the joint estate to a trust, it is deemed to be a donation by both spouses on a 50/50 basis. Therefore, in terms of this section of the act, only 50% of the income will attributed to the donor spouse.

Secondly, where spouses are not married in community of property and an asset owned by one spouse is donated to a trust, the full value of the income will be attributed to the donor spouse.

8.6.3 Section 7(3)

Some taxpayers enter into schemes to avoid or reduce tax. One of these schemes could be to make donations that result in minor children receiving income. Due to the fact that natural persons are taxed based on a sliding scale, this scheme will be beneficial since the minor children will probably be taxed at a rate that is lower than that of the parent. To address this abuse, an anti-avoidance rule was introduced to attribute the income back to the parent who made the donation and to deem the income to be received by the parent.

It is important to understand who will be a *'minor'* as defined as this rule is only applicable if a parent makes a donation and a minor receives income or income accrues to a minor. A minor is a child younger than 18 years[82]. Therefore, you automatically become a major when you reach the age of 18. Also, a person will be a minor only whilst unmarried. Therefore, if someone below the age of 18 gets married, that person also automatically becomes a major. If that person were to divorce or become widowed prior to reaching the age of 18, that person does not become a minor again. Subsequently, reaching the age of 18 or getting married will trigger the person becoming a major.
This anti-avoidance principle is applicable to donations, settlements or other dispositions made by a parent as a result of which income distributed or allocated to a minor beneficiary of a trust. It is important to always consider that this provision is applicable only to parents making donations, settlements or other dispositions.

[82] S17 *Children's Act* 38 of 2005

Therefore, should a grandparent make a donation, settlement or other disposition and a minor grandchild receives income or income accrues to a minor grandchild, the principles contained in this section won't be applicable. A minor child also includes a stepchild or adopted child.

As soon as a child turns 18, any income that accrues to him/her will be taxable in his/her own hands.

8.6.4 Section 7(4)

At times, in an attempt to get around the implications of the anti-avoidance provision relating to income accrued or received by minor children, taxpayers try to avoid being taxed on income attributed to minor children due to donations, settlements or other dispositions made by themselves and would initiate a scheme where they would donate income to another taxpayer's minor children (minor children other than their own), This is referred to as a 'cross donation'.

This anti-tax avoidance provision was introduced to prevent parents from circumventing the provisions of section 7(3) by introducing a third party to make the donation, settlement or gratuitous disposition and would result in each parent being taxed on the income earned by his/her minor child (and not the income related to his/her donation).

8.6.5 Section 7(5)

Section 7(5) applies where income is accumulated in a trust and is not distributed to beneficiaries. This income is deemed to belong to the person who made the donation, settlement or other disposition to the trust and will have this income vest back to them upon the happening of a certain event. This section is only applicable where income is prevented from accruing to a beneficiary because of a stipulation or condition.

8.6.6 Section 7(6)

When a lender or the donor of a trust retains the power to revoke the rights to income for an entitled beneficiary and/or the power to cancel or amend the trust deed, the provisions of section 7(6) will come into effect. This power comes as a result of a person making a donation or an interest-free loan to a trust.

Where a donor makes a donation, settlement or other disposition and the beneficiary has a vested right to income, but the donor has the right to revoke the beneficiary's right to receive income (through the trust deed), the income will be attributed to the donor through this provision. This is an anti-avoidance principle to curb a person who seeks to avoid or reduce tax by disposing of an income-producing asset while retaining control over the income generated from that asset.

This section overrides the principles around vested income (as discussed earlier). Therefore, even though income might vest in the hands of beneficiaries, the attribution rules of this section will be applicable and trust income will be attributed to and taxed in the hands of the donor when a donation, settlement or disposition is made or in the hands of the lender in the instance of an interest-free loan. It is also important to remember that this section is, therefore, not applicable in the case of discretionary rights.

The question of who should have the entitlement to revoke the beneficiaries' right to receive trust income then becomes pertinent. Interestingly, the provisions of this section will only be applicable if the donor/founder has the right to revoke. Therefore, if anyone else has this right (but not the donor), or the donor renounces such right/power or dies, the attribution rule in section 7(6) will not be applicable.

Authors AP de Koker and RC Williams' commentary and explanation further emphasizes the important distinction on section 7(6) that;

'When the power to revoke is reserved to trustees of which the donor is one and it is clear that the donor cannot revoke without the authority of the remaining trustees, s 7(6), it is submitted, cannot be invoked. But when a donor in his capacity as trustee can revoke without reference to the other trustees, it is submitted that the provision applies.'[83]

8.6.7 Section 7(7)

Section 7(7) applies where a person disposes of a property through means of a donation while retaining the ownership of that property or the right to regain the ownership at a future date. This section also caters for instances where a person does

[83] AP de Koker, RC Williams, March 2022, Silke On South African Income Tax, Lexi Nexis Durban, Available at https://mylexisnexis.co.za/Index.aspx [accessed 6 September 2022]

not necessarily donate the property but cedes the rights to income derived and earned from the property.

Within the context of a trust, if someone donates property into the trust for a certain period of time with the assurance that it will return back to the donor, rental, interest, royalties or all forms of income that is earned through that asset will be taxed in the hands of the person who made the donation and entitled to that property.

This anti-avoidance provision was put in place to target persons with the intention of avoiding tax on the profits or gains from these assets

8.6.8 Section 7(8)

Section 7(8) applies where a non-resident received income by reason of any donation, settlement or any other disposition made by a South African resident. The South African resident will be taxed on the income received by the non-resident at the South African resident's marginal tax rate. This provision of the Act is aimed mainly at facilitating the collection of tax which can be more problematic to collect from a non-resident.

Section 7(8) is an anti-avoidance measure that was implemented as a result of the introduction, on 1 March 2001, of residence basis system of taxation – looking at an individual's residency status, instead of the previous source-based system.

8.6.9 Section 7(9)

When assets are disposed of below market value, they will be deemed to have been donated.

8.6.10 Section 7C

Section 7C was introduced to the Income Tax Act by the Taxation Laws Amendment Act No.15/ promulgated 19 January 2017 and came into effect 1 Match 2017 with a purpose of ensuring that any loan, credit or advance made to a trust is paid back by the trust at the official interest rate or higher. If not, the interest saving portion (which is the difference between the interest at the official rate and the actual interest charged) will constitute a deemed continuous donation. Now this means the interest savings will be subject to donations tax in the hands of the donor. Section 7C also prevents any deductions, losses, allowances, or capital losses to become claimable by the taxpayer in respect to the interest free or low interest loan made to the trust.

Section 7C focuses only on the lender (donor) and not the borrower (trust), so that the trust will not be deemed to have incurred an interest expense of a like amount.[84]

This section was introduced with the aim of restricting taxpayers from transferring wealth to trusts by means of interest-free or low interest loans, advances, or credit, without being subject to tax. Section 7C contain an anti-avoidance measure to curb the use of schemes involving preference share funding.

Taxpayers have a further consideration in the form of Section 7C to take into account when doing estate planning as this provision could lead to a deterrence towards an effective estate plan.

As it currently stands, Section 7C currently does not make provision for the anti-avoidance measures to apply in respect of any loan, advance or credit that a trust provides to another trust. This is an interesting observation and somewhat gap in legislation in this regard.

However, the Draft Explanatory Memorandum on the Taxation Laws Amendment Bill 2021 (TLAB) proposes that changes be made to the anti-avoidance measures under section 7C to curb the use of these new avoidance schemes and ensure that the anti-avoidance measures apply to any loan, advance or credit that a trust, directly or indirectly, provides to another trust where its beneficiaries or the founder are connected persons in relation to the founder or beneficiaries of the trust that provide the loan, advance or credit.

[84] AP de Koker, RC Williams, March 2022, Silke On South African Income Tax, Lexi Nexis Durban, Available at https://mylexisnexis.co.za/Index.aspx [accessed 6 September 2022]

Chapter 9 : Conclusion

This research report aimed at investigating whether or not trusts can be utilised as estate planning and wealth preservation tools.

It has been established that the use and applicability of trusts is wide and vast. With customised and thorough planning, trusts can be an efficient and effective estate planning and wealth preservation tool which is most suitable and practical for an individual during their lifetime and after death. When trusts are set up to complement the estate owners' desires and vision, other benefits can be realised and enjoyed; including tax advantages as well as protection from attachment of assets and an effective means for succession planning.

Aspects around the importance and value derived from constructive estate planning was also discussed. It was highlighted that financial planning works as an eco-system integrating other disciplines for an effective and constructive plan. Trusts are vehicles that can be used for effective estate planning and wealth preservation when woven correctly into the concept of estate planning.

A trust is seen to be a viable mechanism for the protection of assets. It was discussed how a trust can provide protection from creditors, claims during divorce and also peace of mind to business co-owners if the route of a business trust is explored. This further emphasises the effectiveness of trusts as an estate planning and wealth preservation tool.

The topic between trusts and taxation was discussed in great detail. The law has provided restrictions on the ill use of trusts and prevention of tax avoidance. Guidance on who should be taxed on trust income under what circumstances is in accordance with the conduit principle and new legislation of section 7C. With this said, despite the recent changes to law trusts are still effective estate planning and wealth preservation tools.

The conclusion was reached that trusts; if structured accordingly with the adherence to fundamental principles of financial planning and trust law among many other legislation can be used as a wealth preservation and estate planning tool

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