Not everyone should have a Family Trust, but everyone should have a Will

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A family trust is not a magic wand. It will not make all your tax problems disappear, and it is not the right answer for everyone. For the right family, though, it can be a very useful tool. The secret is to know what a trust can and cannot do, and to get proper professional advice before you decide.

What is a trust?

A trust is an arrangement in which one person, the founder, hands over assets to trustees. The trustees look after those assets for the benefit of the beneficiaries, usually the founder's spouse, children and grandchildren. The trust deed sets out the rules the trustees must follow.

The key point is that the trust assets do not belong to the founder, the trustees or the beneficiaries. They belong to the trust. Compare this with a company: if you own shares in a company, those shares form part of your estate when you die. The interest of a beneficiary in a family trust generally does not.

Two kinds of family trust

- **A living trust (inter vivos trust)**: you set it up and register it during your lifetime, and transfer assets to it while you are alive.
- **A testamentary trust**: your will provides for a trust that comes into existence only after your death. This is often used to protect assets left to minor children.

The advantages

- **Protection against creditors**: because the assets belong to the trust and not to you, your personal creditors and those of the beneficiaries

generally cannot claim them. There are exceptions.

- **Protection for vulnerable beneficiaries**: a trust lets you provide for minor children, a family member who struggles with addiction, or someone who cannot manage their own affairs, without handing them assets they cannot control.
- **Estate Duty savings** ("estate pegging"): if you move assets that are expected to grow in value into a trust, that future growth takes place in the trust and not in your estate. This can save a substantial amount of estate duty and capital gains tax when you die.
- **Income Tax planning**: in suitable cases, income can be distributed to beneficiaries who pay tax at lower rates.

The disadvantages

- **Cost:** registering the trust, transferring assets into it, and running it every year all cost money. The independent trustee, your accountant and your lawyer do not work for free.
- **Higher tax in the trust:** income and capital gains taxed in the trust itself are taxed at a higher rate than for most individuals. A trust also does not enjoy the capital gains tax exclusion for a primary residence that you would have as an individual.
- **Administration:** a trust must keep proper records and a separate bank account, file tax returns and comply with beneficial ownership and other reporting requirements.
- **Loss of control:** this is the one most people underestimate. For a trust to work, you must genuinely give up control of the assets. If you treat the trust as your own piggy bank, a court may disregard it, and SARS, your creditors or your spouse in a divorce may be able to get to the assets.
- **Family disputes:** trustees and beneficiaries do not always agree, and trust disputes can be bitter and expensive.

How do assets get into a trust?

- **By your will:** you leave assets to the trust when you die.
- **By donation:** you give assets to the trust. Donations tax may be payable, although there is an annual exemption.

- **By sale:** you sell assets to the trust at market value.
- **By sale on loan account:** you sell assets to the trust and the purchase price stays owing to you as a loan. Be careful: if you charge the trust no interest or less than the official rate of interest, SARS treats the interest you did not charge as a donation each year, and donations tax may be payable.

So, is a trust right for you?

Like any important decision, it comes down to a careful weighing of the costs against the benefits.

As a general guideline, a living trust starts making financial sense if you expect to build up substantial growth assets over the long term, so that the Estate Duty and Capital Gains Tax saved on their future growth clearly outweigh the cost of setting up and running the trust. For smaller estates, the costs and administration often outweigh the tax savings, although a trust may still be worthwhile to protect vulnerable beneficiaries.

A testamentary trust in your will is often a simpler and cheaper option for protecting young children.

Do not forget your will

Whether or not you set up a trust, everyone needs a valid will, and you should review it regularly. Revise it especially when:

- a child or grandchild is born;
- an heir passes away;
- you sell an asset mentioned in your will, or buy one you want to leave to a specific person;
- you marry or divorce;
- you set up a family trust; or
- you acquire assets outside South Africa.

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This article is general information and not legal or tax advice. Speak to a professional about your own circumstances.