ACS ACCOUNTING TRUST **5.11.2012**

<u>TRUSTS – EXPLANATORY MEMORANDUM FOR ACS ACCOUNTING CLIENTS</u>

Dear Client

We have prepared an explanatory memorandum for all clients who are making use of trusts within their business structure. This document is intended to give you an understanding of your trust, the purpose for which it was created, and guidelines for the administration of the Trust.

1. Trust formation and governance

Trusts are legislated by the Trust Property Control Act 57 of 1988. Other laws applicable to Trusts are; Common Law, Law of Contract, Wills Act 7 of 1953, Immovable Property Act 94 of 1965, Income Tax Act, as well as any Acts that may be applicable to a Trading Trust (VAT, Customs and Excise, etc.)

A Trust can be created by agreement, through a will, by court order, or statue.

A Trust can either be a “Real Trust” (or “Ownership” Trust) (this is the most common form of trust, with the trustees as the legal owner and the beneficiaries only having a personal right) OR a “Bewind Trust” (this is used in special circumstances, and the ownership of the asset is vested in the hands of the beneficiary).

A “Real Trust” can be divided further into different types, namely an inter vivos trust (living trust), testamentary trust and business (trading) trust.

A trust deed and letter of acceptance by all trustees is prepared for the Masters’ office. These must be signed and initialled. The Master will then issue a Letter of Authority for the Trust. <u>The Trust only comes into existence once the Letter of Authority is issued</u>. No transactions can occur in this Trust before that date.

The Trust Deed contains all the administration provisions, trustees’ duties and powers, beneficiaries, as well as any other relevant clauses. It is this document that lays out the workings of the trust and is thus the most important document. The banks will require copies, SARS will require copies, as well as any party that you will conduct business with, or contract with. It is important to familiarise yourself with this document, and to keep it up to date with any legislative changes.

2. Essential features

A trust is formed by a donor/founder, who must introduce “something” to the trust (assets, such as property, business assets, money, investments, etc.), whether by donation, or on loan account. The <u>founder must divest himself of control of the assets introduced to the trust</u>. The assets are now controlled by the trustees for the benefit of the beneficiaries of the trust. The main object of a trust is to benefit the beneficiaries.

It is essential that the assets are seen to be controlled by the Trustees for the benefit of the beneficiaries. If it is proved that the founder still maintains essential control of the assets, then the property and the fruits of the property will be deemed to be his (Estate duty and Income tax implications).

The trustees hold an office and therefore act in an official capacity as trustees. The trustees are in a fiduciary position and have a number of duties to perform as trustees, including duties of care, accountability, impartiality and independence.

It is important that the trustees keep a functional separation between control and benefit. A trustee may not deal with trust assets to his own benefit.

The beneficiaries must be considered carefully. If beneficiaries have received and accepted any benefit from the trust and they are named beneficiaries, the beneficiaries will be required to sign all subsequent amending documents which might affect their rights as beneficiaries negatively.

3. Administration requirements

3.1 A trust must have a bank account, and this must be opened as soon as possible after the formation of the trust. If there will be minimal transactions, it may be better to open a bank account with your broker (Investec/Nedbank corporate), which has no or minimal charges. Please ensure that you open an account that SARS can refund any monies to (credit cards, or 32 day notice accounts are not acceptable).

3.2 A trust must be registered for income tax purposes and submit the required returns to SARS.

3.3 A trust must have minutes of all meetings of trustees during the year, including one at year end to approve the distributions made by the trustees (ACS prepares these).

3.4 Financial statements to be drawn up and approved on an annual basis (ACS prepares these).

3.5 The trading activities of the trust must be run through the bank account of the trust, and where possible the distributions to the beneficiaries need to be made directly from the trust, or if the trust deed allows this, it can be made on loan account (most older trusts do not allow this)

3.6 Capital distributions must be made directly to the beneficiaries from the Trust. Pre CGT trusts need to ensure that the trust deed has been amended to allow distributions directly to the individuals where necessary. (Family Trusts were often the only beneficiary before CGT came in, in order to “protect” the assets in the assets trusts).

3.7 An independent trustee must be appointed for all trusts, but especially where the other trustees are also beneficiaries of the trust or where the donor and his/her spouse are the only other trustees of the trust.

4. Advantages of Trusts

4.1 The administration is often much easier and cheaper than a company.

4.2 Protection of assets by taking them out of the personal estate and pegging the value at the loan value. Protection from creditor claims (the chances of an individual being sued are much greater than an entity). Protection from increased Estate Duty in the future.
4.3 The ability to provide for future generations, through a controlled structure.
4.4 The ability to direct taxable income to beneficiaries of the trust (children, spouses, etc.)
4.5 There is more flexibility within the family structure by using a trust/s than in the case of a Company alone.

5. Disadvantages of Trusts

5.1 The administration of a Trust is more cumbersome than that of an individual or partnership.
5.2 SARS is targeting trusts that are not properly administered.
5.3 They can become problematic if they are not set-up correctly to begin with.
5.4 The control of the assets is in the hands of the trustees. The founder/donor loses absolute control of the assets and is now reliant on the will of the trustees as to the management of the trust and the trust assets.
5.5 Tax rate of a trust is highest at 40 %. This is applicable to funds retained in the trust and not distributed, or not deemed to be a distribution. In most cases no funds would be left in the trust to be taxed, unless it was desirable to do so from an Estate Duty perspective.
5.6 You cannot dictate the control of a trust in your will. It is up to the remaining trustees of the trust to determine how the assets will be utilised and the trust distributions made.
5.7 There are many tax issues that need to be considered when distributing the income or capital of the trust. It is not just a simple matter of distributing income, the effect of the donation/loan to the trust needs to be considered first. An interest free loan is a deemed disposition and is treated as a donation. Any income arising from a donation/disposition is deemed to be that of the donor.
5.8 A local trust is generally not permitted to made off-shore investments.

6. Conclusion

A trust is a very good vehicle to use within a family structure, where there are assets to be preserved for future generations, and the size of the estate and funds available warrant the use of a trust.

The founder/donor needs to carefully consider the loss of control of the assets, and that the right trustees are appointed for the administration of the trust. One also needs to bear in mind that in future generations it will not be the same person/s acting as trustee on the trust.

The trust needs to be administered correctly, otherwise the trust can be called into question as a valid trust, and the purpose for using the trust becomes null and void.