TRUSTS:

Problems and disadvantages of trusts

1. Ignorance regarding trust matters

   While some people may think it is fashionable to have a trust, many do not really know what a trust is about and nor do they realise that there are certain legal consequences to the formation of a trust. For example, people sometimes do not appreciate that the control of trust assets must be in the hands of independent trustees.

2. Some other legal entity is intended or would be more appropriate

   Sometimes a planner form a trust when a close corporation or company would have been more appropriate. Members control a close corporation and there is no separation of control from ultimate beneficial ownership. In a trust, by contrast, there must be separation of control of assets (in the hands of the trustees) from benefits derived from those assets (beneficiaries).

3. The planner's own needs are sometimes neglected

   Some trusts are formed without proper consideration of the needs of the planner. A planner may put all or a majority of his or her assets into trust as part of an estate planning arrangement. This could be very effective from the point of view of saving estate duty, but it may very well result in the planner being short of income and/or capital.

4. Planners do not wish to relinquish control of assets

   The terms of a trust deed must ensure that there is a loss of unfettered control of the planner. When a trust is formed, one of the legal consequences is that the planner cannot control trust assets, because trustees control these. If the planner is controlling trust assets, the planner is really carrying on 'as before' as thought the trust has not been formed and is it likely that the so-called trust assets will then be treated as those of the planner. Therefore, if a trust is formed the planner will lose control and ownership of the trust assets.

5. Accounting issues

Audit, accounting and administration costs can be high. The Master of the High Court or the trust deed itself could require that trust accounts be audited. This could be expensive. Administration costs of the trust could also be high because trustees have onerous duties and would consequently be entitled to charge fees commensurate with the high risks involved in administering trust assets.

6. High tax rates

Trusts are subject to the highest rates of income tax, capital gains tax and transfer duty. For example, a trust is taxed at a flat rate of 40 per cent for income tax purposes, and at an effective rate of 20 per cent for capital gains tax purposes. Individuals, however, are taxed on a sliding scale form zero to a maximum of 40 per cent for income tax purposes, and also have the benefits of the tax rebates that are not applicable to trusts.

7. Trustees' duties and liabilities

The duties of trustees are very onerous. One of the problems faced even by a well-meaning trustee is that he/she may be completely unaware of all the duties of trustees, and may therefore easily act in a manner contrary to what is expected of that person or trustee.

A trust deed cannot exempt a trustee form liability if a trustee fails to exercise care or skill. This means that trustees are potentially jointly and severally liable for acting carelessly or without sufficient skill in respect of the administration or investment of trust assets. A trustee must act with the utmost good faith, can only act if authorised to do so, must act within the terms and objectives of the trust deed, and can only act if the trustee has te required capacity to do so. Because trustees are co-owners of the trust property, they should act unanimously in dealing with all trust assets.

Advantages and benefits of trusts

1. Asset and beneficiary protection

   Assets can be fully protected from beneficiaries' creditors and other claimants if they are held in trust. The trust's liability is limited to the extent of trust assets and beneficiaries are not liable for a trusts' debts.

2. Simple to form and flexible

   Trusts can be easily and quickly formed. Trustees and beneficiaries can be both natural and artificial persons and even other trusts. In other words, there is virtually unlimited flexibility as to whom or what can be a trustee and/or beneficiary.

3. Perpetual succession and no interruption in enjoyment

   A trust can exist in perpetuity and can provide for continued existence. This has great advantages because beneficiaries can come and go, die, get divorced or go insolvent and trust assets will continue to be held in trust and be protected from the consequences resulting from all of these sort of misfortunes.

   A trust can be used for easy succession of interests in property because trust assets are owned by the trust (trustees) and not by the beneficiaries.

4. Minimum accounting and disclosure requirements

   There are no specific accounting and disclosure requirements relating to a trust's activities, although a trustee is obliged to account to beneficiaries when requested to do so.

5. Income- and capital gains tax advantages

   If there is no living person who made a donation, settlement or other disposition, then effective income splitting and capital gains tax savings are possible. This is largely because the anti-avoidance provisions of the Income

Tax Act are only effective if there has been a donation, settlement or other gratuitous disposition.

Trusts can be very effective in reducing capital gains liability on the death of a person.

6. Estate planning and inheritance

A trust can effectively result in the freezing or value-pegging of an estate, and this can result in tremendous estate duty savings. Estate duty saving is one of the great advantages of trusts, and many trusts are used as part of estate planning. If properly structured trust assets do not form part of the estate of a deceased or beneficiary. Therefore, assets with high potential for growth can be put into a trust and the growth then takes place in the trust and not in the hands of any planner or beneficiary.

7. Protection of heirs and legatees

A trust can be used for inheritance purposes so that an heir or legatee does not inherit directly, but via a trust. What his means is that an heir or legatee can have all the benefits of the assets that are held in trust without any of the disadvantages of ownership.