What to consider before putting your property in a trust

If you're considering putting your property in a trust, it is useful to know your trust benefits from your tax law in order to determine if this is a viable route for protecting your asset and optimising your money.

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A trust is simply a legal person designed to protect and benefit – both legally and financially – the assets that have been placed in that entity. "While this sounds simple, there is no one-size-fits-all answer to the question of whether to put a property in a trust as it depends entirely on individual needs and circumstances," says Bruce Swain, CEO of Leapfrog.

Why put a property in a trust?

"A trust can be used to cap or lock in the value of the property purchased in the trust. In a trust a property no longer forms part of a personal estate, which means significant savings on estate duty and other costs and taxes upon death," trust and estate expert Nicolaas Brink, an accredited member of the Fiduciary Institute of Southern Africa (FISA), explains.

Furthermore Swain adds: "A property that is in a trust offers protection against creditors in the event of an individual being declared insolvent. A trust also offers continuity in the event of one of the trustees passing."

A trust offers a means for protecting an asset, like a property, from maladministration, reckless management and certain taxes.

Who does the trust vehicle make the most sense for?

There are various reasons and benefits to putting a property into a trust, but the three most obvious reasons are the following, according to Brink: "Business owners who want to protect their liability against creditors. This means that creditors cannot go after the property in the event of debt and/or insolvency.

"Secondly, wealthy individuals who want to save on costs and taxes like estate duty and executor's fees upon death. We say 'wealthy' individuals because the tax benefit (a R2m capital gains exemption on the profit of a primary residence sold) only comes into effect if one owns more than one residential property.

Lastly, but perhaps most importantly for 'ordinary' property owners, families where there is a known history of critical illness (e.g. Alzheimer's) or an individual with a mental disability, should consider putting a property into a trust to ensure suitable management of the asset."

Can anybody elect to put a property into a trust?

Yes, provided certain conditions are met. For example, the person creating the trust (the "trustor") is solvent, doesn't have a criminal record and has never been blacklisted.

Who should rather avoid going this route?

Persons with only one property should avoid going the trust route, Swain explains: "You will forfeit the R2m capital gains rebate in the trust should the property be sold at a profit (as Brink explained above)."

Brink concurs: "Setting up a trust would cost between R4000 and R7000, so that's a cost factor that needs to be taken into account. Bear in mind that the trust also needs to be administered monthly and annually, preferably by a professional person who has experience in trust administration. At least one of the trustees needs to be independent, as in not related as a family member or a connected person in any other way."

The founder of the trust also relinquishes control of the asset and the intended beneficiaries might not receive income for an extensive period, which could have implications.

What are the important legalities around trusts that are worth noting?

Firstly, a trust should have its own bank account. However minimal it is, the associated costs of a bank account must be taken into consideration.

Secondly, should a property in a trust generate rental income, then the trust needs to be registered for income tax and the relevant monies paid to SARS, Swain points out.

Thirdly, Brink elaborates, "a trust needs to be administered by confirming any decisions or transactions in writing. Trustee meetings should be held annually to reconcile and affirm decisions made during the financial year. Furthermore, most decisions in the trust should be done jointly by the trustees and they should act in the interest of all the beneficiaries."

Lastly, trusts are required to have financial statements drafted annually and might need to pay annual income tax in line with SARS regulations.

What are the tax implications?

Income in trusts are taxed at 45% unless the income is distributed to the beneficiaries, in which case each individual beneficiary will be taxed according to the individual income tax tables set out by SARS, starting at 18%.

“Should the trust purchase the property without paying for it, a loan account would be created between the trust and the relevant trustees selling the asset. If the property is not used for residential purposes, and the loan amount currently exceeds R1,333,333, interest would need to be charged at the current office rate of 7.5%. The trustee with the loan account needs to elect whether 20% donations tax is payable on the interest, or whether the interest is declared directly as income in his or her private capacity,” Brink clarifies.

The loan account would be regarded as an asset in the name of the trustee. He or she should be mindful of the effects of such a loan upon liquidation or death.

What happens when one wants to get the property out of the trust?

The trustees need to agree jointly that the property may be sold, and it needs to be in the best interest of the beneficiaries.

What is the thing that is most misunderstood about trusts?

Trusts needs to be administered even if it is dormant. Trusts which are not dormant also need to be administered to avoid it being regarded as null and void by SARS and the Master of the High Court.

There is a general misconception that if the trust assets still belong to the founder or trustees that they can operate it as if it is their own personal asset. Brink says this is not the case as the trustees of a trust manage the trust property on behalf of the beneficiaries.

Trusts and estate planning – what are the need-to-knows?

“A trust can be a useful tool for tax savings upon death, but this should not be the only reason for opting to go this route,” Swain cautions.

Brink adds that trusts can also be used to protect the interest of minors in the event of parents passing away. In the event of parents passing and a property is not in a trust, then a testamentary trust may be used as an alternative to be created upon death, but to make use of this option your living will needs to be up to date. If you don’t create a trust, and you don’t have a will and minors are left behind, all your assets are sold and paid over to the Master of the High Court’s Guardian Fund. The guardian of the minor should apply then to the Master for maintenance money, which may be challenging.

“The main reason to create a trust should always be to protect the asset, especially against beneficiaries who don’t have the know-how or ability to effectively manage their finances,” Brink concludes.