

Buying Property in a Trust

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- briefly touching on a few perceived disadvantages.

* Firstly many people are under the impression that one needs to be wealthy to set up a trust, nothing could be further from the truth, in fact the less you have the more you need a trust, the wealthy will do just fine if they face a financial crisis, us lesser mortals will lose everything if we do not protect it.

* A further common myth that pervades, being that the Government is looking at trusts. Trusts were previously not defined in the Income Tax Act as taxpayers, this clearly gave rise to serious abuse of trusts for tax purposes. The Government has since 1991 made various amendments to the act to combat these practises. Since 2002 there have been no more amendments, so we can safely assume that there is a degree of stability in that area. Further, the manner in which we will advise that you use your trusts, and the way they hold assets and trade, are securely within in the ambit of all existing laws and specifically the Income Tax Act.

* There is the big transfer duty debate, transfer duty is higher in a trust as the transfer duty is levied at a flat rate of 10 %, however this is lower than the VAT that you pay when buying from a developer, the cost of the duty is further skewed, when one acquires property at the lower end of the market, as there is a sliding scale that applies to natural persons. The initial extra cost, is well worth paying as will become evident when we address asset protection and death costs and taxes.

* Control: legally and technically, once a trust is formed, the assets that are held in trust are separate from the individual. The control of the assets are now no longer in the hands of the individual, however realistically the individual will retain control as they are still trustees of the trust, and with certain subtlety drafted clauses the control may be retained, by control we mean control in inverted commas, ie negative control or being privy to all decisions,

* Set up costs: there are clearly going to be legal fees incurred in the establishment of your trusts, be advised that you should utilise the services of an expert as we often come across poorly drawn deeds, or deeds that do not give you all of the benefits we will discuss shortly.

* Administration: a trust needs to be administered, the Trust Property Control Act, requires that a simple set of financials be drawn, please take note that it is not mandatory that the financials be audited, as this will result in unnecessary further costs, so simple financials will suffice which are not costly.

* The high tax rate opinion: trusts are the most highly taxed entities or person in South Africa, they are taxed a rate of 40%, however there are mechanisms to minimise tax payable through the use of a trust, paradoxically, through the conduit principle, tax efficiencies can be achieved and the Trust is actually an entity which will make provision for tax savings, which you can not personally or through a Company achieve. So whether you have an income tax or capital gain, in the Trust the taxation can be minimized if not avoided.

The concept of a trust and the benefits of a trust.

* A trust is a separate entity from an individual, totally distinct as one person from another, however not unlike a CC or PTY LTD but quite unique, in that it is not a creature of statute, but it is the product of a contractual arrangement. The Income tax act, deeds registry act, transfer duty act, Value added Tax Act and the Insolvency act afford a trust legal personality.

* We can contrast a Trust with a CC or a Pty Ltd which are entities created by completing and registering certain statutory forms with the Registrar of Companies which then registers the CC or Pty Ltd and it comes into being. A Trust is created by contract which is a Legal document, commonly referred to as a Trust Deed. The following points are important to remember, a Trust while not legally being referred to as a person is separate from you, a trust is not owned by any one, and a trust never dies or terminates unless it is terminated by agreement or it is sequestrated if it is unable to pay its debts. The latter qualities make a Trust the only entity which will afford total asset protection and estate duty savings along with a myriad of other benefits, which we will discuss shortly.

* There are various types of trusts, namely;

- o Testamentary trusts,
- o Vesting or Bewind Trusts,
- o Special Trusts and
- o Discretionary Trusts, we will only be discussing Discretionary trusts as, the other forms of trust are of no benefit to us as they do not afford the necessary asset protection and estate duty savings and Capital tax saving benefits that discretionary trusts are able to offer.

* A trust is such a wonderful tool in that it is not owned by anyone, it does not die and it is totally separate from the

persons who have formed it and or control and benefit from it. These qualities have no match as you will soon discover, and which we will point out.

Formation of a trust

As mentioned earlier a trust if formed by contract it is a contract entered into by a Founder who places certain assets under the administration of the Trustees for the benefit of beneficiaries. The parties are the Founder and the Trustees, in certain instances Beneficiaries are also party to the contract

Trusts Benefits

- * Asset Protection
 - o Divorce
 - o Business creditors
 - o General creditors
 - o Claims
 - o Retrenchments
 - o Sureties

As individuals we face a number of potential situations which can result in us losing all of our hard earned assets, cash, investments and properties.

We have listed a number of instances which are common which can result in this transpiring.

An existing business, or a new business which ends up in trouble often results in you having to make good to creditors, for unpaid rental agreements, suppliers, staff, the Receiver of revenue, loans, overdrafts and the like

If you have signed a surety for any person or your own business you are exposed to that claim if it is not settled.

Divorce is often an emotional time, and very often irrational decisions are made which could result in assets being sold or being forced to part with assets which you did not intend to.

You could face claims by creditors of your spouse if you are married in community of property.

Generally you have creditors which could lay claim to your assets if you can not pay your debts.

In the event that you are retrenched, for any variety of reasons you could be in a position where you are financially vulnerable, as you might not be able to meet your obligations, leaving your assets at risk to creditors.

The individual can face a claim for damages; this might cause the assets to be attached.

The above paints a pretty bleak picture; the above can be avoided and contained through the establishment of a Trust, or a combination of trusts. The trust is the only legal vehicle which can offer an individual total asset protection, this is achieved by virtue of the fact that a trust is not owned by any person, this gives it a legal personality of its own quite distinct from the individual.

Once the assets have been moved into the trust, they no longer belong to the individual. There are certain laws that need to be borne in mind before the assets are safe.

There is a window period prescribed in the Insolvency Act, this affords creditors protection from delinquent creditors, we certainly are not in that category, we do however need to ensure that we have safely moved our assets into a trust, so that these time periods have elapsed and the assets that have been moved are not liable to attachment under the relevant sections of the Act, it prescribes that if a creditor has a claim against an individual who is solvent, and who has moved/sold/ transferred or donated his assets, the creditor may if the assets were moved within a 6 month period, reverse such transactions and attach the assets and sell them.

The situation is even worse if the individual is insolvent at the time of the shifting of assets; the period is then extended to 24 months before the assets are safe from a creditor reversing such transferred assets.

Benefits on Death

No Capital Gains - Capital gains tax is a form of tax levied on natural and legal persons, it was introduced on the first of October 2001. The tax normally only comes into effect when an asset is sold that has appreciated in value, there are other instances where the tax will be deemed to have been triggered, one such event is your death, you are deemed to have sold all your assets to your deceased estate. Therefore all the assets that you own at the time of your death,

including properties, will attract CGT at a rate of 10% (we will for simplicity sake ignore roll overs and exemptions for now) this is further exacerbated by the fact that the tax is due even though no money has changed hands or been received, this will inevitably leave your estate in a illiquid position. This can be avoided by merely placing all the assets in trust. The trust does not die and therefore the CGT will not be triggered saving the investor huge amount of CGT, 10% of the value of the growth of any assets in your estate at the time of your death.

No estate duty - On the death of an individual the receiver of revenue lurks ever so near to get a further portion of the investor's estate in the form of estate duties. Any person who dies or who owns property in this country will be subject to Estate duties, please note that this covers all your world wide assets. This also affects any non-resident or citizen who has property in this country. The scope of property and assets is very widely defined and covers numerous classes of property and assets and all forms of rights to property, policies, annuities, investments and business. The tax is levied at a rate of 20 % of the value of any assets you have in excess of 1.5 million, after certain deductions have been made. This is a massive amount of money to have to part with because of your death; the real sting in the tail is that this is a tax on after tax money and assets, and in certain cases fictional assets such as goodwill, which might be worthless after your death.

It is vital / critical to establish the correct structure / order to ensure that you pay a minimal amount if not Zero death duty. An average estate will pay approx 30% of any net values of such estate. It is important to note that certain assets which are not in your name could be deemed to be your assets i.e Usufruct rights, interests in property, assurance policies, the latter along with all assets, business (huge Value) properties, movable assets, investments, cash unit trusts, shares, time share etc. all of these assets are valued and will form part of the estate of the individual, after deductions of debts and certain exemptions and estate in excess of 1.5 million is taxed at 20%.

The solution to this frightening proposition is simple, by establishing the Family Trust and ensuring that all the assets are held by trust, the trust never dies, our law allows for the Trust to continue in perpetuity. On the death of the individual they should pay zero Estate duty.

No executors fees - The investors death is again a hunting ground for further costs, not only is the estate subjected to CGT, and estate duties but also to executor's fees. An executor is the person or company or firm that winds up the estate of the individual, for this task they are entitled to a maximum fee of 3.5 % of the gross value of the estate plus VAT in certain circumstances, please note the GROSS value of the estate, (excluding liabilities etc This is one of the most understated costs, as the impact of the costs are not adequately explained to people. As your objective is to acquire as many properties as the bank will finance for you, your estate is going to be quite substantial which means that that you are in for some serious executor's fees. Again the solution to this is the formation of a trust, as the individual will not own any assets, and all property will be held by a trust or combination of trusts, the estate should be zero or inconsequential, thereby eliminating the executor's fees payable.

Protection of minors - Our law does not allow for minors to directly inherit, therefore an individual who wants to leave all or any assets to minor persons will not be able to do so, or persons not adequately addressing the issue in their wills or via testamentary trusts will end up with a situation where all the assets will be liquidated into cash. This is the position as the funds or the cash needs to be held by the guardians fund. The fund can only hold cash as they do not have the ability or resources to administer property, this great fund is controlled by the Government, and pays interest of +- 3%.In the event monies are not claimed, they are forfeited to the state, wonderful thought!

In the interim the minors will have limited or no access to the fund for their needs, education, health, well being housing. Your dream of passing on your hard earned work in establishing your property portfolio to children is impossible as Guardians Fund can only hold cash, and all your efforts will be lost. The solution is to have all your assets and your properties in a trust, as the trust survives your death; any beneficiary may benefit and access assets immediately. Also bear in mind that property administered by your appointed Trustees will accrue at a much better rate than the interest earned in the Guardians Fund, on their majority they will have access to a great property portfolio.

Saving of costs on death, in establishing a trust a host of costs can be saved as the entity continues in perpetuity.

Donations tax: This is another one of SARS anti avoidance mechanisms; you are not even allowed to give your assets away, other than to your spouse, and certain tax exempt institutions. You are limited to donations of R 30k per annum, this places you in an invidious position, if you wish to give assets or cash to children or parents or family or dependents, if you do you will face a taxation of 20% on any amount over 30k, this can be resolved by making these persons beneficiaries of your trust, a trust is exempt form donations made in pursuance of the trust.

We re-iterate that there is no necessity for a trust to terminate, a trust does not die and can therefore continue in perpetuity. This allows for the continuation of the assets, property portfolio which allows for future generations to benefit from your labour, no costs, no transfer, no cancellation of bonds, there is no Estate Duty, CGT or executors.

On the death of any individual, their estate is frozen, this transpires in order for the Executor to wind up the estate, i.e collect assets, pay debts, taxes, and only after that to make our bequests then distribute benefits to the beneficiaries and

Heirs. All the while Spouse and dependants of the deceased have no access to any monies or assets; complex estates could take numerous years between 2-5 years to wind up.

As a Trust holds the assets and cash, they are immediately accessible versus the situation where individual dies and takes 2-5 years to wind up, causing hardship to spouse and dependants.

Ensure your deed is correctly structured as in the event that it is mandatory to terminate at a point the above benefits could be lost to descendants and future descendants.

SARS allows for a R1 Million exemption on an individual's primary residence. Many persons are persuaded to acquire their home into their or their spouse's names to benefit from the exemption. A practical illustration will demonstrate that there is only a miniscule benefit to be had. If Individual is taxed at max rate of 40% CGT rate= 10% of 1BAR= R100K, 1BAR today is less than 1 BAR 2001. (Rand, inflation) what is it worth in 10 years time, the benefit is actually only R100k, however, contrast this with the fact that if you face Creditors or liabilities you may lose the home. Are you ever going to sell your primary residence? If not, CGT is not applicable. In event of your death and the home is in your name you will pay 20% Estate Duty CGT on any capital growth in excess of 1BAR (current growth 30% that is mini scale). Executors fees, costs to transfer property, versus placing the home in a trust, which affords asset protection, estate duty saving, no CGT, no Executors fee, continuity if sell use conduit max to personal rate only forfeit R100k.

We strongly recommend that one always takes the long term view into account. If long term then it must be held in a Trust as the reality is, you will die; you will probably have an issue with Creditors, with a possibility of selling prior to the above trust events transpiring.

Situation in terms of liquidating the estate has no cash to pay the tax. This is even more important for us as property investors as we have accessed a large portion of this growth during our lifetime, this results in liquidations of properties to meet CGT defeating objectives of passive income and growth to Heirs. Solution: having a property portfolio in a Trust, a trust does not die or terminate therefore no CGT costs.

article written by DVK national attorneys www.iprotect.co.za