

Trusts and loan accounts

Experts have been warning us for quite some time against the injudicious use of trusts. As from 1 March 2017 trusts are taxed at a flat rate of 45% (increased from 41%). The effective capital gains tax rate for trusts increased to 36%, compared to 18% for individuals. Trusts should be set up for the right reasons, e.g. to look after minors if both their parents should become deceased or to protect family assets. To set up trusts for the sole purpose of minimising tax, is from now on, a fruitless exercise.

Trust owners have in the past sold their growth assets to a trust on an interest-free loan account, with the purpose of pegging the value of the asset in their estate for estate duty purposes. The growth in the asset therefore took place in the hands of the trust, not the owner. As from February this year, this estate pegging strategy will no longer be beneficial from a tax point of view, as the deemed interest on the interest-free loan will be seen as a donation for donations tax purposes which is charged at a flat rate of 20%. A tax payer does still have the possibility of donating R100 000 pa to a trust, which may be used to off-set this obligation, if the donation is not used for other purposes. The loan furthermore remains as an asset in the original owner's estate (and will generate both estate duty and executor's fees). It also remains accessible to the original owner's creditors.

This is a very simplified description of a possible loan account scenario in a trust. The onus is on trustees to be aware of all the pitfalls associated with different types of loan accounts and the taxes which may be owing because of them.

Our advice: For investment monies in a trust, consider a sinking fund policy owned by the trust. Sinking funds are taxed according to the four funds taxation approach at a flat rate of 30% on all income. An effective rate of 12% for taxable capital gains applies. Contact your Finfoocus financial adviser for more information on how the new legislation affects your situation and for possible solutions.