Using a trust as part of your retirement planning:

Five good reasons

23 August 2012 by Tiny Carroll, Fiduciary Specialist at Glacier

The pundits tell us that we can expect to live longer and experience better health after retirement than our parents and their parents before them ever did. While this is obviously good news it does mean that making additional provision for retirement becomes even more necessary for those who wish to enjoy financial security along with an extended life expectancy.

This article looks at five reasons for considering a trust, and more specifically, a trust which uses an endowment policy as its main investment, as part of a retirement planning strategy.

It is not the purpose of this article to downplay the important and very necessary role played by traditional pension, provident and retirement annuity funds - using a trust as part of one's retirement planning should be a supplementary means of building retirement capital outside of one's personal estate.

Reason 1: Annual donations tax concession

Individuals are allowed to donate up to R100000 each to any person including a trust each year – for married couples this means R200000 each year. Donations above the R100000 limit will be subject to donations tax. (Remember that the concession includes donations of occasional birthday gits to children and friends).

The donations tax concession is not cumulative – this means that if you do not use it in a particular year, the benefit is lost.

Donations to the trust can be used by the trustees to fund the premiums on an endowment policy owned by the trust.

The benefit here is that the premium, as well as the growth thereon, is removed from the planner's personal estate.

Reason 2: The endowment advantage

Using an endowment as the savings vehicle has a number of tax and administration advantages, including:

- Income and capital gains are taxed within the endowment at the insurer's effective tax rate of 30% – which is lower than the 40% flat rate applicable to trusts.

- Gains in an endowment will be taxed at an effective rate of 10% as opposed to the effective CGT rate for trusts which is 26.6%.

- Because no income arises in the trust (the income arises in the endowment) the complex income tax deeming provisions are not triggered, which eases the income tax and tax-administration burden normally associated with trust income and capital gains.

- After maturity, partial withdrawals from the endowment will not be taxable for the trust or the trust beneficiaries.

- The "tax-free" withdrawals from the endowment which are distributed to the beneficiary or utilised by the trustees for the benefit of the beneficiary will not have the effect of pushing up his or her marginal tax rate. This means that the marginal tax rate applicable to traditional annuity income is not increased, thereby enhancing the return on other forms of taxable income.

Reason 3: Protection on divorce or insolvency

Up until retirement from a retirement fund a member's benefit (pension interest) may, in terms of the Divorce Act, be regarded as part of his or her assets which are subject to division on divorce.

Trust assets will not be part of either party's estate in the event of divorce – provided that the trust functions as a trust and that the ownership of trust assets vests in the trustees for the benefit of the trust estate and trust beneficiaries. If the trust is merely the alter ego of the "planner" the assets supposedly held in trust will be subject to division on divorce.

Like retirement fund benefits, trust assets will not be attachable by creditors in the event of the planner's insolvency. (The same proviso as above applies.)

Reason 4: Tax free lump sums at retirement

Retirement fund lump sum benefits in excess of R315000 (plus any previously disallowed contributions) will be taxed in accordance with the published scales.

Lump sums withdrawn from the endowment and awarded to a beneficiary will not be taxable either in the trust or in the hands of the beneficiary.

In appropriate cases the "award" to a beneficiary from the trust can take the form of a loan/s. The loan debt owing to the trust will need to be settled from assets in the beneficiary-lender's estate on his/her death, thereby creating an estate duty deduction which can be used to reduce the dutiable value of the planner's estate. The planner's living expenses in effect become an estate duty deduction.

Reason 5: Mind over matter

Diseases such as Alzheimer's or dementia - often associated with old age - can sometimes impair a person's faculties to such an extent that he or she is no longer competent to manage their own affairs.

It is a common mistake to believe that a power of attorney granted to a family member, while still mentally competent, will suffice and that the holder of the power of attorney will be able to transact on behalf of the aged relative. A power of attorney will lapse when the giver of the power is no longer mentally competent. The patient's financial welfare and care will depend on the appointment of a curator. The appointment of a curator or curator bonis is a costly and often lengthy process.

Instead, the trustees of a trust which has been specifically established to take care of aged beneficiaries will be able to utilise trust funds for the care and wellbeing of the beneficiary.

Conclusion

As indicated at the outset, it is only one's imagination that limits the use of trusts. Building a protected source of capital to be used to provide for financial peace of mind after retirement is but one of a trust's many uses. However, the decision to use a trust and the application of the endowment within the trust must be taken only after proper consultation with a qualified financial adviser.