The trials of trusts

By Letitia Watson
Send suggestions and requests to yourmoney@you.co.za. We may answer your questions in this column but won't reply personally.

A trust might seem like a safe option but ensure you can navigate your way through five common problem areas

WE'VE received several letters from readers complaining about trusts.

Your Money spoke to Erik Troost of African Mutual Trust about common problems with trusts and how to avoid them.

KOBUS GALLOWAY

Trustees

Think carefully when choosing them. The trustees manage and administer a trust. For instance, they have to invest the trust funds and pay the beneficiaries. They also have to ensure the beneficiaries all benefit fairly. People sometimes appoint only one trustee or two who are in cahoots with each other. If the trustees neglect to do their job it's likely the beneficiaries won't receive the benefits as intended.

The solution: appoint at least three trustees, of which one is independent, such as an attorney or trust company. If the testator has complex assets such as a farm or business, appoint trustees – people or institutions – who are knowledgeable about these assets. The trustees' powers and duties must be outlined in the trust deed or will.

Beneficiaries

There are two kinds of beneficiaries: income beneficiaries who earn an income from the trust, and capital beneficiaries who are entitled to the capital in the trust. A person or institution can be both.

Problems arise if they're not. The income beneficiary might bank on getting the maximum income, while the capital beneficiary might want to see the capital grow so it will at least keep up with inflation until the investment matures.

Let's say a man names his wife as the income beneficiary but his children from a previous marriage are the capital beneficiaries. His widow would want a good monthly income from the trust but the children would like the trust capital to grow or at least not diminish. The trustees have to act fairly and without being influenced by the beneficiaries.

The solution: the trust founder or testator must give the trustees instructions to avoid these awkward situations or even legal action. The trust deed should, for instance, stipulate that preference be given to investments with market-related earnings or a proportional combination of income and capital growth.

Income

The trust deed or will can stipulate that income beneficiaries are entitled to a trust's full net income. The amount must be paid to the beneficiaries on a specific date after deduction of the trustees' fees and other expenses.

Problems arise when the trust deed stipulates the trustees have the discretion to pay out the income, in which case the beneficiaries can't insist on payment of all the net income. They then have to negotiate with the trustees about paying an amount or making interim payments but the trustees still have the final say.

The solution: if the income beneficiary is a spouse or dependant who can't lay claim to the full income, the trust founder or testator must specify what they're entitled to. It can be stipulated that income beneficiaries receive an income that allows them to be in the same financial position they were before the trust was established.

TIP: Make sure the aim of the trust and how it works are clearly set out before signing on the dotted line.

The trustees aren't necessarily tightfisted with payments but must show care when dealing with trust funds. The testator may have decided to leave payments to the trustees' discretion because the beneficiary had been reckless with money in the past.

Children

Often one trust is created to make provision for all the children's studies. One disadvantage is some children could get more benefits than others. Age differences play a role as the trust value can decline from the time the eldest starts studying to when the youngest starts. Some kids opt for long and expensive studies, leaving little for the others.

The solution: create separate trusts for each child, for study purposes and for inheritances.

Holiday homes

These homes are often transferred to trusts for a family to use. This works for some but can create huge problems.

The solution: stipulate clear guidelines about how the property must be used. The beneficiaries can, for instance, be limited to life partners and children, or the house can be sold and the trust dissolved upon the death of the longest-living beneficiary, or sooner if everyone agrees. ■

All heiresses are beautiful

ENGLISH POET JOHN DRYDEN