

Be careful what beneficiaries can do with their rights

PERSONAL FINANCE / 7 MAY 2019, 11:00AM / PHIA VAN DER SPUY



Phia van der Spuy



File Image: IOL



ALL ABOUT TRUSTS

A trust is set up either during the lifetime of a person (an inter vivos trust) or on the death of a person in terms of his or her will (a testamentary trust).

Beneficiaries are those persons who are initially named by the founder in the trust instrument and are subsequently selected by the trustees from time to time in terms of the trust instrument's stipulations, set by the founder. Beneficiaries are the only people who can benefit from a trust. Beneficiaries are usually defined as income and/or capital beneficiaries. This means that the founder can distinguish between who may benefit from the assets and the income of the trust.

Beneficiaries are also either defined as vested or discretionary beneficiaries. Vested rights are acquired by beneficiaries in a vested trust/bewind trust, where the assets vest in the beneficiaries; in other words, the beneficiaries are the rightful owners of the assets and therefore have a right to them, but the administration is taken care of by trustees until, for example, a child turns 25. The beneficiary cannot dispose of the assets until he or she takes over the control over the asset.

The beneficiaries have vested rights to the income and/or assets of the trust. The beneficiaries will be liable for all taxes resulting from the assets. Upon the death of the beneficiary, the assets will be included in his or her estate.

Beneficiaries in a discretionary trust have no right to the income/capital until the trustees have exercised their discretion. All they have is a hope of receiving something from the trust, and they will be entitled to any asset/income only once it is distributed by the trustees. If the trustees vest income or capital gains in a beneficiary, the beneficiary, not the trust, will be liable for tax on such distribution. Upon the death of the beneficiary, only these vested rights will be included in the estate.

Although the founder of the trust may carefully plan who can and who cannot benefit from the trust as described above, you need to keep in mind what the beneficiaries can do with their respective rights. It clearly depends on the type of trust, the classification of the beneficiaries, the rights afforded to the beneficiaries (or the actions that are not prohibited) in the trust instrument, and whether income or capital gains were vested in beneficiaries.

Can a beneficiary renounce his or her benefits?

A beneficiary of a discretionary inter vivos trust, such as a family trust, does not have a right to receive any benefits from the trust, only a hope. This means that such a beneficiary may never receive anything from the trust. Due to the fact that an inter vivos trust is regarded as a contract between two parties (the founder/s and the trustee/s) for the benefit of another (the beneficiary/ies), such a beneficiary has to accept his or her benefits from the trust either by accepting a distribution from the trust or by writing to the trustees to accept the benefits.

Such a beneficiary can repudiate (reject) his or her benefits. Such benefits will then be dealt with in terms of the trust deed. If no alternative manner of dealing with the assets is stipulated in the trust deed, the assets could revert to the founder. This may be useful in the event of a divorce where only one of the parties remains a beneficiary.

The vesting rights in terms of a will occur by operation of law in terms of the law of succession.

The rights of a beneficiary under a testamentary trust therefore vest upon the death of the testator. In terms of the law, a beneficiary of a testamentary trust can repudiate his or her trust benefit. Such repudiation will be retroactive from the moment of the vesting, as if the person was never entitled to any benefit. The benefits will then be dealt with in terms of the will, and if no alternative was catered for in the will, the benefits will be dealt with in terms of the law of intestate succession.

Can a beneficiary cede or sell his or her rights?

Even though a vested right is very different from a discretionary right, a beneficiary of a trust can cede (transfer) both a vested right and a discretionary right to someone else if the trust deed allows it, or does not prohibit it.

In the case of a discretionary trust, any benefits flowing from the cession can be enforceable only by the cessionary (the person who the benefits were ceded to) if and when the trustees exercise their discretion in favour of the cedent (beneficiary), due to the fact that such a beneficiary has no right, but only a hope, of receiving any benefits.

In the case of a vested trust, the beneficiary can cede such vested right, which the cessionary can claim from the trustees. The protection that the founder sought by creating a trust may be lost if a beneficiary was allowed to cede an interest or a right to someone else. This should be prohibited in the trust deed.

People have historically “sold” their trusts in an attempt to save transfer duty. They merely replaced the trustees and beneficiaries to reflect the new “ownership”.

The South African Revenue Service introduced an anti-avoidance provision in 2002 to stop these practices and such transactions/arrangements now attract transfer duty. It is arguable whether a beneficiary can sell his or her interest in a discretionary trust, which is merely a contingent right, or hope in accordance with the judgment in the CIR v Sive’s Estate case of 1955. A discretionary beneficiary’s contingent right has no value, as any benefit allocated to him or her is left to the discretion of trustees, and is therefore not measurable.

You need to remember that changes to the beneficiaries of a discretionary trust, such as a family trust, may create a new trust altogether, as such a trust’s objective is to benefit the named beneficiaries, and a change of beneficiaries changes the objective and creates a new trust. Estate planners need to be bear in mind what beneficiaries might do and may want to prohibit the cession/sale of beneficiaries’ rights, but may want to allow the repudiation of benefits, in trust deeds.

Phia van der Spuy is a registered fiduciary practitioner of South Africa, a master tax practitioner (SA), a trust and estate practitioner and the founder of Trusteeze, a professional trust practitioner.