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TRUSTS & ESTATES ALERT

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PREPARING FOR INCAPACITY

Families are sometimes confronted with the emotionally taxing and difficult problem of assisting a family member, who lacks capacity, with their affairs. The cause of such malady may be physical, mental or both. With increased longevity so, too, rises the prevalence of dementia. Typically, the care of the elderly persons falls on their adult child. To provide such care, the "child" often needs to access their parent's funds to settle ongoing expenses or sell an asset to re-home their parent. Many hold out a Power of Attorney as proof of their entitlement to manage the person's finances and estate. Unfortunately, this reliance is misguided and unlawful.

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It is often the role of legal advisers to be the bearers of this bad news – to explain that the Power of Attorney, in terms of which their client is operating, is in fact invalid. Why is this the case? In terms of South African law of agency, a Power of Attorney becomes inoperative the moment the grantor of the power loses capacity. The reason being that an agent cannot have more power than the principal.

A Power of Attorney has limited application; while useful for someone who may be frail or indisposed or out of the country, or simply not up to dealing with the hurly-burly of commercial life, it has little value in the case of cognitive impediments.

From the very moment an individual exhibits conduct in line with the loss of mental capacity, the application of a Power of Attorney becomes problematic. It is thus unlawful to act based on a Power of Attorney, if you are aware that the principal has lost capacity. In the event of family tensions – which unfortunately often arise in such situations or are exasperated - a person who continues to act on a Power may expose himself to legal disputes and claims.

Appointing a Curator Bonis

The misconception of the benefit of a Power of Attorney may be partly attributable to the fact that, in certain jurisdictions - such as the United Kingdom, Canada, Australia and New Zealand - it is possible, *in anticipation of incapacity*, to grant Power to an agent, which Power will then remain in force, despite incapacity. These Powers of Attorney are designated by different names in different jurisdictions, such as: A Lasting Power of Attorney, a Continuing Power of Attorney or an Enduring Power of Attorney. Two forms are encountered; the first relates to the grantor's health and welfare (or person), and the second relates to the individual's money and property (estate).

In terms of South African law, the only avenue open when confronted with a need to deal with a person's finances who lacks capacity is to make application for the appointment of what is known as a Curator Bonis (and Curator ad Personam in exceptional circumstances).

Traditionally this would be achieved by means of what is known as a Rule 57 Application (in terms of the High Court Rules), by making application to the High

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Court, in the jurisdiction in which the individual resides, to declare such person incapable of managing his own affairs and appointing a person (the Curator Bonis) to take charge of his affairs.

The cumbersome process of appointing a curator

Such application may be brought by any person who has an interest in the relevant individual's affairs, but would mostly be a close family member. This person would have to, with the assistance of an attorney, prepare an affidavit setting out the circumstances of the individual's impairment, as well as setting out details of their income, expenditure, assets and liabilities. The application must be supported by two medical reports, one usually by a general medical practitioner, and the other by an alienist (a neurologist or psychiatrist).

The first step in the process is then to approach the court for the appointment of what is known as a Curator ad Litem. This is usually an advocate of the High Court, who will, for the benefit of the court, confirm that the person is in fact unable to manage their own affairs and that it is in the best interest of the relevant individual. This provides a mechanism to prevent the possible abuse of such a process. The Curator ad Litem will interview the person, medical practitioners and others with knowledge of the person's circumstances and file a report, which, in turn, is supplemented by the Master of the High Court's report, confirming the suitability of the proposed Curator Bonis.

The second step is for the appointment of the Curator Bonis (usually an attorney of the High Court), who will take charge of the individual's estate once appointed by the Master who will issue Letters of Curatorship which provides the authority to administer the estate in the best interest of that individual.

Apart from the cost and delays in bringing such an application, the whole process is rather cumbersome in that all steps taken by the appointed Curator must first be approved by the Master of the High Court and the Curator may be stymied by limited investment powers. The Curator must lodge with the Master of the High Court an annual report of his administration in the form of a Curatorship Account, setting out the income and expenditure during the period, which must be supported by vouchers of all receipts and payments. In many cases, the nature of the work and the poor remuneration often make finding suitable candidates to take on the appointment a difficult task.

The Mental Health Care Act, No 17 of 2002, introduced an alternative simpler procedure to cater primarily for smaller estates. This process does not involve a High Court application, but nonetheless has essentially the same criteria, and an application and medical reports must be lodged with the Master of the High Court, who will then appoint the person so nominated, who is then the designated administrator. While this process is geared to estates where the income of the individual does not exceed R24,000 per annum and the capital R200,000. It can be extended if the Master launches an investigation.

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The Commission sensibly recommended legislation for an Enduring Power of Attorney, both in respect of an individual's person and estate.

An Enduring Power of Attorney on the horizon?

Mindful of the vulnerability of individuals without capacity and the problems confronted by their families, the South African Law Commission lead an investigate, known as Project 122, to address the matter. On 31 March 2004, the Commission published a very comprehensive and detailed report, known as *Assisted Decision Making: Adults with Impaired Decision-Making Capacity*. On publication of the discussion paper, the Commission called for further comments and input. The Commission sensibly recommended legislation for an Enduring Power of Attorney, both in respect of an individual's person and estate.

The detailed Report sets out the circumstances in which such a Power of Attorney may be granted, and endeavours to put in place certain mechanisms of checks and balances for the protection of the relevant individual. It is illuminating to consider what is envisaged in the Bill: Chapter 1 sets out the basic principles which will underpin every case and aims to indicate to whom the legislation will apply. Chapter 2 creates a first tier of substitute decision-making to legalise day-to-day decisions. Chapter 3 creates the mechanism for once-off decisions for short term solutions. Chapter 4 and 5 deal with longer term management of property and personal welfare. Chapter 6 deals with the Enduring Power of Attorney. Chapter 7 provides for the supervisory mechanism to regulate the proposed measures.

The Report culminated in draft legislation which was most recently submitted to the Minister of Justice on 19 September 2016.

The Minister has apparently acknowledged receipt, and while there is a paucity of reasons for the delay or firm timelines for promulgation, on enquiry, the delay appears to be due to the consideration being given to the relevance of the requirements of the United Nations Convention on the Rights of Persons with Disabilities (UNCRPD).

If made law, such an Act will effectively put in place a legal structure that provides a secure and legal option to the current often-flawed and failed general Power of Attorney and a less formal and costly option to the current curator route, while still providing protection for the relevant individual.

An alternative solution: A Special Trust

While a family Trust based on the principle of division of control and enjoyment may provide a partial solution, a more appropriate alternative would be the creation of a so-called *Special Trust* created for the very purpose The Income Tax Act introduced the definition of a Special Trust in 2001. The definition was substituted by s2(1)(za) of the Taxation Laws Amendment Act, No 22 of 2000, effective on the years of assessment commencing on or after 01 March 2012.

A Special Trust A-Type is defined as:

> A trust created solely for the benefit of one or more persons who is or are persons with a disability as defined in section 6B(1) where such disability incapacitates such person or persons from earning sufficient income for their maintenance or from managing their own financial affairs.

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This solution thus overcomes the difficulties and limitations of going the Power of Attorney route as well as avoiding the cumbersomeness of a curatorship.

Section 6B(1) defines a disability as:

> Disability means a moderate to severe limitation of any person's ability to function or perform daily activities because of physical, sensory, communication, intellectual or mental impairment, if the limitation has last or has a prognosis of lasting more than a year, and is diagnosed by a duly registered medical practitioner in accordance with the criteria prescribed by the commission.

Such a trust would have to be created in the usual manner of an agreement between a founder and trustee or trustees, whereby assets are transferred to the trustee to administer the trust for the benefit, in this case, of a person who has a disability. A crucial aspect of such a trust is that it must, during the life of the disabled person, be solely for the benefit of the said individual and only on his or her demise may secondary beneficiaries benefit from either the income or capital of such a trust. At that point, the Trust will, however, cease to be a Special Trust.

The pros of using a Special Trust

The beauty of the solution lies in the fact that the estate, or part of the estate, of a person lacking capacity will be controlled by trustees but solely for the benefit of the relevant person or persons. This solution thus overcomes the difficulties and limitations of going the Power of Attorney route as well as avoiding the cumbersomeness of a curatorship.

The trust and trustee remain subject to the terms of the Trust Deed and the Trust Property Control Act. This ensures transparency and accountability but without the inflexibilities of a curatorship. A further advantage is that special trusts are taxed on a more favourable basis as compared to other trusts. Effectively these Special Trusts, if compliant with the requirements, are taxed in much the same way as an individual, meaning that the tax rate applied to a Special Trust's income is not the higher flat-rate that is applied to a normal trust, but the sliding scale otherwise applied to a natural person. Similarly, capital gains will be subject to a natural person's inclusion rate and the trust will also benefit from the primary residence and yearly abatement of gains.

As to the funding of such a trust, any of the two usual methods may be used, namely either an interest free loan or a donation. The now well publicised disadvantage of interest free loans brought about by the introduction of s7C of the Income Tax Act is, however, not applicable in that this type of Special Trust is exempted in terms of s7C(5)(c).

Similarly, it seems settled that a Special Trust will not need to pay donations tax upfront, if one has reference to the South African Revenue Services' (SARS) recent binding private ruling, BPR306, dated 28 June 2018. In this case, the applicant - a resident adult who was suffering from early onset dementia – wanted, while he was still lucid, to provide and make arrangements for his upkeep and

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While the solution of a Special Trust does not offer relief or a viable alternative if an individual is already suffering from advanced incapacity, it does provide a remedy in anticipation of incapacity in certain circumstances.

wellbeing. He intended to create a trust that would comply with the requirements as set out in the Income Tax Act, and sought a ruling from SARS that the amount that he would contribute towards the trust (so called capitalisation), would not be subject to donations tax as contemplated in terms of s54 and s55.

Obviously, each matter will have to be approached on a case-by-case basis and while there may be some estate duty arbitrage in such a structure, the industry should self-regulate to prevent abuse and not place the continued existence of the benefit at risk by failing to use it for its intended purpose.

While the solution of a Special Trust does not offer relief or a viable alternative if an individual is already suffering from advanced incapacity, it does provide a remedy in anticipation of incapacity in certain circumstances and a much-needed mechanism to protect elderly and vulnerable persons. Otherwise, we wait – hopeful - for the promulgation of the Assisted Decision Making: Adults with Impaired Decision-Making Act.

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