September 2025

Ninety One

Investing for a world of change

Smart legal structures for future-proof financial planning

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The fast view

- Holistic planning must go beyond investments and retirement savings, preparing for possible physical or mental incapacity to ensure continuity and peace of mind. Tools include:
  - A Special Trust Type A offers beneficial tax rates if disability arises, but comes with limitations and potentially burdensome administration.
  - Power of Attorney (POA) is useful for temporary authority for financial tasks but lapses when mental capacity is lost.
  - Administrators (via Master of the High Court under the Mental Healthcare Act) can manage finances if incapacity results from mental illness or severe intellectual disability.
  - Curators (appointed by the High Court) may be required for broader incapacity cases; they manage financial (curator bonis) or personal (curator ad personam) matters, though the process is costly and intrusive.

Holistic financial planning goes beyond investment choices and retirement goals – it must also account for life's uncertainties.

In this article, we explore how to safeguard clients' financial well-being in the face of diminished mental or physical capacity. We unpack ways of future-proofing financial plans to ensure that clients' affairs can be managed effectively should incapacity arise.

Proactive financial planning is essential and financial advisors should guide their clients toward sound legal and financial frameworks that not only preserve autonomy for as long as possible but also ensure continuity and peace of mind. Tools such as a Special Trust Type A, powers of attorney, and the appointment of administrators or curators can be considered.

Special Trust Type A: A beneficial tool for disability planning

A Special Trust Type A is an inter vivos trust that is established while the client is still mentally capable and which can be converted for tax purposes to a Special Trust Type A if the client becomes disabled.

Under Section 6B(1) of the Income Tax Act, the trust may qualify as a Special Trust Type A if the disability is such that it **significantly limits the person's ability to function or perform daily activities due to physical, sensory, communicative, intellectual, or mental impairment**.

Where a trust qualifies as a Special Trust Type A, the trust pays income tax based on the tax rates applicable to natural persons, ranging from 18% to 45%, as opposed to the usual 45% income tax rate for trusts. Additionally, the trust qualifies for the R40 000 annual capital gains tax exclusion and the R2 million primary residence exclusion.

Converting a trust to a Special Trust Type A requires submission of the original trust deed, an IT77TR form, and a valid medical report confirming the qualifying disability.

Although this structure may have significant benefits from a tax perspective, it is worth noting that certain investment types cannot be transferred into the trust, such as living annuities. Annuity income can also not be paid into the trust. It is also important to consider that, if the anticipated disability never materialises, the financial upkeep and administration of the trust could become burdensome. Financial advisors should weigh up these considerations carefully when recommending this option to their clients.

Power of Attorney: Temporary authority, but not necessarily a long-term solution

A Power of Attorney (POA) is often a go-to instrument when clients want to delegate authority, especially when facing physical impairments that prevent them from managing day-to-day financial tasks. A POA allows a designated agent to act on behalf of the principal in either a general or specific capacity. A general POA gives broad authority over financial affairs such as managing bank accounts and investments or purchasing property, while a special POA limits the agent's role to specific tasks like handling tax matters or signing specific documents for a specific investment.

However, financial advisors must educate clients about a crucial limitation: a POA is only valid while the principal retains mental capacity. If that capacity is lost due to dementia, coma, or other mental impairments, the POA becomes invalid. In South Africa we do not have the concept of an enduring POA which can remain in place once a person becomes mentally incapacitated. Therefore, while it remains a useful short-term tool, it should not be relied upon as a long-term incapacity-planning solution.

> POA is only valid while the principal retains mental capacity.

To be valid, a POA must be in writing, it must clearly outline the scope of powers granted, and it must be signed by the principal in the presence of two competent witnesses. Both the principal and agent must be at least 18 years old. Once a POA is in place, it doesn't have the effect that the principal can no longer act on their own behalf. The principal still has the right to manage their own affairs and transact on their own behalf.

Where a client wishes for their financial advisor to act on their behalf in managing their financial affairs, including signing application forms and transaction forms other than those that a Category II financial advisor may sign in accordance with FAIS, it is essential that a POA is built into the mandate that the client signs with the financial service provider.

Note that some powers cannot be delegated – such as initiating divorce proceedings, signing a will, or claiming personal damages. Financial advisors should ensure clients understand the legal limitations and communicate with relevant institutions, such as banks and investment product providers, if a POA is withdrawn or terminated or if it has become invalid due to mental incapacity.

Administrators and curators: In some cases the only option

Where a client becomes mentally incapacitated, family members are left with limited options. In such cases, they may have to approach the courts or the Master of the High Court to appoint someone to manage the client's affairs.

Two routes exist: the appointment of an administrator or a curator. An administrator can be appointed by the Master of the High Court in terms of the Mental Healthcare Act to manage the property of someone diagnosed with a mental illness or a severe intellectual disability. This route is relatively quick and cost-effective, but it is strictly limited to cases where the incapacity stems from such diagnoses. It does not apply to clients who are incapacitated due to physical disabilities, terminal illness, or old age, unless these are accompanied by mental incapacity.

In instances where it is not possible to appoint an administrator, the appointment of a curator by the High Court will be necessary. A curator bonis can be appointed to manage financial matters, while a curator ad personam is appointed to make personal decisions regarding the client's daily living needs, such as healthcare and accommodation.

Although curator applications are expensive, time-consuming, and often intrusive, they may be the only option available.

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The financial advisor's role in protecting the future

Financial advisors are uniquely positioned to guide clients through these legal and financial considerations. Considering tools such as a Special Trust Type A or an appropriate POA early in life can prevent significant emotional and financial strain later. Encouraging clients to think beyond the present moment and plan for the possibility of incapacity is responsible and forward-thinking financial advice.

Important information

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CS_866 09/2025