The viability of the trust as an estate planning tool

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I would like to dedicate this work to my children and close friends who have supported me along the way.
I would further like to extend appreciation to Professor A van der Linde for his guidance, support and many hours of dedication.

"Just because a river is deep does not mean it is wide and just because a river is wide does not mean it is deep"
Jason Rowland

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Summary

Much focus is being placed on the future viability of trusts as estate planning tools. The Davis Tax Committee has been established with one of its objectives being to investigate and make recommendations, with a view of curbing the misuse or abuse of the trust form. A number of these recommendations have been incorporated into legislation. This has resulted in the trust being viewed as having been, or about to be, stripped of the benefits which make it a viable estate planning tool. This mini-dissertation investigates as to whether the trust is still a viable estate planning tool. Chapter 1 presents the research problem and poses research questions that will be discussed with the aim of establishing the viability of the trust as an estate planning tool. In attempting to address this research problem chapter 2 deals with an investigation into the viability of employing the trust as protection mechanism of (estate) assets. Questions pertaining to the insolvency of the various parties to the trust are addressed. Furthermore, the possibility of trust assets being considered part of the founder's estate during divorce proceedings, are investigated. Chapter 3 considers the impact of taxation on the viability of the trust as an estate planning tool. An in depth discussion is undertaken pertaining to the Davis Tax Committee and Taxation Laws Amendment Act of 2016 and Taxation Laws Amendment Bill and Act of 2017, particularly the impact section 7C of the Income Tax Act 58 of 1962 has on loans by so called "connected persons" to the trust. Chapter 4 discusses further non-taxation uses of the trust and certain estate planning techniques incorporating trusts in practice. Chapter 5 contains the conclusion. It is submitted that the trust is still a viable estate planning tool.

Chapter 1: Introduction

1 1 Introductory

The "trust" is often encountered in the context of estate planning.[1] This mini-dissertation will analyse whether the trust is still "viable" as an estate planning tool by taking into consideration current and possible future practices, dictated by current and proposed legislation pertaining to trusts.[2] "Viability" for purposes of this dissertation means something that is capable of working successfully or being feasible or useful in a certain context namely that of trusts in the context of estate planning. The criteria used in this context to determine "viability" for purposes of this dissertation will be whether the trust provides protection of trust assets under certain circumstances;[3] whether it has any tax advantages;[4] whether the trust serves as a tool for the care of family members[5] and other non-taxation purposes of the trust. These criteria are more specifically dealt with in the research questions below.

1 2 Research problem

Much focus is being placed on trusts and the misuse or abuse thereof as estate planning tools. As a result the Davis Tax Committee has been established to investigate this matter.[6] Prior to this, the Minister of Finance[7] indicated in the 2013/2014 budget that government was proposing several legislative measures, to

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1 Meyerowitz ("Estate and Tax planning" 1965 *The Taxpayer* 28) explains it as follows: "To define it in its simplest and basic terms, it is the arrangement, management, securement and disposition of a person"s estate so that he, his family and other beneficiaries can enjoy and continue to enjoy the maximum benefits from his assets or estate during his lifetime and after his death."; Bobbert ("Grondlyne van strategiese boedelbeplanning" 1976 *TRW* 20)explains it as follows: "Estate planning is the process whereby a person acquires property, ensuring that he derives the maximum benefits from his ownership and the enjoyment thereof during his lifetime and that as much as possible and in the most economical manner with the minimum erosion thereof shall devolve upon his heirs when he dies." Van der Westhuizen "The relevancy of inter vivos and mortis causa estate planning when choosing a matrimonial property system" *TRW* 1988 explains it as follows: "The deciding in advance by an estate owner of what to do with his assets and liabilities during his lifetime and upon his death, how to do it, when to do it and who to do it."

2 The word "tool" in the heading of this dissertation has specifically been used due to one of its meanings being: "anything used as a means of performing an operation or achieving an end" : The Collins Dictionary http://www.collinsdictionary.com/dictionary/englis/tool. Accessed 10 October 2017. With specific reference to the definition of a tool above, it can be said that trusts are widely used in practice as a means to an end to achieve certain objectives.

3 See ch 2.

4 See ch 3.

5 For example minor children or disabled family members; see ch 4.

6 Refer to para 5 2 for a detailed discussion on the Davis Committee 2nd report.

7 Minister Nlanhla Nene.

curtail perceived tax avoidance associated with trusts.[8] In the 2016/2017 budget the Minister of Finance[9] further indicated that measures to prevent income-splitting and other tax benefits associated with discretionary trusts were being investigated. He also mentioned that "interest free loans" to trusts would be included under the definition of a "donation",[10] resulting in a donations tax liability. Some of these proposed legislative measures have been passed as legislation.[11] One of the key advantages of a trust namely the "conduit principle" with specific reference to section 25B[12] and paragraph 80 of the Eighth Schedule[13] of the Income Tax Act[14] is under scrutiny but has not yet been addressed in new legislation. The benefit of this principle will be discussed below. Should this "principle" fall away in future the tax efficiency offered by trusts in comparison to other entities such as companies and close corporations will further be reduced.[15]

Estate owners often create trusts for estate planning purposes and specifically to obviate the payment of estate duty and other taxes upon the death of the estate owner.[16] Unfortunately they then often continue to treat the trust assets as their own, resulting in the abuse of the trust.[17] To further compound this problem, testators are often under the false impression that an existing inter-vivos trust and its assets can also be applied to prevent a cash shortfall of the winding up of their personal estates on death. This lulls them into a false sense of security that all is fine when it comes to the issue of estate liquidity, only to find that the assets in the existing inter-vivos do not form part of his estate. His estate experiences a subsequent lack of liquidity resulting in the consequent need to sell off assets in order to provide for liquidity.

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8 Croome *The future taxation of trusts* (2013) http://www.thesait.org.za/news/130111/The-future-taxation-of-trusts.htm accessed 10/09/2013.

9 Minister Pravin Gordhan.

10 A donation takes effect when all the legal requirements of s 55(3) of the Income Tax Act 58 of 1962 are complied with.

11 Taxation Laws Amendment Act 2016 and Taxation Laws Amendment Bill 2017 wrt the addition of s7C of the Income tax Act 58 0f 1962.

12 Pertaining to income earned by a trust.

13 Pertaining to the taxation of capital gains made by a trust.

14 Act 58 of 1962.

15 Pretorius"*Trusts a tax nightmare?"* (2012). http://www.thesait.org.za/news/news.asp?id=104126& hhSearchTerms=%22trusts+and+tax+and+nightmare%22 accessed 10/09/2016.

16 Also known as "estate pegging". See Abrie *et al Estate and financial planning* (2003) 194.

17 Refer to ch2.

This problem is emphasised and illustrated by the decision handed down in *Land and Agricultural Bank of SA v Parker,*[18] where the trustees own breach in running the family trust led to unenforceable transactions. Put differently, there is often conflict between separation of assets and control thereof by the founder. In this case the core idea of the trust is articulated as being:[19]

> "…the separation of ownership (or control) from enjoyment. Though a trustee can also be a beneficiary, the central notion is that the person entrusted with control exercises it on behalf of, and in the interests of, another."

It therefore would appear that the purpose of a trust and expectation from the donor or founder on how it should operate are often not aligned, resulting in negative consequences for the estate owner/founder. In *Nieuwoudt NO v Vrystaat Mielies (Edms) Bpk*[20] Harms JA, drew attention to this by stating:[21]

> "The trust deed in this case is typical of a newer type of trust where someone, probably for estate planning purposes or to escape the constraints imposed by corporate law, forms a trust while everything else remains as before."

Taking the above into account, it then becomes important to look at what the purpose for specifically establishing the trust is and whether a trust is still viable as an estate planning tool in terms of legislation, budget speeches[22] and measures suggested in the Davis Tax Committee 2nd report to curtail the perceived abuse of the trust form.

This legislation[23] and the suggestions offered in the Davis Tax Committee 2nd report is an attempt to prevent the further misuse and abuse of the trust form.[24] This is not the only aspect that brings into question the future viability of a trust. The trust as a protection mechanism of assets is investigated in chapter 2 in the context of insolvency and divorce proceedings. In chapter 3, the taxation aspects pertaining to

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18 2005 (2) SA 77 (SCA) para 86 E/F.
19 Para 26 88C.
20 2004 (3) SA 486 (SCA).
21 2004 (3) SA 486 (SCA) para 17.
22 2009/10; 2013/14; 2016/17.
23 Taxations Laws Amendment Act 2016 and Taxation Laws Amendment Bill 2017; section 7C of the Income Tax Act 58 of 1962.
24 Refer to ch 3 for a detailed discussion.

trusts are investigated, with specific emphasis on the impact that section 7C of the Income Tax Act[25] has and the impact thereof on future lending by "connected persons"[26] to trusts. In addition, the viability of certain trust owned investments is discussed where a comparison is drawn between Collective Investment Schemes[27] and investment products governed by the Long Term Insurance Act.[28] An opinion is delivered based on the impact of taxation on future investment returns.[29]

In chapter 4, a comparison is drawn between trusts and usufructs as to which would be the more effective solution for estate planning purposes. The reason for this is discussion the need of founders,[30] to provide for future generations by either of these two estate planning techniques.[31] Chapter 4 will also briefly focus on other non-tax uses of the trust in order to ascertain the viability thereof as an estate planning tool. Chapter 5 concludes this mini-dissertation by answering the research questions posed with reference to the previous chapters findings, leading to an opinion as to the future viability of the trust as an estate planning tool.

1 3 Research questions

In order to ascertain whether the trust can still be deemed to be a "viable" estate planning tool, the following questions will be investigated:

1 3 1 How "viable"[32] is the trust as a protection mechanism?[33]

1 3 1 1 Are trust assets protected upon the insolvency of one of the parties to a trust?[34]

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25 Act 58 of 1962.
26 See discussion in ch 3.
27 See Governed by the Collective Investment Schemes Control Act 45 of 2002.
28 Act 52 of 1998.
29 See discussion in ch 3.
30 Particularly the farming community (my experience).
31 In light of this discussion, a further planning technique incorporating the use of a trust and usufruct in combination known as the so-called "one year wonder"[31] is discussed via case study. This was Referred to in the budget speech 2009/2010 by Minister Trevor Manual who indicated that measures would be implemented to curb the use of this scheme. This has however not been addressed yet.
32 See para 1 1 above.
33 Refer to ch 2 para 2 2.
34 Refer to ch 2 para 2 2 3.

1 3 1 2 What will the effect be of the abuse of the trust (by the founder) upon the sequestration of the founder's estate?[35]

1 3 1 3 How can trust assets be protected upon the insolvency of a trust beneficiary?[36]

1 3 1 4 Are trust assets protected upon divorce?[37]

1 3 1 5 Do the "so-called core elements" of the trust and other basic trust principles sufficiently protect trust beneficiaries?[38]

1 3 2 Is the trust a viable tax planning tool?:[39]

1 3 2 1 What impact do the Davis Tax Committee suggestions and the introduction of section 7C of the Income Tax Act[40] have on trust loan accounts?[41]

1 3 2 2 What impact do the proposed amendments to section 25B – the so-called "conduit pipe principle."?[42]

1 3 3 What other non-taxation uses potentially result in the trust being deemed a viable estate planning tool?[43]

1 4 Scope of the study

The research focuses on the relevance and viability of ownership trusts and therefore falls within the field of Private Law. The predominant focus will be on the viability of the trust as a protection mechanism of assets in an estate planning context. In this regard emphasis is placed on the protection of assets upon the insolvency of one of the parties to the trust.[44] Special attention is drawn to the abuse of the trust and the effect it has on the estate of the founder upon his personal sequestration. Furthermore, the issue of the abuse of the trust is discussed in the context of a divorce. The scope of the discussion on the abuse of the trust is specifically limited to these two above mentioned aspects. Due to the limitations placed on the length of this mini-dissertation other aspects of the abuse of the trust

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35 Refer to ch 2 para 2 2 4.
36 Refer to ch 2 para 2 2 2 and 2 3.
37 Refer to ch 2 para 2 6.
38 Refer to ch para 2 7.
39 Refer to ch 3 para 3 9 2.
40 Act 58 of 1962.
41 Refer to ch 3 para 3 3, 3 4, 3 5 and 3 6.
42 Section 25B of the Income Tax Act 58 of 1962; see ch 3 below.
43 Refer to ch 4 .
44 Refer to ch 2.

are not dealt with. A separate chapter is devoted to the issue of whether the trust is still viable from a taxation perspective in the context of estate planning. The discussion of this aspect is hereby also explicitly limited to:

(a) a discussion of the so-called conduit principle;[45]

(b) a discussion of the impact of the "new" section 7C of the Income Tax Act brought about by the Taxation Laws Amendment Act of 2016 and refined by the Taxation Laws Amendment Bill of 2017, based on recommendations from the Davis Tax Committee.

Lastly, the study will focus on some other non-tax uses of the trust.

1 5 Purpose, value and aim of study

Growing negative perceptions around the tax treatment of trusts has put planners off recommending trusts to their clients who would otherwise have benefited from the use of a trust. According to Carroll there are a myriad of different reasons for considering a trust and tax is only one consideration to be taken into account.[46] The purpose of this study is to establish the viability of the trust as an estate planning tool through identifying and then investigating specific reasons, including estate planning techniques, for considering a trust. The value of this study is that it shows that the trust is still viable as an estate planning tool. The study however is limited to the scope mentioned above.

1 6 Assumptions of this study

The research is based on the following assumption that estate planning needs to be done, irrespective of future proposals by Government to amend legislation pertaining to trusts. This perceived lack of viability exposes estates to unnecessary risk in the cases where the trust is a viable component of a broader estate plan, but is not selected due to negative perceptions created by the media[47] and proposed legislative changes.

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[45] S25B of the Income Tax Act 58 of 1962.

[46] Carroll "Is a trust still a viable estate planning tool?" 2002 *Insurance and Tax* 24-26.

[47] Jooste "Estate Planning tax trouble for trusts" 2015 *Financial Mail*. http://www.financialmail.co.za/moneyinvesting/2015/08/13/estate-planning-tax-trouble-for-trusts accessed 10/09/2016; Mittner "Tax committee proposes overhaul of trusts" 2015 *Business day* accessed 10/09/2016. http://www.pressreader.com/south-africa/business-day/20150714/textview

1 7 Research methodology[48]

In this dissertation existing knowledge in the field of estate planning is analysed in lieu of the question as to whether the trust is still a viable estate planning tool. An investigation is launched into new legislative measures, recommendations by the Davis Tax Committee, academic hand books and journals and relevant case law.

[48] It is defined as: "The process used to collect information and data for the purpose of making business decisions. The methodology may include publication research, interviews, surveys and other research techniques, and could include both present and historical information." http://www.businessdictionary.com/definition/research-methodology.html accessed 19/11/2016.

Chapter 2: The trust as a protection mechanism of assets

2 1 Introduction

In this chapter the trust as protection mechanism of assets will be investigated. Nunn's,[49] for example, states: "…the most important reason why one should have a trust is for *risk-protection* purposes (including protection against business or personal creditors, professional or delictual claims against you or personal relationships going sour) – *any tax advantage that trusts offer is a bonus.*"[50]

Considering this, the effect of the sequestration of the estates of the parties involved with the trust will firstly be considered. Secondly, the effect of the abuse of the trust of the founder upon the sequestration of the estate of the founder will be investigated. Thirdly, the vulnerability of trust assets upon divorce in the event of the abuse of the trust will be illustrated. Lastly, the effect of the so-called "core elements" of the trust in protecting trust beneficiaries and trust assets will briefly be explained.

2 2 Protection of trust assets upon the sequestration of the estates of one of the parties to the trust[51]

2 2 1 Insolvency of the trustee

A trust is not a legal person per se and is therefore not the owner of the trust assets.[52] The trustee in his/her official capacity as such is actually the owner of the trust assets.[53] Seeing that in the "bewind" trust[54] the trust beneficiary is the owner of the trust assets, the insolvency of the trustee cannot harm the beneficiary in any way. But in the normal case of the "ownership trust"[55] where the trustee is the owner of the trust assets, there is a possibility of harm to the trust beneficiary as the trust

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[49] Nunns "Should I still have a trust in these tax-uncertain times?" 2016 *Millers Attorneys Newsroom* accessed 07/11/2016. *http://www.millers.co.za/NewsPublications/NewsArticle.aspx?CategoryID=1&articleId=1802&Type=Primary#.WDClw2df3IV.*

[50] Emphasis added.

[51] Stander "Hoe veilig is bates in 'n trust in geval van die sekwestrasie van die boedel van een van die betrokke partye?"1999 *TRW* 146-157.

[52] *CIR v MacNeillie's Estate* 1961 (3) SA 833 (A).

[53] S12 Trust Property Control Act 57 of 1988; Cameron et al *Honore's South African Law of Trusts* (2002) 6.

[54] Term used to illustrate the construction of the trust in s1(b) of the Trust Property Control Act.

[55] Term used to illustrate the construction of the trust in s1(a) of the Trust Property Control Act.

assets should theoretically fall into the trustee's insolvent estate. This problem has however been effectively obviated by section 12 of the Trust Property Control Act which now expressly provides that: "Trust property shall not form part of the personal estate of the trustee except in so far as he as the trust beneficiary is entitled to the trust property." The trust beneficiary now in principle enjoy complete protection upon the insolvency of the trustee. This arrangement is not only reasonable but it also promotes legal certainty for the really effective operation of this provision, however, it is important that assets must be identifiable as trust assets. It is important for this reason that the trustee must carry out his duties regarding registration and identification of trust assets with the utmost diligence.[56] Assets however do not form part of the trustee's personal estate and are therefore are "normally" not subject to attachment should the trustee be declared insolvent in a personal capacity, provided there was no abuse of the trust form.[57]

2 2 2 Insolvency of the trust beneficiary

In this instance we need to consider the type of trust in more depth.

(a) The so-called "Bewind" trust:

In the case of the so-called "Bewind" trust, the trustee is merely the administrator/controller of the trust assets and not owner thereof.[58] The assets do not belong to the trustee, but to the trust beneficiary. As a result, these assets form part of the beneficiary's personal estate and are attachable by creditors upon a beneficiary's insolvency.

(b) Discretionary ownership trust:

In this instance the beneficiary only has a *spes*[59] and not a right to trust capital or income. The capital and income is protected until such a time that it vests in the beneficiary.[60]

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[56] Ss 9, 10 and 11 of the Trust Property Control Act.

[57] Refer to para 2 2 footnote 4 where trustee personal estate was sequestrated and trust assets taken into consideration due to the abuse of the trust form.

[58] Honore' (1992)4,222; Olivier (1989)111.

[59] A mere "hope".

[60] Whether vesting has occurred will be determined by the discretion afforded to the trustee. Two scenarios can occur. Where the trustee only has discretion w.r.t. "how" or "when" a payment is made will result in the beneficiary having a vested right. Where the trustee has discretion wrt "who"

Footnote continuous on next page

(c) Non-discretionary ownership trust, without provision for substitution[61]

In the case of the non-discretionary trust (without provision for substitution), the beneficiary has a right to claim against the trustee from the commencement of the trust capital and/or income generated within the trust. This right of claim is seen as an asset within the beneficiary's personal estate and therefore attachable by creditors.[62]

(d) Non-discretionary ownership trust, with provision for substitution

In this instance the effect of direct substitution is that the attainment of vested rights by a capital beneficiary is postponed until the dissolution of the trust. Only if the capital beneficiary, who was originally nominated, is still alive at that stage, does he acquire a vested personal right against the trustee in respect of the trust property.[63] From this the deduction can be made that should such beneficiary become insolvent before the dissolution of the trust there is no vested right for the creditors to attach.[64]

2 2 3 Difference between vested rights and contingent rights in the context of trusts: Examples of clauses[65]

In order to distinguish between vested rights and contingent rights the following clauses as provided by Stander can serve as illustration. It can be summarised as follows:

(a) "*If* there is income, it *must* be apportioned as follows…."

This is an example of a non-discretionary trust where the beneficiary has no vested right. The right is conditional on the trust generating an income, but this conditional

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receives the benefit as well as the discretion not to distribute benefits. This will result in there not being a vested right in the estate of the beneficiary, but merely a hope thereto. The capital will therefore not be attachable until it vests. Stander opines that Section 2 of the Insolvency Act dealing with conditional rights will not be applicable in light of the trust beneficiary merely having a *"hope"* and not a right. Stander *TRW* 1999 151. She also states: "Dit is my submissie dat die voorwaardelike regte waarvan in artikel 2 melding gemaak word nie die verwagting van die trustbegunstigdes onder 'n diskresionere trust insluit nie. 'n Trustbegunstigde onder 'n diskresionere trust verkry voor uitoefening van die diskresie geen regte hoegenaamd nie." See also Olivier *Trustreg en Praktyk* (1989) 92, 143; *Stern and Ruskin NO v Appleson* 1952 3 SA 800 (W) 805.

[61] Also known as the vesting trust.

[62] See discussion below para 2 4.

[63] Abri *et al Estate and financial planning* (2003) 119-121.

[64] See discussion below para 2 4.

[65] Stander 1999 *TRW* 145 157.

right will fall within the estate of an insolvent beneficiary for purposes of section 2 of the Insolvency Act.[66]

(b) "*If* there is income, it *can be* distributed to A as follows: …"

This is an example of a discretionary trust where the beneficiary has no vested right. The trustee has discretion to "whom" to distribute if there is income. The use of the word "can" is indicative of this discretion and is merely offering direction to the trustee but not instruction. This right is therefore excluded from the insolvent estate of A.[67]

(c) "A must receive 30% of trust income on an annual basis"

This is an example of a vested right in favour of A. The trustee has no discretion. As a result, this vested right is an asset within the insolvent estate of A.

(d) "A *can* receive income annually from the trust, should the trustee decide that it must be paid out"

In this instance, we have a discretionary trust, where even though the beneficiary is indicated, the trustee has the right to withhold income. There is therefore not a vested right falling within the insolvent estate of A.

2 2 4 Insolvency/sequestration of estate of founder/estate owner

The assets transferred to the trust by the founder no longer fall within his/her personal estate. Personal creditors generally do not have a claim against trust assets. However, sections 26-31 of the Insolvency Act[68] can be invoked by the creditors to ascertain whether they have any claim.[69] Any loan owing to the founder by the trust will be viewed as an asset in his/her estate and therefore the loan amount would be claimable by creditors, possibly resulting in the trust having to liquidate assets to settle this liability.[70]

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[66] Act 24 of 1936.

[67] For a contra opinion refer to *Jordaan v Jordaan* 2001 (3) SA 288(C) wrt a letter of wishes where the founder was deemed to have abused the trust form.

[68] Act 24 of 1936.

[69] Also refer to *Nedbank v Thorpe* [2008] JOL 22675 (N).

[70] Stander 1999 *TRW* 145 152.

2 3 Protection of benefits against creditors of a beneficiary: Guard against a *nudum praeceptum*

When property is given to a beneficiary with a gift over to trustees to hold in trust for him in the event of his insolvency or the attachment of his property or some similar misfortune, it amounts to a nude prohibition and is automatically invalid.[71] Since the beneficiary owns the property and the restriction is imposed purely in his own interests, it does not bind him, nor does it render protection against insolvency because the gift over to the trustee may constitute a disposition which contravenes the insolvency laws.[72] To provide effective protection a clause like this must meet the following conditions:

(1) The insolvent beneficiary must suffer total forfeiture of his benefits in the circumstances as foreseen (the beneficiary may not later, for example when he is rehabilitated, receive the benefits himself;

(2) the forfeited benefits must pass, in their totality to a third party or class of persons; and

(3) the mentioned "gift over" or transfer of benefits to someone else may take the form of a power conferred on the trustee to appoint new beneficiaries from a class of people in the place of the original beneficiary.[73]

However, if a beneficiary of a discretionary trust should become insolvent and the dispositions to the trust fall outside the limited scope of dispositions in terms of

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[71] *Ruskin v Sapire NO* 1966 2 SA 306 (W).

[72] Stander 1999 *TRW* 145 160.

[73] In *Ruskin v Sapire NO* 1966 2 SA 306 (W) the court state the matter as follows (308A): "It seems that the only way that this object can be achieved is by completely depriving a beneficiary who becomes insolvent from all interest in the estate." In *Vorster v Steyn NO* 1981 (2) SA 81 (O) the facts were as follows: In the application for rehabilitation, the applicant also asked for a declaratory order relating to property he inherited from his father. His father's will had a proviso that, should the applicant be insolvent at the time of his death, the bequest should be held in a trust until such time as the applicant is rehabilitated. The Court held that the proviso in his father's will was a *nudum praeceptum* (of no legal force) and that the envisaged trust would have been invalid. S20(2) of the Insolvency Act 24 of 1936 provides that property acquired during the period of insolvency will be part of the insolvent's estate and thus the property inherited by the insolvent falls into his estate notwithstanding a contrary provision in the testator's will. The court further contended that firstly an inheritance will not fall into the insolvent estate if the testator appoints another beneficiary who should receive the inheritance if the original beneficiary is insolvent. A second possibility is for the will to provide that, in case of insolvency of the beneficiary, the executors will have the exclusive discretion to grant the inheritance to another person. It was argued that section 127(2) of the Insolvency Act gives the court discretion to make such an order part of a rehabilitation order, even if a creditor objects to it. The court correctly rejected this argument.

the insolvency law, proper protection can be rendered to the trust fund vis-à-vis the creditors of such an insolvent beneficiary.[74]

2 4 The so-called "discretionary protective trust"

This concept originates from English and American trust law, but also appears to have application in South African Trust law.[75] The important concept is that there is a valid determinable interest that ends on insolvency unlike the situation of "gifting over" discussed above. Where the trustee therefore has the option to transfer the vested right on insolvency of the trust beneficiary to another beneficiary[76] will result in the trust assets being protected, as the interest/right has reached its limit.[77] The beneficiary has no further vested right that can be attached by the curator of the insolvent estate. The only negative belies the fact that the insolvent beneficiary no longer has any vested right to the trust assets. This however, is a small price to pay when considering the alternative of trust assets being attacked by creditors.

An example of a valid "protection" clause in case of the insolvency of a trust beneficiary,[78] might read as follows:

> "In the instance where a beneficiary is declared insolvent, the trustees must keep such trust funds or assets in a discretionary trust for the benefit of the insolvent beneficiary's spouse and descendants."[79]

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74 Roothman "Die beskerming van voordele aan insolvente begunstigdes in testamente en trustaktes" 1992 *De Rebus* 61.

75 Stander 1999 *TRW* 145 161.

76 Referred to as a "third".

77 *Nudum praeceptum* principle will not apply.

78 Riddall *The Law of trusts* (1992) 231; Hayton *Law relating to trusts and trustees* (1995) 185; a33 Trustee Act/25 (UK); Roothman 1992 *De Rebus* 63-64; Kessler *Drafting Wills and Will trusts* (1995) 213,217.

79 Stander 1999 *TRW* 145 162 is of the opinion that a protective trust is at hand where the founder stipulates that upon insolvency of a trust beneficiary the trust funds or trust assets should be kept by the trustee for the remaining portion of the insolvent's life in a discretionary trust for the maintenance and education of, for example the insolvent beneficiary, his/her spouse and their descendants. However, it is important to keep in mind the requirements in *Ruskin v Sapire NO* 1966 (2) SA 306 (W). See also Roothman 1992 *De Rebus* 61.

2 5 Lack of protection of trust assets upon insolvency of the founder due to the abuse of the trust - piercing the veneer of the trust

2 5 1 The "basic trust idea"

Much focus is being placed on trusts and the misuse/abuse thereof as estate planning tools.[80] The Davis Tax Committee has been established with one of its objectives being to investigate and make recommendations, with a view of curbing the perceived future misuse/abuse of the trust form.[81] In *Nieuwoudt NO v Vrystaat Mielies (Edms) Bpk*[82] Harms JA, drew attention to this problem by stating: "The trust deed in this case is typical of a newer type of trust where someone, probably for estate planning purposes or to escape the constraints imposed by corporate law, forms a trust while everything else remains as before." In *Land and Agricultural Bank of South Africa v Parker*[83] the core idea of the trust is articulated as being: "…the separation of ownership (or control) from enjoyment. Though a trustee can also be a beneficiary, the central notion is that the person entrusted with control exercises it on behalf of, and in the interests of, another."

Cameron explains that the courts will in appropriate cases ensure that the trust form is not abused or debased and that the courts have the power and duty to evolve the law of trusts by adapting the 'trust idea' to the principles of our law. For purposes of illustrating the above mentioned abuse of the trust and the effect thereof in the event of the sequestration of the personal estate of the founder, the following case study serves as an example and warning to founders.

2 5 2 A case study: *Nedbank v Thorpe*[84]

(i) Facts:

For purposes of the discussion the facts and judgement are dealt with in **detail.** Eastshore Development (Pty) Ltd wished to develop properties in the St Francis Bay area. NBS Bank Ltd (one of the applicant's predecessors in title – applicant being

[80] See case law discussed below.
[81] See ch 3.
[82] 2004 (3) SA 486 (SCA) para 17.
[83] 2005 (2) SA 77 (SCA) para 26 88C.
[84] *Nedbank Limited v Thorpe (*7392/2007) [2008] ZAKZHC 72; *(*7392/2007) [2009] ZAKZPHC 44.

Nedbank Ltd) advanced funds by means of separate loans to the three shareholders of Eastshore Development (Pty) Ltd, one of them being the Wentworth Trust. Thorpe (respondent) stood surety for the debt in terms of the monies advanced to the Wentworth Trust. The Wentworth Trust was in arrears with its instalments by October 1997. Eastshore Development (Pty) Ltd was subsequently liquidated.[85]In terms of a judgement of the court handed down on 7 March 2000(which finally came into effect in 2003 after Thorpe's appeals were not upheld), Thorpe, having assumed liability as a surety and co-principle debtor,[86] was indebted to Nedbank for an amount of R2 816 891, 68 together with interest from that date and payment of costs. As at 20 June 2007, no payment had been received from Thorpe since the judgment had been issued against him. As a result of non- payment the amount owing to Nedbank had increased to R6 093 748, 50. The applicant (Nedbank Limited) therefore sought an order provisionally sequestrating the estate of the respondent (Thorpe). The applicant contended that Thorpe had established various family trusts to insulate his wealth from creditors, thereby frustrating their efforts to recover outstanding debts owed to them.[87] The applicant further averred:

> "…that if his estate is sequestrated and a trustee is appointed such trustee will be able to fully investigate the business affairs of the respondent, effectively pierce the veil of trusts and nominees, to locate assets which in reality belong to the respondent personally. For that reason the sequestration will be for the benefit of the respondent's creditors."[88]

The applicant decided to only focus on the Wentworth Trust case which commenced in 1998 and was finalized in September 2003 to illustrate Thorpe's indebtedness to the bank.[89] According to the applicant the respondent contended that he did not have the means in terms of assets or income to settle the debt, carrying with it the admission of insolvency. The resultant application by Nedbank to have Thorpe provisionally sequestrated in 2004 came before McCall J and was unsuccessful.[90] An enquiry in terms of section 65 of the

85 [2008] ZAKZHC 72 para 7.
86 [2008] ZAKZHC 72 para 3.
87 [2008] ZAKZHC 72 para 4.
88 [2008] ZAKZHC 72 para 5.
89 [2008] ZAKZHC 72 para 6.
90 [2008] ZAKZHC 72 para 9. Application dismissed with costs on 19 January 2005.

Magistrates Court Act[91] was launched into Thorpe's financial position, but not completed.[92] The following facts were however obtained by the applicant:

The Robin Thorpe Family Trust was established in 1985[93] and changed its name to the Banavie Trust on 4th July 2002.[94] The income beneficiaries of the trust were the respondent, his wife and two children[95] and Thorpe had no immoveable properties registered in his name.[96] Thorpe resided at 8 Ferndale Avenue, Durban, which was previously owned by the Robin Thorpe Family Trust. It was transferred out of the trust into the name of the respondent's wife, Mrs Helen Thorpe.[97] Thorpe had personal use of a 2005 Bentley Continental GT sports car valued at R2 500 000 purchased and owned by the Banavie Trust. The monthly instalments amounted to R20 820 a month which was paid by the trust. Thorpe personally negotiated the acquisition of the vehicle and provided his personal suretyship in favour of the bank which financed the transaction.[98] After having conducted a search at the Registrar of Companies it was ascertained that Thorpe was a director of at least seven companies and close corporations.[99] Up to the end of 1999 Thorpe's business was Thorpe Insurance Brokers (Pty) Ltd. It appeared that Thorpe owned shares in this company. Thorpe's occupation was that of a short-term insurer broker.[100] These shares were transferred to the Banavie Trust. In 1999 the Registrar of Short-Term Insurance sought and obtained an interdict against both the latter company and the respondent personally which prohibited them from continuing to act as short-term insurance brokers. Thereafter Thorpe Insurance Brokers (Pty) Ltd was put into liquidation.[101] According to the applicant Thorpe continued to operate a short-term insurance brokerage firm called Insurance on Line at Fourth Floor, Hampdon Court, Hampdon Road, Morningside, Durban. The applicant averred that "Insurance Online" was the trading name of a South African company called County Capital (Pty) Ltd.[102]

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[91] Act 32 of 1944.
[92] [2008] ZAKZHC 72 para 11.
[93] [2008] ZAKZHC 72 para 11 1.
[94] [2008] ZAKZHC 72 para 11 2.
[95] [2008] ZAKZHC 72 para 11 3.
[96] [2008] ZAKZHC 72 para 11 4.
[97] [2008] ZAKZHC 72 para 11 5.
[98] [2008] ZAKZHC 72 para 11 6.
[99] [2008] ZAKZHC 72 para 11 7.
[100] [2008] ZAKZHC 72 para 13.
[101] [2008] ZAKZHC 72 para 13.
[102] [2008] ZAKZHC 72 para 14.

Thorpe testified during the section 65 enquiry that during 1998 or 1999 he had disposed of his shares in County Capital (Pty) Ltd to an offshore company and had subsequently not been involved as a director or otherwise in the business. The Banavie Trust however did provide certain "consulting services" to Insurance Online in which Thorpe had no involvement.[103] Standard Bank also produced certain documents at the section 65 inquiry indicating that in May 2003 the respondent completed an application form in which he stated that he was the "owner" of the business called Insurance Online. In the same document he reflected his work email address as robint@insonline.co.za.[104] The applicant also averred that Thorpe personally put up rental guarantees to the landlord in respect of the premises occupied by County Capital (Pty) Ltd.[105] Affidavits by previous employees were also annexed, namely Mr Mark Farrer and Ernst Schwartz. Farrer testified that he was employed by Insurance Online during the period 2002 to 2005 and further quoted:

> "During my period of employment I was in absolutely no doubt that ROBIN THORPE was the owner and *de facto* benefactor of the business COUNTY CAPITAL (PTY) LIMITED t/a as INSURANCE ONLINE."[106]

According to Schwartz it was absolutely clear to him that the respondent controlled the business.[107] Thorpe's children held membership interests in 22 property-owning close corporations, of which the properties had a purchase price of R4 539 000,00. At the section 65 inquiry Thorpe said that these close corporations had been set up by him for the benefit of his children.[108] Thorpe was a trustee of the trust. The beneficiaries of the trust were Thorpe, his wife and various descendants.

The income-generating or asset-holding companies shares, of which Thorpe was a director, were all held by the Banavie Trust. In the year 2005 the trustees of the Banavie Trust allocated an amount of R700 000 to Thorpe. The allocation of funds by the trustees was purely discretionary, the identity of any income recipient being determined at the end of a relevant tax year. The allocation also depended on

[103] [2008] ZAKZHC 72 para 15.
[104] [2008] ZAKZHC 72 para 16.
[105] [2008] ZAKZHC 72 para 17.
[106] [2008] ZAKZHC 72 para 18.
[107] [2008] ZAKZHC 72 para 19.
[108] [2008] ZAKZHC 72 para 20.

whether it is tax-efficient or not to do so.[109] On 28th February 2006 it was decided by the trustees (including Thorpe) that they would not allocate any benefits to Thorpe. This was done so that he would not become a target of his creditors especially the applicant herein.[110] The applicant averred Thorpe was benefitting from informally The use of the Bentley motor vehicle and overseas travel were on three occasions during the year 2005 were cited as such examples.[111]I t was further averred that whatever funds or assets Thorpe received in his personal capacity were transferred to the Banavie, thus benefitting from all business operations that he engaged in.[112] The applicant averred that notwithstanding Thorpe's alleged inability to satisfy the judgment debt, it still believed that Thorpe was possessed of considerable financial assets which a trustee would uncover, benefitting creditors. The applicant also believed that Thorpe continued to engage in his insurance business under the guise of Insurance Online. The assets of this business could be realised for the benefit of creditors.[113] The applicant alleged that an abuse of the institution of a trust had occurred through the use of the Banavie Trust as a vehicle for the respondent's business activities and was simply a mechanism to shield his personal assets from creditors. According to the applicant the Banavie Trust was "the *alter ego*" of the respondent.[114] Provisional sequestration was consequently ordered.[115] In the matter considering the granting of a final sequestration order,[116] the issue of the true status of the trust and its assets were once again central. Here the court conducted a more thorough investigation into the trust and its affairs, and it emphasised the following aspects regarding Mr Thorpe's relationship with the trust:

[109] [2008] ZAKZHC 72 para 21.
[110] [2008] ZAKZHC 72 para 22.
[111] [2008] ZAKZHC 72 para 23.
[112] [2008] ZAKZHC 72 para 24.
[113] [2008] ZAKZHC 72 para 25.
[114] [2008] ZAKZHC 72 para 26.
[115] [2008] ZAKZHC 72 Para 53-54The court (Levensohn) stated as follows: "In my opinion there is a prima facie case that there is a reasonable prospect that investigation and interrogation under the Insolvency Act will yield a not negligible pecuniary benefit to creditors.[54] In the result the application succeeds and I make the following order : -(1) That the estate of Robin Patrick Thorpe, an adult businessman, identity no 5304285019007, with date of birth 28th April 1953, be and is hereby placed under provisional sequestration in the hands of the Master of the High Court, Natal Provincial Division."
[116] [2009] ZAKZPHC 44 para 2.

(ii) Further instances of abuse of the institution of the trust by Thorpe

The applicant relied on the evidence of abuse below as a motivation to request a more thorough investigation through the powers accorded to a trustee, to fully investigate Thorpe's financial position in relation to the Banavie Trust.[117] The trust deeds of the Wentworth Trust (the principal debtor in respect of the debt, *in casu*) and the Banavie Trust (which changed its name from the Robin Thorpe Family Trust) were practically in identical form.[118] The trustees could be replaced from time to time; however, it was noteworthy that the Respondent remained a trustee throughout (and could not be removed).It was apparent that Thorpe controlled the trust and access to the funds held by the trust.It was averred that when income due to Thorpe was received into his personal banking account, he religiously transferred any material credit balance to the Banavie Trust.[119] Thorpe's improbable explanation was that he would have received from the trust more than the trustees wished him to receive and an obligation arose to make repayment. A further excuse was that he erroneously received money that was in fact due to the trust.[120] Transcripts of the S*ection 65* enquiry revealed that Thorpe (and his co-trustees) determined that he should no longer receive any benefits from the trust, specifically because of his involvement in this matter:[121]

> "Did I understand you correctly, for the tax year 2006 you received approximatelyR700 000 from the Banavie Trust? Is that correct? ----That would have been for the year ending February 2006.
>
> Okay. And what have you received from the trust since the 1st of March? ---Nothing.
>
> And why is that? --- As I understand it at the moment, the trustee's have exercised their discretion in making a distribution to me as a beneficiary.
>
> With the greatest of respect that's a bit of gobbledygook to me. I don't exactly understand what you're saying there. What do you mean? --- Well, any income that I receive from the trust is completely at the discretion of the trustees.
>
> You are one of those trustees. --- I happen to be one of four trustees, that's correct.

[117] [2009] ZAKZPHC 44 para 28.
[118] [2009] ZAKZPHC 44 para 16.
[119] [2009] ZAKZPHC 44 para 19.
[120] [2009] ZAKZPHC 44 para 20.
[121] [2009] ZAKZPHC 44 para 21.

> Okay, yes, ja, and (intervention) --- And as things stand at the moment, in exercising that discretion, they've elected not to hand over any amount to me since the 1st of March.
>
> And do you know why? --- I think that it largely stems from the fact that I'm involved in this particular hearing."

(iii) Affluent lifestyle financed by means of "trustee remuneration":

Thorpe was not in deprived e.g. although he claims that since February 2006, he received no benefit from the trust, it was the trust that financed his overseas travel during April 2006.[122] Thorpe claimed that he only ever received *"discretionary"* income as determined by the trustees. This was not supported by his tax return for the tax year ended February 2006, which recorded that neither he nor his children were beneficiaries of any trust. In a tax return prepared by co-trustee and accountant, he declares his income as *"trustee remuneration".* He later gives the disingenuous explanation that this was done in error.[123] It was averred that the Banavie Trust allowed Thorpe to enjoy an affluent lifestyle. The trust purchased a new 2005 model Bentley Continental GT motor vehicle at a cost of R2.5 million at monthly instalments of approximately R20 000.00 for Thorpe's use. Thorpe arranged for its acquisition (and bound himself as surety for the liability of the trust in connection with the transaction).[124]

(iv) Slip of the tongue reveals true intentions:

Thorpe attempted to distinguish himself from the trust. His proverbial slip of the tongue revealed the contrary however. For instance during the section 65 enquiry, he replied to a question as follows:[125]

> "At one stage I had considered, and when I say I, I'm really talking on behalf of the trust, Investment in the Point Road Development, or for the Point Development. And it had been something that had been mooted, and again it's something that never came to fruition."

Thorpe's answers under the section 65 enquiry caused the bank officials to

[122] [2009] ZAKZPHC 44 para 22.
[123] [2009] ZAKZPHC 44 para 23.
[124] [2009] ZAKZPHC 44 para 24.
[125] [2009] ZAKZPHC 44 para 25.

labour under the impression that he was able to give undertakings with regard to the income of the Banavie Trust or the income of companies owned by the trust.[126] It was averred that complete control of the trusts vested in Thorpe and that enough evidence was provided to suggest that the **Banavie Trust** was the alter ego Thorpe. He utilized it for the purposes of receiving income generated from his various activities and at the same time insulating his assets and wealth from his creditors.

Prior assessments made of the short term insurance broking business were again deliberated.[127] Prior assessments made of other companies and close corporations were also again deliberated. In addition, Pillay J points out that Thorpe lied during the section 65 enquiry.[128] As evidence Pillay J cites the following instances:[129]

> "41.1 With regard to Brightmore CC and Holdthor Life and Pension Brokers CC, he testified on 30 May 2006 that he had disposed of his interests, claiming that his membership interest in the former had been sold some years previously, to a purchaser whose identity he did not recall.
>
> 41.2 That information was false. He was in fact still the sole member of both close corporations when he gave that evidence. What he in fact did was to dispose of those interests to a close associate, Barbara Gail Shaw, acting once again as trustee of a trust, and did so only on 13 June 2006, two weeks after he had testified.
>
> 41.3 The Respondent's response to this evidence is evasive. He claims that the Applicant is being "unfair" to him and records that he refutes the "innuendo" (but, significantly, not the facts which give rise to it).
>
> 41.4 It also means that the Respondent's written statement of his assets as 'nil' was inaccurate."

Pillay J went on further to assert that he agreed with the applicant's submissions and that the investments in properties affected through close corporations for the benefit of Thorpe's minor children needed to be further investigated. Thorpe had stood surety on behalf of these close corporations. It was concluded that these

[126] [2009] ZAKZPHC 44 para 26.
[127] (7392/2007) [2009] ZAKZPHC 44 para 29-40 3.
[128] [2009] ZAKZPHC 44 para 41.
[129] [2009] ZAKZPHC 44 para 41 1 -41 4.

investments could not be viewed entirely in isolation and that it would be useful for the trustee to investigate these acquisitions.[130] In the provisional sequestration application Levinsohn DJP with reference to Section 10 of the Insolvency Act[131] discussed the issue whether he is of the opinion *prima facie* that there is reason to believe that it would be to the "advantage of creditors" if Thorpe's estate were to be sequestrated.[132]

With reference to the citation of the leading case *Meskin & Co v Friedman*[133] and A*mod v Khan*[134] in various decisions Levinsohn DJP averred that an investigation into Thorpe's financial position when entering into the agreements would be a useful starting point.[135] The question was posed as to why a man of straw would guarantee the trust's liability?[136]

(v) Piercing the veneer of the trust form

The acquisition of the Bentley motor vehicle caused Levinsohn to refer to the issue proffered by Cameron JA in *Land and Agricultural Bank of South Africa v Parker*[137] where the learned judge of appeal made reference to *"piercing the veneer"* of the trust form in favour of creditors by saying the following:

> "[37] The courts will themselves in appropriate cases ensure that the trust form is not abused. The courts have the power and the duty to evolve the law of trusts by adapting the trust idea to the principles of our law (*Braun v Blann and Botha NNO and Another).*[138] This power may have to be invoked to ensure that trusts function in accordance with principles of business efficacy, sound commercial accountability and the reasonable expectations of outsiders who deal with them. This could be achieved through methods appropriate to each case.
>
> …………
>
> [37.3] It may be necessary to go further and extend well-established

[130] [2009] ZAKZPHC 44 para 43.
[131] Act 24 of 1936.
[132] [2008] ZAKZHC 72 para 37-38.
[133] 1948 (2) SA 555 (W) para 558-559.
[134] 1947 (2) SA 432 (N).
[135] [2008] ZAKZHC 72 para 46.
[136] [2008] ZAKZHC 72 para 47.
[137] 2005 (2) SA 77 at 90-91
[138] 1984 2 SA 850 (A).

principles to trusts by holding in a suitable case that the trustees' conduct invites the inference that the trust form was a mere cover for the conduct of business 'as before', and that the assets allegedly vesting in trustees in fact belong to one or more of the trustees and so may be used in satisfaction of debts to the repayment of which the trustees purported to bind the trust. Where trustees of a family trust, including the founder, act in breach of the duties imposed by the trust deed, and purport on their sole authority to enter into contracts binding the trust, that may provide evidence that the trust form is a veneer that in justice should be pierced in the interests of creditors."

Therefore, it was probable that "the true and complete control of the trusts" vested in Mr Thorpe. Moreover, there was enough evidence that he utilised the trusts to receive income generated by his various activities and to "insulate his wealth and assets" from his creditors.[139] Levinsohn DJP, stated that in his view Thorpe's objection to the application by Nedbank for provisional sequestration was a spurious one.[140] He further stated:[141]

"The affairs of the trust are integrally entwined with the respondent personally. There is evidence that he received at one stage an amount of R700 000, 00 from the trust. He says quite glibly that it is for the trust (meaning himself and the remaining trustees) to turn the tap on or off depending on the exigencies of the situation. In my opinion a forensic examination of the assets of the trust, their acquisition, cash flows and the respondent's loan account in the trust should be the subject matter of close scrutiny. In my view there is a real prospect of such examination showing that the trust is a mirage used by the respondent for his own commercial ends."

The issue of Thorpe making false declarations to Standard Bank that he was the owner of Insurance Online affected his credibility. Levinsohn contended that it was difficult to see how he could have made such a mistake and that Thorpe in fact was the beneficial owner either through shareholding, trusts or otherwise. The learned judge stated that Thorpe's; *"…denials once again have a very hollow ring".*

[139] [2009] ZAKZPHC 44 para 27; Blignaut *Curbing the abuse of trusts: is the independent trustee the solution?* LLM mini-dissertation UP (2016)17.
[140] [2008] ZAKZHC 72 para 50.
[141] [2008] ZAKZHC 72 para 50.

In addition, further pointing in the same direction, was the evidence that Thorpe personally procured a rental guarantee in favour County Capital (Pty)Ltd trading as Insurance Online.[142]The court (Levensohn) stated as follows:

> "*In my opinion there is a prima facie case that there is a reasonable prospect that investigation and interrogation under the Insolvency Act will yield a not negligible pecuniary benefit to creditors.*
>
> *[54] In the result the application succeeds and I make the following order : -*
>
> *(1) That the estate of Robin Patrick Thorpe, an adult businessman, identity no 5304285019007, with date of birth 28th April 1953, be and is hereby placed under provisional sequestration in the hands of the Master of the High Court, Natal Provincial Division."*

(vi) Judgement in terms of final sequestration order

In delivering his judgment, Pillay J made reference to the difference in the standard of proofs in respect of provisional and final sequestration orders with reference to *Jansen J in London Estates (Pty) Ltd v Nair:*[143]

> "……...the standard of proof differs in respect of a provisional and final order (cf. Sacks Morris (Pty) Ltd v Smith, 1951(3) at p. 170 (0). This must relate to the proof of the facts giving rise to the belief – not to the degree of conviction the belief engenders. In both cases the facts must show that there is a reasonable prospect – not necessarily likelihood, but a prospect which is not too remote – that some pecuniary benefit will result to creditors. But in the case of a provisional order there need only be prima facie proof of those facts; in the case of a final order the Court must be satisfied that those facts exist, presumably on a balance of probabilities. This must be the case whether the applications are opposed or not."

Pillay J further made reference to the issue of "advantage to creditors" as quoted by Levinsohn in the provisional sequestration application with reference to *Amod v Khan.*[144] He further referred to Leveson J in *Hillhouse v Stott;Freban Investments (Pty)Ltd v Itzkin; Botha v Botha*[145] on this same issue. In delivering

[142] [2008] ZAKZHC 72 para 51.
[143] 1957 (3) SA 591 (N) 593.
[144] 1947 (2) SA 432 (N) 438.
[145] 1990 (4) SA 580 (W).

his judgment, Pillay J referred to the manner in which Thorpe had been conducting his business affairs, his evasiveness and obfuscation. The learned judge further concluded that a further investigation and enquiry[146] might indeed unearth assets which could benefit the applicant. Consequently, the final sequestration order was granted.

2 5 3 Conclusion

As has been discussed above there are clear benefits to the trust being used as a protective mechanism for estate planning purposes. This is provided that there is not abuse of the "trust form".[147] Based on this discussion, it is my submission that the trust is therefore still a viable in the context of being a protection mechanism of estate assets in terms of insolvency.

2 6 Protection of trust assets upon divorce

The possible inclusion of assets of an abused[148] trust either in the personal estate of a spouse or taking the value of such assets into account during divorce proceedings has been the subject of much litigation recently.[149]

Costa[150] highlights a typical scenario during divorce proceedings:

- The husband created the trust during marriage and transferred assets thereto;
- the husband is the wealthier spouse; and
- the wife has a proprietary claim in a divorce action against the husband for transfer of a share of his assets.

He further indicates that the husband then often "gleefully" states that his estate has little value and concedes that the value lies within the trust established during the marriage. As these assets are owned by the trust, they are not to be taken into

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[146] Ito s12 of the Insolvency Act 24 of 1936.

[147] *Nieuwoudt NO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) para 17; *Land and Agricultural Bank of South Africa v Parker* 2005 (2)SA 77 (SCA) para 26 88C*; Nedbank Ltd. v Thorpe* [2008] JOL 22675 (N).

[148] Also herein referred to as the *alter-ego* trust.

[149] Du Toit "Trusts and the patrimonial consequences of divorce: Recent developments in South Africa*"* 2015 *Journal of Civil Law Studies* 678-692; Smith "Perspectives on the juridicial basis for taking the value of trust assets of alter ego trusts into account for the purposes of accrual claims at divorce"2017 *SALJ(to be published)*.

[150] Costa "Trusts- How vulnerable are they to attach in divorce proceedings?"2002 *Litigation Werks* 4.

account in determining the value of his estate during divorce proceedings. Costa states that this approach is unfair and inequitable and a strong case can be made out in law that it is without substance. If the wife can show that the trust is the husband's alter ego, the assets of the trust can be deemed to form part of the husband's estate and subject to a proprietary claim by the wife.[151] Costa then investigates factors indicating *de facto* control over trust assets followed by a look into how the founder's intentions at the time of establishing the trust can also have an impact on the inclusion of trust assets within the founder's estate. Factors indicating the *de facto* control over trust assets by the husband include:

(i) The husband is one of three trustees. The other two may be an accountant and attorney who are friends of the husband. They will be reluctant to go against the husband's decisions, resulting in conflict.

(ii) The husband is the guiding hand when investments are done – monies paid to or on behalf of the husband as trust beneficiary.

(iii) Negative control in the form of a *veto* clause in a foreign trust whereby the protector (husband) can veto decisions made by the trustees.

(iv) Not acting in good faith through the transfer of assets into trust at a time when husband was considering divorce proceedings, so as to reduce the wife's proprietary claim. A classic case of fraud according to Costa.He mentions that there are many reasons for creating a trust such as benefiting the family and their minor children, savings on estate duty through transfer of growth assets to the trust, protection from creditors and avoidance of capital gains tax,[152]but these benefits however can be negated and thus attacked during divorce proceedings if:[153]

(i) The parties did contemplate the dissolution of marriage by making provision therefore in the trust deed;

(ii) in the instance where had the wife been emancipated she would not simply have stood by to disposal of assets to the trust. *Costa* refers here to "economic abuse"; and

[151] Costa 2002 *Litigation Werks* 4.
[152] For discussion see ch 3 below.
[153] Costa 2002 *Litigation Werks* 5.

(iii) the husband causes the trust to acquire assets that he ordinarily would have owned.[154]

In light of a changing jurisprudential landscape the judiciary will be slow to allow persons to hide assets within trusts to frustrate divorce proceedings. Costa states:

> "The spirit and values espouses by our new Constitution have stimulated a jurisprudential environment of fairness, equity and justice, in which most judges will be slow to allow a husband to use his trust as a means of frustrating his wife's claim for proprietary relief in divorce proceedings."[155]

Interestingly, consequences of this changed mind set might include[156] the protection of proprietary rights of spouses on divorce or death in the event of assets having been transferred to trust during trust during marriage; and trustees being cited as defendants during divorce proceedings, having to account for their conduct. Furthermore,Van der Westhuizen[157] avers that when in doubt about the role of the trust rather join the trust, trustees and beneficiaries. He states that:

> "[when] the intention is to have the trust declared a sham or "break into the trust" and cause a trust asset to be awarded to one of the spouses (usually the non-controlling spouse) it is submitted that a joinder of the trust (trustees) and all the beneficiaries as well as all relevant parties will be peremptory."

Van der Westhuizen discusses the case of *Brunette v Brunette & Another* [158] where Chetty decided to join the family trust to divorce proceedings due to allegations that at no time was there in reality a separation of the trust assets from that belonging to the businesses. In delivering judgement, the learned judge states

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[154] Costa makes reference to a redistribution order in favour of the wife .In this instance the intentions of the parties need to be considered and the object of the transferor (even if bona fide) could result in such an order. He also refers to section 13 of the Trust Property Control Act 57 of 1988 where the trust be dissolved and assets distributed between the parties.

[155] Costa 2002 *Litigation Werks* 5.

[156] Costa 2002 *Litigation Werks* 5.

[157] Van der Westhuizen "What every attorney should know about trusts (After the DTC & sec 7C)" 2017 *Millers Inc Attorney seminar* 386 391. He discusses the case of *Brunette v Brunette* where Chetty decided to join the family trust to divorce proceedings due to allegations that at no time was there in reality a separation of the trust assets from that belonging to the businesses. In delivering judgement, the court states: "If the applicants' contentions are correct then the manner in which the trusts had been administered in the past becomes highly relevant in determining whether or not they should be regarded as constituting partnership assets to be taken into account in any distribution order in terms of section 7(3) of the Divorce Act."

[158] [2009] JOL 23416 para 4.

> " If the applicants' contentions are correct then the manner in which the trusts had been administered in the past becomes highly relevant in determining whether or not they should be regarded as constituting partnership assets to be taken into account in any distribution order in terms of section 7(3) of the Divorce Act."

2 6 1 Consideration of the various marital property systems during divorce proceedings where trusts and trust assets are brought under investigation

The aspect of "piercing" in the context of divorce law caused a lot of uncertainty. The uncertainty was predominantly caused by the question whether taking trust assets into account in assessing the value of the trustee-spouse's estate actually amounts to "piercing" or whether doing so was due to the exercising of a judicial discretion to redistribute assets in the case of marriages in terms of the Divorce Act.[159] As a result, this uncertainty has spilled over into other marital regimes, creating doubt as to the relationship (if any) between the spouses' chosen matrimonial property system and the availability of "piercing" as a remedy.[160] Taking this uncertainty into account, this discussion will now focus on the impact of divorce proceedings on trusts where the applicant has applied to have trust assets taken into account in these proceedings as part of the respondent's estate. The discussion now briefly addresses the various marital property systems with reference to the latest relevant case law.

(a) Marriages out of community of property prior to 1984

In *Badenhorst v Badenhorst*[161] assets taken into account in divorce proceedings belonging to (trustees of) the trust were brought under investigation. This was not a

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[159] S 7(3) of Act 70 of 1979; Smith "Statutory discretion or common law power? Some reflections on "veil piercing" and the consideration of (the value of) trust assets in dividing matrimonial property at divorce –Part One"2016 *TRW* 68 77; *Van Zyl v Kaye* 2014 (4) SA 452 (WCC) 461 par 23.

[160] Smith *TRW* 2016 68 77; See Van der Linde "Whether trust assets form part of the joint estate of parties married in community of property: comments on "piercing of the veneer" of a trust in divorce proceedings" 2016 *THRHR* 165 172 173.

[161] 2006 (2) SA 255 (SCA). Also see *Jordaan v Jordaan* 2001 (3) SA 288 (C) which had to deal with a "letter of wishes" ito the Jupossama trust granting founder access at any stage during his lifetime to trust capital. In addition in the Groothoek trust, he forbade payment by trustees to his daughter

Footnote continuous on next page

vesting trust but a discretionary trust where the founder still appeared to have full control over trust affairs. As a result the value of assets were taken into account in terms of section 7(3)-(5) of the Divorce Act[162] pertaining to a redistribution of assets. In De Waal's opinion[163] the court gave an answer which meant that the trust in question was ignored or seen in a different light, and the court went "behind the trust form". De Waal makes reference to synonymous descriptions used to indicate this such as; "disregarding the veneer of the trust", "disregarding the trust", "treat the trust as the alter ego of one or more of the trustees" and "even piercing the veil of the trust."[164] It has been questioned whether the trust veneer was in effect pierced in this case as the court did not explicitly rule as such, but relied on section 7(3) of the Divorce Act.[165] It is submitted that De Waal is correct in his interpretation.[166]

(b) Marriages out of community of property including accrual (after 1984)

The question to be asked is whether the assets belonging to the trust be taken into account in for purposes of the calculation of an accrual claim.[167]

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and in the JJ Jordaan trust controlled who may use the Onrusrivier house and evicted his wife therefrom.

162 Act 70 of 1979.

163 De Waal "The abuse of the trust (or: "Going behind the trust form"), The South African Experience with some comparative perspectives" 2012 *Rabels Zeitschrift* 2.

164 See also Van der Linde "Debasement of the core idea of a trust and the need to protect third parties" *Journal of Contemporary Roman-Dutch Law* 371 376-380 – the various synonymous descriptions are discussed and with reference to *Van der Merwe NO v Hydraberg Hydraulics; Van der Merwe v Bosman* 2010 (5) SA 555 (WCC) where the conclusion is drawn based on this judgement that the correct terminology is 'piercing the veneer of a trust'. According to the court, the decision to 'disregard the veneer' of the trust, like one to pierce the corporate veil (in case of a juristic person) would be a decision to afford an equitable remedy.

165 See in this regard Binns-Ward in *Van Zyl v Kaye* 2014 (4)SA 452 (WCC) 461 par 24: "The issue in Badenhorst was a just and equitable distribution of assets between spouses in terms of section 7(3) of the Divorce Act 70 of 1979." He goes on further to indicate that, "…the court did not go behind the trust form".

166 For an alternative view see Stafford *"A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego in the context of South African trust law: The dangers of translocating company law principles into trust law"* (LLM thesis 2010 Rhodes). He criticizes the decisions in *Parker, Badenhorst and Van der Merwe* for suggesting or finding that the veneer of the trust could be pierced in the circumstances of the specific cases.

167 See in this regard earlier conflicting case law on this aspect. For a discussion see Van der Linde 2016 *THRHR* 165 169; *BC v CC* 2012 (5) SA 562 (ECP); *Miller v Miller* [2014] JOL 32176 (KZP); *RP v DP* 2014 (6) SA 243 (ECP) the court contended that if the trust was proved to be an alter ego of one of the parties, trust assets ought to be included in the estate for determination of accrual.

Smith[168] refers to Van Wyk's[169] warning that the Matrimonial Property Act 88 of 1984 (the MPA), which introduced the accrual system into South African law seemed "deficient" in protective measures against fraudulent alienations of assets aimed at defeating the other spouse's equalization [accrual] claim". Van Wyk specifically mentions alienations of property to a discretionary trust as a manner to engage in "preventative estate planning prior to divorce".[170] In the latest case of *RM v VM*[171] it was settled that trust assets held within a so-called "alter ego" trust can be taken into account in the calculation of an accrual claim.

In considering the facts of *RM v VM*, it would be prudent to first consider the case of *Badenhorst* as a point of departure.[172] Smith contends that two schools of thought evolved as a result of the *Badenhorst case* pertaining to taking the trust assets into account in the context of accrual claims:[173]

(i) *Badenhorst* involved the exercising of common law power having been transplanted from company law (principle of piercing the 'corporate veil') into trust law. *Alkema* opined that it was 'fallacious' to argue that the court's discretion to take the value of the assets of an *alter ego* trust into account was derived from (and restricted to) marriages to which the discretionary powers conferred by s 7(3) to (6) of the Divorce Act applied. In the result, the common law power could also be exercised in the accrual context.

(ii) There is a fundamental difference between redistribution orders and accrual claims.[174] In essence, the decision in *Badenhorst* could not be applied to cases where parties were married out of community of property including accrual. This would mean that effectively trust assets could not be considered as they fell outside a person's estate. It is submitted that this was a narrow approach to a significantly larger problem.

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168 Smith "Trust assets and accrual claims at divorce: The SCA opens the door" 2017 *DR* 22.

169 Van Wyk "Community of property and accrual sharing in terms of the Matrimonial Property Act, 1984 – Part 2" 1985 *DR* 59.

170 Van Wyk 1985 *DR* 60.

171 (332/2015) 2017 ZASCA 5 hereafter referred to as *RM v VM*.

172 2006(2)SA 255(SCA) ; Smith 2017 *DR* 22.

173 Smith 2017 *DR* 22.

174 Smith 2017 *DR* 22; Ploos van Amstel J in *MM v JM* 2014 (4) SA 384 (KZP);In contrast to the former, ss 3, 4 and 5 of the MPA simply provided for a factual, mathematical calculation and did not permit a court 'to make an assessment of what it deems to be "just"' (at para 12 in the *MM* case). The MPA did, therefore, not permit any asset that did not form part of a spouse's estate to be taken into account in calculating the accrual claim (para 19 in the *MM* case).

The case of *WT v KT*[175] which followed, did nothing to solve the uncertainty, but rather compounded it. Thankfully, the judgement of the Supreme Court of Appeal in *RM v VM*, in Smith's[176] words, has rectified this unsavoury state of affairs. RM v VM will now be discussed in more detail.

Facts:

By the time this case came before the Supreme Court of Appeal, the appellant and respondent had been married and divorced no less than three times between 1986 and 2011. According to the respondent the first two marriages failed due to the husband's infidelity. To avoid a repeat, upon entering the final marriage the parties' antenuptial contract stipulated that if the appellant were to have an extra-marital affair he would have to provide the respondent with fixed property of a certain value within three months of such a potential divorce.[177] The parties were married out of community of property with the inclusion of the accrual system. Upon the final divorce decree, the parties entered into a settlement agreement (made an order of court) that provided that the respondent's patrimonial claim, stemming from the ante nuptial contract would be postponed *sine die*.[178] This led to legal proceedings in the court *a quo*[179] following which the Supreme Court of Appeal granted leave to appeal the entire judgement.[180]

The two main issues in the appeal case related to the interpretation of the ante nuptial contract (provisions excluding certain assets from the accrual system and pertaining to the appellant's infidelity) and whether certain trust assets could be taken into account for purposes of the respondent's accrual claim.[181] The specific assets to be considered for accrual purposes were those within the Shajo trust and

175 2015 (3) SA 574 (SCA) Parties married in community of property.

176 Smith 2017 *DR* 22.

177 [2017] ZASCA para 6: "…fixed property to the value of R300 000 (Three Hundred Thousand Rand). Such property shall be given to the principal VT within 3 (three) months after dissolving of the marriage. REM shall pay the transfer and bond registration costs of the said fixed property as well as the monthly instalments on the said property, bonded by a financial institution. This figure of R300 000 (Three Hundred Thousand Rand), is to escalate at 10% (Ten Percent) per annum."

178 (332/2015) [2017] ZASCA para 1-3; 6&7; Smith "Perspectives on the juridicial basis for taking (the value of) trust assets of alter ego trusts into account for the purposes of accrual claims at divorce" *SALJ* 2017(to be published).

179 Unreported case *VM v REM* Gauteng Division of the High Court, Pretoria case no 559/2007

180 [2017] ZASCA para 1.

181 [2017] ZASCA para 2.

the Capmark Business trust.[182] The court a quo had ruled that the trust assets were not excluded by the accrual due to the trust being an *alter ego* of the appellant and could therefore justifiably be taken into consideration for purposes of assessing the respondent's accrual claim. The Supreme Court of Appeal on appeal with a majority bench agreed with the first finding of the court a quo in stating:[183]

> "I agree with the view of Professor Jacqueline Heaton, as to the meaning of the phrase 'any other asset acquired by virtue of the possession or former possession of such asset'. What is envisaged is 'the particular asset, its proceeds, and assets which replace the excluded asset or are acquired with its proceeds'. This phrase in the ANC owes its origin to s 4(1)(b)(ii) of the Act which provides that: 'An asset which has been excluded from the accrual system in terms of the ante nuptual contract of the spouses, as well as any other asset which he acquired by virtue of his possession of the first-mentioned asset, is not taken into account as part of that estate at the commencement or the dissolution of his marriage.' The court a quo accordingly correctly concluded that the assets held by the Shajo Trust and Capmark Business Trust, were not excluded from the accrual of the appellant's estate in terms of the ANC."

Importantly, in contrast to the decision in *WT v KT,*[184] the Supreme Court of Appeal in *RM v VM*[185] held that a wife in the position of the respondent who was neither a beneficiary of the trusts, nor a third party transacting with the trusts and to whom her husband, in his capacity as the trustee of the trusts, did not owe a fiduciary duty, had *locus standi* to advance a claim that the trust veneer be "pierced".[186] The claim was an equitable remedy that lay against the trust or the errant trustee on the basis that there was an unconscionable abuse of the trust form by the trustee, in his or her administration of the trust through fraud or dishonesty with the improper purpose of evading a liability, or avoiding an obligation.[187]

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[182] [2017] ZASCA para 10.
[183] *M v M* [2016] ZASCA 5 para 14.
[184] 2015 3 SA 574(SCA); (332/2015) [2017] ZASCA para 19-20.
[185] [2017] ZASCA para 19-20.
[186] Smith *DR* 2017 22 states: "Secondly, the SCA emphatically rejected the finding in the WT case that an aggrieved spouse, who was neither a beneficiary of the trust, nor a third party who had transacted with it, had no standing to impugn the management of a trust because no fiduciary duty was owed to such a spouse. In fact, as the SCA pointed out in the REM case, the fact that no fiduciary duty was owed to such a spouse was irrelevant."
[187] [2017] ZASCA para 17, 19-20; *Van Zyl NNO v Kaye NO* 2014 (4) SA 452 (WCC) para 21-22; Smith 2017 *DR* 22: "The critical issue instead was whether the spouse was seeking to advance a

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The onus was on the respondent to prove that the appellant transferred personal assets to the trusts and dealt with them as if they were assets of the trusts, with the fraudulent or dishonest purpose of avoiding his obligation to properly account to the respondent for the accrual of his estate and thereby evade payment of what was due to the respondent, in accordance with her accrual claim.[188] It was held that although the appellant administered the trusts with very little regard for his duties as a trustee, the evidence did not prove that he transferred personal assets to these trusts and dealt with them as if they were assets of these trusts, with the fraudulent or dishonest purpose of avoiding his obligation to properly account to the respondent for the accrual of his estate.[189] Accordingly, the assets held by these trusts did not form part of the appellant's personal estate and were not subject to the accrual claim of the respondent. Of significance in this case is the distinction provided by the Supreme Court of Appeal pertaining to "sham trusts" and instances where a litigant sought to "pierce the veneer" of a trust as the *alter ego* of a trustee.[190]

In summary, what makes this judgement significant is that a monumental step has been taken in removing the hurdle encountered by the aggrieved spouse having to be either a trust beneficiary or third party who has transacted with the trust.[191] This judgement by the Supreme Court of Appeal has resulted in the trust veneer being

patrimonial claim that the other spouse had attempted to prejudice by administering a trust in such a manner as to amount to an unconscionable abuse of the trust form. Of crucial importance, the SCA correctly held that in marriages involving the accrual system, this would occur where a trustee-spouse transferred personal assets to a trust and dealt with them as if they were trust assets in a fraudulent or dishonest attempt to conceal them and thus prejudice the aggrieved spouse's accrual claim. In these circumstances, trust assets could 'be used to calculate the accrual' of the errant trustee-spouse's estate and to 'satisfy any personal liability of [that spouse] to make payment to the [aggrieved spouse]'" (para 19 and 20)."

[188] *(*332/2015) [2017] ZASCA para 2-3; 15,16.

[189] (332/2015) [2017] ZASCA para 20; Smith 2017 *SALJ* 8.

[190] (332/2015) [2017] ZASCA para 17; Smith 2017 *DR* 22: "While the former implied that a valid trust never existed, the latter entailed a remedy aimed at combating the abuse of an existing trust. This remedy could be styled as – 'an equitable remedy in the ordinary, rather than technical, sense of the term; one that lends itself to a flexible approach to fairly and justly address the consequences of an unconscionable abuse of the trust form in given circumstances. It is a remedy that will generally be given when the trust form is used in a dishonest or unconscionable manner to evade a liability, or avoid an obligation' (para 17)."

[191] Smith "Statutory discretion or common law? Some reflections on "veil piercing" and the consideration of (the value of)trust assets in dividing matrimonial property at divorce – Part Two" 2017 *TRW* 16.

able to be "pierced" –at least in principle- in marriages involving the accrual system.[192]

(c) Marriages in community of property

The next question is whether assets belonging to a form part of a joint estate of parties who are married in community of property? According to Smith[193] it would be fairly simple in the typical case of dissolution of a marriage in community of property involving the assets of an *alter ego* trust (at least in theory) to establish a nexus between compliance with the "control test"[194] and taking the assets into account in terms of dividing the joint estate. This contention is based on the very nature of community of property which is indicative of an intention between the spouses to create a "universal economic partnership"[195] from the outset. The community of property system further infers by implication that a legal obligation is imposed for this "partnership"[196] to be divided equally at divorce.It is submitted that this approach adopted by the court in the case of *WT v KT*[197] is incorrect.[198] The decision in *WT v KT* has led to the seemingly misplaced interpretation that trust assets are only subject to attachment in terms of section 7(3) of the Divorce Act which would effectively exclude parties married in community of property.[199] According to Smith:[200]

> "A particular difficulty in that case was a dearth of evidence regarding the joint estate or her status as a trust beneficiary. In addition, as the trust in question had been created (and the trust property had been transferred to it) prior to the spouses' entering into their marriages, the SCA was able to hold that the appellant's "conduct could hardly have been motivated by the implications of a future divorce".[201] In such an instance, compliance with the "control test" is insufficient; a further nexus – supported by the facts at hand and the matrimonial

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[192] Smith 2017 *SALJ* (to be published).
[193] Smith 2017 *TRW* 1 3.
[194] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) para 3 3 part one.
[195] Hahlo *The South African Law of Husband and Wife* (1985) 157.
[196] Hahlo 162.
[197] *WT v KT* 2015 (3) SA 574 (SCA) para 33.
[198] Smith 2016 *TRW* 68 93 concludes that this interpretation is incorrect.
[199] This section only finds application wrt to marriages out of community of property concluded prior to 1984.
[200] Smith 2017 *TRW* 1 2.
[201] *WT v KT* 2015 (3) SA 574 (SCA) para 29.

property system in question – is required before such trust assets may conceivably be taken into account."

Further to this, a claim by an aggrieved spouse can only be instituted in instances where he/she had transacted with the trust and fallen victim to a breach of the control/enjoyment divide which constitutes the cornerstone of our trust law. After having used a hypothetical example akin to the facts in *Badenhorst* [202] it is averred by Smith[203] that in future, a court should distinguish the matter before it from the judgement in *WT v KT*. It must be distinguished on the facts of the case and specifically on the basis that in contrast to *WT v KT*, a spouse's conduct must indeed be "motivated by the implications of a future divorce." Smith then further contends that the court should find that the fact that the applicant being neither a trust beneficiary or a third party who transacted with the trust to be irrelevant. As a result, the trust assets should be taken into account for purposes of dividing the joint estate.[204]

2 6 2 Conclusion

The decision in *RM v VM*[205] has clarified the matter in that trust assets are attachable irrespective of whether the aggrieved spouse was a beneficiary of the trust or transacted with it. It is therefore of paramount importance that trust affairs are handled correctly so as to ensure the efficacy of the trust as a protection mechanism upon divorce. *Smith*[206] contends that this decision endorses the sentiment expressed in *RP v DP*[207] that the power to "pierce" the trust veneer stems from the common law, being able to be exercised in the context of all matrimonial property systems and exists independently of the Divorce Act [208] and the Matrimonial Property Act.[209]

[202] 2006 (2) SA 255 (SCA) para 3 3 part one.
[203] Smith 2017 TRW 1 7.
[204] Smith 2017 *TRW* 1 7.
[205] (332/2015) [2017] ZASCA.
[206] Smith 2017 *DR* 22.
[207] 2014 (6) SA 243 (ECP) para 35, 56.
[208] Act 70 of 1979.
[209] Act 88 of 1984; Smith 2016 *TRW* 68 85.
Due to the Constitutional Court judgement in *Gumede v President of the Republic of South Africa* 2009 (3) SA 152 (CC) the position in terms of customary marriages is different – a redistribution order may be sought irrespective of the date on which such a marriage was concluded and applicable matrimonial property system.

However, of importance to consider is that the fact that the power exists does not necessarily permit it to be exercised.[210] Two distinct processes[211] are involved, the first being to establish that one is dealing with an *alter ego* trust, which can be answered with reference to the control test, enunciated in the *Badenhorst*[212] case. The second process that follows is to establish whether the applicable matrimonial property system imposes an obligation on the divorcing spouses. One of the divorcing spouses must have tried to evade this obligation by means of an *alter ego* trust. The existence of this obligation form the *nexus* between the common law power existing and the exercising thereof. Smith further provides an example of this nexus:

> "So, for example, the REM case shows that in the case of a marriage to which the accrual system applies, the obligation sought to be evaded is the obligation to provide a true and accurate reflection of the trustee-spouse's accrual. In the case of a marriage to which s 7(3) of the Divorce Act applies, the nexus is provided by the possibility of a redistribution order that, if granted, permits a (partial) transfer of assets to a spouse in circumstances in which he or she would otherwise not be entitled thereto because they are married out of community of property."

This decision creates certainty in terms of marriages including the accrual system and corrects the erroneous approach adopted in *WT v KT.*[213] The principles enunciated in this decision are further capable of being applied in other matrimonial property systems as well. This decision has therefore contributed to making piercing the "trust veneer" a more viable remedy for aggrieved spouses.[214] Smith[215] succinctly summarizes as follows:

> "The Supreme Court of Appeal has taken a significant step in the broader context of curbing the abuse of the trust form that has become so prevalent in recent decades."

[210] Smith 2016 *TRW* 68 85-89.
[211] Smith 2017 *DR* 22.
[212] *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) para 3.3 part one.
[213] 2015 (3) SA 574 (SCA).
[214] Smith 2017 *DR* 22.
[215] Smith "Perspectives on the juridical basis for taking (the value of) trust assets of aler ego trusts into account for the purposes of accrual claims at divorce" 2017 *SALJ* 9 (to be published).

In conclusion the trust is still a viable protection mechanism of assets in terms of divorce proceedings, provided the trust is not abused as originally questioned by Costa and confirmed in the latest case of *RM V VM* and other cases discussed prior to that above.

2 7 Protection of trust beneficiaries through the application of so-called "core – elements" of the trust[216]

2 7 1 Introduction

The question is often asked whether the South African trust (law) sufficiently protects trust beneficiaries against contingencies such as the personal insolvency of a trustee, his death or divorce, as well as in the event of the maladministration of the trust.[217] The South African trust lacks the essential feature of the English trust, namely the "dual ownership" of the trustee and the trust beneficiary.[218] The reason for this "dual ownership" of the English trust is the *protection* of the trust beneficiary.[219] By establishing certain "core elements" of the South African trust, De Waal indicates that the South African trust is indeed a true and proper trust in view of the protection it affords trust beneficiaries. This is achieved without the need to embrace the "dual ownership" concept.[220] These "core elements" are: The fiduciary position of trustees; trusteeship as an "office"; the fact that the trustee, in the event of

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[216] This discussion is based on a publication Van der Linde"Protection of trust beneficiaries through the application of basic trust principles" *Essays in Honour of JohanScott* 2017 (to be published).

[217] De Waal "The core elements of the trust: Aspects of the English, Scottish and South African trust compared" 2000 *SALJ* 548 557.

[218] The English trust is defined in terms of a divided title between trustee and the beneficiary. The trustee has "legal ownership" and the beneficiary "equitable ownership" or "beneficial ownership". This constitutes the essence of the English trust: see De Waal 2000 *SALJ* 548 550. Although the terms "trust" and "trustee" are of English origin, the English trust law was not received into the South African law unchanged. A unique South African trust law, based on Roman Dutch legal principles, but also influenced by the English law, was developed by the legislature, the courts and legal practitioners in order to satisfy modern requirements of practice – Cameron *et al* Honoré's *South African Law of Trusts* (2002) 21-24. In *Braun v Blann and Botha* 1984 (2) 850 (A) 859D-G, Joubert AR declared: "The trust of English law forms an integral part of all common law legal systems, including American law. In its strictly technical sense the trust is a legal institution *sui generis*. In South Africa, which has a civil law legal system, the trust was introduced in practice during the 19th century by usage without the intervention of the Legislature but the English law of trusts with its dichotomy of legal and equitable ownership (or "dual ownership" according to the American law of trusts) was not received into our law. The English conception of an equitable ownership distinct from, but co-existing with, the legal ownership is foreign to our law. Our Courts have evolved and are still in the process of evolving our own law of trusts by adapting the trust idea to the principles of our own law". See also *Crookes v Watson* 1956 (1) SA 277 (A) 297E-F.

[219] De Waal 2000 *SALJ* 548 557.

[220] De Waal 2000 *SALJ* 548 569.

him having ownership of the trust assets,[221] in effect has two separate estates;[222] and the principle of real subrogation.[223] A combination of these "core elements" and the application of basic trust principles in general, provide sufficient protection to a trust beneficiary against contingencies mentioned above. Two of these "core elements" recently found application in the case of *Watson v Cockin NO*[224] in view of the unlawful manner in which the trustees administered the trust.[225]

2 7 2 *Watson v Cockin* (Facts and judgement)

The applicant approached the court in order to resolve disputes[226] which arose between herself, her mother (first respondent) and her two brothers (second and third respondents) relating to an family *inter vivos* trust (hereinafter "the trust") created during March 1996 by her late father (hereinafter the "deceased").[227] The deceased and first respondent were appointed and authorized as the first trustees to the trust. The fourth and fifth respondents are companies which are run by the second and third respondents respectively. The trust is the sole shareholder of both the fourth and fifth respondents.[228] In terms of the joint will of the deceased and the first respondent one third of the value of[229] their common residence was bequeathed to the applicant. The remaining two thirds of the value of this property, membership interests in a close corporation and all personal assets of the deceased, were bequeathed to the trust.[230] According to the deed of trust the trust was created in order to benefit the capital beneficiaries which were defined by the deed of trust as the deceased and the first respondent together with their children, namely, the

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[221] See s 1(a) of Trust Property Control Act 57 of 1988.

[222] The fact that the trustee in this construction has a personal estate and a trust estate (as trustee). See in this regard the requirements in terms of ss 10, 11 and 12 of the Act. S12 provides: "Trust property shall not from part of the personal estate of the trustee except in so far as he as trust beneficiary is entitled to the trust property."

[223] The proceeds of a trust asset (if sold) or the substitute asset (if proceeds have been used to buy something else) will also be subject to the trust – see De Waal 2000 *SALJ* 548 564. The principle of real subrogation is, unfortunately, limited to a lawful replacement of assets by a trustee.

[224] [2016] ZAGPPHC 259.

[225] In this contribution emphasis will be placed on the fiduciary position of a trustee and trusteeship as an office.

[226] The disputes escalated to such extent that it was descried by the court as an "uncompromising and acrimonious family fued." It seems as though the court is asked to pronounce on the rights of the parties and to ensure that the Master could exercise its powers.

[227] Para 1. The deceased passed away on 2013-06-26.

[228] Para 2.

[229] The property apparently had to be sold.

[230] Para 3.

second respondent, the third respondent and the applicant.[231] The income beneficiaries were defined as "the persons who shall benefit from the income of the trust in terms of the discretionary powers of the trustees, and may include the capital beneficiaries, their parents, spouses, widows, lawful issue *and such other natural persons who the Trustees may appoint from time to time*". According to paragraph 4.2 the trust shall during its existence have not less than two or more than five trustees in office at any time.[232] If the number of trustees are reduced to less than two, the remaining trustee shall have no power to act with respect to the trust fund, except to the extent that it may be necessary to appoint new trustees in terms of paragraph 4.3 of the trust deed. Paragraph 7.7 thereof in addition specifically stipulates that a quorum of trustees shall be two trustees. The trustees shall not conduct any business at any meeting unless there is a quorum present, other than the appointment of a further trustee, if there is only one trustee at the time.[233] The powers as well as the obligations of the trustees are comprehensively dealt with in the trust deed including the obligation to keep proper records and accounts reflecting truly and correctly the trustees' administration of the trust fund. Since the deceased passed away the following occurred: (a) The first respondent, in a letter, advised the applicant and the second and third respondents, of the minutes of a meeting (held by herself) of the trust on 19 July 2013. She appointed the second and third respondents as trustees, appointed them as only "beneficiaries" and removed applicant as beneficiary of the trust.[234] (b) Even though the Master had not issued letters of authority to the second and third respondent they have alienated assets and distributed capital and income from the trust. (c) R6,3 million of the deceased in an offshore bank account was withdrawn and used to buy holiday properties in Mauritius. These properties were not purchased in the name of the trust, but in the names of the first, second and third respondents. According to the applicant these funds form part of the deceased's estate which he bequeathed to the trust. The brothers, however, averred that these funds were donated to them by their late father

[231] No provision is seemingly made for substitution. This can therefore be regarded as a non-discretionary vesting trust with regard to the capital. The mentioned beneficiaries therefore had vested rights in the capital.
[232] Para 5. Except in the event of a Financial Institution as described in Act 56 of 1964 being appointed as trustee, in which event such financial institution may act as sole trustee.
[233] Para 6.
[234] Para 10.

before his death,[235] and therefore did not part of the bequeathed estate. According to the applicant these factors constituted very good reason why independent trustees should be appointed. The trust is the sole beneficiary that stands to gain if the donation were to be set aside or the money were to be paid back to the deceased's estate for any other reason. However, only independent trustees would be willing to investigate the alleged donation.[236] The trust, as sole beneficiary, had an interest in this amount and the validity of the alleged donation to the first second and third respondents. If the first, second and third respondents, who had benefited from the alleged donation, were to be left with the sole control of the trust as trustees, this donation would never be investigated and challenged on behalf of the trust. (d) The second and third respondents were in *de facto* control of the fourth and fifth respondent, namely two companies conducting a manufacturing business. The trust was the sole shareholder of both companies. In terms of the financial statements of the fifth respondent, an unsecured long-term liability in favour of the trust increased from R1 082 022 to R1 253 923. The conclusion to be drawn was that the trust lent and advanced the sum of R171 901 to the fifth respondent during the time the first respondent was the only trustee and would not have had the power to do so.[237] A loan was also made by the fourth respondent to the trust in the amount of R783 157.[238] It seems as though the brothers were the "operating minds" behind transactions following between the fourth and fifth respondents and the trust account.

2 7 3 Judgment

During the exposition of the facts, the court, *inter alia*, made the following observations: The attempt to exclude the applicant from the trust fund or to amend the trust deed was "obviously" invalid.[239] Despite being unable to act on behalf of the trust and to deal with the assets of the trust, that was exactly what the first, second

[235] Paras 17, 18, 19 and 20. There was no indication, however, that they paid "donations tax".
[236] The third respondent in fact stated that the applicant was not supposed to know of the existence of the offshore funds. This attitude, if anything, was according to the applicant even more reason why independent trustees should be appointed.
[237] Para 21.
[238] According to the brothers, this was not a loan to the trust but in fact only reserves of the fourth respondent that was kept in the account of the trust to be utilized when the funds were required.
[239] Para 11. The court did not elaborate on this issue.

and third respondents had been doing.[240] It seemed that the fourth respondent was using the accounts of the trust as if it was the fourth respondent's own business account.[241] There was a deliberate attempt by first, second and third respondents to push the applicant out, to deprive her of the required information regarding the trust and in sharing in the benefits of the trust. The second and third respondents appeared to be using the trust as their *alter ego* and the trust assets as their own, and also the fourth and fifth respondents as their own property.[242] After discussing *Land and Agricultural Bank of South Africa v Parker,* the court established that there was a need for an adequate separation of control by the trustees from the enjoyment by the beneficiaries. This would only be possible if sufficient independent trustees were to be appointed. The court[243] also referred to the observation by Cameron JA in *Parker,* that from a historical perspective the English law trust and the trust-like institutions of Roman and Roman-Dutch law, were designed essentially to protect the weak and to safeguard the interests of those who are absent or dead. This guiding principle provided the foundation for major court decisions over the past century in which the trust form was adapted to South African law. This meant that the trustee is appointed and accepts office to exercise fiduciary responsibility over property on behalf of and in the interest of another.[244] This aspect is expanded on below. The court, in pronouncing on the rights of the parties and to ensure that the Master was placed in a position to exercise his powers in terms of the Act, made the following order: (a) The applicant is an income[245] and capital[246] beneficiary of the trust; (b) the Master was directed to consider exercising his power in terms of section 7(2) to appoint as co-trustee so many independent persons so as to ensure that an adequate separation of control (by the trustees) from enjoyment (by the beneficiaries) was maintained in the trust; (c) the Master was directed to consider exercising his power in terms of section 16(2) to cause an investigation to be carried out by some fit and proper person appointed by him into the trustee's administration

[240] Para 14.
[241] Para 27.
[242] Para 30.
[243] Para 31.
[244] *Parker* paras 19 and 20.
[245] Para 37 1 2.
[246] Para 37 1 1. The wording of this aspect by the court is problematic. If the court meant that applicant is a member of the class of possible income beneficiaries, it is correct. However, if the court meant that applicant is an income beneficiary with vested rights in the income, it is open for criticism.

and disposal of trust property of the trust;[247] (d) unless and until the Master issued letters of authority in favour of additional trustees, the first, second and third respondents were interdicted and restrained from acting or purporting to act on behalf of the trust;[248] (e) the first respondent, in her capacity as trustee of the trust, was ordered to deliver to the Master and to the applicant the financial statements of the trust for the past three financial years and the bank statements of the trust for the past three years.[249]

2 7 4 Discussion

The trustee stands in a fiduciary relationship with the beneficiaries and in terms of his fiduciary office owes the "utmost good faith towards all beneficiaries, whether actual or potential".[250] This single fiduciary duty can be referred to as a general fiduciary duty as described by Du Toit.[251] This general fiduciary duty is multi-faceted, comprising the duty of care, the duty of impartiality, the duty of independence and the duty of accountability.[252] It can further be contended that the duty of care is the most significant component of a trustee's general fiduciary duty.[253] In *Watson* the (first respondent) mother can be said to have neglected her duty of care comprising the duty to observe the provisions of the trust deed,[254] to preserve the trust property and the duty of supervision and enquiry.[255] In terms of section 9 of the Trust Property Control Act[256] the mother (first respondent) did not act as a *bonus materfamilias*. The

[247] Para 37 3.
[248] Para 37 4.
[249] Para 37 5.
[250] *Doyle v Board of Executors* 1992 (2) SA 805 (C).
[251] Du Toit "The Fiduciary Office of Trustee and the Protection of Contingent Trust Beneficiaries" 2007 *Stell LR* 469 473.
[252] Du Toit 2007 *Stell LR* 469 476.
[253] Du Toit 2007 *Stell LR* 469 474; The common law standard of care in this regard is reflected in s9 of the Trust Property Control Act 57 of 1988, which stipulates that a trustee shall in the performance of his duties and the exercise of his powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another.
[254] Paras 4 2 and 7 7 of the trust deed.
[255] The transfer of funds and sale of assets occurred without any formal decisions being taken in this regard and without the trustees having the capacity to act. Clauses 4.2 and 3.4 of the deed of trust required a minimum number of trustees to hold office. This, according to *Parker* (par 11) is a capacity – defining condition. It lays down a prerequisite that must be fulfilled before the trust estate can be bound. When fewer trustees than the number specified are in office, the trust suffers from an incapacity that precludes action on its behalf. There was, for the reasons above thus no quorum present as required in terms of para 7.7 of the deed of trust. See also *Steyn NNO v Blockpave (Pty) Ltd* 2011 (3) SA 528 (FB).
[256] Act 57 of 1988.

so-called "watch-dog" function required of a trustee was not fulfilled by her.[257] The court consequently identified the need for the Master to appoint an "independent trustee" as envisaged in *Land and Agricultural Bank v Parker.*[258] Adherence to the basic trust idea or essential notion of the trust law, namely separation of ownership (or control) from enjoyment, would according to the court in *Watson,* only be possible if sufficient independent trustees were to be appointed to avoid a situation where trustees/beneficiaries of the trust could take majority decisions to the detriment of *other beneficiaries.*[259] In *Parker* the court established the need for such independent trustee in situations where it emerges that the trustees are *all* beneficiaries; and the beneficiaries are all related to one another.[260] An independent outsider, according to *Parker*[261] does not have to be a professional person. Such person will remember that failure to observe these duties can be breach of trust.[262] A further component duty is a trustee's duty to act with the requisite impartiality. This implies the avoidance of a conflict of interest between a trustee's personal interests and those of the beneficiaries.[263] One feature of this general rule of conduct is that the trustee must

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[257] See for a detailed discussion De Waal "The liability of co-trustees for breach of trust" 1999 *Stell LR* 21.

[258] 2005 (2) SA 77 (SCA).

[259] Para 32.

[260] Para 35.

[261] Para 36 indicates that this independent trustee can be someone who with proper realisation of the responsibilities of trusteeship accepts office in order to ensure that the trust functions properly, the trust deed is observed and for the conduct of other trustees to be scrutinized and checked.

[262] Interestingly, the recent Chief Master's Directive 2 of 2017 dated 06/03/2017 para 38, indicates that the Master views an "independent trustee" in the event of a "family business trust" in the following fashion: An independent trustee - (a) *Must be* an independent outsider with proper realisation of the responsibilities of trusteeship, and two accepts office in order to ensure that the trust functions properly and that the provisions of the trust deed are observed. Such independent outsider does not have to be a professional person such as an attorney or accountant. (b) *May be* a professional accountant, admitted attorney, an advocate who is affiliated to the relevant professional body or association, trust companies. Boards of executors or fiduciary practitioners who are members of FISA and may even be chosen from the ranks of business associates. (c) *Has no family relation or connection, blood or other. To any of the existing or proposed trustees, beneficiaries or founder of the trust* (emphasis added). (d) *Must* be competent to scrutinise and check the conduct of the other appointed trustees who lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the trust instrument (emphasis added). (e) *Has no* reason for concluding or approving transactions that may prove to be invalid, because he or she would be knowledgeable about the law of trusts. (f) Would not have any interest in the trust property as a beneficiary. (g) Is not disqualified by the Trust Property Control Act, 1988 from acting as a trustee; and (h) *Has* knowledge and experience of the business field in which the trust operates; and (i) *Should be* a person who will not accept office without being aware that failure to observe the duties of independent trustee may risk action for breach trust. Whether *all* of these requirements are in line with the court's recommendation in *Parker's* is debatable, especially par (c) above.

[263] Cameron *et al* 315; *Hoppen v Shub* 1987 (3) SA 201 (C); *Jowell v Bramwell-Jones* 2000 (3) SA 274; *Standard Bank v Koekemoer* 2004 (6) SA 498 (SCA).

not make an unauthorized profit from the administration of the trust. Therefore, unless properly authorized, a trustee is not allowed to buy trust property, to sell his private property to the trust, to borrow money from the trust or to lend money to the trust.[264] A trustee must, furthermore, not favour one beneficiary or group of beneficiaries above another, but must treat all impartially.[265] In exercising their discretion (*in casu* with regard to the income beneficiaries), trustees must apply the principles of natural justice.[266] A trustee must apply his/her mind to the actual exercise of any discretion which requires a wider and more comprehensive inquiry into matters.[267] These principles were seemingly not applied by first respondent when initially removing[268] the applicant as a beneficiary, and later by not awarding her any income as (potential) income beneficiary. A conflict therefore arose between the interests of the newly appointed (yet unauthorized) trustees'[269] business interests and their duties towards the beneficiaries. A last fiduciary duty endowed upon

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[264] De Waal 2000 *SALJ* 548 558; Para 16 and 26 where the first trustee as only trustee did not have the authority to borrow money. The second and third respondents were in *de facto* control of the fourth and fifth respondent, whilst not yet being permitted to act as trustees.

[265] *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA) 284. For discussion of the question whether this implies equal treatment and the presumption of equality in parental bequests see Cameron *et al 316.*

[266] Van der Westhuizen "What every attorney should know about trusts (after the DTC & Se 7C) 2016 *Seminar* Millers Inc Attorneys Inc 142.

[267] Van der Westhuizen *Seminar* 2016 141. He points out that modern trust deeds will define beneficiaries as a class or group from which trustees can select *one or more in equal or unequal shares*. Such specification was absent in *Watson*.

[268] The first respondent did not have the power to make such a decision. Since the applicant has, furthermore, arguably, accepted her appointment as a capital beneficiary, she could not be removed by first respondent without her consent. See *Crookes v Watson* 1956 (1) SA 277 (A); *Hofer v Kevitt* 1998 (1) SA 382 (SCA); *Potgieter v Potgieter* 2012 (1) SA 637 (SCA), with regard to the *inter vivos* trust being seen as a *Stipulatio Alteri*. The question whether the provisions of an *inter vivos* trust deed with regard to the amendment of the deed can overrule the above exposition, by expressly permitting amendments of the trust deed by the trustees *without* the consent of beneficiaries with vested rights in the trust and who have accepted their benefits under the trust deed was answered in *Potgieter*. The essence of this question was summarized by Claassen "Die wysiging van *inter vivos* –trustaktes: 'n evaluerende perspektief op die *Potgieter*-saak" 2014 *Acta Juridica* 243. It seems that if the trust deed expressly permits the amendment of the deed by the trustees without the involvement of the beneficiaries, the consent of the beneficiaries who have vested rights will not be required, provided the amendment which is made falls within any condition which is set for amendment by the trustees in the trust deed. This appears to have been one of the issues in the *Potgieter* decision where the amendments made by the trustees did not fall within those permitted in the trust deed. If the trust deed is silent on the involvement of beneficiaries in the amendment of the deed, then the common law rules will apply and the consent of the beneficiaries with vested rights will be required, provided they have already accepted the benefit. In my view it will be safer to always obtain the consent of beneficiaries with vested rights. Despite sentiments to the contrary in *Hofer*, and the fact that contractual principles apply, author submits that a trustee' fiduciary duty requires him to act for the benefit of all beneficiaries whether actual or potential.

[269] Second and third respondents.

trustees is the duty of accountability in respect of trust administration.[270] A breach of general fiduciary duty[271] can result in the trustees being personally liable in terms of a delictual action for damages,[272] should all the elements[273] of a delictual action be met. This provides a degree of security and protection to the trust beneficiary, provided the trustee has the ability to make good for the loss incurred due to his breach of general fiduciary duty.[274] The fact that a trustee occupies an "office" essentially means that the trust possesses a public element.[275] The most important manifestation of this is the role that Master and the court play in the proper administration of trusts.[276] This is nowhere better reflected than in the Trust Property Control Act, namely: (a) The requirement that trusts must be registered with the Master of the High Court;[277] (b) the provision that a person shall act as trustee only if authorized thereto in writing by the Master;[278] (c) the extensive provisions

[270] By maintaining proper accounts of transactions and rendering proper account of trust administration when requested by beneficiaries; Du Toit 2007 *Stell LR* 469 475 indicates that a trustee's accountability is facilitated through the trustee's compliance with his duty to separate trust property from his persona property and therefore, the last-mentioned duty is, for purposes of enumerating the component duties of a trustee's general fiduciary duty, included under a trustee's duty to account for trust administration; *Watson v Cockin* (para 30) highlights how the first, second and third respondents deliberately attempted to deprive the applicant of information,[270] therefore falling foul of this component of the general fiduciary duty bestowed upon trustees.

[271] Comprising the components thereof discussed above.

[272] The principal civil remedy against an errant trustee is therefore the *actio legis Aquiliae* for the recovery of delictual damages.

[273] Although a claim for possible breach of trust did not form part of the current proceedings, it may be an aspect applicant can consider in the future. The applicant/plaintiff will first have to show that the trustee performed a wrongful act. The trustee's breach of trust must secondly be ascribed to fault, be it in the form of international wrongdoing (*dolus*) or negligence (*culpa*). The conduct must thirdly have caused damage. For a detailed discussion on the element of fault see De Waal "The liability of co-trustees for breach of trust" 1999 *Stell LR* 21; Cameron *et al* 362-368; Du Toit *South African Trust law – Principles and Practice* (2002) 84. For a discussion of the damage requirement see Cameron *et al* 362-369. The fact that the proof of patrimonial loss is fundamental to a successful claim under the Aquilian action implies that a plaintiff's right of action is incomplete until damage is sustained by reason of the defendant's wrongful conduct. A trust beneficiary who holds a vested right to trust income and/or capital, but whose enjoyment of trust benefits is postponed until termination of the trust, may therefore not succeed in proving actual damage during the operational period of the trust. Such a beneficiary may have to postpone the institution of an action for the recovery of damages until termination of the trust, at which time the full extent of his loss will only become apparent (Du Toit 87). In *Jowell v Bramwell-Jones* 2000 (3) SA 274 (SCA) the court decided that an action for damages was premature until it could be established that damages were indeed suffered when the trust capital become payable in the future.

[274] It is therefore always advisable for trustees to furnish security for the proper administration of the trust.

[275] De Waal 2000 *SALJ* 548 566.

[276] De Waal 2000 *SALJ* 548 566.

[277] S 4(1).

[278] S 6(1).

concerning the furnishing of security by trustees;[279] (d) the power of the Master to appoint trustees;[280] (e) the power of the court to vary trust provisions and to terminate trusts;[281] (f) the power of the Master to call upon trustees to account;[282] and the power of the court and the Master to remove trustees from office.[283] Section 6(1) of the Act is of specific importance in view of the facts in *Watson*. Section 6(1) states that any person who has been appointed as a trustee, shall act in that capacity only if authorized thereto in writing by the Master.[284] Any agreement therefore entered into by such trustee before authorization will be void and such act cannot be ratified.[285] In *Watson*[286] referral is made to Cameron JA in *Land and Agricultural Bank of South Africa v Parker*[287] where he states:

> "It follows that a provision requiring a specified minimum number of trustees must hold office is a capacity-defining condition. It lays down a prerequisite that must be fulfilled before the trust estate can be bound. When fewer trustees than the number specified are in office, the trust suffers from an incapacity that precludes action on its behalf".

The Trust Property Control Act does not contain any provision that generally empowers the Master to refuse authorization of a duly appointed trustee except in cases where the applicant cannot furnish security when required to do so. The Master may, however, remove authorized trustees on specific grounds set out in section 20(2) of the Act, and consequently it can be argued that persons who fall within the ambit of these specific grounds at the time of application for authorization should not be authorized as trustees in the first instance. Based on the above, the actions of the trustees in not fulfilling their duty in terms of administration of the trust

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279 S 6(2).
280 S 7.
281 S 13.
282 S 16.
283 S 20(1) and 20(2).
284 In *Simplex (Pty) Ltd v Van der Merwe NNO* 1996 (1) SA 111 (W) 112I-113C the court emphasized that section 6(1) is not purely for the benefit of the beneficiaries of the trust but in the public interest to provide proper written proof to outsiders of incumbency of the office of trustee. The whole scheme of the Act is to provide a manner in which the Master can supervise trustees in the proper administration of trusts properly and s 6(1) is essential to such purpose. By placing a bar on trustees from acting as such until authorised by the Master, the Act endeavours to ensure that trustees can only act as such if they comply with the Act. This ensures that the trust deed is lodged with the Master and that security, if necessary, is lodged with him before trustees starting binding the trust's property.
285 *Simplex (Pty) Ltd v Van der Merwe* 1996 (1) SA 111 (W) and *Luppacchini NO v Minister of Safety and Security* 2010 (6) SA 457 (SCA).
286 Para 13.
287 2005 (2) SA 77 (SCA) para 11.

provide sufficient grounds for their removal as trustees.[288] In *Watson*, two of the mentioned "core elements"[289] afforded protection to the trust beneficiary. The fiduciary position of a trustee and the fact that trusteeship is an "office", thereby providing a public element to this position, came to the applicants' "aid" in the declaration of her rights. *Watson*, furthermore, illustrates the need for trustees to realise their powers as well as the responsibilities and duties trusteeship entails. A failure to observe these duties may risk action for breach of trust.

2 8 Final remarks

A properly drafted (discretionary ownership trust) and the proper administration of such a trust in terms of adherence to basic trust principles can indeed serve as mechanism to protect assets upon the sequestration or divorce of the founder. It is therefore submitted that the trust is therefore still a viable estate planning tool provided that basic trust principles are adhered to.

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[288] The case of *Tijmstra NO v Blunt-MacKenzie NO* 2002 (1) SA 459 (T), serves as illustration of the circumstances or grounds upon which a trustee can be removed from office by the court. All six trustees were removed from office albeit for different reasons. It appears as if a trustee may be removed even though his actions were *bona fide*. In contrast *mala fides* or even misconduct are not necessarily requirements for the removal of trustees. Whenever trust assets are endangered and it is in the interest of the trust beneficiaries, a trustee should be removed. Specific grounds include *inter alia*: (a) where the trustee, without furnishing any explanation for his conduct, removes trust funds from an apparently safe investment with a financial institution and transfers them to his personal account (474C/D); (b) where the trust deed requires that, if a decision is to be taken, especially the sale of immovable property, notice must be given to all the trustees so that they may decide thereon, and the trustee deliberately refrains from informing one of his co-trustees of the intended decision. Such conduct may very well amount to *mala fides* (468H-J; 469A-B); (c) where the trustee does not ascertain from the trust deed what the rights and obligations of the office of trustee entails (468H-J); (d) where the trustee treats the trust and its assets as his own, for example by selling the trust assets without the proper approval of the other trustees as required by the trust deed (468B-C); (e) where the trustees express no independent views about matters affecting the trust, but relies entirely upon a dominant co-trustee and approves of his (wrongful) conduct (472A/B-C); and (f) where the trustee, without objection, allows grave misconduct on the part of a co-trustee in the administration of trust property, and thus exercises no control at all over the trust property (476D-477B). These facts show similarities to those of *Watson in casu.*

[289] See par 1 above.

Chapter 3: The impact of taxation on the viability of the trust as an estate planning tool

3 1 Introduction

Prior to 1 March 2017, estate planners were able to loan monies and/or effect transfer of assets via interest free/low interest loan accounts.[290] In these tax avoidance schemes, taxpayers would transfer assets to a trust and the purchase price that the trust owed in respect of the assets was outstanding as a loan, advance or credit in favour of that taxpayer on which no interest or very low interest was charged. Alternatively, a taxpayer could advance a low interest or interest-free loan, advance or credit to a trust in order for the trust to use the money to acquire assets.[291] In this chapter the proposed and current legislative amendments pertaining to the taxation of trusts are discussed in more detail by starting with a timeline of the development of these amendments and proposals. The impact of this changed legislation is then analysed. This has been done by means of case studies considering current and future environments. However, this analysis is restricted due to length constraints. The following research questions will lay the foundation for this discussion in order to ascertain whether the trust is still viable from a taxation perspective: Is the trust a viable tax planning tool?;[292] the impact of the Davis Tax Committee suggestions and the introduction of section 7C of the Income Tax Act on trust loan accounts[293] and the impact of proposed amendments to section 25B – the so-called "conduit principle".[294]

[290] Taxation Laws Amendment Act, 2016 came into effect on 1 March 2017 putting an end to interest-free loans to trusts with the addition of s7C of the Income Tax Act 58 of 1962. Refer to para 3 3 for detailed discussion.
[291] "Refinement of measures to prevent tax avoidance through the use of trusts" Memorandum to the Draft Taxation Laws Amendment Bill, 2017.
[292] Refer to para 3 9 2.
[293] Act 58 of 1962.
[294] S 25B of the Income Tax Act 58 of 1962; see para 3 6.

3 2 Historical timeline of proposed amendments and new legislation[295] including the new Taxation Laws Amendment Bill, 2017[296]

Trusts have been under attack by [government][297] for many years in South Africa. On 17 July 2013 the Minister of Finance[298] announced the members of the Tax Review Committee (the Committee) as well as the Committee's Terms of Reference. This tax review committee has become known as the Davis Tax Committee.[299] The Committee's objective is to assess South Africa's tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability.[300] In assessing South Africa's tax policy framework, the DTC has identified the disparity that exists between the number of registered trusts and registered trust tax payers.[301] The historical timeline below is indicative of how trusts have been discredited by government through making them as tax unfriendly as possible.[302] There has subsequently been a push back by industry[303] resulting in many of the initial proposals by government not been followed through.[304] According to Van der Spuy, it appears that government does not have a clear, uniform strategy pertaining to the roll-out of its proposals and that the South African Revenue Services[305] is ignoring proposals put forth by the Davis Tax committee.[306] The timeline of these "moderated attacks"[307] on trusts since the establishment of the Davis Tax Committee[308] over time can be chronologically ordered as followed:

[295] Taxation Laws Amendment Act, 2016; See for a discussion Van der Spuy *Demystifying trusts in South Africa* (2017) 80 – 101.
[296] [B27-2017].
[297] My emphasis.
[298] Minister Pravin Gordhan.
[299] Hereinafter referred to as the DTC.
[300] http://www.taxcom.org.za/aboutus.html
[301] *Momentum* "Davis Tax Committee 2nd Report Summary" 2016.
[302] Van der Spuy (2017) 80; Trevor Manual referred to trusts as being used to avoid paying estate duty in the 2009 budget speech; also refer to fn 33.
[303] Van der Spuy (2017) 81; Industry bodies such as the South African Institute of Tax Professionals – see ch 3 para 3 6 for detailed commentary.
[304] Van der Spuy (2017) 80.
[305] Hereinafter referred to as SARS.
[306] Van der Spuy (2017) 81.
[307] Van der Spuy 2017 para 10.2 80.
[308] Established in 2014.

(a) July 2015: The DTC's first *interim* report published

The DTC proposed the removal of the so- called "conduit pipe principle"[309] and for the trust to be taxed as a separate taxpayer,[310] to keep trust tax rates at 41%, no need to change interest on loans to trusts and the lender could utilize the R100 000 annual donations exemption[311] to write down trust loans.

(b) February 2016: Budget Speech

The Minister of Finance[312] indicated that interest free loans to trusts were to be regarded as a donation, that there were plans to introduce measures to limit income splitting[313] and that the capital gains inclusion rate was to be increased from 66.6% to 80%.

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[309] S25B Income Tax Act 58 of 1962; refer to para 3 8 for discussion and a case study comparing the current scenario versus the impact of the proposed removal of the so-called "conduit pipe principle" on the viability of the trust in terms of taxation as an estate planning tool.

[310] The DTC retracted on this proposal in December 2015.

[311] Ch II Part V s 56 (2) Act 58 of 1962.

[312] Pravin Gordhan.

[313] The Business Dictionary http://www.businessdictionary.com/definition/income-splitting.html: "Shifting income from a higher tax bracket operation (or a family member) to one falling in a lower tax bracket, in order to reduce overall tax burden" accessed 22/11/2017 ; Holdstock SAIT "Trusts - Is the Conduit Principle In Peril?" 2013 SAIT *News and Press:Trusts* accessed 22 October 2017 http://www.thesait.org.za/news/127167/Trusts---Is-the-Conduit-Principle-In-Peril-.htm: "Treasury and the South African Revenue Service (SARS) seem to be concerned about trusts, largely because of the income-splitting opportunities that trust law affords. These are based on the well-established conduit principle in terms of which, if income accrues to a trust and the trustees award it to one or more beneficiaries in the same year, the income retains its nature in the hands of the beneficiary. In fact, the Eight Schedule to the Income Tax Act, No 58 of 1962 provides specifically for this application in the context of capital gains tax (CGT) in that it provides: that any gain arising in a trust from distribution of an asset to a beneficiary is taxed as a capital gain in the hands of the beneficiary; and that where a capital gain arises in a trust as a result of the disposal of an asset of the trust, the trustees may in the same year award the gain to one or more beneficiaries. The problem for the fiscus is that the conduit principle may be used for income splitting and deduction splitting." On the income side, interest income is perhaps the best class of income to use in an example. Assume that there are three beneficiaries of a trust, who are natural persons, and in the current year the trust earns interest of R75,000. If the trust retains the interest and pays tax on it, it gets no exemption and the tax liability at 45% is R33,750. Now assume that the trustees award the interest in equal proportion to the beneficiaries. The tax liability of each beneficiary will be as follows: interest income R25,000, of which R23,800 is exempt (this would be R34,500 for a beneficiary older than 65). The taxable balance is thus R1,200 on which, even at the maximum marginal rate of 45%, the tax would be R540. The total tax payable on the interest would thus be R540 x 3 = R1,620. For CGT purposes there is a similar result. On a capital gain of R120,000 the trust's tax liability would be 120,000 x 80% x 45% = R43,200. On the same gain distributed equally to them, the three beneficiaries would pay a maximum between them of 120,000 x 40% x 45% = R21,600; and this result ignores the fact that the tax rate of a beneficiary could be as low as 18% depending on the beneficiary's total taxable income." **The example above has been updated with the current 2017/2018 tax tables.**

(c) 24 August 2016: DTC's second *interim* report

The second *interim* report suggested the removal of the "conduit pipe principle" once again,[314] highlighted the tax benefits from interest free loans,[315] the inclusion of interest free loans as a measure to trigger section 3(3)(d) of the Estate Duty Act,[316] the increase of the estate duty abatement[317] from R3, 500,000 to R15, 000,000, the increase of estate duty from 20% to 25% for estates in excess of R30, 000,000,[318] the repeal of the capital gains tax rollover [between spouses],[319] an increased capital gains tax exemption at death from R300,000[320] to R1,000,000, a repeal of inter-spouse donations tax exemption[321] except for reasonable maintenance and the introduction of wealth tax.

(d) July 2016: October 2016: Taxation Laws Amendment Bill, 2016 and Tax Administration Laws Amendment Bill, 2016

The initial proposal by SARS and National Treasury, contrary to the DTC's first *interim* report was to introduce section 7C of the Income Tax act, interest was to be treated as income for income tax purposes, there was to be no annual interest exemption[322] allowed against this calculated interest amount [in hands of lender],[323] tax not claimed back from trust within three years would be regarded as a further donation subject to donations tax and the lender cannot utilize the R100, 000 annual donations exemption to write down the trust loan.[324] The amended proposal put forth by SARS and National Treasury on 25 September 2016 deemed interest [not

[314] Refer to para 3 2(a).
[315] First time mentioned by the DTC.
[316] Act 45 of 1955; this proposed inclusion is to apply in the instance of bringing assets which are under the control of the deceased person into the estate as a deemed asset where a no interest or low interest loan (below the official interest rate) exist between a trust and a connected person. The rationale is that such a loan provides the lender with *de facto* control over the trust assets. In addition a recommendation was made to tax the notional interest that is 'supposed' to be charged on the loan using the official interest rate. Interest free or low interest loans trigger section 7 and the attribution rules in the Eighth Schedule of the Income Tax Act
[317] S4A of act 45 of 1955.
[318] The introduction of a progressive system similar to the income tax system.
[319] My emphasis; 8th Schedule Part III s 11(1) of the Act 58 of 1962; S 9HA(2)(b) of Act 58 of 1962; 8th Schedule Part V s 25(4) of Act 58 of 1962.
[320] 8th Schedule Part II s 5(2) of Act 58 of 1962.
[321] Ch 2 Part V s56(1) of Act 58 of 1962.
[322] Ch 2 Part 1 s 10(1)(i) of Act 58 of 1962.(i) Persons 0ver 65 = R34 500 annual exemption. (ii)Persons under 65 = R23 800 annual exemption.
[323] My emphasis.
[324] Para 3 2(a); fn 312.

claimed by lender][325] to no longer be an income tax item but rather to be seen as a donation, the scope of section 7C to be applied narrowly in terms of the connected person rule,[326] provided for exclusion to trusts other than wealth transfer trusts,[327] allowed the utilization of the annual R100, 000 donations tax exemption[328] to be written down against a trust loan and removed donations tax on no-recovery of tax from trust.

(e) 22 January 2017: Taxation Laws Amendment Act, 2016 promulgated

The only portion of the Taxation Laws Amendment Bill relevant to trusts promulgated into legislation was section 7C of the Income Tax Act which is discussed in detail below.[329] This section was introduced to further prevent trusts from being used to avoid or reduce estate duty and/or donations tax and came into effect on 1 March 2017.

(f) 22 February 2017: Budget speech

In delivering the budget speech the Minister of Finance[330] did not mention the implementation of the DTC second *interim* report proposals pertaining to inter-spousal transfers, removal of the “conduit pipe principle” or the inclusion of interest free loans as a measure to trigger section 3(3)(d) of the Estate Duty Act.[331] However, the trust tax rate was increased to 45% and loans to companies [by connected persons][332] owned by trusts were brought under the umbrella of section 7C of the Income Tax Act.

(g) 19 July 2017: Draft Taxation Laws Amendment Bill

Since the introduction of the anti-avoidance measure, it has come to Government’s attention that taxpayers have discovered ways to avoid the deemed annual donation

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[325] My emphasis.

[326] Only naturally connected persons, or at the natural person’s instance, by a company in which that person, together with connected persons in relation to that natural person, hold an interest of at least 20%; for a detailed assessment of what comprises a connected person refer to para 3 3 2 3.

[327] Refer to para 3 3 3.

[328] Refer to fn 312.

[329] Refer to para 3 5 for an in depth discussion.

[330] Pravin Gordhan.

[331] Refer to para 3 2(c).

[332] My emphasis. For a detailed discussion refer to para 3 4 3 3.

triggered by the anti-avoidance measure. Refinement measures to curb the abuse of the trust and tax avoidance have been proposed by the legislator.

(h) 25 October 2017: Taxation Laws Amendment Bill[333]

The abovementioned draft has acceded into a Bill. The differences between the draft bill and bill are highlighted below. The wording of section 7C is quoted in instances where the TLAB proposes changes to section 7C that were not proposed in the DTLAB. The changes between the TLAB and DTLAB are minor. In the TLAB the addition of the word "company " has been added as well as having done away with reference to a "natural person" and replaced it with "person". When considering the definition of person in terms of the Income Tax Act[334] it is submitted that the reason for doing so is to widen the definition of a person so as to include the trust and therefore to ensure the successful application of the provisions discussed above in the TLAB.[335]

(i) The TLAB makes specific reference to a trust holding "20 per cent" equity shareholding or voting rights in a company

Current section 7C (1)(b) (01/03/2017)	**DTLAB (19/07/2017)**	**Taxation Laws Amendment Bill 2017 (25/10/2017)**
"…directly or indirectly provides to a trust in relation to which that person or company, or any person that is a connected person in relation to that person or company, is a connected person."	"…directly or indirectly provides to— (i) a trust in relation to which— *(aa)* that person or company, or *(bb)* any person that is a connected person in relation to the person or company referred to in item *(aa)*, is a connected	"…directly or indirectly provides to— (i) a trust in relation to which— *(aa)* that person or company, or *(bb)* any person that is a connected person in relation to the person or company referred to in item *(aa)*, is a connected

[333] [B27-2017]. Hereinafter referred to as the TLAB.

[334] Act 58 of 1962 s1 Interpretation: ""person"includes—a) an insolvent estate; b) the estate of a deceased person; c) any trust; and d) any portfolio of a collective investment scheme, but does not include a foreign partnership.

[335] Refer to para 3 5 -3 6.

	person; or (ii) a company that is a connected person in relation to the trust referred to in subparagraph (i).”;	person; or (ii) a company ***if at least 20 per cent of –(aa) the equity shares in that company are held, directly or indirectly; or (bb) the voting rights in that company can be exercised, by the trust referred to in subparagraph (i) or by a beneficiary of that trust.”***

(ii) Replacement of term “natural person” with “person” in newly inserted section 7C(1A)

Current section 7C(1) (01/03/2017)	**DTLAB (19/07/2017) – Insertion of section 7C(1A)**	**Taxation Laws Amendment Bill 2017 (25/10/2017) – Insertion of section 7C(1A)**
“(1)This section applies in respect of any loan, advance or credit that— (a) a natural person; or (b) at the instance of that person, a company in relation to which that person is a connected person in terms of paragraph (d)(iv) of the definition of connected person, directly or indirectly provides to a	“4(b) insertion after subsection (1) of the following subsection: “(1A) If a ***natural person*** acquires a claim…”	“5(b) “insertion after subsection (1) of the following subsection: “(1A) If a ***person*** acquires a claim…”

trust in relation to which that person or company, or any person that is a connected person in relation to that person or company, is a connected person."		

(iii) Further reference to section 7C(1A) not applied in TLAB.

Current section 7C (1) (01/03/2017)	**DTLAB (19/07/2017)**	**Taxation Laws Amendment Bill 2017 (25/10/2017)**
As above	"4(c) by the substitution in subsection (2) for the words following paragraph *(b)* of the following words: "of any amount owing in respect of a loan, advance or credit referred to in subsection (1) or subsection (1A)."	Not applied

(iv) Addition of the word "company" in section 7C(5) which addresses loans excluded from the provisions of section 7C (2) & (3)

Current section 7C(5) (01/03/2017)	**DTLAB (19/07/2017)**	**Taxation Laws Amendment Bill 2017 (25/10/2017) – changes in terms of (a), (d) and (f)**
"(a) that trust is a public benefit organisation…" "(d)(i) the person referred	No changes suggested in terms of section 7C (5)(a),(d),(f).	"(a) that trust ***or company*** is a public benefit organization…"

to in subsection (1)(a) or the spouse of that person used that asset as a primary residence as contemplated in paragraph (b) of the definition of 'primary residence' in paragraph 44 of the Eighth Schedule throughout that year of assessment…" "(f) that loan, advance or credit was provided to that trust in terms of an arrangement that would have qualified as a sharia compliant financing arrangement…"		"(d) that the trust ***or company***…" "(d)(i) the person referred to in subsection (1)(a) or the spouse of that person used that asset as a primary residence as contemplated in paragraph (b) of the definition of 'primary residence' in paragraph 44 of the Eighth Schedule throughout ***the period during*** that year of assessment ***during which that trust or company held that asset***;… " "(f) that loan, advance or credit was provided to that trust ***or company*** in terms of an arrangement that would have qualified as a shariah compliant financing arrangement…"

In terms of the TLAB a number of paragraphs are deemed to have come into operation retrospectively on 19 July 2017[336] and 1 March 2017.[337] Questions as to

[336] S5(1)(a),(b),(c),(d),(e),(f),(g),(h).
[337] S5(1)(i).

the constitutionality of retrospective legislation have been raised.[338] A detailed discussion of initial and final proposals including comments by an industry stakeholder[339] follows below.[340] An analysis of section 7C of the Income Tax Act as it is currently applied will now follow.

3 3 The introduction of section 7C of the Income Tax Act

In an attempt to further prevent trusts from being used to avoid or reduce estate duty and/or donations, section 7C was proposed in the Draft Taxation Laws Amendment Bill 2016 and the Draft Taxation Administration Bill 2016 which were released for public comment on 8 July 2016.[341] National Treasury and SARS briefed the Standing Committee on Finance on 24 August 2016. Public comments to the committee were presented at a hearing that was held on 14 September 2016. The final report back to the committee was on 21 September 2016.The Taxation Laws Amendment Act, 2016,[342] introduced section 7C of the Income Tax Act.[343]

3 3 1 Reason for implementing section 7C[344]

According to National Treasury, at issue is the avoidance of estate duty and donations tax when a person sells assets to a trust and the sale of those assets is financed by way of an interest free loan or a loan with interest below market rates. Donations tax will not be triggered on the asset when the asset is sold at market value to a trust in this manner because there is no gratuitous disposal as required for

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[338] For an interesting discussion on the constitutionality of retrospective legislation refer to Brink *et al* "Important judgment on the constitutionality of retrospective legislation" 2017 *CDH Tax and exchange control alert*; *Pienaar Brothers (Pty) Ltd v Commissioner for South African Revenue and Another (GNP)* 87760/2014 (unreported).

[339] In this instance SAIT.

[340] Refer to para 3 6.

[341] The uncertainty pertaining to interest free loans has existed for numerous years as can be seen in Stark's article "Is the granting of an interest-free loan for tax planning purposes from the lender's perspective under threat? 2008 *De Jure* 174 174-187.

[342] Promulgated on 22 January 2017, effective 1 March 2017.

[343] Refer to para 3 2 (e); Van der Westhuizen "What every attorney should know about trusts (After the DTC & sec 7C)" 2017 *Millers Inc Attorney seminar* 206 211; Divaris "The Taxation of trusts" *BSP Seminars* 367-397.

[344] "1 6 Introducing measures to prevent estate duty and donations tax avoidance through transfer of assets to a trust using interest free loans" 2016 *Explanatory memorandum on the Taxation Laws Amendment Bill (Draft)* 8-9 http://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202016%20Draft2016%20Draft%20Explanatory%20Memorandum%20on%20the%202016%20Draft%20Taxation%20Laws%20Amendment%20Bill.pdf accessed 10/10/2017; Chambers "Introduction of New Anti Avoidance Legislation in South Africa" 2017 *The Kestrel* (July) http://juristax.com/uploads/1500891208_JurisTax-Newsletter-Newsletter-July.pdf accessed 29/10/2017.

donations tax purposes. Coupled with the above, in some instances the seller reduces the loan capital which is supposed to be paid back to him/her by donating amounts to the trust to be set off against the loan to the trust using the current provisions of section 56(2)*(b)* which provides for the R100 000 annual exemption from donations tax. This further avoids estate duty through the tax-free reduction of the asset base of the seller achieved by such annual donation to the trust. Due to the fact that the loan is an interest free loan or a loan with interest below market rates, no interest is paid to the seller or interest paid is less than market rates, the seller will not be liable for income tax on the interest that is forgone or will not be liable for income tax on the interest that is below market rates. This results in a further reduction of the tax base.

3 3 2 The main factors of this section, insofar it impacts the use of trusts as an estate planning vehicle

The main factors taken into account upon ascertaining whether section 7C will apply to a specific scenario are discussed below.

3 3 2 1 A loan, advance or credit needs to have taken place

A loan/advance/credit is made to a trust (directly or indirectly);[345] by a natural person, that is a connected person in relation of the trust, or by a company at the instance of a natural person, where that natural person is a connected person in relation to that company and the trust.[346] If a loan, advance or credit was provided by a company to a trust at the instance of more than one person that is a connected person in relation to that company as referred to in paragraph (b) of subsection (1), each of those

345 "Explanatory Memorandum to the Taxation Laws Amendment Bill" 2016; Teubes *et al* "Section 7C of the Income Tax Act" 2017 *Momentum Internal explanatory publication* (June) 4: "…an indirect loan to a trust is where the connected person lends money to a third party with the understanding that that third party on-lends the funds to the trust – to overcome the connected person requirement – where the third party is required to cede the rights in terms of the loan to the connected person as security for the loan eg Peter and his spouse and children are beneficiaries of the Rabbit Trust. Peter enters into a loan with a business partner, Paddington, who is not a connected person in relation to any of the trusts. He lends him R1 500 000. It is an interest-free loan that is payable on demand and subject to the condition that Paddington lends the R1 500 000 to the Rabbit Trust on the same basis (no interest and payable on demand). In addition Paddington has to cede the loan to Peter as security for the loan made between them. In this instance the loan will still fall into the ambit of section 7C and Peter will still be viewed as the lender and he will still be liable for donations tax, as if he made the loan to the Rabbit Trust in his personal capacity."

346 S 7C (1)(a) &(b).

persons must be treated as having donated, to that trust, the part of that amount that bears to that amount the same ratio as the equity shares or voting rights in that company that were held by that person during that year of assessment bears to the equity shares or voting rights in that company held in aggregate by those persons during that year of assessment.[347] If more than one natural person made the loan to the trust, the donation will split proportionately between them. This section will apply irrespective of when the loan was made.[348]

3 3 2 2 No Interest/ interest charged at rate lower than official rate

No interest is charged on that loan, or interest is charged at a rate below the official rate (currently 7.75% per annum).[349] There is a deemed donation[350] made by the natural person to the trust, that is equal to interest at 7.75% per annum, or the difference between the actual interest rate being charged and the official rate of 7.75% per annum. The donation is deemed to take place on the last day of the year of assessment of that trust.[351] The following case studies illustrate the potential donations tax implications as a result of section 7C:[352]

(a) Interest free loan

Peter, a beneficiary of the Rabbit Family Trust, lent R5 000 000 to the trust, charging no interest. The deemed donation for that year of assessment will be equal to R5 000 000 x 7.75%[353] = R387 500. Assuming Peter made no additional donations during the tax year, donations tax will be payable on R287 500 (R387 500 – R100 000). Therefore Peter will have to pay R57 500 donations tax.

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[347] S7C (4).

[348] Whether it was made prior to, on or after the effective date is irrelevant. It applies retrospectively to loans made prior to 1 March 2017, however, the actual donation will be deemed to take place on the last day of any given tax year. For this 2017/18 tax year it will be on 28 February 2018.

[349] Official rate para 1 7th Schedule (linked to the repurchase rate plus one percent); SARS "Legal Counsel – Interest Rates –Table 3)" accessed 14/10/2017.

[350] S7C(3)(a)&(b); S64. Donations tax levied at 20%; Teubes *et al* "Section 7C of the Income Tax Act" *Momentum Internal explanatory publication* (June) 2017: "Natural persons are entitled to a donations tax exemption of up to R100 000 per annum. Therefore the lender will only pay donations tax on the deemed donation insofar it exceeds R100 000 being the annual donations tax exemption for individuals in terms of s56(2)(a)&(b) of the Income Tax Act. The result is that donations tax will only be payable on interest-free loans in excess of R1 290 000 (R1 250 000 x 7.75% = R99 975)."

[351] S7C (3)(a) & (b).

[352] Teubes *et al* 5-6.

[353] Previously 8%. Adjusted to current official interest rate of 7.75% –refer to fn 344.

(b) Interest charged at rate lower than official rate

Peter lent the trust R5 000 000 at an interest rate of 5% per annum. The deemed donation for the year of assessment will be equal to (R5 000 000 x 7.75%) – (R5 000 000 x 5%) = R387 500. R387500 – R250 000 = R137 500. Assuming Peter made no other donations during the year, he will be liable for 20% donations tax on R37 500 (R137 500 – R100 000). Therefore he will have to pay R7 500 donations tax as well as income tax[354] on the interest earned (paid by the trust to him).

3 3 2 3 The so-called "connected person" in relation to a trust

The Income Tax Act defines a "connected person" in relation to a trust as a beneficiary[355] of that trust and a connected person in relation to that beneficiary.[356] A beneficiary is defined as follows: "in relation to a trust means a person[357] who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust". It is submitted that this definition is very wide and has the effect that a beneficiary will include income and capital beneficiaries in relation to vested/ "bewind" trusts and discretionary trusts. A "connected person" in relation to a beneficiary, that is a natural person, will include any relative.[358] Therefore it will include that person's spouse;[359] anybody related to that person within the third degree of consanguinity; anybody related to that person's spouse within the third degree of consanguinity; and the spouse of anybody related within the third degree of consanguinity to that person or to that person's spouse.[360] A connected person in

[354] Nel. Telephonic and e-mail discussion on 08/11/2017.

[355] "Beneficiary" S1(b)(i).

[356] "Beneficiary" S1(b)(ii).

[357] S 1 "person": "includes— a) an insolvent estate; b)the estate of a deceased person; c)any trust…"

[358] S1 ""relative" in relation to any person, means the spouse of such person or anybody related to him or his spouse within the third degree of consanguinity, or any spouse of anybody so related, and for the purpose of determining the relationship between any child referred to in the definition of "child" in this section and any other person, such child shall be deemed to be related to its adoptive parent within the first degree of consanguinity."

[359] S1 ""spouse", in relation to any person, means a person who is the partner of such person— (*a*) in a marriage or customary union recognised in terms of the laws of the Republic; (*b*) in a union recognised as a marriage in accordance with the tenets of any religion; or (*c*) in a same-sex or heterosexual union which is intended to be permanent, and 'married', 'husband' or 'wife' shall be construed accordingly: Provided that a marriage or union contemplated in paragraph (*b*) or (*c*) shall, in the absence of proof to the contrary, be deemed to be a marriage or union out of community of property."

[360] Based on this definition the following will include connected persons in relation to a natural person: children (first degree of consanguinity);grandchildren (second degree of consanguinity),great-grandchildren (third degree of consanguinity),parents (first degree of consanguinity),grandparents (second degree of consanguinity),great-grandparents (third degree of consanguinity);brothers and

Footnote continuous on next page

relation to a company includes any person that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of the shares or voting rights in that company.[361] The following examples[362] illustrate the donations tax impact of a connected person lending money to a trust:

(a) Example of an Interest free loan received by a "relative" of a "connected person"

Peter's great-grandmother lent money to the Rabbit Family Trust in 1987. The loan was for an amount of R1 000 000 and it was interest free. In her will she bequeathed the loan to Peter's mother, Angela, and therefore the trust now owes Angela R1 000 000. There is still no interest being charged on the loan. Angela is a connected person in relation to Peter who is a beneficiary of the Rabbit Family Trust and therefore the loan will fall within the ambit of section 7C. The deemed donation made by Angela to the trust is R1 000 000 x 7.75% per annum = R77 500. Assuming Angela made no other donations during the year, she will not have to pay any donations tax, as the total donation is less than the R100 000 annual limit.[363]

(b) Example of Interest charged at rate lower than official rate by "connected person" in relation to a company

Rabbit (Pty) Ltd lent R14 500 000 to the Rabbit Family Trust for investment purposes. The shareholders of Rabbit (Pty) Ltd are Peter's father (Pete) and his uncle (Andrew) and Peter himself. They each own 10% respectively. The remaining 70% is held by unrelated third person. Rabbit company charges 4% per annum interest on the loan. There deemed donation is calculated as follows: (R14 500 000 x 7.75%) – (R14 500 000 x 4%) = R543 750. As Peter, Pete and Andrew own 30% of the shares in Rabbit (Pty) Ltd, only 30% of the deemed donation is attributed to them in equal shares. Therefore R163 125 of the deemed donation will be attributed to them, which is equal to R32 625. Assuming no other donations are made by any one of them during that tax year, no donations tax will be payable.[364]

sisters (second degree of consanguinity); nephews and nieces (third degree of consanguinity) and uncles and aunts (third degree of consanguinity).

[361] S1 "connected person" (d)(iv).

[362] Teubes *et al* 6.

[363] Refer to fn 312.

[364] Refer to fn 312.

3 3 2 4 The denial of tax losses or deductions[365]

Section 7C(2) determines that no deduction, loss, allowance or capital loss can be claimed by the trust in respect of a disposal, including a way of a reduction or waiver, or the failure to claim for the payment, of any amount owing, in respect of a loan/advance/credit provided to the trust by a connected person. Often lenders of no or low interest loans will cancel or waive a loan – effectively write the loan off – which results in the reduction of that lender's asset base for estate duty purposes. To counter this method from being used to reduce estate duty, no deduction of this nature may be claimed in respect of interest-free or low interest loans made by connected persons to a trust.

3 3 3 Excluded trusts

In terms of section 7(C)(5),[366] the following trusts will not be affected by the provisions of section 7C:[367]

3 3 3 1 Loan, advance or credit to trusts operated as public benefit organizations

The trust is a public benefit organization as approved by the Commissioner in terms of section 30(3).

3 3 3 2 Small business entities

The loan, advance or credit to a trust operated as a small business funding entity approved by the Commissioner in terms of section 30C.[368]

3 3 3 3 Loan, advance or credit provided by person with vested interest[369]

The loan, advance or credit was provided to the trust by a person with a vested interest in the trust or in return for a vested interest in the trust and,[370] the beneficiaries of the trust hold a vested interest in all the receipts and accruals and

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[365] Teubes *et al* 6.
[366] Income Tax Act 58 of 1962.
[367] Ss(2)&(3).
[368] S7C(5)(a); a small business funding entity is a trust that is approved by SARS and the main purpose of the trust is to provide funding to small business entities.
[369] Vested interest wrt interest and capital.
[370] S7C (5)(b).

assets of that trust;[371] no beneficiary of the trust can hold or acquire an interest in the trust other than a vested interest in the receipts and accruals of that trust;[372] the vested interest of each beneficiary is determined solely by reference to and in proportion to the assets, services or funding contributed by that beneficiary to that trust and,[373] none of the vested interests held is subject to a discretionary power conferred on any person in terms of which that interest can be varied or revoked.[374] It is submitted that where income or capital is irrevocably vested in a beneficiary but not physically paid to that beneficiary will not be regarded as a loan account for the purposes of section 7C. To ensure that this vested amount does not constitute a loan to the trust by the beneficiary for the purposes of section 7C, the following factors should be present: (a) The vested amount may not be paid to that beneficiary until the happening of a certain event or certain age as provided for in the trust deed, or (b) the trustees must have the full discretion to determine when payment is eventually made to the beneficiary, (c) the retention of the vested amount in the trust was not at the instance of the beneficiary, and (d) The trustees will manage and administer the vested amount for the benefit of that beneficiary.

3 3 3 4 Loan, advance or credit to a special trust

The trust is a special trust as defined in paragraph (a) of the definition contained in the Act.[375]

3 3 3 5 Loan, advance or credit to trust to purchase a primary residence

The loan was wholly or partly used to fund the acquisition of a property used as a primary residence[376] by that person (the lender) or that person's spouse and the loan relates to part of that loan that funded the acquisition of the property.[377]

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[371] S7C(b)(i).
[372] S7C(b)(ii).
[373] S7C(b)(iii).
[374] S7C(b)(iv); Teubes *et al* 7 ": " Note that the trust envisaged above does not necessarily include all vested trusts and is specifically aimed at trusts where the beneficiary's interest is determined by their contribution made to the trust. This would typically be a business trust where the beneficiary is also generally the trustee and all the beneficiaries share in the profits and losses of the trust based on the vested right they hold. The exclusion will also apply in respect of *bewind* trusts where the beneficiary of that trust makes a loan to the trust that is interest-free or a low interest loan. "
[375] Limited to apply in respect of special trusts set up for disabled beneficiaries.
[376] S7C(d)(i).
[377] S7C(d)(ii).

(a) Case study of a loan to a trust, to fund the acquisition of a property used as a primary residence where the full loan amount used for the purchase

Peter lends money to his family trust and the trust uses the loan to purchase a property and Peter (or his spouse) uses the property as their primary residence. It is not a requirement that the loan is the only means of finance for the property. However, it is a requirement that the loan cannot be used for any other purpose than purchasing the property. Therefore, if Peter lent the trust R1 000 000 and the trust acquired a property for R3 000 000 of which R2 000 000 was financed by way of a bond in addition to Peter's loan, the exclusion will apply.[378]

(b) Case study of a loan to a trust, to fund the acquisition of a property used as a primary residence where a portion of loan amount used for the purchase

If Peter lent the trust R3 000 000 and the trust acquired a property for R2 000 000 and applied the remaining R1 000 000 for other investments, the exclusion will not apply, regardless of whether Peter and/or his spouse is using the property as a primary residence.

3 3 3 6 The loan, advance or credit or advance is an affected transaction

The loan is an affected transaction as defined in section 31(1)[379] of the Income Tax Act (transfer pricing provisions).[380]

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[378] Nel CA (SA), Tax specialist and Head of the School of Applied Tax (SAIT Tax Faculty). Telephonic and e-mail conversation held on 08/11/2017. Does not agree with this view.

[379] S7C(e).

[380] National Treasury "1.6. Introducing measures to prevent estate duty and tax avoidance through the use of interest free or low interest loans to a trust" *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2016* 12.The interaction between section 7C and section 31*:* This anti-avoidance measure seeks to curb the unfair advantage of using loans that are not subject to interest at market rates have. Similarly, the transfer pricing rules in the Act also apply to counter the mispricing of cross-border loan arrangements. In order to ensure that there is no overlap or double taxation in respect to low or no interest loans made to foreign trusts, the anti-avoidance measure under section 7C will not apply to a loan that is subject to the transfer pricing rules in section 31 of the Act.

3 3 3 7 Loan, advance or credit in terms of a Shariah compliant finance arrangement

The loan was provided to the trust in terms of an arrangement that is a Sharia compliant finance arrangement as contemplated in section 24JA,[381] had the trust been a bank.

3 3 3 8 The loan, advance or credit is deemed a dividend

The loan is subject to the provisions of section 64E(4).[382] This is where a loan is made to a trust by a company and this section deems that loan as a dividend. It is submitted that the circumstances should support the fact that there was no intention by either party's to enter into a loan agreement. It is important that estate planners and their trust administrators review their financial statements to ensure they clearly indicate that such amounts owing to beneficiaries are not loans but in fact vested income/capital not yet paid. In certain instances corrective measures may be necessary to change the wording on the financial statements. Such amounts should not be noted as loans but rather as vested amount retained for the benefit of a specific beneficiary.[383]

3 4 Possible options to counter the negative consequences of section 7C

The two options selected below have been chosen due to the relative certainty of them being counters to the consequences of section 7C. The options to counter the impact of section 7C are at this stage are limited yet evolving. [384]

3 4 1 Repay or reduce the loan account

The trust can repay the loan account to the lender in full or to the extent that the loan amount remains at R1 290 000. The donations tax payable by the lender will be R99 975 which is less than the annual donations tax exemption for individuals.[385] To

[381] S7C(f).
[382] S7C(G).Therefore, any loan made by a connected person to any of the trusts listed above will not result in a deemed donation and no donations tax will be payable. Therefore no-interest or low-interest loans can be used to fund these trust structures without any donations tax implications.
[383] Teubes *et al* 9.
[384] Teubes *et al* "Section 7C of the Income Tax Act" 2017 *Momentum Internal explanatory publication* (June) 9-10.
[385] Donations tax exemption for individuals in terms of s 56(2)(a)&(b) of act 58 of 1962; Teubes *et al* 9.

achieve this objective may entail the trustees (of the trust) liquidating some assets to obtain the funds necessary to repay the loan. Another option is that the trustees consider transferring assets to the lender as repayment of the loan.[386]

3 4 2 Donation of loan account between spouses

Donations tax is only payable where the loan is in excess of R1 290 000[387] (assuming the lender does not use the R100 000 annual donation exemption for other purposes). The option of donating the balance of the loan in excess of R1 290 000 to a spouse can be considered as there is no donations tax between spouses.[388] The result will be that the spouse can use their annual R100 000 tax-free donation in respect of this portion of the loan and effectively reducing the donations tax payable by the lender by maximum of R20 000. It is important to note that the portion of the loan donated to the spouse is an asset in the estate of that spouse and that spouse's creditor will be able to lay claim to that asset in the event of sequestration and divorce proceedings.[389] In the event of death it will also be part of that spouse's deceased estate and subject to estate duty.[390]

3 4 3 Charge interest on the loan

The lender can prevent the application of section 7C by levying interest on the loan of 7.75% per annum. The trust will have to pay the interest to the lender, which will require positive cash flow. It is unlikely that the trust will enjoy a tax deduction for the interest paid, unless the trust applied the loan to generate taxable income – section 11(a) determines that expenses made in the production of income will be tax deductible.[391]

[386] Teubes *et al* 9.
[387] Refer to para 3 4 1.
[388] Nel e-mail conversation 08/11/2017. This can be an impermissible avoidance scheme.
[389] Refer to detailed discussion in ch 2.
[390] S 2(2) read in conjunction with 1st Schedule s1 (a) of Act 45 of 1955.
[391] Nel e-mail conversation 08/11/2017. It is unlikely s11(a) will apply however a deduction can be claim in terms of s24j(2) of the Income Tax Act.

3 4 3 1 Cost comparison: paying donations tax and repaying the loan

The founder has lent R5 000 000 to the trustees of the family trust. The following two scenarios are considered:[392]

3 4 3 2 Allow the provisions of section 7C to apply resulting in a deemed donation on a zero interest loan

The deemed interest (7.75%)[393] on the loan is R387 500. Assuming the annual exemption in respect of donations is also taken into account (R100 000), it will result in R287 500 being subject to donations tax. Therefore the lender will be liable for R57 500.

3 4 3 3 Interest charged @ 7.75% per annum by lender

The trust will have to pay the lender R387 500 per annum. This will be gross income in the hands of the lender and the annual interest exemption will apply. Therefore the taxable interest is R376 200 (assuming the lender is under 65 and the interest exemption is R23 800). The income tax payable will be as follows:

(i) marginal rate of 18% - R 67 716

(ii) marginal rate of 30% - R112 860

(iii) marginal rate of 45% - R169 290.

To determine which option is the most viable, the size of the loan and the marginal tax rate of the lender will be the deciding factors. However, as can be seen in this example it will be more cost effective for the lender to pay the donations tax in terms of section 7C[394] even when considering an 18% marginal tax rate. Assuming the lender pays tax at a 45% marginal tax rate, he will be worse off by (R169 290 – R60 000)[395] = R109 290 per annum by the trust paying him interest.

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[392] Teubes *et al* 9.
[393] Official interest rate -refer to fn 344.
[394] Refer to fn 308.
[395] Refer to (a) above.

3 4 4 Outright donation vs deemed donations when making new loans[396]

Instead of 'selling' assets to the trust or lending funds to the trust to acquire assets, the estate planner can consider donating the asset/cash amount to the trust from the outset. Therefore pay the donations tax on the full value transferred to the trust upfront rather than setting up the interest-free loan. The following table will compare the actual cost associated with both options. It is assumed that the estate planner wishes to transfer R5 000 000 to the trust.

Table 1: Cost comparison – outright donation versus interest-free loan triggering section 7C[397]

Outright donation		**Interest-free loan triggering section 7C**	
Donated amount	R5 000 000	Deemed interest at 7.75%	R387 500
Less tax-free donation	R100 000	Less tax-free donation	R100 000
Taxable donation	R4 900 000	Taxable donation	R287 500
Donations tax @ 20%	**R980 000**	**Donations tax @ 20%**	**R57 500**

Based on the above comparison between and outright donation and interest-free loan triggering section 7C, it will take 16 years before the deemed interest payable in terms of s7C equal that paid upfront[398] due to the outright donation.

[396] Teubes *et al* 10.

[397] Teubes *et al* 10.

[398] S60(f). SARS "Legal Counsel – Interest Rates –Table 3)" accessed 14/10/2017.
A donation takes effect when all the legal requirements of section 55(3) of the Income Tax Act 58 of 1962 are complied with; Donations tax must be paid by the end of the month following the month during which the donation takes effect or such longer period as SARS may allow (s60(1)) .

3 5 Refinement of measures to prevent tax avoidance through the use of trusts: National Treasury and South African Revenue Services[399]

In 2016, an anti-avoidance measure aimed at curbing the transfer of growth assets to trusts for estate planning purposes through the use of interest-free or low interest loans was introduced in the Income Tax Act (the Act). Under the current anti-avoidance measure, the interest forgone in respect of interest-free or low interest loans arising in exchange of which natural persons transfer assets or advanced to trusts to fund the acquisition of assets are treated as an on-going and annual donation made by the lender on the last day of the year of assessment of the lender.Since the introduction of the anti-avoidance measure, it has come to Government's attention that taxpayers have discovered ways to avoid the deemed annual donation triggered by the anti-avoidance measure. The 2017 Budget stated that anti-avoidance provisions will be put in place to avoid this structure from being used to circumvent the consequences of section 7C. National Treasury and SARS received responses from 1 420 organisations and individuals on the Draft 2017 Taxation Laws Amendment Bill and the Draft 2017 Taxation Administration Laws Amendment Bill. Public comments to the Standing Committee on Finance were presented at a hearing that was held on 29 August 2017. There were 11 organisations that submitted their comments to the Standing Committee on Finance for public hearings. Subsequently, National Treasury and SARS held public workshops on the public comments on 4 and 5 September 2017.[400] This Draft Response Document contains draft responses to the most pertinent issues raised by the public during the public hearings and workshops.[401]

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[399] National Treasury and SARS "Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017" Explanatory memorandum on the Taxation Laws Amendment Bill 13-14 accessed 15/10/2017. http://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LPrep-Resp-2017-01%20-%202017%20Draft%-20Response%20Document%20-%202017%20Draft%20TLAB%20and%-20TALAB%20-%2014%20September%202017.pdf.

[400] National Treasury and SARS "Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017" Explanatory memorandum on the Taxation Laws Amendment Bill 4 -5 accessed 15/10/2017. http://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LPrep-Resp-2017-01%20-%202017%20Draft%20Response%20Document%20-%202017%20Draft%20TLAB%20and%-20TALAB%20-%2014%20September%202017.pdf.

[401] Refer to fn 398.

3 5 1 Identified "tax loopholes" that could circumvent section 7C

The following scenarios have specifically been identified as potential tax loopholes to avoid the provisions of section 7C and have thus been addressed accordingly.

3 5 1 1 Interest-free loans, advances or credit and low interest loans, advances or credit made to companies owned by trusts[402]

Initially it was contended that s7C would not apply in the instance where a loan was made to a company that further on lent the funds to a company, of which the trust is 100% shareholder. In order to avoid the application of the anti-avoidance measure, taxpayers advance interest free or low interest loans to companies whose shares are held by trusts. By advancing the loan to the company rather than the trust, the anti-avoidance measure will not apply as it currently only applies to loans advanced to trusts. As such, the *fiscus* will forgo the ongoing and annual donations tax on the deemed donation. These companies benefit from this low or no interest funding and tax can only be collected at a much later stage when the company makes distributions to the trust.[403]

3 5 1 2 Transfer of loan claims to current or future beneficiaries of trusts[404]

Under this avoidance scheme, taxpayers enter into an arrangement under which the loan claim of the natural person who made the loan, advance or credit to the trust (or the natural person at whose insistence a company made a loan to a trust) is transferred to another natural person. The natural person that the loan claim is transferred to is usually a current beneficiary of the trust or a future beneficiary of the trust to which the loan, advance or credit is made, such as a child or a spouse. By subsequently transferring the loan claim, taxpayers argue that this breaks the link between the natural person who advanced the loan and the loan. Because of this, the natural person to whom the loan claim is transferred does not account for the deemed ongoing and annual donation as that natural person did not advance the loan to the trust.

[402] "Refinement of measures to prevent tax avoidance through the use of trusts" Memorandum to the Draft Taxation Laws Amendment Bill, 2017 8.
[403] Nel e-mail conversation 08/11/2017. This only applies if the trust owns shares in the company.
[404] "Refinement of measures to prevent tax avoidance through the use of trusts" Memorandum to the Draft Taxation Laws Amendment Bill, 2017 8.

3 5 2 Proposals by National Treasury and SARS to curb tax avoidance[405]

In order to curb the abovementioned avoidance, it is proposed that interest free or low interest loans, advances or credit that are made by a natural person or a company (at the instance of a natural person) to a company that is a connected person in relation to a trust should also fall under the anti-avoidance measure. Furthermore, where a person that is a connected person in relation to a trust acquires a loan claim to an amount owing by that trust in respect of a loan, advance or credit that was originally advanced by a natural person or a company (at the instance of a natural person) to that trust, the person who acquires that claim will be deemed to have advanced the amount of that claim as a loan on the date that person acquired that claim. In view of the fact that this anti-avoidance measure intends to close a loophole created as a result of 2016 tax amendments, the proposed provision in the 2017 Draft TLAB will come into operation on the date of publication of the 2017 Draft TLAB for public comment being 19 July 2017.

3 5 2 1 Companies held by trusts to be included under section 7C[406]

(a) Comment by public participants

The explanatory memorandum indicates that companies that are held by trusts will be included in the rule. However, the wording in the 2017 Draft TLAB refers to companies that are connected persons in relation to a trust and does not require a shareholding by the trust in that company. The connected person test for trusts goes much further than what the explanatory memorandum indicates to be the intention of National Treasury.

(b) Response by National Treasury and the South African Revenue Services

The proposal was accepted by SARS and National Treasury. The explanatory memorandum correctly indicates the type of companies envisaged. As such, a

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[405] Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017.

[406] "1.3. Refinement of measures to prevent tax avoidance through the use of trusts" *Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017* 13.

shareholding requirement will be included in the 2017 Draft TLAB to indicate that only companies in which trusts hold shares will be subject to the anti-avoidance measure. As a result, interest free or low interest loans made to companies in which a trust holds at least 20 per cent of the shares or voting rights will be subject to this anti-avoidance measure.

3 5 2 2 The provision that deems interest forgone to be an on-going donation should be extended to such companies[407]

(a) Comment by public participants

The 2017 Draft TLAB includes loans made to companies in the scope of the anti-avoidance measure. However, the provision that deems interest forgone to be an on-going donation available in the current section 7C(4) of the Act has not been extended to loans made to such companies.

(b) Response by National Treasury and the South African Revenue Services

The proposal was accepted by SARS and National Treasury. The loans made to companies envisaged under this anti-avoidance measure will also be made subject to the deeming provision under section 7C (4) of the Act.

3 5 2 3 Section 7C to include interest-free or low interest loans made to companies held by trusts in the anti-avoidance measure[408]

(a) Comment by public participants

The Draft 2017 TLAB contains amendments made to section 7C that seek to include interest-free or low interest loans made to companies held by trusts in the anti-avoidance measure. It is understood that this has been done in order to curb the circumvention of the current rules that only apply to interest-free or low interest loans made to trusts by using companies to indirectly benefit trusts. However, it should be

[407] "1.3 Refinement of measures to prevent tax avoidance through the use of trusts" *Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017* 13.

[408] *Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017* 14.

noted that when the anti-avoidance measure was first introduced in 2016, it was accepted that in some instances interest-free or low interest loans that are made to trusts do not always result in the tax free transfer of wealth as some trusts have been established for other purposes that do not evade tax. In order to exclude those acceptable uses of trusts, various exclusions relating to the loans made to trusts that do not avoid tax were included. By including companies held by trusts in the anti-avoidance measure, it is also necessary to ensure that exclusions relating to the acceptable use of trusts must also be extended to interest-free or low interest loans made to companies held by trusts that do not result in the tax free transfer of wealth.

(b) Response by National Treasury and the South African Revenue Services

The proposal was accepted by SARS and National Treasury. Where relevant, exclusions will be extended to interest-free or low interest loans made to such companies that to cover scenarios where companies held by trusts are used for purposes other than to indirectly facilitate the tax free transfer of wealth. In particular the following exclusions relating to companies held by trusts are envisaged.

3 5 2 4 Proposed exclusion for all business trusts (and by extension, business companies held by trusts) in terms of 2017 budget review[409]

(a) Comment by public participants

The 2017 Budget Review proposed that there would be an exclusion for all business trusts (and by extension, business companies held by trusts), however such proposal in not included in the 2017 Draft TLAB.

(b) Response by National Treasury and the South African Revenue Services

The proposal was not accepted by SARS and National Treasury. In 2016 an exclusion to the anti-avoidance measure was included for vesting trusts. This is because the income and assets vest in the beneficiaries of trusts and are thus included in the estate of those beneficiaries. With regards to discretionary trusts, this

[409] Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 14.

vesting does not occur outside of the trustees' discretion and often such trusts are used for estate planning for this exact reason. It is therefore not considered prudent to exclude all business trusts. The current exclusion of vesting trusts is adequate and in line with the intention of the provision. It then follows that companies held by trusts which are set up for estate planning purposes should also not be excluded as the benefit they derive from interest free or low interest loans is reflected in the value of the shares held by the trust.

3 6 Commentary by the South African Institute of Tax Professionals: Draft Taxation Laws Amendment Bill 2017 and Draft Tax Administration Laws Amendment Bill 2017[410]

3 6 1 Refinement of measures to prevent tax avoidance through the use of trusts

The amendment is considered too wide and will accordingly have numerous unintended consequences as illustrated below specifically pertaining to employee share schemes. The following examples illustrate the concerns highlighted by the South African Institute of Tax Professionals.

- **Example 1**

Company A established an employee share scheme which has as its legal base a vested trust owning 20% of the issued equity shares of Company A. All the employees are vested beneficiaries of the share scheme trust, including the Founder, Mr X, who is also an employee. Separately and unrelated to the share scheme, Mr X owns all of the shares in Company B. Mr X has partially funded the acquisition of an asset by Company B by advancing an interest-free loan to Company B. Mr X is a connected person in relation to Company B, and also in relation to the trust. The result is that Company B and the trust are connected persons in relation to each other. Mr X's personal loan to Company B will therefore

[410] SAIT "Comments from the SAIT Personal Tax Work Group on the draft Taxation Laws Amendment Bill (draft TLAB) and draft Tax Administration Laws Amendment Bill (draft TALAB) pertaining to key personal tax issues."18/08/2017 5-7 accessed 15/10/2017. http://c.ymcdn.com/sites/www.thesait.org.za/resource/resmgr/2017_Draft_Bills/SAIT_2017_DTLAB_-_Personal_T.pdf

be subject to Section 7C, despite the fact that neither the funding nor Company B having anything to do with the trust.

- **Example 2**

Mr A established a trust for his family, which does not hold any underlying company. His wife, Ms A, who is a beneficiary of the trust, is an independent businesswoman, who wholly-owns a resident company, Company C. She has partly-funded the operations of Company C with an interest-free loan from her own funds. Company C and the trust are connected persons because Ms A is a connected person to Company C, and is also a connected person to the trust. Ms A's personal loan to Company C will be subject to Section 7C, despite neither the fact that the funding, nor Company C having anything to do with the trust.

3 6 2 Suggested solution by the South African Institute of Tax Professionals

It is proposed that the reference to a “connected person” in subparagraph (ii) be limited to paragraph (d)(i) of the definition of connected person. This change would mean that the focus would require a more than 50 per cent share ownership connection.

3 7 Proposed amendment by Treasury and South African Revenue Services to exclude employee share scheme trusts from measures to prevent tax avoidance through the use of trusts

In order ensure that employee share schemes are not negatively affected, it is proposed[411] that a specific exclusion for employee incentive schemes should be provided. However, certain requirements must be met for the exclusion to apply. These requirements are introduced in order to ensure that owners of businesses do not abuse the exclusion to transfer wealth to family members that are in the employ of the business.

[411] S5(1)(i) Taxation Laws Amendment Bill 2017 [B 27-2017].

3 7 1 Problem identified by the South African institute of Tax Professionals

One of the requirements for the exclusion to apply is that no person who holds at least 20% of a widely-held company (together with his connected persons) participates in the employee share scheme. Yet, there are owner-managed companies and family businesses that have employee share schemes in which the owners and/or their families would also participate. If this requirement were to apply, the entire employee share scheme would be caught, even in relation to non-connected employees. This would mean that the full loan by the company to the trust to acquire the shares would be tainted despite the lack of any tax avoidance intention.

3 7 2 Suggested solution by the South African Institute of Tax Professionals

Consideration should be given to apportioning the loan between the tainted portion and the excluded portion. In other words, to the extent that at least 20% owner/s (together with their connected persons) have a beneficial interest, the tax avoidance rules can apply.

3 8 Proposed amendment by Treasury and South African Revenue Services to clarify the rules relating to the taxation of employee share- based schemes

In order to address the anomaly arising from the interaction between section 8C(1A) of the Act and paragraph 80(2A), the proposed legislation adds new paragraph 64E into the Eighth Schedule (which deals with disposals by a trust in terms of a share incentive scheme). This legislation clarifies the amounts included in the employee’s income in terms of section 8C of the Act will be disregarded by the share incentive scheme for CGT purposes. In addition, changes will be made to paragraph 80(2) of the Eighth Schedule to clarify that these provisions will be subject to paragraph 64E of the Act. Paragraph 80(2A) of the Eighth Schedule will be deleted.

3 8 1 Commentary by the South African Institute of Tax Professionals

The amendment has been strongly welcomed by solving a longstanding problem.

3 9 Methods considered as a means of negating section 7C

Various methods of negating section 7C are discussed below. These methods have been encountered in practice.

3 9 1 The "in duplum" rule

The *"in duplum"*[412] rule originated from the South African common law and has been applied through South African case law for over 100 years.

3 9 1 1 Introduction

The main aim of the "*in duplum"* rule is to protect borrowers from exploitation by lenders that allow and, in some cases, cause interest to accumulate unabated leading borrowers into further indebtedness. In terms of the common law "in duplum" rule, interest charged on a debt stops to run (i.e. accrue) where the total amount of the unpaid interest equals the unpaid principal debt." A statutory *"in duplum"* rule was later introduced into South African law in the National Credit Act No. 34 of 2005 ("NCA") which came into effect on 1 June 2007.[413] The statutory "*in duplum"* rule is different from the common law "*in duplum"* rule in that the statutory *"in duplum"* rule applies to both unpaid interest and other finance related costs, whereas the common law *"in duplum"* rule only applies to unpaid interest. As a result, the statutory *"in duplum"* rule is regarded as being more onerous on credit providers and providing more protection for borrowers than the common law *"in duplum"* rule because the limit will be reached sooner given that other finance related costs that must be taken into account in respect of the statutory *"in duplum"* rule. Furthermore, the statutory *"in duplum"* rule overrides the common law *"in duplum"* rule in instances where a debt is regarded as a credit agreement governed by the NCA. However, in instances where a debt is not regarded as a credit agreement governed by the NCA, then the common law "*in duplum"* rule applies.

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[412] English translation from Latin of "*duplum"* is double. Latin Dictionary http://www.latin-dictionary.org/duplum. Accessed 29/10/2017.

[413] The statutory *"in duplum"* rule goes even further in its application as it provides for a limit on a number of costs, in addition to unpaid interest, which added together may not be more that the unpaid principal debt. These costs include initiation fees, services fees, credit insurance, default administration fees and collection costs.

3 9 1 2 Proposal by National Treasury:[414] *The introduction of section 7D*

It has come to Government's attention that some taxpayers are relying on the *"in duplum"*[415] rules to circumvent the above-mentioned anti-avoidance rules. Taxpayers rely on the "*in duplum"* rules to distort the quantification of the tax benefit derived from a zero or low interest loan between connected parties, on the difference between the amount of interest actually incurred and the amount of interest that would have been incurred at the official rate. These taxpayers claim that if a zero or low interest loan is advanced and the unpaid interest on that loan (and other costs, in the case of the statutory *"in duplum"* rule) reaches the amount of the unpaid principal debt, the *"in duplum" rules* apply to stop the interest (and other costs, in the case of the statutory *"in duplum"* rule) from running.[416] Consequently, if the *"in duplum"* rules apply, then the application of the current anti avoidance rules on the tax benefit on zero or low interest loans must also not be applied.[417] The anti-avoidance rules that deal with the tax consequences of zero or low interest loans in employer-employee relationships; shareholder-company relationships and natural connected person-trust relationships were introduced for purposes of determining the tax benefit derived from a zero or low interest loan between connected parties, on the difference between the amount of interest actually incurred and the amount of interest that would have been incurred at the official rate. They are meant to override all instances where interest is either not levied or levied at a rate below the market value, irrespective of whether the *"in duplum"* rule applies or not. It is proposed that clarification be made in the Act so that anti-avoidance rules dealing with zero or low interest loans should apply in spite of the application of either the statutory *"in duplum"* rule or the common law *"in duplum"* rule.This propsed amendment comes into effect on 1 January 2018 applies in respect of interest incurred or deemed to have been incurred on or after that date.

[414] National Treasury "2.6. Interaction between the "In duplum" rule and the statutory tax legislation." Explanatory memorandum on the Taxation Laws Amendment Bill, 2017 (Draft) 32- 34; Nel "Trusts and Deceased Estates Seminar 2017 *SAIT* 23.

[415] Refer to fn 410.

[416] National Treasury "2.6. Interaction between the "In duplum" rule and the statutory tax legislation." Explanatory memorandum on the Taxation Laws Amendment Bill, 2017 (Draft) 34.

[417] National Treasury "2.6. Interaction between the "In duplum" rule and the statutory tax legislation." Explanatory memorandum on the Taxation Laws Amendment Bill, 2017 (Draft) 32-34; Nel "Trusts and Deceased Estates Seminar 2017 *SAIT* 23.

3 9 2 The possibility of defeating section 7C with the prescription of debt

It has recently been submitted by certain trust practitioners that the effect of section 7C can be defeated by means of intuiting that the debt has prescribed.

3 9 2 1 Introduction

In terms of the Prescription Act,[418] prescription begins to run as soon as a debt is "due". Accordingly, an on-demand loan will ordinarily prescribe (or be extinguished) three years after the date on which the loan was advanced, unless prescription is interrupted by an express or tacit acknowledgment of liability by the debtor or the service on the debtor of any process whereby the lender claims payment of the debt.

3 9 2 2 Prescription as an argument in terms of on-demand loans

In the case of *Trinity Asset Management (Pty) Ltd v Grindstone Investments (Pty) Ltd*,[419] the lender had demanded repayment of the loan more than three years after the loan was advanced and the Supreme Court of Appeal held that the debt had prescribed by that time.[420] The Constitutional Court confirmed that the general rule is that a loan that is repayable on demand becomes due and, accordingly, prescription begins to run, as soon as the loan is advanced to the debtor.[421]

3 9 2 3 The viability of arguing prescription to counter section 7C

Scott[422] succinctly states:

> "In the absence of an express term regarding the commencement of prescription, it appears that the courts will consider contextual factors such as the

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[418] Section 10(1) and s11 of Act 68 of 1969.

[419] (1040/15) [2016] ZASCA 135.

[420] Scott *et al* "Prescription of on demand loans – The Constitutional Court's decision in Trinity v Grindstone" 2017 *Werksmans Legal Brief* (October). The argument was raised that if the parties clearly indicate that they intend demand to be a condition precedent for the debt to become due, prescription will only begin to run from the date of demand. However, the SCA did not decide this question as, in its view, it was far from clear that the parties had such an intention. This decision was taken on appeal to the Constitutional Court and on 5 September 2017 judgement in *Trinity Asset Management (Pty) Limited v Grindstone Investments 132 (Pty) Limited* [2017] ZACC 32 was handed down.

[421] Scott *et al* 2017: "This because the creditor has the exclusive power to demand that performance be made when the creditor so chooses. In reaching this conclusion, the Court referred to previous decisions in which it was held that a debt is due if the debt is immediately claimable by the creditor and the debtor is under an obligation to perform immediately in respect of the debt. In other words, a debt is due when the creditor's cause of action is complete, when everything has happened which would entitle the creditor to institute action and to pursue his or her claim."

[422] Scott *et al* 2017.

circumstances under which the loan agreement was entered into and whether the parties have a special relationship, such as a familial relationship. However, what constitutes a "clear indication" in certain circumstances may not necessarily be so in others and each loan agreement will have to be assessed on a case-by-case basis."

It is submitted, that as this prescription has not yet been tested in the context of section 7C, it will therefore also have to be handled on a case by case basis as indicated above. It is further submitted, based on both the Supreme Court of Appeal and Constitutional Court decisions,[423] that prescription could be a viable argument to defeat section 7C.

3 10 The impact of proposed amendments to section 25B – the so called "conduit pipe principle"

3 10 1 National Treasury and the South African Revenue Services are concerned about the possible abuse of trusts by means of income splitting opportunities and tax benefits that trusts offer taxpayers.

The *fiscus* is left with a smaller tax base due to the flexibility and flow-through nature of trusts.[424] According to Swart:

> "It can be concluded from the DTC's First *Interim* Report on Estate Duty that the main amendment to the taxation of trusts will be the abolishment of the conduit pipe principle. One of the foremost rationales behind this proposed repeal is due to the estate duty avoidance capability of a trust – hence, the DTC decided to propose very harsh income tax measures to reduce the tax attractiveness of a trust."[425]

The proposed amendments will lead to questions as to the viability of the trust as an estate planning tool.[426]

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[423] Refer to para 3 7 2 2 above.

[424] Petersen *Taxation of a trust: the impact of statutory anti-tax avoidance measures on the effectiveness of the discretionary family trust as an estate planning vehicle in South Africa* (LLM-dissertation University of Western Cape 2013) 10.

[425] Swart *Tax benefits of discretionary trusts: abolishment of the conduit pipe principle* (LLM mini-dissertation North-West University 2014).

[426] Petersen (LLM-Dissertation University of the western Cape 2013) 10: "It will thus be important for estate owners to consider these envisaged tax amendments when they come into operation, in order to ascertain the full extent of the implications and then it can also further be determined what the impact of these changes will be on the effectiveness of the discretionary family trust as an estate planning instrument in SA in the future."

3 10 2 Case study: A comparison between current and proposed legislation impacting the so-called "conduit pipe principle" and the impact thereof on the trust as an estate planning tool[427]

The Bruce Dixon Family Trust is a discretionary *inter vivos* trust. The trust has one beneficiary who is a natural person, aged 23, and a South African resident. The trust received the following amounts during the 2018 year of assessment:

(1) Proceeds from the disposal of a capital asset of the trust R1 500 000

(2) Interest received from South African investments R50 000

(3) Dividends received from South African investments R50 000.[428]

Assume for this scenario that the capital asset is not an allowance asset and that it has a base cost of R500 000. Table 1 depicts the income tax calculation of the trust and beneficiaries if the trustees decide to distribute all of the accruals in the trust to the beneficiary during the 2018 year of assessment.

(a) Trustees distribute all accruals to trust beneficiaries[429]

Table 2: Current income tax liability

Income tax liability of the **discretionary trust**	Amount (R)
Taxable income	0
Income tax of the **beneficiary**	Amount (R)
Gross income[430]	50 000
Less: Exemptions[431]	23 800
Income	26 200

[427] Swart *Tax benefits of discretionary trusts: abolishment of the conduit pipe principle* (LLM mini-dissertation North-West University 2014) 43 -48. Case study updated with current tax legislation. I also used new trust names although the actual case study is obtained from the dissertation of Swart.

[428] Dividends – Not taxable in hands of trust or beneficiary. Dividend withholding tax payable by company.

[429] The Bruce Dixon Family Trust has no taxable income, as all the mentioned accruals vest in the beneficiary in the same year of assessment in which the amounts were received by or accrued to the trust. At the discretion of the trustees, the amounts vested in the beneficiary. It is assumed in the scenario that the beneficiary receives no other income.

[430] Interest of R50 000.

[431] Refer to fn 323.

Add: Taxable capital gain[432]	384 000
Taxable income[433]	410 200
Ordinary income tax	97145[434]
Less: Primary rebate	13 635
Tax liability towards SARS	83 510

(b) Income tax of discretionary trust and beneficiary where the trustees do not distribute any accruals to the beneficiary

Table 3 illustrates the income tax liability should the trustees decide not to distribute any of the accruals to the beneficiary. In other words: all of the accruals are retained in the trust for the 2018 year of assessment.

Table 3: Current income tax liability[435]

Income tax liability of the **discretionary trust**	Amount (R)
Gross income[436]	50 000
Add: Taxable capital gain[437]	800 000
Taxable income	850 000
Ordinary income tax[438]	382 500
Tax liability towards SARS	382 500

432 Ch 2 Part 1 s26A , 8th Schedule Part II s3 (a) & Part II section 5(1) read in conjunction with Part II section 10 (a) of Act 58 of 1962. Calculation of the capital gain: ([1 500 000 – 500 000] –R40 000) x 40% = 384 000.

433 Assume that the beneficiary had no other income or accruals during the year of 2017.

434 The calculation of the normal income tax: 61 910 + 31% x (410 200 - 296 540) = 97 144,6 (rounded off to 97 145).

435 None of the accruals were distributed to the beneficiary (none were vested in the beneficiary) and therefore the amounts will not be taxed in the beneficiary's hands, but in the hands of the trust. Due to the fact that the trust is not a natural person, it does not qualify for the basic interest exemption.

436 Interest income R50 000.

437 Ch2 Part 1 s26A, 8th Schedule Part II section 3(a) read in conjunction with Part II section 10 (c) of Act 58 of 1962. Calculation of the capital gain: [1 500 000 – 500 000] x 80% = 800 000.

438 Calculation of ordinary income tax: 850 000 x 45% = 382 500. No primary rebate or annual exclusion or applies to trusts – refer to table 1 above where a primary tax rebate is applicable to the individual beneficiary.

(c) Income tax of discretionary trust where the trustees distribute all accruals to the beneficiary (after abolishment of the conduit pipe principle)

For the following calculation of the income tax treatment of the discretionary trust and its beneficiary, the same set of facts and amounts will be used as in (a) and (b) above, except that the income tax liability will be calculated in the light of the DTC's proposed changes and amendments (the abolishment of the conduit pipe principle). Table 4 indicates what the income tax treatment of the trust and the beneficiary will be if the trustees would decide to vest all of the accruals in the beneficiary in the 2018 year of assessment.

Table 4: Income tax liability after abolishment of conduit pipe principle[439]

Income tax liability of the **discretionary trust**	Amount (R)
Gross income[440]	50 000
Add: Taxable capital gain[441]	800 000
Taxable income	850 000
Deduct: Distribution to beneficiary of taxable income[442]	850 000
Tax liability of trust towards SARS	0

(d) Income tax of beneficiary where the trustees distribute all accruals to the beneficiary (after abolishment of conduit pipe)

Table 5 illustrates what the income tax liability will be for a discretionary trust and its beneficiaries when the DTC's proposed amendments take effect. It depicts how the calculation of taxable income will function from March 2016, after the changes in legislation have been enacted.

439 There will be no income tax consequences for the trust, because the distribution of the taxable income to the beneficiary is deemed a deduction for the determination of the trust's taxable income. R850 000 will be taxed in the hands of the beneficiary. With the abolishment of the conduit pipe principle, the income (interest and dividends) does not retain its nature. The combination of capital and exempt income accruals is distributed to the beneficiary as normal taxable income.

440 Interest R50 000.

441 Refer to fn 403.

442 The effect of the new amendments and proposals will be that the distribution of taxable income to a beneficiary will be deemed a deduction against the taxable income of the trust.

Table 5: Income tax liability after abolishment of conduit pipe principle[443]

Income tax liability of the **beneficiary**	Amount (R)
Taxable income received from discretionary trust	850 000
Taxable income	850 000
Normal tax	267 125[444]
Less: Primary rebate	13 635
Tax liability of beneficiary towards SARS	253 490

3 10 3 Conclusion: Impact of future abolishment of s25B

Should the proposed amendments be implemented, the original nature of the accruals will no longer be retained.[445] When the conduit pipe principle is applied to the above-mentioned scenario, the effective payment owed to SARS by the beneficiary for accruals received from the trust, amounts to R68 154. On the other hand, with the proposed abolishment thereof, the same beneficiary who received the exact same amount will have income tax liability towards SARS to the amount of R253 490. This is an alarming increase of about 200% in income tax.

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[443] The trust will not be liable for payment of any income tax, because the distribution of the taxable income to the beneficiary is deemed a deduction against the taxable income of the trusts for the relevant year of assessment. The amount distributed to the beneficiary vests in the beneficiary and therefore is taxable in the beneficiary's hands. Due to the abolishment of the conduit pipe principle, the accruals do not retain their original nature and that is why the beneficiary does not qualify to make use of the R40 000 annual exclusion, or the inclusion rate of 40% of net capital gains for purposes of capital gains tax. The beneficiary also cannot use the dividend or interest exemptions, since the beneficiary only received 'taxable ordinary income' under the new rules of taxation of trusts.

[444] Calculation of normal tax: 209 032 + 41% x (850 000 - 708 310) = 267 124, 90 (rounded to 267125).

[445] Brink *et al* "An investigation into the future of discretionary trusts in South Africa – an income tax perspective" 2014 *JEF* 795-818 812:"The scrapping of the conduit pipe principle, meaning that the amounts distributed to the beneficiaries will no longer retain their original identity and those amounts will become income in nature in the hands of the beneficiary. The beneficiary therefore does not qualify for the basic interest exemption, annual [CGT my emphasis] exclusion of R30 000 [Increased to R40 000 in 2018 - my emphasis] or the inclusion rate of 33.3%[40% 2018 my emphasis] of net capital gains for purposes of capital gains tax. Any distributions to beneficiaries would be treated as a deductible payment by the trust to the extent that there is current taxable income."

3 11 The trust as the tax payer of last resort

Although trusts are considered high taxpayers, it should be remembered that trusts are taxpayers of last resort.[446]The tables below compare the effective tax rates relevant to a trust with a company/closed corporation and individual to establish the viability of the trust as a tax payer of last resort. The scenario whilst the estate planner is alive is first considered, followed by the scenario at death.[447]

Table 6: Scenario whilst estate planner is alive

	Trust		Company/CC		Individual	
	Capital	Revenue	Capital	Revenue	Capital	Revenue
Income	R100	R100	R100	R100	R100	R100
Inclusion rate	80%	100%	80%	100%	40%	100%
Taxable income	R80	R100	R80	R100	R40	R100
Tax rate	36%[448]	45%	22.4%[449]	28%	18%[450]	45%
Taxation	R36	R45	R22,40	R28	R18	R45
After tax	R64	R55	R77,60	R72	R82	R55
Dividend tax @ 20%[451]	-	-	R15,52[452]	R14,40[453]	-	-
Total tax	**R36,00**	**R45,00**	**R37,92**	**R42,40**	**R18,00**	**R45,00**

[446] Van der Spuy (2017) 79.
[447] Van der Spuy (2017) 79.
[448] 45% trust tax rate x 80% inclusion rate.
[449] 28% company tax rate x 80% inclusion rate.
[450] 45% maximum marginal tax rate x 40%
[451] Ch 2 Part VIII s 64E(1) of Act 58 of 1962.
[452] Assumption that full after tax proceeds from capital gain distributed as dividends. R77.60 x 20%.
[453] Assumption that full after tax revenue distributed as dividends. R72 x 20%.

Table 7: Scenario upon death of estate planner[454]

	Trust	Company/CC	Individual
Gross personal estate value[455]	**-**	**-**	**R100**[456]
Estate duty payable	**-**	**-**	**R 20**
Total tax cost[457]	**-**	**-**	**R 38**

3 12 Conclusion

Analysing the results from the above comparison (table 6), it can be seen that government is in the process of closing the gap between income tax and capital gains tax, as well as between different taxpayers.[458] Van der Spuy further contends that the only exception is when capital gains are taxed in an individual's hands, but cautions against looking at this in isolation, submitting that government encourages people to hold assets in their personal names [estates][459] so as to access the assets upon death triggering both estate duty[460] and capital gains tax.[461] In addition executor's fees[462] need to be considered as well, bringing the total costs of merely winding up the estate [due to these costs and taxes][463] in excess of 30% of the gross estate value.[464]

Whilst it may be tempting and popular to consider that the trust is not viable as an estate planning tool from a tax perspective, it should be borne in mind that the

[454] My emphasis added to analysis by Van der Spuy in table 6 above.
[455] For purposes of this illustration assume s4A of Estate Duty Act abatement of R3,500,000 exhausted and that the estate planner is not married (s4q of the Estate Duty Act will not apply – discussed in ch 4 below)
[456] Value of company shares held by estate planner in personal estate.
[457] Capital gains tax (deemed disposal on death) + estate duty. For purposes of this example assume the R300 000 CGT exemption on death has been taken into account in terms of 8th Schedule Part II s 5(2) of Act 58 of 1962.
[458] Van der Spuy (2017) 79.
[459] My emphasis.
[460] 1st Schedule s1(a) of Act 45 of 1955.
[461] Van der Spuy (2017) 79; refer to table 7; refer to fn 399.
[462] S103(1)(a) of the Administration of Estates Act 66 of 1965.
[463] My emphasis.
[464] Van der Spuy (2017) 80.

avoidance of so-called "death taxes" and administration costs[465] will often outweigh the higher capital gains tax rate upon the actual disposal of assets by a trust, as illustrated above.[466] Capital gains tax is only payable by a trust upon the physical disposal of an asset resulting in a capital gain in contrast to assets deemed sold every time a person dies. This could occur a number of times over generations [an example would be assets transferred from one personal estate to another by bequest].[467] The result of this is indicated in the table 7 above where the maximum total tax cost[468] incurred by the individual for retaining assets (shares in this instance) is R38 or 38% whilst a trust would only incur a maximum of 36% effective capital gains tax on disposal of assets and no estate duty. A further advantage of the trust is the so-called "conduit pipe principle" to channel income and capital gains to trust beneficiaries. This can be further illustrated in the scenario where the trustees (of the trust) do not dispose of capital assets and retain them for current and future generations of beneficiaries, whilst making use of the so-called "conduit pipe principle" to channel income to such beneficiaries.[469] In this instance the effect of capital gains tax is negated as the trustees do not plan to sell capital assets. It is submitted, based on experience that this is a common practice in the farming community.[470] Swart[471] summarizes the tax position of trusts as follows:

> "It is clear from this study that the abolishment of the conduit pipe principle will adversely impact the taxation of trusts and their beneficiaries. Although trusts should never be created solely for the goal of attaining tax benefits, it was indicated throughout the study that the tax benefits posed by discretionary inter vivos trusts contributed greatly to its popularity as an estate planning instrument. The use of this type of trust will still prove to be an extremely beneficial estate planning instrument, due to its numerous other advantages, but estate planners and owners need to heed the word of caution with reference to the changes in

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465 Estate duty and executor's fees.
466 Van der Spuy (2017) 80.
467 My emphasis.
468 Refer to fn 421.
469 This income and gains are taxed in the hands of the beneficiary. Refer to para 3 8 2 1; *Armstrong v CIR* 1938 AD 343 10 SATC 1; Stiglingh et al *SILKE: Suid-Afrikaanse Inkomstebelasting* (2015) 877; Honiball *et al The Taxation of Trusts in South Africa* (2009) 72; *SIR v Rosen* 1971 1 SA 177 (A); *Estate Dempers v SIR* (3) SA 410 (A) SATC 36.
470 Morgan "Estate planning: Should I transfer my farm to company or trust?" 2017 *Money web* (Sept) https://www.moneyweb.co.za/mymoney/moneyweb-financial-planning/do-i-transfer-my-farm-to-a-company-or-trust-for-my-kids/ accessed 29/10/2017.
471 Swart *Tax benefits of discretionary trusts: abolishment of the conduit pipe principle* (LLM mini-dissertation North-West University 2014) 53.

the taxation of trusts. They need to be aware of these changes in order to make informed decisions as to who will receive income and capital and consequently who will carry the tax liability. SARS will always be skeptical towards trusts and this complication may prove to be only the beginning of a greater assault on trusts as the most effective and beneficial estate planning instruments for South African estate owners and trust parties."

Therefore, by taking in to account so-called "death taxes",[472] estate administration costs,[473] and analysis done by Swart,[474] it is submitted that whilst the so-called "conduit pipe principle" is still applicable[475] that the trust is still a viable estate planning tool in terms of taxation. This is confirmed by Nel[476] who agrees that the trust is still viable from a taxation perspective, especially when considering the impact of so-called "death taxes" on the estate planner's estate. Interestingly, Nel further submits that in the event of section 25B of the Income Tax Act (so-called "conduit pipe principle") being repealed, it would make practical sense for the marginal tax rate of trusts to be brought in line with that of the company i.e. 28% due to the risk of abuse in the form income splitting having effectively expired.

[472] Estate duty at 20%.
[473] Executors fees.
[474] Refer to fn 460.
[475] Swart LLM mini-dissertation NWU (2014) 49-50: "It is clear to see that the DTC's proposed amendments to the taxation of discretionary trusts will have a drastic negative effect for the beneficiaries of such trusts. When discretionary trusts lose their ability to act as flow-through instruments and able to only distribute taxable income, the beneficiaries are disqualified of making use of the basic-interest exemption, the dividend exclusion and the capital gains tax concessions that were usually available for natural persons. These amendments to the taxation of trusts will nullify any and all tax advantages that discretionary inter vivos trusts offered to natural person beneficiaries."
[476] Telephonic and e-mail conversation held on 08/11/2017.

Chapter 4: Other non-taxation uses of the trust resulting in the trust being a viable estate planning tool

4 1 Introduction

In this chapter other non-taxation uses of the trust as indicated in research question 1 3 3 are discussed. Cameron *et al,* for example, states:[477] "The flexibility of trusts contributes greatly to their popularity and the multifarious purposes to which they are put."

4 2 "Pegging" of asset values

This is achieved by selling growth assets to a discretionary family trust in which the founder, spouse and children are the beneficiaries. This is often achieved by means of structuring a loan account. All future capital appreciation will take place in the trust and not in the founder's estate, resulting in a significant saving in estate duty.[478] Tables 1 and 2 below illustrate the estate pegging advantages that the trust offers in terms of current legislation and practices implemented by financial planners.

Table 1: The pegging of asset values (example 1)

Assets: R1 000 000; Growth: 15% p.a.; Time frame: 5 years ; Death value: R2 000 000		
Option Selected:	Trust option Trust purchases R1 mil assets via loan account. Growth occurs within trust	Assets kept in estate Growth occurs within estate
Estate duty @ 20%	R200 000	R400 000

Firstly, it is evident from Table 1 that the estate duty payable by not using the trust option is doubled due to the assets at death being subject to estate duty.[479] Secondly, in practice, a loan account is often reduced through the founder writing down the loan account by means of setting off the R100, 000 annual donations

[477] *Honore's South African Law of Trusts* (2002) 19.
[478] Refer to ch 3 para 3 3.
[479] Section 2 read in conjunction with the 1st schedule of Act 45 of 1955.

exemption[480] against the original loan amount. In the example below based on the same figures, the founder reduces the loan by setting off R100, 000 per annum against the loan account. This is often merely an accounting entry in practice and not a physical cash exchange. Should the founder want to reduce the loan account which is seen as an asset within his estate even quicker by means of donation offset, he can donate an additional R100, 000 to his spouse[481], who then also donates R100, 000 to the trust which is set off against the outstanding loan[482] by the trust. I have illustrated this in Table 2 below:

Table 2: The pegging of value assets (example 2)

Assets: R1, 000, 000; Growth: 15% p.a. Time frame: 5 years; Future Value: R2 000 000	
Step 1: Trust purchases R1 mil assets from founder	Step 2: Founder donates R100,000 p.a. to trust as an offset against the loan for 10 years
Result: Estate duty payable after 10 years = Nil ; Assets to the value of R2,000,000 in trust	

This practice has however come under the spotlight, and hence the reason for section 7C of the Income Tax Act[483] being introduced.

4 3 Family succession planning, easy ownership and generation skipping

Assets forming part of a discretionary trust do not form part of the beneficiaries' personal estates and can therefore benefit future generations.[484] Whilst assets are held (by trustees) in trust and not disposed of, there is no capital gains tax

[480] Ch II Part V section 56 (2) Income Tax Act 58 of 1962.However, s7C has negatively impacted this practice. Refer to ch 3 para 3 3 for discussion on s7C.
[481] Ch II Part V section 56(1)(b) Act 58 of 1962.
[482] This repeal of section 12(5) of the Eighth Schedule to Income Tax Act 58 of 1962 enables a testator to bequeath his loan account back to (trustees of) the trust in terms of the will without triggering a capital gain for the trust (debtor).
[483] Act 58 of 1962; refer to ch 3 para 3 3.
[484] Refer to ch 2 para 2 3 2 2.

implication.[485] There is no complicated estates administration process as the trust continues until the trustees decide to wind it up.[486] Cameron *et al* states: "The trust accommodates the autocrat, present and posthumous, and the liberal... [T]he founder may give the beneficiaries fixed rights or may by setting up a discretionary trust allow trustees a wide discretion to give or withhold benefits and even to choose beneficiaries within a defined class."[487]

4 4 Anonymous ownership

Trust deeds are generally regarded as not being open for public inspection even though they are lodged with the master.[488] The trust affairs are generally regarded as being confidential and there is no need to disclose the identity of beneficiaries to the public.[489]

4 5 Limited liability of trustees

The trustees are only liable for debts in their representative capacity as trustees.[490]

4 6 Lack of regulation

Trusts are to a large extent regulated by South African common law. The Trust Property Control Act is not a codification of the law regulating trusts and does not place onerous regulatory requirements on a founder or trustees.[491] The benefits of the absence of such regulatory requirements are: (a) Trusts can be easily and quickly formed, and there is no detailed process required in forming a trust.[492] Section 4 of the Trust Property Control Act provides that a trust document must be lodged with the Master, however the trust itself does not have to be registered nor does it need to comply with any drafting or formation formalities;[493] (b) trust names are not regulated to the extent that names of companies and close corporations are

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[485] Refer to 8th Schedule Part III section 11 Act 58 of 1962 for what is a disposal; refer to ch 2 para 2 3 2 7 above for a discussion on capital gains tax impact should trust ultimately dispose of assets.
[486] Refer to ch 2 para 2 3 2 2.
[487] 20.
[488] Burger *The future of trusts as an estate planning tool* LLM dissertation NWU (2011) 138, Honiball *et al The Taxation of Trusts in South Africa* (2009) 12.
[489] Geach et al *Trusts Law and Practice* (2007) 219.
[490] Burger 137, *Ehrlich v Rand Cold Storage & Supply Co Ltd* 1911 TPD 170, Honiball *et al* 11; refer to ch 2 para 2 2 1 for discussion on insolvency of trustee.
[491] Burger 136, Honiball *et al* 10.
[492] Geach *et al* 217.
[493] Honiball *et al* 10.

regulated;[494](c) no limitation exists on a trust regarding the provision of financial assistance to obtain an interest in itself;[495](d) no rules regulate the maintenance of trust capital and [496] although any amendment to the trust deed has to be lodged with the Master, no other documents have to be lodged on a regular basis.[497]

4 7 Minimum accounting and disclosure requirements

There are no minimum accounting and disclosure requirements. Therefore, (trustees of) a trust are not obliged to appoint an auditor or even have audited financial statements prepared.[498]

4 8 Certain diseases such as dementia[499]

These diseases can affect a person's ability to manage their own affairs and are normally associated with old age. Carroll mentions that a power of attorney granted whilst the giver is still mentally competent will lapse when the giver is no longer mentally competent.[500] A curator will need to be appointed to care for this person which is costly and a lengthy process. A more viable option according to Carroll would be the trust[501] because:

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

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[494] Geach *et al* 217.
[495] Honiball *et al* 11.
[496] Honiball *et al* 11, Pretorius *et al Hahlo's South African Company Law through cases A source Book* 2012 125 refers to section 38 of the Companies Act 71 of 2008 which places restrictions on financial assistance for acquisition or purchase of shares. This is not only an extension of the capital maintenance rule but also has the purpose of preventing the abuse of control.
[497] Section 4(2) of Act 57 of 1988, Honiball *et al* 11.
[498] Geach *et al* 219.
[499] Alzheimer's is the most common form of dementia, a general term for memory loss and other intellectual abilities serious enough to interfere with daily life. Alzheimer's disease accounts for 60 to 80 percent of dementia cases http://www.alz.org/alzheimers_disease_what_is_alzheimers.asp.
[500] Carroll "Trust with endowment" *Witness Weekend* (25/08/2012) 15 accessed 10/10/2016. http://newmediadigital.co.za/glacier/September/media/25%20August%20Witness%20Weekend%020Money%20Trust%20with%20endowment%20Tiny%20Carroll.pdf
[501] Carroll 15.

4 9 The so-called "Special trust"

A "Special trust"[502] is categorised as a type "A" or type "B" special trust depending on the specific role (trustees of) the trust need to fulfil. Below is a brief discussion on the special trust:

4 9 1 Special trust for disabled persons

This is referred to as the "Type A" special trust. The aim of this trust is to benefit a person/s with a serious mental or physical disability as defined in section 1 and section 6B(1) of the Mental Health Care Act.[503] This person is unable to maintain themselves or manage their own affairs.

4 9 2 Special trust for surviving spouse and/or minor children

This is referred to a "Type B" special trust. The purpose of establishing this testamentary trust is to benefit relatives of the testator under the age of 18. In practical terms it means that a testamentary trust will qualify as a "Type B" special trust where all the beneficiaries are relatives (such as surviving spouse and descendants) provided one of them is still a minor[504]. According to Kernick this is the most common type of testamentary trust encountered in wills.[505] Table 3 illustrates the difference between a special trust and *inter vivos* "ownership" trust that can be summarized as follows:

Table 3: Difference between a special trust and *inter vivos* ownership trust

Special Trust (Type A and B):	Inter vivos ownership trust
Taxation	
Income distributed taxed in hands of beneficiaries[506] Income not distributed taxed as a natural person and not at a fixed tax rate of 45%	Income distributed taxed in hands of beneficiaries Income not distribute taxed at fixed tax rate of 45%

[502] Botha *et al The South African Financial Planning Handbook* (2013) 829.
[503] Act 17 of 2002.
[504] Eloff "Special Trusts" 2015 *Allegiance Consulting*.
[505] Kernick "Some thoughts on testamentary trusts" 2008 *De Rebus* 50.
[506] Section 25B of Act 58 of 1962. Refer to ch 3 para 3 8 for discussion on future of "conduit" principle.

Annual tax exclusion/rebates (CGT and Income Tax)	
Yes	No

Based on the results of the comparison in table 3, it is clear that the "special" trust has a tax advantage over the *inter vivos* "ownership" trust. I submit that the "special" trust therefore is an extremely viable method of providing for and benefiting persons that are unable to care for themselves particularly when the protection of assets[507] is considered in conjunction with the tax advantage enjoyed as mentioned. According to Stats SA in 2014, 13 676 (55,4%) of the 24 689 divorces had children younger than 18 years. About 22 218 children aged less than 18 years were affected by divorces that took place in 2014.[508] Parents are faced with the situation where the trust relationship no longer exists due to divorce and the minor children still need to be cared for and maintained. I therefore submit that in such a scenario, a viable option would be a testamentary trust to the benefit of the minor children should one of the parents die. This will ensure that the children's financial needs are provided for by (trustees of) the "special" trust whose fiduciary duty is at all times to administer trust capital and income for the best interests of the children.

4 10 The preferability of the trust over a usufruct[509]

The use of both the trust and usufruct is usually to achieve the same goal through very different means.

4 10 1 The benefits of a usufruct

In many cases, the testator wants to ensure that the surviving spouse, children and other members of the family are taken care of in the event of his/her death. This is often done by means of a usufruct in favour of the surviving spouse (usufructuary), while the bare dominium is bequeathed to a child or (trustees of) a trust (bare dominium holder). In such instances, where a usufruct is created in favour of the spouse, the client's deceased estate will be entitled to a substantial deduction in

[507] Refer to ch 2 for detailed discussion on protection.
[508] Statistics SA *Statistical release P307* http://www.statssa.gov.za/publications/P0307/P03072014.pdf accessed 27/10/2016.
[509] Abrie *et al Estate and Financial Planning* (2003) 139-142

terms of section 4(q) of the Estate Duty Act[510] as the value of the usufruct, depending on the life expectancy of the surviving spouse, is quite close to the value of the property in its entirety. While this is an advantage in the deceased estate, the payment of estate duty is merely being deferred to when the surviving spouse dies. It can also create a bigger capital gains tax liability when the bare dominium holder sells the property in the future. Benefits of the trust versus pitfalls of a usufruct are discussed below.

4 10 2 Benefits of the trust *versus* pitfalls of a usufruct[511]

(a) Flexibility in general

As indicated above[512] Cameron *et al* views this as one of the most important features of the trust. They indicate that the machinery of administration may be varied: the number of trustees, their mode of appointment and replacement, the system of management, the period of their appointment, their remuneration and (within limits) the degree of discretion entrusted to them, all depend on the intention of the founder as expressed in the trust instrument. The founder may him- or herself be a trustee and keep a close check on the management of the trust, and may reserve the right to nominate additional trustees and fill vacancies. Alternatively the founder may not be a trustee and may leave those appointed trustees the widest freedom to carry on business, invest, and sell as they think fit.[513] An example would be the scenario where the trust beneficiaries have to move from a farm to the city. In this case, the trustees could decide to sell the farm and apply the proceeds to the benefit of the beneficiaries by for example purchasing a house in the city. This option would not be possible with a usufruct.

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[510] S4(q): "so much of the value of any property included in the estate which has not been allowed as a deduction under the foregoing provisions of this section, as accrues to the surviving spouse of the deceased: Provided that—(i) the deduction allowable under the provisions of this paragraph shall be reduced by so much of any amount as the surviving spouse is required in terms of the will of the deceased to dispose of to any other person or trust; (ii) no deduction shall be allowed under the provisions of this paragraph in respect of any property which accrues to a trust established by the deceased for the benefit of the surviving spouse, if the trustee of such trust has a discretion to allocate such property or any income there from to any person other than the surviving spouse."

[511] Du Toit *South African Trust Law Principles and Practice* (2002) 166-167; Abrie *et al* 139-142.

[512] Ch 4 para 4 1.

[513] 20.

(b) Income flexibility

Income can be awarded to a trust beneficiary according to his/her needs and the balance retained within the trust, making provisions for contingencies. With a usufruct, the usufructuary is entitled to the entire income without retention of excess income for future contingencies.

(c) Costs

A trust costs more to administer than a usufruct due to trustee remuneration, trust books having to be written up each year and tax returns having to be filed, thus requiring an accounting officer.

(d) Indefinite duration

The duration of a trust may be adapted and may even be indefinite according to the circumstances whereas with a usufruct, the bare dominium holder will only inherit the farm outright upon the death of the usufructuary, irrespective of having attained age of majority or not. This could result in a minor inheriting a farm outright.

(e) Financing

Financing is more readily available to the trustees of a trust than to an owner of a fixed asset but burdened by a usufruct.

(f) Estate duty exemptions

Trust assets are not usually[514] liable for estate duty (therefore effective as an estate-pegging vehicle) whereas assets burdened by usufruct will attract estate duty.

(g) Protection of assets

Trustees of a trust can own any asset type and a usufruct can effectively be held over any type of asset. In practice usufructs are normally restricted to fixed property. The usufruct is registered in the deeds office and therefore fixed property can only be transferred upon cancellation of this registration. In terms of other types of

[514] Exception s3(3)(d) of Act 45 of 1955.

property no such protection exists. Should these other types of property be disposed of contrary to the usufruct agreement, the injured party will have very little recourse. In fact, the injured party is usually unaware of unauthorized behaviour prior to the disposal taking place. Trust assets, on the other hand are however protected as discussed in chapter 2 above.

(h) Warning: adherence to basic trust principles (the basic trust idea) and the importance of avoiding traps and pitfalls in the formation and/or administration of a trust

Although the trust is preferred to the usufruct, it is important to adhere to basic trust principles as discussed in chapter 2.[515]A number of traps and pitfalls need to be borne in mind when dealing with trusts according to Olivier:[516] These pitfalls include the "substance over form" principle, the serious intention to create a trust, control through the provisions of the trust deed, control through a letter of wishes, control by the beneficiaries and breach of fiduciary duty.

4 11 The viability of using the trust in terms of certain dispositions to a surviving spouse in order to save so- called "death taxes":[517] some questions from practice

The following questions are often asked from an estate planning perspective:[518]

- **Will a bequest to a trust of which the spouse is a beneficiary result in an estate duty exemption in terms of section 4q(ii) of the Estate Duty Act?**[519]

It has been confirmed through South African Revenue Services practice note 35 issued on 17 September 1994 in the decision handed down in *Income Tax Case*[520] that this exemption is applicable to bequests to a trust in favour of a surviving spouse. In order for this exemption to apply however, the surviving spouse needs to have a vested right to trust capital and/or income.

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515 For a detailed discussion of such traps and pitfalls see Olivier "Trusts: Traps and Pitfalls" 2001 *SALJ* 224 – 231 and the discussion on the abuse of the trust in ch2.
516 Olivier "Trusts: Traps and Pitfalls" 2001 *SALJ* 224 – 231.
517 Estate duty and capital gains tax.
518 Questions I receive as a Fiduciary specialist employed by Momentum trust Ltd.
519 Act 45 of 1955.
520 *1520* (54 SATC 168).

Criticism of the need for a vested right in term of section 4q(ii)

It is submitted that having a vested right to trust property and/or income as a beneficiary is problematic. The surviving spouse's vested right to trust capital and/or income would fall within his/her personal estate on death. The estate of the vested beneficiary would therefore not be pegged.[521] The property held in trust by the trustees or income over which there is a vested right would possibly have increased in value prior to the vested beneficiary's death. This vested right and resultant claim against trust capital/income would be subject to estate duty and executors fees in the deceased beneficiary's estate. In addition, trust capital and/or income are also attachable in the instance of the vested beneficiary going through a divorce[522] and/or experiencing financial difficulties such as insolvency.[523] I submit that section 4q(ii) of the Act therefore has limited value as far as estate planning is concerned. It may only be of value in the instance where the surviving spouse is unable to administer his/her own affairs and as a result thereof, a trust needs to be established whereby trustees can administer these vested rights on behalf of the surviving spouse.

- **Is the so-called "one-year wonder still viable?**[524]

The aim of the one year usufructuary interest scheme commonly referred to as the "one year wonder" is to result in reduction of estate duty payable on both the deaths of the testator and his/her spouse. This is done by the estate owner bequeathing the bare dominium to (trustees of) the trust and use thereof by means of a successive usufruct to the surviving spouse for the duration of her lifespan and for 1 year thereafter to a child. The usufruct in favour of the spouse is excluded from the payment of Estate Duty in terms of section 4q(i) of the Act. The estate duty payable on the successive usufruct is determined in terms of section 5(1)(b)[525] of the Act as

[521] Refer to ch 4 para 4 2 1 for a discussion on "estate pegging".

[522] *Badenhorst v Badenhorst* 2006 2 SA 255 (SCA) - assets taken into account in divorce proceedings belonging to (trustees of) the trust. This was not a vesting trust but a discretionary trust where the founder still appeared to have full control over trust affairs. As a result these assets were taken into account in terms of s7(3) of the Divorce Act 70 of 1979. The argument to be made, based on this decision is that on divorce therefore a vested right will most certainly be taken into consideration as it forms part of the beneficiary's estate.

[523] Refer to ch 2 for a detailed discussion on protection against divorce and insolvency.

[524] With specific reference to the combination of a trust and usufruct.

[525] "… in the case of any such fiduciary, usufructuary or other like interest in property as is referred to in paragraph (a) of section 3(2), an amount determined by capitalizing at twelve per cent the annual value of the right of enjoyment of the property in which the deceased held any

Footnote continuous on next page

the lesser of life expectancy of the successive usufructuary or period stipulated (usually 1 year).

Example of one-year usufructuary interest scheme[526]

Let's assume a family where the husband is 73 and wife 65. They are married by *antenuptual* contract and have a grown son of 40 years old. The husband's estate consists of property of R2 800 000 and other assets of R1 000 000. The husband bequeaths a usufruct over the property in favour of the wife. Upon the wife's death, the usufruct will pass to the eldest son for a period of one year. Upon completion of the one year, the usufruct will pass to the (trustee of) family *inter vivos* trust for perpetuity. We will only consider the scenario where the husband dies first in the example below:

(a) Value of bare dominium and initial usufruct

The bare dominium is valued as follows in the husband's estate:

- Market value - usufruct value (below) (R 2.8 m – R 2 298 780) = R 501 220.
  The bare dominion (R501 220) + R 1 000 000 assets passes to the family trust.
  Estate duty = (R 1 501 220 – R 3 500 000[527]) x 20% = R0.

The initial usufruct in favour of the spouse is calculated as follows:

- Market value x 12% x life expectancy of usufructuary (wife) discounted at 12%:

[(R 2.8 m x 12%) x 6.84161] = R 2 298 780.

(b) Death of surviving spouse (usufructury) and value of successive usufruct

The wife dies a year later. The usufruct is now left to the son and is calculated the same way as above but based on a fixed term of 1 year.

Market value x 12% x 1 year period discounted at 12%:

- [(R 2.8 m x 12%) x 0.8929] = R 300 014.40.

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such fiduciary, usufructuary or other like interest, to the extent to which the person who upon the cessation of the said interest of the deceased in consequence of the death of the deceased becomes entitled to any right of enjoyment of such property of whatever nature, over the expectation of life of such person, or if such right of enjoyment is to be held for a lesser period than the life of such person, over such lesser period:…".

[526] Richter Life "Using usufructs for estate planning" 2004 *Independent Focus* accessed 21/10/2016 – updated ito 2016 legislation ito s4A abatement. http://www.i-focus.co.za/usufruct.htm.

[527] Abatement ito s4A of the Act.

- Total value of her estate (usufruct and other assets of R1 000 000) = R1 300 014.40.

Estate duty payable = R0 (less than R 3 500 000).[528]

Result: Total estate duty paid after both deaths = R 0.

Final remarks: viability of the "one year wonder" usufructuary interest scheme

There is uncertainty around the viability of using the "one year wonder" going forward based on comments made by Trevor Manuel to close down[529] the operation thereof in the 2009 budget review. However, the proposed amendments were not proceeded with. Van Gijsen[530] suggests that the rationale for not proceeding was due to there not being a loss to the *fisucus* as the use of limited interests has the effect of reducing the base cost of an asset for capital gains tax purposes. By expanding on van Gijsen's opinion it is evident that should the trust ultimately sell the assets, the South African Revenue Services will regain revenue through the increased capital gains tax payable based on the lowered base cost. It however is submitted that this practice should nevertheless be discouraged due to the future viability thereof, particularly in light of the Davis Tax Committee[531] having been established. Part of the DTC recommendations are that trusts be more closely examined[532] as well as *bare dominium* and *usufruct* agreements.[533] In conclusion, it is submitted that it is a matter of time before this tax "loophole" is closed.

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[528] Abatement ito s4A of the Act.

[529] Budget 2009/10 24 accessed 21/10/2016. http://www.treasury.gov.za/documents/national%20budget/2009/guides/Budget%20Proposals%202009.pdf.
"*One-year usufructuary interest schemes:* A commonly known one-year usufructuary scheme exists in the market that allegedly undermines the estate duty. This scheme involves the estate duty-free transfer of a life-time usufructuary interest to a spouse, with the children receiving the bare dominium. On the death of the spouse, the usufructuary interest is transferred with a one-year interest going to a person, after which the remaining rights transfer to the intended heirs. The scheme essentially relies on the misapplication of the 12 per cent per annum valuation presumption in the context of a one-year interest. This scheme will accordingly be closed."

[530] Van Gijsen "Calculating the bare dominium value of property subject to successive usufructs" *Insurance and Tax Journal* 2013 accessed 21/10/2016. https://www.fisa.net.za/wp-content/uploads/2013/10/Bare-dominium.pdf.

[531] Hereinafter referred to as DTC.

[532] Refer to ch5 para 5 1.

[533] DTC presentation to Standing Committee of Finance 29/11/2016.Refer to ch 5 para 5.

- **Are policy proceeds payable to a trust in favour of a surviving spouse or children exempt from estate duty in terms of section 3(3)(a)(i) of the Estate Duty Act.**

Momentum Trust Ltd confirms that 98% of clients that they engage are married out of community of property of which 60% exclude the accrual.[534] This is of relevance as for section 3(3)(a)(i) of the Estate Duty Act to apply there needs to be an ante nuptial contract.[535] The financial planning opportunity here comprises the application of section 3(3)(a)(i) of the Estate Duty Act[536] which provides that any domestic policy recoverable by a surviving spouse or child of the deceased under a duly registered ante nuptial or postnuptial contract is excluded from the definition of deemed property and therefore exempt from Estate Duty. The question that arises that is of significance to this study is whether section 3(3)(a)(iA) will apply in cases where policy proceeds pay out to either a *mortis cause* or *inter-vivos* trust to the benefit of a surviving spouse and/or children of the deceased. It is submitted that the definition recoverable is wide enough to include the instance of policy proceeds paying into a trust (*mortis causa* or *inter-vivos*) to the benefit of the children/and or spouse of the deceased and should result in the proceeds thereof being excluded from Estate Duty. It is of interest to note that this financial planning technique combining the provisions in terms of section 3(3)(a)(iA) of the Act with the establishment of a trust is often overlooked by estate planners. This often overlooked opportunity affords the estate planner the ability to protect assets for minor children by means of a trust whilst at the same time saving on estate duty. It is therefore this protection of assets and a tax saving in conjunction that strongly endorses the argument in favour of the trust being a viable estate planning tool.

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[534] Weyer" A perfect wedding gift…Have you considered the real cost of not including the provisions of Section 3(3)(a)(i) of the Estate Duty Act in an ante-nuptial contract?" 2016 *Momentum Leverage.*

[535] From these statistics it would appear that most couples are marrying out of community of property with/without accrual.

[536] "Property which is deemed to be property of the deceased includes—
(a) so much of any amount due and recoverable under any policy of insurance which is a 'domestic policy', upon the life of the deceased as exceeds the aggregate amount of any premiums or consideration proved to the satisfaction of the Commissioner to have been paid by any person who is entitled to the amount due under the policy, together with interest at six per cent per annum calculated upon such premiums or consideration from the date of payment to the date of death: Provided that the foregoing provisions of this paragraph shall not apply in respect of any amount due and recoverable under a policy of insurance, if— (i) the amount due under such policy is recoverable by the surviving spouse or child of the deceased under a duly registered *ante-nuptial or post nuptial* contract;".

In conclusion therefore, it is submitted that of the three scenarios discussed, the only viable scenario is the third scenario where policy proceeds payable to a trust in favour of a surviving spouse or children are exempt from estate duty in terms of section 3(3)(a)(i) of the Estate Duty Act. This is due to the so-called one year wonder being under the spotlight of SARS as discussed above and the application of section 4q(ii) requiring vesting in the hands of the surviving spouse, resulting in the testamentary disposition therefore to the trust falling within her estate for estate duty purposes.

4 1 2 Conclusion

It is submitted, based on the discussion above, that the trust is still a viable estate planning tool in view of the non-taxation uses of the trust. This is in addition to the trust as a protection mechanism of assets which was discussed in depth in chapter 2.

Chapter 5: Conclusion

This mini-dissertation investigated the viability of the trust as an estate planning tool.

In chapter 2 it has been established that the trust is a viable protection mechanism of assets provided that there is not an abuse of the “trust form”. This discussion particularly reflected on the protection of assets upon the insolvency of one of the parties to a trust and the effect of the abuse of the trust in the event of the sequestration of the founder’s estate, or upon divorce. The conclusion was reached that a properly drafted discretionary ownership trust document and the proper administration of such a trust in terms of adherence to basic trust principles can indeed serve as protection mechanism in the above mentioned scenarios.

In chapter 3, the impact of taxation on the viability of the trust as an estate planning tool was discussed. Section 7C has changed the landscape pertaining to the flow of money to trust in the form of interest-free/low interest loans and has therefore had a negative impact on connected parties involved in lending to trusts. This legislation is ever evolving so as to counter evolving methods of reducing the efficacy thereof. It is further submitted that the abolishment of the conduit pipe principle will adversely impact the taxation of trusts and their beneficiaries. It is submitted that despite the recent legislative interventions the trust is still viable, albeit to a limited degree, from a taxation perspective.

Chapter 4 briefly discussed various non-taxation uses of the trust, although the primary focus of this mini-dissertation was on the trust as protection mechanism and viability in terms of taxation. The conclusion was reached that because of the non-taxation uses the trust is still a viable estate planning tool.

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