

**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**

A thesis submitted in fulfilment of the
requirement of the degree of

MASTER OF LAWS

of

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by

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DECLARATION

I acknowledge that all references are accurately recorded and that, unless otherwise stated, all work herein is my own. I certify that this thesis has not been submitted for a degree at any other university.

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15 December 2010

ABSTRACT

This thesis analyses the doctrines of the sham and the alter-ego and their application to the law of trusts in South Africa. Following an initial examination of the historical development of the law of trusts in English law and the principles of equity law, the study focuses on the current legal status of the trust *inter vivos* in South Africa and the similarities to its English forerunner. The work traces the sham doctrine back to its origins in English law, where the term “sham” was first used in the context of fraud and dishonesty in cases involving matters arising from hire-purchase agreements, and explains how it gradually began to find its place in the law of trusts. During the exploration, the work highlights the cornerstone of the sham doctrine’s development, the *Snook* test, which in effect became the internationally accepted guideline for any sham trust enquiry. In terms of the alter-ego doctrine, the work highlights the birth of the principle in Australian law and the doctrine’s immediate reception into other common law jurisdictions and its resultant development. The growth, maturity and popularity of the doctrines are key to the thesis and, in the course of the investigation, the study provides a legal-comparative analysis of the treatment of the doctrines in the context of trusts against that in other common law countries. The study then shifts its focus to South Africa’s interpretation and application of these doctrines in trust law, and reveals the erroneous judicial development in which the courts have in some instances mistakenly replaced the sham doctrine with the company law doctrine of piercing the corporate veil or, in other instances, have erroneously conflated the two trust doctrines. The results highlight a breach of a fundamental rule observed overseas – the “no half way house” rule, which specifically cautions against South Africa’s chosen direction when allowing the lifting of a trust’s veil. The study closes with suggestions as to how the country could reconcile the problems underlined in the thesis by means of law reform, as well as offering practical advice for settlors, trustees and beneficiaries, the core of which is given in the handbook that accompanies this thesis.

“Certainty is the principle virtue of every legal system”

A Oakley
Constructive Trusts 3 ed (1997) Sweet & Maxwell: London.

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TABLE OF CONTENTS

Declaration	ii
Abstract	iii
Acknowledgments	v
Table of Contents	vi
List of Authorities and Mode of Citation	ix
Table of Cases	xvii
Table of Statutes	xxx
Abbreviations	xxxix
CHAPTER 1 THE CONTEXT, GOALS AND METHODOLOGY	
1. A brief context	1
2. Goals of the study	5
3. Methods and structure	7
CHAPTER 2 TRACING THE DEVELOPMENT OF THE SOUTH AFRICAN LAW OF TRUSTS	
1. Definition of “trust”	9
2. Historical overview	11
2.1 The German <i>Treuhand</i>	12
2.2 The English Law of trusts	12
2.3 The Law of Equity	14
2.4 The identity of the South African law of trusts	17
3. The nature, use and main features of trusts	19
4. Different types of trust	21
4.1 The testamentary trust	21
4.2 The <i>bewind</i> trust	23
4.3 The trust <i>inter vivos</i>	23
5. Parties to a trust and the nature of the trust instrument	25
5.1 The nominee settlor	25
5.2 The settlor	26
5.3 The trustee	27
5.4 The beneficiary	32
6. The formation of a trust	35
6.1 Intention	36
6.2 Obligation	37
6.3 Property	38
6.4 Object	41
6.5 Legality	42
7. Good Business Practice	45
8. Conclusions	47

CHAPTER 3	THE LAW OF TRUSTS POST <i>PARKER</i>	
1.	Introduction	48
2.	The <i>Parker</i> case	49
3.	The <i>Badenhorst</i> cases	53
	3.1 The court of first instance	53
	3.2 The appeal	55
4.	The <i>Van der Merwe</i> case	59
5.	Conclusions	65
CHAPTER 4	THE DOCTRINES OF THE “SHAM”, THE “ALTER-EGO” AND “THE PIERCING OF THE CORPORATE VEIL”	
1.	Introduction	68
2.	The doctrine of the sham	70
	2.1 Foreign law precedent	70
	2.1.1 Sham transactions	70
	2.1.2 Sham trusts	78
	2.1.3 The sham synopsis and the proof thereof	97
	2.1.3.1 Foreign sham trust cases subsequent to the <i>Snook</i> judgment	97
	2.1.3.2 Ascertaining the true nature of the transaction	101
	2.1.3.3 Onus and burden	106
	2.1.3.4 The emerging sham	107
3.	The doctrine of the alter-ego	109
	3.1 Foreign law precedent	110
	3.2 The alter-ego synopsis	121
4.	The Interrelationship of the doctrines of the sham and the alter-ego	123
5.	The doctrine of piercing the corporate veil	125
	5.1 Introduction	125
	5.2 A brief theoretical exposition on the doctrine of piercing the corporate veil	127
6.	Conclusions	131
CHAPTER 5	COMPARATIVE ANALYSIS	
1.	Introduction	134
2.	The rights of beneficiaries?	135
3.	The contradictions in South African Trust Law	145
	3.1 The interrelationship of the doctrines of the sham and the alter-ego	146
	3.2 The compatibility of the doctrine of piercing the corporate veil	150
	3.3 Sham trusts	157

3.4	Alter-ego trusts	167
4.	The Consequences of finding a trust to be a sham or an alter-ego	172
4.1	The strict academic approach	173
4.2	The intermediate-equity approach	175
5.	Conclusions	176

CHAPTER 6 RECOMMENDATIONS AND CONCLUSIONS

1.	Introduction	179
2.	Recommendations	181
2.1	The trust instrument	181
2.1.1	Drafting	181
2.1.1.1	Generally	181
2.1.2	The formation of a sound trust instrument	184
2.1.3	Scope of the amendment power	186
2.1.4	Protection clauses	192
2.1.5	Control through provisions in the trust instrument	195
2.1.6	Beneficiary control over trustees	197
2.2	The settlor	198
2.3	The trustees	200
2.3.1	Choosing trustees	201
2.3.1.1	Settlors as trustees	201
2.3.1.2	Independent non-professional trustees	202
2.3.1.3	Independent professional trustees	203
2.3.2	Trustee ethics and duties	207
2.4	Disclosure of information	210
2.5	Legal technicalities	215
2.5.1	Redefining sham and alter-ego trusts in South Africa	215
2.5.2	Ratification	216
3.	Conclusions	218

APPENDIX

A.	A Developed Trust Instrument – The Smith Family Trust Model	224
B.	Trusts – A Guide for Founders, Trustees and Beneficiaries	

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National Westminster Bank plc v Jones [2001] 1 BCLC 98

P

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R v Dimsey [2000] QB 744

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S

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Saunders v Vautier 1841 (4) Beav 115

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Shalson and Others v Russo and Others [2003] EWHC 1637

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V

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Y

Yorkshire Railway Wagon Co. v Maclure (1882) 21 ChD 309

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B

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Gregory v Helvering, Commissioner of Internal Revenue [1935] 293 US 465

H

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K

Kadota Fig Association of Producers v Case-Swayne Co 73 Cal App 2d 796, 167 P 2d 518 (1946)

M

Markosian v Commissioner (1980) 73 TC 1235

P

Priestley v Treasurer & Receiver General 120 NE 100, 230 Mass 452 (1918)

S

Simson v Klipstein 262 Fed 823 (1920)

TABLE OF STATUTES

South Africa

The Administration of Estates Act 66 of 1965

The Alienation of Land Act 68 of 1981

The Close Corporations Act 69 of 1984

The Companies Act 71 of 2008

The Constitution of the Republic of South Africa 1996

The Deceased Estates Act 66 of 1965

The Deeds Registries Act 47 of 1927

The Divorce Act 70 of 1979

The Estate Duty Act 45 of 1955

The Income Tax Act 58 of 1962

The Promotion of Access to Information Act 2 of 2000

The Trust Property Control Act 57 of 1988

The Value Added Tax Act 89 of 1991

Australia

The Trusts Act of 1973

The United Kingdom

The Rent Act of 1977

ABBREVIATIONS

A	Appellate Division (SA)	EDL	Eastern Districts Local
AC	Appeal Cases (UK)		Division Reports (SA)
AD	Appellate Division (SA)	(Edms) Bpk	Private Limited Company (SA)
Adv	Advocate	eg	for example
AJ	Acting Judge	Eq	Equity Court (UK)
AJA	Acting Judge of Appeal	ER	English Reports (Reprint)
All ER	All England Reports	<i>et al</i>	and others
All SA	The All South African Law	EWHC	High Court of England and
	Reports (SA)		Wales Reports
ALR	Australian Law Reports	FamCA	Family Court of Australia
ALJR	Australian Law Journal	ff	and following
	Reports	FLC	Family Law Cases (UK)
ATC	Australian Tax Court Reports	FLR	Federal Law Reports
BCLR	Butterworths Constitutional	fn	footnote
	Law Reports (SA)	GenN	General Notice
C	Cape of Good Hope	HC	High Court
	Provincial Division Law	HL	House of Lords (UK)
	Reports (SA)	<i>Ibid</i>	In the same place
CA	Court of Appeal (UK)	Ie	That is
<i>Cambridge LJ</i>	<i>Cambridge Law Journal</i>	ILR	International Law Reports
CC	Close Corporation (SA); or	J	Judge; or Justice
	Constitutional Court (SA)	JA	Judge of Appeal
Cf	Compare	<i>JBL</i>	<i>Journal of Business Law</i> (UK)
Ch	Chancery Law Reports (UK)	JDR	Juta's Daily Reports (SA)
Ch D	Chancery Division Law	<i>JOL</i>	<i>Judgments online</i>
	Reports (UK)	<i>JJS</i>	<i>Journal for Judicial Science</i>
<i>CILSA</i>	<i>Comparative and</i>	JLR	Jersey Law Reports
	<i>International Law Journal of</i>	KB	King's Bench Division
	<i>Southern Africa</i>		Reports (UK)
CIR	Commissioner for Inland	LAWSA	The Law of South Africa
	Revenue	Lloyd's Rep	Lloyd's Reports (UK)
CJ	Chief Justice	LQR	Law Quarterly Review
CLR	Commonwealth Law Reports	LR	Law Review
CPD	Cape of Good Hope	Ltd	Public Company (SA)
	Provincial Division Reports	<i>MUELJ</i>	Murdoch University
CTR	Cape Times Reports (SA)		Electronic Journal of Law
D	Durban & Coast Local	N	Natal Provincial Division
	Division (SA)	<i>NJLJ</i>	<i>New Jersey Law Journal</i>
DP	Deputy President	NLR	Natal Law Reports
<i>DR</i>	<i>De Rebus</i>	NPD	Natal Provincial Division
E	Decision of the Eastern Cape		Reports
	Provincial Division (SA)	NSWLR	New South Wales Law
ed	edition; or editor		Reports (Australia)
EDC	Eastern Districts Court	NZCA	New Zealand Court of Appeal
	Reports		Reports

NZFLR	New Zealand Family Law Reports	ss	sections
NZHC	New Zealand High Court Reports	STC	Simon's Tax Cases
NZLR	New Zealand Law Reports	<i>Stell LR</i>	<i>Stellenbosch Law Review</i>
O	Orange Free State Provincial Division (SA)	Str	Strange's King's Bench Reports (UK)
<i>Oxford LJ</i>	<i>Oxford Law Journal</i>	T	Transvaal Provincial Division
para	paragraph	TC	Official Tax Case Reports (UK)
paras	paragraphs	TH	Transvaal High Court Reports
PC	Privy Council (Commonwealth)	<i>THRHR</i>	<i>Tydskrif vir Hedendaagse Romeins-Hollandse Reg</i>
(Pty) Ltd	Private Limited Company (SA)	TPD	Transvaal Provincial Division Reports
(Pvt) Ltd	Private Limited Company (Zimbabwe)	TS	Transvaal Supreme Court Reports
QB	Queen's Bench Division Reports (UK)	<i>TSAR</i>	<i>Tydskrif vir die Suid-Afrikaanse Reg</i> (Journal of South African Law)
Rep	Reports	UK	United Kingdom
s	section	UKHL	United Kingdom House of Lords
SA	South African Law Reports	US	United States
<i>SAC LJ</i>	<i>Singapore Academy of Law Journal</i>	U.S.	United States Reports
<i>SALJ</i>	<i>South African Law Journal</i>	viz	that is
S.A.R.S.	The South African Revenue Service	Vol	Volume
SC	Decision of the Supreme Court or Cape Supreme Court Reports (SA)	VR	Victoria Reports (Australia)
SCA	Supreme Court of Appeal (SA)	W	Witwatersrand Local Division (SA)
SCC	Supreme Court of Canada	WAR	West Australian Reports (Australia)
SECLD	Decision of the South Eastern Cape Local Division	WLD	Witwatersrand Local Division Reports (SA)
SR	Southern Rhodesia Law Reports (Zimbabwe)	WLR	Weekly Law Reports (UK)
SR (NSW)	New South Wales State Reports (Australia)	WTLR	Wills Trusts Law Reports
		<i>Yale LJ</i>	<i>Yale Law Journal</i> (US)

CHAPTER 1

THE CONTEXT, GOALS AND METHODOLOGY

1. A BRIEF CONTEXT

Many people, often without realising it, will come into contact with a trust in one form or another at some point in their lives. Be that as it may, it is submitted that trusts are widely misunderstood by those who use them, wish to use them, or adjudicate disputes concerning them. Trusts have become a global phenomenon, although they are most commonly found in those countries where the legal system has its roots in English law. South Africa is no exception, having used this legal institution since the turn of the 19th century. Today trusts are a vibrant and authentic institution of modern South African law for which the courts have devised distinctively South African rules and principles,¹ and for which new uses are constantly being developed. After years of academic thought, the South African Legislature introduced the Trust Property Control Act,² which came into operation on 1 March 1989 and sought to introduce an authoritative statutory definition of, amongst other things, “trust”, “trustee” and “trust instrument” into South African law.³ The Act is concise and seeks only to regulate certain administrative aspects of a trust, and also to empower the Master of the High Court to oversee and act in certain ways in respect of trust affairs and to impose certain duties on trustees.

Today’s law of trusts is therefore no longer confined to the traditional common law principles that previously existed. Since the implementation of the Constitution of the Republic of South Africa, 1996, together with the functioning of the Act, South African courts have become obliged to give the fullest protection to the beneficiaries of an *inter vivos* trust and, in so doing, keep a watchful eye on miscreant trustees. However, unlike most other common law jurisdictions, the *inter vivos* trust in South Africa is based on the law of contract and not the law of equity. The consequence of the above is a seeming mismatch of beneficiary rights and trustee obligations, and a mountain of legal disparities.

¹ E Cameron *et al Honoré’s South African Law of Trusts* 5 ed (2002) 2.

² Act 57 of 1988. Hereafter referred to as “the Act”.

³ Cameron *et al Honoré’s South African Law of Trusts* 2.

Trusts are, in principle, a simple concept whereby a private legal arrangement transfers the ownership of someone's assets (commonly the settlor)⁴ to a small group of people (referred to as the trustees) to look after and use to benefit a defined (or reasonably identifiable) group of beneficiaries. The newly transferred assets thereby fall under the protection of the trust's veneer (or veil) and thus fall outside the scope of a settlor's (or trustee's) estate. In the process, the trust assets cannot be used in settlement of any claims against the estates of a settlor or trustee.

In 2005 one of the most significant developments in trust law since the promulgation of the Act occurred when the Supreme Court of Appeal (SCA) handed down judgment in *Land and Agricultural Bank of South Africa v Parker and Others*.⁵ Cameron JA, writing a unanimous judgment, noted that a trust, although a useful instrument in the management of assets, is often exploited for the protection it offers.⁶ The learned judge reasoned that in the light of the widespread abuse of the trust form, it may be necessary to extend the well-established principles of company law to trust law. In particular, the court necessitated the importation of the doctrine of piercing the corporate veil, as well as the future possibility of also extending the *Turquand* Rule⁷ in the same manner.

The outcome of the *Parker* judgment is that the courts are now able to 'pierce the veneer' of a trust, should the conduct of its trustees invite the inference that the trust form was a mere façade for conducting a business "as before", and that assets allegedly vested in trustees in fact belong beneficially to one or more trustees.⁸ Under such circumstances, the veil will be lifted, and the trust property which was once protected by the trust becomes exposed to the claims of third-party creditors.

This study therefore analyses the newly founded risk now faced by thousands of South African trusts of being set aside by the courts as "alter-ego" or "sham" trusts. In particular,

⁴ The term "settlor" is synonymous with "founder" in the Trust Property Control Act.

⁵ 2005 (2) SA 77 (SCA).

⁶ Paras 23–24.

⁷ Based on the rule developed in *Royal British Bank v Turquand* 1856 119 ER 866.

⁸ Para 37.3.

the research focuses on recent important judgments, including the decision of Cameron JA in *Parker* and the resultant ripple-effect of the judgment in subsequent cases, such as *Van der Merwe NO and Others v Hydraberg Hydraulics CC and Others*; *Van der Merwe NO and Others v Bosman and Others*.⁹ Recent South African cases have ultimately led to a law of trusts skewed by judicial development.

Although the South African courts acknowledge and often “make use” of the doctrines of the sham and the alter-ego, a lack of investigation and understanding of these delicate principles has over the past five years led to many unwarranted developments. In the matter of *Badenhorst v Badenhorst*,¹⁰ the SCA once again sought to develop trust law, and the ripple-effect of the *Parker* judgment became apparent. What is evident from *Badenhorst* is that the courts are willing to pierce the trust should they find the trust to be the alter-ego of the settlor.

An examination of trust doctrines reveals many details which South African courts have erroneously not taken note of. To begin with, the doctrine of the “sham” has its origins in English law. The *Snook* test,¹¹ which sets out the shamming status of any transaction, is unanimously accepted in Australia, New Zealand, Canada and the United Kingdom. This test has been adopted and readily applied in the majority of sham trust cases abroad and, in summary, requires there to be a common intention between the settlor and at least one trustee to mislead or deceive third parties into the belief that the trust is genuine when in fact it is not.¹² Should the facts before the court fit the *Snook* test, the court may declare the trust void and lift the veil.

Foreign law precedent suggests that, unlike a sham trust, an alter-ego trust is more limited and represents two distinct situations. The first is where assets are settled on a trust but the trustees of the trust act as mere puppets, doing whatever they are instructed to do. The second is where the trust property is treated as if it were personally owned by the trustees or settlor,

⁹ 2010 (5) SA 555 (WCC).

¹⁰ 2006 (2) SA 255 (SCA).

¹¹ Based on the case of *Snook v London & West Riding Investments Ltd* 1967 (2) QB 786.

¹² *Official Assignee in Bankruptcy in the Property of Gary Martin Reynolds v Wilson & Others* 2008 NZCA 122.

instead of belonging to the trust.¹³ Should the facts of the case give rise to the decision that the trust is the alter-ego of the settlor,¹⁴ the finding of an alter-ego trust merely serves as evidence in the conclusion that a trust is a sham. A trust in this instance is not void, and the veil may not be lifted without further evidence indicating the trust to be a sham (with the use of the *Snook* test).

In this regard, as will be seen in Chapter 3 below, the court erred by either replacing the test for a sham with the test developed by the court, or, in the alternative, ignoring the question of sham and relying on the doctrine of piercing the corporate veil. Unbeknown to Combrinck AJA was the fact that the alter-ego trust argument is not an argument of sham.¹⁵ For the sake of clarity, the argument of sham arises when it is found that the arrangements apparently in place are not real. As it relates to a family trust, the concept of sham requires there to be a finding at law that a part or the whole of the trust is in fact a façade.¹⁶

An examination of the law in the British Commonwealth of Nations revealed a number of interesting and relevant developments. The distinction between the doctrines of the sham and the alter-ego was confirmed in the case of *Official Assignee in Bankruptcy in the Property of Gary Martin Reynolds v Wilson & Others*,¹⁷ where the New Zealand Supreme Court cautioned against the amalgamation of the two doctrines. In particular, Robertson J reasoned that, if alter-ego trusts were to be automatically recognised as shams, the common intention requirement held in *Snook* would be negated. The learned judge pointed out that the result would be the creation of a halfway house between a conventional sham trust and a valid trust and that such a development would be effectively to rewrite the traditional understanding of a sham.¹⁸

¹³ *Faucilles* 90 ATC 4003.

¹⁴ In certain circumstances, the controller may instead be the trustee.

¹⁵ *Sagl v Sagl* 1997 (31) RFL 405 (Ont Gen Div) 409.

¹⁶ *Faucilles* 90 ATC 4003.

¹⁷ 2008 NZCA 122.

¹⁸ Para 58.

An examination of the *ratio decidendi* in the *Parker* case raises questions. The trust in dispute was neither held to be a sham nor was it declared the alter-ego of the settlor. Overseas it is settled practice that the veil of a trust cannot be lifted unless the trust is declared a sham. Hence the importation of the doctrine of piercing the corporate veil, which, in effect, allowed the court to lift the trust veil without employing the necessary trust doctrines. In this thesis it is argued that the SCA failed to realise the incompatibility of the imported corporate law doctrine and trust law, thus developing South African trust law incorrectly and unnecessarily.

In essence, the South African approach concerning the piercing of the *inter vivos* trust's veneer differs significantly from the global trend. Abroad it is common practice to analyse the material facts presented and to pierce the veneer of a trust in circumstances where the doctrine of the sham prescribes such measures. South African courts have adopted an *ad hoc* basis for making such a decision, using the newly imported doctrine of piercing the corporate veil as opposed to the correct trust doctrine. The implications of this can be severe for the parties to a trust. Moreover, the failure to appreciate and distinguish relevant trust law doctrines properly is offensive not only to the rights of beneficiaries, but also to the very essence of the trust entity and the duty of South African courts to uphold those rights. Recommendations are necessary in order to correct the superfluous development. It is for these reasons that this research was undertaken.

2. GOALS OF THE STUDY

The primary goal of the study is to identify the problems with veil-lifting in South African trust law by means of an examination of the doctrines of the sham and the alter-ego, and to provide practical solutions to address these problems. The research thus focuses on a practical and legal comparison between South Africa and other common law jurisdictions which allow for the piercing of the veneer of a trust by means of the application of those doctrines.

Critical to the study, it was necessary to ascertain key information concerning the extent and nature of the protection afforded by the trust *inter vivos* abroad, as well as the approach

followed for veil-lifting. The study then seeks to blueprint the above pattern, focusing on the customary approach as to how and when trusts abroad are pierced.

The secondary goal of this research is therefore to prove that the veneer of the trust *inter vivos* can only be breached by the courts through the proper use of the appropriate trust doctrines and by no other means. This will therefore serve as evidence that not only have South African courts been unable to apply the relevant trust doctrines, but the importation of any company law doctrine to replace these principles is not only unwelcome but technically unsound.

Specifically, this research sets out to achieve the following:

- a) To identify the theoretical boundaries of the protection afforded by the trust *inter vivos*.
- b) To ascertain the manner in which common law jurisdictions abroad pierce a trust *inter vivos*.
- c) By means of a qualitative comparison, to provide evidence that the veil-lifting approach in South Africa differs fundamentally from that of other countries.
- d) To show that the South African approach to the lifting of the trust veil is fundamentally flawed, and that South Africa should adhere to the settled practices abroad.
- e) To outline the common features of other jurisdictions in relation to the application of relevant trust doctrines.
- f) To establish the inter-relationship between the doctrines of the “sham” and the “alter-ego.”
- g) To propose appropriate remedies to alleviate the legal disparities in South African trust law.
- h) To produce a thorough and complete practical administrative handbook for settlors, trustees and beneficiaries in the light of the current trust laws.

3. METHODS AND STRUCTURE

Owing to the diverse nature of the legal issues faced in this thesis, the study does not conform to a single set of concepts or theories. The adopted research methodology is a qualitative approach. In broad terms, the most inclusive framework for the thesis is case law. Foreign case law aids in ascertaining the common approach to veil-lifting of the trust *inter vivos*. This framework also allows for an insight to be gained into these foreign courts' interpretation of the doctrines of the sham and the alter-ego. Relevant foreign legislation also accompanies this framework. South African case law is also a highly emphasised source for the thesis: the general trend of the courts across the country in relation to trust disputes is what has inevitably prompted this investigation. Both foreign and local case law therefore serve as the backbone of the research. There is, however, a scarcity of legal material and cases in this field in South Africa, so reference often is made to case law, journal articles and legal texts from the UK, Jersey, Australia, New Zealand, Canada and the United States.

The thesis has been divided into six chapters, with an accompanying handbook. Chapter 1 serves as an introduction. The second chapter focuses on a historical analysis of the development of the South African law of trusts, touching on its roots in English law, contract law and the law of equity. This is followed by an exposition of the nature, use and main features of today's trusts. The chapter concludes with an enquiry into the formation of a trust, in company with the *essentialia* of the trust entity. Chapter 3 gives a full account of the most relevant South African trust law, with a special focus on the cases of *Parker*, *Badenhorst* and *Van der Merwe*. The chapter reveals the abovementioned negative "ripple-effect" on South African trust law. Chapter 4 traces the development of the doctrines of the sham, the alter-ego and the doctrine of piercing the corporate veil in comparable foreign jurisdictions. In particular, the research focuses on the evolution of sham transactions into the modern-day principle of the sham trust. The doctrine of the alter-ego is defined and its nature traced through relevant foreign case law. The doctrine of piercing the corporate veil is examined through foreign trends, the tests which have arisen in foreign case law, and also the established South Africa approach to the piercing of the corporate veil.

Chapter 5 begins with an investigation of the rights of beneficiaries, taking into account the origins of trust law, the common law relating to such rights, South African case law and academic writings on the matter. This serves as an important backdrop to the chapter, which proceeds to disentangle the confusion in South Africa pertaining to veil-lifting in trust law. With its particular focus on the *Parker*, *Badenhorst* and *Van der Merwe* cases, as well as other relevant South African cases, Chapter 5 is instrumental in illustrating the relevance of the trust doctrines in South African law, the irrelevance of the doctrine of piercing the corporate veil and the correct application of these trust doctrines in considerations of veil-lifting. The chapter concludes with an exploration of the consequences of a court's decision to declare a trust a sham or an alter-ego.

The concluding chapter seeks to offer legislative, judicial and administrative recommendations in the light of the unwarranted developments in South African trust law. Such recommendations aim to realign South African trust law with the current trends practised overseas.

This thesis reflects the law as stated in the sources available to the author as at 15 December 2010.

CHAPTER 2

TRACING THE DEVELOPMENT OF THE SOUTH AFRICAN LAW OF TRUSTS

1. DEFINITION OF “TRUST”

The term “trust” is conventionally used in both a wide and a narrow sense. In the wide sense, “trust” is a generic term referring to any legal arrangement in terms of which a functionary controls and administers property on behalf of another, or in pursuance of an impersonal goal.¹ This arrangement is, however, rarely referred to as a “trust”, and is more commonly labelled tutorship, curatorship, executorship, trusteeship in an insolvent estate, or agency.² These instances are, however, referred to as trusts in the wide sense due to the common characteristic of all trusts. Such trusts are typified by a fiduciary relationship between the parties concerned in terms of which the trustee in the wide sense is duty-bound to show utmost good faith in the administration of the property at hand, for the benefit of the trust beneficiary in the wide sense.³

This study, however, focuses specifically on the “trust” in the narrow sense. This type of trust exists when one person (the settlor) has handed over or is bound to hand over the control of property to another (the trustee), which property and/or its proceeds is to be administered by the trustee for the benefit of some person or persons (the beneficiary) or in the pursuance of an impersonal object.⁴ It is evident from this definition that the separation between control over property and the benefit derived from such control which characterises the trust in the wide sense is also a feature of the trust in the narrow sense:⁵

“The distinction between trusts in the wide and narrow sense becomes pertinent when trusteeship under each is at issue. The trustee of a trust in the narrow sense holds an office and is, as such, subject to

¹ *Conze v Masterbond Participation Trust Managers* 1993 (3) SA 786 (C) 794D–E.

² F du Toit *South African Trust Law: Principles & Practice* 2 ed (2007) 2.

³ du Toit *South African Trust Law* 2.

⁴ W Abrie *et al Estates: Planning and Administration* Volumes 1–3 4 ed (2000) 27–28.

⁵ du Toit *South African Trust Law* 2.

control by the Master of the High Court and the High Court itself. Whereas some trustees in the wide sense do hold office ... others do not necessarily act in an official capacity.”⁶

Usefully, the Hague Convention states that the term “trust” refers to the legal relationship created *inter vivos* or on death by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or a specified purpose.

With the inception of the Trust Property Control Act,⁷ which came into operation on 1 March 1989, an authoritative statutory definition of “trust” was introduced into South African law. The statutory definition conforms to the Hague Convention, referring to trusts in the narrow sense.⁸ According to s 1 of the Act:

“‘trust’ means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed –

- (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or
- (b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class or persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act.”⁹

The Act therefore adopted the definition set out by the Hague Convention that the trust assets constitute a separate fund and are not part of the trustee’s own estate. Notably, though, the

⁶ du Toit *South African Trust Law* 3. It is noted, however, that it is indeed possible to have a trust in the narrow sense over which the Master does not exercise control because it is an oral trust.

⁷ Act 57 of 1988. Hereafter referred to as “the Act”.

⁸ In the matter of *Conze v Masterbond Participation Trust Managers* 1996 (3) SA 786 (C) 797, Friedman JP noted that the term “trust” as defined in the Act relates to a trust in the strict or narrow sense, where the trustee becomes the owner of the trust property for the purposes of the administration thereof for the benefit of the beneficiary.

⁹ Act 66 of 1965.

trustee is described as administering for some other person, or for an impersonal reason; there is nothing to prevent the settlor from being a beneficiary, or indeed the sole beneficiary.¹⁰ Similarly, the trustee too may be a beneficiary, but may not be the sole beneficiary. “Every trust therefore imports the element of holding or administering property in part at least for a person or object other than the trustee.”¹¹

According to the Act, ownership of the trust property may therefore vest in either trustee or beneficiary. Interestingly, “trustee” in this definition includes an administrator. Thus a seemingly broad definition of trusts in the narrow sense has been legislated. The reasons for this characterisation of the definition are terminological, administrative and functional,¹² bearing in mind that the terms “trustee” and “administrator” have become interchangeable over time, although “administrator” has now been replaced by the term “trustee” in the Administration of Estates Act.¹³

2. HISTORICAL OVERVIEW

The idea of trust stems from the depths of antiquity and is a universal concept.¹⁴ Although Roman and Roman-Dutch law form the basis of South African common law, the trust idea, as it was received in South African jurisprudence, derives mainly from Germanic and English law.¹⁵ It is not my intention to make the comparative study undertaken here all-inclusive in its scope. The jurisdictions examined have been selected on the basis that they are typical examples of the modern-day trust as found in South Africa. Certain trust-like institutions (*trustagtige figure*) in civil-law jurisdictions such as Germany (the *Treuhand*), the Netherlands (the *bewind* or *fiducia*) or Belgium (the *stichting* or *fiducia*) are not examined thoroughly. Those institutions mentioned below are used to provide a brief historical overview only.

¹⁰ E Cameron *et al Honoré's South African Law of Trusts* 5 ed (2002) 11.

¹¹ *Goodricke v Registrar of Deeds, Natal* 1974 (1) SA 404 (N) at 408.

¹² Cameron *et al Honoré's South African Law of Trusts* 8.

¹³ Act 66 of 1965.

¹⁴ NJ van der Merwe and CJ Rowland *Die Suid-Afrikaanse Erfreg* 6 ed (1990) 342; MJ de Waal “Authorisation of Trustees in Terms of the Trust Property Control Act” (2000) 62 *THRHR* 472 at 548.

¹⁵ PA Olivier *Trust Law and Practice* (1990) 8.

2.1 THE GERMANIC *TREUHAND*

In Germanic tribal custom, there was no such thing as testamentary succession. The *Treuhand*, however, developed as an exception to these strict Germanic rules. According to the *Lex Salica*,¹⁶ which codified the legal rules of the Salin Franks, property was permitted to be transferred to an intermediary with instructions as to the disposal of the property in favour of nominated beneficiaries upon the transferor's death.¹⁷ The intermediary was to be known as the *Treuhänder* and eventually the *saalman* (from the word “*sala*”, meaning transfer). Despite the fact that the intermediary could become the owner of the property should the transferor die, the intermediary did not receive any benefit from this ownership, as the transferor continued to retain the use and enjoyment of the property until his death.¹⁸

Interestingly, even once the Germanic tribes had become familiar with the Roman principles of testamentary succession, the *Treuhand* as embodied in the *saalman* institution did not disappear completely, and was further adapted in order to fulfil many other functions.¹⁹ Today it is still possible to create a *Treuhand* and traces of the institution are also detectable in a similar institution, known as the “*use*”, which was developing in England at the time. This was to be the forerunner of the trust as we know it today.²⁰

2.2 THE ENGLISH LAW OF TRUSTS

During the crusades of the 13th century in which English noblemen fought, these men were away for long periods of time. They were also the most significant landowners in England under the old feudal land system. The problem therefore arose as to who would be able to direct how the land should be used if the landowner was out of the country. Thus, the concept of the *use* was born.²¹

¹⁶ Title 46.

¹⁷ du Toit *South African Trust Law* 16.

¹⁸ HR Hahlo “The Trust in South African Law” (1961) *SALJ* 195 at 198.

¹⁹ Olivier *Trust Law and Practice* 9.

²⁰ MM Corbett “Trust Law in the 90s: Challenges and Change” (1993) 56 *THRHR* 262 at 263.

²¹ A Hudson *Understanding Equity & Trusts* 3 ed (2008) 13.

In essence, the *use*²² entailed that:

“A (the *feoffer*) transferred something to B (the transferee or *feoffee*) to the use of C (the *cestui que use*).²³ B became the owner of the property so transferred, not for his own benefit, but for the benefit of C.”²⁴

The *use* was also used by the Franciscan friars, who, as missionaries, required some form of accommodation, especially when settling in a new location. However, as they were bound by an oath of poverty, they could not hold any property. In consequence, a custom arose in terms of which a benefactor would transfer land to a borough community “to the use of the friars.”²⁵

In both instances, equity recognised that land could be left by the landowner “to the use” of another while the landowner was unable to exercise his legal rights in person. Importantly, equity recognised that in such an arrangement, the landowner should be treated as retaining some property rights.²⁶ Consequently, equity came to recognise an arrangement by which the landowner would pass the legal rights in the land to a trusted person (or “trustee”) so that the trustee could control the use of the land, but on the understanding that the definitive rights to the property remained with the landowner as the “beneficiary” of the arrangement.²⁷ Notably, upon the knight’s return, the *feoffee* was bound to transfer it back to the knight. In the event of the crusader’s non-return, the *feoffee* had to transfer the property to a nominated beneficiary.

Today traces of the *use* can still be seen in English law and, astonishingly, the *Treuhand* continues to exist in Germany. Although modernised, the trust retains the basic concepts which were developed more than eight centuries ago.

²² From the Latin *ad opus*.

²³ du Toit *South African Trust Law* 16.

²⁴ *Ibid.*

²⁵ Corbett 1993 *THRHR* 262.

²⁶ Hudson *Equity & Trusts* 13.

²⁷ *Ibid.*

2.3 THE LAW OF EQUITY

Strictly speaking, the principles of equity are the rules which have been developed by the Courts of Chancery over the centuries.²⁸ Equity traces its philosophical route from the ancient Greek philosopher Aristotle and, in particular, lends credence to the notion that a judge may ignore a legal rule if its literal application would cause an injustice which the legislator could not have intended.²⁹ The following principles come from Aristotle and concern the difference between common law and equity:

“For equity, though superior to justice, is still just... justice and equity coincide, and although both are good, equity is superior. What causes the difficulty is the fact that equity is just, but not what is legally just: it is a rectification of legal justice.”³⁰

Equity offers a better form of justice than the common law because it provides for a specific judgment as to right and wrong in individual cases, thus rectifying errors of fairness which the common law would otherwise have had:

“The explanation of this is that all law is universal, and there are some things about which it is not possible to pronounce rightly in general terms; therefore in cases where it is necessary to make a general pronouncement, but impossible to do so rightly, the law takes account of the majority of cases, though not unaware that in this way errors are made... So when the law states a general rule, and a case arises under this that is exceptional, then it is right, where legislator owing to the generality of his language has erred in not covering that case, to correct the omission by a ruling such as the legislator himself would have given if he had been present there, and as he would have enacted if he had been aware of the circumstances.”³¹

Therefore, equity exists to rectify what would otherwise be an error in the application of a common law to factual situations in which judges have developed common law principles, or the legislators who passed the statutes but could not have intended the error.³²

²⁸ Hudson *Equity & Trusts* 1.

²⁹ *Ibid.*

³⁰ Aristotle *Nichomachean Ethics* (334BC) Book 5.

³¹ *Ibid.*

³² Hudson *Equity & Trusts* 2.

It is believed, however, that English courts have not expressly adopted the ideas of Aristotle nor of any other philosopher as part of equity, but rather that the core principles of English equity are in sympathy with the philosophical tradition that the courts consider the conscience of the individual defendant in any particular case.³³

In essence equity is thus a collection of legal principles that allowed the courts to reach fair results in cases in which it appeared that the rigour of the common law would otherwise have led to injustice.³⁴

“Equity was necessary to provide social justice in these early days. However, as social life became more complicated, the rules of equity have become more formalised and slightly less flexible. Therefore, the trust became a more rigid institution in the 19th century as it was used by commercial people to develop the means of holding property and conducting trade during the social and industrial advances in Great Britain.”³⁵

Accordingly, the most important equitable principle is that the jurisdiction of the court is to act *in personam*. The court is thus concerned with the conscience of the individual defendant as much as with any strict rule.³⁶ A court of equity will therefore make an order based on the facts of an individual case so as to prevent that particular person from continuing to act unconscionably. As it relates to trust law, equity will look at how a trustee is dealing with a beneficiary’s property, or to a claimant’s fear that the defendant will move his or her property out of the jurisdiction before trial. In all circumstances, a court of equity employs common sense. Equity will always look at intent as opposed to form.³⁷ The most relevant advances in modern equity are obviously focused on the trust. In jurisdictions where equity is recognised, beneficiaries – unlike in South Africa – have rights against the trust as well as the trustees. Beneficiaries acting together, and as such constituting 100 per cent of the equitable interest in the trust, can direct trustees as to how they should deal with the property.³⁸

³³ Hudson *Equity & Trusts* 1.

³⁴ Hudson *Equity & Trusts* 5.

³⁵ *Ibid.*

³⁶ Hudson *Equity & Trusts* 7.

³⁷ Hudson *Equity & Trusts* 11.

³⁸ This is the rule formulated in the case of *Saunders v Vautier* 1841 (4) Beav 115.

The equitable interest a beneficiary has in a trust is a dynamic of English law which separates all other legal spheres with that of England. The very nature of trust law is defined through equity in England. For instance, contrast the South African definition of a 'trust' from that below:

“The essence of a trust is the imposition of an equitable obligation on a person who is the legal owner of property (a trustee) which requires that person to act in good conscience when dealing with that property in favour of any person (the beneficiary) who has a beneficial interest recognised by equity in the property. The trustee is said to ‘hold the property on trust’ for the beneficiary. There are four significant elements to the trust: that it is equitable, that it provides the beneficiary with rights in property, that it also imposes obligations on the trustee, and that those obligations are fiduciary in nature.”³⁹

Other propositions which dictate the law of equity are as follows:⁴⁰

- Equity will not suffer a wrong to be without a remedy.
- Equity follows the law.
- Where there is equal equity, the first in time shall prevail.
- He who seeks equity must do equity.
- He who comes to equity must come with clean hands.
- Delay defeats equities.
- Equality is equity.
- Equity looks on that as done that which ought to have been done.
- Equity imputes an intention to fulfil an obligation.
- Equity will not permit statute or common law to be used as an engine of fraud.⁴¹
- Equity will not permit a person who is a trustee of property to take benefit from that property *qua* trustee.⁴²
- Equity abhors a vacuum.⁴³

³⁹ GW Thomas and AS Hudson *The Law of Trusts* (2004) 36.

⁴⁰ J McGhee *Snell's Equity* 31 ed (2004) 27.

⁴¹ *Rochefoucauld v Boustead* 1897 1 Ch 196.

⁴² *Westdeutsche Landesbank Girozentrale v Islington LBS* 1996 2 All ER 961.

⁴³ *Vandervell v IRC* 1967 1 WLR 495.

Whichever way equity and trust law is to be viewed, it is a certainty that this institution does not find itself in South African law. However, the principles entrenched in the law of equity are pertinent for understanding the manner in which the law of trusts has been developed in English law. Furthermore, the principles of equity are useful for adapting existing South African trust law practices where necessary, and such standards will help in the development of several of this study's hypotheses.⁴⁴

2.4 THE IDENTITY OF THE SOUTH AFRICAN LAW OF TRUSTS

Trusts were introduced in the Cape in 1815, after the British had occupied the area intermittently between 1795 and 1806. The Articles of Capitulation,⁴⁵ amongst other things, guaranteed the existing rights and privileges of the Cape *burgers*, including Roman-Dutch law, the legal system put into effect in the Cape by the Dutch settlers almost a century and a half earlier.⁴⁶ Notwithstanding the use of Roman-Dutch law, a gradual assimilation of English legal principles and institutions was unavoidable. Trusts were no exception. Having being introduced into the Cape in 1815, they spread quickly through Natal and eventually the rest of the country. "The British officials and settlers who came to the Cape in the early nineteenth century brought with them the words 'trust' and 'trustee' and the notion of a trust as it was conceived in England and to some extent Scotland."⁴⁷ Soon after, wills, deeds of gift, land transfers and antenuptial contracts began to make use of the notion of trusts, and a variety of 19th century statutes at the Cape and in Natal used the mechanism of a trust and trustees.⁴⁸

In 1833 South Africa saw the first case in which a trust was the subject of litigation – *Twentyman v Hewitt*.⁴⁹ The case appears to have sparked the establishment of the first trust companies within the country as these companies undertook the administration of deceased estates as well as offering themselves as trustees to private trusts. The first was the South

⁴⁴ See, for instance, Chapter 6, 4.2 "The Intermediate-Equity Approach".

⁴⁵ Articles of 10 and 18 January 1806.

⁴⁶ du Toit *South African Trust Law* 18.

⁴⁷ Cameron *et al Honoré's South African Law of Trusts* 21.

⁴⁸ Cape: Ords 4 of 1829, 5 of 1832, 71 of 1830, 86 of 1831, 5 of 1832, 7 of 1836, 2 of 1842, 6 of 1843, 5 and 7 of 1845, 13 of 1846, 9 of 1855, 17 of 1859, 31, 32 and 34 of 1861, 20 of 1863, 3 of 1873, 17 of 1876, 7 of 1882, 33 of 1884; Natal: Ords 4 of 1849, 11 of 1856, 27 of 1874 and 10 of 1881 per Cameron *et al Honoré's South African Law of Trusts* (note 145) 21.

⁴⁹ 1833 (1) Menz 156.

African Association for the Administration and Settlement of Estates, founded in 1834. According to some, it was the first such company in the world, although such an instance has been reported as having existed in Massachusetts in 1818.⁵⁰ Today, there are thousands of trust companies in South Africa, controlling billions of rands in trust funds. These trust companies and are seen as financial institutions and their officers are subject to stringent liabilities in carrying out the trusts they assume, carrying liabilities similar to those imposed on banks.⁵¹

Despite the historical influence of England and Scotland, not all the South African trust law rules follow English law. There has indeed been only a partial reception of English trust law in South Africa:⁵²

“The most important import from England has been the conception that trusteeship is an office subject to public control. A trustee has two capacities, one as a private citizen, the other as trustee or administrator. The trustee may die, resign or be removed from office as trustee. The trustee then automatically loses or must transfer to a successor the ownership or control of the trust property, in contradistinction with his or her private estate. But the form in which this conception has been received has been to treat trusteeship as analogous to the Roman and Roman-Dutch institutions of tutorship, curatorship and administratorship.”⁵³

Of course, South African common law itself handles many other characteristics of trust law in South Africa. The creation and revocation of trusts is an example of a purely South African approach to trust law. In essence, South African trust law is a mixture of English, Roman-Dutch and distinctively South African rules, with South African rules continually growing in importance.⁵⁴ Analytically, if not historically, these can be viewed as natural developments from “the rules of such institutions as the *fideicommissum*,⁵⁵ *fiducia*, *stipulatio alteri*, tutorship, curatorship and common law administratorship. But historically the rules of trust

⁵⁰ Cameron *et al Honoré's South African Law of Trusts* 21.

⁵¹ Cameron *et al Honoré's South African Law of Trusts* 22.

⁵² *Braun v Blann & Botha NNO* 1984 (2) SA 850 (A) 866–867.

⁵³ Cameron *et al Honoré's South African Law of Trusts* 22.

⁵⁴ Cameron *et al Honoré's South African Law of Trusts* 23.

⁵⁵ Notably, in *Braun v Blann*, the court held that a *fideicommissum* and a trust are separate and distinct legal institutions and it was wrong to equate a trustee of a testamentary trust with a fiduciary. In its conclusion, the court held that a testamentary trust was a legal institution *sui generis*.

law have at least these three main sources, and trust law is all the stronger for being able to draw so widely.”⁵⁶ As former Chief Justice Corbett correctly stated, “the fascinating structure that South African courts, practitioners, officials and legislators have built up and are still developing is a selective form of ‘jurisprudential osmosis’.”⁵⁷ Thus South Africa, through the assimilation of English law and Roman-Dutch law, together with the refinement of these rules by the courts and the Legislature, has developed a genuinely hybrid and well-respected law of trusts. Geach and Yeats note that “the common law in South Africa, together with good practice that has developed over the years by practitioners and trust companies, currently forms the cornerstone of the law of trusts in South Africa.”⁵⁸ In the context of trusts, knowledge of the development of South African law is important because a trust, as we know it today, was unknown to the Roman-Dutch law practised here.⁵⁹

3. THE NATURE, USE AND MAIN FEATURES OF TRUSTS

For a long time trusts were thought to be exclusively for the powerful and wealthy, and beyond the average South African’s reach. In more recent times, as the complexity and risk of conducting business increases and society in general become more litigious, many people are taking up the opportunity to use this ever-practical asset protection tool. Moreover, today, the flexibility of trusts contributes greatly to their popularity and the multifarious purposes to which they are put.⁶⁰ 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 the degree of discretion entrusted to them, all depend on the settlor as expressed in the trust instrument.⁶¹ According to Edmonds Judd, a member of the New Zealand Law Association of Legal Practices, the sole purpose for most people in establishing a trust is to safeguard a family’s assets and wealth against risk, and for a variety of reasons, which may include:

- protecting assets from business risk;
- protecting children’s inheritance from claims;

⁵⁶ Cameron *et al Honoré’s South African Law of Trusts* 23.

⁵⁷ Corbett 1993 *THRHR* 56; Cameron *et al Honoré’s South African Law of Trusts* 23.

⁵⁸ WD Geach and J Yeats *Trusts Law and Practice* (2007) 6.

⁵⁹ *Braun v Blann and Botha*.

⁶⁰ Cameron *et al Honoré’s South African Law of Trusts* 19.

⁶¹ *Ibid.*

- providing for special family needs, such as a child with a disability;
- protecting assets in a second marriage, a relationship situation and/or a relationship breakdown;
- preventing claims on one's estate when one dies (family protection and testamentary promises);
- protecting assets against the possible introduction of capital gains tax or estate duty;
- providing funding for educational costs for children and/or grandchildren;
- allowing family assets, such as family homes, to pass to the next generation without exposing inheritances to estate duty tax, or in order to
- give to the community through a charitable trust.⁶²

Whatever the purpose may be, the ease of establishing a trust undeniably adds to the attractiveness of this tool. Referring to the establishment of the trust *inter vivos*,⁶³ the settlor gives, or transfers, property to the trustees to hold for the beneficiaries. Any property or asset can be transferred to a trust; however, it is generally recommended only to transfer assets which are likely to retain or increase their value. Practically speaking, this often involves transferring a family home, a rental property, vehicles and monetary investments.

The ultimate reason behind a trust's ability to protect assets is the legal veneer that encloses the trust property. In *Commissioner for Inland Revenue v Friedman and Others NNO*⁶⁴ it was confirmed that a trust is not a legal person, but rather an accumulation of rights and duties which constitute the trust estate and form a separate entity.⁶⁵ Although forming a separate entity, that entity, such as a deceased estate, is not a legal *persona*.⁶⁶ Of course, when litigating, it is always important to cite the parties in the proceedings correctly, and in order to

⁶²Edmonds Judd "Trusts - Why Establish Them"

http://www.edmondsjudd.co.nz/dms/images/custom_content/Fineprint_45_may.pdf (accessed 1 February 2010).

⁶³ See below.

⁶⁴ 1993 (1) SA 353 (A) at 10.

⁶⁵ Although in some instances a trust is recognised as a person by statute: Section 1 of the Income Tax Act 58 of 1962 defines a trust as a person for the purposes of income tax and capital gains purposes. Similar instances can also be seen in the Value Added Tax Act 89 of 1991, the Deeds Registries Act 47 of 1927 and the Companies Act 71 of 2008. For further reading on the lack of juristic personality, see *Commissioner of Inland Revenue v MacNeillie's Estate* 1961 (3) SA 833 (A), and *Crumdall Brothers (Pvt) Ltd v Lazarus NO and Another* 1992 (2) SA 423 (Z).

⁶⁶ L Stander "Piercing the Veneer of the Trust in South African Trust Law: Liability of Trustees of a Business Trust for Fraudulent Trading" (2008) 17 *INSOL* 165 at 166.

litigate against an entity, it must have legal standing. Unlike other corporate entities, a trust lacks *locus standi*, and it is this lack of legal personality which translates into a lack of legal standing. Thus, in order to litigate on behalf of or against a trust, it is the trustees in their capacity as trustees who must bring and defend actions in relation to a trust. Furthermore, it is the pure nature of the trust, in its foundation as a separate entity, that allows assets to be transferred into a trust, and if correctly done so, *ceteris paribus*, the trustees will retain the property and become the new legal owner(s) of such property, distinct from any previous legal relationship which the property had. Therefore, the legal veneer, which is discussed at length in this study, is merely the legal separation of ownership between the settlor, his or her estate and the transferred asset(s).

4. DIFFERENT TYPES OF TRUST

Although often considered a single concept, the trust as it currently operates may take on a variety of different forms, and with an assorted history the complex origins of the trust in South Africa undoubtedly add to the disclarity of the legal institution today. Undeniably however, the different forms and uses that the trust institution offers only add to the attractiveness of this asset preservation tool, and the seeming ruggedness of this institution should see it surpass all its critics' predictions.

4.1 THE TESTAMENTARY TRUST

Although the South African trust has English roots, the English law of trusts has not been received in our law and thus forms no part of our law. In *Estate Kemp v MacDonald's Trustee*⁶⁷ the court held that, despite this, the court could accommodate the institution and would therefore give effect to a testamentary disposition expressed by way of a trust.⁶⁸ In order to do so, a solution had to be found whereby the simultaneous proprietary rights of a trustee and a trust beneficiary under English law could be recognised in accordance with Roman-Dutch legal principles.⁶⁹ The answer was in found in the *fideicommissum*, with the testamentary trustee being equated to a fiduciary (under a *fideicommissum purum*; a transient

⁶⁷ 1915 AD 491.

⁶⁸ At 508.

⁶⁹ Corbett 1993 *THRHR* 263.

form of the *fideicommissum*).⁷⁰ The result indicated that the momentary rights of the fiduciary and the immediate acquisition of rights by the fideicommissary prompted the inference that they were both simultaneous fideicommissary property – a position which corresponds with the simultaneous ownership of the trustee and beneficiary under the English law of trusts.⁷¹ The *fideicommissum* therefore became not only the vehicle for the introduction of the testamentary trust into South African law, but also the construction, illustrating its legal nature.⁷² Deciding the correctness of this decision was a task undertaken by the court in the *Braun* case, drawing on a number of points:

“... many of the functions which the *fideicommissum*, either by itself or in conjunction with other devices of the Roman law, performed could have been performed by the trust had the latter been known to the Romans, but the fact remains that historically- and jurisprudentially the *fideicommissum* and the trust are separate and distinct legal institutions, each of them having its own set of legal rules. The *fideicommissum* has a long and intricate history which cannot be traced and analysed in a judgment.... 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.”⁷³

The Appellate Division (AD) found that in South African law the trust *inter vivos* is created by way of a stipulation for the benefit of a third party, a *stipulatio alteri*, but the equation of the testamentary trust with the *fideicommissum* was rejected. The AD noted in this regard that it was unequivocally incorrect, through history and jurisprudence to equate the testamentary trust with the *fideicommissum*.

Evidently, the precise legal nature of the testamentary trust is as yet still unknown. However, its purpose and function have been well established in South Africa, and it is used in much

⁷⁰ At 502–503.

⁷¹ du Toit *South African Trust Law* 21.

⁷² *Ibid.*

⁷³ At 858–859.

the same way as its English brother. Generally speaking, a testamentary trust is used as a legal institution in the context of the law of testate succession. “In general a testator resorts to this legal institution if he [or she] wishes to benefit a particular beneficiary (the trust beneficiary) but wants to place ownership and/or control over the assets in the hands of another person (the trustee).”⁷⁴ This type of trust is created in a will, *mortis causa*, and is acknowledged in the Act.

4.2 THE *BEWIND* TRUST

This type of trust occurs when ownership of the trust property is conferred on the trust beneficiary, while control over and administration of the same trust property is vested in the trustees of the trust.⁷⁵ This type of trust is also a form of the trust in the narrow sense.⁷⁶

4.3 THE TRUST *INTER VIVOS*

It has been authoritatively decided that the trust *inter vivos* is created by a *stipulatio alteri* – a contract between a trust settlor and a trustee for the benefit of a trust beneficiary.⁷⁷ This declaration is stated cautiously, as the use of the *stipulatio alteri* to accommodate the trust *inter vivos* is met with fierce academic opposition: the point to be made is that at the least, through its creation, a *nexus* exists between the two. In *Crookes NO v Watson and Others*,⁷⁸ a matter dealing with the amendment of a trust instrument, Centlivres CJ seemed to assume too much of this underlying relationship where he held that the principles applicable to an *inter vivos* trust are to be found in the law of contract, due to the fact that a trust instrument executed by a settlor and a trustee for the benefit of another is a contract between two persons for the benefit of a third person.⁷⁹ However, it is respectfully submitted that the generalisation

⁷⁴ MJ de Waal and MC Schoeman-Malan *The Law of Succession* 4 ed (2008) 168.

⁷⁵ *Conze* 794 E–D; De Waal and Schoeman-Malan *Succession* 159.

⁷⁶ *Braun v Blann and Botha* 864G–H.

⁷⁷ *Crookes NO v Watson and Others* 1956 (1) SA 277 (A); MJ de Waal “In Search of a Model for the Introduction of the Trust Into a Civilian Context” (2001) 1 *Stell LR* 63 at 77.

⁷⁸ 1956 (1) SA 277 (A).

⁷⁹ At 287H. Importantly, it must be noted that this conclusion reflects the position of only *inter vivos* trusts. Although a highly debatable realisation, the courts have supported this finding. In *Crookes* Centlivres CJ reasoned (at 286) that:

“[t]here is nothing else in the deed which seems to me to need consideration and the question now arises as to the principle of Roman-Dutch law which is applicable in the present case. We are not concerned with the English law of trusts which has never to my knowledge been held to be applicable

that a trust *inter vivos* can in all respects be equated with a *stipulatio alteri* should be rejected. The most accurate proposition was noted in the matter of *Mariola v Kaye-Eddie*,⁸⁰ and that is to view the trust *inter vivos* in the same light as the testamentary trust – an institution *sui generis*.

Regardless of the technical aspects of a trust *inter vivos* and its *status quo*, the most notable and distinguished feature is that it is a living trust. A trust *inter vivos* is created during the lifetime of the settlor, and there are two types of trust in this respect: vested trusts and discretionary trusts. In vested trusts the benefits of the beneficiaries are set out in the trust

in South Africa. The cases quoted by the appellants' counsel support the view that a trust deed executed by a settlor and a trustee for the benefit of certain other persons is a contract between the settlor and the trustee for the benefit of a third person and that the settlor and the trustee can cancel the contract entered into between them before the third party has accepted the benefits conferred on him under the settlement."

After examining the relevant Roman-Dutch authorities, Centlivres CJ noted (at 289):

"I can see no reason in law why a contract between a settlor and trustees, which is intended for the benefit of a third party, should not be capable of being amended by agreement between the settlor and the trustees, as long as the third party has not accepted the benefit of the contract. Up to this stage there is no *vinculum juris* as between the beneficiary and the settlor or trustees."

In the matter of *Hofer and Others v Kevitt NO and Others* 1998 (1) SA 382 (SCA) 387 Van Coller AJA held the following:

"[the appellants] submitted that an approach which recognises that an *inter vivos* trust in South African law is not purely contractual in nature should be adopted. Support for this approach is to be found ... not only in the minority judgments of Schreiner JA and Fagan JA in *Crookes'* case but also in the judgment of Steyn JA in that case ... Once it is accepted that a trustee is not merely a party to a contract with the founder, the trustee, in view of his [or her] fiduciary position, so it was argued, may only agree to a revocation or amendment of the trust agreement if he considers it to be in the interests of the beneficiaries or potential beneficiaries. I cannot agree with this argument ... In the present case the amendments were made before the benefits had been accepted by or on behalf of the children ... and consequently they were on the authority of *Crookes'* case, valid. During argument [the appellants] ... submitted that the majority judgment was wrong but the submission was made without any motivation or conviction ... In my judgment, it cannot be said that the majority judgment was clearly wrong."

It is submitted that there are a number of reasons why Centlivres CJ's *ratio* falls short. First, the principles governing *inter vivos* trusts cannot be considered in a vacuum. It would be absurd to believe that the law of contract, which supposedly applies to trusts *inter vivos*, does not apply to testamentary trusts. Both are governed by the same branch of law, and therefore the *ratio* could be accurate only if the law of contract applied to testamentary trusts as well. Second, the *ratio* of Centlivres CJ mistakenly squeezes a trust into the form of a *stipulatio alteri*. In Honoré, Cameron notes (at 34) that:

"[i]t is sometimes said that a trust set up by a living founder (trust *inter vivos*) is a contract for the benefit of a third person (*stipulatio alteri*) or transfer to a trusted friend on specified terms (*fiducia cum amico*). The point correctly made is that such a trust is usually created by way of a contract that contains a stipulation in favour of the beneficiary, who on acceptance acquires an indefeasible right under the trust. A trust *inter vivos* can be revoked or varied in the same manner as a contract, *viz* with the concurrence of the contracting parties including any third party beneficiaries who have accepted ... But this does not establish that trusts *inter vivos* are contracts or a species of contract, and the suggestion that 'in our law a consensual trust is nothing but a contract' suggests an unfortunate reductionism that ignores the subtlety of 200 years of historical development, while threatening to impoverish our law of obligations."

This view, it is submitted is more accurate.

⁸⁰ 1995 (2) SA 728 (W) at 731C–D.

instrument and are to be adhered to as accurately as is possible, whereas in a discretionary trust the trustees have full discretion at all times as to how much and when each beneficiary is to benefit.

Family trusts have a prominent basis in the trust *inter vivos* and may take the shape of either (or both) a discretionary or a vested trust. This type of trust *inter vivos* is designed to secure the interests and protect the property of a group of family members,⁸¹ but is increasingly receiving negative attention from the courts. Careful consideration should be paid to the administration of family trusts because what will become evident below is that the assets in such a trust are often not protected, despite the intentions and beliefs of the settlor.

5. PARTIES TO A TRUST AND THE NATURE OF THE TRUST INSTRUMENT

The provisions of a trust instrument are important because they are the trust's constitutive charter.⁸² It is essential at this stage to define with certainty all persons involved in the establishment and administration of the trust *inter vivos*. The parties who concern this work are (a) the nominee settlor; (b) the settlor; (c) the trustee; (d) the beneficiary, and (e) the Master of the High Court. The parties (a) through to (d) are discussed below with frequent commentary as to the Master's contingent role in relation to those parties. Furthermore, insight into the key features, nature and contents of the trust instrument are examined throughout the study.

5.1 THE NOMINEE SETTLOR

The nominee settlor⁸³ is the agent of the true settlor. This person is therefore usually someone approached by the settlor to form the trust in their own name and is given instructions as to what the trust instrument should contain. A nominee settlor is usually used in instances where the true settlor wishes to detach him- or herself from the ownership of the trust. Thus the nominee settlor's name would appear on a trust instrument and, after the initial donation, then

⁸¹ Geach and Yeats *Trusts* 13.

⁸² *Land & Agricultural Bank of South Africa v Parker and Others* 2005 (2) SA 77 (SCA) para 10.

⁸³ Sometimes mistakenly referred to as "the planner".

disappears. It is submitted that this strategy is unnecessary and a court would most likely, if required, look through the formality and hold the principal settlor to be the true settlor of the trust.

5.2 THE SETTLOR

The settlor, otherwise referred to as the ‘founder’ or ‘donor’, is the person who in reality establishes the trust. Notably, even in the absence of a trustee, a trust can still be valid because s 7 of the Act establishes that the Master of the High Court must appoint a trustee in the absence of any other appointment. The settlor is the person who makes the initial “making over”. Geach and Yeats observe the following regarding the importance of the settlor’s initial making over:

“To ensure that the trust is actually formed, it is important to (a) ensure that the founder has legal capacity ... and (b) that the amount stipulated as the amount of the original donation that establishes the trust is actually paid over to the trustees. If the amount is not paid by the founder to the trustees, the creation of the trust is suspended until such time as the amount is in fact paid to the trustees. If there is any doubt as to whether or not the trust has been formed, it is submitted that the onus to prove its existence will be on those persons who allege the existence of the trust. This is because a trust imposes a burden or obligation on trust assets, and a freedom of obligations is presumed.”⁸⁴

A trust may also have more than one settlor. Although unusual, business trusts often have several settlors who act together in agreement to form the trust. Once a trust is formed, however, be it a family trust or a business trust, the settlor becomes incapable of controlling or managing trust assets in his or her capacity as settlor. As seen in the *Crookes* case, it is possible for the settlor to be a trustee. Significant to this discussion is that a settlor can play an important role in the amendment of the provisions of a trust *inter vivos*.

A common reason the settlor may use the trust *inter vivos* was displayed upon the death of the late Harry Oppenheimer. The South African mining tycoon, reputed to be one of the ten richest men in the world, went to his grave leaving little trace of his vast personal fortune.

⁸⁴ Geach and Yeats *Trusts* 58.

Conservatively estimated to be worth more than R30 billion around the time of his death, Oppenheimer's will declared a mere R307 million as his personal wealth. The remainder of his fortune had been carefully placed in a trust to protect his assets for the future benefit of his family. The attempt to minimise estate duty paid off, and to this day serves as a practical example of the enormous benefit of trusts that the ultra-rich can indeed make use of.⁸⁵

5.3 THE TRUSTEE

The trustees of a trust *inter vivos* undoubtedly form the backbone of a trust's activities. A person becomes appointed as a trustee in terms of a trust instrument or by the Master if the trust instrument does not provide for it. Such person must accept the appointment, upon which the Master must then also authorise the appointment by issuing written letters of authority. Thus, the process works as follows: appointment, acceptance and authorisation. Section 1 of the Act defines "trustee" as "any person (including the founder of a trust) who acts as trustee by virtue of an authorization under section 6 [authorisation of trustee and security] and includes and person whose appointment as trustee is already of force and effect at the commencement of this Act".

Importantly, trustees have bare ownership of trust assets, and must administer assets in accordance with the terms of the trust instrument. Such ownership, or co-ownership in the case of multiple trustees, is non-beneficial and the common law rule is that decisions of substance regarding any transaction in respect of trust matters must be reached by all the trustees unanimously.⁸⁶

⁸⁵ According to the Estate Duty Act 45 of 1955, the current exemption stands at R3,5 million.

⁸⁶ *Nieuwoudt and Another v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA); *Coetzee v Peet Smith Trust* 2003 (5) SA 674 (T).

A seemingly vital concept in South Africa today is the independence of trustees. In the matter of *Land and Agricultural Bank of South Africa v Parker and Others*⁸⁷ Cameron JA reasoned that the:

“[E]ssential notion of trust law, from which the further development of the trust form must proceed, is that enjoyment and control should be functionally separate ... it is separation that serves to secure diligence on the part of the trustee, since a lapse may be visited with action by beneficiaries whose interests conduce to demanding better.”⁸⁸

The court in this instance proposed the compulsory future use of an independent trustee in all types of business and family trusts where (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another. The rationale behind such a development is that an independent trustee can have no interest in concluding transactions that may prove invalid.

In practice, what often happens is that the settlor appoints existing professional advisers as trustees.⁸⁹ However, in reality, these professional persons may not be independent in the sense required because they are likely to accede to the wishes and demands of the settlor without objectively taking into account all beneficial interest and all circumstances before arriving at a decision.⁹⁰ The notion of the independent trustee is to combat such circumstances.

It is noteworthy that the King Code on Corporate Governance⁹¹ recommended that there should ideally be a majority of independent non-executive directors on the board of directors of a company in order to ensure good corporate governance.⁹² In the same manner trusts too should have a majority of independent trustees who are not in any way related to the settlor or beneficiaries. Geach and Yeats submit that a “majority of independent trustees will not only ensure good corporate governance, but will ensure that there is a separation of control of the

⁸⁷ 2005 (2) SA 77 (SCA).

⁸⁸ Para 22.

⁸⁹ Geach and Yeats *Trusts* 41.

⁹⁰ *Ibid.*

⁹¹ King Report on Corporate Governance March 2002.

⁹² Geach and Yeats *Trusts* 84.

trust from the enjoyment of benefits.”⁹³ However, practically speaking, the above notion is realistic only with regard to large family and business trusts, because the independent trustees’ fees will eventually erode the income of smaller trusts. Indeed, in the case of smaller trusts, a single independent trustee should be adequate.

The Act also imposes several duties on trustees. Since these are duties imposed by statute, there is little uncertainty surrounding them and trustees are therefore not only required to acquaint themselves with these duties, but also to ensure practical compliance with them.⁹⁴

The most relevant duty conferred through the Act is the duty to act with care, diligence and skill. According to s 9 of the Act, a trustee is obliged to conduct the administration of a trust in the utmost good faith as a sensible trustee. Such standard of care expected of a trustee is defined by the common law principle of a *bonus et diligens paterfamilias*. In *Sackville West v Nourse*⁹⁵ the court held that this standard implied that a trustee is required to show greater care in administering trust property than might be expected of him when dealing with his own property.⁹⁶ According to du Toit, the duty of care is of the utmost importance:

“A trustee’s duty of care is the most important manifestation of the fiduciary nature of a trustee’s office, it being an accepted principle of South African law that a trustee, as any other functionary relationship, must perform his duties and exercise his powers in utmost good faith. Any omission to conduct the affairs of a trust in accordance with the above standard results in breach of trust by trustee. The duty of care therefore establishes the basis for the various remedies awarded to trust beneficiaries and third parties in consequence of a trustee’s breach of trust.”⁹⁷

Other duties founded by the Act include: the duty to bank all monies and to do so in a separate banking account; the duty to lodge the trust instrument with the Master; the duty to furnish the Master with an address for the service of notices and processes; the duty to obtain written authorisation from the Master to act as trustee; the duty to register and identify trust

⁹³ Geach and Yeats *Trusts* 85.

⁹⁴ *Ibid.*

⁹⁵ 1926 AD 516.

⁹⁶ At 533–534.

⁹⁷ du Toit *South African Trust Law* 71.

property; the duty to protect trust documents; the duty to take only reasonable remuneration; the duty to account to the Master when requested to do so, and the duty to perform all duties imposed by the trust instrument.

The remaining duties bestowed upon trustees stem from the trust instrument, decided case law and common law. Generally speaking, trustees are under a duty to find unanimity in making decisions;⁹⁸ to invest productively;⁹⁹ to avoid risk;¹⁰⁰ to identify and account to beneficiaries;¹⁰¹ to make proper distributions to the identified beneficiaries;¹⁰² to appoint the stipulated number of trustees;¹⁰³ to ensure that a proper system of control is in place,¹⁰⁴ and also to obtain expert advice.¹⁰⁵

Perhaps one of the most important duties that arises as a result of one person's assuming responsibility to manage and control assets on behalf of another is a fiduciary duty. A fiduciary is a person who undertakes or assumes responsibility to act for or on behalf of and in the interests of another.¹⁰⁶ In particular this duty requires that property under the control of trustees must be managed and controlled for the purposes of the trust instrument and for the

⁹⁸ *Coetzee v Peet Smith* 2003 (5) SA 674 (T). Unless the trust instrument provides otherwise, trustees are at all times to reach decisions of substance regarding a trust unanimously.

⁹⁹ In *Administrators, Estate Richards v Nichol* 1999 (1) SA 551 (SCA) it was stated that if the trust is to endure for a long period, the trustees are obliged to invest the assets of the trust in a manner that provides adequate income as well as capital growth.

¹⁰⁰ In *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T) it was made clear that when trustees dealt with or invested money, this had to be done with safety and security, and monies were not to be placed in anything involving an element of uncertainty or risk.

¹⁰¹ *Potgieter en 'n Ander NNO v Shell Suid-Afrika (Edms) Bpk* 2003 (1) SA 163 (SCA). Identifying the beneficiaries of a trust is not always easy. Sometimes there may be certainty regarding their rights, for example income or capital, or uncertainty regarding their status as beneficiaries. Furthermore, there is a duty, as discussed in the matter of *Doyle v Board of Executors* 1999 (2) SA 805 (C), to keep proper accounts for the trust and distribute necessary information to beneficiaries accordingly.

¹⁰² *Liebenberg NO v MGK Bedryfsmaatskappy (Pty) Ltd* 2003 (2) SA 224 (SCA). A trustee must apply the trust assets as provided for in the trust instrument for the benefit of the beneficiaries.

¹⁰³ *Land and Agricultural Bank of South Africa v Parker* 2005 (2) SA 77 (SCA). Where a trust instrument prescribes a minimum number of trustees to be in office, such requirement is a capacity-defining condition. Failure to meet the requirement will inevitably result in acts by appointed trustees being invalid.

¹⁰⁴ Geach and Yeats *Trusts* 96. Trustees should make certain that the correct systems are in place to ensure that assets are not lost and their actual location is recorded.

¹⁰⁵ Expert advice extends to all areas beyond the trustee's own experience or expertise. According to Geach and Yeats *Trusts* 96, circumstances which would require a trustee to enlist the services of an expert or make use of expert advice include the investment and financial affairs of the trust.

¹⁰⁶ MS Blackman *et al Commentary on the Companies Act* (2002) 208.

benefit of the beneficiaries. According to Blackman, there are certain fundamental fiduciary duties, and trustees are accordingly prohibited from the following:

- a) Exceeding their powers;
- b) Exercising their powers for an improper purpose;
- c) Fettering their own discretion;
- d) Placing themselves in a position where their personal interests conflict with their duties to the beneficiaries;
- e) Making a secret profit;
- f) Competing with any business of the trust;
- g) Making personal use of or abuse confidential information, or
- h) Unduly favouring one beneficiary to the detriment of another or others.¹⁰⁷

Impartiality is therefore a prominent fiduciary duty of trustees, who should always conduct all trust administration in an impartial manner. According to du Toit, this duty comprises two elements:

“On the one hand a trustee must avoid a conflict of interest between his personal concerns and his official duties. An important manifestation of this rule is that a trustee is not permitted to derive unauthorised profit from the administration of a trust. A trustee is therefore in general not allowed to purchase trust property, either directly or indirectly, nor cede it to himself in his personal capacity. A trustee should also not borrow trust money nor involve himself in any other conduct which may result in self-enrichment at the cost of the interests of the trust and its beneficiaries... The second aspect to the duty of impartiality relates to a trustee’s obligation to treat beneficiaries impartially, particularly when trust income and/or capital is distributed. Impartiality in this context often refers to the equal treatment of present and/or future beneficiaries, but may in certain circumstances entail discrimination between beneficiaries in favour of those with the greatest need.”¹⁰⁸

Whichever way impartiality is to be viewed, it is evident that this common law duty, together with the statutory duty of care, diligence and skill, has incited the new and increasingly important requirement of the independent trustee. Thus the trustee must exercise an

¹⁰⁷ Blackman *Commentary on the Companies Act* (2002) 208.

¹⁰⁸ du Toit *South African Trust Law* 71–72.

independent discretion at all times with respect to trust matters, and must not be under the undue influence of any person, particularly not the settlor of the trust.¹⁰⁹ In the *Parker* case Cameron JA made the following comment regarding the notion of the independent trustee:

“The independent outsider does not have to be a professional person, such as an attorney or accountant: but someone who with proper realisation of the responsibilities of trusteeship accepts office in order to ensure that the trust functions properly, that the provisions of the trust deed are observed, and that the conduct of trustees who lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the trust deed can be scrutinised and checked. Such an outsider will not accept office without being aware that failure to observe these duties may risk action for breach of trust.”¹¹⁰

5.4 THE BENEFICIARY

Bearing in mind that trusts are generally created to benefit one or more persons or classes of person, the trust beneficiary forms an integral part of the institution. Any person, be it born or unborn, natural or juristic, can become a beneficiary. This is because the law sets no requirements for trust beneficiaries, and thus they need not have contractual or legal capacity. Furthermore, trusts for unformed companies have also received approval by the courts, although Cameron *et al* maintain that such a trust is not one in the strict or narrow sense.¹¹¹

Importantly, and something which has become popular over the years, a trustee may also be a beneficiary¹¹² or even the sole beneficiary in a trust, although a trustee may not be the sole beneficiary as well as the sole trustee,¹¹³ as there would be no separation of the control from the enjoyment of the trust assets.

¹⁰⁹ Geach and Yeats *Trusts* 91.

¹¹⁰ Para 36.

¹¹¹ Cameron *et al Honoré's South African Law of Trusts* 553. Acceptance by a trustee or agent for an unformed company is possible but does not give it an indefeasible right as beneficiary until it comes into existence and accepts the designation.

¹¹² *The Master v Edgewcombe's Executors* 1910 TS 263 274.

¹¹³ See, for example, *Goodricke & Son v Registrar of Deeds, Natal* 1974 (1) SA 404 (N).

In *Jewish Colonial Trust v Estate Nathan*¹¹⁴ the issue of ambiguity regarding the identification of beneficiaries in the trust instrument arose. The court held that, if the name or description used in the trust instrument does not unequivocally designate any one person or body, the court may declare on a true interpretation of the trust instrument, that in the light of the admissible evidence, a certain beneficiary was intended.

Beneficiaries also enjoy a wide spectrum of rights. Income and capital rights are normally the first differentiation. The trust instrument in this regard should always distinguish between income and capital beneficiaries as well as give clear definitions as to what exactly is income and what is capital for the purposes of the trust. According to Geach and Yeats, owing to the difficulties that may arise where both classes of beneficiary are designated in the trust instrument, it may be desirable for the trust instrument to provide that in the event of the income of a trust being insufficient for the maintenance, education or medical care of an income beneficiary, then the capital of the trust may be used to make good on any shortfall.¹¹⁵ “A clause of this nature will not only ensure that the needs of beneficiaries are taken into account and will eliminate hardship, but will also enable trustees to focus on ensuring capital growth that exceeds the inflation rate.”¹¹⁶ It is evident that, when trustees try to maximise income flows to meet the needs of income beneficiaries, the long-term security and value of assets is compromised.

Other important privileges which affect trust beneficiaries are variable and fixed rights. Also largely dependent on the trust instrument, a beneficiary may be entitled to a fixed amount of income, or it could be entirely variable. The variation may also depend on economic circumstances, or even the happening of a specified event. Defining these rights is therefore of the utmost importance in order to avoid confusion down the line.

A trust instrument may also allow a beneficiary the right to use and enjoy trust assets. The formation of this right in the trust instrument should be carefully thought out and planned, as

¹¹⁴ 1930 NPD 1.

¹¹⁵ Geach and Yeats *Trusts* 118.

¹¹⁶ *Ibid.*

disputes often arise regarding the obligation of the beneficiary to preserve and maintain the asset:

“In the absence of a clause giving clear directions as to how costs and expenses are to be treated, a distinction should be drawn between costs and expenses that are necessary to keep the property in a usable form (such as repair and maintenance) and other costs (such as rates, employee costs and improvements).”¹¹⁷

As previously noted, beneficiaries also have either a discretionary or a vested right. A discretionary right is in the nature of a contingent right or a *spes* or hope. The trustee will at times exercise discretion in favour of a beneficiary with a discretionary right and the beneficiary will in turn benefit to the extent that the discretion has been exercised in his or her favour.¹¹⁸ On the other hand, a beneficiary with a vested right can enforce that right by calling upon the trustees to deliver to that beneficiary income or capital or a specific asset, depending on whether the right is a vested right to income, capital or a specific asset.¹¹⁹ Note, however, that both discretionary and vested beneficiaries have personal rights against the trustees because the rights that a beneficiary has, whether discretionary or vested, are personal rights.¹²⁰

Clearly of significance to this study, a beneficiary also has a right – albeit a limited one – to information. Such information concerns the matters of the trust, and is commonly enforced in order to gather knowledge as to the manner in which assets have been invested and distributed as well as the financials of the going concern. This right is contingent to a trustee's duty to account to beneficiaries.¹²¹

¹¹⁷ Geach and Yeats *Trusts* 121.

¹¹⁸ Geach and Yeats *Trusts* 120.

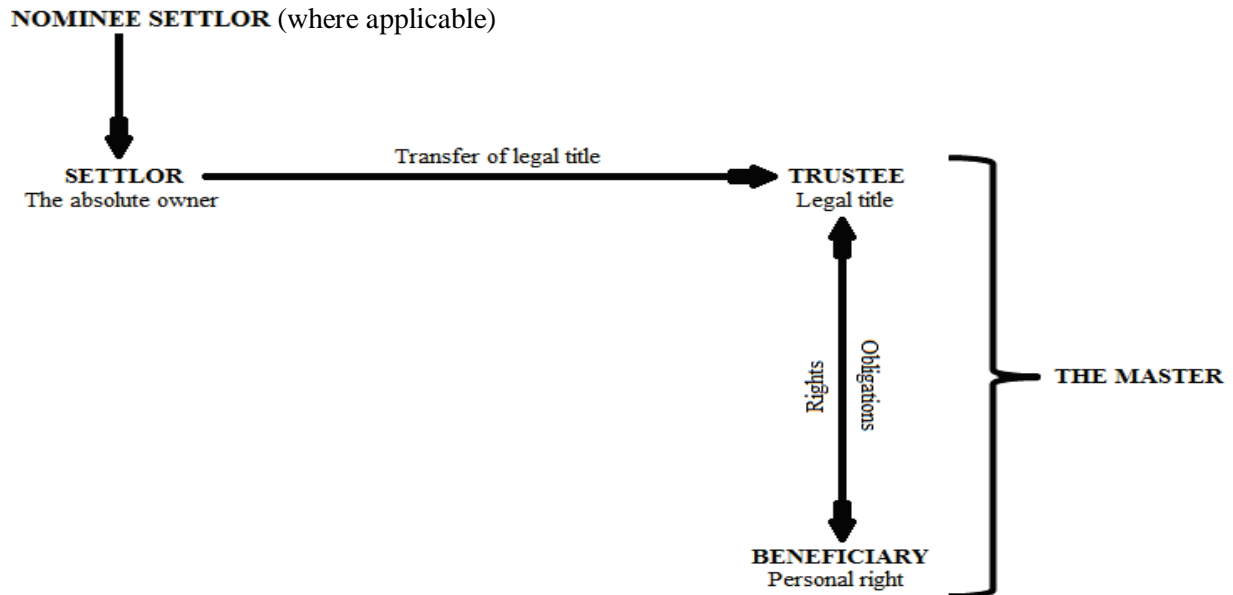
¹¹⁹ Geach and Yeats *Trusts* 121.

¹²⁰ A personal right is, however, to be contrasted with a real right in that a real right is enforceable against the entire world, whereas a personal right is against the trustees.

¹²¹ Geach and Yeats *Trusts* 123.

In summary, the basic structure of the trust in the narrow sense can be depicted by Figure 2.1:

Figure 2.1: The Parties that Constitute the Structure of a Trust



6. THE FORMATION OF A TRUST

For a valid trust to be created (a) the settlor must intend to create one, (b) the settlor's intention must be expressed in a mode appropriate to create an obligation, (c) the property subject to the trust must be defined with reasonable certainty, (d) the trust object, which may either be personal or impersonal, must be defined with reasonable certainty, and (e) the trust object must be lawful.¹²²

Notably, the designation of a trustee as well as the acceptance by the designated trustee is not essential to the existence of a trust. According to *Committee of the Johannesburg Public Library v Spence*,¹²³ as long as the obligation to create or administer a trust is present, the Master or the court will, if necessary, see that the trust is put into effect by appointing a trustee.¹²⁴ Furthermore, the matter of *Deedat v The Master*,¹²⁵ established that it is not

¹²² *Administrators, Estate Richards v Nichol* 1996 (4) SA 253 (C) 258E–G.

¹²³ 1898 (5) OR 84.

¹²⁴ At 89.

essential that the trust property be transferred to the trustee or beneficiary: all that is necessary for the existence of a valid trust is that the settlor should be under a duty to give the control of the property to a trustee.¹²⁶

6.1 INTENTION

Any person with contractual capacity or the capacity to create a will may create a trust. Furthermore, a trust may be set up by a court, by statute or on statutory authority. Importantly, an intention to create a trust must be present in each case, since a trust imposes a burden on the trust property and freedom from burden is presumed.¹²⁷ With regard to trusts in the narrow sense, the settlor should intend that the transferee should hold an office by virtue of which duties attaching to the office will descend to a successor in office rather than to the deceased trustee's executor.¹²⁸

In order to ensure sufficient intention it is necessary for the settlor of a trust to demonstrate a clear and explicit intention to create a trust.¹²⁹ Relatively, the settlor must confer sufficient independence on the supposed trustee as well as adequately vest property in the trustee, otherwise the trustee becomes a mere agent and the element of intention will be lacking. Crucially, the intention to create a trust *inter vivos* must be shared by the settlor and the prospective trustee:

“Intention is inferred from the circumstances and depends on what words are used, how formal the arrangement is, what the normal practice is in the context, and other factors ... and [w]ords such as ‘trust’ and ‘administrator’ point to the creation of a trust, but are not conclusive, since they may have been employed by mistake, or may denote trusts or trust-like arrangements only in a wide sense.”¹³⁰

¹²⁵ 1998 (1) SA 544 (N).

¹²⁶ Cameron *et al Honoré's South African Law of Trusts* 176.

¹²⁷ Cameron *et al Honoré's South African Law of Trusts* 118. See further, *Ex parte Kaminsky* 1917 TPD 338.

¹²⁸ Cameron *et al Honoré's South African Law of Trusts* 118. Such a person is to hold the property in a purely administrative capacity, whereas in the latter, the transferor does not intend that anyone other than the transferee should be burdened with the obligation.

¹²⁹ MM Corbett *et al The Law of Succession in South Africa* 2 ed (2001) 395-396.

¹³⁰ Cameron *et al Honoré's South African Law of Trusts* 119.

According to *Prichard's Trustee v Estate Prichard*,¹³¹ if a settlor has endowed the intended trustee with a discretion to create a trust or to implement its provisions, an intention on the part of the settlor may be lacking. However, if an intention to create a trust is evident from the trust instrument, together with the surrounding circumstances, the use of mere directory or precatory words by the settlor will not preclude the formation of a trust.¹³²

In the case where the intention to create a trust is not clearly stated, the courts have accepted that the creation of a trust can be inferred, even though there are no explicit references to the trust. On this point, in the case of *Harper v Epstein*,¹³³ Schreiner JA concluded that such an interpretation should proceed on the lines that what must be ascertained is what the settlor meant or intended by using the words.¹³⁴ Nevertheless, the bottom line in this enquiry is neatly set out in *Dempers and Others v The Master and Others (1)*,¹³⁵ where the presiding judge noted: “[t]he vital question to be answered is whether he [the settlor] has expressed his intention with sufficient clarity to create an obligation.”¹³⁶ The importance of this element should not be undermined, and its particular relevance will become sufficiently clear upon an examination of the doctrines of the sham and the alter-ego.

6.2 OBLIGATION

In its simplest expression, the intention must be expressed in a mode appropriate to create an obligation. Therefore, it is necessary to house the intention in some legally recognised form, such as a will, contract, transfer, statute, treaty or court order. It is of no importance whether the act was unilateral – such as a will, statute or court order – or bilateral – such as a contract or treaty.

¹³¹ 1912 CPD 87 at 96.

¹³² *Corbett Succession* 396.

¹³³ 1953 (1) SA 287 (A).

¹³⁴ At 297H.

¹³⁵ 1977(4) SA 44 (SWA).

¹³⁶ At 58B–C.

Cameron *et al* describe the so-called obligation as either:

“(i) the obligation resting on the trustee to administer the property for the trust object, or (ii) the obligation resting on the founder or on another (eg the founder’s executor) to take the necessary steps to ensure that the property is administered by a trustee, for example by transferring the property to the latter.”¹³⁷

The legal obligation referred to under the obligation requirement depends on the particular situation at hand. “If the trust property has already been transferred to or placed under the control of a duly appointed trustee, the obligation refers to the obligation imposed on such trustee to administer the trust property in pursuance of the trust object.”¹³⁸ It thus follows that for the creation of a trust *inter vivos* by way of contract (between the settlor and the trustee), the appointment of a trustee and their acceptance of such appointment are not essential for the creation of a legitimate trust. It does however stand to reason that with the creation of a trust *inter vivos* by way of *stipulatio alteri*, such is indeed required.¹³⁹

6.3 PROPERTY

Trust property can consist of any asset or group of assets, movable or immovable as well as corporeal or incorporeal.¹⁴⁰ As such, any asset that can be held in ownership and that can be converted into money if liquidated can constitute trust property.¹⁴¹ According to the Act, “trust property” is described as “movable or immovable property and includes contingent interests in property which in accordance with the provisions of a trust instrument are to be administered or disposed of by a trustee.”¹⁴²

¹³⁷ Cameron *et al* *Honoré’s South African Law of Trusts* 138.

¹³⁸ du Toit *South African Trust Law* 30.

¹³⁹ *Ibid.* The bilateral nature of the act of creation, stemming from the contractual basis of the trust *inter vivos*, necessitates *consensus ad idem* between founder and trustee and as such, the trustee’s acceptance of such appointment.

¹⁴⁰ Cameron *et al* *Honoré’s South African Law of Trusts* 146.

¹⁴¹ du Toit *South African Trust Law* 30.

¹⁴² Section 1 of the Trust Property Control Act 57 of 1988.

Whatever form the property subject to a particular trust takes, it is essential that such property be defined with reasonable certainty,¹⁴³ and failure to do so will result in the non-creation of the trust. The onus of such determination falls on the trust instrument, and if no property at all is located in the trustee, then a trust in the wide sense only may be the result. This was the case in the matter of *Conze*, where investors sent funds to their agent, Masterbond, who even though described as the “trustee”, paid the funds to a corporate investment company on the investor’s behalf. The court noted that there was therefore no “notional transfer of funds from Masterbond as agent to Masterbond as trustee”.¹⁴⁴

Importantly, “if the description of the trust property is ambiguous, the ambiguity is resolved like any other in a will or contract by recourse to such intrinsic or extrinsic evidence as is admissible for the purpose.”¹⁴⁵ In the case of *Deedat and Others v Master of the Supreme Court, Natal and Others*,¹⁴⁶ the facts of which case followed similar lines, the court confirmed that at common law one of the essential elements of a valid trust “is a definite or identifiable subject-matter.”¹⁴⁷ The court held that, although the trust instrument declared a “clear intention on the part of the settlors and trustees to create a charitable trust for the promotion of the charitable or religious activities of the Islamic faith”,¹⁴⁸ the trust instrument did not expressly identify its source and exact nature.¹⁴⁹

Drawing on the above definition of a “trust” in the Act, of particular relevance is the statement “‘trust’ means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed.”¹⁵⁰ A trust will thus obviously exist only if there is a factual making over or bequest of assets to at least one trustee. Where a settlor of a trust *inter vivos* makes a nominal amount available in order to establish a trust “(for example, the founder donates R1 000 as the initial amount in order to form the trust), it is important that this amount is actually received and banked by trustees,

¹⁴³ du Toit *South African Trust Law* 30.

¹⁴⁴ At 793F–G.

¹⁴⁵ Cameron *et al Honoré’s South African Law of Trusts* 147.

¹⁴⁶ 1995 (2) SA 377 (AD).

¹⁴⁷ At 383E–F.

¹⁴⁸ At 383E–I.

¹⁴⁹ The court held the trust to be void *ab initio*. This decision was however overturned on appeal by the Appellate Division, as it was then.

¹⁵⁰ Section 1 of the Trust Property Control Act 57 of 1988.

and the trustees accepting [of] these assets [is what] ... actually forms the trust.”¹⁵¹ If the amount is not actually paid over to the trustees, it must be argued that the trust has not yet been formed. Moreover, the requirements of s 10 of the Act establish that should any money be received by a trustee, that person “shall deposit such money in a separate trust account at a banking institution”. Thus it would be unacceptable that such money be placed in the petty cash box.¹⁵²

On a practical note, *inter vivos* trusts are normally formed by trustees’ acquiring a nominal sum of money in terms of the trust instrument. On behalf of the trust, the trustees afterwards purchase the majority of trust assets from the settlor on loan account. According to Geach and Yeats, in practice many trusts have acquired assets from a settlor, and the settlor holds a loan account in the trust. In this way any increase in the market value of assets takes place in the trust, and the settlor effectively freezes his or her estate at the time that assets were acquired by the trust.¹⁵³ This act of making over an asset to the trustees forms the trust. From a tax perspective, s 55(1) of the Income Tax Act¹⁵⁴ defines “donee” as including a trustee where assets are given to a trust for the benefit of any beneficiary. In order to avoid double donations tax, s 56(1)(l) exempts from donations tax distributions from a trust to a beneficiary. Usually the assets are sold to the trust at current market value to avoid having to pay donations tax (in the context of the trust *inter vivos*).

Typically, trusts do not have the cash available to pay the purchase price, so the sale creates a debt due to the settlor which is forgiven over time. The process is as follows: a transfer of property may take one of two forms, either a donation or a sale. If the transaction is by way of sale and the trust does not have the funds available, the transaction goes through the trust’s loan account. Thus the lender becomes the debtor and the trust’s loan account is credited with the amount, with a concurrent debit in the trust’s asset account. In order for the trust to reduce the debt, the trustees will use the annual limit per tax payer for donations,¹⁵⁵ and the beneficiaries (as well as the settlor), if agreed upon, will donate, say, R100 000 per annum to

¹⁵¹ Geach and Yeats *Trusts* 38.

¹⁵² *Ibid.*

¹⁵³ Geach and Yeats *Trusts* 14.

¹⁵⁴ Act 58 of 1962.

¹⁵⁵ This limit currently stands at R100 000.

the trust and in doing so reduce the loan account by the said amount. Donating at a rate of R100 000 per annum can be a slow process, and in order to make the most of the advantages of having a trust, it is important not to delay the process of transferring assets. It is important to remember that until the loan account is diminished, the loan to the trust forms an asset in the creditor's estate and, as such, is available to his or her creditors in turn. The risk is diminished over time, thus the earlier the donations begin, the better.

6.4 OBJECT

The trust object must be sufficiently certain.¹⁵⁶ This means that the object of the trust has to be stated in clear terms in the trust instrument, and that a trust without an indication of the object to be served by the restrictions imposed on the trust property constitutes a *nudum praeceptum* and is consequently ineffectual.¹⁵⁷ Normally trusts are set up to benefit one or more persons or classes of persons. Should the trust be effected so as to benefit one or more persons, such persons must be identifiable with reasonable certainty. This is often the duty of the settlor, although he or she need not appoint the beneficiaries him or herself, as a power to appoint can within limits be bestowed on the trustees. The power to appoint enables the trustees to identify individual trust beneficiaries, usually from a group of beneficiaries designated by the settlor.¹⁵⁸

The same guidelines must be followed for trusts which are established for an impersonal object. The settlor must therefore define such object (often charitable in nature) with sufficient certainty. The court's stringent approach to this requirement was observed in the matter of *Re Grayson*¹⁵⁹ where a testator attempted to set up a charitable trust. According to the court, the terms contained in the trust instrument were vague and as such the trust was declared invalid as the testator had failed to impose a binding obligation on his executors to create a trust.

¹⁵⁶ HL Swanepoel "Oor Stigting, Trust, Fideicommissum, Modus en Beding ten behoeve van 'n Derde" (1956) 19 *THRHR* 198.

¹⁵⁷ du Toit *South African Trust Law* 31.

¹⁵⁸ *Braun v Blann and Botha* 867A.

¹⁵⁹ 1937 AD 96.

Accordingly, when the trust object is for the benefit of persons or classes of people, two main rules must be taken into account. First, if the person for whose benefit the trust is intended is not named or determinable, the trust fails for lack of a certain object,¹⁶⁰ and, second, if the trust derogates from the rights of the owner of the trust property, the restrictions it contains must be imposed in the interests of a person other than the owner, otherwise it is a *nudum praeceptum*.¹⁶¹ When there is no designated beneficiary, the trust automatically fails.¹⁶²

6.5 LEGALITY

Simply put, the trust object must be lawful. According to the decided case of *Oosthuizen v Bank Windhoek*,¹⁶³ a trust object will be unlawful if it is illegal, contrary to public policy or *contra bonos mores*. Obviously, illegality is a notion easily determinable by the courts, but *bonos mores* represents a slightly more problematic determination. Hahlo observes that “[t]imes change and conceptions of public policy change with them”¹⁶⁴ and therefore an arrangement considered in conflict with public policy or *contra bonos mores* in the past need not necessarily be so considered at present, while, conversely, prevailing public policy considerations might require invalidity to be imposed on an arrangement regarded as completely valid in the past.¹⁶⁵ An enquiry into case law reflects that the element of legality is more often than not an inquisition founded by testamentary trusts. As for the trust *inter vivos*, should the object of the trust be to protect the beneficiary against the claims of his or her creditors, the trust is not unlawful.¹⁶⁶

Regarding the elements of legality and object, an interesting development in the law took place recently in South Africa. In the case of *Peterson NO and Another v Claassen and Others*,¹⁶⁷ the Western Cape High Court was faced with an exception raised by the

¹⁶⁰ Cameron *et al Honoré’s South African Law of Trusts* 151.

¹⁶¹ *Ibid.*

¹⁶² See *Harper v Epstein* 218 (1) SA 287 (A); *Batt v Batt’s Widow* 1853 (2) Menz 408.

¹⁶³ 1991 (1) SA 849 (Nb).

¹⁶⁴ HR Hahlo “Jewish faith and race clauses in wills” (1950) *SALJ* 231 at 240.

¹⁶⁵ du Toit *South African Trust Law* 32.

¹⁶⁶ See, for example, *Hiddingh’s Trustee v Colonial Orphan Chamber and Hiddingh* 1883 (2) SC 273; *Minister of Education v Syfrets Trust Ltd NO and Another* 2006 (4) SA 205 (C); and *Ex Parte BOE Trust Ltd* 2009 (6) SA 470 (WCC) and *Curators Ad Litem to Certain Beneficiaries of Emma Smith Educational Fund v The University of KwaZulu-Natal* [2010] ZASCA 136.

¹⁶⁷ 2006 (5) SA 191 (C).

defendants to the plaintiffs' particulars of claim on the basis that they were vague and embarrassing. The plaintiffs in the matter, being the joint liquidators and trustees in a number of interlinked insolvent estates, sought to set aside the transfer of those properties as well as an order declaring that the transfers of the relevant land were void and that the deeds of transfer be cancelled.

The grounds relied upon by the plaintiffs were that the defendants had devised a scheme which was intended to defraud their personal creditors and those of the Family trust and the corporation by dissipating the assets of the insolvent entities to new trusts.¹⁶⁸ The fraudulent scheme devised also required the defendants to obtain a decree of divorce so as to separate their joint estate. To this end, seven new trusts were created and registered and immediately after their registration, the defendants sold immovable properties registered in their names to two of the seven newly formed trusts. To complicate matters further, with the transfer of each property, a mortgage bond was registered over them in favour of the second defendant (Absa Bank Ltd).¹⁶⁹ During the period of transfer, two previously properties of the original Family trust were sold to another of the new trusts, with the occurrence of another mortgage bond being registered thereafter.

Unsurprisingly, the plaintiffs alleged that the intended effect of the scheme was to divest the insolvent entities of their assets and to place them beyond the reach of creditors and that it constituted fraud on the creditors of the estates of the insolvent entities.¹⁷⁰

In reaching a decision, Bozalek J examined the difference between the object of a trust and the purpose thereof:

“The object is openly proclaimed and ascertainable and all parties who have dealings with that trust will be held to have knowledge of the trust's object. In the present case the objects of the three new trusts which took transfer of the properties were entirely lawful, the primary object being in each case

¹⁶⁸ Para 5.

¹⁶⁹ Para 6.

¹⁷⁰ Para 7.

‘om bates en inkomste te bekom en aan te wend tot uiteindelijke voordeel van die begunstigde’ ... By contrast where a trust is formed for an illegal or unlawful purpose this knowledge is jealously guarded by those who harbour such purpose. This is but one reason, although an important one, why the purpose of a trust, where it is an illegal or immoral purpose but is known only to the founder and to the trustees, cannot be equated in all circumstances with that trust’s (lawful) object.’¹⁷¹

The learned judge then inspected the common law view of an agreement with which the purpose behind it is illegal: “At common law an agreement is unenforceable if the ultimate purpose of the parties is prohibited by common law.”¹⁷² Whether or not the contract is void however requires further attention, because as Bozalek J noted in his judgment, the “general rule has been relaxed to some extent in the situation where one party enters into the contract for an illegal purpose but the other knows nothing of that purpose and is entirely innocent. In such a case the innocent party can enforce the contract but the guilty party cannot.”¹⁷³

Notably, Bozalek J fairly reasoned that:

“the fact that a trust is created for an unlawful purpose does not automatically render it void. Such an approach has anomalous and unfair results, not least of which is that where transfers of properties are effected for a fraudulent purpose using a trust, a different result will obtain depending on whether the trust is created with that purpose in mind or whether that purpose pre-exists the establishment of the trust.”¹⁷⁴

The judge therefore adopted the view that where a trust is created for an illegal purpose, agreements which it thereafter purports to conclude may be void or voidable in accordance with the ordinary contractual principles and depending on the individual circumstances of each agreement.¹⁷⁵ Bozalek J held that for those reasons, even if the illegal purpose contended for by the plaintiffs rendered the new trusts void, the excipient, as an innocent third party, was not thereby stripped of the rights of security in the properties which it

¹⁷¹ Paras 16-17.

¹⁷² Para 19.

¹⁷³ *Ibid.*

¹⁷⁴ Para 21.

¹⁷⁵ Para 22.

acquired for at fair value.¹⁷⁶ The court thus upheld the exception, and the plaintiff's particulars of claim, were deemed vague and embarrassing.

7. GOOD BUSINESS PRACTICE

The above five elements impose several duties upon settlors and trustees to a trust and, as observed by Geach and Yeats, the following five observations serve as good business practice: First, there must be a written document, in this case the trust instrument.¹⁷⁷ Second, there must be at least one trustee and one beneficiary. Third, the trustees must have legal ownership of the trust property. Fourth, the trustees must hold the trust property for the benefit of the beneficiaries and, finally, the fifth expression is that there must be a clear separation of control from the enjoyment of trust assets.¹⁷⁸ It is appropriate at this stage to consider each element separately below.

In s 1 of the Act,¹⁷⁹ a trust instrument is defined as “a written agreement or a testamentary writing or court order according to which a trust is created.”¹⁸⁰ This founding document of the trust is the trust deed or instrument. A trust instrument must contain the names of the beneficiaries or a list of the objects of the trust as well as the terms of the trust. The trust instrument should also identify the trustee(s). In the absence of such appointment, the Master is empowered in terms of s 7 of the Act to appoint at least one trustee in order to avoid a nullity.

¹⁷⁶ Para 39.

¹⁷⁷ Except in the case of an oral trust, which never has to be reduced to writing. The Trust Property Control Act recognises oral trusts to a limited degree. Section 2 provides that if there is an oral agreement by which a trust is created or varied and if such agreement was reduced to writing, that written document will for the purposes of the Act, be deemed to be a trust instrument. Geach and Yeats *Trusts* point out (at 27) that:

“[I]t is necessary to comply with the provisions of the Trust Property Control Act, not least because before a person can validly act as trustee that person must have obtained the prior written consent of the Master to do so, and the Master [in terms of s 6 of the Act] will certainly not authorise a person to act as trustee if there is not a ‘trust instrument’ as envisaged by the Trust Property Control Act.”

Needless to say, the Master as well as the Act will not have jurisdiction and influence over oral trusts that are not reduced to writing.

¹⁷⁸ Geach and Yeats *Trusts* 3.

¹⁷⁹ Act 57 of 1988.

¹⁸⁰ Section 1 of the Trust Property Control Act.

In the second expression, it is of the utmost importance that not only should there be at least one trustee and one beneficiary, but that those two parties not be the same person. The reasoning behind this prerequisite is articulated in *Thorpe v Trittenwein*,¹⁸¹ where Scott JA reasoned that there must not be a blurring of the separation between ownership and enjoyment, and that separation is the very core of the idea of a trust.¹⁸²

In the third expression, it is a requirement that the property to be held in trust be transferred to the trustees during the lifetime of the settlor (for an *inter vivos* trust) and that ownership of the assets shifts to the trustees. Upon the death of the settlor, and in accordance with his or her will, all trust property not yet transferred should be bequeathed to the trust or otherwise made over to the trustees, and when that occurs ownership of the assets passes to the trustees.

In the fourth expression, although the trustees have legal ownership of the trust property, the ownership is non-beneficial. This “bare-ownership” requires the trustees not to benefit personally or enjoy the trust property¹⁸³ but rather to act in accordance with the trust instrument and in the best interests of the beneficiaries.¹⁸⁴ Stander articulately expresses this notion as follows:

“The trustees are not the agents of the trust nor for that matter of the beneficiaries. They are subject to a fiduciary obligation and have the power and duty, in respect of which he/she may be held to account, manage, employ or dispose of the trust assets in accordance with the terms of the trust instrument and the special duties imposed by law. It is often said that trustees must use greater care in handling trust property than they might in dealing with their own property. Trustees are in a fiduciary position and in dealing with the money of the beneficiary obliged to observe due care and diligence.”¹⁸⁵

¹⁸¹ 2007 (2) SA 172 (SCA).

¹⁸² Para 17.

¹⁸³ Geach and Yeats *Trusts* 2. Note, however, that a trustee who is also a beneficiary is entitled to beneficial ownership. This must not, however, overshadow their concurrent non-beneficial interest as a trustee in the execution of their duties as a trustee.

¹⁸⁴ Indeed, if the trustees are professional trustees, they may benefit by charging fees. They may also (although not regarded as good practice) be beneficiaries. In this regard, it is of paramount importance that trustees distinguish the two separate positions they may find themselves in, adhering to the fiduciary duty laid out in s 9 of the Trust Property Control Act.

¹⁸⁵ Stander 2008 *INSOL* 166.

In the fifth and final expression, a clear separation of the control of trust property from the enjoyment of the assets is essential. Each trustee must act in all trust matters with the utmost good faith and observe all duties imposed in terms of the Act and by the common law.¹⁸⁶ In this regard, the appointment of one or several independent trustees is recommended in order to maintain the distinction mentioned above.

8. CONCLUSIONS

From a comparatively humble and uncertain inception, the trust has been developed to such an extent that a unique and distinctively South African law of trusts has been formed. Although this development was initially undertaken exclusively by the courts, it later became clear that the intervention of the Legislature was necessary in order to clarify the uncertainties created by the exercise of judicial discretion. Even though legislation has succeeded, to an extent, in providing the clarity sought, a number of problematic issues still exist. Owing to the simplicity of the Act and the ever-increasing discretion used by the courts to interpret the law of trusts, this sphere of the law remains vague. Moreover, the uncertainty lends itself not only to the ambiguity of the law of trusts in general, but also to the difficulty now faced by those who use trusts legitimately.

Regardless of the above, the law and principles laid down in this chapter serve as the most crucial reference point for an interpretation of the relevant case law in South Africa,¹⁸⁷ as well as the articulation of the recommendations that follow.¹⁸⁸

¹⁸⁶ Geach and Yeats *Trusts* 3.

¹⁸⁷ See Chapter 3 below.

¹⁸⁸ See Chapter 6 below.

CHAPTER 3

THE LAW OF TRUSTS POST *PARKER*

1. INTRODUCTION

This chapter introduces three landmark decisions central to this thesis, and is divided into three sections. The first examines the Supreme Court of Appeal's (SCA) decision in the matter of *Land and Agricultural Bank of South Africa v Parker and Others*¹ with specific emphasis on the court's development of trust law in accordance with business efficacy, commercial accountability and the reasonable expectations of outsiders – the supposed duty pronounced on by the court which has in turn led to the adoption of the doctrine of piercing the corporate veil – an unsightly and erroneous development. This section then undertakes a comprehensive examination of the court ruling, clearing up any potential speculation as to the status of the law following the *Parker* judgment. It is submitted that what will become apparent from Cameron JA's decision is that the court in fact ignored the doctrine of the sham, and instead adopted the doctrine of piercing the corporate veil into trust law – a company law principle foreign to the law of trusts. The case also introduces the topic of the independent trustee, a feature of modern-day trust law which has become increasingly important in South Africa.

The second section of this chapter examines the South African High Court decision of *Badenhorst v Badenhorst*² and the subsequent appeal to the SCA, *Badenhorst v Badenhorst*.³ This case is important as it illustrates the negative ripple-effect the *Parker* case has had on the South African law of trusts. In addition, the *Badenhorst* case offers an insight into the courts' lack of understanding of the doctrines of the sham and the alter-ego. A case which should have simply fallen under the rules of the alter-ego principle became in effect confused, resulting in the amalgamation of the trust doctrines, a mistake which disrupted the rules of trust veil-lifting in South Africa.

¹ 2005 (2) SA 77 (SCA).

² 2005 (2) SA 253 (C).

³ 2006 (2) SA 255 (SCA).

The third section of this chapter covers the recent case of *Van der Merwe NO and Others v Hydraberg Hydraulics CC and Others; Van der Merwe NO and Others v Bosman and Others*.⁴ The inclusion of this matter helps to measure the ripple-effect of the *Parker* case five years later and offers a somewhat similar, yet “fresh” judicial perspective on the rules of trust veil-lifting in South Africa.

The three cases above, together with those mentioned in Chapter 5 which include *Jordaan v Jordaan*,⁵ *Nedbank Ltd v Thorpe*,⁶ *Nel and Others v Metequity Limited and Another*,⁷ *Nieuwoudt and Another v Vrystaat Mielies (Edms) Bpk*,⁸ *Thorpe v Trittenwein and Another*⁹ and *Grobbelaar v Grobbelaar*¹⁰ provide a much needed insight into the pertinent South African trust law developments and provide the basis for the foreign law comparison on point.

The unwelcome development in South African trust law, on the other hand, will allow for the courts to make a value judgement in future. As a result, owing to the aforementioned precedent, future courts will not be obliged to follow the strict trust law doctrines and allow for an equitable decision based on fairness and public policy. This unenvisaged development in South African law comes at the price of legal uncertainty and a law of trusts disturbed by the law of commerce – a con which largely outweighs any pros.

2. THE PARKER CASE

This case was heard on appeal in the SCA. The facts concerned an insolvent family trust which had been established in 1992. The settlor, Mr Parker, a previously well-off Lichtenburg farmer, named the trust after his wife (“the Jacky Parker Trust”). The named beneficiaries of the trust included Mr and Mrs Parker¹¹ and their descendants. The trustees were the Parkers and their family attorney, who subsequently resigned in 1996, leaving the

⁴ 2010 (5) SA 555 (WCC).

⁵ 2001 (3) SA 288 (C).

⁶ [2009] ZAKZHC 44.

⁷ 2007 (3) SA 34 (SCA).

⁸ *Bpk* 2004 (3) SA 486 (SCA).

⁹ 2007 (2) SA 172 (SCA).

¹⁰ Case No 26600/98 (unreported judgment of the Transvaal Provincial Division).

¹¹ Hereafter referred to as “the Parkers”.

Parkers as the sole remaining trustees. The trust instrument required a minimum of three trustees in office at all times, and stipulated that should the number fall below that mark, the remaining trustees were empowered to appoint a third. The court concluded that this power, together with the minimum requirement, in effect placed a duty on the Parkers to appoint a third trustee when one resigned.¹²

In breach of the remaining trustees' (the Parkers) duty to give effect to the terms of the trust instrument, they failed for nearly two years to do so. From April to October 1998, whilst operating below the sub-minimum, the Parkers accepted loans for the repayment of which they purported to bind the trust. On behalf of the trust as co-principal debtor and surety the Parkers entered into a series of agreements in which the companies connected to their family business obtained considerable advances from the bank. Upon firm direction from the Master to appoint a trustee, the Parkers assigned their son as the third trustee – who, too, was a beneficiary.

In September 2000, the bank obtained a provisional order to sequester the trust after the Parkers' business dealings began to fail. The court *a quo* confirmed the orders of sequestration and refused leave to appeal. However, the trust obtained leave and successfully appealed the decision to the full bench, thus setting aside the sequestration order.¹³ The Supreme Court of Appeal granted special leave to the bank to appeal the judgment.

Cameron JA reasoned that the trust deed is the constitutive charter of the trust and, as such, any act outside the provisions of the instrument cannot bind the trust estate.¹⁴ Thus, the Parkers were incapable of entering into any loan agreements or business transactions on the trust's behalf, even with a majority vote, as the trust deed required three trustees to be in office.

¹² Para 3.

¹³ *Parker No v Land and Agricultural Bank of South Africa* (2003) 1 ALL SA 258 (T).

¹⁴ Para 10.

In terms of going behind the trust form, Cameron JA stated that the essential notion of trust law is that enjoyment and control should be functionally separate.¹⁵ With regard to s 9 of the Trust Property Control Act,¹⁶ the duties imposed on trustees and the standard of care required on them derives from this principle. Cameron JA cautioned against the Parkers' disregard of this fundamental principle in the following terms:

“It is evident that in such a trust there is no functional separation of ownership and enjoyment. It is also evident that the rupture of the control/enjoyment divide invites abuses. The control of the trust resides entirely with beneficiaries who, in their capacity as trustees, have little or no independent interest in ensuring that transactions are validly concluded. On the contrary, if things go awry, they have every inducement as beneficiaries to deny the trust's liability. And no scruple precludes their relying on deficiencies in form or lack of authority since their conduct as trustees [will] unlikely ... be scrutinised by the beneficiaries. This is because the beneficiaries are themselves, or those who through close family connection have an identity of interests with them.”¹⁷

In other words, as trustees and principal beneficiaries, the Parkers had an interest in obtaining loans from the bank. The Parkers' actions thus did not derive from their fiduciary duty as responsible trustees, but rather from their capacity as beneficiaries who required protection from their creditors. Furthermore, Cameron JA warned that, while outsiders have an interest in self-protection, the primary responsibility for observance with the formalities, and for ensuring that contracts lie within the authority conferred by the trust instrument, lies with the trustees. The logic adopted by the learned judge underpins the rule that outsiders contracting with an entity and dealing in good faith may presume that acts performed within its constitution and powers have been properly and duly performed, and are thus not bound to enquire whether acts of internal management have been met.¹⁸

¹⁵ Para 22.

¹⁶ Section 9 of the Trust Property Control Act 57 - “Care, diligence and skill required of trustee” states:
“(1) 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.
(2) Any provision contained in a trust instrument shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust where he fails to show the degree of care, diligence and skill as required by subsection (1).”

¹⁷ Para 29.

¹⁸ Para 37.1.

On this point, Cameron JA eloquently expressed the inference which could therefore be drawn:

“... that the trustee who concluded the allegedly unauthorised transaction was in fact authorised to conduct the business in question as the agent of the other trustees.... Such an inference may in a suitable case be drawn from the fact that the other trustees previously permitted the trustee or trustees in effective charge of affairs free rein to conclude contracts. A close identity of interests between trustee-beneficiaries, as in most family trusts, may make it possible for the inference of implied or express authority to be more readily drawn.”¹⁹

After cautiously suggesting the above, the court went on to make its landmark decision, varying the law of trusts, which is most applicable to this study. Cameron JA reasoned that, based on the evidence before the court, it may be necessary to extend the well-established principles of company law into trust law.

Accordingly, where the conduct of the trustees invites the inference that the trust form is a mere façade for the conduct of a business “as before”, and that the assets allegedly vesting in trustees in fact belong beneficially to one or more of the trustees (a complete failure to give away control of the property), the trust assets may be used in repayment of debts to which the trustees purported to bind the trust.²⁰

The *obiter* statement articulated by Cameron JA was as follows:

“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.”²¹

¹⁹ Para 37.2

²⁰ Para 37.3.

²¹ *Ibid.*

The SCA pointed out that the pretension to bind the trust estate during the two-trustee period was an act of usurpation that simply compounded the breach of trust they committed by failing to appoint a third trustee.²² The appeal of the bank consequently succeeded, and the sequestration order against the trust was reinstated.

3. THE BADENHORST CASES

3.1 THE COURT OF FIRST INSTANCE

In *Badenhorst*, the plaintiff, Ian Badenhorst sued his wife, Lynette Badenhorst, in the court *a quo* for a decree of divorce and ancillary relief. The defendant counter-claimed and sought a redistribution order, in terms of s 7(3) of the Divorce Act,²³ whereby 50 per cent of the value of the plaintiff's estate would be awarded to her. Included in the prayer was a claim that the assets within the family trust ("the Jubilee Trust") be regarded as assets in the plaintiff's estate. The defendant alleged in support of her claim that the trust was controlled by the plaintiff and was in effect his alter-ego. It was further alleged that both parties had in fact contributed income and talent in order to acquire the trust assets and had the trust not been created at all, the assets would have vested in the plaintiff's estate.

The plaintiff, Mr Badenhorst, and his brother were the co-trustees of the family trust. The capital beneficiaries included the four children born of the marriage, and the income beneficiaries were Mr and Mrs Badenhorst.²⁴ In terms of the trust instrument, the respondent had the right to discharge his co-trustee and appoint someone in his place at his own discretion. Furthermore, the trustees had an unfettered discretion to do with the trust assets and income as they saw fit.

In coming to a decision in the court *a quo*, Ngwenya J examined the possibility of the trust being the alter-ego of the plaintiff. The question structured by the court was "whether the ... Jubilee Trust [was] used by the plaintiff such that [it was] his convenient vehicle to amass

²² Stander 2008 *INSOL* 168.

²³ Act 70 of 1979.

²⁴ Hereafter referred to as "the Badenhorsts".

assets.”²⁵ In the defendant’s evidence in chief, she testified that the plaintiff did as he pleased as regards the property of the Jubilee Trust, but conceded under cross-examination that she could not deny that he consulted his brother, the other trustee, when dealing with the finances and immovable property pertaining to the trust. The defendant further admitted that she kept the trust assets as a bookkeeper separately from those of the plaintiff. The defendant testified further that, where the plaintiff was to make payment on behalf of the trust from his personal account, the trust was debited accordingly, and *vice versa*.²⁶

Accordingly, Ngwenya J noted: “[a]part from the general statements that the plaintiff was manipulating the trust there is no factual basis upon which I can come to the conclusion that the trust was a vehicle through which the plaintiff protected himself.”²⁷ The defendant’s counsel referred to the matter of *Jordaan v Jordaan*²⁸ as authoritative in support of the contention the presiding judge must have in mind that the plaintiff had access to the assets of the trust.²⁹ In *Jordaan*, Traverso J noted:

*“Maar daar kan nie uit die oog verloor word dat die verweerder in die verlede en ongetwyfeld ook in die toekoms, die plaas gebruik het om vir hom finansiële voordeel in sy persoonlike hoedanigheid in te hou nie. Na my mening sou dit reg en billik wees indien ek ingevolge die bepalings van Art 7(5) van die Wet op Egskeidings die bates van hierdie plaas in aanmerking neem, by hierdie beoordeling van die vraag of dit in die omstandighede reg en billik sal wees om ’n herverdelingsbevel te maak met die basis dat daar ’n ‘clean break’ bewerkstellig word.”*³⁰

²⁵ Para 20.

²⁶ Para 23.

²⁷ *Ibid.*

²⁸ 2001 (3) SA 288 (C).

²⁹ Para 23.

³⁰ At 299G–I. The statement loosely translates as follows: “But we cannot lose sight that the defendant in the past and certainly in the future will use the farm to benefit himself financially in his personal capacity. I believe it would be right and fair if, under the provisions of s 7(5) of the Divorce Act, the assets of the trust be taken into account during this assessment of the enquiry as to whether, in the circumstances, the redistribution is fair and reasonable and that a ‘clean break’ has been achieved”.

Ngwenya J dispelled the contention, explaining that the argument that the plaintiff and the defendant were entitled to the farm was irrelevant. The presiding judge importantly noted the following:

“The Jubilee Trust is a separate legal entity which stands to benefit her own children. If [the defendant’s counsel] meant in [their] submission that I must regard it as a separate entity, and yet take into account that the plaintiff had unlimited access to it, I have grave difficulties with this reasoning. It is contradictory. It implies that I must make an adverse order against the trust via the back door. Simply put ... I must order the plaintiff to transfer an amount of R946 046,50 to the defendant. The defendant will, in turn, thus, have her estate increased to the net value of R1 924 366,50. That of the plaintiff reduced to R946 046,50. Because the plaintiff has unlimited access to Jubilee Trust, even if he cannot raise this amount from his own assets, so proceeds this reasoning, he should be able to access Trust property to satisfy this order. *In my judgment, unless I find the trust to be a sham, I cannot make an order like this.* When I find the trust to be such, I hope I will make a clear order to this effect.”³¹

In the court *a quo*’s closing, Ngwenya J reasoned that, despite the extensive powers granted to the plaintiff in the trust instrument, there was no reason to believe that the plaintiff abused his powers, nor that the assets which the trust owned and acquired over a period of time were acquired through means which were prejudicial to the matrimonial estate.³² Ngwenya J remarked: “This trust however remained an independent entity. It is not the alter-ego of the plaintiff ... I therefore do not have reasons to make an order that any asset belonging to either of these trusts should be transferred to the defendant or any other person.”³³ The decree of divorce was granted, without the inclusion of the trust property.

3.2 THE APPEAL

A year later, the *Badenhorst* case reached the SCA, despite the court *a quo* refusing the application for leave to appeal. Leave to appeal was granted by the SCA on two grounds: first, that the court *a quo* had erred in not taking into account that the respondent enjoyed the benefit of occupying, farming, and receiving an income from the farm and, second, that the court found that the assets of the Jubilee Trust did not form part of the parties’ “joint” estate

³¹ Para 25. My emphasis added.

³² Para 28.

³³ *Ibid.*

and that the appellant was therefore not entitled to 50 per cent thereof.³⁴ The appellant, Lynette Badenhorst, therefore sought an order for the addition of 50 per cent of the net value of the trust to be paid to her by the respondent.

Combrinck AJA noted that the crisp issue on appeal was whether, when making a redistribution order in terms of s 7(3) of the Divorce Act, the assets of an *inter vivos* discretionary trust created during the marriage should be taken into account.³⁵ Upon resolving the debate, the learned judge reasoned that “[a] trust is administered and controlled by trustees, much as the affairs of a close corporation are controlled by its members and a company by its shareholders.”³⁶ Combrinck AJA further articulated that, although the assets vested in the trustees and did not form part of the respondent’s estate, this did not exclude them *per se* from consideration when determining what must have been taken into account when making a redistribution order.³⁷ With regard to the idea of lifting the veil of the trust, the learned judge set out the logic behind the question, as follows:

“To succeed in a claim that trust assets be included in the estate of one of the parties to a marriage there needs to be evidence that such party controlled the trust and but for the trust would have acquired and owned the assets in his own name. Control must be *de facto* and not necessarily *de iure*. A nominee of a sole shareholder may have *de iure* control of the affairs of the company but the *de facto* control rests with the shareholder. *De iure* control of a trust is in the hands of the trustees but very often the founder in business or family trusts appoints close relatives or friends who are either supine or do the bidding of their appointer. *De facto* the founder controls the trust. To determine whether a party has such control it is necessary to first have regard to the terms of the trust deed, and secondly to consider the evidence of how the affairs of the trust were conducted during the marriage.”³⁸

In contrast to the court *a quo*’s findings, Combrinck AJA held that the respondent seldom consulted or sought the approval of his co-trustee and was, in short, in full control of the trust.³⁹ Furthermore, the court noted that the respondent paid limited regard to the difference between trust assets and his own assets. Combrinck AJA noted for example, in a written

³⁴ *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA) at para 6.

³⁵ Para 1.

³⁶ Para 9.

³⁷ Para 9.

³⁸ Para 9.

³⁹ Para 11.

application for credit facilities with the local co-operative, that the respondent listed the trust's assets as his own, and the liabilities in the form of bonds over the fixed property and the rental income from the trust assets were also described as his own. Moreover, a property registered in the name of the respondent was financed by the trust. The respondent also received income from an estate agent company, when in fact the shares were owned by the trust. "It is evident that, but for the trust, ownership in all the assets would have vested in the respondent."⁴⁰

Addressing the question of whether trust assets could be taken into account in a redistribution order, the court referred to *Grobbelaar v Grobbelaar*⁴¹ where de Vos AJ came to the following conclusion:

*"Inaggenome die diskresionêre aard van die trust, verweerder se feitelike algehele beheer daaroor, die feit dat eiseres nie meer 'n begunstigde van die trust gaan wees nie en die feit dat die trust in wese bestaan uit bates wat die verweerder versamel het, meen ek egter dat die trust se bates moet in ag geneem word by beoordeling van beide die onderhoudseis en die herverdeling van bates."*⁴²

Similarly, Combrinck AJA highlighted the court's ruling in the matter of *Jordaan v Jordaan*,⁴³ (as also in the unreported decision of the Cape High Court *Pienaar v Pienaar*⁴⁴) where Louw J noted:

"In 1996 the bare *dominium* of the land ... was sold and transferred to the trust. In my view, given the reason for these transactions (estate planning aimed at reducing or avoiding estate duties on his death) and the control which the defendant, who is not a beneficiary under the trust, retained over the land through his controlling position as donor/trustee of the trust ... and the fact that he has, despite the separate existence of the trust and the separate bank account which was opened and operated by the trust, continued to treat the farm and the rental income of the trust as his own in all but name, the farm

⁴⁰ *Ibid.*

⁴¹ Case No 26600/98 (unreported judgment of the Transvaal Provincial Division).

⁴² The statement loosely translates as follows:

"Considering the discretionary nature of the trust, the defendant's overall factual control, the fact that the plaintiff is no longer a beneficiary of the trust, and the fact that the trust consists of assets that the defendant had collected, I believe that the trust's assets must be considered when assessing both the maintenance and redistribution of assets."

⁴³ 2001 (2) SA 288 (C).

⁴⁴ Case No 8713/2003 (unreported judgment of the Cape High Court).

should, for the purposes of section 7(3) of the Divorce Act, be treated as if it is the defendant's personal property."⁴⁵

Unsurprisingly, Combrinck AJA held that the present case was a classic example of the one party having full control of the assets of the trust and merely using it as a vehicle for his business activities.⁴⁶ On the face of it, it appears as if Combrinck AJA formulated a unique test for the inclusion of assets and for the most part, disregarded Ngwenya J's more accurate assertion in the trial court judgment. The SCA reasoned that the value of the trust assets should have been added to the value of the respondent's estate and, on the basis of the above knowledge, that the decision of the trial judge to exclude the trust assets amounted to a clear misdirection.⁴⁷ The learned judge also noted a further misdirection, in the decision as to what is a just and equitable distribution: Ngwenya J started from the premise that at the commencement of the marriage neither party had any assets – he started therefore, from what he called a “clean slate”.⁴⁸ This, according to Combrinck AJA, is incorrect, as the respondent brought into the marriage from its inception a running farm complete with livestock, machinery, vehicles and everything else necessary for a successful farm.⁴⁹ Accordingly, the appeal succeeded. The court held that the appellant be awarded an additional amount by taking the total of the net asset value of the parties' estates and that of the trust, calculating a percentage which was considered just and equitable for the appellant's contribution and deducting what she already possessed.⁵⁰

⁴⁵ Paras 29–34.

⁴⁶ Para 10. There is some thought that this may be the case with the majority of business trusts. At first, it may seem as though there is a blurring of the line between the average business trust and a sham trust operated under the veil of a family trust. However, a business trust, although different from the more passive trust formed as part of an estate duty plan, or formed in order to protect assets, is operated in order to pursue the interests of the beneficiaries in accordance with the mandated business objects of the trust instrument. In *Badenhorst* (para 10), Combrinck AJA noted that Mr Badenhorst was using the family trust as a vehicle for *his own* business activities (emphasis added), which fell far short of the family trust's mandate (to protect the assets in the interests of the family members).

⁴⁷ Para 13.

⁴⁸ *Ibid.*

⁴⁹ *Ibid.*

⁵⁰ Para 16.

5. THE VAN DER MERWE CASE

This case arose through two separately instituted applications which came before Binns-Ward J in the Western Cape High Court. In both instances the applicants were the trustees of the Monument Trust,⁵¹ and had bought a business from Hydraberg Hydraulics CC and the land on which the business was operated. The seller was the Hydraberg Property Trust and the sale was in terms of a single indivisible agreement in favour of the applicants. The first application which came before the court was for the rectification of the deed of sale to reflect the correct description of the trust and for an order directing the trust to effect transfer.⁵² The second application sought to enforce a restraint of trade included in the sale agreement.⁵³ The applications were heard together.

The property subject to the deed of contract was registered in the names of Clarke and his wife. The couple owned the property jointly and in undivided shares.⁵⁴ Significantly though, the parties had executed a deed of alienation in 2005, some three years prior to the conclusion of the contract in issue.⁵⁵ Thus, the Clarkes had bound themselves, as sellers, to sell the property to the Hydraberg Property Trust. The property had, however, not yet been transferred to the Hydraberg Property Trust when the contract in issue was concluded.

In light of the indivisibility of the agreement, the outcome of the applications hinged on whether the Hydraberg Trust was bound to the contract. The contract was however only signed by two of the three trustees, and so the respondents argued that the agreement was void for two reasons, namely, that the trust had not been properly represented and also, that there had been no written authority from the trust, as required by s 2(1) of the Alienation of Land Act,⁵⁶ to empower the two (out of the three) trustees to have executed the agreement of sale as agents of the trust.

⁵¹ Para 1.

⁵² Para 2.

⁵³ Para 3.

⁵⁴ Para 5.

⁵⁵ *Ibid.*

⁵⁶ Act 68 of 1981.

In defence, it was disputed by the respondents that the third trustee, Gerhard, was not in fact a trustee at the time in which the contract of sale was entered into. Furthermore, the trust instrument provided for the entrenchment of Clarke and Bosman's position as trustee for as long as they might wish to hold office. The instrument also denoted that the independent trustee may be dismissed if the majority of the other trustees so decide.⁵⁷ The trust instrument also required there to be a minimum of three trustees in office at all times.

Binns-Ward J noted in his judgment that it was not in dispute that Slabbert, who had been appointed as the third trustee upon the establishment of the trust, was not informed or consulted by the remaining two trustees regarding the conclusion of the contract.⁵⁸ Furthermore, the learned judge reasoned that “[i]f Slabbert was indeed still one of the trustees at the time, the omission to involve him in the decision to conclude the agreement would ordinarily have fatal consequences for the validity of the agreement”.⁵⁹

On consideration of the trust instrument and the pertinent provisions regarding trustee capacity, Binns-Ward J reasoned that:

“It is evident from these provisions that unanimity amongst the trustees is not required in order for decisions to be made effectively in respect of transactions concerning the administration of the trust and the dealing with its assets in terms of the powers conferred on the trustees in terms of clause 6 of the trust deed. It is sufficient if the relevant decision enjoys the support of a majority. A majority decision is competent only if adopted by a majority of the trustees present at a quorate meeting of trustees. Whether such a 'meeting' would need to be one at which the trustees attending were physically present together, or whether the 'meeting' could be held in some alternative form, is a question which it is not necessary to decide. It is evident, however, that in order to qualify as 'a meeting', all the trustees in office would have to receive notice thereof so as to be able to participate in it if they so wished. Slabbert did not receive any such notice and was therefore not afforded an opportunity to participate in the decision by the Trust to sell the fixed property. The terms of the trust instrument which provide for the trustees to make decisions by a majority vote at a quorate meeting do not provide an exception to the rule that all the trustees must act jointly; they merely provide that, subject to the indemnity in clause

⁵⁷ Para 6.

⁵⁸ Para 13.

⁵⁹ *Ibid.*

5.7, a majority decision will bind the dissenting or absent trustees. The minority is obliged to act jointly with the other trustees in executing the resolution adopted by the majority.”⁶⁰

On the evidence before the court, the court concluded that Slabbert did not resign as trustee in terms of s 21 of the Act or in the appropriate manner, as prescribed in the trust instrument. In order to prove that Slabbert’s appointment as a trustee had been terminated, the applicants relied on the fact that Slabbert, who confirmed this in a confirmatory affidavit, had told the attorney representing the purchaser that he was unaware that he was a trustee. He further supposed to the attorney that he was in any event unable to perform his duties as a trustee due to a breach of trust and confidence between the other two trustees and himself.⁶¹ Slabbert confirmed that he resigned from office as trustee at least a year prior to the Hydraberg transaction.⁶²

Relevantly, the applicants further alleged that should the court find Slabbert to have held the position of trusteeship during the period of the transaction, that by application of the *Turquand* Rule,⁶³ the agreement should nevertheless be held to bind the trustees. Binns-Ward J explained the above Rule entails that:

“a party dealing in good faith with a company is entitled, if the latter's affairs appear to be being conducted in a manner permitted by its memorandum and articles, to assume that any internal formalities required thereby have been duly complied with.”⁶⁴

After careful consideration, Binns-Ward J agreed with Cameron *et al*’s view in *Honoré* that the rule that trustees must act jointly in the discharge of their functions is not a matter of ‘internal management’, but a matter of capacity.⁶⁵

⁶⁰ Para 16.

⁶¹ Para 19.

⁶² *Ibid.*

⁶³ Based on the rule developed in *Royal British Bank v Turquand* [1856] 119 ER 866.

⁶⁴ Para 26.

⁶⁵ Para 31.

The applicants added a further alternative should their endeavour to invoke the *Turquand* Rule fail:

“... that the court should disregard the veneer of a trust under which Clarke and Bosman had in fact conducted their personal business as usual. After all, it is apparent that Clarke and Bosman represented that they were the only trustees of the Trust. Furthermore, it is evident that they must in fact have conducted themselves as such quite consistently, and in a number of matters besides the purported conclusion of the option agreement. In this regard it is apparent that Clarke and Bosman must have conducted the business of the Trust, including making decisions on the distribution of its income for a year or more without the involvement of their co-trustee, Slabbert.”⁶⁶

Binns-Ward J evaluated the conduct of the trustees in light of the applicants’ prayers and reasoned that the structure and operation of the Hydraberg Property Trust was of paramount interest to the court. The learned judge remarked that the provision of a separation between the person or persons vested with the ownership and control of property from the person or persons for whose benefit or enjoyment the property is held has appositely been described as ‘the core idea’ or ‘the essential notion’ underlying the trust form as a legal concept.⁶⁷

Binns-Ward J applauded Cameron JA’s comments in *Parker*:

“In *Parker’s* case, *supra*, the Supreme Court of Appeal observed that ‘[T]he great virtue of the trust form is its flexibility, and the great advantage of trusts their relative lack of formality in creation and operation: “the trust is an all-purpose institution, more flexible and wide-ranging than any of the others”. It is the separation of enjoyment and control that has made this traditionally greater leeway possible. The courts and legislature have countenanced the trust’s relatively autonomous development and administration because the structural features of “the ordinary case of trust” tend to ensure propriety and rigour and accountability in its administration.’ ... Cameron JA, however, discerned that since the mid-1980’s there had been a noticeable change brought about by the formation of many business trusts ‘in which functional separation between control and enjoyment is entirely lacking. This is particularly so in the case of family trusts - those designed to secure the interests and protect the property of a group of family members, usually identified in the trust deed by name or by descent or by degree of kinship to the founder.’ I doubt that anyone with a modicum of commercial law experience would doubt the pertinence of this insight concerning what Harms JA in *Nieuwoudt* [disparagingly]

⁶⁶ Para 32.

⁶⁷ Para 33.

described as a ‘newer type of trust’. Cameron JA proceeded ‘The core idea of the trust is debased in such cases because the trust form is employed not to separate beneficial interest from control, but to permit everything to remain “as before”, though now on terms that privilege those who enjoy benefit as before while simultaneously continuing to exercise control.’⁶⁸

Crucially, the judge concluded that the Hydraberg Property Trust carried with it, the unwholesome hallmarks of the ‘newer type’ of business trust.⁶⁹ Binns-Ward J concluded:

“Although the trust instrument makes provision for the mandatory appointment of a third so-called ‘independent’ trustee, that trustee holds office only at the pleasure of Clarke and Bosman, or should the latter have resigned or forfeited their office (for example, as a consequence of having been sequestered), at the pleasure of the substitute trustees appointed by their respective family member beneficiaries. The independent trustee’s position can in any event never prevail against that of Clarke and Bosman, who if they vote together will always constitute a majority. In theory the trust could operate with a real functional separation between control and benefit were additional independent trustees to be appointed thereby overriding the otherwise controlling majority of the entrenched initially appointed beneficiary trustees or their successors. Having regard to the provisions of the trust instrument considered as a whole, it is no cause for surprise to find that no additional trustees have been appointed during the five years of the Trust’s existence. Instead, as is all too likely to happen with such a trust structure, the beneficiary trustees have sidelined the independent trustee; and, when he ceased to [fulfill] his essential role in the control of the Trust’s affairs, they blithely proceeded without him, indifferent to the trust instrument’s requirement that there be a minimum of three effectively functioning trustees and oblivious of their obligation, should this requirement fail for any reason, to ensure the appointment of an additional or replacement trustee.”⁷⁰

Unsurprisingly, the ripple-effect of the *Parker* case continued half a decade after the landmark judgment was handed down in 2005. Binns-Ward J argued that the trust form should not lightly be countenanced by the courts in cases in which the veil of a trust is used as protection by the trustees against fraud and dishonesty and to raise unscrupulous defences against *bona fide* third parties seeking to enforce the performance of contractual obligations purportedly entered into by such trustees ostensibly in that capacity.⁷¹

⁶⁸ *Ibid.*

⁶⁹ Para 35.

⁷⁰ *Ibid.*

⁷¹ Para 38.

The judge held that:

“In *Parker*, Cameron JA ventured the following observations in this connection: ‘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 ... 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’ and ... ‘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.’ A decision to disregard the veneer would, like one to pierce the corporate veil, be a decision to afford an equitable remedy. The weight of the policy considerations arising from the need to respect corporate or juristic personality that make piercing the corporate veil a rare event is less, I venture, in the matter of disregarding the form of an example of the ‘newer type of trust’. In the latter type of case no question of disregarding juristic personality presents. On the contrary the issue in such cases of abuse of the trust form is whether or not it would be conscionable for a court to give credence to a natural person’s disguise of him or herself as a trustee of what is in reality treated by such person as his or her own property.”⁷²

In the courts findings, the learned judge stated, much like in the *Parker* case, that the facts of the case illustrated the classic example of an abuse of the trust form flowing directly from the conduct of the two trustees in respect of ownership of the fixed property and having no distinction between their responsibilities as trustees and their expectations as beneficiaries:

“They treat the property as their own, and invoke the existence of the trust only when it suits them. There has not been any suggestion that in acting as they did at the time Clarke and Bosman prejudiced the rights of the beneficiaries of the Trust. On the contrary, the evidence is that the third (independent) trustee would have consented to the transaction, had his input been sought. It is apparent that the only reason that non-compliance with the requirements of the trust instrument is being raised at this late stage is because it apparently no longer suits the personal interests of Clarke and Bosman for effect to be given to the contract they purported to enter into. In principle I consider that it would be unconscionable to allow them to get away with such behaviour.”⁷³

⁷² Para 38.

⁷³ Para 39.

Importantly, Binns-Ward J held that this matter would have been an appropriate case to have disregarded the veneer of the trust form.⁷⁴ According to the learned judge, this might have been so in one of two ways: “[b]y holding the delinquent trustees personally liable for performance, or by directing the trust to perform as if the obligation had been properly incurred by the trustees acting in the capacity that they purported to.”⁷⁵

The final course of the matter was however changed due to the formalities applying in respect of the alienation of land:

“Whereas, as between the parties to the contract I might, on the basis described at some length above, have been able to disregard the veneer of the trust to overcome an unscrupulous resort by the trustees to internal formalities and conveniently assumed lack of capacity to escape contractual obligations, I am not able to ignore the trust’s existence as a formally constituted legal concept when it comes to compliance with the peremptory requirements of applicable legislation. When law and equity cannot concur, it is the law that must prevail. As mentioned earlier, it was not competent for the trustees of the Trust to act other than jointly. Therefore, as also mentioned earlier, Clarke and Bosman, being only two of the three trustees in office, could bind the Trust in respect of a sale of immovable property only by acting together with their co-trustee as joint principals, alternatively, on the written authority of all of the trustees given acting jointly.”⁷⁶

Thus, the application for an order compelling the transfer of the fixed property as well as the enforcement of the restraint of trade clause was dismissed.

6. CONCLUSIONS

In *Parker*, the court mentions that certain types of business trusts have developed in which functional separation between control and enjoyment is entirely lacking.⁷⁷ Cameron JA pointed out that this is particularly so in the case of family trusts, those designed to secure the interests and protect the property of a group of family members, usually identified in the trust

⁷⁴ Para 41.

⁷⁵ *Ibid.*

⁷⁶ Para 42.

⁷⁷ Para 25.

instrument by name, descent or by degree of kinship to the founder.⁷⁸ For estate planning purposes or to escape the constraints imposed by corporate law, assets are put into a trust “while everything else remains as before”.⁷⁹ The core idea of the trust is debased in such cases because the trust form is employed not to separate beneficial interest from control, but to permit everything to remain “as before”, though now on terms that privilege those who enjoy benefit as before while simultaneously continuing to exercise control.⁸⁰

Upon taking the above into consideration, Cameron JA insisted that the courts must themselves in appropriate cases ensure that the trust form is not abused:

“The courts have the power and duty to evolve the law of trusts by adapting the trust idea to the principles of our law.... This power may have to be invoked to ensure that trusts function in accordance with the principles of business efficacy, sound commercial accountability and the reasonable expectations of outsiders who deal with them.”⁸¹

Cameron JA noted that “[w]here trustees of a family trust ... act in breach of their duties imposed by the trust instrument, 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 interest of creditors.” (My emphasis added.) Regardless of the court’s subsequent investigation regarding legal standing, which is irrelevant to this study, what has become substantially clear is the ripple-effect Cameron JA’s *obiter* statements have had on subsequent cases.

In *Badenhorst*, Ngwenya J in the court *a quo* imposed a strict interpretation of the facts and law, crucially noting that unless the court found the trust to be a sham, he may not, following the principal rules of trust law, pierce the veneer of the family trust and expose the trust assets to the matrimonial claim. However, on appeal to the SCA, whether directly or indirectly

⁷⁸ *Ibid.*

⁷⁹ Para 26. The court refers to *Nieuwoudt and Another NNO v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) 493.

⁸⁰ Para 26.

⁸¹ Para 37. The court refers to *Braun v Blann and Botha NNO and Another* 1984 (2) SA 850 (A).

influenced by *Parker*, the court took on a completely different approach towards the matter. Combrinck AJA implicitly accepted the trial court's conclusion that, unless the court finds the trust to be a sham, no redistribution order can be made with regard to the trust property.⁸² The court then went on to give an exposition of the careless mistakes made by the respondent, ignoring the overarching question of sham. Combrinck AJA instead reasoned that in order to grant the claim that trust assets be included in the respondent's estate, there needs to be evidence that the respondent controlled the trust and, but for the trust, would have acquired and owned the assets in his name.⁸³

In effect, the SCA made one of two mistakes regarding *Badenhorst*. The first is that they replaced the test for sham with their own, where Combrinck AJA explained that the crucial issue of *de facto* control is the deciding point upon which the court may pierce the veneer (bearing in mind that, prior to this statement, the learned judge had agreed with the court *a quo*, in that the court may not pierce the trust unless the court finds such trust to be a sham). Alternatively, the court, as in *Parker*, ignored the doctrine of the sham, and pierced the trust based on nothing more than what could only be the doctrine of piercing the corporate veil.

It is also apparent that the *Van der Merwe* case followed upon similar lines to the *Parker* case. Had it not been for the alienation of land technicality, Binns-Ward J would have pierced the veneer of the Hydraberg Property Trust purely on the precedent set by Cameron JA in *Parker* and what Harms JA in *Nieuwoudt* unsympathetically described as "the newer type of trust".⁸⁴

The decisions, with respect, reflect significant misunderstandings of the doctrines of the sham and the alter-ego, which have in turn led to two judgments which take South African trust law into strange and uncharted territory.

⁸² Para 7.

⁸³ Para 9.

⁸⁴ Para 17.

CHAPTER 4

THE DOCTRINES OF THE “SHAM”, THE “ALTER-EGO” AND THE “PIERCING OF THE CORPORATE VEIL”

1. INTRODUCTION

It is evident in *Badenhorst v Badenhorst*¹ that the courts are willing to pierce the veneer of a trust should it appear that a trust is in fact the alter-ego of a settlor. Furthermore, Combrinck AJA implicitly accepted the trial court’s conclusion that, unless the court finds a trust to be a sham, no redistribution order can be made.² This supports the academic opinion that in *Badenhorst* the court did in fact find the trust to be a sham.³ In *Land and Agricultural Bank of South Africa v Parker and Others*,⁴ however, no reference was made to the trust being either a sham or the alter-ego of the Parkers. Instead, Cameron JA referred to the family trust as a “veneer that in justice should be pierced in the interests of the creditors.”⁵ In *Van der Merwe NO and Others v Bosman and Others*⁶ Binns-Ward J stated that:

“[a] decision to disregard the veneer would, like one to pierce the corporate veil, be a decision to afford an equitable remedy ... The weight of the policy considerations arising from the need to respect corporate or juristic personality that make piercing the corporate veil a rare event is less ... in the matter of disregarding the form of an example of the ‘newer type of trust’. In the latter type of case no question of disregarding juristic personality presents. On the contrary the issue in such cases of abuse of the trust form is whether or not it would be conscionable for a court to give credence to a natural person’s disguise of him or herself as a trustee of what is in reality treated by such person as his or her own property.”⁷

Bearing the above in mind, it is submitted that in all three cases the findings were inaccurate. The decisions respectfully reflect a lack of knowledge of the doctrine of the “sham” as well as the principle of the “alter-ego”, which have, in turn, led to three ill-founded decisions, not

¹ 2005 (2) SA 253 (C).

² Para 7.

³ H Joffe “The Future of Trust Law” (2007) *DR* 25 at 26.

⁴ 2005 (2) SA 77 (SCA).

⁵ Para 37.3.

⁶ 2010 (5) SA 555 (WCC).

⁷ Para 39.

to mention the other South African cases revolving around these two particular decisions. Furthermore, in those cases it was undecided whether or not such trusts were in fact invalid. These uncertainties can be made clear by reference to foreign law, where in many countries such practices regarding this area of trust law have been settled.

The aim of this chapter is thus to examine the doctrines of the “sham”, the “alter-ego” and the “piercing of the corporate veil”. With respect to the doctrine of the sham, foreign case law will be employed in order to trace the roots of the doctrine, beginning with the broader definition of sham transactions and followed by the subsequent interpretation of this classification, which has led to the evolution of the sham trust. The tendencies discovered in the past – together with the modern-day interpretation of the doctrine – are later contrasted with its application in South Africa.⁸

The doctrine of the alter-ego, too, is traced back to its source, followed by the ensuing use of this principle in the courts across the world today. What the findings reveal – specifically the doctrine’s fundamental principles, function and use – is, in Chapter 5, then compared to the interpretation and application by the South African Judiciary.

The final principle reviewed in this chapter, the doctrine of piercing the corporate veil, is important to consider as well. In *Parker* the court inadvertently sought to incorporate it into the trust *inter vivos*, when Cameron JA reasoned that it was necessary to use the doctrine,⁹ which, until then, had been solely reserved for use in companies and other entities attributed with separate legal *persona*. Notably, the learned judge further reasoned that it may be necessary in the future also to extend the *Turquand* Rule¹⁰ in the same manner,¹¹ a rule also reserved for entities clothed with separate legal *persona*. In order to inspect the doctrine’s

⁸ See Chapter 5.

⁹ Para 37.3. ‘Where trustees of a family trust, including the founder, act in breach of the duties imposed by the trust deed, and purport to act 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 interest of creditors’.

¹⁰ Based on the rule developed in *Royal British Bank v Turquand* [1856] 119 ER 866.

¹¹ Para 18. ‘Within its scope the [*Turquand*] rule may well in suitable cases have a useful role to play in securing the position of outsiders who deal in good faith with trusts that conclude business transactions’.

suitability in trust law, this section explores the historical use of the doctrine in common law systems overseas as well as the use of the principle locally.

2. THE DOCTRINE OF THE SHAM

Documents or arrangements which have been falsely created will not be permitted to prevent a court from getting at the real truth of the matter,¹² and “if it [is] a mere cloak or screen for another transaction one [can] see through it.”¹³ Such documents or transactions are generally referred to as “shams”.¹⁴ The doctrine, which first surfaced in England in the late 1800s, was necessitated through contentions of fraud and dishonesty in cases related to taxation, sale agreements and tenureships. As will become apparent, through time, the scope of the principle broadened, eventually gaining relevance and coherence in the law of trusts.

2.1 FOREIGN LAW PRECEDENT

2.1.1 SHAM TRANSACTIONS

The underlying idea of the sham doctrine is well illustrated by reference to Diplock LJ’s statement in *Snook v London and West Riding Investments Ltd.*¹⁵ This matter involved a hire-purchase agreement between the plaintiff and the defendant company which had been entered into in order to refinance the purchase of a motor vehicle. The vehicle was in the possession of the plaintiff, but had been subject to another hire-purchase agreement between the plaintiff and TI Ltd. In the hire-purchase agreement the cash price for the car was stated as £800 and the initial payment was to be £500. These figures were, however, fictitious. The defendant paid out £300, of which £160 was paid to TI Ltd, £125 was paid to the plaintiff and £15 was retained by the intermediary finance company that filled out the figures.¹⁶ In an action for the recovery of the motor vehicle by the defendant, it was held by Denning LJ that the title to the vehicle had been passed to the defendants who were not parties to the sham financing operation. It was furthermore found by Diplock LJ and Russell LJ that as the defendant was

¹² *In re Watson* [1890] 25 QB D 27 at 33.

¹³ *Yorkshire Railway Wagon Co. v Maclure* (1882) 21 Ch D 309 at 318.

¹⁴ M Conaglen “Sham Trusts” (2008) 67 *Cambridge LJ* 176 at 176.

¹⁵ [1967] 2 QB 786.

¹⁶ S Pryke “Sham Trusts” http://www.fiduciarylegal.com/uploads/Sham_Trusts_Lecture_2005_FL_title_.pdf (accessed 8 April 2009).

not a party to the sham, the plaintiff was stopped on the basis of documents from denying the defendant's title to the car.¹⁷ In his judgment, Diplock LJ stated:

“As regards the contention of the plaintiff that the transactions between himself, Auto Finance and the defendants were a ‘sham’, it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. But one thing, I think, is clear in legal principle, morality and the authorities... that for acts or documents to be a ‘sham’, with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.”¹⁸

The above *dictum* has acquired “canonical” status,¹⁹ having been cited and adopted as an authoritative statement of the sham doctrine in common law jurisdictions worldwide. It will, however, be evident later that the adoption of Diplock LJ's formulation in *Snook* has led to a restrictive view of the concept of sham. Interestingly, though, it is believed that this narrow view appeared to prevail prior to the *Snook* case and as long ago as 1882, where the court in *Yorkshire Railway Wagon Company v Maclure*²⁰ considered the idea of a “device” or “cloak” to conceal a transaction. The question faced by the court was whether a purported sale and leaseback agreement between a railway company and a wagon supply company was in truth a secured loan. Lindley LJ stated the following:

“I understand that the view the learned judge took was this, that this transaction of hire was a mere device or cloak to conceal a loan. If that had been the view I took of the facts, I should have come of course to the same conclusion. I should disregard or throw aside the cloak, and look at the real transaction alone. But for reasons I will give presently I am satisfied that the purchase and hire transaction was the real transaction, in this sense – that the parties meant it to operate according to its tenor as comprised in the deeds. It was not intended by them as a mere blind or cloak for something

¹⁷ Pryke “Sham Trusts”.

¹⁸ At 802.

¹⁹ *A v A* [2007] EWHC 99 (Fam) para 32.

²⁰ (1882) 21 ChD 309.

behind, it was a transaction substituted for another, but *bona fide* substituted, and intended to be acted upon according to its purport and apparent effect.”²¹

Jessel MR commented further on the matter:

“But even if the Wagon Company understood it [the sale and leaseback agreement] as a loan, in order to set aside the deed, that is to treat it as a nullity you must show that the Railway Company were parties to the understanding.”²²

There are also a number of cases which arose through the United Kingdom’s Tax Court and which, at the time, added to the jurisprudence of the doctrine. In *Dickenson v Gross*,²³ a taxpayer who owned various farms formed a partnership between himself and his three sons. The farms were then leased to the partnership at a determined rent. The partnership agreement provided that the accounts were to be drawn up annually, that the net profits were to be divided equally between the parties and that each partner on his own could endorse cheques. However, no rent was paid, nor were the accounts drawn up and no profits were distributed. Moreover, the only cheques drawn were by the taxpayer, and business income was paid *ad hoc* into the partnership account and the taxpayer’s private account. Rowlatt J confirmed the Commissioners of Tax’s findings that there was no partnership in existence for tax purposes. The learned judge said:

“The partnership deed here ... was a deed perfectly good according to its tenor ... But ... the facts show that in very many ways the deed was simply set on one side and disregarded, and when you find the deed is disregarded, and also that it was entered into for the purpose of obtaining relief from taxation, one is apt ... to pay attention to those circumstances ... in which it was disregarded.”²⁴

²¹ At 317.

²² At 314.

²³ (1927) 11 TC 614.

²⁴ At 620.

Rowlatt J added that the Commissioners:

“have not used the word ‘sham’ but I think they have put it even more clearly. They say: The facts here were not a partnership although there was a bit of paper in drawer, which if the facts had been according to it, would have shown there was a partnership.”²⁵

With respect to sham transactions in a company, the English Appeal Court held in *Gilford Motor Co v Horne*²⁶ that a person could not incorporate a company as a “cloak or sham” to enable him to commit a breach of covenant under his contract as managing director.²⁷ Evidently, these early English cases involving sham transactions prompted a surge in interest in the sham worldwide. In *Bateman Television v Coleridge Finance Co Ltd*,²⁸ the New Zealand court reasoned that a sham: “is an act done or document executed that is intended to mislead. It is where the parties resort to a form of action or document which does not fit the real facts in order to deceive a third person.”²⁹ In the Supreme Court of Canada the approach recommended by Martland J in *Minister of National Revenue v Cameron*³⁰ was to follow the rules laid down in *Snook*. This matter dealt with the distribution of income and the taxation consequences thereof and was the first reported case in Canada dealing with sham transactions. In considering the contention that the agreement between the two respondents was nothing but a sham, the learned judge cited the definition of a sham set out by Diplock LJ in *Snook*. Martland J then remarked: “I am not prepared to find that the agreement between Campbell Limited and Independent was a sham. The legal rights and obligations which it created were exactly those which the parties intended”.³¹

Returning to England, in *Massey v Crown Life Insurance Co*,³² an employment law case, a stern view was taken of the sham. The appellant, who had previously been employed as a branch manager by the respondent, had entered into a new agreement whereby he was to become a freelance agent. The appellant, under his new position no longer received wages

²⁵ *Ibid.*

²⁶ (1933) Ch 935.

²⁷ At 957.

²⁸ [1929] NZLR 794.

²⁹ At 813.

³⁰ [1974] SCR 1062.

³¹ At 1069.

³² [1978] 2 All ER 576.

with a deduction for income tax and national insurance contributions, but rather the full amount, on which he was assessed on as a self-employed person. The appellant was subsequently dismissed, and sought to make a claim for wrongful dismissal on the grounds that their relationship as employer and employee had remained. In holding the arrangement to be a genuine transaction, rendering the appellant the status of a self-employed person, Lord Denning MR made this point in his inimitable way:

“[I]f the true relationship of the parties is that of master and servant under a contract of service, the parties cannot alter the truth of that relationship by putting a different label on it ... On the other hand, if their relationship is ambiguous and is capable of being one or the other, then the parties can remove that ambiguity, by the very agreement itself which they make with one another. The agreement itself then becomes the best material from which to gather the true legal relationship between them.”³³

The court noted, importantly, that if the relationship between the parties was ambiguous in any way, then the parties could remove that ambiguity by stipulating what the legal situation between them should be. The genuine relationship could then be determined from the agreement itself. The court found that there were no “tricks” involved and both parties had acted in accordance with the terms of the arrangement. The claim was dismissed. A further and, it is submitted, a more accurate articulation of a sham was given in *IRC v Garvin*,³⁴ where Buckley LJ insistently noted that the question of whether or not a transaction is a sham must be an issue of fact. His lordship continued by saying:

“In this jurisdiction the function of determining the facts of the case belongs exclusively to the Commissioners. We cannot treat as a sham any transaction which the Commissioners have found to have taken place and which they have not found to be a sham.”³⁵

Sham transactions had, for the most part, maintained the stringent guidelines set out in *Snook*. The Australian Tax Court sustained this trend in the matter of *Clyne v Deputy Federal Commissioner of Tax*.³⁶ In this matter the court held that for an arrangement to be a sham there must be a finding that there was a common intention between the parties to the

³³ At 579.

³⁴ (1980) STC 295.

³⁵ At 300.

³⁶ (1983) ATC 4503.

arrangement that the transaction was a cloak or disguise for some other, real transaction, or no transaction at all.³⁷ It is evident when one examines the cases that the common intention requirement urged in *Snook* has seeped through as the general guideline. In the Canadian matter of *Stuart Investments Ltd v The Queen*,³⁸ the facts of which involved a lengthy tax battle between the two parties which had gone on for nearly sixteen years, the respondent had alleged that one of the appellant's transactions prior to litigation was a sham. In two of the lower courts the transaction had been found to be a sham, whereas the Federal Court of Appeal found it unnecessary to determine whether or not the term "sham", in the circumstances of the case, was properly applicable to the transaction. In reaching this conclusion, it was observed that the evidence had clearly pointed in that direction.³⁹ Estey J noted the following in his majority judgment:

"The element of sham was long ago defined by the courts and was restated in *Snook v London & West Riding Investments, Ltd*, [1967] 1 All ER 518. Lord Diplock ... found that no sham was there present because no acts had been taken ... which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations ... which the parties intend to create."⁴⁰

The Supreme Court of Canada had without hesitation adopted the English approach regarding the definition of sham.

A similar view was taken by Croom-Johnson LJ in *Hilton v Plustitle Ltd*.⁴¹ This case concerned an attempt by the plaintiff, a landlord, to avoid giving security of tenure to a tenant by letting only to a company. Prior to the dispute, the plaintiff suggested that the second defendant buy an off-the-shelf company with whom the plaintiff then entered into an agreement for the grant of a lease. The agreement specified that the second defendant was to be the occupier of the property. On a claim by the plaintiff for the possession of the property, the second defendant contested that the allocation of tenancy to the company was a sham and should be ignored, that it was, in reality, the second defendant who was granted tenancy and

³⁷ At 4508.

³⁸ [1984] 1 SCR 536.

³⁹ At 572.

⁴⁰ At 553.

⁴¹ [1988] 3 All ER 760.

who should therefore have enjoyed the protection afforded to a statutory tenant.⁴² Croom-Johnson LJ of the English Court of Appeal rejected the argument, and relevantly cited the shortened version expressed by Bingham LJ in *Antoinaides v Villiers*:⁴³ “Put more shortly, a sham exists where the parties say one thing intending another.”⁴⁴ For that reason, his lordship agreed with the court *a quo*’s conclusion that there was no sham, and it was indeed the intention of both parties for the tenancy to be granted to the company and not the second defendant.⁴⁵

In Australia at the time, the Judiciary confirmed the decision in *Clyne* to adopt the definition set out in *Snook*, and in *Sharrment Pty Ltd v Official Trustee in Bankruptcy*,⁴⁶ Lockhart J remarked that a sham is something which is not genuine or true, but false or deceptive. Where it is alleged that the trusts of a settlement are a sham, it is necessary to prove that it was the intention of the settlor that the settlement itself be a sham.⁴⁷ This point was further enunciated by the learned judge, as follows:

“A ‘sham’ is ... something that is intended to be mistaken for something else or that is not really what it purports to be. It is a spurious imitation, a counterfeit, a disguise or a false front. It is not genuine or true, but something made in imitation of something else or made to appear to be something which it is not. It is something which is false or deceptive.”⁴⁸

Another key English case concerning sham transactions was that of *Hitch & Others v Stone*.⁴⁹ The case concerned a tax-avoidance scheme involving an agreement between a farming family and certain companies. The scheme revolved around a lease of the family farm to

⁴² In terms of s 2 of the Rent Act 1977.

⁴³ [1988] 2 WLR 139.

⁴⁴ At 147.

⁴⁵ This was also the approach adopted by Ralph Gibson LJ in *Gisborne v Burton* (1988) 3 All ER 760 at 772, who, in explaining that the essential question is always to determine the reality of the transaction, reasoned that:

“[I]f the nature of the transaction was made clear to both sides, together with the consequences which would follow by way of reduced statutory protection ... and that there was thus informed assent and understanding by all parties.”

⁴⁶ [1988] 18 FCR 449.

⁴⁷ At 454.

⁴⁸ At 537.

⁴⁹ (2001) STC 214 (CA).

these companies. The *dictum* of Diplock LJ in *Snook* was cited as the appropriate test for a sham, Arden LJ noting the following:

“An inquiry as to whether an act or document is a sham requires careful analysis of the facts, and the following points emerge from the authorities. First, in the case of a document, the court is not restricted to examining the four corners of the document. It may examine external evidence. This will include the parties’ explanations and circumstantial evidence, such as evidence of the subsequent conduct of the parties. Second, as the passage from *Snook* makes clear, the test of intention is subjective. The parties must have intended to create different rights and obligations from those appearing from the relevant document, and in addition they must have intended to give a false impression of those rights and obligations to third parties. Third, the fact that the act or document is uncommercial, or even artificial, does not mean it is a sham. A distinction is to be drawn between the situation where parties make an agreement which is unfavourable to one of them, or artificial and a situation where they intend some other arrangement to bind them. In the former situation, they intend the agreement to take effect according to its tenor. In the latter situation, the agreement is not to bind their relationship. Fourth, the fact that parties subsequently depart from an agreement does not necessarily mean that they never intend the agreement to be effective and binding. The proper conclusion to draw may be that they agreed to vary their agreement and that they have become bound by the agreement as varied.⁵⁰ Fifth, the intention must be a common intention.”⁵¹

Evidently, the definition in *Snook* had in fact become the universal test for determining whether or not a transaction was a sham. It is submitted that, although somewhat restrictive, the basic premise of the guideline laid down by Diplock LJ, coupled with the elucidation in various other cases, leads to the following interpretive definition of a sham transaction:

A sham transaction is an act done or document executed between the parties to the act or execution with the common intention to conceal the true nature of the transaction and to use the concealment as a cloak of disguise which falsely and deceptively cloaks the transaction in the eyes of third parties and the courts, so that it appears to be something different from what in fact it is in reality.

⁵⁰ See, for example, *Garnac Grain Co Inc v HMF Faure & Fairclough Ltd* [1966] 1 QB 650 at 683–684, *per* Diplock LJ.

⁵¹ At 229.

In *Jones v Lipman*,⁵² Russell J neatly put it as follows: “a device and a sham, a mask which [the defendant] holds before his face in an attempt to avoid recognition by the eye of equity.”⁵³ The consequence of the statement by Diplock LJ in *Snook* has been decisively influential in many other areas of law worldwide. The test, which has subsequently been termed “the *Snook* test”, can be easily traced into a number of trust-related authorities.

2.1.2 SHAM TRUSTS

It was inevitable, by the nature of the instrument, that the modern-day trust, too, would be used in an abusive fashion; and should a trust be established to protect assets, it is only to be expected that it may be challenged at some stage.⁵⁴ And, with respect to the doctrine of the sham, the exposé of sham transactions is but the tip of the iceberg. Sham transactions have of late become much more prevalent in the guise of trusts, and the “sham trust”, as it is referred to, holds the same key characteristics of the original “sham transaction”. In the event of a sham trust, a trust *inter vivos* would have been created, the trust assets having been transferred to the trustee, but the trustee does not hold the assets beneficially. Thus, the trust purports to have been established on the terms of a particular trust instrument, but these terms do not reflect the parties’ true intentions, the trust document being proffered with the intention of misleading third parties as to the true terms of the trust.⁵⁵ The *Snook* test referred to above, much like any other transaction, plays an integral part in the determination of whether the trust is a sham. In fact, what will become apparent is that the *Snook* test has become the most widely accepted means of ascertaining the sham status of a trust, and without its application the trust cannot be termed a “sham”.

*Waters’ Law of Trusts in Canada*⁵⁶ offers an insightful definition of a sham trust:

“... used in the trust law setting, now a practice in Canada as elsewhere, [the term sham trust] describes a trust that the courts will declare void because the provisions in the trust instrument do not represent the settlor’s true intent as to the terms upon which the trustee is to hold the trust asset(s). Though the

⁵² [1962] 1 WLR 832.

⁵³ At 836.

⁵⁴ JW Brown *New Zealand Master Trusts Guide* 2 ed (2005) 40.

⁵⁵ D Brownbill *Sham Trusts* (Personal publication, Maitland Chambers: London, 2004) 2.

⁵⁶ DWM Waters *Waters’ Law of Trusts in Canada* 3 ed (2005).

trust instrument sets out the persons or purposes that are the benefit, the settlor's true intent is to retain control of the assets purportedly held in trust because the true intent is to appear to have disposed of the assets and so as to evade tax, defeat personal creditors, or to prejudice the claims of an estranged spouse or the children of the relationship."⁵⁷

It is noteworthy that the most common challengers of these trusts have been spouses, creditors and revenue collectors. If the court finds that a trust is a sham, the result may be the loss of the asset if the challenger is a creditor or property relationship claimant. Thus, the effects can be harsh on all the parties to the trust in some way or another, and being able clearly and precisely to identify a sham trust should be of the utmost importance in any court considering an allegation of a sham.

Despite what English jurists may believe, the most dated cases which link both the doctrine of the sham and trust law together can be found in the US. In *Gregory v Helvering, Commissioner of Internal Revenue*,⁵⁸ the issue at hand was whether the *corpus* of the trust established by the respondent should for income tax purposes be treated as his. The court, having regard to the substance as opposed to the form of the arrangement, held that abusive trust arrangements may be viewed as sham transactions, and the Internal Revenue Service may ignore the trust and its transactions for tax purposes.⁵⁹ One year prior to the *Snook* case, in the matter of *Scott v Federal Commissioner of Taxation Solutions (No 2)*,⁶⁰ Windeyer J identified the relevant factors to be considered, as follows:

“... if the scheme, including the deed, was intended to be a mere façade behind which activities might be carried on which were not to be really directed to the stated purposes but to other ends, the words of the deed should be disregarded ... A disguise is a real thing: it may be an elaborate and carefully prepared thing; but it is nevertheless a disguise. The difficult and debatable philosophic questions of the meaning and relationship of reality, substance and form are for the purposes of our law generally resolved by asking: did the parties who entered into the ostensible transaction mean it to be, and in fact

⁵⁷ *Waters Law of Trusts* 145.

⁵⁸ [1935] 293 US 465. See also *Helvering Commissioner of Internal Revenue v Clifford* [1940] 309 US 331.

⁵⁹ XIV 1 CB 193.

⁶⁰ [1966] 40 ALJR 265.

use it as, merely a disguise, a façade, a sham, a false front – all these words have been metaphorically used – concealing their real transaction.”⁶¹

Critically, even before the introduction of the *Snook* test – a year prior in fact – the common principles of sham transactions which are evident in *Snook* can be noted in Windeyer J’s remarks.

Remaining in the US, in *Markosian v Commissioner*,⁶² the court placed its emphasis on the parties’ observation of the terms of the trust. In this matter the trust was declared a sham because the parties had failed to comply with both the trust instrument and the supporting documents, while the relationship of the grantors to the property had failed to differ in any material aspect. Not too long after the decision in *Markosian*, the New Zealand Court of Appeal handed down a significant decision in *Marac Finance Ltd v Virtue*.⁶³

Concerned with the directions of the trust instrument, it was reasoned that where the genuineness of the documentation is challenged, a trust may be treated as a sham only:

“... where the document does not reflect the true agreement between the parties in which case the cloak is removed and recognition given to their common intentions; and where the document was *bona fide* in inception but the parties have departed from their initial agreement and yet have allowed its shadow to mask their new arrangement.”⁶⁴

While staying true to the requirements in *Snook*, the Court of Appeal advised, through an *obiter dictum*, that a sham could be affirmed in only two instances: first, if the facts indicate that, upon the trust’s inception, the parties used the trust as a cloak which concealed the common intentions of the parties, or, second, if the trust was legitimately set up, and the

⁶¹ At 279.

⁶² (1980) 73 TC 1235.

⁶³ [1981] 1 NZLR 586 (CA).

⁶⁴ At 588.

parties veer from the agreement and use the trust as a “shadow” to conceal the new arrangement.⁶⁵

A seemingly seminal Jersey case for the progression of the doctrine in modern law was that of *Abdel Rahman v Chase Bank (CI) Trust Company Limited and Others*.⁶⁶ The facts concerned a wealthy Lebanese domiciliary who established a trust in 1977. The trust contained a number of provisions whereby trustee actions required Mr Rahman’s consent, and some which did not. In particular, the trust instrument allowed Mr Rahman to allocate one-third of the capital of the trust fund to a nominee of his choice without trustee consent, and the trust instrument directed the trustees to apply the capital or income of the trust to or for the benefit of Mr Rahman. Upon the death of Mr Rahman, his widow and the estate of his mother sought a declaration by the court invalidating the trust on the grounds that, first, the trust instrument was in breach of the maxim *donner et retenir ne vaut*⁶⁷ and, second, that the trust was a sham. In coming to a conclusion, the court noted some particular instances which warranted attention: funds were commonly paid out of the trust at the instruction of Mr Rahman, without any real thought as to the basis on which they were paid; and payments were made directly from the trust banker to Mr Rahman without consulting the trustee until afterwards.⁶⁸ In its conclusion, the court held that Mr Rahman exercised dominion and control over the trustee in the management and administration of the settlement, including distributions of capital to himself, to others as gifts or loans, and the making and disposal of investments.⁶⁹ Moreover, he treated the assets comprised in the trust as his own and the trustee as though he were his agent. Thus, the settlement was declared a sham on the facts, in the sense that it was made to appear to be genuine, but it was not.⁷⁰

⁶⁵ At 587–590.

⁶⁶ [1991] JLR 103.

⁶⁷ This principle, which has since been removed from Jersey law by statute, literally translates to: “to give and retain is worthless”. The essence of the notion is that a gift into a trust will not be effective if the settlor retains the power to deal freely with the assets.

⁶⁸ At 157.

⁶⁹ At 167.

⁷⁰ At 169.

The entrenchment of the sham doctrine in New Zealand was affirmed by the New Zealand Court of Appeal in *NZI Bank Ltd v Euro-National Corporation Ltd*.⁷¹ Discussing the law relating to shams, the court noted that a document may be brushed aside if and to the extent that it is a sham, which may take the form of either of two situations:

“The first is where the document does not reflect the true agreement between the parties in which case the cloak is removed and recognition is given to their common intentions. The second is where the document was *bona fide* in inception but the parties have departed from their initial agreement while leaving the original documentation to stand unaltered.”⁷²

The New Zealand Judiciary seemed persistent in clarifying that a sham trust may be fashioned either at the trust’s inception, or at a later stage; and, notably, the trend to adopt the *Snook* test into trust disputes was becoming a frequent occurrence across the globe. In the case of *Merklinger v Merklinger*⁷³ the court dealt with a husband who had acquired a summer cottage through a specially incorporated company. Upon transfer of the deed, he then transferred the shares into a trust *inter vivos* for his children. During post-matrimonial litigation, the court accepted evidence indicating that the husband had clearly treated the property as his own, whilst pleading a trust when it suited him. The Court confidently held that the claim of a trust for the children was a pure sham and that if ever there was a trust, it was for the benefit of the husband.⁷⁴

In 1994, in *Midland Bank Plc v Wyatt*,⁷⁵ Young QC was confronted with the first case in the UK involving a sham trust. The matter involved a property purchased by the defendant and his wife in 1981. In 1987 the defendant entered into a trust instrument with his wife, giving the equity in the property to his wife and two daughters in order to protect his family from the possible commercial consequences of the textile business he was setting up.⁷⁶ The trust instrument was prepared by Mr Wyatt’s solicitor and witnessed by a family friend. Mrs Wyatt could not remember either signing the instrument or what it meant. Regrettably, the

⁷¹ [1992] 2 NZLR 528 (CA).

⁷² At 539.

⁷³ [1992] 11 OR (3d) 233 (Ont Gen Div).

⁷⁴ At 241–242.

⁷⁵ [1995] 1 FLR 696.

⁷⁶ Pryke “Sham Trusts”.

instrument was never returned to the solicitor, but rather kept in the house safe. The solicitor was not advised that the trust instrument had been signed, and thought that Mr Wyatt may have been having second thoughts about the instrument. On the refinancing of the property a year later, the new lender was not made aware that Mr Wyatt was not the beneficial owner of the property. Unfortunately, Mr Wyatt's new business went under, wherefore Mr Wyatt handed in the declaration of trust to his solicitors. The plaintiff contended that the trust was a sham and could thus be ignored. However, the defendant, Mr Wyatt, argued that, according to *Snook*, the trust could be a sham only if both parties to the trust had the common intention that it was not intended to take effect and be acted upon. The learned judge noted that:

“Subsequent to the execution of the trust deed nothing had changed in Mr Wyatt's behaviour or attitude with regard to his dealings involving Honer House [the house property]. I do not believe Mr Wyatt had any intention when he executed the trust deed of endowing his children with his interest in Honer House, which at the time was his only real asset. I consider the trust deed was executed by him, not to be acted upon but to be put in the safe for a rainy day. As such I consider the declaration of trust was not what it purported to be but a pretence, or as it is sometimes referred to a ‘sham’.”⁷⁷

Young QC went on to scrutinise Diplock LJ's comments in *Snook*, stating:

“I do not understand Diplock LJ's observations regarding the requirement that all parties to the sham must have a common interest to be a necessary requirement in respect of all sham transactions. I consider a sham transaction will still remain a sham transaction even if one of the parties to it merely went along with the ‘shammer’ not either knowing or caring about what he or she was signing. Such a person would still be a party to the sham and could not rely on any principle of estoppel such as was the case in *Snook* – the defendant there not being a party to the transaction at all ... I do not accept therefore the defendants' contention that it is a necessary requirement for the plaintiff to establish that both Mr Wyatt and Mrs Wyatt had a common intention that the declaration of trust signed by them was not intended to take effect and be acted upon by them as from the time of its execution.”⁷⁸

Significantly, the Judge dissected the *Snook* test and reasoned that the common interest requirement, which is so often reported as the cornerstone of the test, can be viewed as a flexible criterion. However, in *Midland Bank Plc*, Young QC considered that a sham

⁷⁷ At 707.

⁷⁸ At 699.

transaction would still remain a sham transaction even where one of the parties was not fully aware of the nature of the transaction and simply went along with it. Such a party would remain a party to the sham. He considered Diplock LJ's observations and commented that:

“... in their proper context [they] state no more than where a ‘sham’ transaction affects the rights of a third party, the ‘shammer’ cannot rely on the sham transaction unless the third party is also a party to the sham. The ‘shammer’ is otherwise estopped by his conduct from so relying on the sham transaction.”⁷⁹

Thus, according to Young QC, that party would still be a party to the sham and could not rely on any principle of estoppel. Consequently, the declaration of the trust sought to be relied upon was void and consequently unenforceable.

A year later, the Australian Administrative Appeals Tribunal held a trust to be a sham where the actions, or inactions, as the case may be, of the trustees negated the trust.⁸⁰ The facts concerned a challenge by the Commission of Taxation regarding certain alleged distributions to a beneficiary of a trust *inter vivos*. Notably, the distributions had been retained by the trustee and invested in the settlor's business. The tribunal looked at the evidence presented and noted that there was no written acknowledgment for the alleged distribution; that the information concerning distributions to beneficiaries was conveyed not by the trustees, but by other relatives; that the beneficiary who received the distribution was in bad health and in difficult financial circumstances, yet no distribution had actually occurred; and that on the beneficiary's unfortunate death, the distributions were not included in the beneficiary's inventory. The Commissioner, in deciding whether the distributions were a sham, accepted the conclusions reached in *Sharrment* to adopt the *Snook* test. McDonald DP concurred with Lockhart J and noted:

“A ‘sham’ is therefore, for the purposes of Australian law, something that is intended to be mistaken for something else or that is not really what it purports to be. It is a spurious imitation, a counterfeit, a

⁷⁹ At 701.

⁸⁰ Case S45 (1996) ATC 443.

disguise or a false front. It is not genuine or true, but something made in imitation of something else or made to appear to be something which it is not. It is something which is false or deceptive.”⁸¹

The judge then reviewed the guidelines applied by Lockhart J within the context of the facts in *Sharrment*, stating them in his own way, as follows:

“1. The fact that the transaction involved a ‘round robin’ of cheques does not necessarily establish that the transaction is a sham, even when no party has funds to meet the cheques.

2. The artificiality of the transaction does not give rise to its characterisation as a sham or to the characterisation of the constituent documents as a sham so long as each document ‘had the effect that it purported to have’, and so long as none of the documents purported ‘to do something different from what the parties had agreed to do’.

3. The complexity of the transaction does not in itself establish its character as a sham.

4. A purported disposal of property or purported creation of a debt may be a sham where donor and donee or lender and debtor do not intend to give effect to the transaction, it being agreed between them that there will be no change in the legal and beneficial ownership of the property.

5. The fact that a transaction may have been intended to present a shield against creditors does not ... characterise it as a sham. Transactions may in themselves be legally effective although intended to achieve an unacceptable purpose. The essential question seems to be whether what has been done has been genuinely done.

6. Circumstances giving rise to suspicion do not establish a transaction as a sham unless it can be shown that the outward and visible form does not coincide with the inward and substantial truth.”⁸²

On reflection, McDonald DP reasoned that:

“... an allegation of ‘sham’ is to be determined having regard to the intentions of the parties involved in a transaction and that, in considering those intentions, reference to what was sought to be achieved by the transaction will be of no assistance or, at most, of very limited assistance ... For the purposes of the

⁸¹ Para 22.

⁸² *Ibid.*

instant case, the Tribunal is to decide whether it was ever intended that the beneficiaries would benefit from distributions made by the Trust.”⁸³

In conclusion, the circumstances of the case indicated to the tribunal a lack of any real intention to see that the purpose for which the trust had been established was actually implemented. The tribunal was thus satisfied that the transactions were a sham, having emphasised that the trust lacked substance and not form.⁸⁴ However, conversely to the apparent rigid application of the sham doctrine, the Ontario case of *Sagl v Sagl*⁸⁵ highlighted Canada’s flexibility of application. In this instance, the husband, Mr Sagl, was one of the beneficiaries of a discretionary family trust. He was also a trustee of the trust with the power to appoint and remove trustees. Evidently, Mr Sagl had no intention of defeating his wife’s entitlement to the assets therein contained; however, Mr Sagl had always treated the trust property as his own, going so far as to include the trust assets in statements as to his personal assets and making use of friends as trustees. The court, although concerned with these facts, agreed with the husband’s submission that it would be “turning trust law upside down to say the trust was a sham.”⁸⁶ On the contrary, in *R v Dimsey; R v Allen*,⁸⁷ the English Court of Appeal upheld the basic premise of the *Snook* test: no intention means no sham. The matter concerned alleged fraudsters, who had, amongst other things, set up a tax avoidance scheme involving the use of companies incorporated from outside the UK to evade paying tax. Laws LJ approved Diplock LJ’s test in *Snook*, and added:

“But here the question is, was Mr Allen [the defendant] the beneficial owner the true owner of the shares, the properties and the bank balances in question? If he was then clearly the schedule of assets which he provided to the Revenue in answer to their enquiries was entirely wrong. If he appreciated that he should have declared [them] to the Revenue, then he was cheating the Revenue by failing to do so.... That is entirely right [*viz* that the assets belonged to the trusts] unless you are satisfied that the various very lengthy trust deeds you have seen are a sham, that is to say, documents which purport to show a legal situation which is other than the real one intending to give the appearance of creating legal rights different from the actual legal rights, if these trust deeds are a sham then it is open to you to find that the defendant was the beneficial owner of the various assets, knew that he was, and was cheating

⁸³ Paras 22–26.

⁸⁴ Para 26.

⁸⁵ [1997] 31 RFL (4th) 405 (Ont Gen Div).

⁸⁶ At 409.

⁸⁷ [2000] QB 744; [2000] 3 WLR 273.

the Revenue in not disclosing the various [assets] in the schedule of assets which he was required to give them.”⁸⁸

In the matter of *Bank of Credit and Commerce International (Overseas) Ltd and Others v Akindede*⁸⁹ and also of *Macniven v Westmoreland Investments Ltd*,⁹⁰ both judgments were delivered on appeal within four months of each other in the Royal Court of Justice and the House of Lords, respectfully, both based the sham enquiry around the *Snook* test. In *BCCI* and *Macniven*, Nourse LJ and Hobhouse L respectfully faced two similar scenarios of spiralling share procurements and sale agreements which were alleged to be a sham. In *BCCI* his lordship warranted the classical definition propounded by Diplock LJ, and held that the facts did not pass the muster of *Snook*, though he did recognise that the artificial nature of any arrangement may be evidence of dishonesty.⁹¹ Although the Commissioners did not follow through with the shamming allegation, in *Macniven*, Hobhouse L also concluded that the agreement was not a sham on the basis that the facts did not align themselves with the principles laid down in *Snook*. The payments in issue were thus declared real and not artificial in the eyes of the court.⁹²

Much as in *Hitch*, a similar stance on the matter was adopted in Jersey in the case of *Re Esteem Settlement, Grupo Torras SA and Others v Sabah and Others*,⁹³ where litigation arose out of fraud committed by Sheikh Fahad Mohammed al Sabah on Grupo Torras to the value of US\$430 million. In this matter the focus of the sham argument fell on the legal issue as to whether it is necessary for both the settlor and the trustees of a settlement to be parties to a sham or whether it is possible to have a so-called “unilateral sham”.⁹⁴ The underpinning importance of this inquisition cannot be under-emphasised, as the *Snook* test has its basis in

⁸⁸ At 772.

⁸⁹ (2001) Ch 437.

⁹⁰ (2001) BTC 44.

⁹¹ At 441. His lordship thereafter reasoned:

“I agree that the ... agreement was not a sham. There was no evidence to suggest that the defendant at any rate intended that it should be incapable of taking effect according to its terms. Accordingly, the requisite common intention that the agreement was not to create the legal rights and obligations which it gave the appearance of creating was absent.”

⁹² Para 96.

⁹³ [2003] JLR 188.

⁹⁴ Pryke “Sham Trusts”.

an arrangement being a bilateral action. Prior to the proceedings, Grupo Torras had successfully traced the proceeds of the fraud into two Jersey trusts, the Esteem Settlement and the No 52 Trust. Grupo Torras therefore sought to have these trusts invalidated on the basis that the trusts were a sham. Significantly, the presiding judge disagreed with the notion of a unilateral sham, holding that in order for a trust to be a sham, both the settlor and the trustee must intend that the true arrangement is otherwise than as set out in the trust instrument.⁹⁵ The Royal Court noted in particular that a trust instrument will not be held to be a sham unless both the settlor and the trustee have the necessary shamming intention. It is submitted that the reason for such a firm stance is due to the fact that, if decided otherwise, a trust might be considered invalid simply because of the secret and unexpressed intention of the settlor.

Thus, drawing directly on the guidance given by Diplock LJ in *Snook*, at the time the trust was established and prior to Sheikh Fahad's fraud against Grupo Torras, the trusts commenced with clean assets. His lordship further noted the following points:

- The trust was established by deed, which had been the subject of detailed consideration and prepared by a solicitor.⁹⁶
- All contact, at the time of the establishment of the trust, was between the trustees and Sheikh Fahad's solicitors.⁹⁷
- There was an absence of any reassurance from the trustees to Sheikh Fahad that they would always follow his instructions.⁹⁸
- The trustee in question was a substantial professional trustee.⁹⁹

⁹⁵ Para 53.

⁹⁶ Para 20.

⁹⁷ Para 20.

⁹⁸ Para 52.

⁹⁹ Para 282.

Reflecting the guidance of both *Snook* and *Wyatt*, the Jersey Royal Court proffered the following test:

“It follows that in our judgment, in order to succeed, the plaintiffs will need to establish that, as well as [the settlor], [the trustee] intended that the assets would be held upon terms otherwise than as set out in the trust deed or, alternatively, went along with [the settlor’s] intention to that effect without knowing or caring what it had signed, and that both parties intended to give a false impression of the position to third parties or to the court.”¹⁰⁰

According to Richmond-Coggan, the above test, in the case of professional trustees conducting themselves sensibly and with due consideration, can be seen to be an extremely onerous test for the prospective claimant to overcome.¹⁰¹ Moreover, it is a test that requires the parties to undertake a detailed analysis of the dealings between settlor and trustee, not only at the time at which the trust was set up, but also subsequently.¹⁰² Munby J reiterated this theme in *A v A*:¹⁰³

“I agree with that analysis [in *Re Esteem*]. What is required is a common intention, but reckless indifference will be taken to constitute the necessary intention. An allegation of sham is a serious matter. As Neuberger J said in *National Westminster Bank plc v Jones* ... ‘there is a very strong presumption indeed that parties intend to be bound by the provisions of agreements into which they enter, and, even more, intend the agreements they enter into to take effect.’ Moreover, and because as Neuberger J pointed out ... ‘a degree of dishonesty is involved in a sham’, it follows that: ‘there is a strong and natural presumption against holding a provision or a document a sham.’ Moreover, it has to be borne in mind that a finding of sham may have serious implications, not least for trustees. As the Royal Court of Jersey said in *CI Law Trustees Limited and Another v Minwalla and Others*... ‘It is a serious matter to find that a professional trustee in Jersey has been party to a sham. It is a finding moreover which might well have adverse consequences under the statutory regime which regulates the activities of professional trustees in Jersey and which, incidentally, is absent in England and Wales.’”¹⁰⁴

¹⁰⁰ Para 59.

¹⁰¹ W Richmond-Coggan “Attacking the assets of a trust: the courts use of freezing orders” (2007) 13 *Oxford LJ* 18 at 19.

¹⁰² *Ibid.*

¹⁰³ [2007] EWHC 99 (Fam).

¹⁰⁴ Paras 52–54.

The approach set out in *Re Esteem* was subsequently endorsed by the English Court in the case of *Shalson and Others v Russo and Others*.¹⁰⁵ The facts concerned fraudulent activity committed by an Italian national, Onofrio Russo, against several persons and companies, including that of Peter Shalson. One of the claims brought forward by Mr Shalson was that a particular trust established by the defendants known as “Brookcastle settlement” was a sham. Rimer J referred to Diplock LJ’s comments in *Snook* as well as the decisions in *Hitch* and *Re Esteem*.¹⁰⁶ In the presiding judge’s conclusion, Rimer J noted the following:

“After a careful consideration of the authorities the Royal Court of Jersey held in *Abacus (CI) Limited and Others v Sheikh Fahad Mohammed al Sabah and Others* ... that the like principle applies to an allegedly sham settlement: both the settlor and the trustee must intend the settlement to be a sham, and they rejected the proposition that all that counts is the settlor’s intention.”¹⁰⁷

Rimer J then concluded:

“I respectfully regard the approach adopted by the Royal Court in the [*Re Esteem*] case as correct. It is not only squarely in line with the guidance given by the Court of Appeal in *Snook* and *Hitch*, it also appears to me to be correct in principle. The settlor may have an unspoken intention that the assets are in fact to be treated as his own and that the trustee will accede to his every request on demand. But unless that intention is from the outset shared by the trustee (or later becomes so shared), I fail to see how the settlement can be regarded as a sham.”¹⁰⁸

This is an interesting case, in that it appears almost to have been accepted by the court that, contrary to the intention of the trustee, Mr Russo’s own intention probably had been that the assets should be treated as his own. Nevertheless, the court held that the trustee’s intention had throughout been an honest one, and it had never shared any contrary intention with Mr Russo.¹⁰⁹ Thus, what is unmistakably apparent is the court’s absolute unwillingness to recognise a sham unless both the settlor and the trustee have a shared intention to that effect. This fundamental concept to the doctrine of the sham has since been well entrenched and

¹⁰⁵ [2003] EWHC 1637.

¹⁰⁶ Pryke “Sham Trusts”.

¹⁰⁷ Para 188.

¹⁰⁸ Para 190.

¹⁰⁹ Richmond-Coggan 2007 *Oxford LJ* 20.

commonly accepted as correct throughout the UK. The decisions have as such firmly clarified the essential elements of a sham trust. A suitable example of a case highlighting the elements of a sham trust is *Mackinnon v The Regent Trust Company Ltd and Others*.¹¹⁰

In the Bailiff's discussion regarding the proposition that the trusts in question were a sham, the following was held:

"In my view, it is implicit ... that the settlor and trustee must have a joint intention to present the declared trusts to a third party as genuine, or in other words must have intended to mislead or deceive. Applying a common sense approach to the matter, it is inherent in the establishment of a sham trust that the parties to the arrangement intend to mislead or deceive others ... In my judgement such an intention is a necessary element of a sham trust. If the plaintiff is alleging a sham he must plead an intention to mislead or deceive others."¹¹¹

On appeal,¹¹² this position was confirmed by Southwell QC. The learned judge noted, first, that in order for a trust to be declared a sham, both the settlor and trustee must have intended that the true position would not be as set out in the trust instrument, but that either the trust was invalid and of no effect, or that the assets of the trust were held for the settlor absolutely, so that the assets were simply held to her order. Second, that both the settlor and the trustee intended to give a false impression to a third party or parties (including other beneficiaries and the Courts) that the assets had been donated into a trust and were held on the terms of the trust instrument.¹¹³ Southwell QC also noted the difference between "giving a false impression" and "deceit" and that the two should not be equated for the purposes of a sham (as was done in the trial court): "[d]eceit is an English tort with particular requirements. What is required in a case based on 'sham' is a common intention to give a false impression."¹¹⁴

¹¹⁰ [2004] JLR 477.

¹¹¹ Para 22.

¹¹² *Mackinnon v The Regent Trust Company Ltd and Others* [2005] JLR 198.

¹¹³ Para 15.

¹¹⁴ Para 17.

This position was reiterated in the complicated tax case of *Raftland v Deputy Federal Commissioner of Tax*,¹¹⁵ where Kirby J held that the trust in question was a sham because it was not intended by the settlor or the trustee to have substantive, as opposed to apparent, legal effects.

More recently, the latest sham trust case to emerge is that of the *Official Assignee in Bankruptcy in the Property of Gary Martin Reynolds v Wilson and Others*,¹¹⁶ which was heard in the New Zealand Court of Appeal. In short, the appellant represented¹¹⁷ Mr Reynolds, a bankrupt property developer who owed more than NZ\$500 000 to his creditors post-bankruptcy. In an attempt to decrease his liabilities, the Official Assignee of Mr Reynolds sought a court order declaring the GM Reynolds Family Trust (which held a house in Queensland) a sham. If such an order were to be granted, the property would in reality be the property of Mr Reynolds and thus available to his creditors to liquidate. The claim was brought against the legal owners of the Queensland house, the trustees of the GM Reynolds Family Trust.

Robertson J accepted the *Snook* test to be correct, noting that a sham exists where there is an intention to conceal the true nature of a transaction.¹¹⁸ This point was further demonstrated as follows:

“A trust will be held to be a sham where there is an intention to have an express trust in appearance only. An example is where the settlor seeks the protection offered by the pretence of there being a valid trust. A sham requires an intention to mislead. Equity looks to intent rather than form. The absence of an intention to create a genuine trust prevents the trust from being valid, because the essential ingredients for its creation [are] missing. The trust is void for the lack of intention to create a trust.”¹¹⁹

The appellant’s main contention in arguing that the court *a quo* had erred in not finding the trust to be a sham was that it was in fact not necessary to prove a common intention between

¹¹⁵ [2007] FCAFC 4.

¹¹⁶ [2008] NZCA 122.

¹¹⁷ Para 19: "The OA stands in the shoes of the settlor".

¹¹⁸ Para 26.

¹¹⁹ Para 26.

both the settlor and the trustees. On this issue Robertson J once again referred to *Snook*, noting that Diplock LJ held that “all parties to the transaction must share a common intention before a sham finding could be made.”¹²⁰ Interestingly, the appellant sought to distinguish from *Snook*’s bilateral requirement by contending that *Snook* involved a bilateral transaction (a hire-purchase agreement), whereas in the context of trusts, transactions are unilateral – “a settlor can unilaterally create a trust, and a trust is complete, without any element of acceptance by the trustee.”¹²¹ The court, however, rejected this argument, holding true to *Hitch*, *Re Esteem Settlement* and *Shalson*, which courts had all supported the same argument and had explicitly disagreed. Robertson J reasoned that this disagreement was based on four main reasons highlighted in *Re Esteem Settlement*, which are:

- “(a) Previous authority suggests a common intention is required;¹²²
- (b) It would be absurd if in circumstances where a trustee has acted as a perfect trustee applying assets in good faith that the secret, unexpressed intention of the settlor that a trust be a sham could cause the trust to be held to be invalid.¹²³ Estoppel would prevent the settlor from attacking the trust but a third party would not be stopped. The Deputy Bailiff stated, ‘such extraordinary consequences, must at least, raise questions as to whether [the plaintiff’s counsel’s] formulation of the law can be correct’;
- (c) Gifts should not be invalidated solely on the basis of intention, some prejudice is required in order to reject the validity of a formal legal document;¹²⁴ and
- (d) Trusts are not necessarily unilateral transactions.¹²⁵ The Court found that the trust deed in this case was not unilateral as it contained terms for the benefit of the trustee such as remuneration.”¹²⁶

As has been clearly illustrated in the above cases, Robertson J agreed with the requirement that there must be a common intention before a transaction is found to be a sham. The learned Judge further reasoned that equal importance must be placed on the initial intention to create

¹²⁰ At 802.

¹²¹ Para 30.

¹²² Para 53(i).

¹²³ Para 53(iii).

¹²⁴ Para 53(iv).

¹²⁵ Para 53(viii).

¹²⁶ Para 33.

a trust. After all, a court cannot hold that a trust exists unless it is satisfied that there was the intention to create such a trust.¹²⁷ Such a determination was sketched, as follows:

“In determining whether the requisite intention exists the Court may look at the nature of the transaction and the whole of the circumstances attending the relationship between the parties. The overall question is whether in the circumstances of the case, and on the true construction of what was said and written, a sufficient intention to create a trust has been manifested... The creation of a trust is rightly described as a unilateral transaction. If objectively assessed, a settlor intends to create a trust, and the other certainties and requirements of constitution are present then the intentions of the trustee will be irrelevant. Conversely, if objectively the settlor does not intend to create a trust then one of the core certainties is missing and there cannot be a valid trust. The trustee’s intentions are not critical.”¹²⁸

Robertson J did, however, further note that within the trust, not all transactions take the same form. The learned judge asserted that some are unilateral because the settlor and the trustee are not separate persons, and there is therefore no possibility of mutuality in any mental state, thus precluding a common intention.¹²⁹ On the other hand, Robertson J concluded that some trusts are practically speaking bilateral as they entail an actual intention and a consciousness of the settlor and the trustee(s).¹³⁰ Nevertheless, Robertson J held that, be that as it may, if only the settlor’s duplicitous intention is required, then it is relatively straightforward to set aside a sham trust; but few sham trusts will be set aside if common intention is required and this would therefore promote commercial certainty.¹³¹

Significantly, Glazebrook J investigated the link between the concept of a sham and that of intent. In summary, the learned judge found that where a sham is alleged, the search is for subjective intent that the transaction is a sham. This is because the whole point of a sham is that, if looked at objectively, it is intended to have an effect other than the effect it would have.¹³² Furthermore, when assessing whether a trust is a sham or not, the courts, in the opinion of Glazebrook J, must consider contemporary evidence of the actions (and words) of

¹²⁷ Para 43.

¹²⁸ Paras 44–45. See further *Mallott v Wilson* (1903) 2 Ch 494, where it was held that if a trustee disclaims, the trust still subsides.

¹²⁹ Para 51.

¹³⁰ Para 51.

¹³¹ Para 53.

¹³² Para 108.

the relevant parties showing that the trust was not intended to be genuine. In terms of the onus and burden in relation to allegations that a trust is a sham, it was held that the party asserting the existence of the sham bears the onus of proving this on a balance of probabilities.¹³³

Much as in *Markosian* and *NZI Bank*, the court in *Reynolds* acknowledged that some trusts are intended to be legitimate from their outset, but that during the course of the life of the trust the parties then change their intention (to manage the trust as if it were a sham) and act on this intention thereafter. Robertson J remarked as follows in this regard:

“Once a trust is validly created, the beneficiaries have an interest in the trust property that cannot easily be undone. Unless the later appearance of a sham can be traced back to the creation of the trust, the trust remains valid. An exception to this could be where an item of property is later transferred to the trust, the trust could be a sham with respect to that property only, but the remainder of the trust would remain valid.”¹³⁴

In the court’s conclusion, Robertson J and Glazebrook J dismissed the sham allegations of the family trust. In its findings, the court held that the documentation which was completed was consistent with Mr Reynolds’ subjective wish to create a trust. On the findings of the judge, there were non-complicit trustees who entered into the transaction and acquired property (and administered that property even if not very well) in the name of the trust, and so they could not be said to have intended the trust to operate as a mere sham.¹³⁵

In the US the Supreme Court has consistently stated that the substance as opposed to the form of a transaction is controlling for tax purposes. Interestingly, though, the US has been able to achieve something other foreign courts have not. Solely for tax purposes, but still of value, the American courts apply the so-called “*Buckmaster* 4-factor approach” in order to decide

¹³³ Para 111.

¹³⁴ Para 57.

¹³⁵ Para 95.

whether a trust is a sham. This approach was formed in the case of *Buckmaster v CM*¹³⁶ and comprises a four-stage enquiry, as follows:

“(1) Whether the taxpayer’s relationship, as grantor, to the property differed materially before and after the trust’s formation. Did the taxpayer transfer assets to the trust, continue to use the assets and receive income from the assets for his efforts? (2) Whether the trust had an independent trustee. Was there any meaningful restriction on the taxpayer’s use of the trust property for his own purposes or access to the trust’s accounts? (3) Whether an economic interest passed to other beneficiaries of the trust. Did the taxpayer transfer an economic interest to a third party when he transferred his assets to the trust? Did the taxpayer actually transfer away all of his legal and beneficial interests in his assets, including the tools of his trade, for practically nothing in return? (4) Whether the taxpayer felt bound by any restrictions imposed by the trust itself or the law of trusts. Were the actions of the taxpayer limited by any restrictions imposed by the trust agreement or the law of trusts as to the use of the transferred property? Did the taxpayer have unrestricted use and control over the property without fiduciary limitations imposed on trustees?”¹³⁷

This somewhat ingenious and original test differs vastly from the *Snook* test, and displays a completely new set of guidelines for the trust to meet. What is of particular interest here is that no common or bilateral intention to sham is necessary in order for the trust to be void as per the sham doctrine. What is abundantly clear is the emphasis to look past the form of the trust and into the substance of the arrangement. This is evident in the approach’s examination of the internal administration of the trust (the independent trustee requirement and the settlor’s limitations as imposed by the trust instrument), as well as the effect the trust has on the settlor. In other words, does he or she clearly cede all property rights of the donated assets to the trust for the benefit of the beneficiaries?

Should the *Buckmaster* 4-factor approach be broadened to include trusts, it is submitted that it would still not be a candidate as a viable alternative to the *Snook* test because the approach lacks the restrictive attitude formulated in *Snook*, which has to a greater or lesser extent, been praised in subsequent judgments.

¹³⁶ (1997) TC Memo 236.

¹³⁷ R Sommers “Sham Trust Analysis” http://www.taxprophet.com/pubs/sham_Trust_Analysis.htm (accessed 9 April 2009).

2.1.3 THE SHAM SYNOPSIS AND THE PROOF THEREOF

In brief, it is evident that the concept of sham transactions, through the ages, seeped into trust law. And what was once a theory has now become a firm principle in the law of trusts. Although the sham doctrine is still a concept which is continually evolving, the basic premise laid down in *Snook* has become the most relevant guideline in ascertaining the sham status of any trust. Thus, when proving a sham, it is necessary to establish a subjective bilateral shamming intention at the time of the trust's establishment. In this regard focus will be on contemporaneous documentary records and oral evidence of key witnesses under cross-examination. Compounding the difficulty of proof, it is unfortunately unlikely that parties with an intention to sham will leave any documentary evidence or make detrimental admissions. What is evident from the above cases is that courts are hesitant to make a finding of a sham unless there is very strong evidence to the like. The courts have, however, examined the subsequent conduct of the parties in order to verify the shamming intention at the outset. In *Re Esteem* the court held that “[t]rustees who in good faith consider the exercise of their fiduciary duties under a discretionary trust cannot be said to be under the requisite control of another person.”¹³⁸

2.1.3.1 FOREIGN SHAM TRUST CASES SUBSEQUENT TO THE *SNOOK* JUDGMENT

The above cases constitute the foreign sham trust cases that were available for review. Cases subsequent to the *Snook* case (1969) have, for the purposes of classification, been considered once again. In order to give an outline of the sham trust cases referred to above, Table 4.1 below provides a summary of foreign court judgments concerning sham trusts. Running in chronological order, the table depicts: (1) the case name; (2) the jurisdiction in which the case was heard; (3) the court it was heard in; (4) whether the court applied the *Snook* test; (5) whether the trust in question was pierced by the court, and (6) the corresponding court reasoning. The table is necessary in order to round off the chapter's foreign sham trust analysis. However, the focus of this table is on whether the court made use of the *Snook* test and the outcome thereof.

¹³⁸ Para 124.

Table 4.1: The Foreign Evolution of the Sham Trust: Summary

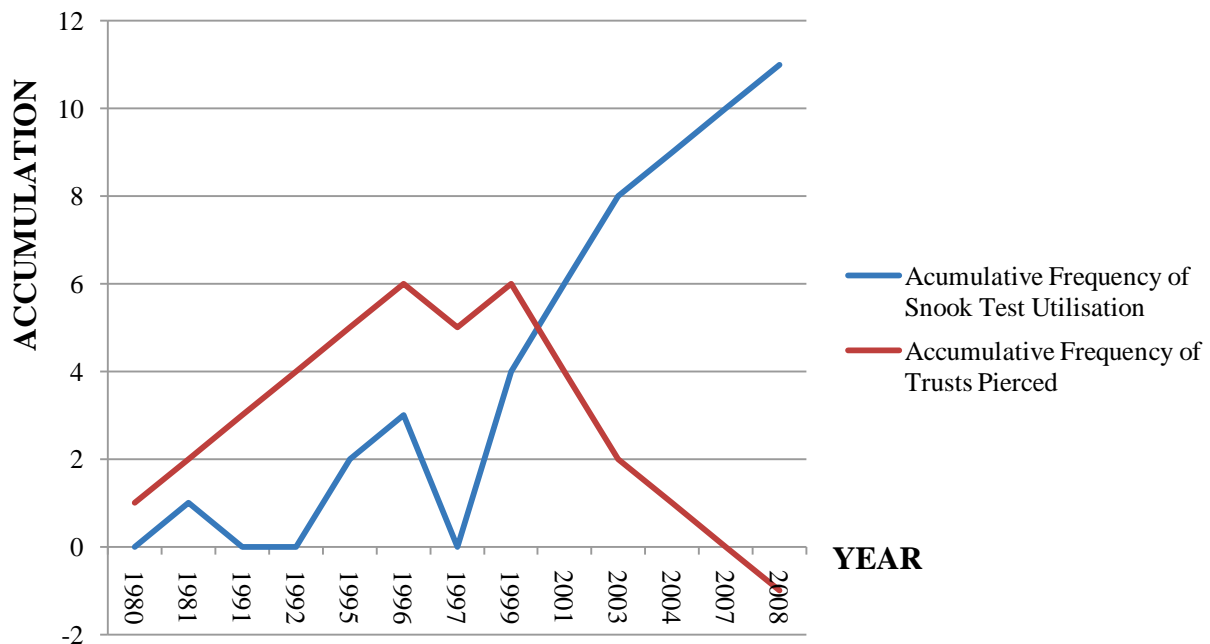
Year	Case Name	Jurisdiction	Court	Application of the <i>Snook</i> Test?	Result: Trust Pierced?	Reason
1980	<i>Markosian v Commissioner</i>	United States	The U.S. Tax Court	No	Yes	Settlor and trustee failed to comply with trust instrument and property not administered differently post settlement
1981	<i>Marac Finance Ltd v Virtue</i>	New Zealand	The NZ Court of Appeal	Yes	Yes	Trust instrument did not reflect the common intentions of the parties since the trust's inception
1991	<i>Abdel Rahman v Chase Bank</i>	Jersey	The Jersey Royal Court	No	Yes	Accused exercised dominium and control over the trustees and treated trust assets as his own
1992	<i>Merklinger v Merklinger</i>	Canada	Ontario General Division	No	Yes	Husband treated trust property as his own without having regard to the interests of the beneficiaries
1995	<i>Midland Bank v Wyatt</i>	England	Family Law Court	Yes	Yes	Plaintiff produced declaration of trust upon shamming allegation; no other effort was made to create the trust
1996	Case S45	Australia	Administrative Appeals Tribunal	Yes	Yes	Lack of evidence indicating trust was established for purpose set out and documented
1997	<i>Sagl v Sagl</i>	Canada	Ontario General Division	No	No	No evidence that settlor intended trust to defeat his co-beneficiaries
1999	<i>R v Dimsey; R v Allen</i>	England	English Court of Appeal	Yes	Yes	Trust instrument reflected one situation, while the trustees carried out another, fraudulently
2001	<i>BCCI v Akindele</i>	England	Royal Court of Justice	Yes	No	The facts did not pass the <i>Snook</i> test
2001	<i>Macniven v Estmore Investments</i>	England	House of Lords	Yes	No	The facts did not pass the <i>Snook</i> test

Year	Case Name	Jurisdiction	Court	Application of the <i>Snook</i> Test?	Result: Trust Pierced?	Reason
2003	<i>Re Esteem Settlement: Grupo Torras</i>	Jersey	The Jersey Royal Court	Yes	No	Court held that it would be highly exceptional to invalidate a trust that was initially valid on grounds of public policy
2003	<i>Shalson v Russo</i>	England and Wales	The High Court of England and Wales	Yes	No	No intention from the outset to regard the trust as a sham
2004	<i>Mackinnon v Regent Trust Company</i>	Jersey	The Jersey Royal Court	Yes	No	Trusts established by the settlor for the benefit of close family. Held, it could not be concluded against her that she had in fact pretended, for more than 20 years, that she had established trusts in their favour, while not having done so
2007	<i>A v A</i>	England and Wales	The High Court of England and Wales	Yes	No	Facts did not pass the <i>Snook</i> test. Held, the court cannot grant relief because the husband's arrangements appear to be artificial. The judge warned, in particular, about the need for care, where third-party interests were involved
2008	<i>OA in Bankruptcy of Reynolds v Wilson</i>	New Zealand	The NZ Court of Appeal	Yes	No	Documentation consistent with settlor's subjective wish to create trust

The cases cited above have already been discussed in detail. It is noteworthy that the application of the *Snook* test has become a worldwide trend. Undoubtedly, the general tendency has been to use the test more frequently when dealing with a sham trust allegation. Corresponding to this upward trend, there has been a somewhat remarkable propensity not to pierce the trust, or lift the veil, so to speak. The results from the above summary are best depicted graphically.

The graph below provides a graphical illustration of the tendencies which have been discovered.

Figure 4.1: Foreign Courts: Frequency of the *Snook* Test Utilisation and the Correlation to the Frequency of Trusts Pierced



The blue line represents the accumulative net amount of cases in which the court adopted the *Snook* test so as to determine whether a trust was a sham. The last decade, especially, indicates that the test has become the norm abroad. The red line characterises the accumulative net frequency with which these trusts were in fact pierced. The downward trend is unmistakable. Evidently there is an inverted relationship between the frequency of use of the *Snook* test and the corresponding incidence of the amount of trusts subsequently pierced.

The results undeniably reflect the restrictive view of the concept of sham as realised by Diplock LJ. The stringent guidelines contained in the test have thus significantly reduced the number of trust piercings over time. This is a welcome result, for the reason that once a trust is validly created, the beneficiaries have an interest in the trust property that should not easily be undone, and the courts should thus be constrained in their veil-lifting discretion.

2.1.3.2 ASCERTAINING THE TRUE NATURE OF THE TRANSACTION

The duty of the courts is therefore to discover the true nature of the transaction in question. The above cases relating to both sham transactions and sham trusts suggest that there are six questions involved in ascertaining this. The *first question* is: what was the genuine intention of the parties?¹³⁹ In *Northumberland Insurance Ltd v Alexander*,¹⁴⁰ Clarke J remarked:

“... it is the intention of the parties to the transaction which determines whether the act or document was intended to be operative according to its tenor or whether it was simply a façade or a disguise. It is not essential, in my view, that the façade disguises another or different transaction. It is enough if it creates the appearance that the contractual relationship between parties is different from the actual relationship.”¹⁴¹

The genuine intention of the parties to the transaction is thus imperative.¹⁴² In *Sharrment*, Lockhart J reasoned that in order to determine this enquiry, reference is to be made of their actual intentions whether by direct evidence or by inference from the circumstances of the transactions.¹⁴³ Hunt J reiterated this theme in *Coppleson v Federal Commissioner of Taxation Solutions*,¹⁴⁴ noting that: “It is the intention of the parties to the transaction which determines the question whether the act or document was never intended to be operative according to its tenor at all, but was rather meant to cloak another and different transaction.”¹⁴⁵

The *second question* in determining the true nature of the transaction is that the legal character of the agreement which embodies the transaction must be considered.¹⁴⁶ It is only where the genuineness of the agreement evidenced by the documents is challenged that it is then necessary to consider whether the substance of the transaction as represented by the

¹³⁹ R Holmes “Sham Trusts and Sham Transactions” <http://www.rossholmes.co.nz/article.php?id=112> (accessed 12 March 2010).

¹⁴⁰ [1984] 8 ACLR 882.

¹⁴¹ At 888–889.

¹⁴² *Boydell v James* (1936) 36 SR (NSW) 620; *Dennis Willcox Pty Ltd v Federal Commissioner of Taxation Solutions* (1976) 10 ALR 513; *Coppleson v Federal Commissioner of Taxation Solutions* (1981) 34 ALR 377; *Sharrment v Official Trustee in Bankruptcy* [1988] 18 FCR 449.

¹⁴³ At 539.

¹⁴⁴ (1981) 34 ALR 377.

¹⁴⁵ At 381.

¹⁴⁶ Holmes “Sham Trusts and Sham Transactions” .

documents is not the true substance of the transaction, and the documents themselves are a cloak to conceal its true nature.¹⁴⁷ Thus, the modern trend is for the courts to try to give business efficacy to commercial transactions. If a court is satisfied that the real intention of the parties was to enter into a binding agreement, then the court will do its best to give effect to that intention.¹⁴⁸ Interestingly, the modern-day approach can be contrasted with the earlier judicial approach, when a finding of sham inevitably enabled a court to infer the true nature of the arrangement in an “in-substance” manner.¹⁴⁹

The third step in the enquiry is as follows: In arriving at the determination, all circumstances and incidents of the ostensible transaction must be taken into account.¹⁵⁰ Thus, prior to any issue of sham, it is imperative that a systematic and objective approach is examined so as to ascertain the nature of the transaction. In the matter of *Re Securitibank Ltd*,¹⁵¹ Richardson J reasoned: “[i]t is well settled that, where documents have been drawn to define the relationship of persons involved in a business operation, the true nature of the transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out.”¹⁵² This point was reiterated in *Commissioner of Inland Revenue v Europa Oil*:¹⁵³ “It is the legal character of the transaction which is decisive, not the overall economic consequences to the parties.”¹⁵⁴ Under a similar mindset, Richardson J outlined the crucial role evidence plays in the sham enquiry. In his majority judgment of *Buckley & Young Ltd v Commissioner of Inland Revenue*,¹⁵⁵ the learned judge noted: “it is well established that the true nature of a transaction must be ascertained by reference to the legal arrangements actually entered into and carried out”.

¹⁴⁷ *Re Securitibank Ltd (No 2)* [1978] 2 NZLR 136.

¹⁴⁸ *Attorney-General v Baker Bros Ltd* [1976] 2 NZLR 495.

¹⁴⁹ Holmes “Sham Trusts and Sham Transactions”. See for example, *Polsky v SA Services* [1951] 1 All ER 185, where Goddard L had no difficulty inferring from the fact that there had not been payment of a deposit, as set out in a hire-purchase agreement used in a refinancing situation, that he was dealing with a clear case of sham.

¹⁵⁰ Holmes “Sham Trusts and Sham Transactions”.

¹⁵¹ [1978] 2 NZLR 136.

¹⁵² At 167–168.

¹⁵³ [1971] NZLR 641.

¹⁵⁴ At 648–649.

¹⁵⁵ [1978] 2 NZLR 485.

These words were outlined in *Commissioners of Inland Revenue v Ramsay*,¹⁵⁶ per Wright L, who reasoned:

“The decision in any particular case can only be arrived at by considering what is the substance of the transaction in question, and what is the substance of that transaction can only be ascertained by a careful consideration of the contract which embodies the transaction. That being so, in our judgment what has to be done here is to examine the particular clauses of... the agreement in question, and to see what is the appropriate conclusion ... to be arrived at on the consideration of that agreement.”¹⁵⁷

Thus, the court is duty-bound to construe the trust instrument as a whole and the judge will need to be persuaded that the trust document was used by both the settlor and the trustee as a camouflage, to conceal the true position of the arrangement. The *fourth step* in this enquiry reads as follows: The court may receive oral evidence as to the intentions of the parties. In the majority of cases dealt with thus far, oral evidence has indeed served a crucial role in the courts determination. The reason is that, as noted in the above, there is often very little physical or documentary evidence left behind by the shamming parties to indicate their ill intentions. The Australian case of *Hawke v Edwards*¹⁵⁸ usefully interpreted this important emphasis in the process of the sham determination, where Jordan CJ confirmed the following:

“... oral evidence is admissible in such proceedings that the parties intended themselves to be bound only by a contemporaneous oral agreement and that the document was brought into existence as a mere piece of machinery for serving some other purpose than that of constituting the real agreement between them. Oral evidence may also be given that the document is a sham – that it was never intended by the parties to be operative according to its tenor at all, but was meant to cloak another and different transaction.”¹⁵⁹

In addition, in *Hitch*, Arden LJ confirmed that the court may examine external evidence. This will include the parties’ explanations and circumstantial evidence, such as evidence of the

¹⁵⁶ (1935) 20 TC 79.

¹⁵⁷ At 94.

¹⁵⁸ (1947) 48 SR (NSW) 21.

¹⁵⁹ At 23.

subsequent conduct of the parties.¹⁶⁰ Evidence of subsequent conduct has, however, been treated with caution thus far. Arden LJ explains:

“... the fact that parties subsequently depart from an agreement does not necessarily mean that they never intended the agreement to be effective and binding. The proper conclusion to draw may be that they agreed to vary their agreement and that they have become bound by the agreement as varied.”¹⁶¹

The implications of this limitation on trusts is that once a trust has been validly created, a subsequent agreement between the settlor and the trustee that the trust will be a sham merely exposes the trustee to a claim for breach of trust.¹⁶² This profound conclusion was expounded upon by Munby J in *A v A*:

“A trustee who has *bona fide* accepted office as such cannot divest himself of his fiduciary obligations by his own improper acts. If therefore, a trustee who has entered into his responsibilities, and without having any intention of being party to a sham, subsequently purports, perhaps in agreement with the settlor, to treat the trust as a sham, the effect is not to create a sham where previously there was a valid trust. The only effect, even if the agreement is actually carried into execution, is to expose the trustee to a claim for breach of trust and, it may well be, to expose the settlor to a claim for knowing assistance in that breach of trust. Nor can it make any difference, where the trust has already been properly constituted, that a trustee may have entered into office – may indeed have been appointed a trustee in place of an honest trustee – for the very purpose and with the intention of treating the trust for the future as a sham. If, having been appointed trustee, he has the trust property under his control, he cannot be heard to dispute either the fact that it is trust property or the existence of his own fiduciary duty.”¹⁶³

This rather interesting conclusion can be supported historically. In *Hitch*, his lordship remarked:

“... the fact that the act or document is uncommercial, or even artificial, does not mean that it is a sham. A distinction is to be drawn between the situation where parties make an agreement which is unfavourable to one of them, or artificial, and a situation where they intend some other arrangement to

¹⁶⁰ Para 65.

¹⁶¹ At 229–230.

¹⁶² Conaglen 2008 *Cambridge LJ* 193.

¹⁶³ Para 43.

bind them. In the former situation, they intend the agreement to take effect according to its tenor. In the latter situation, the agreement is not to bind their relationship.”¹⁶⁴

The notion can, however, be contrasted with the situation faced in *Rahman*. The trust in this instance was still declared a sham because the trustee was never made master of the assets. The settlor intended to and in fact did retain control of the capital and income of the trust fund throughout his lifetime, and used the trust and the trust instrument to make testamentary dispositions.¹⁶⁵

Returning to the ascertainment of the true nature of the transaction, *the fifth step* in the enquiry is as follows: The court may have regard not only to the inferences drawn from its acceptance of such evidence, but also those which flow from disbelief.¹⁶⁶ Thus, the court should be wary of the unreliable witness and scrutinise all testimonials objectively. Should the presiding judge be of the opinion that a witness has offered incomplete, incoherent or untrustworthy evidence, that too should be taken into consideration and, if need be, be used together with other evidence, to infer the intention to sham.

The last step in the enquiry flows from the previous one, and is the following: To create an inference of a sham in the absence of direct evidence is to reach a finding, one which cannot be made if another inference is at least equally open.¹⁶⁷ Seen more as a warning than as an actual stage in the enquiry, the caution originates from the basic principles of the law of evidence. *Marac* is a perfect example of this: there during proceedings it was established that where the genuineness of the documentation is challenged, a trust may be treated as a sham only in two situations (if the concept of the emerging sham is allowed): first, where the document does not reflect the true agreement between the parties, in which case, the cloak is removed and recognition given to their common intentions;¹⁶⁸ and second, where the trust instrument was *bona fide* in inception, but the parties have departed from their initial

¹⁶⁴ Para 67.

¹⁶⁵ At 168.

¹⁶⁶ Holmes “Sham Trusts and Sham Transactions”.

¹⁶⁷ *Ibid.*

¹⁶⁸ *NZI Bank* 539.

agreement and have allowed its shadow to mask their new arrangement.¹⁶⁹ Once it is established that a transaction is not a sham, its legal effect will be respected.¹⁷⁰

In the matter of *Re W (Ex Parte Orders)*,¹⁷¹ Munby J made a useful observation that is well worth restating here. The judge reasoned that: “[t]he court should adopt a robust questioning and [where appropriate], sceptical approach to trust and company structures, but that [does] not mean that it [can] ride roughshod over established principles where third party interests [are] involved.”¹⁷²

2.1.3.3 ONUS AND BURDEN

In order to answer the questions: Who bears the onus of proving a sham? and What burden of proof must that person meet?, consideration must once again be directed to foreign authority. In the matter of *Mikeover Ltd v Brady*,¹⁷³ the court noted that the party asserting the existence of a sham bears the onus of establishing it.¹⁷⁴ This view was mimicked by Neuberger J in *National Westminster Bank plc v Brady*, as well as by Munby J in *A v A*.¹⁷⁵

In order to answer the second question, attention should be focussed on the nature of the proceedings. Even in extreme matters such as *Re Esteem*, litigation was directed by way of civil procedure. It thus follows that the burden of proof in matters dealing with the sham status of a trust, is that of an ordinary civil burden, ie the balance of probabilities. That said, an allegation of a sham is a serious matter,¹⁷⁶ and as has been evident in the above case exploration, the courts will not lightly reach a conclusion of a sham.

¹⁶⁹ *Ibid.*

¹⁷⁰ *Ibid.*

¹⁷¹ [2000] 2 FLR 927.

¹⁷² At 938–939.

¹⁷³ (1989) Ch 86 103 (CA).

¹⁷⁴ At 626.

¹⁷⁵ [2001] 1 BCLC 98 and [2007] EWHC 99 (Fam) 53 respectively.

¹⁷⁶ *A v A* para 53.

In *National Westminster Bank*, Neuberger J shared his thoughts on the matter:

“... there is obviously a strong presumption, even in the case of an artificial transaction, that the parties to what appear to be perfectly proper agreements on their face, intend them to be effective, and that they intend to honour and enjoy their respective obligations and rights. That is supported by the fact that an allegation of sham carries with it a degree of dishonesty, and the court should be slow (but not naively or unrealistically slow) to find dishonesty.”¹⁷⁷

Conaglen submits that this reflects the normal approach to the burden of proof in civil cases, pursuant to which “the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability.”¹⁷⁸

2.1.3.4 THE EMERGING SHAM

A somewhat conflicted view has arisen regarding the notion of an emerging sham. This idea acknowledges that some trusts are intended to be legitimate from their outset, but that during the course of the life of the trust the parties then change their intention – to manage the trust as if it were a sham – and act on this intention thereafter. The case of *NZI Bank* touched on the question of the notion’s legitimacy. The court in this instance pointed out that a document may have been *bona fide* at inception, but the parties then departed from the initial agreement and the trust thus in fact became a sham. In *Reynolds* Robertson J reflected on the intricacies of recognising an emerging sham:

“A trust is validly created, the beneficiaries have an interest in the trust property that cannot easily be undone. Unless the later appearance of a sham can be traced back to the creation of the trust, the trust remains valid. An exception to this could be where an item of property is later transferred to the trust, the trust could be a sham with respect to that property only, but the remainder of the trust would remain valid.”¹⁷⁹

¹⁷⁷ Para 46.

¹⁷⁸ Conaglen 2008 *Cambridge LJ* 193; *Re H (Minors)* [1996] AS 563 at 586.

¹⁷⁹ Para 57.

Having regard to *Marac*, it was noted above that Richardson J said:

“Where the essential genuineness of the documentation is challenged a document may be brushed aside if and to the extent that it is a sham. There are two situations: (1) where the document does not reflect the true agreement between the parties in which case the cloak is removed and recognition given to their common intentions; and (2) where the document was *bona fide* in inception but the parties have departed from their initial agreement and yet have allowed its shadow to mask their new arrangement.”¹⁸⁰

However, *Marac* involved a financing agreement, not a trust. A practical example of the emerging sham is when a genuine trust is established, the trustees initially practise good behaviour, but, then, over time, they stop meeting in order to discuss and document their activities on behalf of the trust. The records documenting the decisions are thus not kept and the settlor gradually starts to treat the trust assets as if they were his or her very own property. Notably, the lack of documentation will not of itself make a trust a sham, but will inevitably assist a court in finding that a sham exists. Another, more obvious example is where the settlor of an established trust changes his or her intentions regarding the trust. The settlor might in this case use the trust to defraud creditors and instruct his or her trustees to follow their commands.

Unfortunately, accepting the notion of an emerging sham is more complicated than it may seem at first. In *Shalson*, Rimer J made a very valid point when he noted that, as a matter of principle, a trust which was initially not a sham cannot subsequently become one. The reason for this is that for a properly constituted trust to become a sham after its inception would require all the beneficiaries with the requisite shamming intention to join together with the trustees for that purpose.¹⁸¹ Munby J elaborated on the matter in *A v A* (discussed above), reasoning that a trust could not as a matter of law be a sham if either of the original trustees were not parties to the sham at the time of their appointment, unless the beneficiaries were to join the trustees with the intention of creating a sham, and thereafter participate together as

¹⁸⁰ At 558.

¹⁸¹ This is applicable only where beneficiaries have either a vested right or, in English law, an equitable interest. In South Africa, the intention of the beneficiaries would be irrelevant.

such.¹⁸² The court was unable to agree with the concept, reasoning that a sham could be one only if it existed from the beginning, but, Munby J further explained that it would, however, be possible for a trust which was initially a sham subsequently to lose its character.¹⁸³

The point to be understood, taking into account the proponents and opponents of the idea, is that a sham is not the same as where there is a valid trust, but when the trustee, for whatever reason, defaults on his or her duties and fails to administer the trust according to the trust instrument or his or her other legal duties. This, then, is a breach of trust in which the trustee is personally liable to the beneficiaries of trust for the losses he or she has caused.¹⁸⁴ As has been discussed in *Snook*, the test requires both the settlor and at least one other trustee to go along with the sham. A trustee acting on his or her own accord only fails to follow his or her duties owed to the beneficiaries. This is in line with the *Reynolds* case, as Robertson J was fairly specific in noting that the appearance of a sham would need to be traced back to its creation.

As yet the legitimate use of the emerging sham is still uncertain. The fair approach, it is submitted, would be to recognise the concept of an emerging sham in the very strictest of senses. It is possible for a settlor and trustee to abuse the trust after its inception, should they share a bilateral intention. Thus, staying within the realms of the *Snook* test, it would seem that this would be a welcomed and intelligent development which broadens the sham horizon to a more realistic level. Moreover, the recognition of the emerging sham is clearly necessary to cover situations where a trust's objectives are subverted only after it has been set up.¹⁸⁵

3. THE DOCTRINE OF THE ALTER-EGO

This doctrine, which is often masked in the description of a trust being the “alter-ego”, “puppet” or “nominee” of a settlor, is a principle separate and distinct from the sham doctrine.

¹⁸² Para 44.

¹⁸³ Para 45.

¹⁸⁴ WH Muller *et al Anti-money Laundering - International Law and Practice* (2007) 31.

¹⁸⁵ The *Rahman* case is useful as an example here. The settlor in this matter created the trust with an initial US\$100, which is standard. There was no shamming intention at that moment. That only came later.

In essence, an alter-ego trust represents two distinct situations. The first is where assets are settled on a trust, but the trustees of the trust act as mere puppets, doing whatever they are instructed to do. The second is where the trust property is treated as if it were personally owned, instead of belonging to the trust. Interestingly, as will be noted below, the majority of both foreign and local alter-ego cases revolve around matrimonial proceedings.

Astonishingly, despite the fact that the courts today have asserted an increasing interest in trusts, many settlors continue to treat trust assets as if they still own them, failing to observe even the most basic principles of the fiduciary duties they created. Courts may under such circumstances be compelled to look behind the guise and into the reality of the situation, which ultimately may lead to a declaration that the trust is in fact the alter-ego of the settlor or trustee.

The principle of the alter-ego has a settled function overseas, but just how exactly can one identify an alter-ego trust? Moreover, how does this doctrine differ from the sham doctrine? Furthermore, what are the consequences of such a finding? The answer to these questions can be found in the exploration of the principle in foreign law that follows.

3.1 FOREIGN LAW PRECEDENT

*Ascot Investments Pty Ltd v Harper*¹⁸⁶ was one of the earliest cases in which the High Court of Australia discussed the notion of the “alter-ego” or “puppet”. Gibbs J suggested that an alter-ego trust occurs where a person is held to have control over an express trust to such an extent that the trustees are considered to be “mere puppets” of the defendant.¹⁸⁷ Robertson J commented on Gibbs J’s characterisation in *Reynolds*, and reasoned:

“There are instances of where a valid trust has been established but the trustee’s discretion has been subsumed by the controller to such a degree that in reality decisions made about the operation of the trust are made by the controller. It is argued that the relinquishment of control by the trustee to the controller allows the Court to find that the trust structure is a façade that can be disregarded. The level

¹⁸⁶ [1981] 148 CLR 337.

¹⁸⁷ At 355.

of control over the trust property by someone other than an appointed trustee is said to justify the Court piercing the express trust and thereby making what would otherwise be trust property, available to third party claimants.”¹⁸⁸

In *Ascot*, the court identified that when a third party is a mere puppet of a party to a marriage, this could be determining as an exception to the lack of power a court has to make orders against third parties.¹⁸⁹ Without refining this thought, Gibbs J left the jurisprudence of the alter-ego open to interpretation. A Sydney barrister eloquently elaborated on the judge’s remarks:

“The second exception which Gibbs J referred to was where the third party is a mere puppet of the spouse. There is no reported case where this concept has been dealt with in circumstances where a spouse had no legal control over the third party. The question therefore arises as to the circumstances in which this exception may apply. It may be that this exception only applies in circumstances which satisfy the current criteria as to when a third party can be treated as the alter ego of a party. It may be that such an approach is too restrictive and that it is intended to cover some of the problem areas described above ... If the spouse is not in effective legal control; receives financial benefits from the trust which may be deductible in the hands of the trust; may have a loan account with the trust; is likely to be the only person to receive benefit from the trust during the lifetime of the spouse; is also not able by the terms of the trust deed to access profit and corpus of the trust then why should not the assets of this trust be treated as the property of the spouse ... In the result there may be circumstances which do not fit easily with the established approaches to the third party problems but may yet be capable of just resolution within established principle.”¹⁹⁰

Evidently the “puppet” described above can be depicted as a creature that from a distance appears to have independent animation, but in reality has no independence at all, and is incapable of making a move without the direction of another. In relation to trusts, the puppet – or creature as, it may often be characterised – is the trustee of an *inter vivos* trust who is powerless to the commands and directives issued by the settlor or co-trustee.

¹⁸⁸ Para 64.

¹⁸⁹ At 355.

¹⁹⁰ SR O’Ryan “Property Proceedings: The Search for Property” Family Law Conference, Perth, 1992.

In pronouncing on the confusion between the doctrines of the sham and the alter-ego, a number of Family Law Court decisions have incorrectly created the impression that if a trust is the alter-ego or puppet of the settlor it can be disregarded. Three examples of such a decision are to be found in the cases of *In the Marriage of Ashton*,¹⁹¹ *In the Marriage of Goodwin*¹⁹² and *Davidson and Davidson*.¹⁹³

In *Ashton* a husband replaced himself as trustee of the family trust with a company and continued to act as sole appointer for the family trust. Furthermore, Mr Ashton was never a beneficiary, but consistently received income from the trust. The court found that the husband was “in full control of the assets of the trust.”¹⁹⁴ The evidence was clear that he had applied the assets and income as he wished and for his own benefit.¹⁹⁵ Strauss J, on behalf of the Full Court, subsequently held:

“The powers which the husband has in the Ashton Family Settlement give him control of the trust either as trustee or through a trustee which is his creature, and at the same time he is able to apply all the income and property of the trust for his own benefit. In my opinion, in a family situation such as the one here, this court is not bound by formalities designed to obtain advantages and protection for the husband who stands in reality in the position of the owner. He has *de facto*, legal and beneficial ownership – no person other than the husband has any real interest in the property or income of the trust except at the will of the husband.”¹⁹⁶

Thus, the trust property was taken into account when making the redistribution order.¹⁹⁷ Similarly, in *Goodwin*, the trust beneficiaries were the husband, wife and family. The husband had the sole power to appoint and remove trustees (although he was not entitled to be a trustee). Mr Goodwin also had the power to alter the trust instrument and to add or remove beneficiaries, which he used following the couple’s separation, removing the wife and their two children as beneficiaries. The trustee of the family trust was a company, of

¹⁹¹ [1986] 11 FLR 457.

¹⁹² [1990] 101 FLR 386.

¹⁹³ [1991] FLC 192.

¹⁹⁴ At 461.

¹⁹⁵ *Ibid.*

¹⁹⁶ At 653.

¹⁹⁷ See further *In the Marriage of Davidson (No 2)* [1990] 101 FLR 373 for an identical conclusion on the trust instrument.

which Mr Goodwin was the director alongside his accountant. The Family Law Court held that “the trust property was, in reality, the property of the husband”,¹⁹⁸ ordering the trust assets to be realised as part of Mr Goodwin’s personal estate. On appeal the court considered that it “seems not unreasonable for his Honour to have concluded that the husband’s co-directors would act upon his instructions in relation to matters affecting the trust.”¹⁹⁹ Under cross-examination, Mr Goodwin admitted that he had practical control of the funds of the trust, and the court saw this and his action in removing the claimant wife as beneficiary of the family trust as further evidence of the trust being his alter-ego. The learned judge reasoned that rather than the power of appointment being a fiduciary power, it was but a power which, by the terms of the trust instrument, the husband may exercise for the purposes of controlling the trust for his own benefit, should he so choose.²⁰⁰

In *Davidson*, the facts resembled those of *Ashton*, where the husband was the appointer and the other trustee was controlled by him as shareholder. The court found that, notwithstanding the existence of a valid trust, the trust was the husband’s alter-ego. Under cross-examination, Mr Davidson believed that he had complete control of the trust and supervision of its operations. The court noted that the husband had absolute control of the trustee company, and the said company had become his “creature” or “puppet”. The trust assets were dealt with accordingly, as in *Ashton* and *Goodwin*.

In summary, the decisions in *Ashton*, *Goodwin* and *Davidson*²⁰¹ were based on the finding that each respective trust was the alter-ego of the settlor. Such a conclusive factor allowed the Family Law Court to “pierce the veneer” of the family trust, and look behind the trust, so to speak. What will become evident is that this severe action illustrates a lack of understanding of the alter-ego doctrine and, under such false interpretation, violates the rules of the sham doctrine.

¹⁹⁸ At 392.

¹⁹⁹ At 272.

²⁰⁰ At 273.

²⁰¹ See also *Begum v Ali* FC AK Fam-2001-004-866 and *Milankov v Milankov* [2002] 93 FC 905, where the courts adopted a similar approach, both in relation to matrimonial disputes.

A more nuanced approach was adopted in the matter of *In the Marriage of Gould*,²⁰² where Fogarty J correctly stated that:

“... the description of an entity as the ‘alter ego’ or ‘puppet’ of a person really denotes something different. Correctly described, it is not an assertion that it is a ‘counterfeit, a facade or a false front’. Rather, it describes an actual situation although as a matter of law or practicality the actions of the other entity may be capable of and may in fact be controlled by the party in question. For example, a party may establish a trust over which he or she exercises control. That trust may in turn own or control property. It may be correct to describe that trust as the alter ego or even perhaps the puppet of that party, but it would not be correct to describe its existence or its ownership or control of property as a sham. Transactions entered into by it under which it deals with its property by, for example, a transfer of property to a third party would not be a sham transaction. It is likely to be a genuine transaction although the evidence may demonstrate that the transaction was carried out ‘by direction of or in the interest of the party’.”²⁰³

Thus, the court correctly identified that alter-ego trusts differ materially from sham trusts. An alter-ego trust is not a “façade”, as is the case of a sham, but rather an actual ongoing situation in which a power shift has occurred, and this transfer of control from the trustees to a dominant settlor or single trustee diminishes the purpose for which the trust was set up. This interesting interrelationship between the two doctrines is discussed in detail in Chapter 5.

*Prime v Hardie*²⁰⁴ is a classic case which represents the narrow view of alter-ego trusts, this example being from New Zealand. The facts concerned a family trust controlled by two trustees, the husband (Mr Hardie) and a close friend. The trust property included a house (the “Rahopara Street house”) which Mr Hardie, his wife and their two children lived in. A few years after the creation of the trust, Mr Hardie decided that he wished to end the marriage, and foolishly sought to keep the trust property for himself. Mr Hardie had deceitfully persuaded his wife and children to move temporarily out of the house and into a motel, after which Mr Hardie informed his wife of his plans to end the marriage. To stop his family from moving back into the house, Mr Hardie had arranged for the family home to be rented out to

²⁰² [1993] 17 FLR 156.

²⁰³ At 167.

²⁰⁴ [2003] NZLR 481.

the two trustees. What is noteworthy is that Mr Hardie had always included the trust property in his annual tax returns. In the majority judgment of Salmon J, the following was held:

“What is clear on the evidence ... is that the trust was effectively Mr Hardie's alter-ego. He was the principal (although not the only) beneficiary. He borrowed the money which enabled the trust to purchase its assets. He paid the interest on the mortgages and rates and insurance. In the 1998 financial year his personal income return showed an apparently fictitious rental received from Rahopara Street of \$3 600 and deductions for interest, depreciation and other items resulting in a net loss of \$10 975 which he claimed as a tax deduction against his personal income.”²⁰⁵

The court found on the evidence that the trust was the husband's alter-ego, the Rahopara Street home being treated as though it was owned by the defendant. The court applied the case of *Lankow v Rose*,²⁰⁶ and imposed a constructive trust²⁰⁷ on the property owned by the trust in favour of the wife.

In *Glass v Hughey*²⁰⁸ the facts concerned business assets owned by a family trust which came into dispute upon divorce proceedings. In particular, the husband was entitled to acquire ownership of the family trust's primary asset by a contract in which a shareholding of the asset (a company) would be transferred to him. Prior to litigation the trust had purchased shares in a company, EVP International Ltd, which owned a business run by the defendant. Shortly after the couple separated, EVP sold its shares to a holding company, EVP Holding Ltd. The company took up 75 per cent of the shares, the balance of which was purchased by an entrepreneur. Under examination it was determined that the plaintiff had made a significant contribution to the defendant's business assets and the parties had had a reasonable expectation of her sharing in the assets.

²⁰⁵ Para 30.

²⁰⁶ [1995] 1 NZLR 277 (CA).

²⁰⁷ Although constructive trusts do not form part of South African law, the principal determination of the alter-ego trust by the court still stands.

²⁰⁸ [2003] NZFLR 865.

Under cross-examination the husband maintained that by restructuring EVP International the residual sale proceeds were his own, when, in fact, they belonged to the trust. Priestly J applied the rationale in *Prime* and stated the following by way of *obiter*:

“I find that the trust has for all intents and purposes been disregarded by the husband so far as his operation of International is concerned and, so far as the wife’s claim is concerned should be regarded as a sham or more particularly the husband’s alter ego.”²⁰⁹

When the entrepreneur established his majority holdings, a shareholder agreement, to which the husband was a party, was signed, and provided that the shares owned by the trust were to become the husband’s sole property. The learned judge concluded that: “It thus ill behoves the husband to endeavour to raise as a defence to the wife’s equitable claim the point that International is owned not by him but a separate entity, the trust.”²¹⁰

Prime and *Glass* are two cases which clearly reflect the confusion displayed by many courts when interpreting the doctrine of the alter-ego. In *Glass* Priestly J went as far as to say that the trust in issue should be regarded as a sham, or more particularly the husband’s alter-ego. Bluntly stated, this interpretation is incorrect. What will become apparent is that the two doctrines are two separate arguments with very little in common. On the other hand, the facts of the cases do aid in demonstrating the notion of the alter-ego, which has most frequently been identified through a spouse’s unwillingness to separate trust assets from those of his own.

Remaining in New Zealand, the case of *Fay v Chirnside*²¹¹ was the next reported case to deal with the alter-ego principle. Notably, the judicial use of the alter-ego had not been restricted to relationship–property type claims only. In a successful claim in the New Zealand High Court for an account of profits, Mr Fay was in a joint property development venture with Mr Chirnside. During the attainment of a major tenant, the defendant chose to dispense with the

²⁰⁹ Para 89.

²¹⁰ Para 91.

²¹¹ Unreported, HC Dunedin, CIV 2001-412-00012, 2003.

plaintiff and in his place bring into the project a number of investors. This was achieved through a company in which a trust associated with the defendant took a 75 per cent interest in the venture. The court held: “It would appear that the trust associated with Mr Chirnside is in substance, his alter-ego and I will generally refer to the trust’s 75 per cent stake in RPL as if it were Mr Chirnside’s.”²¹²

Reluctant to use the alter-ego principle at a whim, the court in *P v P*²¹³ demonstrated the importance of examining the facts first, before labelling a trust the alter-ego of the settlor on impulse. The facts, which once again concerned a trust property claim upon the breakdown of a marriage, involved several trusts which the defendant formed between 1997 and 1998. During this period the matrimonial home was transferred by the couple to two mirror trusts, each party being owed a debt of roughly NZ\$1 million by their respective trusts. Another trust was subsequently formed to purchase the husband’s surgical consultancy practice and consultancy rooms. This trust also held the shares of a company incorporated during the above period, of which the husband was director. In accordance with the trust instrument, the husband was a discretionary beneficiary. Counsel for the plaintiff contended that the scenario was an *Ashton*-type situation, arguing that the respondent husband had a controlling interest as a discretionary beneficiary and by being a director of the company. Importantly, the court noted that there was no evidence of similar control of the relevant trusts in the matter and that the parties’ children had remained major beneficiaries throughout the existence of the trust.²¹⁴ Furthermore, having regard to the administration of the trust, the trustees were the respondent, a barrister and an accountant, all of whom knew each other personally. In its conclusion, the court stood firm, reasoning that there was no evidence to suggest that the trustees had acted at any time other than *bona fide* in terms of their obligations as trustees in terms of the trust instrument and that there was nothing in the instrument which favoured the respondent in terms of the exercise of the trustee’s discretion.²¹⁵

²¹² Para 6.

²¹³ [2003] NZFLR 925.

²¹⁴ Para 135.

²¹⁵ Para 137.

In the case of *Charman v Charman*²¹⁶ the existence of the doctrine in modern-day English law emerged, although the expression was never specifically used. In this matrimonial property matter, the wife issued a petition for divorce which included a disputed application for ancillary relief. During the marriage the husband had made a fortune in the insurance market in London.²¹⁷ The husband conceded that the assets which fell for division in the proceedings amounted to £59 000 000, although the wife contended that the relevant assets amounted to £126 000 000, the difference representing the assets of a trust now situated in Bermuda (the Dragon Holdings Trust). The beneficiaries of the trust included the husband, the wife and their two children. The sole trustee was a private trust company. Wilson J stated that the question is easily framed as being whether the trust was a financial resource of the husband or, more simply put, whether, if the husband were to request the trustee(s) to advance the whole (or part) of the capital of the trust to him, the trustee(s) would be likely to do so.²¹⁸ The learned judge added that much consideration should be given to Butler-Sloss LJ's *obiter* statement in the matter of *Browne v Browne*²¹⁹ and that, in this context, the question is more appropriately expressed as whether the spouse has "immediate access to the funds" of the trust rather than "effective control"²²⁰ over it.²²¹ In the court's conclusion it was accepted that the trustee held the income for the husband absolutely, and thus regarded the trust as an abuse of the 'interest in possession trust'. The full amount of the trust was thus taken into account during property redistribution considerations.

In Australia two cases have recently emerged dealing with the alter-ego contention. In *Richstar Enterprises*, French J determined that the court was able to grant the orders sought by the Australian Securities and Investments Commission in respect of the property of a person, and apply that order to assets within a family trust. This was decided upon in spite of the fact that the defendant was one of two directors of the corporate trust and one of two joint appointers to the trust. "Many would have thought that this was sufficient to achieve the

²¹⁶ [2005] EWCA Civ 1606.

²¹⁷ Para 4.

²¹⁸ Para 12.

²¹⁹ [1989] 1 FLR 292.

²²⁰ At 239.

²²¹ The difference between effective and immediate being that the wife in this instance did not have "immediate" access to the funds within the trust, whereas the husband did. Therefore the wife had only "effective" control, and the husband had "immediate" control. Interestingly, this was construed in *Charman* to be whether the trustee would be likely to advance the capital immediately or in the foreseeable future.

protection that may have been sought. At the time that it was needed, it was not available.”²²² In *Daniels*, the Court of Appeal was called on to revise a Family Law Court’s decision about whether assets within a family trust may be the subject of a property order imposed upon an individual. The facts concerned an unpaid child maintenance debt, where the Family Law Court found it necessary to order the disposal of the property of the parent who was in arrears. The reason for employing the alter-ego principle was that there were no other assets out of which the child support debt could have been settled, and therefore assets within the family trust were argued to be the cure. Thus, in order to do so and give effect to the order, the court maintained that it would be necessary to determine that the assets of the trust were the property of the parent owing the child maintenance. The judge of appeal upheld the lower court’s decision confirming that there was no error found in applying the alter-ego principle under the particular circumstances, and the trust was opened in order to satisfy the outstanding maintenance.

Evidently the Australian courts also confused the separateness of the two doctrines. Fortunately, over the past few years, the courts across the common law systems appear to have picked up on these mistakes and have since begun to realise the distinctiveness of the two principles. *Genc v Genc*²²³ exhibited this new awareness and involved an appeal against a decision of O’Donovan J in the New Zealand Family Law Court. The parties met in 1994 and married in 1999, before separating in 2002. Mr Genc had prior to their stated intention to marry at the end of 1998, set up the Genc Family Trust. That same year the trust not only acquired shares in a newly formed company, but purchased the Gencs’ family residence and was to be the home of the parties during the subsistence of their marriage. The applicant, Mrs Genc, argued that the disposition of property to the trust was made in order to defeat the statutory claim she would have had. The High Court confirmed the Family Law Courts decision:

“The sales to the trust were made at the time when the applicant was unable to rely upon any statutory relationship property regime, as supporting any right by her to an interest in the property in question,

²²² P Bobbin “Alter Ego Trust Failure” http://www.argylelawyers.com.au/pdf_files/fin_dit_pub/AP143058.pdf (accessed 9 April 2009).

²²³ [2006] NZFLR 119.

on which basis it is difficult to see how it could be argued that any disposition of property to the trust was made either with the intention of defeating any claim by the applicant or has had that effect.”²²⁴

This finding was made regardless of the fact that the trust and the transfer of property had been established before the Genc’s marriage. Notably, all of the cases thus far have dealt with alter-ego trusts in the context of *de facto* (*Genc*) or marital relationships. However, none of these cases have conclusively addressed the theoretical basis upon which a court is justified in finding an alter-ego trust. It is submitted that there are a number of reasons for the uncertainty. First, the majority of cases confuse the doctrine of the sham with that of the alter-ego and the resultant effect on the development of these principles has been unconstructive. Second, the courts have struggled to address with any confidence the question of what exactly happens when a trust is declared a sham or the alter-ego of the settlor, which only adds to the perplexity of the matter. Thus, the issue requires a higher degree of “reading between the lines” in order to achieve attribution to the alter-ego principle. Fortunately, the case of *Reynolds* once again sheds some light on what is surely becoming an entanglement of legal doctrines. Robertson J described the alter-ego principle as follows:

“These are instances where a valid trust has been established but the trustee’s discretion has been subsumed by the controller to such a degree that in reality decisions made about the operation of the trust are made by the controller ... The assumption of factual control by someone other than a trustee (or a sole trustee if there is more than one trustee) or by someone without legal right to exercise such power cannot of itself invalidate a trust. As noted by Jessica Palmer at 89: The alter ego, as factual control, should be an impotent, meaningless concept. In the eyes of the law, factual control has no effect on legal ownership. Indeed a stranger who takes control of trust assets will be considered a trustee *de son tort* and be liable to account for the property of beneficiaries. Factual control of trust property cannot justify recognition that the controller thereby owns the trust assets ... The alter ego concept, as it relates to factual control, serves to attribute an individual’s actions to those of the organisation that he is controlling. It is not a mechanism whereby an individual can appropriate property to him or herself by virtue of control that he or she exercises.”²²⁵

²²⁴ Para 28.

²²⁵ Paras 64–69.

Thus, crucial to the alter-ego doctrine is the recognition that control alone does not provide justification for looking behind the veneer of a trust:

“The uptake of control by someone other than an authorised person cannot be sufficient to extinguish the rights of the beneficiaries under a trust. It is difficult to see the alter ego trust operating... as an independent cause of action”.²²⁶

3.2 THE ALTER-EGO SYNOPSIS

In general terms, should it be proven that a party has the ultimate control of a trust, or that the trust is a creature wholly controlled by him- or herself as trustee or settlor, coupled with the capacity to derive benefit from the trust, then the trust may be treated as the alter-ego of the trustee or settlor. Apart from the various mistakes made across the world in which the doctrine of the alter-ego is often amalgamated with the doctrine of the sham, clear evidence exists that the two are separate and distinct. Unlike a sham, an alter-ego trust is intended to be a genuine trust. There is no requirement of an intention to deceive or mislead. Although dealt with below, it is important to confirm at this stage that – correctly interpreted – the sham trust argument is therefore an independent cause of action, whereas the alter-ego argument is not. The consequence of this fundamental distinction is that an alter-ego trust, on its own, cannot be pierced.

With the above difference highlighted, we must now turn our attention to the common theme of control. Consistently, no matter the case, an alter-ego allegation concerns *de facto* control. The question, though, remains: How much control is necessary to prove an alter-ego trust successfully?

The South African High Court recently addressed this question in the matter of *Brunette v Brunette and Another*.²²⁷ Chetty J, examining the situation, stated that in practice the settlor often places *de iure* control of the assets of a business of a family in the hands of trustees. But

²²⁶ *Reynolds* para 70.

²²⁷ 2009 (5) SA 81 (SE).

the trustees act as mere puppets in the hands of the settlor, who manages the trusts through them, and *de facto* it is the settlor who controls the trust despite the fact that the *de iure* control is in the hands of the trustees.²²⁸ The learned judge noted that, in order to determine whether a settlor was in *de facto* control, the court will have regard to:

1. the terms of the trust instrument, and to
2. evidence of how the trusts were conducted.²²⁹

In addition to this somewhat general outline, the American courts have considered a number of factors to determine whether a corporation is the alter-ego of a shareholder. These include:

1. the absence of formalities and records that are part and parcel of corporate existence;
2. the use of funds for personal rather than corporate use;
3. a lack of business discretion displayed by the dominated corporation;
4. the non-functioning of other shareholders, officers or directors, and
5. whether the corporation in question had property used by a dominating shareholder as if it were his or her own.²³⁰

If one were to replace “corporation” with “trust” and “shareholder(s)” with “trustee(s)”, the above definition most definitely serves useful when considering factors which may aid in proving an alter-ego allegation. The relevant factors would thus be:

1. the absence of formalities and records that are part and parcel of the trust. The formalities which are pertinent to this discussion include the trust instrument, a separate banking account, banking records, and properly documented minutes of the trustees’ meetings;
2. the use of funds for personal rather than trust use;
3. a lack of business discretion displayed by the trustees. Such discretion falls under the fiduciary duty a trustee owes to the beneficiaries, and may also concern the duty to seek external advice on professional matters which are out of the scope of the trustee’s personal knowledge;
4. the non-functioning of the trustees or settlor, and

²²⁸ Para 3.

²²⁹ Paras 3–4.

²³⁰ AF Vitiello and AB Kessler “Piercing the Trust Veil: How Foolish Beneficiaries can Compromise Foolproof Trusts” (2008) 194 *NJLJ* 535 at 536.

5. whether the trust in question had trust property used by a dominating trustee or settlor as if it were his or her own.

4. THE INTERRELATIONSHIP OF THE DOCTRINES OF THE SHAM AND THE ALTER-EGO

As has often been the case, the alter-ego and sham doctrines are frequently conflated. On appeal, in the matter of *Reynolds*, the term “alter-ego trust” was suitably used to describe the situation where the settlor controls the trust to such an extent that the trustees relinquish control and are said to be mere puppets of the settlor. Under such circumstances a valid trust could be created, but the trustees’ discretion is then subsumed by the settlor to the extent that the trust is merely the alter-ego of the settlor. From a matrimonial standpoint, the English courts have accepted the confines of this distinction and, as seen in *Charman*, should a spouse – who is the settlor of the trust – be able successfully to request the trustees to advance the whole or part of the capital of the trust to himself or herself, that trust will to all intents and purposes be regarded as the alter-ego of the settlor.²³¹ Clearly such instances negate the trustees’ fiduciary duty as well as the object of the trust to be for the benefit of the beneficiaries.

In both Australia and New Zealand, with the exception of *Gould*, the Family Law Courts have demonstrated a failure to appreciate the difference between a “sham” and an “alter-ego” trust by amalgamating the principles, and consequently these cases need to be treated with a great deal of caution. Thus the question still remains: what, if any, relationship is there between the two doctrines?

It has already been firmly established that, unlike an allegation of a sham, the alter-ego trust argument cannot form the basis of an independent cause of action. However, factual control

²³¹ Indeed, it is not the success of the request that is the determining factor, but the *de facto* authority of the trustees to say “no”.

of a trust by someone other than those authorised to have such power is not an irrelevant consideration.²³²

Robertson J confirmed this thought in *Reynolds* as follows:

“Such control may give rise to a claim for breach of trust. Evidence of such control may be relevant to the question of whether a trust is a sham in that it may evidence a lack of true intention to form a trust. That is not to say that an alter ego trust is the same as a sham.”²³³

Thus, what the Court was correctly trying to say is that a finding of *de facto* control may indeed help establish that a trust is a sham, if the evidence indicates that there was no intention to establish a trust according to the terms of the trust instrument. However, such a finding does not automatically lend itself to the establishment of a sham trust. Thus, should the court then be of the opinion that a trust was in fact the alter-ego of a party to the trust, the trust is not a sham. But such evidence may aid the court in adducing that there was an intention to mislead from the inception of the trust, or from the time when the particular property was disposed of to the trust. “Evidence of effective control of the trust post settlement may be used to infer the requisite intention.”²³⁴

The Appeal Court thus accepted the trial court’s treatment of the alter-ego trust argument: “Alter-ego trusts are not an independent cause of action, nor are they the same as shams. In the trust context, alter-ego arguments are confined to evidence to help establish a sham which is how [the trial court] treated the matter.”²³⁵ *Gould* was applied in *Reynolds* as Chisholm J correctly stated:

“The underlying common intention requirement for a sham has been consistently adopted by the Court of Appeal and is clearly binding on this Court. If alter ego trusts were to be automatically recognised as shams that underlying requirement would be negated. The result would be that a half way house

²³² *Reynolds* para 71.

²³³ *Reynolds* para 71.

²³⁴ *Ibid.*

²³⁵ *Reynolds* para 72.

between a conventional sham trust and a valid trust would be created. In *Re Securitibank Limited (No.2)* at 168 Richardson J seems to have rejected the possibility that there is any half way house. I accept that view. It seems to be that to adopt a half way house would be to effectively re-write the traditional understanding of a sham.”²³⁶

Thus, if alter-ego trusts were to be automatically recognised as shams, the common intention requirement held in *Snook* would be annulled. The result, referred to as the “half way house”, is an unwarranted and unwelcome development which only serves to confuse the well-established doctrines.

5. THE DOCTRINE OF PIERCING THE CORPORATE VEIL

5.1 INTRODUCTION

In the sphere of companies the directors and members of a company ordinarily enjoy extensive protection against personal liability. This is one of the cornerstones of South African company law, and has been so since 1897, when the House of Lords handed down its decision in *Salomon v Salomon & Co Ltd.*²³⁷ One of the most fundamental consequences of incorporation is that a close corporation, as well as a company, is a juristic entity separate from those who control it. Incorporation also entails “limited liability” of the director and members, with the result that they are generally not liable for the debts of the corporation. Furthermore, the assets of a corporation are the exclusive property of the corporation itself and not of those who control it. In *Salomon*, the *locus classicus* on this topic, Lord MacNaghten said the following with regard to some of the motives for incorporation:

“Among the principal reasons which induce persons to form private companies ... are the desire to avoid the risk of bankruptcy, and the increased facility afforded for borrowing money. By means of a private company a trade can be carried on with limited liability, and without exposing the persons interested in it in the event of failure to the harsh provisions of the bankruptcy law.”²³⁸

²³⁶ *The Official Assignee v Wilson & Anor and Others* [2006] NZHC 389 at para 58.

²³⁷ [1897] AC 22.

²³⁸ At 52.

Even though this fundamental rule has considerable influence in company law worldwide, including South Africa, it cannot be absolute and, as such, allows for exceptions. A company's separate existence is, by way of metaphor, described as a "veil". This veil is said to separate the company from its directors and protect them from the claims of those who deal with the company. The corporate veil, then, is a fundamental aspect of company law and is a protective device for those who exist behind it.²³⁹ However, under limited circumstances, the courts may ignore the limited liability of the company or close corporation and "pierce the corporate veil" such that the members or directors of the company become liable for the actions of the entity, despite their separate identities. Consequently, the courts will treat the company's executives as if they were the owners of the company's assets and as if they were conducting the company's business in their own personal capacities.

The SCA in *Parker*²⁴⁰ prompted a new era in trust law. Cameron JA, writing a unanimous judgment, noted that the trust, although a useful instrument in the management of assets, is often exploited for the protection it offers. The learned judge reasoned that in light of the widespread abuse of the trust form, it may be necessary to extend the well-established principles of company law into trust law. In particular, the court felt it necessary to import the doctrine of piercing the corporate veil from company law into trust law. Subsequently, the outcome has been that the courts now have a wider discretion when it comes to piercing the veneer of a trust and, according to Cameron JA, should the conduct of a trustee invite the inference that the trust form was a mere façade for the conduct of a business "as before", and that the assets allegedly vesting *de iure* in the trustees in fact belong *de facto* to one or more trustee, the veil will be lifted, and the trust property which was once protected by the trust will become susceptible to the claims of third-party creditors.

It is debatable whether or not this was the correct development. In order to find an answer, it is necessary to take a closer look at the company law doctrine and then make comparisons with the principle in relation to the trust *inter vivos*.²⁴¹

²³⁹ N Hawke *Corporate Liability* (2000) 126.

²⁴⁰ A *ratio* supported by Binns-Ward J in the *Van der Merwe* case.

²⁴¹ Such comparison is undertaken in Chapter 5.

5.2 A BRIEF THEORETICAL EXPOSITION ON THE DOCTRINE OF PIERCING THE CORPORATE VEIL

According to Blackman:

“Veil piercing takes at least two forms. Firstly, there are cases where the court disregards the company and treats the members²⁴² as if they had been acting in partnership (or where the company has a single member, as if he had been acting on his own behalf), with the consequence that they are, for example, held to be the owners of property otherwise owned by the company, or to be personally liable for its debts and other liabilities.”²⁴³

Second, there are those circumstances where obligations incurred by shareholders in their personal capacity are treated as if they were incurred by the company. Whatever form it takes, veil-lifting is an “exceptional procedure.”²⁴⁴

Because veil-lifting is an exception to the rule of separate legal personality and not the rule itself, courts must be careful to permit it only in egregious cases. Accordingly, in this area of the law, it has understandably been stated time and time again that courts lift the veil reluctantly.²⁴⁵ In the matter of *Hülse-Reutter and Others v Gödde*,²⁴⁶ Scott JA reasoned that a court has no general discretion simply to disregard the existence of a separate corporate identity whenever it deems it just or convenient to do so. The circumstance in which a court may lift the veil was summed up in the court’s decision as follows:

“Much will depend on a close analysis of the facts of each case, considerations of policy and judicial judgment. Nonetheless what, I think, is clear is that as a matter of principle in a case such as the present there must at least be some misuse or abuse of the distinction between the corporate entity and those who control it which results in an unfair advantage being afforded to the latter.”²⁴⁷

²⁴² The term “members” is used loosely in this study to describe the controlling executives in the case of a company.

²⁴³ MS Blackman *et al Commentary on the Companies Act* (2002) 4–133.

²⁴⁴ MS Blackman “Companies” in WA Joubert (ed) *LAWSA Vol 4(1)* (1995) para 43.

²⁴⁵ J Cohen *Veil Piercing - A Necessary Evil?* (LLM thesis, UCT, 2006) 20.

²⁴⁶ 2001 (4) SA 1336 (SCA).

²⁴⁷ Para 20.

Similarly, in *The Shipping Corporation of India Ltd v Evdomon Corporation and Another*²⁴⁸ Corbett CJ required substantial proof of an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs prior to the piercing.²⁴⁹ In the matter of *Airports Cold Storage (Pty) Ltd v Ebrahim and Others*,²⁵⁰ as judge of first instance Griesel J confirmed the above reasoning, noting that the requirement of fraud or other improper conduct finds resonance in the provisions of s 65 of the Close Corporations Act,²⁵¹ where the Legislature, with regard to close corporations, constructed a statutory remedy which is equivalent to the court's jurisdiction at common law allowing for the piercing of the corporate veil in relation to a company.²⁵² The learned judge further noted that in circumstances where a court is asked to pierce the veil of a company, the court will do so only where special circumstances exist indicating that the company or close corporation is a mere façade concealing the true facts:

“Fraud will obviously be such a special circumstance, but it is not essential. In certain circumstances, the corporate veil will also be pierced where the controlling shareholders do not treat the company as a separate entity, but instead treat it as their ‘alter-ego’ or ‘instrumentality’ to promote their private, extra-corporate interests.”²⁵³

However, on appeal,²⁵⁴ Cameron JA noted that it was unnecessary to consider the applicability of both s 65 of the Close Corporations Act²⁵⁵ and the issue of fraud.²⁵⁶

On the international front it is evident that, in order to pierce the corporate veil, foreign courts require at least two prerequisites to be present. First, there must be control over the finances, policies and practices to the extent that the company has no separate mind, will or existence from those who control it.²⁵⁷ This, on its own, will not be conclusive enough, as a proper examination of Lord Halsbury's judgment in *Salomon* suggests. Accordingly, a sub-condition

²⁴⁸ 1994 (1) SA 550 (A).

²⁴⁹ At 566.

²⁵⁰ 2008 (2) SA 303 (C).

²⁵¹ Act 69 of 1984.

²⁵² PM Meskin *Henochnberg Commentary on the Close Corporations Act* Issue 13 (1997) 189.

²⁵³ Para 12.

²⁵⁴ *Ebrahim and Others v Airports Cold Storage (Pty) Ltd* [2008] ZASCA 113.

²⁵⁵ Para 25.

²⁵⁶ Para 25.

²⁵⁷ Blackman “Companies” in Joubert *LAWSA* (1995) para 43.

of this first condition that must be taken into account by the courts prior to their intervening is whether the company is being used for the purpose of fraud or as a means to avoid other legal obligations.²⁵⁸ Second, it must be remembered that veil-lifting is an exceptional procedure, requiring exceptional circumstances. The general rule is that the separate corporate personality should be upheld, except in the most unusual circumstances.²⁵⁹

In South Africa, there have been many approaches to veil-lifting, however, none as popular and as widely applied in the courts as the categorisation approach. This approach, which was established by the courts, sets out various categories which must be taken into consideration prior to making a decision whether to pierce the veil or not. These categories include “in the interests of justice”, “equity”, “alter-ego”, “fraud or improper conduct” and “agency”.

“In the interests of justice” is a category which lays the policy foundation for the exception to the doctrine of piercing the corporate veil. Thus, the courts will pierce the corporate veil in instances where it would result in justice prevailing.²⁶⁰ However, the category is seemingly vague and offers little more than a reminder to the courts of their jurisprudential duties. In *Botha v Van Niekerk*²⁶¹ the court held that it would hold someone other than the company liable for its debts if an unconscionable injustice had been suffered as a result of what was, to the right-minded person, conduct that was clearly improper.

The “equity” category in this instance remains two-fold. First, there is the policy-based argument that it is unfair to allow the owners of a company to avoid debts at the expense of the company’s creditors and, second, the allegation that the owner acted fraudulently or that he or she disposed of the company’s assets so as to prejudice the company and its creditors.²⁶² According to Matherson and Eby, however, “while some courts use equity as a

²⁵⁸ *Cohen Veil Piercing* 22.

²⁵⁹ *Ibid.*

²⁶⁰ *Cohen Veil Piercing* 31.

²⁶¹ 1983 (3) SA 513 (W).

²⁶² *Cohen Veil Piercing* 39.

gloss when considering the ‘alter-ego’ category, other courts have pierced the corporate veil based on equitable situations alone.”²⁶³

The “alter-ego” query maintains that the courts should pierce the veneer of those companies which do not carry on their own business or affairs, but rather act in the furtherance of the affairs of the controlling members, “resulting in the situation where the controlling members do not treat the company as a separate entity, resulting in an abuse of the separateness of the company”.²⁶⁴

“Fraud or improper conduct”, which has been briefly explored above, is one of the most commonly cited reasons for piercing the veneer. Linked with the “interests of justice” category, courts invoke this category to try to achieve justice for the parties involved. Most cases indicate that where there is an avoidance of an existing obligation and such avoidance would result in an injustice, then it would result in the veil being lifted.²⁶⁵ In *Dadoo Ltd v Krugersdorp Municipal Council*,²⁶⁶ the learned judge held that, if a transaction may in truth be within the provisions of a statute but the parties call it by a name or cloak it in a guise calculated to escape those provisions, the court will strip off its form and disclose its real nature and the law would prevail.²⁶⁷

According to Blackman, the “agency” category involves identifying a company that is merely a conduit for the controlling members to carry on their own personal business, resulting in an abuse of the separateness of the company.²⁶⁸ This is so because the company in such a scenario does not carry on its own business affairs, but rather acts in pursuance of the affairs of the controlling members.

²⁶³ JH Matheson and RB Eby “The Doctrine of Piercing the Veil in an Era of Multiple Limited Liability Entities: An Opportunity to Codify the Test for Waiving Owners’ Limited-Liability Protection” (2000) 75 *Washington Law Review* 147 at 180.

²⁶⁴ *Cohen Veil Piercing* 43.

²⁶⁵ *Cohen Veil Piercing* 32. See further *Lategan and Another NNO v Boyes and Another* 1980 (4) SA 191 (T), where the court pierced the veil due to a finding of fraud. Thus, the company in this instance was held liable for the obligations of the members.

²⁶⁶ 1920 AD 546.

²⁶⁷ At 200.

²⁶⁸ Blackman “Companies” in Joubert *LAWSA* (1995) para 46.

Apart from the categorisation approach, three other tests have been used in both foreign and local jurisdictions. The first is the “good commercial reason test”. This test speaks for itself in that it asks the question: Does it make good commercial sense to have created a limited liability company? If so, then the courts will be reluctant to pierce the corporate veil. However, according to Payne the test has an inherent flaw, as any acquisition, creation or use of the corporate structure would satisfy it, since it can almost always make good commercial sense to make use of the corporate structure.²⁶⁹

The second test is known as the “promotion of private interests/alter-ego test”. As described above, the courts are willing to pierce the corporate veil in cases where the controlling members do not treat the company as a separate entity. However, in this test, the alter-ego enquiry is the only enquiry.

The third test, better known as the “control test”, is allied to the “alter-ego test”.²⁷⁰ In the case of *Greater Johannesburg Transitional Metropolitan Council v Eskom*²⁷¹ the SCA held that the control test was suitable for the purpose of deciding whether a public company is the alter-ego of the government that established it. In this test, the court will pierce the corporate veil in circumstances where the members of the company have control and ownership over the company as well as its finances, resulting in a company that has no mind of its own. What is of crucial significance to the control test is the manner in which the control is exercised, and not the control itself.²⁷²

6. CONCLUSIONS

The aim of this chapter has been two-fold. The first was to analyse the doctrines of the sham and the alter-ego in the context of trust law. Most importantly, this evaluation has been sourced from foreign law. Although no single jurisdiction can provide a firm stance on the doctrines, the consolidation of the approaches applied abroad most certainly shows a

²⁶⁹ PJ Payne “Lifting the Corporate Veil: A Reassessment of the Fraud Exception” (1997) *Cambridge LJ* 284 at 285.

²⁷⁰ Cohen *Veil Piercing* 30.

²⁷¹ [1999] ZASCA 95.

²⁷² MP Larkin and FHI Cassim “Company Law” (2000) *The Annual Survey of South African Law* 486 at 491.

chronological progression towards a better understanding of these principles. The broad structural nature of the doctrines can now be clearly differentiated as well as understood.

The second aim of this chapter has been to elucidate the basic principles of the doctrine of piercing the corporate veil. The latter examination is as important as the former as all three doctrines play a role in the confused state the South African law of trusts is currently experiencing.

It is not incorrect to assume that the facts of a particular case will be determinative. However, it is imperative that a proper understanding of the principles and the application of these three doctrines is obtained prior to their use in court. The reason for this caution is that when the courts lift the veil, the effect thereof is substantial and is potentially damaging to the parties involved. It is for this reason that foreign courts observe the strictest approach (the *Snook* test) when considering the casting aside of a trust's veneer.

With regard to the sham doctrine, courts may choose to forgo the requirement that the abusive party be a settlor of the trust since such requirement may not serve any legitimate rationale. However, this not only debases the foundation of the *Snook* test, but also inappropriately exposes the trust to third-party piercing. This is because the settlor, along with the trust instrument, underpins a trust's existence. In a nutshell, the *Snook* test is correct in that it maintains that a trust cannot be void if it was set up correctly and the settlor still, to the best of his or her knowledge and energy, carries forward the terms of the trust instrument. Trustees, on the other hand, form the foundation of a trust's administration. Correctly, a trustee who acts contrary to the wishes of the settlor and against the trust instrument cannot alone affect the validity of a trust. The Trust Property Control Act²⁷³ accurately reflects this as a breach of his or her fiduciary duty, which does not in turn open the trust up to piercing. However, a settlor and a trustee together conspiring against the beneficiaries and/or the trust instrument should – and does – allow for an allegation of shamming which, if declared as such, will permit the trust to be set-aside and susceptible to third-party claims.

²⁷³ Section 9 - "Care, diligence and skill required of trustee", read together with s 16 - "Master may call upon trustee to account" and s 19 - "Failure by trustee to account or perform duties".

Unmistakably, in order to justify a conclusion that the trust is a sham, the requisite intention to mislead must be a common intention of the parties and the test of intention is subjective. This is the only means of piercing the veneer of a trust *inter vivos* and it was revealed in Figure 4.1 above. “A device and a sham, a mask which the settlor holds before his face in an attempt to avoid recognition by the eye of equity.”²⁷⁴ Importantly, it must be recalled that a sham is not the same as where there is a valid trust but the trustee for whatever reason defaults on his or her duties and fails to administer the trust according to the instrument or any other legal duties. That is a breach of trust for which the trustee is personally liable to the beneficiaries of the trust for the losses caused. A finding of sham by a court is a finding that the trust does not and, never has, existed, barring an emerging sham. A trustee who has colluded with a settlor to create a sham exposes him- or herself to significant financial and regularity risk, because of the inherent element of deception involved in creating a sham.²⁷⁵ Furthermore, an accusation of an alter-ego trust should always be distinguished from that of a shamming allegation. The conclusion that a trust is in fact a mere puppet of the settlor or trustee does no more than:

1. add to the evidence which the courts consider when pronouncing on the validity of a trust, and
2. expose the trustee to a claim for breach of his or her fiduciary duties.

All the above theory is, however, hollow as it is devoid of a comparison between what this chapter has established as the most practical and modern interpretation of the doctrines, on the one hand, and the South African approach, on the other. The next chapter reveals that the two approaches are strikingly dissimilar.

²⁷⁴ *Jones v Lipman* 1962 1 WLR 832 at 836.

²⁷⁵ *Muller et al Anti-money Laundering* 30.

CHAPTER 5

COMPARATIVE ANALYSIS

1. INTRODUCTION

The international framework set out in the previous chapter provides a benchmark for the application of the doctrines of the sham, the alter-ego and the piercing of the corporate veil. In this chapter relevant South African cases are measured against the foreign standards in order to contrast South Africa's application of the principles with those of the rest of the world. Furthermore, the analysis of South African case law also focuses on instances where the sham doctrine was not employed, yet the veil of the trust was pierced.

Although the application of the doctrines of the sham and the alter-ego are fiercely contested – with courts and commentators ascribing diverse meanings to them, one can be certain about the following presumption: the trust *inter vivos* cannot be pierced without a finding of a sham. At the bare minimum, a court should at least acknowledge the *Snook* test and decide on an alternative option if that is deemed to be in the interests of fairness and justice.

The aim in this chapter is therefore to provide an exposition of the erroneous developments in South African trust law regarding the lifting of a trust's veil. This enquiry involves many technical principles, often at play simultaneously, and the complexity has unmistakably caused much confusion, the result of which is a law of trusts not only muddled but unconcerned about the rights of beneficiaries – arguably the cornerstone of a trust.

The starting point of this analysis is an examination of the rights of beneficiaries in South Africa, taking into account the Constitution of the Republic of South Africa, 1996,¹ the Trust Property Control Act² and the common law. This is followed by an account of the

¹ Hereafter referred to as “the Constitution”.

² Act 57 of 1988. Hereafter referred to as “the Act”.

contradictions between South African trust laws and abroad. The segment looks in particular at South Africa's unjustifiable amalgamation of the doctrines of the sham and the alter-ego; the interrelationship of the doctrines which has subsequently arisen; sham trusts in South Africa; and, lastly, alter-ego trusts in the Republic. The chapter then seeks to ascertain the correct consequences of a finding of a sham or an alter-ego trust, turning on the question of void and voidable trusts.

2. THE RIGHTS OF BENEFICIARIES?

The rights of beneficiaries are an important consideration, and should be kept in mind throughout the remainder of this thesis. More often than not, the effects of veil-lifting are serious, often denying beneficiaries the trust property which they had either a right to receive or, at least, a legitimate expectation of receiving. For this reason, it is imperative to have an appreciation of the nature of the beneficiaries' rights in order to understand the underlying message of this work.

To begin with, a beneficiary may have any number and a variety of rights, depending on the terms and conditions of the trust instrument or upon the manner in which trustees have, or have not, exercised their discretion in favour of a beneficiary.³ The most important classification of these rights is into discretionary rights and vested rights, as well as income rights and capital rights.⁴ A discretionary right is nothing more than a contingent right – a *spes* or a hope. Importantly, contingent rights are not dependent on the exercise of a discretion, but may also be conditional upon the occurrence of an uncertain future event. To this extent, “[i]f a trust instrument provides that a beneficiary's acquisition of a personal right to claim payment of trust income and/or capital from the trust's trustee is not immediate but rather contingent upon the occurrence of an uncertain future event, the right to trust income and/or capital will only vest in such beneficiary if and when the contingency has taken place or the condition has been fulfilled.”⁵ Consequently, only if the trustees exercise their discretion in favour of a beneficiary with a discretionary right will that beneficiary benefit to

³ WD Geach and J Yeats *Trusts Law and Practice* (2007) 19.

⁴ The differentiation of income rights and capital rights is discussed in Chapter 2.

⁵ F du Toit *South African Trust Law: Principles & Practice* 2 ed (2007) 108.

the extent that the discretion has been exercised in their favour.⁶ Until such time as the trustees have exercised their discretion, a discretionary beneficiary has only a hope that some benefit will be received in the future. Thus, in the case of a discretionary trust, the beneficiaries do not have a vested right in the trust property, and any income or capital received by the beneficiary is determined purely in the discretion of the trustees.

A vested right, on the other hand, gives a beneficiary far more certainty, in the sense that a beneficiary with a vested right knows exactly what he or she can expect in the way of assets, income or benefits from a trust.⁷ A vested right therefore allows a beneficiary to enforce that right by calling upon the trustees to deliver income or capital to the beneficiary. In particular, a beneficiary with a vested right carries a personal right or a right *in personam*. This right is a right against the trustees to claim income and/or capital or the transfer of an asset.⁸ This right can be contrasted with the discretionary right, which is nothing more than an optimistic expectation that income or capital will eventually accrue to a beneficiary.

Vested or contingent, capital or income, beneficiaries do have rights which are inherent in the trust institution itself.⁹ The Act places several duties upon trustees to act in the best interests of the beneficiaries.¹⁰ Besides the fiduciary duties set out in s 9, s 13 allows a court to vary a trust instrument in instances, above all else, when a provision in the instrument prejudices the interests of beneficiaries. Section 20 of the Act empowers the Master or any person with such interest (such as a beneficiary) to apply to the High Court for the removal of a trustee. The application will be granted in terms of s 20(2)(e) if the applicant can prove that the trustee, amongst other things, failed to perform satisfactorily any duty imposed upon him or her under the Act. Thus, for instance, a beneficiary can, upon the presentation of sufficient

⁶ Geach and Yeats *Trusts* 20.

⁷ *Ibid.*

⁸ Geach and Yeats *Trusts* 21.

⁹ As opposed to the nature of the right bestowed upon the beneficiary through the trust instrument.

¹⁰ Section 9 of the Trust Property Control Act - "Care, diligence and skill required of trustee" states:

- "(1) 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.
- (2) Any provision contained in a trust instrument shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust where he fails to show the degree of care, diligence and skill as required in subsection (1)."

evidence in a court of law, have a trustee removed for failing to meet the necessary standard of care, diligence and skill required of him or her.

Put simply, once a trust has been validly created, the beneficiaries have an interest in the trust property which should not easily be undone. Unfortunately, there seems to be a trend in South Africa to disregard completely the interests of beneficiaries. This problem extends far beyond *Badenhorst v Badenhorst*,¹¹ but such a case is useful for highlighting this predicament. In the above case, there were six beneficiaries of the family trust in total. As discussed in Chapter 3, Mr and Mrs Badenhorst were income beneficiaries, while the four children born of the marriage were capital beneficiaries. Furthermore, it is undeniable that each beneficiary had an interest in the trust and towards the trust property. For the children of the marriage, the capital interest they obtained was unquestionably *res sic stantibus* a matter of inheritance or at least a future donation, as was to be expected. The problem with the decision in this matter, it is submitted, is that upon the court's declaration that the trust property be taken into consideration in the redistribution order, 50 per cent of the trust property would subsequently be handed over to one beneficiary, leaving the five remaining beneficiaries with the residue.

It is acknowledged that the court did not order the transfer of half of the trust property; in fact, Mr Badenhorst was free to pay the amount in his own manner. He was free to sell trust assets necessary to make the payment, or for it to be taken out of his personal estate. Nevertheless, the net result was a loss in the value of Mr Badenhorst's estate.¹² It is correctly noted by Cameron *et al* that in South Africa, beneficiaries do not have an equitable interest in trust property as is the case under English law.¹³ Be that as it may, such an order still contradicts the very essence of a trust, and in particular a family trust. After all, if the trust really was a sham, then the beneficiaries' rights would be illusory because the parties to the sham would almost certainly not intend really to benefit the beneficiaries.¹⁴ Courts should therefore be cautious in granting such orders in the light of the drastic outcome that may result. In this

¹¹ 2006 (2) SA 255 (SCA).

¹² Furthermore, should the respondent, for instance, have taken a mortgage bond out on any of the trust property in order to finance the redistribution of the trust property, the net loss incurred would have extended to the property within the trust.

¹³ E Cameron *et al* *Honoré's South African Law of Trusts* 5 ed (2002) 23.

¹⁴ So this problem therefore arises only where the trust is (wrongly) pierced because it is an alter-ego trust.

vein, the South African courts need to demonstrate added consideration to an allegation of shamming or a contention of an alter-ego trust. In the light of this, it is submitted that it was inequitable that the beneficiaries in *Badenhorst* suffered as a result of the court's incorrect application of the relevant doctrines.

In many instances, both the husband and the wife are trustees of a family trust. Moreover, both are usually beneficiaries of the trust. Unsurprisingly, this can become a difficult situation, because a trustee should always act impartially. The above situation ordinarily complicates the independence of the trustees, and often one of the spouses (or partners, as the case may be)¹⁵ will merely “go along” with the instructions and wishes of the other trustee-spouse (or trustee-partner). Bearing this in mind, as was demonstrated in the previous chapter, the outright majority of alter-ego trust disputes arise upon the dissolution of a marriage. As was the case in *Badenhorst*, the wife counter-claimed in the High Court and sought a redistribution order in terms of s 7(3) of the Divorce Act,¹⁶ whereby 50 per cent of the value of the plaintiff's estate would be awarded to her, including the assets within the family trust. Mrs Badenhorst (the “non-trustee-spouse”) relied heavily on the contention that the family trust was the alter-ego of the plaintiff (the “dominant trustee-spouse”).

Unlike this situation, similar divorce proceedings are met with the scenario that the spouses or partners are trustees of the family trust. Thus, in most instances, the party alleging the alter-ego is in fact a trustee and, as such, has accepted and held the office of trusteeship for many years prior to the divorce proceedings.¹⁷ The first mistake, which will soon become apparent, is that the passive trustee-spouse relies on the alter-ego contention in order to legitimise the piercing of the family trust and the subsequent inclusion of the trust assets in the personal estates of the spouses for redistribution purposes. This is incorrect, as it is certain that an alter-ego trust cannot on its own be pierced. As has been already discussed, proof of an alter-ego trust, according to the established trust doctrines, only serves as an item of

¹⁵ For the sake of fluidity herein, I will refer to “spouse” and “spouses”, and wish that it be interpreted to include Muslim marriages, customary marriages, same-sex life partnerships and any other form of official relationship recognised in South Africa.

¹⁶ Act 70 of 1979.

¹⁷ See, for example, *Browne v Browne* [1989] 1 FLR 292, *Midland Bank Plc v Wyatt* [1995] 1 FLR 696 and *Land and Agricultural Bank of South Africa v Parker and Others* 2005 (2) SA 77 (SCA).

evidence that the trust in question is a sham. However, not to veer off the point, one must again bear in mind that such a passive trustee-spouse did in fact accept the responsibilities and duties imposed upon him or her when that person accepted the position of trusteeship. Thus, although in many cases a passive trustee-spouse may contend that such position was undertaken under duress and through the directions of the other spouse, or that such person undertook the role in ignorance, neither knowing nor caring about the role that they had assumed, that person is still a legitimate trustee burdened by the common law and statutory duties which thus ensue.

The above common scenario is cause for concern. Whether the spouse contending an allegation of alter-ego is or is not a co-trustee¹⁸ is of no relevance at this time. According to s 20(1) of the Act, a trustee may, on the application of any person having an interest in the trust property (ie a trustee or beneficiary, for instance), at any time be removed from his or her office by the court, if the court is satisfied that such removal will be in the interests of the trust and its beneficiaries. Furthermore, s 20(2)(e) of the Act allows the Master to remove any trustee from office if the trustee fails to perform satisfactorily any duty imposed upon him or her by or under the Act. Thus, the obvious question to pose is this: Why is the spouse contending an alter-ego trust only at the time of the dissolution of the marriage?

The answer to the above question has hitherto been ignored in the South African courts. Is it fair that the soon-to-be-former spouse opposes the internal management of the family trust when it suits them? It is submitted that if the alleged alter-ego trust is a concern, then the spouse should have raised their objections earlier. This may seem idealistic, but any person

¹⁸ It should be borne in mind that in the event of a spouse's not being a trustee, as is the case in *Badenhorst*, he or she would still (in most instances) have consented to the transfer of the shared family assets into the trust, and would be compensated by way of a payment or a loan account in their favour. Thus, such party, although not actively involved in the decisions of the trust, consented to the transfer of ownership of the assets and assumed the risks as well as the rewards which would have ensued once the assets fell behind the protective curtain of the family trust.

The assets which were once part of the spouse's personal estate are thus replaced by another, being the cash which that person received for their contribution to the trust, or a loan account. The loan account would thus become the only real right such spouse would now have in relation to a trust *inter vivos*, should the spouse be a non income or capital vested beneficiary. Legitimately, the spouse may claim what is owed to him or her upon divorce proceedings, as this is a personal right in their favour. Should the spouse have diminished the loan account by way of donation through the years, it should not follow that such a spouse should have recourse, as ignorance is not an excuse in our law.

accepting the office of trusteeship undertakes to perform their duties thereafter and to take reasonable steps to guard the trust property in the interests of the beneficiaries. In the case of a spouse's not being a trustee, that person still has a right to have the trustee removed, and the wording of s 20 of the Act clearly intends this. The fact that the allegations are made upon divorce proceedings seems to demonstrate that the "interested party" was comfortable with the trust arrangements for the duration of the relationship.

The above argument is predictably compounded in the case of a trustee-spouse's contending, upon the dissolution of their marriage that the trust is the alter-ego of his or her co-trustee-spouse. Given that the passive trustee-spouse has accepted the office of trusteeship, that trustee will hold the exact same duties and responsibilities that the other trustees do. Thus, any transactions made by, or other behaviour of, the dominant trustee-spouse which may point to the existence of an alter-ego trust, should be contended immediately. In the majority of cases, the trust instrument empowers a trustee only to make certain transactions upon the approval of the other trustees, otherwise the transaction is void, barring further leeway provided by the trust instrument.

To restate this as a practical example: a husband and wife are co-trustees. The wife in this scenario is the passive trustee throughout the existence of her trusteeship. However, upon the application for a divorce, she inevitably contends that she 'merely went along with the wishes of her husband' and that the trust was her husband's alter-ego and that she is therefore entitled to a half-portion of the trust property because the assets "should be treated as being part of his estate upon redistribution". Would this not be firm evidence that the wife is in fact in breach of her fiduciary duties as a trustee? It is submitted that the answer to this question is "yes", and there are a few reasons for this submission:

First, any trustee, whether independent, passive or active, has a duty to act with care, diligence and skill. This duty is enforced in the Act itself and provides that a trustee must act

with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another.¹⁹ Geach and Yeats submit that:

“Reckless behaviour by a trustee would clearly fall foul of this provision, but so would negligence, sloppiness, and general tardiness in carrying out any act on behalf of the trust. A trustee can, it seems, fall foul of this duty either by an act or by an omission, and a trustee who merely leaves trust matters in the hands of others, with no further query or interest, would most certainly be in breach of this duty.”²⁰

The passive trustee-spouse in the above example clearly falls within those guidelines, and thus failed to fulfil her duty.

Second, all trustees are bound to find unanimity in making decisions. This duty (which can be overridden by the trust instrument), which is imposed upon all trustees through the common law, implies that all substantive decisions be made unanimously, and that non-substantive issues be decided by majority vote.²¹ Past decisions and transactions made prior to the pending alter-ego dispute in the example above should have been concluded as such. Thus, the passive trustee-spouse either agreed and confirmed the dominant trustee-spouse’s decisions, or failed to raise a concern or dispute a decision. In consequence, all trustees are bound jointly by the acts, decisions and undertakings of the other trustees which have been approved. Any unapproved activities are most certainly deemed to be approved should the other trustees fail to dispute their validity. It can therefore be concluded that the passive trustee-spouse did in fact approve the alleged “alter-ego” actions of her co-spouse, or otherwise omitted to argue the validity of the decisions, and failed to comply with this duty, as well as the previously mentioned duty.

An interesting argument which has not yet been raised is whether the doctrine of *estoppel* has any application in the above circumstances. In particular, the implication of accepting *estoppel* by acquiescence is that because the passive trustee failed to refute the active trustee’s alter-ego actions, the passive trustee may be said to have acquiesced to the position

¹⁹ Section 9 of the Act.

²⁰ Geach and Yeats *Trusts* 85.

²¹ *Coetzee v Peet Smith Trust* 2003 (5) SA 674 (T).

taken by the active trustee, and thus is considered to have lost the legal right to claim an alter-ego trust later on.

Third, any trustee who accepts office, no matter the terms of his or her appointment, has a duty to act independently. This may seem difficult when the co-trustee is a spouse, but the truth of the matter is that the passive trustee-spouse accepted the office of trusteeship, and had therefore undertaken to be bound by the duties imposed upon him or her. If any duty was to be seen as impossible to adhere to, then such trustee should not have accepted the appointment. This duty is eloquently described by Geach and Yeats as follows: “A trustee must exercise an independent discretion at all times with respect to trust matters, and must not be under the undue influence of any person, particularly not of the planner or founder of the trust.”²² It can therefore be concluded that a passive trustee-spouse alleging that the family trust is the alter-ego of his or her co-trustee-spouse has failed to comply with this duty, because such trustee was, and still is, under a duty to act impartially as well as to dispute any activities which are not in the best interests of the beneficiaries.

Fourth, it must be remembered that a trustee occupies a fiduciary position. A trustee is, as a result, legally bound to act at all times within the confines of the law in the best interests of all the beneficiaries. Therefore, surely a trustee who seeks a court order to include the family trust assets in the other spouse’s estate for the purposes of a redistribution order is in breach of his or her fiduciary duty owed to beneficiaries? Certainly the consequences of such an order would not be to the benefit of the beneficiaries. Of course, such an order would be to the benefit of one beneficiary – being the spouse who is seeking to reclaim about half of the assets in the trust (assuming that person is also a beneficiary), but this would undeniably be to the detriment of the remaining beneficiaries and therefore contradicts the very essence of the office which such trustee has accepted and by which they are subsequently bound.

Last, all of the above reasons are supported by a trustee’s power to take legal opinions and to enter into law suits or to go to arbitration. Accordingly, a trustee is bound, in the discharge of

²² Geach and Yeats *Trusts* 91.

the duties of trusteeship, to settle any objections or differences which may arise between trustees legally. As such, there cannot be any excuse for failing to resolve any problems which may have arisen and which led to the apparent alter-ego circumstances.

Consequently, it can be argued that a passive trustee-spouse who for the first time alleges that the trust is the alter-ego of the co-trustee-spouse only upon divorce proceedings has in fact breached one or many trustee duties which he or she was or is bound by, and is consequently in breach of. Furthermore, if one were to analyse the concept of an alter-ego trust, it may be argued that because the passive trustee-spouse has not corrected or even contested the activities of the other co-trustee until divorce, and has in fact been willing to safeguard his or her assets in trust as it suited them and then seen fit to cry foul and level accusations when it did not, then, ironically, that may become evidence that the trust was in fact the alter-ego of the passive co-trustee-spouse.

Regarding the rights of beneficiaries, another question that arises upon the allegation of a sham or an alter-ego is this: Where does the Constitution fit in with all of the above? Section 25(1) of the Constitution states that “[n]o one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property”. Undoubtedly, the provision applies to trust property, and should therefore have a bearing on the potential deprivation of the property from a beneficiary. The question thus arises: when a spouse seeks an order to include trust property in the personal estate of the other spouse, would the effect thereof not be to deprive other beneficiaries arbitrarily of the trust property, assuming the remaining beneficiaries hold a similar legal title to the assets? The legal conundrum posed is therefore for a direct horizontal application of the property rights. Section 8, the application section of the Bill of Rights, provides for the direct horizontal application of fundamental rights in certain circumstances.²³ According to Currie and de Waal, “direct horizontal application means that the rights protected in the Bill bind not only the state in its relations with individuals, but that individuals may, where appropriate, directly assert their constitutional rights both against the state and other individuals.”²⁴ Section 8(2) of

²³ I Currie and J de Waal *The Bill of Rights Handbook* 5 ed (2005) 557.

²⁴ Currie and de Waal *BOR Handbook* 558.

the Constitution provides that a provision of the Bill of Rights will bind individuals “if, and to the extent that, it is applicable, taking into account the nature of the right and of any duty imposed by the right”. It is submitted that a beneficiary with a vested right in a trust property may be able to argue successfully that the inclusion of trust property for the purposes of a redistribution order is an arbitrary deprivation of property. This would, of course, be a “last resort” route for beneficiaries. Such beneficiaries may arguably have more success bringing a claim to the High Court for damages arising out of the passive trustee’s breach of trust.²⁵

The exposé in this section serves to add an additional and important point of view. As yet, in their judgments the South African courts have not considered the effects of a finding of a sham or an alter-ego on the remaining beneficiaries. Moreover, the duties accepted by a passive trustee-spouse have seemingly been forgotten. It is fairly evident at this point that all trustees are obliged to adhere to the duties they accepted upon appointment and one set of fiduciary standards should apply to all trustees. Importantly, this section differentiated between trustee-spouses and non-trustee-spouses. As has been made abundantly clear, a co-trustee-spouse should also be measured against the fiduciary yardstick he or she seeks to enforce against the other. Significantly, though, it must be remembered that a non-trustee-spouse who seeks to invoke the alter-ego doctrine against their soon to be ex-spouse also had recourse during the subsistence of their marriage. The powers granted in the Act²⁶ would most definitely allow a concerned spouse to seek recourse against a mischievous trustee-spouse. In fact, not only would such a route be considered feasible, it would be in the best interests of the spouse to do so, because any actions undertaken by the trustee-spouse which are not legitimate may lead to an allegation of a sham by a third party, and may therefore jeopardise the safety of the trust property.

²⁵ The following should however be considered: in *Minister of Education v Syfrets Trust Ltd NNO 2006 (4) SA 205 (C)* at paras 19–20, Griesel J states: “However, even if it were to be held that the order sought does indeed constitute a ‘deprivation’, I am not persuaded that any such deprivation could be regarded as ‘arbitrary’. For a deprivation to be arbitrary, it must be procedurally unfair or must take place without sufficient reason.” The learned judge insisted at paras 19–20 that deprivation of property would not be considered arbitrary given a court hearing.

²⁶ Specifically s 20(1) of the Act:

“A trustee may, on the application of the Master or any person having an interest in the trust property, at any time be from office by the court if the court is satisfied that such removal will be in the interests of the trust and its beneficiaries”.

On this point, it is submitted that both trustee-spouses and non-trustee-spouses who, for the first time, bring forward an alter-ego allegation during divorce proceedings, have most definitely weakened their case because an alter-ego allegation is a serious one, bringing about a variety of consequences, some of which can be severe.

So it follows that such accusation should have been pursued earlier had the trust in fact truly been the alter-ego of the other spouse. Waiting until divorce proceedings may thus lead to the inference that the spouse who is pointing fingers was actually content with the goings on of the family trust prior to the proceedings. Will this, however, be enough to succeed in an argument of *estoppel* and/or to support a claim for damages for breach of trust? A foreseen compromise by the courts could in fact be to take the trustee's passivity into account in making the redistribution order.

3. THE CONTRADICTIONS IN SOUTH AFRICAN TRUST LAW

In a series of recent judgments, the SCA has emphasised the importance of adherence to basic trust principles in the formation and administration of trusts.²⁷ In *Land and Agricultural Bank of South Africa v Parker and Others*²⁸ Cameron JA explained that during the last two decades there had been a change in that certain types of trust had developed in which functional separation between control and enjoyment was entirely lacking.²⁹ Following similar lines, various cases have emerged in which the courts have sought to straighten out the unwanted tendencies which had begun to increase in the country. Unintentionally, however, the development of South African trust law which would thus ensue³⁰ created many contradictions within that sphere of law. In particular, the interrelationship of the doctrines of the sham and the alter-ego has become confused. It is furthermore submitted that the doctrines have been mistakenly employed, resulting in the fusion of incompatible company law doctrines with those reserved for the law of trusts. The unwarranted, and for the most part unforeseen adverse effects have seemingly debased the essence and primary purpose of the

²⁷ A Van Der Linde and S Lombard “*Nel v Metequity Ltd* 2007 (3) SA 34 (SCA)” 2007 *De Jure* 429 at 429.

²⁸ 2005 (2) SA 77 (SCA).

²⁹ Para 25.

³⁰ See, for example, *Van der Merwe*.

doctrines of the sham and the alter-ego, resulting in a highly dissimilar operation of the trust doctrines to that of its foreign law usage. The section below tells this story.

3.1 THE INTERRELATIONSHIP OF THE DOCTRINES OF THE SHAM AND THE ALTER-EGO

A common misconception that has evolved locally is that a trust may be disregarded if it is the alter-ego of the settlor or dominant trustee. This is, however, a challenge faced throughout the common law jurisdictions abroad. In Australia and New Zealand the impression that a trust may be disregarded if it is an alter-ego trust or “puppet” of the settlor once dominated the respective Family Law Courts.

The misunderstanding which emerged was debated at length over the years until the correct position crystallised in *The Official Assignee v Wilson & Anor and Others*.³¹ As was noted in the previous chapter, the Australian case of *In the Marriage of Gould*³² was an important milestone in the resolution of this matter. In Fogarty J’s judgment, the learned judge explained the material difference between the two doctrines as follows:

“... the description of an entity as the ‘alter ego’ or ‘puppet’ of a person really denotes something different. Correctly described, it is not an assertion that it is a ‘counterfeit, a facade or a false front’. Rather, it describes an actual situation although as a matter of law or practicality the actions of the other entity may be capable of and may in fact be controlled by the party in question ... a party may establish a trust over which he or she exercises control. It may be correct to describe that trust as the alter ego or even perhaps the puppet of that party, but it would not be correct to describe its existence or its ownership or control of property as a sham.”³³

³¹ [2006] NZHC 389.

³² [1993] 17 FLR 156.

³³ Para 167.

Interestingly though, many years prior to the above rationalisation, Richardson J explored the possibility of having a “half way house” between the doctrines of the sham and the alter-ego. The statement is to be found in the case of *Re Securitibank Limited (No 2)*³⁴ as follows:

“I consider there is no halfway house in this class of case where, as Barker J expressed it, there is ‘a situation where the documents indeed record the intention of the parties but which are considered by the Court not to express the pith and substance of the transaction’. It is a matter of first ascertaining the true nature of the transaction by a consideration of the legal character of the agreement which embodies the transaction. It is only where the genuineness of the agreement evidenced by the documents is challenged that it is then necessary to consider whether the substance of the transaction as represented by the documents is not the true substance of the transaction and the documents themselves are a cloak to conceal its true nature.”³⁵

In *G v T*³⁶ O’Reilly J confirmed the findings held in *Gould*, which were applied in *The Official Assignee v Wilson*. The High Court decision handed down by Chisholm J was ingeniously well expressed, and the importance of the following assertion should not be under-estimated:

“If alter ego trusts were to be automatically recognised as shams that underlying requirement would be negated. The result would be that a half way house between a conventional sham trust and a valid trust would be created. In *Re Securitibank Limited (No 2)* ... Richardson J seems to have rejected the possibility that there is any half way house. I accept that view. It seems to be that to adopt a half way house would be to effectively re-write the traditional understanding of a sham ... Put another way, the fact that a trust is the alter ego or puppet of the settlor does not of itself make the trust a sham because, amongst other things, the requisite common intention for a sham will not necessarily be present.”³⁷

The rule that emerged became known as the “no half way house” rule, and it is clearly correct. In *Official Assignee in Bankruptcy in the Property of Gary Martin Reynolds v Wilson and Others*,³⁸ the Court of Appeal had predictably expressed its distaste for the previous findings

³⁴ [1978] 2 NZLR 136 (CA).

³⁵ At 168.

³⁶ [2003] FamCA 1076.

³⁷ *The Official Assignee v Wilson* at paras 57–58.

³⁸ 2008 NZCA 122.

of the New Zealand Family Law Court's decisions in *Prime v Hardie*³⁹ and *Glass v Hughey*⁴⁰ as well as many other Australian Family Court rulings where the courts had disregarded trusts on the basis that they were effectively the alter-ego of the settlor.

Robertson J further noted:

“Factual control of a trust by someone other than those authorised to have such power is not an irrelevant consideration. Such control may give rise to a claim for breach of trust. Evidence of such control may be relevant to the question of whether a trust is a sham in that it may evidence a lack of true intention to form a trust. That is not to say that an alter ego trust is the same as a sham. A finding of effective control may help establish that a trust is a sham if it indicates that it was not intended that the trust take effect according to its terms. To establish a sham, the intention to mislead must be shown to have existed from the inception of the trust (or from the time when particular property was disposed to the trust). Evidence of effective control of the trust post settlement may be used to infer the requisite intention. We are satisfied that Chisholm J's treatment of the alter ego trust argument was correct. Alter ego trusts are not an independent cause of action, nor are they the same as shams. In the trust context, alter ego arguments are confined to evidence to help establish a sham which is how he treated the matter.”⁴¹

In the South African context, aside from Ngwenya J's *a quo* judgment of in the *Badenhorst v Badenhorst*⁴² case, the “no half way house” rule has repeatedly been broken. In *Badenhorst*, the court *a quo* judge expressed the correct position to be undertaken by the courts when he noted that, in order for the redistribution order to take into account the assets held in the family trust, the court would have to find the trust to be a sham, and not the alter-ego of Mr Badenhorst.⁴³ This is the current approach undertaken overseas which gives effect to the sham doctrine and is congruent with the notion that the alter-ego trust argument cannot on its own be an independent cause of action. With regard to the allegation of the trust's being Mr Badenhorst's alter-ego, the trial court accepted evidence which plainly contradicted this. Under cross-examination, Mrs Badenhorst conceded that her husband had always consulted his co-trustee when dealing with the finances and immovable properties pertaining to the trust.

³⁹ [2003] NZLR 481.

⁴⁰ [2003] NZFLR 865.

⁴¹ Paras 71–72.

⁴² 2005 (2) SA 253 (C).

⁴³ Para 25.

Furthermore, Mrs Badenhorst had kept the trust assets as a bookkeeper separately from those of the plaintiff. She testified further that, where the plaintiff was to make payment on behalf of the trust from his personal account, the trust was debited accordingly, and *vice versa*.⁴⁴ Ngwenya J accordingly held that “[a]part from the general statements that the plaintiff was manipulating the trust there is no factual basis upon which [the court can] come to the conclusion that the trust was a vehicle through which the plaintiff protected himself”.⁴⁵

Unfortunately, the coherence displayed in Ngwenya J’s decision was later undone on appeal to the SCA. In the later case, Combrinck AJA implicitly accepted the trial court’s conclusion that, unless the court finds the trust to be a sham, no redistribution order can be made.⁴⁶ This was, however, all that was discussed on the matter, after which the acting judge went on to rule in favour of Mrs Badenhorst. Combrinck AJA held that the present case was a classic example of the one party having full control of the assets of the trust, and merely using it as a vehicle for his business activities. The court held that the value of the trust assets should have been added to the value of the respondent’s estate and, on the basis of this decision, that the decision of the trial judge to exclude the trust assets amounted to a clear misdirection.⁴⁷

This supports the academic opinion that in *Badenhorst* the court did in fact find the trust to be a sham.⁴⁸ Worryingly, however, Combrinck AJA’s reasoning for the inclusion of the trust assets was that Mr Badenhorst had full control of the assets of the trust and used the trust as his own personal vehicle in pursuit of his own private business affairs. Thus, the Appeal Court had pierced the trust by way of the alter-ego doctrine, even though it was expressly agreed upon that such redistribution could not occur without a finding of a sham. Failing to observe his own words, Combrinck AJA neither cited nor in any way relied upon the *Snook* test. This is the half way house Robertson J had cautioned against. It is plainly evident

⁴⁴ Para 23.

⁴⁵ Para 23.

⁴⁶ Para 7.

⁴⁷ Para 13.

⁴⁸ See, for example, H Joffe “The Future of Trust Law” (2007) *DR* 25 at 26.

therefore that Combrinck AJA pierced the veneer of the trust solely on the finding of an alter-ego.⁴⁹

3.2 THE COMPATIBILITY OF THE DOCTRINE OF PIERCING THE CORPORATE VEIL

Judicial discretion to disregard a juristic person's separate personality is a generally accepted principle in South African common law.⁵⁰ The separate juristic personality of a company can be disregarded by way of the doctrine of piercing the corporate veil, as discussed in Chapter 4. Notably, the doctrine was recognised as part of the South African legal system in the case of *Lategan and Another v Boyes and Another NNO*,⁵¹ where Le Roux J held, "I have no doubt that our Courts would brush aside the veil of corporate identity time and again where fraudulent use is made of the fiction of legal personality."⁵² Furthermore, in terms of s 65 of the Close Corporations Act,⁵³ the judiciary is empowered to negate separate juristic personality where it is found that "the corporation of, or any act by or on behalf of, or any use of, that corporation, constitutes a gross abuse of the juristic personality of the corporation as a separate entity".⁵⁴

The ability to brush aside the corporate façade is nevertheless limited, and for good reason. In *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*⁵⁵ Smalberger JA was emphatic on the point that:

"... a court has no general discretion simply to disregard a company's separate legal personality whenever it considers it just to do so ... It is undoubtedly a salutary principle that our courts should not lightly disregard a company's separate personality, but should strive to give effect to and uphold it. To do otherwise would negate or undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach to it. But where fraud, dishonesty or other improper conduct ... [is] found to be present, other considerations will come into play. The need to

⁴⁹ Without sufficient recognition being given to doctrine of the sham, it would be unwarranted to adduce that the learned judge had conflated the alter-ego enquiry with the sham doctrine.

⁵⁰ Van der Linde and Lombard 2007 *De Jure* 436.

⁵¹ 1980 (4) SA 191 (T).

⁵² At 201.

⁵³ Act 69 of 1984.

⁵⁴ Section 65 of the Close Corporations Act.

⁵⁵ 1995 (4) SA 790 (A).

preserve the separate corporate identity would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil.”⁵⁶

It has therefore been well established that a court can pierce a corporate veil by treating the assets, rights or liabilities of a company as those of its controlling shareholder, whether to impose liability upon the company for its controller’s action or to impose a liability of the company upon its controller, where the company’s action has operated to mask an action that, in substance, is the act of the controller.⁵⁷ In *Parker* the underlying question was whether it was possible to pierce the veneer of a trust so as to attribute its assets to the trustees. Indirectly the answer given by Cameron JA was in the affirmative, although a careful reading between the lines of the lengthy judgment is needed in order to arrive at this conclusion.

In reply to any criticisms against this thesis, there are several judgments subsequent to *Parker* in which the court applied the *dictum* of Cameron JA. These cases form the “ripple effect” previously referred to in this thesis. The most recent of those is the matter of *Van der Merwe* as well as *Knoop NO and Others v Birkenstock Properties (Pty) Ltd and Others*.⁵⁸ The facts in *Knoop* involved the applicants, who were the trustees in the insolvent estate of Etrechia Birkenstock and who sought an anti-dissipation order from the Bloemfontein High Court. In coming to a decision, Nxusani J referred to the *Parker* judgment and noted the following:

“... A court may be empowered to go behind a Trust form. This may exist where enjoyment and control are not functionally separate in the Trust instrument. It is this separation that serves to secure diligence on the part of Trustees because it secures diligence since a lapse may be visited with action by the beneficiaries whose interests conduce to proper control. This separation also ensures independence and the careful scrutiny of transactions designed to bind the Trust.”⁵⁹

“... Where Family Trusts are concerned it usually occurs that functional separation between control and enjoyment is lacking. These Business Trusts are designed to secure the interests and protection of a

⁵⁶ At 29–31.

⁵⁷ DJ Hayton “Shams, Piercing Veils, Remedial Constructive Trusts and Tracing” (2004) 8 *JLR* 1 at 2.

⁵⁸ [2009] ZAFSHC 67.

⁵⁹ Para 26.

group of family members either identified in the Trust by name or by descent or by degree of kingship (*sic*) to the founder.”⁶⁰

“... Where a Family Trust is set up to ensure either estate planning or to escape the constraints imposed by corporate law and assets are put into a Trust, a court may in appropriate cases look beyond the Trust form. A critical consideration here would be the time-line between the creation of the Trust and the complaint regarding the conduct.”⁶¹

“... The reason for looking behind the Trust form is because usually everything has remained ‘as before’. Where the rupture of the control/enjoyment divide results in abuse, beneficiaries who control the Trust, will in their capacities as Trustees, have little or no independent interest in ensuring that transactions are validly concluded. If things go awry they would have every inducement as beneficiaries to deny the Trust’s liability. They are also unscrupulous in that they are easily able to rely on deficiencies in form or lack of authority because their conduct as Trustees is unlikely to be scrutinised by the beneficiaries. In such cases the Trustees are the beneficiaries or those who through close family connection have an identity of interest with them.”⁶²

Evidently Nxusani J was of the opinion that a court does in fact have the discretion to pierce a trust in the same way as a company or a close corporation. If one were to disagree with this submission, consideration would have to be given to para 17 of his judgment:

“In my opinion it matters not whether the corporate entity is a Trust or a company. Provided it can be established on a balance of probabilities, that the particular transactions complained of were the tainted fruits of fraud or other improper conduct, a court would, in appropriate circumstances, disregard the separate legal personality in order to reveal the perpetrator as the ‘true villain of the piece’.”⁶³

Essentially, these are comments made in the light of Cameron JA’s decision in *Parker*.⁶⁴ Notably, the circumstances described by Cameron JA and Nxusani J in which it may be appropriate to pierce the veneer of a trust are similar to those applicable to a company. Crucially though, a trust misses the key ingredient which motivates the application of the doctrine of piercing the corporate veil – separate legal personality. In this regard a company

⁶⁰ Para 28.

⁶¹ Para 29.

⁶² Para 30.

⁶³ Para 17.

⁶⁴ Amongst other cases, see further *Cape Pacific Ltd v Lubner* 1995 (4) SA 790 (A).

is distinct from those who control it. This allows a company to perform juristic acts in its own name, as well as to sue and be sued. This, according to the case of *Salomon v Salomon & Co Ltd*,⁶⁵ is what affords the members of close corporations and directors of companies the well-established protection against personal liability. This is the core of the corporate veneer. Needless to say, the doctrine of piercing the corporate veil acts to discard the separate corporate personality of a company or close corporation. A trust, on the other hand, does not have separate legal personality, nor does it have *persona standi in iudicio*. It thus follows that, on a technical front, the doctrine is incompatible with the trust entity. Evidently this was not taken into consideration in the *Parker* case.

The court also referred to another company law principle known as the *Turquand* Rule. Based on the case of *Royal British Bank v Turquand*,⁶⁶ the rule dictates that each outsider contracting with the company in good faith is entitled to assume that the internal requirements and procedures have been complied with, even if they are not. The company will consequently be bound by the contract even though all matters of internal management and procedure (to enable the representative to act on behalf of the company) have not been complied with.⁶⁷ Cameron JA reasoned that within its scope, the rule that outsiders contracting with an entity and dealing in good faith may assume that acts performed within its constitution and powers have been properly and duly performed, and are not bound to enquire whether acts of internal management have been complied with. Furthermore, the learned judge reasoned that the rule may well in suitable cases have a useful role to play in safeguarding outsiders from the spurious contestation of liability by trusts that conclude business transactions.⁶⁸

Geach and Yeats correctly point out that the difficulty in applying the *Turquand* Rule to trusts is that it is not always obvious what constitutes an act of internal management.⁶⁹ In

⁶⁵ [1897] AC 22 (HL).

⁶⁶ [1856] 119 ER 866.

⁶⁷ ML Benade *et al Entrepreneurial Law* 4 ed (2008) 151.

⁶⁸ L Stander "Piercing the Veneer of the Trust in South African Trust Law: Liability of Trustees of a Business Trust for Fraudulent Trading" (2008) 17 *INSOL* 165 at 170; *Parker* para 18.

⁶⁹ Geach and Yeats *Trusts* 68.

*Nieuwoudt and Another NNO v Vrystaat Mielies (Edms) Bpk*⁷⁰ the trust had entered into an agreement with a close corporation for the sale of 900 tons of maize which had not yet been planted. The agreement was concluded by one of the trustees and was later ceded to the respondent. In response to a request for acknowledgement of the cession by the cessionary, the trust alleged that the original document was a nullity, and would not be given effect to. The SCA in this matter, although not deciding on whether or not the *Turquand* Rule applied to trusts, did state that one must not believe that the ambit of authority conferred by a trust instrument is simply a matter of internal management with which outsiders need not concern themselves.⁷¹ The court did, however, make it known that a third party pleading ignorance of the ambit of authority of trustees will not be accepted. It follows that where a specified number of trustees are required in terms of the trust instrument (as was the case with the Parkers' trust instrument), the appointed trustees lack authority to act on behalf of the trust. It too is clear that the failure to appoint the required number of trustees is not simply an act of internal management. Therefore the *Turquand* Rule will operate only in cases where there is a need for internal formalities, and then the rule operates in favour of the person who would have no way of knowing whether or not these internal formalities took place.⁷² In *Nieuwoudt's* case, Harms JA stated that a third party would not be entitled to assume, merely from the fact that one trustee can be authorised to exercise the powers of all of them, that such authorisation had in fact been given.⁷³

Truth be told, the use and practicality of the *Turquand* Rule in trust law is a moot point. The uncertainty, once again faced by importing a distinctively company law doctrine, surely outweighs any advantages of such a development.⁷⁴

One cannot describe the impact of the *Turquand* Rule without considering the doctrine of constructive notice. In the case of companies, the doctrine of constructive notice denotes that

⁷⁰ 2004 (3) SA 486 (SCA).

⁷¹ Para 21.

⁷² Geach and Yeats *Trusts* 69.

⁷³ Para 22.

⁷⁴ First, the courts have displayed an unwillingness to accept that the failure to appoint the required number of trustees is an act of internal management, defeating the point of this rule's incorporation. Second, as has been cautioned in the latter part of this argument, rewriting the law of trusts requires extraordinary circumstances. It is submitted that such circumstances fail to exist in this instance.

a person transacting with a company is deemed to have notice of any restriction upon a director or officer's authority that is contained in the company's constitution.⁷⁵ Therefore the doctrine operates in favour of companies and against a person who has not read its constitution, and a person in such a circumstance cannot plead that he or she did not know of the provisions of the company's constitution as he or she is deemed to know them.⁷⁶ Importantly, the doctrine does not apply to close corporations, because s 17 of the Close Corporations Act specifically excludes the presumption of constructive notice of particulars in the founding statement and other documents.⁷⁷ In the case of companies, however, the doctrine of constructive notice may apply. Every member of the public has a right of access to the memorandum and articles lodged with the Registrar. However, with regard to trusts, outsiders do not have an automatic right of access to the copies of a trust instrument which is lodged with the Master.⁷⁸ According to s 18 of the Act, the Master will consider giving copies of this document only to those outsiders who in the opinion of the Master can show sufficient interest in the trust instrument and subsequent payment of the prescribed fee. Notably, the effect of the *Nieuwoudt* judgment regarding internal management and a third party's inability to plead ignorance is that this principle has the same effect as the doctrine of constructive notice. Geach and Yeats submit that this is so, even though (a) there is no central register for trusts such as for companies and close corporations, (b) there are several Master's offices, and (c) a Master may refuse an outsider sight of a trust instrument.⁷⁹

This viewpoint is not supported by the author. Cameron *et al* argues in favour, noting that the "suggestion that the ambit of authority conferred by the trust instrument is a matter of 'internal management' with which outsiders need not concern themselves is contrary to both principle and authority and must be discounted".⁸⁰ In this vein, the only established consequence where trustees purport to bind the trust but act without the requisite authority or represent an incapacitated trust, prior to *Parker*, is an action against the trustees in their

⁷⁵ Blackman *Commentary on the Companies Act* (2002) S-36.

⁷⁶ Geach and Yeats *Trusts* 67.

⁷⁷ Section 17 of the Close Corporations Act states:

"No person shall be deemed to have knowledge of any particulars merely because such particulars are stated, or referred to, in any founding statement or other document regarding a corporation registered by the Registrar or lodged with him, or which is kept at the registered office of a corporation in accordance with the provisions of this Act."

⁷⁸ Note further that if the trust is foreign, the trust instrument is unlikely to be lodged anywhere as most foreign jurisdictions regard trusts as purely private institutions.

⁷⁹ Geach and Yeats *Trusts* 69.

⁸⁰ Cameron *et al Honoré's South African Law of Trusts* 324.

capacity as such on the grounds of unjust enrichment, should the trust estate have been enriched.⁸¹ Therefore, the acceptance of the constructive notice doctrine into trust law fails for many reasons, including those noted by Geach and Yeats above. Moreover, much like the *Turquand* Rule, this doctrine was constructed specifically within the scope of company law and it does not logically follow that such a device has application in the field of trust law.

Ultimately, neither the *Turquand* Rule nor the doctrine of constructive notice has a place in trust law. The incompatibility of both principles with trust law is evident in their application to company law. The ambit of the *Turquand* Rule is limited only to the internal management of a corporation and the SCA expressly noted this in *Nieuwoudt*.⁸² *Cameron et al* did not fully consider the degree of the extension proposed.

Ironically, in *Honoré*, *Cameron et al* states the following when commenting on the case of *Man Truck & Bus SA v Victor*:⁸³

“It is certainly in our view wrong to impose on the trust, which has no legal personality, company law doctrines such as the *Turquand* rule (*Royal British Bank v Turquand* [1856] 119 ER 866 (Ex Ch)), under which outsiders dealing with a company are entitled to assume that internal rules and regulations have been fulfilled. The decision to this effect in *Man Truck & Bus SA v Victor* 2001 (2) SA 562 (NC), reached with no allusion to trust law principles or authorities, disregarded beneficiaries’ interests while overlooking the fact that outsiders dealing with a trust know that they are not dealing with a company.”⁸⁴

Accordingly, in *Honoré* *Cameron et al* agrees with my viewpoints, yet provides for the opposite *ratio decidendi* in the *Parker* case. This was not a once-off statement either: *Cameron et al* further remarks in *Honoré* that the judgment in the *Man Truck & Bus SA* case “illustrates the danger of imprudently translocating legal doctrines from one area of the law to

⁸¹ *Ferera Ltd v Vos NO and Others* 1953 (3) SA 450 (A) at 465.

⁸² In *Nieuwoudt*, the court reasoned that a third party would not be entitled to assume, merely from the fact that one trustee can be authorised to exercise the powers of all of them, that such authorisation has in fact been given.

⁸³ 2001 (2) SA 562 (NC).

⁸⁴ *Cameron et al Honoré’s South African Law of Trusts* 95 (at note 437).

another without due caution and consideration.”⁸⁵ Cameron *et al* therefore highlights the very point this thesis seeks to make.

Both the *Re Esteem Settlement, Grupo Torras SA and Others v Sabah and Others*⁸⁶ and *Shalson and Others v Russo and Others*⁸⁷ cases are also noteworthy for being occasions where the Court was invited to lift the veil of the trust. Richmond-Coggan suggests that the extension of the principle to trusts is dangerous, which, if it were to be accepted by the courts, would create great uncertainty for trustees and beneficiaries alike.⁸⁸ Unlike in South Africa, a resoundingly negative answer was given in both cases. In the *Esteem Settlement* case, the Jersey Royal Court considered at length whether such a principle could apply even in relation to trusts. In this matter the applicants sought to persuade the court that, where the interests of justice required it, the court was entitled to look behind the trust and treat the assets as if they were the individual’s own.⁸⁹ In considering this question, the court emphasised the distinction between a company, which is a legal entity in its own right, and a trust, which is instead really no more than a statement of the duties owed by the trustees to their beneficiaries.⁹⁰ The Jersey Royal Court therefore refused to adopt the doctrine of piercing the corporate veil, noting that the principle has no applicability to trusts. The findings in the *Esteem Settlement* case did not, however, deter the claimants in *Shalson* from inviting the court to pierce the veneer of Mr Russo’s settlement. The court also dismissed the invitation, noting that the suggestion had no legal limb on which to stand on.⁹¹

3.3 SHAM TRUSTS

Evidently, South African courts and local academics alike have struggled to grasp the doctrine of the sham. More often than not, the term “sham” has been widely used to describe the apparent abuse of the trust *inter vivos*, without any further elaboration. Worryingly, many writers and judges seem to use the words “sham”, “veneer”, “alter-ego” and “façade”

⁸⁵ Cameron *et al* *Honoré’s South African Law of Trusts* 34.

⁸⁶ [2003] JLR 188.

⁸⁷ [2003] EWHC 1637.

⁸⁸ W Richmond-Coggan “Attacking the Assets of a Trust: The Courts’ use of Freezing Orders” (2007) 13 *Oxford LJ* 18 at 26.

⁸⁹ Hayton 2004 *JLR* 2.

⁹⁰ *Ibid.*

⁹¹ *Ibid.*

interchangeably. At this point, it should be fairly clear that this is incorrect. Moreover, without using the test set out in *Snook*, courts and commentators have instead ascribed their own meanings and parameters to the doctrine, which in turn has debased the purpose of the longstanding trust principle.

The *Parker* case seems to be the origin of this phenomenon, and the *dictum* laid down by Cameron JA has been taken quite literally as a guideline for the application of the sham doctrine. Professor Williams has articulately demonstrated the conundrum emphasised in this thesis:

“In this *dictum*, the Supreme Court of Appeal [in *Parker*] seems to foreshadow that, in an appropriate case, a court would hold that a trust, though duly formed and registered, is in law a sham, and that trust assets are in reality owned by one or more trustees, and are therefore available to meet claims of the latter’s creditors ... if the trust form were ‘abused’, for example, if it were a mere sham or ‘veneer’ which ought to be pierced in the interest of creditors, *then the court, on the authority of the Supreme Court decision in Land and Agricultural Bank v Parker, had the power at common law to do so.*” (Emphasis added.)⁹²

In essence, the doctrine of the sham has been convoluted, and the courts have since *Parker* confused the doctrine of piercing the corporate veil with that of the sham. The word “sham” is used as a description, whereas the requirements of the corporate law doctrine are used to decide when it may be appropriate to look behind the veneer of a trust *inter vivos*. The *Knoop* case (discussed above) is an excellent example of the ripple effect caused by the *Parker* case.

Other cases too have relied upon the *dictum* in *Parker*. In the matter of *Nedbank Ltd v Thorpe*,⁹³ the bank had applied for the provisional sequestration of the estate of Thorpe, who had bound himself as surety for an un-repaid loan of R6 million. The Durban High Court accepted evidence by way of affidavit which suggested that Thorpe had over time conducted his business via corporate entities and trusts. Moreover, he had established several family

⁹² RC Williams “Trust Law Up-date” http://www.saipa.co.za/documents/Professional_Accountant_November_December_2008.pdf (accessed 21 February 2010).

⁹³ [2009] ZAKZHC 44.

trusts which he used to protect his wealth, especially the Banavie Trust, of which he was a trustee and a discretionary beneficiary. The trust held many valuable assets, including an expensive Bentley motor vehicle which Thorpe had exclusive use of. In deciding whether the trust was a sham, Levinsohn DJP held that:

“This circumstance by itself creates the strong suspicion that the respondent is simply conducting his personal business through the trust and that the trust is simply the vehicle to do so. The impression is created that the remaining trustees while notionally independent persons may simply be doing the respondent’s bidding. The acquisition by the trust of a luxury motor vehicle points in that direction and raises pertinently the issue proffered by Cameron JA in *Land and Agricultural Bank of South Africa v Parker and Others* 2005 (2) SA 77 (SCA) at 90–91 ... 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.”⁹⁴

Ultimately, Levinsohn DJP made an order for the provisional sequestration of Thorpe’s estate, and a year later Pillay J confirmed that the sequestration would be to the advantage of Thorpe’s creditors, thus confirming the *rule nisi* granted by Levinsohn DJP in 2008.⁹⁵

An earlier judgment which, too, forms part of the “ripple effect” is that of *Thorpe and Others v Trittenwein and Another*,⁹⁶ where the SCA warned that those who choose to conduct business through the medium of a trust in order to obtain some financial advantage can have no cause for complaint when this method of structuring their business works to their disadvantage. Pertinent to this discussion, in dismissing the appeal, Scott JA noted the following:

“But the trust is typical of the modern business or family trust in which there is a blurring of the separation between ownership and enjoyment, a separation which is the very core of the idea of a trust. (See *Land and Agricultural Bank of SA v Parker*, *supra*, para 19 at 86E.) Those who choose to conduct business through the medium of trusts of this nature do so no doubt to gain some advantage, whether it be in estate planning or otherwise. But they cannot enjoy the advantage of a trust when it suits them and cry foul when it does not.”⁹⁷

⁹⁴ Paras 49–50.

⁹⁵ *Nedbank Limited v Thorpe* [2008] ZAKZHC 72.

⁹⁶ 2006 (3) SA 427 (SCA).

⁹⁷ Para 17.

Other cases have also confirmed the rationale of *Parker*. In *Nel and Others v Metequity Limited and Another*⁹⁸ Streicher JA shadowed the words of Cameron JA in *Parker* regarding the issue of lack of separation between control and enjoyment, and the effect thereof on validity.⁹⁹

The above is demonstrably a departure from the formalistic approach that is so often a product of the reasoning in *Snook*. One cannot deny that the *Snook* test is the only appropriate guideline for the assessment of a sham, and to hold a trust to be a sham without the *Snook* enquiry is incorrect in law. In many South African cases, the court in fact did not refer to the trust as a sham, but instead cast aside the protective veil in the knowledge that it was empowered to do so by way of the *Parker dictum*. The *dictum* is as follows: where there is a functional separation between control and enjoyment within the trust, and although assets are put into trust, everything remains as before. This will be evidence that the trust form was a mere façade for the conduct of a business “as before”, and that assets allegedly vesting (or vested) in trustees in fact belong to one or more trustees.

Accordingly, in any case, including those mentioned above, should a court in some way order assets held in trust to be distributed to a third party or a creditor for any reason, the court has effectively pierced the trust. What has already been firmly established is the only way in which a trust can be ‘pierced’ is with the use of the *Snook* test to assert that the trust is a sham, and only if the enquiry passes the test, should a court open up the trust and allow creditors and other third parties access to the trust’s assets.

Returning to the *Parker* case, there can be no room for debate as to the trust’s legal capacity upon completion of the commercial agreements with the bank. In the words of Cameron JA in *Parker*, “the trustee body envisaged in the trust deed was not in existence, and the trust estate was not capable of being bound”.¹⁰⁰

⁹⁸ 2007 (3) SA 34 (SCA).

⁹⁹ Para 5.

¹⁰⁰ Para 14.

Ironically, it is submitted that a simpler solution therefore existed at the hands of the SCA. This alternative solution was highlighted *in pari materia*, *Chetty NO and Others v Knowles NO and Another*,¹⁰¹ where the trustees of a family trust sought an order directing the respondents to transfer ownership of certain immovable property into the trust's name. The application arose from a sale agreement in terms of which the respondents sold the property to the applicants' trust.¹⁰² According to the applicants, the trust had complied with all its obligations arising out of the agreement, and was therefore entitled to the transfer of the immovable property. However, the respondents alleged that the agreement had been validly cancelled, and sought an order to that effect. Similar to the facts of *Parker*, the trust instrument required a minimum of three trustees in office at all times. Prior to execution of the sale agreement, one of the trustees resigned, leaving the remaining two trustees in office. The court held that the remaining two trustees did not have the capacity to conduct the business of the trust at the time that the agreement of the purchase and sale was concluded.¹⁰³ Accordingly, the court declared the agreement of purchase and sale null and void. The contract was voided, and the parties were ultimately restored to the position they were in prior to the agreement.¹⁰⁴

Had Cameron JA followed a more restrictive approach to the facts of the *Parker* case, he, too, would have held the loan agreements to be null and void. By cancelling the loan agreements, the SCA would have been in a position to restore the bank to its original position, as was done in *Chetty*. Consequently, there would have been no necessity to pierce the veneer of the trust. It is submitted that a court should explore the possibility of piercing only as a desperate last resort – if a less drastic alternative is available, that should be followed.

The concept of the sham has been defined and analysed in much detail. From the decisions examined, it is possible to set out the exact operation of the doctrine in Table 5.1, below.

¹⁰¹ 2006 JOL 17817 (N).

¹⁰² Para 3.

¹⁰³ Para 25.

¹⁰⁴ This approach too was adopted in *Thorpe*, where Scott JA held an agreement of sale void *ab initio* because one of the trustees had signed the deed of sale without the written authority of the other two trustees.

Table 5.1 The Essential Features of the Sham Doctrine¹⁰⁵

Principle	Origin
A common intention must exist between the parties to the sham, that acts done or documents executed do not create the legal rights and obligations which they appear to create. Put differently, it must be shown that both the settlor and the trustee had intended, from the inception of the trust arrangement involving the assets claimed, that the transfer of legal title would be merely a façade concealing the actual arrangements between the parties. ¹⁰⁶	<i>Snook v London and West Riding Investment Ltd.</i> ¹⁰⁷
A sham is the act done or document executed that is intended to mislead. It is where the parties, in order to mislead third persons, resort to a form of action or document which does not fit the real facts.	<i>Bateman Television v Coleridge Finance Co Ltd.</i> ¹⁰⁸
A sham does not apply to transactions that are intended to take effect, and do take effect, between the parties according to their tenor, even though those transactions may have the effect of fraudulently preferring another person.	<i>Hitch & Others v Stone;</i> ¹⁰⁹ <i>Paintin and Nottingham Ltd v Miller Gale and Winter.</i> ¹¹⁰
A sham may exist at the outset or emerge over time.	<i>NZI Bank Ltd v Euro-National Corporation Ltd;</i> ¹¹¹ <i>Marac Finance Ltd v Virtue.</i> ¹¹²
Where a portion of a transaction is a sham, its effect is limited to that portion only.	Case W49. ¹¹³
There is no half way house between the doctrines of the sham and the alter-ego. Thus, a finding of an alter-ego trust does not automatically lead to the inference that the trust is a sham. The consequence, in essence, is that an alter-ego trust on its own may not be pierced.	<i>Re Securitibank Limited (No.2);</i> ¹¹⁴ <i>Official Assignee in Bankruptcy in the Property of Gary Martin Reynolds v Wilson and Others.</i> ¹¹⁵
The positive identification of a sham trust empowers the court to lift the veil of the trust.	<i>Re Securitibank; Wilson; Midland Bank v Wyatt;</i> ¹¹⁶ <i>Re Esteem Settlement, Grupo Torras SA and Others v Sabah and Others.</i> ¹¹⁷

¹⁰⁵ New Zealand Commissioner of Inland Revenue “Sham - Meaning of the Term” 9 *Tax Information Bulletin* 7 at 7.

¹⁰⁶ T Hang “Reservation of Settlor’s Powers” (2009) *SAC LJ* 517 at 536.

¹⁰⁷ [1967] 1 All ER 518.

¹⁰⁸ [1929] NZLR 794.

¹⁰⁹ (2001) STC 214 (CA).

¹¹⁰ [1971] NZLR 164.

¹¹¹ [1992] 2 NZLR 528 (CA).

¹¹² [1981] 1 NZLR 586 (CA).

¹¹³ [1989] ATC 460.

¹¹⁴ [1978] 2 NZLR 136 (CA).

¹¹⁵ [2008] NZCA 122.

¹¹⁶ [1995] 1 FLR 696.

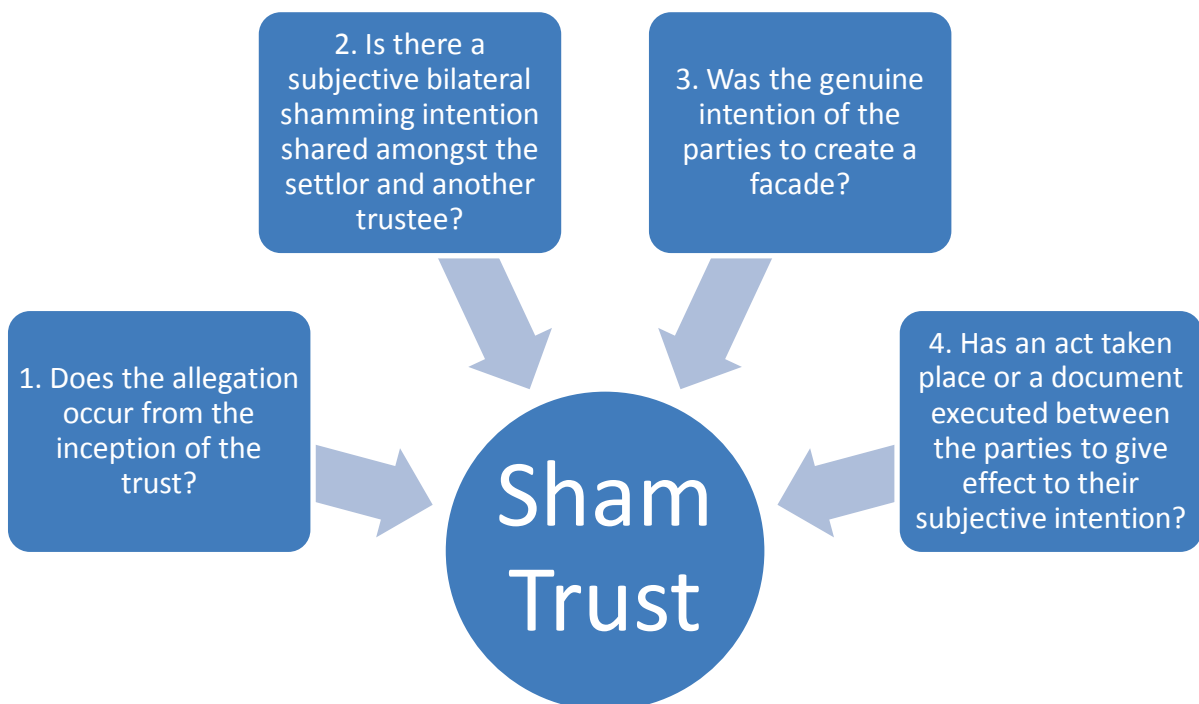
¹¹⁷ [2003] JLR 188.

Professor Hang neatly describes the reasoning behind the doctrine:

“Serving only to weave a deceitful front so as to allow the settlor to evade his creditors or to avoid family succession or matrimonial claims, and no other useful purpose at all, a sham trust arrangement would be a clear-cut scenario in which there is no reason to regard the ‘trust’ arrangement as valid.”¹¹⁸

Having most certainly “put to rest” the discrepancies evident in South African law regarding the utilisation of the sham doctrine, the obvious question that follows is: What would have happened, had the doctrine been correctly applied? In order to answer this question as best as possible, it is necessary to break down the *Snook* test into a step-by-step inquisition. Figure 5.1 below reflects the scenario of the original sham doctrine as interpreted in *Snook*. Answering “yes” to all four questions will most certainly point to a sham trust in terms of the *Snook* test.

Figure 5.1 The *Snook* Test: Sham *ab initio*



¹¹⁸ Hang 2009 *SAcLJ* 536.

Figure 5.2: The Emerging Sham

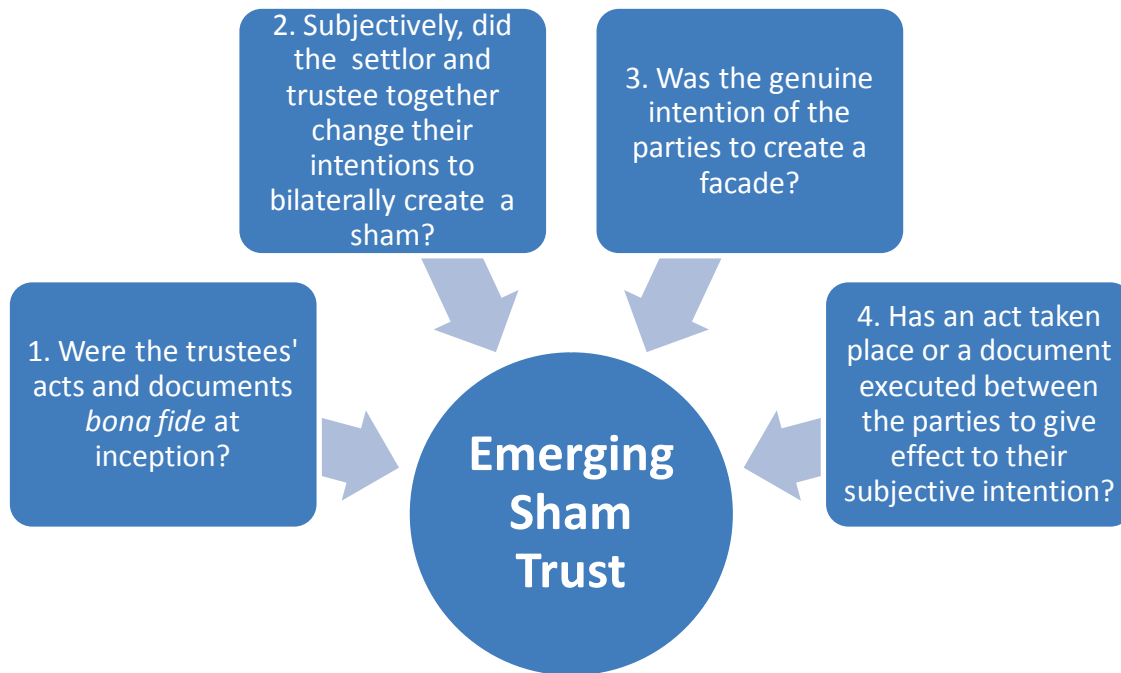


Figure 5.2 above, on the other hand, depicts the emerging sham enquiry. Taking into account the investigation undertaken in Chapter 4, the above diagram recognises emerging shams only in the strictest of degrees. Thus, an emerging sham would occur where the document was *bona fide* at inception, but the parties have departed from their initial agreement and have allowed the trust to mask their new arrangement. Importantly, it must be recognised that an emerging sham will be identified only if both the settlor and a trustee other than the settlor share this new shamming intention, thus staying true to the bilateral intention required in the *Snook* test.

Those activities undertaken by either a settlor or a trustee on their own cannot fall under the emerging sham and consequently would result instead in a claim for breach of trust. Whether it be a sham trust *ab initio* or an emerging one, it is submitted that although many courts are adamant that the two parties be specifically the settlor and a trustee for the purposes of the *Snook* test, the settlor may in fact be replaced by a “dominant trustee”, should the settlor have died or not be a beneficiary under the trust. This thought takes account of those modern-day trusts which are purposefully settled by a third party at the request of the true settlor.

5.3: The Complete Sham Enquiry

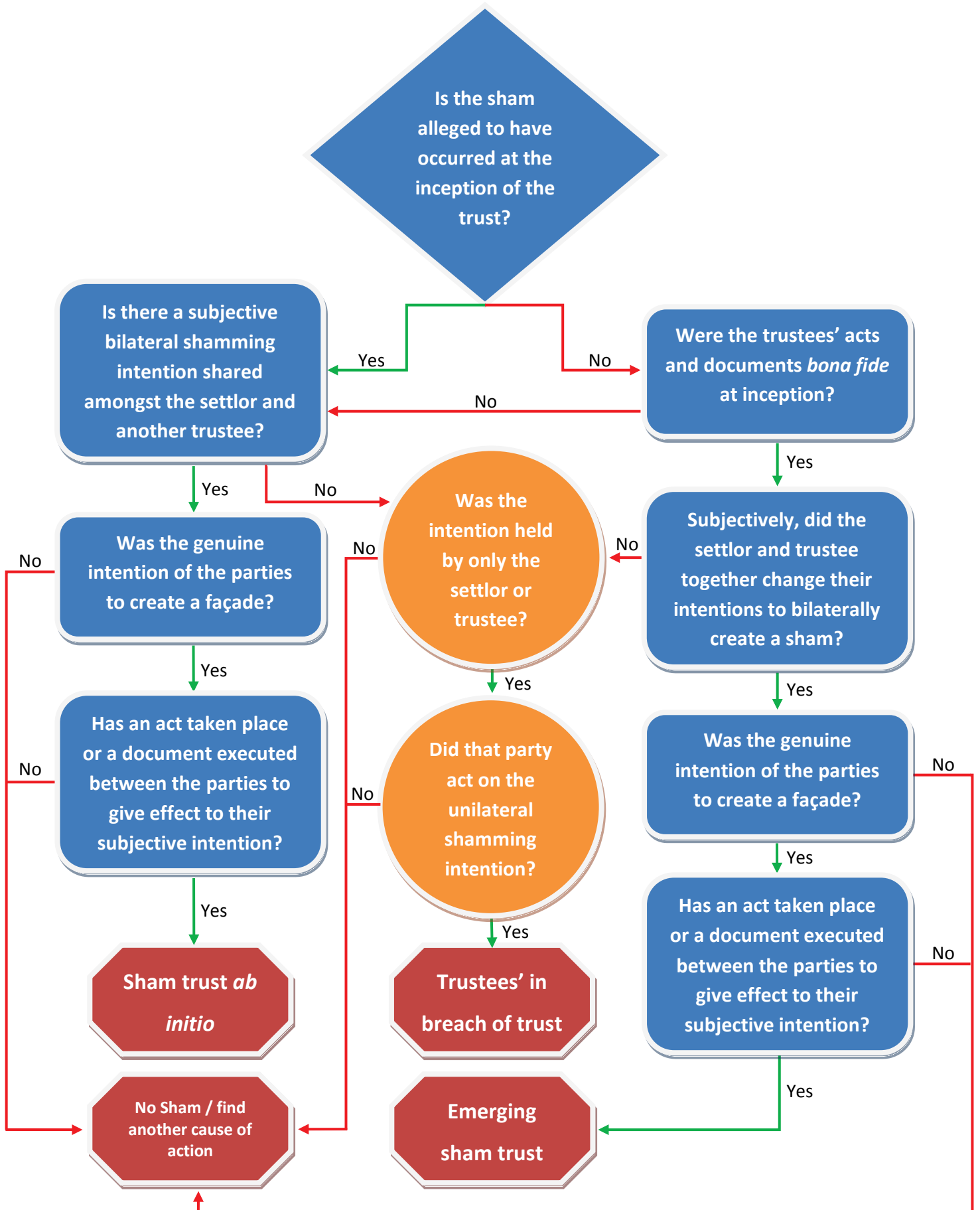


Figure 5.3 above is the outcome of the research undertaken in Chapter 4. The flowchart takes account of the current strict approach adopted by the courts around the world. In order to make a finding of a sham, all the boxes need to be ticked. The diagram can also help with making a decision on an emerging sham and even a breach of trust. These are the most common alternatives to the direct sham verdict. Using the *Parker* case as an example, let us see what the result would be according to the diagram:

Step 1: Is the sham alleged to have occurred at the inception of the trust?

No. The Family Trust, which was established in 1992, was legitimately created. There seems to be no evidence which would suggest the settlor (Mr Parker) and the trustees (the Parkers and their family attorney) had colluded at the commencement of the trust to create a sham.

Step 2: Were the trustees' acts and documents bona fide at inception?

Yes. The Jacky Parker Trust was set up in good faith. No act or document can point to the contrary.

Step 3: Subjectively, did the settlor and the trustee together change their intentions bilaterally to create a sham?

No. Although the Parkers failed for nearly two years to give effect to the terms of the trust instrument and appoint a third trustee, the evidence does not suggest that the co-trustees wished to use the trust to conceal a transaction. Although the Parkers accepted loans and contracted on behalf of the trust as co-principal debtor and surety in a number of agreements, the Parkers still wished those transactions to operate according to its tenor. As was decided in *Yorkshire Railway Wagon Company v Maclure*:¹¹⁹ “it was not intended by them as a mere blind or cloak for something behind, it was a transaction ... and intended to be acted upon according to its purport and apparent effect”.¹²⁰

¹¹⁹ (1882) 21 Ch D 309.

¹²⁰ At 317.

Step 4: Was the intention held by only the settlor or trustee?

No. Unfortunately, the court never enquired into the individual intentions of the Parkers. As such there can be no inference which would suggest either of the parties wished to use the trust as a sham.

Result:

No sham – find another cause of action. Thus, the product of the diagram is in line with my previous submissions. There was no sham, not even an emerging sham. The result opens the door to other possibilities, such as voiding the agreements. The court could therefore make an order to restore the Bank to the position it was in prior to the agreements.

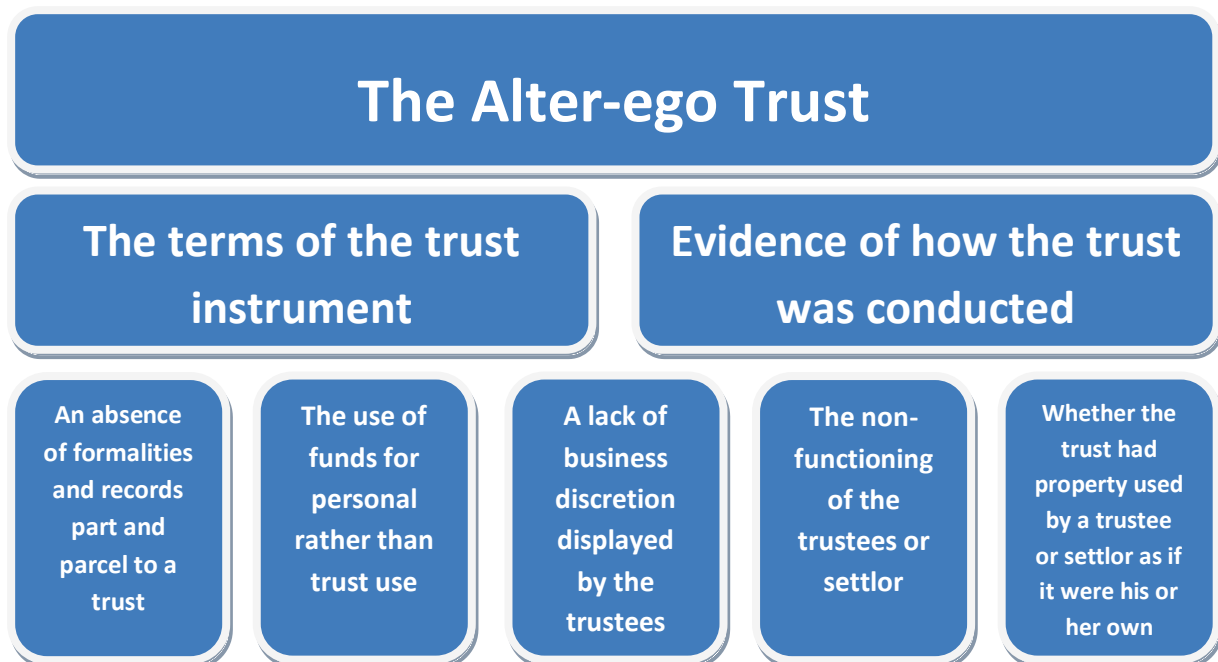
3.4 ALTER-EGO TRUSTS

An important by-product of Figure 5.3 is the effect it would have had on many alter-ego cases in South Africa. The statement “a trust cannot be pierced without a finding of a sham” holds true for all scenarios, including the matrimonial and partnership disputes which arise upon divorce proceedings, whereby one of the parties to the relationship asserts that the trust property be regarded as forming part of the personal estate of the other spouse for the purposes of redistribution. The reason for this assertion is that in order to give effect to such a wish, the court would have to disregard the trust structure, effectively piercing the trust. The making of such an order has become more frequent over time, although the courts do not make an enquiry into the sham status of the trust or announce that the trust has been disregarded. What in fact is the norm is that a court will make a finding of an alter-ego trust and then include the trust property in the estate of one of the spouses. This is a perturbing tendency.

In order to challenge various South African court decisions, it is necessary to cast our minds briefly back to the research undertaken in Chapter 4. The outcome of the foreign alter-ego investigation was that the alter-ego principle was often amalgamated with the doctrine of the sham. In opposition to this development, it must be remembered that, unlike a sham trust, an alter-ego trust is intended to be genuine. Consequently, there is no requirement of an

intention to deceive or mislead. What is required in order to prove an alter-ego trust, however, is *de facto* control. According to Chetty J in the case of *Brunette v Brunette and Another*,¹²¹ in order to determine whether a settlor (or dominant trustee) was in *de facto* control, the court would have regard to the terms of the trust instrument as well as evidence of how the trust was conducted.¹²² The general requirements enumerated by the learned judge, coupled with the five requirements adapted from the American court guideline,¹²³ allow the following factors, illustrated in Figure 5.4, to be used as an indication of whether the trust can fall under the alter-ego doctrine:

Figure 5.4 The Elements of an Alter-ego Trust



The diagram above is useful for an alter-ego enquiry. There are three layers attached to an alter-ego analysis. The top layer is the conclusion that the trust is in fact the alter-ego of the settlor or dominant trustee. The middle layer comprises the words of Chetty J, where he indicated the two factors important in the enquiry, namely “the terms of the trust instrument” and “evidence of how the trust was conducted”. These two aspects overshadow the bottom layer and provide the most important avenues to examine when addressing the questions specified in the bottom layer. Should evidence indicate that all five factors are present, the

¹²¹ 2009 (5) SA 81 (SE).

¹²² Paras 3–4. See also, the *Badenhorst* SCA case.

¹²³ See Chapter 4.

trustee or settlor may be deemed to have *de facto* control of the trust – an alter-ego trust conclusion will most likely thus follow.

A crucial step forward has thus been made regarding how a court may decide whether or not the trust is an alter-ego trust. The question which still lingers, however, is what would the point be of proving an alter-ego trust if one may not pierce it? Robertson J contends that a finding of *de facto* control may help establish whether a trust is a sham if the evidence indicates that there was no intention to establish a trust according to the terms of the trust instrument.¹²⁴ In this instance, a court would have to be persuaded that there was an intention to mislead from the inception of the trust or from the time when the particular property was disposed to the trust. Significantly, though, the intention to misuse the trust would have to be shared by another trustee or the settlor. In all other situations, the proof thereof can only bring about a claim for breach of trust against that particular trustee.

The point is easily made with reference to the *Badenhorst* case. Marcus notes that:

“... it is intended that the trust be treated as a separate legal entity which is not capable of being assailed by creditors ... the case of *Badenhorst* illustrates that this protection is not absolute ... While the Cape High Court had protected the separate identity of trusts, the Appeal Court did not. Instead, it upheld the long-established principle that the assets (and liabilities) in a trust vest in the trustees, but also noted that a trust is a legal animal all of its own. The court went on to find that the mere fact that assets vest in the trustees, and do not form part of the husband’s estate, does not exclude them from consideration when determining what must be taken into account in a redistribution order consequent on divorce proceedings. The court held that to succeed in a claim of this kind there needs to be evidence that the party controlled the trust and that, but for the trust, would have acquired the assets in his or her own name.”¹²⁵

¹²⁴ *Wilson* para 71.

¹²⁵ R Marcus “Trust Busters” (2006) 6 *Without Prejudice* 55 at 55.

The conclusions reached by Marcus run concurrent with those in this thesis. The court did in fact cast aside the veil of the Badenhorsts' family trust on evidence which supported a finding of an alter-ego:

“It was noted by the court that very often, in cases of trusts, whilst *de jure* control vested in the hands of the trustees, the founder (who is often a beneficiary of the trust) may have *de facto* control over the assets. The court observed that it was easy to appoint relatives or friends who are ‘either supine or do the bidding of their appointer’. If *de facto* control of assets vested in the founder and/or a trustee, then the assets held in the trust could be regarded as those of the controller. Control is a matter of fact, and the court considered the terms of the trust deed as well as evidence as to how the affairs of the trust were conducted during the marriage. In the case in question, it was clear that the husband and founder of the trust, who was also a trustee and income beneficiary, arranged the affairs of the trust in such a way that he controlled what happened with the assets. He paid scant regard to the difference between his own assets and the assets in the trust, and hardly ever sought advice or consent of his fellow trustee (his brother) in making any decisions as regards the trust’s assets.”¹²⁶

On this premise, the SCA found that the assets in the trust should be taken into account as part of the redistribution order.

It would be wrong to presume that the *Badenhorst* case is confined to matters within divorce proceedings. Marcus submits that:

“While this case concerns itself particularly with divorce proceedings, its wider ramifications should not be ignored. Conceptually, the principle enunciated in the case could be extended to assist creditors who wish to attack the status of trusts as a separate legal entity. It will no doubt be open for them to argue that (rather like piercing the corporate veil in a company) the separate legal identity of the trust and its trustees should be ignored, and that assets contained in the trust should form part of the controllers’ estate.”¹²⁷

The ripple effect is indeed apparent as the SCA had once again pierced the trust without an accurate finding of a sham.

¹²⁶ Marcus 2006 *Without Prejudice* 55.

¹²⁷ *Ibid.*

Progressively, the amalgamation of the doctrines together with the new precedent constructed in *Parker* and followed in *Badenhorst* has led to the wide discretion a court now has to “pierce a trust”. In *Nedbank*, Levinsohn DJP held the following after reflecting on the judgment in *Parker*:

“This circumstance by itself creates the strong suspicion that [Thorpe] is simply conducting his personal business through the trust and that the trust is simply the vehicle to do so. The impression is created that the remaining trustees, while notionally independent persons, may simply be doing [Thorpe’s] bidding. ... In my view, there is a real prospect of [a forensic examination] showing that the trust is a mirage used by [Thorpe] for his own commercial ends.”¹²⁸

Following Levinsohn DJP’s judgment, Pillay J confirmed the *rule nisi* by way of the alter-ego doctrine:

“It is indeed probable that the true and complete control of the trusts vests in the Respondent [Thorpe]. There is in my view evidence to suggest that the Banavie Trust is the alter ego of the Respondent and is utilized by him for the purposes of receiving income generated from various activities and at the same time insulating his assets and wealth from his creditors.”¹²⁹

Various other court cases, including *Thorpe v Trittenwein*, displayed similar interpretations of the discretion traversed through *Parker*:

“Those who choose to conduct business through the medium of trusts of this nature do so no doubt to gain some advantage, whether it be in estate planning or otherwise. But they cannot enjoy the advantage of a trust when it suits them and cry foul when it does not. If the result is unfortunate, Thorpe has himself to blame.”¹³⁰

Similar to the outcome in *Badenhorst*, in *Jordaan v Jordaan*¹³¹ it was also decided that because of the manner in which the trusts were administered, the value of the trust property

¹²⁸ Paras 49–50.

¹²⁹ Para 27.

¹³⁰ *Thorpe v Trittenwein* para 17.

¹³¹ 2001 (3) SA 288 (C).

was to be taken into consideration for the purposes of a redistribution order in terms of s 7(3) of the Divorce Act.

4. THE CONSEQUENCES OF FINDING A TRUST TO BE A SHAM OR AN ALTER-EGO

The final issue to address regarding the application of the doctrines is the consequences that flow from a finding of a sham or an alter-ego. It is not immediately apparent from the above investigation what consequence should follow from finding that the parties to an arrangement entered into it with the intention of misleading others. In one sense the arrangement does not truly reflect what the parties intended, and so it could be considered void on the basis of contract law as the party contracting with the trust was unaware of its true nature and thus ought not be bound to it.¹³² On the other hand, the parties to the sham entered into it with an intention to mislead others – which is fraudulent – suggesting that the transaction should perhaps instead be treated as merely voidable.¹³³

A further query that arises is the actual status of the trust itself. After a finding of a sham or an alter-ego, does the trust continue to exist, or would it dissolve? In *Jordaan Traverso J* (after declaring the trust to be the alter-ego of the husband, Mr Jordaan) remarked:

*“Vir bogenoemde redes kom ek tot die gevolgtrekking dat by die beoordeling van die vraag wat die omvang van die herverdelingsbevel moet wees, dit reg en billik is om die bates van die trusts in ag te neem. Vanweë hierdie bevinding is dit nie nodig om te besluit of dit in die omstandighede nodig is om die ‘corporate veil’ deur te dring nie.”*¹³⁴

¹³² It would be unconscionable to allow the trustees to avoid liability as a result of their own dishonesty, so the stance would have to be similar to that seen in *Man Truck & Bus v Victor*, where the innocent party is restored to their position prior to the agreement.

¹³³ M Conaglen “Sham Trusts” (2008) 67 *Cambridge LJ* 176 at 202.

¹³⁴ Para 34. The statement loosely translates as follows: “For these reasons, I come to the conclusion that, in assessing the question of the extent to which the trust assets are to be taken into account in the redistribution order, the query is done on the basis of what is right and fair. Because of this, it is not necessary to decide upon the issue of piercing the ‘corporate veil’”.

The court further remarked: “[e]k is tevrede dat die verweerder hierdie bedrag kan bekostig selfs uit sy persoonlike bates.”¹³⁵ It would be interesting to know whether these trusts still exist today. *Badenhorst* adds to the confusion in this regard, as the court desisted from saying that the trust was invalid.

The last factor which requires attention is, in reality and from a practical standpoint, taking into account the occurrences and interpretation of the doctrines abroad, whether only sham trusts are capable of being pierced.

It is submitted that there are two avenues which could be followed in South Africa based on the research undertaken for this thesis. The first option would be the “strict academic” approach, which is based squarely on the acknowledgment of the “no half way house” rule, as well as the intention behind the stringent sham guidelines outlined in *Snook*. The second approach available is the “intermediate-equity” approach. This approach seeks an equitable remedy, taking into account the individual facts of the case as well as the possibility of relaxing the “no half way house” rule.

4.1 THE STRICT ACADEMIC APPROACH

This strict academic approach makes use of the classic rules contained within the doctrines of the sham and the alter-ego. The foundation for this policy is the observance of the separate legal identity of a trust *inter vivos*, and that only upon the finding of a sham may such trust be pierced. Thus, an alter-ego trust on its own cannot be pierced. This is because, as Robertson J fairly noted in *Wilson*, the uptake of control by someone other than an authorised person cannot be sufficient to extinguish the rights of the beneficiaries under a trust.¹³⁶

¹³⁵ *Ibid.* The statement loosely translates as follows: “I am satisfied that the respondent can afford to pay this amount himself out of his personal assets.”

¹³⁶ Para 70.

If a court is to hold that a trust is the alter-ego of a controller – in other words, if all the bottom boxes are ticked in Figure 5.4 – then in order to pierce the trust, the facts would have to pass through Figure 5.3 (the complete sham enquiry) and the result would need to be an emerging sham. The reason for this condition is that an alter-ego trust is intended to be genuine from the inception of the trust, and therefore piercing is limited to an emerging sham.

Should the result of the sham enquiry be an emerging sham trust, the court would have had to accept evidence which suggested that the controller was assisted by another trustee. This result would thus meet the exacting requirements in *Snook* of a bilateral intention. However, proof in court would be difficult, as counsel would have to persuade the court that the shared intention between the controller and the other trustee was to create a façade. In this instance a façade could be proven if the controller and trustee had chosen to disregard the trust instrument and instead used the trust from that point onwards as an instrument to hide behind when it suited them, and to ignore when it did not. The approach would therefore adhere to the doctrine of the sham, the *Snook* test and the less powerful alter-ego doctrine.

Should the facts and evidence not lend themselves to the inference that an emerging sham was created, the finding of an alter-ego trust should in any case allow for an action against the guilty parties for breach of their fiduciary duties. Following this, a trustee could then be sued personally by a beneficiary or other interested party.

Transactions between innocent third parties and a sham trust are therefore void. The trust too would be void because the trust object would not be lawful, and thus no trust would theoretically have come into existence. The overseas cases favour the view that a sham transaction is “void and unenforceable”¹³⁷ and “wholly invalid and of no effect”.¹³⁸ This view is taken in order to give practical effect to the underlying purpose of the sham doctrine:¹³⁹ to enable the court to “see through” the false façade and “look at the real transaction”. A court

¹³⁷ *Midland Bank plc v Wyatt* [1995] 1 FLR 696 at 707; *Chase Manhattan Equities Ltd v Goodman* [1991] BCLC 897.

¹³⁸ *Rahman v Chase Bank (C.I.)Trust Co. Ltd* [1991] JLR 103 at 168; *Minwalla v Minwalla* [2005] EWHC 2823 (Fam) 60; *Grupo Torras SA v Al-Sabah* [2003] JLR 188 at 552.

¹³⁹ Conaglen 2008 *Cambridge LJ* 203.

would thus have to order the Master to deregister the trust as well as require the trustees of the void trust to notify, cancel and restore all affected third parties. What happens to the trust property thereafter is undecided overseas. Assuming there are assets after creditors have been paid, then logically the trust assets would move back into the settlor's estate (or his or her deceased estate). Should a third party sustain economic loss under these sham conditions, the third party would be entitled to sue the shamming parties. The plaintiff's case would thus be based on Aquilian liability¹⁴⁰ for pure economic loss caused by the breach of a legal duty owed to the contracting third parties to apprise them of true facts.¹⁴¹

The advantages of this approach are that the "no half way house" rule would be upheld along with the classical sham definition laid down in *Snook*. Moreover, this strategy would undoubtedly align the country with the strict modern approach adopted in New Zealand. A firm reason for the adoption of this policy would be that a court should at all times bear in mind that the invalidation of a trust would extinguish the income and capital rights of the beneficiaries. This reasoning explains why foreign courts observe the strictest approach when considering the casting aside of a trust's veil.

4.2 THE INTERMEDIATE-EQUITY APPROACH

This intermediate-equity approach makes use of various aspects of the law of equity together with good common sense. The core idea of this approach is that the law recognises the substance of the situation rather than the form. Importantly, though, this approach should also have its limitations.

The foundation of this strategy is that a court should, in exceptional circumstances, allow for the relaxation of the 'no half way house' rule where necessary. Thus, for example, should a court properly declare a trust to be the alter-ego of a dominant trustee-spouse, the court could, in the interests of fairness and justice, allow for the trust to be pierced without having to declare it a sham.

¹⁴⁰ In delict on the basis of the *actio legis Aquiliae*.

¹⁴¹ This is based on the precedent laid down by Fourie J in *Kantey & Templer (Pty) Ltd and Another v Van Zyl NO 2007 (1) SA 610 (C)*, as it is submitted, is applicable in a sham trust scenario.

Among the various principles of equity applicable to this approach, the propositions “he who seeks equity must do equity” and “delay defeats equity” are highly applicable. Thus, a court would not have the discretion to pierce an alter-ego trust if the person who seeks the piercing is a trustee. As has been elaborately debated earlier in this chapter, such an application is far too late to be considered and, as such, the trustee seeking the piercing of the trust is in breach of his or her own fiduciary duties, because that person would, during the existence of the trust, merely have left matters in the hands of others. A balance should therefore be arrived at.

The proof of a sham by way of the *Snook* test would thus void the trust. Transactions between innocent third parties and a sham trust would also be void. With this approach, however, alter-ego trusts will be considered voidable at the moderate discretion of the court, which should in any case still consider the impact a decision may have on the innocent beneficiaries (if any) of the trust.

5. CONCLUSIONS

General principles are important in any legal system as their application ensures consistency, logicity and predictability. Admittedly, there are varying approaches abroad concerning the policies followed regarding sham and alter-ego enquiries. What we do know, though, is that the majority of countries use the *Snook* test in order to define and identify a sham trust. Unlike South Africa, each country has adopted and adhered to the approach, barring developments which have occurred by way of precedent. In South Africa the lack of a single, clearly defined principle has resulted in a number of overlapping rights, duties and other factors which the courts are to consider. The lack of continuity has undoubtedly led to the widespread confusion concerning these important principles.

In *Parker*, the SCA emphasised the importance of the adherence to basic trust principles in the formation and administration of trusts. It is submitted that the courts, too, should “adhere” to the basic trust principles. In their case, though, observance would require extensive research into the nature and history of the doctrines in order to arrive at a fair strategy which both upholds and respects the underlying characteristics of the doctrines.

At present, it is apparent that the *Parker* case has infused a generic test. Problematically, though, the test has to decide whether or not a trust may be pierced, and not specifically whether or not the trust is a sham. It is respectfully submitted that the decision in *Parker* reveals that the South African Judiciary has mistakenly adopted a test based on whether there is functional separation between control and enjoyment. In *Badenhorst*, another test which has subsequently been used is the “but for” test. Combrinck AJA held in the matter that the appellant was entitled to a half-share in the family trust because the other party controlled the trust and, but for the trust, he would have acquired and owned the assets in his own name.¹⁴² In *Van der Merwe*, the Western Cape High Court elaborated on the precedent in *Parker* and set forth a new test. The assessment which Binns-Ward J formulated in the matter involves the issue of evidence of abuse by the trustees. “[T]he issue in such cases of abuse of the trust form is whether or not it would be conscionable for a court to give credence to a natural person’s disguise of him or herself as a trustee of what is in reality treated by such person as his or her own property.”¹⁴³

The suggested approaches in section 4, above, assimilate the various methods used abroad. These are not the only possibilities available, but are what I would consider the necessary two options. By choosing such an avenue, the assorted notions and arguments enumerated in this chapter must be considered, and such consideration should take into account the precedent that would best fit future interpretation of trust issues in this country. The use of the *Snook* test is, however, mandatory and a sham declaration too will always void a trust. Furthermore, it would be altogether incorrect to use the doctrine of piercing the corporate veil in order to pierce a trust.

The results of this study suggest that New Zealand has interpreted and applied the trust doctrines the most precisely and no fault can be identified in the recent Court of Appeal ruling in *Wilson*. Ironically, though, with the precise understanding comes a purist point of view on the piercing of trusts. Thus, New Zealand is proving that it is possible to follow through with the “strict academic” approach, and for it to operate successfully in a legal system. Such an approach should not be disregarded.

¹⁴² Para 9.

¹⁴³ Para 38.

Notwithstanding South Africa's misdirections in the application of the law pertaining to trusts, it should be clear from this thesis that there is still the potential to salvage this area of the law. A truly mismanaged trust should be dealt with according to trust law and not company law. Moreover, such trust principles should be respected and employed with caution. It is thus submitted that the courts should change the existing approach in order to create certainty, predictability and a more sound trust law in harmony with its very origins.

The legal personality of a company is a matter of substance and not merely a technicality which may be shifted to other areas of the law. Substance must not be cast aside in the name of apparent convenience, and piercing the veneer of a trust imposes a scheme of rights and obligations on the parties that is very different from those upon which they arranged their affairs. Accordingly, when the courts lift the veil, the effect of doing so is substantial and is also potentially damaging to those parties. "But in all cases the expressed intention of the parties prevails until it is shown that there is some other intention which is disguised by the expressed intention."¹⁴⁴

¹⁴⁴ JF Coaker and DT Zeffert *Mercantile Law of South Africa: Wille and Millin* 18 ed (1984) 24.

CHAPTER 6

RECOMMENDATIONS AND CONCLUSIONS

1. INTRODUCTION

“Trusts have now pervaded all fields of social institutions in common-law countries. They are like those extraordinary drugs curing at the same time toothache, sprained ankles, and baldness sold by peddlers on the Paris boulevards; they solve equally well family troubles, business difficulties, religious and charitable problems. What amazes the sceptical civilian is that they do really solve them!”¹

This thesis has set out to study the pierceability of the trust *inter vivos* in South Africa from a legal-comparative perspective. Above I make reference to Pierre Lepaulle’s statement made in 1927. Unbelievably, the essence of a trust has remained unchanged for the best part of a century. The simplicity, practicality and advantages it has over other institutions bode well for the sustainability of the trust. But what has changed is the society in which a trust is now employed. It is undoubtedly necessary for South Africa to keep pace with the modern trends occurring in other common law jurisdictions. Smith and Van der Westhuizen² state that:

“[W]ithin the context of the law of trusts, judicial support for the necessity of progressive development is evident in the case of *Braun v Blann and Botha NNO and Another*:³ it is one of the functions of our law to keep pace with the requirements of changing conditions in our society.”⁴

Regarding trust law, Pace and Van der Westhuizen⁵ also favour legislative reform:

“[T]he substantial increase in the number of trusts in the last decade, and the corresponding increase in their use in commerce, have caused existing legislation to become in need of urgent attention, either

¹ P Lepaulle “Civil Law Substitutes for Trusts” (1927) 36 (8) *Yale LJ* 1126 at 1126.

² BS Smith and WM van der Westhuizen “The need for legislative reform regarding the authorisation of trustees in the South African law of trusts” (2007) 32(1) *JJS* 163 at 171.

³ 1984 (2) SA 850 (A).

⁴ At 866H.

⁵ RP Pace and WM van der Westhuizen “Wills and Trusts”

[http://bwpubs.uovs.ac.za/nxt/gateway.dll?f=templates\\$vid=MyLNB:10.1048/Enu](http://bwpubs.uovs.ac.za/nxt/gateway.dll?f=templates$vid=MyLNB:10.1048/Enu) (accessed 21 February 2010).

because of deficiencies or because technical and time requirements demanded by the modern commercial community and world were not foreseen and, thus, have not been provided for in the Trust Property Control Act.”

The research undertaken in this thesis clearly indicates that the case law in South Africa conflicts not only with itself, but also with that of the rest of the world. Although not all foreign jurisdictions have followed the contemporary use of the trust doctrines as New Zealand has, the courts abroad have maintained judicial certainty by applying the *Snook* test and, for the most part, respecting the separateness of the doctrines of the sham and the alter-ego.

For the above reasons, it is submitted that there is a need for both legislative and judicial reform. In this chapter I argue for certain advancements in the law that would, in my opinion, correct the pitfalls in South African trust law as best as possible. These developments can be implemented through Parliament, the courts, or in a few instances, both.

Over and above the suggestions put forward in this chapter, I also provide many administrative recommendations targeted at trustees, settlors, beneficiaries and people considering setting up trusts. These recommendations are the result of the research carried out for this thesis. I discuss the duties and ethics required of trustees and settlors in order to avoid a sham or alter-ego contention, with specific emphasis on the characteristics of diligence, honesty, integrity, impartiality and knowledge. The intricacies involved in drafting a modern trust instrument are also examined and accompanied by various recommendations surrounding the purpose and object of the document, trustee amendment power and protection clauses.

While the handbook which accompanies this work is a product of the entire thesis, the topics covered in this chapter refer in greater detail to some of the most important issues dealt with in the handbook.

2. RECOMMENDATIONS

2.1 THE TRUST INSTRUMENT

In the light of the recommendations below, one must consider that “a trust only secures absolute certainty when a court proclaims the trust to be valid”.⁶ Thus, the trustees and settlor should take every precaution possible to safeguard their trust against any possible future disputes.

In terms of recommendations, there can be no better starting point than the trust’s constitutive charter.⁷ Reflecting on the words of Cameron JA in *Parker*:

“[I]t is only through the trustees, specified as in the trust instrument, that the trust can act. Who the trustees are, their number, how they are appointed, and under what circumstances they have power to bind the trust estate are matters defined in the trust deed.”⁸

The basic formalities of the trust instrument are covered in Chapter 2; this section, on the other hand, offers a higher degree of insight into how the trust instrument can and cannot be used should the parties to the trust wish to protect their trust from the finding of a sham or an alter-ego.

2.1.1 DRAFTING

2.1.1.1 GENERALLY

The drafter of a trust cannot draft his or her way out of a sham. He or she can, however, help draft their way into one by producing trust documentation which fails to record accurately the

⁶ Mossack Fonseca “Foundation or Trust? A General Overview” www.mossfon.com/trust/institutional_brochure.pdf (accessed 1 June 2010).

⁷ *Land and Agricultural Bank of South Africa v Parker and Others* 2005 (2) SA 77 (SCA) para 10.

⁸ Para 10.

true intention of the settlor.⁹ Thus, the greater the gap between reality and the trust instrument, the greater the possibility of facilitating a sham.

Generally speaking, the provisions of a trust instrument will vary according to the type of trust and the nature of the trust property. The golden rule, however, is to over-formalise the trust instrument. Bearing in mind that, if a trust is declared void, the South African Revenue Service (S.A.R.S.) is entitled to calculate any additional tax owed by the settlor (as the assets would fall back into his or her personal estate), the wording and protection offered in the trust instrument cannot be overlooked.

It should be noted, however, that “over-formalisation” does not imply inflexibility. In fact, a trust instrument should be as flexible as is realistically necessary. There are a number of reasons why trust instruments need to be drafted so that they can be modified to accommodate future changes:

- If a trust is to act as an investment vehicle, it may become too cumbersome and expensive as a result of the requirement that each trustee must sign all banking documents, property transfers, leases, renewals of leases, etc.¹⁰
- Taxation, trust laws and other company laws may change and, in doing so, adversely affect trusts. This will create a need to modify the trust instrument in order to restructure it to best advantage.¹¹
- Changes in relationships will make it desirable for spouses/partners who have separated to cease to be associated with a trust after a settlement has been agreed upon. This will preferably involve the removal of a spouse/partner as a beneficiary, trustee or a person who possesses other administrative entitlements.¹²
- Circumstances could have changed and the provisions of a trust instrument might not adequately provide for these changed circumstances.

⁹ J Kessler “What is (and What is not) a Sham” http://www.kessler.co.uk/dtw/articles/Kessler_What_is_and_what_is_not_a_sham.html (accessed 17 May 2009).

¹⁰ A Grant “Dealing with Property when It is in a Trust” <http://www.anthonygrant.com/trusts/55-dealing-with-property-when-it-is-in-a-trust> (accessed 14 October 2009).

¹¹ *Ibid.*

¹² *Ibid.*

- Any of the conditions dealt with in s 13 of the Act.¹³

For the sake of completeness, it is submitted that the following particulars should always be covered in a trust instrument:

- the name of the trust;
- definitions and interpretation clauses;
- principal objects of the trust;
- power to receive additions;
- power of appointment;
- powers to add and exclude beneficiaries;
- trustee termination, appointment, dispute resolution and sub-minima;
- administrative powers of the trustees;
- extended power of advancement or maintenance;
- indemnity for the trustees out of the trust fund;
- meetings, minutes and accounts;
- duration of the trust;
- registration of the instrument;
- amendment of the instrument, and
- two schedules usually attached to the instrument, the first covering the powers of the trustees and, the second a summary of the initial trust fund.

However, even with a perfectly drafted trust instrument, it would serve little purpose if the parties to the trust did not adhere to its provisions. Selecting trustees is therefore as crucial to the survival of the trust as is the instrument itself.¹⁴

¹³ See the section below for a full record of those factors announced in the Act.

¹⁴ Trustee selection is discussed below.

2.1.2 THE FORMULATION OF A SOUND TRUST INSTRUMENT

A goal throughout this thesis has been to develop a trust instrument which takes into account the various factors which may expose the trust to contention as an alter-ego or a sham. Attached as Appendix A is a family trust instrument drafted to survive sham and alter-ego challenges. The pertinent issues addressed, amongst others, include:

- assurance is given of the separation between control and enjoyment;
- trust administration is complete and adequate;
- a trust bank account is established and used appropriately;
- decision-making is a unanimous process among all trustees;
- a dominant trustee does not emerge;
- a settlor cannot issue instructions to the trustees, nor can he or she act unilaterally;
- assurance of an independent trustee who is actively involved in the decision-making being in office at all times;
- the correct balance of amendment powers is achieved;
- protection clauses are in place, and
- the appropriate trustee duties are spelt out.

Most importantly, however, the trust instrument must reflect the true intention of the settlor. In the interests of trust security this is a fundamental rule which cannot be violated. Consequently, whether a trust is set up to protect a beneficiary against the claims of his or her creditors or to preserve the assets of the family for future generations, such motivation must be declared.¹⁵ Anthony Grant submits that:

“[i]f a trust is to survive claims that it is the alter-ego of a trustee/beneficiary/[settlor] or a sham, it should in substance fulfil the necessary requirements of a trust. This means that it should not be worded in such a way that the settlor has the power to ensure that the assets can be utilised by him/her as a beneficiary in ways which he/she prefers. This means that powers of appointment should preferably be shared with independent trustees; or vested in them alone and that powers to appoint and remove

¹⁵ Note that the former object is not unlawful. See, for example, *Hiddingh's Trustee v Colonial Orphan Chamber and Hiddingh* 1883 (2) SC 273.

trustees and beneficiaries should also be shared with independent trustees or appointers, or vested in them alone.”¹⁶

Over and above all other considerations, it is submitted that in order for any trust to withstand an alter-ego or a sham enquiry, it should be structured and managed so that it is in substance a trust, and is not merely a trust in form.

A current trend is for settlors to diversify their trust into various risk portfolios. Thus, an equity portfolio would fall into a specifically created share trust and business property into a separate property trust. The reason for the diversification is that different assets carry with them different levels of risk. The various types of *inter vivos* trust that can be established include: share, business, property, charitable, trading, investment, family and business property trusts.¹⁷ For the purpose of this thesis, I have chosen to write up a trust instrument.

The generic facts surrounding Appendix A are as follows: Mr Ronald Robin Smith wishes to transfer his family property, holiday house and vehicle into a trust. He is married out of community of property, with accrual, to Mrs Sarah Smith. John and Sarah have two children, Lindsay and David, whom John intends to nominate as capital and income discretionary beneficiaries. John and Sarah also agree to include themselves as discretionary beneficiaries under the trust. John will be the settlor, and will donate an initial R500 to the trust. John has elected Advocate Craig Renoirs as the trust’s independent professional trustee, and wishes to also be a trustee of the family trust. The third and final trustee is Sarah’s sister, Lynda Wynberg, who is not a professional person by title. The object of the trust is to preserve and safeguard the family assets from the couple’s creditors, as well as to minimise any future estate duty.

¹⁶ Grant “Dealing with Property in a Trust”.

¹⁷ To name but a few; this is not an exhaustive list.

2.1.3 SCOPE OF THE AMENDMENT POWER

Section 13 of the Act provides for the amendment of a trust instrument under certain circumstances. Those instances include where the court is of the opinion that the settlor of a trust did not contemplate consequences which (a) hamper the achievement of the objects of the settlor; (b) prejudice the interests of beneficiaries; or (c) are in conflict with the public interest. Discussing public-policy considerations in amendments by court of a trust instrument, Geach and Yeats submit that:

“[t]he provisions of the South African Constitution could have a direct impact on the contents of the provisions of a trust deed and its amendment in terms of section 13 of the ... Act. If a clause of a trust deed is regarded as offending basic principles as set out in the Constitution, this may justify a court making an amendment order in terms of section 13 of the Act. But it is also now clear that if the terms of a deed are illegal, immoral or contrary to public policy, a court does not have to resort to section 13, but can amend a trust deed by striking out the offending clauses in terms of the common law. And it has been held in *Minister of Education v Syfrets Trust Ltd NNO*¹⁸ that what amounts to public policy is to be found in the South African Constitution.”¹⁹

The guidelines are much less certain when it comes to an amendment of an *inter vivos* trust outside the Act:

“To what extent can amendments be made to an *inter vivos* trust without having to make an application in terms of section 13 of the Trust Property Control Act? This raises a number of other questions including: who can propose the making of an amendment? Who can or must first agree to these amendments before they are valid?”²⁰

According to *Hofer and Others v Kevitt NO and Others*,²¹ unless the beneficiaries have accepted the benefit²² stipulated for them in terms of the provisions of the trust instrument, the trust instrument can be varied by agreement between the settlor (if applicable) and the

¹⁸ 2006 (4) SA 205 (C).

¹⁹ WD Geach and J Yeats *Trusts Law and Practice* (2007) 146.

²⁰ Geach and Yeats *Trusts* 149.

²¹ 1998 (1) SA 382 (SCA).

²² The beneficiaries may accept such benefits in writing and addressed to the trustees. Acceptance is automatically assumed if a beneficiary has already received a benefit from the trust.

trustees.²³ The problematic interpretation of *obiter* remarks is highlighted by Geach and Yeats:

“This decision could be interpreted to mean that the founder of an *inter vivos* trust is free to make changes to an *inter vivos* trust at any time by agreement with the trustees. But if the beneficiaries, either vested or discretionary, have accepted the benefits that have or may accrue to them in terms of the trust deed, then ... any variations or amendments thereto can only be made with their approval.”²⁴

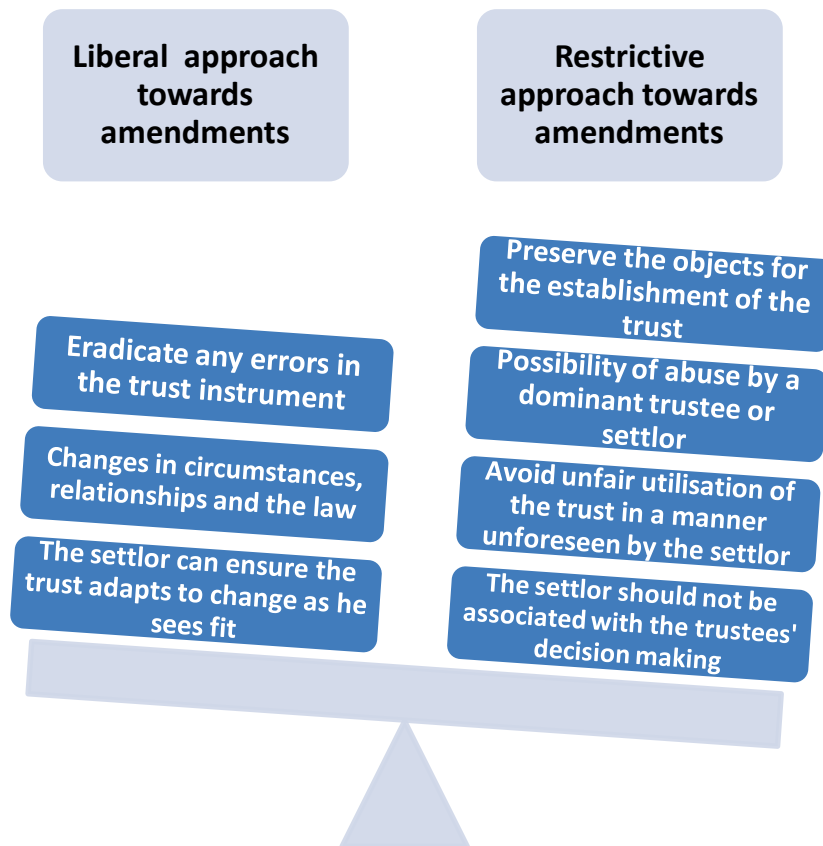
As a result of the common law, if the settlor is still alive, it may be possible for him or her to bypass the beneficiaries and possibly even “bully” the trustees into accepting various amendments to the trust instrument. Moreover, a clause in a trust instrument may allow for a settlor or dominant trustee to pass amendments without the unanimous approval of the trustees. It is submitted that the greater the discretion to be given to a settlor (or dominant trustee), the more carefully the trust instrument must be drafted.

There is therefore a fine balance which needs to be achieved: on the one hand, the trust instrument should recognise that external events or changes may occur, resulting in the need to amend the instrument. On the other hand, the power of amendment needs to be restricted in so much as it is necessary to prevent abuse. See Figure 6.1 below.

²³ Para 10.

²⁴ Geach and Yeats *Trusts* 150.

Figure 6.1 The Considerations of Liberal versus Restrictive Powers to amend Trust Instruments



For the reasons above, it is thus preferable that the modification mechanism does not vest solely with one party who is able to take full benefit of the trust's income and/or assets, but is rather shared with other parties to the trust. A balance between the abovementioned approaches is required, although the effect of the mechanism should lean towards a more restrictive rather than liberal approach regarding trust instrument amendments.

Another important consideration regarding amendments is accommodation for changes in relationships. This is a concern relevant to most *inter vivos* trusts where two of the trustees are related in some way. The most common example would be that of a husband and wife (co-trustee-spouses) who share the power of variation jointly. Should their relationship dissolve, there is a real prospect of a stalemate occurring concerning any future trust decisions. The matter may further be compounded if there is a third trustee and that party sides with either of the trustee-spouses. Although trustee selection is a topic dealt with below,

it is submitted at the outset that trustees sharing any sort of personal relationship should be avoided. Nonetheless, should this not be the case, and the co-trustee-spouses face divorce and redistribution proceedings, trust decisions and amendments must vest in multiple trustees, of whom at least one must be independent. Furthermore, it is submitted that a mechanism must be in place to deal with the “shuffle” that would occur within the trust at the dissolution of the marriage or partnership. Anthony Grant suggests that:

“Where there is a general power of amendment it should be possible to enable a trust deed to be altered so that where the parties separate they can, having resolved their disputes, arrange for the orderly removal from the trust deed of the spouse/partner who is no longer to be associated with the trust.”²⁵

It is therefore important for the amendment clause in a trust instrument to not restrain the trustees from effecting the above shuffle. Moreover, it is submitted from a practical standpoint that a further document will be required.

I have termed this document a “pre-trust post-relationship contract”. The idea behind the agreement is similar to that behind an antenuptial contract, but it deals instead only with matters relating to the trust property and the formalities and administration of the trust, should the two parties end their marriage or partnership. Using this proposed agreement would save both money and time because the former partners would not have to (or be able to) battle for the trust property, proceeds or trusteeship. Furthermore, the agreement may in fact establish that the parties are to ensure the trust remains operative even if their relationship does not. They could then stipulate that both be removed as trustees and be replaced by independent trustees. Simultaneously, the two parties would become vested beneficiaries (if they are not already) with an agreed capital or income distribution as is seen to be fit and fair. It is submitted that such contract is absolutely necessary in the case of family trusts, whether or not the parties are trustees.

²⁵ Grant “Dealing with Property in a Trust”.

In addition, the earlier discoveries in this thesis suggest that an alter-ego clause should also be included in such a contract. The passage in the contract should effectively deny a co-trustee-spouse the opportunity of contending that the trust is the alter-ego of the other trustee-spouse should the ex-partners enter into divorce proceedings. The reason for this agreement is threefold. First, the case law cited in this thesis indicates that the majority of alter-ego claims have their origins in an application for a redistribution order. This is worrying in that it indicates gross abuse of the trust entity because the partners contentedly shield their assets underneath the trust's veil and then, as soon as the relationship breaks down, one of the parties will argue that the trust is the alter-ego of the other and ultimately push the court into piercing the trust. Second, the party alleging the alter-ego is a trustee themselves. As discussed in Chapter 5, by alleging an alter-ego trust, that trustee ironically is in breach of his or her fiduciary duties owed to the trust beneficiaries. Third, it is evident that there has been a mistreatment of alter-ego trusts in South Africa. The confusion between the doctrines of the sham and the alter-ego means that a court may mistakenly void an alter-ego trust.

A contract of this nature would therefore address many of the concerns reflected in this thesis and so, if spouses wish to be co-trustees, the above agreement would definitely smooth things over if the relationship were to end. Should the agreement be respected, the ex-spouses could then replace themselves with independent trustees and apply to the trustees for capital and income distributions which would suit the parties as well as the future of the trust.

A final consideration concerning amendment clauses is the restriction of settlor power. In order to uphold the separation of enjoyment and control, a line so clearly drawn by Cameron JA in *Parker*,²⁶ a settlor should not be given exclusive amendment rights in the trust instrument. Should the settlor wish to maintain a presence around the trust, he or she may be given the right to apply for an amendment, but his or hers should be strictly controlled in the trust instrument, and left to the sole discretion of the trustees to approve or disapprove.

²⁶ Para 23.

In the light of the above considerations, it is submitted that the following amendment clause should be inserted in an *inter vivos* trust instrument:

“Amendment of the trust instrument

1. The trustees may revise or amend this trust instrument provided that such revision or amendment:
 - a. does not constitute any revocation of the trust, and
 - b. does not compromise the purpose and objectives of the trust, and
 - c. is unanimously accepted by the trustees.

2. Should the revision or amendment have the potential to prejudice the rights or interests of any of the existing beneficiaries, the written consent of the beneficiaries whose rights will be prejudiced is required. The beneficiaries herewith referred to in this clause include both vested and discretionary beneficiaries. This provision is not applicable to beneficiaries who:
 - a. have yet to accept (in writing or orally) the benefits that may accrue to them in terms of this trust instrument, and
 - b. have not yet received any benefit in terms of the trust instrument.

3. The trustees may further amend or revise this trust instrument in the event of any legislation necessitating such amendment or revision in order to comply therewith, so long as such amendment or revision complies with subsections 1 and 2 of this clause.

4. Should the settlor wish to amend or revise this trust instrument:
 - a. the settlor should apply to the trustees in writing, setting out the proposed changes and giving reasons for such proposal;
 - b. the trustees must then hold a properly constituted meeting in order to determine the nature of the proposed amendment or revision and assess its merits;
 - c. when making a decision to approve or disapprove such request, the trustees’ decision is subject to the directives, guidelines and rules contained within this clause;

- d. the trustees must inform the beneficiaries and settlor in writing of the decision made and the reasons therefor.
5. No amendment or revision to this trust shall be of any force and effect to the extent that any benefit shall be conferred by such amendment on the settlor or his/her estate, nor shall any variation give the settlor or any trustee the power to appropriate or dispose of any trust property, on his or her or own, as he or she sees fit, for his or her own benefit or for the benefit of his or her estate, whether such power is exercisable by him or her or with his or her consent, and whether such power could be obtained directly or indirectly by the exercise, with or without notice, of power exercisable by him or her or with his or her consent.
6. In the event that any proposed amendment or revision is not unanimously accepted by the trustees, the majority decision will prevail, provided that:
 - a. at least one of the trustees of this trust is an independent professional trustee, and
 - b. the independent professional trustee approves the amendment or revision.
7. This clause does not apply to the powers of addition and exclusion [refer to section dealing with the trustees' powers of addition and exclusion].”

2.1.4 PROTECTION CLAUSES

Overseas there has been a mixed reception regarding the use of protection strategies in trust instruments.²⁷ The basic purpose of such a device is to protect trustees against the residual risks which are inevitable in any trust *inter vivos*. According to Gothard, there are four main types of protection clause.

²⁷ The majority of cases restrict the use of these devices. See further, *Parujan v Atlantic Western Trustees Limited* 2003 JLR N (11).

The first are trustee exemption clauses: “These exempt trustees from liability for specified risk (eg loss to the trust fund resulting from the trustees’ negligence).”²⁸ The basis of this clause is that of the common indemnity clause often found in written contracts. English law still supports the use of these exemption clauses in trust instruments and, notably, *Armitage v Nurse*²⁹ is the leading case in the UK, where the Court of Appeal held that such a clause was effective: “no matter how indolent, [imprudent], lacking in diligence, negligence or wilful [the trustee] may have been, so long as he has not acted dishonestly.”³⁰ Conversely, the Lord Chancellor has argued that “professional trustees” should in future:

“[N]ot be able to rely on a clause exempting them from liability for their own negligence. The ... rationale was that the current law is too deferential to trustees, in particular professional trustees’ as it is not in beneficiaries’ interests for trustees to have the benefit of insurance and sweeping exemption clauses.”³¹

The latter submission is supported in this thesis and it is submitted that trustee exemption clauses should not generally be used in trust instruments. Most importantly, professional trustees and settlors who are trustees (settlor-trustees) should never be covered by these clauses. In this regard, there is assurance that the professional trustee abides by his or her duties and exercises extra caution in the administration of the trust. He or she is likely to charge a much higher fee than ordinary trustees, and is thus expected to deliver the expected diligence in the exercise of his or her responsibilities and ethics. Likewise with settlor-trustees, excluding these persons from the above exemption clause will help to ensure that their unique position is not abused. Particularly in the eyes of the courts, a trust instrument which guarantees that professional trustees execute their duties properly whilst simultaneously limiting the freedom and discretion of a settlor-trustee is, at least on paper, an impermeable arrangement.

²⁸ C Gothard “Trust Administration: A Guide to the New Environment” (2005) *Journal of International Trust and Corporate Planning* 12(3) 177 at 180.

²⁹ [1998] Ch 241.

³⁰ At 251.

³¹ Gothard 2005 *JITCP* 181.

The second trustee protection clause is the duty exclusion clause:

“These exclude or limit specific statutory or common law duties that would otherwise be imposed on trustees. A typical example is the exclusion or limitation of the statutory duty of care ... or so-called ‘anti-Bartlett’ clauses.”³²

It is submitted that such limitation is unwelcome in the modern-day trust instrument as a court may easily conclude that the trust instrument unnecessarily accentuates trustee recklessness and may help a court to infer that the trust was intended to deceive others because the trustees were not obliged to act with care in the interests of the beneficiaries.

The third trustee protection clause is the enlargement of powers clause:

“These confer extended powers on trustees, reducing the possibility of acting *ultra vires*, although the trustees must still act in good faith and in the best interests of beneficiaries, which are irreducible core duties.”³³

It is submitted that the clause may be carefully placed in trust instruments which may require an “above average” vesting of power in the trustees. For example, trustees of an “investment trust”³⁴ may be given the power to appropriate or dispose of property without the approval of the other trustees if such transaction is under a certain value (ie R10 000) and is a transaction in the best interests of the beneficiaries. Such a clause may allow trustees to bypass the time-consuming process of obtaining a quorum in the interests of pursuing a favourable investment, which would have otherwise elapsed. Importantly, this clause must always be subject to a reasonableness criterion.

The fourth protection clause is known as the release and indemnity clause. “These can take a variety of forms, but the most effective ones automatically release an outgoing trustee from

³² *Ibid.*

³³ *Ibid.*

³⁴ “Investment trust” in the South African context refers to a trust entity which exclusively holds equity portfolios as trust property.

specified liabilities and indemnify the trustee of the trust fund in respect of liabilities incurred.”³⁵ Gothard adds: “[t]he usefulness of the indemnity depends on the trust assets, and frequently an outgoing trustee will also seek a separate indemnity from the new trustees and one or more beneficiaries”.³⁶ This clause will most certainly add to the attractiveness of undertaking a role as a trustee, whilst having the flexibility to resign at a later stage without incurring unnecessary liability.

2.1.5 CONTROL THROUGH PROVISIONS IN THE TRUST INSTRUMENT

A trust instrument may be drawn up in such a way that trustees are subject to the wishes and directions of the settlor in execution of their duties. Olivier notes that the result may be that, although the settlor gives up control in form, in substance this is not the case.³⁷ It is submitted that the concern for this arrangement is twofold. First, this was firmly prohibited by Combrinck AJA in *Badenhorst v Badenhorst*,³⁸ where the learned judge noted that to succeed in a claim that trust assets be included in the estate of one of the parties, there needs to be evidence that such party controlled the trust. The judge continued that in this undesirable state of affairs, the trustees would have *de iure* control of the trust while the settlor retains *de facto* control.³⁹ Second, the power retained by the settlor may aid in affirming a sham trust. Pryke accepts this conclusion:

“The reservation of wide powers to the settlor in the trust deed (particularly powers to appoint capital and income and investment powers) will not of themselves be sufficient to give rise to the argument that a trust is a sham. However, obviously the more powers that are reserved to the settlor (or perhaps to third parties who might be under the control of the settlor) the more credibility there will be to a sham argument because of the reduced nature of the trustee’s role.”⁴⁰

It is therefore of the utmost importance that the trust instrument does not contain any clauses which may lend themselves to the conclusion that the settlor has retained a degree of control

³⁵ Gothard 2005 *JITCP* 181–182.

³⁶ *Ibid.*

³⁷ L Olivier "Trusts: Traps and Pitfalls" (2001) 118 *SALJ* 224 at 226–227.

³⁸ 2006 (2) SA 255 (SCA).

³⁹ Para 9.

⁴⁰ S Pryke “Sham Trusts” http://www.walkers.com.ky/pubdocs/Sham_Trusts_S.Pryke.pdf (accessed 8 April 2009).

over the trustees. Moreover, given South Africa's current interpretation of the trust doctrines (and the incorporation of other company law doctrine), mere proof of the settlor's retaining *de facto* control may lead to the lifting of the trust's veil.

Olivier notes certain instances where, from the provisions of the trust instrument, it is clear that the settlor has maintained *de facto* control:⁴¹

- the settlor retains the lifetime power to dismiss and appoint trustees and to vary the provisions of the trust instrument;
- the settlor [in his or her position as settlor] is entitled to a distribution of trust capital or income;
- the trustees must at all times act in the exclusive interest of the settlor, and
- important administrative decisions require the settlor's prior written consent.

Similarly, a settlor-trustee may also retain exclusive *de facto* control by drafting the trust instrument so as to disallow their removal by means of a majority decision made by their co-trustees. Likewise, the trust instrument may be drafted so as to bestow the settlor-trustee with the power to approve and veto trustee decisions. Under such circumstances there is little point in establishing such a trust at the outset, and under the present precedent such a trust would most probably be disregarded in court.

The degree of control required to give rise to a presumption that a separate legal entity has been formed is not yet certain. Certainly, though, the facts of each case have to be analysed to determine whether in substance the trustees were not free to exercise control over the trust assets in the best interests of the beneficiaries.⁴²

⁴¹ Olivier 2001 *SALJ* 227.

⁴² Olivier 2001 *SALJ* 227–228.

2.1.6 BENEFICIARY CONTROL OVER TRUSTEES

An interesting development abroad has reaffirmed the importance of the separation between control and enjoyment. American case law has provided authority for the view that when beneficiaries have control over the trustees, a valid trust will not exist, and that the trustees were in reality the agents of the beneficiaries.⁴³ Olivier asserts that:

“The result is that the beneficiaries are deemed to be partners and may be held personally liable for the debts of the undertaking.... Obviously, the other requirements for a valid partnership, namely that the object must be to make a profit, and that each party has to make a contribution to the undertaking and share in its profits, also have to be present ... the mere fact that the express intention of the parties [was] to form a trust does not stand in the way of a court finding that in substance a partnership was formed.”⁴⁴

In considering the new development, Olivier notes that:

“[I]t may be argued that a similar decision will be reached when the substance over form principle is applied. If in form the trustees have to act independently in the best interests of the beneficiaries, but in substance they are mere puppets in the hands of the beneficiaries, the substance of the agreement may well indicate that a partnership and not a trust was formed.”⁴⁵

Consequently, the separation so often stressed in South Africa is crucial not only in avoiding an alter-ego trust, but also in invalidating the trust. Arguably, the American approach contradicts the doctrine of the sham, because, strictly speaking, only a sham trust may be pierced. If this were the precedent in South Africa, the *dictum* may be taken a step further and one may argue that the majority of the trusts in matrimonial alter-ego cases are also “partnerships” and not trusts in the first place. The American precedent is rejected in this thesis. However, at present most trust disputes in South Africa are adjudicated on the basis of fairness, as opposed to legal theory, so on that basis the outcome of such a case is uncertain.

⁴³ *Simson v Klipstein* 262 Fed 823 (1920); *Priestley v Treasurer & Receiver General* 120 NE 100, 230 Mass 452 (1918); *Kadota Fig Association of Producers v Case-Swayne Co* 73 Cal App 2d 796, 167 P 2d 518 (1946); *Engineering Service Corporation v Longride Development Co* 156 Cal App 2d 583, 320 P 2d 192 (1958).

⁴⁴ Olivier 2001 SALJ 229.

⁴⁵ Olivier 2001 SALJ 228–229.

It is therefore especially recommended that trustees maintain a clear distance from the settlors and their affairs.

2.2 THE SETTLOR

The most simplistic recommendation that is applicable to any settlor is that after the “making over”, they must be prepared to forgo control of the trust assets in favour of the trustees, and the trustees should take a firm stand against interference by the settlor.⁴⁶ This may be tricky when the settlor is also a trustee and even more so if he/she is also a beneficiary. In order to maintain the trust’s standing, this situation should always be avoided. If it cannot – and in many family trust scenarios this is the norm – the use of an independent trustee will be most essential. In this situation, in fact, the majority of trustees should be independent.

The risky scenario above is often thought to be avoided by using a nominee settlor. What often happens then is that an outsider, normally a relative, a lawyer or a trust company, is instructed to settle an initial nominal trust fund. The real settlor then adds a more substantial trust fund and acts as a trustee without being labelled the settlor of the trust. However, the above may in fact have the adverse effect, as Kessler explains:

“It goes without saying that the person who provides trust property directly or indirectly will be the ‘settlor’ for tax purposes and likewise for insolvency and matrimonial law purposes. This style of drafting may have the pernicious result of leading a court to infer an intention to mislead the reader into thinking that the nominee settlor is the only and real settlor. (Though the true and more innocent explanation may be that the parties are seeking confidentiality and mistakenly believe that every trust deed needs a named settlor; or that this is done for no reason whatsoever.) One wonders how often the nominee settlor actually provides the initial trust fund – although fortunately this hardly matters.”⁴⁷

Thus, to avoid any inference that the parties intended to mislead third parties, the true settlor should make the initial settlement. It is submitted that the settlor should then withdraw from all administrative affairs relating to the trust fund, and should not appoint him- or herself as a

⁴⁶ Olivier 2001 *SALJ* 230.

⁴⁷ Kessler “What is (and What is not) a Sham”.

trustee. The appointment of appropriate independent trustees would ensure that the assets are kept safely behind the veil of the trust. The settlor may become a beneficiary and thus still receive the benefits attributed to the trust assets. Importantly, though, the settlor must be accompanied by other co-beneficiaries, because a trust cannot have a sole settlor who is also the sole beneficiary and the sole trustee.

In reality, the above recommendations are directed at persons who are not entirely comfortable with making over their assets into a trust fund. If the trust instrument is sound, independent trustees are appointed and the correct beneficiaries identified (with their corresponding degrees of rights, ie vested or discretionary), one should be comfortable with the arrangement. If one is not, then a trust is quite simply not the correct solution. After all, misadministration would most likely dilute the ability of that trust to meet the purpose for which the trust was established in any case.

Another arrangement which requires attention is the settlor's possible control through a letter of wishes. This letter is normally used to inform trustees how the trust should be administered. It is a document separate from the trust instrument and, strictly speaking, is not legally binding. Thus, trustees have a degree of discretion whether or not to follow the instructions, but often a settlor will have the illegitimate power of substituting trustees through the provisions of the trust instrument, so out of fear, the trustees may follow the wishes of the settlor. Olivier agrees with this postulation, but adds:

“Uncertainty exists whether the mere existence of a letter of wishes results in a founder in substance never intending to give up control of the trust assets. The mere existence of the letter should not in itself be an indication that the formation of the trust was a sham. The facts of each case have to be analysed to determine whether, although in form control of the assets was transferred from the founder, he in substance retained control. If the purpose of the letter is to retain control of the assets and the trustee considered himself bound by it, it may well be incorporated into a trust deed. This may be precisely the effect the founder tried to avoid by not incorporating the contents of the letter in the trust deed, for example, pretending that a vested trust is in effect a discretionary trust.”⁴⁸

⁴⁸ Olivier 2001 *SALJ* 228.

Such circumstance may show an intention to mislead others. Bear in mind that in order to fulfil the bilateral intention in the *Snook* test, a trustee may consciously share the shamming intention of the settlor, or instead neither care about nor dispute the settlor's intentions (thus it is presumed the trustee too shared the shamming intention). It is therefore submitted that for the above reasons, a letter of wishes should be avoided whenever possible. In many instances, however, a letter of wishes is the most practical solution for a settlor who wishes to provide the trustees with guidance as to how the trust should be administered after the death of the default beneficiaries and/or the settlor. With this in mind, should a letter be used, it must be carefully constructed to emphasise that it is in no way binding.⁴⁹

2.3 THE TRUSTEES

“Trusts are not tax-efficient asset-secretive vehicles. To approach them with this in mind not only condemns the client who may in fact have much broader family ideals, it also belittles the protective origins of the trust.”⁵⁰

Arguably, the manner in which trustees conduct their duties and approach the affairs of the trust is one of the most influential aspects affecting the actual protection a trust will ultimately provide. Trustees should not aim to create the “asset-secretive vehicle” mentioned above, but rather an open and transparent entity which invites the views and input of its beneficiaries whilst still maintaining a strict division between control and enjoyment. The achievement of this entity would be a trust in the purest sense, one that is more likely to withstand any disputation against it.

⁴⁹ The letter will normally have the following or similar phrases in it:

Addressed to the trustees ... I would like to clarify that it is not my wish to interfere in any way with your wide powers and discretion as Trustees with the content of this letter.... I also confirm that this not in any way binding on you legally or otherwise.... Nevertheless, I would like for you to know my wishes regarding the exercising of your powers.... [wishes] I would like to repeat that the abovementioned will be an indication about my wishes and a guideline about the employment of the assets.... As Trustees you have wide powers and your discretion is and should be unbounded. I trust that you will exercise your powers in the best interests of the beneficiaries.... Signed the settlor.

⁵⁰ P Bobbin “Beware the Trusty Short Cut”

http://www.argylelawyers.com.au/pdf_files/finsvcs_pub/ap166175.pdf (accessed 17 March 2009).

Below is a discussion of various issues surrounding the use of trustees to safeguard the trust, taking into account the research undertaken for this thesis.

2.3.1 CHOOSING TRUSTEES

Once the decision has been made to establish a trust, choosing the trustees becomes the most important decision the settlor will then make. Moreover, such a decision should also take into account the *obiter* remarks of Cameron JA in *Parker* concerning the independent trustee:

“The debasement of the trust form evidenced in this and other cases, and the consequent breaches of trust this entails, suggest that the Master should in carrying out his statutory functions ensure that an adequate separation of control from enjoyment is maintained in every trust. This can be achieved by insisting on the appointment of an independent outsider as trustee to every trust in which (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another. The independent outsider does not have to be a professional person, such as an attorney or accountant: but someone who with proper realisation of the responsibilities of trusteeship accepts office in order to ensure that the trust functions properly, that the provisions of the trust deed are observed, and that the conduct of trustees who lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the trust deed can be scrutinised and checked. Such an outsider will not accept office without being aware that failure to observe these duties may risk action for breach of trust.”⁵¹

2.3.1.1 SETTLORS AS TRUSTEES

Technically speaking, South African trust laws do allow for those who create a trust to also assume the role of trustee, but this is not advisable. A quick look at the recognised advantages of this arrangement will swiftly highlight the reasons why this risky scenario should be avoided. According to Maxwell, the main advantages of this option are that of control and ease of administration:

“The settlor as trustee is generally free to make whatever decisions they wish without consultation or reference to any other person. Administration is also made easier as there are no independent trustees required to attend meetings and sign documents.”⁵²

⁵¹ *Parker* paras 35–36.

⁵² M Maxwell *Trusts: A Kiwi Sham?* (2007) 45.

Ironically, the benefits emphasise the dangers of this situation, because it will be assumed that the settlor-trustee has operated the trust without respect for the division of control and enjoyment. Perception is therefore the main disadvantage of this arrangement. In the event of the trust's being challenged, it is likely that those making the challenge will work harder to prove that no trust exists.⁵³

In my opinion, someone should establish a trust only if that person is completely comfortable with “making-over” his or her property as well as paying professional trustee fees. If doubt does exist, the potential settlor should rather explore alternative asset management solutions as opposed to making him- or herself a trustee in order to ease his or her reservations.

One of the options below – the independent trustee, either non-professional or professional – is therefore recommended for every trust *inter vivos*. However, should the settlor still wish to be a trustee, all the trustees will have to maintain the very highest standards of administration and record-keeping.⁵⁴

2.3.1.2 INDEPENDENT NON-PROFESSIONAL TRUSTEES

This situation is semantically deceiving because the trustee in this instance will never be considered truly independent. The various types of non-professional trustee who are frequently made use of include friends, family members (who are not beneficiaries), neighbours, colleagues and, in some cases, professionals from other fields.⁵⁵

It is submitted that the use of an independent non-professional trustee is certainly more advantageous for establishing the trust's integrity than the previous settlor-trustee arrangement. That said, however, in reality, “too many non-professional independent trustees

⁵³ *Ibid.*

⁵⁴ *Ibid.*

⁵⁵ *Ibid.*

are used merely to ‘rubber stamp’ decisions for the ‘main trustees’ and this greatly increases the risk of a trust operating under this structure being challenged in the future”.⁵⁶

There are thus a number of reasons why the appointment of this type of trustee should also be avoided. First, it may be argued that the settlor has not actually relinquished ownership and control of the trust property, and is instead relying on the trustees to act as puppets; and, second, there is also the risk that non-professional trustees do not understand their duties fully and may therefore place the trust in danger.

2.3.1.3 INDEPENDENT PROFESSIONAL TRUSTEES

A central theme throughout this thesis has been that enjoyment and control of the trust assets should be functionally separate. It was suggested by Cameron JA in a number of *obiter* remarks that to minimise instances of the abuse of the trust form, the Master should, when registering a trust, insist that there be at least one independent trustee.⁵⁷ According to the learned judge, the duties imposed on trustees, and the standard of care exacted on them, derive from this principle.⁵⁸

Since the judgment in *Parker* there has been much discussion about independent trustees, with many trusts hastily appointing additional trustees and updating their trust instruments in an attempt to conform to the remarks of Cameron JA. The Master’s Office incorporated the suggestions of the SCA in memorandum JM21E, identifying the primary function of the independent trustee as being to ensure adherence to the content of the trust instrument, making sure that no decision made by other trustees is to the detriment of the beneficiaries. Thus, the independent trustee should have the decisive voice in all decisions.⁵⁹

⁵⁶ Maxwell A *Kiwi Sham* 4.

⁵⁷ Para 35.

⁵⁸ Para 22.

⁵⁹ Property Tools “The Role of the Independent Trustee”

http://www.propertytools.co.za/index.php?option=com_content&view=article&id=22:the-role-of-the-independent-trustee&catid=2:articles&Itemid=14 (accessed 30 April 2010).

The thinking behind the implementation of this notion is that the independent trustee should have no reason for concluding or approving a transaction that may prove to be invalid, because first, he or she should be knowledgeable about trust law; and, second, he or she would not have any interest in the trust property or be a beneficiary, and would thus make decisions based on what is correct and in the best interests of all the beneficiaries and the continuation of the trust.

An interesting departure from this train of thought has, however, arisen. In opposition to Cameron JA's view, Kernick queried whether it is correct to lay such emphasis on the separation of enjoyment and control, and to view this separation as the origin of the duties imposed on trustees and the standard of care required of them:

“It seems to me that ... all three are rather manifestations of the fiduciary nature of the institution of trusts, and it is an attempt to ensure the observance of this fiduciary nature that leads to the suggestions that enjoyment and control should be separate, that there are certain duties imposed on trustees and that a particular standard of care is required of them ... The court [in *Parker*] went on to say: ‘And it is separation that serves to secure diligence on the part of the trustee, since a lapse may be visited with action by beneficiaries whose interests conduce to demanding better’. On the contrary, I suggest that it is not the separation as such that secures diligence: Whether he is a beneficiary or not, a trustee’s diligence is secured by his knowledge that an action against him could follow a lapse on his part. And that action could be brought against him not only by a beneficiary, but by any affected party.”⁶⁰

Kernick correctly reasons that separation tends to ensure independence of judgement as it removes conflict of interests and assists impartiality; but so does a trustee’s appreciation of their duties and of the standard of care required of them.⁶¹ Thus, it is not whether a trustee has independence that brings about the separation of enjoyment and control but, rather, it is the observance of their fiduciary duties.

The question therefore arises whether in fact the use of an independent trustee is at all necessary. In New Zealand, case law has established that far more trusts with “independent”

⁶⁰ L Kernick “Declaration of Independence” (2007) *DR* 27 at 28.

⁶¹ Kernick 2007 *DR* 29.

trustees have been set aside as shams than trusts without independent professional trustees.⁶² Whether this is applicable to independent professional trustees is uncertain. Kernick suggests that it would be unwise to burden the Master with the task of identifying what qualifies as an “independent” trustee and of ensuring that there is one in every trust, because the Master’s offices can hardly cope with their present duties.⁶³ Instead, what is suggested is that the Master ensures that the trustees are aware of the seriousness of the duties they have taken on and of the consequences of failing to meet those requirements:

“I suggest, then, that this is where the Master could be of real assistance – not of course, in actually educating trustees himself, but in requiring them to warrant that they have educated themselves. He could therefore refuse to dispense with the provision of security unless each trustee signs, perhaps in affidavit form, an acknowledgment that he is aware of his duties, which could be briefly detailed in the document, together with a quotation of s 9 of the Trust Property Control Act 57 of 1988, also acknowledging that he could be exposing himself to civil and criminal action. If such a form were to replace the present rather bland acceptance of trust form, it might go a long way towards preventing all trustees from shirking their duty or trying to escape the consequences of their dereliction of duty or, perhaps, even from accepting appointment in the first place.”⁶⁴

Taking into account the dissimilar viewpoints, it is submitted that a combination of the two solutions would best fit the current trust laws in South Africa. Thus, the Trust Property Control Act should be amended to ensure independent trustees are used in all *inter vivos* trusts as well as to amend the acceptance of trust form.

In terms of the need for legislative reform, it is submitted that the problems identified above could be alleviated by adequate legislative provisions.

⁶² R Holmes “Sham Trusts and Sham Transactions” <http://www.rossholmes.co.nz/article.php?id=112> (accessed 14 May 2009).

⁶³ Kernick 2007 DR 32.

⁶⁴ Kernick 2007 DR 31. In *Parker*, the court appeared to agree with this conclusion, before the words were lost in the remainder of the judgment. The court noted (at para 36) that a trustee should be someone “with proper realization of the responsibilities of trusteeship ... being aware that failure to observe these duties may risk action for breach of trust”.

Consequently, the amendment submitted below should ensure certainty regarding the necessity of the independent trustee and their duties:

“The Independent Trustee

1. All *inter vivos* trusts, to which this act applies, are to have at least one independent professional trustee in office at all times.
2. Except where the Master authorises otherwise, *inter vivos* trusts which are already in operation are to take reasonable measures to adhere promptly to this provision.
3. If the office of the independent professional trustee cannot be filled or becomes vacant, the Master shall, after consultation with the interested parties, appoint a person who meets the required standards as the trust’s independent professional trustee.
4. Remuneration of the independent professional trustee is to be decided upon and recorded in writing prior to the Master’s issuing authorisation of the independent professional trustee.
5. Trustees are required to amend their trust instruments so as to accommodate this provision.
6. The rights and duties of the independent professional trustee must in no way be diluted, and should at the least be equal to that of the remaining trustees.”

The above amendment must be accompanied by the inclusion in s 1 of the Act of a definition of “independent professional trustee”. The following description serves as a guideline:

“1. Definitions

‘independent professional trustee’ means a normal trustee for all transactions and decisions made by the trustees, but who is a professional chartered accountant, admitted attorney or

legal advocate. This trustee must have no relation or connection, blood or other, to any of the existing or proposed trustees, beneficiaries, settlor or nominee settlor of the trust.”

The final recommendation is for the Master to insist that all trustees, both present and future, warrant in affidavit form that they have educated themselves regarding trustee rights and duties and have accepted the provisions contained in the Act. If a trustee is to waive this responsibility, the Master should have the discretion (and does so in terms of s 6 of the Act) to require the trustee to furnish security.

2.3.2 TRUSTEE ETHICS AND DUTIES

“It is now also clear from recent legal judgments that one of the key requirements for a valid trust is that there must be a separation of beneficial ownership from control. The trustees are required to administer the assets under their control for the benefit of the beneficiaries of the trust. Often, however, the sole trustees of a trust are also the beneficiaries of that trust. In a recent Appellate Division judgment, it was clearly stated that such trusts ‘invite abuses’. And abuses will not be tolerated by the courts.”⁶⁵

A basic, yet highly fundamental responsibility all trustees must adhere to is honesty. In order to minimise the room for an alter-ego or a sham allegation to succeed, all trustees are to act truthfully in all matters concerning the trust. This means that trustees should always treat the trust as it should be treated, and as it always should have been treated.⁶⁶ This ethical duty is what ensures a separation of power, because an honest trustee would not be inclined to conflate enjoyment and control.⁶⁷ It is submitted that even without employing an independent professional trustee, the line between control and ownership is more likely to be observed if the trustees are selected on the basis of their honesty and integrity, in addition to their knowledge of trust affairs.

⁶⁵ Market Views “You may be Disappointed to discover that Your Trust is not a Trust” http://www.sharenet.co.za/marketviews/article/34/You_May_Be_Disappointed_To_Discover_That_Your_Trust_Is_Not_A_Trust (accessed 2 March 2010).

⁶⁶ P Bobbin “Alter-Ego Trust Failure” http://www.argylelawyers.com.au/pdf_files/fin_dit_pub/AP143058.pdf (accessed 9 April 2009).

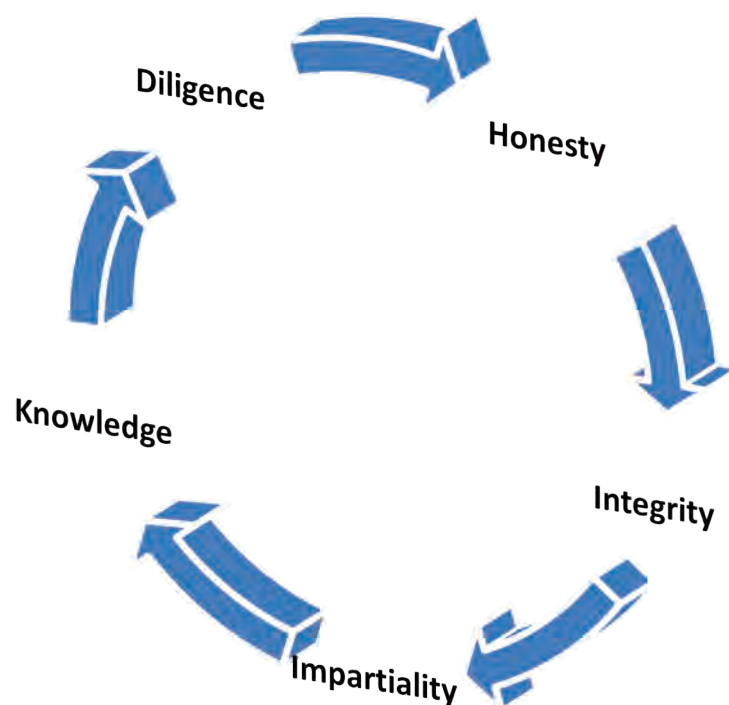
⁶⁷ This is the converse of Cameron JA’s views in *Parker*, where the learned judge reasoned (at para 22) that it is the “separation of powers that serves to secure diligence on the part of the trustee”.

A diligent and honest trustee would also observe impartiality. This fiduciary duty, as pointed out by du Toit,⁶⁸ comprises of two elements:

“On the one hand a trustee must avoid a conflict of interest between his personal concerns and his official duties. An important manifestation of this rule is that a trustee is not permitted to derive unauthorised profit from the administration of a trust ... The second aspect to the duty of impartiality relates to a trustee’s obligation to treat beneficiaries impartially, particularly when trust income and/or capital is distributed.”⁶⁹

Figure 6.2 depicts the most crucial characteristics that constitute the ideal trustee. Importantly, all five elements are required to be present, or else the “chain” breaks. When the chain is broken, the other elements will fall away, because each element relies on the other. Thus, even if the remaining four components are present, the absence of one means that the others could place the trustee's position in jeopardy.

Figure 6.2 The Components that form the “Perfect” Trustee and their Rooted Relationship to One Another



⁶⁸ This duty is covered in greater detail in chapter 2.

⁶⁹ F du Toit *South African Trust Law: Principles & Practice* 2 ed (2007) 71–72.

Besides the ethical considerations that have been key to this discussion, there are a number of statutory and common law trustee duties which need to be emphasised for the purposes of setting out practical recommendations.

Under the common law, trustees have a duty to keep proper records concerning the administration of the trust. This duty is more commonly referred to as the “duty to account”, and is important in defending an alter-ego argument as evidence can then be provided that the trust was properly managed.⁷⁰ At the very least, trustees are required to keep the following records:⁷¹

- trust instruments;
- agreements for sale and purchase of trust assets;
- deeds of acknowledgment of debt;
- deeds of forgiveness of debt;
- trust minutes (in minute book);
- trustee resolutions;
- the trust’s financial accounts;
- beneficiary details;
- the trust’s tax records;
- copies of independent advice given to the trustees, and
- general correspondence.

Trustees should also ensure that all original documents are placed in safe custody.⁷² Realistically, financial records have become one of the most important pieces of evidence against a sham or an alter-ego argument, and trustees must keep track of all income received by, distributions from, and expenditures made by the trust. To further strengthen the banking and financial records, trustees must record which trustees authorised each transaction and, if applicable, under which resolution it was decided. All of the above will, however, serve little purpose if the trustees do not fulfil their statutory duty to open a separate trust bank account.

⁷⁰ Pryke “Sham Trusts”.

⁷¹ Maxwell *A Kiwi Sham?* 53–54.

⁷² Maxwell *A Kiwi Sham?* 54.

The Act provides that whenever a person receives money in his or her capacity as a trustee, he or she shall deposit it in a separate trust account at a banking institution or building society.⁷³ Cameron *et al* noted that the Act does not stipulate whether the account must be in the trustee's own name or in the name of the trust, but in practice, banks and building societies permit accounts to be opened in the name of a trust or in the name of the trustees for the time being of the trust.⁷⁴ It is submitted that it is preferable to open the account in the name of the trust for two important reasons: first, the trustees may change over time and the account would then become ineffective and invalid; and, second, having the account in the trust's own name will help avoid any unnecessary inferences that such trustee had exercised dominance over the other trustees.

Foreign and local case law suggests that the abovementioned responsibilities and duties are those which are most overlooked or ignored by trustees (and settlors) who are party to a sham or an alter-ego trust. Those obligations should always be adhered to by any trustee. There are, of course, many other fiduciary responsibilities which must be observed by trustees, but those set out above are the most critical. The remainder of the trustee duties are set out in the handbook attached to this thesis.

2.4 DISCLOSURE OF INFORMATION

There seems to be much uncertainty in South Africa on the topic of the disclosure of trust information. Interestingly, the same is evident overseas. In Canada, for instance, the basis for the trustees' obligations to provide information has been expressed in two ways:

“On the one hand, it has been put on the proprietary basis that beneficiaries are entitled to inspect trust documents and obtain other information about the trust because they have a proprietary interest in such documents and information corresponding to their interest in the trust property. On the other hand, it has been put more generally on the basis that trustees are administering property for the benefit of

⁷³ Section 10 of the Trust Property Control Act. Applied in *Tijmstra NO v Blunt-Mackenzie NO* 2002 (1) SA 459 (T).

⁷⁴ E Cameron *et al Honoré's South African Law of Trusts* 5 ed (2002) 306.

others and as such are required to provide information and account for their dealings with the trust property.”⁷⁵

Thus, according to Youdan, whichever one of the above is correct will be relevant in the determination of who is entitled to obtain trust information, since the first basis (the proprietary basis) would not allow discretionary beneficiaries access to such information.⁷⁶ The question was, however, answered in a string of judgments, the most recent being *Schmidt v Rosewood Trust Ltd.*⁷⁷ The Privy Council in this matter overturned the Ontario decision of *Re Ballard Estate*,⁷⁸ which favoured the non-proprietary basis for the obligation to provide trust information. Thus, the law as it stands in Canada is that access by beneficiaries to information relating to the trust lies within the discretion of the court and it does not depend on any proprietary entitlement.⁷⁹ There is therefore no direct obligation for trustees to disclose information to the beneficiaries. Should the trustees deny a beneficiary information requested, a court with the appropriate jurisdiction would decide on the matter in terms of the Act and the Promotion of Access to Information Act.⁸⁰

In both Australia and the UK, the disclosure of information is qualified by three rules. In Australia s 52 of the Trusts Act⁸¹ deals directly with this matter and states that:

“Trustees are under a duty to keep and render to the beneficiaries a full and candid record of their stewardship, including all appropriate financial accounts. They may employ accountants to assist in the keeping of proper accounts and can seek reimbursement for such expenses incurred in fulfilling this duty.”

⁷⁵ TG Youdan “Family Trusts” <http://www.dwpv.com/images/Paper - Family Trusts Timothy Youdan.pdf> (accessed 20 March 2010).

⁷⁶ *Ibid.*

⁷⁷ [2003] 2 AC 709.

⁷⁸ (1994) 20 OR (3d) 350 (Ont Gen Div).

⁷⁹ Youdan “Family Trusts”.

⁸⁰ Act 2 of 2000. Hereafter referred to as the “PAIA Act”.

⁸¹ Act of 1973.

Thus, beneficiaries have a *prima facie* right of access to trust documents and information, but this rule does not extend to strangers.⁸² Mahoney J supported this view in *Hartigan Nominees (Pty) Ltd v Rydge*,⁸³ where the learned judge commented:

“In general a trustee is not obliged to volunteer documents or information to beneficiaries or possible beneficiaries. However, if a beneficiary requests it, a trustee is in general obliged to provide documents and information to the beneficiary, at his cost, in relation to the trust property, and to provide an accounting in respect of the administration of it.”⁸⁴

There are three main qualifications to this principle. First, trustees are not bound to disclose reasons for the exercise of their discretion because a trustee’s exercise of a discretionary power cannot be challenged in the absence of *mala fides*.⁸⁵ The requirement would also add to trustees’ already onerous obligations.⁸⁶ The second qualification is that there is no entitlement to documents which are not trust documents. Thus the beneficiaries’ right to inspect documents is limited to trust documents only, and documents such as trustee correspondence is plainly off limits.⁸⁷ The third qualification is secrecy provisions. This limitation holds that:

“[B]eneficiaries’ rights to access information may be regulated by the trust instrument. Thus beneficiaries do not have access to documents which are expressed to be confidential, especially where such documents may relate to the exercise of the trustees’ discretions.”⁸⁸

Similarly, in the UK it was held that trustees who exercise discretionary powers need not disclose why they have exercised their discretion in a particular way.⁸⁹ In the matter of *Re Londonderry’s Settlement*⁹⁰ the English Court of Appeal held that beneficiaries were not entitled to inspect documents if those documents concerned the reasons for the exercise of the

⁸² T Cockburn “Trustee Duties: Disclosure of Information” (2008) 12 *Murdoch University Electronic Journal of Law* 1 at 2.

⁸³ (1992) 29 NSWLR 405.

⁸⁴ At 431.

⁸⁵ Cockburn 2008 *MUEJL* 4.

⁸⁶ *Ibid.*

⁸⁷ Cockburn 2008 *MUEJL* 5.

⁸⁸ *Tierney v King* [1983] 2 Qd R 580.

⁸⁹ *Re Beloved Wilke’s Charity* (1851) 3 Mac & D 440.

⁹⁰ [1965] Ch 918.

trustees' discretion. In Australia and the UK all courts have treated a settlor's letter of wishes as confidential and out of the reach of anyone to whom the letter is not directly addressed.⁹¹

Thus the trend overseas is that trust instruments, annual financial statements and possibly even resolutions should all be made available to both vested and discretionary beneficiaries, should they request them. Any document which does not form part of either would thus not be accessible. In South Africa, s 18 of the Act allows for persons (subject to the Administration of Deceased Estates Act⁹²) with "sufficient interest" to gain copies of documents pertaining to testamentary trusts from the Master. There is, however, no such provision for *inter vivos* trusts. Geach and Yeats state that "every beneficiary, whether that beneficiary has a vested or discretionary right, has a right to information concerning trust matters, including access to information regarding the manner in which trust assets have been invested and distributed."⁹³ This particularly bold statement is, however, not complemented by any evidence in support of it. However, it is believed that this statement was made in the light of the decision in *Doyle v Board of Executors*.⁹⁴ In this case a beneficiary argued that the accounts presented to him were insufficient. Importantly, the court held that the trustee was bound, in the discharge of the duties of trustee, to demonstrate to the beneficiary that what he had received was the correct product of the initial capital, properly administered.⁹⁵ Geach and Yeats comment on the impact of this decision as follows:

"The *Doyle* decision makes it clear that a trustee occupies a fiduciary office. By virtue of that alone, a trustee owes the utmost good faith towards all beneficiaries, whether actual or potential. And so while it is clearly a duty of a trustee to account to a beneficiary when requested to do so, it may be good practice to be proactive and to communicate with beneficiaries on a regular basis."⁹⁶

It is respectfully submitted that the interpretation of *Doyle* and a beneficiary's right to information by Geach and Yeats may be a stretch too far, especially in the light of the bestowal of such drastic powers to discretionary beneficiaries. However, there may be

⁹¹ See, for example, *Re Rabiaotti's Settlements* [2000] WTLR 953.

⁹² Act 66 of 1965.

⁹³ Geach and Yeats *Trusts* 123.

⁹⁴ 1999 (2) SA 805 (C).

⁹⁵ At 815G.

⁹⁶ Geach and Yeats *Trusts* 93–94.

legislation which indirectly supports this view. The PAIA Act, which was enacted to give effect to the constitutional right of access to information held by the State, applies horizontally to any information held by another person or private body when that information is required for the exercise or protection of any rights,⁹⁷ and has as a result turned the principles of informational and document access upside down. Cameron *et al* reasons that the PAIA Act:

“clearly covers the Master with whom trust instruments are lodged, since it applies to all recorded information held in any form by any department of state or administration or any other functionary when exercising a public power or performing a public function in terms of any legislation.⁹⁸ That is, however, as far as the PAIA Act may be applicable in the above deliberation.”⁹⁹

It is submitted that the consequence of the PAIA Act is that s 18 of the Act applies to both testamentary and *inter vivos* trusts. Thus, where information is held by the Master, beneficiaries may circumvent the trustees and, upon written request and payment of the prescribed fee, receive a certified copy of the document, should the beneficiaries prove to the Master that they have “sufficient interest” in such document. Conversely, where information is held by the trustees, and disclosure to the beneficiaries (or other third parties) has been refused, such party would have to rely on the inherent supervisory jurisdiction the courts have over trustees and persuade a court of competent jurisdiction to order the information to be handed down to the interested party. Importantly, documents such as trust instruments, financial statements and accounts should never be refused to a beneficiary because a trust should maintain some level of transparency for the purposes of sustaining its legal validity.

Furthermore, in view of the above, it is suggested that it would be ideal to include in the trust instrument an indication of the agreed level of information that can be made available. Such provision could therefore detail the policies to be followed by trustees regarding the gathering and provision of information.

⁹⁷ Cameron *et al* *Honoré’s South African Law of Trusts* 265–266.

⁹⁸ Cameron *et al* *Honoré’s South African Law of Trusts* 266. Sections 50–73 of the PAIA Act.

⁹⁹ *Ibid.*

2.5 LEGAL TECHNICALITIES

2.5.1 REDEFINING SHAM AND ALTER-EGO TRUSTS IN SOUTH AFRICA

Case law over the last decade has steered South African trust law off the steady path which other foreign law jurisdictions have begun to follow. Undoubtedly, the *Parker, Badenhorst*, and *Van der Merwe* cases are likely to be only the tip of the iceberg of what is to come, if South Africa is to maintain its current direction. Above all else, the conflation of the doctrines of the sham and the alter-ego, the unnecessary importation of the doctrine of piercing the corporate veil, and a general lack of legal certainty surrounding trust law have dictated what could possibly see the end of the *inter vivos* trust as we know it today. Notwithstanding the above concerns, it is clear from this work that there is still the potential to salvage this area of the law. A truly mismanaged trust should be dealt with according to trust law and not company law. It is thus submitted that the courts should change the existing approach in order to create certainty, predictability and a more sound trust law, in harmony with its very origins. The legal personality of a company is a matter of substance and not merely a technicality that may be shifted to other areas of the law. It is submitted that an appropriate amendment to the Trust Property Control Act coupled with a positive and knowledgeable response by the courts will help South Africa to correct the unwanted and unwarranted differences in its trust law.

The first concern which evidently needs addressing is an accurate clarification of the doctrines of the sham and the alter-ego. In this regard, a court could set out a clear description detailing the intrinsic workings of the doctrines, their effect on and application to trust law in South Africa and even a possible test to identify and/or distinguish between the two. Importantly, these significant details need to be ascertained with reference to the *Snook* test, as well as taking into account the recent developments in New Zealand, Australia and the UK. Thus, the examination to be undertaken should follow the same approach as pursued in this thesis.

Without such judicial intervention, it is unlikely that those critical areas of trust law will ever recover. Alternatively, if Parliament were to intervene, the Legislature may be able to publish

an appendix to the Act in the guise of a schedule. Such a “code of good practice” could address the following objectives:

- to identify and define the nature of the doctrines of the sham (including an emerging sham) and the alter-ego;
- to address the applicability of those doctrines in South Africa;
- to provide very broad guidelines for identifying sham and alter-ego trusts, and how to differentiate between the two;
- to prohibit the use of the doctrine of piercing the corporate veil;
- to override any prior legal precedents developed prior to the amendment which may distort the operation of the amendment, and
- to define what impact a finding of a sham or an alter-ego would have on the validity of the trust in issue.

It is submitted that should either of the approaches described above be used, the end result should be a law of trusts that is firmer, more certain and in line with the ethics and values of the South African Constitution. The research undertaken towards this thesis, along with the conclusions reached in Chapter 5, would undoubtedly assist the Legislature and/or Judiciary in reaching the above desired goals. To name but a few, issues such as the rights of beneficiaries, the interrelationship of the doctrines, the compatibility of the corporate law doctrine, and the global tendencies pertaining to sham and alter-ego trusts could be of great assistance. Figure 5.3 “The Complete Sham Enquiry” and Figure 5.4 “The Elements of an Alter-ego Trust” (both in Chapter 5) should both prove useful in creating the appropriate legislative or judicial guidelines.

2.5.2 RATIFICATION

The necessity for statutory intervention is not limited only to the problems discussed above. Outside the scope of alter-ego and sham trusts, there is an important additional matter which should also be attended to for the sake of legal certainty.

Surprisingly, there has been a somewhat mixed reaction to the question of the validity of an act performed prior to the authorisation of a trustee. In *Simplex (Pty) Ltd v Van der Merwe and Others NNO*¹⁰⁰ Goldblatt J held that written authorisation was, by virtue of the Act's¹⁰¹ peremptory nature, a precondition for a trustee's right to act as such.¹⁰² Any action performed prior to authorisation was therefore to be regarded as null and void, and, as a result, incapable of ratification.¹⁰³ Importantly, and for the sake of legal certainty, this approach was sustained in a number of cases¹⁰⁴ subsequent to *Simplex*. However, in *Kropman v Nysschen*¹⁰⁵ MacArthur J held that anything done prior to authorisation was unauthorised, but that such unauthorised acts were capable of ratification at the discretion of the court.¹⁰⁶ The courts are thus faced with a dilemma, and de Waal explains that a choice would have to be made between the two approaches.¹⁰⁷ Smith and Van der Westhuizen argue for the legislative intervention of this matter, simply because no clear choice has been made. Importantly, though, distinction must be made between a contract made by a trustee and one made by an agent in order to determine the validity thereof.¹⁰⁸ It is submitted that Smith and Van der Westhuizen's proposed legislative insertion to the Act would alleviate the above dilemma. The legislative "prototype" suggested would seek to cover instances in which the person has professed to act as a trustee for a trust but is in fact precluded from binding the trust for one of the following reasons: (1) the person has not obtained the requisite authorisation in terms of s 6(1) of the Act; or (2) there was a deficiency in the number of trustees in office as required by the trust instrument or other law.¹⁰⁹ According to Smith and Van der Westhuizen's model, should one of the above scenarios occur, then the contract in question may be ratified, on condition that the additional trustee or trustees are duly authorised and the ratification is consented to in writing by all of the trustees.¹¹⁰

¹⁰⁰ 1996 (1) SA 111 (W).

¹⁰¹ In particular ss 6(1), which states that: "Any person whose appointment as trustee in terms of a trust instrument, section 7 or a court order comes into force after the commencement of this Act, shall act in that capacity only if authorized thereto in writing by the Master."

¹⁰² At 112H-I.

¹⁰³ At 113E-114I. Smith 2007 *JJS* 165.

¹⁰⁴ See, for example, *Van der Merwe v Van der Merwe* 2000 (2) SA 519 (C); *Kriel v Terblanche NO en Andere* 2002 (6) SA 132 (NC); and *Watt v Sea Plant Products Bpk and Others* 1998 (4) All SA 109 (C).

¹⁰⁵ 1999 (2) SA 567 (T).

¹⁰⁶ At 576D-F.

¹⁰⁷ MJ de Waal "Authorisation of Trustees in Terms of the Trust Property Control Act" (2000) 63 *THRHR* 472 at 476.

¹⁰⁸ Smith and Van der Westhuizen 2007 *JJS* 174.

¹⁰⁹ Smith and Van der Westhuizen 2007 *JJS* 183.

¹¹⁰ *Ibid.*

Moreover, the above adjustment would also put to rest the debate as to the applicability of the doctrine of constructive notice¹¹¹ and the *Turquand* Rule,¹¹² as both are therefore rendered ineffectual – a position which should be adopted by the courts even without the proposed amendment.

3. CONCLUSIONS

The main objective of this research was to study, analyse and explain the use, nature and applicability of the doctrines of the sham and the alter-ego in South Africa. Subsidiary to this purpose, this thesis undertook to assess the extent of the problems faced in South African trust law, as well as to provide realistic recommendations in order to alleviate any undue developments in the law as well as to offer practical administrative recommendations which would ensure that a trust retains its protection. To achieve the above objectives, it was necessary to trace the development of the law of trusts through to the latest of the applicable cases in South Africa and then to make informed comparisons with trust law tendencies abroad. Most notably, foreign law precedent relevant to the doctrines of the sham and the alter-ego were contrasted with the South African interpretation of those doctrines in order to ascertain key quantifiable differences. All the issues were studied from a legal-comparative perspective.

As for sham trusts and the corresponding doctrine, the study revealed an overwhelming propensity abroad to follow Diplock LJ's restrictive view of the term "sham" which had emerged in the early matter of *Snook v London and West Riding Investments Ltd.*¹¹³ Although originally conceived and applied in a hire-purchase agreement dispute, the words of his

¹¹¹ "The doctrine implies that an individual or juristic entity that deals with a company is presumed to be informed of any internal formalities or constraints prescribed by the company's public documents, mainly the constitution, relating to the transaction and the authority of the person representing the company in the transaction. The individual or juristic entity is thus prohibited from denying the knowledge of the formalities or constraints." Legal City "Mitigation of the Doctrine of Constructive Notice by the Turquand Rule" <http://www.legalcity.net/Index.cfm?fuseaction=MAGAZINE.article&ArticleID=3548133> (accessed 20 April 2010).

¹¹² "The rule implies that a third party contracting with a company in good faith is entitled to 'assume that the internal requirements and procedures of the company have been complied with'. In those circumstances the company will be bound by the contract even though all its internal affairs may not have been properly ordered" - D Kouvelakis "S 228 and the Turquand Rule"

<http://www.routledges.co.za/publications/article/commercial/2005/3/189> (accessed 20 April 2010).

¹¹³ [1967] 2 QB 786.

lordship soon resonated into other areas of the law, including its very own place in English trust law. The *Snook* test, as it was to become known, dictated that there be a joint common intention between the settlor and at least one trustee other than the settlor him- or herself to present the declared trusts to a third party as genuine, when in reality, the trust was nothing more than a false front. In this study it was confirmed that the restrictive approach to a determination of a sham was, in the light of the interests of innocent beneficiaries, the correct approach for trust law. It is of interest that research conducted in this study¹¹⁴ of cases in the UK, Jersey, Australia and New Zealand revealed that there is an inverse relationship between the number of courts using the *Snook* test and the number of trusts pierced. This finding reflects positively on the test because the nature of the trust institution and the inherent protection it offers to its beneficiaries demand that the courts be constrained in their ability and discretion to pierce trusts.

Another reason the test is useful – and most probably the reason it has become so widely accepted – is the need for clear and definite parameters. Between 2000 and 2010 South African trust law cases patently revealed what could happen without such guidelines. In *Badenhorst v Badenhorst*¹¹⁵ the court *a quo* held that, unless the trust is found to be a sham, the court was not at liberty to pierce it. This strict interpretation of the law was, however, ignored on appeal, and the SCA lifted the veil of the trust on the basis that the respondent controlled the trust and, but for the trust, would have acquired and owned the assets in his own name.¹¹⁶

Worryingly, similar to many cases preceding *Badenhorst*, the trust was pierced without any reference to *Snook*. In fact, there has not been a single reported case in South Africa where either the meaning or the use of a sham has been explicitly defined. There is therefore an urgent need for legislative or judicial intervention to clarify this potentially damaging uncertainty.

¹¹⁴ Depicted in Figure 4.1 “Frequency of the *Snook* Test Utilisation and the Correlation to the Frequency of Trusts Pierced”, Chapter 4.

¹¹⁵ 2005 (2) SA 253 (C).

¹¹⁶ Para 9.

The *Parker* case also caused quite a stir. Probably the most widely discussed trust law case in decades, the SCA made it clear that the courts would have to be much stricter in their insistence that trustees adhere to their legal duties. In fact, Cameron JA argued in *Parker* that where trustees and/or the settlor acts in breach of the duties imposed by the trust instrument, it may provide evidence to assist the court in determining that the trust form was a veneer that should be pierced.¹¹⁷

In the matter of *Van der Merwe*, the Western Cape High Court added to the jurisprudence on trust veil-lifting when Binns-Ward J agreed with Cameron JA's *ratio decidendi* in *Parker* and further held that the case before the court was an appropriate example for the court to exercise its discretion and disregard the veneer of the trust form.¹¹⁸

As a result of these cases, the view on sham trusts in South Africa has become uncertain. Additionally, a perturbing effect of the uncertainties has emerged – being the collapse of the understanding of alter-ego trusts in and the distinct difference between sham and alter-ego trusts. Correctly applied, an alter-ego allegation is a question of *de facto* control. Importantly, various cases in South Africa have emphasised this, and *Brunette v Brunette and Another*¹¹⁹ immediately springs to mind. But South African courts have not attributed the common foreign legal consequence to a finding of an alter-ego. In this respect it has been repeatedly established throughout this thesis that while a sham allegation may form an independent cause of action, the alter-ego argument does not. Thus, in *Badenhorst*, for instance, whereas the facts of the case may have led to the conclusion that the trust was the alter-ego of Mr Badenhorst, that does not automatically allow a court to lift the veil of the trust. As noted above in Chapter 5, a decision needs to be made by a competent court with the necessary authority as to which direction should be followed, the most probable options being the “strict academic approach” or the “intermediate-equity approach”.

¹¹⁷ Para 37.3.

¹¹⁸ Para 41.

¹¹⁹ 2009 (5) SA 81 (SE).

Apart from the legal reservations examined throughout this thesis, there are measures which can be undertaken by parties to a trust in order to ensure that their trust avoids court scrutiny. Thus, over and above the legal theory discussed, this chapter has also sought to provide practical advice regarding many aspects applicable to trustees and settlors. The foremost advice offered is in respect of the drafting of the trust instrument. It should be evident by now that this document forms the foundation of the trust, and should cover all the objectives discussed in section 2.1.2 of this chapter. The scope of the amendment power remains important, and the conclusion reached was that a balance needs to be found between a liberal and a restrictive amendment policy, but should lean more towards restrictive. The submitted provision for amending the trust instrument in section 2.1.3 should be considered, if one were to achieve that result.

It was also found that protection clauses are worthy of consideration when drafting the trust instrument. However, as a recommendation, a trust instrument should not exempt settlor-trustees and professional trustees from liability. In addition, it was concluded that duty exclusion clauses were unwelcome because they may accommodate trustee recklessness. What was found to be useful was the enlargement of power clause, when applicable, as well as the release and indemnity clause. Astute application of these features will undoubtedly certify a higher level of trust assurance.

Most notably, the separation of control and enjoyment has been a message continually emphasised by the courts in South Africa.¹²⁰ This approach has not been disputed in this thesis, because the trust *inter vivos* requires the distinction to be made between those who administer the trust and those who benefit from it. However, the American view that beneficiary control may lead to the inference of a partnership is unequivocally rejected. That said, beneficiary control should never occur; it is submitted that such a situation should rather be dealt with according to the doctrine of the alter-ego.

¹²⁰ In *Parker*, for instance, Cameron JA reasoned (at para 22) that the enjoyment and control of the trust assets should be functionally separated.

It has also been established that in theory a settlor should play a very limited role in the trust. In fact, after making over the trust property, he or she should have no further involvement in the administration of the trust. Practically, however, this is normally far from the actual reality of the trust's affairs. Often the settlor is a trustee, and under such circumstances should be vigilant not to dominate the other trustees. The keeping of accurate minutes and other records cannot be over-emphasised in this scenario, and should reflect shared decision-making. Moreover, deadlocks must be resolved through a decisive casting vote of the trust's independent trustee, and never by the settlor-trustee. In addition, this chapter reached two very important conclusions: first, that nominee trustees must be avoided and, second, that a letter of wishes should be used only when absolutely necessary.

Trustees and their actions have arguably formed the cornerstone of this thesis and in this regard I support Cameron JA's views in *Parker*, and in particular the importance of the point that a trust should always have at least one professional trustee in office at all times. Where I depart from the learned judge's views is on how that should be implemented. An important element such as this should not be open to choice, or even debate, and thus it is recommended that this requirement be legislated.

Legislation has, however, settled the next topic in this chapter – the disclosure of information. It was recommended that policies for trust information disclosure be written into the trust instrument in order to avoid disputes in the future. The policy should always be to allow a beneficiary access to the financial statements and the trust instrument in order to uphold the bare minimum suggested transparency.

The final conclusions reached in this thesis drew on the prevailing doubt which prompted the researching and writing of this thesis. South Africa is in desperate need of a legislative or judicial clarification of the doctrines of the sham and the alter-ego. The research undertaken towards this thesis clearly illustrates the inaccuracies and concomitant uncertainties faced in South Africa's trust law. The entanglement, it is submitted, is remediable, and clear definitions of the doctrines complemented by guidelines similar to those set out herein would

undoubtedly cure many of the misdirections. Moreover, the suggested options would also allow for an outcome much less drastic in comparison to the devastation often caused when the veneer of the trust is pierced.

It is apparent that at present, the law of trusts in South Africa is shadowing the movements of the country's company laws, especially in relation to the rules pertaining to veil-lifting. It is submitted, as the title of this thesis suggests, that there are real and apparent dangers associated with translocating the doctrine of piercing the veil into trust law. The trust law doctrines have proven to work well overseas.

“Few areas of activity have emerged unscathed from the recent worldwide turmoil in the banking system and the consequent weakness in financial markets. Consumer confidence around the world has been battered and the valuation of family assets has been under pressure. All these factors might well deter people from setting up trusts. In reality, the indications are that trusts are still widely seen as a useful way to plan for the long-term future. Generally, the evidence suggest that trusts continue to grow in popularity.”¹²¹

Trusts are here to stay, and it is the duty of the Courts and the Legislature to meet current trends and ensure ongoing development.

¹²¹ Society of Trust and Estate Practitioners “Trusts Explained” www.step.org/PDF/Trusts_Explained.pdf (accessed 10 March 2010).

APPENDIX A

‘THE SMITH FAMILY TRUST’

DEED OF TRUST

Between

MR RONALD ROBIN SMITH

("the founder")

And

ADV CRAIG RENOIRS

MR RONALD ROBIN SMITH

MRS LYNDA WYNBERG

("the trustees")

AND the said appearers declared that WHEREAS:

1. The founders are desirous of creating a trust for the purpose of carrying out the objects hereinafter described;
2. the founders have agreed to donate a sum of money to the said trust, subject to the conditions set out hereunder;
3. the trustees have agreed to accept their appointment as trustees, subject to the said conditions.

IT IS HEREBY AGREED THAT: The founders undertake to donate irrevocably to the trustees, and immediately following the signature hereof, for the objects hereinafter described an amount of R500 (FIVE HUNDRED RAND), subject to the following terms and conditions

(Addendum A):

ADDENDUM A: TERMS AND CONDITIONS

1. DEFINITIONS

In this Trust Deed unless the contrary appears from the context the following expressions shall have the following meanings:

- 1.1** Words importing the singular shall include the plural and vice versa and words relating to any gender shall include the other gender and vice versa.
- 1.2** Where figures are referred to in numerals and in words, if there is a conflict between the two, the words shall prevail.
- 1.3** When any number of days is prescribed in this Trust Deed, same shall be reckoned exclusively of the first and inclusively of the last day, unless the last day falls on a Saturday, Sunday or public holiday, in which case the last day shall be the next succeeding day which is not a Saturday, Sunday or public holiday as prescribed in the Public Holidays Act.
- 1.4** The “trustees” refers to the incumbent of the office of trustee and includes not only the persons who signed this Deed as trustees but also any persons succeeding or assumed by them as trustees according to the provisions of the Deed.
- 1.5** “Independent Trustee” otherwise referred to as “Independent Professional Trustee” means a normal trustee for all transactions and decisions made by the trustees, but who is a professional chartered accountant, admitted attorney or a legal advocate. This trustee must have no relation or connection, blood or other, other than on a professional level, to any of the existing or proposed trustees, beneficiaries, founder or nominee founder of the trust.

- 1.6** The “beneficiaries” mean the persons to whom the trust income and capital will be distributed as selected by the trustees in their discretion from among the members of the class consisting of those persons listed per Addendum B.
- 1.7** “the assets”, “the trust assets”, “the Trust”, “the capital”, “the trust capital” and the “Smith Family Trust” shall be interchangeable and shall mean and include:
- 1.7.1** All assets and investments as described in Clause 8 hereunder, at any time or times hereafter ceded or transferred to and accepted by the trustees by way of addition or accretion to the assets hereby settled, whether by the founder or by any other person or entity in terms of Clause 9 hereof, and either *inter vivos* or by last will.
- 1.8** “Net Income” means the income and/or loss derived from the trust property from time to time, as determined by the trustees in their discretion, after the deduction of all costs and expenses of the administration of the trust and as provided for this Deed, including, trustees’ remuneration, such taxation as may be payable in respect of the income of the trust and such other expenditure as the trustees may in their discretion elect to charge against income.
- 1.9** “The balance of the trust property” means the trust property, (or the balance thereof after use of capital as herein elsewhere provided), and income in the hands of the trustees after deduction therefrom of all unpaid costs, expenses and liabilities of, incidental to, and arising in the course of the administration of the Trust, including trustees’ remuneration, distribution fees in respect of capital distributions and taxation payable in respect of capital distributions and taxation payable in respect of the income of the Trust.
- 1.10** “Distribution” means the payment or delivery to a beneficiary, of net income or any part of the capital of the trust property but shall not include a loan by the trust to a beneficiary. The word “distribute” has a corresponding meaning.

1.11 “Maintenance” used in relation to a person means without derogating from generality of the concept of maintenance, his travels, medical, dental and similar treatment and advice, self actualisation, self development, reasonable pleasures, taxes, general upkeep, welfare and benefit, marriage and education (including higher education), the acquisition or provision of residential facilities or a residence for him, setting him up in a business or a profession or fitting him for a career and funding the promotion of his talents, skills and interests.

1.12 “Person” means a natural person, juristic person, non natural person or trust.

1.13 “Quorum” means a minimum of fifty percent (50%) of trustees in attendance, should there be four or more trustees in office and authorised by the Master. Should there be less than four trustees in office, there should be a minimum of two trustees to constitute a “quorum”, provided that the Independent Trustee is amongst those two trustees. Should there only be one trustee in office, Clause 11 applies.

1.14 The captions to the Clauses of this Deed and the Index are provided for convenience and shall be disregarded for the purpose of the interpretation of this Deed.

1.15 “Lawful issue” means legitimate child.

2. DESCRIPTION OF TRUST ASSETS

The assets of the trust shall consist of the following:

2.1 The aforesaid amount of R500 (FIVE HUNDRED RAND);

2.2 such further donations, grants or bequests to or in favour of the trust as may be made from time to time; as well as

2.3 such further assets or investments as the trustees may acquire for the trust including any income not immediately required for the purpose of the trust and which may be capitalised by the trustees in terms hereof.

3. SETTLEMENT

3.1 The founder has irrevocably settled on the trustees as the initial subject matter, and the trust has taken effect from the date when the Donation constituting this trust was given by the founder.

3.2 The trustees shall have the right at any time and from time to time to change the name of the trust by unanimous agreement.

3.3 The trust shall be known as the **SMITH FAMILY TRUST**.

4. OBJECT OF THE TRUST

4.1 The principal objectives of the trust are that the trustees:

4.1.1 preserve the Trust Fund; and

4.1.2 maintain the Trust Fund; and

4.1.3 enhance the Trust Fund in terms of clause 5 *infra*; and

4.1.4 in their absolute and sole discretion distribute or pay any income, expenses, capital gains, accrued, realised or unrealised gains of the Trust; and

4.1.5 pay distribute or authorise the use of any asset, movable or immovable, whether corporeal comprising the Trust Fund;

For the well-being of any beneficiary, subject to the provisions of this Trust Deed.

5. PURPOSE OF THE TRUST

Save for the fiduciary, administrative, and operational functions of the trustees, it is the duty of the trustees to carry out and conduct the following principal operations and functions on behalf of the Trust, so as to facilitate and achieve the objectives of the Trust:

- 5.1** to invest and employ the Trust Fund, income or capital gains in the broadest sense;
- 5.2** to ensure that the Trust Fund is, as far as is practically possible, rendered economically productive;
- 5.3** to acquire and assert any rights, including rights in movable and immovable property, corporeal and incorporeal assets, for investment, speculative, rental, holding or any other purpose as the trustees in their discretion may determine;
- 5.4** to specifically acquire any immovable property, of any nature whatsoever, and without limiting the generality of the aforesaid, to acquire property of a residential, agricultural, commercial or industrial nature, with or without any improvements to such immovable property;
- 5.5** to develop, hold, gear, re-finance, restructure, mortgage, re-mortgage, encumber and to conduct and execute any and all transactions and agreements relating to any property or any rights in any property so acquired;
- 5.6** to carry on and conduct the business of realtors, estate agents, letting and rent collection agents, property investors, brokers, valuers and developers; further to purchase and/or lease specialised properties for any purpose whatsoever and howsoever they in their discretion deem fit to further the objectives of the Trust.
- 5.7** The trustees are hereby empowered to exercise the powers afforded to them in terms of this Deed to utilise and apply the trust property to any other objective whatsoever.

6. TRUST FUND TO VEST IN TRUSTEES

6.1 Upon the founder having sold, ceded, transferred or selling, ceding or transferring any assets, investments or other property to the trustees, the founder shall be excluded from any right, title and interest therein and the control thereof and all right, title and interest therein, including every right of negotiation, shall vest in the trustees in their fiduciary capacities, subject to the under mentioned terms, provisions, conditions and trustee instructions.

6.2 Howsoever or wherever the capital, income, profits, trust property and/or assets, or capital profits of the trust may be held or registered, they shall be held for the trust and at no time shall the trustees be deemed to acquire for themselves or on their personal account any contingent and/or vested right or interest in the capital, capital profits, income and/or assets of the trust save insofar as the trustee may be a beneficiary of the Trust.

6.3 The trustees undertake:

6.3.1 to indicate clearly in their bookkeeping that the trust property or any capital profits, capital gains, income or profits of the trust is held by them in their capacities as trustees;

6.3.2 if applicable, to register trust property or keep the trust property registered in such a manner to make it clear from the registration that it is a trust asset;

6.3.3 to make any account or investment at a financial institution identifiable as a trust account or trust investment;

6.3.4 in respect of any other trust asset to make such asset clearly identifiable as a trust asset; and

6.3.5 to open a separate trust account at a banking institution or building society and to deposit all money which they may receive in their capacity as trustees therein.

7. THE INDEPENDENT TRUSTEE

It is the intention of the founder that the trust be administered autonomously by the board of trustees and that the board of trustees should at all times function independently and impartially from the instructions and will of the beneficiaries. To this end and to ensure that at all times this intention be upheld *de facto* and *de jure*, the trustees shall undertake that the following provisions be met:

7.1 that at all times during the existence of the trust there shall be an Independent Trustee;

7.2 in the event that an Independent Trustee ceases to be a trustee for any reason whatsoever, the then remaining trustees shall endeavour to appoint another Independent Trustee to the board of trustees;

7.3 The Independent Trustee shall meet all the following criteria and the criteria set out in Clause 1.5, and such trustee particularly:

7.3.1 shall be an “at arm’s length” third party person not connected or related to the founder or any beneficiary; and

7.3.2 shall preferably have the requisite operational, legal, accounting, tax and administrative skills to ensure that the appointed person be properly positioned to carry out the function of an Independent Trustee.

8. TRUST PROPERTY

The Trust Fund shall include:

8.1 the settlement referred to in Clause 3 above;

8.2 any other monies, property or assets which the trustees, in their capacity as such, may acquire by donation, inheritance, purchase, investment, re-investment, loan, exchange or otherwise, as well as

8.3 the undistributed, accumulated or capitalised income, profits or capital profits or gains of the trust as at the end of each financial year of the Trust

9. POWER TO RECEIVE ADDITIONS

The trustees are hereby empowered to accept and acquire for the purpose of the trust gifts, bequests, grants or payments from any person (including the founders or either of them), organisation, state, firm or company that may be given, bequeathed or paid to them as an addition or with the intention to add to the Trust Fund hereby constituted and whether any such addition consists of stocks, shares, moneys, movable or immovable tangible or intangible property, and any addition so accepted and acquired shall be deemed to form part of the Trust Fund and shall be administered and dealt with subject to the terms of this deed of trust. Any additions to the Trust Fund so received by the trustees may be retained by the trustees in the form in which they are received and such retention shall be sufficient compliance with the power to invest herein contained.

10. THE TRUSTEES

10.1 There shall at all times be not less than two trustees in office. The first trustees signing this annexure hereby accept their appointment.

10.2 If at any time there are fewer than two trustees in office, the remaining trustee shall during such time act only to fill the vacancy in such office.

10.3 Subject to Clauses 10.2 above and 10.4 below, any vacancy in the office of trustee shall be filled from time to time by such person as shall be nominated by the trustees remaining in office.

10.4 On the written acceptance of his appointment as a trustee, a succeeding trustee shall be vested with all the powers and subject to all the duties of a trustee, as if he had been one of the first trustees.

10.5 The trustees in office from time to time shall at all times have the right to nominate and appoint such additional trustee or trustees as they may decide, provided that their decision to do so shall be unanimous.

10.6 A trustee need not be a South African citizen or be resident in or domicile in South Africa or be incorporated as a legal person in South Africa.

10.7 The Independent Trustee shall, unless otherwise agreed upon between the trustees, be the administrative trustee who shall be entitled to charge fees for services rendered to the trust as administrative trustee.

10.8 No trustee shall have the power, on his own, to appropriate or dispose of any trust property, as he sees fit, for his own benefit or for the benefit of his estate (this does not apply if such disposition were for the benefit of this Trust Fund). In the event of the board of trustees consisting of only two trustees, then a distribution of capital to any trustee who is a beneficiary shall be made only if approved by the trustees unanimously. This clause does not prevent the trustees from being remunerated in terms of Clause 22.

11. ALTERNATE TRUSTEES

11.1 A trustee shall be entitled to appoint another person (approved by the other trustees in writing) to act as his alternate during his temporary absence or temporary unavailability to act as trustee. An alternate trustee, while so acting, shall have all the duties, functions and powers of the trustee he represents.

11.2 In the event of all serving trustees being so absent or incapable of performing their duties, they are entitled by mutual power of attorney to nominate another person or persons to temporarily act in their place and to act as trustees of the Trust.

11.3 There shall always be not less than two (2) trustees. If no provision has been made for the appointment of a new trustee/s so that, but for this clause there would be insufficient trustees of this Trust, then the remaining trustee/s shall

appoint a trustee/s to fill any vacancies and if there are no trustees at any time, the beneficiary/ies (duly assisted by their guardians where applicable), shall appoint a trustee/s to fill any vacancies.

11.4A written resolution signed by all trustees for the time being, or their respective alternates, shall be as effective as a resolution taken at a meeting of trustees.

12. VACATION OF OFFICE BY TRUSTEE

12.1 The office of any trustee shall be vacated if such trustee:

12.1.1 resigns (which he shall be entitled to do) after giving written notice to the Master of the High Court and the trustees for the time being of the Trust;
or

12.1.2 dies; or

12.1.3 becomes of unsound mind or incapable of managing his affairs, or for any other reason becomes incapable of acting as a trustee or unfit so to act; or

12.1.4 becomes insolvent or is placed under a sequestration order or assigns his estate for the benefit of his creditors, or compounds or attempts to compound or effects or attempts to effect any compromise with said creditors; or

12.1.5 is removed from office by Order of Court.

13. AMENDMENT OF THE TRUST DEED

13.1 The trustees may revise or amend this trust instrument provided that such revision or amendment:

13.1.1 does not constitute any revocation of the trust, and

13.1.2 does not compromise the purpose and objectives of the trust, and

13.1.3 is unanimously accepted by the trustees.

13.2 Should the revision or amendment have the potential to prejudice the rights or interests of any of the existing beneficiaries, the written consent of the beneficiaries whose rights will be prejudiced is required. The beneficiaries herewith referred to in this clause include both vested and discretionary beneficiaries. This provision is not applicable to beneficiaries who:

13.2.1 have yet to accept (in writing or orally) the benefits that may accrue to them in terms of this trust instrument, and

13.2.2 have not yet received any benefit in terms of the trust instrument.

13.3 The trustees may further amend or revise this trust instrument in the event of any legislation necessitating such amendment or revision in order to comply therewith, so long as such amendment or revision complies with subsections 1 and 2 of this clause.

13.4 Should the founder wish to amend or revise this trust instrument:

13.4.1 the founder should apply to the trustees in writing, setting out the proposed changes and giving reasons for such proposal;

13.4.2 the trustees must then hold a properly constituted meeting in order to determine the nature of the proposed amendment or revision and assess its merits;

13.4.3 when making a decision to approve or disapprove such request, the trustees' decision is subject to the directives, guidelines and rules contained within this clause;

13.4.4 the trustees must inform the beneficiaries and founder in writing of the decision made and the reasons therefor.

13.5 No amendment or revision to this trust shall be of any force and effect to the extent that any benefit shall be conferred by such amendment on the founder or his/her estate, nor shall any variation give the founder or any trustee the power to appropriate or dispose of any trust property, on his or her or own, as he or she sees fit, for his or her own benefit or for the benefit of his or her estate, whether such power is exercisable by him or her or with his or her consent, and whether such power could be obtained directly or indirectly by the exercise, with or without notice, of power exercisable by him or her or with his or her consent.

13.6 In the event that any proposed amendment or revision is not unanimously accepted by the trustees, the majority decision will prevail, provided that:

13.6.1 at least one of the trustees of this trust is an Independent Trustee, and

13.6.2 the Independent Trustee approves the amendment or revision.

This clause does not apply to the powers of addition and exclusion. See Clause 14, below.

14. TRUSTEES POWER OF ADDITION AND EXCLUSION OF BENEFICIARIES

14.1 The trustees are hereby empowered in terms of the Trust Deed to add and/or exclude beneficiaries to and from this Trust, on condition that:

14.1.1 The decision is made by means of a written resolution; and

14.1.2 has been decided upon in a meeting which constitutes a 'quorum' as defined in Clause 1.13; and

14.1.3 does not have the effect of leaving this trust without any beneficiaries; and

14.1.4 is made by unanimous agreement.

14.2 Such addition or exclusion will not amount to an amendment of the Trust Deed, despite the consequential necessity to update Addendum A of the Trust Deed.

15. POWER OF THE TRUSTEES

Subject to Clause 13, the trustees are hereby empowered in terms of the Trust Deed to deal with the trust property, capital and/or income and or capital profits or gains of the trust for the benefit and purposes of the Trust, in their discretion, including and without prejudice to the generality of the foregoing, the following specific powers and authorities:

15.1to open and operate any banking account or facility and/or building society account or facility, apply for any credit or debit cards and to draw and issue cheques and to receive cheques, deposits, promissory notes and/or bills of exchange, and attend to any of the latter by electronic, telephonic or internet means;

15.2to acquire, dispose of, invest in, let or hire, exchange, and/or barter movable, immovable or incorporeal property and to sign and execute all requisite documents and to do all things necessary for the purposes of effecting and registering, if needs be, the transfer according to law of any such property. In exercising any powers of sale, whether conferred in this sub-clause or otherwise, they shall be entitled to cause such sale to be effected by public auction or by private treaty and in such manner and on such terms and conditions as they in their sole and absolute discretion may deem fit and in exercising any powers of lease they shall be entitled to cause any property to be let at such rental, for such period and on such terms and conditions as they, in their sole and absolute discretion, may deem fit;

15.3to invest in shares, stocks, debentures, debenture stock, unit trusts, warrants, options, bonds, gilts, securities, promissory notes, bills of exchange and other negotiable instruments. In the event of a company or a unit trust scheme prohibiting, in terms of its articles or regulations, the transfer of shares or units

into the name of the trust as such, the shares or units shall be registered in their personal names or in the names of their representatives and shall be held as nominees on behalf of the Trust;

15.4to retain and allow the trust property or any part or parts thereof to remain in the present state of investment thereof for so long as they think fit;

15.5to lend money on such terms and at such interest and with or without security to beneficiaries as the trustees may determine;

15.6to dispose of and otherwise vary any trust investment;

15.7in their sole and absolute discretion, to borrow money for the purposes of discharging any liability of the trust and/or for the purpose of paying income tax and/or for the purpose of making payment of capital and/or income, and or capital profits or gains to any beneficiary and/or for the purpose of making a loan to any beneficiary and/or for the purpose of making an investment and/or for the purposes of preserving any asset or investment of the trust and/or for the purposes of conducting any type of business or in order to provide any type of services on behalf of the trust and/or any other purpose deemed necessary or desirable by the trustees, at such time or times, at such rate of interest or other consideration for any such loan and upon such terms and conditions as they may deem desirable. Such borrowings may be made from any suitable person or persons and, should they consider it advisable to do so, the trustees may secure the payment of any such loan by pledging or mortgaging the trust property or any part thereof or by any other security device. Any such loan or loans may be extended, renewed or repaid from time to time as the trustees may deem to be in the best interest of the Trust;

15.8to obtain and utilise in the name of the Trust, membership in and any credit facilities from any agricultural or other society and for this purpose to encumber the trust property or any part thereof by way of pledge, hypothec or mortgage as security;

- 15.9** to make donations for charitable, ecclesiastical, educational or other like purposes either from the income, capital profits or gains or the capital of the Trust;
- 15.10** to mortgage, pledge, hypothecate or otherwise encumber any property, asset, income or capital, or capital profits or gains forming part of the trust property and to execute any act or deed relating to alienation, partition, exchange, transfer, mortgage, hypothecation or otherwise, in any deeds registry, mining titles office or other public office dealing with servitudes, usufructs, limited interests or otherwise; and to make any applications, grant consents, and agree to or cause affect of any amendments, variations, cancellations, cessions, releases, reductions, substitutions or otherwise generally relating to any deed, bond, or document for any purpose and generally to do or cause to be done any act whatsoever in any such office;
- 15.11** to appear before the Registrar of Deeds, Registrar of Claims, conveyancer or other proper officer and to execute any Mortgage Bond or Deed of Hypothecation as security for loans of money or as security for any other indebtedness or obligation contracted on the Trust's behalf;
- 15.12** to appear before any Notary Public and to execute any Notarial Deed;
- 15.13** To collect rent, cancel leases, and to evict a lessee from property belonging to the Trust;
- 15.14** to improve, alter, repair and maintain any movable and immovable property of the trust and further to improve and develop immovable property by erecting buildings thereon or otherwise, to expend the capital or income or capital profits of the trust upon the preservation, maintenance and upkeep of such property or buildings, to demolish such buildings or effect such improvements thereto as they may consider fit;
- 15.15** to sue for, recover and receive all debts or sums of money, goods, effects and things, which are due, owing, payable or belong to the Trust, or to enter into any

legal action, whether by way of summons action, application or any other form, in any forum, for any claim or benefit or rights of the Trust;

15.16 to allow time for the payment of debts due to them and grant credit in respect of the whole or any part of the purchase price arising on the sale of any assets constituting portion of the trust property, in either case with or without security and with or without interest, as they may think fit;

15.17 to institute or defend, oppose, compromise or submit to arbitration all accounts, debts, claims, demands, disputes, legal proceedings and matters which may subsist or arise between the trust and any person;

15.18 to attend all meetings of creditors of any person indebted to the trust whether in sequestration, liquidation, judicial management or otherwise, and to vote for the election of a trustee and/or liquidator and/or judicial manager and to vote on all questions submitted to any such meetings of creditors and generally to exercise all rights of or afforded to a creditor;

15.19 to exercise the voting power attached to any share, stock, stock debenture, interest, unit or any company in which the share, stock, stock debenture, security, interest or unit is held, in such manner as they may deem fit, and to take such steps or enter into such agreements with other persons as they may deem fit, for the purposes of amalgamation, merger of or compromise in any company in which the shares, stock, debenture, interest, or unit are held;

15.20 to subscribe to the memorandum and articles of association of and apply for shares in any company and to apply for the registration of any company;

15.21 to determine whether any surplus on the realisation of any asset or the receipt of any dividends, distribution or bonus or capitalisation shares by the trust be regarded as income or capital of the Trust;

15.22 to appoint or cause to be appointed or to remove any one or more of themselves or their nominees as directors or officers of any company whose share form

portion of the trust property, with the right to receive and retain remuneration for their services as directors and other officers;

15.23 to consent to any re-organisation, arrangement or reconstruction of any company, the securities of which form, from time to time, the whole or any part of the trust property and to consent to any reduction of capital or other dealings with such securities as they may consider advantageous or desirable;

15.24 to exercise and take up and realise any rights of conversion or subscription attaching, or appertaining to any share, stock, interest, debenture or unit forming part of the trust property;

15.25 to guarantee the obligations of any person, to enter into indemnities and to bind the trust as surety for, and/or co-principal debtor *in solidum* with any person and/or company in respect of any debt or obligation of that person and/or company, whether for consideration or gratuitously on such terms as they consider fit, including the renunciation of the benefits of excussion and division. The trustees shall be entitled in respect of any obligations or liabilities so assumed by them to pledge, mortgage, cede in security or otherwise encumber all or any of the trust property in such manner and subject to such terms and conditions as they shall deem fit as collateral for such obligations;

15.26 to give receipt, releases or other effectual discharges for any sum of money or thing recovered or received;

15.27 to engage the services of professional practitioners, agents, independent contractors and tradesmen for the performance of work and rendering of services necessary or incidental to the affairs or property of the Trust;

15.28 to enter into any partnership, joint venture, conduct of business or other association with any other person, firm, company or trust for the doing or performance of any transaction or series of transactions within the powers of the trustees in terms hereof, and/or to acquire and/or hold any assets in co-ownership or partnership with any person;

15.29 to determine whether any sums disbursed are on account of capital or income or capital profits or gains or partly on account of one and partly on account of the others and in what proportions, and the decision of the trustees, whether made in writing or implied from their acts, shall be conclusive and binding upon all the beneficiaries;

15.30 to effect an assurance policy on the life of the founder, a trustee and/or a beneficiary, to effect a short term insurance policy, or to take cession of such policy and to pay the premiums for such policy out of the income, capital profits or gains or capital of the Trust. To continue any such policy and/or to surrender, redeem, dispose of, encumber and borrow against any such policy, with the right generally to deal with any such policy as they in their discretion deem fit. If during the currency of the trust a person so assured should die while the assurance policy on his life is still in operation, the proceeds of such policy shall form part of the trust property;

15.31 to contract on behalf of the trust and to ratify, adopt or reject contracts made on behalf or for the benefit of the Trust;

15.32 to employ and pay out of the trust any other person or other persons to do any act or acts, although the trustees or any of them could have done any such act or acts;

15.33 to conduct or carry on any business or to provide any type of services on behalf of and for the benefit of the Trust, and to employ the trust property and income or any capital profit or gain, in the conduct of any such business;

15.34 to hold the whole or any part of the trust property in the name of the Trust, or in their names, or in the names of any other persons nominated by them for that purpose;

15.35 in the event of the trustees obtaining the necessary authority, to incorporate any company, or establish a trust in any place in the world at the expense of the trust with limited or unlimited liability for the purpose of inter alia, acquiring the

whole or any part of the assets of the Trust. The consideration on the sale of the assets of the Trust, or any part thereof, to any company incorporated pursuant to this sub-clause, may consist of wholly or partly paid debentures or debenture stock or other securities of the company, and may be credited as fully paid and may be allotted to or otherwise vested in the trustees and be capital monies in the hands of the trustees;

15.36 in the event of the trustees obtaining the necessary authority, to hold the trust property or any part thereof in or to transfer the administration and management of the trust property or any part thereof to any country in the world;

15.37 to pay out of the income, capital profits or, at their discretion, out of the capital or the trust property all rates, taxes, duties and other impositions lawfully levied or imposed on the trust property or income or capital profits or gains of the trust or any part thereof or on any beneficiary hereunder on account of his interest in the trust hereby created or which may be imposed on the trustees in respect of matters arising out of the Trust;

15.38 to pay out of the income, capital profits or out of the trust property all and/or any expenses (including legal fees) incurred in the administration of the trust or any expenditure incurred pertaining to any activity undertaken by the Trust, or on behalf of any trustee or beneficiary;

15.39 to accept and acquire for the purpose of the trust any gifts, bequests, grants, donations or inheritance from any person or estate, or payments from any person, firm, company or association that may be given, bequeathed or paid to them as an addition or with the intention to add to the funds hereby donated to them. Any additions so accepted and acquired shall be deemed to form part of the trust property to be administered and dealt with subject to the terms of this deed;

15.40 to be entitled to treat as income, or capital profits or gains any periodic receipts although received from wasting assets, and shall not be required to make provision for the amortisation of the same. They shall also be entitled to

determine in such manner as they may consider fit what shall be treated as income and what shall be treated as capital profits or gains in respect of any liquidation, dividend or return of capital in the case of companies whose shares are being held as portion of the trust property by the trustees; and generally to decide any question which may arise as to how much constitutes capital profits or gains and how much constitutes income by apportioning in such manner as they may consider fit;

15.41 to do all or any of the above things and to exercise all or any of the above rights and powers in the Republic of South Africa or in any other part of the world.

16. DECISION OF TRUSTEES

16.1 Subject to Clause 20, a decision of the trustees may be made by:

16.1.1 a resolution approved at a meeting of trustees; or

16.1.2 a written resolution signed by all the trustees (including the duly authorised representative of a trustee).

17. ADMINISTRATION OF TRUST

Subject to their giving effect to the terms of this deed, the trustees shall, in administering the Trust, adopt such procedures and take such administrative steps as they shall from time to time deem necessary or desirable.

18. MEETINGS OF TRUSTEES

18.1 The trustees may meet together for the dispatch of business, adjourn and otherwise regulate their meetings as they think fit. Any trustee shall be entitled on reasonable written notice to the other trustees to summon a meeting of the trustees. All trustees shall be given reasonable notice of any meeting of the trustees.

18.2 The meetings may be held either by the quorum of trustees being physically present as stipulated in Clause 18.4 below, or by the quorum of trustees interacting by way of any means of electronic communication or such other advanced means of communication as decided by the trustees which shall include but not be limited to radio, telephone, closed circuit television or other electronic means of audio or audio/visual communication. If the trustees are in different places or time zones, the meeting will be deemed to be held at the place and time where the majority of the trustees are present, and if there is no majority present at one place, the meeting will be deemed to be held at the time and place specified in the notice calling the meeting. In the event that a meeting is held where the physical presence of the trustees are required, the venue of such meeting shall be decided upon by the trustees.

18.3 At or for each meeting of trustees, the trustees present, in person or by alternate, shall elect a chairperson. Each trustee shall have one vote. Should there be an equality of votes, Clause 20 applies.

18.4 If there is no quorum, the trustees may adjourn the meeting for 24 hours or such longer period as the trustees shall determine, and at the continuation of the said adjourned meeting those trustees who are present shall form a quorum provided that the absent trustees have received reasonable notice of the adjournment and continuation of the meeting.

18.5 The trustees themselves shall determine policy and procedures to be followed at meetings.

18.6 The trustees shall keep minutes of all meetings of trustees concerning the affairs of the Trust.

18.7 The trustees shall meet at least once a year and shall decide upon the use and/or allocations of capital gains, capital profits, capital losses, operating losses, assessed losses, net losses and profits earned or losses incurred or accrued by the Trust, and in accordance with Clause 27 and within their sole, absolute and unfettered discretion to determine whether they are to distribute and pay any

benefits to any beneficiary or to hold any capital gains, capital profits, capital losses, operating losses, assessed losses, net losses, profits for the Trust.

19. EXECUTION OF DOCUMENTS

All negotiable instruments, contracts, deeds and other documents which require to be signed on behalf of the trust shall be signed in such manner as the trustees shall from time to time determine.

20. DISAGREEMENT BETWEEN TRUSTEES

20.1 Provided that there is a 'quorum' as defined in Clause 1.13, any dispute and/or deadlock will be dealt with as follows:

20.1.1 Unless otherwise provided for in this deed, in the event of any disagreements arising between the trustees at any time, the view of the majority shall prevail and be of the same force and effect as if it were a unanimous decision of all the trustees. Should there be an equality of votes, the Independent Trustee shall have the casting vote.

20.1.2 In the event there are only two trustees nominated to the board of the Trust, all decisions to be taken by them, to be effective, must be by unanimous consent. Any issue, event, resolution or motion which is not unanimously agreed upon shall constitute a stalemate and shall be resolved as set out in the provisions contained in and under Clause 20.1.3 below.

20.1.3 Any 'stalemate' that may arise between two trustees, shall be referred to an independent mediator, who is an expert in the field pertaining to the stalemate, and who shall resolve such stalemate within 48 (forty-eight) hours of the stalemate arising.

20.1.3.1 The decision of the mediator shall be final and binding on the trustees subject to the following:

20.1.3.1.1 the mediator shall only be empowered to adjudicate on matters which do not pertain to remuneration and/or monetary consideration; and

20.1.3.1.2 the mediator shall be impartial and shall have an unfettered discretion in making any ruling or adjudication.

20.1.3.2 All cost incurred in referring a stalemate in terms of Clause 20.1.2 *supra* shall be borne by the Trust, save that in the event of the mediator being of the opinion that any trustee who has referred a stalemate has acted in trivial, vexatious, obstructive or unreasonable manner .

20.1.3.3 The parties shall jointly nominate the mediator, provided that, if they are unable to agree on the identity of the mediator within 3 days of the stalemate arising, then the mediator shall be nominated by the trust auditor.

20.1.3.4 Should any stalemate arise between the trustees in regard to remuneration and/or monetary consideration and/or any other stalemate shall be submitted to and decided by arbitration.

20.1.3.5 Arbitration shall be held:

20.1.3.5.1 with only the parties and their representatives present there at;

20.1.3.5.2 unless otherwise agreed in writing where the majority of the trustees may be resident, it being the intention that the arbitration shall, where possible, be held and concluded within 21 (twenty-one) working days after it has been demanded.

20.1.3.6 No trustee or person shall be entitled to demand security for costs from any other trustee in respect of any arbitration proceedings contemplated by this Clause 21 and, notwithstanding anything to the contrary contained herein, the arbitrator shall not have the power to make any order in relation to security for costs for any arbitration proceedings contemplated in this clause.

20.1.3.7 The arbitrator shall be, if the matter in stalemate is principally:

20.1.3.7.1 a legal matter, a practising advocate of not less than 15 (fifteen) years standing, or a practising attorney of not less than 10 (ten) years standing;

20.1.3.7.2 accounting matter, a practising chartered accountant of not less than 10 (ten) years standing;

20.1.3.7.3 any other matter, an independent person agreed upon between the parties.

20.1.3.8 Should the parties fail to agree whether the stalemate is of legal, accounting or other nature within 7 (seven) days after the arbitration has been demanded, then the trust auditor as duly appointed from time to time shall determine whether the stalemate is of a legal, accounting or other nature.

20.1.3.9 The arbitrator shall have the total and unfettered discretion with regard to the proceedings. Furthermore the arbitrator:

20.1.3.9.1 may dispense wholly or in part with formal submissions or pleadings;

20.1.3.9.2 shall include such order as to costs as he deems just provided that any costs incurred in referring a stalemate in terms of

Clause 20.1.3.4 *supra* shall be borne by the Trust, save that in the event of the arbitrator being of the opinion that any trustee who has referred a stalemate and acted in a trivial, vexatious, obstructive or unreasonable manner, where the arbitrator has ruled against such a trustee, the arbitrator may award that such trustee bear the costs of any matter that has been referred;

20.1.3.9.3 the provisions of the Arbitration Act, 1965, or any statute which replaces it, shall not apply;

20.1.3.9.4 the decision of the arbitrator shall be final and binding on the Trust.

21. TRUST ACCOUNTS

The trustees shall cause to be kept complete and accurate records of all receipts, expenditure, assets and liabilities of the Trust. Promptly after the last day of FEBRUARY (or as at such other date as the trustees shall from time to time determine) in each year, the trustees shall cause to be prepared (in accordance with generally accepted accounting principles) financial statements for such period consisting of a balance sheet, a statement of income, capital profits and/or gains and expenditure and a statement of the trust property and liabilities at the close of such period. The trustees shall have the right (but shall not be obliged) from time to time to appoint a practicing Chartered Accountant (SA) to act as the auditor of the Trust, who shall report on the financial statements in the customary manner.

22. TRUSTEE REMUNERATION

The trustees may from time to time determine a reasonable remuneration which shall be paid to them for the administration of the Trust.

23. PROFESSIONAL FEES AND BROKERAGE

Any trustee engaged in any profession shall be entitled to charge for services rendered to the trust at a rate to which he or his firm would have been entitled in the ordinary course of his profession or business.

24. REIMBURSEMENT OF EXPENSES

All *bona fide* costs and expenses incurred by the trustees in the administration of the trust or the exercise of the powers conferred upon them, shall be paid by the trustees out of the trust income, capital profits and/or trust property as decided by the trustees.

25. DELEGATION OF POWERS

The trustees shall at all times be empowered to employ an attorney, accountant, independent contractor, or agent (including a committee) to transact all or any business required or permitted to be done in pursuance of this trust and to effect payment out of the trust property, capital profits or the income of the trust of all charges and expenses so incurred.

26. LIMITATION OF LIABILITY

26.1 Subject to the provisions of the Trust Property Control Act 57 of 1988:

26.1.1 The trustees, shall be indemnified from any claims for any taxation, levies imposts, duties of whatsoever nature and howsoever arising, save that such indemnity extends only to the trustees in their capacity as representative taxpayers on behalf of the Trust.

26.1.2 In the event that any trustee or any person is assessed by the South African Receiver of Revenue to be liable for any taxation as a result of any distribution made by the trustees to any beneficiary in terms of this Trust Deed, then such trustee or person shall be entitled to recover an amount equal to such taxation levied by the South African Receiver of Revenue

from the trust in terms of sections 90 and 91 of the Income Tax Act 58 of 1962.

26.1.3 The following further indemnity is applicable to trustees who are neither the founder, nor the Independent Trustee:

26.1.3.1 each trustee is absolved from all responsibility in the event that the *bona fide* carrying on of their duties, exercise of their powers of administration of the Trust, results in any loss of any part of the Trust Fund, capital profit or income from time to time under their tenure of trusteeship;

26.1.3.2 no trustee shall be answerable for any act, omission, commission, negligence, fraud or improper investment of any trustee or of any attorney, accountant, independent contractor or agent employed by the trustees, except for his/her own personal and wilful fraud or dishonesty;

26.1.3.3 if the trustees should *bona fide* make any payment to any person assumed by them to be thereto entitled hereunder, and it is subsequently found that some other person or persons is or are entitled thereto under this Trust Deed, the trustees shall nevertheless not be responsible for the monies so paid;

26.1.3.4 A trustee shall not be liable for any act of dishonesty committed by another trustee unless her was privy thereto and a trustee shall not be bound to take any proceedings against a co-trustee for any breach or alleged breach of their fiduciary obligations committed by such co-trustee;

26.1.3.5 the trustees shall be indemnified out of and by the trust against all claims and demands that may be made upon them arising out of the *bona fide* exercise of any of the powers conferred under this deed, subject, however, to the provisions of section 9 of the Trust Property Control Act 57 of 1988.

27. DISTRIBUTIONS

27.1 Pending the distribution of the trust property as hereinafter provided, none of the income, losses, operating loss, assessed loss, net loss, capital profits and or capital gains or capital losses of the trust shall be deemed to be attributable to the share or the prospective or contingent share of any beneficiary, save that the trustees, may in their absolute, sole and unfettered discretion distribute, pay or make over any income, losses, operating loss, assessed loss, net loss, capital profits and or capital gains, or capital losses to any beneficiary without maintaining equality as between the beneficiaries, and further to utilise such income, losses, operating loss, assessed loss, net loss, capital profits and or capital gains, or capital losses to pay or apply from time to time in such proportions as the trustees may, in their sole and absolute discretion, consider desirable for the benefit and welfare of all or any one or more of the beneficiaries, without any obligation to maintain equality as between the beneficiaries. The trustees shall be entitled to accumulate the whole or any part of such income, losses, operating loss, assessed loss, net loss, capital profits and or capital gains, or capital losses for any period they shall think fit and either retain the same uninvested (without responsibility for any loss) or invest the same in any of the securities or investments hereinbefore authorised.

27.2 The trustees shall use, pay, distribute or apply the whole or portions of the trust capital or trust property, in such proportions and at such time or times as they in their sole, absolute and unfettered discretion determine, for the benefit of or to all or any one or more of the beneficiaries, without the necessity to maintain equality between the beneficiaries; provided that, without the unanimous consent of all the trustees for the time being, capital distributions shall not be made to a beneficiary who is also a trustee.

27.3 Further and subject to Clauses 27.1 and 27.2 above, the trustees shall in their sole, absolute and unfettered discretion determine whether any distribution which represents the payment or distribution of any capital profit or gain arising out of the disposal of trust property, asset or capital of the Trust, constitutes the vesting of an interest in the capital profit or gain in respect of that disposal for purposes of paragraph 80(2) of the Eighth Schedule to the Income Tax Act 58 of 1962 irrespective of whether the amount actually distributed is lower or higher than the

amount of the capital gain determined in respect of that disposal in terms of the Eighth Schedule to the Act.

27.4 In the event of all the trust property, income and/or capital of the trust having already been used, paid or applied, the trustees shall terminate the trust upon the written agreement of the then trustees and beneficiaries of the Trust, and effect final distributions in terms of Clauses 27.1, 27.2 and 27.3, above. Should perchance, any of the remaining beneficiaries die prior to the date of vesting of the trust property, their share shall be paid to his/her issue by representation *per stirpes* in equal shares (if however, such issue has not attained the age of 25 years the beneficiary's share shall be held over until such issue attains the said 25 years). If any beneficiary shall die before attaining a vested interest hereunder without leaving issue then the share of the trust property which would have gone to such beneficiary shall devolve upon the remaining beneficiaries in equal shares or their issue by representation *per stirpes*. Should, perchance, all the beneficiaries be deceased and there be income or capital of the trust or any trust property on hand, the trustees shall, in order to terminate the Trust, pay or deliver such income or capital to or on behalf of the heir or heirs (testate and/or intestate, as determined by the trustee, having regard to the respective financial circumstances of such heirs) of one, some or all of the beneficiaries, in such proportions as the trustees in their discretion determine.

28. PAYMENT OF BENEFITS

28.1 Any benefits payable or distributed to a beneficiary, whether before or after such benefit or distribution vests in a beneficiary, may be wholly or partly paid to such beneficiary personally, applied for the benefit of such beneficiary or invested on behalf of such beneficiary in any one or more investments, or held under the control of the trustees as the trustees consider appropriate. Any such payment, distribution or investment may be affected wholly or partly in cash or by the delivery of assets.

28.2 In making a distribution or payment at any time to any beneficiary of any portion of the trust property, income or capital profit or gain in terms of this deed, the

trustees shall be entitled to make any such distribution or payment either in cash or in specie or partly in cash and partly in specie. The trustees may in their sole and absolute discretion grant the use of any trust property to any beneficiary with or without consideration therefore. The trustees' valuation of any asset distributed by them in specie in terms hereof shall be final and binding on all interested parties. For the purpose of this clause the word "specie" shall be deemed to include any capital asset at that time held as portion of the trust property which is in a form other than cash money.

28.3 If any beneficiary shall be a minor, the trustees shall not be obliged to pay any income or capital profits or gains of the Trust, or any trust property, to which such beneficiary may be entitled, into the Guardian's Fund, but the trustees may either retain such amounts and deal with them as part of the trust property during the minority of such beneficiary, or they shall be entitled to pay over such amounts either to such minor beneficiary or to his parents or guardian as they in their sole and absolute discretion think fit, and the receipt of such parent or guardian shall constitute a complete discharge to the trustees of all their obligations to the minor beneficiary in regard to the amounts so paid over.

28.4 Notwithstanding anything to the contrary contained in this Deed, unborn children shall not be recognised as having any rights under this Deed or to the trust property or any part of the trust property and the trustees shall not be required to take any account of unborn children in their administration of the trust or any decision affecting the trust including any decision to terminate the Trust.

29. BENEFITS OF TRUST EXCLUSIVE TO BENEFICIARY

Any benefit to which any beneficiary shall become entitled (and any assets acquired by virtue thereof and the income and fruits of such benefit and assets) shall be and remain the sole property of the beneficiary concerned and shall not fall into any community of property nor be subject to any marital power or right of administration of the spouse of such beneficiary or any other person, nor be taken into account for any accrual, or any claim by a life partner or common law husband or wife.

30. ENCUMBRANCE OR DISPOSAL OF BENEFITS

30.1 No beneficiary shall be entitled to any benefits, rights, awards or any hope of or claim or entitlement to any income or capital profits or gains of the trust or trust property, until any such benefit, right, award or hope vests in a beneficiary. Nothing herein contained shall create or confer upon any beneficiary any right or claim to any benefit or award or delivery of any assets hereunder.

30.2 Any benefit, right, award, hope, *spes*, claim or entitlement a beneficiary may have in terms of this trust shall not be capable of being pledged or in any way encumbered, ceded, assigned, dealt with, disposed of or alienated whether voluntarily or as a result of attachment in execution, insolvency or death as the case may be, and no such pledge, encumbrance, cession assignment, dealing, disposal or alienation (whether purported or accomplished) shall have any legal effect or be recognised by the trustees. A beneficiary for the purpose of this clause shall include (but without limitation) the executor and/or administrator and/or trustee of the estate of testamentary trust of a deceased beneficiary, the trustee of any *inter vivos* trust established for the benefit of a beneficiary, the trustee of an insolvent estate of any insolvent beneficiary, the judicial manager or liquidator or any beneficiary which is a company and any other person entitled to exercise any rights in respect of the property of any beneficiary who is under any legal disability of any kind.

30.3 No rights or hopes of the beneficiaries under this trust and no part thereof shall be attachable by any creditor of any beneficiary or vest in his trustee in insolvency and if, prior to any vesting, payment or award being made to any beneficiary, he shall have committed or suffered any act, default or process of law, whereby such rights or hopes or any part thereof would, but for the provisions of this clause, become vested in or payable to any other party or parties or if any beneficiary shall be declared insolvent or assign his estate in favour of his creditors or if an attachment is made or execution is levied on or against the rights or hopes of any beneficiary or any part thereof then and in any or all of such cases such rights and hopes of the beneficiary concerned under this trust shall immediately and entirely thenceforth cease and those rights and hopes shall

thereupon and subject to the provisions below, vest in the trustees to be dealt with by them, subject to the conditions of Clauses 30.3.1 and 30.3.2, namely:

30.3.1 no such beneficiary shall be obliged to repay to the trust any amounts previously paid or advanced to him by the Trust;

30.3.2 the trustees shall be entitled, in their discretion, to continue to hold in this trust for the lifetime of the beneficiary concerned (or such lesser period as they may decide on) the share or part of the share of the trust capital to which he would, but for the provisions of this Clause 30, have been or become entitled and to pay, or without detracting from the other powers conferred on them and subject to such conditions as they may decide to impose, to advance to or to apply for the benefit of him or his brothers and sisters, his spouse, descendants or dependents for his or their maintenance, such portion of the amount so held by them or of the income accruing there from as they in their discretion shall deem fit, and in the case of a Trust;

30.3.3 if the trustees do continue to hold the said share of the trust capital in trust as aforesaid then, notwithstanding that the rights and hopes of the beneficiary shall have ceased and determined and notwithstanding anything to the contrary herein contained, such rights and hopes shall, on the beneficiary's death, devolve upon the parties entitled thereto by substitution determined as at the date of the beneficiary's actual death.

30.4 No beneficiary shall be entitled to anticipate any benefits conferred by virtue of this trust or any rights accruing there under, nor shall a beneficiary be entitled to cede, assign or pledge the same.

30.5 The trustees shall be entitled to acknowledge and accept or refuse to recognise and to treat as null and void any cession, assignment or pledge of the rights or hopes of any beneficiary hereunder. The trustees may refuse to make any payment otherwise than direct to or on behalf of or for the benefit of the person entitled thereto under this Trust Deed.

31. TRUSTEES' INTEREST IN CONTRACTS

31.1 No trustee shall be disqualified by his office from contracting with the trust or any company or firm in which the trust is interested nor shall any contract entered into by the trust or any such company or firm be invalidated or voided by reason of such interest nor shall any trustee so contracting or being so interested or acquiring any benefit under any contract entered into with the trust or any such company or firm be liable to account to the trust for any profits or benefits realised by or under such contract by reason only of his holding that office; provided that he shall have disclosed to the other trustees the nature of his interest before the making of the contract if it shall not already have been known to them.

31.2 The exercise of any of the powers, authorities or discretions conferred upon the trustees shall not be affected or prejudiced by reason of the fact that any of them may be interested or concerned, directly or indirectly in any company in any manner whatsoever, nor shall any trustee be liable because of the fiduciary relationship hereby established or here out arising, to account for any benefit direct or indirect, derived by or accruing to him by reason of any such interest or concern nor shall any act, contract or dealing of the trustee be, because of any benefit, direct or indirect, derived by or accruing to any such trustee, voidable or void, the intent of this provision being to dispense in respect of the trustees or any of them with all the consequences arising from the fiduciary relationship in which they or any of them by reason of their appointment hereunder stand in or toward any such company in which they may be interested or concerned, directly or indirectly, save that in exercising any of the powers, authorities or discretions conferred upon the trustees in terms of this deed, the trustees shall disclose to the other trustees any personal interest they have in such dealings with this trust if it shall not already have been known to the other trustees.

32. TRUSTEES' DISCRETION

The discretionary powers vested in the trustees in terms of this Deed shall be complete, exclusive and absolute and any decision made by them pursuant to any such

discretionary powers shall be binding and unchallengeable by any beneficiary affected thereby or by any other person.

33. EXEMPTION FROM SECURITY

The trustees for the time being of the Trust, whether originally or subsequently appointed, shall not be required to furnish security to the Master of the High Court of South Africa or any other official under The Trust Property Control Act 57 of 1988 or any other legislation which may now be or which may hereafter become of force and effect, for the performance of their duties as trustees, unless the majority of trustees determine otherwise.

34. EFFECT OF CERTAIN EVENTS ON BENEFICIARY'S SHARE OF TRUST PROPERTY

No right or hopes of any beneficiary under this Trust Deed and no part thereof shall be attachable by any creditor of any beneficiary or vest in his trustee in insolvency and if prior to any distribution being made to a beneficiary, he shall have committed or suffered any act, default or process of law whereby such rights or hopes or any part thereof would, but for the provisions of this clause, become vested in or payable to any other party or parties or if any beneficiary shall be declared insolvent or assign his estate in favour of his creditors or if any attachment is made or execution is levied of or against the rights or hopes of a beneficiary or any part hereof or if a beneficiary shall institute proceedings in a Court of Law against the trust or the trustees or any of them in that capacity, then and in any or all such events, the rights and hopes of a beneficiary shall immediately and entirely thenceforth cease and determine as if the beneficiary had died at the time of such cessation and determination and the benefit shall follow the destination it would have followed had the beneficiary in fact died at the said time; provided always that the trustees in their absolute discretion may for as long as they deem fit and in such manner as they deem appropriate apply for the maintenance of such beneficiary, his spouse or issue any benefit to which the

beneficiary himself would have been entitled in terms of this Deed and but for this clause.

35. PAYMENT OF TAX

35.1 Any form of tax or duty assessed against the trust by reason of the provisions of this Deed shall be discharged by the trustees as a first charge out of the trust property.

35.2 For the purposes of raising funds to discharge or refund the amount of any tax or duty referred to above, the trustees may exercise such of their powers as they consider necessary, including their power to borrow monies and their power to realise trust property.

Any such payment or refund may be effected wholly or partly out of income or wholly or partly out of capital.

36. RENUNCIATION BY BENEFICIARY

36.1 Any beneficiary shall be entitled by written notice to the trustees to declare that he shall thenceforth cease to be a beneficiary of the trust and upon delivery of such notice, this trust shall thenceforth take effect as if that beneficiary were dead.

36.2 If it should happen that because of a renunciation by a beneficiary/renunciation by beneficiaries there are no beneficiaries of the trust the trustees are empowered in their sole discretion to nominate a beneficiary or beneficiaries by unanimous written resolution signed by all of them. After such nomination has been made any such nominated beneficiary shall have the same legal status as the original beneficiaries of the Trust.

37. THE PRE-TRUST POST RELATIONSHIP CONTRACT

37.1 This trust recognises and approves the validity of the above relationship contract.

In the event that such a contract is executed and is then duly ratified by way of resolution by the trustees of this Trust, then such contract will be binding on all parties to this Trust Fund.

37.2 In the event of a deadlock when the trustees vote on the approval of the contract, Clause 20 applies.

37.3 The relationship contract, if endorsed by way of resolution of the trustees, may determine steps to ensure that upon the dissolution of the relationship (which is the subject of the contract), that the Trust Fund continues to remain operative.

37.3.1 Such steps may include the addition and/or removal of trustee/s; the addition of Independent Trustee/s; the conversion of discretionary rights into vested rights; as well as any capital and/or income distribution/s.

37.4 The contract will not remove the rights and duties bestowed upon the trustees in terms of Clause 38. Thus, should the time come where it is appropriate to terminate the trust as prescribed in Clause 38, such termination should be carried out, on condition that:

37.4.1 The termination is not caused by the dissolution of the relationship relevant to the contract; and

37.4.2 The termination follows the conditions set out in Clause 38.

38. TERMINATION

It is in the intention of the founder that the trust shall endure in perpetuity, save that in the event of the object and purpose of the trust no longer being capable of being achieved or

in the event of any statutory prescription as to the period the trust may continue to endure, then the trustees may terminate the trust as follows:

38.1the trust shall terminate upon such dates as the trustee shall unanimously decide;

38.2the trustees shall remain vested with all the powers granted in terms of this Trust Deed, as is required to effect and attend to the final distribution and the winding up and termination of the Trust, and to attend to all ancillary and or statutory requirements that need to be effected;

38.3upon the termination of the Trust, the Trust Fund or the balance or portion thereof, or the proceeds of those assets (in each case after payment of all the trust's liabilities or the assumption thereof by the beneficiaries as the trustees and the beneficiaries shall agree upon) shall be distributed to the beneficiaries in any proportion as the trustees in their sole and absolute discretion shall direct;

39. RIGHTS, POWERS, OBLIGATIONS AND DISCRETIONS

Each of the rights, powers, obligations and discretions established by or contained in this Deed is distinct, separate and severable and shall be implemented as such irrespective of how it has been grouped together or linked grammatically.

If any provision hereof or if any such rights, powers, obligations or discretions is found by any Court of competent jurisdiction to be invalid, unlawful or unenforceable for any reason, such finding shall in no way affect any of the remaining provisions of this Deed which shall continue to be of full force and effect.

Should any provisions within this Deed be deemed to conflict with one another, the interpretation of the said provisions should be in such a way as to give effect to the wishes of the founder, the best interests of the beneficiaries and the objectives of this Trust.

ACCEPTANCE BY TRUSTEES:

Name of Trust: SMITH FAMILY TRUST
Founder: RONALD ROBIN SMITH
I D Number: 511201 0198 08 1
Donation: R500.00 (FIVE HUNDRED RAND)
Date of Donation: 22 JANUARY 2011

The trustees hereby accept their appointment as trustees subject to the terms and conditions set out in this deed.

TRUSTEES:

Name: CRAIG RENOIRS
I D Number: 560111 5232 18 3

Name: RONALD ROBIN SMITH
I D Number: 480229 5133 08 1

Name: LYNDA WYNBERG
I D Number: 811201 0198 08 8

Signed at _____ on the _____ day of _____ 20__.

AS WITNESSES:

1. _____

2. _____

FOUNDER: RONALD ROBIN SMITH

Signed at _____ on the _____ day of _____ 20__.

AS WITNESSES:

1. _____

2. _____

TRUSTEE: CRAIG RENOIRS

TRUSTEE: RONALD ROBIN SMITH

TRUSTEE: LYNDA WYNBERG

ADDENDUM B: BENEFICIARIES

The persons as referred to in Clause 1.6 of Addendum A of the Deed shall include the following persons:

Name: RONALD ROBIN SMITH
I D number: 511201 0198 08 1

Name: SARAH SMITH
I D number: 560203 5195 08 3

Name: LINDSAY ANNE SMITH
I D number: 830319 2365 08 7

Name: DAVID BELL SMITH
I D number: 940420 6584 08 5

TRUSTS

**A Guide For Founders,
Trustees and Beneficiaries**

2010



Rowan Stafford



Contents

Introduction	3
The Basics	4
The Parties	8
How Do Trusts Protect Assets?	14
The Formation of a Trust	15
The Trust Deed	16
Trustee Duties and Ethics	23
Choosing Trustees	30
Beneficiary Rights	34
Trust Vulnerability	37
Sham Trusts	39
Alter-ego Trusts	44
The Trustee's Checklist	46
The Trust Property Control Act 57 of 1988	49
References	65

IMPORTANT NOTE

This booklet is intended to be an easy reference, pocket-sized guide for present and future founders, trustees and beneficiaries. This booklet is the product of two years research, produced in conjunction with the author's Master of Laws degree. Some aspects of this booklet are theoretical, although the principal focus is practical.

The information contained herein is a summary of some of the key aspects of trusts, trustees' duties, beneficiaries' rights, proper trust administration and the Trust Property Control Act. Professional advice should always be sought when dealing with matters relating to trusts.

While every care has been taken in the compilation of this booklet, no responsibility of any nature whatsoever shall be accepted for any inaccuracies, errors or omissions.

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Introduction

Various estimates suggest that there are now well over a quarter of a million trusts in use across South Africa. Although there is no way of determining an exact figure, one can be certain that that number, however large it may be, is on the rise. But the increasing popularity of this legal entity unfortunately carries with it an increasing amount of misuse, and with that, more interest and intervention by the courts.

Of late, the South African judiciary has emphatically sought to expose and punish those individuals seeking to misuse trusts. Due to this trend, trusts are no longer the "fail proof" tool they once were. But despite the higher levels of scrutiny, trusts are still a must for anyone who is a professional, intends to amass wealth, or owns their own business.

In the present day, there is still nothing quite like the trust entity, and it is unlikely to be replaced in the near future. The good news is that a trust which is carefully planned, executed and administered should not lose its protective veneer. This booklet will add guidance to some of the most critical administrative aspects of trusts, and should be useful in the hands of those considering setting up an *inter vivos* (living) trust, as well as beneficiaries, trustees and founders.



The Basics

What is a Trust?

There are a number of different types of trusts that are formed for a variety of purposes. What this guide is concerned with are those trusts which fall under the confines of the South African legislation governing trusts - the Trust Property Control Act (the Act).ⁱ More particularly, this guide will deal exclusively with *inter vivos* trusts.

According to the Act, a trust is the arrangement through which control and ownership in property is by virtue of a trust deed made over or bequeathed to another person or persons.ⁱⁱ 'Made over' refers to those trusts which are set up during the lifetime of the founder (the creator) and are known as *inter vivos* trusts. 'Bequeathed' on the other hand denotes a trust which is set up upon the death of the founder (usually by instruction in the deceased's will) and are known as testamentary trusts.

FACT

"A trust is a legal relationship between various parties established either to provide protection from risk or a benefit of some sort"



Why Establish a Trust?

Trusts are set up for a wide range of reasons, usually relating to a person's particular circumstances and the socio-economic environment. The purpose for most people in establishing a trust is to safeguard the family's assets and wealth against risk, and for a variety of reasons which may include:

- Protecting assets from business risk;
- Protecting children's inheritance from claims;
- Providing for special family needs, such as a child with a disability;
- Protecting assets in a second marriage/ relationship situation and/or relationship breakdown;
- Preventing claims on your estate when you die (family protection and testamentary promises);
- Protecting assets against estate duty;
- Providing funding for educational costs for children and/or grandchildren;
- Allowing family assets, such as family homes, to pass to the next generation without exposing inheritances to estate duty tax;
- Giving to the community through a charitable trust.ⁱⁱⁱ



The bottom line is that the choice to establish a trust is a personal one. The decision is one based on weighing up the likelihood of an undesirable event occurring versus the costs and responsibilities of operating a trust.^{iv}

The Advantages of Trusts

- Trusts are most certainly still the most effective way to protect assets from a person's creditors, indiscretions and insolvency.
- Trusts are flexible and can be set up according to the wishes of the founder. Moreover, trust documentation can be amended to stay in line with current trends.
- Trusts are an effective tool to bypass estate duty. The growth on assets, such as shares, transferred to a trust is not subject to estate duty, because the growth belongs to the trust. If you have made use of a loan to the trust, the value of the asset as at the date of transfer remains an asset of your estate because of the loan account in your estate.^v
- Trusts can hold and protect assets for minors and incapacitated dependents.



- Trusts do not die. Not only can the assets remain in the family, but because there is no winding up of the estate, the trust never incurs conveyancing costs, Master's fees or executor's remuneration.
- Loan accounts can be reduced over time by taking advantage of the annual donations tax exemption.^{vi}
- Trusts can be used as effective tax-efficient tools.

The Disadvantages of Trusts

- Assets transferred to a trust are no longer owned by the person establishing the trust or transferring the asset.
- The costs associated with the establishment and continued administration can be expensive. Legal fees to register a trust can cost many thousands and some Masters of the High Court insist that an auditor be appointed to audit a trust before it is registered.^{vii}
- There is no guarantee that the trust will retain its protective veneer should the trust be attacked in court.
- All trustees are required to have dedication and commitment to the administration of the trust.



- Trustees need to be educated on trusts and be familiar with the legislation and common law.
- There is no central Master's office. Because of this, all correspondence with the Master's office needs to happen at the office where the trust was registered.

The Parties

The Founder

The founder, otherwise referred to as the 'settlor' or 'donor' is the person who in reality establishes the trust. Interestingly, a trust may have more than one founder. Business trusts can often have several founders who act together in agreement to form the trust. Once a trust is formed however, be it a family trust or any other type of trust, the founder should no longer control or manage trust assets in his or her capacity as founder. It is possible for the founder to be a trustee,^{viii} but such appointment should be for the right reasons, and not to preserve the control he or she would have otherwise lost.



The Trustee

The trustees undoubtedly form the backbone of a trust's activities. A person becomes appointed as a trustee in terms of a trust deed or by the Master if the trust deed does not provide for it. The nominated person must accept the appointment upon which the Master too must then authorise the appointment by issuing written letters of authority.

Trustees have bare ownership of trust assets, and must administer trust assets in accordance with the terms of the trust deed. Such ownership, or co-ownership in the case of multiple trustees is however non-beneficial – meaning that the

Did you know?

Trusts were introduced in the Cape in 1815 after the British occupied the area intermittently between 1795 and 1806.

ownership does not entitle the trustee to the enjoyment of the trust property.

Perhaps one of the most important duties that arises as a result of one person assuming responsibility to manage and control assets on behalf of another is a fiduciary duty. A fiduciary is a person who undertakes or assumes responsibility to act for or on behalf of and in the interests of another.^{ix} This duty requires that property under the control of trustees be managed and



controlled for the purposes of the trust deed and for the benefit of the beneficiaries. In terms of this duty, trustees are prohibited from the following:

- Exceeding their powers;
- Exercising their powers for an improper purpose;
- Fettering their own discretion;
- Placing themselves in a position where their personal interests conflict with their duties to the beneficiaries;
- Making a secret profit;
- Competing with any business of the trust;
- Making personal use of or abusing confidential information; or
- Unduly favouring one beneficiary to the detriment of another or others.^x

The Beneficiary

Bearing in mind that trusts are generally created to benefit one or more persons or classes of persons, the trust beneficiary forms an integral part of the institution. Any person, be it born or unborn, natural or juristic, can become a beneficiary. This is because the law sets no requirements for trust beneficiaries, and thus, they need not have contractual or legal capacity.



Trustees may also be beneficiaries^{xi} or even the sole beneficiary in a trust, although a trustee may not be the sole beneficiary as well as the sole trustee^{xii} as there would be no separation of the control from the enjoyment of the trust assets.

Beneficiaries also enjoy a wide spectrum of rights. Income and capital rights are normally the first differentiation. The trust deed in this regard should always distinguish between income and capital beneficiaries as well as give clear definitions as to what exactly is income and what is capital for the purposes of the trust. Due to the difficulties that may arise where there are both classes of beneficiaries designated in the trust deed, it may be desirable for the trust deed to provide that in the event of the income of a trust being insufficient for the maintenance, education or medical care of an income beneficiary, then the capital of the trust may be used to make good on any shortfall.^{xiii}

Other important privileges which affect trust beneficiaries are variable and fixed rights. Dependent on the terms of the trust deed, a beneficiary may be entitled to a fixed amount of income or it could be entirely variable. The variation may also depend on the economic circumstances, or even the happening of a specified event.



Defining these rights is therefore of the utmost importance in order to avoid confusion at a later point.

A trust deed may also allow a beneficiary the right to use and enjoy trust assets. The formation of this right in the trust deed should be carefully thought out and planned, as disputes often arise regarding the obligation a beneficiary may have to preserve and maintain the asset. 'In the absence of a clause giving clear directions as to how costs and expenses are to be treated, a distinction should be drawn between costs and expenses that are necessary to keep the property in a usable form (such as repair and maintenance) and other costs (such as rates, employee costs and improvements)' .^{xiv}

Beneficiaries also have either a discretionary or a vested right. A discretionary right is in the nature of a contingent right or a *spes* or hope, thus, the trustee will at times exercise their discretion in favour of a beneficiary with a discretionary right and the beneficiary will in turn benefit to the extent that the discretion has been exercised in their favour.^{xv} On the other hand, a beneficiary with a vested right can enforce that right by calling upon the trustees to deliver to that beneficiary income or capital or a specific asset, depending on whether the right is a vested right to income, capital or a specific asset.^{xvi}



Note however that both discretionary and vested beneficiaries have personal rights against the trustees because the rights that a beneficiary has, whether discretionary or vested, are personal rights.^{xvii}

The Nominee Founder

Should a founder wish to remain anonymous, he may make use of a nominee founder.^{xviii} The nominee founder is the agent of the true founder and is usually someone approached by the founder to form the trust in their own name. The nominee would then be given instructions as to what the trust deed should contain and who the trustees are to be.

Thus the nominee founder's name would appear on the trust deed, and after the initial donation, he would play no further role in the trust.

Nominee founders are however unnecessary and a court would most likely, if required, look through the formality and hold the principal founder to be the true founder of the trust.



How Do Trusts Protect Assets?

A trust's ability to protect assets is attributed to the legal veneer which encloses the trust property. Once a trust is established, any assets which are transferred to the trust immediately change ownership, and the trustees will consequently become the new owner of the property. Thus, once property is made over to the trust, the transferor loses ownership and legal title to the asset.

The trust estate in effect forms a separate entity,^{xix} but unlike a company or close corporation, it does not have its own legal personality.^{xx} As a result, a trust does not have legal standing, and because of this, litigation will always be cited as against the trustees of the trust.

Fact

The "legal veneer" is the legal separation of ownership between the founder, his or her estate and the transferred asset.

The Formation of a Trust



For a valid trust to be created:

- (a) the founder must intend to create one;
- (b) the founder's intention must be expressed in a mode appropriate to create an obligation;
- (c) the property subject to the trust must be defined with reasonable certainty;
- (d) the trust object, which may either be personal or impersonal, must be defined with reasonable certainty; and
- (e) the trust object must be lawful.

It is also not essential that the trust property be transferred to the trustee or beneficiary. All that is necessary for the existence of a valid trust is that the founder should be under a duty to give the control of the property to a trustee.^{xxi}



The Trust Deed

The trust deed is the trust's constitutive charter.^{xxii} Generally speaking, it is only through the trustees, as specified in the trust deed, that the trust can act. Who the trustees are, their number, how they are appointed and under what circumstances they have power to bind the trust estate are matters defined in the trust deed.^{xxiii}

Generally speaking, the provisions of a trust deed will vary according to the type of trust and the nature of the trust property. The golden rule however is to be as thorough as possible when drafting the trust deed, covering all conceivable uncertainties. Bearing in mind that if a trust is declared void, the South African Revenue Service (SARS) is entitled to calculate any additional tax owed by the founder (as the assets would fall back into his or her personal estate), the importance of getting the wording of the trust deed right cannot be underestimated.

This does not however imply inflexibility. In fact, a trust deed should be as flexible as is realistically necessary.



There are a number of reasons why trust deeds need to be drafted so that they can be modified to accommodate future changes:

- If a trust is to act as an investment vehicle, it may become too cumbersome and expensive as a result of the requirement that each trustee must sign all banking documents, property transfers, leases, renewals of leases etc;^{xxiv}
- Taxation, trust laws and other company laws may change, and in doing so, adversely affect trusts. This will create a need to modify trusts and enable them to be restructured to best advantage;^{xxv}
- Changes in relationships will make it desirable for spouses/partners who have separated, to cease to be associated with a trust after a settlement has been agreed upon. This will preferably involve the removal of a spouse/partner as a beneficiary, trustee or a person who possesses other administrative entitlements;^{xxvi}
- Financial or even family circumstances could have changed and the provisions of a trust deed might not adequately provide for these changed circumstances; and
- Any of the conditions dealt with in s 13 of the Act.



Ordinarily, the following sections should always be present in a trust deed:

- The name of the trust ;
- Definitions and interpretation clauses;
- Principal objects of the trust;
- Power to receive additions;
- Power of appointment;
- Powers to add and exclude beneficiaries;
- Trustee termination, appointment, dispute resolution and sub-minima;
- Administrative powers of the trustees;
- Extended power of advancement or maintenance;
- Indemnity for the trustees out of the trust fund;
- Meetings, minutes and accounts;
- Duration of the trust;
- Amendment of the deed;
- Usually two schedules are attached to the deed, the first covering the powers of the trustees and the second being a summary of the initial trust fund.



Take Note

Even with a perfectly drafted trust deed, it would serve little purpose if the parties to the trust did not adhere to its provisions. Selecting trustees is therefore as crucial to the survival of the trust as is the deed itself.

Scope of the Amendment Power

Drafting the amendment clause of a trust deed requires particular attention. There is a fine balance which needs to be achieved: on the one hand, the trust deed should recognise that external events or changes may occur resulting in the need to amend the deed. On the other hand, the power of amendment needs to be restricted in so much as it is necessary to prevent abuse.

The following clause is suggested as the appropriate amendment clause:

Amendment of the trust deed

1. The trustees may revise or amend this trust deed provided that such revision or amendment:



- a. does not constitute a revocation of the trust, and
 - b. does not compromise the purpose and objectives of the trust, and
 - c. is accepted by the trustees unanimously.
2. Should the revision or amendment have the potential to prejudice the rights or interests of any of the existing beneficiaries, unanimous written consent of the beneficiaries is required. The beneficiaries herewith referred to in this clause include both vested and discretionary beneficiaries. This provision is not applicable to beneficiaries who:
- a. have yet to accept (in writing or orally) the benefits that may accrue to them in terms of this trust deed, or
 - b. have not yet received any benefit in terms of this trust deed.
3. The trustees may further amend or revise this trust deed in the event of any legislation necessitating such amendment or revision to comply therewith, so long as such amendment or revision complies with subsections 1 and 2 of this clause.
4. Should the founder wish to amend or revise this trust deed:
- a. the founder should apply to the trustees in writing, setting out the proposed changes and giving reasons for such proposal.



- b. the trustees must then hold a properly constituted meeting in order to determine the nature of the proposed amendment or revision and assess the merits thereof.
 - c. the trustees decision is subject to the directives, guidelines and rules contained within this clause when making a decision to approve or disapprove such request.
 - d. the trustees must inform the beneficiaries and founder in writing of the decision made and the reasons for such decision.
5. No amendment or revision to this trust shall be of any force and effect to the extent that any benefit shall be conferred by such amendment on the founder or their estate, nor shall any variation give the founder, or any trustee the power to appropriate or dispose of any trust property, on his own, as he sees fit, for his own benefit or for the benefit of his estate, whether such power is exercisable by him or with his consent, and whether such power could be obtained directly or indirectly by the exercise, with or without notice, of power exercisable by him or with his consent.
6. In the event that any proposed amendment or revision is not unanimously accepted by the trustees, the majority decision will prevail, provided that:



- a. the trustees of this trust are comprised of at least one independent professional trustee, and
 - b. the independent professional trustee approves the amendment or revision.
7. This clause does not apply to the powers of addition and exclusion [refer to section dealing with the trustees' powers of addition and exclusion].

Take Note

When drafting a trust deed, it is important to make certain that there are no clauses which may lend themselves to the conclusion that the founder has retained a degree of control over the trustees. Similarly, the trust deed should not contain any provisions which allow for a trustee to dominate the other trustees.

Trustee Duties and Ethics



The manner in which the trustees conduct their duties and approach the affairs of the trust is one of the most influential aspects which affects the actual protection a trust will ultimately provide.

‘It is now also clear from recent legal judgments that one of the key requirements for a valid trust is that there must be a separation of beneficial ownership from control. The trustees are required to administer the assets under their control for the benefit of the beneficiaries of the trust. Often however the sole trustees of a trust are also the beneficiaries of that trust. In a recent Appellate Division judgment, it was clearly stated that such trusts “invite abuses”. And abuses will not be tolerated by the courts’.^{xxvii}

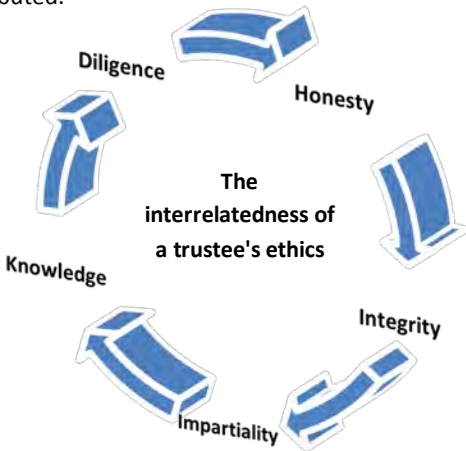
Ethics

All trustees are to act honestly in all matters concerning the trust. This means that trustees should always treat the trust as it should be treated, and as it always should have been treated.^{xxviii} This ethical duty is what ensures a separation of power, because an honest trustee will not be inclined to conflate enjoyment and control.^{xxix}



An honest trustee will also observe impartiality. Impartiality has two elements to it in the context of trusts:

- On the one hand a trustee must avoid a conflict of interest between his personal concerns and his official duties. An important manifestation of this rule is that a trustee is not permitted to derive unauthorised profit from the administration of a trust.
- The second aspect to the duty of impartiality relates to a trustee's obligation to treat beneficiaries impartially, particularly when trust income and/or capital is distributed.^{xxx}



Duties



Under the common law, trustees have a duty to keep proper records concerning the administration of the trust. This duty is more commonly referred to as the “duty to account”, and is important in defending an alter-ego argument as evidence can then be provided that the trust was properly managed.^{xxxii}

At the very least, trustees are required to keep the following records:

- Trust deeds;
- Agreements for sale and purchase of trust assets;
- Deeds of acknowledgment of debt;
- Deeds of forgiveness of debt;
- Trust minutes (in the minute book);
- Trustee resolutions;
- The trust’s financial accounts;
- Beneficiary details;
- The trust’s tax records;
- Copies of independent advice given to the trustees; and
- General trustee correspondence.^{xxxii}



Trustees should also ensure that all original documents are placed in safe custody.^{xxxiii} Realistically, financial records have become one of the most important pieces of evidence against a sham or alter-ego argument, and trustees must keep track of all income to, distributions from, and expenditures by the trust. To further strengthen the banking and financial records, trustees must record which trustees authorised each transaction and if applicable, in terms of which resolution it was decided.

Specific duties in terms of the Trust Property Control Act

Statutory duty	Section of the Act
To lodge with the Master the trust deed	4
To furnish the Master with an address	5
To obtain written authorisation from the Master and lodge security if required	6
To act with care, diligence and skill	9
To bank monies	10
To register and identify trust property	11
To protect trust documents	17
To perform all duties imposed by the trust deed	19
To account to the Master when required to do so	19, 16
To take only reasonable remuneration	22



Specific duties in terms of the Trust Deed and the Common Law

- **The duty to act independently:** a trustee must exercise an independent discretion at all times when dealing with trust matters.^{xxxiv}
- **The duty to invest productively:** if the trust is to endure for a long period, the trustees are obliged to invest the assets of the trust in a manner that provides adequate income as well as capital growth.^{xxxv}
- **The duty to avoid risk:** when trustees deal with or invest money, it must be done with safety and security. Trust assets must not be placed in a situation involving an element of risk and uncertainty.^{xxxvi} In this regard, it is undesirable for trustees to sign a deed of suretyship in which they bind the trust as surety and co-principal debtor for a transaction which is to benefit the trustee or founder's estate in such capacity.
- **The duty to account to beneficiaries:** section 18 of the Promotion of Access to Information Act^{xxxvii} applies to both testamentary and *inter vivos* trusts. Thus, where information is held by the Master, beneficiaries (or other interested persons) may upon written request and payment of the prescribed fee, receive a certified copy of the



document, should they be able to prove to the Master that they have “sufficient interest” in such document.

Conversely, where information is held by the trustees, and disclosure to the beneficiaries (or other third parties) has been refused, such party would have to rely on the inherent supervisory jurisdiction the courts have over trustees and persuade a court of competent jurisdiction to order the information to be handed down to the interested party.

Importantly, documents such as trust deeds, financial statements and accounts should never be refused to a beneficiary because a trust should maintain some level of transparency, for the purposes of sustaining its legal validity. It is suggested that the trust deed should house the agreed level of information which can be made available. Such provision can therefore detail the policies to be followed by trustees regarding information.

- **The duty not to exceed powers and to act only within given powers:** if a power is not conferred on a trust through the trust deed, it will not be inferred. For example, the power to sell a property does not grant a trustee the power to mortgage the property.^{xxxviii}



- **The duty to make proper and correct distributions to identified beneficiaries:** trust assets must always be applied as provided for in the trust deed.^{xxxix} The trustees must also transfer income and/or capital to the beneficiaries when obliged to do so in terms of the trust deed.
- **The duty to identify properly the beneficiaries of the trust:**

Remarkable...

A common reason a founder would make use of the trust *inter vivos* was displayed upon the death of the late Harry Oppenheimer. The South African mining tycoon, reputed to be one of the ten richest men in the world, went to his grave leaving little trace of his vast personal fortune. Conservatively estimated to be worth over R30 billion around the time of his death, Harry's will declared a mere R307 million as his personal wealth. The remainder of his fortune had been carefully placed in trust to protect his assets for the future benefit of his family. The attempt to minimise estate duty paid off, and to this day serves as an enormous reminder of one the greatest benefits of trusts.

although not always as easy as it may sound, the trustees are expected to do so to the best of their ability.



- **The duty to obtain expert advice:** where necessary, trustees must obtain the advice of an expert in the relevant field.
- **The duty to appoint the stipulated number of trustees:** failure to respect this duty may lead to the invalidity of the acts undertaken during the subminimum trustee period.^{xi}
- **The duty to comply with all laws:** trustees must obey all legislation relevant to their undertaking. This includes the Trust Property Control Act, the PAIA Act, the Constitution and the Financial Intelligence Centre Act.^{xii}
- **The duty to ensure a proper system of control is in place:** systems must ensure that assets are kept safe and their actual location is recorded.^{xlii}

Choosing Trustees

Once the decision has been made to establish a trust, choosing the trustees becomes the next important decision the founder will have to make.

Recent South African case law has crystallised the importance of having conscientious trustees who are independent and able to ensure a separation between control and enjoyment.^{xliii}



Founders as Trustees

Founder-trustees are a common occurrence in South Africa, and more often than not, the intentions behind such an arrangement are innocent. Unfortunately, this situation may invite the inference that the founder-trustee has operated the trust without respect for the division of control and enjoyment. For the above reasons, founders should, where possible avoid this scenario. If however it is unavoidable, there are certain formalities which must be paid extra attention:

- a) Trust documentation must all be in order: minutes, financial statements, trustee correspondence and trust resolutions must all be well drafted and kept safe.
- b) There should be at least three trustees in office and at least one of those should be an independent professional trustee.
- c) The founder-trustee must not chair the meetings.
- d) The trust deed specifically permits the founder to be a trustee, so as to be open and transparent with the arrangement. Additionally, the provision should ensure that this trustee does not dominate the other trustees.



Independent Non-professional Trustees

This situation is semantically deceiving because the trustee in this instance will rarely be considered truly independent. The various types of non-professional trustees who are frequently utilised include friends, family members (who are not beneficiaries), neighbours, colleagues and in some cases professionals from other fields.^{xliv}

Whilst this arrangement is more desirable than founder-trustees, often in reality too many non-professional independent trustees are used merely to "rubber stamp" decisions for the dominant trustees.

There are two main arguments against the use of this trustee:

- 1) It may be argued that the founder has not actually relinquished ownership, control and enjoyment of the trust property, and is instead relying on the trustees to act as his puppets.
- 2) There is also the risk that the non-professional trustees do not understand their duties fully and may therefore place the trust in danger.



Independent Professional Trustees

Enjoyment and control of your trust assets must be functionally separate.

It has been suggested by the Supreme Court of Appeal that to try to minimise instances of the abuse of the trust form, the Master should, when registering a trust, insist that there be at least one independent trustee.^{xiv} The thinking behind the implementation of this notion is that the independent trustee should have no reason for concluding or approving a transaction that may prove to be invalid, because firstly, he should be knowledgeable about trust law; and secondly, he would not have any interest in the trust property or be a beneficiary, and would thus make his decisions based on what is correct and in the best interests of all the beneficiaries and the continuation of the trust.

It is recommended that, no matter the level of risk the trust may be exposed to or the value of the property it may own, every trust must have at least one independent professional trustee in office.



The trust deed must recognise the independent trustee, and place emphasis on his presence in trustee meetings and trust decisions.

For Clarity...

‘Independent professional trustee’ means a normal trustee for all transactions and decisions made by the trustees, but who is a professional chartered accountant, admitted attorney or an advocate. This trustee must have no relation or connection, blood or other, to any of the existing or proposed trustees, beneficiaries, founder or nominee founder of the trust.

Beneficiary Rights

A beneficiary may have any number and a variety of rights, depending on the terms and conditions of the trust deed or upon the manner in which trustees have, or have not exercised their discretion in favour of a beneficiary.^{xlvi}



The most important classification of these rights are discretionary rights and vested rights, as well as income rights and capital rights.

A **discretionary right** is nothing more than a contingent right - a *spes* or a hope. Consequently, only if the trustees exercise their discretion in favour of a beneficiary with a discretionary right, will that beneficiary benefit to the extent that the discretion has been exercised in their favour.^{xlvii} Until the time that the trustees have exercised their discretion, a discretionary beneficiary only has a hope that some benefit will be received in the future. Thus, in the case of a discretionary trust, the beneficiaries do not have any vested right in the trust property, and any income or capital received by the beneficiary is determined purely in the discretion of the trustees.

A **vested right**, on the other hand, gives a beneficiary far more certainty in the sense that a beneficiary with a vested right knows exactly what he or she can expect in the way of assets, income or benefits from the trust.^{xlviii} A vested right therefore allows a beneficiary to enforce that right by calling upon the trustees to deliver the income or capital to that beneficiary. Notably, a beneficiary with a vested right carries a personal right. This is a right against the trustees to claim income and/or



capital or the transfer of an asset.^{xlix} This right can be contrasted with the discretionary right, which is nothing more than an expectation that income or capital may eventually accrue to that beneficiary.

Do Not Forget

Trusts can be used for good and bad. An example of a bad use of a trust would be to transfer all assets into a trust to avoid paying out a spouse on divorce. In these instances, the courts may overlook the trust and make an order to disregard the trust.

Vested or contingent, capital or income, beneficiaries do have rights which are inherent in the trust institution itself.¹

The Trust Property Control Act places several duties upon trustees to act in the best interests of the beneficiaries. Besides the fiduciary duties set out in s9, s13 allows a court to vary a trust deed in instances, above all else, when a provision in the deed prejudices the interests of beneficiaries.



Section 20 of the Trust Property Control Act empowers the Master or any person with such interest (such as a beneficiary) to apply to the High Court for the removal of a trustee. The application will be granted in terms of s20(2)(3) if the applicant can prove that the trustee, amongst other things, failed to perform satisfactorily any duty imposed upon him or her under the Act. Thus, for instance, a beneficiary can, upon the presentation of sufficient evidence in a court of law, have a trustee removed for failing to meet the necessary standard of care, diligence and skill required of them.

Trust Vulnerability

The world over, there has been a growing interest in the law and theory surrounding the limits to the protection a trust actually has to offer. In particular, many trust disputes have involved a party attempting to prove that no trust exists and therefore the assets held within it are open to challenge as though they were owned by a particular trustee or the founder.^{li} Unfortunately, in South Africa, the law in this regard is not settled. Most certainly though, South African courts have



the authority at common law to "pierce" the veneer of a trust *inter vivos* in the appropriate circumstances.

The effect of a piercing is that the trust will be looked past, and the court would make a judgment without having regard to the existence of the trust.

The reality of this ability is unsettling for trustees and founders. In South Africa, the courts have developed two distinct routes for trust piercing:

The first is where the conduct of the trustees invites the inference that the trust was a mere façade for the conduct of business 'as before', and that assets allegedly vesting in trustees in fact belong to one or more trustees.^{lii}

The second is where a trustee (or founder) operates the trust with full control over trust assets and merely uses the trust as a vehicle for personal or business activities.^{liii}



The most important consequence of these tendencies is that trustees and founders cannot sit back idly and rely on the trust's veneer to protect the assets. In reality, a trust is only proved to be legitimate if it is the subject of a dispute and a court has to determine its validity.

Therefore, trustees must play an active and determinative role in all trust matters. A trust must be treated with respect and on the assumption that in the future, the trust may be challenged.

Overseas, the system for trust piercing is fairly certain. Although no two jurisdictions follow the same exact rules, the principles and guidelines are standardised. Unlike in South Africa, foreign courts quickly separate alter-ego cases from sham cases, and tend to deal with each allegation separately.

Sham Trusts

The word "sham" has been used in various contexts in South African court judgments, but without clear authority. With respect, courts have tended to use the term as a general description for a trust which is not *bona fide*.



In common law jurisdictions overseas however, the word "sham" refers directly to the doctrine of the sham.

Overseas, the purpose of identifying sham trusts and making use of the doctrine is clear: any piercing challenge directed at a trust *inter vivos* requires a finding of a sham. In broad terms, a declaration that a trust is a sham effectively peels the trust aside, exposing the assets and treating the assets as if they were personally owned by the 'shammer' (usually the founder).

Accepted unanimously in Australia, New Zealand, Canada and the United Kingdom is the *Snook* test,^{liv} which sets out the shamming status of any transaction. This test has been adopted and readily applied in the majority of sham trust cases abroad and in summary, requires there to be a common intention amongst the founder and at least one trustee to mislead or deceive third parties into the belief that the trust is genuine, when in fact it is not.^{lv}

The importance of understanding the sham doctrine lies in the possibility that South Africa may too follow suit. Moreover, the sham doctrine provides critical insight into the key points which are relied upon when foreign courts consider a piercing application.

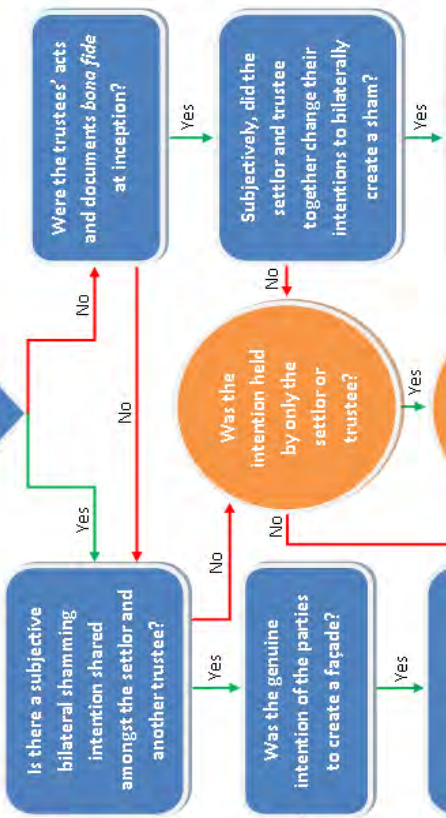


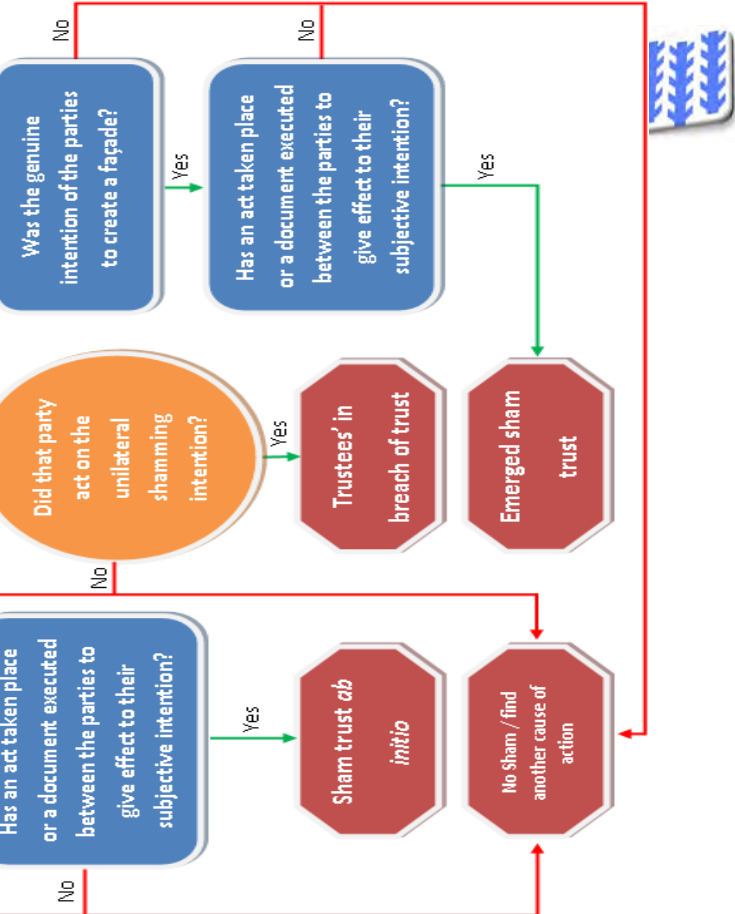
The diagram on the following page illustrates the sham enquiry. Importantly, the test recognises the existence of an 'emerging sham'. An emerging sham incorporates the same *Snook* test, but relaxes the rule that the sham must have occurred from the trust's inception. An emerging sham therefore occurs where the founder and the trustee's intentions change after the trust has been legitimately set up. A sham in this case would therefore only "emerge" later on, and not at the outset.

Fact

A trustee should be in the saddle and firmly holding the reins; he should not be running after the horse desperately trying to mount it - *Parujan v Atlantic Western Trustees Limited*.

Is the sham alleged to have occurred at the inception of the trust?







Alter-ego Trusts

This doctrine, which is often masked in the description of a trust being the “alter-ego”, “puppet” or “nominee” of a founder, is a principle separate and distinct from the sham doctrine. In essence, an alter-ego trust arises in two distinct situations:

- The first is where assets are settled on a trust, but the trustees of the trust act as mere puppets, doing whatever they are instructed to do.
- The second is where the trust property is treated as if it were personally owned, instead of belonging to the trust.

Interestingly, the majority of both foreign and local alter-ego cases revolve around matrimonial proceedings.

In South Africa, the courts have authority at common law to pierce an alter-ego trust. For that reason, trustee independence and his or her complete separation of enjoyment and control cannot be overemphasised.

Overseas, the distinction between sham trusts and alter-ego trust is continuously made, and as such, the courts abroad have lately avoided the temptation to conflate the two doctrines. In



fact, the New Zealand Supreme Court recently cautioned against the past tendency to amalgamate the two, because such a development would be to effectively re-write the traditional understanding of a sham.^{lvi}

The consequence is that unlike sham trusts, a court is not entitled to pierce an alter-ego trust, and that to do so, would be inferring (automatically) that the trust was a sham without conducting the necessary sham enquiry.

Take Note

In South Africa, an alter-ego enquiry often involves a distinction between *de facto* control and *de iure* control: the founder often puts *de iure* control of assets of a business of a family in the hands of trustees. But the trustees act as mere puppets in the hands of the founder who manages the trusts through them, and *de facto* it is the founder who controls the trust despite the fact that *de iure* control is in the hands of the trustees.



At present, the common tendency abroad is for a court to make use of such evidence in its sham enquiry. If the facts lend themselves to the inference of a sham, only then may the trust's veneer be pierced.

Astonishingly, despite the fact that the courts today have asserted an increasing interest in trusts, many founders continue to treat trust assets as if they still own them, failing to observe even the most basic principles of the fiduciary duties they created. Courts may under such circumstances, be compelled to look behind the guise and into the reality of the situation, which ultimately may lead to a declaration that the trust is in fact the alter-ego of the founder or trustee.

The Trustee's Checklist

Often referred to as a trust "warrant of fitness",^{lvii} the table on the following page is a set of questions which may indicate a trust's vulnerability level.



	Yes	No
Have all the trustees read the trust deed in the last year?		
Does the trust have a separate bank account?		
Is there an independent professional trustee in office?		
Have the financial statements been prepared and accepted by the board of trustees each year?		
Have all insurance policies been transferred into the trust's name?		
Is there the sub-minimum number of trustees in office, as specified in the trust deed?		
Do all trustees have a personal copy of the trust deed?		
Have the beneficiaries been identified?		
Has at least one trustee meeting taken place over the past 12 months?		
Have the trustees been issued with a letter of authorisation from the Master?		
Is the majority of trust property situated within the jurisdiction of the Master's office of the High Court where the trust is registered?		
Can beneficiaries obtain copies of trust documentation, such as the trust deed and financial statements?		



	Yes	No
If the trust makes use of a loan account, has the trust made use of the annual donations tax exemption?		
Are the trustees educated and familiar with the Trust Property Control Act and other relevant legislation?		
Are the trustees aware of all their common law and statutory duties?		

As a broad indication, answering “yes” to all the above questions means that the trust is secure. Answering “no” to more than two indicates that the trust does require attention and professional advice should be sought.

The Trust Property Control Act 57 of 1988



[ASSENTED TO 1 JUNE, 1988]
[DATE OF COMMENCEMENT: 31 MARCH, 1989]
(Afrikaans text signed by the State President)

As amended by

Justice Laws Rationalisation Act, No. 18 of 1996
[with effect from 1 April 1997]

ACT

**To regulate further the control of trust property; and to provide for
matters connected therewith.**

ARRANGEMENT OF SECTIONS



1. Definitions
2. Certain documents deemed to be trust instruments
3. Jurisdiction of Masters
4. Lodgement of trust instrument
5. Notification of address
6. Authorization of trustee and security
7. Appointment of trustee and co-trustee by Master
8. Foreign trustees
9. Care, diligence and skill required of trustee
10. Trust account
11. Registration and identification of trust property
12. Separate position of trust property
13. Power of court to vary trust provisions
14. Variation of trust instrument
15. Report of irregularities
16. Master may call upon trustee to account
17. Custody of documents
18. Copies of documents
19. Failure by trustee to account or perform duties
20. Removal of trustee
21. Resignation by trustee
22. Remuneration of trustee
23. Access to court
24. Regulations
25. Application of Act
26. Amendment or repeal of laws, and savings
27. Short title and commencement
- Schedule. Provisions of laws amended or repealed (section 26)



1. Definitions.—In this Act, unless the context otherwise indicates—

“banking institution” means an institution registered otherwise than provisionally as a bank in terms of the Banks Act, 1965 ([Act No. 23 of 1965](#));

“building society” means a mutual building society registered finally as a mutual building society in terms of the Mutual Building Societies Act, 1965 ([Act No. 24 of 1965](#)), or a building society registered finally as a building society in terms of the Building Societies Act, 1986 ([Act No. 82 of 1986](#));

“court” means the provincial or local division of the Supreme Court of South Africa having jurisdiction;

“financial institution” means a financial institution as defined in the Financial Institutions (Investment of Funds) Act, 1984 ([Act No. 39 of 1984](#));

“Master”, in relation to any matter, means the Master, Deputy Master or Assistant Master of the Supreme Court appointed under section 2 of the Administration of Estates Act, 1965 (Act No. 66 of 1965), who under section 3 of this Act has jurisdiction in respect of the matter concerned;

“trust” means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed—

- (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust



instrument or for the achievement of the object stated in the trust instrument; or

- (b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965 (Act No. 66 of 1965);

“trustee” means any person (including the founder of a trust) who acts as trustee by virtue of an authorization under section 6 and includes any person whose appointment as trustee is already of force and effect at the commencement of this Act;

“trust instrument” means a written agreement or a testamentary writing or a court order according to which a trust was created;

“trust property” or **“property”** means movable or immovable property, and includes contingent interests in property, which in accordance with the provisions of a trust instrument are to be administered or disposed of by a trustee.



2. Certain documents deemed to be trust instruments.—If a document represents the reduction to writing of an oral agreement by which a trust was created or varied, such document shall for the purposes of this Act be deemed to be a trust instrument.

3. Jurisdiction of Masters.—

(1) (a) In respect of trust property which is to be administered or disposed of in terms of a testamentary writing, jurisdiction shall lie with the Master in whose office the testamentary writing or a copy thereof is registered and accepted, and in any other case, with the Master in whose area of appointment in terms of the Administration of Estates Act, 1965 (Act No. 66 of 1965), the greater or greatest portion of the trust property is situated: Provided that a Master who has exercised jurisdiction shall continue to have jurisdiction notwithstanding any change in the situation of the greater or greatest portion of the trust property.

(b) Notwithstanding the provisions of paragraph (a) a Master who would otherwise have no jurisdiction in respect of trust property may, on written application by any person having an interest in that trust property, and with the consent of the Master who has such jurisdiction, assume jurisdiction of that trust property.

(2) No act performed by a Master in the *bona fide* belief that he has jurisdiction shall be invalid merely on the ground that it should have been performed by another Master.

(3) If more than one Master has in such belief exercised jurisdiction in respect of the same trust property, that property shall, without prejudice to the validity of any act already performed by or under the authority of any other Master, as soon as it becomes known to the Masters concerned, be administered or disposed of under the supervision of the Master who



first exercised such jurisdiction, and any authorization or appointment of a trustee made by any other Master in respect of that property, shall thereupon be cancelled by such other Master.

4. Lodgement of trust instrument.

(1) Except where the Master is already in possession of the trust instrument in question or an amendment thereof, a trustee whose appointment comes into force after the commencement of this Act shall, before he assumes control of the trust property, upon payment of the prescribed fee, lodge with the Master the trust instrument in terms of which the trust property is to be administered or disposed of by him, or a copy thereof certified as a true copy by a notary or other person approved by the Master.

(2) When a trust instrument which has been lodged with the Master is varied, the trustee shall lodge the amendment or a copy thereof so certified with the Master.

5. Notification of address.—A person whose appointment as trustee comes into effect after the commencement of this Act, shall furnish the Master with an address for the service upon him of notices and process and shall, in case of change of address, within 14 days notify the Master by registered post of the new address.



6. Authorization of trustee and security.

(1) Any person whose appointment as trustee in terms of a trust instrument, section 7 or a court order comes into force after the commencement of this Act, shall act in that capacity only if authorized thereto in writing by the Master.

(2) The Master does not grant authority to the trustee in terms of this section, unless—

- (a) he has furnished security to the satisfaction of the Master for the due and faithful performance of his duties as trustee; or
- (b) he has been exempted from furnishing security by a court order or by the Master under subsection (3) (a) or, subject to the provisions of subsection (3) (d), in terms of a trust instrument:

Provided that where the furnishing of security is required, the Master may, pending the furnishing of security, authorize the trustee in writing to perform specified acts with regard to the trust property.

(3) The Master may, if in his opinion there are sound reasons to do so—

- (a) whether or not security is required by the trust instrument (except a court order), dispense with security by a trustee;
- (b) reduce or cancel any security furnished;



- (c) order a trustee to furnish additional security;
- (d) order a trustee who has been exempted from furnishing security in terms of a trust instrument (except a court order) to furnish security.

(4) If any authorization is given in terms of this section to a trustee which is a corporation, such authorization shall, subject to the provisions of the trust instrument, be given in the name of a nominee of the corporation for whose actions as trustee the corporation is legally liable, and any substitution for such nominee of some other person shall be endorsed on the said authorization.

7. Appointment of trustee and co-trustee by Master.

(1) If the office of trustee cannot be filled or becomes vacant, the Master shall, in the absence of any provision in the trust instrument, after consultation with so many interested parties as he may deem necessary, appoint any person as trustee.

(2) When the Master considers it desirable, he may, notwithstanding the provisions of the trust instrument, appoint as co-trustee of any serving trustee any person whom he deems fit.

8. Foreign trustees.—When a person who was appointed outside the Republic as trustee has to administer or dispose of trust property in the Republic, the provisions of this Act shall apply to such trustee in respect of



such trust property and the Master may authorize such trustee under section 6 to act as trustee in respect of that property.

9. Care, diligence and skill required of trustee.

(1) 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.

(2) Any provision contained in a trust instrument shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust where he fails to show the degree of care, diligence and skill as required in subsection (1).

10. Trust account.—Whenever a person receives money in his capacity as trustee, he shall deposit such money in a separate trust account at a banking institution or building society.

11. Registration and identification of trust property.

(1) Subject to the provisions of the Financial Institutions (Investment of Funds) Act, 1984 (Act No. 39 of 1984), section 40 of the Administration of Estates Act, 1965 (Act No. 66 of 1965), and the provisions of the trust instrument concerned, a trustee shall—

- (a) indicate clearly in his bookkeeping the property which he holds in his capacity as trustee;



- (b) if applicable, register trust property or keep it registered in such manner as to make it clear from the registration that it is trust property;
- (c) make any account or investment at a financial institution identifiable as a trust account or trust investment;
- (d) in the case of trust property other than property referred to in paragraphs (b) or (c), make such property identifiable as trust property in the best possible manner.

(2) In so far as the registration or identification of trust property being administered by a trustee at the commencement of this Act does not comply with the requirements of subsection (1), the trustee shall within a period of 12 months after the said commencement take such steps or cause such steps to be taken as may be necessary to bring the registration or identification of such property into conformity with the said requirements.

(3) Upon application in terms of subsection (2) to bring the registration of trust property into line with the provisions of subsection (1), the officer in charge of a deeds registry where such trust property is registered, shall free of charge take such steps as may be necessary to effect the required registration.

12. Separate position of trust property.—Trust property shall not form part of the personal estate of the trustee except in so far as he as trust beneficiary is entitled to the trust property.



13. Power of court to vary trust provisions.—If a trust instrument contains any provision which brings about consequences which in the opinion of the court the founder of a trust did not contemplate or foresee and which—

- (a) hampers the achievement of the objects of the founder; or
- (b) prejudices the interests of beneficiaries; or
- (c) is in conflict with the public interest,

the court may, on application of the trustee or any person who in the opinion of the court has a sufficient interest in the trust property, delete or vary any such provision or make in respect thereof any order which such court deems just, including an order whereby particular trust property is substituted for particular other property, or an order terminating the trust.

14. Variation of trust instrument.—Whenever a trust beneficiary under tutorship or curatorship becomes entitled to a benefit in terms of a trust instrument, the tutor or curator of such a beneficiary may on behalf of the beneficiary agree to the amendment of the provisions of a trust instrument, provided such amendment is to the benefit of the beneficiary.

15. Report of irregularities.—If an irregularity in connection with the administration of a trust comes to the notice of a person who audits the accounts of a trust, such person shall, if in his opinion it is a material irregularity, report it in writing to the trustee, and if such irregularity is not rectified to the satisfaction of such person within one month as from the date upon which it was reported to the trustee, that person shall report it in writing to the Master.



16. Master may call upon trustee to account.

(1) A trustee shall, at the written request of the Master, account to the Master to his satisfaction and in accordance with the Master's requirements for his administration and disposal of trust property and shall, at the written request of the Master, deliver to the Master any book, record, account or document relating to his administration or disposal of the trust property and shall to the best of his ability answer honestly and truthfully any question put to him by the Master in connection with the administration and disposal of the trust property.

(2) The Master may, if he deems it necessary, cause an investigation to be carried out by some fit and proper person appointed by him into the trustee's administration and disposal of trust property.

(3) The Master shall make such order as he deems fit in connection with the costs of an investigation referred to in subsection (2).

17. Custody of documents.—A trustee shall not without the written consent of the Master destroy any document which serves as proof of the investment, safe custody, control, administration, alienation or distribution of trust property before the expiry of a period of five years from the termination of a trust.

18. Copies of documents.—Subject to the provisions of section 5 (2) of the Administration of Estates Act, 1965 (Act No. 66 of 1965), regarding the documents in connection with the estate of a deceased person, the Master shall upon written request and payment of the prescribed fee furnish a certified copy of any document under his control relating to trust



property to a trustee, his surety or his representative or any other person who in the opinion of the Master has sufficient interest in such document.

19. Failure by trustee to account or perform duties.—If any trustee fails to comply with a request by the Master in terms of section 16 or to perform any duty imposed upon him by the trust instrument or by law, the Master or any person having an interest in the trust property may apply to the court for an order directing the trustee to comply with such request or to perform such duty.

20. Removal of trustee.

(1) A trustee may, on the application of the Master or any person having an interest in the trust property, at any time be removed from his office by the court if the court is satisfied that such removal will be in the interests of the trust and its beneficiaries.

(2) A trustee may at any time be removed from his office by the Master—

- (a) if he has been convicted in the Republic or elsewhere of any offence of which dishonesty is an element or of any other offence for which he has been sentenced to imprisonment without the option of a fine; or
- (b) if he fails to give security or additional security, as the case may be, to the satisfaction of the Master within two months after having been requested thereto or



within such further period as is allowed by the Master; or

- (c) if his estate is sequestrated or liquidated or placed under judicial management; or

 - (d) if he has been declared by a competent court to be mentally ill or incapable of managing his own affairs or if he is by virtue of the Mental Health Act, 1973 (Act No. 18 of 1973), detained as a patient in an institution or as a State patient; or
- [Para. (d) amended by s. 4 of Act No. 18 of 1996.]
- (e) if he fails to perform satisfactorily any duty imposed upon him by or under this Act or to comply with any lawful request of the Master.

(3) If a trustee authorized to act under section 6 (1) is removed from his office or resigns, he shall without delay return his written authority to the Master.

21. Resignation by trustee.—Whether or not the trust instrument provides for the trustee's resignation, the trustee may resign by notice in writing to the Master and the ascertained beneficiaries who have legal capacity, or to the tutors or curators of the beneficiaries of the trust under tutorship or curatorship.

22. Remuneration of trustee.—A trustee shall in respect of the execution of his official duties be entitled to such remuneration as provided for in the trust instrument or, where no such provision is made, to a



reasonable remuneration, which shall in the event of a dispute be fixed by the Master.

23. Access to court.—Any person who feels aggrieved by an authorization, appointment or removal of a trustee by the Master or by any decision, order or direction of the Master made or issued under this Act, may apply to the court for relief, and the court shall have the power to consider the merits of any such matter, to take evidence and to make any order it deems fit.

24. Regulations.—The Minister of Justice may make regulations regarding any matter which in terms of this Act is required or permitted to be prescribed.

25. Application of Act.—This Act shall not apply to a trust which has been exempted by any other Act from the application of the Trust Moneys Protection Act, 1934 (Act No. 34 of 1934), or to a scheme in terms of the Participation Bonds Act, 1981 (Act No. 55 of 1981).

26. Amendment or repeal of laws, and savings.

(1) The laws mentioned in the Schedule are hereby repealed or amended to the extent indicated in the third column thereof.

(2) Anything done under any provision of any law repealed by subsection (1) which may be done under a corresponding provision of this Act, shall be deemed to have been done under that corresponding provision.



27. Short title and commencement.—This Act shall be called the Trust Property Control Act, 1988, and shall come into operation on a date to be fixed by the State President by proclamation in the *Gazette*.

References

ⁱ Act 57 of 1988.

ⁱⁱ Section 1 of the Trust Property Control Act.

ⁱⁱⁱ "Edmonds Judd "Trusts – Why Establish Them" Edmonds Judd *Fineprint* Autumn 2008

http://www.edmondsjudd.co.nz/dms/images/custom_content/Fineprint_4_5_may.pdf (accessed 1 February 2010).

^{iv} M Maxwell *Trusts: A Kiwi Sham?* (2007) 21.

^v B Cameron "A trust is a key tool in planning your estate"

<http://www.roylaw.co.za/home/article/advantagesoftrusts/pageid/estate-planning> (accessed 19 November 2010).

^{vi} The exemption currently stands at R100 000.

^{vii} Cameron "A trust is a key tool in planning your estate".

^{viii} *Crookes NO v Watson and Others* 1956 (1) SA 277 (A).

^{ix} MS Blackman *et al Commentary on the Companies Act* (2002) 208.

^x *Ibid.*

^{xi} *The Master v Edgcombe's Executors* 1910 TS 263 274.

^{xii} See for example, *Goodricke & Son v Registrar of Deeds, Natal* 1974 (1) SA 404 (N).

^{xiii} WD Geach and J Yeats *Trusts Law and Practice* (2007) 118.

^{xiv} Geach and Yeats *Trusts* 121.

^{xv} Geach and Yeats *Trusts* 120.

^{xvi} Geach and Yeats *Trusts* 121.

^{xvii} A personal right is however to be contrasted with a real right in that a real right is enforceable against the entire world, whereas a personal right is against the trustees.

^{xviii} Sometimes mistakenly referred to as "the planner".

^{xix} Although, in some instances a trust is recognised as a person by statute: Section 1 of the Income Tax Act 58 of 1962 defines a trust as a person for the purposes of income tax and capital gains purposes. Similar instances can also be seen in the Value Added Tax Act 89 of 1991, the Deeds Registries Act 47 of 1927 and the Companies Act 71 of 2008. For further reading on the lack of juristic personality, see *CIR v MacNeillie's Estate* 1961 (3) SA 833 (A) and *Crundall Brothers (Pvt) Ltd v Lazarus* 1992 (2) SA 423 (Z) 426.



^{xx} L Stander “Piercing the Veneer of the Trust in South African Trust Law: Liability of Trustees of a Business Trust for Fraudulent Trading” (2008) 17 *INSOL* 165 at 166.

^{xxi} E Cameron *et al Honoré’s South African Law of Trusts* 5 ed (2002) 176.
See further, *Deedat v The Master* 1998 (1) SA 544 (N).

^{xxii} *Parker* para 10.

^{xxiii} *Ibid.*

^{xxiv} A Grant “Dealing with Property in a Trust”

<http://www.anthonygrant.com/trusts/55-dealing-with-property-when-it-is-in-a-trust> (accessed 24 August 2010).

^{xxv} *Ibid.*

^{xxvi} *Ibid.*

^{xxvii} Market Views “You May Be Disappointed To Discover That Your Trust Is Not A Trust”

http://www.sharenet.co.za/marketviews/article/34/You_May_Be_Disappointed_To_Discover_That_Your_Trust_Is_Not_A_Trust (accessed 2 March 2010).

^{xxviii} P Bobbin “Beware the trusty short cut”

http://www.argylelawyers.com.au/pdf_files/finsvcs_pub/ap166175.pdf (accessed 17 March 2009).

^{xxix} This opposes Cameron JA’s views in *Parker*, where the learned judge reasoned at para 22 that it is the separation of powers that serves to secure diligence on the part of the trustee.

^{xxx} F Du Toit *South African Trust Law: Principles and Practice* (2002) 71-72.

^{xxxi} S Pryke “Sham Trusts”

http://www.walkers.com.ky/pubdocs/Sham%20Trusts_S.Pryke.pdf (accessed 8 April 2009).

^{xxxii} Maxwell *A Kiwi Sham?* 53-54.

^{xxxiii} Maxwell *A Kiwi Sham?* 54.

^{xxxiv} Geach and Yeats *Trusts* 91.

^{xxxv} *Administratoris, Estates Richards v Nichol* 1999 (1) SA 551 (SCA).

^{xxxvi} *Tijmsrtra NO v Blunt-Mackenzir NO* 2002 (1) SA 459 (T).

^{xxxvii} Act 2 of 2000. Hereafter referred to as the ‘PAIA Act’.



^{xxxviii} Geach and Yeats *Trusts* 94. See further, *Liebenberg NO v MGK Bedryfsmaatskappy (Pty) Ltd* 2003 (2) SA 224 (SCA).

^{xxxix} Geach and Yeats *Trusts* 95.

^{xi} *Land and Agricultural Bank of South Africa v Parker and Others* 2005 (2) SA 77 (SCA).

^{xli} Act 38 of 2001.

^{xlii} Geach and Yeats *Trusts* 96

^{xliii} *Parker* para 35-36.

^{xliv} Maxwell *A Kiwi Sham?* 45.

^{xlv} *Parker* para 22.

^{xlvi} Geach and Yeats *Trusts* 19.

^{xlvii} Geach and Yeats *Trusts* 20.

^{xlviii} *Ibid.*

^{xlix} Geach and Yeats *Trusts* 21.

ⁱ As opposed to the nature of the right bestowed upon the beneficiary through the trust instrument.

ⁱⁱ Maxwell *A Kiwi Sham?* 85.

ⁱⁱⁱ *Parker* para 37.3.

^{liii} *Badenhorst* para 10.

^{liv} Based on the case of *Snook v London & West Riding Investments Ltd* 1967 (2) QB 786.

^{lv} *Official Assignee in Bankruptcy in the Property of Gary Martin Reynolds v Wilson & Others* 2008 NZCA 122.

^{lvi} *Official Assignee in Bankruptcy* para 58.

^{lvii} NSA Tax “Law Brief March 2009”

[http://www.nsatax.co.nz/ attachments/LawBrief%20for%20Lawyers%20-%20March%202009.pdf](http://www.nsatax.co.nz/attachments/LawBrief%20for%20Lawyers%20-%20March%202009.pdf) (accessed 22 July 2010).