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# MoneyTalk

## Are your Assets safe in a Trust ?

### The separation between trust assets and the personal assets of the trustee

One of the most common reasons why a person forms a trust is to keep assets out of his personal estate and thus beyond the grasp of his creditors. If the terms of the trust are such that he has control of the trust, he obtains the best of all worlds – the trust assets do not form part of his personal estate but he nonetheless has control over those assets (subject to his common-law and statutory duties) just as though he were their owner.

Can the assets of a trust be taken into account by a court when making a distribution order, vis-à-vis a trustee, in terms of **s 7(3) of the Divorce Act 70 of 1979**? This was the issue facing the Supreme Court of Appeal in *L Badenhorst and L Badenhorst (case 7/05, not yet reported)*.

At first instance, the Cape High Court held that the assets of the trust in question had to be disregarded when deciding what redistribution order to make. This conclusion rested on two propositions: firstly, that the trust was a separate legal entity; secondly, that the court could not order that the assets of the trust be taken into account unless the trust was found to be a sham.

On appeal, the Supreme Court of Appeal held the first of these points to be an egregious error, pointing out that it was held by the Appellate Division in *CIR v MacNeillie's Estate* 1961 (3) SA 833 that **a trust is not**

**a legal persona or entity in its own right, and that the assets and liabilities of a trust vest in the trustee.**

Although the judgment does not spell it out, it should be noted that, for the purposes of the Income Tax Act, a trust is indeed a legal persona; (see the definition of “person” in s1 of that Act) and that **s12 of the Trust Property Control Act 57 of 1988** provides that:

“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.”

The Supreme Court of Appeal went on to hold that the mere fact that the assets of the trust in issue in this case vested in the trustee “does not per se exclude them from consideration when determining what must be taken into account when making a redistribution order”. In order for the court to take such assets into account, said the court, **there must be evidence first that the party in question controlled the trust and secondly that, but for the trust, he would have acquired and owned the assets in his own name.**

On the facts, the Supreme Court of Appeal found both of these requirements to have been satisfied, and made a redistribution order which took account of the assets held by the trust.

### The significance of the Badenhorst judgment

It must be borne in mind that the *Badenhorst* judgment was concerned only with the power of a court to make a redistribution order in terms of **s7(3) of the Divorce Act, 1979**. It was held that, for purposes of such a redistribution order, a court can – if the two requirements summarized above are present – make a



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redistribution order which involves funds and assets held by a trust. It is significant that the Supreme Court of Appeal did not endorse the view of the High Court that a redistribution order can only be made, in terms of the Divorce Act, where the trust is a “sham”.

The *Badenhorst* case therefore did not involve an ordinary trade creditor seeking access to funds and assets held in a trust of which the debtor was a trustee, nor did it raise the question of the efficacy of a trust set up to avoid estate duty. The judgment has nothing to say about these two situations, which are often at the forefront of the parties’ minds when they set up a trust.

Seen in a broad perspective, however, **this is the second time in the recent past that the Supreme Court of Appeal has overturned a decision of the High Court and made new law in relation to trusts.**

The first was *Land and Agricultural Bank v Parker* (case 186/2003) in which the court held that a contract entered into by a trust was void because, at the time, the trust lacked capacity in that fewer trustees were in office than the minimum laid down in the trust deed. The judge in the court of first instance had described the argument which was eventually upheld by the Supreme Court of Appeal as “nonsense” and “opportunism”.

South African trust law is dynamic, and the many professional consultants - attorneys, accountants and investment advisers - who regularly form and advise on trusts should not complacently assume that the courts will not disturb established principles and concepts in trust law. Nor should they make the mistake of assuming that a court will be blinded by the black-letter provisions of the trust deed and will not give effect to the underlying reality where the trust is a mere disguise.

We see again in the *Badenhorst* judgment the **SCA’s concern**, which was trenchantly expressed in the *Parker* decision, **regarding trusts being used by a person to divest himself of assets whilst he retains de facto, if not de jure, control over those assets.**

Trustees and their professional advisers should take heed that the SCA seems to be awaiting an opportune case to strike down a trust as a sham where there is no clear separation between beneficial ownership (the right, as a trust beneficiary, to benefit under the trust) and the power (as trustee) to control the distribution of trust income and capital. A finding that a trust is a sham could have catastrophic income tax and estate duty consequences for the founder or trustees, and could also give rise to a claim for damages against the professional adviser who drafted the trust deed in a way which did not preserve the necessary separation.

It is clear, in principle, that **a line can be crossed in regard to the control exercised by a founder or trustee, beyond which a court can hold that the trust is a mere sham**, set up to disguise the reality that the trust assets are the property of the founder or the trustees. The precise location of this line is still unclear. In this particular case, the SCA judgment does not canvas the issue of sham trusts, nor does it say that the trust in question was a sham. The judgment is based four-square on the interpretation of **s7(3) of the Divorce Act 1979.**

This publication was copied from a publication first published by [Siberlnk](#) as a part of the *Corporate Law, Partnerships and Trusts* *Sibergramme 1/2006*

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26 July 06

