STBB

TRUSTS IN GENERAL AND TRANSACTIONS IN RESPECT OF IMMOVABLE PROPERTY TO WHICH TRUSTS ARE A PARTY

March 2019

WHAT IS A TRUST?

There are two types of trusts: *inter vivos* or living trusts, and testamentary trusts, also known as trusts *mortis causa*.

An *inter vivos* trust is an entity which is formed when a person known as a founder, settlor or donor formalises a written document known as a trust deed in terms of which he agrees to transfer certain assets during his lifetime to one or more office holders known as trustees who are bound to administer the assets in terms of the provisions of the trust deed concerned.

A testamentary trust is created in terms of the will of a deceased person. Such a person, known as a testator, bequeaths assets in his will to the trustees, also nominated in terms of the will, and stipulates the terms and conditions which will apply to the trust. This trust, however, does not come into existence until the death of the person concerned and then only if the reason for which the testator intended the trust to be set up actually exists. For example, a trust will not be created where a testator has stipulated in his will that any inheritance which is due to a child under a certain age should be held in trust, but on the death of the testator, there are no children under that age who inherit. Both a trust deed creating an *inter vivos* trust and a will creating a testamentary one will define the aims and objectives of the trust and will contain details of the beneficiaries, who will be entitled to receive income and/or capital from the trust. The trustees are obliged to exercise their powers and duties as defined in the founding document for the benefit of such beneficiaries.

A trust itself does not have legal personality. It is an accumulation of assets and liabilities which vests in the trustees and which must be administered by them. Only through the trustees can the trust act and the number of trustees, their means of appointment and the circumstances under which they can bind the trust are determined in the trust deed.

WHAT FORMALITIES ARE REQUIRED TO REGISTER A TRUST IN SOUTH AFRICA?

In terms of the Trust Property Control Act 57 of 1988, any person who has been appointed as a trustee in terms of a trust instrument, that is either a trust deed creating an *inter vivos* trust or a will creating a testamentary one, is only legally authorised to act in that capacity once he has been formally appointed by the Master of the High Court. To obtain this authorisation, the trustees seeking to be appointed must make application to the Master. The will or the trust deed must be lodged at the Master's Office together with certain other specific documentation in support of the application and, if the Master is satisfied that everything is in accordance with his requirements, he will issue a document known as Letters of Authority in terms of which the trustees of the trust are named. Any change of trustees, for whatever reason, is only of legal force and effect once the original Letters of Authority have been amended by the Master to reflect that change.

WHAT HAPPENS IF A TRUSTEE NAMED IN THE LETTERS OF AUTHORITY RESIGNS OR DIES?

On the death or resignation of a trustee, the Letters of Authority must be returned to the Master for the name of the trustee concerned to be deleted. A written resignation by an outgoing trustee and a resolution by the remaining trustees accepting the resignation would be required by the Master and, in the case of a deceased trustee, a copy of the death certificate would have to be lodged.

If the trust deed specifies there must at all times be no less than a certain number of trustees and, if the death or resignation of a trustee results in the number of trustees falling beneath that number, then the trustees do not have the capacity to enter into a binding transaction on behalf of the trust until the minimum required number of trustees have been formally appointed by the Master and an amended Letters of Authority issued reflecting their names.

WHO CAN BE TRUSTEES OF A TRUST AND HOW MANY TRUSTEES MUST THERE BE?

Any person who has attained the age of majority can potentially be a trustee of a trust.

However, the trust deed often specifically excludes certain persons or classes of persons from being trustees, for example: unrehabilitated insolvents, persons of unsound mind and persons disqualified in terms of the Companies Act from being a director of a company.

The founder of an *inter vivos* trust can be a trustee but, to avoid the possibility of SARS deeming the assets of the trust to be his own, should not be the only trustee.

There is no legally prescribed minimum number of trustees, but the deed of trust or will may specify that the required minimum is a certain number and below that number the trustees are only authorised to act for the limited purpose of appointing a further trustee or trustees to bring their number up to the minimum required. Where the trustees and the beneficiaries of a trust are the same persons, usually related to one another and to the founder, the majority of the Master's offices in South Africa will insist on an unrelated

Cape Town T: 021 406 9100
Claremont T: 021 673 4700
Fish Hoek T: 021 784 1580
Helderberg T: 021 850 6400
Blouberg T: 021 521 4000
Tyger Valley T: 021 943 3800
Illovo T: 011 219 6200
Fourways T: 010 001 2632
Centurion T: 012 001 1546
Bedfordview T: 011 453 0577
East London T: 043 721 1234

party, usually an accountant or other person qualified to act as a professional trust administrator, being appointed together with the related parties. This has been the situation since the landmark case of *Land and Agricultural Bank of South Africa vs Parker* and others (2005(2)SA77(SCA)).

The ideal number of trustees is three: not too many to make the administration of the trust burdensome and an uneven number so that a majority decision can be achieved if required.

HOW DO THE TRUSTEES FORMALISE THEIR DECISIONS?

The founding document will stipulate the process which has to be followed by the trustees to achieve the formalisation of a decision which will legally bind the trust, and this procedure must be followed to the letter to ensure that any transaction to which the trustees are a party cannot be invalidated by virtue of non-compliance.

The majority of trust deeds will cover the following:

- Whether a majority of the trustees must agree on the issue or whether a unanimous decision is required;
- If all of the trustees have to be present at a meeting called for the purpose of making a decision or whether a lesser number will suffice;
- Whether it is possible for a valid decision to be formalised without a meeting of the trustees actually taking place and what the procedure is that must be followed in this event;
- Whether any particular trustee has a casting vote; and
- Whether any majority decision of the trustees shall not be valid unless the vote of a particular trustee is part of the majority.

Whatever the procedure, once a decision has been made by the trustees on any issue, it must be formalised in writing by means of a resolution which must be signed by either all of the trustees or a majority of them, whatever may be required by the deed.

WHAT ARE THE NECESSARY REQUIREMENTS FOR A TRUST TO ENTER INTO A VALID CONTRACT OF PURCHASE, SALE OR MORTGAGE IN RESPECT OF IMMOVABLE PROPERTY?

1. As with all contracts of purchase and sale in respect of land the provisions of section 2 of the Alienation of Land Act 1981 apply in that the deed of sale has to be in writing and the parties thereto or their agents have to be legally authorised to enter into the transaction concerned at the time of signing the contract.

2. The only persons who can purchase an immovable property on behalf of a trust are trustees who have been issued with Letters of Authority by the Master of the High Court in terms of the Trust Property Control Act as discussed above.

3. The required minimum number of trustees should be reflected on the Letters of Authority and if any of the trustees so reflected have resigned or died or no longer qualify to act as a trustee in terms of the trust document, then they must be formally removed from the Letters of Authority by the Master and if necessary replacements should be formally appointed.

4. The purchase of immovable property by trustees who have been nominated in terms of a trust deed which has not been registered with the Master or have been nominated by resolution of existing trustees but have not been issued with Letters of Authority, or on the other hand a transaction entered into by any party who purports to purchase immovable property on behalf of a trust to be formed, is void *ab initio* and cannot be ratified. (See *Van der Merwe vs Van der Merwe en Andere* 2000(2) SA 516 (C)). This is in contrast to the situation with close corporations and companies where a pre-incorporation contract can be ratified and consequently an immovable property can be purchased on account of such an entity still to be formed.

5. The trust deed or will must specifically authorise the trustees to sell, purchase and/or mortgage immovable property as the case may be.

6. Either all the trustees must sign the contract or a resolution which is fully compliant with the procedure and formalities laid down in the founding document must be passed prior to the deed of sale being signed, authorising the transaction concerned and nominating a trustee or trustees to enter into the contract on behalf of the trust. Any deed of sale entered into by one trustee purporting to act on behalf of the trust, but without a valid resolution having been passed authorising him to do so, will be void *ab initio* for lack of compliance with section 2 of the Alienation of Land Act and incapable of ratification. (*See Thorpe NO vs Trittenden* (2006) SCA 30.)

Any person responsible for ensuring the validity of a deed of sale or mortgage to which a trust is a party should, in the light of the above, have sight of the following documents:

- A copy of the trust deed;
- A copy of the most up-to-date Letters of Authority issued by the Master of the High Court;
- The authorising resolution; and
- Copies of the identity documents of all of the trustees to establish that they are one and the same persons as the trustees reflected on the Letters of Authority. In family

Cape Town T: 021 406 9100
Claremont T: 021 673 4700
Fish Hoek T: 021 784 1580
Helderberg T: 021 850 6400
Blouberg T: 021 521 4000
Tyger Valley T: 021 943 3800
Illovo T: 011 219 6200
Fourways T: 010 001 2632
Centurion T: 012 001 1546
Bedfordview T: 011 453 0577
East London T: 043 721 1234

trusts, father and son may have similar names. A utility bill for each of the trustees should also be requested.

These documents should be perused and, if necessary, questions asked to ensure that:

- The trust deed authorises the trustees to enter into the transaction;
- The signatories to the resolution are the appointed trustees according to the Letters of Authority;
- The resolution has been taken in compliance with the provisions of the trust deed for a valid resolution;
- The resolution authorises the trustee or trustees signing the contract to do so; and
- The resolution adequately authorises the transaction being contemplated, preferably by reference to the specific immovable property and the selling price, purchase price or mortgage amount, whichever is applicable.

WHY SET UP A TRUST?

The most common reasons for setting up a trust are:

- To protect assets for minor children or other beneficiaries in the event of your death;
- To reduce the amount of estate duty which may be payable by your estate on your death;
- To protect your assets in the event of your insolvency; and
- To administer assets for charitable purposes.

WHAT ARE THE POSSIBLE DISADVANTAGES OF USING A TRUST AS A VEHICLE TO OWN IMMOVABLE PROPERTY?

The main disadvantages are:

1. The *cost factor*, particularly the following:

- The initial costs payable to the professional advisor to establish and register an *inter vivos* trust.
- The higher percentage of the capital gain on the disposal of an immovable property, which is potentially taxable: 80% of the gain must be included as opposed to 40% in the case of an individual person.
- The loss of the primary residence exemption for capital gains tax purposes (currently R2 million) if the immovable property registered in the name of the trust is the founder's place of primary residence.
- The rate of normal taxation is higher in trusts than it is for an individual person; with certain limited exceptions trusts are taxed at a flat rate of 45%.
- If the founder wishes to donate an immovable property already registered in his name to a trust, donations tax currently at the rate of 20% will be payable on the market value of the property less whatever amount in law a taxpayer may donate annually free from donations tax, currently R100 000. (Donations tax can be avoided in this situation by the founder selling the immovable property to the trust for its market value. The trust then effectively owes the founder the purchase consideration, which debt remains an asset in the founder's estate for estate duty purposes. Any increase in the value of the immovable property would, however, be in the hands of the trust, resulting in a potential estate duty saving when the founder dies.)
- The costs of administering the trust on an ongoing basis, particularly if the services of a professional trustee are used.
- In circumstances where a trust owes the purchase consideration of an asset to, for example, the founder, section 7C of the Income Tax Act, effective from 1st March 2017, provides that if interest is charged on such a loan account at a rate less than the official rate of ...%, then the difference between the official rate and the actual rate charged will be deemed by SARS as a donation and donations tax of 20% will be payable thereon by the person who granted the loan.

2. The loss of complete control which the founder loses over the assets:

Founders of *inter vivos* trusts often have the perception that they will still have absolute control over the assets forming part of the trust because of being the founder as well as one of the trustees and, in some cases, also having a casting vote or veto. However, in law, this is not the case: the assets, once transferred, are owned by the trustees and the business of the trust can only be dealt with legally according to the provisions of the trust deed.

A properly constituted trust deed designed to hold assets which would otherwise form part of the founder's estate with a view to reducing the amount of estate duty payable in the founder's estate on his death must create some distance between the founder, the trustees and the beneficiaries to avoid, in particular, SARS deeming the capital and income to be owned by the founder. Many founders who are also trustees act as if the trust assets are their own and ignore the procedural requirements for a valid resolution as defined in the trust document, resulting in contracts entered into on the basis of the invalid resolution being void. In the case

Cape Town T: 021 406 9100
Claremont T: 021 673 4700
Fish Hoek T: 021 784 1580
Helderberg T: 021 850 6400
Blouberg T: 021 521 4000
Tyger Valley T: 021 943 3800
Illovo T: 011 219 6200
Fourways T: 010 001 2632
Centurion T: 012 001 1546
Bedfordview T: 011 453 0577
East London T: 043 721 1234

of *Badenhorst vs Badenhorst* 2006 (2) SA 255 (SCA), the court took this even further than the Parker case (see above) and held that, where the 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 a contract binding the trust. It may provide evidence that the trust is a veneer which should be pierced in the interests of creditors of the founder's personal estate.

AN IMMOVABLE PROPERTY CAN BE REGISTERED IN THE NAME OF A COMPANY OR A CLOSE CORPORATION WHERE THE SHARES IN THE COMPANY OR THE MEMBERS INTEREST IN THE CLOSE CORPORATION ARE HELD BY A TRUST

The main advantage of this option is that the tax rate applicable to companies and close corporations is lower than that applicable to trusts.

The main disadvantage is that trusts are not required to comply with the sometimes onerous statutory requirements which are applicable to companies.

Insofar as close corporations are concerned, it has only been possible since the passing of the Close Corporations Amendment Act 25 of 2005 for an *inter vivos* trust to own a member's interest in a close corporation. Whether this option can be used with regard to any particular trust will have to be considered, taking into account the restrictions and requirements as set out in the said Act.

It has always been possible under the original Close Corporations Act for a testamentary trust to own a member's interest.

ARE THERE ANY FORMALITIES WHICH MUST BE COMPLIED WITH BEFORE THE TRUSTEES OF A TRUST REGISTERED IN A FOREIGN COUNTRY CAN TRANSACT IN SOUTH AFRICA?

In terms of section 8 of the Trust Property Control Act, where a person who has been validly appointed outside South Africa as a trustee of a trust registered in a foreign jurisdiction wishes to transact in respect of assets within South Africa, the provisions of the said Act apply and he cannot so transact until he has been authorised by the Master to do so by means of Letters of Authority issued in his favour by the Master of the High Court.

To apply for Letters of Authority, it would be necessary to lodge with the Master a notarially certified copy of the trust deed in respect of the foreign trust as well as certain other documentation and requirements, one of which may be the provision of security. Unless security is given, it will be obligatory to provide a South African domicilium acceptable to the Master, which will usually necessitate the trustees using the services of a professional trust administrator whose address will be the domicilium of the trust.

Once the Master has issued Letters of Authority in favour of the foreign trustees, all the same principles outlined above will need to be considered to ensure the validity of a transaction.

Cape Town T: 021 406 9100
Claremont T: 021 673 4700
Fish Hoek T: 021 784 1580
Helderberg T: 021 850 6400
Blouberg T: 021 521 4000
Tyger Valley T: 021 943 3800
Illovo T: 011 219 6200
Fourways T: 010 001 2632
Centurion T: 012 001 1546
Bedfordview T: 011 453 0577
East London T: 043 721 1234