Costly words

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A recent court case, *The Abraham Krok Trust v SARS* (Case No 58/2010), concerning a Trust housing some of the wealth of the Krok dynasty – themselves no strangers to the media – had the legal and tax fraternity abuzz.

One of the many attractive and distinctive features of the South African trust, is the fact that it is a vehicle which can exist *ad infinitum*. It thereby offers continuity as well as asset protection over generations. Yet it is precisely this potential longevity that complicates the trust draftsman's brief as his work must be capable of dispelling any claims of vagueness and ambiguity in years to come yet must also make provision for a range of contingencies that is near impossible to foresee.For this reason, a trust deed's provisions are generally drafted to ensure as much flexibility as possible for future unknown circumstances.

But what to do in a situation where the trust deed did not afford such flexibility and the trustees, at face value, acted in contravention of the trust deed? This case illustrates the potential dire financial and legal consequences that may follow where distributions are made which may be in contravention of the trust deed– as it was in the opinion of the court *a quo*. It also highlights the degree of skill required of the drafter of the deed and the responsibility of the trustees in their decision making.

The material facts

The facts were essentially the following - in 1973, the Appellant Trust was established to be administered by the trustees for the benefit of the founder's six children. A substitution of the trust deed was effected in 1981 and in terms of the new trust deed, the assets of the Appellant Trust were deemed to be divided into six sub-trusts, one for the benefit of each child. The sub-trusts were, however, still governed by the 1981 trust deed and were administered collectively under the auspices of the Appellant Trust. In 1994, a further six trusts were established, again one for the benefit of each child. These two sets of trusts then entered into a sale agreement in terms of which each of the 1981 sub-trusts sold to its 1994 counterpart trust, capital assets of which the purchase price were to be discharged by each of the 1994 trusts assuming certain liabilities while the greater balance was left on interest free loan account.

The awards to the "beneficiaries"

In 1997, the Appellant Trust awarded an amount equivalent to the amount owing to the 1994 trusts and it was further agreed by the trustees that the award would be set-off against the debt arising from the sale. While a draftsman would usually, with the aim of ensuring flexibility, also include in addition to the stated individual beneficiaries, any trust of which the individuals are beneficiaries, this particular trust deed did not do so. Thus the validity of the awards to the sub-trusts were contentious as they were not made to the stated beneficiaries of the trust, and were potentially in contravention of the trust deed and the trustees' powers. It may be worthwhile noting that the trustees at all times genuinely believed that they were authorised to make the awards. It was this award on which the Commissioner sought to tax the Appellant Trust for donations tax as well as interest. The collective assessment of the trust amounted to a staggering R78 682 849 and R93 862 092 in interest. Having objected to the assessment without success, the trustees appealed to the tax court where they met with a similar fate, and thus appealed to the Supreme Court of Appeal.

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Donations tax in respect of trust awards

The relevant tax, donations tax, is levied on the value of any property disposed should it be gratuitous. A disposal also includes the gratuitous waiver or renunciation of a right. A donation made by a trustee to the beneficiary of a trust would therefore ordinarily attract donations tax. But an exemption to the tax is offered through s56(1)(l) of the Income Tax Act, which exempts '*property which is disposed of under a donation if such property is disposed of under and in pursuance of any trust*'. The rationale for this exemption was given in *Welch's Estate v Commissioner, South African Revenue Service* 2005 (4) SA 173 (SCA) where it was stated that the apparent purpose of the exemption is simply to avoid donations tax being levied twice upon what is, in reality, one donation traceable to the initial act of the donor in settling assets upon the trust.

The finding of the court

The Supreme Court of Appeal (SCA) was prepared, without much elaboration on the topic, to accept that whatever the nature of the awards, they were the '*disposals of property*' as contemplated by the definition of a '*donation*' and were made '*gratuitously*.' Consequently they would thus ordinarily attract donations tax. The question before the SCA was focused therefore

on whether the donation fell within the ambit of the statutory exemption as having been disposed of '*under and in pursuance of any trust*.' Important to this enquiry was the issue of whether the award was authorised by the trust deed in this particular instance.

The trustees in the present case did not – in the words of the court "*pin their colours to either mast*" but instead awaited the court's pronouncement on the validity or otherwise of the disposal. They therefore argued both ways – first that on a proper construction of the deed, the trustees had no power to make the awards, thus rendering the awards invalid, and consequently, on the basis that the charging section only applied to legally valid donations, the awards could not constitute a donation as contemplated by the Act. Alternatively if the awards were found to be authorised, then they fell within the exemption. The Commissioner countered the first argument by contending that it did not matter whether the disposals were valid or invalid at law – in either event the disposals occurred in fact and the relevant section required no more than that. As to the second argument, the Commissioner contended that the awards were not authorised by the trust deed and were thus not made '*under and in pursuance*' of the trust and fell foul of the exemption provision.

The SCA did not find it necessary to address these issues authoritatively and instead proceeded on the basis of an assumption in favour of the Commissioner that the exemption provision is only applicable to a donation that the trustees are authorised by the trust deed to make, as well as the further assumption that the court (including the tax court) has the competency to pronounce on this question. The Court consequently focused its attention on the particular trust deed and its construction.It considered the particular clause in the trust deed which dealt with capital disposals and conferred upon the trustees "*the right to, if they in their sole and absolute discretion deem it necessary, apply and utilize any portion of the capital of the trusts, for the benefit of the child for whom the trust has been established and should they in their discretion deem fit, for the benefit of any of the other children, should circumstances in their opinion so warrant.*" The clause also required such application to be made towards the purposes set out in the income application clause, being "*for the benefit of the children and for their maintenance, well being, education, upbringing and reasonable pleasures.*"

The Court concluded that the clauses, if read together, conveyed clearly that capital of the trust may be applied for the benefit of the children in a manner that the trustees may determine in their absolute discretion. Furthermore as there was no dispute that the disposals in this case indeed benefited the children, the Court found that the trustees were authorised to make them. Consequently the Court ordered the court *a quo's* order to be overturned and substituted with an order setting the assessment aside.

Although the case has been classified as having no precedential significance, it does lay a foundation for further debate and, some thoughts follow:

Validity as a requirement

First it is regretted that the Court did not utilise the opportunity to decide the issues as to whether only lawful disposals will qualify as donations as contemplated in the Act and similarly, whether only lawful donations qualify for exemption. The Court merely stated instead that "*it is not usual for a court to pronounce upon the validity of a bilateral transaction if all the interested parties are not before it*" – which they usually will not be in tax proceedings. By itself that seems to me to suggest that the legislature did not intend s54 to apply only to an authorised donation (as submitted for the trustees) nor to exempt from donations tax only authorised donations (as submitted for the Commissioner) and thus the validity or invalidity of the transaction would be irrelevant. But once more it is not necessary to pursue that enquiry." In the court *a quo*, it had been found that the awards were in fact *ultra vires* the trust deed, but that notwithstanding the consequential void nature thereof *inter partes*, it can still give rise to liability for donations tax, in that court reliance was placed on the case of *MP Finance Group CC (In Liquidation) v C :SARS* 69 SATC 141 where it was said that *"an illegal contract is not without all legal consequences and it can, indeed have fiscal consequences."*

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Construction of the trust deed

It is also unfortunate that no further guidance was given as to construction rules applicable to trusts. An *inter vivos* trust is regarded as a specie of the *stipulatio alteri*, (a contract for the benefit of a third party) and thus, by analogy, the rules applicable to the interpretation of contracts would apply.

Consequently, as with the interpretation of written contracts, the point of departure is to ascertain the grammatical and ordinary meaning of the words used, as determined within the context of the instrument (the trust deed) as a whole. Particularly important in a trust setting is the rule that that the "*trust speaks from the time of its execution and must be interpreted at such time. It is the settlor's intention at that time which must be ascertained from the language he used in the circumstances*" – from the case of *Moosa and Another v Jhavery* 1958 (4) SA 165 (N). In the present instance, the further trusts did not exist at the time of the execution of the trust deed in 1973, nor at time of substitution of the trust deed in 1981, and it is doubtful whether the founder's intention as to beneficiaries can be said to have included these entities.

Perhaps decisive in the present instance is the further rule that where there is ambiguity in the trust document, an interpretation favouring the basic purpose and scope of the trust deed must be favoured. Consequently as it is clear that the purpose of the trust was to benefit the children and as it was not disputed that the children would benefit from the award to the specific trusts dedicated to each of them, the awards could pass muster under the broader intent of the trust.

Care, diligence and skill required of trustees

It is, however, quite disconcerting that the trustees of the particular trust did not ascertain the scope of their authority prior to making the awards, even more so when the substantial value of the awards is taken into account. Trustees derive their powers from the trust instrument and thus are limited in

their actions to its particular content. As the trust instrument is the document to which the trustees must adhere, there is a duty upon the trustees to acquaint themselves with the contents, to observe it and give lawful effect to it. As per Kirk-Cohen in *Tijmstra NO v Blunt-Mackenzie No And Others* 2002 (1) SA 459 (T), *"One cannot be a trustee without ascertaining what the rights and obligations of that office entail,"* where trustees do not observe the trust deed it is, potentially, grounds for their removal. It is also incumbent upon the trustees to identify the beneficiaries and to make distributions to them in accordance with the trust deed. This stems from the core function of trustees which is to administer the trust assets received from the founder for the benefit of the beneficiaries. Moreover, the award to a person who is not a beneficiary of the trust also calls into question the standard of "*care, diligence and skill,*" which the Trust Property Control Act expressly requires and which our common law regards as being higher than that which an ordinary person may observe in the management of his or her own affairs.

The phrase "*for the benefit of…*"

In the trust context, this phrase has surfaced in at least one other SCA case as well, namely *Potgieter en 'n Ander NNO v Shell Suid-Afrika (Edms) Bpk* 2003 (1) SA 163 (SCA) where the Afrikaans translation of this phrase was considered. In this case, the trustees of a family trust signed a deed of suretyship whereby they bound the trust as surety and co-principal debtor for a close corporation. One of the beneficiaries of the trust was the sole member of this close corporation. In time, the close corporation was liquidated and the debtor sued the trust based on its obligations in terms of the suretyship. The trust deed empowered the trustees to perform any act whatsoever save for guaranteeing the performance of contracts and obligations to any person or company as surety and co-principal debtor, unless such guarantee was "*ten behoewe van 'n begunstigde*" (in favour of the beneficiary). Thus the question before the Court was whether the trustees had the necessary authority to enter into the suretyship based on their powers as set out in the trust deed. The Court referred to the case of *S v Moloi and another* 1987 (1) SA 196 (A) were the Court had, after consideration of Afrikaans dictionaries found the phrase to have only one meaning , namely – "tot voordeel, ten bate (dienste van); in belang van." (of, for the benefit of, in the interest of) The Court found that *prima facie* the facts indicated that it was the intention of the trustees to benefit the relevant beneficiary or act in his interest by entering the suretyship. This impression had not been rebutted by the trustees and consequently they had to accept the risk of liability for the trust. While this phrase may, therefore, be widely and purposefully interpreted so as to bring within its ambit various actions that have at their core the benefit of the trust beneficiaries, this must be contrasted with one of the essentials requirements for the validity of a trust as discussed next.

Certainty of beneficiaries

One of the *essentalia* for the valid formation of a trust is that its object must be defined with reasonable certainty. This entails that where the trust is not for an

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impersonal object, the beneficiaries must be named or at least be ascertainable persons or classes of persons. Where persons or a class of beneficiaries cannot be objectively determined, a trust will fail in its entirety. In light of such a severe consequence, it is advisable therefore to describe adequately the beneficiaries rather than leaving it to the interpretation of the court. This may not always be as favourable as in this case and may prove to be a far costlier option. It would also be prudent to allow for possible alterations in distribution strategies in years to come by including not only the individuals, but also further entities from which the trust beneficiaries will substantially benefit, again subject to the requirement that these entities are capable of being reasonably ascertained.

Conclusion

This case illustrates the importance of certainty in both the drafting the trust deed, and in its subsequent administration. In the context of trust matters, this may not be an easy task, but a lesson can perhaps be learnt from the Roman rhetorician and advocate, Quintillan who, as early as the 1st century AD, imparted the wisdom that in writing, one should not aim at being possible to understand, but at being impossible to misunderstand. ◆

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