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THE FIDUCIARY INSTITUTE OF SOUTHERN AFRICA



Shams, and looking ‘behind’ the trust form – an update

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Agenda

1. Sham trusts
2. Alter-ego trusts
3. Going behind the trust form
4. *Van Zyl v Kaye N.O.*
5. Conclusion



- English law

- *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786

“... 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

- New Zealand
 - *Official Assignee in Bankruptcy in the Property of Gary Martin Reynolds v Wilson & Others [2008] NZCA 122*
- Robertson J agreed with Snook “*all parties to the transaction must share a common intention before a sham finding could be made.*”
- “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.



- A sham trust exists where a trust would be created, the trust assets transferred to the trustees, but the trustees do not hold the assets beneficially
- Thus, the trust purports to have been established on the terms of a particular trust deed, but these terms do not reflect the parties' (the settlor and trustees) true intentions, the trust deed being proffered with the intention of misleading third parties as to the true terms of the trust
- In order to be considered a sham trust, such arrangement must have been created with a common bilateral intention of the settlor and at least one trustee
- The settlor in this instance refers to the true settlor and not any nominee settlor
- The trust deed is the sham



Sham trusts

- According to M J de Waal *The Abuse of the Trust (or: “Going Behind the Trust Form”)*, whether or not a trust is a sham has everything to do with the requirements for the creation of a valid trust
 1. **Founder’s intention**
 2. Intention appropriately expressed
 3. Trust property defined
 4. Trust object defined
 5. **Object must be lawful**
- Emerging sham?
- Can a sham trust under new trusteeship regain normative trust status?



Alter-ego trusts

- The alter-ego doctrine is a principle separate and distinct from the sham doctrine.
- 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

Alter-ego trusts

- 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
- *Badenhorst v Badenhorst* 2006 (2) SA 255 (SCA):
...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



Sham trusts

- Not settled law in other jurisdictions as to the outcome of a sham trust. Two possibilities exist:
 - Trust 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
 - 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



Consequences of a sham/ alter-ego

Alter-ego trusts

- The law is settled
 - As a general rule, a finding of an alter-ego trust on its own does not void the trust
 - *Official Assignee in Bankruptcy* :
“*the uptake of control by someone other than an authorised person cannot be sufficient to extinguish the rights of beneficiaries*”
- Breach of trust



Abuse of trust

- According to de Waal, look at the principles of trust administration:

1. The trustee is bound to exercise an independent discretion

2. The trustee must give effect to the trust deed, properly interpreted

3. The trustee must act with care, diligence and skill



Signals of abuse

1. The trust deed

- The constitutive charter – Cameron JA (*Land and Agricultural Bank v Parker*)
- Independent trustee provisions
- Provisions relating to the appointments and dismissals of trustees
- Sub-minima provisions
- Scope of amendment power
- No settlor control



Signals of abuse

2. The actions of the trustee and/or founder
 - The trustee must give effect to the trust deed, properly interpreted
 - Dominant trustee
 - Trustees to act with care, diligence and skill
 - Alter-ego



Going behind the trust form and the abuse of trust

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- *Badenhorst*
- *Nedbank Ltd v Thorpe* [2008] JOL 22675 (N)
- *Van der Merwe NO and Others v Hydraberg Hydraulics* CC 2010 (5) SA 555 (WCC)



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Going behind the trust form and the abuse of trust

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Rees & Others v Harris & Others [2011] JOL 28014 (GSJ)

Thus, in appropriate circumstances, the veneer of a trust can be pierced in the same way as the corporate veil of a company. Consequently, where the trustees of a trust clearly do not treat the trust as a separate entity, and where special circumstances exist to show that there has been an abuse of the trust entity by a trustee, the veneer must be pierced. It follows that if a legitimately established trust is used or misused in an improper fashion by its trustees to perpetrate deceit, and/or fraud, the natural person behind the trust veneer must be held personally liable. In these circumstances, if it is demonstrated that a trustee who has de facto control of trust assets effectively acquired and owned such assets for his own benefit only, such assets can in appropriate circumstances be considered to be those of the said trustee.



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- Facts
- *“Establishing that a trust is a sham and ‘going behind the trust form’ entail fundamentally different undertakings. When a trust is a sham, it does not exist and there is nothing to ‘go behind’.”*
- *“Holding that a trust is a sham is essentially a finding of fact. Inherent in any determination that a trust is a sham must be a finding that the requirements for the establishment of a trust were not met, or that the appearance of having met them was in reality a dissimulation.”*



Van Zyl NO and Another v Kaye NO and Another [2014] ZAWCHC 52

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- *“Going behind the trust form...entails accepting that the trust exists, but disregarding for given purposes the ordinary consequences of its existence. This might entail holding the trustees personally liable for an obligation ostensibly undertaken in their capacity as trustees, or holding the trust bound to transactions ostensibly undertaken by the trustees acting outside the limits of their authority or legal capacity as such.”*



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Van Zyl NO and Another v Kaye NO and Another [2014] ZAWCHC 52

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- *“Going behind the trust form (or ‘piercing its veneer’, as the concept is sometimes described) essentially represents the provision by a court of an equitable remedy to a third party affected by an unconscionable abuse of the trust form. It is a remedy that will be afforded in suitable or appropriate cases. The notion of the provision of such a remedy has been postulated as a desirable development in our law.”*



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- Relief now available in our law for sham trusts and abuse of trust instances
- Clarification on the alter-ego doctrine in South Africa
- Sham:
 - Are the elements of a valid trust not present?
 - Trust void, go through purification and unwinding process
- Abuse of trust:
 - Was there an unconscionable abuse?
 - Trustee/s personally liable

Thank you

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Prof Marius de Waal

De Waal, M. 2012. The abuse of the trust (or: "Going behind the trust form"): The South African experience with some comparative perspectives. The Rabel Journal of Comparative and International Private Law, 76(4):1078-1100.

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