The intersection between trust law and matrimonial property law at divorce: Certainties and Obscurities

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1) INTRODUCTION: The "CORE IDEA" of SA trust:

There must at all times be a SEPARATION of ownership (or CONTROL) of trust assets, from ENJOYMENT of trust benefits:

(***Landbank v Parker*** 2005 (2) SA 77 (SCA)).

This principle is "reinforced" by § 12 of the TPCA:

"Trust property shall not form part of the personal estate of the trustee except in so far as he as the trust beneficiary is entitled to the trust property."

- But, in recent times trust form increasingly **ABUSED**:

  → especially in family trusts / business trusts; and where trustees are also beneficiaries:

  ➔ "**DEBASEMENT of core idea**"

  ➔ "*alter ego*" of trustee / trust founder

  ➔ possibly justifies "going behind" the trust form or "piercing the veil" of the trust.

MJ de Waal (2012) *Rabels Zeitschrift:*

- Distinguishes between "SHAM" and "ABUSE" scenarios;
- Abuse occurs as a result of lack of adherence to the "CORE DUTIES" of a trustee:

1) Trustee must exercise an **independent discretion**;
2) Trustee must **give effect to the trust deed**;
3) Trustee must **act with care, diligence and skill** in performing duties/exercising powers.

Also: Violation of the **joint-action rule** (F du Toit *Journal of Civil Law Studies* 2015: 666).

Trust assets and Divorce

Badenhorst v Badenhorst 2006 (2) SA 255 (SCA):

- LEGAL QUESTION:
  - Can trust assets be taken into account for the purposes of a redistribution order (§ 7(3) – (6) Divorce Act)?

SCA in *Badenhorst*:

- This "is a classic instance of [the respondent] having full control of the assets of the trust and using the trust as a vehicle for his business activities":
- *Why?*

  Trust deed:

  - Nominal amount provided by respondent's father as trust founder;
  - Respondent and brother were co-trustees, but latter could be discharged at any time by respondent;
  - Trustees granted *carte blanche* to deal with assets as they saw fit.

Administration of trust:

- Respondent rarely consulted his co-trustee;
- Income that should have been paid to the trust (as a shareholder) was paid to respondent personally;
- Property owned by respondent was financed by the trust;
- Trust property described as personal property for purposes of credit applications.

SCA: "Control Test"

"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*."**

To determine whether a party has such control:

(i) Terms of the trust deed, and

(ii) Evidence of how the affairs of the trust were conducted during the marriage.

- *Because this test complied with*:

  → **VALUE** of trust assets added to Mr Badenhorst's personal estate

- ***BUT:*** *Badenhorst* created confusion:

  → Was the court "piercing" the trust veil or exercising wide discretion in § 7?

- Conflicting case law:

(1) Binns-Ward J in ***Van Zyl v Kaye*** 2014 (4) SA 452 (WCC) at par [23]:

"I am not aware of any matter in which a South African court has yet 'pierced the veneer' of a trust … *Badenhorst* did not entail any disregard of the trust involved in that case …"

In essence: *Badenhorst* "went to the application of section 7(3) – (5) of the Divorce Act, rather than to any remedy for abuse of the trust form."

(2) Opposite view: ***RP v DP*** 2014 (6) SA 243 (ECP):

- "[T]he power of piercing *either the corporate or the trust veil* ***is derived from common law and not from any general discretion a court may have***. It is a function quite separate from … making a redistribution order under s 7 of the Divorce Act 70 of 1979 … and must not be confused or conflated with such power."

- *Badenhorst* **therefore involved a piercing** because "[t]he only way the personal assets of a trustee can include what is *notionally* regarded as trust assets is by lifting or piercing the trust veil and finding that the trust is indeed the *alter ego* of the trustee …"

More recent views:

- ***WT v KT*** 2015 (3) SA 574 (SCA):
  * Although confirmed that “the legal principles [pertaining to 'looking behind' the veneer of an *alter ego* trust] **have in essence been transplanted from the arena of 'piercing the corporate veil’”,**
  * Court of the view that ***Badenhorst*** actually involved exercise of **“wide discretion” conferred by § 7 of the Divorce Act, that was *not available in other marriages*.**

Net effect of *WT*:

- *Even if* a trust is proved to be the trustee-spouse's *alter ego*, the value of trust assets can only be taken into account if marriage falls within redistribution competency in § 7(3)!! (See e.g. Du Toit 2016: 696, 697; Van der Linde 2016 *THRHR*: 172, 173).

- *BUT*: This permits "**divorce planning**":

  → Allows trustee-spouse to "insulate" trust assets while simultaneously abusing the trust!

  -> Does not square with trust law;

  -> Allows a spouse to evade obligations imposed by matrimonial property law at divorce.

Also:

- A spouse who is *neither a beneficiary* of the trust *nor a third party who contracted with it* has no standing "to challenge the management" of the trust **because no fiduciary duty** is owed to such a spouse (par [33])

Now: Most authoritative view

- ***REM v VM*** 2017 3 SA 371 (SCA) (9 March 2017):
- Parties married with accrual system;
- Held:

It is possible to "go behind" the trust if the aggrieved spouse can comply with the following "**TEST**", namely proving that the other spouse:

> "transferred personal assets to [the trust] *and dealt with them as if they were assets of [the trust]* ***with the fraudulent or dishonest purpose of avoiding his obligation to properly account to the [aggrieved spouse] for the accrual of his estate*** *and thereby evade payment of what was due to the respondent, in accordance with her accrual claim*."

AND:

- If this “test” is complied with:

- A **declaration could be made** that trust assets are to be used:

    1) to *calculate* accrual, and

    2) to satisfy any personal liability of that spouse to make payment to the other spouse.

AND:

- The view in ***WT*** regarding STANDING (*locus standi*) of a spouse who is neither a trust beneficiary nor a third party who contracted with the trust was WRONG:
- Why?

- Breach of "fiduciary duty" is not decisive;
- What *is decisive* is that trust was unconscionably abused **to evade an obligation owed to third party or a spouse**.

Implications of new legal position

1) Resolution of "stalemate" after earlier conflicting case law regarding accrual system:

- ***MM v JM*** 2014 4 SA 384 (KZP): Matrimonial Property Act (MPA) does not permit a court to make a judgment based on what it feels to be **"JUST"** vs

- ***RP v DP*** 2014 6 SA 243 (ECP): Piercing *may* take place in accrual context, because the court is exercising a **power derived from COMMON LAW**.

- Now: ***REM v VM***:

- Appears to support view in *RP v DP*:

→Piercing the trust veil is a power that *is derived from common law*, and *exists independently* of Divorce Act or MPA;

- Two processes involved:

1) Is the trust an *alter ego* trust?

Answer: Use "control test" as set out in *Badenhorst*

2) If so, was trust unconscionably abused *to evade an obligation imposed by matrimonial property law*?

- In the case of the accrual system, this obligation is **to PROPERLY ACCOUNT** to the other spouse for the accrual of his/her estate:

  ➔ Trust has thus been "abused" to evade payment of what is RIGHTFULLY DUE to the other spouse.

- ***But***: What about the fact that the MPA *does NOT expressly provide a court with a DISCRETION* similar to s 7(3) – (6) of Divorce Act?

- My view: *REM* is leading us to conclude that:

(i) There is ample room for a divorce court to conduct an in-depth factual investigation to assess the "true" accrual (see e.g. ***YB v SB*** 2016 1 SA 47 (WCC)); and

(ii) MPA must be interpreted in line with the PURPOSE of the Act: To facilitate legal and economic equality between spouses;

(iii) This purpose is undermined if a trust is abused to conceal true value of accrual;

∴ The common law power **can therefore CO-EXIST** with the MPA.

Conclusion:

- *VALUE* of trust assets may be added to a spouse's accrual in appropriate cases:
  - Where trust was *alter ego* of spouse; and
  - (Ab)used to conceal true accrual.

(2) What are the implications of *REM* for OTHER matrimonial property systems?

- Remarks in *REM* regarding standing were not confined to accrual system (see para [20]):

"There can be no basis in logic or principle for a distinction to be drawn between legal standing to advance a claim to pierce the veil of a trust, by a third party who transacts with the trust on the one hand, and a spouse who seeks **to advance a patrimonial claim**, on the other. … In either case, a claim lies against the trust, or the errant trustee, on the basis that the unconscionable abuse of the trust form by the trustee, in his or her administration of the trust, through fraud, dishonesty or an improper purpose *prejudices the enforcement of the obligation owed to the third party, or a spouse*."

Thus:

- *Regardless* of the matrimonial property system involved, and provided the facts allow for this:
- any spouse has standing "to advance a patrimonial claim"
- on the basis that a trust has been unconscionably abused *to prejudice the enforcement of an obligation* owed to that spouse (such as one imposed by *matrimonial property law*).

- Thus:

- The obligation sought to be evaded provides a NEXUS (link) between the common law power to pierce and the actual EXERCISING thereof in the context of an *alter ego* trust;

- E.g.: Section 7(3) marriages, marriages with complete separation of property, etc

  (For suggestions, see Smith 2017 *JJS* pp 1 *et sqq*)

- All legal advisers should be aware of this possibility (or threat!) and advise clients accordingly !!

Three final points to ponder:

- 1) Swain JA in *REM*:

<u>If "test" satisfied</u>:

"a declaration could be made that the trust assets … are to be used ***to calculate* the accrual** … ***as well as satisfy any personal liability*** of the appellant to make payment to respondent"

(Also: Binns-Ward J in *Kaye* at par [21]:

"The remedy might entail … a declaration *that a trust asset shall be* ***made available*** to *satisfy the personal liability* of a trustee …"

***OBSCURITY**: What does this mean?*

- *Can a trust asset itself be "made available"?*

BUT: Binns-Ward J qualifies this: "but it *does not detract from the character of the asset as one of the trust* and not that of the trustee"

- *Seems contradictory?*

Two possibilities:

1) *In the sense for e.g. of being used as security?*
2) *In the case of a simulated transaction?*

- 2) ***OBSCURITY:***
- Why does the *REM* court persistently refer to "**the assets**" of the trusts potentially forming part of the appellant's estate and not ***their value***?

- SCA found that trusts were validly created and that the assets had properly been transferred to them.

- THUS: only ***their VALUE*** could potentially have been taken into account *in consequence of a piercing*.

- 3. ***Obiter:***

What about marriages **IN C.o.P**?

Recent opinion (paraphrased):

"If you are married in community of property you may place a portion of the assets in a trust, but only the half that belongs to you …"

- *I disagree*:
- If trust created *during* the marriage, you may place any separate property in a trust, but **joint property** can only be transferred if this is done in accordance with the MPA (i.e consent requirements).

Conclusion

- In the wake of *REM* we do have certainty regarding trust assets *in principle* being "attacked" on divorce,

- BUT: We still need further guidance from case law as to the finer details.

THANK YOU !!!