

Trust assets and accrual claims at divorce: Some implications of the latest case law, 2022

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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**, as we know, the trust form has been **abused** in recent decades – much case law on this issue.
- However, the **DISTINCTION** between abuse and “sham” must be borne in mind:
 - See generally MJ de Waal (2012) *Rabels Zeitschrift* (pp 1078 – 1100)
 - ***Van Zyl v Kaye*** 2014 (4) SA 452 (WCC).

SHAM:

- **Requirements** for valid trust not met;
- Crucial issue: **INTENTION** to create a trust lacking;
- Finding of **fact**;
- Two scenarios:
 - (i) Founder **“thought”** he/she was creating a trust, but in actual fact it was something else (e.g. partnership)
 - ***Khabola v Ralitabo*** [2011] ZAFSHC 62 (24 March 2011)

OR:

- (ii) Founder gives it **“name or shape”** of a trust, not to express its true nature, **but to disguise it** so as to gain an advantage otherwise not bestowed by law
 - ***Humansdorp Co-op v Wait*** Case no 2896/2012, ZAECGHC (1 November 2016).

[See **Smith 2019 SA Law Journal 550 – 580**]

Consequences of sham:

- **No trust** comes into existence *ab initio*;
- “**Substance over form**” applied (e.g. partnership or agency)
- **Assets still vest in personal estate** of founder / person who “transferred” assets to “trust”
- Neither “trustees” nor “beneficiaries” acquire rights in these capacities

ABUSE

- **Valid trust**

- Occurs as a result of:

(1) **“BREACH OF CORE IDEA”** of trust: → **Lack of adherence to the “CORE DUTIES”** of a trustee:

- (i) Trustee must exercise an **independent discretion**;
- (ii) Trustee must **give effect to the trust deed**;
- (iii) Trustee must **act with care, diligence and skill** in performing duties/exercising powers.
- (iv) Violation of the **joint-action rule** (F du Toit *Journal of Civil Law Studies* 2015: 666).

AND / OR:

(2) Trust used for **dishonest or unconscionable manner to evade a liability or avoid an obligation.**

Consequences of ABUSE:

- Valid trust
- Finding that trust was “*alter ego*” of trustee / trust founder
- Justifies “going behind” the trust form or “piercing the veil” of the trust.
 - i.e. **DISREGARDING** the existence of trust *for a particular purpose*,
 - Examples:
 - Insolvency (*FNB v Britz* [2013] JOL 29875 (GNP));
 - Holding trust / trustees to obligations (*Van der Merwe v Hydraberg Hydraulics* 2010 (5) SA 555 (WCC));
 - **Divorce** – matrimonial property law.

2) Trust assets and Divorce

Starting point:

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:** *Van Zyl v Kaye* 2014 (4) SA 452 (WCC) at par [23] vs *RP v DP* 2014 (6) SA 243 (ECP).

THEN: ACCRUAL CLAIMS

- **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.

- REM seemed to support *RP* case:
 - A court's power to pierce veneer of trust **derives from COMMON LAW** and does not depend on legislation (e.g. *Divorce Act / Mat Prop Act*)
- REM "TEST": 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, in the wake of *Badenhorst* and *REM* an important question arose:
 - What about a “squeaky clean” trust that is **NOT** an *alter ego* trust?

NOW: Most recent case law:

PAF v SCF [2022] ZASCA 101 (22 June 2022)

- **Facts:**

- Marriage with **accrual system** in 2001;
- 20 days before divorce trial, applicant creates a trust in British Virgin Islands;
- A day later, he transfers R 2,2 million to trust (£ 115 000);
- Brother is sole trustee;
- Daughter is sole beneficiary (apparently for her maintenance);
- Respondent: Creation of trust and transfer = **abuse of trust form** to **reduce her accrual claim**.

SCA (unanimous):

- Piercing trust's veneer **derives from common law** and has nothing to do with *Divorce Act* or *Mat Prop Act*;
- “**Control test**” in *Badenhorst* to be used:
 - NB!! Can be applied **to all** matrimonial property systems;
 - **BUT**, on the facts, this test does NOT find application!
 - *What now?*

- There is a **SOLUTION**, provided by the **PROVISO** in *Badenhorst!!!*

➔ *After* setting out “Control test”, court had remarked as follows:

“... It may be that in terms of the trust deed **some or all the assets are beyond the control of the founder**, for instance where a vesting has taken place by a beneficiary, such as a charitable institution accepting the benefit. In such a case, **provided** the party **had not made the bequest with the intention of frustrating the wife’s or husband’s claim** . . . the asset or assets concerned **cannot** be taken into account.”

As such:

- **Absence of control** does NOT necessarily exclude abuse of trust form;
- A “court must **vigilantly examine the facts in each case** to determine allegations of trust form abuse”
- ∴ Court may pierce trust veneer EVEN IF spouse did not “control” the trust:
- **TEST**: “bequest” made to trust ***intended to frustrate other spouse’s claim***

- **FACTORS** court considers:
 - (i) **Timing** of creation and donation to trust;
 - (ii) **Trust established in British Virgin Islands**
 - why not in SA?
 - makes it more difficult and expensive for respondent to question management of trust;
 - (iii) **No consultation with respondent about creation of trust**
 - despite history of consulting each other in important matters
 - (iv) **No immediate need to provide for maintenance of child**
 - applicant was in any event obliged to do so ²²

3) Conclusions:

- **Spouses beware** – courts are empowered to conduct **an in-depth factual enquiry** to determine **true value of accrual** (*YB v SB* 2016 1 SA 47 (WCC); *BC v CC* 2012 5 SA 562 (ECP));
- A “court must **vigilantly examine the facts in each case** to determine allegations of **trust form abuse**” (*PAF v SCF* paras 36; 44);
- This can involve **two possibilities**:

Conclusions:

- In accrual marriages, value of trust assets can be considered:

1) If **two-stage test** in *REM* met (i.e. *alter ego* scenario);

AND/OR:

2) If *proviso* in *Badenhorst* applied – “**vigilant examination of facts**” indicates that transfer to trust was made **with intention of frustrating other spouse’s accrual claim.**

THUS, NB FOR PRACTITIONERS:

- Today, **not only “alter-ego” trusts** can be attacked, but also **“squeaky clean”** trusts!
- Spouses and practitioners **must be alerted to this possibility!!!**



THANK YOU!