

Does a trust require an independent trustee



Often, when dealing with our clients trust matters, we are asked whether the clients brother/sister/closest friend would be a suitable independent trustee for their trust.

Although not required in terms of the Trust Property Control Act, it has become practice because of various case law and rulings, to appoint a truly independent trustee. This challenges the way most family trusts have historically functioned.

In the below article, Phia van der Spuy explains the importance of an independent trustee and how this impacts your trust. Better to know when to appoint an independent trustee than to risk the legitimacy of the trust being called into question.

In the context of estate planning, a trust can be described as a legal relationship, which has been created by a person (known as the founder or donor), through placing assets under the control of another person (known as the trustee) during the founders lifetime (an intervivos trust), or on the founders death (will trust, testamentary trust or trust mortis causa), for the benefit of third persons (the beneficiaries). A trust is an arrangement that allows a person to hold assets (without owning them) for the benefit of the trust beneficiaries. This definition makes it clear that somebody sets up a trust for the benefit of beneficiaries (not just yourself, as one of the beneficiaries), transfers assets into a trust and then appoints trustees to manage the trusts assets

on behalf of such beneficiaries. A person cannot be the founder, the only trustee and the only beneficiary, as a trust is a contract and one cannot contract with oneself. If you want to be the founder, a trustee and the only beneficiary, then you would have to appoint an independent trustee to the trust, for it to be valid.

Many people just cannot get their minds around the fact that trusts assets no longer belong to them, but to the trusts, and that it should be managed accordingly. This frequently lead to the abuse of trust assets by some trustees, who act alone, for their own benefit, and not for the benefit of all beneficiaries. Any indication that the founder and/or trustee retain control over the assets may result in the trust being labelled as an alter ego trust; in other words, an extension of one self. If you intended to create a trust, but you deal with the trust assets as if they are your own, then your creditors, the South African Revenue Service (SARS) and soon-to-be-ex-spouse can attack the trust, and have it labelled as an alter ego trust. Even though the trust does in fact exist, the Courts will disregard the trust and treat the assets as if they belong to you. There must be a clear separation of control from enjoyment of trust assets. All trustees – and not just one of them – should control the trust assets for the enjoyment of the beneficiaries. You will experience dire consequences if your trust is labelled an alter ego trust.

Because of the manipulation and abuse of trust assets, typically by one dominant trustee, to the detriment of creditors, the Courts became impatient with such trustees who compromise any creditors through their behaviour. In 2005, in the landmark Land and Agricultural Bank of South Africa v Parker case, the Court suggested that each family trust should appoint an independent trustee. Although it was not legislated, the Master of the High Court preferred if a trust had an independent trustee appointed. However, in March 2017, the Chief Master issued a directive, which sets the

requirement for the appointment of an independent trustee for all trusts, which are defined as family business trusts. This is typically a trust set up for the protection of family assets, where the trustees are all beneficiaries and they are all related. These trustees are also empowered in terms of the trust deed to enter into transactions which create debt in the trust. If no independent trustee is appointed for such a family business trust, the Master of the High Court will refuse the registration of the trust. The rationale is for creditors to get comfort that the trust is run properly, and that creditors can comfortably do business with the trust, because of transparency and honesty, and with the assurance that the trust deed is observed. The intention is not for the independent trustee to make decisions on behalf of the trust, or to override the other trustees, but rather to support the other trustees to observe the requirements of the trust deed and relevant trust legislation.

An independent trustee must be an independent outsider who accepts office to ensure that the trust functions properly, and that the provisions of the trust deed are observed. The independent trustee could be a person or an entity who has no family relation or connection, blood or otherwise, to the trustees, beneficiaries or founder of the trust, and who is also not a beneficiary of the trust. You can, for example, not appoint your son-in-law, accountant or financial advisor as the independent trustee, as he/she will not be regarded to be acting independently. Which hat will he/she be wearing when making decisions with co-trustees that of an objective trustee, or acting for his wife, for his accounting practice or his advisory practice?

The independent trustee is not required to be a professional person, but it should be a person who fully realises the responsibilities he/she is accepting when agreeing to act as a trustee. He/she must also be qualified in the view of the Master of the High Court to act as a trustee. The less an

independent trustee is related to the other trustees, the more independent he/she is seen in the eyes of creditors and SARS.

In many cases, non-independent trustees do not have enough knowledge of – and experience in – the proper administration of trusts. Furthermore, they may lack expertise in utilising the vehicle of the trust to maximise benefits on behalf of the beneficiaries. This expertise would include the ability to negotiate and enter into business contracts; holistic tax and succession planning; and ensuring the optimal growth of the trust assets. It is in the best interest of the trust that the independent trustee has enough knowledge of the impact of statutory requirements on the trust, including an understanding around compliance with relevant tax law, and the effect of changes in legislation on the trust. Make sure, you appoint a reputable independent trustee, typically through a professional body or association recognised by the Master of the High Court, such as the Fiduciary Institute of South Africa (FISA).

The Master of the High Court may, in certain circumstances, dispense with the appointment of an independent trustee and make use of one of the following alternatives:

- Forego the appointment after receiving representations from the founder showing good cause to dispense with the appointment
- Request security from trustees
- Request that financial statements be annually audited, and that the auditor be instructed to inform the Master of the High Court when potential harm to creditors is likely to take place

The independent trustee will have to complete and sign a J417 Master of the High Court form and sign an affidavit, making various declarations and undertakings. Even though the appointment of an independent trustee is only compulsory for new trusts, a change in trustees for existing trusts will also

trigger the requirement for an independent trustee, as the completion of the J417 form requires the appointment of an independent trustee if the trust meets the definition of a family business trust, and no independent trustee is appointed yet.

Ensure that the trust deed provides for the replacement of the independent trustee in the event that the rest of the trustees are of the view that such independent trustee does not act in the best interest of the beneficiaries and do not embrace the intention of the founder, as stipulate in the trust deed. Be careful about professionals setting up trusts and creating a permanent role for themselves in the trust in the way they draft the trust deed. SARS, creditors and soon-to-be-ex-spouses frequently make attempts to attack trusts by labelling them as alter ego trusts, but it can be mitigated through the appointment of independent trustees. So, it may be worth your while to consider appointing an independent trustee to mitigate against this risk, rather than to just view it as a nuisance to comply with.

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