

WHEN GOOD INTENTIONS GO BAD: CONSIDERING THE AMENDMENT OF A TRUST DEED WITH GREAT CARE

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Abstract:

During the past decade, the use of the trust instrument forms an integral part of most estate planning structures. This paper addresses the following key question: what are the consequences if the amendment of a trust deed is declared invalid? This research incorporates current legal principles and reviews recent case law. Discussion emphasise that current parties to a trust need to be aware of the drafting, decisions and planning of any amendment of a trust deed. In conclusion the consequences based on recent decisions highlights the need to be aware of the rights of trust beneficiaries, whether the amendment of an *inter vivos* trust deed is possible without the consent of beneficiaries and provides clarity on issues regarding trust administration.

Key Words: Amendment, Trust beneficiaries, Trust deed, Trustees.

Introduction:

*“Men trip not on mountains they trip on molehills.”*¹⁸²

Many research studies have focused on the use of the trust entity in current South African trust law. Today, the flexibility of a trust contributes greatly to the popularity and the many purposes for which it is being used. Currently the law of trusts is no longer confined to the traditional common law principles that use to exist. For the sake of clarity, South African courts have over the last decade become obliged to give effect to the fiduciary duties of trustees, trust administration and the fullest protection to the rights of trust beneficiaries.

This paper focus on a specific topic and gives voice to the unforeseen consequences of a seemingly “mere” act - the amendment of a trust deed. A trust is established by means of a trust deed which serves as its founding document.¹⁸³ This takes on the form of a contractual arrangement between the founder¹⁸⁴ and the trustees.¹⁸⁵ With this in mind, although a trust is a very useful instrument, certain amendments to a trust deed are required from time to time. A trust deed can be amended by the founder and trustees by means of an amendment agreement in which the proposed amendments to the trust deed are contained and again submitted to the Master of the High Court. It can also be amended in accordance with a variation clause in the trust deed or by way of a court application.

Unfortunately there is a newly founded risk now faced by thousands of South African amended trusts of being set aside by the courts as invalid, especially in cases which involve trust beneficiaries.¹⁸⁶ With particular focus on case law, it emphasises the relevance of the proper knowledge of trust law principles in current South African law.

¹⁸² Chinese proverb.

¹⁸³ The essential elements of a trust should be identified in this document which includes the founder, trustees, beneficiaries and trust assets. The founder must have the intention of creating a trust by way of handing assets to the trustees to be administered for the benefit of the trust beneficiaries. According to legislation all trust deeds must be lodged and registered with the relevant Master of the High Court.

¹⁸⁴ The founder can also be referred to as “the creator of the trust”, “donor” or “settlor”.

¹⁸⁵ Trustees must hold and administer property for the benefit of beneficiaries and are the office-bearers of a trust as defined in section 1 of the *Trust Property Control Act 57* of 1988.

¹⁸⁶ Beneficiaries are those in whose favour a trust is created. It must be a defined or reasonably identifiable group. A general distinction can be drawn between income and capital trust beneficiaries. The former benefit from the income or proceeds generated by the trust and whereas the latter benefit from the trust property or capital, usually upon termination of the trust.

Discussion:

The idea of a trust is a universal concept. Through the influence of English law¹⁸⁷ and Roman-Dutch law, current legislation¹⁸⁸ and refinement of certain rules by our South African courts, our trust law has developed into a vibrant, challenging and well-respected law of trusts. Critical to this paper, is the necessity to ascertain basic trust law concepts and relevant information concerning the extent and nature of the trust, especially with reference to the rights of trust beneficiaries.¹⁸⁹ In principle, trusts are a simple concept whereby a trust is the arrangement through which the control and ownership in property of someone's assets (the founder) is transferred¹⁹⁰ to a group of people (referred to as the trustees) to look after and use to benefit the beneficiaries. These transferred assets fall under the protection of the trust and fall outside the scope of a founder and the appointed trustee's estates. The trust assets can therefore not be used in settlement of any claims against the estates of a founder or trustees. Consequently, with this established protection mechanisms in mind, it confirms the purpose for establishing a trust. A trust is a versatile entity that can be used (among others) – to safeguard a family's assets and wealth against risks, protection against creditors, business activities, control wealth distribution to beneficiaries, reduce potential estate duty, minimize other tax liabilities or even for a charitable purpose.¹⁹¹

In 2011 one of the most significant developments tripped South African trust law off the steady "amendment" path. The following set of facts relating to the validity of the amendment to a trust deed emerged. The Supreme Court of Appeal handed down judgment in *Potgieter and Another v Potgieter NO and Others*.¹⁹² The main concern which evidently needs addressing was the fact whether the amendments of the original trust deed were valid.

A family trust was established with two capital beneficiaries, the children of the founder, namely A and B. After divorcing their mother, the founder remarried a woman, Z, with two children of her own, X and Y. These two children and their mother were then included by means of *an amendment of the original trust deed*. This amendment were entered into between the founder and the appointed trustees, which also includes the new wife, Z.

Although there were many amendments, the main amendment concerned extension towards the beneficiaries.¹⁹³ Unfortunately A and B were not consulted on this amendment and did not

¹⁸⁷ Hayton, David. *The Law of Trusts*. Sweet and Maxwell: London, 2002 at 6-8; Cameron, Edwin, Marius De Waal, and Basil Wunsh. *Honoré's South African Law of Trusts*. Durban: Juta, 2007 at 21-27; Du Toit, Francois. *South African Trust Law: Principles and Practice*. Durban: Butterworths, 2002 at 21-25; *Estate Kemp v MacDonald's Trustee* 1915 AD 491.

¹⁸⁸ *Trust Property Control Act* 57 of 1988.

¹⁸⁹ Unfortunately current legislation does not define the word "beneficiary". Du Toit, Francois. *South African Trust Law: Principles and Practice*. Durban: Butterworths, 2002 at 108. As stated by Du Toit the origin, nature en extent of the rights of beneficiaries are determined by the imposition of a fiduciary office on the trust's trustee, the kind of trust concerned as well as the provisions of the trust deed itself. Beneficiaries can however enjoy a variety of rights than can be classified as: "subjective rights", "vested rights" and "contingent rights". For purposes of this paper these rights and the fiduciary duties of trustees will not be discussed in further detail. For further discussions see Olivier, P.A., S. Strydom and G.P.J. van den Berg. *Trust Law and Practice*. Durban: LexisNexis, 2011 at 4-23 and Geach, Walter, and Jeremy Yeats. *Trusts: Law and Practice*. Durban: Juta, 2007 at 113-133 and further reference to *Gross v Pentz* 1996 4 SA 617 (A).

¹⁹⁰ Transferred by means of made over or bequeathed. A trust *mortis causa* is created by way of a will. Du Toit, Francois. *South African Trust Law: Principles and Practice*. Durban: Butterworths, 2002 at 108. For purposes of this paper there will be only made reference of the *inter vivos* trust that is created and becomes effective whilst the founder is still alive (a trust created by a *stipulation alteri* – a contract between the founder (*stipulans*) and a trustee (*promittens*) for the benefit of a beneficiary (the third party). Olivier, P.A., S. Strydom and G.P.J. van den Berg. *Trust Law and Practice*. Durban: LexisNexis, 2011 at 5(3)-5(5) and Hahlo.H.R. *The Trust in South African Law*. South African Law Journal, 1961 at 195 and 202. With further reference to *CIR v Estate Crewe* 1943 AD 656; *Crookes v Watson* 1956 1 SA 277 (A); *Joubert v Van Rensburg* 2001 1 SA 753 (W); *Braun v Blann and Botha* 1984 2 SA 850 (A) and *Kropman v Nysschen* 1999 2 SA 567 (T).

¹⁹¹ See some relevant case law: *Parker NO v Land and Agricultural Bank of SA* 2003 1 All SA 258 (T); *Nedbank Limited v Thorpe* 2008 JDR 1237 (N); *Peterson and Another NNO v Claassen and Others* 2006 5 SA 191 (C); *Ehrlich v Rand Cold Storage and Supply Company Ltd* 1912 TPD 170; *Goodricke and Son (Pty) Ltd v Registrar of Deeds (Natal)* 1974 1 SA 404 (N) and *CIR v Pretorius* 1986 1 SA 238 (A).

¹⁹² *Potgieter and Another v Potgieter NO and Others* 2001 JOL 27782 (SCA). See also Olivier, P.A., S. Strydom and G.P.J. van den Berg. *Trust Law and Practice*. Durban: LexisNexis, 2011 at 2(30)-2(30)2.

¹⁹³ *Potgieter and Another v Potgieter NO and Others* 2001 JOL 27782 (SCA) par 27. In the main the children A and B were no longer the only capital beneficiaries of the trust as they were reduced to members of a class of

consent to the changes. In the meantime the founder changed his will to the effect that apart from some legacies, the residue of his estate was bequeathed to the trust (*now amended*). It was clear that it was his intention that A, B and his new wife and her children might also potentially benefit from the trust. The founder subsequently died.

A and B contested the amendment of the trust deed (as usual there was a dispute about money held in trust) on the grounds that the trust deed could only be changed with their consent as current capital beneficiaries. In addition the current trustees, including Z, argued that the amendments were made before beneficiaries A and B had accepted any benefits conferred upon them. Therefore the amendment of the trust deed was valid.

An *inter vivos* trust (as in this instance) is based on the law of contract and more specifically as a contract for the benefit of a third party.¹⁹⁴ It is exactly with this in mind that any variation of the terms of an *inter vivos* trust must therefore be done in terms of the law of contract and requires at least the consent of the founder and the trustees. Unless the beneficiaries have accepted the benefits stipulated for them, an *inter vivos* trust can be varied by agreement only between the founder and the trustees. The importance was to establish whether the beneficiaries have acquired any form of a right, whether they have accepted any benefits conferred upon them and if their consent were needed. However, it is accepted that the natural guardian of minors can indicate acceptance of the benefits conferred upon them by the trust deed on their behalf. In drafting the trust deed, the founder (the father), indicate at that stage as natural guardian of his then “minor children” acceptance of the benefits conferred upon them.¹⁹⁵

The court *a quo* reasoned that the amendment was invalid based on various technical reasons. Surprisingly the learned judge, with the unusual intervening, concludes that the enforcement of the trust deed in its original terms would be in conflict with the deceased’s intention and would therefore effectively exclude X, Y and Z from any benefit deriving from the deceased’s estate.¹⁹⁶ An order was granted which according to the court would give effect to the *real intention of the deceased*. A and B were awarded one-fifth each, while the other potential beneficiaries, X, Y and Z retained their rights in terms of the amended trust deed in respect of the remaining trust assets.

This leads to the appeal to the Supreme Court of Appeal. If the amendment to the deed was declared invalid, the new spouse and her children will not be able to benefit in terms of the trust deed. Therefore, if A and B could convince the court on the facts of the case that the variation was invalid, despite the intention of the deceased, only they were entitled to the trust assets.

On appeal the court necessitated that the *stipulatio alteri* finds application and the applicable legal principles are well settled. These principles were formulated:¹⁹⁷

“A trust deed executed by a founder and trustees of a trust for the benefit of others is akin to a contract for the benefit of a third party, also known as a *stipulation alteri*. In consequence, the founder and trustee can vary or even cancel the agreement between them *before the third party (beneficiary) has accepted the benefits* conferred on him or her by the trust deed. But once the beneficiary has accepted those benefits, the trust deed can only be varied with his or her consent.” (own emphasis).

potential beneficiaries; the trustees were afforded absolute discretion regarding the selection of a beneficiary and the time the rights would vest in a beneficiary, if at all (this can have the possible effect that there might be no allocation to A and B).

¹⁹⁴ As already mentioned - the current legal position with further reference to *CIR v Estate Crewe* 1943 AD 656; *Crookes v Watson* 1956 1 SA 277 (A); *Hofer v Kevitt* 1998 1 SA 382 (A) and *Doyle v Board of Executors* 1999 2 SA 805 (C). Olivier, P.A., S. Strydom and G.P.J. van den Berg. *Trust Law and Practice*. Durban: LexisNexis, 2011 at 2(3)2 – 2(30)4.

¹⁹⁵ *Potgieter and Another v Potgieter NO and Others* 2001 JOL 27782 (SCA) par 19 and 23. The argument was that the benefits conferred on them in the original trust deed were accepted by the deceased on their behalf as reflected in the preamble of the trust deed itself and minutes of a meeting.

¹⁹⁶ *Potgieter and Another v Potgieter NO and Others* 2001 JOL 27782 (SCA) par 12-16.

¹⁹⁷ *Potgieter and Another v Potgieter NO and Others* 2001 JOL 27782 (SCA) par 18.

The Supreme Court of Appeal placed its emphasis on the basic fundamentals of the current law of contract. The *status quo* is being upheld: the contractual arrangement constitutive of a trust *inter vivos* is to be regarded as a *stipulatio alteri*. The outcome of the judgment is that once beneficiaries have accepted any benefits, the trust deed can only be varied with his or her consent as they have now acquired rights. The judgment had been delivered by Brand JA:¹⁹⁸

“I do not think it can be said that at the time of the variation agreement, the appellants enjoyed no vested rights to either the income or the capital of the trust. They were clearly contingent beneficiaries only. *But that does not render their acceptance of these contingent benefits irrelevant.....* The import of acceptance by the beneficiary is that it creates a right for the beneficiary pursuant to the trust deed, while no such right existed before. The reason why, *after that acceptance, the trust deed cannot be varied without the beneficiary’s consent*, is that the law seeks to protect the right thus created for the first time. In this light, the question whether the right thus created is enforceable, conditional or contingent should make no difference. The only relevant consideration is whether the right is worthy of protection, and I have no doubt that it is” (own emphasis).

The amendment of the original trust deed under these circumstances were declared invalid. The amended trust deed was therefore void and consequently unenforceable.

Upon taking the above into consideration, the probable good intentions by the founder, especially when drafting his will to provide for *all* his loved ones by using the amended trust, turned bad. The reason for this caution is that it is imperative that when using a trust, one needs a proper understanding of the consequences of basic trust law principles.

Conclusion:

This again highlights some home ground rules that are followed in our current common law with specific reference to the amendment of a trust deed. It is settled practice in South African trust law that a trust can be amended subject to what the court’s powers are in terms of the current legislation, common law rules as well as what the trust deed itself stipulates. The point to be understood is that it is apparent that at present, many trusts in South Africa are shadowed by possible “small” amendments previously made.

Undoubtedly, this is likely to be only the tip of the iceberg of what is to come. A new era in trust law is daunting upon us as knowledgeable parties know to benefit from these circumstances, poor trust administration and the lack of basic trust law principles will have far reaching effects.

Even though the *Potgieter*¹⁹⁹-case has succeeded in providing clarity sought, a number of problematic issues still exist. The uncertainty leads to the difficulty now faced by those who use trusts that had been amended.²⁰⁰ In some instances there are currently no clarity or relevant documentation to support or verify if any beneficiaries already received or accepted any benefits, or if there is any documentary proof of the necessary consent for any amendments. Should the facts fit the basic principle of consent, a trust in this instance is not void. If it can be proved that there has been acceptance of any kind, any amendment without consent may be declared void. As a result, taking into account the afore-mentioning ruling, future courts will now be obliged to follow this decision.

Problematically though is that in practice it is impossible to determine how many amended trust deeds (currently active) might be invalid. The recommendation is that trustees urgently need to verify any amendments and to get hold of such trust deeds. They need to be certain of the current amendment clauses and obtain any relevant documentation or verify any potential activity that might indicate acceptance of any kind. It is undoubtedly necessary for current trustees as from now on to verify the rights of beneficiaries, to make sure whether the founder is still alive, to be certain of the

¹⁹⁸ *Potgieter and Another v Potgieter NO and Others* 2001 JOL 27782 (SCA) par 28.

¹⁹⁹ *Potgieter and Another v Potgieter NO and Others* 2001 JOL 27782 (SCA).

²⁰⁰ The possibility is that an amended trust could have been registered more than a decade ago with the eventuality that all transactions subsequent to this period could be void and consequently unenforceable.

content of current amendment clauses and keep all relevant documents and minutes of meetings up to date. For as the saying goes:

“*An ant may well destroy a whole dam*”.²⁰¹

To prevent further damage - trustees must get to work.

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Legislation:

Trust Property Control Act 57 of 1988.

²⁰¹ Chinese proverb.