

The position of assets vested in a sham trust

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ABSTRACT

Key concepts: sham trust; *inter vivos* trust; contract of sale; Snook test; law of contract; intention; assets; legal position

The concept of a sham trust has changed over the years. Presently it is defined as a perceived entity that is not entirely what it portrays to be. In addition, a sham is therefore regarded as invalid with a deceiving nature. A sham trust has the consequence that all the benefits and protection of assets are destroyed, seeing that no trust actually came into existence.

Considering the above, for the purpose of the present study, only an *inter vivos* trust was evaluated and discussed in detail. The law of contract is considered to be the foundation of the principles for an *inter vivos* trust. Therefore, the law of contracts can be applied to solve problems presented by trusts.

During the course of the present research, it became evident: in instances where a trust is declared a sham, the consequence is that the trust will be deemed void.

There are instances where a sale agreement has been concluded prior to the discovery of the true nature of the trust, namely it being a sham. This raises the question on the legal position of assets vested in a sham trust. A further question arises about the consequences and whether the courts should set a guideline for such instances. From the findings it is evident that such a guideline is necessary. This would enable courts to determine the consequences of assets vested in a sham trust.

There are various possibilities regarding consequences for assets vested in a sham trust. To determine the applicable consequence, the court should deal with each case individually based on the facts of that particular circumstances. This consequence could either entail that the assets should fall within the founder's personal estate, or whether the concluded sale agreement should be deemed void.

It is evident that the courts struggled with the distinction between a sham and alter ego trust, however, the case law referred to below gives more clarity in this regard. A proper formulation of the aspects of sham and alter ego trusts was provided in the cases of *Van Zyl v Kaye*¹ and *Van der Merwe v Hydraulics*.² The formulation of the two aspects in the above-mentioned cases was confirmed in the Supreme Court of Appeal judgement in the case of *WT v KT*.³ In the *Khabola v Ralitabo*,⁴ the court dealt with the typical example of the sham trust. In brief, the facts of the case were, that the parties had the intention to establish a partnership that was simulated to be a trust.⁵

¹ *Van Zyl v Kaye* NO 2014 4 SA (WCC).

² *Van Der Merwe v Hydraulics* CC 2010 5 SA 555 (WCC).

³ *WT v KT* 2015 3 SA 574 (SCA).

⁴ *Khabola v Ralitabo* NO 2011 ZAFSHC 62.

⁵ *Khabola v Ralitabo* NO 2011 ZAFSHC 62 para 4.

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"Trust in the LORD with all your heart and lean not on your own understanding."⁶

⁶ Proverbs 3:5

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LIST OF ABBREVIATIONS

CLJ	Cambridge Law Journal
MERC	Mercantile Law Journal
RabelsZ	The Rabel Journal of Comparative and International Private Law.
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse reg
TSAR	Tydskrif vir die Suid Afrikaanse Reg

1 Introduction

1.1 Background and problem statement

It is a well-established fact that trusts as legal instruments are widely used in estate planning.⁷ In the context of this research a trust is defined as in the *Trust Property Control Act*:⁸

as the arrangement through which ownership in property of one person is by virtue of a trust instrument made over or bequeathed-

- a) to another person, the trustee, in whole or part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in
 - b) the trust instrument or for the achievement of the object stated in the trust instrument; or
 - c) to the beneficiaries designated in the trust instrument, where property is placed under control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,
- but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estate Act 66 of 1965.

This individual may not exercise the right on behalf of him-/herself, but rather a fixed or ascertainable person or people as the beneficiary, or for a lawfully fixed or ascertainable impersonal object.⁹ Botha¹⁰ describes a trust as follows:

It is a legal relationship which has been created by a person (known as the "founder") through placing assets under the control of another person or persons (known as the "trustee") during the founder's lifetime (an "*inter vivos* trust") or on the founder's death (a "testamentary trust"), for the benefit of third persons (the "beneficiaries").

It should be noted that for the purpose of the present study only the *inter vivos* trust was researched and discussed. In comparison to other common law jurisdictions, the approach followed by South Africa differs for *inter vivos* trusts, seeing that these legal

⁷ Olivier *Trustreg en Praktyk* 1; Olivier 2001 *SALJ* 224; Botha *et al The South African Financial Planning Handbook 2017* 824.

⁸ 57 of 1988.

⁹ Swanepoel *Oor stigting, Trust Fideicommissum, Modus en beding te behoewe van derde* 7; Botha *et al The South African Financial Planning Handbook 2017* 824.

¹⁰ Botha *et al The South African Financial Planning Handbook 2017* 824; Stiglingh *SILKE: South African Income Tax* 827.

instruments are based rather on the law of contract, than the law of equity. This was confirmed in *Crookes NO v Watson and Others*,¹¹ where the court held that the principles of an *inter vivos* trust are found in the law of contract since the trust instrument is used by a trustee and a founder to benefit a listed beneficiary.¹² In other words, the *inter vivos* trust can be seen as a contract concluded between two parties, which benefits a third person.¹³ In this regard, a trust can actually be viewed as an agreement in terms of the law of contract, whereby a party transfers control of assets over to the trustees, who manage and control the assets to the benefit of a third person or persons (i.e. the beneficiaries). Consequently, it is necessary not only to grasp the requirements of a valid trust fully, but also understand the requirements to which the relevant parties must adhere, to realise a valid contract.

It is essential to ascertain the original intention of the founder when a trust was created to determine whether the trust is deemed valid or invalid. Therefore, it is necessary to establish the requirements of a valid trust before considering how trusts are utilised.¹⁴ Should the parties adhere to the requirements, a valid trust will be created. However, not all so-called "trusts" are valid, mainly because the founder from the outset does not intend to create a valid trust. These trusts can be referred to as *sham trusts*. A trust is considered to be invalid if it is a *sham trust*. The reason is that this instrument does not meet the requirements for a valid trust. However, in the case of an *alter-ego* trust, the trustee has full control and the trust is managed as the trustee's *alter ego* of to his/her benefit. In most instances an *alter ego* trust is still deemed valid. According to de Waal,¹⁵ the requirements to create a valid trust determine whether or not a trust is deemed to be a sham. He further explains:

In my view the question whether or not a trust is a sham has everything to do with the requirements for the creation of a valid trust.¹⁶

¹¹ *Crookes NO v Watson* 1956 1 SA 277 (A).

¹² 1956 1 SA 277 (A) 278D.

¹³ Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego in the context of South African trust law: The dangers of translocating company law principles into trust law* 70.

¹⁴ Olivier 2001 *SALJ* 225.

¹⁵ De Waal 2011 *Rabels Zeitschrift* 1096.

¹⁶ De Waal 2011 *Rabels Zeitschrift* 1096.

There are instances where an existing trust is considered to be either a *sham trust* or a trust where abuse occurs. Typically, a trust is a relatively easy-controllable entity, with limited statutory requirements. However, it may happen that trustees abuse these benefits, do not abide by the terms of the trust deed or the provisions of the *Trust Property Control Act 57 of 1988*. As a result, trust abuse occurs. In extreme cases, an entity such as a trust, seemingly was erected, but the requirements for a valid trust were not fulfilled, which will thus deliver a *sham trust*.

A common misconception is that *sham trust* or *alter-ego trust* refer to the same situation, as these terms are often used interchangeably, which can cause confusion.¹⁷ However, in recent times the courts have provided some clarity and guidance in this regard. An *alter-ego trust* refers to the position where the trustee has used the trust as his/her *alter ego*, and in this instance the trustee regards the trust's assets to be his/her own.¹⁸ Furthermore, in this form of trust there is no clear distinction between *de facto* and *de iure* control, or between use and management. On the other hand, a *sham trust* is considered to be invalid, since the true intention lacks to create a trust, thus there can be no mention of such a legal instrument. De Waal¹⁹ explains the distinction between a *sham trust* and the abuse of a valid trust as follows:

It has been argued that sham situations on the one hand, and abuse situations on the other, are approached from different theoretical angles. In the case of a sham, the question is whether a valid trust has been created at all. Here, the emphasis falls on the requirements for the creation of a valid trust; specifically, that the founder must have the intention to create a trust. In the case of an abuse situation, the premise is that there is a valid trust, but that there may exist a justification for going behind the trust and ignoring the trust for a particular purpose. However, the distinction between the two situations is not only important for theoretical clarity. It also has practical implications. The most important one – and the one to which I will briefly refer here – is that it is decisive for the application (or destination) of the trust assets. This, in turn, has implications for both the trust beneficiaries and third parties (such as a trustee's spouse or private creditors).²⁰

¹⁷ Nedbank date unknown <https://www.nedbankprivatewealth.co.za/south-africa/fiduciary-focus-trust>.

¹⁸ SAIT 2012 <http://www.thesait.org.za/news/87399/Trust-assets-may-be-treated-as-the-personal-assets-of-a-trustee-who-has-used-the-trust-as-alter-ego.htm>.

¹⁹ De Waal 2011 *Rabels Zeitschrift* 1096.

²⁰ De Waal 2011 *Rabels Zeitschrift* 1096.

The concept of a *sham trust* has evolved over time, although it is generally regarded as a perceived entity – not what it portrays to be. In this regard, a *sham* is considered to be deceiving, and thereby invalid.

The practical consequence of a *sham trust* is that it destroys the benefit of protection for the assets, seeing that no trust existed from the start.²¹ It is essential to evaluate the intention of the parties. If such intention lacks, the trust is deemed to be a *sham*.²² This process disguises the true nature of a trust and is merely created to cause misrepresentation.

Furthermore, the parties attempted to conceal the true nature of the agreement, which is usually disguised as false pretence. This is done, to gain a form of advantage, or to overcome a disability which the law would impose otherwise. When asked to make a decision on this matter, the court has to acknowledge the true intended nature of the original transaction.²³ Therefore, it can be concluded that the concept of a *sham trust* is acknowledged and commonly found in the context of trusts.²⁴ However, at this stage there are few precedents in South Africa concerning the legal position of assets vested in such a *sham trust*. Although there are only few precedents regarding this aspect in South Africa, reference can be made to the case of *Van Zyl v Kaye*,²⁵ in which the court held that the applicants have to prove that the trust is a sham, in order for the property to not be vested in the trust.

For an international perspective, the present study also considered the Canadian position on *sham trusts*. In the Canadian law a *sham trust* is also deemed to be invalid as it fails to portray the true intention or nature of the original transaction.²⁶ Therefore, the present study deemed it beneficial to consider and compare Canadian law to South African law, by referring specifically to Canadian stipulations. The legal position on assets vested in a *sham trust* in Canada was determined, as well as the manner in

²¹ Ross Holmes 2015 <http://www.rossholmes.com/index.php/sham-trusts>.

²² Ammundsen 2014 <http://www.adls.org.nz/for-the-profession/news-and-opinion/2014/9/26/a-rose-by-any-other-name-%E2%80%93-sham-trust-finding/>.

²³ Anon 2009 https://www.saica.co.za/integritax/2009/1711_Trusts_held_to_be_a_sham.htm.

²⁴ Anon 2014 <http://www.dgadvocates.com/wp-content/uploads/2014/01/Sham-Trusts.pdf>.

²⁵ 2014 4 SA 452 (WCC) para 19.

²⁶ Anon date unknown <https://www.lawteacher.net/free-law-essays/equity-law/examining-the-intricacies-of-sham-trusts-equity-law-essay.php>.

which the situation is approached in that country. This enabled the researcher to reach a possible conclusion on the legal position of assets vested in a *sham trust* in South-African law.

In light of the exposition above, the problem statement on which the present study was based can thus be formulated as follows:

The issue that currently exists regarding what happens to assets vested in a *sham trust* needs to be addressed.

1.2 The case study

For the purpose of the present research, the following case study was used to derive a possible answer on the legal position of assets vested in a *sham trust*:

Mr X (the founder) has created an *inter vivos* trust, according to which he will also be one of the trustees. Mr X did not truly have the intention to establish a trust, as the terms of the trust deed do not reflect the true intentions of the parties, which has the effect of misleading third parties. The true intention of Mr X was to create the impression of a trust.²⁷ The trust has purchased both movable and immovable property through a sale agreement from Y. After completing the sale agreement, a third party claimed that the trust is a sham.

1.3 Research question

Based on the problem statement mentioned in paragraph 1.1, the general research question can be formulated as follows: What is the legal position of assets vested in a *sham trust*, specifically, focussing on the following questions:

- What are the requirements of a valid trust?
- What is understood by the concept of sham and *alter ego*?
- What are the consequences of a trust being declared a sham?
- What are the requirements of a valid contract?
- What are the consequences of an invalid contract?
- What is understood under the principle substance over form?

²⁷ See also page 27.

- What is the Canadian position regarding *sham trusts*?

1.4 Outline of research

Against the background of the discussion above, the present study's main objective was to establish the legal position of assets vested in a *sham trust*. The study was conducted in the form of a literature review where the researcher critically considered and consulted the following sources: textbooks, case law, and various internet sources. The focus was further on the legal position of assets in a sham trust, by considering South African and Canadian case law.

The research in this dissertation is outlined as follows:

- **Chapter 1** introduces the existing issue with regard to the legal position of assets vested in a *sham trust*.
- **Chapter 2** discusses the requirements of a valid trust, as well as the concept sham.
- **Chapter 3** investigates the general principles of a contract, as well as whether a trust can possibly fall within the law of contracts.
- **Chapter 4** examines the Canadian position on *sham trusts*.
- **Chapter 5** presents the conclusion, after carefully considering the relevant research in this study.

2 Requirements of a valid trust

2.1 Introduction

The aim of this chapter is to discuss the requirements of a valid trust. Therefore, this section focuses firstly on the specific requirements that must be met for a trust to be valid. Secondly, the concepts of a sham and alter ego will be examined and discussed, focusing on instances when a trust is deemed invalid.

When a trust is considered to be invalid, this implies that all the requirements for a valid trust are not met, which in extent means that this legal instrument cannot ensure protection of the trust property. A trust is furthermore considered to be invalid in the case of a sham trust, since the trust does not really exist. On the other hand, in the case of an *alter-ego* trust, the trustee has full control of this instrument. In such an instance, the trust is managed as an *alter ego* of the trustee for his/her own benefit. Nevertheless, an *alter-ego* trust is still deemed to be valid.²⁸

Since South African trust law is well developed, there is no lack of literature about trusts.²⁹ Therefore, it is possible to determine the requirements of a trust, by examining textbooks, journal articles and case law. Since the 19th century, the introduction of trusts has been rooted firmly in South African law, as well as in the commercial practice – to such an extent that it would be extremely difficult to terminate trust instruments in legal practice.³⁰ Trusts are thus considered as one of the most purposeful instruments that legal and commercial practitioners use to protect assets.³¹ Although it is deemed a purposeful instrument, South African courts had stated that trusts do not generally have a legal personality.³² Cameron JA elaborated on this matter in *Land and Agricultural Bank of South Africa v Parker*,³³ by explaining:

²⁸ In other words, where a trust is considered to be operated as the *alter ego* of a person, the trust can in extent not ensure the necessary protection of the assets.

²⁹ Olivier *Trustreg en Praktyk* 1; De Waal 2012 *RabelsZ* 1081.

³⁰ Du Toit *South African Trust Law Principles and Practice* 18.

³¹ Du Toit *South African Trust Law Principles and Practice* 1.

³² *Lupacchini NO and Another v Minister of Safety and Security* 2010 6 SA 457 (SCA) para 1; De Waal 2009; Croome *et al Tax Law An Introduction* 382.

³³ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 SCA.

[A trust] is an accumulation of assets and liabilities. These constitute the trust estate, which is a separate entity. But though separate, the accumulation of rights and obligations comprising the trust estate does not have legal personality. It vests in the trustees, and must be administered by them – and it is only through the trustees, specified as in the trust instrument, that the trust can act.³⁴

It is significant to note that a trust is considered to be a separate “person” for tax purposes. Croome³⁵ confirms this legal fact, even though South African courts do not generally recognise a trust as a legal person. Prior to this confirmation, income tax treatment of trusts was prompted in *Friedman and Others NNO v CIR*,³⁶ as it was held that the income retained in a trust was not taxable. The court argued that the trust is not a taxable entity, nor are the trustees viewed as its representative taxpayers.³⁷ The challenge was upheld, resulting in an amendment to the definition of “person” to include a trust. This decision also resulted in the inclusion of section 25B into the *Income Tax Act*.³⁸

In light of the argument above, section 1 of the *Income Tax Act*,³⁹ defines a trust as a “person” for income tax purposes and the *Companies Act*,⁴⁰ defines a trust as a “juristic person”, even though a trust does not possess juristic personality outside statute. In addition, a trust was considered to be resident if it is incorporated, formed, established, or has its place of effective management in South Africa for tax purposes.⁴¹ However, the trust income can be taxed in the hands of the beneficiary, donor or the trust as “person”, depending on the circumstances.⁴² Moreover, it is important to define the term “trust”, before writing on the law of trusts. Such writing is surprisingly difficult, since the term “trust” is considered as a broad and flexible concept. The reason is that it is not easy to capture the essence of the concept with any degree of accuracy.⁴³ Therefore, De Waal supports Hayton’s perceptive remark in this regard:

³⁴ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 SCA para 10.

³⁵ Croome *et al Tax Law an Introduction* 382.

³⁶ *Friedman and Others NNO v CIR* 1993 1 SA 353 (A).

³⁷ *Friedman and Others NNO v CIR* 1993 1 SA 353 (A) para 360G-H; Croome *et al Tax Law An Introduction* 382.

³⁸ *Income Tax Act* 58 of 1962

³⁹ *Income Tax Act* 58 of 1962; Stiglingh *SILKE: South African Income Tax* 827.

⁴⁰ *Companies Act* 71 of 2008.

⁴¹ *Du Plessis* 2010 *SA Merc LJ* 322.

⁴² *Du Plessis* 2010 *SA Merc LJ* 322.

⁴³ De Waal 2000 *SALJ* 548.

Like an elephant, a trust is difficult to describe but easy to recognise.⁴⁴

Olivier⁴⁵ has the same point of view, by agreeing that it is not difficult to explain what a trust entails, however, to provide a brief description is not that simple.⁴⁶ It should, be noted, however, that the *Trust Act* shall only apply to a trust in the narrow sense, namely *inter vivos* and testamentary trusts.⁴⁷ In addition, Cameron JA points out that a trust is "an accumulation of assets and liabilities", which subsequently constitutes the trust estate as a separate legal entity.⁴⁸ However, though separate, the accumulated rights and obligations comprising the trust estate do not have legal personality. Therefore, these trust elements vests in the trustees. As a result, it must be administered by the trustees, and only those who are specified in the trust instrument.⁴⁹ Honoré⁵⁰ confirms the aforementioned, by stating that a trust can be defined as a legal instrument where a person, who is the trustee, holds or administers the trust property separately from his/her own property, to the benefit of another person or purpose

De Waal⁵¹ is of opinion that the definition of a "trust" should be more specific. In this regard, he refers to the following definition used by an international Working Group that was set up to present a comparative historical analysis of both the trust and trust-like devices:

A trust is defined as a relationship in which one or more persons (the trustees) hold property, but administer it either for the benefit of someone else (the beneficiary) or to further some particular purpose.⁵²

⁴⁴ De Waal 2000 *SALJ* 548.

⁴⁵ Olivier and Van den Berg *Praktiese Boedelbeplanning* 177.

⁴⁶ Olivier and Van den Berg *Praktiese Boedelbeplanning* 177.

⁴⁷ *Jamneck et al Erfreg in Suid-Afrika* 191; Olivier and Van den Berg *Praktiese Boedelbeplanning* 179; Oakley Parker and Mellows: *The Modern Law of Trusts* 97.

⁴⁸ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) par 10; *Lupacchini v Minister of Safety and Security* (16/2010) [2010] ZASCA 1.

⁴⁹ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) par 10.

⁵⁰ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 1; Davis *et al Maatskappye en ander Besigheidstrukture* 381.

⁵¹ De Waal 2000 *SALJ* 549.

⁵² De Waal 2000 *SALJ* 549.

The definition above has a similar ring to the one presented in article 2 of the *The Hague Convention on the Law Applicable to Trusts and on their Recognition*, which reads as follows:

For the purpose of this Convention, the term "trust" refers to the legal relationships created- *inter vivos* or on death- by a person or settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.⁵³

In light of the discussion above, it is evident that these definitions closely correspond to the standard text on trusts and the *Trust Property Control Act*,⁵⁴ as provided for the South African lawyer. However, certain requirements should still be met before a trust is established. Therefore, this chapter focuses on the requirements of a valid trust, followed by the consequences if the prescribed requirements are not adhered to. The specific research question for this section can thus be formulated as follows: What are the requirements to create and register a valid trust?⁵⁵

2.2 Creation of trust

A trust can be created in various ways, the most common being a formal manner. According to this manner, the trust can be put into writing or created through agreement, a will, statute, or a court order.⁵⁶ Therefore, the trustee must indicate clearly that he/she has the intention that the trust should exist and clearly state the purpose of the trust and in which manner this legal instrument will be managed.⁵⁷ Furthermore, it is important that the trustees' intention is clearly definable and considered sufficient for the requirements of a trust.⁵⁸

A trust *inter vivos* can be created by verbal agreement between the founder and the trustees, and provided it remains verbal, the Trust Property Control Act does not apply to such trusts unless reduced to writing. If it is reduced to writing but not signed by any of the parties, it then falls within the scope of the definition of a trust

⁵³ Article 2 of *The Hague Convention on the Law Applicable to Trusts and on Their Recognition* 1985; Oakley Parker and Mellows: *The Modern Law of Trusts* 14.

⁵⁴ 57 of 1988; Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 1; De Waal 2000 *SALJ* 549.

⁵⁵ The present study focuses solely on an *inter vivos* trust.

⁵⁶ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 118; Van der Westhuizen *Wills and Trusts* B7.

⁵⁷ Frere-Smith *Manual of South African Trust Law* 60.

⁵⁸ Frere-Smith *Manual of South African Trust Law* 60.

instrument as defined in the Trust Property Control Act. It is, however, recommended that a trust always be reduced to writing for the sake of legal certainty.⁵⁹

If the trustees state their intentions unequivocally, it eliminates doubts about the legal nature of the trust that is created and its purpose as such.⁶⁰ As pointed out above, certain requirements must be met before a trust is considered to be valid. These requirements are essential since establishing the validity of a trust is the starting point to determine whether such a legal instrument can be deemed a sham or not.⁶¹ Therefore, it is necessary that these essential elements are discussed in more detail below.

2.3 Requirements for a valid trust

There are various requirements that must be met when establishing a valid trust. First of all, to create a valid trust, the founder must have the intention to create a valid trust, and the founder must express his/her intention in a way appropriate to present an obligation. Secondly, an unambiguous definition of the trust property must be included. The trust object must be defined with a degree of certainty, which may be personal or impersonal. Finally, the defined trust object must be of a lawful nature.⁶² Thus, in order for a trust to be deemed valid, the trust has to meet the requirements, which are elaborated below.

2.3.1 Intention

A trust can be created by a person who has the necessary capacity to undertake contractual obligations. A trust, more specifically a testamentary trust, can be erected by a person with the legal capacity to draft a testament.⁶³ However, it is necessary to distinguish between the intention to create a trust in the narrow or strict sense.

The intention to create a valid trust should, therefore, be clear, certain and unambiguous.⁶⁴ It is evident that, the intention must be present when a person creates

⁵⁹ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 139; Van der Westhuizen *Wills and Trusts* B7.1; Olivier and Van den Berg *Praktiese Boedelbeplanning* 179.

⁶⁰ Frere-Smith *Manual of South African Trust Law* 60.

⁶¹ Van der Westhuizen *Wills and Trusts* B8.

⁶² Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 91; Olivier and Van den Berg *Praktiese Boedelbeplanning* 178.

⁶³ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 91.

⁶⁴ Du Toit *South African Trust Law* 27.

a trust. Therefore, for the trust to be legally valid, it must have a valid and legal purpose.⁶⁵ In *Peterson v Claassen*,⁶⁶ the court distinguished between the object and purpose of a trust. The object of a trust, that needs to be lawful for the trust to be valid, is ascertainable to all the parties involved, or any person that deals with a trust. Moreover, the purpose of a trust is in some cases only known to the founder, especially in cases that are unlawful and immoral. However, if a trust is created for an unlawful purpose the trust is not automatically deemed invalid.

In certain instances, the intention to create a trust may be inferred from specific circumstances. This is in spite of the fact that the founder has not used words that are designed to create a trust, or precatory terms from which the intention to create a trust can be inferred. Thus, the founder will be held to have had the necessary intention if it appears that this was the common intention by him-/herself and the trustees from all the circumstances.⁶⁷ In the case of *CIR v Pretorius* the court held that:

Where the intention to create a trust is lacking, the effect depends on whether the testator or donor intended to benefit the person to whom the property was given. If the intention to benefit was present, the supposed trust is disregarded and the legatee or donee takes free of any burden. If the person to whom the property is given is not intended to be a beneficiary, the gift is invalid and may be recovered by the founder or his estate. If the intention to create a trust is lacking because the trustee is insufficiently independent, the "substance over form" principle can apply, and the transaction is then construed for what the real intention is, that is, agency, partnership, sale, etc.⁶⁸

It is evident that the true intention behind a transaction is important, and not what is recorded in the resulting contracts. This principle does only apply in instances where the parties did not intend the trust to have the legal effect as conveyed by the terms to the outside world. In legal terms, this is referred to as the principle of "substance over form", which will be examined closer subsequently.

⁶⁵ See also page 20.

⁶⁶ 2006 5 SA 191 (C) para 11-15.

⁶⁷ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 99.

⁶⁸ *CIR v Pretorius* 1986 1 SA 238 (A) par 23; Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 99.

2.3.1.1 *Khabola v Ralitabo*⁶⁹

In this case the parties had the intention to create a partnership or similar association which they portrayed and simulated as a trust. Upon discovery that the parties formed the partnership with an agreement between the parties that the applicant act as a general manager, which resulted in the trust seeming to be simulated. According to South African law, each case is based on its own circumstances, which are kept in mind in the determination as to whether the intention to establish a trust is absent.

Consequently, in instances where the intention of the parties was to establish something other than a trust, it will result in the transaction being interpreted according to the parties' intention.⁷⁰

2.3.2 *The founder expressing his/her intention to create an obligation*

A requirement mentioned above is that the founder must express his/her intention in such a manner that will create an obligation. However, this requirement is not sufficient for a trust to be deemed valid, unless it was made orally or written in some form, such as a will, transfer, contract, statute, or a judicial order. This would be the only way to create a legal obligation.⁷¹ In this regard, section 2 of the *Trust Property Control Act* states that if an oral agreement is put down in writing, it can be considered that a trust has been created. The following quote from the Fundamentals of Fiduciary services describes the nature of the obligation:

The obligation envisaged is either (i) the obligation resting on the trustee to administer the property for the trust object, (which will apply when a trustee has accepted the appointment as trustee and the property has been transferred to or placed under the control of the trustee) or (ii) the obligation resting on the founder or on another to take the necessary steps to ensure that the property is administered by a trustee (which will apply when a trustee has not been appointed or has not accepted office or when, though there is a trustee, the property has not been transferred to or placed in the control of the trustee).⁷²

Furthermore, for a trust to be established, control of the trust property must be handed over by a legally valid mode of transfer, which creates an obligation.

⁶⁹ *Khabola v Ralitabo* 2011 ZAFSHC 62.

⁷⁰ See also page 27 where this applicable to the case study in the conclusion.

⁷¹ Trusts unlimited 1990 http://trustguru.co.za/Essentials_of_Valid_Trusts.html.

⁷² Fundamentals of Fiduciary services par 11.5.2.

Therefore, the founder must bound him-/herself by contract to hand over control, or he/she must be bound in some other way, for example, by statute or court order to do so. This implies that the founder is obliged to hand over control of the trust property. Formalities are necessary when creating a trust, especially to create an obligation, which the trust needs to exist.⁷³ This specific obligation will depend on the various situations at hand, as explained below:⁷⁴

The trust created by means of a contract is a species of a *stipulatio alteri* and as such it has to comply with all the requirements of a valid contract. A trust *inter vivos* can be created orally and the Trust Property Control Act does not apply to such trusts whether created before or after the said Act came into operation on 31 March 1989 unless reduced to writing and not necessarily signed.⁷⁵

From the discussion above, it is clear: In the absence of a juristic act that imposes an appropriate obligation, no trust is created. As a result, the purported disposition will not have a legal effect.⁷⁶ However, it is important to note that the formalities necessary to create the obligation for the trust's existence, are exactly similar to the formalities necessary for the creation of a trust.⁷⁷

In this regard, Smuts⁷⁸ provides a practical, yet relevant, example: a person who decides to create a trust, must first put the trust agreement into writing. Once the trust is registered, the following step is to move the assets from the personal estate to the trust. In other words, the founder entrusts his/her assets to the trust. Therefore, the obligation rests on the trustee to administer the property of the trust to the benefit of the beneficiaries. This implies that the property in the trust does not form part of the founders own personal estate anymore.

⁷³ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 80.

⁷⁴ Du Toit *South African Trust Law* 30.

⁷⁵ Van der Westhuizen *Wills and Trusts* par 8.2; Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 249.

⁷⁶ Van der Westhuizen *Wills and Trusts* par 8.2.

⁷⁷ Van der Westhuizen *Wills and Trusts* par 8.2.

⁷⁸ Smuts *Die Suid Afrikaanse Reg* 114. When a trust is created, it consists of three parties, namely, the founder, trustees and beneficiaries. The latter being the party who hopes to benefit, even though this does not have to be the main objective of the trust, it may even be impersonal to an extent.

2.3.3 Property

The trust property must be defined with sufficient certainty.⁷⁹ Such a property can consist of assets that are movable or immovable, corporeal or incorporeal.⁸⁰ Therefore, a trust cannot exist if property is not transferred to it. A trust usually starts off with a donation by the founder to the trustees, which forms the first trust property. The identification of the trust property will occur in the trust instrument, which must be determined with certainty.⁸¹ If the trust property is not identified with sufficient certainty, the trust is deemed invalid, since there is no room for uncertainty. Van der Westhuizen⁸² confirms this prerequisite:

Failure to identify the subject matter of the trust adequately, renders the trust invalid.⁸³

In *Deedat v The Master*,⁸⁴ the court held that where there currently are no assets, but identifiable ones are to be acquired in the future, a trust can be considered to exist or created.⁸⁵ In addition, if a trust, in the course its existence, becomes devoid of all its assets, the trust will cease to exist. However, it is required of a founder of a trust to be divested in certain legal proprietary rights, as well as to maintain a degree of control over the assets of a trust.⁸⁶ Possible ambiguities in describing the property in a trust can be resolved through the usual measures in a contract. In these instances, the founder of the trust's intention can be considered decisive. An incorrect description of the trust property, as an unintentional mistake does not necessarily mean prejudice. However, in the case of an *inter vivos* trust, it also follows that the parties must comply with ordinary rules of the law of contract.⁸⁷

⁷⁹ Van der Westhuizen *Wills and Trusts* par 8.3.

⁸⁰ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 85.

⁸¹ Du Toit *South African Trust Law* 30.

⁸² Van der Westhuizen *Wills and Trusts* par 8.2.

⁸³ Van der Westhuizen *Wills and Trusts* par 8.2.

⁸⁴ 1995 2 SA 377 (A) 385C; Van der Westhuizen *Wills and Trusts* par 8.2.

⁸⁵ Van der Westhuizen *Wills and Trusts* par 8.2.

⁸⁶ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 6.

⁸⁷ Van der Westhuizen *Wills and Trusts* par 8.5.

2.3.4 Object

The object of the trust must be spelt out clearly and unambiguously.⁸⁸ In this regard, the object can apply for more than one ascertainable person, or may entail one or more objects, which are impersonal.⁸⁹ Furthermore, the trust object must be lawful, in order to create a valid trust.⁹⁰ In *Peterson v Claassen*,⁹¹ a distinction was made between the object and the purpose of a trust. The object entails clear terms outlined in the trust instrument and all the parties involved in the trust are cognisant of the trust's object.⁹² On the other hand, the purpose is merely what is supposed to be achieved by using the trust.⁹³

2.3.5 Legality

The final requirement for a trust to be deemed valid is whether its purpose is lawful. Therefore, the trust object must be defined with sufficient certainty and should not be illegal, against public policy, or *contra bonos mores*.⁹⁴ Furthermore, a trust's creation should be for valid purposes.⁹⁵ However, certain instances where a trust has been created for an unlawful purpose does not automatically render it void. Nevertheless, where a trust has been created for a clear illegal purpose, agreements which it purports to conclude thereafter may be deemed either void or voidable. This applies especially in accordance with ordinary contractual principles and the various circumstances surrounding the conclusion of each agreement.⁹⁶ Bozalek J draws the following important distinction in the *Peterson* case,⁹⁷ between the object and the purpose of a trust:

There is, in my view, a material difference between the object of a trust and the purpose thereof. The object is openly proclaimed and ascertainable and all parties

⁸⁸ Du Toit *South African Trust Law* 31.

⁸⁹ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 151. The object of the trust can be of personal or impersonal nature.

⁹⁰ *Peterson v Claassen* 2006 5 SA 191 (C) par 11. Hereafter the *Peterson* case.

⁹¹ Du Toit *South African Trust Law* 30; *Peterson* case par 11.

⁹² Du Toit *South African Trust Law* 30.

⁹³ Du Toit *South African Trust Law* 31.

⁹⁴ Trusts unlimited 1990 http://trustguru.co.za/Essentials_of_Valid_Trusts.html; Du Toit *South African Trust Law* 32; *Peterson* case par 11; It should be noted that, *contra bonos mores* is defined as something that is against the common good.

⁹⁵ LW 2014 <http://linandwoodlaw.com/estate-planning/wills-and-trusts/what-are-the-requirements-in-a-valid-trust/>.

⁹⁶ Estate planning and Fiduciary Services Guide par 11.5.2

⁹⁷ *Peterson and Another NNO v Claassen and Others* 2006 5 SA 191.

who have dealings with that trust will be held to have knowledge of the trust's object. In the present case, the objects of the three new trusts which took transfer of the properties were entirely lawful, the primary object being in each case 'om bates en inkomste te bekom en aan te wend tot uiteindelijke voordeel van die begunstigde'.⁹⁸

In light of the discussion above, it follows that trusts should also comply with ordinary rules, whether rules of the law of contract for *inter-vivos* trusts, or those regulating the drafting and signing of wills for testamentary trusts. Therefore, it should be noted that the Master or any other state authority does not determine the legality or validity of an *inter vivos* trust. As a matter of course, the trust instrument must be lodged and filed with the Master of the High Court.⁹⁹ However, the state does not censor the trust's objects. Thus, those interested in the matter are expected to establish whether the trust is either unlawful, or invalid.¹⁰⁰

On the other hand, the Master has the power to refuse or accept a will, in the case of a testamentary trust, until the court has determined its validity for the purposes of section 8(4) of the *Administration of Estates Act* 66 of 1965. The result would be that any trust created in the will can also be declared invalid and the testamentary trust does fall under the Master's scrutiny for validity in this instance. Once the requirements have been considered, it is necessary to understand the implications if all these prescriptions have been met, or if one is possibly omitted.

2.4 Consequences of not adhering to the requirements

Once the prescribed requirements have been met, a valid trust would have been established. Nevertheless, if a requirement is not adhered to, the trust is deemed invalid and non-existent. Therefore, as mentioned previously, the determining of a trust's validity is deemed to be the starting point when the question is whether a trust is a sham or not.¹⁰¹ It is, therefore, evident that the essentials for the formation of a valid trust are highly significant.

⁹⁸ *Peterson and Another NNO v Claassen and Others* 2006 5 SA 191 para 16.

⁹⁹ Section 4 of the *Trust Property Control Act* 57 of 1988.

¹⁰⁰ Estate planning and Fiduciary Services Guide par 11.5.5.

¹⁰¹ Van der Westhuizen *Wills and Trusts* B8.

2.5 The concepts of a sham and alter ego

2.5.1 Concept of a sham trust

When considering the concept of a "sham trust" it is evident the South African courts instead tend to refer to the "abuse" of the trust figure or using the trust as an "alter ego". However, in the case of a sham trust, there is no true intention to create a trust. In this regard, the invalidity of a sham trust is due to the original intention lacking to create a trust. In other words, if the intention to create a trust was absent in the first place, there can be no trust. Thus, to elucidate the concept of a "sham trust" it is necessary to refer to case law. *In Zandberg v Van Zyl*,¹⁰² Innes JA, made the following remark:

A sham trust exists where the trust appears to have been established on the terms of a particular trust deed, but these terms do not reflect the parties' (the founder and trustees) true intentions, thereby misleading third parties about the true terms of the trust.¹⁰³

According to De Waal,¹⁰⁴ the key aspects to determine whether a trust is a sham or not, lie within the requirements that are essential to create a valid trust. However, when considering a sham, the first requirement is particularly relevant, namely intention. As was mentioned previously, there must be an intention for the trust to come into existence. If intention lacks, the actual intention is to create a different instrument and no trust comes into existence. In this regard, the main issue is whether the trust is a sham or not. In such an instance, the jurisprudence is relevant regarding the simulation of transactions or issue of sham.

2.5.1.1 Simulated transactions

Determining whether a transaction is deemed to be "disguised" or "simulated" is crucial. This issue can be resolved by simply establishing whether the parties to the contract intended to give effect to it, or whether there was a mutual understanding not do so.¹⁰⁵ Therefore, in *Zandberg v van Zyl*,¹⁰⁶ to grasp the concept of a "sham

¹⁰² *Zandberg v Van Zyl* 1910 AD 302.

¹⁰³ Nedbank date unknown <https://www.nedbankprivatewealth.co.za/south-africa/fiduciary-focus-trust>. This will be discussed in more detail under 2.5.2.

¹⁰⁴ De Waal 2012 *RabelsZ* 1085.

¹⁰⁵ PWC 2009

https://www.saica.co.za/integritax/2009/1743_Disguised_or_simulated_transaction.htm.

¹⁰⁶ *Zandberg v van Zyl* 1910 AD 302.

trust", it is essential to understand what Innes JA meant, when he formulated the classic guiding principle of simulated transactions. This was ultimately defined as follows:

They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be. The maxim then applies *plus valet quod agitur quam quod simulate concipitur*.¹⁰⁷

According to Innes JA, the above-mentioned principle can be summarised in the maxim *plus valet quod agitur quam quod simulate concipitur*.¹⁰⁸ Therefore, the challenge is to determine the real intention of the parties, which differs from the simulated intention.¹⁰⁹ Clearly, the correct answer cannot be based on a general rule, seeing that, in each case, this is a question of fact.¹¹⁰ Furthermore, De Waal,¹¹¹ is of the opinion that this formulation about simulations is important when considering the concept of a sham. The reason is that Innes JA strikingly outlined various points that help one grasp the concept of a sham.¹¹² The general rule is that parties intend a contract as exactly what it purports to be, however, there are instances where they may endeavour to conceal its true character. In such instances, the court must consider the true nature of the transaction substance and not what it purports to be in form. In South Africa, there are numerous cases in which the courts had to decide whether a specific agreement between parties is in actual fact in the alleged agreement form, rather than being disguised as something else.

According to the *Zandberg* case,¹¹³ it had to be established whether the founder intended the trust to be what it portrays, or whether this instrument was established with the idea of disguising its true nature.¹¹⁴ It is possible that the founder did not actually intend to create a trust, but rather a partnership, agency or another modus.¹¹⁵

¹⁰⁷ *Zandberg v Van Zyl* 1910 AD 302 at 309. (hereafter the *Zandberg* case).

¹⁰⁸ De Waal 2012 *RabelsZ* 1083; This means the following: "The real intention carries more weight than a fraudulent formulation or pretence."

¹⁰⁹ De Waal 2012 *RabelsZ* 1083.

¹¹⁰ De Waal 2012 *RabelsZ* 1084.

¹¹¹ De Waal 2012 *RabelsZ* 1084.

¹¹² De Waal 2012 *RabelsZ* 1084.

¹¹³ *Zandberg v Van Zyl* 1910 AD 302.

¹¹⁴ De Waal 2012 *RabelsZ* 1085.

¹¹⁵ De Waal 2012 *RabelsZ* 1085.

A further possibility is that the founder had no intention of creating a legal institution at all, but only to use the name or concept of a trust to a form of personal advantage.¹¹⁶ This raises a further question, namely whether the trust at issue is indeed a sham trust, which will have the effect that no trust was established.¹¹⁷ Such a scenario will, according to the *Zandberg* case,¹¹⁸ lead the court to consider the true nature of the intention, rather than what it pretends to be.¹¹⁹ To ascertain this nature, the true intention of the founder will have to be compared with the simulated intention, to reach a conclusion.¹²⁰ The manner of comparison will differ from case to case, which means that the general rule will rarely be applicable.¹²¹

2.5.1.2 The "sham trust" in English law

The English law contains significantly more content on the issue of a sham, by referring specifically to the trust law. A detailed discussion of this content is not relevant or required in this section, although, certain aspects are relevant to the concept of a sham trust within a South African context. Several similarities can be discerned between the English law and South African laws when investigating the basic concept of a sham. According to Stafford, a "sham trust" in essence entails:

Documents or arrangements which have been falsely created will not be permitted to prevent a court from getting at the real truth of the matter, and "if it [is] a mere cloak or screen for another transaction one [can] see through it." Such documents or transactions are generally referred to as "shams".¹²²

From the definition above, it is clear that in the case of a sham trust, there is no true intention to create a trust, but rather create the *impression* that a trust has been created, when in fact it entails a different instrument. As was pointed out previously, the invalidity of a sham trust is a mere result of intention lacking to create a trust and thus, there can be no trust. Therefore, the documents or arrangements which are created falsely with the objective of misleading a court about the truth of the matter,

¹¹⁶ Zangenberg *The relevance of "trust" assets upon divorce* 36.

¹¹⁷ De Waal 2012 *RabelsZ* 1086.

¹¹⁸ 1910 AD 302.

¹¹⁹ Zangenberg *The relevance of "trust" assets upon divorce* 36.

¹²⁰ De Waal 2012 *RabelsZ* 1086.

¹²¹ De Waal 2012 *RabelsZ* 1086.

¹²² Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego in the context of South African trust law: The dangers of translocating company law principles into trust law* 70.

are regarded as shams. One of the leading cases in this regard is *Snook v London and West Riding Investment Ltd*¹²³ which shall be discussed below.

2.5.1.3 *Snook v London and West Riding Investment Ltd*¹²⁴

Hudson¹²⁵ defines the concept of a sham as follows:

Scheme of action or a pattern of documentation which seeks to create the impression that the state of affairs is one thing when in fact it is something else.¹²⁶

Hudson's definition builds on the leading case of *Snook v. London and West Riding Investments Ltd*,¹²⁷ in the English law.¹²⁸ The definition in *Snook* has become a universal criterion to establish whether a transaction is considered to be a sham or not.¹²⁹ The court held that a sham can be considered to be action taken or documents drawn up by the respective parties of the sham. These documents are handed to third parties prior to the court appearance, with the intention of creating legal obligations and rights between the parties.¹³⁰

Certain sources of English law, based on the law of trusts, regularly refer to the requirements for a valid trust when dealing with the issue of a sham trust. The act of creating a trust should comply with certain forms of certainty.¹³¹ These entail: certainties of the intention, the matter, and the object. These three forms of certainty are deemed crucial in the act of creation of a trust.¹³² In South African law, the certainty of *intention* is a decisive factor when discerning the nature of a sham trust.¹³³ If evidence comes to light that the founder's true intention was to create no trust, but rather another objective, it can be concluded that no trust was established. This also applies to instances where a founder falsely implies that a trust has been created, in order to achieve a certain goal or receive a certain advantage. The latter will be

¹²³ *Snook v London and West Riding Investment Ltd* 1967 1 All ER 518.

¹²⁴ *Snook v London and West Riding Investment Ltd* 1967 1 All ER 518.

¹²⁵ Hudson *Equity and Trusts* 1057.

¹²⁶ Hudson *Equity and Trusts* 1057.

¹²⁷ *Snook v London and West Riding Investment Ltd* 1967 1 All ER 518.

¹²⁸ De Waal 2012 *RabelsZ* 1089.

¹²⁹ Moshidi *Lack of protection of outsiders in dealings with trusts* 23.

¹³⁰ De Waal 2012 *RabelsZ* 1089.

¹³¹ De Waal 2012 *RabelsZ* 1089.

¹³² De Waal 2012 *RabelsZ* 1090.

¹³³ Van der Westhuizen *Wills and Trusts* B8.

deemed a sham (and thus, no trust established). Therefore, according to Moffat,¹³⁴ the certainty if intention lacks, gives rise to a sham intention.¹³⁵

2.5.1.4 The burden of proof concerning the allegation of a trust being a sham

When evaluating the finding of a sham, the issues surrounding the proof of such a sham must be considered. This implies that the principle should be applied regarding burden of proof for the allegation of the trust being a sham. In other words, where does this burden of proof lie? These issues about the onus and burden of proof are particularly relevant for the present study. To determine the onus and burden, two aspects must be addressed briefly.¹³⁶

In the first instance, it should be determined on whom the onus rests of proving a sham. This can be done by taking foreign authority into consideration, as explained below:

The party asserting the existence of a sham bears the onus of establishing that.¹³⁷

Secondly, the specific burden of proof must be identified. In this instance, Conaglen is of the opinion that the usual civil burden of proof such as the balance of probabilities, should apply by considering the common-sense proposition of the respective parties' documents. Furthermore, it may not be assumed that the respective parties have used incorrect wording that could have been misinterpreted, thus causing a misunderstanding of the true nature of the position.¹³⁸

2.5.1.5 Consequences of a "sham trust"

As was discussed previously, for a trust to exist, there must be significant intention.¹³⁹ A trust cannot be abused if it is not deemed to be valid, therefore, it must comply with all the requirements to establish a valid trust.¹⁴⁰ If the intention is not present, or the

¹³⁴ Moffat and Garton *Moffat's trust law: text and materials* 184.

¹³⁵ Moffat and Garton *Moffat's trust law: text and materials* 184.

¹³⁶ Conaglen 2008 *CLJ* 192; Stafford *A legal-comparative study of the interpretation and application* 107.

¹³⁷ Conaglen 2008 *CLJ* 192; Stafford *A legal-comparative study of the interpretation and application* 107.

¹³⁸ Conaglen 2008 *CLJ* 192; Stafford *A legal-comparative study of the interpretation and application* 107.

¹³⁹ Moshidi *Lack of protection of outsiders in dealings with trusts* 28.

¹⁴⁰ There is an important distinction between sham and abuse, that will be emphasized in this

real intention is to create another type of instrument, it is obvious that there is no mention of an actual trust.

In the case of a sham trust it therefore, becomes clear that no trust had existed. Van der Linde¹⁴¹ confirms when there is no real intention to create a trust, this is sufficient evidence for the court to conclude that the main purpose of the trust was to cause deception, which caused another person to be misled by the trust. It appears, however, that the courts are unwilling to declare that a trust is a sham and would rather attempt to apply the *alter-ego* principle, if possible.¹⁴² This principle is discussed in the following subsection.

2.5.2 Alter ego

In the Supreme Court of Appeal, in the case of *Badenhorst v Badenhorst*, the court formulated a test on how to determine whether a trust is being used as an alter ego. The court stated that sufficient evidence needs to exist that a party controlled the trust in acquiring assets, which without the trust would have been in his own name. the court held that the control must be *de facto* and not *de iure*. Furthermore, in the case of *Hydraberg Hydraulics*,¹⁴³ the court held that in determining whether it would be equitable for the court to pierce the veneer, the court would need to consider if giving credence to a natural person's disguise of himself as a trustee would be conscionable.

The court made the following remarks in the case of *Van Zyl*, of what the consequences of transactions, agreements and assets in the case of a trust being used as an alter ego. Firstly, if the court goes behind the trust form, it entails that the existence of the trust is accepted but disregarded for given purposes for the ordinary consequences of the existence of such a trust. Secondly, the possibility arises that the trustees could be held personally liable for obligations undertaken during their capacity as trustees. Thirdly, the court made the remark that a trust may be bound to transactions undertaken by trustees that acted outside their legal capacity or limits.

section.

¹⁴¹ Van der Linde 2012 *THRHR* 382.

¹⁴² Van der Linde 2012 *THRHR* 382.

¹⁴³ 2010 5 SA 555 (WCC).

When considering the concept of *alter ego*, the basis remains that the trust is deemed valid in principle. In this instance, it is acceptable for the court to ignore the initial purpose for which the trust was created.¹⁴⁴ The *alter-ego* rule can be explained as follows:

The *alter ego* doctrine is also known as the instrumentality rule because the corporation becomes an instrument for the personal advantage of its parent corporation, stockholders, directors, or officers. When a court applies it, the court is said to pierce the corporate veil.¹⁴⁵

This legal rule has a substantial influence on the final ruling of the courts on trusts. Therefore, courts consider whether the founder or the trustee is the same person as his/her trust. This enables the court to establish how the trust's assets should be dealt with in cases of *alter ego*, as explained by Nedbank:

An *alter ego* trust presents where the necessary requirements for a valid trust is present when the trust is established, but the trustees of the trust act as puppets, doing whatever they are instructed to do by the founder or another trustee. It would also present where the trust property is treated by the founder or a trustee as if it were personally owned by him/her, instead of belonging to the trust.¹⁴⁶

In light of the argument above, it is clear that when a trustee manages a trust for his/her personal benefit, this instrument is being abused as the *alter ego* of the trustee. To determine whether a trust is being used as an *alter ego*, it is necessary to consider certain factors. These entail the power invested in each trustee, the number of trustees, who is a particularly dominant trustee, and the understanding that is used to make decisions. These factors can be relayed to the fact that trustees are not allowed to abuse the trust, for example, by managing it for their personal benefit. If not, this instrument will be considered to be the *alter ego* of the trustees. In the case of a sham trust, there is no true intention to create a trust, which underscores its invalidity.

Van der Linde¹⁴⁷ points out the dilemma to ascertain the nature of a sham:

¹⁴⁴ De Waal 2012

https://scholar.sun.ac.za/bitstream/handle/10019.1/85023/dewaal_abuse_2012.pdf.

¹⁴⁵ Anon date unknown <http://legal-dictionary.thefreedictionary.com/Alter+Ego>.

¹⁴⁶ Nedbank date unknown <https://www.nedbankprivatewealth.co.za/south-africa/fiduciary-focus-trust>.

¹⁴⁷ Van der Linde 2012 *THRHR* 382.

Difference in opinion on what constitutes a "sham trust" (invalid) is evident from case law, academic research, and practitioners' views of a sham.¹⁴⁸

Thus, as was established above, in the case of a sham, the trust is deemed invalid and does not exist.¹⁴⁹ As a result there can be no reliance on the trust deed.¹⁵⁰ Therefore, the trust's assets remain in possession of the trustee or founder.¹⁵¹ This means that no rights will vest in trustees or beneficiaries regarding the assets.¹⁵² For an extended period, the legal consequences of a sham trust were unclear. Therefore, the following aspects have been identified to help determine when there would be consequences of a sham trust. A trust is considered to be void when: firstly, there is a misconception about the true nature of the trust; and secondly, when the parties entering the trust are aware that this instrument is a sham, and have the intention to mislead others and the court.¹⁵³

2.6 Conclusion

The most common way to create a trust, is to conclude a formal agreement, which puts the trust in writing. A trust can also be created through a written will, statute, or a court order. It is necessary to meet all the prescribed requirements in order to create a valid trust. If these requirements are not adhered to, the trust is deemed invalid. It was found that intention is considered the fundamental principle on which a trust is based. The founder must clearly state the true intention of the trust to eliminate doubts about its legal nature and purpose. If a trust is created for a purpose other than a legally binding one, in principle it is invalid and for all purposes non-existent. When a founder thus, establishes a trust, he/she must create a legal obligation and clearly define the trust property along with the object of the trust, which in essence must be lawful. To conclude, a trust is only considered to be legally valid once it contains all the essentials and once all the requirements have been adhered to.

¹⁴⁸ Van der Linde 2012 *THRHR* 382.

¹⁴⁹ Moshidi *Lack of protection of outsiders in dealings with trusts* 24.

¹⁵⁰ Moshidi *Lack of protection of outsiders in dealings with trusts* 24.

¹⁵¹ Moshidi *Lack of protection of outsiders in dealings with trusts* 24.

¹⁵² Moshidi *Lack of protection of outsiders in dealings with trusts* 24.

¹⁵³ Nedbank date unknown <https://www.nedbankprivatewealth.co.za/south-africa/fiduciary-focus-trust>.

If the legal principle above is applied to the case study in chapter 1, it is necessary to determine whether the essential requirements have been met for a valid trust to exist. In light of the discussion above, it is evident that Mr X did not truly intend to create an *inter vivos* trust, as Mr X only intended to create the impression of a trust, rather than a valid trust. Mr X intended to rather form a partnership. Consequently, in instances where the intention of the parties was to establish something other than a trust, it will result in the transaction being interpreted according to the parties' intention.¹⁵⁴

As a result, that Mr X has given a false pretence of his intentions, he will not be entitled to conclude the recognised agreement for an *inter vivos* trust.

Furthermore, if the founder of a trust has remained in control of the trust property, according to the principle of "substance over form" that trust will be deemed valid. As a result, the trust property will fall into the founder's personal estate. However, it is necessary to consider the general principles of a contract, especially that of sale, to determine the possible legal position of assets vested in a *sham trust*. The approach in South African law differs significantly for *inter vivos* trusts, in comparison with other common law jurisdictions. In South Africa, these trusts are based on the law of contract, rather than the law of equity. Therefore, it is necessary to derive the answer regarding the legal position of the assets vesting in a *sham trust* from the law of contract.

¹⁵⁴ *Khabola v Ralitabo* 2011 ZAFSHC 62.

3 General contractual principles

3.1 Introduction

The aim of this chapter is to discuss the requirements of a valid contract. Therefore, this section will focus on the specific requirements that must be met for a contract to be valid. In essence, a contract is considered to be invalid if all the requirements are not met, which will entail that the contract will be either void or voidable.¹⁵⁵

In South African courts, a difficult concept to define and understand is the legal nature of a trust instrument. The definition of a trust incorporates three individual aspects that must be considered. Firstly, the act of transferring the assets of the respective individual to the trust, will have the effect that ownership will be fully divested in the trust. The second aspect concerns the fact that the assets currently vested in the trust must be administered on behalf of a specified beneficiary or group of beneficiaries, as discussed in chapter 2. The third aspect is the requirement that administration of the trust's assets must adhere to the terms laid out in the trust agreement.¹⁵⁶ South Africa has an entirely different approach to *inter vivos* trust, compared to other common law jurisdictions. In South African law, these trusts are based in the law of contract, rather than the law of equity. According to Joffe¹⁵⁷ it is important to realise that:

Even though South Africa applies the law of contract and not the law of equity, unlike the jurisdictions mentioned above, a "sham attack" is consistent with South African legal principles.

This difference in application has a substantial impact on the rights of beneficiaries, as well as on the obligations of trustees, which causes numerous legal disputes.¹⁵⁸ In essence, a trust is a concept of a legal arrangement, which creates a transfer of asset ownership to a group of people, known as trustees. This group maintains and manages the assets to benefit a selected person or persons.¹⁵⁹ The assets that have been transferred to the trust, are covered by the protection provided by the trust's veneer. The result is that the respective assets are not deemed to be the trustee's property.

¹⁵⁵ Fouchè *Principles of Contracts and Commercial Law* 39.

¹⁵⁶ Stephens *When to cry, "Sham"* 13.

¹⁵⁷ Joffe 2007 *De Rebus* 26.

¹⁵⁸ Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego* 23.

¹⁵⁹ Stiglingh *SILKE: South African Income Tax* 827.

Furthermore, the assets vested in a trust, may not be used for any claims made against a trustee, or the trust itself.¹⁶⁰ In certain instances, where the trust's assets have been surrendered as security to a bank, the assets could be seized if the debt was not paid. Referring to the case study presented in chapter 1, it was evident in chapter 2 that the essential requirements were not met, therefore, a valid trust was not created. Thus, it is necessary to consider the general principles of a contract and the specific principles of a contract of sale to determine the possible consequences if the trustees purchase property through a *sham trust*.

3.2 The trust *inter vivos*

In South African law, a trust is established when an agreement is concluded between the founder and the trustees. This agreement is based on consensus reached between the two parties. The agreement entails that the trustees manage the trust to the benefit of a third party known as a beneficiary.¹⁶¹ The aspect of consensus is of importance, as a lack thereof would result in no consequences being formed from the agreement.

According to De Waal, the founder's intention is important in determining whether a trust is what is portrayed to be. This is necessary, as it will determine if an actual trust has come into existence, or if any other legal institution has been established. When there is no intention from the founder to create a trust, the conclusion can be reached that the trust is possibly a sham, resulting that no trust comes into existence. The challenge arises to determine the real intention, as intended by the founder, as opposed to the simulated intention. The latter will be a question of fact, and determination will prove to be difficult, as the application of general rules will act as poor guidelines.¹⁶² Therefore, it can be said that the challenge is consequently to establish the parties' real intention, which differs from the simulated intention.¹⁶³

¹⁶⁰ Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego* 23.

¹⁶⁰ Van der Linde 2012 *THRHR* 382.

¹⁶¹ *Crookes NO v Watson* 1956 1 SA 277 (A); and reconfirmed in *Hofer v Kevitt* 1998 1 SA 382 (SCA).

¹⁶² De Waal 2012 *RabelsZ* 1095.

¹⁶³ De Waal 2012 *RabelsZ* 1098.

For a valid trust to exist, the founder of such trust is required to have the intention to establish the trust. Consequently, if a founder has no such intention, or has the intention to create another legal institution, a valid trust would not have come into existence.

According to a decision reached by the Appellate Division,¹⁶⁴ an *inter vivos* trust is established by a *stipulation alteri*, which is in essence a contractual agreement between a trustee and trust founder on behalf of a beneficiary of the trust.¹⁶⁵ Therefore, careful consideration must be taken, seeing that there are several scholarly opinions on the matter. An example is found in the case of *Doyle v Board of Executors*.¹⁶⁶ In this case, Slomowitz AJ¹⁶⁷ asserted that certain aspects and questions regarding an *inter vivos* trust are not answered sufficiently by referring to the law of contract.¹⁶⁸ Furthermore, Stephens¹⁶⁹ is of the opinion that:

... while there are indeed similarities and overlapping principles between trusts and contracts, the former arrangements manifest additional dimensions which distinguish them from something as two dimensional as a contract. Furthermore, the fact that trusts are afforded juristic personality by certain legislation certainly sets them apart from ordinary contracts.

The case of *Crookes v Watson*,¹⁷⁰ which dealt with an amendment of a trust, also stated that the principles of an *inter vivos* trust are found in the law of contract. The reason is that the trust instrument is used by a trustee and a founder to benefit a listed beneficiary. Van der Linde¹⁷¹ indicates that this can be viewed as a contract concluded between two parties, which benefits a third person. In the Supreme Court of Appeal, the case of *Potgieter v Potgieter*,¹⁷² refocused the attention of trusts as contracts, by referring to cases such as, *Crookes and Hofer v Kevitt*.¹⁷³ Brand JA¹⁷⁴ made the following statement in this regard:

¹⁶⁴ *Crookes NO v Watson* 1956 1 SA 277 (A).

¹⁶⁵ Stephens *When to cry, "Sham"* 16.

¹⁶⁶ *Doyle v Board of Executors* 1999 2 SA 805 (C).

¹⁶⁷ *Doyle v Board of Executors* 1999 2 SA 805 (C) 813A-B.

¹⁶⁸ Stephens *When to cry, "Sham"* 17.

¹⁶⁹ Stephens *When to cry, "Sham"* 18.

¹⁷⁰ *Crookes NO v Watson* 1956 1 SA 277 (A) para 306A-B.

¹⁷¹ Van der Linde 2012 *THRHR* 382.

¹⁷² *Potgieter v Potgieter NO* 2012 1 SA 637 (SCA).

¹⁷³ Stephens *When to cry, "Sham"* 39.

¹⁷⁴ *Potgieter v Potgieter NO* 2012 1 SA 637 (SCA) para 18.

As I see it, the legal principles that find application are well settled and I did not understand any of the parties to contend otherwise. I believe these principles can be formulated thus: 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 stipulatio alteri*.

Honore¹⁷⁵ confirms that the principles of an *inter vivos* trust are found in the law of contract. Therefore, there is no reason why the application of the law of contracts cannot be used to solve problems presented by trusts. Furthermore, the same approach was followed in *Groeschke v Trustee for the Time Being of the Groeschke Family Trust and Others*,¹⁷⁶ which is a recent judgement. Bester AJ¹⁷⁷ relied on the *Potgieter* case when he stated that a deed of trust is considered as a contract. However, in *Groeschke v Trustee for the Time Being of the Groeschke Family Trust and Others*,¹⁷⁸ the Supreme Court of Appeal held that a trust is a contract, which is akin to a *stipulation alteri*.¹⁷⁹

In the case of *Hofer v Kevitt*,¹⁸⁰ the appellants requested a further explanation about the classification of an *inter vivos* trust as a *stipulation*. The court rejected their request on the basis that their argument was unreasoned and unconvincing.¹⁸¹ However, Van Coller AJA¹⁸² did consider the similarities and differences between the contractual and fiduciary relationship, due to the fact that certain aspects of law should be understood by referring to the fiduciary capacity that is invested in a trustee, rather than considering the principles of the law of contract.

The cases of *Hofer* and *Crookes* concerned the validity of a trust deed variation. Both these cases suggest that a variation is a contractual issue based on the law of contract. It is a known fact that relying on the law of contract, will provide an easier and clearer path to reach an outcome on the true nature of a specific trust.¹⁸³ An *inter vivos* trust

¹⁷⁵ Cameron, De Waal and Wunsh *Honore's South African Law of Trusts* 25.

¹⁷⁶ *Groeschke v Trustee for the Time Being of the Groeschke Family Trust* 2013 3 SA 254 (GSJ).

¹⁷⁷ *Groeschke v Trustee for the Time Being of the Groeschke Family Trust* 2013 3 SA 254 (GSJ) para 10.

¹⁷⁸ *Groeschke v Trustee for the Time Being of the Groeschke Family Trust* 2013 3 SA 254 (GSJ) para 10.

¹⁷⁹ Stephens *When to cry, "Sham"* 40; A *stipulatio alteri* is a contract for the benefit of a third party.

¹⁸⁰ *Hofer v Kevitt* 1998 1 SA 382 (SCA); Stephens *When to cry, "Sham"* 39.

¹⁸¹ *Hofer v Kevitt* 1998 1 SA 382 (SCA) 388F.

¹⁸² *Hofer v Kevitt* 1998 1 SA 382 (SCA) 386H.

¹⁸³ Stephens *When to cry, "Sham"* 16; *Hofer v Kevitt* 1998 1 SA 382 (A) 33 para 386H.

is thus an agreement made in terms of the law of contract. According to this agreement, a party transfers control of assets to the trustees, who manage and control these assets for the benefit of a third person or persons, known as beneficiaries. An alternative approach can be used, where the assets are in fact vested within the beneficiaries and only placed under the control of the trustees to manage on their behalf. This legal instrument is known as a "bewind" trust. However, an *inter vivos* trust is created by either a juristic person or a natural person, while the latter is still alive. This person will manage assets to support listed beneficiaries, who are usually family members. Such a legal instrument can either be a vested, or discretionary trust.

There are various ways in which assets can be transferred to an *inter vivos* trust, the most common being by sale or donation.¹⁸⁴ In the event of property being sold to a trust, it is essential that a sale agreement must be secured. Furthermore, it is a statutory requirement that the sale of immovable property must be in a written agreement; if the agreement is not in writing, the property will not be registered. Failure to secure a sale agreement, will result in SARS regarding the transaction to be a donation. Trust property can either be movable or immovable. This will include contingent interests vested in property, which are managed, disposed of, and administered by a trustee, as outlined in the terms of the trust deed. For the purpose of the present study, it is necessary to grasp the requirements of a contract, and particularly, the contract of sale regarding immovable property.

3.3 Contract of sale

The contract of sale is the most common type of contract.¹⁸⁵ According to Hutchison,¹⁸⁶ a contract is essentially an agreement between two or more parties, although not all agreements are considered as contracts. Furthermore, a contract can be defined as an agreement entered into by two or more individuals whose purpose is to create a legally recognised obligation or obligations. However, Hutchison¹⁸⁷

¹⁸⁴ Mcpherson 2006 <https://www.property24.com/articles/buying-and-selling-of-property-by-a-trust/4090>.

¹⁸⁵ Smuts *Die Suid-Afrikaanse Reg* 127.

¹⁸⁶ Hutchison *et al Kontraktereg* 4.

¹⁸⁷ Hutchison *et al Kontraktereg* 6.

disagrees with the latter definition, and argues that a further element may need to be added to this definition, namely that the agreement must be binding to both parties.

In light of the discussion above, it is evident that a contract of sale must comply with specific requirements. In this regard, it is essential that the contract of sale complies with the requirements of legality and public policy, whilst considering constitutional values and morals. The parties must comply with specific common law requirements before a contract is deemed to be valid and legally binding on the contracting parties. The requirements are: consensus, contractual capacity, certainty, possibility, legalities and formalities.¹⁸⁸ These aspects are expounded in the following section.

3.4 Requirements of a valid contract

For a valid contract to realise, certain essential requirements must be fulfilled, which will establish a valid binding agreement.¹⁸⁹ This agreement consists of the requirements that must to be adhered to – as discussed below.

3.4.1 The consensus and intention of the parties

The corresponding intentions of the contracting parties, in other words, consensus, form the basis of the contract.¹⁹⁰ The consensus or agreement is generally reached between two or more contracting parties about the terms of the contract, as well as future performances.¹⁹¹ According to Fouchè,¹⁹² the unanimity between contractual parties is considered as the cornerstone of a contract. However, it is essential that the parties to the agreement are aware of the other parties' intended performance, before an agreement can be reached.¹⁹³ Fouchè¹⁹⁴ asserts that the parties must negotiate, in order to be unanimous.¹⁹⁵ He explains his opinion:

The intention to conclude a contract is not sufficient to create a contract. The intention must be communicated to other contracting parties and the latter must in

¹⁸⁸ Mbhele *The South African Law of Contracts* 7. The general requirements for a valid contract are discussed in section 3.4.

¹⁸⁹ Botha *et al The South African Financial Planning Handbook* 2017 155.

¹⁹⁰ Van der Merwe *et al Kontraktereg Algemene Beginsels* 20.

¹⁹¹ Botha *et al The South African Financial Planning Handbook* 2017 155.

¹⁹² Fouchè *Principles of Contracts and Commercial Law* 40.

¹⁹³ Botha *et al The South African Financial Planning Handbook* 2017 155.

¹⁹⁴ Fouchè *Principles of Contracts and Commercial Law* 39.

¹⁹⁵ Fouchè *Principles of Contracts and Commercial Law* 39.

turn make his intention known to the first. An interaction of communication of their intentions is thus required to reach an agreement- the negotiations.¹⁹⁶

Such agreements are formalised by making an offer and accepting it.¹⁹⁷ According to Kerr,¹⁹⁸ the parties must enter into the transaction with a serious and deliberate intention, for a lawful obligation to be established. Botha¹⁹⁹ concurs that, for the contract to become legally binding, it is necessary that the contracting parties enter into the agreement with deliberate and serious intent, which will imply that binding rights and obligation are created in law. However, in instances where intention lacks, even though the parties to the agreement have serious intent, there will be no contract.²⁰⁰

Generally, consensus is considered to be reached, once the will or intention of one contractual party coincides with the will or intention of the other party. Thus, the act of accepting an offer constitutes the necessary consensus.²⁰¹ Therefore, the offer must be accepted for a contract to come into existence. The party must accept this offer voluntarily and act affirmatively in this regard.²⁰² However, it is possible that consensus can be improperly obtained under certain circumstances, such as false impression, threats or harm, undue influence, or bribery. In such cases, the contract can be deemed either null and void, or voidable and can be set aside by the innocent party.²⁰³

In addition, there are instances where a contract is deemed to be unenforceable. This is where the contract terms are illegal or cannot be realised. It is necessary to understand the implications of these concepts. For example, if a contract has been regarded to be void from the beginning, it is *void ab initio* and the contract is deemed never to have taken place, seeing that one of the essential elements had not been

¹⁹⁶ Fouchè *Principles of Contracts and Commercial Law* 39.

¹⁹⁷ Mbhele *The South African Law of Contracts* 7; Botha *et al The South African Financial Planning Handbook* 2017 155.

¹⁹⁸ Kerr *The Principles of the Law of Contract* 41.

¹⁹⁹ Botha *et al The South African Financial Planning Handbook* 2017 155.

²⁰⁰ Kerr *The Principles of the Law of Contract* 41.

²⁰¹ Mbhele *The South African Law of Contracts* 7.

²⁰² Botha *et al The South African Financial Planning Handbook* 2017 155.

²⁰³ Mbhele *The South African Law of Contracts* 8.

met.²⁰⁴ This may occur for example, where one of the parties is declared insane, which means the party does not have the requisite capacity to contract. Another example is where there was not a definite agreement on performance, or the performance was deemed to be against public policy.²⁰⁵

On the other hand, voidable contracts may be put aside, although still being deemed valid, since the essential elements are present. However, there is a reason, flaw or cause, which existed at the time of the agreement, thereby entitling one of the parties to cancel the contract.²⁰⁶ In this regard, it can be claimed that both parties are to be restored to their prior positions.²⁰⁷ According to Van der Merwe,²⁰⁸ the elements of consensus can be expressed as follows: the contracting parties must agree on the consequences they want to make alive, have the intention to bind themselves legally, and must be aware of their unity.

3.4.2 Contractual capacity

The parties must have the contractual capacity to enter into a contract. This implies the capacity to perform juristic or legal acts, such as concluding a valid contract.²⁰⁹ An essential element of the contract will be absent, if it is evident that one or more parties have limited or no capacity to contract. Foucè²¹⁰ made this situation clear:

Contractual capacity is the capacity the law grants a person to perform valid legal acts. Only persons with the required capacity may conclude contracts.

It is generally assumed that the parties entering into contracts have the contractual capacity to do so. This means these individuals are deemed capable of concluding contracts, unless the contrary has been proven.²¹¹ However, certain individuals are limited by law, therefore, in order for these parties to conclude a valid legal act, they must perform within certain parameters.²¹² Furthermore, there are other parties that

²⁰⁴ Botha *et al The South African Financial Planning Handbook* 2017 158.

²⁰⁵ Botha *et al The South African Financial Planning Handbook* 2017 158.

²⁰⁶ The remedy available in this regard is rescission.

²⁰⁷ The remedy available in this regard is restitution.

²⁰⁸ Van der Merwe *et al Kontraktereg Algemene Beginsels* 21.

²⁰⁹ Botha *et al The South African Financial Planning Handbook* 2017 155; Mbhele *The South African Law of Contracts* 7.

²¹⁰ Foucè *Principles of Contracts and Commercial Law*.

²¹¹ Foucè *Principles of Contracts and Commercial Law* 63; Mbhele *The South African Law of Contracts* 7.

²¹² Foucè *Principles of Contracts and Commercial Law* 63.

cannot conclude legal acts, such as even a contract at all, seeing that they have no contractual capacity to do so.²¹³ The reason is that such a party is unable to form an expression of intention, which in turn causes a lack of capacity.

Botha²¹⁴ differentiated between the three categories of capacity to contract. Firstly, there is no capacity to act, which includes children under the age of seven, as well as insane persons. The reason is that they are unable to perform a juristic act, or enter into a contract unaided. In other words, either the curator of the insane person or the guardian of the child, must enter into the contract on their behalf. Secondly, the party has limited capacity to act, which entails that minors between the ages of seven and 18 years are able to perform certain juristic acts themselves, however they still acquire the consent of either their parents or guardians.²¹⁵ Thirdly, the party has the full capacity to act, which implies the ability to perform any juristic act and enter into any contract. The latter category includes all persons over the age of 18, and who have not been declared insane.²¹⁶

3.4.3 Certainty

A general requirement for a contract is that the agreement must bring certainty about its legal consequences.²¹⁷ In certain instances, contracting parties fail to state clearly and disclose the required performances to which they are committed. They may also neglect to include the necessary material facts about their commitments. As a result, such information may not be provided by permissible extrinsic evidence. Furthermore, the agreement does not contain the *naturalia* or general principles based in the law of contract. Thus, the agreement will be deemed null and void.²¹⁸ Therefore, the performance must be certain or reasonably ascertainable and possible, otherwise the

²¹³ Botha *et al* *The South African Financial Planning Handbook* 2017 155.

²¹⁴ Botha *et al* *The South African Financial Planning Handbook* 2017 155.

²¹⁵ Botha *et al* *The South African Financial Planning Handbook* 2017 155; Hutchison *et al* *Kontraktereg* 159.

²¹⁶ Botha *et al* *The South African Financial Planning Handbook* 2017 155; Hutchison *et al* *Kontraktereg* 163.

²¹⁷ Van der Merwe *et al* *Kontraktereg Algemene Beginsels* 205.

²¹⁸ Van der Merwe *et al* *Kontraktereg Algemene Beginsels* 205.

contract will be void. This is especially applicable in instances where the obligations and performances that each party undertake are defined vaguely.²¹⁹

3.4.4 Possibility

The general requirement in this regard, is that it must be possible to render the performances at the time that the contract was concluded.²²⁰ In *Gassner v Minister of Law and Order*,²²¹ Van Zyl J held the following:

Our Roman legal sources deal fully with impossibility in contract. In his *Institutes* Gaius makes it clear that an agreement is invalidated if it requires performance of that which cannot be performed.

However, the contract will not create any legal obligations where it is impossible to render the above-mentioned performances. Furthermore, the performance agreed on after the agreement has been concluded, must be objectively possible.²²² Fouché²²³ applies a general principle, where it can be stated that the contract will be void, if the performance is impossible. Subjective impossibility means that although someone else may be able to deliver the particular achievement, the debtor is unable do so. Therefore, subjective impossibility implies the inability of the debtor to perform.²²⁴ The possibility or impossibility of performance is measured through a commercial criterion.²²⁵ In instances where the description of the performance is vague, or clarity lacks, the contract is deemed void.

3.4.5 Lawfulness

A contract that has been concluded in accordance with common law and South African statute, is deemed to be lawful.²²⁶ A contract will be regarded to be enforceable if it is lawful, whereas it is considered void, if it is unlawful.²²⁷ This means, therefore, that

²¹⁹ Fouché *Principles of Contracts and Commercial Law* 87.

²²⁰ Mbhele *The South African Law of Contracts* 11.

²²¹ *Gassner v Minister of Law and Order* 1995 1 322 (C) 326D.

²²² Van der Merwe *et al Kontraktereg Algemene Beginsels* 171.

²²³ Fouché *Principles of Contracts and Commercial Law* 87.

²²⁴ Van der Merwe *et al Kontraktereg Algemene Beginsels* 172.

²²⁵ Fouché *Principles of Contracts and Commercial Law* 88.

²²⁶ Fouché *Principles of Contracts and Commercial Law* 83.

²²⁷ Fouché *Principles of Contracts and Commercial Law* 83.

the parties must not be required to perform an illegal act in terms of the contract,²²⁸ as Fouchè states clearly:

Lawfulness refers to the conclusion, purpose or performance of the contract.²²⁹

In light of the argument above, if a contract is against public policy or the morality of the society, the contract will not be enforceable.²³⁰ Contracts that are against public policy or good morals are often prohibited by legislation.²³¹ It is important to note that an agreement will be void if its purpose is to commit a crime. In such a case, the performance to be rendered is regarded as unlawful.²³² If the parties to a contract do not meet requirements of legality, the result may be that the contract is deemed void and unenforceable.

A distinction should be drawn between two forms of illegality. On the one hand, for *statutory* illegality, the intention of the legislature is to render a contract void, since it is restricted by legislation. On the other hand, *common law* illegality implies that a contract is against public policy.²³³ When a contract is void due to illegality, various consequences must be considered.

Firstly, the contract cannot be enforced, especially since an unlawful contract is void or invalid by omitting one of the requirements for a valid contract.²³⁴ Furthermore, an unlawful contract does not create obligations and cannot be enforced, therefore, the applicable rule is the *ex turpi causa non oritur actio*, more commonly known as the *ex turpi*-rule.²³⁵ For example, if a party has suffered damage as a result of such a contract, this individual may not claim damages from the other party.²³⁶ A court has no discretion to provide relief to this rule or be lenient with its enforcement, in other words, there are no exceptions to this rule, as explained by the example below:²³⁷

²²⁸ Botha *et al The South African Financial Planning Handbook* 2017 157.

²²⁹ Fouchè *Principles of Contracts and Commercial Law* 83.

²³⁰ Botha *et al The South African Financial Planning Handbook* 2017 157.

²³¹ Fouchè *Principles of Contracts and Commercial Law* 83.

²³² Fouchè *Principles of Contracts and Commercial Law* 83.

²³³ Mbhele *The South African Law of Contracts* 11.

²³⁴ Hutchison *et al Kontraktereg* 199.

²³⁵ Hutchison *et al Kontraktereg* 199; This means that an action will not arise where there is a dishonourable cause.

²³⁶ Hutchison *et al Kontraktereg* 199.

²³⁷ Hutchison *et al Kontraktereg* 199.

Where a car thief fails to deliver a stolen vehicle to the purchaser even though the latter has already made payments, the court will not authorise such delivery.²³⁸

In general, if a contract is void and performance has already taken place, restitution of the performed act must be granted in principle.²³⁹ In this regard, where ownership of the performance has not passed, it is repaid with the *rei vindicatio*, however, if ownership has passed, the claim for the return of the performance is based on unfair enrichment.²⁴⁰

Secondly as a consequence: where two parties are equally guilty, the one in possession is considered to be in the stronger position.²⁴¹ The rule that applies is *par delictum*, which will prevent restitution. This rule does not exclude the enforcement of unlawful contracts through a demand for specific compliance. However, the rule does prevent parties from reclaiming their performance under an unlawful contract.²⁴² The *par delictum*-rule is based on two considerations of public policy. Firstly, a court will not assist those who approach with "dirty hands", and will discourage unlawful contracts. Secondly, the *par delictum* is only valid where the parties are equally guilty of concluding an unlawful agreement.²⁴³ The rule will, therefore, not apply where the plaintiff is less guilty than the defendant, or is not at all guilty morally, seeing that the party that has already performed in terms of the unlawful contract may recover his/her performance.²⁴⁴

3.4.6 Formalities

The general rule regarding the validity of a contract, is that there are no prescribed formalities for a contract to be valid.²⁴⁵ In other words, the intention of the parties does not have to be announced to contract in any formal manner. Therefore, a contract will be considered as concluded between the parties to an agreement, once there is certainty on the terms of the contract and the offer and acceptance has been communicated with sufficient clarity. In such a case, the contract may be valid,

²³⁸ Mbhele *The South African Law of Contracts* 12.

²³⁹ Hutchison *et al Kontraktereg* 200.

²⁴⁰ Hutchison *et al Kontraktereg* 200.

²⁴¹ Hutchison *et al Kontraktereg* 200.

²⁴² Hutchison *et al Kontraktereg* 200.

²⁴³ Hutchison *et al Kontraktereg* 200.

²⁴⁴ Mbhele *The South African Law of Contracts* 12.

²⁴⁵ Fouchè *Principles of Contracts and Commercial Law* 83.

whether being concluded tacitly, or verbally. However, legislation have instituted exemptions to the general rule as mentioned above. Therefore, for contracts to be valid, the parties must comply with various formalities.²⁴⁶ These formalities outlined in legislation, entail that a contract must be in writing; notarially executed; and be registered. According to Hutchison,²⁴⁷ the statutory-imposed formalities as required by legislation may in certain instances mean that the parties must comply with sanctioned stipulations. The contract can be invalidated, rendered voidable, or even have no impact on the legality of the transaction, if the parties have not followed the sanctioned formalities. In such an instance, it may even imply that one of the parties violates a statute. Furthermore, non-compliance in this regard may mean that by enforcing the contract, the other parties may be influenced/impacted detrimentally.

In certain instances, the parties concluding a contract may decide that, whilst they enter into an agreement, it is subject to a number of formalities.²⁴⁸ This is commonly known as self-imposed or agreed formalities. However, there are two scenarios in this regard, which depend on the parties' intention. In the first instance, self-imposed formalities are deemed as established preconditions to which parties must adhere in order for an agreement to be deemed valid. In other words, if all the contractual requirements and formalities of such a contract have not yet been adhered to, the agreement will not come into existence.

Finally, formalities that are agreed on provide mere evidence of a verbal agreement between the parties. The agreement between the parties do not have to be in a particular external form, to establish a contract.²⁴⁹ Therefore, only once the parties have reached consensus and complied with all the requirements, a valid contract will come into being, whether the self-imposed requirements have been adhered to or not. It is significant that statutory formalities do not only apply when concluding a contract, but also when amending one.²⁵⁰

²⁴⁶ Fouchè *Principles of Contracts and Commercial Law* 83.

²⁴⁷ Hutchison *et al Kontraktereg* 158.

²⁴⁸ Mbhele *The South African Law of Contracts* 14.

²⁴⁹ Van der Merwe *et al Kontraktereg Algemene Beginsels* 137.

²⁵⁰ Mbhele *The South African Law of Contracts* 14.

The aspects discussed above are the basic requirements for a valid trust to be established. A detailed discussion of the essentialia of a sale agreement for immovable property follow below.

3.5 Essentialia of a contract regarding sale of immovable property

The common law generally requires no formalities regarding the validity or enforceability of contracts.²⁵¹ This principle does currently still apply for contracts of sale of movable property. However, when buying immovable property, there are certain statutory form requirements that must be met in order to establish a valid contract.²⁵² In terms of section 2 *Alienation of Land Act*,²⁵³ the formalities in respect of alienation of land are outlined as follows:

(1) No alienation of land after the commencement of this section shall, subject to the provisions of section 28, be of any force or effect unless it is contained in a deed of alienation signed by the parties thereto or by their agents acting on their written authority.

(2) The provisions of subsection (1) relating to signature by the agent of a party acting on the written authority of the party, shall not derogate from the provisions of any law relating to the making of a contract in writing by a person professing to act as agent or trustee for a company not yet formed, incorporated or registered.

(2A) The deed of alienation shall contain the right of a purchaser or prospective purchaser to revoke the offer or terminate the deed of alienation in terms of section 29A.

In light of the discussion above, it is evident that transfer of ownership follows a two-step process, which is the agreement of sale, as well as its registration, before transfer of ownership can take place. Furthermore, the purpose of statutory formalities is to prevent possible disputes and eliminate uncertainties about the content of the contract. However, for the valid conclusion of a contract of sale, there must be an agreement between both the seller and buyer. This agreement centres on the essentials such as the nature of the contract, the property being sold and the purchase price.²⁵⁴ These requirements are discussed below.

²⁵¹ Nagel *et al Kommersiële Reg* 199.

²⁵² Nagel *et al Kommersiële Reg* 199; Section 2 (1) of the *Land Alienation Act* 68 of 1981 is applicable to sale agreements regarding immovable property.

²⁵³ Section 2 *Alienation of Land Act*, 68 OF 1981.

²⁵⁴ Glover *Kerr's Law of Sale and Lease* 8; Hutchison *et al Kontraktereg* 247; Nagel *et al Kommersiële Reg* 194.

3.5.1 Description of the property being sold

As mentioned above, a mutual agreement is necessary between the buyer and the seller focusing on the item of sale, otherwise there would be no valid contract.²⁵⁵ The requirement provides that the sale item must be determined or determinable at the time of conclusion. Therefore, if the description of the sale item is vague or over-circumscribed that it is impossible to determine the exact nature of what is being sold, the contract will be seen as void.²⁵⁶

In instances where property is sold, the property's description is not always identical to that used in the title deed. However, the descriptions must be sufficiently similar to identify the property without having to consult external evidence and explanations. In the recent case of *Kingswood Golf Estate (Pty) Ltd v Witts-Hewinson*,²⁵⁷ the written agreement gave an incorrect description of a clubhouse for the golf estate that was to be built in the near future. The purchaser attempted to utilise and rely on a description of the clubhouse that was provided by the developer in the newsletter, which was posted after the already-signed agreement was completed. The court concluded that the newsletter was not sufficient to bind the developer contractually, seeing that the newsletter was not signed, neither included into the terms of the agreement between the parties.²⁵⁸

3.5.2 The purchase price defined clearly

To establish a valid contract, the seller and the buyer must reach agreement on a clear or determinable purchase price.²⁵⁹ There are specific requirements for valid pricing; the parties must agree on a price; there must be certainty about the price; and the price must consist of current money. Once these requirements have been met, a valid contract has been established for the sale item.²⁶⁰ If the purchase price for the property is not determined, it should at least be determinable by evaluating the description of the property, or by using a prescribed formula. In the case of *Dales*

²⁵⁵ Nagel *et al Kommersiële Reg* 194; Hutchison *et al Kontraktereg* 247.

²⁵⁶ Nagel *et al Kommersiële Reg* 199.

²⁵⁷ *Kingswood Golf Estate (Pty) Ltd v Witts-Hewinson* 2013 JDR 2722 (SCA) para 8.

²⁵⁸ 2013 JDR 2722 (SCA) para 20.

²⁵⁹ Glover *Kerr's Law of Sale and Lease* 62; Van der Merwe *et al Kontraktereg Algemene Beginsels* 197.

²⁶⁰ Nagel *et al Kommersiële Reg* 199.

v Rheeder,²⁶¹ the court held that although in certain instances a purchase price can be vague, it will not necessarily invalidate the agreement. The reason is that the price would still be determinable by considering the provided description of the property.²⁶²

The case of *Slabbert v Slabbert*,²⁶³ provides significant insight about the time that the purchase price is due. In this case, the form of payment was not outlined in the agreement; instead it was mentioned that the price would be payable as agreed. The court concluded that the manner of payment is a material term stipulated in an agreement.²⁶⁴ The oral agreement between the mentioned parties was not put in writing, therefore, the agreement was deemed to be void – due to its vagueness.

Furthermore, numerous agreements between parties have been deemed void due to uncertainty about the way or manner in which the purchase price should be paid. In the case of a sale, the agreement typically would stipulate various manners in which the purchase price can be paid. In the case of *Nelson Mandela Bay Metropolitan Municipality v Fourie*,²⁶⁵ the court held that in an instance where an agreement provides two manners for payment, it is clear that the parties intended that this payment should form part of the agreement as an essential or material term. In such an instance, the parties must choose one of the manners of payment, which implies that the method of payment not used will be disregarded. In the mentioned case, the alternative manner of payment was not disregarded. This caused confusion about the manner of payment on which the parties agreed originally.²⁶⁶ As a result, the parties did not reach consensus, which implies the agreement is deemed to be invalid.

3.5.3 Sale agreement reduced to writing

Usually the entire contract is contained in a written document, however it is not a requirement that it should be embodied in such a single document.²⁶⁷ Furthermore, the rule directed against extrinsic evidence, must be applied. This is known as the parole-evidence rule. As a general rule its purpose is to stipulate that no oral evidence

²⁶¹ *Dales v Rheeder* 2011 JDR 0336 (KZP).

²⁶² 2011 JDR 0336 (KZP) para 5.

²⁶³ *Slabbert v Slabbert* [2011] ZAFSHC 165.

²⁶⁴ [2011] ZAFSHC 165 para 17.

²⁶⁵ *Nelson Mandela Bay Metropolitan Municipality v Fourie* 2010 ZAECPEHC 48 para 7.

²⁶⁶ *Nelson Mandela Bay Metropolitan Municipality v Fourie* 2010 ZAECPEHC 48 para 6.

²⁶⁷ *Van der Merwe et al Kontraktereg Algemene Beginsels* 201.

in a lawsuit is permissible to supplement, amend, or contradict the written contract.²⁶⁸ Full particulars of essential provisions and the basic aspects of the agreement must be embodied in the deed of alienation.

When considering the *Land Alienation Act*,²⁶⁹ it is clear that the purpose is to avoid uncertainty and disagreement regarding the content of agreements of sale on immovable property. Therefore, it is paramount that the material terms of a sale agreement should be put in writing. The material terms of a contract include the essential terms as well as the terms necessary to form a complete agreement. In the case of *Roachbreakers and Parts (Pty) Ltd v Rolag Property Trading (Pty) Ltd*,²⁷⁰ the court concluded that for a sale agreement to be valid, its terms must be put in writing and signed by the parties to the agreement. Furthermore, all the terms of the contract should adhere to the statutory requirements. If any terms deviate from the requirements or formalities, the term and contract as a whole is deemed to be void.²⁷¹

3.5.4 Signature of parties

The *Land Alienation Act*²⁷² requires the sale agreement to be signed by both contracting parties or their duly authorised agents. If the agreement is not signed by the parties, it is deemed void. There is no clear provision in the Act on where the parties should sign the document, although in time certain ways or practices have been established. This practice involves parties and a witness signing the document at the end.

3.5.5 Case law

South African courts often have to decide whether an ownership transfer of property has taken place in an instance where the agreement is defective. The case of *Legator McKenna v Shea*,²⁷³ confirmed that the true consideration is whether or not an agreement is deemed to be a real agreement that came into existence between the parties. The concept of a "real agreement" is founded on a theory that scrutinises the

²⁶⁸ Van der Merwe *et al Kontraktereg Algemene Beginsels* 201.

²⁶⁹ 68 of 1981.

²⁷⁰ *Rockbreakers and Parts (Pty) Ltd v Rolag Property Trading (Pty) Ltd* 2010 2 SA 400 (SCA) para 7.

²⁷¹ *Rockbreakers and Parts (Pty) Ltd v Rolag Property Trading (Pty) Ltd* 2010 2 SA 400 (SCA) para 7.

²⁷² Section 2(1) of the *Land Alienation Act* 68 of 1981.

²⁷³ *Legator McKenna v Shea* 2010 1 SA 35 (SCA) para 23.

seller's intention to let the transfer of ownership take place. This should be considered together with the purchaser's intention to become the lawful owner of the property concerned.²⁷⁴

Furthermore, in the above-mentioned case, the *curator bonis* for the person with brain injuries, had concluded a sale agreement for immovable property before the Master's letter to confer executorship had been issued. This meant that the sale agreement was deemed invalid, however the curatorship received the necessary letter before the actual transfer of property took place.²⁷⁵ Thus, at the time of concluding the real agreement, the *curator bonis* had obtained proper authorisation. In other words, a valid real agreement was concluded and the transfer of ownership of the property took place, thus, the immovable property could not be vindicated from the purchaser.

The court reached a similar conclusion in *Kriel v Terblanche*,²⁷⁶ where the trustees of a trust had concluded a sale agreement, without being properly appointed. At a later stage, the trustees were duly appointed, and the transfer of the property took place since a valid agreement existed between the parties. In the case of *Nedbank Limited v Mendelow*,²⁷⁷ Mrs Valente was the registered owner of immovable property. A week before her passing, her son Riccardo committed fraud by forging her signature for a sale agreement according to which her property was sold to a company. Thereafter, the executors of Mrs Valente's estate made an application to set aside the sale agreement and transfer of the property. The court held that the transfer of the property's ownership could not have taken place, seeing that it was based on actions of fraud.²⁷⁸

In light of the discussion above, a contract of sale is established when one party makes an item available to another party, after agreeing with the requisite intention that in return a payment of a specified price will be made.²⁷⁹ It is necessary that the parties have the intention to create an agreement, which reflects the characteristics of a sale

²⁷⁴ 2010 1 SA 35 (SCA) para 31.

²⁷⁵ 2010 1 SA 35 (SCA) para 8.

²⁷⁶ *Kriel v Terblanche NO* 2002 6 SA 132 (NC) para 12.

²⁷⁷ *Nedbank Ltd v Mendelow* 2013 6 SA 130 (SCA) para 3.

²⁷⁸ *Nedbank Ltd v Mendelow* 2013 6 SA 130 (SCA) para 13.

²⁷⁹ Glover *Kerr's Law of Sale and Lease* 3.

contract. However, South African courts are clear that where the true identity is disputed about a type of contract, the substance of the parties' main intention will be relevant and not the label attached to the agreement they made.²⁸⁰ The element of intention is used in this regard to distinguish genuine sale contracts from simulated contracts, which are "dressed up" as sale contracts, but entail other forms of contracts.²⁸¹

3.6 Requirements for a trust to conclude a valid purchase, sale or mortgage agreement, in terms of immovable property

It is a requirement that the deed of sale must be put in writing. In addition, the respective parties or their duly authorised agents must sign the agreement.²⁸² This requirement applies to agreements of sale and purchase of land in terms of section 2 of the *Alienation of Land Act*.²⁸³ The only parties allowed to purchase immovable property for a trust, are those trustees in possession of a letter of authority obtained from the Master of the High Court, subject to the provisions of the *Trust Property Control Act*.²⁸⁴ This letter of authorisation stipulates the names of all the trustees, while the trust deed stipulates the number of trustees who must sign the contract, in order for the immovable property to be transferred.

Furthermore, any amendments to the trustees, if necessary, must be done formally by the Master. A purchase agreement of immovable property shall be deemed void if the nominated trustees have not been authorised by the Master in a letter of authority. However, it is important to note that the Master does not review the content of the deed. In other words, a sham trust can be registered with an authorised trustee without the Master having the power to act in this regard. A further requirement is that the trustee must have sufficient authorisation to sell, buy, or mortgage immovable property. Such authorisation must to be obtained through the trust deed.

²⁸⁰ *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* 1941 AD; *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 3 SA 951A-B; *Glover Kerr's Law of Sale and Lease* 6.

²⁸¹ *Glover Kerr's Law of Sale and Lease* 6.

²⁸² Mbhele *The South African Law of Contracts* 13.

²⁸³ Section 2 of the *Land Alienation Act* 68 of 1981.

²⁸⁴ *Trust Property Control Act* 57 OF 1988.

Finally, the contract or resolution that adheres to the mentioned procedures and formalities outlined in the founding document, should be signed by all the trustees. This document is considered as a prerequisite for signing the sale agreement, which will authorise the transaction. After the authorisation of such a transaction, a trustee nominated by the trust, may enter into an agreement, or conclude a contract on behalf of the trust. If a trustee acts on behalf of the trust, without acquiring the necessary resolution that grants authorisation, the trust shall be deemed to be void *ab initio*. The reason is that the parties did not adhere to the provisions outlined in section 2 of the *Alienation of Land Act*.²⁸⁵ Ratification in this instance is not possible.

3.6.1 The applicability and relevance of the *Turquand rule* to trusts

The Turquand Rule covers the law of companies, and is part of the common law.²⁸⁶

This rule reads as follows:

Persons contracting with a company and dealing in good faith may assume that acts within its constitution and powers have been properly and duly performed, and are not bound to enquire whether acts of internal management have been regular.²⁸⁷

This rule has been codified and currently is part of section 20(7) of *Companies Act*,²⁸⁸ which states:

A person dealing with a company in good faith ... is entitled to presume that the company, in making any decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its Memorandum of Incorporation and any rules of the company, unless, in the circumstances, the person knew or ought reasonably to have known of any failure by the company to comply with any such requirement.

For example, where a company's memorandum of incorporation grants the managing director permission to enter into agreements, a contracting third party may assume that the person acting on behalf of the company has the necessary capacity and authorisation to do so.²⁸⁹ Thus, it can be assumed that all the internal requirements for delegation have been met. A company is bound to such an agreement, even if it comes to light that the internal requirements have not been adhered to.

²⁸⁵ Section 2 of the *Land Alienation Act* 68 of 1981.

²⁸⁶ Du Toit 2004 *TSAR* 150.

²⁸⁷ Du Toit 2004 *TSAR* 150.

²⁸⁸ Section 20(7) of *Companies Act* 71 of 2008; Du Toit 2004 *TSAR* 150.

²⁸⁹ Du Toit 2004 *TSAR* 152.

However, the question whether or not the *Turquand rule* should apply to trusts, creates a controversy with which the Supreme Court of Appeal has not dealt yet. In the case of *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*,²⁹⁰ the court rejected the idea of this rule as the court was sceptical of the application thereof.²⁹¹ The reason is that company law is closely related to the legal principle of constructive notice, which implies that, when a third-party deal with a company, the third party is considered to have knowledge to some extent of the internal documents and regulations of the company. In the mentioned case there was doubt whether the public could be assumed to have knowledge of the contents of a trust deed since these are mostly private documents. However, in *Land and Agricultural Bank of SA v Parker*,²⁹² Cameron JA²⁹³ stated that:

... within its scope the rule may well in suitable cases have a useful role to play in securing the position of outsiders who deal in good faith with trusts that conclude business transactions.

Based on the discussion above, it is clear that, according to the current law, it would be advisable in any instances where a trust is dealt with, to accept that the rule does not apply. The parties who wish to reach a contractual agreement with a trust should consider specific precautionary measures. Firstly, the parties should request to inspect the letter issued by the Master, which grants authority for the trustees to act in a certain way.²⁹⁴ Secondly, they should request to inspect the original trust deed to confirm and ascertain its authenticity. Finally, the parties should ensure the necessary internal requirements have been adhered to.²⁹⁵ However, regarding the latter measure, it is evident that the average person will not have the necessary knowledge in this regard, or even be aware that they must examine the deed. Therefore, it is advisable that the client's current lawyer provides the necessary information on this matter.

In light of the argument above, trustees who enters into an agreement on behalf of the trust, should ensure they are duly authorised to enter into such agreements.

²⁹⁰ *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 3 SA 486 (N).

²⁹¹ *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 3 SA 486 (N) para 8.

²⁹² *Land and Agricultural Bank of SA v Parker* 2005 2 SA 77.

²⁹³ *Land and Agricultural Bank of SA v Parker* 2005 2 SA 77 para 18.

²⁹⁴ Kloppers 2006 *TSAR* 419.

²⁹⁵ Du Toit 2004 *TSAR* 160.

However, the trustee of a sham trust is probably aware of the fact that there is no trust. Furthermore, the trustees must adhere to the strict compliances stipulated in the individual provisions of the particular trust deed.

It must be pointed out that one of the challenges a seller experiences, is that the *Turquand rule* does not apply to trust law.²⁹⁶ In other words, the seller cannot merely assume that the trustees have the necessary authority. Furthermore, the Master is also not responsible for ensuring that the trust is not a sham, which means no protection is offered to the seller. Therefore, it is essential to note the possible consequences of a sham trust, as well as a void contract, which are discussed below.

3.7 Consequences of a *sham trust* and a void contract

In instances where a trust has been declared to be a sham, it means that the trust never existed, leading to various practical implications.²⁹⁷ The most important implication concerns the destination of the trust assets. This, in turn, will have implications for third parties such as private creditors and the trust's beneficiaries. However, for present purposes, it is important to consider a simulation or a sham in the true sense of the word.²⁹⁸ The reason is that the transaction will have no effect.²⁹⁹ In other words, neither the other "trustees", nor the "beneficiaries" will acquire any rights to these assets. This will also be true for both the "trustee's" spouse and private creditors. De Waal³⁰⁰ refers to Hudson who describes this effect:

That no equitable interest will be deemed to have been created in that property on the basis that no trust ever came into existence.

Fouchè³⁰¹ states that the consequences of a void contract are that powers, rights or obligations do not arise in an instance of a void contract.³⁰² Van der Merwe³⁰³ explains the legal consequences due to the failure to comply with statutory formalities as the contract is absolutely void. In other words, there is no legal commitment. If either

²⁹⁶ Du Toit 2004 *TSAR* 151.

²⁹⁷ De Waal 2012 *RabelsZ* 1098.

²⁹⁸ De Waal 2012 *RabelsZ* 1098.

²⁹⁹ De Waal 2012 *RabelsZ* 1098.

³⁰⁰ De Waal 2012 *RabelsZ* 1098.

³⁰¹ Fouchè *Principles of Contracts and Commercial Law* 95.

³⁰² Fouchè *Principles of Contracts and Commercial Law* 95.

³⁰³ Van der Merwe *et al Kontraktereg Algemene Beginsels* 206.

party performs in whole or in part, the one is not entitled to recover the performance of the other contracting party. However, any party that has fully or partially performed, is entitled to recover the other contracting party's delivered performance. The buyer who performs under such a void contract is entitled to recover the following from the seller: a reasonable compensation for any necessary expenses with or without the owner's consent for the conservation or improvement of the land; any improvement made with the explicit or implied consent of the owner or seller. On the other hand, the seller, who has already placed the buyer in possession of the immovable property, is also entitled to recover the following from the buyer: a reasonable compensation for occupation, use and enjoyment of the immovable property which the buyer had; and the compensation for any intentional or negligent damage caused by the buyer to the immovable property.³⁰⁴

Glover³⁰⁵ confirms the legal position on formalities and requirements for a sale agreement of immovable property that are not met. He refers specifically to section 2(1),³⁰⁶ namely that an agreement for the sale of immovable property, which does not comply with the set formalities as required, will not be of "any force or effect".³⁰⁷ In other words, the agreement is not considered as a contract, therefore, no action can be maintained through it. Furthermore, Glover³⁰⁸ concurs with Van der Merwe above on the consequences of the deeds of alienation, which are deemed to be void or terminated. However, it is significant that section 28(2)³⁰⁹ states that alienation in any way, which does not comply with the provisions as outlined in section 2(1),³¹⁰ shall be deemed valid *ab initio*. This applies to instances where the alienee had performed in full following the terms of the deed of alienation or contract, and the immovable property in question has been transferred to the alienee. Glover³¹¹ is of opinion that this is a sensible approach, as it reflects the fact that the transaction's goal and

³⁰⁴ Van der Merwe *et al Kontraktereg Algemene Beginsels* 206.

³⁰⁵ Glover *Kerr's Law of Sale and Lease* 123.

³⁰⁶ Section 2(1) of the *Land Alienation Act* 68 of 1981.

³⁰⁷ Glover *Kerr's Law of Sale and Lease* 123.

³⁰⁸ Glover *Kerr's Law of Sale and Lease* 123.

³⁰⁹ Section 28(2) of the *Land Alienation Act* 68 of 1981; Glover *Kerr's Law of Sale and Lease* 123.

³¹⁰ Section 2(1) of the *Land Alienation Act* 68 of 1981.

³¹¹ Glover *Kerr's Law of Sale and Lease* 124.

purpose have been reached, therefore, there is no need for the situation to be reversed.

In terms of the *Trust Property Control Act*,³¹² it is important to note that all trusts must to be lodged and registered with the Master of the High Court. However, as mentioned previously, the Master does not determine whether the trust is a sham. The Master simply registers the trust and issues the letter of authority to those who have completed the document for acceptance of trusteeship. Furthermore, a trustee or trustees of a trust may only act in that capacity if the Master authorised it in writing.³¹³ This authorisation is known as "Letters of Authority". Therefore, if a trustee is not in possession of such a valid letter of authority, he or she is not allowed to deal with trust property, or act on behalf of the trust.³¹⁴ A trustee must possess an authority letter to be able to conclude agreements for immovable property on behalf of the trust.³¹⁵ In the case where a trustee does not possess such a letter of authorisation, the contract shall be deemed null and void, which means it cannot be ratified or resuscitated.³¹⁶

Furthermore, it is essential that the parties entering into a contract has contractual capacity. As discussed in section 3.4.2, this refers to the capacity to perform juristic or legal acts such as concluding a valid contract.³¹⁷ However, if an essential element of the contract is absent, then it is evident that one or more of the parties will have limited or no capacity to contract, as explained by Fouchè:

Contractual capacity is the capacity the law grants a person to perform valid legal acts. Only persons with the required capacity may conclude contracts.

This is probably one of the first problems parties encounter with *sham trusts*, since a trust did not exist. Thus, the parties acting on behalf of the trust are not really trustees, therefore, they are not competent to act on behalf of the "trust" In other words, if one of the requirements are not met, the result is that the contract is deemed to be

³¹² *Trust Property Control Act* 57 of 1988.

³¹³ Kruger 2017 <http://www.schindlers.co.za>.

³¹⁴ Kruger 2017 <http://www.schindlers.co.za>.

³¹⁵ Kruger 2017 <http://www.schindlers.co.za>.

³¹⁶ Kruger 2017 <http://www.schindlers.co.za>.

³¹⁷ Botha *et al* *The South African Financial Planning Handbook* 2017 155; Mbhele *The South African Law of Contracts* 7.

void. In such a case, it is evident that the parties are not obliged to perform, thus cannot claim performance in this regard. In the instance where either one, or both parties, have already performed and afterwards realise that their contract is deemed to be void, restitution must take place. However, where a party refuses restitution, it is possible that the other party can institute a claim based on the grounds of unjust enrichment.³¹⁸

3.8 Conclusion

To conclude, the general principles of a contract are essential to the law of trusts. These principles provide a foundation on which the *inter vivos* trusts are based. The legal nature of a trust is considered as its most important aspect, seeing that all other principles and terms are based on this legal nature.³¹⁹ However, the *inter vivos* trust does not possess a legal personality. Thus, there is no *locus standi* for the trust to sue or be sued. Unless juristic personality is conferred by a statute, suing is prohibited for either party of such a trust.

As a general rule, there is no prescribed formalities to determine the validity of a contract. However, when buying immovable property, there are certain statutory form requirements that must be met for an agreement between parties to establish a valid contract.³²⁰ However, when considering a contract of sale, it is necessary that the parties have the intention to create an agreement, which reflects the characteristics of a sale contract. Once all the requirements have been met regarding immovable or movable property, a valid sale agreement exists.

The substance-over-form principle is important to determine the true nature or substance of the contract. A court will give preference to the substance of a contract rather than its falsely portrayed form. The idea is to eliminate the ability of contracting parties to disguise the true nature of the contract by portraying it falsely in a different form. A contract is void if the requirements are not adhered to, which means no contract came to exist. Therefore, the contracting parties are not obliged to perform,

³¹⁸ Fouché *Principles of Contracts and Commercial Law* 95.

³¹⁹ Stephens *When to cry, "Sham"* 13.

³²⁰ Nagel *et al Kommerciële Reg* 199; Section 2 (1) of the *Land Alienation Act* 68 of 1981 applies to sale agreements on immovable property.

and no contracting party can claim performance. In the instance where both parties have performed, and then realise that the contract is void, restitution must take place to restore the parties to the position they were in prior to the agreement. Regarding the principle of a sham trust, if a trust is deemed to be a sham, no effect will be given to a transaction. This implies that the founder will remain the owner of the trust assets and the trustees or beneficiaries will acquire no rights to these assets.

Returning to the case study in chapter 1, it was evident from chapter 2 that Mr X did not truly intend to create an *inter vivos* trust, therefore, the trust is deemed a sham. However, it is necessary to consider the general principles of a contract and particularly, the sale of immovable property, to determine what the legal position of assets vested in a *sham trust* would be. South Africa has a different approach to *inter vivos* trusts, compared to other common law jurisdictions. South African trusts are based in the law of contract, rather than on the law of equity. Therefore, it is necessary to derive the answer on this issue from the law of contract. After considering the law of contract, there are possible outcomes, that would apply to the case study.

In the first instance, where the formalities and requirements have not been met in a sale agreement of immovable property, the legal position on the immovable property is determined by section 2(1) of the *Alienation of Land Act*.³²¹ It stipulates that an agreement for the sale of immovable property, which does not comply with the set formalities as required, will not be of "any force or effect".³²² The agreement will not be considered as a contract, which means that no action can be attached to it. Failure to comply with statutory formalities will result in the contract to be deemed totally void. In other words, no legal commitment came into existence.

In the case of *van der Merwe v Hydraberg Hydraulics CC*,³²³ the court dealt with the instance that a trustee or trustees do not have the correct written letter of authority to act on behalf of the trust. This is of importance with reference to the *Alienation of Land Act*.³²⁴ In the *Hydraberg case*,³²⁵ the concluded agreement was deemed to be

³²¹ Section 2(1) of the *Land Alienation Act* 68 of 1981.

³²² Glover *Kerr's Law of Sale and Lease* 123.

³²³ 2010 5 SA 555 (WCC).

³²⁴ 68 of 1981.

³²⁵ 2010 5 SA 555 (WCC).

void for the reason that proper representation of the trust was not complied with, as well as for the fact that there was no written authority from the trust as stipulated in section 2(1) of the *Alienation of Land Act*.³²⁶ In this instance the Act requires that at least two of the three trustees act as agents in the conclusion of the sale agreement.

Furthermore, should either party performs in whole or in part, he/she is not entitled to recover the performance of the other contracting party. However, any party that has fully or partially performed according to the contract, is entitled to recover the delivered performance of the other contracting party. The purchasing party, who performed under such a void contract is entitled to recover a reasonable compensation for any necessary expenses with or without the owner's consent for the conservation or improvement of the land. The party may also recover any improvement with the explicit or implied consent of the owner or seller. Conversely, the seller who has already placed the buyer in possession of the immovable property is also entitled to recover a reasonable compensation. This could be for occupation, use and enjoyment of the immovable property which the buyer had. This includes recover compensation for any intentional or negligent damages caused by the buyer to the immovable property.

Furthermore, when considering the basic requirements for a valid trust to be established, it was evident that the requirement of contractual capacity was an issue in the case of Mr X. As in the case of considering a sham trust, it is evident that no trust came to exist, which means there were no trustees who possessed the authority to act on behalf of the trust, therefore, the contract is deemed to be void. It is significant that, if trustees are aware of the fact that the trust is a sham, they commit a material misrepresentation, which influences the validity of a contract.

The trustees may have acted in accordance to a valid letter of authorisation issued by the Master. In addition, the so-called "trust deed" gave the trustees the capacity to conclude a contract on behalf of the trust. Despite these factors, a fundamental aspect is absent. The fact is that a valid trust never existed, which means that all agreements or transactions derived from the so-called "trust", is deemed to be invalid. In this case

³²⁶ 68 of 1981.

it is also important to consider the *Trust Property Control Act*,³²⁷ as the trust must be lodged and registered with the Master of the High Court. Trustees only receives authority to act in such capacity if they are in possession of a valid Letter of Authority. If they do not have such authorisation, the transaction will be deemed to be null and void.³²⁸

In the second instance, where alienation took place in any way, which does not comply with the provisions outlined in section 2(1) of the *Land Alienation Act*,³²⁹ such a transaction will be deemed valid *ab initio*. In other words, the immovable property shall vest in the personal estate of Mr X, as section 28(2) of the *Land Alienation Act* provides for such instances. Therefore, where the property was transferred and payment took place, the result will be that the immovable property will vest in the trust.

In the case of a simulation or a sham, it is important to note the true sense of the word *simulation*, as the transaction will be disregarded and be given no effect. This will have the implication that the founder will be deemed to be the owner of the trust assets. Moreover, the trustees and beneficiaries will not be entitled to any rights to these assets. This will also be the case in instances where private creditors are involved. However, as a result of the trust being a sham, it will be necessary for a change of ownership to occur at the Registrar of Deeds.

The transfer that must take place, will in essence be a one of property from the name of the invalid trust to the name of the founder (Mr X). However, if it is assumed that the transfer of property already took place, no payment, therefore, was made to Mr Y. The consequences of a void contract will be no rights, obligations, or powers arising from the contract. Thus, as in this instance where either one or both of the parties have already performed and thereafter realised that their contract is deemed to be void, restitution must take place. However, where Mr X refuses to do that, Mr Y can institute a claim based on the grounds of unjust enrichment against Mr X.³³⁰

³²⁷ *Trust Property Control Act* 57 of 1988.

³²⁸ Kruger 2017 <http://www.schindlers.co.za>.

³²⁹ Section 2(1) of the *Land Alienation Act* 68 of 1981.

³³⁰ Fouché *Principles of Contracts and Commercial Law* 95.

To provide an international perspective, the Canadian position on *sham trusts* will be considered in the following chapter³³¹ of this dissertation.

³³¹ Chapter 4.

4 The Canadian position on *sham trusts*

4.1 Introduction

The purpose of this chapter is to examine the Canadian position on *sham trusts*, in order to determine possible lessons for the South African position, when dealing with assets in a *sham trust*. Therefore, this section discusses the three forms of certainties, as required by the English law in order to create a valid trust.

For a trust to be valid, it requires the coincidence of three conditions which are known as "the three certainties". If any of these conditions are absent then the trust will be void ab initio, from the very start.

The concept of a *sham trust* originated in the English law. Therefore, it is necessary to consider English law, seeing that it provides a much richer academic literature on sham issues, compared to South African law, and is also based on the context of trusts. The concept of a *sham trust* has led to the so-called *Snook test*, which is used and accepted in several countries, including Canada. Therefore, a detailed evaluation of Canadian trust doctrines will benefit the present study, as it will point out various aspects that South African courts to date have not addressed. This point is emphasised by De Waal:

It appears that English and South African law share an understanding of the basic sham idea.³³²

Canada follows the English law, which means that principles of the English law are applicable when determining the position in Canada on a sham trust, and the assets vested in such a trust.³³³

4.2 Sham transactions

Waters³³⁴ provides an insightful perspective on the definition of a sham trust:

... used in the trust law setting, now a practice in Canada as elsewhere, [the term sham trust] describes a trust that the courts will declare void because the provisions in the trust instrument do not represent the settlor's true intent as to the terms upon which the trustee is to hold the trust asset(s). Though the trust instrument sets out the persons or purposes that are the benefit, the settlor's true intent is to retain control of the assets purportedly held in trust because the true intent is to appear to

³³² De Waal 2012 *RabelsZ* 1093.

³³³ De Waal 2012 *RabelsZ* 1094.

³³⁴ Waters *Law of Trusts in Canada* 145.

have disposed of the assets and so as to evade tax, defeat personal creditors, or to prejudice the claims of an estranged spouse or the children of the relationship.

As mentioned previously, the doctrine of sham originated in English law. According to De Waal,³³⁵ it is also possible to find a solution on the approach to *sham trust* issues in the English law. According to Botha,³³⁶ the concept of a trust is used in several countries, including South Africa, as a popular vehicle for investment and estate planning. Kloppers³³⁷ confirms that the use of *inter vivos* trusts for estate planning has increased significantly in the last two decades.³³⁸ It is noticeable that Canada relies on the English law. Thus, when considering the concept of a sham, the Canadian law refers directly to the so-called doctrine of sham in the common law jurisdictions from overseas. In addition, it is necessary to consider the three conditions, known as "the three certainties", which are required for a trust to be deemed valid. Conversely, the trust will be deemed to be void *ab initio*,³³⁹ in instances where one or more of these conditions are absent. Therefore, it is essential to understand these three certainties, which will be expounded below.

4.2.1 *The three certainties*

According to English law, three certainties must be met, in order for an *inter vivos* trust to be valid. Firstly, there must be certainty of intention, which entails that the settlor must have clearly intended the assets to be transferred to the trust, and held in the trust, in order to benefit the beneficiaries.³⁴⁰ However, this requires a contextual approach, which examines the actions of the parties, including the surrounding circumstances, and the words of the trust instrument. The elements of intention are necessary, in order to prove a sham. In *Antle v R*,³⁴¹ the Federal Court of Appeal reversed the findings of the Tax Court of Canada. This was after the latter court rejected a *sham-trust* argument, on the grounds that there was no intention to deceive.³⁴² The Federal Court of Appeal concluded that, based on the factual findings

³³⁵ De Waal 2012 *RabelsZ* 1093.

³³⁶ Botha *et al* *The South African Financial Planning Handbook* 2017 155.

³³⁷ Kloppers 2006 *TSAR* 415.

³³⁸ Muller *South African Income Tax Perspective* 4.

³³⁹ In other words, the trust will be deemed to be void from the start.

³⁴⁰ *Watt Trusts* 67.

³⁴¹ *Antle v R* 2009 *TCC* 465.

³⁴² *Antle v R* 2009 *TCC* 465 para 74.

by the judge, the settlor and trustee are considered to have given a false impression of the rights and obligations created between them. Therefore, based on the argument above, it should have led to a finding that the trust is deemed to be a sham. For a sham to exist, it is considered sufficient that the parties to a transaction present it differently from what they know the transaction to be. The latter will thus be sufficient to demonstrate intentional deception. Failure to adhere to certainty of intention will have the result that the property donated by the settlor to be vested in the trust, will fall back to the settlor's personal estate.³⁴³

Secondly, the certainty of object requires that the parties must specify clearly who the trust intends to benefit. If individuals are named as the beneficiaries of the trust, then the object should be evident. However, additional care is necessary in instances where a class of beneficiaries are named, to ensure the identity of those beneficiaries can be ascertained.³⁴⁴ The certainty of objects is summarized below:

The Certainty of Objects refers to the fact that you must be certain who the beneficiaries of the trust are. For a trust to be valid, the trustee must know who they are to direct the benefits of the trust property towards, and who can hold the trustee to account in the event of anything going wrong. As such, a group so large or so vague that the trustee would be unable to identify who the beneficiaries are would not be valid.³⁴⁵

Thirdly, there must be certainty of subject-matter. There are two aspects to this requirement. Firstly, the trust property subject to the trust terms, must be described clearly in the trust instrument. Secondly, the nature of the interest owed to the various beneficiaries should be stipulated unambiguously. Upon the transfer of the property, there must be sufficient certainty as to the property that is to form the subject of the trust. In addition, the amount each beneficiary is entitled to receive should be clearly stated in the trust deed.³⁴⁶

The first requirement, certainty of intention, is considered to be decisive to determine whether a trust is a sham, similar to the case in South African law. Therefore, no trust will come into existence, if the founder did not intend to create a trust, but rather a

³⁴³ Watt *Trusts* 73.

³⁴⁴ This implies classes such as "children", "nieces and nephews", and should be sufficiently certain, however, classes such as "close friends" or "family" may not be as certain.

³⁴⁵ Hull 2012 <https://hullandhull.com/2012/01/trust-basics-the-three-certainties/>.

³⁴⁶ Hull 2012 <https://hullandhull.com/2012/01/trust-basics-the-three-certainties/>.

different legal instrument. In instances where the founder wants to create the impression that a trust has been established, to deceive potential creditors, the trust will be deemed to be a sham or pretence. As a result, no trust will come into existence, as explained below:³⁴⁷

The purpose of identifying sham trusts and making use of the doctrine is clear: any piercing challenge directed at a trust *inter vivos* requires a finding of a sham. In broad terms, a declaration that a trust is a sham effectively peels the trust aside, exposing the assets and treating the assets as if they were personally owned by the "shammer" (usually the founder). Accepted unanimously in Australia, New Zealand, Canada and the United Kingdom is the Snook test, which sets out the shamming status of any transaction.

Conaglen³⁴⁸ points out that, prior to applying the Snook test, it was already clear that the parties had to have the intention to mislead, in order for a transaction to be deemed a sham. Therefore, if such an intention is absent, the court must follow the objective meaning of the parties' arrangements. However, in light of the argument above, it is essential that all three requirements are met. Especially the requirement of *intention* is essential in determining whether a trust is a sham. This requirement is clear from the above-mentioned Canadian application of the Snook test, which is also followed in the English law. Thus, the Snook test is discussed in more detail, along with other foreign examples of case law. This is done to determine the importance of the element of intention when declaring a trust as a sham.

4.3 Foreign case law

4.3.1 Snook test

Diplock LJ³⁴⁹ formulated his view on the definition of a sham in *Snook v London and West Riding Investments Ltd*,³⁵⁰ as follows:

... if it has any meaning in law, 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 rights and obligations (if any) which the parties intend to create. A sham is in essence a pretence; it is a transaction which in legal reality is

³⁴⁷ De Waal 2012 *RabelsZ* 1083. Researcher's own emphasis.

³⁴⁸ Conaglen 2008 *CLJ* 183.

³⁴⁹ *Snook v London and West Riding Investments Ltd* 1967 2 QB 802.

³⁵⁰ *Snook v London and West Riding Investments Ltd* 1967 2 QB 786 (hereafter the *Snook* case).

one thing but is dressed up to pretend to be something else. As Lord Wilberforce said: "whilst professing to be one thing, it is in fact something else.

The Snook test is used to shed light on the shamming status of a particular transaction. This test is accepted widely and used readily in cases where the aspect of a sham trust is dealt with. Briefly put, the *Snook* test requires a common intention present between all the parties aimed at misleading or deceiving third parties to believe that the trust is a legal and legitimate trust.³⁵¹ In an instance where a trust is deemed to be a sham, a court will regard the pretence of such a trust as void.³⁵²

In examining the cases dealing with a sham, it is evident that the requirement of a common intention found in the *Snook* case, is used as a general guideline to reach a conclusion about sham.³⁵³ However, South Africa deviated from the Snook test. In the matter of *Nel v Metequity*,³⁵⁴ the court considered and evaluated the lack of separation between control of the trust and its enjoyment. This is an important court case, as it deviates from the formalistic and trusted approach of the *Snook* case. Although the Snook test was not applied in this particular set of facts, it is still necessary to bear in mind that this *test* is an appropriate and accepted guideline to determine a sham transaction or, more specifically, a *sham trust*. Regarding South African courts, it should be understood that these courts do not refer to the concept of a sham trust, but rather employ terms such as "the protective veil", as in the knowledge of the *Parker dictum*, explicated below:³⁵⁵

Where there is a functional separation between control and enjoyment within the trust, and although assets are put into trust, everything remains as before. This will be evidence that the trust form was a mere façade for the conduct of a business "as before", and that assets allegedly vesting (or vested) in trustees in fact belong to one or more trustees.

³⁵¹ Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego* 4.

³⁵² Hinks 2016 [https://ca.practicallaw.thomsonreuters.com/6-383-2143?ransitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://ca.practicallaw.thomsonreuters.com/6-383-2143?ransitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1).

³⁵³ In *Sagl v Sagl* 1997 (31) RFL 405, Canada's flexibility of its application was highlighted.

³⁵⁴ Van Der Linde and Lombard 2007 *De Jure* 429; *Nel v Metequity Ltd* 2007 3 SA 34 (SCA) para 19.

³⁵⁵ Kloppers 2006 *TSAR* 420.; *Land and Agricultural Development Bank of SA v Parker* 2004 4 All SA 261 (SCA) para 29.

This dictum implies that the court refers to the functional separation between control over and enjoyment of a trust. This is accompanied by the understanding that although assets vested in a trust, the facts and circumstances remain the same.³⁵⁶

4.3.2 *Minister of National Revenue v Cameron*³⁵⁷

The Supreme Court of Canada, in the case of *Minister of National Revenue v Cameron*,³⁵⁸ held that the court should apply the rules outlined in the *Snook* case. This case dealt with the distribution of income and its tax implications with regard to sham transactions. After carefully considering the agreement between the parties, the court concluded that the transaction was nothing less than a sham.³⁵⁹ However, after the judge referred to the definition of a sham, he remarked that, he will not declare the *agreement* to be a sham. The reason is that the legal rights and obligations created by the agreement were a true reflection of what the parties intended them to be.³⁶⁰

4.3.3 *Stubart Investments Ltd v The Queen*³⁶¹

In the Canadian court case between *Stubart Investments Ltd v The Queen*,³⁶² the court dealt with a battle of tax that prolonged for a period of approximately 16 years. The respondent in the case, made an allegation that one of the transactions which the applicant made prior to the commencement of litigation was a sham. According to the findings of other courts on two separate occasions, the transaction was found to be a sham. The matter then proceeded to the Federal Court of Appeal, which concluded that it was unnecessary to decide whether the use of the term sham, in this case, was correct and applicable.³⁶³ When considering the facts that led to the court's conclusion,

³⁵⁶ Van der Linde and Lombard 2007 *De Jure* 430.

³⁵⁷ [1974] SCR 1062.

³⁵⁸ [1974] SCR 1062.

³⁵⁹ [1974] SCR 1062 para 25.

³⁶⁰ Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego* 73.

³⁶¹ *Stubart Investments Ltd v The Queen* 1984 1 SCR 536.

³⁶² 1984 1 SCR 536.

³⁶³ 1984 1 SCR 572.

it is evident that the evidence did point in that direction.³⁶⁴ In this regard, Estey J³⁶⁵ noted the following in his majority judgment:

The element of sham was long ago defined by the courts and was restated in *Snook v London & West Riding Investments, Ltd*, [1967] 1 All ER 518. Lord Diplock ... found that no sham was there present because no acts had been taken ... 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 ... which the parties intend to create.

In light of this judgement, it should be noted that the Supreme Court of Canada has accepted the definition of a sham trust according to the English law. In this regard, Stafford³⁶⁶ refers to an insightful definition of a sham trust. According to this definition, a sham trust is regarded as a trust that a court will declare void due to the provisions contained in the trust that do not reflect the true intention of the founder. The founder's true intention in a *sham trust* is to maintain control over the trust assets and achieve further hidden purposes such as tax evasion or defeating the claims of personal creditors. However, it is important to understand that it is not always the founder, but also the trustees who have a similar intention in a sham trust, namely to maintain control over the trust assets.

4.5 Consequences of a sham in the English law

It is necessary to examine the possible consequences of a sham trust, especially after it has been established that the transaction was indeed a sham. However, after analysing the various principles, for example, the three certainties, and considering the Snook test, it is not immediately obvious what consequences should be applied.

According to Conaglen,³⁶⁷ in instances where the parties entered into an agreement with the intention to mislead others, the arrangement does not reflect the parties' true intention. Therefore, the transaction is considered to be void. Furthermore, as was pointed out, the Canadian law relies strongly on the English law, specifically the *Snook test*. It is evident from the discussion above that, a *sham trust* is void rather than

³⁶⁴ Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego* 75.

³⁶⁵ *Stuart Investments Ltd v The Queen* 1984 1 SCR 553.

³⁶⁶ DWM Waters *Waters' Law of Trusts in Canada* 145; Stafford *A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego* 78.

³⁶⁷ Conaglen 2008 *CLJ* 202.

voidable, seeing that, if a trust is void, it is not regarded as valid or legally binding. In the contrary, if a voidable trust is legally binding, unless a certain party requests that the trust be declared void.

Conaglen³⁶⁸ emphasises that the favoured view of sham transactions is that these are deemed to be "void and unenforceable", as well as "wholly invalid and of no effect". Therefore, the effect of a sham trust is that it is ineffective, and third parties have the opportunity of treating the trust property as still belonging to the settlor. In other words, the trust property still forms part of the settlor's estate, as De Waal explains:

In English law neither the "trustee" nor the "beneficiaries" will acquire any rights with regard to these assets.³⁶⁹

The English law, and the Snook test, consider the beneficial owner of the various assets vested in a sham trust as the settlor.

4.6 Conclusion

As mentioned previously, a sham trust originated in the English law. In addition, a cursory overview of this concept in the English law has proven to be necessary. This has been done by considering aspects of Canadian case law. The so-called Snook test has been developed to determine whether a trust should be considered a sham. The consideration of Canadian law proves beneficial for dealing with sham trusts. The reason is that South African law shares the same understanding about the basic idea of a sham. The concept of a trust is used in several countries, including South Africa as a popular vehicle for investment and estate planning.

With regard to trusts, three certainties were found to be outlined in the English law, used by Canada, that must be met for a valid *inter vivos* trust to be formed. Firstly, certainty of intention entails that the settlor should have clearly intended that the assets be transferred to the trust, held by the trust and managed to the benefit of the beneficiaries. Secondly, the certainty of object, implying it should be specified clearly who the trust intends to benefit. Thirdly, certainty of subject matter, which entails that

³⁶⁸ Conaglen 2008 *CLJ* 203.

³⁶⁹ De Waal 2012 *RabelsZ* 1098.

the trust property must have a clear description in the trust instrument and that nature of interest owed to the beneficiaries must be clearly stipulated.

In conclusion, when examining Canadian case law that deals with a sham, it is evident that the common intention of the Snook test is applied as a general guideline to ascertain whether or not a trust is a sham. South African courts have deviated from the Snook test by moving further to evaluate the lack of separation between control over the trust and its enjoyment. Therefore, once a trust has been declared a sham, the consequence would be that the trust is void.

5 Conclusion

The aim of this mini-dissertation was to establish the consequences for assets vested in a trust in an instance where the trust is deemed to be a sham. This matter has been discussed critically and analysed throughout the present study, by referring to legislation, case law, and textbooks. To conclude the study, it is important to understand the requirements of a valid trust and consider the accompanying law of contract. Furthermore, the study gave a brief overview of Canadian law, to compare its legal position on sham trusts to the current legal position in South Africa.

The specific requirements that must be met for a trust to be valid were investigated in chapter 2. It was found the most common way to create a trust, is to conclude a formal agreement, which puts the trust in writing. A trust can also be created by means of a will, statute or a court order, as discussed in paragraph 2.2. It became evident from chapter 2 that the requirements for *validity* are the fundamental aspects on which a trust is based. Therefore, it is necessary to meet the prescribed requirements to establish a valid trust. A trust will only be deemed valid if all the requirements are adhered to. In paragraph 2.6 it was brought to light that the *intention* is considered as the most important requirement and the fundamental principle for a valid trust. The true intention of the trust must be stated clearly by the founder to eliminate possible doubts about its legal nature and purpose.

Regarding the case study provided in chapter 1, chapter 2 illustrated the necessity of considering the essential requirements to determine whether or not a valid trust exists. However, it was evident from the case study that Mr X never truly intended to create an *inter vivos* trust, resulting in the trust being deemed a sham. As discussed in paragraph 2.5.1, where intention is absent, the real intention is to create a different legal instrument than a trust. This means that no trust comes into existence. Therefore, in the case where the founder lacks the intention to create a trust and the trustees are insufficiently independent, the principle of "substance over form" will apply, as discussed in paragraph 2.3.1.1. In other words, the transaction is then construed for the real intention. Therefore, where Mr X has given a false pretence of his intentions, he will not be entitled to conclude the agreement to establish an *inter vivos* trust. If the founder of a trust has remained in control of the trust property, the

principle of "substance over form" implies that the trust will be deemed invalid, resulting in the trust property falling into the founder's personal estate.

Chapter 3 in the present study dealt further with the general principles of a contract, particularly the contract of sale, to determine the legal position of assets vested in a *sham trust*. Therefore, an answer has been derived from the law of contract. The general principles of the law of contract are crucial to the law of trusts, as they provide a fundamental foundation for the principles of the *inter vivos* trusts. There are various ways in which assets can be transferred to a trust, of which the most common is an agreement of sale. However, the sale agreement must be structured properly and must contain the necessary essentialia.

The following aim of the study was to discuss the requirements that parties must adhere to, in order for a valid contract to be created. Firstly, there must be *consensus* and *intention* established between the parties. Secondly, the parties to a contract must have the necessary *contractual capacity* to enter into any form of agreement. Thirdly, there must be a degree of *certainty* about the legal consequences of the contract and its binding effect. A more general requirement is *possibility*, seeing that parties must find it possible to render performance at the time the contract was concluded. Furthermore, the requirement of *lawfulness* must be met, which entails that the contract concluded between the parties must adhere to the common law and other relevant provisions of statute. Finally, a contractual agreement between parties must adhere to certain *formalities*.

The above-mentioned requirements were duly discussed in paragraph 3.4. However, one of the first problems became apparent and was discussed in paragraph 3.4.2. This was the instance where an essential element of the contract lacks. In such an instance, one or more of the parties is left with limited or no capacity to contract. Seeing that a trust did not exist, it implies that the individuals acting on behalf of the trust are not really trustees. As a result, they are not competent to act on behalf of the "trust".

As a general rule, statute does not stipulate any requirements for formalities. However, when buying immovable property, there are certain statutory form requirements that

must be met to establish a valid contract.³⁷⁰ Once all these essentials of a contract have been met, the agreement between the parties will constitute a legal and binding contract. A valid contract of sale entails that the parties to the agreement must have the intention to create an agreement that reflects the true characteristics of a sale contract.

A contract is deemed void if the requirements are not adhered to. Thus, parties to a void contract, are not obliged to perform, and a contracting party cannot claim performance. In the instance where both parties have performed, and thereafter realised that the contract is void, restitution must take place. The parties should be restored in the position they were prior to the agreement. This is usually done through a court order. Furthermore, if the trust is deemed to be a sham, no effect will be given to any of its transactions. The implication will be that the founder of the trust will remain the owner of the trust assets and the trustees or beneficiaries will acquire no rights on these assets.

Referring to the case study provided in chapter 1, it was evident from chapter 2 that Mr X did not truly intend to create an *inter vivos* trust, which means that the trust is deemed a sham. The principles of a contract for the sale of immovable property must be considered to determine the legal position of assets vested in a *sham trust*. As discussed in paragraph 3.1, South Africa has a different approach to *inter vivos* trusts, compared to other common law jurisdictions. According to South African law, these trusts are based in the law of contract, rather than the law of equity. Therefore, it is necessary to investigate the law of contract. Possible outcomes that may be applied to the case study are discussed below.

Where the formalities and requirements have not been met for a sale agreement of immovable property, the legal position of the immovable property is determined by section 2(1) of the *Land Alienation Act* 68 of 1981. This Act states that an agreement for the sale of immovable property, which does not comply with the set formalities as required, "will not be of any force or effect".³⁷¹ Failure to comply with statutory

³⁷⁰ Nagel *et al Kommersiële Reg* 199; Section 2 (1) of the *Land Alienation Act* 68 of 1981 is applicable to sale agreements regarding immovable property.

³⁷¹ Glover *Kerr's Law of Sale and Lease* 123.

formalities will deem the contract to be absolutely void. Any party that has fully or partially performed according to the contract, is entitled to recover the delivered performance of the other contracting party. The purchasing party, who performed under such a void contract, is entitled to recover a reasonable compensation for necessary expenses, with or without the owner's consent, for the conservation or improvement of the land.

When considering the basic requirements to establish a valid trust, it was evident that the *contractual capacity* was an issue in the case of Mr X. As in the case when considering a sham trust, it is evident that no trust came to exist in this case study. Thus, no trustees had the authority to act on behalf of the trust, which resulted in the contract to be deemed void.

The trustees may have acted in accordance with a valid letter of authorisation issued by the Master. In addition, the so-called "trust deed" may have provided the trustees the capacity to conclude a contract on behalf of the trust. However, a fundamental aspect was found to be omitted, namely intent. Therefore, the fact that a valid trust never existed, implied that all agreements or transactions derived from the so-called "trust", are deemed to be invalid. In the case of Mr X, it is also important to consider the *Trust Property Control Act*,³⁷² seeing that the trust must to be lodged and registered with the Master of the High Court. A trustee only receives authority to act in such capacity if he/she is in possession of a valid Letter of Authority. Without this authorisation, the transaction will be deemed to be null and void.³⁷³

In the case where property was alienated in a manner that contradicts section 2(1) of the *Land Alienation Act*³⁷⁴, the transaction will be deemed valid *ab initio*, as discussed in paragraph 3.7. This would mean that the immovable property will vest in Mr X's personal estate. In this instance, section 28(2) provides the regulation. In other words, where transfer of the property and payment for it took place, the immovable property will vest in the trust. In the case of a simulation or a sham, the transaction will be disregarded and be given no effect. The implication will be that the founder is deemed

³⁷² *Trust Property Control Act* 57 of 1988.

³⁷³ Kruger 2017 <http://www.schindlers.co.za>.

³⁷⁴ Section 2(1) of the *Land Alienation Act* 68 of 1981.

the owner of the trust assets. Thus, the trustees and beneficiaries will not be entitled to any rights regarding these assets.

This will also be the case were private creditors are involved. However, seeing that the trust is considered a sham, a change of ownership will be necessary, to register the property at the Registrar of Deeds. This will entail a transfer of property from the name of the invalid trust to that of the founder (Mr X). The reason is that, in the context of a trust, the founder will remain owner of the trust assets. In the second instance, it may be assumed that the transfer of property already took place, but no payment has been made to Mr Y. The consequences of a void contract will result in no rights, obligations, or powers based on the contract.

Therefore, as in the instance of Mr X, where either one or both parties have already performed and then realised their contract is deemed to be void, restitution must take place. However, where Mr X refuses to effect restitution, Mr Y can institute a claim based on the grounds of unjust enrichment against Mr X.³⁷⁵

To provide an international perspective, the Canadian position on *sham trusts* was investigate briefly in chapter 4. This is important since it brought to light that the concept of a sham trust originated in the English law. The so-called Snook test has been developed to evaluate whether a trust should be considered a sham. The law in South Africa shares the same understanding about the basic idea of a sham. The present study found three certainties outlined in the English law, as used by Canada. These certainties must be met for a valid *inter vivos* trust to be formed. As discussed in paragraph 4.2.1, the tripartite certainties entail: intention, object and of subject-matter. When referring to Canadian case law, it is evident that the *Snook test* is considered as a general guideline to determine whether a trust should be deemed a sham or not.

However, in South Africa, a different and more extensive test is applied. This test allows the courts to consider and evaluate the separation of enjoyment of trust assets from the control over such assets. Nevertheless, the one true test remains: where a trust is deemed to be a sham, the trust will be considered void. Furthermore, it is

³⁷⁵ Fouché *Principles of Contracts and Commercial Law* 95.

evident that there are various possible consequences for the assets vested in a sham trust. However, the circumstances of each case shall determine whether it falls within the founder's estate,³⁷⁶ or whether the contract of sale as a whole is deemed to be void, resulting in restitution or a claim for unjustified enrichment.

In conclusion, it is evident that the legal position of assets vested in a *sham trust* are dependent on the circumstances of each case, as each case differs. Generally, a *sham trust* is considered to be void. The research showed that in most cases where a sale agreement has been concluded, such agreement shall also be deemed void. Although this is generally the case there are certain instances where the sale agreement shall still be valid, as legislation has made provisions for such circumstances.

³⁷⁶ This is regulated by section 28(2) of the *Land Alienation Act* 68 of 1981.

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