



The importance of a properly drafted trust deed

ABRAHAM KROK TRUST v Commissioner, SARS

In this case, the Supreme Court of Appeal ('SCA') once again reminds us that a *laissez-faire* approach to trust administration could have costly results. The issue before the court was whether a distribution made by the trustees of the original trust to further trusts created for the beneficiaries of the original trust, constituted a donation in terms of section 54 of the Income Tax Act ("the Act"). The trustees argued that the exemption in terms of section 56 (1) of the Act applied. Section 56 (1) stipulates that "donations tax shall not be payable in respect of the value of any property which is disposed of under a donation, if such property is disposed of under and in pursuance of any trust". In this case the recipients of the funds were not named beneficiaries in the original trust deed.

This matter was first dealt with in the tax court under case no ITC 1840. The commissioner had assessed the taxpayer for donations tax of R78 682 849 as well as interest thereon. The original trust, "the 1981 Trust" was created for the benefit of the donor's six children. In 1994 six additional trusts were settled for the benefit of the same beneficiaries, hereinafter referred to as the "1994 Trusts." A sale agreement was entered into whereby the 1981 Trust sold assets to the 1994 Trusts. The 1981 Trust later made an award to the 1994 Trusts of the same amount owing to it in respect of the sale agreements entered into between the trusts. The trustees of both trusts in turn set-off the amount of the awards against the debts owing to the 1981 Trust. The Commissioner refused to allow the 56 (1)(l) exemption on the basis that the 1994 Trusts were not beneficiaries of the 1981 Trust - as a result the awards were not made 'in pursuance of any trust' - and assessed the 1981 Trust for donation's tax in an amount of some R78 682 849 plus interest. The Tax Court upheld the Commissioner's assessment.

The appeal to the SCA was based on the proper construction of the trust deed. Clause 12.1 of the deed stated that the capital of the trust may be applied for the "benefit of the children in the manner that the trustees may determine in their absolute discretion". The SCA was of the view that the language in the trust deed was wide enough to encompass the disposals in question, in that they were of a capital nature and for the benefit of the children. The appeal was thus upheld. Although the decision went in favour of the trustees in this case, clearer drafting of the trust deed could have saved the trusts the expense of litigation all the way to the SCA.

This case once again illustrates that it is not enough to determine that a trust is appropriate; you need to ensure that the deed is drafted by a specialist with your specific requirements and circumstances in mind. The trustees must be familiar with the contents of the deed in order to effectively manage the trust. In addition, trustees need to obtain ongoing advice in relation to the day to day management and taxation of a trust. We frequently see clients who have set up trusts and never transferred assets to them, or whose deeds are defective, or who do not benefit from the tax advantages, simply because they don't know how to. Template type deeds drafted by non-specialists more often than not result in potentially crucial errors which range from deeds that do not provide for adopted children, or default beneficiaries, to those that grant trustees impermissible powers, or powers that if used, would contravene exchange control regulations, and so on.

Trust law (and the taxation of trusts) is a complex technical area and trustees who take their fiduciary duties seriously, will consult specialists when setting up and managing the affairs of a trust.