

OLDMUTUAL

# Premiums & Problems

## Article Edition 130

January 2025



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We extend our sincere gratitude to Juta and Company (Pty) Ltd for their generous sponsorship of the Literary Award prizes.

## Premiums & Problems Literary Award

The recipient of the  
Premiums & Problems Article Edition  
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**For the contribution titled**

### **Section 42 – Asset for Shares Transactions and Possible Pitfalls**

In reaching their decision, the judges considered the articles' technical accuracy, informativeness, potential for reader learning, effectiveness in conveying relevant information, originality, practical applicability, and potential marketing benefits.

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# General



**DO GREAT THINGS EVERY DAY**

Old Mutual Life Assurance Company (SA) Limited is a licensed FSP and Life Insurer.

## Business Email Compromise in South Africa: Legal and Practical Safeguards for Financial Services Providers



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### Introduction

According to an article published on IT Web<sup>1</sup>, the impact of cybercrime on the South African economy is alarmingly significant, with losses estimated at R2.2 billion annually. This is equivalent to around 0.03% of the country's GDP which was approximately R7 trillion, according to Stats SA.<sup>2</sup> Further to this, South Africa ranks as the eighth most targeted country globally for ransomware<sup>3</sup> attacks, with over half of South African firms experiencing ransomware incidents in the past year.<sup>4</sup> Alongside ransomware, another rapidly growing threat to business is Business Email Compromise (BEC).

<sup>1</sup> <https://www.itweb.co.za/article/cyber-crimes-annual-impact-on-sa-estimated-at-r22bn/JN1gPvOAxY3MjL6m>

<sup>2</sup> Statistics South Africa. 2024. *Gross Domestic Product: Quarter 4: 2023*.

<sup>3</sup> The Oxford Dictionary defines ransomware as "a type of malicious software designed to block access to a computer system until a sum of money is paid."

<sup>4</sup> <https://www.itweb.co.za/article/cyber-crimes-annual-impact-on-sa-estimated-at-r22bn/JN1gPvOAxY3MjL6m>

BEC is a type of cybercrime where criminals illegally access an email account and communicate as if they are legitimate users. Criminals steal account holders' credentials through phishing<sup>5</sup> or other tactics, then exploit them to access email accounts.<sup>6</sup>

According to Microsoft,<sup>7</sup> there are five different types of BEC:

1. Data theft: Scammers start by targeting the HR department and stealing company information, making it easier to carry out one of the other BEC scams and make them seem more believable.
2. False invoice scheme: Posing as a legitimate vendor the company works with; the scammer emails a fake bill that often closely resembles a real one.
3. CEO fraud: Scammers either spoof or hack into a CEO's email account and then email instructions to employees to make purchases or send money via wire transfer.
4. Lawyer impersonation: In this scam, attackers gain unauthorised access to an email account at a law firm and send clients fraudulent invoices or payment links. While the email address is legitimate, the bank account details are not.
5. Account compromise: Scammers use phishing or malware to infiltrate the email account of a finance employee, such as an accounts receivable manager. They then send fake invoices to the company's suppliers, directing payments to a fraudulent bank account.

Given the growing threat, both the legal landscape and regulatory frameworks in South Africa are evolving to combat BEC. This article will delve into relevant case law in South Africa and explore the latest joint standard issued by the Financial Sector Regulation Act (FSCA) to provide further insights into Business Email Compromise and its implications.

## Case law investigation

### Edward Nathan Sonnenberg Inc v Judith Mary Hawarden

To understand BEC better, we can examine the recent Supreme Court of Appeal (SCA) case, *Edward Nathan Sonnenberg Inc v Judith Mary Hawarden*.<sup>8</sup> In this case, a buyer purchased property and made an initial deposit successfully after verifying the bank details provided by the estate agent. However, when she later received email instructions regarding the remaining balance, a cybercriminal had intercepted the communication, altered the bank details, and removed the fraud warning. The buyer unknowingly paid R5.5 million into a fraudulent account and sued the conveyancer (appellant), claiming they had a duty to warn her about the risks of cyber fraud.

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<sup>5</sup> Phishing is not explicitly defined in South African legislation. According to Oxford Dictionary, phishing is "the fraudulent practice of sending emails or other messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords and credit card numbers."

<sup>6</sup> <https://www.sabric.co.za/stay-safe/business-email-compromise/>

<sup>7</sup> <https://www.microsoft.com/en-za/security/business/security-101/what-is-business-email-compromise-bec#areaheading-oca7w5>

<sup>8</sup> *Edward Nathan Sonnenberg Inc v Judith Mary Hawarden* (421/2023) [2024] ZASCA 90

The High Court initially found the conveyancer liable for failing to warn the buyer about BEC risks. However, the SCA overturned this decision, ruling that the buyer was responsible for not taking sufficient steps to protect herself, as she had been warned of the risks and could have verified the details.

For financial planners, this case emphasises the importance of personal due diligence and client education in cybersecurity. While service providers should take precautions, clients must also take responsibility for verifying sensitive financial details, especially when warned of potential risks.

As far as financial service providers (FSPs) are concerned, section 11 of the General Code of Conduct for Financial Service Providers and Representatives stipulates that:

*“A provider must at all times have and effectively employ the resources, procedures and appropriate technological systems that can reasonably be expected to eliminate as far as reasonably possible, the risk that clients, product suppliers and other providers or representatives will suffer financial loss through theft, fraud, other dishonest acts, poor administration, negligence, professional misconduct or culpable omissions.”*

### **Gerber v PSG**

This duty placed on FSPs is demonstrated in the case of *Gerber v PSG*.<sup>9</sup> In this case, the plaintiff's funds were fraudulently transferred due to a BEC scam. PSG Wealth Financial Planning, which managed the plaintiff's share portfolio, was contractually obligated to protect the plaintiff from fraud but failed to properly verify the banking details before making the payment.

The court held PSG liable, emphasising that under Section 11 of the General Code of Conduct for Financial Services Providers, FSPs must implement adequate resources, procedures, and technological systems to mitigate the risk of financial loss due to cyber threats. This ruling reinforces the legal duty of FSPs to protect clients from cybercrime, and failure to meet these obligations can result in serious legal consequences.

The case sets an important precedent, stressing that FSPs must adopt proactive cybersecurity measures and robust client protection strategies. Compliance with regulatory standards alone is insufficient; financial institutions must continuously update their security protocols to address evolving cyber threats and ensure the safety of client assets.

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<sup>9</sup> *Gerber v PSG Wealth Financial Planning (Pty) Ltd (36447/2021) [2023] ZAGPJHC 266*

## Financial Sector Conduct Authority - Joint Standard 2 of 2024 – Cybersecurity and cyber resilience.<sup>10</sup>

The *Joint Standard 2 of 2024* under the Financial Sector Regulation Act<sup>11</sup> places significant cybersecurity and cyber resilience responsibilities on financial institutions in South Africa. These requirements are directly relevant to FSPs and financial planners, emphasizing the need for robust systems to protect client information and mitigate cyber risks, including BEC.

The Standard emphasises the importance of proportional cybersecurity measures, which must align with the financial institution's nature, size, complexity and risk profile. Financial planners, as part of the financial services ecosystem, must ensure that their firms adopt sound practices and governance structures for managing cyber risks. Here's how the Standard's key elements apply to FSPs:

1. **Tailored cybersecurity approach:** Financial planners must implement cybersecurity strategies suited to their firm's specific operations and risk profiles. The strategy should be integrated into the broader risk management framework and regularly updated to address evolving cyber threats. FSPs need to regularly assess their own risk exposure and client interactions to ensure that protective measures are sufficient.<sup>12</sup>
2. **Governance and oversight:** Clear governance structures must be in place to manage cyber risks, with well-defined roles for all management levels. Financial planners should ensure that their firms establish a dedicated cyber and information security function with direct reporting lines to leadership, ensuring that risk management is treated as a critical business issue.<sup>13</sup>
3. **Cyber hygiene and protection:** Financial planners must implement essential cybersecurity hygiene practices, including multi-factor authentication (MFA), secure configurations, and access management to protect client information. This includes rigorous network perimeter defence and regular vulnerability and patch management to ensure that their systems are resilient against cyber threats like BEC.<sup>14</sup>

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<sup>10</sup> Financial Sector Regulation Act, 2017. Joint Communication 2 of 2024. Publication of the Joint Standard 2 of 2024 – Cybersecurity and cyber resilience.

<sup>11</sup> Financial Sector Regulation Act, 2017. Joint Communication 2 of 2024. Publication of the Joint Standard 2 of 2024 – Cybersecurity and cyber resilience.

<sup>12</sup> Financial Sector Regulation Act, 2017. Joint Communication 2 of 2024. Publication of the Joint Standard 2 of 2024 – Cybersecurity and cyber resilience at section 3

<sup>13</sup> Financial Sector Regulation Act, 2017. Joint Communication 2 of 2024. Publication of the Joint Standard 2 of 2024 – Cybersecurity and cyber resilience at section 5

<sup>14</sup> Financial Sector Regulation Act, 2017. Joint Communication 2 of 2024. Publication of the Joint Standard 2 of 2024 – Cybersecurity and cyber resilience at section 8

## How can financial service providers “FSP” and financial planners avoid BEC?

The case law, including *Gerber v PSG*, shows that courts hold FSPs to a high standard when it comes to protecting clients against cybercrime. Financial planners should draw the following key lessons from the case, section 11 of the General Code of Conduct and the Joint Standard to avoid liability in BEC incidents:

1. **Install adequate security systems:** The case of *Gerber v PSG* highlights the legal duty of FSPs to implement adequate security measures. Keep all software and security tools updated to minimise vulnerabilities. Implementing proper cybersecurity systems is not optional but a critical duty, especially when managing clients' sensitive financial data.
2. **Limit information sharing:** In accordance with data protection regulations like the Protection of Personal Information Act<sup>15</sup> (POPIA), financial planners have a legal obligation to limit the unnecessary sharing of sensitive client information.<sup>16</sup> The *Gerber v PSG* case further supports this, as the court ruled that security lapses and poor handling of personal information contributed to the loss. Sensitive client information should not be unnecessarily shared online or made publicly accessible. Financial planners should exercise caution in sharing client details and ensure that data-sharing agreements with third parties are in compliance with data protection regulations, such as POPIA.<sup>17</sup>
3. **Third-party due diligence:** Section 11 of the General Code of Conduct for Financial Service Providers and Representatives obligates FSPs to employ the necessary resources and technological systems to eliminate, as far as reasonably possible, the risks posed by theft, fraud, and other dishonest acts. This includes conducting due diligence on third-party service providers to ensure that they have robust cybersecurity measures in place, which can prevent vulnerabilities that may expose clients to BEC risks. The case law emphasizes that FSPs must not only protect their own systems but also ensure that their external partners meet high security standards.
4. **Employee training:** The FSCA Joint Standard 2 of 2024 mandates financial institutions to have clear governance structures and a robust cyber risk management framework. Part of this responsibility includes regular training for employees on cybersecurity threats.<sup>18</sup> Employees should be trained to recognise phishing emails, verify unusual requests, and follow secure protocols when handling sensitive information.
5. **Two-factor authentication:** The FSCA Joint Standard 2 of 2024 further requires FSPs to adopt protective cybersecurity measures, including Multi-Factor Authentication (MFA), to safeguard financial transactions.<sup>19</sup> Two-factor authentication is a simple but effective layer of security that significantly reduces the risk of BEC, by requiring a second form of verification beyond the compromised password, reducing the likelihood of unauthorised

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<sup>15</sup> 4 of 2013

<sup>16</sup> Sections 8 and 9 of the Protection of Personal Information Act 4 of 2013

<sup>17</sup> Protection of Personal Information Act 4 of 2013

<sup>18</sup> Financial Sector Regulation Act, 2017. Joint Communication 2 of 2024. Publication of the Joint Standard 2 of 2024 – Cybersecurity and cyber resilience at section 7.2.7

<sup>19</sup> Financial Sector Regulation Act, 2017. Joint Communication 2 of 2024. Publication of the Joint Standard 2 of 2024 – Cybersecurity and cyber resilience at section 8.3

access. Financial planners should ensure that both their firms and clients utilise MFA, especially for transactions involving sensitive data.

6. **Verification of email address and requests:** Cybercriminals often use email addresses that closely resemble legitimate ones, like in the case of *Gerber v PSG*, where the defendant's failure to verify email requests led to a fraudulent transfer. Financial planners must encourage employees and clients to verify all financial transaction requests via alternative communication methods, such as a phone call, to confirm authenticity and avoid falling for fraud.
7. **Urgent reaction emails:** Cybercriminals often create a sense of urgency to trick individuals into making mistakes, especially with financial transactions or sensitive information. Be cautious of emails asking for urgent actions, like immediate payments to avoid penalties. Always verify such requests through another communication method, such as a phone call. The legal frameworks and case law discussed, stress the importance of verifying any urgent financial requests through alternate communication methods

By staying vigilant and proactive, financial planners can effectively safeguard client assets from the growing threat of BEC. The Joint Standard 2 of 2024, combined with the case law discussed in this article, underscores the critical importance of a comprehensive cybersecurity strategy for protecting client trust and minimizing legal and financial risk.

## Conclusion

In an era where cyber threats are increasingly sophisticated, FSPs and financial planners must remain vigilant to protect against Business Email Compromise (BEC). By adopting a proactive approach that includes robust security systems, careful information sharing, stringent data processing agreements, comprehensive employee training, and advanced authentication measures, one can significantly reduce the risk of BEC. Ensuring that third parties adhere to high-security standards and double-checking the authenticity of urgent communications further enhances one's defences.

Importantly, financial planners are also encouraged to cultivate cybersecurity awareness among their clients. Clients should be educated on common cyber threats, such as phishing and email spoofing, and taught how to verify communications, especially when it involves sensitive financial transactions. Financial planners should regularly remind clients to double-check any unexpected payment requests or account changes by contacting the relevant parties directly through trusted channels, such as a phone call. Encouraging clients to implement best practices like two-factor authentication for their personal and business accounts further strengthens their protection against BEC.

Embracing these practices not only safeguards sensitive client information but also reinforces the commitment to maintaining the highest standards of security and trust in the financial services industry. By fostering a culture of awareness and responsibility, both FSPs and their clients can work together to create a more secure financial environment.

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### Joint Standard

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# Two Worlds, One Oath: The Need to Evolve Commissioning Practices

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## Introduction

Commissioners of Oaths (hereafter “commissioners”) play an important role in the legal system by verifying and certifying documents and declarations. Their responsibilities include ensuring the authenticity of signatures and administering oaths, affirmations, and affidavits, all of which are essential in maintaining the integrity of the legal process. By ensuring that statements are made under oath and documents are properly witnessed, commissioners help prevent fraud, uphold accountability, and provide an additional layer of trust and credibility in both public and private affairs. The function of a Commissioner of Oaths in South Africa has traditionally relied on in-person interactions, which are essential for ensuring the authenticity of legal affirmations.

This article explores the essential functions of Commissioners of Oaths, detailing the processes and qualifications required for appointment, as established by the Justices of the Peace and Commissioners of Oaths Act. It further highlights the pressing need for legislative reform to adapt to the rapid advancements in technology, particularly in the wake of the COVID-19 pandemic, which has accelerated the adoption of virtual commissioning. While digital platforms have enabled Commissioners to perform their duties remotely, it is important to recognise that not all South Africans have equal access to the internet and modern technologies. This disparity underscores the importance of a balanced approach that integrates both traditional and virtual commissioning practices, ensuring that legal services remain accessible to all individuals.

## Legal framework

The primary legislation governing commissioners is the Justices of the Peace and Commissioners of Oaths Act.<sup>1</sup> This Act and its Regulations outline the qualifications, duties, and powers of commissioners of oaths. Commissioners are appointed in terms of this Act and are legally authorised individuals empowered to administer oaths or affirmations or take a solemn or attested declaration from any person<sup>2</sup> to witness signatures, authenticate documents, and in compliance with statutory requirements.

The Minister of Justice, or any officer of the Department of Justice with the rank of director or higher, who is delegated by the Minister in writing, has the authority to appoint any person as a commissioner of oaths for any specified area.<sup>3</sup> This delegation must be documented in writing by the Minister or the delegated officer.<sup>4</sup>

## Eligibility criteria

The persons who may act as commissioners are identified in the Regulations promulgated in terms of the Act. There are two methods for becoming a commissioner:

1. **Ex officio:** This is granted automatically to an individual holding a specific position or office. These appointments are derived from the nature of their role rather than a formal application process.<sup>5</sup> The regulations concerning the Designation of Commissioners of Oaths under section 6 of the Act (GN 903 in GG19033 of 10 July 1998, as amended, and GN 109 in GG22030 of 2 February 2001) specify various offices designated by the Minister as commissioners of oaths, or
2. **By appointment:** If a particular office is not designated as a commissioner of oaths by the Minister, individuals occupying an undesignated position may apply to the Department of Justice and Constitutional Development for designation as a commissioner of oaths. This application requires completing the prescribed Form J5. Although it is not clear from the Act what criteria is used to determine suitability for the appointment, the Form J5 does require an individual to motivate why their appointment is in the public interest.

An individual's designation as a commissioner is valid only while they hold the specified post. Upon resigning or retiring from this position, they automatically lose the designation as an ex officio commissioner of oaths. To retain the designation after leaving the post, they must submit a new application to the Department of Justice, including a completed Form J5 and the necessary supporting documents.

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<sup>1</sup> 16 of 1963.

<sup>2</sup> Section 7.

<sup>3</sup> Section 5.

<sup>4</sup> Section 2.

<sup>5</sup> Section 6.

## Application process

While Gauteng has established a codified process outlined in the *Guidelines on Steps to Follow When Applying to Become a Commissioner of Oaths in Gauteng* (dated 20 May 2021) ("the Guidelines"), a standardised guideline has not been formalised by the Department of Justice. However, it may be assumed that similar guidelines would apply in other provinces in the absence of an official procedure.

In terms of the Guidelines, individuals must submit the completed Form J5 to the relevant Magistrate's Court or they can contact the Director of Legal Services at their nearest provincial office. This application form should be accompanied by a certified copy of the applicant's identity document and a letter of recommendation from their employer, motivating the need for a Commissioner of Oaths in that particular area. A short interview will be conducted by the designated official at the Magistrates' Court upon submission of the application form, this is to verify the provided information. Following the interview, the application will be forwarded to the regional office for processing and approval. The application process may vary based on jurisdiction, so applicants should check for any specific requirements or procedures relevant to their area. The following criteria reflect common considerations typically applied by the Department of Justice and Constitutional Development when assessing the applications for Commissioner of Oaths appointments. While not explicitly outlined in legislation, they are drawn from practical experience and the Department's discretion in managing the appointment process:

- Applicants should not have a criminal record and maintain a positive standing within the community. This requirement is implied by the Act to uphold the integrity of the office.
- Applicants must justify the need for their appointment, often by demonstrating frequent involvement in legal or administrative processes that require the administration of oaths. This requirement is not explicitly stated in the Act, it is a practical consideration for the appointing authority.
- No specific educational qualifications are mandated, but Commissioners generally have a background in the legal field or related experience. Legal practitioners, attorneys, advocates, and magistrates are commonly eligible, though other individuals with relevant experience or knowledge may also be considered.
- Appointments are typically tied to specific geographical areas to ensure accessibility to Commissioner of Oaths services. While this too is not explicitly stated in the Act, it is a practical measure to meet public needs.

Following the assessment, the Minister of Justice, or a delegated official, reviews the recommendations from the assessment process and makes the final decision on the application. If the application is approved, the appointment is formalised, and the new Commissioner of Oaths receives a certificate of appointment. To ensure transparency, the appointment is usually published in the Government Gazette, offering official notice of the new appointment. It may also be announced through other channels. These public records help ensure the appointment process remains transparent. Making the appointment publicly known through official channels like the Government Gazette ensures that the process is open and visible to the public, thereby preventing any unfair practices.

## Ex officio appointment

Ex officio appointments are automatically granted to an individual holding a specific position or office. This type of appointment is based on the nature of the individual's role, it is thus not tied to the individual but to the office they occupy. Their jurisdiction is also limited to the specific area assigned to their office. This means that the persons appointed as Commissioner ex officio may only act within the area, region, or district for which they have been appointed in terms of their service conditions. For example, a Commissioner in Gauteng may not act as Commissioner whilst attending a meeting in Cape Town. Consequently, if the individual leaves that position that confers this authority, they lose the ability or power to act as a commissioner.

Regulation 30<sup>6</sup> provides for the appointment of commissioners for insurance companies, distinguishing between staff employed at the head office and those in other offices for insurers registered under the now-repealed Insurance Act.<sup>7</sup>

Members of the Financial Planning Institute of Southern Africa (FPI) holding the Certified Financial Planner (CFP®) designation are automatically appointed as ex officio commissioners, contingent on maintaining their CFP® status.<sup>8</sup> Similarly, CFA Charter holders received ex officio status through Government Gazette No. 41811 (3 August 2018), under the Justices of the Peace and Commissioners of Oaths Act.

These designations allow both CFP and CFA professionals to administer oaths, affirmations, and certify documents, provided they comply with relevant regulations. Staying informed about regulatory changes is essential for maintaining compliance. These professionals can enhance their practice by offering commissioner services to their clients. This offers clients a convenient service and builds rapport with their clients. This in turn may assist in attracting more clients, differentiating their services, and strengthening professional networks. This value-adding service may further boost credibility and one's appeal with clients. It is important to note that only individuals employed in a specific role at an institution and who fall within one of the abovementioned staff categories may act as a commissioner based on the office they hold.

Section 10 of the Act sets out certain circumstances under which a Commissioner of Oaths is prohibited from acting but does not provide specific examples of these prohibitions. However, it is important for commissioners to have a clear understanding of these restrictions in order to maintain compliance with the law and protect themselves from potential legal consequences. Being aware of these limitations enables them to act ethically and avoid conflicts of interest, ensuring the integrity of the documents they certify and protecting both themselves and the parties involved. Commissioners must ensure that the deponent fully comprehends the content of the declaration they are making. If the commissioner determines that the deponent lacks sufficient understanding, they should not proceed with the process. This approach protects both the commissioner and the integrity of the declaration and

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<sup>6</sup> GN 903 of 10 July 1998.

<sup>7</sup> 27 of 1943.

<sup>8</sup> This official appointment was authorised under Section 6 of the Justices of Peace and Commissioners of Oaths Act and published in Government Gazette R112 on 8 February 2008

ensures that any oath or affirmation the deponent makes is made with clear intent and awareness.<sup>9</sup>

Commissioners are responsible for certifying that all documents are complete and accurate. If any information is missing or the document is not properly prepared, certification should not occur.

## Best practices for commissioners

### Administering an oath or affirmation

The procedures for administering oaths and affirmations are detailed in Regulation 2(2) and (3) of GNR 1258 of 21 July 1972. Deviations from these procedures may invalidate the oath or affirmation. Before proceeding, the commissioner must confirm that the deponent understands the declaration and is willing to take the oath or affirmation, which should not be prohibited by law. The specific phrases to be used are:

- **Oath:** "I swear that the contents of this declaration are true, so help me God."
- **Affirmation:** "I truly affirm that the contents of this declaration are true."

Before administering the oath or affirmation, the commissioner should ask the deponent:

1. Whether they understand the declaration.
2. Whether they have any objections to the oath.
3. Whether they consider the oath binding on their conscience. If the deponent confirms understanding and acceptance, the oath is administered; otherwise, the affirmation is provided.

### Deponent's signature

The deponent must sign the declaration in the presence of the commissioner.<sup>10</sup> If the deponent is unable to write, they shall in the presence of the commissioner, make a mark or thumbprint at the bottom of the declaration. If the commissioner have any doubts about the deponent's inability to write, they must request that this inability be certified by a trustworthy third party at the foot of the declaration.<sup>11</sup> In cases where a deponent is unable to sign a document and instead uses a mark or thumbprint, it is recommended, though not explicitly legislated, that the commissioner follows certain best practices. These are important to ensuring that the deponent's intentions are clear, their identity is verified, and the document's legal integrity is upheld. To this end, it is advisable for the commissioner to prepare a separate affidavit certifying that:

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<sup>9</sup> Regulation 2.

<sup>10</sup> Regulation 3(1)

<sup>11</sup> Regulation 3(2)

- They have confirmed the deponent's identity and is satisfied that the mark or thumbprint belongs to the correct person. This step helps to safeguard against fraud or impersonation.
- The contents of the document were read to or explained to the deponent prior to them making their mark or thumbprint. This ensures that the deponent fully understands the contents they are agreeing to.
- The deponent was of sound mind and able to comprehend the implications of the document they were signing. This is crucial to prevent challenges to the validity of the document on grounds of mental incapacity.

Although this process is not legislated, it reflects the principles outlined in the Act and the Regulations. Adhering to these steps can thus protect both the deponent and the Commissioner by ensuring that the commissioning process is thorough, clear, and trustworthy.

### **Commissioner's signature<sup>12</sup>**

Once the deponent has completed their signature or mark on the declaration, the commissioner is responsible for certifying that the deponent understands the contents of the declaration. This certification must be provided below the deponent's signature or mark and should include the date and details on how and where the declaration was administered.<sup>13</sup> The commissioner must sign the declaration and print their full name and business address beneath their signature. The commissioner must also state their official designation and the area for which they are appointed. If the commissioner holds their position *ex officio*, they are required to specify the office they hold.<sup>14</sup> Typically, this information is recorded on an official stamp that only requires the signature of the commissioner of oaths.

### **Fee for services rendered**

A commissioner is prohibited from charging any fee for administering an oath or affirmation or for attesting any declaration.<sup>15</sup> This means that the services provided by a commissioner in these capacities are free of charge. The issue of fees presents a potential conflict when financial advisors also serve as Commissioners of Oaths. While financial advisors can charge fees for their advisory services, Regulation 6 prohibits Commissioners of Oaths from charging fees for administering oaths or certifying documents due to their ethical and legal responsibilities.

If clients view the commissioning service as part of the paid advisory package, it may raise ethical and regulatory concerns. Advisors could face serious consequences if found to be indirectly charging for these services, as such actions might be seen as an abuse of power and a violation of the FAIS General Code of Conduct.

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<sup>12</sup> Regulation 4

<sup>13</sup> Regulation 4(1)

<sup>14</sup> Regulation 4(2)

<sup>15</sup> Regulation 6.

## Conflict of interest

A commissioner is not allowed to administer an oath or affirmation in matters where they have a personal interest. This helps prevent conflicts of interest and ensures impartiality in the administration of oaths and affirmations.<sup>16</sup> If the commissioner has a personal interest in the document or transaction, their objectivity may be compromised. They must avoid any situations that could influence their impartiality.<sup>17</sup> A conflict of interest occurs when a financial services provider (FSP) or representative has an actual or potential interest that may influence their ability to provide objective and unbiased services. According to Regulation 7, a commissioner of oaths must not administer an oath or affirmation in matters where they have a vested interest. Section 3 of the FAIS General Code of Conduct defines a conflict of interest as a situation where a provider's interest could affect their impartiality in fulfilling obligations to clients, including financial interests, ownership stakes, or third-party relationships.

Commissioning documents can lead to direct conflicts, as the primary duty is to offer unbiased advice in the best interests of clients. Therefore, advisors must avoid such conflicts. Acting as a commissioner of oaths while holding a financial interest in certified documents compromises an advisor's objectivity and may result in penalties from the Financial Sector Conduct Authority (FSCA) under the FAIS Act.

## Verification of documents

Commissioners have a responsibility to conduct due diligence when certifying documents, as failure to verify their authenticity could result in liability. This places an additional duty of financial planners designated as commissioners. The Act mandates commissioners to verify both the identity of the deponent and the authenticity of the documents, with non-compliance leading to penalties.

Providing these services within a financial advisory practice can raise regulatory, legal, and ethical issues, exposing advisors to potential penalties under both the Justices of the Peace and Commissioners of Oaths Act and the FAIS Act.

By understanding these responsibilities and implementing standard best practices, financial planners can effectively manage their roles, ensuring compliance with legal standards and safeguarding their clients' interests.

## Virtual commissioning

The COVID-19 pandemic significantly altered our daily lives and professional practices, including the role of a commissioner. It accelerated the adoption of digital technologies and introduced the concept of Virtual Commissioners of Oaths. Social distancing and lockdowns made it challenging for people to attend in-person meetings, underscoring the need for

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<sup>16</sup> Regulation 7.

<sup>17</sup> Regulation 7.

remote alternatives to ensure legal processes could continue without disruption. Consequently, virtual commissioning gained traction, as evidenced by various cases. This practice involves using digital platforms, such as video conferencing tools like WhatsApp video calls, to perform functions traditionally carried out in person. This shift was necessary to maintain continuity in legal services while adhering to health and safety protocols during the pandemic.

In *Knuttel N.N.O. and Others v Bhana and Others*,<sup>18</sup> the case revolved around the eviction of tenants from a property owned by a trust. As part of the eviction process, the applicants submitted a founding affidavit to support their case. However, the affidavit became contentious due to the way it was commissioned: the deponent, unable to meet in person due to being infected with COVID-19, signed the affidavit during a WhatsApp video call with the Commissioner of Oaths. The respondents challenged the validity of the affidavit, arguing that the affidavit failed to meet the regulatory requirement of being signed "in the presence of" the commissioner. This was because South African law traditionally requires that a deponent and commissioner be physically together during the signing process to ensure authenticity and prevent fraud. The court acknowledged the unusual nature of the situation, noting that COVID-19 presented exceptional challenges that required a flexible approach to legal processes. In its decision, the court accepted the affidavit, ruling that the virtual commissioning through WhatsApp constituted "substantial compliance" with the Justices of the Peace and Commissioners of Oaths Act, given the exceptional circumstances.

While the ruling demonstrated the court's willingness to adapt to technological solutions during a public health crisis, the judgment stopped short of permanently redefining the legal requirement of "presence" to include virtual methods. The decision opened the door to future debates on the broader adoption of virtual commissioning but highlighted that further legislative reforms would be necessary to provide clearer guidance. While the court evaluated whether virtual commissioning met the requirements for substantial compliance with existing Regulations, it did not address the broader interpretation of "in the presence of."

In *ED Food SRL v Africa's Best (Pty) Ltd (GJ)*,<sup>19</sup> the case involved a legal dispute over a contract for the supply of food products. ED Food SRL (the applicant) claimed that Africa's Best had failed to meet its contractual obligations, leading to financial losses. This case became particularly relevant during the COVID-19 pandemic, as physical meetings for legal proceedings were limited due to lockdown measures. To support its claims, ED Food submitted an affidavit that had been commissioned via a video call, as the deponent was unable to attend in person because of pandemic restrictions. The court ultimately ruled that this method of commissioning the affidavit met the standards for substantial compliance with the legal requirements of the Justices of the Peace and Commissioners of Oaths Act.

The significance of this case lies in its acceptance of virtual commissioning during extraordinary circumstances. However, similar to the *Knuttel NO v Bhana and Others* case, it did not fully address whether the traditional requirement for physical presence could be

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<sup>18</sup> *Knuttel N.O. and Others v Bhana and Others* (38683/2020) [2021] ZAGPJHC 874; [2022] 2 All SA 201 (GJ) (26 August 2021).

<sup>19</sup> *ED Food SRL v Africa's Best (Pty) Ltd (GJ)* (unreported case no 2022/1245, 14-3-2024).

interpreted to include virtual methods in the future. This highlights a growing recognition of the need to adapt legal practices in response to modern challenges, particularly when maintaining legal integrity and accessibility during crises such as the COVID-19 pandemic.

While these cases show the judiciary's willingness to consider virtual methods in specific situations, they did not fundamentally change the interpretation of physical presence requirement in the commissioning process. A significant development occurred in the *LexisNexis South Africa (Pty) Ltd v Minister of Justice and Correctional Services*<sup>20</sup> case. It addressed an important issue regarding the meaning of the term "in the presence of" as outlined in Regulation 3 of the Justices of the Peace and Commissioners of Oaths Act. This legal matter, as with the previous cases, emerged during the COVID-19 pandemic, which prompted a reconsideration of virtual commissioning as an alternative to the traditional "in-person" methods due to the need for social distancing.

In this case LexisNexis questioned the current regulation to find out if virtual meetings via video conferencing could fulfil the requirement for physical presence when commissioning affidavits. The company argued that with advancements in technology, virtual methods could effectively verify identities and maintain the integrity of legal documents. This approach would better meet the needs of legal professionals and their clients, especially in a rapidly changing environment. Essentially, they believed modern technology could support the legal process while offering more flexible service delivery. Judge Swanepoel ruled that the Regulation still requires physical presence. He relied on the dictionary definition of "presence" and relevant case law to support his decision, emphasising that expanding the interpretation to include virtual processes would be beyond judicial authority. This decision highlighted a significant gap between existing Regulations and the advances in technology, pointing to a clear need for legislative reform to address the realities of modern technology.

This ruling is significant for several reasons. First, it underscores the regulatory limitations, revealing how outdated laws can hinder legal processes in the face of evolving technology. Second, it emphasizes the urgent need for legislative reform to keep pace with modern practices, particularly as many legal processes move online. Adapting regulations is crucial to maintaining the integrity of the legal framework while better serving practitioners and clients. Lastly, the ruling highlights the limitations of judicial authority in interpreting laws, especially regarding new technologies. While courts can apply laws, they cannot change them fundamentally. Thus, updating laws to align with technological advancements and societal needs is essential for ensuring that legal systems remain effective and relevant.

In the recent *VJS v SH*<sup>21</sup> case, the applicant, employed by the US Embassy and stationed in Islamabad, encountered challenges with the conventional commissioning of his affidavit due

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<sup>20</sup> *LexisNexis South Africa (Pty) Ltd v Minister of Justice and Correctional Services* (unreported case no 2023-010096).

<sup>21</sup> *VJS v SH*, Case No. 19578/2024 (Western Cape High Court, October 22, 2024).

to security concerns and his remote location. His legal representative explained that visits to a local embassy or police station could compromise his job, adding that he wouldn't be returning to South Africa until year's end. Given these circumstances, they requested the court accept the affidavit's virtual commissioning, emphasising the urgency of enforcing the existing divorce order, particularly for child maintenance. The court ruled in favour of "substantial compliance," allowing virtual commissioning since both parties could see and hear each other, satisfying the oath's intent. This decision differs from ruling in the *LexisNexis South Africa (Pty) Ltd v Minister of Justice and Correctional Services* case, where physical presence was deemed necessary. These differences reflect an ongoing judicial debate over the "in the presence" requirement, especially in light of technological advancements and practical limitations, particularly in cases like those during COVID-19 such as *Knuttel N.N.O. v Bhana* and the *ED Food SRL v Africa's Best* cases, who allowed virtual methods in exceptional circumstances but maintained the traditional stance on physical presence.

Collectively, these rulings highlight the urgent need for amendments to the Justices of the Peace and Commissioners of Oaths Act to provide clearer guidelines while preserving the integrity of legal processes.

In today's digital age, the role of a Commissioner of Oaths extends to certifying electronic documents, a subject addressed under Section 18 of the Electronic Communications and Transactions Act<sup>22</sup> (hereafter referred to as the ECT Act). While the Act does not explicitly outline the certification process for electronic documents, it provides essential guidance on how to approach such situations. For instance, a commissioner may be asked to certify a printed copy of a Certificate of Incorporation that has been electronically transmitted by the Companies and Intellectual Property Registration Commission (CIPC). The question arises: can the Commissioner certify this printed copy as a true representation of the original electronic document?

According to Section 18 of the ECT Act:

1. If a law mandates that a document requires notarisatation, then using an advanced electronic signature will meet this requirement.<sup>23</sup>
2. When a document exists only in electronic form, you can fulfil the certification requirement by providing a printed version certified as a true reproduction of the original document.<sup>24</sup>
3. If a document exists in physical form, e.g. paper, an electronic copy can be certified as a true copy of the original, provided the certification is accompanied by an advanced electronic signature.<sup>25</sup>

According to section 18 of the ECT Act, commissioners of Oaths can certify printed copies of electronic documents as true copies. However, this comes with extra responsibility. Since electronic documents can be changed without any visible signs, commissioners must be sure

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<sup>22</sup> 25 of 2002.

<sup>23</sup> Section 18 (1).

<sup>24</sup> Section 18(2).

<sup>25</sup> Section 18(3).

of the original document's authenticity before certifying it. If, however, there is any doubt about the electronic document's integrity, they should avoid certifying the printed copy. Certification should always be based on the authenticity of the original. By following these guidelines, commissioners can navigate the rules for certifying electronic documents while ensuring compliance and maintaining certification integrity.

## Conclusion

Traditional commissioning provides a structured environment where the commissioner can directly observe the deponent, allowing them to assess the deponent's behaviour, understanding, and the context of the oath or affirmation. Virtual commissioning, on the other hand, uses technology to connect people remotely. While it does offer significant convenience, it also presents challenges, such as verifying identities, authenticating documents, and upholding the integrity of the process. These challenges highlight the need for updated regulations and stringent security measures.

The ongoing judicial debate further emphasises the necessity for legislative updates that address these technological developments; however, we should not overlook the fact that there are individuals who do not have access to these advancements. Although regulations currently lag behind these changes, a balanced approach that incorporates both traditional and virtual methods is needed to uphold the integrity of the commissioning process while ensuring accessibility for all South Africans by catering for both and aligning with the diverse needs of a rapidly changing society.

In this evolving landscape, it is imperative for financial planners to observe and promote best practices in both traditional and virtual commissioning methods. By staying informed about the implications of these legal developments, they can better serve their clients, ensuring that the integrity of their financial documentation is maintained in all circumstances.

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# Financial Fallout: Navigating the Impact of Divorce

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## Introduction

Marriage has historically been considered a cornerstone of society, offering a foundation for family life, social stability, and personal fulfilment. However, not all marriages endure the test of time, and some couples find themselves facing divorce. Divorce, often a deeply emotional and life-altering experience, also carries significant financial implications that can ripple through every aspect of an individual's life. From the division of assets and debts to the potential changes in income and expenses, the economic consequences of ending a marriage can be profound and long-lasting. This article explores the financial fallout of divorce, offering insights and strategies to help individuals navigate these challenges and secure their financial future in the aftermath of a marital split.

The latest divorce statistics in South Africa, released by Statistics South Africa on 14 March 2024, provide a detailed look into the trends and patterns of divorces highlighting the evolving dynamics of marital relationships in the country. The divorce statistical data illustrates the number of published divorces in South Africa by population group from the years 2013 – 2022. For the year 2022, there were 20 196 completed divorce forms that Statistics South Africa received and processed. The number 20 196 indicates an increase of 1 988 (10,9%) divorces from the 18 208 cases processed in the year 2021.<sup>1</sup> The harsh reality facing many South Africans is that many marriages end in divorce. Furthermore, the financial and emotional consequences for those involved are profound, making it crucial to manage emotions to avoid making hasty financial decisions.

Given the high rates of divorce in the country, one of the goals of any divorcing couple should be to protect their assets and ensure an equitable division during the divorce. Protracted litigation or negotiations can be taxing for both spouses. Additionally, extended legal proceedings can be counterproductive, as they only serve to diminish the value of the estate the couple are disputing. Consequently, besides getting expert legal advice, many divorcing couples are now wisely seeking financial advice on how best to separate marital assets before finalising their divorce settlement. The finality of a divorce order means that the financial consequences of your divorce cannot be undone, and if it is faulty or inequitable, an ex-spouse can be left in a financially unstable position that may take many years to overcome.<sup>2</sup>

## Maintenance

Maintenance is seen as a contractual obligation arising from the maintenance duties between spouses in a marriage. Under Common Law, parties to a marriage have a reciprocal duty to support each other. This duty ends when the marriage is terminated due to divorce or death. Maintenance includes the provision of accommodation, clothing food, medical service, and other necessities. The extent of this duty of support is determined, inter alia, by the social status of the parties, their means of income and the cost of living.<sup>3</sup>

This situation can cause great hardship when a spouse has been unable to build an estate during the marriage and has reached an age where they can no longer realistically earn an adequate income. In such cases, a new duty of support may arise upon divorce through two primary mechanisms. Firstly, the couple may agree that one party will pay maintenance to the other, creating a contractual duty of support. Secondly, if no settlement agreement exists, the court may issue a maintenance order based on the statutory powers granted by the Divorce Act.<sup>4</sup> According to Section 7(1) of the Divorce Act,<sup>5</sup> the court may grant an order for maintenance in accordance with any written agreement between the parties. If no agreement is reached, Section 7(2) of the Divorce Act<sup>6</sup> allows the court to determine a just

<sup>1</sup> Statistical Release, Marriages and Divorce 2022 available at <https://www.statssa.gov.za/publications/P0307/P03072022.pdf> accessed on 06.09.2024

<sup>2</sup> Craig Torr 'A – Z of Divorce Financial Planning' available at <https://www.moneyweb.co.za/financial-advisor-views/the-a-z-of-divorce-financial-planning/>, accessed on 30.05.24

<sup>3</sup> Heaton and Kruger, South African Family Law (2023) at 54

<sup>4</sup> Act 70 of 1979

<sup>5</sup> Act 70 of 1979

<sup>6</sup> Act 70 of 1979

maintenance order, taking into account various factors, such as the existing or prospective means of each of the parties, their respective earning capacities, financial needs and obligations, the age of each of the parties, the duration of the marriage, the standard of living of the parties prior to the divorce and the conduct of both parties in so far as it may be relevant to the breakdown of the marriage.<sup>7</sup>

## Division of assets

The division of assets and liabilities is a central issue in divorce proceedings and is determined by the marital regime the spouses elected when they entered into their marriage. In South Africa, the following marital regimes are applicable:

- a) Marriage in community of property: This is the default regime where both spouses share equal ownership of all assets and liabilities acquired before and during the marriage.
- b) Marriage out of community of property (with the inclusion of the accrual system): Under this regime, each spouse maintains a separate estate during the marriage, but the growth of their respective estates is calculated and shared equally upon the dissolution of the marriage through divorce or death.
- c) Marriage out of community of property (with the exclusion of the accrual system): In this regime, each spouse's assets and liabilities remain separate throughout the marriage, and there is no sharing of accruals upon the dissolution of the marriage through divorce or death.<sup>8</sup>

## Background

Until the commencement of the Matrimonial Property Act<sup>9</sup> on 1 November 1984, two main matrimonial property systems existed in South Africa, namely marriage in community of property with the marital power, and marriage out of community of property (with the exclusion of both community of profit and loss and the husband's marital power). The latter matrimonial property system is also known as complete separation of property. While other matrimonial property systems were possible, they seldom occurred in practice. The Matrimonial Property Act did not abolish the two matrimonial property systems which were most common before 1984, but it abolished the marital power and introduced a variation of marriage out of community of property, namely the accrual system. However, the primary matrimonial property system has always been, and still is, universal community of property. In fact, when a couple enters into a civil marriage, a rebuttable presumption arises that they are marrying in community of property.<sup>10</sup>

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<sup>7</sup> Heaton and Kruger, *South African Family Law* (2023) at 158

<sup>8</sup> M Botha et al, *The South African Financial Planning Handbook* (2024) at 454

<sup>9</sup> Act 88 of 1984

<sup>10</sup> Heaton and Kruger, *South African Family Law* (2023) at 61

### Marriage in community of property

Marriage in community of property is the default marital regime. If persons marry without entering into an antenuptial contract, the matrimonial property applicable will be in community of property. The assets owned by the spouses are pooled together to form one joint estate. Similarly, both spouses are equally responsible for any debts ('liabilities'), irrespective of which spouse incurred them. This means that all assets and liabilities acquired by both spouses before their marriage, as well as those acquired during the subsistence of the marriage, are combined.<sup>11</sup>

Both spouses thus have an equal interest in the joint estate, with each having a 50% claim on the total value of all assets and liabilities combined. Consequently, neither spouse has a distinct, separate estate.<sup>12</sup> However, certain assets are excluded from the joint estate, including assets received as gifts or inheritances; any donations made between spouses; compensation received for patrimonial damages (e.g. personal injury settlements) and any assets explicitly mentioned in an antenuptial contract. If assets are not specified or excluded under these categories, the assets are automatically included in the joint estate. Upon dissolution of the marriage through divorce or at death, the assets and liabilities of the joint estate are divided equally between the spouses.<sup>13</sup>

### Marriage out community of property (with the inclusion of the accrual system)

Section 2 of the Matrimonial Property Act,<sup>14</sup> provides that in respect of marriages out of community of property entered into after 1 November 1984, an accrual system will automatically apply unless it is expressly excluded. Under the accrual system, each spouse will continue to conduct their own estate independently of the other during the subsistence of the marriage. However, at the dissolution of the marriage, through death or divorce, the party whose estate shows no growth or has a smaller growth compared to the other party, will be entitled to claim half of the difference between the growths of both estates.<sup>15</sup> The net effect of the accrual system is that the wealth acquired by the two spouses during the subsistence of their marriage is shared equally at the dissolution of the marriage.

Certain assets, do not form part of the accrual claim in terms of the Matrimonial Property Act:<sup>16</sup>

- any assets expressly excluded in terms of the couple's antenuptial contract, including the proceeds and replacement of such assets,
- any inheritance, legacy or donation received by a spouse from a third party during the marriage,
- any donations between the spouse; and
- any non-patrimonial damages (for defamation or pain and suffering) received by a spouse during the marriage.

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<sup>11</sup> M Botha et al, The South African Financial Planning Handbook (2024) at 454

<sup>12</sup> M Botha et al, The South African Financial Planning Handbook (2024) at 454

<sup>13</sup> M Botha et al, The South African Financial Planning Handbook (2024) at 455

<sup>14</sup> Act 88 of 1984

<sup>15</sup> M Botha et al, The South African Financial Planning Handbook (2024) at 455

<sup>16</sup> Act 88 of 1984

### Marriage out community of property (with the exclusion of the accrual system)

This matrimonial property regime involves an antenuptial contract (i.e. an agreement concluded before the marriage) where community of property and profit and loss are excluded. There is no joining of the spouses' estates into one joint estate. Further, everything that belonged to either party before the marriage and is acquired by either party during the marriage, will remain their exclusive property and liability. This system allows each spouse to retain full independence, control, and contractual capacity of their own estate, which protects each spouse's estate against claims by the other spouse's creditors.<sup>17</sup>

The parties do not share assets or accrual. This can be disadvantageous to a spouse who chooses to invest emotionally by staying at home to raise children and thus does not have the same or any earning capacity as the other spouse. In the event of a divorce, the non-earning spouse does not get to share in the estate of the income-earning spouse. At the dissolution of the marriage, this spouse will not have any claim against assets or accrual which may be unfair because the other spouse had the benefit of the other spouse being a home giver or raising the children.<sup>18</sup>

### **Pension interest**

Pension interest in the context of divorce proceedings means:<sup>19</sup>

- (a) the benefits to which a member of a pension fund (excluding a retirement annuity fund) would have been entitled in terms of the rules of that fund if their membership of the fund would have been terminated on the date of the divorce on account of their resignation from their office, i.e. the member's notional withdrawal benefit as at date of divorce; and
- (b) the total amount of the contributions to the fund by a member of a retirement annuity fund up to the date of the divorce, together with a total amount of annual simple interest on those contributions up to that date, calculated at the same rate as the rate prescribed as at that date by the Minister of Justice in terms of section 1(2) of the Prescribed Rate of Interest Act<sup>20</sup>, for the purposes of that Act.

A pension interest is not an asset in a person's estate, because the right to claim the benefit only vests in the person when the benefit accrues to them (which usually occurs when they reach a specific age, retires, resigns, or is dismissed or retrenched). Under the common law, the pension interest of the spouse who is a member of the pension fund has traditionally not been considered part of the joint estate. The spouse who is not a member had no entitlement to a portion of the member spouse's pension interest upon divorce. This position was altered by the Divorce Amendment,<sup>21</sup> which introduced sections 7(7) and 7(8) into the Divorce Act,

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<sup>17</sup> M Botha et al, The South African Financial Planning Handbook (2024) at 455

<sup>18</sup> 'Advantages and Disadvantages Marriage Out COP Excluding Accrual' available at [https://www.antenuptial24.co.za/index.php?option=com\\_content&view=article&id=56:advantages-and-disadvantages-of-a-marriage-out-of-community-of-property-excluding-accrual&catid=31&Itemid=144](https://www.antenuptial24.co.za/index.php?option=com_content&view=article&id=56:advantages-and-disadvantages-of-a-marriage-out-of-community-of-property-excluding-accrual&catid=31&Itemid=144) accessed on 30.05.2024

<sup>19</sup> M Botha et al, The South African Financial Planning Handbook (2024) at 552

<sup>20</sup> Act 55 of 1975

<sup>21</sup> Act 7 of 1989

thereby introducing the concept of sharing a pension interest upon the dissolution of a marriage through divorce.<sup>22</sup>

In terms of section 7(7)(a) of the Divorce Act,<sup>23</sup> a spouse's "pension interest" is deemed to be part of their assets upon divorce for purposes of determining the patrimonial benefits to which the spouses may be entitled. A spouse's pension interests are therefore included for purposes of dividing their assets and when calculating the value of their estate(s) for purposes of maintenance.<sup>24</sup> Further, section 7(7)(a) is a provision that must be invoked during the divorce proceedings to deem such pension interest to be an asset in the joint estate when determining the patrimonial consequences of the divorce. It is only by means of this deeming provision that a non-member spouse would be able to secure a part of the member spouse's pension interest.<sup>25</sup>

Section 7(8) of the Divorce Act reads as follows:<sup>26</sup>

Notwithstanding the provisions of any other law or of the rules of any pension fund-

- (a) the court granting a decree of divorce in respect of a member of such a fund, may make an order that—
- (i) any part of the pension interest of that member which, by virtue of subsection (7), is due or assigned to the other party to the divorce action concerned, shall be paid by that fund to that other party when any pension benefits accrue in respect of that member;
  - (ii) the registrar of the court in question forthwith notify the fund concerned that an endorsement be made in the records of that fund that that part of the pension interest concerned is so payable to that other party and that the administrator of the pension fund furnish proof of such endorsement to the registrar, in writing, within one month of receipt of such notification;
- (b) any law which applies in relation to the reduction, assignment, transfer, cession, pledge, hypothecation or attachment of the pension benefits, or any right in respect thereof, in that fund, shall apply mutatis mutandis with regard to the right of that other party in respect of that part of the pension interest concerned.

The effect of section 7(7)(a) of the Divorce Act,<sup>27</sup> ("the deeming provision") is that the pension interest of a party to the divorce action is deemed to be part of their assets for the purposes of the divorce. The deeming provisions states unequivocally that a pension interest is deemed to be part of the assets of a divorcing spouse in the determination of the patrimonial benefits to which the spouses may be entitled. As a result, the value of the pension interest is automatically included for purposes of determining the proprietary consequences of the divorce even if the divorce order does not expressly mention the

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<sup>22</sup> Oosthuizen N.O v D.J.P.B and Others (20665/2021) [2023] ZAGPPHC 30, para 8

<sup>23</sup> Act 70 of 1979

<sup>24</sup> Heaton and Kruger, *South African Family Law* (2023) at 130

<sup>25</sup> Oosthuizen N.O v D.J.P.B and Others (20665/2021) [2023] ZAGPPHC 30, para 9

<sup>26</sup> Act 70 of 1979

<sup>27</sup> Act 70 of 1979

pension interest.<sup>28</sup> Section 7(8) of the Divorce Act,<sup>29</sup> then authorises the court to order that the non-member be paid a share of the pension interest when the member becomes entitled to a benefit in terms of the rules of his fund. The reference to “any divorce action” in the deeming provision indicates it applies to all marriages.<sup>30</sup> However, section 7(7)(c) of the Divorce Act<sup>31</sup> excludes from the ambit of the deeming provision, marriages out of community of property with the exclusion of the accrual system entered into on or after 1 November 1984.<sup>32</sup>

## Divorce Order

Section 7(8) of the Divorce Act,<sup>33</sup> read together with Section 37D(4)(a) of the Pension Funds Act (“PFA”),<sup>34</sup> outlines specific conditions that a divorce order must meet for a fund to process a non-member spouse's claim. These conditions are:

- ❑ the order must specifically provide for the non-member spouse's entitlement to a “pension interest” as defined in the Divorce Act,
- ❑ the fund that must deduct the “pension interest” must be named or identifiable,
- ❑ the order must set out a percentage of the member's “pension interest” or a specific amount, and
- ❑ the fund must be expressly ordered to endorse its records and make payment of the “pension interest.”

If the divorce order does not strictly meet the above requirements, it will not be compliant with the specific conditions for a divorce order and will therefore not be enforceable against the fund. The fund in question has no discretion in this regard because it is strictly bound by the provisions of the PFA read together with the Divorce Act. To prevent a Pension Fund Administrator from rejecting a divorce order due to incomplete wording or insufficient identification of the pension interest, it is recommended to initially provide the Administrator with a draft of the settlement agreement or the proposed order. This allows the Administrator to verify the phrasing. Amending a divorce order retrospectively is a highly expensive and lengthy process that should be circumvented at all costs.<sup>35</sup>

A pertinent question that often arises in practice is, ‘who bears the onus of submitting the divorce order to the fund’? Section 7(8)(a)(ii) of the Divorce Act<sup>36</sup> refers to the registrar of the court in question having to “notify the fund concerned that an endorsement be made in the records of that fund that that part of the pension interest concerned is so payable to that other party and that the administrator of the pension fund furnish proof of such endorsement to the registrar, in writing, within one month of receipt of such notification. The divorce order

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<sup>28</sup> Heaton and Kruger, *South African Family Law* (2023) at 131

<sup>29</sup> Act 70 of 1979

<sup>30</sup> Act 70 of 1979

<sup>31</sup> Act 70 of 1979

<sup>32</sup> M Botha et al, *The South African Financial Planning Handbook* (2024) at 552

<sup>33</sup> Act 70 of 1979

<sup>34</sup> Act 24 of 1956

<sup>35</sup> Tracey – Leigh Wessels ‘Pension Interest on Divorce’ available at <https://www.traceyleighwessels.com/pension-interest-on-divorce/> accessed 30.05.2024

<sup>36</sup> Act 70 of 1979

itself usually specifies who would be responsible for submitting the order to the fund concerned. In the absence of a specific obligation contained in the divorce order, it is usually the non-member spouse that claims payment of her portion of the pension interest that submits the order to the fund, together with her request for and instructions as to the manner of payment.<sup>37</sup>

### ***Ndaba v Ndaba 2017(1) SA 342 (SCA)***

The parties were married in community of property and divorced on 25 May 2012. The divorce order granted by the Court included a provision which reads as follows: "the deed of the settlement between the parties ... [annexed] is made an order of the court." The parties' deed of settlement provided, that their joint estate would be divided equally between them.<sup>38</sup>

The court *a quo* ruled in favour of the respondent, stating that in the absence of a court order by the divorce court declaring the pension interest of the member spouse part of the joint estate, such pension interest did not form part of the joint estate. Aggrieved with the outcome, the appellant approached the Supreme Court of Appeal (SCA).<sup>39</sup> The issue before the court was, whether a non-member spouse in a marriage in community of property is entitled to the pension interest of a member spouse if the divorce order does not explicitly declare the pension interest as part of the joint estate.<sup>40</sup> The (SCA) interpreted section 7(7)(a) and 7(8) of the Divorce Act,<sup>41</sup> the (SCA) held that the legislative intent was to enhance the non-member spouse's patrimonial benefits beyond what was available under common law.

The (SCA) also distinguished between the automatic application of section 7(7)(a) and an order in terms of section 7(8). The language of s 7(7)(a) is clear and unequivocal. It vests in the joint estate, the pension interest of the member spouse for the purposes of determining the patrimonial benefits, to which the parties are entitled as at the date of their divorce. However, the Court interprets section 7(8) as purely necessary to create the mechanism in terms of which the retirement fund of the member is statutorily bound to effect payment of the portion of pension interest (as at date of divorce) directly to the non-member spouse as provided for in section 37D(1)(d)(i) of the Pension Funds Act (PFA).<sup>42</sup>

### **Forfeiture of Patrimonial Benefits**

Section 9(1) of the Divorce Act<sup>43</sup> empowers the court that grants a divorce order on the ground of the irretrievable breakdown of the marriage to order total or partial forfeiture of benefits, considering the following factors: the duration of the marriage; the circumstances

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<sup>37</sup> Hettie Joubert 'Momentum Legal Update 6 of 2015' available at [https://eb.momentum.co.za/webDocumentLibrary/LegalUpdates/2015/Legal\\_Update\\_6-2015\\_Divorce\\_order\\_issues\\_relatinq\\_to\\_members\\_pension\\_interest\\_March2015.pdf](https://eb.momentum.co.za/webDocumentLibrary/LegalUpdates/2015/Legal_Update_6-2015_Divorce_order_issues_relatinq_to_members_pension_interest_March2015.pdf) accessed 30.05.2024

<sup>38</sup> *Ndaba v Ndaba 2017(1) SA 342 (SCA)* para 2

<sup>39</sup> *Ndaba v Ndaba 2017(1) SA 342 (SCA)* 162, para 6 - 7

<sup>40</sup> *Ndaba v Ndaba 2017(1) SA 342 (SCA)* 162, para 11

<sup>41</sup> Act 70 of 1979

<sup>42</sup> *Ndaba v Ndaba 2017(1) SA 342 (SCA)* 162, para 24 - 28

<sup>43</sup> Act 70 of 1979

which led to the breakdown of the marriage; and any substantial misconduct on the part of either spouse.

The generally accepted view is that forfeiture of benefits does not entail that a spouse loses his or her own assets. It merely entails that the spouse loses the claim they have to financial benefits generated by the other spouse. Thus, for example, if the marriage is in community of property, the spouse against whom a court orders total forfeiture receives only those assets they brought into the joint estate, unless one of them brought more than half the assets into the joint estate. In the latter event, they will receive half the joint estate. In essence therefore, a forfeiture order is effective only if it is made against the poorer spouse. The same problem arises if the accrual system applies to the marriage, for then the spouse whose estate shows the larger accrual retains his or her half of the difference between the accrual in the spouses' respective estates.<sup>44</sup>

In a marriage in community of property, the benefits which can be forfeited include the right to occupy premises in terms of a tenancy, residential permit or statutory lease which was conferred on the spouse against whom the forfeiture order operates but in respect of which the other spouse paid the rent. Benefits which can be forfeited in the case of a marriage out of community of property include the right to share in the accrual of the other spouse's estate; benefits by virtue of a succession clause; and marriage settlements. For example, if a husband made a marriage settlement to his wife and the promised asset was transferred to the wife during the subsistence of the marriage, the court may order the wife to return the asset. If the asset was never transferred, the court may make an order that the wife may no longer enforce the donation.<sup>45</sup>

Only those benefits which exist at the time of the divorce can be forfeited. Thus, for example, if a spouse is ordered to forfeit a retirement annuity, it is only the value of the annuity as a pension interest at the date of the divorce which is forfeited. Consequently, the forfeiture order does not mean that the spouse in whose favour the forfeiture order operates must receive the full proceeds of the retirement annuity when it falls due, including the growth that has been accumulated after the divorce.<sup>46</sup>

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<sup>44</sup> Heaton and Kruger, *South African Family Law (2023)* at 136

<sup>45</sup> Heaton and Kruger, *South African Family Law (2023)* at 137

<sup>46</sup> Heaton and Kruger, *South African Family Law (2023)* at 137

## Conclusion

Divorce is a complex process with significant financial implications. Understanding the intricacies of matrimonial property regimes, maintenance obligations, and asset division is crucial to navigating this challenging time. By consulting a financial adviser and/or legal adviser, both parties (spouses) can make informed financial decisions to cushion the impact of divorce and secure their long-term financial well-being.

When contemplating marriage or considering divorce, it is essential to understand the implications of your matrimonial property regime. The nature of your marriage contract will dictate how assets are divided and navigating this process can be complex and emotionally taxing. The maintenance obligations can vary depending on factors such as the parties' income, needs, and the duration of the marriage. It is essential to consider maintenance agreements and potential court orders. Maintenance, following a divorce, is a continuation of the support obligations that existed during the marriage. Post-divorce, a new duty of support can arise in two ways, through a mutual agreement between the spouses or a court order given authority through statutory provisions.

During divorce proceedings, a spouse may be entitled to a share of the other spouse's retirement fund benefits, known as the 'pension interest.' This entitlement depends on the matrimonial property regime, the antenuptial contract, and the type of retirement fund involved. It is crucial that the pension interest order in the divorce settlement agreement must be meticulously drafted to meet strict criteria, as failure to do so may result in the pension fund refusing to execute the instruction.

A financial adviser can provide an estimated calculation of the pension interest claim, which may assist the attorney in drafting the settlement agreement and ensuring the instruction is actionable. If a party is awarded a share of their ex-spouse's pension interest, they will need to make strategic decisions regarding the pension fund capital. An experienced adviser can explain the financial implications of withdrawing the capital, including potential tax liabilities that may reduce the benefit the party will receive. By taking these steps, individuals can better manage the financial complexities of divorce and work towards a more secure financial future.

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# Power of Attorney in Financial Planning

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### Introduction

A power of attorney can be a useful, albeit complex, instrument in financial planning. A financial adviser needs to know when a client's circumstances dictate the need for a power of attorney. Does the client require a general power of attorney for all matters or a special power of attorney for a specific transaction? It is equally important to understand the limits of a power of attorney and when it becomes invalid.

The role of the financial adviser extends beyond mere recommendation; it includes providing personalised solutions to mitigate financial risks by identifying potential threats, diversifying investments, and recommending suitable insurance products. One essential tool in this arsenal is a power of attorney tailored to the client's specific needs.

Elderly clients often face challenges due to physical frailty, making it difficult for them to sign documents or manage banking tasks. As the risk of losing mental capacity increases with age, it is crucial for clients to plan for their future care, including assisted living and private nursing, while they still have the mental capacity to make informed decisions. This proactive estate planning can help ensure availability at preferred facilities when needed and reduce the potential for abuse of power of attorney by family members seeking to benefit unduly during vulnerable times.

Similarly, in business succession planning, clients may be unable to handle daily operations due to illness or geographical limitations, which can disrupt the supply chain and adversely affect the business. Although suitable insurance products may cover some financial losses due to the client's incapacity, a power of attorney is essential for authorizing trusted agents to manage ongoing business functions such as negotiations and banking. This arrangement helps prevent unforeseen delays that could lead to additional costs or contract losses. Clients can appoint multiple agents for specific tasks, ensuring collaboration towards the same goals. However, financial services providers must now obtain a duly completed mandate from clients, as the previous practice allowing transactions based solely on power of attorney is no longer permissible under the Financial Advisory and Intermediary Services Act. The mandate must clarify how clients will interact with the financial services provider and who is authorized to act on their behalf.

This article will provide insight into the use, validity requirements, general and special powers of attorney, limitations, potential lapsing, and termination, ensuring that financial advisers and clients alike can navigate this area with confidence.

## The South African approach to a power of attorney

Traditionally, an individual cannot conclude any juristic act on behalf of another person, without having the necessary authority.<sup>1</sup> This authority is commonly granted by expression of intention to grant such a person said rights, more commonly in the form of a written document referred to as a power of attorney.<sup>2</sup> In South African law, a power of attorney is not considered a contract, but rather a unilateral juristic act – an expression of will by the principal that the agent is authorised to conclude juristic acts on their behalf.<sup>3</sup> Simply put, it is a legal document that grants another person, known as an agent, the authority to act, or make decisions on behalf of the person granting this authority, known as the principal, as is based on the South African law of agency.<sup>4</sup>

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<sup>1</sup> JC De Wet 'The Act of Representation' (2013) 1 *LAWSA* (3<sup>rd</sup> ed) at 133.

<sup>2</sup> *Ibid.*

<sup>3</sup> South African Law Commission Discussion Paper 105 (Project 122) *Assisted Decision-Making: Adults with Impaired Decision-Making Capacity* (2004).

<sup>4</sup> Xavier Tekana 'Power of Attorney: Background, Requirements, and Termination' 26 October 2022 available at <https://www.millers.co.za/OurInsights/ArticleDetail.aspx?Title=Power%20of%20Attorney%20%20Background%20Requirements%20and%20Termination#:~:text=Requirements%20for%20a%20power%20of%20attorney%20to%20be%20valid&text=Although%20it%20is%20not%20specified,of%20giving%20evidence%20in%20court> accessed on 29 October 2024.

## Parties to a power of attorney:

### The principal

Various terms, like "principal," "grantor," or "donor of power," are used to describe the person who empowers somebody else to perform actions in their name. The principal must ensure that the acts performed, and decisions made by the agent, are in fact the principal's will.

Due to the serious implications of the duties and responsibilities involved the decision must not be made frivolously. The principal must fully comprehend and appreciate the significance of their decision. If the principal grants the power of attorney due to a misunderstanding of what the true function of a power of attorney is, the consequences could be devastating with irreversible damage. Voluntary and informed consent of the principal is crucial.

### The agent (or representative)

A representative is an individual who performs a legal act with the purpose of establishing, modifying, or ending legal relationships on behalf of someone else, rather than for their own benefit.<sup>5</sup> Given the responsibility bestowed on the agent, it is advisable that they be a major who is competent, trustworthy and understands the scope of their duties. They are expected to make financial and legal decisions as well as sign legal documents on the principal's behalf. They are expected to act in the best interest of the principal. They must act only within the bounds of their delegated duties in the power of attorney. An agent can be a family member, friend, attorney, or financial adviser, to name but a few.

What needs to be considered in the event of a financial adviser acting as an agent in a client's power of attorney, are the ethical concerns regarding a potential conflict of interest. The financial adviser will be receiving commission from their work as a financial adviser and now be in a position to make decisions for the client which would be favourable to themselves. The financial adviser must adhere to the FAIS GCC when accepting the role of an agent for their client. According to section 2 of the FAIS GCC, financial service providers and their representatives are obligated to act honestly, fairly, with due skill, care, and diligence, and in the interests of clients and the integrity of the financial services industry, at all times.

Section 3 of the FAIS GCC addresses requirements related to financial interests and conflict of interest management policies. This includes specific duties such as the obligation for financial service providers and their representatives to disclose to clients any personal interest in the relevant service, or any circumstance that could create an actual or potential conflict of interest. Additionally, they must take all reasonable steps to ensure fair treatment of the client.

- The agent, who is appropriately authorised, is legally protected from any liability arising from a contract or agreement entered into on behalf of the principal. If an agent is not properly authorised and misleads a third party during a juristic act that they have the requisite authority, the third party can hold the said agent personally liable for breach of "warranty of authority".<sup>6</sup> In this case, the principal acquires no rights and incurs no duties

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<sup>5</sup> JC De Wet 'The Act of Representation' (2013) 1 LAWSA (3<sup>rd</sup> ed) at 126.

<sup>6</sup> Ibid at 163.

with regard to the specific juristic act. A person who continues to act on an invalid power of attorney does so fraudulently. While there are no formal requirements for the document, it must clearly indicate that it is intended as a Power of Attorney (POA). It should show that the principal has properly appointed the agent to act on their behalf and agrees to be bound by the agent's actions. Both the principal and the agent must possess legal capacity, meaning that when the agent undertakes an act or transaction, the principal must also be legally capable of performing that same act.<sup>7</sup> It requires the principal to have contractual capacity i.e. the principal must be of sound mind to delegate to another person to act on their behalf. The agent cannot perform any legal act on behalf of the principal, which the principal is unable to do themselves. The principal must fully appreciate and understand the nature, extent as well as consequences of granting the power of attorney.<sup>8</sup> Further best practices include:

- The power of attorney must clearly describe and identify the principal and agent as well as the extent of the powers granted to the agent.<sup>9</sup>
- Any limitations and or restrictions must be detailed in full in the power of attorney.
- While not required in South African law, it is common practice to have the power of attorney witnessed by two competent witnesses who are 14 years or older. The witnesses cannot in any way benefit from the said power of attorney.<sup>10</sup> In the writer's opinion having two witnesses to a power of attorney demonstrates that the principal was of sound mind and has not acted under undue influence or coercion as the principal has signed the power of attorney voluntarily. There is no formal document or form described for a power of attorney to be valid. Therefore, it is beneficial to have a power of attorney drafted by a legal professional which addresses the powers in detail accurately.
- In the case of a power of attorney executed outside of South Africa for use in South Africa, it must be executed in the presence of a notary public of that country. Different countries have their own requirements to be fulfilled for proper authentication.<sup>11</sup> The Consular Notarial Services in South Africa legalise official documents for use abroad for both South African citizens and foreign nationals.<sup>12</sup> Legalisation grants legal validity to South African public documents, allowing them to be recognised outside South Africa.<sup>13</sup> This process involves affixing, sealing and signing documents with either an Apostille Certificate (for countries in the Apostille Convention)<sup>14</sup> or a Certificate of Authentication (for non-signatory countries). In essence, legalization verifies the signature and seal on a public document.<sup>15</sup> South African diplomatic and consular representatives abroad can only legalise foreign-issued documents if already authenticated by the foreign authority in their accredited country; they do not issue apostilles, only certificates of authentication.

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<sup>7</sup> Cloete, Mpikwane and Fakier 'Premiums and Problems' 129 ed (2024) F107.

<sup>8</sup> Tekana, X 'Power of Attorney: Background, Requirements, and Termination'.

<sup>9</sup> Ibid.

<sup>10</sup> Seliane S, 'Are you sure your power of attorney is legal?'

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<sup>12</sup> Department of International Relations and Cooperation 'Consular Notarial Service: Legalisation of official (public) documents' available at <https://dirco.gov.za/consular-notarial-services/> accessed on 31 October 2024.

<sup>13</sup> Ibid.

<sup>14</sup> Article 4 of The Hague Convention of 5 October 1961 (Abolishing the Requirement of Legalisation for Foreign Public Documents).

<sup>15</sup> Ibid at Article 5.

## Types of power of attorney

There are two types of powers of attorney recognised in South Africa:

### General power of attorney

A general power of attorney gives the agent broad authority to perform various acts and transactions on the principal's behalf, usually without specific restrictions. This authority commonly encompasses the ability to buy and sell property, carry out banking transactions, and manage general affairs. It is typically utilised when the principal cannot personally handle their affairs due to reasons such as travel, a hectic schedule, or physical limitations.<sup>16</sup> This ensures that the principal's financial matters are taken care of seamlessly in her absence.

### Special Power of Attorney

The special power of attorney details the limits of the agent's powers to specific activities that the principal has identified.<sup>17</sup> In other words the agent will only have the power of attorney in respect of a specific financial transaction which the principal may not be physically able to attend to themselves. After completion of the specified act, the power of attorney is no longer in force.

An example of this is a principal who is selling their property in South Africa who will be outside of the country during the transfer process. This principal will grant a special power of attorney to their agent to attend to the signing of transfer documents and other requirements in their stead. Once the property transfer is registered in the Deeds Office the special power of attorney will no longer be in force as the objective has been fulfilled.

### **The following are specific types of powers of attorney required by different institutions which financial advisers should be aware of:**

Many South African banks and financial institutions do not accept a power of attorney other than the ones drafted by them. This power of attorney drafted by these institutions usually restricts the agent to perform limited acts on the accounts of the account holder, the principal.

The South African Revenue Services (SARS) has four types of powers of attorney forms:<sup>18</sup> Dispute Resolution Power of Attorney Form, Special Power of Attorney (SSPOA), Special Power of Attorney by Tax Practitioner (TPPOA) and Authority on Special Power of Attorney by Tax Practitioner (ASPOA). These are required for the tax affairs of a principal. If the financial adviser would be assisting the principal with specific tax-related work, any of these would be required.

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<sup>16</sup> Cloete et al F107-F108.

<sup>17</sup> Ibid.

<sup>18</sup> South African Revenue Services 'Forms' available at <https://www.sars.gov.za/legal-counsel/tax-administration/forms/> accessed 31 October 2024.

In respect of property transactions, the original signed power of attorney, together with the other relevant transfer documents, must be registered in the Deeds Office, in terms of section 13(2) of the Deeds Registries Act.<sup>19</sup>

## Restrictions and limits

A principal may only delegate powers that they are capable of exercising themselves. The agent cannot act outside of the scope of the power of attorney. In respect of a special power of attorney, the agent is restricted in their delegated authority to only act in terms of the specified duties in the said power of attorney. A principal is not allowed to give power of attorney to a person to sign the principal's will or initiate divorce proceedings on their behalf.<sup>20</sup> A will can be signed by means of a fingerprint with a Commissioner of Oaths certificate if the testator is unable to provide their signature. The power of attorney must describe in detail clearly the scope of the duties being delegated to the agent to avoid any misinterpretation<sup>21</sup>. The below mentioned case provides insight into a dispute regarding the scope of a power of attorney.

In *Van Rheede van Oudtshoorn v Investec Bank Limited*<sup>22</sup> the Supreme Court of Appeal dealt with exceeding the scope of a power of attorney. The court had to decide whether the deed of suretyship executed by Robin Beale & Associates Ltd on behalf of the appellant, Mr van Oudtshoorn, was binding upon him in terms of the scope of the power of attorney. Ms Claire Dillon, of the firm of Robin Beale & Associates Ltd ('RBA'), a firm of tax advisers, assembled the scheme<sup>23</sup>. The court held that:

According to the appellant, Ms Dillon's authority in terms of the power of attorney was limited to authorising her to borrow money on his behalf. The submission fell short when consideration was given to the terms of the power of attorney as a whole. Having regard to those terms, the court concluded that Ms Dillon was authorised to execute the deed of suretyship on behalf of the appellant. The next issue was whether in executing the deed of suretyship, Ms Dillon exceeded her authority by binding the appellant to pay an amount above the maximum amount that he could be called upon to contribute to the partnership. The court found that the appellant's submission on this score was flawed, in that on a proper reading of the power of attorney, it was evident that whilst the capital amount of any loan was limited to the capital contribution to the partnership, the actual financial commitment was considerably greater. Therefore, the authority given to RBA under the power of attorney to execute a suretyship on behalf of the appellant was not restricted to the capital contribution to the partnership.<sup>24</sup>

In the writer's opinion this case illustrates the need for clear explicit instructions to be included in a power of attorney which details the powers and scope thereof for the agent. In order to avoid misinterpretation and potential abuse of a power of attorney, it should be carefully

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<sup>19</sup> 47 of 1937.

<sup>20</sup> Louis Schoeman 'Power of attorney – A useful guide for South Africans' available at <https://sashares.co.za/power-of-attorney/#gs.gvvej9> accessed 31 October 2024.

<sup>21</sup> Tekana, X, 'Power of Attorney: Background, Requirements, and Termination'.

<sup>22</sup> *Van Rheede van Oudtshoorn v Investec Bank Limited* [2012] JOL 29297 (SCA) paragraph 28

<sup>23</sup> *Van Rheede van Oudtshoorn v Investec Bank Limited* [2012] JOL 29297 (SCA) paragraph 2

<sup>24</sup> *Van Rheede van Oudtshoorn v Investec Bank Limited* [2012] JOL 29297 (SCA) paragraph 28

drawn and strictly interpreted. Where it is meant to authorise a specific financial transaction it should detail the nature of the transaction, as well as the outcome expected.

### **Duration of POA**

A power of attorney which is older than two years may not be accepted by some financial institutions due to the potential risk of abuse by the agent. Business in the financial services industry is highly sensitive by nature with life-changing consequences. An institution which does not accept an older power of attorney may call on the principal to confirm if they are aware of the power of attorney and whether they still authorise it. It is important for a power of attorney to be reviewed on a yearly basis to decide if it is still required and if it needs to be amended.

### **Use of a power of attorney**

There are various circumstances which could lead to a power of attorney becoming necessary for clients to have for example a person may be out of the country for a while or facing health challenges that render them incapable of signing documents, handling their finances, or taking legal action. In the writer's experience a client required a power of attorney to be granted in favour of his wife as he was to undergo a surgery which could potentially render him unable to use his hand if there were surgical complications. The power of attorney proved to be useful for the period during which he was unable to use his hand. It must be kept in mind that the client must always be of sound mind and have the capacity to act for the power of attorney to remain valid.

### **Lapsing and termination of a power of attorney**

The mental capacity of the principal is of utmost importance to the validity of the power of attorney. If the principal becomes mentally incapacitated the validity of the power of attorney lapses. There are various circumstances in which a principal could find themselves in this situation such as mental illness, dementia, Alzheimer's disease or surviving a stroke to name a few. One may think that in the abovementioned circumstances the power of attorney is most needed as the principal can no longer make decisions for themselves, however, it is those very circumstances of losing their mental capacity which invalidate the power of attorney.<sup>25</sup> The agent can only act in terms of the same capacity as the principal currently has.

### **The enduring power of attorney**

An enduring power of attorney (EPOA) is a legal document that allows someone to make decisions on the principal's behalf if they become unable to do so due to incapacity. It

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<sup>25</sup> Ashertons Attorneys 'Dementia and Incapacity: What is a Power of Attorney and is it Forever?' available at <https://www.southafricanlawyer.co.za/article/2019/10/dementia-and-incapacity-what-is-a-power-of-attorney-and-is-it-forever/> accessed on 31 October 2024.

remains effective even if the principal loses the ability to manage their own affairs. Unlike some countries, South African law does not recognise enduring powers of attorney. This current position has been strongly criticised by disability activists. In 2004 a detailed report by the South African Law Commission titled "Assisted Decision Making: Adults with Impaired Decision-Making Capacity" recommended legislation for an enduring power of attorney to be introduced into our law both in respect of an individual's person and estate. Draft legislation was submitted to the Minister of Justice in September 2016. An enduring power of attorney would allow for a power of attorney to continue to be valid after a person loses their mental capacity to act. The writer's view is that an enduring power of attorney would be extremely beneficial and practical for families dealing with a principal who develops mental incapacity as they would be able to continue acting on the instructions of the principal whilst avoiding the high costs and lengthy legal process involved with the appointment of a curator.

### **Legal processes available to assist with mental incapacity in South Africa**

Currently, the options available to those assisting people with mental incapacity are the following:<sup>26</sup>

#### **Curator**

Firstly, there is the option to apply for a curator bonis in terms of Rule 57 of the Uniform Rules of the High Court in respect of mentally ill or mentally deficient persons; persons, who owing to physical infirmity cannot manage their own affairs; and persons declared prodigals. This is a lengthy and costly process which potentially adds to an already stressful situation for the parties involved.

#### **Administration**

The second option is to apply for the appointment of an administrator in terms of the Mental Health Care Act.<sup>27</sup> This option was introduced when the Mental Health Care Act came into operation on 15 December 2014. The Act provides for the appointment of an administrator to care for and administer the property of a person who is mentally ill or a person with severe or profound intellectual disability. Since this process is initiated directly with the Master it is a more cost-effective and time-efficient option than the common law application to the High Court. It must be noted that this option is only available under very specific circumstances for smaller estates, assets up to R200,000 and annual income up to R24 000, so this is not a viable solution for most people.<sup>28</sup> This once again highlights the gap in the South African healthcare system as there needs to be a solution for the administration of a mentally incapacitated individual beyond that low threshold.

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<sup>26</sup> Anél Strampe 'Legal Position of Mentally Incapacitated persons – A Need for Law Reform' *Premiums and Problems* ed 120.

<sup>27</sup> 17 of 2002.

<sup>28</sup> *Ibid.*

## Special trust

A further option is to establish a special trust for the benefit and care of the principal while they still have capacity to act. If a trust is created during the client's lifetime and they then become afflicted by mental health conditions, their financial affairs would continue as before, by the trustees of the trust. Therefore, the appointment of trustees should be carefully considered in anticipation of these potential circumstances.<sup>29</sup> The Trustees will act within their duties as detailed in the Trust. This provides a solution to the difficulties and limitations of a power of attorney as well as avoiding the tedious process of curatorship.<sup>30</sup> The Income Tax Act defines a special trust Type A as: "a trust created solely for the benefit of a person(s) with a "disability" as defined in section 6B(1), where the disability makes it impossible for the person(s) from earning enough money for their care or from managing their own financial matters". Section 6B(1) defines a disability as: "a moderate to severe limitation of a person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment. The disability must be diagnosed by a duly registered medical practitioner, and that disability must have lasted or has a prognosis of lasting more than one year."

## Revocation of a power of attorney

- ❑ The principal is allowed to unilaterally revoke a power of attorney at any time thereby terminating the power of attorney.<sup>31</sup>
- ❑ Unless the principal indicated a specific time frame for the validity of the power of attorney in the document, a power of attorney normally terminates in the following circumstances:
  - ❑ In the case of the principal becoming insolvent and their estate being sequestrated; or
  - ❑ in the event of the principal becoming mentally impaired, no longer able to manage their affairs, and make their own decisions;<sup>32</sup> or
  - ❑ due to the death of the principal;<sup>33</sup>
  - ❑ in the circumstances of either party being an entity, the closure or dissolution of the said entity will terminate any authority delegated in the power of attorney.
- ❑ Although not required, it is best practice to have a clear detailed written document for the termination or revocation of the power of attorney which is dated and signed by the principal.

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<sup>29</sup> Phia van der Spuy 'Trustee, be mindful of your mental capacity' available at <https://trusteeze.co.za/article/trustee-be-mindful-of-your-mental-capacity> accessed on 31 October 2024.

<sup>30</sup> Anél Strampe 'Legal Position of Mentally Incapacitated persons – A Need for Law Reform' *Premiums and Problems* ed 120.

<sup>31</sup> Burger Huyser Attorneys 'Who Can Override A Power Of Attorney?' available at <https://www.burgerhuyserattorneys.co.za/who-can-override-a-power-of-attorney/> accessed on 31 October 2024.

<sup>32</sup> Ashertons Attorneys 'Dementia and Incapacity: What is a Power of Attorney and is it Forever?' *supra*.

<sup>33</sup> Tekana, X, 'Power of Attorney: Background, Requirements, and Termination' *supra*.

## Conclusion

Clients must fully understand the implications of establishing a power of attorney, as this legally binding document grants significant authority to the agent. It is beneficial for clients to be guided on their rights, the scope of the power of attorney and its restrictions. Choosing a trustworthy and capable agent should be an informed decision. In this regard, the financial adviser will be able to assist the client while following section 8 of the FAIS General Code of Conduct ("the FAIS GCC"),<sup>34</sup> which requires Financial Service Providers to provide suitable advice by considering the client's circumstances and the risks involved. This section mandates that providers must:<sup>35</sup>

- Conduct a thorough analysis of the client's financial situation.
- Identify and explain the risks associated with any decisions.
- Ensure that clients understand the implications of their financial decisions

Financial advisers would benefit from being aware of the benefits and uses of a power of attorney as well as the limits thereof. A power of attorney should not be seen as a silver bullet for all difficult situations the client may be in. Proper understanding of a power of attorney allows the adviser to advise the client if they require a power of attorney and more importantly what type is best suited to their specific circumstances. A financial adviser should also advise the client to consult with an attorney in respect of the drafting of the power of attorney. A principal who holds a position of authority and responsibility should understand and appreciate the gravity of their position before making an informed decision in respect of granting an agent a power of attorney. Equally, the agent needs to act with integrity and care in fulfilling their duties in terms of the power of attorney always prioritizing the principal's best interest.

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<sup>34</sup> General Code of Conduct for Authorised Financial Services Providers and Representatives BN80/2003.

<sup>35</sup> Ibid at section 8.

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Uniform Rules of the High Court



# Section 63 of the Long-Term Insurance Act Protection of Policy Benefits

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## Introduction

When someone becomes insolvent, the Insolvency Act<sup>1</sup> casts a wide net regarding what constitutes property of the insolvent. This includes moveable or immovable property, wherever situated within the Republic of South Africa. Movable property is all property owned by the insolvent person and every right or interest they hold in property that is not immovable property.<sup>2</sup> The purpose of this article is to discuss the effects that insolvency will have on a life insurance policy when it pays out. Questions that need to be answered include the impact a beneficiary nomination on a life policy has on a deceased insolvent's estate and the rights of creditors and trustees of a deceased insolvent estate against the individuals who receive these benefits.

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<sup>1</sup> Act 24 of 1936

<sup>2</sup> Insolvency Act, Section 2

A life insurance policy on the life of a person is considered a deemed asset in that person's estate when they pass away, and the life insurance policy becomes payable.<sup>3</sup> The definition of property contained in section 2 of the Insolvency Act reads as follows: "Property means movable or immovable property wherever situated within the Republic and includes contingent interest in property other than the contingent interest of a fidei commissary heir or legatee".<sup>4</sup> This definition is wide enough to include a life policy on the life of the insolvent, and a life policy that the insolvent might own on the life of a third party. The property of the insolvent person vests in the trustees of the insolvent estate.<sup>5</sup> There are, however, certain exceptions to this. In terms of section 63 of the Long-Term Insurance Act,<sup>6</sup> the proceeds of certain insurance policies and the assets acquired with these proceeds are protected in the event of a person's insolvency.

### Section 63 of Long-Term Insurance Act

The main purpose of section 63 is to protect the proceeds of life and other insurance policies that are payable to the insolvent policyholder from forming part of their insolvent estate. Section 63 applies to the following long-term insurance policies: assistance, life, disability and health policies.<sup>7</sup> This protection applies to the policy benefits provided to a person, where that person or their spouse is the life insured.<sup>8</sup> Interestingly, the term "spouse" is not defined in the Long-Term Insurance Act<sup>9</sup> but there are some views that it includes persons married by customary marriages, Islamic rites as well as same-sex unions.<sup>10</sup>

The protection also applies to assets acquired exclusively with these policy benefits.<sup>11</sup> For the protection of section 63 to be applicable, the policy must have been in force for at least three years,<sup>12</sup> and the assets must have been purchased with the protected policy benefits. The protection of the assets bought with the policy proceeds is limited to a period of five years after the date that the policy benefits were provided.<sup>13</sup> It is important to note that the protection under section 63(1)(a) and (b) will not apply if it can be shown that the policy in question was taken out with the intention to defraud creditors.<sup>14</sup>

Section 63 is only applicable to policy benefits that are provided to a person who is the life insured on a policy or whose spouse is the life insured.<sup>15</sup> This was confirmed in the case of *Majiedt NO and Steynberg NO v Prinsloo*.<sup>16</sup> Section 63(1)(b) and section 63(3)(a) also provide for the protection of the policy benefits if the insured person is survived by a spouse, child,

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<sup>3</sup> Section 3(3)(a) of the Estate Duty Act 45 of 1955

<sup>4</sup> Act 24 of 1936, Section 2

<sup>5</sup> Insolvency Act, Section 20(1)(a)

<sup>6</sup> Act 52 of 1998

<sup>7</sup> Long-Term Insurance Act, Section 63(1) read with Section 1

<sup>8</sup> Insolvency Act, Section 63(1) read with Section 1

<sup>9</sup> Act 52 of 1998

<sup>10</sup> Alastair Smith: "The protection of Insurance Policies from Insolvency under Section 63 of the Long-Term Insurance Act 52 of 1998 (2000) 12 Merc LJ at para 4

<sup>11</sup> Long-Term Insurance Act, Section 63(1)

<sup>12</sup> Long-Term Insurance Act, Section 63(2)

<sup>13</sup> Long-Term Insurance Act, Section 63(2) read with Section 63(1)

<sup>14</sup> Long-Term Insurance Act, Section 63(4)

<sup>15</sup> Meskin's Insolvency Law, 2024, Chapter 5.3.2.1

<sup>16</sup> (641/2021) High Court Free State Division at 49

stepchild or parent. The policy benefits that devolve upon them will also not be available for the payment of the insolvent's debts.

### **The effect of a beneficiary nomination on a policy on the protection of Section 63**

Section 63 applies to policy benefits "provided or to be provided" to a person while they are alive and to certain close family members of that person upon their death. Section 63(3)(a) further stipulates that the policy benefits must "devolve" upon such persons as referred to in subsection 1.<sup>17</sup> The question is whether benefits payable in terms of a beneficiary nomination to the persons mentioned in section 63(3)(a), "devolve" upon them.

In *Meskin's Insolvency Law*<sup>18</sup> it is argued that for a benefit to devolve upon such persons, it must fall in the estate as property of the deceased, and they must receive it as beneficiaries or heirs from the deceased estate. It is further argued in *Meskin* that when benefits are paid to those persons by the insurer as beneficiaries on the policy, section 63 is not applicable, as the benefits are then not "provided or to be provided to the deceased protected person from the estate". Instead, the benefit is paid by the insurer directly to the person on acceptance of the benefit. Thus, the benefit does not fall into the deceased estate unless the beneficiary declines it. For a benefit to devolve upon someone, the benefit must first go the estate and then from there go to the person in terms of the deceased's will. A beneficiary nominated on the policy will receive the benefit directly from the insurer and not through the estate of the deceased.

In the case of *Naidoo v Discovery Life*<sup>19</sup> the court found that with a pure risk policy, payment of the proceeds only occurs upon the death of the insured life. Therefore, the policy proceeds can never be paid to the policyholder or the beneficiary during the lifetime of the insured life. Although the policyholder has certain contractual rights during their lifetime, such as the right to nominate or change beneficiaries or to terminate the policy, the policy itself is not an asset in the estate of the policyholder. The policy proceeds will go directly to the nominated beneficiary upon the death of the life assured and acceptance of the benefit by the beneficiary. The court confirmed the view of the Supreme Court of Appeal in the case of *Pieterse v Shrosbee and Others*.<sup>20</sup>

From the above, it can be argued that for the protection under section 63 to be applicable, the policy benefits must flow directly from the estate of the protected person to the persons mentioned in section 63(3)(a) as mentioned in the example above. If the policy benefits are paid to any such person as a nominated beneficiary on the policy after the death of the protected person, these policy benefits will not be protected by the provisions of section 63.

Mabe Z and Mbiriri E summarise the position as follows in their article "The Payout of a Life Insurance Policy into Unrehabilitated Insolvent's Estate: *Malcom Wentzel v Discovery Life Limited: In Re Botha v Wentzel* (1001/19) [2020] ZASCA 121:<sup>21</sup>

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<sup>17</sup> Section 63(10) of Act 52 of 1998

<sup>18</sup> 2024, Chapter 5.3.2.1

<sup>19</sup> (202/2017) ZASCA 88 at (10) and (11)

<sup>20</sup> 2005(1)SA 309 (SCA)

<sup>21</sup> PER/PELJ 2022(25) - DOI

*“Section 63 protects the proceeds of life and other insurance policy benefits that are payable to the insolvent policyholder from forming part of his insolvent estate. It also protects the assets acquired exclusively from the proceeds of those policy benefits for five years from the date on which the policy benefits was provided. The protection is applicable to life and other insurance policies where the insolvent or his spouse is the life insured, and the policy has been in existence for at least three years. Section 63 does not mention the marital regime of the insolvent beneficiaries. However, the protection applies only where the insolvent is the beneficiary of the insurance policy and does not apply where the beneficiary is a third party. Where the owner of the policy nominated him or herself as a beneficiary, all the policy proceeds will pay to him or her directly, to the exclusion of the creditors”*

Does this then mean that the trustees or creditors of an insolvent person/estate can lay claim to the benefits paid to a third party as a nominated beneficiary because section 63 does not provide protection?

In *Meskin's Insolvency Law*<sup>22</sup> it is argued that the policy proceeds do not suddenly become the property of the deceased simply because section 63 is not applicable. Section 20(2) of the Insolvency Act states that the property of the insolvent shall include all property on the date of sequestration,<sup>23</sup> as well as all property which may accrue to the insolvent during sequestration.<sup>24</sup> The term “property” is also defined in section 2 of the Insolvency Act as movable or immovable property situated within the Republic and includes contingent interests in property.

To address this question, it is important to discuss the two scenarios. The first is where the deceased was insolvent before their death and the second scenario is where the deceased's estate only became insolvent after their death.

### **When a person is declared insolvent while still alive and prior to their death.**

During the life of a person who has been declared insolvent i.e. their assets have exceeded their liabilities, and they are not able to pay of their debts, any policy proceeds that pay out directly to them will be protected in terms of section 63(1)(b)(i). If the policy has been in force for at least three years, the policy proceeds and assets acquired with these proceeds will not be liable for attachment for a period of five years. An exception to this is where a debt is secured by the policy.<sup>25</sup>

If the insolvent dies before they are rehabilitated, section 63(1)(b)(ii) applies to policy proceeds payable due to the death of the insolvent. If the insolvent is survived by a spouse, child, stepchild, or parent the policy proceeds are not available for purpose of the payment of their debts. However, the policy proceeds will only be protected if they devolve upon the spouse, child, stepchild, or parent of the insolvent, as discussed above.<sup>26</sup>

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<sup>22</sup> 2024, Chapter 5.3.2.1

<sup>23</sup> Section 20(2)(a)

<sup>24</sup> Section 20(2)(b)

<sup>25</sup> Section 63(1)(b)

<sup>26</sup> Long-Term Insurance Act 52 of 1998 - Section 63(3)(a)

What happens when policy proceeds are paid out to a third party who is not the spouse, child, stepchild, or parent of the insolvent?

To answer this question, it is important to understand the role of a trustee of an insolvent person. During their lifetime, the policy owner has the right to manage the policy, including the right to surrender the policy or appoint or change a beneficiary. This right vests and forms part of their estate. Therefore, if an insolvent owns a policy on their life and is subsequently sequestrated, they will no longer have the right to manage the policy, as these rights now vest in the trustees.<sup>27</sup>

This means that the trustees will have the right to change or cancel the beneficiary nomination on the policy or to surrender the policy. If the trustees remove the beneficiary nomination, the payout will then form part of the insolvent estate. However, if the trustees do not cancel the beneficiary nomination or remove the third-party beneficiary, the proceeds of the policy will be paid to the nominated third-party beneficiary upon their acceptance of the benefits and will not vest in the insolvent estate. Consequently, creditors of the insolvent will not be able to claim the proceeds of the policy. This was confirmed in *Warricker and Another NNO v Liberty Life*.<sup>28</sup> If the insolvent receives the benefit, it will be excluded from the insolvent estate. In the cases of *Pieterse v Shrosbee and Others*, *Shrosbee NO v Love & Others*<sup>29</sup> the Court confirmed that a beneficiary nomination, until revoked, will pay to the nominated beneficiary and not the estate of the deceased.

## Insolvency after death

What happens if a person's estate becomes insolvent after death, i.e. the estate liabilities exceed the assets in the estate? The purpose of section 63(1)(b)<sup>30</sup> is to protect an insolvent person's policy benefits after death. However, due to a difference in the wording of subsection 63(1)(b)(i) compared to subsection 63(1)(b)(ii), the issue of an estate becoming insolvent after death is not specifically addressed. Section 63(1)(b)(i) refers to policy benefits not being able to be attached or subjected to execution during the lifetime of the insolvent while section 63(1)(b)(ii) refers to policy benefits being excluded upon the death of the insolvent when survived by a spouse, child, stepchild, or parent. It does not refer to policy benefits being excluded from the insolvent estate when it becomes insolvent after death.<sup>31</sup> Therefore, it seems that the protection of section 63 does not extend to policy benefits payable to and estate of a deceased policyholder who is declared insolvent after death.

When the executor of a deceased estate determines that the estate is insolvent, the estate must then be dealt with per the provisions of section 34 of the Administration of Estates Act<sup>32</sup> or the Insolvency Act. This could be in terms of the provisions of section 34(1),<sup>33</sup> where the estate is surrendered by the executor upon the directions of the creditors, or section 34(13),<sup>34</sup>

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<sup>27</sup> Meskin's Insolvency Law, 2024, Chapter 5.3.2.1 A

<sup>28</sup> 2003(6) SA 272 (W)

<sup>29</sup> 2005(1) SA 309 (SCA) at para 10

<sup>30</sup> Act 52 of 1998

<sup>31</sup> Section 63(1)(b)(ii) of Act 52 of 1998

<sup>32</sup> Act 66 of 1965

<sup>33</sup> Act 66 of 1965

<sup>34</sup> Act 66 of 1965

where the estate is sequestrated at the instance of the creditors. In such cases, all of the deceased's assets and policy benefits fall in the deceased's estate and must be administered by the executor or the trustee, whatever the case may be.<sup>35</sup> The difference is that, with ordinary insolvency, the protected portion of the policy falls outside the insolvent estate, but in the case of an insolvent estate, the policy proceeds fall into the insolvent estate and must be dealt with the executor or trustee, who must deal with the protected portion separately.<sup>36</sup>

For the protection of section 63 to apply, the protected policy proceeds must go to the surviving spouse, child, stepchild, or parent of the deceased. If the policy proceeds are bequeathed to someone else, the protection of section 63 is not available and the policy proceeds will be available for the payment of claims by the creditors of the estate.<sup>37</sup> Where the protected policy pays out directly to a surviving spouse, as a beneficiary, the policy will not be dealt with by the executor and will therefore be excluded from the insolvent estate.<sup>38</sup> The reason for this is because the beneficiary nomination is seen as a contract for the benefit of a third party. This concept is known in our law as a stipulation alteri: The policy owner contracts with the insurance company to pay the policy benefits to the beneficiary on the death of the life assured. The beneficiary can enforce the payment of the benefits once it becomes payable, and the beneficiary has accepted the benefits.

This view was also followed in the case of *Shrosbree v Van Rooyen*<sup>39</sup> where the court held that the insolvency law is a debt-collecting mechanism, and that section 63(1)(b) is wide enough to also cover the possibilities listed in section 63(1)(a). Mabe Z and Mbiriri E also hold the opinion that the proceeds of life insurance policy benefits do not form part of an insolvent estate, regardless of whether the deceased's estate was sequestrated.<sup>40</sup> The learned authors, with many others, believe that the court erred in its finding, based on section 20 of the Insolvency Act, that where policy proceeds pay out to an unrehabilitated insolvent spouse, it is included in the insolvent estate of that unrehabilitated spouse. They argue that section 63 of the Long-Term Insurance Act should apply and that the policy proceeds must be exempt from the insolvent estate. This view is also confirmed in *Meskin's Insolvency Law*.<sup>41</sup>

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<sup>35</sup> Meskin's Insolvency Law, 2024, Chapter 5.3.2.1 B

<sup>36</sup> Meyerowitz on Administration of Estates, 2023 Edition, paragraph 17.10.

<sup>37</sup> Meyerowitz on Administration of Estates, 2023 Edition, paragraph 17.10

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<sup>39</sup> 2004 1 SA 226 (SE) 231

<sup>40</sup> PER/PELJ 2022(25) – DOI, page 17

<sup>41</sup> 2024, Chapter 5.3.2.1 B

## Conclusion

In conclusion, it is clear from the above that life policy proceeds payable to a surviving spouse, child, stepchild, or parents of an unrehabilitated insolvent at the death of that person, will be excluded from the insolvent estate of the deceased life assured. This is the case whether the policy proceeds are bequeathed to them or whether they are received through a beneficiary nomination. If the proceeds are distributed to them by way of the insolvent's will, the proceeds will be protected under section 63 of the Long-Term Insurance Act. If the proceeds are distributed to them by way of a beneficiary nomination, it will also be protected because the beneficiary nomination is considered a *stipulatio alteri*, and the rights to the proceeds of the policy only vest after death. The trustees do not have any rights to claim the policy proceeds after death if there are nominated beneficiaries who accept the benefits.

If the policy proceeds are bequeathed in a will to someone other than the persons mentioned in section 63(1)(b)(ii), the proceeds will not be protected and will form part of the insolvent estate. If the proceeds are paid to any other person through a beneficiary nomination on the policy, the same *stipulatio alteri* principle applies as discussed above.

Where the policy proceeds are paid to an estate that becomes insolvent after the death of the policyholder, it is submitted that policy benefits paid to the spouse, child, stepchild, or parent of deceased policyholder via the estate should be protected under section 63. If the policy proceeds are paid directly to them via beneficiary nominations, the policy proceeds will also not form part of the insolvent deceased estate due to the *Stipulatio Alteri* concept as discussed above. However, if the policy proceeds are bequeathed to any other third party in the will of the deceased, it will form part of the insolvent estate of the deceased. If the proceeds are paid to any other third party in terms of a beneficiary nomination, it will not form part of the insolvent estate of the deceased due to the same *Stipulatio Alteri* principle.

It is important for financial planners to familiarise themselves with the provisions of section 63 and the protection that it provides on life policies that pay to insolvent policyholders and or their beneficiaries.

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# Managing Firearms in a Deceased Estate: A Guide for Financial Planners

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## Introduction

Financial planners can play a crucial role in guiding clients through the complexities of estate planning and administration. Estate planning often involves various types of assets, but one asset that requires special attention in South Africa is firearms. Mismanagement of firearms in a deceased estate can lead to severe legal consequences, making it essential for financial planners and executors to understand the legal framework set by the Firearms Control Act,<sup>1</sup> hereinafter referred to as FCA.

The FCA outlines specific regulations regarding the transfer, storage, and disposal of firearms in such cases. It defines a firearm broadly to include any device capable of discharging a bullet or projectile through a barrel or cylinder by means of burning propellant, with a muzzle energy exceeding 8 joules (6 ft-lbs). This includes both commercially manufactured and handmade firearms. Therefore, if you possess a handmade gun, it must be licensed and registered according to the same regulations that apply to any other firearm. This includes passing a competency test, obtaining the appropriate firearm license, and ensuring proper storage and handling.

This article offers a comprehensive overview to assist financial planners in effectively advising their clients on firearms management within estate planning.

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<sup>1</sup> 60 of 2000.

## Immediate procedure to follow regarding inherited firearms

When a firearm owner passes away, the person who inherits the firearm is required to apply for an appropriate licence, permit or authorisation if they intend to keep it,<sup>2</sup> or dispose of it in terms of the Act if they don't want to keep it.<sup>3</sup> They might be required to apply for and be issued a temporary licence, issued under section 21, to allow for a reasonable time to dispose of it.<sup>4</sup>

Executors of deceased estates must comply with both estate administration laws and the regulations set out by the FCA, including the prescribed storage and disposal of any firearms licensed to the deceased.<sup>5</sup> Appointing an executor can be a lengthy and time-consuming process due to various factors, including the approval requirements of the Master of the High Court, who must formally appoint the executor. The executor's primary responsibility is to safeguard the assets of the estate, which include firearms until they are lawfully transferred or disposed of.

## Temporary firearm possession before executor appointment

Before the appointment of an executor, an heir, next of kin or close relative of the deceased, who has proper storage facilities for firearms may, in terms of section 21 of the FCA, be granted a permit to possess the firearms of the deceased. If no proper storage facilities are available, the firearms must be stored with a licensed firearms dealer until licences are obtained. Storage costs will be for the estate account. One common misconception is that licensed firearms can automatically be passed on to heirs without additional paperwork. Inheriting a firearm involves specific legal requirements, which requires attention from the heir:

- Apply for a license: If the heir wishes to keep the firearm, they must apply for the appropriate license, permit, or authorization.<sup>6</sup>
- Obtain a competency certificate: For a muzzle-loading firearm, the heir must obtain the necessary competency certificate.<sup>7</sup>
- Deactivate or dispose: If the heir does not wish to acquire the firearm or fails to obtain the necessary license or competency certificate, the firearm must be deactivated or disposed of in compliance with the FCA.<sup>8</sup>

## Application for temporary possession

Heirs can apply for temporary possession of the inherited firearm by completing a SAPS518 form (Application for a Temporary Authorisation to Possess a Firearm), which must be submitted to the designated firearms officer in the area to request to legally possess a firearm

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<sup>2</sup> Section 148(1)(a).

<sup>3</sup> Section 148(1)(b).

<sup>4</sup> Section 148(2).

<sup>5</sup> Section 147(1) and (2).

<sup>6</sup> Section 148(1)(a).

<sup>7</sup> Section 148(1)(b).

<sup>8</sup> Section 148(1)(c).

for a specified period.<sup>9</sup> The completed application must be handed to the relevant designated firearms officer in the area where the applicant resides. The temporary permit must be valid at least until the letter of executorship has been issued and the executor has been appointed, after which the executor will take ownership of the firearm.

If the objective is solely legal storage of the firearm, it is recommended that a person with the necessary competency and licenses for other firearms apply for a storage permit in terms of Regulation 86(4) by completing a SAPS 539 form at their local police station. The application form should be accompanied by a copy of the applicant's ID, proof of address and their SAPS-issued competency certificate. Documents required from the estate include the executor's ID, letter of appointment, the deceased's ID, death certificate and copies of the licenses for the firearms to be stored.

### **Legal responsibilities of executors regarding firearms<sup>10</sup>**

After being appointed, the executor must be given full particulars of the deceased's firearms and ammunition to draw up an inventory.<sup>11</sup> The executor must also be given full particulars of the person who has the deceased's firearms and ammunition in safekeeping with a copy of the permit if such a permit was issued. The executor must take the necessary steps to ensure the firearms and ammunition are safely stored in a safe or strongroom that conforms to the prescripts of SABS Standard 953-1 and 953-2, unless other specifically provided in the Regulations.<sup>12</sup>

Regulation 103<sup>13</sup> requires the executor to deliver a letter or document to the Registrar of Firearms (a position held by the National Commissioner of the South African Police Service)<sup>14</sup> which must contain the following details:

- The full name, identity number and address of the deceased, who is the holder of the licence, permit or authorisation
- The address where the firearms and ammunition are stored
- A copy of the inventory of the firearms and ammunition
- A copy of the letter of appointment as executor, administrator, trustee or curator
- A copy of the death notice of the deceased holder of the licence, permit or authorisation
- The full names, identity numbers and addresses of all the beneficiaries, if the firearms and ammunition devolved by testamentary or intestate succession.

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<sup>9</sup> The form is issued in terms of section 21 of the FCA.

<sup>10</sup> The information provided serves as a basic guideline for what an executor should do in line with the provisions of the Act. However, inconsistencies may arise in practice. It is recommended that if firearms are present in the estate, the executor consult with a firearms expert to navigate these complexities effectively.

<sup>11</sup> Regulation 103(3)(a) of the Firearm Control Regulations (Hereinafter "Regulation"). This duty is also applicable to an appointed administrator, trustee, curator or liquidator of the estate.

<sup>12</sup> Regulation 86(1).

<sup>13</sup> Regulation 103(3)(b).

<sup>14</sup> Section 123.

The executor may hold the firearms in safekeeping under the authority of a permit ammunition devolved by testamentary issued in terms of section 21 of the FCA.<sup>15</sup> If the heir of the deceased estate is a holder of a valid firearm license, they may apply for authorisation or a permit to be issued<sup>16</sup> under the FCA to hold the firearms and ammunition in safekeeping. The executor must issue a letter of consent allowing the heir to store the firearm temporarily.<sup>17</sup> This letter will only be issued to the relevant heir once the executor is satisfied that the firearms and ammunition are safely stored as prescribed by Regulation 86. A copy of the letter of consent needs to be lodged with the designated firearms officer in the area where the heir resides with a request for the officer to visit the person or heir who has been permitted to keep the firearms and ammunition in safe storage, to ensure that all the legalities and requirements are being complied with.<sup>18</sup>

The letter of consent must specify the following:<sup>19</sup>

- The reason for safekeeping
- How long the person concerned may hold the firearms in safe storage
- The name, identity number and physical address of the deceased license holder
- Adequate details and particulars to enable identification of the license, permit of authorisation and the firearm.
- The name, identity number and physical address of the person to whom permission has been given to hold the firearm in safe storage.
- It is important to take note of the fact that the letter of consent grants permission only for storage, not for use.<sup>20</sup> The Registrar of Firearms must be provided with the following information by the executor within 14 days of receipt of notification of appointment as executor:<sup>21</sup>
- Name and physical address of the deceased
- Inventory of all firearms and ammunition as referred to above
- A copy of the letters of executorship
- Address at which the firearms are stored
- Copy of the executor's letter of permission to the heir for storage
- Copy of the death certificate
- Names, addresses and ID numbers of all beneficiaries if the firearms and ammunition must be transferred as per testamentary disposition or law of intestate succession.

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<sup>15</sup> Section 21(5)(a) and (b).

<sup>16</sup> SAPS 239 form.

<sup>17</sup> Regulation 103(2)(b).

<sup>18</sup> Regulation 103(2)(c).

<sup>19</sup> Regulation 86(4)(c).

<sup>20</sup> South African Police Service FAQ: Safe storage of firearms and ammunition for estates of insolvent or deceased persons available at [https://www.saps.gov.za/services/flash/firearms/faq\\_estate\\_firearms.php](https://www.saps.gov.za/services/flash/firearms/faq_estate_firearms.php) accessed on 21 November 2024.

<sup>21</sup> Regulation 103(3)(b).

## Complying with Firearms Control Act: Transfer and disposal options

The executor must ensure that firearms are transferred in accordance with the Act, which allows for several options:

- 1) **Transfer to an heir or legatee:** If the heir or legatee to whom the firearm was bequeathed, wishes to keep the firearm, they must apply for an appropriate licence, permit or authorisation in terms of the Act.<sup>22</sup> The licence must align with the type of firearm they wish to inherit (i.e., defence, hunting, etc.). The following is a summary of common firearms and their associated licenses under the Act however, this list is not exhaustive. For a comprehensive understanding of all firearm types and the relevant licenses, individuals should refer to the FCA:
  - **Self-Defence:** Section 13 allows for the licensing of handguns specifically for self-defence purposes. The applicant must demonstrate a genuine need for protection and meet specific competency and background checks.
  - **Hunting:** Licenses issued under section 15 are for firearms intended for hunting. The applicant must provide proof of hunting activities, membership in a hunting organization, or other valid reasons for requiring a firearm for this purpose.
  - **Sport Shooting:** Section 16 permits the licensing of firearms for sport shooting activities. Applicants must be members of a recognized shooting club and provide evidence of participation in competitive shooting events.
  - **Collecting:** Firearms licensed under section 20 are for collectors, allowing ownership of specific historical or significant firearms. Collectors must demonstrate a legitimate interest in firearms as a collection and adhere to storage and display regulations.
- 2) **Sale of firearm:** If no heir or legatee is willing or able to inherit the firearm, the executor may sell the firearm to a licensed dealer or individual subject to the provisions of the Administration of Estates Act 66 of 1965 and the FCA. The purchaser must obtain or possess the relevant license before the firearm can be transferred.<sup>23</sup>
- 3) **Surrender to the South African Police Services (“SAPS”):** If the firearm cannot be transferred or sold, the executor can surrender it to SAPS.<sup>24</sup>

## Legal consequences of non-compliance

Failure to comply with the provisions of the handling of firearms in a deceased estate according to the FCA can result in significant penalties. A person is guilty of an offence if, among others, they contravene or fail to comply with the provisions and directions of the Act, including possessing a firearm without a valid licence, permit or authorisation,<sup>25</sup> could face a fine of up to R100 000 or imprisonment for a period of up to 25 years.<sup>26</sup> Any individual who becomes aware of a firearm or ammunition in unlawful possession and fails to promptly report

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<sup>22</sup> Section 148(1)(a).

<sup>23</sup> Section 31(2) & (3).

<sup>24</sup> Section 147 and 145 read together with the Regulations.

<sup>25</sup> Section 120(1)(a), (b) and (c).

<sup>26</sup> Schedule 4 of the Act.

its location to a police official also commits an offence.<sup>27</sup> The executor must ensure that all actions taken in relation to the firearms are documented and performed in accordance with both the FCA and the Estate Duty Act.<sup>28</sup>

If a person is convicted of a minor firearm-related offence, punishable by a fine or imprisonment of up to five years, the Registrar may issue an infringement notice (also referred to as an “administrative fine”) to the individual in person. This notice will include specific details about the alleged offence.<sup>29</sup>

## Practical examples

### **Example 1: Transferring a firearm to an heir**

*Peter, a licensed firearm owner, passes away, leaving behind a hunting rifle in his estate. His son John, who is 25 years old, is named as the heir to the rifle in Peter's will. John does not currently have a firearm license but wishes to inherit the rifle as he is a keen hunter.*

The executor of the estate must inform the Registrar of Firearms of Peter's death within 14 days and submit the necessary documents, including the death certificate and details of the firearm. Since John is not yet licensed to possess the rifle, the executor has two options: apply for a temporary permit to store the firearm or arrange for a licensed firearms dealer or the police to store it.

John must then apply for a firearm licence, stating that he intends to use the rifle for hunting and sports shooting.<sup>30</sup> In his application, he must meet all requirements for firearm ownership, including demonstrating a valid reason for possession, passing competency tests, and undergoing background checks.

Once John is granted the license, the firearm can legally be transferred to him, and he can take possession of it. The executor will finalise the transfer of ownership with the CFR to ensure all legal records reflect the new owner, John.

As a result, John legally inherits the rifle after obtaining his firearm license and the estate is wound up without any legal violations. In practise, if John does not currently have competency for the specific category of firearm, the application process for competency can take approximately 6–8 months to be approved by SAPS. However, if he already has competency for other categories of firearms and applies for additional competency (specifically for this category of firearm), it may take around 6 months to obtain the additional competency.

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<sup>27</sup> Section 120(2)(a).

<sup>28</sup> 45 of 1955.

<sup>29</sup> Section 122.

<sup>30</sup> Sections 15 and 16.

Unfortunately, the application for competency and the application for a firearm license cannot be submitted simultaneously. The net effect is that he will need to wait for the competency to be approved before he can apply for his license. The total process can therefore take approximately 14 months. The cost of firearm storage must also be considered. The option to store a firearm with an SAPS539 permit at the premises of a current license holder is thus a better choice.

### **Dual licensing<sup>31</sup>**

If firearms are registered under a parent's name, it is advisable for the spouse to obtain the necessary competency certificate and apply for licenses in their own name. Doing so can significantly simplify the process of firearm storage in the event of the firearm owner's death and reduce the costs associated with administering the deceased estate.

The so-called "dual licenses" play an important role here. (Note: These "dual licenses" refer to additional licenses granted to individuals residing in the same household as the primary license holder, as permitted under Section 12 of the Firearms Control Act. However, this arrangement only applies if both parties meet the legal requirements for competency and licensing.)

With this arrangement, both spouses would legally hold licenses for all the firearms and be permitted to use them. This option eliminates the need for duplicate firearms to be purchased and registered solely under the spouse's name.

Upon the passing of the primary license holder, the surviving license holder retains their valid license. However, any heirs wishing to inherit the firearm must apply for a new license in their name.

### **Example 2: Sale of firearms due to heirs' ineligibility or refusal to accept them**

*Sarah, a registered handgun owner, passes away leaving her handgun as part of her estate. Her children, all majors, are named as heirs but are not interested in owning firearms and do not hold licenses.*

The executor must notify the Registrar of Sarah's death and arrange for the firearm to be stored by a licensed firearms dealer until the estate is wound up. Since none of Sarah's children wish to inherit the handgun, the executor must arrange for its sale. He must find a buyer who is a licensed firearm holder. The buyer must apply for a separate licence for this newly acquired firearm.<sup>32</sup> The buyer cannot take possession of the firearm until the transfer is completed and a valid license<sup>33</sup> is issued. Once the licence is approved, the handgun is transferred to the buyer, and the proceeds of the sale are paid into the deceased estate. These funds are then distributed according to Sarah's will.

Through this process, the firearm is lawfully sold and is kept out of unlicensed hands.

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<sup>31</sup> Section 12.

<sup>32</sup> Section 11.

<sup>33</sup> Section 3(1)(a).

### **Example 3: Surrendering firearms to the police for destruction**

*David, a retired security officer, passes away leaving behind two firearms—a revolver and a shotgun. The executor establishes that none of the beneficiaries in David's will are interested in acquiring the firearms and they do not want them to be sold.*

The executor must still notify the Registrar of Firearms of David's death within 14 days, as required under the FCA. The executor has the option to temporarily store the firearms with the SAPS or with a licensed dealer, in accordance with the Act. Alternatively, the executor may surrender the firearms to the SAPS for destruction.<sup>34</sup> To do so, the executor contacts the SAPS to arrange the surrender of the firearms.<sup>35</sup> The firearms and ammunition, along with any documentation verifying ownership by the deceased estate, should be handed over to the designated police station.

The SAPS will then provide the executor with confirmation that the firearms have been received.<sup>36</sup> The firearms will be safely destroyed, and the estate avoids the potential risks associated with unlicensed ownership or illegal possession. By following these steps, the executor fulfils their legal duty as executor and complies with the provision of the FCA.

### **Example 4: Handling unlicensed firearms discovered during estate administration**

*Donavan passes away and during the winding up of his estate, the executor discovers an unlicensed antique or collectable firearm in his house that was not mentioned in his will. The executor immediately informs the Registrar of Firearms of the discovery of an unlicensed firearm in the estate.*

The SAPS will verify whether the firearm is listed in the Central Firearms Registry and assess whether it can legally be classified as an antique or collectable. Firearms classified as collectables must be licensed under Section 17 of the FCA. If the firearm is not classified as a collectable, the executor, in consultation with the heirs of Donovan's estate, may choose to surrender it to SAPS for destruction. Alternatively, if the firearm qualifies as an antique with significant historical value, the executor can arrange for its preservation through a legal transfer to a museum or public collector, provided this complies with the FCA's licensing and transfer requirements.

By ensuring the unlicensed firearm is handled in accordance with the law, the executor prevents it from being illegally possessed or used, thereby avoiding potential legal consequences for Donovan's estate and heirs.

These case studies illustrate the practical steps and legal procedures required for handling firearms in an estate. Whether firearms are transferred to heirs, sold, surrendered, or destroyed, compliance with the FCA is essential to avoid severe penalties. Executors must act responsibly and follow due process to ensure that firearms are lawfully managed as part of the estate.

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<sup>34</sup> Regulation 94.

<sup>35</sup> Regulation 94(2).

<sup>36</sup> Regulation 94(5).

## Conclusion

Handling firearms within a deceased estate in South Africa requires meticulous attention to both legal and procedural requirements. Executors play a vital role in ensuring compliance with the FCA and other relevant legislation, such as the Administration of Estates Act and Estate Duty Act. From securing the firearms, applying for the necessary permits and notifying the authorities to ensuring lawful transfer or disposal, each step carries significant legal responsibilities.

Financial Planners play a crucial role in assisting clients with the inclusion of firearms in their wills. When firearms are part of an estate, financial planners must ensure that these assets are handled in compliance with the FCA, which requires that firearms are properly licenced and registered. The planner must work closely with legal professionals to ensure that the transfer of firearms, whether through inheritance or sale, adheres to legal requirements. This includes ensuring that the beneficiaries possess the necessary competency certificates and licenses to own firearms. Additionally, the financial planner may advise clients on the proper storage of firearms, possible restrictions, and tax implications of inheriting firearms. Proper planning ensures that the firearms are transferred without legal complications, safeguarding the interests of both the client and beneficiaries.

The consequences of non-compliance are severe, with penalties ranging from hefty fines to lengthy prison terms under section 120 of the Firearms Control Act. Executors, heirs, and financial planners must understand these complexities to avoid potential legal pitfalls.

For this reason, executors are strongly encouraged to seek the guidance of legal professionals and firearms experts. Their specialised knowledge ensures that firearms are lawfully dealt with, protecting both the estate and its beneficiaries from unnecessary risk. Financial planners, in particular, must proactively assist clients in preparing for the transfer of firearms, ensuring that all necessary documentation and licensing requirements are met well in advance.

By handling firearms with diligence and foresight, executors can effectively protect the estate's interests, preserve the value of these assets, and protect all parties from unintended legal consequences. Proper planning and strict adherence to the law ensure that firearms are either seamlessly passed on to the next generation or disposed of appropriately, without compromising the legacy or wishes of the deceased.

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# Spousal Consent Unlocked: A Financial Adviser's Guide to Managing Joint Estates in Community of Property Marriages

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## Introduction

In South Africa, some marriages are concluded under the matrimonial property regime known as "community of property".<sup>1</sup> This marital regime stipulates that spouses married in community of property, share a single joint estate, which includes both assets and liabilities.<sup>2</sup> The legal structure that governs these marriages places considerable importance on mutual consent, particularly when one spouse seeks to manage, dispose of, or bind significant assets of the joint estate. Under South African law, the Matrimonial Property Act 88 of 1984, plays a very important role in regulating spousal consent.<sup>3</sup>

This article delves into the concept of spousal consent, the Matrimonial Property Act, and how it applies in practice, with particular reference to the landmark case *Marais N.O. and Another v Maposa and Others (642/2018) [2020] ZASCA 23*.<sup>4</sup> It is very important for financial advisers to understand these legal principles, as part of their professional mandate often involves guiding clients married in community of property in making important decisions, including those relating to estate planning, business planning, retirement planning, investment planning, and asset management. Moreover, the correct interpretation of spousal consent under the Matrimonial Property Act is vital for advising clients on avoiding legal disputes that could arise in the future if this concept is misunderstood.

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<sup>1</sup> Glossary of the different marital regimes in SA, Moneyweb, 7 March 2023

<sup>2</sup> Botha, M, Rossini, L, Geach, L.W, Goodall, B, du Preez, L & Rabenowitz, P, P.P. 2024. The South African Financial Planning Handbook

<sup>3</sup> Under South African law, the Matrimonial Property Act 88 of 1984, plays a very important role in regulating spousal consent.

<sup>4</sup> *Marais NO and Another v Maposa and Others (642/2018) [2020] ZASCA 23 (25 March 2020)*

## Sections 14 and 15 of the Matrimonial Property Act: Spousal consent

To fully understand the concept of spousal consent, it is necessary to examine the relevant sections of the Matrimonial Property Act. In terms of section 14 of the Matrimonial Property Act, spouses married in community of property have equal rights regarding the disposal of assets, contracting debts and managing the joint estate. Each spouse's estate is merged into one, creating a unified pool of assets and liabilities. Both partners are jointly responsible and liable for decisions that affect this estate.<sup>5</sup>

At the heart of spousal consent is section 15 of the Matrimonial Property Act, which also governs the management of joint estates in marriages in community of property.

*"15(1)- Subject to the provisions of subsections (2), (3) and (7), a spouse in a marriage in community of property may perform any juristic act with regard to the joint estate without the consent of the other spouse."*<sup>6</sup>

From an advice perspective, it is crucial for financial advisers to understand section 15(1) of the Matrimonial Property Act because it directly affects the financial decisions and obligations that a client who is married in community of property may face. Financial advisers must understand that while either spouse can independently perform juristic acts, some exceptions do exist, which are aimed at protecting the non-contracting spouse. Failure to consider these exceptions could lead to significant legal and financial consequences, such as the transactions being declared invalid or exposing the joint estate to unnecessary risk. For financial advisers, understanding these nuances is essential when guiding clients through decisions involving asset management, investments, and liabilities, ensuring that all actions align with legal requirements and the client's long-term financial goals. This awareness helps prevent costly mistakes and legal disputes that could arise from improperly executed transactions, especially in scenarios where spousal consent is mandated but overlooked.

Further attention is brought to section 15(2)<sup>7</sup>

*"Such a spouse shall not without the written consent of the other spouse –*

- a) alienate, mortgage, burden with a servitude or confer any other real right in any immovable property forming part of the joint estate;*
- b) enter into any contract for the alienation, mortgaging, burdening with a servitude or conferring of any other real right in immovable property forming part of the joint estate;*
- c) alienate, cede, or pledge any shares, stock, debentures, debenture bonds, insurance policies mortgage bonds, fixed deposits or any similar assets, or any investment by or on behalf of the other spouse in a financial institution, forming part of the joint estate;*
- d) alienate or pledge any jewellery, coins, stamps, paintings, or any other assets forming part of the joint estate and held mainly as investments;*

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<sup>5</sup> Section 14

<sup>6</sup> Matrimonial Property Act 88 of 1984

<sup>7</sup> section 15 (2) Matrimonial Property Act 88 of 1984

- e) *withdraw money held in the name of the other spouse in any account in a banking institution, a building society, or the Post Office Savings Bank of the Republic of South Africa;*
- f) *enter, as a consumer, into a credit agreement to which the provisions of the National Credit Act, 2005 apply, as 'consumer' and 'credit agreement' are respectively defined in that Act, but this paragraph does not require the written consent of a spouse before incurring each successive charge under a credit facility;*
- g) *as a purchaser enter into a contract as defined in the Alienation of Land Act, 1981 (Act No. 68 of 1981), and to which the provisions of that Act apply;*
- h) *bind himself as surety."*

Thus, Section 15(2) lists several transactions that require the written consent of the other spouse. These include, but are not limited to:

1. Alienating or mortgaging immovable property that forms part of the joint estate.
2. Entering into a contract to sell immovable property.
3. Conferring a servitude on immovable property.
4. Binding oneself as surety for another person.

Since these transactions affect the long-term financial stability of the joint estate, it is considered significant. Written consent is therefore necessary, as it provides clear documentation and ensures that the non-contracting spouse is fully aware of, and agrees to, the potential implications of the transaction.

For financial advisers, understanding the requirements of section 15(2) is critical because these transactions can significantly impact the financial health of the joint estate. When advising clients who are married in community of property, financial advisers must ensure that both spouses are fully informed and compliant with these legal requirements before proceeding with any significant financial commitments. Transactions involving immovable property, servitudes, or acting as a surety have long-term consequences, and the failure to obtain written consent from the other spouse can lead to legal disputes, financial penalties, or the transaction being declared unenforceable. By addressing the need for spousal consent proactively, financial advisers can safeguard the joint estate and maintain the integrity of the financial advice they provide.

Note must also be taken of section 15 (3)<sup>8</sup>

*"A spouse shall not without the consent of the other spouse –*

- a) alienate, pledge, or otherwise burden any furniture or other effects of the common household forming part of the joint estate;*
- b) receive any money due or accruing to that other spouse or the joint estate by way of –*
  - i) remuneration, earnings, bonus, allowance, royalty, pension, or gratuity, by virtue of his profession, trade, business, or services rendered by him;*
  - ii) damages for loss of income contemplated in subparagraph (i);*
  - iii) inheritance, legacy, donation, bursary, or prize left, bequeathed, made, or awarded to the other spouse;*
  - iv) income derived from the separate property of the other spouse;*
  - v) dividends or interest on or the proceeds of shares or investments in the name of the other spouse;*
  - vi) the proceeds of any insurance policy or annuity in favour of the other spouse;*
- (c) donate to another person any asset of the joint estate or alienate such an asset without value, excluding an asset of which the donation or alienation does not and probably will not unreasonably prejudice the interest of the other spouse in the joint estate, and which is not contrary to the provisions of subsection (2) or paragraph (a) of this subsection."*

Section 15(3) deals with transactions that require verbal consent, such as the donation of assets from the joint estate or the alienation of assets without value. While verbal consent is legally sufficient in these cases, the Matrimonial Property Act introduces certain safeguards to ensure that such transactions do not unfairly prejudice the interests of the non-contracting spouse. For instance, Section 15(8) provides that the court may examine whether the donation is reasonable, taking into account the value of the asset, the spouses' financial standing, and any other relevant factors. This provision allows for judicial intervention in cases where one spouse acts in a way that may compromise the joint estate's financial integrity.

For financial advisors, understanding transactions that require verbal consent under Section 15(3) is equally important. Although verbal consent may seem less formal than written consent, financial advisors must emphasize to their clients that it still carries significant legal weight, and improper or reckless use of such transactions could have a negative impact on the joint estate. Financial advisors should be cautious when guiding clients through transactions involving donations or alienation of assets without value, as they could still be subject to judicial scrutiny if challenged.

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<sup>8</sup> section 15 (3) Matrimonial Property Act 88 of 1984

Another important consideration is Section 15(9)<sup>9</sup>

*“When a spouse enters into a transaction with a person contrary to the provisions of subsection (2) or (3) of this section, or an order under section 16 (2), and –*

- a) that person does not know and cannot reasonably know that the transaction is being entered into contrary to those provisions or that order, it is deemed that the transaction concerned has been entered into with the consent required in terms of the said subsection (2) or (3), or while the power concerned of the spouse has not been suspended, as the case may be;*
- b) that spouse knows or ought reasonably to know that he will probably not obtain the consent required in terms of the said subsection (2) or (3), or that the power concerned has been suspended, as the case may be, and the joint estate suffers a loss as a result of that transaction, an adjustment shall be effected in favour of the other spouse upon the division of the joint estate.”*

Section 15(9) addresses the consequences of a transaction entered into without the required spousal consent. If a third party (such as a buyer or creditor) did not know, and could not reasonably have known, that spousal consent was required, the transaction is deemed to have been entered into with the necessary consent.

It is important to note that the burden of proof lies with the party seeking to enforce the transaction, who must show that they acted reasonably in assuming that consent was given.

This provision ensures that no spouse can act unilaterally to the detriment of the joint estate while recognising the legitimate interests of those who may enter into transactions with one spouse in good faith.

### **Practical application: *Marais N.O. and Another v Maposa and Others*<sup>10</sup>**

The principles of spousal consent under the Matrimonial Property Act were rigorously tested in the case of *Marais N.O. and Another v Maposa and Others*.<sup>11</sup> This case involved the transfer of a significant asset from the joint estate of Mr and Mrs Broodie, who were married in community of property. The key legal issue in the case was whether Mr. Broodie's donation of 75% of his members' interest in a close corporation (CC) to his children from another relationship and their mother, Ms Ledwaba, was valid in the absence of spousal consent from Mrs Broodie.

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<sup>9</sup> Matrimonial Property Act 88 of 1984

<sup>10</sup> *Marais NO and Another v Maposa and Others* (642/2018) [2020] ZASCA 23 (25 March 2020)

<sup>11</sup> *Marais NO and Another v Maposa and Others* (642/2018) [2020] ZASCA 23 (25 March 2020)

## Factual Background<sup>12</sup>

Mr and Mrs Broodie were married in community of property in 1967, and over the years, they accumulated a joint estate that included a substantial asset in the form of members' interest in Seepunt CC. The close corporation owned valuable property in Cape Town, and Mr Broodie had acquired a 100% interest in the CC. Without obtaining his wife's consent, Mr Broodie transferred 75% of his interest in the CC to Ms. Ledwaba, with whom he had an extramarital relationship, and to their children.

Following Mr Broodie's death, Mrs Broodie sought to challenge the validity of the donation, arguing that it had been made without her consent, as required by section 15 of the Matrimonial Property Act. The case eventually reached the Supreme Court of Appeal (SCA), where the court had to decide whether the lack of spousal consent rendered the transaction invalid and unenforceable.

The main legal issue before the SCA was whether the transfer of the members' interest in the CC was a transaction that required Mrs Broodie's written consent under section 15(2) of the Matrimonial Property Act. The court also had to consider whether the transaction could be deemed valid under section 15(9) if the recipients of the donation (Ms Ledwaba and her children) did not know, and could not reasonably have known, that spousal consent was required.

## The court's findings<sup>13</sup>

The court found that the donation of 75% of the members' interest in Seepunt CC was indeed a transaction that required Mrs Broodie's written consent under section 15(2). The transfer constituted a significant alienation of an asset that formed part of the joint estate, and it was clear that Mrs Broodie's interests were prejudiced by the donation. The court further held that Ms Ledwaba and her children could not rely on the deemed consent provision in section 15(9) because they had reason to know that spousal consent was required. Ms Ledwaba had been aware of Mr Broodie's marriage to Mrs Broodie, yet she made no inquiries as to whether the required consent had been obtained. The court held that a reasonable person in her position would have made such inquiries, and her failure to do so precluded her from relying on the deemed consent provision.

As a result, the court declared the transaction void and set it aside, reaffirming the importance of obtaining spousal consent in transactions involving significant assets of the joint estate.

Understanding the implications of spousal consent in marriages governed by community of property is essential for financial advisers. The Matrimonial Property Act 88 of 1984 ensures that both spouses are protected from unilateral actions that could be detrimental to the joint estate. Some decisions that are minor may be executed unilaterally, however, decisions that could substantially impact the joint estate, would necessitate mutual consent.

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<sup>12</sup> <https://www.studocu.com/en-za/document/university-of-the-witwatersrand-johannesburg/family-law/marais-v-https://www.stbb.co.za/wp-content/uploads/Family-Law.pdf>

<sup>13</sup> Marais NO and Another v Maposa and Others (642/2018) [2020] ZASCA 23 (25 March 2020)

## Conclusion

Section 15 of the Matrimonial Property Act establishes a clear framework for managing and disposing of assets, requiring spousal consent for certain transactions to safeguard the non-contracting spouse's interests.

The landmark case *Marais N.O. and Another v Maposa and Others* underscores the importance of adhering to these legal requirements. The Supreme Court of Appeal's decision in this case reaffirmed that transactions involving substantial assets, such as the transfer of members' interest in a business, must comply with the spousal consent provisions, to be valid. The ruling also highlighted the limitations of the deemed consent provision, reminding third parties to exercise caution when dealing with one spouse in a community of property marriage.

For financial advisers, the Marais case and the Matrimonial Property Act serve as a critical reminder of the need for thorough due diligence when advising clients married in community of property. Advisers must be mindful of the statutory requirements for spousal consent, especially in transactions involving high-value assets, to avoid legal disputes and ensure that their client's interests are fully protected. By understanding these legal principles, financial advisers can provide informed guidance, helping clients navigate the complexities of managing joint estates while adhering to South Africa's matrimonial property laws.

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# Calculation of the Value of Shares in a Private Company for Estate Duty and Capital Gains Tax Purposes at the Death of a Shareholder

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## Introduction

The purpose of this article is to provide insight into the valuation of ordinary shares in an unlisted company or member's interest in a close corporation for purposes of estate duty and capital gains tax (CGT) at the death of a shareholder or member.

## Shareholding in a private company

While shares in a company listed on a stock exchange can be valued and transferred or sold relatively easily, it is often more complex when the shares are held in a private company.

A company consists of directors and shareholders, and in some cases, the shareholder is also a director. The deceased person must be replaced as soon as possible after the letter of executorship has been received. This minimises the risk to the business, especially when the deceased was a director with decision-making and signing powers.

## Member's interest in a close corporation

A close corporation is a business entity where each member owns a percentage of the business. While close corporations have been discontinued as a business entity and new close corporations can no longer be registered, existing close corporations are still recognised, or members may choose to convert them into companies. In contrast to a company, which has both shareholders and directors, a close corporation only has members.

The valuation, administrative and inheritance processes for dealing with shareholding in private companies and members' interests in close corporations are identical.

## Section 5(1)(f) *bis*

Section 5 of the Estate Duty Act<sup>1</sup> ("the Act") specifies the basis for valuing all property and deemed property included in an estate. Shares in unlisted companies are valued according to the provisions of section 5(1)(f)*bis*, regardless of whether they are sold during the liquidation of the estate, and the realised price is disregarded if they are sold.<sup>2</sup> The Act defines<sup>3</sup> "shares" to include any members' interest or any class of shares, stock, debenture stock, debentures or right to purchase members' interests or to subscribe for or purchase shares, stocks or debentures. It also defines "company" to include any company or close corporation incorporated in the Republic or elsewhere. Section 5(1)(f)*bis* of "the Act" provides that unlisted shares must be taken into account at their value on the date of death of the deceased, subject to a number of valuation rules. If upon a winding-up of the company, the deceased would have been entitled to share in the assets of the company to a greater extent pro rata to shareholding or membership than other shareholders or members, no lesser value shall be placed on the shares held by the deceased than the amount to which he would have been so entitled if the company had been in course of winding-up and the said amount had been determined as at the date of his death.<sup>4</sup>

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<sup>1</sup> Estate Duty Act No.45 of 1995

<sup>2</sup> Section 5(1)(a) of the Estate Duty Act No.45 of 1995

<sup>3</sup> Section 5(5) of the Estate Duty Act No.45 of 1995

<sup>4</sup> Section 5(1)(f)*bis*(iii) of the Estate Duty Act No.45 of 1995

## Valuation of shares for estate duty purposes

Upon death, an individual is deemed to dispose of all their assets under section 9HA(1) of the Income Tax Act,<sup>5</sup> at an amount received or accrued equal to the market value of those assets at the date of death. There are some exceptions to this rule, such as assets bequeathed to a resident surviving spouse, but for the purposes of this article we will assume that no exceptions apply. The term "market value" is defined in paragraph 1 of the Eighth Schedule to the Income Tax Act and means market value contemplated in paragraph 31 of the Income Tax Act, which provides that the market value of shares not listed on a recognised exchange must be determined at a value equal to the price which could have been obtained upon a sale of the share between a willing buyer and a willing seller dealing at arm's length in an open market. The Act does prescribe a specific valuation method for unlisted shares.

The net asset value method is often used and involves determining the market value of the company's assets less its liabilities, then dividing this by the number of shares in issue. This method of valuation would be appropriate when the value of the company is largely determined by its assets. In some cases, SARS will reduce the net asset value by any contingent dividends tax, income tax on the deemed disposal of trading stock or operating assets<sup>6</sup> and CGT. If a company is to be wound up, the winding up would trigger these taxes and therefore it would be appropriate to allow the reduction of the net asset value of the shares with these taxes.

When the value of the company is dependent on future profits, a valuation method, such as the discounted cash flow method, that takes future income into account may be more appropriate. One of the largest assets such a company owns is goodwill which is not reflected on its balance sheet.

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<sup>5</sup> Income Tax Act 58 of 1962

<sup>6</sup> In terms of Section 8(4)(a) of the Income Tax Act, an amount that has been previously allowed as a deduction must be included in a taxpayer's gross income if it has been recovered or recouped during the year of assessment.

**Example: Valuation of shares for estate duty and capital gains tax purposes**

The financial statements of XYZ (Pty) Ltd. as of the date of the shareholder's death reflect the following assets and liabilities:

**Assets**

Immovable property – at cost	R8 000 000
Plant and equipment	
At cost	R6 000 000
Accumulated depreciation (R4 200 000)	
Carrying amount	R1 800 000
Trade and other receivables	R700 000

**Liabilities**

Long-term loan	R1 000 000
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Company XYZ (Pty) Ltd was registered on 1 November 2003 with 1 000 issued shares of R1 each. The shareholders were and still are as follows:

Mr. A – 1000 shares (100% shareholding)

The immovable property was valued at R13 000 000 and the plant and equipment at R4 500 000 as of the date of death of Mr. A.

**Calculation****The net asset value method****Assets**

Fair market value of immovable property	R13 000 000
Plant and equipment	R4 500 000
Trade and other receivables	R700 000
Total assets	<u>R18 200 000</u>

**Liabilities**

Long-term loan	R1 000 000
Total Liabilities	<u>R1 000 000</u>

**NET ASSET VALUATION****R16 200 000**

The net asset value can be reduced by any contingent income tax on the deemed disposal of trading stock or business assets, CGT, and dividends tax, because the winding up of the company would trigger these taxes.

Income tax on recovery (recoupment of depreciation on business assets)

Market value business assets (plant and equipment)	R4 500 000
Less: Carrying value business assets	<u>R1 800 000</u>
Recovery	R2 700 000
Tax at 27% on recovery	<u>R729 000</u>

Capital gains tax on immovable property

Market value of immovable property	R13 000 000
Less: Base Cost of immovable property	<u>R8 000 000</u>
	R5 000 000
CGT inclusion rate 80%	R4 000 000
Tax at 27%	<u>R1 080 000</u>

Dividend tax

Net asset value of shares	R17 200 000
Less: Income tax on recovery	R729 000
Capital Gains Tax	<u>R1 208 000</u>
	R15 263 000
Dividend Tax at 20%	<u>R3 052 600</u>

### Value of shares for estate duty and capital gains tax purposes

Net asset value of shares	R17 200 000
Less: Income Tax on Recovery	R729 000
Capital Gains Tax	R1 080 000
Dividend Tax	R3 052 600
VALUE OF SHARES FOR ESTATE DUTY AND CGT PURPOSES	<u>R12 338 400</u>

### Estate duty

The value of the shares, as calculated above, will be included in the estate of the deceased shareholder for estate duty purposes, irrespective of whether it is sold in the course of liquidation of the estate, and disregards the price realised if so sold.

### Capital gains tax (CGT)

Capital gains are determined and then a portion thereof is included in the taxable income of a taxpayer. Capital gains are therefore included in the determination of normal tax and incorporated as part of the Income Tax Act. A capital gain is the proceeds (or deemed proceeds) from the disposal (or deemed disposal) of an asset less the base cost.<sup>7</sup> To calculate the CGT liability, the base cost will be subtracted from the market value and this amount is then multiplied by the inclusion rate, after applying all applicable exclusions.

It is also necessary to consider whether the taxpayer qualifies for the capital gain concession granted on the disposal of an interest in a small business.<sup>8</sup>

Subject to certain exceptions<sup>9</sup> the valuation of shares in a private company for estate duty and CGT purposes are the same, except where the company owns farming property on which a *bona fide* farming undertaking is being carried on. The fair value of the farming property can be reduced by 30 per cent for calculating the value of the shares for estate duty purposes<sup>10</sup> but this reduction is not allowed for CGT purposes.

The base cost of shares in a private company can be determined according to one of the following methods:<sup>11</sup>

- i. **Market value at valuation date:** which determines the base cost of the asset as the market value of the asset at a specific valuation date. The valuation date is typically the date when the asset was acquired or when it first became subject to capital gains tax. Market value refers to the price that the asset would fetch in an open market between a willing buyer and a willing seller.

<sup>7</sup> Premiums and Problems. Edition 127, Page A45

<sup>8</sup> See paragraph 57 of the 8th Schedule of the Income Tax Act

<sup>9</sup> See 31(4) of the 8th Schedule of the Income Tax Act

<sup>10</sup> Section 1 of the Estate Duty Act No.45 of 1995

<sup>11</sup> See paragraph 20, 27 & 30 of the 8th Schedule of the Income Tax Act

- ii. **20% of proceeds less expenditure incurred on/after valuation date:** Under this method, the base cost of the asset is calculated as 20% of the proceeds from the disposal of the asset, minus any expenditure incurred on or after the valuation date. This method is often used when the exact historical cost of the asset is not available, or when it is impractical to determine it accurately.
- iii. **Time-apportionment base cost:** This method is applicable when an asset was acquired before 1 October 2001, and it involves adjusting the base cost of the asset based on the period of ownership after that date. The base cost is apportioned over the period of ownership from 1 October 2001 to the date of disposal, considering any improvements, additions, or enhancements made to the asset during that period.

In the above-mentioned example, the base cost of the shares of Mr. A in Company XYZ (Pty) Ltd. will be R 1 000. The shares were acquired by him after 1 October 2001 at cost of R 1 000 (1 000 shares of R1 each).

## Conclusion

It is important for advisors and estate planners to have some insight regarding the valuation of ordinary shares in an unlisted company for estate planning purposes since it can play an intricate role in determining the potential estate duty and CGT implication in the estate of a client who holds shares in an unlisted company or member's interest in a close corporation.

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# Tax on Limited Rights: A Tax Comparison of a Vested Trust and a Usufruct

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## Introduction

One of the most important documents that a person will set up and sign in their life is their will. This article will look at the tax implications of limited rights created in a will. The focus will be to consider a single scenario in terms of which a vested trust and the use of a usufruct are applied and then to compare the tax implications.

A limited right can be described as a right or interest of whatever nature to or in property. There are many examples of such rights including: a *usufruct*, *usus*, the right of *habitatio* or the right to income from a trust and the right to occupy trust property.<sup>1</sup> For this article, we will focus on a vested trust and usufruct.

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<sup>1</sup> LexisNexis South Africa on Estate Planning, D Davis & RD Jooste at 12.7.

Many estate planners make use of these methods. It is important to consider what the tax implications would be as this will play an integral role in deciding which technique to use. It is also important to consider that this is strictly based on a single scenario and only considers the tax implications. There are numerous other factors that need to be considered for each specific client, and this cannot be looked at in isolation.

When deciding whether to place assets in a vested trust or to use a usufruct, it is important to understand the objectives behind these estate planning techniques. While this article focuses on the tax implications, it is important to note that a planner might recommend the use of a usufruct to ensure that the surviving spouse has a place to live and can benefit from the asset, while simultaneously securing the eventual ownership of the asset. A usufruct can also be used when the client may not have sufficient provisions for the taxes due upon death and seeks to leverage the tax benefits of a usufruct by delaying the onset of the costs. However, all parties must be fully informed, whether immediate or future, and make provisions accordingly.

A vested trust, on the other hand, can secure assets for minor heirs or protect against the risk of heirs squandering their inheritance. Placing assets in a trust can protect them from creditors and matrimonial disputes while creating tax benefits by removing the ownership from a person's estate.

The brief explanations above are merely examples of potential reasons for their use. The primary objective is to highlight the tax implications for the client and raise awareness of the complexities that certain clauses in a will can create, rather than to recommend when each technique should be applied.

Careful consideration is needed when drafting a will and advising clients on estate planning. The estate plan should reflect and illustrate the effects of the will's clauses, creating a holistic plan that the client can fully understand and that accurately depicts the scenario they will face upon death.

### **The testamentary bequests the client intends to consider**

A client needs to have their will drafted but is unsure whether to bequeath their farm to a vested trust or whether to use a usufruct. First, we will have a look at how each of these clauses would be worded:

A bequest to a vested trust:

*"I bequeath my immovable agricultural property to my trustees to be held in trust and invested by it in terms of my Will. My trustees shall pay to my said wife the net income arising from my trust until her death.*

*I authorise the trustees, after taking into account such other income and resources as my spouse may possess, to augment the income paid to her out of the capital of the trust should it, in its absolute discretion, consider that the income is not sufficient to enable her to maintain her accustomed standard of living or provide for essential medical and other necessary expenses.*

*The trustee shall have the power to terminate the trust at any time in their discretion, subject to the condition that the trust will not terminate before the death of my spouse.*

*At the termination of the trust, the capital of the trust shall devolve upon my son Justin.*

*I nominate my son, Justin, and my attorney Peter of Peter Piper Attorneys as trustees of the trust."*

The wording for a usufruct:

*"I bequeath my immovable agricultural property to my son, Justin, failing him, then to his son, subject to a lifelong usufruct in favour of my spouse.*

*I direct that my spouse will not be called upon to furnish security for acting in such a capacity.*

*I direct that my spouse shall be responsible for the payment of rates and taxes and any levies.*

*I direct that my spouse shall be responsible for maintenance and repairs of the asset and taking out any short-term assurance and paying the premium thereof."*

One would need to calculate the respective taxes associated with each scenario. With the above clauses in mind, one can now consider the tax implications of each scenario.

### **The vested testamentary trust as an estate planning structure**

A trust is defined in section 1 of the Trust Property Control Act<sup>2</sup> as an arrangement by which the ownership in property of one person is, by way of a trust instrument (e.g. the will of a person), made over to another person/s (the trustee/s) to be administered or disposed of for the benefit of the person or class of persons (the beneficiaries) as stipulated in the trust instrument.<sup>3</sup>

A trust can be a discretionary trust or a vesting trust. Vested rights mean that an individual is the owner of that right, which includes the right to use and enjoyment. In a vesting trust, the beneficiaries have a vested right to all or a defined part of the income or capital of the trust, or both, while in a discretionary trust, the vesting of trust income and capital takes place at the discretion of the trustees. In a discretionary trust, a beneficiary obtains no vested rights to trust income or capital unless and until the trustees exercise their discretion to vest such income or capital in a beneficiary.<sup>4</sup> This vesting can occur even if the actual distribution to the beneficiary is deferred to a later date. When obtaining a vested right to trust income or trust capital or to an asset of the trust, the beneficiary could potentially be liable for income tax or capital gain tax in accordance with the provisions as set out in Section 25B and the Eighth Schedule of the Income Tax Act 58 of 1962.<sup>5</sup>

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<sup>2</sup> Trust Property Control Act 57 of 1998.

<sup>3</sup> Premiums and Problems Article Edition 124, CJ Le Roux & D Harris, *Testamentary Trusts simplified*, at A2.

<sup>4</sup> Fundamentals of Financial Planning, Page 463 and 464.

<sup>5</sup> SILKE on South African Income Tax RC Williams & AP de Koker, LexisNexis 2024. SS12.19.

In a *bewind* or vested trust, the trustees have no beneficial interest in the trust property and are obliged to hold and apply it for the benefit of the beneficiary or the accomplishment of the stated purpose in accordance with the terms of the trust.<sup>6</sup>

Where the terms of the trust have been reduced to writing, the document is known as the 'trust instrument,' but it is more commonly referred to as the 'trust deed'<sup>7</sup> and in the case of this article, is incorporated in the will of an individual and is called a testamentary trust. This document will then record the essential elements of the trust, which include but are not limited to the assets to be held in the trust, the names of the trustees and beneficiaries, the powers of the trustees, the rights of the beneficiaries to income and capital of the trust and the circumstances in which or the time when the trust will terminate.

### The tax implications when creating a vested testamentary trust

When considering this structure, one needs to be aware of which taxes are applicable when making the testamentary wishes to distribute these assets. Therefore, consideration must be given to assets acquired after 1 October 2001, which are subject to capital gains at disposal. A disposal, for capital gains tax purposes, is regarded as any act, event or operation of law which will result in the creation, variation, or extinction of an asset. The definition is extremely wide and covers almost all instances in which there is a change in ownership of an asset.<sup>8</sup>

When bequeathing an asset to a testamentary trust it will be subject to capital gains tax as it is applicable as per the disposal explanation. The base cost we will assume is unknown and there is no known or available pre-valuation date, therefore we will be entitled to use the 20% of proceeds method.<sup>9</sup>

#### Example 1:

One can assume the testator wants to bequeath the farm, that was acquired 10 years ago, for which no valuation was done in 2001. The testator and the spouse are currently 61 years old, and their son, Justin is 30 years old. The current market value of the farm is R15 000 000. To determine the base cost, we will use the '20% of proceeds method'. If one decides to use the '20% of proceeds method' to determine the valuation date value of the property or if one has failed to obtain the Land Bank valuation by 30 September 2004, then they will not be allowed to use the market value less 30% for determining the proceeds at death.<sup>10</sup>

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<sup>6</sup> SILKE on South African Income Tax RC Williams & AP de Koker, LexisNexis 2024. SS12.19.

<sup>7</sup> Fundamentals of Financial Planning, Page 464.

<sup>8</sup> Premiums & Problems, Edition 127, Page A45 and A46.

<sup>9</sup> SARS comprehensive guide to Capital Gains Tax, Page 263.

<sup>10</sup> SARS comprehensive guide to Capital Gains Tax (Issue 9), Page 322.

## Vested trust

### a) Capital gains tax:

Farm at market value	15 000 000
Less the base cost (20% method)	3 000 000
Capital gain	12 000 000
Less CGT exclusion at death	(300 000)
Net capital gain	11 700 000
Inclusion rate of 40%	4 680 000
Assume marginal rate of 45%	
Total CGT payable by first dying spouse	R 2 106 000

One also needs to consider the estate duty implications that are applicable at the death of a natural person, who is ordinarily a resident in South Africa and who is taxed on their worldwide property and deemed property in their estate. This article looks specifically at the instance of immovable property on which *bona fide* farming operations take place. This property is considered at its fair market value, which is the value obtained by reducing the price between a willing buyer and seller in an open market by 30%.<sup>11</sup>

### b) Estate Duty:

Assets payable to estate	15 000 000
Less	
30% of bona fide agricultural land	4 500 000
Capital gains tax liability	2 106 000
Less Primary abatement	3 500 000
Dutiable Estate at 20%	4 894 000
Estate duty payable by first dying spouse	978 800

As is indicated from the calculations, there is a capital gains tax implication of R2 106 000 payable by the first dying spouse and an estate duty implication of R978 800 payable by the first dying spouse.

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<sup>11</sup> SARS comprehensive guide to Capital Gains Tax, Page 319.

## The usufruct as an estate planning structure

A usufruct is created in the form of a testamentary bequest (a will) or by means of a contract. It enables the holder (usufructuary) of the limited right to use and enjoy the fruits of the property which belongs to someone else (the bare dominium holder), subject to the condition that the substance of the property is maintained. A usufruct can be granted for different periods, that being for a specific term or until the happening of a specific event.<sup>12</sup>

A usufruct is commonly used to ensure the right of occupation for a surviving spouse while the bare dominium holder would usually be a major child. Although this is one of the most common reasons for the use of the usufruct, it can be used in respect of any other user and bare dominium holder and not only for a spouse and children. Another major reason for the use of the usufruct and why it can be such an effective estate planning tool is because of the tax savings it can provide at a certain time; however, it is not without complications. That is why it needs to be properly understood and applied.

## The tax implications when creating a usufruct

When a usufruct is granted in favour of a surviving spouse as per the example, it essentially results in a disposal of the bare dominium to another person and is regulated by paragraph 40(1) of the Eighth Schedule of the Income Tax Act.<sup>13</sup> The usufruct granted to the spouse will result in a rollover for capital gains tax purposes.<sup>14</sup> This application of the law means that it will be necessary to separate the portion of the base cost and market value that is granted to the usufructuary and bare dominium respectively. The difference between the market value and base cost portion allocated to the bare dominium will be used to determine the capital gain in the hands of the client (deceased). The interest in a usufruct or other like interests in property are valued by capitalising the annual value of the property by 12%, in which the client (deceased) held the interest, over the life expectancy of the person obtaining the benefit (usufructuary) or if the limited right is to be enjoyed for a lesser period, then over that lesser period.<sup>15</sup>

With the information regarding the farm as well as the abovementioned separation information, one can determine the capital gains tax applicable in the hands of the client (deceased) as per the information provided in example 1:

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<sup>12</sup> Premiums & Problems, Edition 127, Page E25.

<sup>13</sup> Income Tax Act 58 of 1962.

<sup>14</sup> Paragraph 40(1)(a) with paragraph 67(2)(a) of the Income Tax Act 58 of 1962.

<sup>15</sup> SARS comprehensive guide to Capital Gains Tax, Pg 667.

Value of the base cost in favour of the bare dominium:

Base cost as per 20% method	$15\,000\,000 \times 20\% = 3\,000\,000$
Therefore:	
The annual value of the base cost subject to <i>usufruct</i> :	$3\,000\,000 \times 12\% \times 7,16020$ (life expectancy of the usufructuary) = 2 577 672
Portion of the base cost to <i>bare dominium</i>	$3\,000\,000 - 2\,577\,672 = 422\,328$
The annual value of the market value subject to <i>usufruct</i> :	$15\,000\,000 \times 12\% \times 7,16020$ (life expectancy of the usufructuary) = 12 888 360
Portion of the market value to <i>bare dominium</i>	$15\,000\,000 - 12\,888\,360 = 2\,111\,640$

The difference between the market value and base cost portion allocated to the bare dominium will be used to determine the capital gain in the hands of the client, therefore:

Market value allocated to bare dominium:	2 111 640
Base cost allocated to bare dominium:	422 328
Provides a capital gain in clients hands:	1 689 312
Less exclusion at death <sup>16</sup> :	(300 000)
Net capital gain:	1 389 312
Inclusion rate of 40%:	555 725
Assume marginal rate of 45%:	
Total Capital Gains Tax Payable by client:	250 076

<sup>16</sup> Premiums & Problems, Edition 127, Page A53.

No capital gains tax on the spouse's portion as it qualifies for a roll-over under section 9HA(2) read with section 25(4) and the capital gains by the deceased is payable in terms of section 9HA(1) on the disposal of the bare dominium portion.<sup>17</sup>

The estate duty implications when the usufruct is bequeathed to the surviving spouse means that it qualifies for a section 4(q) deduction in terms of the Estate Duty Act, 45 of 1955.<sup>18</sup> This bequest is free from estate duty for the client.

Let's consider the facts at hand, the value of the usufruct qualifying for the 4q deduction:

Market value of the farm:	15 000 000
Less	
30% bona fide agricultural land to heir other than spouse: <sup>19</sup>	4 500 000
Value of the farm subject to usufruct:	10 500 000
Annual value of the farm (10 500 000 x 12%):	1 260 000
Present value of R1 per annum on spouses' life (A.n.b. 62):	7,16020
(4q) deduction in client's estate (1 260 000 x 7,16020):	9 021 852

Bearing this in mind the estate duty calculation for the first dying spouse will look as follows:

Market value of the farm:	15 000 000
Less:	
30% on bona fide agricultural land to heir other than spouse:	4 500 000
Value of usufruct to surviving spouse:	9 021 852
Capital gains tax:	250 076
Primary abatement:	3 500 000
Estate duty payable:	0
Unused portion of primary abatement:	2 271 928

<sup>17</sup> SARS comprehensive guide to Capital Gains Tax, Pg 828.

<sup>18</sup> SILKE South African Income Tax, AD Koekemoer, LexisNexis 2018. SS27.6.12.

<sup>19</sup> SILKE South African Income Tax, AD Koekemoer, LexisNexis 2018. SS27.5.4.

Therefore, there is no estate duty payable in the estate of the first dying spouse and the unused portion of the primary abatement will roll over to the last surviving spouse and can be used by her to reduce her estate duty liability at her death.

When the usufructuary passes away, then the bare dominium holder becomes the full owner of the property. Essentially it comes down to the only value that is included in the estate would be the value of the usufruct as opposed to the full value of the asset passing from the client to the surviving spouse and then to the child or a trust.<sup>20</sup> There is however a value that passes to the bare dominium holder, and this is calculated by deducting the value of the usufruct from the market value of the farm. If the value passing to the bare dominium at the date of the clients' death exceeds the primary abatement, then it will be subject to estate duty.<sup>21</sup>

For the last dying spouse, in this scenario, the only value that will be included in the estate is the value of the usufruct. Therefore, the calculation would look as follows:

Estate duty payable in the last dying spouse's estate:	
Deemed asset not payable to the estate:	9 021 852
Less	
Less Primary abatement:	3 500 000
Less unused abatement from the first dying spouse:	2 271 928
Dutiable estate at 20%:	3 249 924
Estate duty payable in surviving spouses' estate	649 985

In this scenario, there is a capital gains tax implication of R250 076 in the estate of the first dying spouse for the portion of the usufruct that accrues to bare dominium holder (Justin). There is no estate duty that will be payable by the estate of the first dying spouse, but there is an estate duty implication in the estate of the last dying spouse. The Justin is liable for this estate duty implication, by way of apportionment on the death of the last surviving spouse because the property accrues to him.

To determine the amount to be paid by way of apportionment, one must consider the value of the ceasing usufruct ( $10\,500\,000 \times 12\% \times 7,16020$ ) over the total value of the primary abatement, with the unused portion of the first dying spouse's abatement and the total gross dutiable estate ( $3\,500\,000 + 2\,271\,928 + 3\,249\,924$ ) and this value is multiplied by the estate duty payable. Had the surviving spouse held any assets subject to estate duty, then it would

<sup>20</sup> Insurance & Tax, M Botha, volume 24, June 2009.

<sup>21</sup> Insurance & Tax, M Botha, volume 24, June 2009.

allow one to see what her portion of the estate duty liability would be, but in this case, there are no such assets, and the bare dominium is liable for the estate duty apportioned to him.

The calculation should look as follows:	$(10\,500\,000 \times 12\% \times 7,16020) / (3\,500\,000 + 2\,271\,928 + 3\,249\,924) \times 649\,985$ .
This gives us the following calculation:	$9\,021\,852 / 9\,021\,852 \times 649\,985 = 649\,985$

In summary, the taxes of the vested trust and the usufruct would look as follows:

<b>Vested trust:</b>	<b>Usufruct:</b>
Capital gains tax: R2 106 000 (first dying spouse)	Capital gains tax: R250 076 on portion to bare dominium (Justin). Roll-over on spouses portion.
Estate duty: R978 800 (first dying spouse)	Estate duty: None – 4(q) deduction in terms of the Estate Duty Act.
No costs any further	Taxes applicable in last dying spouses' estate:
	Estate duty: R649 985 payable by bare dominium as per apportionment
	Capital Gains Tax: At the death of the last dying spouse – None, assets fully vest in the <i>bare dominium</i> .

The *bare dominium* (Justin) must be aware of the apportionment that he will be liable for in the last dying spouses' estate because of the ceasing of the *usufruct*. Another important factor for the *bare dominium* holder is the capital gains tax implication of which the base cost applicable to the property is R422 328. This could result in a significant capital gains tax implication, should Justin ever sell the property or pass away. Consider that the current market value is R15 000 000. For illustration, we can assume the farm vests in Justin immediately and he sells it. His CGT implication will be:

$$R15\,000\,000 - R422\,328 = R14\,577\,672$$

$$R14\,577\,672 - R300\,000 \text{ (exemption)} = R14\,277\,672$$

$$R14\,277\,672 \times 40\% = R5\,711\,068$$

$$R5\,711\,068 \times 45\% = R2\,569\,980$$

## Conclusion

As it stands, the use of a vested trust requires the provision of R3 084 800 in terms of taxes that are applicable. Although the vested trust has much higher immediate tax obligations, once these taxes are paid, no further taxes will be due as long as the assets remain in the trust. The trust has a much higher inclusion rate for capital gains tax purposes (80%) and therefore the effective rate is 36% if one assumes a marginal tax rate of 45%. This should be considered when evaluating the use of this structure, with the goal of retaining growth assets within the trust.

The usufruct requires R250 076 in the estate of the first dying spouse. The rest of the costs must be carried by the *bare dominium* holder, such as the R649 985 in apportionable estate duty at the death of the last dying spouse. The *bare dominium* holder could also face a very large capital gains tax implication should he sell the farm or pass away. The reason for the large capital gains tax implication is that the farm must be sold at its fair market value (currently R15 000 000) and the base cost will be the portion of the base cost awarded to the *bare dominium* holder, that being R422 328.

This article contrasts two very specific scenarios against each other. It is evident that both the options considered have their advantages and disadvantages, the financial planner needs to ask themselves, "Which of these options is most suitable to my client?" A financial planner should consider each option carefully in light of the client's circumstances and objectives. With this thorough consideration, the client can make an informed decision, allowing the estate planning method to be applied for their maximum benefit.

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# The Importance of a Legal Audit on Trust Deeds

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## Introduction

The process of registering a trust includes the lodgement of the trust deed by the trustees at the office of the Master of the High Court that has jurisdiction.<sup>1</sup> The lodgement of the document is merely a matter of record and does not give the document any legitimacy or validity. The Master's office does not have the same power as the registrar of companies, who approves or disapproves documents; it is merely a registry where trust documents are filed.<sup>2</sup>

A trust deed is a critical document that outlines the terms and conditions of a trust and must be reviewed and audited regularly to ensure that it remains relevant and effective in achieving the trust's objectives. Neglecting to review the document can result in unforeseen legal and financial complications, disputes, and possibly negative consequences for beneficiaries.<sup>3</sup>

This article focuses on the importance of regular trust audits by analysing certain potentially problematic clauses.

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<sup>1</sup> Section 4 of the Trust Property Control Act 57 of 1988.

<sup>2</sup> W Geach and J Yeats, *Trust Law and Practice* (2007) 6.

<sup>3</sup> Trustees for the Future "Maintaining your trust: Why regular review and audit of your trust deed is just important as servicing your vehicle available at <https://www.linkedin.com/pulse/maintaining-your-trut-why-regular-review-aufit/> 25 April 2023.

## Role-players

When auditing a trust, one must first determine who the role players are, such as the founder, the current trustees the beneficiaries. Secondly one needs to understand the purpose of the trust, is such as a normal family trust, a business trust, or a special trust. The focus of this article will be on a discretionary inter vivos family trust.

## The Founder

The founder and trustees enter into a contract for the benefit of the beneficiaries, also known as a *stipulatio alteri*. The founder can be a trustee as well as a beneficiary under the trust and it is important that the founder has contractual capacity to act.<sup>4</sup> The founder may be an unrelated person, a family member or the planner who wishes to set up a trust for the family.

The role of the founder throughout the trust document needs to be assessed in the light of who the founder is and what powers are given to such a person. Clauses that require careful consideration when the planner is the founder include the following:

- The founder has the right to hire and fire trustees;
- The sole right of the founder to amend the trust instrument without the trustees;
- The founder having a second or casting vote in the event of a deadlock on votes;
- A testamentary reservation clause in which the founder reserves the right to dispose of trust assets in their will.<sup>5</sup>

The above clauses can indicate that the founder has *de facto* control over the trust and could thus be seen as the alter ego of the founder, which should be avoided.<sup>6</sup> The risk if the trust is seen as the alter ego of the planner especially in the case of divorce, the court can rule that the assets in the trust be taken into account when determining the redistribution amount as was seen in *Jordaan v Jordaan*<sup>7</sup>.

In the past, it was a common practice to appoint an unrelated person to be the founder of the trust. Please note that the founder of a trust cannot be replaced once the trust is registered with the Master of the High Court. This can lead to practical difficulties when amending the trust deed if such a person cannot be traced, as the founder while alive must be part of any amendments that is done because it is a contract between the founder and the trustees for the benefit of a third party. Another very important consideration when using an unrelated person is that section 9(4)(b) of the Transfer Duty Act,<sup>8</sup> which provides an exemption from paying transfer duty where immovable property is transferred to a beneficiary under the trust, will be lost.

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<sup>4</sup> *Crookes NO v Watson* 1956 (1) SA 277 (A).

<sup>5</sup> P van der Spuy, *Demystifying trusts in South Africa* (2017) 47.

<sup>6</sup> *Badenhorst v Badenhorst* 2006 (2) SA 255 SCA.

<sup>7</sup> 2001 (3) SA 288(C).

<sup>8</sup> Act 40 of 1949. No transfer duty will be payable where an immovable property is transferred to a beneficiary and the founder and that beneficiary of the trust is within three degrees of consanguinity.

## The Trustees

The management of the trust is entirely in the hands of the trustees. The trust deed normally requires a specified number of trustees to be appointed before a valid act can be performed. The Supreme Court of Appeal in the *Land and Agricultural Bank of South Africa v Parker*,<sup>9</sup> made it very clear that this is a capacity-defining clause. If a trust deed stipulates that it requires a minimum of three trustees to be in office, and further states that the majority of the trustees can make a valid decision, the required minimum number of trustees must be in office before the majority can prevail.<sup>10</sup>

Trustees must read and understand their powers, duties and responsibilities outlined in the trust deed. Trustees must take note of clauses that specify conditions of when a trustee can be removed from office, whether the trust indicates that decisions taken by the trustees will be unanimous or if a majority will prevail. A commonly found clause in trusts is: “*if the majority of trustees unanimously request a trustee to resign from office.*” What options are available to the remaining trustees should the trustee be unwilling to resign?

The Court in *Du Plessis NO and Others v Van Niekerk and Others*<sup>11</sup> held that the specific wording is a mere request which can either be accepted or declined by the trustee in question. This means that the trustees may need to approach the High Court or, in certain instances, the Master of the High Court in terms of section 20 of the Trust Property Control Act (hereafter referred to as “the Act”)<sup>12</sup> to remove a trustee. The above case makes it clear that even if the trust deed specifies that the co-trustees have the authority to remove a trustee from office, it will only be possible under the circumstances set out in section 20 of the Act, and that a trustee cannot be removed from office without reasonable cause.

On 6 March 2017, the Chief Master issued a directive<sup>13</sup> stating that all trusts registered for the first time with the Master and classified as a “family business trust”<sup>14</sup> must have an independent trustee. The purpose of this directive is to protect outsiders dealing with these trusts. A question then arises on how “independent” an “independent” outsider trustee truly is, and whether such a trustee will effectively prevent the abuse of power, especially when they are compensated for their services.<sup>15</sup>

Reported and unreported court cases<sup>16</sup> have shown that the unfortunate reality is that “independent outsiders” have not always been able to prevent the trust from being abused by co-trustees.<sup>17</sup> Practically speaking, this means that where all the beneficiaries are related and all or some of them are also trustees, the Master of the High Court must insist on an “independent” trustee. This person can be related to the other trustees, provided that such a person is not a beneficiary of the trust. The term “related” is not defined but for these purposes one can assume that the ordinary meaning which means “*persons related by blood or*

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<sup>9</sup> 2005 (2) SA 77 (SCA).

<sup>10</sup> W Geach and J Yeats, *Trust Law and Practice* (2007) 79.

<sup>11</sup> 836/2018 ZAFSHC 120 (26 June 2018).

<sup>12</sup> 57 of 1988.

<sup>13</sup> 2 of 2017

<sup>14</sup> Paragraph (a) of the Directive defines it as “Trustees have the power to contract with independent third parties, thereby creating trust creditors”.

<sup>15</sup> PR Pace et al *Wills and Trusts* November 2023 6.2.2

<sup>16</sup> *Jordaan v Jordaan* 2001 3 SA 288 (C), *Morrell v Demo and Others* (unreported Gauteng case no. 2011/5122) just to mention some cases.

<sup>17</sup> *Ibid* 14

*marriage to a beneficiary*" will most likely apply.<sup>18</sup> For existing trusts, it will be in the discretion of the Master of the High Court to refuse the issue of letters of authority until such time as the requirement is met.<sup>19</sup>

## Beneficiaries

Even though the Act does not define the word "beneficiary", the essence of a trust is that the trustees hold assets on behalf of beneficiaries or on behalf of some object, such as a charity.<sup>20</sup> Beneficiaries need to be identifiable or be ascertainable through either through a description of class such as "*the descendants of*" or a person identified by name, Identity number or "*the lawful spouse of the founder*". The danger of using such a description is that any future spouse of the founder will qualify as a beneficiary and that might not be the intention.

There must also be a clear distinction between income beneficiaries and those who can benefit from capital. A clause that is often added to trust deeds specifies that "*the relatives of the capital beneficiaries related to them by blood or affinity*" are also income beneficiaries. It is important to understand how wide this clause defines potential beneficiaries, and the planner should be made aware of who might be potential beneficiaries, such as extended family and extended family of in-laws. If this clause is part of the trust deed, it becomes very important to consider the structure of the amendment clause in the trust deed. If the trust deed requires beneficiaries to be part of any amendment it might become a tedious task to trace and involve all such persons.<sup>21</sup>

Trusts are generally created to continue for generations; therefore, the planner and the drafter must make provision for current and future beneficiaries by specifying "*legal descendants of my children per stirpes*" as an example. The amendment clause in the trust is often worded to state that "*after the death of the founder, the trustees will not be allowed to amend the beneficiary clause.*" If this clause is included in the trust deed, it is important for the planner to understand that the list of beneficiaries must be as comprehensive as possible from the start, as after death, it will not be possible for the trustees to amend the beneficiary clause.

## Annual Financial Statements

The Act contains several sections indicating that trustees must ensure proper accounting records are kept.<sup>22</sup> While the compilation of annual financial statements is not a statutory requirement, it is considered to be a requirement for holding office as a trustee.<sup>23</sup> Financial statements are required to account for annual income, expenses and capital gains for the year and are necessary for completion of the trust's tax return. Even if a trust is not generating

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<sup>18</sup> It will normally mean that people within three degrees of blood or marriage will be seen as "related" October 25<sup>th</sup> 2019.

<sup>19</sup> Ibid note 14

<sup>20</sup> Ibid note 5 at 49.

<sup>21</sup> P van der Spuy Trust Eeze "Be Mindful how beneficiaries are defined in the trust deed" August 5<sup>th</sup> 2022.

<sup>22</sup> Sections 11,16,17 and 19.

<sup>23</sup> Ibid note 9 at 188.

any income and its assets are not constantly changing, the trustees should still have financial statement prepared to confirm that they are aware of exactly what assets are held in trust.<sup>24</sup>

In practice, in the absence of any statutory obligation, the Master of the High Court will insist on an auditor/accounting officer to be appointed.<sup>25</sup> Once again it is important to note what the clause in the trust deed stipulates in terms of the appointment of an auditor and if the financials should be audited annually. It is suggested that an accounting officer, as prescribed in section 62 of the Close Corporation Act, will be sufficient<sup>26</sup> as audit, accounting and administration costs can be high.<sup>27</sup>

## Amendment of trust deeds

There are several reasons why a founder and/or trustees might want to amend the trust deed. These reasons include situations where trustees' powers not given to them in the current trust deed, where certain clauses were poorly drafted and need amendments, or the founder wishes to change the beneficiaries.

First, one needs to determine if the trust deed allows for amendments to be made, including who has the authority to make such amendments and under what circumstances and if the clause governing amendments is legal and effective.<sup>28</sup> Secondly it is important to consider whether the founder is alive and what powers were retained, to amend the trust deed. Even if the founder does not have expressed power in the trust deed, as long as the founder is alive the court in *Hofer v Kevitt*<sup>29</sup> referred to the *Crookes v Watson*<sup>30</sup> in which it was accepted that a trust *inter vivos* is a contract for the benefit of a third party and unless beneficiaries have accepted the benefit stipulated for them, the trust deed can be varied by agreement between the founder and the trustees. However, if the founder is deceased and there is no power conferred upon the trustees to make amendments, section 13 of the Act provides that the trustees must apply to court to amend the deed.

A further point to consider is, whether a beneficiary needs to be involved in amendments to the trust deed, especially if the trustees and or founder wants to remove a beneficiary. If the beneficiary has accepted (either vested or discretionary) benefits, the beneficiary becomes part of the contract and any variations or amendments thereto can only be made with their approval.<sup>31</sup> There is no prescribed form for the acceptance of benefits, and such acceptance does not mean that the beneficiary acquired vested rights in the property or that the personal rights have turned into real rights or ownership.<sup>32</sup>

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<sup>24</sup> Ibid note 9 at 194.

<sup>25</sup> P van der Spuy Trust Eeze "The role and responsibilities of the trust auditor/accountant. June 19<sup>th</sup> 2020.

<sup>26</sup> 69 of 1984.

<sup>27</sup> SAIPA (South African Institute of Professional Accountants) member guide p17 at <https://www.saipa.co.za>.

<sup>28</sup> Ibid note 9 at 144.

<sup>29</sup> 1997 (4) ALL SA 620 (SCA).

<sup>30</sup> 1956 (1) SA 277 (A).

<sup>31</sup> D Buys "Amendment of trust deeds, should beneficiaries be added?" Premiums and Problems Article Edition 110 January 2015, B34.

<sup>32</sup> PR Pace et al Wills and Trusts November 2023 6.3.1.1

## Testamentary Reservation

This is a clause in a trust deed that grants a specific person, typically the founder, the power to determine certain aspects relating to trust assets in their will. For example, vesting of assets or termination date and/or the formula for the distribution of the assets regarding capital and/income.<sup>33</sup> This power allows the founder to reserve a contractual right to unilaterally amend the trust deed using a last will and testament. One of the essential elements in creating a valid trust is that the assets must be administered separately from the estate of the founder of the trust, otherwise there might be a tax implication. This becomes especially important in light of section 3(3)(d) of the Estate duty Act<sup>34</sup> that states that any property that the deceased was, immediately prior to their death, competent to dispose of for their own benefit or for the benefit of their estate, will be deemed to be part of the deceased's estate for estate duty purposes. This clause is normally assessed together with other clauses, such as the founder retaining the right to hire and fire trustees or having a second or casting vote. These are all factors that will be considered when whether that person has retained effective control of the trust and its property. In the light of the above it is recommended that planners do not utilise this power in their wills and that consideration is given to remove this clause from the trust deed.

## Arbitration

Another commonly found clause in a trust deed is *"if a majority vote or unanimous decision cannot be obtained, the dispute shall be referred to a retired Appellate Division Judge or Senior Council appointed by the Chairman of the Bar Council."* It is beneficial that the trust deed has a clause stipulating how trustee disputes or deadlocks should be dealt with. However, it is recommended that there should first be an option of mediation, as it is more informal and less expensive than formal arbitration or court proceedings<sup>35</sup>. One can also limit the costs of formal arbitration by stipulating that an attorney with the required knowledge in trusts will preside over any legal aspects and an accountant will preside over any accounting issue related to the trust.

## Is the trust compliant?

It is vital that trustees understand their fiduciary duties, responsibilities, and obligations when assuming the role of a trustee. The keeping of proper records and minute books can involve a lot of administrative work. Most trust deeds specify that trustees must have at least one trustee meeting a year. Problems can arise if those meetings do not take place if no real decision-making occurs and/or if resolutions are not properly drafted. Failure to keep books and records can have serious consequences for trustees, as beneficiaries are entitled to have full access to trust records and accounts at any time.<sup>36</sup> Trustees can be held accountable in

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<sup>33</sup> S Singh "Testamentary reservation – Too much control? Sentinel April 28, 2021 at <https://sentinelinternational.co.za/2021/04/testamentary-reservation-too-much-control/>.

<sup>34</sup> 45 of 1955.

<sup>35</sup> P van der Spuy Trust Eeze "Trustees can manipulate a trust".

<sup>36</sup> WD Geach, J Yeats Trusts Law and Practice 2007 212.

their personal capacity if they fail to act carefully, diligently, or skilfully and can be removed from their duties.<sup>37</sup>

Trustees are often of the opinion that the trust does not require a bank account. However, for a trust to be validly formed, the founder is required to donate to the trust and in most cases, the founder specifies an amount of money<sup>38</sup> as the initial donation. Section 10 of the Act states that: *“whenever a person receives money in his/her capacity as trustee, he/she shall deposit such money in a separate trust account at a banking institution.”* This is required by law and leaves no discretion in the hands of the trustees whether to open an account or not.<sup>39</sup>

Some clients often believe that if their trust is not a “trading” trust then it is not necessary to register for income tax purposes. The Receiver of Revenue makes it very clear that once a trust is registered with the Master of the High Court the trustees must register the trust for taxes, regardless of whether the trust has any transactions or assets. Once a trust is registered for income tax, the trustees are required to submit annual tax returns in respect of the trust.<sup>40</sup>

## Beneficial Ownership

A new definition was added to section 1 of the Trust Property Control Act, defining “Beneficial Owner” in line with international standards. This definition refers to people who benefit from and have ownership rights over assets held in a trust. A “beneficial owner” is always a natural person and include the trustees, beneficiaries, and the founder of the trust.

This came into effect on 1 April 2023 and trustees must in terms of section 11A(1)<sup>41</sup> :

- Establish and record the beneficial ownership of the trust.
- Keep up-to-date records of amounts distributed or vested in beneficiaries.
- Lodge a register of the beneficial ownership information with the Master of the High Court.
- Disclose to an accountable institution that they engage within the capacity of a trustee that the relevant transaction or business relationship relates to trust property.
- Record the details of the accountable institution.

Section 6(1A)(e)(i) of the Act was also amended to state that if a trustee has been convicted of money laundering, terrorist financing or proliferation financing activities, that person will be disqualified from acting as a trustee.

Failure to comply with the requirements may result in a penalty up to R10 million and/or five years imprisonment for trustees.

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<sup>37</sup> Section 9(2) Trust Property Control Act 57 of 1988.

<sup>38</sup> R100

<sup>39</sup> P van der Spuy Trust Eeze “Why a trust requires its own bank account, September 17 2020 <sup>40</sup> <https://sars.gov.za/business-and-employers/trusts/registering-as-a-trust/>

<sup>41</sup> Trust Property Control Act 57 of 1988. This is a new section that was added to the Act.

## Conclusion

This article is important not only for the parties involved in a trust to take note of certain potentially problematic clauses but also as a warning for trust drafters to avoid using templates. Instead, they should apply their minds to the client, and tailor the trust to the client's circumstances and needs. What is also often forgotten is that once a trust has been formed, trustees have obligations and beneficiaries have certain rights. Planners must analyse whether a trust is indeed the correct vehicle for them, as not all individuals are willing to give up control and that can cause the very existence of the trust to be questioned.

It is recommended that a trust deed undergo a legal audit every three to five years, as legislation and circumstances change. A legal audit is an affordable way to ensure that your deed is up to date, valid and that the provisions promote the fulfilment of the trust's purpose. However, it is crucial that it be done by a professional with extensive experience in trusts.

When making amendments, it is often more beneficial to revise the entire trust deed rather than just addressing problematic clauses. Keeping track of amendments can become difficult, especially if several changes have been made previously.

Trusts can be complex and are often poorly drafted and administered. The duties, roles, and powers of the named trustees as well as the existence of the trust is often overlooked. It is therefore not only important for clients to review their trust deeds often but to ensure that a specialist in the area does the trust audit.

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# Alter Ego Trusts and the Concealment of Assets in Divorce

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## Introduction

It is an unfortunate reality that nearly half of marriages end in divorce. During divorce proceedings, spouses often disagree on how assets accumulated during the marriage should be divided and on the distribution of these assets. They may also experience distress over the manner in which the assets should be distributed.

Divorce has a profound impact on an individual's economic status and quality of life. As a result, some spouses may establish trusts just before divorce or challenge trusts set up by their spouses to maximise their claims.

A key advantage of using a trust is asset protection, including protection from claims arising in divorce. Trusts effectively separate ownership from enjoyment, allowing a person to benefit from an asset without holding legal ownership.

In *PAF v SCF*<sup>1</sup> the Supreme Court of Appeal (SCA) dealt with the issue of the concealment of assets in divorce. There are no legislative provisions specifically governing when trust assets should be considered when determining the patrimonial consequences of a marriage. This article examines what the courts considered in this case and provides guidelines on what to think about before a trust can be questioned and a trust veil lifted in divorce matters.

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<sup>1</sup> 2022 (6) SA 162 (SCA)

## What is a trust?

A "trust" refers to an arrangement in which one person's property is transferred to another person, known as the trustee, through a trust instrument. The trustee is responsible for managing or disposing of the property according to the trust's provisions for the benefit of designated beneficiaries or to achieve specific objectives stated in the trust instrument. This definition excludes scenarios where property is administered by an executor, tutor, or curator under the Administration of Estates Act, 1965 (Act 66 of 1965).<sup>2</sup>

## "Piercing the trust veil"

The term is derived from "piercing the corporate veil" which is provided in section 20(9) of the Companies Act. It refers to the disregard of the legal personality of corporations and holding either the directors/shareholders or members of the entity personally liable for the responsibilities of the business. This would occur in instances where any act on behalf of the entity (company, or a close corporation) constitutes an abuse of the legal personality of the company/close corporation as a separate entity.

This practice is now implemented against trustees who abuse the use of trusts, i.e. where the founder of a trust still controls and manage the assets in the trusts. This is referred to as "piercing the trust veil."<sup>3</sup>

## Matrimonial property regimes

When discussing divorce, it is essential to first understand the different matrimonial property regimes recognised in South Africa, as specified in the Matrimonial Property Act.<sup>4</sup> These include:

- (i) Marriages in community of property;
- (ii) Marriages out of community with the accrual; and
- (iii) Marriages out of community of property without the accrual.

## Marriages in community of property

Upon marriage, the spouses' assets and liabilities are combined into a joint estate and each spouse has an equal share of the joint estate. In the absence of an ante-nuptial contract, marriages in a community of property are the default option for couples. Upon the dissolution of the marriage, either through divorce or death, the joint estate is divided in equal shares between the spouses.

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<sup>2</sup> Section 1 of Trust Property Control Act 57 of 1988.

<sup>3</sup> 71 of 2008.

<sup>4</sup> 88 of 1984.

## Marriage out of community of property with the accrual

Before the marriage, it is necessary to enter into an ante-nuptial contract, which excludes the community of profit and loss. The ante-nuptial contract must be drafted by legal professional with the requisite skill and knowledge and signed in front of a notary public and registered with the Deeds Registry Office.

The accrual can be simply defined as the net value of each spouse's estate, representing the amount by which the net value of their estate at the dissolution of the marriage exceeds the net value at the commencement of the marriage.<sup>5</sup> The accrual system results in the sharing of wealth, ensuring that both spouses maintain independent estates during the marriage. Upon dissolution of the marriage (on divorce or death) the spouse showing the smaller accrual since the inception of the marriage can claim an amount equal to half the difference between the accrual of the respective estates of the spouses.<sup>6</sup>

The accrual system which can protect spouses who may have focused on domestic responsibilities who have not accumulated assets in their own right, and not left destitute by the dissolution of the marriage.

## Marriages out of community of property without the accrual

Before the conclusion of the marriage, it is necessary to sign an ante-nuptial contract in front of a notary and have it registered at the Deeds Registry Office. The contract has to explicitly exclude the application of the accrual system; otherwise, the accrual will automatically apply. Under this property regime, each spouse independently manages their own estate and retains it upon dissolution of the marriage.

Matrimonial property regimes determine the dissolution of estates either at divorce or death and with marriages out of community of property with the accrual, the parties are obligated to disclose their respective estates, to determine if there is an accrual claim.<sup>7</sup> With this context in mind, the issue of concealment of assets in divorce, as addressed in *PAF v SCF*, will now be examined.

## PAF v SCF

The applicant and the respondent were married out of community of property, subject to the accrual system, and were in the process of getting divorced. Twenty days before the divorce trial commenced in the KwaZulu-Natal Division of the High Court in Durban, the applicant established a trust, with his brother as the sole trustee and the parties' minor daughter as the sole beneficiary.

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<sup>5</sup> Supra note 4 section 3.

<sup>6</sup> Supra note 4.

<sup>7</sup> Section 7(3) of Divorce Act 70 of 1979 and supra note 4 Section 3.

The applicant founded the trust under the laws of the British Virgin Islands, pursuant to a settlement agreement with his brother, and concluded a written deed of donation with the trust. Under this deed, he donated a sum of £115 000 to the trust, which was equivalent to R2 205 362 at the time. Around the same time, the applicant transferred a sum of £125 000 (equivalent to R3 377 481 at the time) into his father's bank account, allegedly as repayment of a loan advanced by his father approximately 25 years earlier.

Upon discovering these transactions, the respondent amended her counterclaim to request that the calculation of the accrual include the value of both transactions. The High Court granted a decree of divorce, but reserved judgment on the determination of the proprietary consequences of the marriage. The court later ruled that the two transactions were concluded with the 'fraudulent intention' of depriving the respondent of her rightful accrual claim. Consequently, it ordered that the value of the two transactions be considered part of the applicant's assets for the purposes of calculating the accrual. The High Court subsequently granted the applicant leave to appeal to the full court. However, the applicant failed to prosecute his appeal timeously, resulting in the appeal lapsing.

### Application of the law

The SCA had to determine whether assets donated to a trust during divorce proceedings should be considered as part of the donor spouse's estate for purposes of calculating accrual. In the absence of specific legislative guidelines, the court examined relevant case law and arguments to inform its ruling.

On behalf of the applicant, reference was made to *MM and Others v JM*<sup>8</sup> where it was argued that there was no legal basis for the order made by the High Court. In the *MM* case, the judge distinguished between a court's consideration of a claim for a redistribution order in terms of section 7(3) of the Divorce Act and its consideration of an accrual claim under section 3 of the Matrimonial Property Act. Three propositions were presented as follows:

- (1) An accrual claim was determined on a 'factual and mathematical basis and was not a matter of discretion;
- (2) That there was no authority in the Matrimonial Property Act to have regard to assets which did not form part of a spouse's estate on the basis that it would be 'just' to do so; and
- (3) Lastly, there was no legal basis for an order that assets which did not form part of a spouse's estate should be deemed to form part of it for purposes of determining the accrual.<sup>9</sup>

However, in *RP v DP and Others*<sup>10</sup>, Alkema J took the opposite view. He conducted a thorough analysis of the development of the court's common law power to pierce the corporate veil and explained (at paragraph 31):

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<sup>8</sup> 2014 (4) SA 384 (KZP).

<sup>9</sup> *Supra* note 1 par 33.

<sup>10</sup> 2014 (6) SA 243 (ECP).

'... [T]he power of piercing either the corporate or the trust veil is derived from common law and not from any general discretion a court may have. It is a function quite separate from, for instance, the exercise of discretion in making a redistribution order under section 7 of the Divorce Act and must not be confused or conflated with such power.'

The court in *PAF v SCF* held that although the accrual claim only arises at the dissolution of the marriage, both spouses acquire a protectable contingent right against each other during the subsistence of the marriage, which the law will protect in circumstances of irregularity and a lack of bona fides. Thus, upon vesting of such right, there is a legal obligation on both spouses to satisfy the accrual claim (and hence to share in their respective gains) at the dissolution of their marriage.<sup>11</sup>

Furthermore, section 7 of the Matrimonial Property Act requires both spouses to furnish 'full particulars of the value' of their estates. Therefore, an accurate reflection of the parties' respective accruals is necessary to give effect to the intention behind the legislature's provision of the accrual system in the first place.<sup>12</sup>

Accordingly, where there is an allegation that one of the spouses had sought to evade this obligation by abusing the trust form - for example by transferring assets to a trust to reduce the value of their estate, and consequently their accrual liability - a court is not prohibited from inquiring into that issue. It is empowered to conduct an in-depth examination of the facts to determine whether a trust form has been abused. If this is established in that factual inquiry, the court is empowered to pierce the trust veil and order that the value of such assets be considered in the calculation of the accrual.<sup>13</sup>

## The control test

The test of whether trust assets should be considered when determining the patrimonial consequences of marriage was set out in *Badenhorst v Badenhorst*<sup>14</sup> as follows:

'... To succeed in a claim that trust assets be included in the estate of one of the parties to a marriage there needs to be evidence that such party controlled the trust.....Control must be *de facto* and not necessarily *de iure*.<sup>15</sup> A nominee of a sole shareholder may have *de iure*<sup>16</sup> control of the affairs of the company but the *de facto* control rests with the shareholder. *De iure* control of a trust is in the hands of the trustees but very often the founder in business or family trusts appoints close relatives or friends who are either supine or do the bidding of their appointer. *De facto* the founder controls the trust. To determine whether a party has such control it is necessary to first have regard to the terms of the trust deed, and secondly to consider the evidence of how the affairs of the trust were conducted during the marriage.'

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<sup>11</sup> Supra note 1 para 35.

<sup>12</sup> Supra note 1 para 35.

<sup>13</sup> Supra note 1 para 36.

<sup>14</sup> 2005 ZA SCA 116; 2006(2) SA 255 para 9.

<sup>15</sup> *De facto* describes practices that exist in reality, regardless of whether they are officially recognized by laws. It is commonly used to refer to what happens in practice, in contrast with *de jure* ("by law").

<sup>16</sup> *De jure* describes something that happens according to the law or by right.

The SCA held that the *Badenhorst* test is and should be applicable in marriages subject to an accrual system as both the redistribution order in terms of section 7(3) of the Divorce Act and the accrual system in terms of section 3 of the Matrimonial Property Act, have as their objective, just and fair patrimonial consequences of a marriage.<sup>17</sup> Although the 'control' was not satisfied in the unique circumstances of the present case, this was not decisive, as reliance could be placed upon the proviso to the 'control test' in *Badenhorst*, where a donation is found to have been made with the intention of frustrating the other spouse's accrual claim. The SCA found that the facts of the present case fell within this proviso.<sup>18</sup>

The SCA preferred the approach in *RP v DP* that the power to pierce the trust veil is founded in the common law and exists independently of the Divorce Act or the Matrimonial Property Act and is thus in principle applicable to marriages subject to the accrual system. It viewed the approach in *MM v JM* to be inflexible. The SCA emphasised that where the trust form is abused to prejudice an aggrieved spouse's accrual claim, a court should exercise its wider power in terms of the common law to prevent such prejudice.<sup>19</sup>

The absence of 'control' does not necessarily exclude the possibility of trust form abuse. A court must thoroughly examine the facts of each case to determine allegations of trust form abuse. If such abuse is found, a court is empowered to lift the trust veil.<sup>20</sup>

### The court's factual enquiry

The SCA then turned to the factors which the High Court had considered for its conclusion that the value of the donation to the trust should be deemed as part of the applicant's assets for the purposes of calculating the accrual. The factors were:

#### (1) The timing of the creation of the trust and the donation made to it;

The applicant offered no credible explanation for why he was genuinely motivated to create a trust for the parties' daughter before the trial was due to start, where the issue of maintenance for the child was to be determined.<sup>21</sup>

Closely connected to the timing of the creation of the trust and the donation to it, are two further considerations, namely;

- the motivation why the applicant sought legal advice about the creation of the trust,<sup>22</sup>
- the transfer of funds to the applicant's father. The applicant had the funds available and chose to repay the 'loan' just before the respondent's accrual claim was to be determined in court.<sup>23</sup>

The timing was suspicious, and the applicant failed to provide an explanation.

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<sup>17</sup> Supra note 1 para 41.

<sup>18</sup> Supra note 1 para 42.

<sup>19</sup> Supra note 1 para 39.

<sup>20</sup> Supra note 1 para 44.

<sup>21</sup> Supra note 1 para 47.

<sup>22</sup> Supra note 1 para 48.

<sup>23</sup> Supra note 1 para 49.

**(2) The fact that the trust was established in the British Virgin Islands;**

It seems that the applicant's wish was to place the trust, and the donation made to it out of the respondent's reach. There is no credible explanation as to why the trust could not be created in South Africa.<sup>24</sup>

**(3) The applicant did not consult the respondent about the creation of the trust;**

The applicant's response is that because the parties were married out of community of property, he was free to do as he pleased with his separate asset. However, the trust and donation were purportedly made for the benefit of their daughter. This is a significant financial decision affecting one's child to which the respondent (mother) would ordinarily have been privy.<sup>25</sup>

**(4) That there was no immediate need to provide for the maintenance of the child;**

Had the donation not been made, the amount of the donation would have been available in the calculation of the applicant's accrual and what the respondent was entitled to as her accrual share. This would similarly apply with respect to the deceased estate in the event of the applicant's untimely passing.<sup>26</sup>

Given these considerations, the fact that the respondent was not consulted on the creation of the trust, stood out oddly. This is particularly so in the light of the respondent's contingent right to share in the accrual, as mentioned earlier.

The SCA considered each of these factors and concluded that the High Court was correct in its decision to go behind the trust form and order that the value of the donation to the trust be considered as part of the applicant's assets in calculating the accrual. It thus concluded that the appeal was correctly dismissed, and accordingly, there were no prospects of success on the underlying legal issue.

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<sup>24</sup> Supra note 1 para 51.

<sup>25</sup> Supra note 1 para 52.

<sup>26</sup> Supra note 1 para 53.

## Trusts and divorce: How to avoid the trust veil from being pierced

To prevent the trust veil from being pierced, attention should be paid to the **governance** of the trust and the **time frame** of establishing the trust.

### 1. Governance

#### Control of the trust assets

The trust assets should not be under the control of the founder of the trust. The founder must relinquish ownership of the property, and not have form of control over the trust assets.<sup>27</sup> The founder relinquishes ownership by giving/donating his assets to the trustees or beneficiaries as per the definition of a trust above.

It is the responsibility of the trustees to manage the trust assets on behalf of the beneficiaries. The trust deed should further include a clause that emphasises the separation of control over trust assets from the founder. For example:

*"Notwithstanding the provision of this trust deed; no individual person, including the founder, may control, dispose of or make use of the capital or income of the trust save by permission of the majority of trustees."*<sup>28</sup>

#### Appointment of trustees: Right to hire and fire

It is common for the founder to have the authority to appoint and remove trustees in practice. However, the risk associated with this right is that the South African Revenue Service (SARS) could claim that the founder or any individual retaining such authority has maintained effective control over the trust property and is competent to dispose of the assets for the benefit of his or her estate.<sup>29</sup>

Consequently, upon the person's death, the property may be deemed property for estate duty purposes. Therefore, it is suggested that the right to appoint and/or remove trustees should be determined by a majority of the other trustees and not be limited to the founder or any other person.

- Furthermore, the following requirements must be met for the proper appointment of a trustee is typically appointed in terms of the trust deed. If a trust deed fails to appoint a trustee, the Master will make the appointment;
- the person must have the capacity to act as trustee and the must not be disqualified from doing so;
- the person appointed must obtain written authorisation by the Master to act as trustee;
- the person must accept appointment as trustee; and the person must furnish security if required to do so.<sup>30</sup>

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<sup>27</sup> Supra note 2.

<sup>28</sup> South African Financial Handbook 2024 (21<sup>st</sup>) edition Chapter 32.18.

<sup>29</sup> In terms of section 3(3)(d) of the Estate Duty Act 45 of 1955.

<sup>30</sup> Supra note 28 Chapter 32.11.

## Appointment of independent trustees

*In the context of alter ego trusts and the concealment of assets in divorce proceedings, the appointment of independent trustees is a critical factor. An individual or a company can act as a trustee, but the trust must have at least one independent trustee, and it is preferable to have a significant number of independent trustees. This arrangement allows for the separation of control over the trust assets from their beneficial use, helping to ensure transparency and mitigate claims of misuse or manipulation of trust assets.*<sup>31</sup>

## Administration of the trusts

Trustees have a duty to maintain records and ensure accountability. According to section 11 of the Trust Property Control Act, every trust must have an asset register. Trustees must clearly indicate, through the registration or identification of trust property, that it is indeed trust property. Additionally, under section 10, a trustee is required to open a separate trust account at a banking institution. This means that each trust must have its own bank account, ensuring that the funds of one trust are not mixed with those of another. A well-managed trust demonstrates that it was established without malice. Furthermore, adherence to the requirements set forth in the Trust Property Control Act regarding record-keeping and separate banking accounts safeguards against potential concealment of assets, ensuring that the trust is managed in a manner that upholds the principles of fairness and accountability.

## 2. Timing of the trust

The founder should avoid establishing a trust during divorce proceeding or just before divorce proceeding are initiated, as that may be an indication that the trust is merely an alter ego to conceal assets from the other spouse. The timing of setting up a trust is closely linked to the true intentions behind the trust. If the intent is to hide assets, the courts have the authority to lift the trust veil and consider the trust assets for distribution in divorce matters.

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<sup>31</sup> Supra note 28.

## Conclusion

It is clear that when a court pierces the trust veil, this action is not related to the exercise of a statutory discretion in terms of either the Matrimonial Property Act or the Divorce Act. Instead, the court does so based on its common law authority, which derives from the principles of piercing the corporate veil in the realm of company law.<sup>32</sup>

Trusts are valuable estate and financial planning tools, widely used for purposes such as asset freezing and asset protection, amongst other things. However, if a party transfers assets into a trust with the intention of misleading or defrauding a spouse of their potential claims in an imminent divorce action, the validity of the trust may be called into question due to the lack of bona fides on the part of the founder or trustees.

Given the above considerations, it can be concluded that the timing of setting up a trust is crucial in determining whether it functions as an alter ego trust. In addition to timing, the motive of the founder should be examined and if there is any conflict of interest. A thorough factual enquiry can help prevent parties in divorce proceedings from concealing assets in alter ego trusts.

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<sup>32</sup> Supra note 3 para 37.

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Companies Act 71 of 2008

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Estate Duty Act 45 of 1955

Matrimonial Property Act 88 of 1984

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## Section 4(q) Via Testamentary Trust

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### Introduction

For financial planners, setting up the right structures to build and protect clients' assets is crucial, both during their lifetime and after their death. A last will and testament, combined with a comprehensive estate plan, plays a key role in minimizing taxes, preventing conflicts among dependents, and protecting accumulated wealth for beneficiaries. One way to minimise taxes is by using the section 4(q) deduction under the Estate Duty Act.<sup>1</sup> This means that any asset bequeathed by the first-dying spouse to the surviving spouse will be exempt from estate duty and capital gains tax.

In many cases, the first dying spouse wants to leave their entire estate to the surviving spouse to utilise the section 4(q) deduction, but they may also be concerned about what happens if the surviving spouse remarries or depletes all the funds, leaving nothing for the children.

The question is, can you benefit your spouse and qualify for section 4(q) in terms of the Act and also pass your assets on to children at the same time?<sup>2</sup> Yes, you can. By using a testamentary trust in the correct manner, in accordance with your last will and testament and by meeting the requirements set out in section 4(q)(ii), this is possible.<sup>3</sup>

The focus of this article is to explore how to qualify for section 4(q) via a testamentary trust while ultimately passing the capital to your children upon a certain event.<sup>4</sup>

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<sup>1</sup> Estate Duty Act 45 of 1955.

<sup>2</sup> Estate Duty Act 45 of 1955.

<sup>3</sup> Section 3: Estate Duty Act 45 of 1955.

<sup>4</sup> Estate Duty Act 45 of 1955.

## What is estate duty and capital gains tax?

Estate Duty is levied on the worldwide property and deemed property of a natural person who is ordinarily resident in South Africa and on South African property of non-residents. Estate duty is levied on the net estate, known as the dutiable estate. The net estate is calculated by deducting allowable deductions under section 4 and the section 4A abatement which is R3 500 000 from the total value of the estate. The first R3 500 000 of a person's estate is exempt from estate duty. The estate duty rates are 20% for estates valued below R30 million and 25% for estates greater than R30 million.<sup>5</sup>

While death triggers potential estate duty it is also considered a deemed disposal for capital gains tax purposes. According to paragraph 40(1) of the Eighth Schedule of the Income Tax Act, the deceased is deemed to have disposed of their assets at market value at the time of death, with the base cost determined similarly. At death, there is a once-off exclusion of R300 000. This means that the R300 000 of the gain or the loss will not attract any tax on capital gains made. Any amount over and above the R300 000 will have an inclusion rate of 40% and then this amount will attract the applicable tax as per the deceased individual's marginal rate.

Transfers of assets to a surviving spouse is seen as a "roll-over regime" and are governed by section 9H of the Income Tax Act. When assets are transferred between spouses, any capital gain or loss is disregarded. This also applies to sales or donations between spouses. However, the surviving spouse's estate remains liable for estate duty and capital gains tax on their death.

## Section 4(q) deduction of the Estate Duty Act

Section 4(q) of the Estate Duty Act provides that so much of the value of any property included in the estate which has not been allowed as a deduction under the foregoing provisions of section 4 of the Estate Duty Act, as accrues to the surviving spouse of the deceased: Provided that-

- (i) The deduction allowable under the provisions of this paragraph shall reduce by so much of any amount as the surviving spouse is required in terms of the will of the deceased to dispose of to any other person or trust;
- (ii) No deduction shall be allowed under the provision of this paragraph in respect of any property which accrues to a trust established by the deceased for the benefit of the surviving spouse if the trustee of such trust has the discretion to allocate such property or any income therefrom to any person other than the surviving spouse.

This means that spouses enjoy a certain amount of leniency from the South African Revenue Services (SARS) when transferring assets between them. Should the marriage dissolve by way of death, the deceased spouse will not pay estate duty on any of the assets bequeathed to the surviving spouse due to the deduction under the provisions of section 4(q) of the Estate Duty Act.

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<sup>5</sup> Section 4A of the Estate Duty Act 45 of 1955.

Furthermore, with effect from 1 January 2010, the portion of the abatement amount not used as section 4A abatement (currently R3 500 000) will be rolled over to the estate of the surviving spouse. This could result in the surviving spouse having an abatement of up to R7 000 000.<sup>6</sup> The abatement may only be claimed if the executor submits the estate duty return of the first dying spouse.<sup>7</sup>

### **Who qualifies to be a surviving spouse for section 4(q) purposes?**

Different laws serve different purposes and contexts. Tailoring the definition of "spouse" ensures that the law is applied correctly and fairly in each specific context, whether it is for tax purposes, inheritance, or maintenance. Each Act has its own objectives and policy goals. For example, the definition of "spouse" in the Maintenance of Surviving Spouses Act might be broader to ensure financial support, while the definition in tax legislation might be more specific to prevent abuse of tax benefits.

The Estate Duty Act has a broader definition of "spouse" to ensure comprehensive financial protection and support for all types of surviving partners, unlike the Income Tax Act which has a narrower definition to prevent tax benefit abuse.

### **Surviving spouse in terms of the Estate Duty Act**

The Estate Duty Act defines a "spouse," in relation to a deceased person, as a person who was their partner at the time of death, in:

- (a) a marriage or customary union recognised by South African law;
- (b) a union acknowledged as a marriage according to religious beliefs; or
- (c) a same-sex or heterosexual union deemed by the Commissioner to be intended as permanent.

Additionally, any marriage or union described in paragraphs (b) or (c) will be without community of property unless proven otherwise.

### **Surviving spouse in terms of the Income Tax Act<sup>8</sup>**

In terms of section 1(1) a spouse in relation to any person, means a person who is the partner of such person-

- (a) in a marriage or customary union recognised in terms of the laws of the Republic.
- (b) in a union recognised as a marriage in accordance with the tenets of any religion; or

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<sup>6</sup> Section 4A (2) of the Estate Duty Act 45 of 1955.

<sup>7</sup> section 4A (5) of the Estate Duty Act 45 of 1955.

<sup>8</sup> Section 1 (1) Income Tax Act 58 of 1962

(c) in a same-sex or heterosexual union which is intended to be permanent, and “married”, “husband” or “wife” shall be construed accordingly: Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union out of community of property.

### **Surviving spouse in terms of the Maintenance of Surviving Spouses Act<sup>9</sup>**

In terms of the Maintenance of Surviving Spouses “ surviving spouse” means in a marriage dissolved by death and includes a spouse of a customary marriage which was dissolved by a civil marriage contracted by her husband in the customary marriage to another woman on or after 1 January 1929 (the date of commencement of sections 22 and 23 of the Black Administration Act, but before 2 December 1988 (the date of commencement of the Marriage and Matrimonial Property Law Amendment Act)).<sup>10</sup>

### **Surviving partner qualifying for section 4(q)**

The Income Tax Act includes a life partner in the definition of spouse, and it extends to donation tax, which isn't payable on donations made between life partners.<sup>11</sup> The Estate Duty Act also provides the inclusivity of a life partners upon one's demise. This means that section 4(q) deduction is enjoyed by the surviving life partner should the deceased leave their entire estate to the surviving partner.

### **Implementation of section 4(q) via testamentary trust**

#### **What is a testamentary trust and how is it created?**

A trust is an agreement which is created to hold assets for the benefit of certain persons or entities (beneficiaries).<sup>12</sup> In terms of common law, a testamentary trust is in line with the approach that it is to be regarded as a will and the rule, *voluntas testatoris servanda est*.<sup>13</sup>

Testamentary trusts are commonly known as will trusts and is established in accordance with the terms outlined in the last will and testament, which serves as the trust deed. These terms will specify the income and/or capital beneficiaries, trustees of the trust, when the trust will terminate and the powers and responsibilities of the trustees. Testamentary trusts are often created to hold property for the benefit and protection of the interest minors and other persons who are incapable of managing their own affairs.

A Testamentary trust cannot be registered with the Master of the High Court during the lifetime of the testator. Testamentary trusts exist from the testator's date of death.

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<sup>9</sup> Maintenance of Surviving Spouses Act 27 of 1990

<sup>10</sup> Marriage and Matrimonial Property Law Amendment Act 3 of 1988

<sup>11</sup> Section 1(1) of the Income Tax Act of 58 of 1962.

<sup>12</sup> Section 1 of the Trust Property Control Act 57 of 1998.

<sup>13</sup> Effect should be given to the testator's and/or testatrix's wishes.

By drafting a valid will, a testamentary trust is created. At the winding up of the deceased estate, the executor will follow the specific stipulations in a person's will that a trust must be set up. These stipulations in the will serves the same purpose as a trust deed, which means that the will is the trust deed. The will must contain evidence that it is the testator's or testatrix's intention to create a trust, and it must be clear on what property must be moved into the trust and full details each beneficiary and trustees.

### Requirements for a valid will

Although the legislation does not define the term "will", a will can be defined as a unilateral, voluntary declaration of will by the testator in a legally prescribed way specifying how their estate should be distributed upon their death.<sup>14</sup> A will is expressly excluded from the provisions in terms of the Electronic Communication and Transaction Act 25 of 2002 and must be a physical document. Pursuant to section 1 of the Wills Act a testament also means a "codicil and any other testamentary document but must meet the requirements set out in section 2(1) (a) of the law.

The valid execution of a will means that all the statutory requirements set for the creation of a will are met. The formalities for the valid execution of a will are regulated by section 2(1)(a) of the Wills Act 7 of 1953.

The first requirement is that the testator signs the will at the end of it in the presence of at least two competent witnesses. The second requirement is that if it is signed by someone else signing the will on behalf of and at the direction of the testator in the presence of the testator, at least two competent witnesses and a commissioner of oaths, and the commissioner of oaths certifying the will.

Meyerowitz and Cilliers<sup>15</sup> states for a will to be drafted well, certain general rules should be followed:

1. A well-drafted will should be clear to any person to able them to understand the will; the will should not be vague.
2. It should be clear that the draftsman by knowing exactly what he is meant to say; the language should be in accordance with the rules of grammar.
3. The draftsman must be sure that he understands the wording he is using and the words that should be always throughout the will have the same sense.
4. Words which are vague and depend upon their context for their meaning or which are capable of more than one meaning should be either be avoided or precisely in the will; the order of the will should be logical.
5. The draftsman should use paragraphing and or clear reference and the draftsman should have a good knowledge of the practical aspects of winding up an estate.

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<sup>14</sup> <https://www.investopedia.com/terms/w/will.asp>

<sup>15</sup> Meyerowitz and Cilliers's : The Law and Practice of Administration of Estates and Their Taxation (2023)

## The impact of the Intestate Succession Act 81 of 1987

If a spouse or a partner dies without a will, the estate falls under the law of intestacy. This means that a person cannot prescribe how his estate should be divided at his death and there will be no control over estate duty and capital gains tax consequences. The person also loses the benefit of utilising section 4(q) and cannot use a testamentary trust for inheritance, but most importantly the person cannot protect any assets against creditors or any other third parties.

## Qualifying for the section 4(q) deduction via testamentary trust

The section 4(q) testamentary trust can be structured with the section 4(q) deduction of the Estate Duty Act in mind. This provision is stipulated in section 4(q)(ii), but this deduction is only applicable if the wording in the last will and testament is precise. In terms of section 3(2)(a) of the Estate Duty Act, "property" includes "any fiduciary, usufructuary, or other like interest". This means that any property bequeathed to the trustee(s) of the widow trust for the benefit of the surviving spouse will qualify for section 4(q) deduction as the surviving spouse is the sole income beneficiary of the trust during their lifetime. However, no deduction will be allowed if a trustee has a discretion to allocate such property or any income therefrom to any person other than the surviving spouse.

Section 4(q)(ii) of the Estate Duty Act states that no deduction shall be allowed under the provision of section 4(q) in respect of any property which accrues to a trust established by the deceased for the benefit of the surviving spouse, if the trustee of such trust has a discretion to allocate such property or any income therefrom to any person other than the surviving spouse. Therefore, should the trustees benefit only the surviving spouse section 4(q) deduction will qualify.

This unique estate planning tool can protect children's inheritance while also benefiting a surviving spouse. A section 4(q) testamentary trust typically structured to safeguard the surviving spouse, especially if they have limited financial knowledge or capability. The spouse becomes the exclusive income beneficiary for their lifetime, ensuring financial security while preserving capital for eventual distribution to the children.

In the **Income Tax Case 1520 (54 SATC)**, the court had to decide whether a deduction was permissible. The value was not seen as a deduction by the Commissioner of Inland Revenue. The testator had directed that the income of a trust created in terms of his will was to be available to the administrators (trustees) of the trust, for the maintenance and welfare of his wife and any surplus income being retained as income or re-invested as capital at the discretion of the administrators (trustees). The trust would terminate upon the death of the testator's wife when the assets would devolve upon his three sons or their issue. The issue here was that the testator died in 1986, before section 4(q) was contained in the Act. The court concluded that as it was clearly the deceased's intention that the administrators (trustees) of his estate should use the entire income from the trust for the benefit of his wife and that a beneficial interest which fell within the definition of property has accrued to her.

The court held that the Commissioner was incorrect in not allowing a deduction under section 4(q) of the Estate Duty Act.

### **What is capital in a section 4(q) testamentary trust?**

For the purpose of trust and estates, any gain or loss arising from the sale of an asset is considered to be capital. It must also include any expenses incurred during the maintenance and sale of the asset.

### **What is income in a section 4(q) testamentary trust?**

Income is defined as any income that is produced by an asset, excluding the profit made of the sale of an asset or from a business. Examples of income includes interest, dividends, business profits and rent received.

### **The income and capital beneficiaries in the section 4(q) testamentary trust**

The will must distinguish between capital and income beneficiaries, who will be entitled to income and/or capital. But as mentioned above it is important to qualify for the section 4(q) deduction the surviving spouse must be income and capital beneficiary during his/her lifetime or base of the conditions on when the trust must terminate to ensure that the ultimate capital beneficiaries are the children.

### **The trustees of the section 4(q) testamentary trust**

In the will the testator must nominate trustees. The trustees' obligations are to keep records, administrating the trust, manage the assets and distribute any or all income and capital to the beneficiary, in this case to the surviving spouse.

### **Tax implications of the section 4(q) via testamentary trust**

The section 4(q) testamentary trust is not classified as a special trust. Therefore, any income generated in the trust is taxed at 45%.<sup>16</sup> However, if section 25B of the Income Tax Act is applied and the income is distributed to the surviving spouse as the sole income beneficiary, it will be taxed at their individual marginal rate rather than at the 45% trust income tax rate. This is known as the conduit principle.

Additionally, any capital gains within the trust is taxed at 36%. Paragraph 80(20) of the Eighth Schedule does not apply here, because the ultimate capital beneficiaries cannot benefit until death of the income beneficiary.<sup>17</sup>

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<sup>16</sup> *Income Tax Act 58 of 1962.*

<sup>17</sup> Paragraph 80 of the Eighth Schedule deals with capital gains attributable to beneficiaries of trusts. When an asset is vested by a trust in a South African resident beneficiary, a capital gain flowing from the vesting is generally attributed to the resident beneficiary.

## Example of 4(q) testamentary trust wording in the last will and testament

It is important for the testator to use the correct wording in the last will and testament to qualify for the South African Revenue Service to allow section 4(q) deduction in terms of the deceased estate. **An example of such a will:**

This is the last will of me (the name and identity number of the testator), married out or in community of property to (name of spouse), presently domiciled and resident at (specify).

- **Revocation:**

I revoke all my previous wills made by me.

- **Nomination of executor and trustees and waiver of security:**

I nominate (name of nominee) as the executor of my will and the trustee of my estate with the power of assumption and substitution and I hereby direct that they be exempted from having to find security for the due fulfilment of their duties as such.

- **Bequest of estate:**

"I bequeath my entire estate to the trustee(s) of a widow's testamentary trust to be established on the date of my death and subject to the provisions of the relevant clause named in my last will and testament."

- **Income and/ or beneficiary clause:**

The said spouse, shall be the income beneficiary of this trust, during her lifetime; or

The capital beneficiary will be my wife, and those nominated in the capital clause below, other than my wife, the capital beneficiaries will not have access to the capital during my wife's lifetime; or

The Trustee(s) shall provide income from the Trust for the maintenance and general benefit of my wife, and shall, after provision for reasonable living expenses and the cost of maintaining the assets, pay the net monthly to my wife; or

If the net income is insufficient to cover these living expenses and costs, I authorize the Trustees to use some of the trust capital, solely for the benefit of my spouse, over which my Trustee(s) have no discretion, to meet this shortfall to fill."

It is my intention to give my trustee/s powers in the widest sense and therefore, all words and sentences contained herein should be interpreted. In this will, unless the context is indicated otherwise, the following words shall have the following meanings:

"Capital" means the entire estate as referred to above as well as capital gain made on the realisation of an asset, this excludes any income but including any net income which has accrued to the capital.

"Net income" means the balance of the income out of my trust after my trustee/s has paid and all other expenses in regard to my trust have been covered.

"Heirs" are my said (specify) children or their issue *per stirpes*.

"Maintenance" means the amount which my surviving spouse requires to maintain a reasonable standard of living, taking into consideration the standard of living which were

accustomed to and shall include payment of money by my trustee/s to cover fully or partially their costs of living, reasonable expenses and pleasures, vacations, traveling, medical and similar expenses.

- **Income/ Capital to surviving spouse:**

My trustee/s shall pay the income from trust as maintenance to my said spouse (name) until his/her death (or remarriage). If the said spouse considers that such income is not sufficient for the maintenance of themselves, my trustee/s at their discretion may pay a portion of the capital of the trust.

- **Termination clause:**

Upon the death or the remarriage of my spouse, whichever occurs first, the trust shall terminate, and my trustees shall pay the capital of the trust, or so much thereof as shall then remain, to my children who have already attained the age of (*specify*) years, shall receive his or her share of the capital of the trust.

If any of the children should die before reaching the age of (*specify*) years, the portion of the remaining capital of the trust which has been paid to such child shall go to his or her children in equal shares *per stirpes*.

## Conclusion

it is clear from the discussions above that a person can still qualify for a section 4(q) deduction by establishing a testamentary trust. Through careful estate planning and by drafting a valid will, an individual can ensure that their surviving spouse is supported, their assets are protected, and their children benefit from their estate.

It is important that the last will and testament are drafted correctly for the South African Revenue Service to allow the section 4(q) deduction.<sup>18</sup> This means that the testamentary trust clauses in the will needs to be in line with the requirements stipulated in section 4(q) (ii).<sup>19</sup> It is also important that the surviving spouse is the “only” income and capital beneficiary of the testamentary trust to qualify for the deduction.<sup>20</sup> However, the testator and testatrix can set the terms and conditions in the last will and testament for when the trust can terminate and ultimately benefit the children. It is advisable to consult with a legal professional who specialises in estate planning to ensure that the will is compliant and optimally structured to maximise the benefits of section 4(q). This will help avoid potential issues with the SARS and ensure that the estate is distributed according to the testator's wishes.

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<sup>18</sup> *Estate Duty Act 45 of 1995.*

<sup>19</sup> Section 4 (q): *Estate Duty Act 45 of 1995.*

<sup>20</sup> Section 4 (q): *Estate Duty Act 45 of 1995.*

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# Considerations in Respect of Digital Assets in the Estate Planning Process

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## Introduction

Estate plans and individuals' last wills and testaments primarily account for traditional assets with economic value, such as real estate, cars, jewellery, art, bank accounts, investments, and policies. However, living in a digital age with rapid technological developments, has significantly changed in the nature of these traditional assets and how we deal with them. With widespread adoption of digital channels, investment and banking accounts are now fully accessible online, information is stored in the cloud, and physical photographs and music collections have been replaced by digital images and streaming playlists. Additionally, certain investments now exist solely in digital form, held in digital wallets.

There has also been widespread adoption by individuals and businesses of storing and accessing information in the “cloud” or through other digital means. Physical photographs have been replaced by digital images, music collections no longer consist of records and CDs but are now playlists on streaming services,<sup>1</sup> and certain investments only exist in digital form, held in digital wallets.

This shift has led to the emergence of the concept of “digital assets”, with explosive growth in volume of ownership and control of such assets.<sup>2</sup> Digital assets include a wide range of items, some of which hold monetary value, like cryptocurrencies and non-fungible tokens, which exist solely in digital form, while others may only hold sentimental value or only has value for the creator, like personal photographs. The rise of social media influencers and content creators, along with the monetisation of social media accounts and other personal digital assets, has also created a whole new subclass of digital assets. The term “digital assets”, therefore, now encompasses much more than the traditional concept of “assets” which are generally resources expected to provide a future benefit to its owner<sup>3</sup>.

Digital assets are often entirely overlooked by estate planners in the estate planning process.<sup>4</sup> This is not necessarily because these assets are unimportant, but often estate planners are unsure or lack the knowledge about which digital assets to include, and how to classify and deal with these assets in estate plans. Additionally, some individuals may not recognize the potential value of their digital assets, or they may be unaware of which assets they own and can bequeath.

A survey conducted by Canada Life in February 2024<sup>5</sup> highlights this gap, revealing that while 95 percent of adults in the United Kingdom have digital assets (which for purposes of the survey included electronic devices such as smartphones, laptops and tablets, as well as soft assets such as photos, subscriptions and social media accounts), and 49 percent have wills, only 12 percent have included at least one digital asset in their wills. Approximately 37 percent have not considered their digital assets when drafting wills. Even though 69 percent of adults have social media accounts or profiles, only 9 percent have included this in their wills and only 19 percent of the survey participants left instructions or passwords in respect of their digital assets.

As our online presence grows, and more aspects of our lives are managed digitally digital assets and personal information are becoming increasingly valuable. An individual potentially has a whole virtual estate consisting of digital assets.<sup>6</sup> Therefore, there is a real risk that these digital assets, and their associated value, whether monetary or sentimental, may be lost or misused if not identified, managed and included in the estate planning process. However, digital assets pose conceptual challenges for estate planning and succession,<sup>7</sup> Especially

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<sup>1</sup> TM Ferges 'Estate Planning and Administration in the Digital Age' (2018) November *Taxes The Tax Magazine* 33 at 33.

<sup>2</sup> R Genders and A Steen 'Financial and estate planning in the age of Digital assets: A Challenge for advisors and administrators' (2017) 3(1) *Financial Planning Research Journal* 75 at 77.

<sup>3</sup> The Investopedia Team 'What is an asset? Definition, Types, and Examples' available at [www.investopedia.com/terms/a/asset.asp](https://www.investopedia.com/terms/a/asset.asp), accessed on 8 November 2024.

<sup>4</sup> Genders & Steen op cit note 2 at 77.

<sup>5</sup> Canada Life 'Only 12% of people with a will include their digital assets' available at [www.canadalife.co.uk/news/only-12-of-people-with-a-will-include-their-digital-assets](https://www.canadalife.co.uk/news/only-12-of-people-with-a-will-include-their-digital-assets), accessed on 8 November 2024.

<sup>6</sup> Ferges op cit note 1 at 33.

<sup>7</sup> H Conway and S Grattan 'The "new" new property: Dealing with Digital Assets on death' (2017) 9(1) *Modern Studies in Property Law* 99 at para III.

given the lack of a clear legal definition. This article explores the topic of digital assets and provide potential solutions and guidelines for financial planners and their clients to effectively integrate them into estate planning.

## What is a digital asset?<sup>8</sup>

Most laws relating to estate administration were written well before the digital era leaving no clear definition of a digital asset in South African law or global standard.<sup>9</sup>

Definitions vary from simple, such as "... any assets that can be accessed and held online in digital form",<sup>10</sup> to more technical, like "...any item of text or media that has been formatted into a binary source that includes the right to use it".<sup>11</sup> Some definitions focus on potential value creation,<sup>12</sup> while others disregard value entirely.

The term digital asset is often only used in the context of crypto assets.<sup>13</sup> However, digital assets encompass much more than only crypto assets.

One of the few definitions of a digital asset that exists in legislation is contained in the Revised Uniform Fiduciary Access to Digital Assets Act (2015) ("RUFADAA"), legislation enacted in the United States of America. A digital asset is defined in the RUFADAA as "an electronic record in which an individual has a right or interest".<sup>14</sup> A record in this context means information inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.<sup>15</sup> Therefore, it will include any electronically stored information, whether the location where the information is stored is the internet, social media apps, emails, a private computer network, personal computer, table, phone or external portable storage device.<sup>16</sup> The definition does not include an underlying asset or liability unless the asset or liability is itself an electronic record.<sup>17</sup> As an example, while an online investment account is a digital asset the cash deposited into the account and accessed through the online account is not in itself a digital asset. However, if a cryptocurrency is deposited into an online account, both the online account and the cryptocurrency are digital assets as cryptocurrency is itself a digital asset.<sup>18</sup> Note that the definition does not require the digital asset to have extrinsic or economic value, or to be an "asset" in the traditional sense of the word.

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<sup>8</sup> For purposes of this article, references to digital assets include digital assets in the broad sense, and not only those with economic value or benefit similar to traditional assets.

<sup>9</sup> Genders & Steen op cit note 2 at 79.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> The Investopedia Team 'Digital Asset: Meaning, Types, and Importance' available at [www.investopedia.com/terms/d/digital-asset-framework.asp](https://www.investopedia.com/terms/d/digital-asset-framework.asp), accessed on 8 November 2024.

<sup>13</sup> Financial Sector Conduct Authority GN 1350 of 19 October 2022: Declaration of a crypto asset as a financial product under the Financial Advisory and Intermediary Services Act, 2022, defines "crypto asset" as a digital representation of value that (a) is not issued by a central bank, but is capable of being traded, transferred or stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility; (b) applies cryptographic techniques; and (c) uses distributed ledger technology. Cryptocurrencies, like Bitcoin, are examples of crypto assets.

<sup>14</sup> D Walker 'The New Uniform Digital Assets Law: Estate Planning and Administration in the Information Age' (2017) 52(1) *Real Property, Trust and Estate Law Journal* at 53.

<sup>15</sup> Walker op cit note 13 at 53.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

<sup>18</sup> Ferges op cit note 1 at 34.

There is a seemingly endless list of things that can constitute digital assets in terms of the very broad definitions mentioned above and the list keeps growing as technology advances. Digital assets can contain personal or business information and can be income producing, or merely sentimental. Though there might be some overlap, and different authors list or classify different items as digital assets, Beyer suggests the following classifications:<sup>19</sup>

#### ❑ **Personal**

These are personal or sentimental assets held on an electronic device or in the cloud. These can include emails, messages in messaging apps such as WhatsApp, and personal files, digital photographs, videos and audio files.<sup>20</sup>

#### ❑ **Social media**

Social media profiles and accounts involve interactions with other people on websites or through apps e.g. Facebook, X, Instagram, LinkedIn, and YouTube accounts. It may also overlap with personal assets, as it may include social media messaging and can also serve as storage for photos, videos, and other electronic files.<sup>21</sup> These accounts or websites can also host blogs, vlogs and podcasts. It may be used for personal use or could be monetised.

#### ❑ **Financial accounts**

These include online bank, investment and other financial accounts (including crypto assets). These accounts are increasingly designed to be accessed only online with few to no paper records or monthly statements.<sup>22</sup> Many financial institutions also no longer email statements, but information can be accessed by the account holder logging onto an online account. This also includes crypto assets and tokens. Many people also pay accounts, subscriptions, etc., through online payment accounts like PayPal. Users can link a debit or credit card to the account or transfer funds into a wallet to use for online payments. Payment solutions, like Payflex, allow users to buy and receive an item upfront from an online seller, but pay for the item in instalments at no additional cost or interest.

#### ❑ **Business accounts**

This includes information stored by individuals engaged in business activities or commerce and includes a wide range of information relating to the business, its customers, debtors, etc.<sup>23</sup>

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<sup>19</sup> GW Beyer 'Web Meets the Will: Estate Planning for Digital Assets' (2015) 1 *NAEPC Journal of Estate & Tax Planning* 28 at 28-29.

<sup>20</sup>Beyer op cit note 18 at 28.

<sup>21</sup>Ibid.

<sup>22</sup>Ibid at 29.

<sup>23</sup>Ibid.

However, other forms of digital assets have also emerged, which do not necessarily fit neatly into these classifications:

#### ❑ **Website and app registrations and accounts**

This includes a wide variety of registrations and accounts like online shopping or service accounts (e.g. Takealot or UberEats), online gambling accounts, tax submissions (e.g. SARS e-filing) and medical scheme portals.

#### ❑ **Subscriptions**

This could include subscriptions to magazines, papers or online streaming services (e.g. Netflix).

#### ❑ **Loyalty and reward schemes<sup>24</sup>**

Many businesses have created loyalty and reward schemes for their customers. Members of these programs could accumulate a number of points or miles. The rules of the scheme to which the client belongs will determine whether the accrued points may be transferred to someone other than the member.

#### ❑ **Other digital assets<sup>25</sup>**

This could include, for example, virtual gaming assets that may be worth real-world money, digital music and video collections, or which could be used to gain access to other virtual assets, including purchased content, domain names and websites, digital rights to literary, musical, video production, theatrical works, online courses or channels.

Although digital assets are usually accessed via computers, tablets, smartphones and other electronic devices, the actual device on which the digital asset is stored, generated or accessed, is generally not considered a digital asset but is rather referred to as a digital or electronic device. A client can bequeath specific electronic devices in a will, but it does not automatically entitle the beneficiary to the information on, or accessed through, the electronic device.<sup>26</sup> While for many, most of these assets are not income-producing or do not have obvious extrinsic economic value, they may have sentimental value to surviving relatives and friends.<sup>27</sup> For others, like social media influencers and content creators, digital assets are a source of income and may hold considerable value. Mr Beast, estimated the highest earning social media content creator in the world, has earned approximately US\$85m from his social media content, sponsored videos, and paid endorsements.<sup>28</sup>

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<sup>24</sup>Ibid.

<sup>25</sup>Ibid.

<sup>26</sup> C Gilroy 'Digital Inheritance – What happens to your digital assets when you pass away?' *Goughs Solicitors* available at [www.goughs.co.uk/news/digital-inheritance-what-happens-to-your-digital-assets-when-you-pass-away](http://www.goughs.co.uk/news/digital-inheritance-what-happens-to-your-digital-assets-when-you-pass-away), accessed on 14 November 2024.

<sup>27</sup>Walker op cit note 13 at 54.

<sup>28</sup> M Craig et al 'Top Creators 2024' available at [www.forbes.com/sites/stevenbertoni/2024/10/28/top-creators-2024-the-influencers-turning-buzz-into-billions](https://www.forbes.com/sites/stevenbertoni/2024/10/28/top-creators-2024-the-influencers-turning-buzz-into-billions), accessed on 14 November 2024.

Irrespective of the value of the digital assets, every category of digital assets needs to be considered when drafting an estate plan.

### Digital assets as property and the ownership of digital assets

As already noted earlier, digital assets pose various challenges in estate planning and succession. It crosses the boundaries between tangible and intangible assets, economic and sentimental value, and property, intellectual property, contract, privacy and succession law.<sup>29</sup>

Since some digital assets are not property in the traditional sense when considering it for estate planning purposes, it is important to determine whether these digital assets represent a personal right or constitute property, as property is what succession law channels.<sup>30</sup> In addition, even if it does constitute property, it must be determined who the actual owner is, whether it is transferable or not,<sup>31</sup> as all property is not necessarily capable of transfer,<sup>32</sup> and whether it has economic or sentimental value. However, determining these aspects may not be easy and there are varying opinions and a lot of complexities relating to these issues.

According to Conway and Grattan, the most important factor will be the terms of the individual service agreement concluded between the account holder and the service provider.<sup>33</sup> An account may have been used to store or generate a digital asset which is a distinct item of property which may be transferable, and which could constitute intellectual property. In terms of the Facebook and Instagram terms of services, the account holder retains ownership of the intellectual property rights in content the account holder creates and shares. However, the account holder grants these sites permissions to use the content, as detailed further in the terms of service.<sup>34</sup> At the same time, account holders are not allowed to transfer any rights or obligations under the terms to anyone else without Facebook's consent and the account does not confer any third-party beneficiary rights.<sup>35</sup> This means that even with the login details, or a bequest in terms of a will, the account cannot be transferred to the deceased's heirs without the service provider's consent, nor does the beneficiary obtain any rights in respect of the account. It is also not clear whether a service provider has any duty to preserve an account holder's digital assets for the benefit of the estate's beneficiaries.<sup>36</sup>

The terms of service of other websites may provide that information uploaded or shared to the website is owned by website<sup>37</sup> stripping the account holders of their ownership rights in respect of such digital assets, even if they constitute property. The account may also be a licensing or use agreement, such as for software or email accounts, which is generally regarded as a personal right which expires on the death of the individual, and traditionally does not fall within

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<sup>29</sup>Conway & Grattan op cit note 7 at para VI.

<sup>30</sup>Ibid at para III.

<sup>31</sup>C Meyer 'When Two worlds collide: Digital assets and your estate plan' (2024) 30(4) *Trusts & Trustees* 181 at 183.

<sup>32</sup>Conway & Grattan op cit note 7 at para III.

<sup>33</sup>Ibid.

<sup>34</sup>Facebook 'Term of Service' available at [www.facebook.com/legal/terms](http://www.facebook.com/legal/terms), accessed on 14 November 2024 at para 3 and Instagram 'Terms of Use' available at <https://help.instagram.com/581066165581870/>, accessed on 14 November 2024.

<sup>35</sup>Facebook op cit 31 at para 4 and 6.

<sup>36</sup>D Booyens *The impact of privacy policies and terms of service on a user's freedom of testation* (unpublished LLM mini-dissertation, North-West University, 2018) at 36.

<sup>37</sup>Ferges op cit note 1 at 34.

a testator's jurisdiction.<sup>38</sup> However, some may argue that it may constitute subcategories of property because even though a person's email account may be maintained under a licensing arrangement with the service provider, the actual email messages may attract the same property and copyright laws as letters written on paper,<sup>39</sup> though it is not clear whether service providers acknowledge such copyright.<sup>40</sup> Even if they did, access to such emails still remain a challenge.<sup>41</sup> To complicate matters even further, the nature of the asset can change.<sup>42-43</sup> For example, the nature of a digital photograph or an email can change from digital to physical by printing it.

Unlike hard copy books, records, CDs and DVDs, generally movies, music and books in digital form (unless it is original content generated by the account holder and in respect of which they have intellectual property rights), are licensed and not sold to an account holder<sup>44</sup> and cannot be not transferred. For example, the Kindle Store's terms of use stipulate that Kindle content is licensed, not sold, to the account holder by the content provider and the account holder may not assign any rights to the content or any portion of it to any third party.<sup>45</sup> This is certainly true for streaming services but what if the account holder purchased a specific book, song or movie in digital form? Like with hard copies, an account holder can build up a significant library, in respect of which the account holder expended financial resources to acquire such items, and which holds value, and had it been in hard copy, the owner would have been able to sell, bequeath or gift it to someone else. The use and enjoyment obtained through these licences are similar to those obtained in similar items in their traditional form, but it deprives account holders of rights like the right to sell, bequeath or lend such digital assets.<sup>46</sup> Service providers are essentially changing the nature of ownership rights by contractually imposing terms such as prohibiting the right to transfer digital assets, and limiting the rights normally associated with ownership.<sup>47</sup>

Some writers therefore argue that the law should extend the same rights and freedoms to digital assets that it does to most other forms of personal property, that individuals should have decision-making powers in respect of such assets, and that contracts should not be allowed to divest individuals of the ability to control their digital property and redefine property interests in digital assets.<sup>48</sup>

The Administration of Estates Act<sup>49</sup> defines property in section 1 as including any contingent interest property. Due to the broad scope of the definition, one can argue that it would include digital assets<sup>50</sup> giving an executor certain powers in respect of such digital assets. However, for the time being, the position seems to be that an account holder's property and ownership rights attached to digital assets, and consequently whether such digital assets may

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<sup>38</sup>Conway & Grattan op cit note 7 at para III.

<sup>39</sup>Ibid.

<sup>40</sup>Booyens op cit note 33 at 44.

<sup>41</sup>Ibid.

<sup>42</sup>Beyer op cit note 18 at 28.

<sup>43</sup>GW Beyer and KM Griffin 'Estate planning for digital assets' (2011) *July Estate Planning Studies and Briefs* 1 at 1.

<sup>44</sup>Booyens op cit note 33 at 52.

<sup>45</sup>Amazon 'Kindle Store Terms of Use' available at

[www.amazon.com/gp/help/customer/display.html?nodeId=201014950](http://www.amazon.com/gp/help/customer/display.html?nodeId=201014950), accessed on 14 November 2024 at para 1.

<sup>46</sup>Booyens op cit note 33 at 25.

<sup>47</sup>Booyens op cit note 33 at 25.

<sup>48</sup>Conway & Grattan op cit note 7 at para III.

<sup>49</sup>66 of 1965.

<sup>50</sup>Booyens op cit note 33 at 45.

be bequeathed to a beneficiary or transferred, are ultimately dictated by the nature of the digital asset and the terms and conditions of the service provider<sup>51</sup> which may result in a limitation of an account holder's and executor's authority and power in respect of such digital assets.

Estate planners must therefore consider the terms of each agreement that their client, as account holder, concluded with the relevant services provider (usually in the form of the account holder accepting the terms and conditions before the account is created), to determine whether the accounts or digital assets constitute property, whether the client has ownership thereof, whether it may be transferred, and the type of value ascribed to it.

### **Access to digital assets on death or incapacity**

Most clients or their survivors are often more concerned about accessing or terminating online accounts, such as email accounts, upon the individual's death than ownership and transferability of these accounts.<sup>52</sup> This raises questions about access to online accounts, irrespective of whether it is used to store digital assets or whether it is only licence or use agreements. Service providers have increasingly started putting policies in place to regulate access and what happens to an account holder's account on inactivity or death<sup>53</sup>. However, these policies differ and the policies may be unilaterally altered by the service provider.<sup>54</sup> Because of the agreement between the account holder and the service provider,<sup>55</sup> privacy policies and contractual limitations,<sup>56</sup> service providers are often either unwilling or unable to allow third parties, like relatives, to access the accounts where digital assets are stored, in case of the account holder's incapacity or death.

It can be very onerous for family, next of kin, executors or administrators to identify the digital assets held by the client and then engage with each service provider to gain access to accounts or information.<sup>57</sup> If access is denied, they may need to apply to court to compel the service provider to grant access or provide information.<sup>58</sup> This process can be additionally, providing login details to an executor or relatives may contravene the terms of service of the service provider. For instance, Facebook prohibits sharing passwords, granting account access to others or transferring an account to anyone else without their permission.<sup>59</sup>

All of the above pose challenges for executors in South Africa.

In this regard, the USA is again a step ahead with the Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA), which eases the way for fiduciaries to access the client's accounts. The RUFADAA allows fiduciaries<sup>60</sup> the authority to access and manage digital assets

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<sup>51</sup> Ibid at 35.

<sup>52</sup> Conway & Grattan op cit note 7 at para III.

<sup>53</sup> Booysens op cit note 33 at 2.

<sup>54</sup> Conway & Grattan op cit note 7 at para III.

<sup>55</sup> Genders & Steen op cit note 2 at 76.

<sup>56</sup> Booysens op cit note 33 at 2.

<sup>57</sup> Beyer op cit note 18 at 29 and Beyer & Griffin op cit note 40 at 2.

<sup>58</sup> Ibid.

<sup>59</sup> Facebook op cit 31 at para 3.1

<sup>60</sup> Fiduciary is defined in RUFADAA as original, additional, or successor personal representative, conservator, agent, or trustee. Personal representative is defined as an executor, administrator, special administrator, or person that performs substantially the same function.

after a client's death or incapacity, in the same manner that they manage tangible and traditional property and assets,<sup>61</sup> provided the client gave prior consent in their estate planning documents or if a court has appointed the fiduciary. The RUFADAA also grants the service that maintains the digital asset, the "custodian", legal authority to deal with the appointed fiduciaries.<sup>62</sup> The RUFADAA further allows the client to decide on the access given to the executors and follows a three-tier priority system.<sup>63</sup> Online tools, such as Google's Inactive Account Manager<sup>64</sup> and Facebook's Legacy Contact,<sup>65</sup> have priority over other instructions, including the terms of service agreement. In the absence of an online tool, the client's instructions in their will, power of attorney, or other legal documents will be followed. If the client did not address either of these issues, the terms of service agreement will determine the extent of the executor's access. However, even if the client did not give prior consent or appointed a fiduciary, the RUFADAA still provides for a process for the fiduciary to submit a request to the custodian of the digital asset, who must have a process for handling such requests.<sup>66</sup>

The RUFADAA sets out a number of other useful provisions to regulate access to digital assets by fiduciaries. The power afforded to fiduciaries by the RUFADAA to access the digital asset is crucial from an estate administration perspective. If the asset is transferrable, the fiduciary can take control, maintain, manage and dispose of the digital asset in accordance with the client's wishes.<sup>67</sup> It can also assist the fiduciary in identifying other assets in the estate.<sup>68</sup>

Introducing similar legislation in South Africa could enhance the ability of executors to manage digital assets effectively and efficiently, providing clear legal authority and guidelines for accessing, controlling and distributing these asset in line with the deceased's wishes.

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<sup>61</sup>Ferges op cit note 1 at 34.

<sup>62</sup>ibid

<sup>63</sup>K Miller 'The Law Office of Raymond E. Brown, LLC – Estate Planning' 2024 available at [www.raymondbrownlaw.com/rufadaa-explained](http://www.raymondbrownlaw.com/rufadaa-explained), accessed on 11 July 2024.

<sup>64</sup>Google 'About Inactive Account Manager' available at <https://support.google.com/accounts/answer/3036546?hl=en>, accessed on 14 November 2024.

<sup>65</sup>Facebook 'About legacy contracts on Facebook' available at [www.facebook.com/help/1568013990080948](http://www.facebook.com/help/1568013990080948), accessed on 14 November 2024.

<sup>66</sup>Miller op cit note 59.

<sup>67</sup>Ferges op cit note 1 at 34.

<sup>68</sup>ibid.

## Why is it important to include digital assets in estate planning?

### ❑ Prevent losses to the estate and the deceased's beneficiaries<sup>69</sup>

Some digital assets may have monetary value or be income-producing. If the administrator, executor or beneficiaries are unaware of the asset or unable to access them - whether to maintain it or liquidate them - it could result in a financial loss for the estate. In the past, one could sift through postal correspondence to identify assets owned by a deceased person. It is still possible to approach a financial institution with the ID number of the deceased client to establish if they held an account there. However, with the number of financial institutions, locally and abroad, it is impractical to approach each one for verification.

For decentralised assets, like cryptocurrencies, if the investment was made through a crypto asset financial service provider in South Africa, it may be possible to establish if an account was held with the service provider. However, if the asset was acquired or created through other means, there may be no record of them, nor a centralised institution that can search for an account or the assets. In addition, most of these assets can only be accessed with a personal key and will be lost forever if a person does not have the key. For example, Gerald Cotton who died in 2018 held 115 000 customers' cryptocurrency worth US\$190 million in an offline cold wallet to which only he knew the password, rendering the asset inaccessible.<sup>70</sup>

Many digital assets may not have economic value but hold significant sentimental value for friends and family. In the past, special pictures, letters and journals were kept in boxes in a cupboard or in albums. Today, these items are mostly stored in the cloud or posted on social media. If the deceased's survivors are unaware of the existence of these assets or do not know where and how to access them, these digital assets – and the story of the deceased's life - could be lost forever to relatives and future generations.<sup>71</sup>

For instance, when Leonard Bernstein died in 1990, he left behind a password-protected file on his computer containing the manuscript of his memoir. Despite attempts, no one has been able to unlock the file, potentially losing a document of both commercial and sentimental value forever.<sup>72</sup> This highlights the importance of ensuring that digital assets, whether valuable or sentimental, are accessible to loved ones after death.

### ❑ Assist in the administration of the estate<sup>73</sup>

Apps are used daily for a variety of purposes, including communicating, managing finances and paying bills, monitoring fitness and health, ensuring personal security, entertainment, keeping driving logs, submitting insurance claims, and shopping, just to name a few uses. All of these require registrations and login credentials. Many people have become hoarders of online accounts and information. The situation becomes even more complicated if an

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<sup>69</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 2.

<sup>70</sup>Wikipedia "Quadriga (company) available at [https://en.wikipedia.org/wiki/Quadriga\\_Fintech\\_Solutions](https://en.wikipedia.org/wiki/Quadriga_Fintech_Solutions), accessed on 14 November 2024.

<sup>71</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 3.

<sup>72</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 2.

<sup>73</sup>Beyer op cit note 18 at 29 and Beyer & Griffin op cit note 40 at 2.

individual is incapacitated rather than deceased, as an incapacitated person will continue to have ongoing expenses that a deceased person would not have.<sup>74</sup>

Sorting through a person's online life can be a daunting and time-consuming task. As noted earlier, it is often onerous for family members, next of kin, executors or administrators to determine the digital assets held by the client.<sup>75</sup> Incorporating digital assets in the estate planning process can ease the burden on the family and the executor by providing a clear path for identifying the client's digital assets and accounts.

#### ❑ **To prevent identity and content theft**<sup>76</sup>

In addition to needing access to information for personal and estate administration purposes, details about online accounts are necessary to ensure that these accounts are closed or deleted to prevent theft of the deceased's or incapacitated person's identity or assets.<sup>77</sup> Criminals can hack and hijack these accounts and obtain valuable information, not only about the client but his family, friends, business associates and assets. Financial institutions might not automatically know that a person has died and will generally only freeze an account once they have received notification of death and a death certificate. Often, the notification is left to the executor of the estate, whose appointment may take some time or the executor or next of kin may not be aware of an account, resulting in the notification possibly only taking place months after the person's death, if at all. This creates a window of opportunity for criminals who may have gained access to the deceased's identity or accounts to misuse the person's identity or steal the assets.

The client may have copyright on certain content, for example social media content like blogs or vlogs, especially if the client is a content creator or influencer. If the executor or family is not aware of the content, or does not protect it, it may be copied or stolen.<sup>78</sup>

#### ❑ **Information protection**<sup>79</sup>

A client may also hold information, like private emails, messages, documents or information he or she does not wish family to know about or see.<sup>80</sup> Without designating appropriate people to deal or delete with such materials or accounts, persons to whom it may be hurtful may see it, or the wrong person may come across this information and use it inappropriately or in embarrassing manner.<sup>81</sup>

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<sup>74</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 3.

<sup>75</sup>Beyer op cit note 18 at 29 and Beyer & Griffin op cit note 40 at 2.

<sup>76</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 2.

<sup>77</sup>Ibid.

<sup>78</sup>Beyer & Griffin op cit note 40 at 2.

<sup>79</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 3.

<sup>80</sup>Ibid.

<sup>81</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 2.

### ❑ **To prevent defaults and cancellations**<sup>82</sup>

Online accounts need to be discovered quickly to avoid payment defaults and cancellations.<sup>83</sup> For example, if there are utility accounts in respect of a property where the family resides or property insurance policies in respect of a motor vehicle, which were paid by the incapacitated or deceased client, arrangements must be made as soon as possible for continued payment thereof to avoid cancellations or interruption. The client may be the owner of commercially valuable domain names or websites and if these are not kept current, registration thereof could lapse.<sup>84</sup>

### ❑ **Business continuity**

If the incapacitated or deceased person runs a business, especially as a sole proprietor, and is the only one with access to accounts, his executors, employees, or survivors not having access to accounts may result in contractual defaults, debts and employees not being paid, and monies owing from debtors not being collected.<sup>85</sup> This could also have a significant impact on the value of the person's personal estate.

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<sup>82</sup>bid.

<sup>83</sup>Beyer op cit note 18 at 30 and Beyer & Griffin op cit note 40 at 3.

<sup>84</sup>bid.

<sup>85</sup>Beyer op cit note 18 at 30, and Beyer & Griffin op cit note 40 at 3 and Gilroy op cit note 23.

## Practical suggestions for estate planning in respect of digital assets

When dealing with digital assets, the identification, management, transfer or closure of such assets, should be considered in the estate planning process.

### ❑ Awareness

Estate planners should convey the scope and importance of digital assets and creating an inventory thereof, to their clients.

### ❑ Method

As stated by Beyer and Griffen,<sup>86</sup> there is no "right" way to plan for digital assets. Estate planners should consider the types of digital assets and decide on the best way of dealing with these. For instance, will all digital assets, including those with sentimental or informational value also be included in the client's will, or will it be addressed in a separate document? Should the client make use of digital vault to store a list of accounts with login details or will a list be provided to the executor with the will?

### ❑ Identification of digital assets

An estate planning questionnaire should include questions about the client's digital assets to identify such assets.<sup>87</sup> Financial planners and clients should also review the terms of services or use of such assets to determine any estate planning provision to be made in respect of such assets and how it can be accessed after incapacity or death of the client.

### ❑ Establish where digital assets are stored

Establish whether digital assets are stored locally on electronic devices, like computers or smart phones, or in the cloud, and how they can be accessed.

Beyer<sup>88</sup> suggests that clients should consider copying content stored online to, for instance, an external hard drive. These can then be stored safely and bequeathed to a named beneficiary. Even though this addresses access challenges, it is not practical in my opinion as the device on which it is saved may become corrupted, it will require constant updating, and if the information is unencrypted, it is vulnerable to data theft. This method maybe useful for storing and transferring sentimental digital assets like holiday photos,<sup>89</sup> though the same effect can be achieved by storing photo albums in a secure cloud account and sharing the folders with selected persons. Many cloud storage options allow account holders to share a folder with other email addresses.

It is recommended that digital assets not be stored locally on electronic devices, but rather in secure cloud accounts protected by strong usernames and passwords, allowing access from any device. This approach helps prevent the loss of digital assets if electronic devices

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<sup>86</sup>Beyer & Griffin op cit note 40 at 4.

<sup>87</sup>Genders & Steen op cit note 2 at 79 and Beyer op cit note 18 at 33.

<sup>88</sup>Beyer op cit note 18 at 32.

<sup>89</sup>Ibid.

are stolen, broken or destroyed. Additionally, if the electronic device where the digital asset is stored belongs to an employer, and not the client, the employer may lock, remotely delete or take possession of the device, blocking access to personal digital assets stored on the device.

#### ❑ **Prepare a list of all digital assets**<sup>90</sup>

Digital asset information is constantly changing and may be stored on, or accessed through, a variety of devices. As new websites and apps are created, and our use thereof increases, we continuously create new social media, online shopping, subscription, or gaming accounts. Therefore, clients should keep a list of their digital assets. The list will also be important for the executor when drafting an inventory of the estate, if the estate includes digital assets of value, like cryptocurrency accounts. If the client operates a business, and has digital business assets, the client should also consider who would need access to these assets immediately upon their death or incapacity. A list of suggestions of items that should be included has been included at the end of the article.

The challenge is now how to keep record of these accounts. There is unfortunately no easy answer. It will be an ongoing process (and hassle) to keep a list up to date. It is recommended that clients immediately update their list when a new account is opened. The list should include the website or platform name or address and at least a username, and if the account has monetary value, it should be noted.

Some authors recommend including in the list, in addition to the username, the pin or password of each account,<sup>91</sup> and other important information like security questions or whether the account requires two-factor authentication.<sup>92</sup> However, this exposes the client to significant risk if the list falls into the wrong hands.<sup>93</sup> To mitigate some of this risk, Beyer suggests that the client creates two documents, one with usernames and one with passwords and storing the documents in different locations or giving it to different family members.<sup>94</sup> This is also not an optimal solution.

In addition, as already noted, sharing one's username and password with a third party may be against the terms and conditions of an online account.<sup>95</sup> Cyber security experts recommend that account holders do not use the same password for all accounts. Considering the number of different passwords one needs, one can easily forget the password used for a specific account, leading to frequent use of the "Forgot Password" password reset functionality. In addition to maintaining a list of accounts, it will be onerous to continuously update the list of accounts with changed passwords. Even if the list is in electronic form, like in an online password vault where new accounts and changed passwords can automatically be saved, it needs to be password protected itself, and the

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<sup>90</sup>Meyer op cit note 28 at 183.

<sup>91</sup>Beyer op cit note 18 at 38 and Beyer & Griffin op cit note 40 at 6.

<sup>92</sup>Meyer op cit note 28 at 183.

<sup>93</sup>Beyer op cit note 18 at 38 and Beyer & Griffin op cit note 40 at 6.

<sup>94</sup>Ibid.

<sup>95</sup>Beyer op cit note 18 at 33.

client will still need to share the location of the list and how to access it in case of incapacity or death.

Under legislation such as RUFADAA, an executor will not require the passwords to access the accounts but will gain access in terms of the provisions of RUFADAA if certain requirements are met. However, in the absence of legislation like RUFADAA, there are technological solutions available to address this problem. Companies like the Swiss company, SecureSafe,<sup>96</sup> have created functionality to help persons manage what they call a “data inheritance”.<sup>97</sup> In addition to an online password vault, it has functionality whereby one can assign some or all data to chosen beneficiaries and provide a person, like an executor, with an activation code. The person with the activation code uses the code which triggers a data inheritance process. Before a beneficiary can access the data, a blocking period will be activated. The purpose of the blocking period is to allow the account owner to stop the inheritance process in case it was triggered accidentally or by an unauthorised person or at an unauthorised time trying to gain access to the account holder's data. Once the blocking period has expired, the data will be made available to each beneficiary for download. The beneficiaries only have access to the download and not to the account. This will enable beneficiaries to delete or deactivate accounts, use saved passwords to access financial data, such as banking accounts, or share accounts (if allowed), or access important documents. However, only time will tell whether these types of processes will be adopted widely and can be used effectively.

#### ❑ Determine what should happen with the client's digital assets<sup>98</sup>

The client and estate planner must familiarise themselves with the terms and conditions of the accounts to establish the client's rights, ownership, and which digital assets are transferable, and accordingly stipulate the relevant beneficiaries and arrangements for what should happen with the data held in such accounts and the closure of the accounts.

Many service providers have policies on what happens to accounts of incapacitated or deceased account holders.

Most banks and investment product suppliers will already have clearly defined processes about what will be required from an administrator or executor to have funds transferred from a digital account into an estate account and for closure of the account. Crypto asset exchanges, like Luno, have similar processes for accessing accounts of deceased clients.<sup>99</sup>

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<sup>96</sup>SecureSafe available at [www.securesafe.com/en](http://www.securesafe.com/en), accessed on 14 November 2024.

<sup>97</sup> SecureSafe 'Data Inheritance: How It Works and Why It Matters' available at <https://help.securesafe.com/data-inheritance>, accessed on 14 November 2024.

<sup>98</sup>Meyer op cit note 28 at 183.

<sup>99</sup> Luno 'How do I access the crypto of a deceased Luno customer?' available at <https://guide.luno.com/hc/en-gb/articles/11035596965405-How-do-I-access-the-crypto-of-a-deceased-Luno-customer#:~:text=Rest%20assured%20that%20we%20have,the%20appointed%20executor%20or%20administrator>, accessed on 14 November 2024.

In respect of digital assets like photographs, a client may be willing to provide family members and friends with access to it while still alive.<sup>100</sup> As already noted, many cloud storage options allow account holders to share a folder with other email addresses. Microsoft allows persons who have the account credentials of a deceased or incapacitated person to close accounts themselves, without notification to Microsoft. However, it will only consider releasing information on receipt of a subpoena or court order.<sup>101</sup> Google offers functionality to account holders to choose up to ten people (trusted contacts) to share information (including passwords stored in Google) with, via a link, in case of death. The account holder can select what information to share with whom and even write a personal note to each person on the list. Google monitors accounts for activity and an account remains inactive for a certain amount of time, a notification will be sent to the trusted contacts.<sup>102</sup> Google also provides for requests to close the account of a deceased account holder, withdraw funds from a deceased account holder's account, or to obtain data from a deceased user's account. However, it does not provide login details or passwords to the account itself.<sup>103</sup>

Apple allows an account holder to add a legacy contact for an Apple ID to access data stored in the Apple account after the account holder has passed away. However, the account holder must share an access key with the legacy contact and the legacy contact must request access from Apple with the legacy key and a death certificate, alternatively access may be requested with a court order. A request for the deletion of an account may be submitted without a legacy key.<sup>104</sup> Facebook and Instagram accounts can be memorialised which helps keep it secure by preventing anyone from logging into it or it from being deleted.<sup>105</sup> Facebook also allows account holders to designate a person, a legacy contact, to manage an account holder's account if it is memorialised. However, it only allows limited disclosure of information from the account holder's account after it has been memorialised.<sup>106</sup>

### ❑ Placing the digital assets in a trust<sup>107</sup>

Beyer suggests that clients with digital assets of substantial value should consider placing such assets in a trust. The client could register accounts the name of the trust. Because many digital assets take the form of license or user agreements which terminate upon death, if the

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<sup>100</sup> Beyer op cit note 18 at 33.

<sup>101</sup> Microsoft 'Accessing Outlook.com, OneDrive and other Microsoft services when someone has died' available at [https://support.microsoft.com/en-us/account-billing/accessing-outlook-com-onedrive-and-other-microsoft-services-when-someone-has-died-ebbd2860-917e-4b39-9913-212362da6b2f#:~:text=You%20don't%20need%20to,\(2\)%20years%20of%20inactivity](https://support.microsoft.com/en-us/account-billing/accessing-outlook-com-onedrive-and-other-microsoft-services-when-someone-has-died-ebbd2860-917e-4b39-9913-212362da6b2f#:~:text=You%20don't%20need%20to,(2)%20years%20of%20inactivity), accessed on 14 November 2024.

<sup>102</sup> Google op cit note 60.

<sup>103</sup> Google 'Submit a request regarding a deceased user's account' available at <https://support.google.com/accounts/troubleshooter/6357590?hl=en#:~:text=We%20can%20work%20with%20immediate,secure%2C%20safe%2C%20and%20private>, accessed on 14 November 2024.

<sup>104</sup> Apple 'How to request access to a deceased family member's Apple Account' available at <https://support.apple.com/en-za/102431#:~:text=In%20the%20unfortunate%20event%20of,the%20data%20stored%20with%20it>, accessed on 14 November 2024.

<sup>105</sup> Facebook 'Request to memorialise or remove an account' available at <www.facebook.com/help/1111566045566400>, accessed on 14 November 2024.

<sup>106</sup> Facebook op cit 31 at para 5.

<sup>107</sup> Beyer op cit note 18 at 37 and Beyer & Griffin op cit note 40 at 5.

accounts are in the name of the trust, such agreements will not terminate on the death of the client enabling the trustees to still access the information.

### ❑ Digital executor

The concept of a digital executor has started emerging abroad.<sup>108</sup> The client may want to consider naming a 'digital executor' in addition to nominating the official executor who will administer the deceased estate. The role of such a digital executor could be a formal co-executor appointment or it could be a more informal appointment of an individual, who has expertise with computers, tasked by a deceased to collate and manage his/her digital information on death.<sup>109</sup> Surviving family may lack the technical skill, or emotional readiness to deal with these assets, or some of the information may be sensitive and the client may not want certain persons to view or access the information.<sup>110</sup> In addition, the digital executor may discover assets while reviewing information that need to be included in the formal administration of the estate. Where engagement with online service providers is required relating to online accounts, the digital executor can collate the requirements and information and engage with the services providers, if formally appointed as executor, or notify the official executor of the requirements, who in turn will then engage with such service providers.

### ❑ Inclusion in the client's will

It is advisable to only include digital assets which have economic value, of which the testator is the owner, and which is transferable to heirs, in a will. It is not recommended to include instructions or access details of such assets, and other digital assets which are not included the will, in the will as these may change frequently<sup>111</sup> and a number of people will have access to the will once it is lodged with Master of the High Court.

The recipient of a client's electronic devices does not automatically have the right to the information on it. If it is not the client's intention that the recipient of the device should also come in possession of the information thereon, it should be arranged that the devices are formatted and all information thereon deleted before the device is handed over to the recipient.

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<sup>108</sup> Conway & Grattan op cit note 7 at para IV.

<sup>109</sup> Ibid.

<sup>110</sup> Beyer op cit note 18 at 29-30 and Beyer & Griffin op cit note 40 at 2-3.

<sup>111</sup> Beyer op cit note 18 at 37 and Beyer & Griffin op cit note 40 at 4.

## Conclusion

Our online presence is expanding at a rapid rate and digital assets are becoming more prominent, widely used, and valuable.

Few people consider digital assets, especially those that might not have monetary value, in the estate planning process. This is due to people not understanding what might constitute digital assets and the value thereof, whether monetary or sentimental, the consequences of not identifying, managing and providing for digital assets in the estate planning process and uncertainty about how to deal with these assets. The uncertainty about the status of ownership and control of, and access to, digital assets in law, contribute to these issues. Many jurisdictions' laws do not provide for the unique features of digital assets, and where there are such laws, they vary between jurisdictions.<sup>112</sup>

As such, the need for clear legislative guidance to address these challenges is becoming increasingly important. As Booyens notes, drafting a will to regulate digital assets has little effect in the absence of local legislation that compels service providers to co-operate.<sup>113</sup>

Hopefully, with the growth and prevalence of these assets, legislators will give it the attention it deserves. Technology companies are also expected to develop better ways to manage and access digital assets more easily while still complying with the contractual terms concluded with account holders and securing personal information.

Despite all these complications and uncertainty, it is imperative that estate planners start becoming familiar with digital assets, understand how they are accessed, the property rights associated with these assets, including it in the estate planning process, and assisting clients in understand the implications of overlooking these assets in their estate planning.

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<sup>112</sup> Genders & Steen op cit note 2 at 79.

<sup>113</sup> Booyens op cit note 33 at 58.

## Example of items to be included in a digital asset questionnaire/list<sup>114</sup>

### Electronic Devices

Device	Personal/Business	Username	Pin/Password	Beneficiary
Computer				
Cellphone				
Tablet				
E-reader				
Gaming console				
External storage device				

### Email accounts

Email address	Personal/Business

### Websites/Domains

Website/Domain Name	Personal/Business	Webhost	Username

### Online storage

Name	Personal/Business	Website	Username
Dropbox			
Google Drive			
iCloud			
OneDrive			

<sup>114</sup> Adapted from Beyer op cit note 18 at 34-37.

**Software licences**

Name	Personal/Business	Website	Username
Microsoft			
Adobe			

**Banking & Loan accounts**

Institution	Type of account	Website	Account no	Personal/Business	Username

**Investments, Retirement Savings & Crypto Assets**

Institution	Type of account	Account no	Website	Personal/Business	Username

**Insurance & Medical Aid**

Institution	Policy description	Policy no	Website	Personal/Business	Username

**Tax**

Tax no	Website	Personal/Business	Username

**Utilities, subscriptions & miscellaneous**

Institution	Description	Account no	Website	Personal/Business	Username
Municipal					
Car tracking					

<b>Cellphone provider</b>					
<b>Internet provider</b>					
<b>Newspapers</b>					
<b>Magazines</b>					

### Social media

<b>Institution</b>	<b>Website</b>	<b>Personal/Business</b>	<b>Username</b>
<b>Facebook</b>			
<b>Instagram</b>			
<b>LinkedIn</b>			
<b>X</b>			
<b>YouTube</b>			
<b>Pinterest</b>			
<b>TikTok</b>			

### Streaming

<b>Institution</b>	<b>Website</b>	<b>Personal/Business</b>	<b>Username</b>
<b>Netflix</b>			
<b>Disney+</b>			
<b>Amazon Prime</b>			
<b>Spotify</b>			
<b>iTunes</b>			
<b>Apple Music</b>			
<b>DSTV</b>			
<b>Showmax</b>			

**Online accounts**

*This should include e.g. online shopping and app accounts (e.g. Takealot), grocery and food delivery accounts (e.g. Checkers Sixty60), accommodation booking accounts (e.g. Airbnb),*

Institution	Website	Personal/Business	Username

**Membership accounts**

Institution	Website	Membership no	Personal/Business	Username

**Loyalty programmes**

Institution	Website	Membership no	Personal/Business	Username

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# The Nature of Beneficiary Rights in a Trust

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## Introduction

The Law of Trusts in South Africa is complex and involves an intricate framework of rules and structures that have evolved from English common law and Roman-Dutch law. South African trusts are based on the law of contract. Trusts have been utilised in South Africa for almost two centuries, with the first recorded case dating back to 1833.<sup>1</sup> The definition of trust in our legislation indicates that this construct is unique. A fundamental difference between South African trusts and offshore trusts can be attributed to their legal foundations. South African trust law is rooted in Roman- Dutch law, however when English law was first introduced to South Africa, the concept of a trust was absorbed, save for one key element, that of dual ownership, was not fully adopted.<sup>2</sup>

In contrast, offshore trusts are based on English law's concept of equity, which adopts two types of ownership – legal and beneficial.<sup>3</sup> It is this difference in the concept of ownership that ascribes to the South African trusts unique design. Against an estate planning backdrop, a trust can be described as a legal relationship that has been created by a person (known as the founder, settlor or donor) by placing assets under the control of another person (the trustee) during the founder's lifetime (an *inter vivos* trust) or on the founders' death (testamentary trust) for the benefit of third persons (the beneficiaries).<sup>4</sup>

This article aims to unravel and clarify the nature of the rights of beneficiaries of a trust arrangement.

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<sup>1</sup>"Historical development of Trusts," Trusts Unlimited, n.d., [http://trustguru.co.za/Trust\\_Historical\\_development.html](http://trustguru.co.za/Trust_Historical_development.html).

<sup>2</sup> <https://www.ocoorian.com/insights-news-press-releases/understanding-offshore-trusts-key-differences-considerations-south#>

<sup>3</sup> *Ibid*

<sup>4</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021

## Types of Trusts

There are numerous types of trusts in South Africa, determined by the manner in which they are classified. Trusts are classified based on:

- Whether the founder is alive (*inter vivos* trust) or dead (trust *mortis causa* or testamentary trust).
- The purpose of the trust (special trusts, charitable trusts, employee trusts, trading trusts are examples)
- The rights of beneficiaries and ownership of trust property.<sup>5</sup>

The focus here will be on the latter, as it pertains to the nature of the rights of beneficiaries in a trust. Being cognisant of the nature of the rights of beneficiaries in trusts is necessary for both beneficiaries and trustees to ensure effective trust management and protect the interests of all parties involved. Furthermore, it may impact estate planning, taxation, and the legal standing of the trust.

- (i) Trusts in the strict sense (ordinary trusts) – the trustees are non-beneficial owners of the trust assets. This means the assets are owned by the trustees not for their own benefit, but to benefit the beneficiaries of the trust.<sup>6</sup>
- (ii) *Bewind* trust – the beneficiaries are the owners of the trust assets, but the trustees manage and control the trust assets.<sup>7</sup>
- (iii) Discretionary trusts- the beneficiaries do not have vested rights to the trust income or capital. Instead, the trustees have discretion over which beneficiaries will receive benefits and when distributions will occur. The beneficiaries have merely a *spes*<sup>8</sup> and not a right to the income and /or capital. This is the most common type of trust in South Africa.<sup>9</sup>
- (iv) Vesting trusts - Trusts where income, capital gains or assets are vested to a beneficiary in terms of the Trust instrument.<sup>10</sup>

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<sup>5</sup> M Botha, L Du Preez, W Geach, B Goodall, J Palframan, P Rabenowitz, L Rossini Fundamentals of Financial Planning 2017 482

<sup>6</sup> Phia Van der Spuy "Chapter 4- Types of Trusts recognised under South African Law" Demystifying Trusts Second Edition 2021

<sup>7</sup> Ibid

<sup>8</sup> Hope or expectation

<sup>9</sup> Phia Van der Spuy " Chapter 4- Types of Trusts recognised under South African Law" Demystifying Trusts Second Edition 2021

<sup>10</sup> <https://www.sars.gov.za/businesses-and-employers/trusts/types-of-trust/>

## Vested rights versus Contingent rights

A vested right is defined as a “right accrued to a possessor with no conditions,” or the legal definition being “a right belonging completely and unconditionally to a person as a property interest which cannot be impaired or taken away without the consent of the owner.”<sup>11</sup>

A personal right (a right *in personam*) is a legal right against another person, usually emanating from a contract.<sup>12</sup> A beneficiary who holds a vested right – i.e., a right to claim income or capital from the trustees according to the provisions of the trust deed – also acquires a personal right.

A beneficiary with a vested right will have a personal right of recourse against the trustees to “ensure they perform their duties in accordance with the provisions of the trust instrument.”<sup>13</sup> However, vested rights come with certain drawbacks and may be less effective for estate planning. The potential disadvantages include tax inflexibility, exposure to creditors and being included as property for estate duty purposes.

The wording of the trust instrument must be carefully drafted and, for existing deeds, carefully interpreted. A trust deed may specify that a beneficiary has a vested right in the ‘trust capital’ alternatively in the ‘trust assets.’<sup>14</sup> It is important to interpret the term ‘trust capital’ as it is defined in the trust instrument and determine whether it can be construed as a vested right in the ‘trust assets.’ Based on this interpretation, the beneficiary may have:

- a vested right in the residue of the trust at its termination, or
- a vested right in the profits but not in the ‘trust assets.’

There is currently no authority for how the trust capital should be dealt with if the clause is either ambiguous or silent on the issue of whether the beneficiary has a vested right in the residue of the trust at its termination or a vested right in the profits but not the trust assets. It is submitted that each case will have to be decided upon its merits. The Trust Property Control Act<sup>15</sup> regulates the requirements for the control of the trust property, the rights, and obligations of the trustees but not with the rights pertaining to beneficiaries.

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<sup>11</sup> Phia Van der Spuy “Chapter 4 Types of Trusts recognized under South African Law” Demystifying Trusts Second Edition 2021 P 32

<sup>12</sup> Phia Van der Spuy “Chapter 18-Beneficiaries” Demystifying Trusts Second Edition 2021 477

<sup>13</sup> Phia Van der Spuy “Chapter 18-Beneficiaries” Demystifying Trusts Second Edition 2021 476

<sup>14</sup> Phia Van der Spuy “Chapter 18-Beneficiaries” Demystifying Trusts Second Edition 2021 478

<sup>15</sup> 57 of 1988

## Tax Implications

Beneficiaries with vested rights are liable for the tax on the distributions made to them. Any capital gains from the vested assets will be attributable to the vested capital beneficiaries. Similarly, any vested income will be taxable in the hands of the income beneficiaries. If the trust receives income and distributes it to the beneficiaries in the same year, the beneficiaries will be taxed on the income rather than the trust.<sup>16</sup> Likewise, if the trust makes a capital gain and retains it, the trust will be taxed on the capital gain. If the gain is distributed to a beneficiary, it will be taxed in the hands of the beneficiary. This is referred to as the "conduit pipe principle."<sup>17</sup>

The conduit pipe principle is a concept that is distinctive to the trust structure, as trustees can opt to distribute income or capital gains to the beneficiaries during the year of assessment whilst retaining its nature, whether it be interest, rental or dividends in the hands of the beneficiaries. Trustees can also apply the conduit pipe principle to split income and capital gains amongst a number of beneficiaries, potentially resulting in little or no tax being paid on trust income and capital gains. This is known as "income splitting" and is another unique advantage of the trust construct.

The application of the conduit pipe principle was examined in the Supreme Court of Appeal (SCA) case of *Commissioner, SARS v Thistle Trust*.<sup>18</sup> This case focussed on the taxation of capital gains in layered trust structures. Layered trusts are multi-tiered or multiple trust structures. Layered trusts provide an extra measure of protection for estate pegging purposes.

### Facts of *Commissioner, SARS v Thistle Trust*

The Thistle Trust was a beneficiary of other property-owning trusts known as Tier 1 Trusts. The Tier 1 trusts disposed of capital assets resulting in capital gains which vested in the Thistle trust in the year of assessment in which the disposals occurred. The Thistle Trust in turn vested the proceeds in its resident natural person beneficiaries, who declared the capital gains as income taxable at the rate applicable to natural persons.

The court found that the facts of the case did not support the application of the conduit pipe principle. Although the SCA's decision did not entirely discard the conduit pipe principle, it rendered the principle inapplicable to tiered trust structures when distributing a capital gain i.e., where a trust is a beneficiary of another trust and has a vested right to a capital gain from that trust.

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<sup>16</sup> S25B Income Tax Act 58 of 1962

<sup>17</sup> Phia Van der Spuy "Chapter 18-Beneficiaries" *Demystifying Trusts* Second Edition 2021 464

<sup>18</sup> (516/2021) [2022] ZASCA 153

Financial planners should consider collapsing their trust structures to avoid capital gains being taxed at the trust rate of 36% instead of the effective tax rate for natural persons, which ranges from 0% to 18%. This inefficacy of the utilisation of the conduit pipe principle negatively impacts the beneficiaries as the distribution to them is diluted by the payment of higher taxes. The necessity of setting up multi-tiered trusts should be carefully considered taking into account the effect on the beneficiaries rights.

## Rights of beneficiaries

The rights of beneficiaries are often misunderstood. It is contended that there can be a misconception that a beneficiary's rights are minimal and that trustees have complete reign over how trust assets are managed and distributed.<sup>19</sup> In reality, all beneficiaries, including discretionary beneficiaries, have certain rights that must be recognised and upheld.

Beneficiaries have the following rights:

- **Right to information**

This right was firmly established in the case of *Doyle v Board of Executors*.<sup>20</sup> Mrs D was the income beneficiary, and her son was to become the capital beneficiary upon her death. When Mrs D passed away, the son demanded full accounting from the date that BoE was appointed as trustee. BoE contended that only the income beneficiary could request this accounting as she was the only beneficiary at the time and that the son became entitled to the accounting only as of the date of Mrs D's death.

The Court dissented and held that the trustees have a duty to provide full trust administration reports and accounting records to trust beneficiaries, including contingent beneficiaries who may be born later, dating back to the time the discretionary trust was created. The judge also entrenched that beneficiaries with only a contingent right are entitled to have access to books of account of the trust. However, the Court also emphasised that there may be limitations on these rights and stated that the beneficiaries could not interfere with the trustee's discretion regarding decision-making. This decision signifies the need for trustees to be fully transparent at all times. In instances where the trust deed empowers the trustees to exclude any beneficiary from future benefits, such beneficiaries will no longer have any rights, including the right to receive information about the trust. The planner should be cautious of drafting such a clause as future trustees may abuse this clause to deliberately exclude certain beneficiaries.<sup>21</sup>

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<sup>19</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021 474

<sup>20</sup> 1999 (1) All SA 309( C)

<sup>21</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021 475

- **A personal right against the trustees for the trustees' compliance with their duties<sup>22</sup>**

The rights of contingent beneficiaries in a discretionary trust were addressed in the case of *Gross v Pentz*<sup>23</sup>. It was established that, although contingent beneficiaries have no vested rights in the trust assets, they still have vested interests in the proper administration of the trust. In *Griessel v de Kock*<sup>24</sup> the Court held that a contingent beneficiary has rights worthy of protection by the court, including the right to protect their interests against maladministration by trustees. The court stipulated that the "role of a trustee in administering a trust calls for the exercise of a fiduciary duty owed to all the beneficiaries of a trust, irrespective of whether they have vested rights or are contingent beneficiaries whose rights to the trust income or capital will only vest on the happening of some uncertain future event."

This vested interest in the proper administration of the trust is a personal right against the trustees for the performance of an obligation.<sup>25</sup> In essence, this means that the trustee must either act or refrain from certain acts. In the *Gross v Pentz*<sup>26</sup> case, the court clarified the "direct actions" that can be brought by a beneficiary in their own right against a trustee for one of the following reasons:

- (i) Maladministration of trust assets, resulting in a loss to the beneficiary
- (ii) Failure to pay or transfer to a beneficiary what is due to them under the trust instrument
- (iii) Paying one beneficiary what is not due to them

It should be noted that the court held that only a beneficiary with a vested right can initiate such an action and not a beneficiary who has a contingent right to income and/or capital and/or capital gains.<sup>27</sup>

- **A personal right in the trust income, capital gains, and/or capital/ assets as per the trust instrument<sup>28</sup>**

A personal right in the trust income, capital gains, and/or capital/assets is granted to the beneficiary who has a vested right i.e., a right to claim income and/or capital from the trustees according to the provisions of the trust deed but limited to the rights attached to such vested right.

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<sup>22</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021

<sup>23</sup> (414/95)[1996] ZASCA 78

<sup>24</sup> (334/18) [2019] ZASCA 95

<sup>25</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021

<sup>26</sup> (414/95)[1996] ZASCA 78

<sup>27</sup> Estate Bazley v Estate Amott 1931 NPD 481

<sup>28</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021

- **A personal right in the trust income, capital gains, and/or capital/ assets as vested by the trustees in a discretionary trust<sup>29</sup>**

Discretionary or contingent beneficiaries do not have real rights in the trust assets. The trust assets belong to the trustees in their representative capacity<sup>30</sup> on behalf of the beneficiaries. A real right will be created if the trustees exercise their discretion to distribute the trust assets and transfer ownership to the beneficiaries.

Discretionary or contingent beneficiaries may have rights of enjoyment of trust assets.<sup>31</sup> Although this right of enjoyment is considered a contingent right, it maintains its status as a personal right in the hands of the beneficiary, bestowing the beneficiary with an interest in the trust assets.

- **Real rights to assets – *bewind* trust<sup>32</sup>**

A real right is an absolute right and is enforceable against the world at large as opposed to a personal right which is enforceable against a specific person i.e.: the other party to the obligation.<sup>33</sup>

The beneficiary acquires ownership of the asset at the creation of the trust. The trustees, as non-beneficial owners are responsible for the management and administration of the trust assets for the benefit of the beneficiaries. The beneficiaries of the *bewind* trust generally have certain legal limitations for example the beneficiary is still a minor or is of unsound mind.

- **A right to be involved in a decision to amend a trust instrument or deregister a discretionary trust**

Trustees have an overarching responsibility to act in the best interests of the trust and its beneficiaries. This fiduciary duty is an onerous, legal obligation to manage the trust assets. In the best interests of both actual and potential beneficiaries of the trust.

It is trite that where a beneficiary has accepted benefits from a trust, they are deemed to be a party to the original agreement.<sup>34</sup> As such, it would be necessary for the beneficiary to consent to any amendment to the trust instrument. When drafting a trust deed, it is important to note that including a clause allowing the trustees to unilaterally amend the trust deed will be ineffective. The consent of the beneficiaries who have accepted benefits will be required, irrespective of any clauses in the trust deed stating the contrary.

<sup>29</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021

<sup>30</sup> CIR v MacNeillies' Estate 1961 (3) SA 883 (A)

<sup>31</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021

<sup>32</sup> Ibid

<sup>33</sup> [www.brainscape.com/flashcards/module-2-real-rights-limited-real-rights-780411/](http://www.brainscape.com/flashcards/module-2-real-rights-limited-real-rights-780411/)

<sup>34</sup> Crookes v Watson (268/54) [1955] ZASCA 75

A beneficiary is deemed to have accepted benefits if one of the following occurs:

- If the beneficiaries have written to the trustees to accept their benefits, regardless of whether the trustees exercise their discretion in the future.
- If there were previous amendments to the trust deed and the beneficiaries accepted these amendments, it may suggest acceptance of benefits
- If the beneficiaries have previously accepted distributions, it may indicate that they have accepted benefits under the trust.<sup>35</sup>

The case of *Potgieter v Potgieter*<sup>36</sup> clearly demonstrates the court's inclination to protect beneficiaries from trustees who negligently or imprudently amend the trust deed to the detriment of the contingent beneficiary. The Court concluded that "even beneficiaries who have contingent rights are entitled to protection."

It is also significant to note that a beneficiary considered to have "sufficient interest in the trust property" may also approach the court to amend the trust instrument. Section 13 of the Trust Property Control Act<sup>37</sup> provides that if a trust instrument contains a provision that brings about consequences which, in the opinion of the court, the founder of the trust did not contemplate or foresee, and which is in conflict with the public interest, the court may delete or vary such provision or make an order that the court deems just. Section 13 is also available to beneficiaries of a testamentary trust.

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<sup>35</sup> Phia Van der Spuy "Chapter 18 Beneficiaries" Demystifying Trusts Second Edition 2021 482

<sup>36</sup> 2012(1) SA 637 SA

<sup>37</sup> 57 of 1988

## Conclusion

It is imperative to understand and evaluate the rights conferred on beneficiaries when drafting a trust deed. The purpose of the trust must be aligned with the rights granted to the beneficiaries. Establishing trusts and selecting beneficiaries requires a thorough understanding of trust law and accurate, detailed comprehension of the founder's intentions and personal circumstances. Estate planners should carefully consider the appointment of beneficiaries in a trust deed, as it may not be possible to remove them without their consent once they have accepted benefits under the trust. The construction of trust structures must consider whether its purpose – be it business, investment or for the benefit of family members. A one-size-fits-all approach will not effectively address the needs of every client.

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# Including Crypto Assets in your Retirement Planning: Sound Strategy or Speculation?

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## Introduction

Retirement planning has traditionally revolved around the strategic allocation of resources into conventional asset classes such as equities, fixed income instruments, and real estate, which have long been the stalwarts of retirement portfolios. However, the emergence of crypto assets introduces a paradigm shift that could potentially redefine the landscape of retirement planning in South Africa. While the traditional practices may not yet endorse the inclusion of crypto assets into retirement investment strategies, the increasing popularity of crypto assets is undeniable. Whilst acknowledging the growing interest and adoption of crypto assets, it is important to be aware of the potential opportunities and inherent risks associated with this unconventional approach.

This article explores the intersection of retirement planning and crypto assets, examining the broader category of crypto assets and various ways of incorporating them into a retirement planning investment portfolio. It provides insights into the risks and opportunities involved in incorporating crypto assets into one's retirement portfolio.

## All cryptocurrencies are crypto assets, but not all crypto assets are cryptocurrencies<sup>1</sup>

The terms “digital assets,” “crypto assets,” and “cryptocurrency” are often used interchangeably, but they have distinct meanings:

**Digital assets** encompass a broad range of items stored in digital form, including documents, media files, and virtual goods in video games. These assets exist electronically and are accessible via digital networks.<sup>2</sup>

**Crypto assets** are a specialised subset of digital assets that rely on blockchain technology for creation, storage, and exchange. Blockchain technology is a method of recording data that is highly secure and resistant to tampering or fraud. Data is stored and controlled by a single entity, blockchain distributes the ledger across a network of nodes.<sup>3</sup> Each node maintains a copy of the ledger, ensuring that there is no single point of failure or control. This decentralisation makes blockchain highly resilient to tampering and corruption, as any changes to the ledger must be verified and agreed upon by the majority of the network participants.<sup>4</sup> The blockchain serves as a decentralised ledger, ensuring transparency and security by recording all transactions across a network of computers.<sup>5</sup> The mechanics of crypto assets involve a decentralised validation process of transactions by a network of computers, or nodes, through complex mathematical algorithms.<sup>6</sup> This decentralised nature eliminates the need for intermediaries, providing users with greater control over their financial transactions. Notable types of crypto assets include cryptocurrencies (such as Bitcoin and Ethereum), stablecoins (pegged to stable assets like the US dollar), non-fungible tokens (NFTs) representing unique digital items, and central bank digital currencies (CBDCs) issued by a country's central bank.

**Cryptocurrency** specifically refers to virtual currencies that operate on decentralised blockchains. These cryptocurrencies offer security, borderless transactions, and independence from traditional financial systems.<sup>7</sup>

## South African preferred definition

The Intergovernmental Fintech Working Group (IFWG) defines crypto assets as *"a digital representation of value that is not issued by a central bank, but is capable of being traded, transferred or stored electronically by natural and legal persons for the purpose of payment,*

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<sup>1</sup> For this article, we will be discussing the broader category of crypto assets and the various ways of incorporating them into a retirement planning investment portfolio.

<sup>2</sup> Lyle Daly. 'What are digital assets?' available at <https://www.coinbase.com/learn/crypto-basics/what-are-digital-assets>, accessed on 12 October 2024.

<sup>3</sup> Jordan Cole. 'The mechanics of cryptocurrency transactions and blockchain' available at [https://blockapps.net/blog/the-mechanics-of-cryptocurrency-transactions-and-blockchain/#The\\_Fundamentals\\_of\\_Blockchain\\_Technology](https://blockapps.net/blog/the-mechanics-of-cryptocurrency-transactions-and-blockchain/#The_Fundamentals_of_Blockchain_Technology) accessed on 14 October 2024.

<sup>4</sup> Daly, L supra accessed 14 October 2024.

<sup>5</sup> Adam Hayes, 'Blockchain facts: What is it, how it works and how it can be used' available at <https://www.investopedia.com/terms/b/blockchain.asp> accessed on 14 October 2024.

<sup>6</sup> Cole, J supra accessed 14 October 2024.

<sup>7</sup> Jordan Cole. 'Cryptocurrency explained: the world of digital currency' available at <https://blockapps.net/blog/cryptocurrency-explained-the-world-of-digital-currency/> accessed on 14 October 2024.

*investment and other forms of utility, and applies cryptographic techniques and uses distributed ledger technology*".<sup>8</sup> This definition is an overarching term that includes various types of crypto asset tokens, such as exchange or payment tokens, security tokens, and utility tokens. Consequently, crypto assets comprise of cryptocurrencies, non-fungible tokens (NFTs), and stablecoins, while excluding central bank digital currencies (CBDCs).

### **The legal position of crypto assets in South Africa**

Various government and financial regulatory authorities have issued statements, position papers and formed working groups to address the risks and develop a coherent policy framework for crypto assets.

In October 2022, the FSCA declared crypto assets — referred to as “a digital representation of value” — as financial products under section 1(h) of the Financial Advisory and Intermediary Services Act (FAIS).<sup>9</sup> As a result, every crypto asset service provider must be authorised as a financial services provider under FAIS to render financial services with respect of crypto assets. Existing providers were required to apply for authorisation by the end of November 2023. Consequently, crypto assets are now subject to FSCA regulations, including Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) requirements.

In South Africa, the recognition of cryptocurrencies means that they are acknowledged by the government and financial authorities as valid for use in transactions, investments, and other activities. Businesses and individuals can legally buy, sell, hold, and trade cryptocurrencies and they can use them as a medium of exchange in transactions if both parties agree.

However, cryptocurrencies are not considered legal tender. Legal tender refers to the currency that must be accepted if offered in payment of a debt. In South Africa, the South African Rand (ZAR) is the only legal tender, meaning it is the only currency that businesses and individuals are legally required to accept as payment. The distinction means that while cryptocurrencies are legal and recognized for certain purposes, they do not have the same status as the Rand and their acceptance is voluntary in transactions.

In the context of retirement planning, Regulation 28 under the Pension Funds Act<sup>10</sup> safeguards members' savings by limiting investments in specific assets and emphasising diversification. As of 3 January 2023, the Amendments to Regulation 28 (GN 46649 of 1 July 2022) prohibits investments in crypto assets, which according to the National Treasury, is due to the perceived volatility and lack of regulation of crypto assets. This amendment limits the extent to which funds may invest in a particular asset or particular asset classes and prevents excessive concentration risk. However, crypto assets can still form part of your discretionary investments, allowing you to supplement your retirement portfolio outside of regulated retirement funds.

While the issue of regulation of crypto assets is still evolving, it is possible that it could unfold further through the Conduct of Financial Institutions Bill (COFI), which will serve as the future consolidated legal framework governing the conduct of all financial institutions. It aims to

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<sup>8</sup> Intergovernmental Fintech Working Group, 'Position paper on crypto assets' available at [https://www.treasury.gov.za/comm\\_media/press/2021/IFWG\\_CAR%20WG\\_Position%20paper%20on%20crypto%20assets\\_Final.pdf](https://www.treasury.gov.za/comm_media/press/2021/IFWG_CAR%20WG_Position%20paper%20on%20crypto%20assets_Final.pdf), accessed on 22 May 2024.

<sup>9</sup> Act 37 of 2002.

<sup>10</sup> Act 24 of 1956.

enhance consumer protection, ensure financial stability, maintain market integrity, foster innovation, and align with international standards, thereby creating a balanced approach that supports both growth and safety in the financial sector.<sup>11</sup> Financial services associated with crypto assets will be incorporated into the licensing activities outlined by the COFI Bill, potentially expanding the regulatory scope beyond the current confines of the FAIS Act.

### What makes crypto assets appealing?

Crypto assets use cryptography and blockchain technology to secure and verify transactions without the need for centralised control and intermediaries, such as traditional banks.<sup>12</sup> Ownership involves anonymity linked to a lengthy and intricate computer-generated password known as the "private key." If this key is lost or stolen, the assets become vulnerable, and there is no way to recover or access it.

Investors are attracted to crypto assets for several reasons, most notably the decentralisation aspect,<sup>13</sup> which eliminates the need for a central authority and intermediaries, enabling independent financial management. The potential for high returns is another significant motivator, driven by the inherent volatility in crypto asset markets, which offers opportunities for substantial profits.

Crypto assets also introduce a novel asset class, allowing diversification beyond traditional asset classes, spreading risk, and enhancing portfolio resilience. The underlying technology, particularly blockchain, is compelling, as its decentralised and transparent nature is expected to revolutionise various industries. Global accessibility is a key feature, facilitating seamless cross-border transactions without traditional banking constraints, which is particularly appealing to those engaged in international trade. Lastly, privacy considerations enhance the appeal, as the anonymous nature of transactions offers a higher level of financial privacy compared to traditional banking.

### How should retirees approach this speculative asset class when considering its role within their portfolios?

Crypto assets offer investors innovative and diverse opportunities for strategic optimisation of their retirement portfolios, enhancing the overall performance of their portfolios and addressing market challenges. These opportunities include:

#### □ **Diversification potential**

Diversifying with crypto assets can add resilience to retirement portfolios, ensure adaptability to changing financial landscapes and can reduce overall risk. Crypto assets historically exhibit a low correlation with traditional financial assets, such as stocks and bonds, meaning their price movements often diverge from those in traditional

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<sup>11</sup> Preamble of the draft Bill.

<sup>12</sup> Bunjaku, F., Gjorgieva-Trajkovska, O. & Miteva-Kacarski, E., 2017. Cryptocurrencies - Advantages and Disadvantages. *Journal of Economics*, 2(1), 31, 32.

<sup>13</sup> Axel Nussbaumer, 'Four reasons crypto is still an attractive investment' available at accessed 7 October 2024.

markets.<sup>14</sup> The unique market drivers for crypto assets — including blockchain technology developments, adoption trends, and digital asset-specific macroeconomic considerations — contribute to their distinct behaviour. Including crypto assets in a retirement portfolio provides a new source of return that operates independently of traditional market drivers, adding an element of diversification to the portfolio.

Certain crypto assets, such as Bitcoin, are notably regarded as 'digital stores of value' and serve as hedges against inflation. According to *Bitcoin Magazine*, the concept of a "store of value" refers to goods that can retain or increase their worth over time rather than decline in value.<sup>15</sup> This concept is used to describe a mechanism that enables individuals to preserve their wealth and mitigate the eroding effects of inflation, making such assets valuable for retirement planning. Crypto assets offer a distinctive avenue for diversifying a retirement portfolio, acting as a safeguard against conventional economic uncertainties. They offer global diversification by surpassing geographical boundaries and regulatory limitations, allowing for exposure across different regions, which augments portfolio diversification.

#### □ **Decentralised finance (DeFi)**<sup>16</sup>

DeFi, short for decentralised finance, refers to a set of financial services and applications built on blockchain technology, primarily on platforms like Ethereum. DeFi aims to recreate and enhance traditional financial services, such as lending, borrowing, trading, and more, in a decentralised and permissionless manner. It leverages smart contracts, which are self-executing contracts with the terms of the agreement directly written, partially or fully, into code. For retirees, DeFi offers potential higher yields through various lending platforms, where interest rates are determined by algorithms. For instance, yield farming allows retirees to lock their funds into liquidity pools, contributing to the smooth functioning of decentralised platforms in exchange for tokens or interest. Additionally, staking involves retirees securing a blockchain network by locking up their assets and earning rewards in the form of additional tokens or income. These activities can provide a potential source of passive income, appealing to retirees seeking to enhance their financial portfolios. However, it is important to be mindful of the associated risks, including market volatility and the lack of regulatory oversight in the DeFi sector.

#### □ **Inflation hedge**

Crypto assets, particularly Bitcoin, are often considered safeguards against inflation which can preserve purchasing power in retirement. Bitcoin's limited supply, which is capped at 21 million coins, contrasts with traditional currencies, potentially offering a hedge as demand rises.<sup>17</sup> The decentralised nature of crypto assets shields them from government monetary policies that can lead to inflation in traditional currencies. Due

<sup>14</sup> Iyer, R. & Popescu, A., 2023. New Evidence on Spillovers Between Crypto Assets and Financial Markets, International Monetary Fund, 2.

<sup>15</sup> Bitcoin Magazine. 'Store of value: A comprehensive guide' available at <https://bitcoinmagazine.com/guides/store-of-value>, accessed 5 January 2024.

<sup>16</sup> Sharma, R., 2023. 'What is decentralised finance (DeFi) and how does it work?' available at [https://www.investopedia.com/decentralized-finance-defi-5113835#:~:text=Decentralized%20finance%20\(DeFi\)%20is%20an%20emerging%20financial%20technology%20that%20c hallenges,peer%2Dto%2Dpeer%20transactions](https://www.investopedia.com/decentralized-finance-defi-5113835#:~:text=Decentralized%20finance%20(DeFi)%20is%20an%20emerging%20financial%20technology%20that%20c hallenges,peer%2Dto%2Dpeer%20transactions), accessed on 5 January 2024.

<sup>17</sup> Bunjaku et al. (2017) 37.

to its global exposure, retirees can diversify their holdings and safeguard purchasing power amid economic uncertainties or currency devaluations.

While the advantages of investing in crypto assets for their potential as an inflation hedge are evident, it is essential to weigh these benefits against their inherent limitations. Factors such as market volatility, dependence on sentiment, regulatory uncertainties, limited historical data, perceptions and adoption rates, technological changes, susceptibility to market manipulation, and correlations with traditional assets significantly impact their effectiveness as a reliable hedge against inflation. Investors who are considering crypto assets for this purpose should weigh these limitations against the potential benefits, conduct thorough research, and consult with financial advisers to make informed decisions based on their individual risk tolerance and financial goals.

### Risks and concerns inherently associated with crypto assets

#### □ **Volatility**

The inherent volatility of the crypto asset market is a crucial consideration for retirees, particularly those who prioritise stability in their investment portfolios. Crypto assets are known for their significant price fluctuations, often exceeding the variability observed in traditional investment vehicles such as stocks and bonds.<sup>18</sup> This volatility, driven by factors like market sentiment, regulatory changes, and technological advancements, makes it difficult to predict investment performance.

For investors who are used to the steadiness of traditional investments, the unpredictable nature of crypto asset prices may be a deterrent. The risk of capital erosion, where sudden drops in crypto asset prices could diminish the overall value of a retiree's investment holdings, is especially critical for those relying on these investments to provide a steady income during retirement. In addition, risk-averse investors may find it challenging to navigate the emotional toll of market turbulence, potentially leading to hasty decisions that could negatively impact the long-term return of their financial portfolios.

#### □ **Security challenges**

Crypto assets, being entirely digital and often stored in online wallets or exchanges, are prime targets for malicious cyber attackers. Cybercriminals frequently exploit vulnerabilities in security infrastructure to gain unauthorised entry to exchanges or wallets, potentially resulting in the theft of private keys and valuable digital assets. Additionally, phishing attacks use deceptive tactics to trick users into revealing sensitive information, such as private keys or login credentials. The prevalence of malware and ransomware targeting cryptocurrency users highlights the need for proactive measures to protect against malicious software specifically designed to compromise the security of private keys.

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<sup>18</sup> S Kamil, 'The twists and turns of crypto volatility explained' available at <https://coinmetro.com/learning-lab/crypto-volatility-explained> accessed on 7 October 2024.

### □ **Regulatory uncertainty**

Measures addressing market manipulation, fraud, and illicit activities contribute to a more stable environment, which is crucial for retirees prioritising the preservation of capital and consistent returns to sustain their retirement lifestyles. The tax implications of crypto asset investments also weigh heavily on retirees' decisions. Evolving regulations regarding the taxation of crypto assets, including capital gains taxes and reporting requirements, are important considerations to ensure compliance and minimise tax-related uncertainties.

Regulatory approval or disapproval of specific investment products, such as cryptocurrency exchange-traded funds (ETFs), can impact retirees' access to diversified investment opportunities. Approval of such products provides retirees with more conventional avenues for exposure to crypto assets, potentially aligning with their established investment preferences. The evolving regulatory landscape also introduces compliance challenges, particularly concerning reporting requirements and adherence to anti-money laundering (AML) and know-your-customer (KYC) standards.

### **Practical tips to consider before investing in crypto assets for retirement**

Retirees looking to incorporate crypto assets into their retirement planning should approach this decision with due seriousness. Given the importance of retirement planning, thoughtful consideration, meticulous planning, and thorough research are essential. Begin by understanding the fundamentals of these assets and seek professional advice to navigate this space wisely. Additionally, consider the following practical steps:

#### □ **Invest through reputable exchanges**

When investing in crypto assets, it is important to use reputable exchanges that are registered as crypto Financial Service Providers (FSPs) with the FSCA. The crypto market has experienced a significant number of frauds and scams, making it essential to choose a platform that is recognised and regulated by the FSCA. This provides an added layer of security and recourse, helping to protect your investments from fraudulent activities and ensuring that the exchange operates under strict regulatory standards. Always verify the registration status of any crypto exchange before engaging in transactions to safeguard your investments.

#### □ **Learn through available educational resources**

Online courses offer structured learning experiences, covering topics such as blockchain technology, wallets, and the decentralised nature of crypto assets. Written guides and articles on reputable financial websites offer comprehensive explanations of concepts, providing clear and concise information suitable for beginners. Video content from industry experts can simplify complex ideas, making them accessible for visual learners. These resources may include presentations and talks on video-sharing platforms ("vlogs"). Podcasts are convenient for those who prefer audio learning, while books authored by industry experts can offer in-depth knowledge for those looking to

build a comprehensive understanding. Staying informed about the latest trends and developments is essential, and by exploring these diverse educational resources, can help retirees tailor their learning experience to their preferred methods of understanding complex financial concepts.

□ **Consult with your financial adviser**

Retirement planning involves considerations of risk management, income stability, and long-term financial sustainability. Financial advisers skilled in both traditional and crypto assets can guide retirees through this complex process. They assess the benefits and risks to ensure the strategy aligns with the retiree's financial goals. They can provide insights into regulatory developments, market trends and emerging technologies, helping retirees make informed decisions. They can also assist in balancing traditional, stable assets with the growth potential of crypto assets. Working with a financial adviser can help retirees ensure that the inclusion of crypto assets aligns with their overall financial plan.

□ **Start with a small initial investment**

By allocating a modest percentage of their overall investment portfolio to crypto assets, retirees can manage the associated risks and volatility more effectively. This deliberate and cautious approach allows retirees to gain exposure to the relatively new asset class while providing an opportunity to assess their comfort level and familiarity with the unique dynamics of crypto assets. Financial analysts often suggest limiting cryptocurrency to between 5% and 10% of one's overall portfolio at most.<sup>19</sup> This approach also provides retirees with the flexibility to learn and adapt to the intricacies of crypto asset investments gradually. Given the dynamic nature of the crypto asset market, where prices can fluctuate significantly over short periods, starting with a small allocation serves as a risk mitigation strategy. It ensures that any potential losses or gains are proportionate to the allocated portion of the portfolio, aligning with the conservative investment preferences often associated with retirees and safeguarding their financial well-being during retirement. It also offers an opportunity to gauge their emotional response to market fluctuations.

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<sup>19</sup> David Shaw 'How to Create a Well-Balanced Crypto' available at <https://www.financemagnates.com/thought-leadership/how-to-create-a-well-balanced-crypto-portfolio/>, accessed 5 May 2024.

## A suggested crypto allocation strategy for retirement portfolio

To maximise the crypto allocation in your portfolio while mitigating risk, it is essential to maintain a balanced mix of assets. A cautious allocation strategy to consider might look like this:<sup>20</sup>

1. **60% Stablecoins:** By allocating the majority of the cryptocurrency holdings to stablecoins, which are pegged to fiat currencies like the US Dollar, investors can help manage volatility. Stablecoins offer several advantages over traditional fiat currency and cash products. They provide price stability, making them suitable for everyday transactions. Additionally, stablecoins are globally accessible, have lower transaction fees and can hedge against inflation. They are less susceptible to market volatility. In summary, stablecoins combine the benefits of cryptocurrencies with the stability of fiat currency, making them an attractive choice for investors and users alike. Examples include USDT (Tether),<sup>21</sup> USDC (USD Coin), and BUSD (Binance USD).
2. **30% Blue-chip cryptocurrencies:** A portion of a portfolio could be dedicated to well-established and reputable cryptocurrencies with a proven track record, such as Bitcoin (BTC) and Ethereum (ETH). These blue-chip assets are considered relatively stable compared to other cryptocurrencies and have demonstrated resilience over time.
3. **10% Low-risk altcoins or DeFi tokens:** Reserving a smaller allocation for low-risk altcoins or decentralised finance (DeFi) tokens that show promise but come with lower volatility and risk levels can also be considered as part of this hypothetical allocation strategy.

This cautious allocation strategy aims to strike a balance between stability and potential growth, reducing overall portfolio risk while still allowing for exposure to the cryptocurrency market. Additionally, regular portfolio monitoring and adjustments may be necessary to align with changing market conditions and investment goals. As with any investment decision, it is essential to conduct thorough research, exercise caution, and regularly review your portfolio to adapt to changing market conditions and investment objectives.

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<sup>20</sup> The example provided in this article is for illustrative purposes only and should not be interpreted as legal or financial advice. Readers should consult with qualified professionals for guidance tailored to their specific circumstances.

<sup>21</sup> Tether gold is backed by physical gold. It represents ownership of real gold bars stored in secure vaults in Switzerland, which could be delivered to any address in Switzerland when you redeem your tokens.

## Conclusion

South African retirees considering the inclusion of crypto assets in their retirement portfolio face a unique landscape compared to their counterparts in other countries. Challenges include stricter regulations from the FSCA, which could limit investment options and access for retirees. The evolving tax treatment of crypto assets adds another layer of uncertainty. Additionally, unlike some developed nations, South African pension funds are currently prohibited from investing in crypto assets, further limiting access to safer investment vehicles like crypto ETFs.

However, there are also opportunities. Crypto assets like Bitcoin, perceived as a store of value, might be attractive to South African retirees seeking protection against inflation that erodes the purchasing power of the rand. Crypto assets also offer global diversification, potentially mitigating risks associated with local economic fluctuations. While inherently volatile, some crypto assets have historically offered higher returns compared to traditional investments, which could be appealing to retirees seeking to supplement their income, but it necessitates a high tolerance for risk.

South Africa's growing tech-savvy population could make the adoption of crypto assets easier for retirees compared to countries with limited technological access. Crypto assets could even offer financial inclusion for unbanked or underbanked South African retirees, providing an alternative avenue to store and manage their wealth.

By carefully weighing these unique challenges and opportunities, South African retirees can make informed decisions about incorporating crypto assets into their retirement plans.

Retirees who are keen to explore the potential of incorporating crypto assets into their retirement portfolios are advised to take a thoughtful and cautious approach. Thorough research, along with guidance from knowledgeable professionals experienced in both traditional and crypto assets, is crucial for providing valuable insights and helping retirees craft a well-balanced retirement strategy that aligns with their financial objectives and risk tolerance.

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# Housing Loans and Guarantees Backed by Retirement Funds

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## Introduction

For many people, buying a house is one of the biggest investments they will ever make. Unfortunately, many South Africans struggle to secure the loans needed to purchase their dream home.<sup>1</sup> The reasons for this may be due to insufficient income or assets, credit history or high debt-to-income ratios. However, a lesser-known alternative form of housing finance exists where the loan is secured by retirement fund savings, instead of a mortgage bond. This article considers the legislative provisions and conditions that apply when securing a housing loan or guarantee through a retirement fund, the purpose for which housing loans or guarantees are granted as well as the tax implications, when they do arise, and limitations.

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<sup>1</sup> Momentum Corporate, Housing Loan Guarantee Funds At Work brochure, August 2020, page 3

## What is a housing loan and a guarantee?

A housing loan, also referred to as a mortgage bond is a type of loan designed to help individuals finance the purchase, construction or renovation of an immovable property. The borrower acquires the immovable property with financial assistance from a lender or financial institution, which provides the loan amount. In exchange, the borrower commits to the repayment of the loan amount, with interest, over a specified period. Typically, the loan agreement includes some form of collateral. If the borrower defaults on repayment the lender has the right to take possession of the property. Often the immovable property is the collateral, but other assets can also be used as collateral for the loan. For example, financial assets such as stocks and shares (listed on the JSE) or endowment policies can serve as collateral.

Another way to secure the lender, other than using collateral, is by providing a guarantee. A guarantee is a third-party assurance where a commitment is made by a third party to promise to repay the lender if the borrower fails to do so, thereby providing protection against potential loss to the lender.<sup>2</sup> If the borrower defaults on payment, the guarantor agrees to settle the loan.

## Provision of housing loans and guarantees in terms of the Pension Fund Act

Pension-backed home loans, in terms of section 19(5) of the Pension Funds Act (hereinafter referred to as the Act),<sup>3</sup> allow members of retirement funds to secure a home loan using their retirement fund savings as collateral. This provides an alternative to traditional mortgage bonds and may make it easier to obtain financing.<sup>4</sup> Whilst legislation allows for pension-backed home loans and guarantees, it is also necessary that the retirement fund rules of the retirement which a member belongs to, must also make provision for pension-backed loans and guarantees.

The Act outlines the provisions relating to housing loans and guarantees, specifically:

- a. The purpose for which a housing loan or guarantee may be issued;
- b. The conditions that must be met;
- c. The maximum loan value.

Under this section, a member can borrow funds to purchase or renovate a property or pay off an existing housing loan. Alternatively, these funds can be used to guarantee a housing loan.<sup>5</sup>

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<sup>2</sup> Megan Hanna, What is a guaranteed loan? At <https://www.consumeraffairs.com/finance/what-is-a-guaranteed-loan.html>. Accessed on 25 September 2024

<sup>3</sup> Act 24 of 1956.

<sup>4</sup> Pension Fund Home Loans, What you need to know at <https://www.standardbank.co.za/southafrica/personal/learn/what-are-pension-backed-housing-loans>, accessed on 25 September 2024.

<sup>5</sup> Toy Meyer, Under the new pension fund regulations, can you borrow money from your provident fund, Money Web 15 April 2021 at 1, available at <https://www.moneyweb.co.za/ga/advisor-questions/under-the-new-pension-regulations-can-you-borrow-money-from-your-provident-fund/>, accessed on 18 September 2024.

## The purpose for which housing loans or guarantees can be issued

According to section 19(5)(a), requests of housing loans or guarantees must align with the following purposes:

- (i) To redeem a loan granted to the member, secured either by a pledge from the member to the fund or by immovable property owned by the member or their spouse, where a residence is or will be erected for occupation by the member or a dependant.
- (ii) To acquire immovable property, or erect a residence on such property, which is owned or will be owned by the member or their spouse for occupation by the member or a dependant.
- (iii) To make additions or alterations, or to maintain or repair a residence of which ownership or the right to ownership was acquired by the member or their spouse, provided the property is occupied or will be occupied by the member or a dependant.

Examples of section 19(5) application:<sup>6</sup>

- If a member wants to build a house on their spouse's property or construct a house for their son to live closer to university, can they be granted a loan or guarantee? Yes, they can, because it aligns with section 19(5)(a)(ii) in that the house is an immovable property to be erected, the member's spouse owns the property, and their dependant son will occupy the home.
- A member wants to pay off their existing housing loan because the bank's interest rate is higher than that of the pension fund. Does this purpose align with section 19(5)? Yes, it does. The purpose of the loan is to repay an existing loan, for a home that belongs to the member and is occupied by the member which is permissible under section 19(5)(a)(i).
- A member wants to renovate a house they inherited, does the purpose of the member's housing loan or guarantee request align with section 19(5)? Yes, in terms of section 19(5)(a)(iii) of the Act, pension funds can provide housing loans or guarantees to members to make additions, alterations, maintain or repair a residence, provided the home is occupied by the member or their dependant.<sup>7</sup>

## The conditions for issuing housing loans or guarantees

In addition to aligning with section 19(5), obtaining a housing loan or guarantee from a retirement fund requires meeting specific legislative conditions to ensure lender protection. Sections 19(5)(b) and (c) outline the conditions that must be fulfilled for a housing loan or guarantee to be issued to members. These conditions are:

- (i) The loan or guarantee must be secured by a first mortgage on the property or a pledge from the member's benefits in the fund, or both.
- (ii) No loan or guarantee may be issued if any amount is outstanding on another loan granted by the fund for a different property.
- (iii) The interest rate on the loan must meet or exceed the prescribed minimum, which is currently the South African Reserve Bank repo rate plus 5.5%.

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<sup>6</sup> FSCA eLearning platform, Trustee Tool kit, <https://elearning.fsca.co.za/learner/learning/course/2>

<sup>7</sup> Ibid

- (iv) The loan, including interest, must be redeemable over a maximum period of 30 years. If the loan extends beyond the member's retirement, the outstanding balance must be repayable from no more than one-third of the retirement benefit due to the member.

It is also worth noting that:-<sup>8</sup>

- A fund may not grant a loan or guarantee in respect of a home loan, if it has received notification of a pending divorce via a divorce summons, unless the non-member has provided their consent thereto.
- With regard to the new retirement reform and the component system, savings withdrawal will be permitted to the member, provided the withdrawal will not result in there being insufficient remaining funds to repay the loan or guarantee.

### **The maximum loan value of a housing loan or guarantee**

The Pension Funds Amendment Act<sup>9</sup> has changed and capped the amount of a loan or guarantee provided by an employer in terms of section 19(5) to a maximum of 65% of the member's benefit available, including the member's interest in the savings, retirement and vested components. This change seeks to align section 19(5) with Regulation 28, as amended, to reduce pension benefit exposure to loans and guarantees.<sup>10</sup>

### **Allowable deductions in terms of the Act**

Section 37A(1)<sup>11</sup> protects the benefits of retirement fund members, ensuring that no benefit provided for in the rules of a registered fund shall be capable of being reduced, suspended, transferred, ceded, forfeited or otherwise extinguished or impaired.

However, section 37D permits certain deductions from retirement benefits. In relation to housing loans and guarantees subsections 37D (1)(a)(i) and (ii) are applicable and provide for exceptions to section 37A(1). It provides for the deduction of –

- i. a loan granted to a member or
- ii. the deduction of any amount for which the fund becomes liable under a guarantee furnished in respect of a member for a loan granted by some other person to the member, from
  - a. the amount of the benefit a member or beneficiary becomes entitled in terms of the rules of the fund; or
  - b. in the case of a transfer of a member to another fund, the amount of the transfer benefit, if the trustees are satisfied that it is not reasonably possible to negotiate repayment or to transfer the loan or guarantee; or
  - c. upon the default by the member of the repayment while he or she remains in the fund.

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<sup>8</sup> Sherwin Hans, Hotline No. 6 /2024, Old Mutual, The impact of the two-pot reforms on section 37D claims, page 2

<sup>9</sup> Act 31 of 2024, section 19(5)

<sup>10</sup> Pension Funds Amendment Bill B3B-2024, General Explanatory Note, page 26

<sup>11</sup> Supra note 3

In terms of section 37D(1)(b)(i) the employer may deduct from the member's retirement benefits on the date of retirement or when they cease to be a member of the fund. This deduction may be made in respect of a loan granted by the employer to the member or where the employer becomes liable under a guarantee it provided for a loan granted by another person to the member.

### Taxation of the benefits

If, under unavoidable circumstances, repayment of a member's loan from retirement benefits occurs, a taxable benefit arises for the member. Trustees must ensure compliance with the Income Tax Act<sup>12</sup> and consult the South African Revenue Services (SARS) before authorising the redemption of housing loans from retirement benefits.<sup>13</sup> Section 37D(1)(a) clearly states that the fund may deduct any amount due on the benefit in question by the member, in accordance with the Income Tax Act as well as any amount due to the fund. The deductions and tax consequences will apply to the savings component, retirement component and the vested component of the three components of the retirement fund.<sup>14</sup>

Some examples to explain deductions in terms of section 37 D and tax implications on the deduction:

- **Example one:** Member A takes out a housing loan from XYZ bank, with the pension fund providing a guarantee. The member defaults on payments and fails to repay the loan for six months. The outstanding loan amount is R800 000 and the fund value R2 500 000. Once the Board of the fund determines that no other solution is feasible, the pension fund covers the outstanding loan balance of R800 000.

The fund may deduct the tax due on the outstanding loan in terms of paragraph 2(1)(b) of the Second Schedule<sup>15</sup> as well as the outstanding loan in terms of section 37D(1)(a)(ii)(aa).

Applicable tax table: Withdrawal Lumpsum Tax table

Tax on R800 000:

$$125\,730 + (27\% \times 74\,000)$$

$$=R145\,710$$

Amount deducted by the fund: R800 000 + R145 710 =R945 710

Fund value of retirement benefit: R1 554 290

<sup>12</sup> Income Tax Act 58 of 1962, schedule 2

<sup>13</sup> FSB Circular PF 92, September 1997 at 1

<sup>14</sup> Supra at note 12

<sup>15</sup> Ibid at page 4

- **Example two:** Member A of XYZ provident fund was granted a housing loan by his provident fund. Upon resigning from his employment due to a new job offer, he wishes to transfer his provident fund benefits to his new employer's provident, which does not offer housing loans. The outstanding loan is R950 000. Member A's fund value is R2 000 000. If it is not possible for the member to repay the loan or transfer it, the previous employer's provident fund may deduct the tax due on R950 000 in terms of paragraph 2(1)(b) of Schedule 2 of the Income Tax act, as well as the outstanding amount of the loan in terms of section 37D 1(a)(ii).

Applicable tax table: Withdrawal Lumpsum Tax table

Tax on R950 000:

$$125\,730 + (27\% \times 224\,000)$$

$$=R186\,210$$

Amount retained by the old provident fund: R950 000 + R186 210 = R1 136 210

Balance of withdrawal benefit transferred to new provident fund: R863 790

- **Example three:** Member A has a fund value of R900 000. If Member A defaults on the repayment of R200 000 of his housing loan provided by the retirement fund and neither the member nor the Board of the fund can agree on restructuring the accrued debt or any other arrangement, section 37D(1)(a)(ii)(cc) allows for the deduction of the amount due, as well as the tax on the benefit amount in terms of paragraph 2(1)(b) of the Second Schedule

Applicable tax table: Withdrawal Lumpsum Tax table

Tax on R200 000:

$$R200\,000 \text{ less } 27\,500 \times 18\%$$

$$=R31\,050$$

Amount deducted by the fund: R200 000 + R31 050= R231 050

Remaining balance of the fund value: R668 950

## Limitations of housing loans or guarantees

The primary purpose of pension funds is to provide annuities or lump sum payments to members or their dependants and/or beneficiaries upon the member's retirement or death. Permitting housing loans reduces these benefits; therefore, members must have a genuine intention to repay a loan before retirement. Furthermore, the Act does not intend for loans to be granted for purposes other than housing.<sup>16</sup>

There have been instances of misconduct related to the issuance of housing loans and guarantees, which led to the issuing of PF Circular 92. Some examples of this misconduct include:<sup>17</sup>

- i. Pension funds redeeming a loan granted to a member by someone other than the fund, where the loan was not secured by a mortgage bond over immovable property (section 19(5)(a)(i)).
- ii. Granting a loan to a member for the upgrade of another person's house, without obtaining prior exemption. Generally, the property concerned must belong to the member, their spouse or be occupied by the member or their dependants (section 19(5)(d)) unless prior exemption in terms of section 19(6)(a) is obtained.
- iii. Pension funds granting housing loans to members to acquire property other than their primary home for example a holiday home or commercial property
- iv. The granting of housing loans to members for purposes other than housing (section 19(5)(a))
- v. Granting of housing loans for amounts in excess of additions, alterations, maintenance or repairs (section 19(5)(a)(ii))
- vi. Granting housing loans to members where the capital is not redeemable within 30 years, without obtaining exemptions in terms of section 19(6)(a).

The FSCA will not hesitate to investigate such instances if it becomes aware of a contravention of the Act<sup>18</sup> It will also take the necessary action to ensure compliance.

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<sup>16</sup> FSB Circular PF 92, September 1997 at 1

<sup>17</sup> Ibid

<sup>18</sup> Ibid page 2

## Conclusion

The article considers the alternative option for the purchase, renovation, maintenance or repairs of a residence through funding a retirement fund. While the Act allows for this benefit, it depends on whether the fund rules provide for house loans and guarantees to its members.

The purpose and conditions of acquiring the housing loan or guarantee are comprehensively outlined in section 19. By conforming to the relevant legislature and Circular, the potential for misconduct is minimised. The legislation discussed in this article is designed to enable trustees to assist members in financing their genuine housing needs and is not intended as a means to access a member's retirement benefits prematurely.<sup>19</sup>

The relevant sections of the Act have served a useful purpose and in the vast majority of cases are applied within the spirit and the letter of the law. It would therefore be unfortunate if the relevant legislation had to become more restrictive or repealed because of abuse and irregularities by a minority.<sup>20</sup>

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<sup>19</sup> Ibid at 1

<sup>20</sup> Ibid at 5

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# Divorce and Retirement Funds: When the Member Spouse Resigns or Retires During a Divorce

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## Introduction

We all dream of a fairytale wedding and a happily ever after, but life is not always fair, and some marriages end in divorce. Divorce has significant social and financial implications for both parties.<sup>1</sup> It is important to understand your matrimonial property regime as it may affect the division of assets, whether individually owned or jointly, in the event of a divorce.<sup>2</sup> For instance, in a marriage in community of property, both spouses are entitled to each other's retirement funds when they divorce, which means that a member spouse's pension interest forms part of the assets of the joint estate upon divorce.<sup>3</sup> When navigating retirement funds and divorce it is important to be familiar with the Divorce Act<sup>4</sup> and the Pension Funds Act.<sup>5</sup>

This article focusses on what happens when a member of a retirement fund resigns or retires during divorce proceedings. What are the rights and responsibilities of the divorcing spouses?

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<sup>1</sup> Khabo L 'Divorce and your retirement savings', 2020

<sup>2</sup> Khabo L 'Divorce and your retirement savings', 2020

<sup>3</sup> Khabo L 'Divorce and your retirement savings', 2020

<sup>4</sup> 70 of 1979

<sup>5</sup> 24 of 1956

## Matrimonial regimes in South Africa

There are different types of marriages or matrimonial property regimes that prospective spouses can choose from in South Africa. In terms of the Matrimonial Property Act,<sup>6</sup> there are three marriage regimes to choose from: marriage in community of property, marriage out of community of property with the accrual system and marriage out of community of property without the accrual system.<sup>7</sup> Marriage in community of property means that spouses merge their separate estates into one estate called the joint estate (which includes all assets and liabilities). Marriage out of community of property with the accrual system means that the parties will share in the accrual or growth of the estate during the subsistence of the marriage. If spouses are married out of community of property without the accrual system, then the parties have separate estates (each party retains what is theirs).<sup>8</sup>

When spouses go through a divorce and were married in community of property, they have to equally divide the joint estate upon divorce. In terms of Section 7(7) of the Divorce Act,<sup>9</sup> the pension interest of a member's retirement fund shall be deemed to be part of the assets of the joint estate for spouses married in community of property. Section 7(8) goes further to provide that a court granting a decree of divorce may make an order for a retirement fund to pay a portion of the pension interest of a member to his/her spouse and may further order the fund to make an endorsement in its records to reflect such order.<sup>10</sup> This is further supported by Section 37D(4)(a)(i)(aa) of the Pension Funds Act,<sup>11</sup> which provides that a fund may make a deduction from a member's pension interest in the fund mentioned in, or identifiable from, the divorce order.<sup>12</sup> This means that when spouses are married in community of property and they get a divorce, the non-member spouse is entitled to portion of the member spouses pension interest in their retirement fund, and the decree of divorce must clearly state this.

### What happens when a member of a retirement fund resigns during divorce proceedings?

As mentioned above, the Divorce Act states that pension interest is deemed to form part of the joint estate for spouses married in community of property, and the Pension Funds Act directs funds to pay the non-member spouses from the retirement fund as per the decree of divorce. So, if there is no decree of divorce yet, that is, the divorce is not finalised, what happens?

The Divorce Act<sup>13</sup> defines pension interest as the benefits that the member would have been entitled to in terms of the rules of the fund had his/her membership been terminated on the date of divorce as a result of resignation.<sup>14</sup> Looking at this definition regarding a pension fund, it appears to apply only when the member is a member of the fund at the date of divorce.<sup>15</sup> The benefit in question is what the member would have been entitled to "if their membership

<sup>6</sup> 88 of 1984

<sup>7</sup> Malan Lourens Viljoen Inc, 'What to do before you say "I do"'

<sup>8</sup> Malan Lourens Viljoen Inc, 'What to do before you say "I do"'

<sup>9</sup> 70 of 1979

<sup>10</sup> Sanlam Article 'Order in respect of pension interest in the case of marriages in community of property', 2021.

<sup>11</sup> 24 of 1956

<sup>12</sup> Sanlam Article 'Order in respect of pension interest in the case of marriages in community of property', 2021

<sup>13</sup> 70 of 1979 Definition's clause

<sup>14</sup> Sanlam article 'What is pension interest' May 2019.

<sup>15</sup> Joubert H 'Divorce order issues relating to a member's pension interest' Momentum Legal Update No. 6 of 2015.

had been terminated on the date of divorce due to their resignation from their position".<sup>16</sup> If the member had already left their employment and become entitled to their benefits before the divorce, then the formula that calculates benefits based on a hypothetical resignation is not strictly applicable.<sup>17</sup> This means that the non-member spouses can no longer claim from the fund when the member exists the fund by resignation before the divorce is finalised.

For example, if A initiates divorce proceedings against B and at the time the summons is issued and served, B is a member of a pension fund. After receiving the divorce summons, B decides to resign from their employment and withdraws their pension while the divorce is pending. In this scenario, when the divorce is finalised, A will not be able to claim from B's pension because B would have already withdrawn it and is no longer a member of the pension fund.

In the case of *CNN v NN*,<sup>18</sup> the court granted a decree of divorce and dissolved the marriage between the parties on 14 October 2022. The court also incorporated a settlement agreement which was signed by both parties into the decree of divorce. The respondent (member spouse) had been served with divorce summons on 18 March 2021 and subsequently resigned from employment on 7 May 2021, approximately two months after being served with the divorce summons. By the time the court granted the divorce, the respondent was no longer a member of a retirement fund and thus did not have a pension interest that would be allocated to the applicant.

At the time the divorce order was granted, the respondent's pension benefits were still held by the fund. After the decree of divorce was granted, the applicant approached the respondent's pension fund to claim payment of what she believed belonged to her. It was at that stage that the respondent's pension fund informed her that the respondent was no longer a member of the pension fund. The applicant was informed that the divorce order could not be enforced as it fell short of the legislative requirements necessary for its enforcement. Notably, the respondent's fund advised the applicant to furnish a divorce order, which would direct the fund to pay a pension benefit instead of a pension interest. The applicant was advised that the respondent's pension interest had accrued, and his pension interest was nil.

Due to the contents of the letter from the respondent's pension fund, the applicant was encouraged to bring an application to amend the phrase 'pension interest' and replace it with 'accrued pension benefit' as contained in the divorce order. Furthermore, the court enquired from the applicant's counsel whether such a statutorily recognised phrase 'pension interest' could be replaced with the phrase 'accrued pension benefit' and if such an amendment could be enforced in terms of the Divorce Act. The court stated that the applicant was 'incorrectly advised to approach this court to vary the divorce order to allow her to claim the respondent's accrued pension benefit' and such an amendment would be unenforceable (paragraph 13). The respondent was not a member of a pension fund, at the time the divorce order was granted therefore the order 'could not be enforced in terms of sections 7(1) and 7(8) of the Divorce Act'.

The court further held that this case highlighted 'an important gap in the law regulating pension interests in South Africa.' As the law stands, there is not sufficient legal framework that

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<sup>16</sup> Joubert H 'Divorce order issues relating to a member's pension interest' Momentum Legal Update No. 6 of 2015

<sup>17</sup> Joubert H 'Divorce order issues relating to a member's pension interest' Momentum Legal Update No. 6 of 2015

<sup>18</sup> [2023] ZAGPJHC 208 (23 February 2023)

allows a non-member spouse to claim pension benefits of the member spouse directly from the fund if the spouse exits the fund before divorce. As a result, this gap opens the door for member spouses to resign from the pension fund after being served with summons, thus keeping their pension benefits from their non-member spouses. Section 7(7) of the Divorce Act has created a legislative framework that makes it possible for a non-member spouse to claim a portion of the member's pension interest as at the date of divorce.

The issues discussed in the case *CNN v NN* are prevalent in society and the loophole of member spouses resigning to keep their retirement funds away from the non-member spouse is common. When a member spouse decides to resign while the divorce is pending, by the time the decree of divorce is granted the funds are no longer in the retirement fund. This is a major loophole that puts the non-member spouse at a disadvantage because even if the decree of divorce is correctly worded, it cannot be enforced thus infringing on the rights of the non-member spouse.

### **What happens when a member of a retirement fund retires during divorce proceedings?**

What are the rights of the non-member spouse? When a member of a retirement fund retires, they can take up to one third of their retirement money as a lump sum, while two thirds is used to purchase an annuity.<sup>19</sup> A living annuity is defined as a right that a member, former member, or member's beneficiary has to an annuity that has been purchased from an external source or provided by the fund from the date the member exited the fund.<sup>20</sup> When a retirement fund member purchases an annuity, the capital amount paid, either to the insurer or the fund, is invested in specific asset classes according to the annuitant's preferences.<sup>21</sup>

It is generally accepted that a living annuity is a vehicle that is meant for people who have reached retirement or early retirement age. Retirement fund members invest in living annuities through their retirement benefits to secure regular income post their retirement.<sup>22</sup> Once living annuities have been purchased, retirement fund members will cease to be members of their retirement funds, and their membership will be terminated in accordance with the rules of their funds.<sup>23</sup> The South African law on this issue indicates that living annuities do not form part of former retirement fund members' estates and thus, cannot be taken into consideration when spouses divorce.<sup>24</sup>

In the case of *Montanari v Montanari*,<sup>25</sup> the parties were married out of community of property with the inclusion of the accrual system. The respondent used his pension benefits to purchase three living annuities during the marriage and sought a declaratory order that these annuities should not be regarded as assets in his estate for the purposes of calculating the accrual. The

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<sup>19</sup> SARS website 'Tax and retirement'.

<sup>20</sup> Marumoagae MC 'Deprivation of Retirement Benefits on Divorce through Living Annuities in South Africa' *Journal of African Law*, Volume 66.

<sup>21</sup> T Bester "Comparing five annuity options offered at retirement in South Africa" (MCom thesis, Stellenbosch University 2016) at 41.

<sup>22</sup> Marumoagae MC 'Deprivation of Retirement Benefits on Divorce through Living Annuities in South Africa' *Journal of African Law*, Volume 66.

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<sup>24</sup> Marumoagae MC 'Deprivation of Retirement Benefits on Divorce through Living Annuities in South Africa' *Journal of African Law*, Volume 66.

<sup>25</sup> *Montanari v Montanari* ZAGPJHC (unreported) 14/26868.

court had to determine whether the living annuities purchased long before the parties' divorce proceedings, formed part of the accrual of the husband's estate upon divorce. The court held that because the statutory purpose of a living annuity was to provide an income stream, therefore the living annuity does not form part of the plaintiff's estate for the purposes of accrual.

The court held that that there was no dispute that the living annuities were contracts complying with the requirements of the Income Tax Act. The annuity contracts state that once a living annuity is purchased the underlying capital in it is no longer accessible to the annuitant. The proceeds or annuity income do not fall within the definition of 'pension interest' as outlined in the Act. Therefore, the annuitant cannot give part or all of the living annuities to an ex-spouse.

The SCA further stated that the above findings do not prevent the applicant from claiming in respect of the respondent's annuities. The court referenced the decision made in *De Kock v Jacobson*.<sup>26</sup> In that case, the court had to determine whether a pension that the husband was receiving was an asset in the joint estate of a couple married in community of property. The court affirmed that the accrued right to pension should form part of the parties' property. In the *De Kock* case, the court concluded that there was no logical or legal reason why both cash components and the accrued right to the pension should not form part of the community of property existing between the parties prior to the divorce. The court held that the respondent had a clear right to investment returns yielded by his capital re-investment with Sanlam, in the form of future annuity income which he draws from the agreement. Such annuity is evidently an asset that can be valued.

The decision made by the SCA in the *Montanari* case clarified the legislative position. The value of an annuitant's right to receive future annuity payments is an asset in his estate for purposes of calculating the accrual.<sup>27</sup> When calculating the annuitant's accrual during divorce proceedings, the annuity payments from a living annuity may be considered. However, the capital value of the living annuity itself cannot be divided between the parties involved in the divorce.<sup>28</sup>

### **What can spouses who are married in community of property do to prevent the member spouse from resigning or retiring during divorce proceedings?**

In most instances, when parties go through a divorce their relationship is already strained and co-operation between the parties is a big challenge. To protect the pension interest in the retirement fund, the non-member spouse can, after issuing divorce summons and serving them on the member spouse, make an application to the same court to freeze the retirement fund pending the finalisation of the divorce. This is an application that is made (rules for motion proceedings apply) and the member spouse may oppose such an application. The court, after hearing both parties, will then decide whether to grant the order. Each case is dealt with

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<sup>26</sup> *De Kock v Jacobson & another* 1999 (4) SA 346 (W).

<sup>27</sup> De la Harpe L 'Living annuities at divorce' May 2020.

<sup>28</sup> Momentum legal update 9 of 2020 'Case law on divorce in respect of living annuities.'

on its own merits. This will assist the non-member spouse in “protecting” the retirement fund monies until the divorce is finalised.

Is it legally valid to make an application interdicting a retirement fund from releasing a member's funds pending the finalisation of a divorce? In the case of *M v M and SANDF and GEPF*,<sup>29</sup> the court explained the requirements for an interim interdict. These requirements are there must be a prima facie right; a well-grounded fear of irreparable harm if the relief is not granted; an absence of an alternative remedy; and that the balance of convenience favours the grant of the interim relief. The court held that the prima facie right had been established by the fact that the applicant was married to the first respondent in community of property. There was no alternative remedy because the first respondent was about to retire, meaning no other options were available under the circumstances. Regarding irreparable harm and balance of convenience, the applicant's fear would be realised if the first respondent, upon retirement, was awarded all of his pension interest (before divorce). Therefore, the applicant's fear was justifiable, and the balance of convenience tilted in the applicant's favour. It is evident in the case of *M v M and SANDF and GEPF* that such an application can be granted by a court where the requirements for an interdict have been met.

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<sup>29</sup> [2022] ZAGPPHC 113.

## Conclusion

The Divorce Act makes provision for pension interest as part of the assets in the joint estate when parties are divorcing. The Pension Funds Act directs funds to pay out the pension interest as a result of the decree of divorce. However, there are areas in the law that still need clarity, in particular regarding outright protection for the non-member spouse when a member leaves the fund during divorce proceedings. It is not right that the non-member spouse must approach a court to have their rights protected, especially since some spouses do not have the financial means for litigation. Non-member spouses should be protected in legislation, in line with the principles of marriage and their matrimonial property regime.

When one is faced with such a situation, it should as a general rule be advised that the non-member spouse makes an application to the same court that the divorce is instituted, to seek an interdict to prevent the retirement fund from releasing any funds while the divorce is pending. This is currently the only practical solution under the existing legislation governing divorces and retirement funds.

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## Section 37 C Benefits: Choosing Between Beneficiary Funds and Trusts – A Guide for Financial Advisers

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### Introduction

In recent years, financial advisers have faced increasing complexities in their roles, particularly in relation to the legal and regulatory landscape. The current focus in the industry on the introduction of the Two-Pot system, alongside the intricacies of familiar legislation such as section 37C of the Pension Funds Act,<sup>1</sup> poses risks when offering advice. The saying “the devil is in the detail” rings especially true here, as small oversights can lead to significant consequences. One such area of complexity involves advising clients on whether to opt for a beneficiary fund or a trust as the vehicle to receive retirement benefits upon death. This article aims to clarify the distinction between beneficiary funds and trusts, ensuring that financial advisers can guide their clients towards informed decisions.

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<sup>1</sup> Act 24 of 1956

## Beneficiary funds

### What is a beneficiary fund?

A beneficiary fund is defined in the Pension Funds Act<sup>2</sup> as:

*“a fund referred to in paragraph (c) of the definition of ‘pension funds organisation’.”*

Paragraph (c) of the definition of pension funds organisation<sup>3</sup> reads as follows:

*“(c) any association of persons or business carried on under a scheme or arrangement established with the object of receiving, administering, investing and paying benefits that became payable in terms of the employment of a member on behalf of beneficiaries, payable on the death of more than one member of one or more pension funds,”*

A beneficiary fund is therefore a fund established to receive, invest and administer lump sum benefits awarded in terms of Section 37C of the Pension Funds Act<sup>4</sup> to a beneficiary on the death of a member, where the benefit is not paid directly to the beneficiary or to a trust that was nominated by the member, but was awarded to the beneficiary fund in the discretion of the trustees of a retirement fund. Payment to a beneficiary fund is deemed to be payment to the relevant beneficiary.<sup>5</sup> Section 37C of the Pension Funds Act<sup>6</sup> specifically stipulates that no payment may be made to a beneficiary fund that is not registered under the Act.<sup>7</sup>

Beneficiary funds were introduced by the Financial Services General Laws Amendment Act,<sup>8</sup> following the Fidentia Living Hands Scandal, to receive employment-related death benefits such as group life benefits (approved or unapproved), retirement fund credits, accrued leave pay, and more. The definition of “pension fund organisation” was amended to allow beneficiary funds to receive benefits from “unapproved” group life insurance policies as well.<sup>9</sup> Currently, it appears that beneficiary funds will not be allowed to receive benefits that is not related to employment, such as death benefits from retirement annuities and preservation funds.<sup>10</sup> According to the SA Financial Planning Handbook, the COFI Bill<sup>11</sup> proposes to amend the definition of a beneficiary fund to address this issue.<sup>12</sup> Beneficiary funds are unique to South Africa and apply to employer funds but they do not apply to the Government Employees Pension Fund (GEPF), which makes use of the Guardian’s Fund.<sup>13</sup>

Under the Pension Funds Act, beneficiary funds are a type of pension fund and is therefore subject to the same strict regulatory, governance, and compliance requirements as

<sup>2</sup> Act 24 of 1956

<sup>3</sup> Act 24 of 1956, Section 1(1) definition of pension fund organisation

<sup>4</sup> Act 24 of 1956

<sup>5</sup> Section 37 C (2)(a) of the Pension Funds Act 24 of 1956

<sup>6</sup> Act 24 of 1956

<sup>7</sup> Ibid

<sup>8</sup> Act 22 of 2008, Section 15(2)(a)

<sup>9</sup> Marius Botha, SA Financial Planning Handbook, 2024 Edition, Section 6, Chapter 35 Retirement Funds, 35.4 Different types of retirement funds

<sup>10</sup> Ibid

<sup>11</sup> The Conduct of Financial Institutions (COFI) Bill proposes to create a single comprehensive law for all matters of market conduct in the financial sector, and repeal amongst others FAIS, the Long-term Insurance Act, the Short-term Insurance Act, the Collective Investment Schemes Control Act and portions of the Pension Funds Act

<sup>12</sup> Marius Botha, SA Financial Planning Handbook, 2024 Edition, Section 6, Chapter 35 Retirement Funds, 35.4 Different types of retirement funds

<sup>13</sup> <https://www.news24.com/citypress/personal-finance/personal-finance-how-to-use-your-beneficiary-fund-to-provide-for-your-child-20230917>

retirement funds. Beneficiary funds are typically controlled by an independent trustee, principal officer, and an independent auditor, and they must submit annual audits and reports to the Financial Services Board (now the Financial Sector Conduct Authority, or FSCA).<sup>14</sup> It is subject to regulation by the FSCA and the Prudential Authority (PA).<sup>15</sup>

There are twenty-four registered beneficiary funds in South Africa, holding assets totalling R23.37 billion for over 160 000 minor children,<sup>16</sup> although beneficiary funds can be used for majors.

### Primary purpose and costs of a beneficiary fund

Silke<sup>17</sup> states that a beneficiary fund is designed to accept, administer and invest lumpsum death benefits which have been allocated to the minor dependants of deceased pension fund members, as envisaged in section 37C of the Pension Funds Act.<sup>18</sup> FISA elaborates on the purpose of a beneficiary fund and published in a media statement that a beneficiary fund's purpose is to protect its members, most commonly minors and those with disabilities.<sup>19</sup>

The provision for members' education costs is given the highest priority. Education costs include school fees, stationery, transport, and even school uniforms. Therefore, it is important to ensure that the benefits available last, at least, until the minor has completed their education.<sup>20</sup>

A beneficiary fund must conduct an annual audit, have independent trustee representation on its board, and the fund must report to the FSCA annually on financial statements.<sup>21</sup> Since the beneficiary funds are also subject to annual audits and reports to the FSCA, costs would include reporting and governance fees, fund expenses, investments fees, administration fees and capital introduction fees.<sup>22</sup>

### How a beneficiary fund work in practice

The beneficiary fund as a type of pension fund,<sup>23</sup> must be registered with the FSCA and be approved by the South African Revenue Services (SARS). The death benefit received is invested and the fund provides for the child's daily living costs through monthly payments to the legal guardian and/or caregivers depending on the circumstances. Expenses such as

<sup>14</sup>[https://eb.momentum.co.za/webDocumentLibrary/2017/A\\_trust\\_or\\_a\\_beneficiary\\_fund\\_Make\\_the\\_right\\_choice\\_option\\_2.pdf](https://eb.momentum.co.za/webDocumentLibrary/2017/A_trust_or_a_beneficiary_fund_Make_the_right_choice_option_2.pdf)

<sup>15</sup><https://www.fisa.net.za/wp-content/uploads/2022/06/Consumer-Education-BENEFICIARY-FUNDS-June-2022.pdf>

<sup>16</sup> <https://www.moneyweb.co.za/in-depth/fedgroup/keeping-the-vulnerable-safe-the-need-for-specialisation-in-beneficiary-fund-management/>

<sup>17</sup> AP de Koker, Silke on South African Income Tax, Chapter 4, Special Inclusions, Section 4.30 Fund Benefits – Beneficiary Funds

<sup>18</sup> Act 24 of 1956

<sup>19</sup> <https://www.fisa.net.za/wp-content/uploads/2021/11/Hurford-FISA.pdf>

<sup>20</sup> Ibid

<sup>21</sup> Mangammbi Mafanywa Jeffrey, 2013, The Laws regulating Beneficiary funds in South Africa: A critical analysis, a mini-dissertation, University of Limpopo, page 20.

<sup>22</sup>[https://eb.momentum.co.za/webDocumentLibrary/2017/A\\_trust\\_or\\_a\\_beneficiary\\_fund\\_Make\\_the\\_right\\_choice\\_option\\_2.pdf](https://eb.momentum.co.za/webDocumentLibrary/2017/A_trust_or_a_beneficiary_fund_Make_the_right_choice_option_2.pdf)

<sup>23</sup> Read the definitions of "pension fund" and "pension fund organisation" together in section 1 of Pension Funds Act 24 of 1956

school fees and medical costs may also be paid from the fund. If regular income is not needed, then the income will be reinvested and added to the capital in the fund.

Each member has their own sub-account, and every account is separately accounted for.<sup>24</sup> Financial advisers should have a family consultation with the members of the beneficiary fund to ensure that all members and their guardians understand how the beneficiary fund works, and what claims they may institute against the fund.

Beneficiary funds make regular income payments to the guardian or the caregiver responsible for caring for the member. In practice, guardians can request income changes, to have income reinvested or reduced. Guardians can also apply to have the income increased, however, a budgeting exercise will then be conducted, and the trustees must approve the increased income before it can be affected.<sup>25</sup> Income can be paid monthly, quarterly, biannually, and annually.

Beneficiary funds only make ad hoc capital payments for educational purposes, or when the final termination payment is made to the beneficiary. When the beneficiary reaches the age of majority, they become entitled to the balance of the capital that the beneficiary fund holds. The beneficiary will receive payment of the balance that is held in the fund free of tax or can opt to leave the remaining benefit in the beneficiary fund until they give instructions for it to be distributed to them.<sup>26</sup>

If the member of a beneficiary fund passes away, the balance in the beneficiary fund will be paid into the beneficiary's estate. If the estate is not reported at a Master's office, then the balance will be paid into the Guardian's Fund, which is managed by the Master's offices.<sup>27</sup>

### Taxation of benefits

Lump sum death benefits are taxed when transferred to beneficiary funds as a death benefit, in terms of the death benefit/retirement tax table, using the deceased member's tax data. However, the growth within the beneficiary fund is tax-free and both capital and income payments made by beneficiary funds are tax-free.<sup>28</sup>

### Advantages of beneficiary funds

The advantages of beneficiary funds are that it is strictly regulated and controlled by the FSCA. The adjudication of pension funds complaints rest with the Pension Funds Adjudicator, and the adjudicator has jurisdiction to deal with complaints relating to the administration of beneficiary funds.<sup>29</sup> The definition of complaint in the Pension Funds Act<sup>30</sup> have the

<sup>24</sup> <https://www.fisa.net.za/wp-content/uploads/2022/06/Consumer-Education-BENEFICIARY-FUNDS-June-2022.pdf>

<sup>25</sup> <https://www.fisa.net.za/wp-content/uploads/2021/11/Hurford-FISA.pdf>

<sup>26</sup> [https://eb.momentum.co.za/webDocumentLibrary/2017/A\\_trust\\_or\\_a\\_beneficiary\\_fund\\_Make\\_the\\_right\\_choice\\_option\\_2](https://eb.momentum.co.za/webDocumentLibrary/2017/A_trust_or_a_beneficiary_fund_Make_the_right_choice_option_2)

<sup>27</sup> <https://www.sanlam.co.za/personal/financialplanning/willtrustsestates/Pages/beneficiary-fund.aspx>

<sup>28</sup> Manual on Retirement Funds, 2024 Edition, Kobus Hanekom, Taxation of Retirement Funds, Chapter 8, 8.18 Taxation of beneficiary funds

<sup>29</sup> Mangammbi Mafanywa Jeffrey, 2013, The Laws regulating Beneficiary funds in South Africa: A critical analysis, a mini-dissertation, University of Limpopo, page 22.

<sup>30</sup> Act 24 of 1956

requirement that the complaint must be in relation to a fund, and as pointed out previously in this article a Beneficiary Fund falls within the definition of a “pension fund organisation”.<sup>31</sup>

Employers can have peace of mind that their employees are protected and that their employees' benefits will be strictly managed to protect their dependants. The “best-kept secret” is that capital or income that is paid out by the beneficiary fund to the member is exempt from tax.<sup>32</sup> Beneficiary funds are also a very cost-effective alternative to a trust. When a member reaches the age of majority the member is encouraged to leave the benefit in the fund until they are older and better equipped to make financial decisions. The major member may request that the benefit stays in the beneficiary fund and is still administered by the fund. The member therefore must consent that the benefit stays in the beneficiary fund<sup>33</sup> Beneficiary funds are also protected from creditors.<sup>34</sup>

### **Disadvantages of beneficiary funds**

The main concern with beneficiary funds is that a member becomes entitled to the capital when they reach the age of majority, which is currently 18 years. Although the beneficiary is encouraged through member counselling by the fund to leave the benefit in the fund, even after they reached majority, this must happen with the permission and on instruction of the beneficiary. Another disadvantage of beneficiary funds is that they can only receive employment-related death benefits (including group life benefits).<sup>35</sup> As pointed out by author Marius Botha,<sup>36</sup> this has the unintended consequence that beneficiary funds will not be allowed to receive death benefit transfers from sources such as retirement annuities and preservation funds, since these benefits are not related to employment.

A beneficiary fund is established under the Pension Funds Act to receive and manage lump-sum death benefits for beneficiaries. It is strictly regulated, tax-efficient, and primarily serves minors or those with disabilities. Financial advisers must understand its operations and associated costs to guide clients effectively.

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<sup>31</sup> Read the definitions of “pension fund” and “pension fund organisation” together in section 1 of Pension Funds Act 24 of 1956

<sup>32</sup> AP de Koker, Silke on South African Income Tax, Chapter 4, Special Inclusions, Section 4.30 Fund Benefits – Beneficiary Funds

<sup>33</sup>[https://eb.momentum.co.za/webDocumentLibrary/2017/A\\_trust\\_or\\_a\\_beneficiary\\_fund\\_Make\\_the\\_right\\_choice\\_option\\_2](https://eb.momentum.co.za/webDocumentLibrary/2017/A_trust_or_a_beneficiary_fund_Make_the_right_choice_option_2).

<sup>34</sup> <https://www.news24.com/citypress/personal-finance/personal-finance-how-to-use-your-beneficiary-fund-to-provide-for-your-child-20230917>

<sup>35</sup>[https://eb.momentum.co.za/webDocumentLibrary/2017/A\\_trust\\_or\\_a\\_beneficiary\\_fund\\_Make\\_the\\_right\\_choice\\_option\\_2](https://eb.momentum.co.za/webDocumentLibrary/2017/A_trust_or_a_beneficiary_fund_Make_the_right_choice_option_2).

<sup>36</sup> Marius Botha, SA Financial Planning Handbook, 2024 Edition, Section 6, Chapter 35 Retirement Funds, 35.4 Different types of retirement funds

## Trusts

### Payment of section 37C benefit to a trust

It is well established that payment made by a registered fund to a trust is acceptable in terms of section 37(2) of the Pensions Fund Act,<sup>37</sup> therefore the member may nominate an inter vivos or testamentary trust to receive the benefit. This section in the Act states as follows:

*(2)(a) For the purposes of this section , a payment by a registered fund for the benefit of a dependant or nominee contemplated in this section shall be deemed to be a payment to such dependant or nominee, if payment is made to—*

*(i) a trustee contemplated in the Trust Property Control Act , 1988, nominated by—*

*(aa) the member;*

*(bb) a major dependant or nominee, subject to subparagraph (cc); or*

*(cc) a person recognised in law or appointed by a Court as the person responsible for managing the affairs or meeting the daily care needs of a minor dependant or nominee, or a major dependant or nominee not able to manage his or her affairs or meet his or her daily care needs;*

However, the devil is in the detail. This does not mean that the section 37C benefit can be paid into a discretionary trust, as this will be against section 37C. Unfortunately, it is often assumed in practice that “a trust is a trust is a trust,” but in the case of section 37C benefits, the requirement is that payment should only be made to a vested trust.

The type of trust that a fund may pay into was scrutinised in the *McLoughlin*-case.<sup>38</sup> In this case, the guardian wanted the death benefit to be paid into a discretionary testamentary trust that was created for the minor heir in the last will and testament of the deceased. The fund rejected the guardian's request for three reasons:

- (a) The capital for each beneficiary was not ring-fenced in the trust;
- (b) The capital in the trust did not vest in the beneficiary (since it was a discretionary trust); and
- (c) There was no guarantee that the benefit will be paid to the minor's estate on the death of the minor.

The adjudicator ruled as follows:

*"The submissions indicate that the board of the first respondent exercised its discretion reasonably in refusing to pay the death benefit allocated to the minor children into a discretionary trust. This is due to the fact that it cannot guarantee that the benefit would be used for the benefit for the minor children and the complainant did not provide any evidence to the contrary... Thus, the complainant must either apply for an amendment of the trust deed or establish a non-discretionary trust that guarantees the interest of the minor children and does not give the trustees a wide discretion regarding use of the funds in the trust."*<sup>39</sup>

<sup>37</sup> Section 37(2)(a) of the Pension Funds Act 24 of 1956

<sup>38</sup> *McLoughlin v Lifestyle Retirement Annuity Fund* and another case no. PFA/GP/00025293/2016/SM 13 September 2016 (PFA)

<sup>39</sup> *Ibid*

This highlights the importance of funds scrutinising trust deeds and ensuring that the benefit payable from the fund will be used for the beneficiary only. This also offers a valuable lesson to financial advisers to also scrutinize trust deeds to ensure that when advising that a trust be used as vehicle to receive section 37C benefits for beneficiaries/dependants on the death of a member, the three requirements pointed out by the adjudicator above are met, before this advice is incorporated into the client's estate planning.

In summary, the beneficiary of a testamentary or inter vivos trust should have a vested right in the Section 37C death benefits paid to the trust. No one else, other than the beneficiary may benefit from the vested trust and the right of the beneficiary belongs completely and unconditionally to the beneficiary and cannot be taken away without the consent of the beneficiary with such vested right.<sup>40</sup>

Discretionary trusts are immensely popular in practice and financial advisers often (incorrectly) assume that retirement fund benefits can be paid into a discretionary trust for a beneficiary or dependant. A discretionary trust allows trustees to benefit any beneficiaries from a class of beneficiaries at their discretion and does not meet the requirement that the beneficiary must have a vested right to the Section 37C death benefits.

### **Requirements that must be met before payment can be made to a trust to receive a section 37C benefit<sup>41</sup>**

- i. The trust deed must specifically state that the trustees of the trust can accept retirement fund benefits. If the trust deed does not contain such a provision, then the trust deed needs to be amended to allow the trustees to receive payments from a retirement fund.
- ii. Furthermore, there must be no powers given to the trustees of the vested trust that would allow them to override any decision taken by the trustees of the retirement fund.
- iii. The retirement fund benefit must be for the sole benefit of the specific dependant, and the dependant should have a vested interest in terms of the trust deed.
- iv. The trust deed must specify that, should the beneficiary with the vested right pass away, the benefit must be included in the estate of the vested beneficiary. The trust deed cannot make provision that the retirement fund benefit may be redistributed to other beneficiaries.

### **Trust regulation**

The trust deed outlines the purpose of the trust and would indicate who the beneficiaries are, as well as whether they qualify for income only or for both income and capital from the trust. An inter vivos trust is registered with the Master of the High Court during the client's lifetime, while a testamentary trust is registered after the death of the client and after the estate has been wound up by the trustees of the testamentary trust, as appointed in the client's will. The trust must also be registered with SARS for tax purposes. The Master of the High Court in whose

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<sup>40</sup> Chirkoot J, Payment of Retirement Fund benefits to a Trust, Premiums & Problems Article Edition 2023, page C4.

<sup>41</sup> Ibid, page C8

area the main asset of the trust is registered will regulate the trust, and the trust will be subject to the Trust Property Control Act,<sup>42</sup> and the trust deed will further regulate how the trust should be administered.

Often, a trust does not have to be audited unless the trust deed specifically requires an audit.<sup>43</sup>

### **Taxation if trust received section 37C benefits**

Benefits that vest in the beneficiary of a vested trust are taxable in the hands of the beneficiary and not in the hands of the trust. Likewise, any income or capital gains that vest in a beneficiary is taxable in their hands and not in the trust.<sup>44</sup> Distributions from the trust are not subject to tax.

### **Advantages if a trust receives section 37C benefits**

While a beneficiary fund is strictly regulated to receive only retirement fund benefits, there are no such restrictions on a trust. A trust can receive any benefits permitted by the trust deed. The trust deed must allow the trustees to accept retirement fund or employer-related benefits for them to receive section 37C benefits. Since it must be a vested trust, as discussed earlier, the trust deed and not the discretion of the trustees of the trust will determine when the beneficiary is entitled to the capital of the vested trust.<sup>45</sup>

### **Disadvantages if a vested trust receives section 37C benefits**

Income and capital gains are taxable in the hands of the beneficiaries with vested rights at their applicable marginal tax rates. If the trust deed requires an annual audit, the trust must undergo this audit, and the trust must be regulated and administered in accordance with the trust deed of the trust. Trustees are not required to send a report to the FSCA, unlike beneficiary funds, which are strictly regulated in terms of reporting to the FSCA.<sup>46</sup> If the estate is nominated as the beneficiary of the death benefit, executors fees of 4.06 % (including VAT) will apply, and the proceeds will be temporarily frozen whilst the estate is wound up, leaving the beneficiary destitute and without provision.<sup>47</sup> Financial advisers must also keep in mind, that a trust must be registered with the Master's offices, which could cause further delays.

In summary, a vested trust can receive section 37C benefits, but not all trusts qualify. Advisers need to ensure that the trust deed meets specific legal requirements to safeguard beneficiaries. While vested trusts provide flexibility, the tax burden on the beneficiary and potential administrative delays are key drawbacks.

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<sup>42</sup> Act 57 of 1988

<sup>43</sup>[https://eb.momentum.co.za/webDocumentLibrary/2017/A\\_trust\\_or\\_a\\_beneficiary\\_fund\\_Make\\_the\\_right\\_choice\\_option\\_2](https://eb.momentum.co.za/webDocumentLibrary/2017/A_trust_or_a_beneficiary_fund_Make_the_right_choice_option_2).

<sup>44</sup> Ibid

<sup>45</sup> Ibid

<sup>46</sup> Van der Merwe C, Protection of retirement benefits after death, Premiums & Problems Article Edition 2015, page D6.

<sup>47</sup> Ibid

## Practical considerations for financial advisers

Despite the content discussed in this article and the author's practical experience, some financial advisers still opt for a trust to receive Section 37C employer-benefits upon the death of the client-member. If financial advisers choose a testamentary trust, the following clause could be used in the client's will to create a vested trust to receive the section 37C benefits from the employer. It is important to ensure that the beneficiary nominations on the employer-benefits align with the estate planning, and that trustees of the retirement fund are informed.

### Example of a vested testamentary trust clause for receiving section 37C benefits

*"The trustees of my Retirement Fund and Group Life Fund were requested during my lifetime to pay a percentage of the net proceeds of my retirement fund and group life assurance to my \*son/daughter, \_\_\_\_\_ as beneficiary, with the wish that the proceeds shall be held in a trust which is hereby created for his/her benefit, and which request is hereby confirmed.*

*My herein nominated trustee is empowered to accept the said proceeds that shall be administered in terms of the powers granted herein for the following purposes. My trustee is empowered to use so much of the net income and, if found necessary, of the capital as it shall decide, for the maintenance, education, general welfare, and benefit of my \*son/daughter, \_\_\_\_\_. Any surplus income shall be capitalised. It is my wish that my said \*son/daughter shall receive the best education possible. The trust shall terminate when my said \*son/daughter attains the age of \* (\*) years, when my trustee shall pay the capital of the trust, as it then exists together with any accumulated revenue to him/her.*

*Should my said \*son/daughter however predecease me, the benefit that would have devolved upon him/her shall devolve upon \_\_\_\_\_."*<sup>48</sup>

Incorporating a well-drafted testamentary trust clause can help financial advisers ensure that their clients' estate planning objectives align with legal requirements and provide clear, secure pathways for distributing section 37C benefits.

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<sup>48</sup> Old Mutual Trust Clause

## Conclusion

Financial advisers must remember that ignorance is a liability. Best practice is to remain informed, consult legal experts and attend workshops to ensure that they are fully equipped to advise clients accordingly that the clients can make informed decisions when doing estate planning. This will enable clients for receiving their retirement fund benefits and navigate section 37C requirements effectively to meet their specific needs.

This analysis underscores the importance of understanding the differences between vested trusts and beneficiary funds as vehicles for receiving employer-benefits on the death of a member to a retirement fund. Financial advisers should pay close attention to the details when advising clients, as the implications of these choices can be significant. Ensuring thorough knowledge of the relevant legislation and regulations is essential to avoid costly mistakes and provide accurate guidance. Advisers must base their recommendations on a comprehensive understanding of the law to better assist clients in making informed decisions regarding estate planning and retirement fund benefits.

In conclusion, advisers are encouraged to regularly consult the FSCA's latest guidelines on beneficiary funds and seek legal opinions when trust structures are involved in estate planning. Engage with a legal professional today to ensure your client's trust structures and beneficiary funds fully comply with current regulations.

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# The Two Pot Retirement System

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## Introduction

The Two Pot Retirement System came into effect on 1 September 2024. The practical application of this system is discussed in this article, inclusive of the latest amendments that will be introduced once the 2024 Revenue Laws Amendment Bill<sup>1</sup> is signed into legislation.

## Rationale for the Introduction of the Two Pot System

The introduction of the Two-Pot System addresses two key concerns:<sup>2</sup>

- Low preservation rates: The Government is concerned about the lack of preservation of retirement savings by South Africans, especially in relation to pension and provident funds where such savings are often accessed upon resignation.
- Emergency access needs: The Government acknowledges that access to retirement savings could be a necessity, especially for emergencies.

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<sup>1</sup> The latest version of the 2024 Revenue Laws Amendment Bill was published by National Treasury on 30 October 2024: [https://www.treasury.gov.za/legislation/bills/2024/\[B18-2024\]-%20\(Revenue%20Laws\).pdf](https://www.treasury.gov.za/legislation/bills/2024/[B18-2024]-%20(Revenue%20Laws).pdf)

<sup>2</sup> Draft Explanatory Memorandum on the Revenue Laws Amendment Bill, 2022, dated 29 July 2022, page 3.

The “Two Pot” System aims to solve these issues by enforcing the preservation of retirement savings until retirement, whilst at the same time allowing for specified withdrawals before retirement without requiring the member to exit the relevant retirement fund.

### The Concept of the Two Pot System

The term “Two Pot” System is, in a sense, misleading as existing members of pension, provident or retirement annuity funds on 31 August 2024, would have three components (pots) from 1 September 2024:



Vested Component	Savings Component	Retirement Component
<p>The fund value in a pension, provident or retirement annuity fund on 31 August 2024, minus once-off seed capital allocated to the Savings Component, plus subsequent investment growth thereon.</p>	<p>One-third of the contributions made to a pension, provident or retirement annuity fund from 1 September 2024 plus once-off seed capital allocated from the fund value as on 31 August 2024, plus subsequent investment growth thereon.</p>	<p>Two-thirds of the contributions made to a pension, provident or retirement annuity fund from 1 September 2024 plus investment growth thereon.</p>

Where a person starts contributing to a new pension, provident fund or retirement annuity policy/contract on or after 1 September 2024, such fund, or policy/contract will consist of two components only: a Savings Component and a Retirement Component.

Persons who were members of preservation funds on 31 August 2024 will only have a Vested Component and a Savings Component in the preservation fund. The Savings Component will only consist of seed capital that would have been allocated to this component in the fund as discussed below. Such members will not have a Retirement Component, as contributions to preservation funds are not allowed: the interest in preservation fund only consists of transfers from a pension, provident or other preservation fund.

Special rules apply to provident and provident preservation fund members aged 55 or older on 1 March 2021 who remained members of such funds. This topic is discussed below.

If a transfer to a preservation fund occurs after the implementation of the Two Pot system on 1 September 2024, the rules for transfers between different retirement funds will apply. Please refer to the discussion below for more details.

## The Vested Component

The Vested Component consists of the fund value in a pension, provident, retirement annuity or preservation fund on 31 August 2024, plus subsequent investment growth thereon. An amount of seed capital would however have been allocated from the fund value as on 31 August 2024 to the Savings Component (see the discussion of the Savings Component below).

### (i) **Allowable withdrawals from the Vested Component before retirement**

Allowable pre-retirement withdrawals (retirement fund lump sum withdrawal benefits) from the Vested Component remain mostly unchanged from the position that prevailed before 1 September 2024 and are thus dependent on the type of retirement fund.

#### **Pension and provident funds:**

Members may withdraw from the Vested Component before retirement upon dismissal, resignation, or retrenchment from employment.

#### **Retirement annuity funds:**

A member of a retirement annuity fund is allowed to withdraw from the Vested Component before retirement in the following instances:<sup>3</sup>

- If such member ceased to be a South African tax resident for a continuous period of three years; or
- If such member departs from South Africa upon expiry of a work or visitor's visa; or
- If such member's total retirement interest in retirement annuity fund (the total value of all contracts or policies in the same retirement annuity fund) does not exceed R15 000, and such members ceases to make contributions to the fund

#### **Pension preservation and provident preservation funds:**

Members may withdraw from the Vested Component before retirement in the following instances:<sup>4</sup>

- If the transfer from a pension or provident fund to a pension preservation or provident preservation fund occurred before a fund member reached the retirement age as per the rules of the pension or provident fund, one withdrawal from such preservation fund is allowed before the member retires (if the fund member had already made this one allowable withdrawal, no further withdrawals are allowed); or
- If such a member ceased to be a South African tax resident for a continuous period of three years; or
- If such a member departs from South Africa upon expiry of a work or visitor's visa.

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<sup>3</sup> The commutation of an interest in a retirement annuity fund based on formal application for emigration by 28 February 2021, on condition that such emigration was approved by 28 February 2022 has been phased out and is not allowed anymore.

<sup>4</sup> *Ibid.*

## **(ii) Taxation of a retirement fund lump sum withdrawal benefit (withdrawal from Vested Component before retirement)**

A retirement fund lump sum withdrawal benefit received from the Vested Component before retirement is taxed in accordance with the following tax table:

<b>Taxable Lump Sum</b>	<b>Rate of Tax</b>
R0 – R27 500	0% of taxable lump sum
R27 501- R726 000	18% of taxable lump sum above R27 500
R726 001 – R1 089 000	R125 730 plus 27% of taxable lump sum Above R726 000
R1 089 001 and above	R223 740 plus 36% of taxable lump sum above R1 089 000

It is important to note that the application of the above tax table is cumulative over a fund member's lifetime and the following lump sums received prior to receipt of the retirement fund lump sum withdrawal benefit will influence such fund member's tax liability:

- Retirement fund lump sum benefits sums received from a pension, provident, retirement annuity or preservation fund on retirement on or after 1 October 2007; and
- Retirement fund lump sum withdrawal benefits received from a pension, provident, retirement annuity or preservation fund on withdrawal (before retirement) on or after 1 March 2009; and
- Severance benefits received from an employer upon ceasing employment on retrenchment, or disability or at the age of 55 or older on or after 1 March 2011.

## **(iii) Treatment of the Vested Component on retirement**

As a general rule, a fund member will only be entitled to a maximum lump sum equal to one third of the value of the Vested Component on retirement, and the balance would have to be used to purchase an annuity (income). There are however the following exceptions to this rule:<sup>5</sup>

- If the cumulative value of two thirds of the Vested Component plus the full value of the Retirement Component do not exceed R165 000, the full value of the Vested Component and Retirement Component may be taken as a lump sum.
- If a person was a member of a provident or a provident preservation fund on 1 March 2021, there will be vested rights in relation to the regime applicable to provident funds that applied before 1 March 2021. The amount related to these vested rights will not form part of the calculation of the Two Thirds of the Vested Component as alluded in the previous bullet, and this amount may be taken as a lump sum.

<sup>5</sup> See the examples dealing with the various components on retirement.

**(iv) Taxation of benefits (retirement fund lump sum benefits and annuities) received from the Vested Component on retirement (or death)**

A retirement fund lump sum benefit received from the Vested Component on retirement (or death) is taxed in accordance with the following tax table (in the event of death, the retirement fund lump sum benefit received by dependants or beneficiaries of the deceased fund member will be taxed in the hands of the deceased fund member):

<b>Taxable Lump Sum</b>	<b>Rate of Tax</b>
R0 – R550 000	0% of taxable lump sum
R550 001- R770 000	18% of taxable lump sum above R550 000
R770 001 – R1 155 000	R39 600 plus 27% of taxable lump sum Above R770 000
R1 155 001 and above	R143 550 plus 36% of taxable lump sum above R1 155 000

It is important to note that the application of the above tax table is cumulative over a fund member's lifetime and the following lump sums received prior to receipt of the retirement fund lump sum benefit will influence such fund member's tax liability:

- Retirement fund lump sum benefits sums received from a pension, provident, retirement annuity or preservation fund on retirement on or after 1 October 2007; and
- Retirement fund lump sum withdrawal benefits received from a pension, provident, retirement annuity or preservation fund on withdrawal (before retirement) on or after 1 March 2009; and
- Severance benefits received from an employer upon ceasing employment on retrenchment, or disability or at the age of 55 or older on or after 1 March 2011.

Annuities are added to the gross income of the fund member (or his/her dependants or beneficiaries in the event of death) and taxed as normal income.

## The Savings Component

One-third of a fund member's contributions paid to a pension, provident or retirement annuity fund from 1 September 2024 is paid into the Savings Component.

In addition to this, once-off "seed capital" would have been allocated to the Savings Component in a pension, provident, retirement annuity or preservation fund on the following basis: 10% of the fund value on 31 August 2024 but limited to a maximum amount of R30 000.

### **Example 1 – Seeding Capital Less than R30 000:**

If the value of a fund member's Vested Component was R50 000 on 31 August 2024, 10% of this amount (i.e., R5,000) would be allocated to the Savings Component:  $R50\,000 \times 10\%$ .

### **Example 2 – Seeding Capital equal to R30 000:**

If the value of a fund member's Vested Component was R1 000 000 on 31 August 2024, 10% of this amount (i.e., R100,000) would normally be allocated to the Savings Component. However, since the seed capital is capped at R30,000, only R30,000 would be allocated.

Where there is more than one contract/policy in a fund (for example in a retirement annuity fund), the calculation of the seed capital will be calculated per contract, i.e. 10% of the value of the Vested Component on 31 August 2024 but limited to a maximum amount of R30 000 per contract/policy.<sup>6</sup>

### **Example 3 – Seeding Capital – Multiple Contracts/Policies in a Retirement Fund:**

John is the contracting party on two retirement annuity policies/contracts in the ABC Retirement Annuity Fund. The value of the Vested Component in policy 1 on 31 August 2024 was R100 000 and the value of the Vested Component in policy 2 on 31 August 2024 was R800 000.

Therefore:

- (a) In respect of policy one the seeding capital will be:  $R100\,000 \times 10\% = R10\,000$ .
- (b) In respect of policy two the seeding capital will be:  $R800\,000 \times 10\% = R80\,000$ , but it will be limited to R30 000.

<sup>6</sup> The definition of "Savings Component" in the 2024 Revenue Laws Amendment Bill published by National Treasury on 30 October 2024 provides as follows: 'savings component' means a component established in terms of the rules of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund for a person who is a member of that fund: Provided that the rules of the fund provide that— (a) a one-off amount of 10 per cent of the total value of **each contract** in the fund as at 31 August 2024, limited to R30 000, is allocated to this component on or after 1 September 2024:

**(i) Allowable withdrawals from the Savings Component before retirement**

A fund member is allowed to receive one savings withdrawal benefit per tax year (between 1 March of one year and 28/29 February of the next year) before retirement from the Savings Component.<sup>7</sup>

The minimum allowable annual withdrawal amount is R2 000<sup>8</sup> and there is no maximum amount limit (other than the total value of the Savings Component).

The ability to receive a savings withdrawal benefit from the Savings Component will be applied per fund (if a fund member is a member of more than one retirement fund, an annual withdrawal will be allowed from each fund) and per contract/policy<sup>9</sup> (if a fund member has more than one contract/policy in a retirement annuity fund or a preservation fund, an annual withdrawal will be allowed from each contract or policy).

If a fund member terminates his/her membership of a fund (for example exiting a pension or provident fund on resignation from employment or transferring from one retirement annuity fund to another) and has already received a savings withdrawal benefit in the tax year that he/she exits the fund, such person will be allowed to opt for an additional savings withdrawal benefit if the remaining value of the Savings Component in the fund that he is exiting is less than R2 000.<sup>10</sup>

**(ii) Taxation of a savings withdrawal benefit (withdrawal from Savings Component before retirement)**

A savings withdrawal benefit received from the Savings Component prior to retirement will be added to a fund member's gross income and taxed as normal income according to such member's marginal tax rates.

It will therefore not influence the tax liability (i.e. it will not be aggregated) in respect of future:

- Retirement fund lump sum withdrawal benefits received from the Vested Component or the Retirement Component (retirement fund lump sum withdrawal benefits from the Retirement Component are allowed in limited instances) before retirement; or
- Retirement fund lump sum benefits received from the Vested Component, the Savings Component or the Retirement Component on retirement.

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<sup>7</sup> Paragraph (a) of the definition of 'savings withdrawal benefit' as per section 1 of the 2024 Revenue Laws Amendment Bill published by National Treasury on 30 October 2024.

<sup>8</sup> Paragraph (c) of the definition of 'savings withdrawal benefit' as per section 1 of the 2024 Revenue Laws Amendment Bill published by National Treasury on 30 October 2024.

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid.*

The South African Revenue Service (SARS) issued a media release<sup>11</sup> on 23 August 2024 entitled "Tax Implications of Withdrawing from Two-Pot Retirement System". The following issues were highlighted in this media release:

- Persons not registered for tax must do so before applying for a savings withdrawal benefit. If a person is not registered, the tax directive will be rejected.
- Taxpayers must ensure that they have no outstanding returns and do not owe SARS. Debt owed to SARS will be deducted from the withdrawal amount.
- After a registered taxpayer has applied for a savings withdrawal benefit, the fund will apply to SARS for a tax directive to inform fund how much tax to deduct. If the taxpayer is compliant, it will take up to 48 hours for SARS to issue tax directive.
- Before the final amount is paid, the fund will be informed to also deduct any outstanding debt on behalf of SARS before the amount is paid out. If the taxpayer has a debt arrangement with SARS, the withdrawal will not be affected.
- A tax calculator is available on e-Filing and the SARS website ([www.sars.gov.za](http://www.sars.gov.za)) to assist fund members with an illustrative amount that they can possibly expect as a payout. Relevant and accurate information must be provided to get a clear estimate.

### **(iii) Treatment of the Savings Component on retirement**

On retirement, fund member will be able to elect to take the remaining value in Savings Component as:<sup>12</sup>

- a lump sum; or
- an annuity; or
- a combination of a lump sum and an annuity.

### **(iv) Taxation of benefits (retirement fund lump sum benefits and annuities) received from the Vested Component on retirement (or death)**

The tax treatment of retirement fund lump sum benefits and annuities received from the Savings Component on retirement (or death) is the same as equivalent benefits received from the Vested Component (see the discussion above) on retirement (or death).

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<sup>11</sup> <https://www.sars.gov.za/media-release/tax-implications-of-withdrawing-from-two-pot-retirement-system/>

<sup>12</sup> Paragraph (g) of the definition of 'savings component' as per section 1 of the 2024 Revenue Laws Amendment Bill published by National Treasury on 30 October 2024.

## The Retirement Component

The Retirement Component consists of two-thirds of contributions made to a pension, provident or retirement annuity fund from 1 September 2024, plus subsequent investment growth thereon.

### **(i) Allowable withdrawals from the Retirement Component before retirement**

As a general rule, fund members do not have access to the Retirement Component before retirement. However, there are two exceptions to this rule:

- If the fund member ceases to be a South African tax resident for a continuous period of three years; or
- If the fund member departs from South Africa upon the expiry of a work or visitor's visa.

### **(ii) Taxation of a retirement fund lump sum withdrawal benefit (withdrawal from Retirement Component before retirement)**

A retirement fund lump sum withdrawal benefit received from the Retirement Component before retirement is taxed in the same way that such a benefit received from the Vested Component is taxed (See the discussion above). However, as indicated above, the receipt of a retirement fund lump sum withdrawal benefit from the Retirement Component is allowed in very limited circumstances.

### **(iii) Treatment of the Retirement Component on retirement**

As a general rule, the full value in a fund member's Retirement Component must be used to purchase an annuity (income) on retirement and no lump sum payment may be paid from the Retirement Component.

There are however the following exceptions to this rule:

- If the cumulative value of two-thirds of the Vested Component plus the full value of the Retirement Component does not exceed R165 000, the full value of the Vested Component and Retirement Component may be taken as a lump sum.
- If a person was a member of a provident or a provident preservation fund on 1 March 2021, there will be vested rights in relation to the regime applicable to provident funds that applied before 1 March 2021. The amount related to these vested rights will not form part of the calculation of the two-thirds of the Vested Component as alluded in the previous bullet, and this amount may be taken as a lump sum.

**(iv) Taxation of benefits (retirement fund lump sum benefits and annuities) received from the Retirement Component on retirement (or death)**

The tax treatment of a retirement fund lump sum benefit and annuity received from the Retirement Component on retirement (or death) is the same as equivalent benefits received from the Vested Component (see the discussion above) and Savings Component on retirement (or death).

**Examples: Treatment of the Various Components on Retirement**

**Example 4: Two-thirds of Vested Component and Full Value of Retirement Component Exceed R165 000 (No Vested Provident Fund Rights)**

At the date of Waldo's retirement from a pension fund, the full value of his Savings Component is R10 000, the full value of his Vested Component is R180 000, and the full value of his Retirement Component is R50 000. What is the maximum amount that Waldo may take as a lump sum on retirement?




Answer:

R120 000 (two-thirds of the Vested Component) + R50 000 (full value of Retirement Component) = R170 000.

As this amount exceeds R165 000, the Retirement Component may not be commuted as a lump sum on retirement.

A maximum of one third of the Vested Component would be allowed to be commuted as a lump sum (if Waldo elects to do so).

The full value of the Savings Component may be taken as a lump sum (if Waldo elects to do so).

<b>Savings Component</b> R10 000	<b>Vested Component</b> R180 000	<b>Retirement Component</b> R50 000
		
<b>Full value (R10 000) may be taken as a lump sum</b>	<b>Maximum of one third (R60 000) may be taken as a lump sum</b>	<b>No lump sum payment allowed – full value must be used to purchase an annuity</b>

Therefore, the maximum allowable lump sum is: R10 000 (full Savings Component) + R60 000 (one third of the Vested Component) = R70 000.

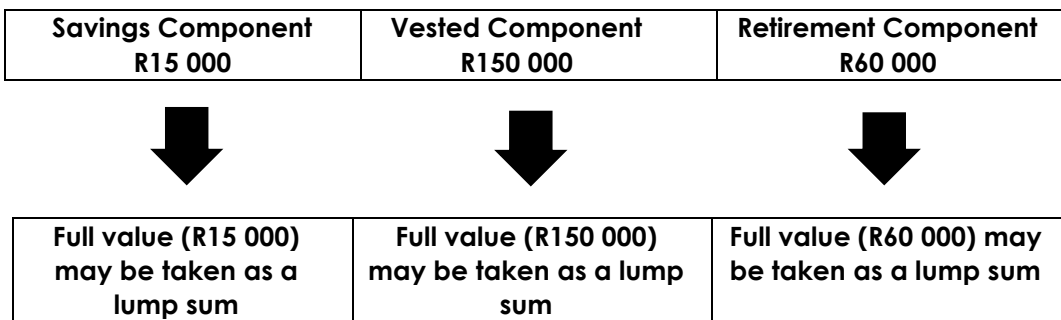
**Example 5: Two Thirds of Vested Component and Full Value of Retirement Component do not Exceed R165 000 (No Vested Provident Fund Rights)**

At date of Wayne's retirement from a pension fund, the full value of his Savings Component is R15 000, the full value of his Vested Component is R150 000, and the full value of his Retirement Component is R60 000. What is the maximum amount that Wayne may take as a lump sum on retirement?

Answer:  
 $R100\ 000$  (two-thirds of the Vested Component) +  $R60\ 000$  (full value of Retirement Component) =  $R160\ 000$ .

As it does not exceed R165 000, the Vested Component and Retirement Component may be fully commuted as a lump sum on retirement.

The full value of the Savings Component may be taken as a lump sum (if Wayne elects to do so).



Therefore, the maximum allowable lump sum is:  $R15\ 000$  (full Savings Component) +  $R150\ 000$  (full Vested Component) +  $R60\ 000$  (full Retirement Component) =  $R225\ 000$ .

**Example 6: Two Thirds of Vested Component and Full Value of Retirement Component Exceed R165 000 – Vested Provident Fund Rights in Vested Component**

At date of Sifiso's retirement from a provident fund:

- ✓ the full value of his Savings Component is R30 000; and
- ✓ the full value of his Vested Component is R610 000. Sifiso was younger than 55 and a member of this provident fund on 1 March 2021. The Vested Component of R610 000 consists of vested provident fund rights (contributions made before 1 March 2021 and growth thereon) of R400 000 and non-vested rights (contributions made from 1 March 2021 to 31 August 2024 and growth thereon) of R210 000; and
- ✓ the full value of his Retirement Component is R150 000.

What is the maximum amount that Sifiso may take as a lump sum on retirement?

Answer:

The maximum lump sum that Sifiso may elect to receive on retirement is as follows:

- The vested provident fund rights (contributions made before 1 March 2021 and growth thereon) in the Vested Component of R400 000 is not subject to annuitisation and may be taken as a lump sum (if Sifiso elects to do so); and
- As far as non-vested rights (contributions made from 1 March 2021 to 31 August 2024 and growth thereon) in the Vested Component of R210 000 and the Retirement Component is concerned: R140 000 (two-thirds of the non-vested provident rights in the Vested Component, i.e. two-thirds of R210 000) + R150 000 (full value of Retirement Component) = R290 000. As it exceeds R165 000, the Retirement Component may not be commuted as a lump sum on retirement. A maximum of one third of the non-vested provident rights in Vested Component would be allowed to be commuted as a lump sum (if Sifiso elects to do so).
- The full value of the Savings Component may be taken as a lump sum (if Sifiso elects to do so).

<b>Savings Component</b> <b>R30 000</b>	<b>Vested Component</b> <b>R610 000:</b> <b>Vested provident</b> <b>fund rights</b> <b>= R400 000</b> <b>Non-vested provident</b> <b>fund rights</b> <b>= R210 000</b>	<b>Retirement Component</b> <b>R150 000</b>
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<b>Full value (R30 000)</b> <b>may be taken as a</b> <b>lump sum</b>	<b>Full vested provident</b> <b>fund rights (R400 000)</b> <b>and maximum of one</b> <b>third of non-vested</b> <b>provident fund rights</b> <b>(R70 000) may be taken</b> <b>as lump sum</b>	<b>No lump sum payment</b> <b>allowed – must be fully</b> <b>used for annuity</b>
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Therefore, maximum lump sum allowed is: R30 000 (Full Savings Component) + R400 000 (Full vested provident fund rights in Vested Component) + R70 000 (One third of non-vested provident fund rights in Vested Component) = R500 000.

**Example 7: Two Thirds of Vested Component and Full Value of Retirement Component do not Exceed R165 000 – Vested Provident Fund Rights in Vested Component**

At date of Lerato's retirement from a provident fund:

- ✓ the full value of the Savings Component is R20 000; and
- ✓ the full value of the Vested Component is R520 000. Lerato was younger than 55 and a member of a provident fund on 1 March 2021. The Vested Component of R520 000 consists of vested provident fund rights (contributions made before 1 March 2021 and growth thereon) of R400 000 and non-vested rights (contributions made from 1 March 2021 to 31 August 2024 and growth thereon) of R120 000; and
- ✓ the full value of the Retirement Component is R60 000.

What is the maximum amount that Lerato may take as a lump sum on retirement?

Answer:

The maximum lump sum that Lerato may elect to receive on retirement is as follows:

- The vested provident fund rights (contributions made before 1 March 2021 and growth thereon) in the Vested Component of R400 000 is not subject to annuitisation and may be taken as a lump sum (if elected); and
- As far as non-vested provident fund rights (contributions made from 1 March 2021 to 31 August 2024 and growth thereon) in the Vested Component of R120 000 and the Retirement Component is concerned: R80 000 (two-thirds of the non-vested provident fund rights in the Vested Component, i.e. two-thirds of R120 000) + R60 000 (full value of Retirement Component) = R140 000. As it does not exceed R165 000, the Retirement Component as well as the non-vested provident fund rights in the Vested Component may also be commuted as a lump sum on retirement (if elected).
- The full value of the Savings Component may also be taken as a lump sum (if Lerato elects to do so).

<b>Savings Component</b> <b>R20 000</b>	<b>Vested Component</b> <b>R520 000:</b> <b>Vested provident</b> <b>fund rights</b> <b>= R400 000</b> <b>Non-vested provident</b> <b>fund rights</b> <b>= R120 000</b>	<b>Retirement Component</b> <b>R60 000</b>
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<b>Full value (R20 000)</b> <b>may be taken as a</b> <b>lump sum</b>	<b>Full vested provident</b> <b>fund rights (R400 000)</b> <b>and the full non-vested</b> <b>provident fund rights</b> <b>(R120 000) may be</b> <b>taken as lump sum</b>	<b>Full Retirement</b> <b>Component may be</b> <b>taken as a lump sum</b>
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Therefore, full commutation allowable is: R20 000 (Full Savings Component) + R400 000 (Full vested provident fund rights in Vested Component) + R120 000 (Full value of non-vested provident fund rights in Vested Component) + R60 000 (Full Retirement Component) = R600 000.

**Example 8: More than One Policy/Contract in a Retirement Fund**

Joe has 2 policies/contracts in the DEF Retirement Annuity Fund. On retirement:

- ✓ the full value of his Vested Component in respect of policy 1 is R300 000, and the full value of the Retirement Component is R80 000. The value of the Savings Component is R20 000; and
- ✓ the full value of his Vested Component in respect of policy 2 is R90 000, and the full value of the Retirement Component is R30 000. The value of the Savings Component is R10 000.

What is the maximum amount that Joe may take as a lump sum on retirement?

Answer:

maximum lump sum that Joe may elect to receive on retirement is as follows:

- R200 000 (two-thirds of the Vested Component in respect of policy 1, i.e. two-thirds of R300 000) + R80 000 (full value of Retirement Component in respect of policy 1) + R60 000 (two thirds of the Vested Component in respect of policy 2, i.e. two-thirds of R90 000) + R30 000 (full value of Retirement Component in respect of policy 2) = R370 000.
- As the amount of R370 000 exceeds R165 000, the total Retirement Component (R80 000 + R30 000 = R110 000) may not be commuted as a lump sum on retirement (the full amount to be used to purchase an annuity).
- As the amount of R370 000 exceeds R165 000, a maximum of one third of the total Vested Component (R300 000 + R90 000 = R390 000) may be commuted as a lump sum = R130 000 and the balance of R260 000 has to be used to purchase an annuity).
- The full value of the total Savings Component (R20 000 + R10 000 = R30 000) may be taken as a lump sum (if Joe elects to do so) = R30 000.

<b>Savings Component:</b> R20 000 (policy 1) + R10 000 (policy 2) = R30 000	<b>Vested Component:</b> R300 000 (policy 1) + R90 000 (policy 2) = R390 000	<b>Retirement Component:</b> R80 000 (policy 1) + R30 000 (policy 2) = R110 000
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<b>Full value (R30 000) may be taken as a lump sum</b>	<b>Maximum of one third of Vested Component, i.e. R130 000 may be taken as a lump sum and the balance must be used to purchase an annuity</b>	<b>Full Retirement Component must be used to purchase an annuity.</b>
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Therefore, the maximum lump sum commutation allowable is: R30 000 (full Savings Component) + R130 000 (one-third of total Vested Component, i.e. of both policies) = R160 000.

**Note:** There appears to be different views regarding the instance where there is more than one policy/contract (and thus by implication more than one Retirement Component and possibly Vested Component) in a retirement fund. An alternative view to the solution of Example 8 above, is that the value of the various components should be calculated per policy/contract and not per retirement fund. In my opinion, this view is incorrect for the following reasons:

- The calculation of the “de minimis” amount, which determines whether a full commutation on retirement is allowed, has historically been applied per fund, and not per individual contract/policy.
- If it was the intention of the legislature to amend this calculation, i.e. to be applied per policy/contract, the legislation would have explicitly stated so. The definition of Savings Component makes it clear that the seed capital payable to the Savings Component is applied per contract/policy<sup>13</sup> and the definition of “savings withdrawal benefit” likewise provides that a savings withdrawal benefit is allowed per policy/contact.<sup>14</sup> The definition of “retirement annuity fund” as far as it relates to a full commutation on retirement however refers to two thirds of the total member’s interest in the Vested Component calculated together with the total member’s interest in the Retirement Component.<sup>15</sup>

### **Members of Provident Funds and Provident Preservation Funds that were 55 Years of Age or Older on 1 March 2021 and Remained Members of the Same Fund**

Provident fund and provident preservation fund members who were 55 years of age or older on 1 March 2021 who remain members of the same provident fund/provident preservation fund until retirement, are not subject to the annuitisation regime that became applicable to provident funds on 1 March 2021. In a nutshell, this means that such persons would still be allowed to take the full retirement interest in a provident/provident preservation fund as a lump sum on retirement, and no portion thereof needs to be applied to purchase an annuity.

These members are however allowed to elect if they want to be subject to the Two Pot system:

- If they do not elect to be subjected to the Two Pot system, the status quo would remain as is, and they would be able to access the full retirement interest as a lump sum on retirement. This would however mean that they would not contribute to a Savings Component (or a Retirement Component) and would thus not have access to their provident fund savings before retirement, unless they resign, or are dismissed or retrenched from employment (or where they still have the option to make a withdrawal form a provident preservation fund before retirement).
- They may however elect to be subjected to the Two Pot system within 12 months from 1 September 2024. If this election is made:
  - ✓ A once-off amount of 10 per cent of the value of such member’s Vested Component as at the last day of the month in which they make the election,

<sup>13</sup> Paragraph (a) of the definition of “savings component” in the 2024 Revenue Laws Amendment Bill published by National Treasury on 30 October 2024, provides as follows: “(a) a one-off amount of 10 per cent of the total value of each contract in the fund as at 31 August 2024, limited to R30 000, is allocated to this component on or after 1 September 2024:”

<sup>14</sup> Paragraph (b) of the definition of “savings withdrawal benefit” in the 2024 Revenue Laws Amendment Bill published by National Treasury on 30 October 2024, provides as follows: “(b) where a member has multiple contracts in the same fund, one withdrawal during a year of assessment may be made from each of the contracts:”

<sup>15</sup> The amendment of subparagraph (ii) of paragraph (b) of the definition of “retirement annuity fund” by the 2024 Revenue Laws Amendment Bill published by National Treasury on 30 October 2024, provides as follows: “that on retirement not more than one-third of the member’s interest in the vested component may be commuted for a single payment, and that the remainder, calculated together with the total value of the member’s interest in the retirement component, must be paid in the form of an annuity (including a living annuity), a combination of annuities (including a combination of methods of paying the annuity) or a combination of types of annuities except where two-thirds of the total member’s interest in the vested component, calculated together with the total member’s interest in the retirement component does not exceed R165 000, or where the member is deceased:”

limited to a maximum amount of R30 000, will be allocated to the Savings Component from the Vested Component with effect from the last day of the month in which the election is made.

- ✓ One-third of contributions from the month following this election date will be allocated to the Savings Component and two-thirds of contributions will be allocated to the Retirement Component.
- ✓ The remaining value in the Vested Component, plus subsequent investment growth thereon, would be available to be received as a lump sum on retirement, should the fund member elect to do so.

**Example 9: Provident Fund Member 55 Years of Age or Older on 1 March 2021**

Pete was 55 years of age on 1 March 2021 and a member of a provident fund. He remained a member of this same fund. On 10 March 2025, he opts to partake in the Two Pot system. On 31 March 2025, the value in his provident fund was R4 200 000.

Explain to Pete:

- ✓ How much seed capital will be allocated to his Savings Component; and
- ✓ How the remaining capital in his Vested Component (after deduction of the seed capital) will be treated on retirement; and
- ✓ How contributions made to this provident fund from 1 April 2025 will be treated.

Answer:

- Seed capital: R30 000 ( $R4\ 200\ 000 \times 10\% = R420\ 000$  but limited to R30 000) would be allocated to Pete's Savings Component as seed capital at the end of March 2025.
- Remaining capital in Pete's Vested Component: The fund value at the end of March 2025 was R4 200 000. This means that R4 170 000 (R4 200 000 minus R30 000 seed capital) plus subsequent growth thereon would constitute a vested provident fund right that would be available as a lump sum on retirement.
- Contributions made from 1 April 2025: These contributions would be split between the Savings Component (one-third) and the Retirement Component (two-thirds).

**Example 10: Provident Fund Member 55 Years of Age or Older on 1 March 2021 – Retirement Component Exceeding R165 000 on Retirement**

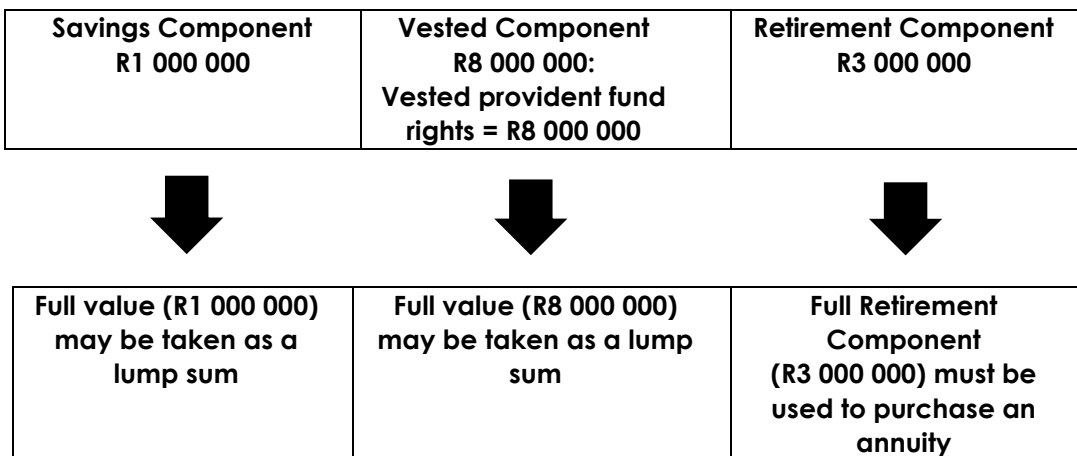
Etienne was 58 years of age and a member of a provident fund on 1 March 2021. Etienne opted to partake in the Two-Pot system. Etienne retires from this provident fund in 2030 and that at this stage:

- ✓ the full value of the Savings Component in the provident fund is R1 000 000; and
- ✓ the full value of the Vested Component in the provident fund is R8 000 000; and
- ✓ the full value of the Retirement Component in the provident fund is R3 000 000.

What is the maximum amount that Etienne may take as a lump sum on retirement?

Answer:

- As Etienne was older than 55 on 1 March 2021 and remained a member of the provident fund, the full Vested Component of R8 000 000 would constitute vested provident fund rights. These vested provident fund rights in the Vested Component are not subject to annuitisation and may be taken as a lump sum (if elected); and
- The full value (R1 000 000) of the Savings Component may also be taken as a lump sum (if Etienne elects to do so).
- As far as the Retirement Component is concerned: there are no non-vested provident fund rights in the Vested Component (two-thirds of 0 = 0).  
Therefore: 0 + R3 000 000 (full value of the Retirement Component) = R3 000 000. As it exceeds R165 000, the full Retirement Component must therefore be used to purchase an annuity.



Therefore, the maximum allowable lump sum is: R1 000 000 (full Savings Component) + R8 000 000 (full vested provident fund rights in Vested Component) = R9 000 000. The full Retirement Component (R3 000 000) must be used to purchase an annuity.

**Example 11: Provident Fund Member 55 Years of Age or Older on 1 March 2021 – Retirement Component Not Exceeding R165 000 on Retirement**

Anne was 60 years of age on 1 March 2021 and a member of a provident fund. She remained a member of this same fund. She opted to take part in the Two Pot system.

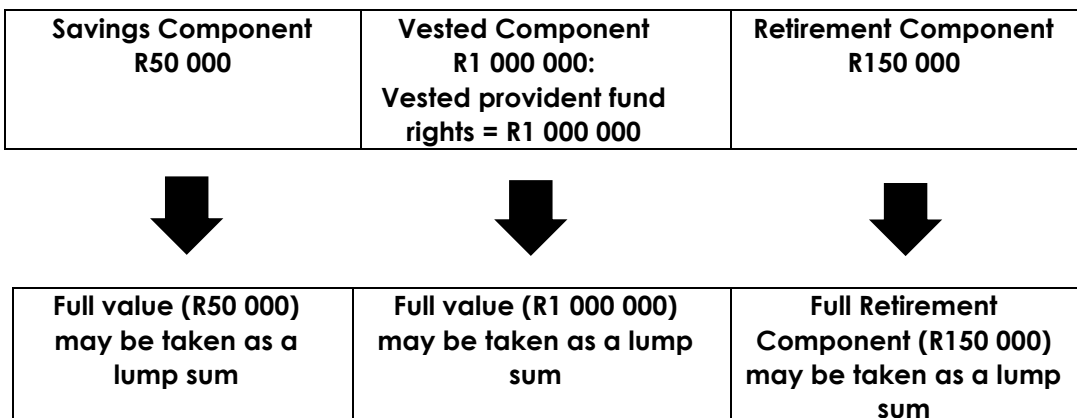
Anne retires from this provident fund in 2026 and at that stage:

- ✓ the full value of the Savings Component is R50 000; and
- ✓ the full value of the Vested Component is R1 000 000. As she was older than 55 on 1 March 2021 and remained a member of the provident fund, the full Vested Component of R1 000 000 would constitute vested provident fund rights; and
- ✓ the full value of the Retirement Component is R150 000.

What is the maximum amount that Anne may take as a lump sum on retirement?

Answer:

- As Anne was older than 55 on 1 March 2021 and remained a member of the provident fund, the full Vested Component of R1 000 000 would constitute vested provident fund rights. These vested provident fund rights in the Vested Component are not subject to annuitisation and may be taken as a lump sum (if elected); and
- The full value (R50 000) of the Savings Component may also be taken as a lump sum (if the fund member elects to do so).
- As far as the Retirement Component is concerned: there are no non-vested provident fund rights in the Vested Component (two-thirds of 0 = 0). Therefore: 0 + R150 000 (full value of the Retirement Component) = R150 000. As it does not exceed R165 000, the full Retirement Component may also be taken as a lump sum (if elected).



Therefore, the maximum allowable lump sum is: R50 000 (full Savings Component) + R1 000 000 (full vested provident fund rights in Vested Component) + R150 000 (full Retirement Component) = R1 200 000.

**Example 12: Provident Preservation Fund Member 55 Years of Age or Older on 1 March 2021**

Sipho was 56 years of age on 1 March 2021 and a member of a provident preservation fund. He transferred to the provident preservation fund in April 2020 – at this stage he had not reached normal retirement age in the provident fund that he transferred from. He remained a member of this provident preservation fund. On 1 March 2025, he opts to partake in the Two Pot system. On 31 March 2025, the value of his retirement savings in this provident preservation fund was R4 000 000. He has not made any pre-retirement withdrawals from the provident preservation fund.

Explain to Sipho:

- ✓ How much seed capital will be allocated to his Savings Component; and
- ✓ The rules applicable to access to the retirement savings in both his Vested Component and his Savings Component before retirement, and the taxation thereof.

Answer:

- R30 000 ( $R4\,000\,000 \times 10\% = R400\,000$  but limited to R30 000) would be allocated to his Savings Component as seed capital at the end of March 2025.
- This amount, plus growth thereon, would be available as a savings withdrawal benefit. Therefore, because Sipho had transferred to the preservation fund before he reached normal retirement age in the provident fund that the transfer was made from:
  - ✓ he would still have his one allowable withdrawal available from the Vested Component (as it has not been taken yet). This withdrawal would be taxed as a retirement fund lump sum withdrawal benefit (R27 500 @ 0% etc.); and
  - ✓ he would also be able to receive a savings withdrawal benefit from the Savings Component once per tax year. The savings withdrawal benefit would be added to his gross income and taxed as normal income according to his marginal rate of tax.

**Example 13: Provident Preservation Fund Member 55 Years of Age or Older on 1 March 2021 – Lump Sum on Retirement**

Vusi was 56 years of age on 1 March 2021 and a member of a provident preservation fund. He remained a member of this same fund. On 1 March 2025, he opts to partake in the Two Pot system.

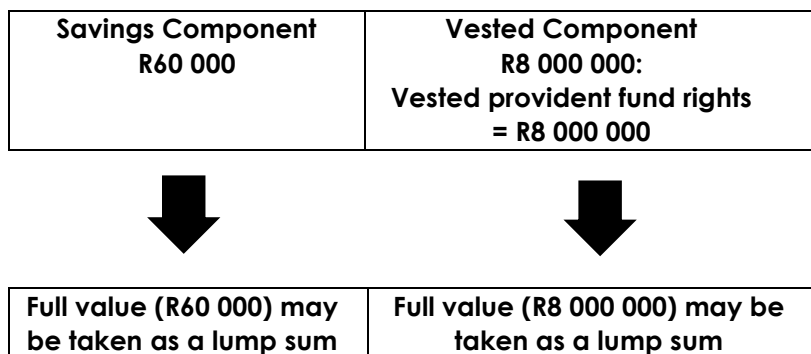
Vusi retires in 2030 and at this stage:

- ✓ the full value of the Savings Component is R60 000; and
- ✓ the full value of the Vested Component is R8 000 000. As he was older than 55 on 1 March 2021 and remained a member of the provident fund, the full Vested Component of R8 000 000 would constitute vested provident fund rights; and
- ✓ There would be no Retirement Component: as no contributions are made to preservation funds, this would mean that no contributions were made after Vusi opted to partake in the Two Pot system.

What is the maximum amount that Vusi may take as a lump sum on retirement?

Answer:

- The Vested Component would only consist of vested provident fund rights (Vusi was older than 55 of 1 March 2021). These vested provident fund rights in the Vested Component in the amount of R8 000 000 are not subject to annuitisation and may be taken as a lump sum (if elected); and
- The full value (R60 000) of the Savings Component may also be taken as a lump sum (if the fund member elects to do so).



Therefore, the maximum allowable lump sum is: R60 000 (full Savings Component) + R8 000 000 (full vested provident fund rights in Vested Component) = R8 060 000.

## Transfers Between Various Components in the Same Retirement Fund

A fund member may transfer between the following components in a pension, provident, retirement annuity or preservation fund:

- From the Savings Component to the Retirement Component in the same fund; and
- From the Vested Component to the Retirement Component in the same fund.

These allowable transfers will occur tax-free.

## Transfers Between Different Retirement Funds

Where a fund member makes an allowable transfer from one fund to another fund, such fund member may not leave any of the components behind in the fund being transferred from. A fund member may transfer between the following components:

- From the Savings Component of the fund being transferred from to the Saving Component or Retirement Component of the fund being transferred to; and
- From the Vested Component of the fund being transferred from to the Vested Component or Retirement Component of the fund being transferred to; and
- From the Retirement Component of the fund being transferred from to the Retirement Component of the fund being transferred to.

## Exclusions from the Two-Pot System

The Two Pot System will not be applicable in the following instances:

**(i) Provident and provident preservation fund members 55 year of age or older on 1 March 2021**

Provident and provident preservation fund members who were 55 years of age or older on 1 March 2021 and remained members of the same fund will not be subjected to the Two Pot system if such members do not elect to partake in the Two Pot System (see discussion above for more details).

**(ii) Legacy retirement annuity fund policies**

Legacy retirement annuity fund policies are excluded from the Two Pot system, as the inclusion of such policies would require a re-design of the product structure thereof. These policies will however only be excluded in respect of contracts issued before 1 September 2024.

Legacy retirement annuity policies are policies with a pre-universal life or universal life construct, subject to conditions that the Financial Sector Conduct Authority (FSCA) may determine. These conditions are set out in *FSCA RF Notice 17 of 2024: Determination of Conditions for Purposes of the Definition of Legacy Retirement Annuity Policy*.

**(iii) Pensioners**

A person receiving a pension from a retirement fund (i.e. where such person has already retired from the fund).

**(iv) Beneficiary Funds**

These are funds established with the object of receiving, administering, investing and paying benefits on behalf of beneficiaries, that was paid on the death of a member of a retirement fund.

**(v) Certain Unclaimed Benefits**

A fund member to whom an unclaimed benefit, as defined in section 1 of the Pension Funds Act, is due on 31 August 2024.

**(vi) Liquidator Appointed**

A fund where a liquidator has been appointed in terms of the Pension Funds Act before 31 August 2024.

**(vii) Funds with No Assets**

A fund with no member assets immediately before 1 September 2024.

## Conclusion

The introduction of the Two Pot retirement system marks a pivotal shift in the South African retirement landscape, presenting both challenges and opportunities for financial advisers. With the recent legislative amendments, it is crucial for advisers to not only grasp the technicalities of these changes but also to understand how they practically impact clients' portfolios. By staying informed and proactively adapting to these shifts, you can ensure that your financial advice remains sound, relevant, effective, and aligned with the evolving regulatory environment. This knowledge will be key in helping clients navigate their retirement planning with confidence and security.

## Bibliography

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Income Tax Act, No. 58 of 1962, as amended.

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SARS Media Release: *Tax Implications of Withdrawing from Two-Pot Retirement System*, dated 23 August 2024: <https://www.sars.gov.za/media-release/tax-implications-of-withdrawing-from-two-pot-retirement-system/>

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## Section 42 – Asset for Shares Transactions and Possible Pitfalls

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### Introduction

Asset-for-share transactions have become an important mechanism in modern-day finance and corporate restructuring, enabling businesses and individuals to achieve strategic goals while optimising their tax efficiency. Governed by section 42 of the Income Tax Act<sup>1</sup> (hereinafter referred to as "the Act"), these transactions allow the transfer of assets in exchange for shares in a resident company, deferring immediate tax liabilities and facilitating a range of corporate strategies. This includes corporate reorganisations, incorporating sole proprietorships and using tax efficiency strategies. Asset-for-share transactions offer a flexible way to align business operations with long-term goals.

However, despite their growing popularity, these transactions are complex and there are potential pitfalls that necessitate careful consideration and expert guidance. This article aims to clarify the fundamentals of asset-for-share transactions, highlight the tax implications and requirements under section 42 and explore practical examples and potential pitfalls to help stakeholders make informed decisions.

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<sup>1</sup> 58 of 1962.

## What is an asset-for-share transaction?

Section 42 of the Act governs asset-for-share transactions, where a person exchanges an asset (excluding restraints of trade or personal goodwill) for equity shares in a resident company.<sup>2</sup> This section is divided into two parts: the first part addresses domestic transactions, while the second part deals with cross-border transactions. This article will focus exclusively on the domestic transactions. Section 42(1)(i) requires that for a transaction to qualify, the asset's market value must meet or exceed its base cost if held as a capital asset or match the amount considered under section 11(a) or 22(1) or (2) if held as trading stock. It further requires that the person disposing of the asset must receive equity shares and hold a qualifying interest in the company at the close of the disposal day. Additionally, section 42(1)(ii) requires the company acquiring the asset to treat it as either trading stock or a capital asset, depending on the original holder's classification. A special case arises if the asset, originally held as a capital asset, is treated as trading stock by the acquiring company, provided that the individual and the company are not part of the same group of companies. This ensures that the transaction aligns with the nature of the asset and the post-transfer ownership structure.

## Capital gains tax (CGT)

An asset-for-share transaction defers the immediate capital gains tax or normal tax on the asset transfer,<sup>3</sup> allowing the company to acquire the asset at its original base cost, while the individual receives shares with the same base cost as the disposed asset. This deferral mechanism facilitates reorganisations and incorporations by postponing tax liabilities until the eventual sale of the assets outside the group.

## Value added tax

While this type of transaction can delay capital gains tax, it does not necessarily also avoid transfer duty or value added tax (hereinafter referred to as "VAT").<sup>4</sup> However, if both parties involved are VAT vendors, section 8(25) of the Value-Added Tax Act<sup>5</sup> (hereinafter referred to as the "VAT Act"),<sup>6</sup> might allow for a VAT exemption.

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<sup>2</sup> Section 9(1)(a) of the Act states that a company is a "resident" if it –

- is incorporated, established, or formed in South Africa; or
- has its place of effective management in South Africa; and
- a tax treaty does not deem that company to be exclusively a resident of another country for purposes of the application of any tax treaty.

<sup>3</sup> Section 42(2).

<sup>4</sup> [Section 42 Asset-for-Share Transactions: The unsuspected dangers when transferring immovable property - Barnard | Law Firm \(barnardinc.co.za\)](https://www.barnardinc.co.za). 27/06/2024.

<sup>5</sup> 89 of 1991.

<sup>6</sup> Section 9(15A).

In SARS's Binding Private Ruling 317,<sup>7</sup> the applicant planned to transfer assets and liabilities related to Business A to the co-applicant in exchange for equity shares. The transaction would be treated as a going concern. For VAT purposes, the applicant and the co-applicant were deemed to be one and the same person, as both are registered vendors and have agreed in writing to the disposal of Business A as a going concern. Despite the deemed unity for VAT purposes, the applicant can deduct VAT incurred on goods or services related to the disposal of Business A as input tax, provided it meets the criteria under sections 16(2), 17(1), 17(2) and 20 of the VAT Act.<sup>8</sup>

## Transfer Duty

Where the parties are non-VAT vendors, the Transfer Duty Act's<sup>9</sup> (TDA) sections 9(1)(l)(i) and 9(15A) could provide exemptions under certain circumstances. Property acquired through an asset-for-share transaction, under which the supplier and recipient are considered the same entity as per section 8(25) of the VAT Act, is also eligible for exemption from transfer duty.<sup>10</sup> Section 9(15) provides a transfer duty exemption for transactions that qualify as taxable supplies for VAT purposes. However, under section 8(25) of the VAT Act, certain transactions are not considered taxable supplies, meaning section 9(15) wouldn't apply if section 8(25) is in effect. Section 9(15A) was created to ensure that asset-for-share transactions, which would be treated as VAT transactions if not for section 8(25), still qualify for the transfer duty exemption. It appears that section 9(15A) is meant for transactions involving VAT, while section 9(2)(l)(i) applies when VAT regulations are not applicable.<sup>11</sup>

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<sup>7</sup> South African Revenue Service Binding Ruling 317: 2019.

<sup>8</sup> Binding Ruling 317 2019: paras. 1-7.

<sup>9</sup> 40 of 1949.

<sup>10</sup> Stigling *et al* 2024: 1096.

<sup>11</sup> Stigling *et al* 2024: 1096.

**Transfer Duty is calculated on the following sliding scale based on the value of the property for 2025 (1 March 2024 – 28 February 2025):**

Value of the Property (Rand)	Tax Rate
1 – 1 100 000	0% of the property value
1 100 001 – 1 512 500	3% of the value above R1 100 000
1 512 501 – 2 117 500	R12 375 + 6% of the value above R1 512 500
2 117 501 – 2 722 500	R48 675 + 8% of the value above R2 117 500
2 722 501 – 12 100 000	R97 075 + 11% of the value above R2 722 500
12 100 001 and above	R1 128 600 + 13% of the value exceeding 12 100 000

**For example,** ABC (Pty) Ltd owns only residential properties and generates income solely from rental activities.<sup>12</sup> The directors and shareholders want to transfer one of these properties, valued at R5 million, to a different company, XYZ (Pty) Ltd, in order to limit the risk associated with this business. XYZ (Pty) Ltd only makes exempt supplies for VAT purposes<sup>13</sup> and is not a registered VAT vendor. Section 9(15A) thus does not apply because the transaction is not regulated by VAT regulations. As a result, this provision cannot be used for the exemption. Section 9(2)(l)(i) of the TDA provides a more general and comprehensive exemption for asset-for-share transactions, regardless of VAT considerations. The inclusion of this section indicates a legislative intent to simplify and broadly apply the exemption to asset-for-share transactions. The transfer duty liability of approximately R342 100 is thus exempted in terms of section 9(2)(l)(i).

### Securities transfer tax (STC)

Securities transfer tax<sup>14</sup> is applied to the transfer of securities and came into effect on 1 July 2008.<sup>15</sup> A "security" refers to a share or depository receipt in a company or a member's interest in a close corporation. This tax is charged on each transfer of a security issued for a close corporation or company established within South Africa or a company based outside South

<sup>12</sup> [Transfer Duty Exemption - Unicus Tax Specialists SA](#). 06/09/2024.

<sup>13</sup> As per section 12(c)(i).

<sup>14</sup> The tax levied on every transfer of a security. A security in essence means any share or depository receipt in a company, or member's interest in a close corporation.

<sup>15</sup> [Securities Transfer Tax | South African Revenue Service \(sars.gov.za\)](#) 26/09/2024.

Africa but listed on a South Africa exchange. It is also charged on the reallocation of securities from a restricted stock account to an unrestricted stock account. The tax rate is set at 0.25% of the value of the security. An asset-for-share transaction will also be exempted from securities transfer tax in terms of section 8 of the Securities Transfer Tax Act,<sup>16</sup> regardless of whether the person acquires the security as a capital asset or trading stock and regardless of the market value of the asset disposed of in exchange for the security.<sup>17</sup>

## Section 42 requirements

To qualify for the tax relief outlined in section 42 of the Act, the following conditions must be met:<sup>18</sup>

### Transferor and asset eligibility:

The transfer must involve an asset, excluding those linked to restraint of trade or personal goodwill, being transferred to a South African resident company. The term "person" does not have any restrictions and can also include trusts.<sup>19</sup> For example, the Pretorius Family Trust can transfer a property to Pretorius Properties (Pty) Ltd, integrating it into the family's business of interest-bearing property investments.

### Asset valuation:

The asset's market value must exceed its base cost, as determined under sections 11(a), 22(1), or 22(2). The "market value" refers to the price achievable between willing buyers and sellers in an open market, while "base cost" is defined in the Eighth Schedule, adjusted under either paragraph 26 or 27 if applicable. This condition prevents the application of asset-for-share provisions in cases where asset disposal would result in a loss.<sup>20</sup> Should the consideration for the asset be deemed inadequate by the Commissioner for South African Revenue Services, it may be considered a donation for donations tax purposes under section 58(1), except when both the transferor and transferee belong to the same group of companies, qualifying for exemption under section 56(1)(r).<sup>21</sup>

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<sup>16</sup> 25 of 2007.

<sup>17</sup> Stigling *et al* 2024: 1101.

<sup>18</sup> [Section 42 Asset-for-Share Transactions: The unsuspected dangers when transferring immovable property - Barnard J Law Firm \(barnardinc.co.za\)](https://www.barnardinc.co.za) 13/07/2024.

<sup>19</sup> Stigling *et al* 2024: 830.

<sup>20</sup> (Paragraph (a)(i)(aa) and (bb) of the definition of 'asset-for-share transaction' in section 42(1)).

<sup>21</sup> Stigling *et al* 2024: 830.

### Qualifying interest:

At the end of the transfer day, the transferor must hold a qualifying interest<sup>22</sup> in the transferee company, typically involving ownership of at least 10% of the equity shares<sup>23</sup> and voting rights. Alternatively, the transferor must be a natural person actively engaged full-time in the business of the transferee company, or a controlled group company associated with it.<sup>24</sup>

**For example,** Jane owns a piece of commercial property worth R5 million. She decides to transfer this property to a company, XYZ (Pty) Ltd, in exchange for shares in XYZ (Pty) Ltd. By the end of the day, Jane must hold at least 10% of the equity shares and voting rights in XYZ (Pty) Ltd. This means if XYZ (Pty) Ltd has 1 000 shares, Jane must receive at least 100 of those shares. Alternatively, if Jane is a natural person actively engaged full-time in the business of XYZ (Pty) Ltd or a related company, she can also meet the qualifying interest requirement. This ensures that Jane maintains a significant stake or active involvement in XYZ (Pty) Ltd after the transfer, allowing the transaction to qualify for the tax benefits under section 42 of the Act.

### Asset classification continuity:

The asset must maintain its original classification upon transfer. If the asset was trading stock for the transferor, it must be acquired by the transferee company as trading stock. Similarly, if it was a capital asset for the transferor, the transferee company must acquire it as a capital asset. An exception exists when the asset is a capital asset and the transferor and transferee are not part of the same group of companies, requiring the transferee to treat it as trading stock.<sup>25</sup>

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<sup>22</sup> "Qualifying interest" of a person means –

- An equity share held by that person in a company which is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds that share.
- An equity share held by that person in a portfolio of a collection investment scheme in securities.
- Equity shares held by that person in a company that constitute at least 10 per cent of the equity shares and that confer at least 10 per cent of the voting rights in that company.

[Para. (c) substituted by section 36(a) of Act No. 17 of 2023]

- An equity share held by that person in a company which forms part of the same group of companies or that person; or

[Para. (d) substituted by section 36 (b) of Act No. 17 of 2023]

- An equity share held in a portfolio of a hedge fund collective investment scheme.

<sup>23</sup> An 'equity share' includes a participatory interest in an 'equity' collective investment scheme (s 41(1)), expanding the definition of 'equity share' in section 1.

<sup>24</sup> (Paragraph (a)(A) and (B) of the definition of 'asset-for-share transaction' in section 42(1)).

<sup>25</sup> (Paragraph (a)(ii) of the definition of 'asset-for-share transaction' in section 42(1)).

Transferor	Acquiring Company	Circumstances when applied
Trading stock	Trading Stock	
Capital Asset	Capital Asset	
Capital Asset	Trading Stock	Only if the person and company do not form part of the same group of companies. <sup>26</sup>

### Anti-avoidance rules

A crucial stipulation within section 42 mandates an 18-month holding period for both the assets and shares acquired, except in cases involving subsequent transactions governed by sections 45, 46, or 47 of the Act. Conducting consecutive transactions under section 42 with the same assets and shares risks violating this holding period requirement, potentially triggering adverse tax consequences.<sup>27</sup>

In a notable case, BPR 393,<sup>28</sup> the South African Revenue Service (hereinafter referred to as "SARS") reviewed a scenario where a company wanted to separate its financial services and insurance business into different entities.<sup>29</sup> The company used consecutive section 42 transactions for this restructuring. Firstly, it transferred assets to a new holding company, which then passed them on to its subsidiaries (SubCco 1 and SubCo 2). Even though the holding company only held the assets for a short period of time before transferring them, SARS ruled that the assets continued to be treated as capital assets.<sup>30</sup> This decision highlighted the importance of maintaining proper tax treatment during business restructures.<sup>31</sup> If a follow-up transaction involving the same assets and shares is conducted under section 42, there is a risk of violating the 18-month holding rule, which could lead to negative tax implications.<sup>32</sup>

In another notable case, BPR 399,<sup>33</sup> SARS addressed a case where a South African company, owned by a sole proprietor, transferred an aircraft (a business asset) to the company in terms

<sup>26</sup> Stigling *et al* 2024/1: 831.

<sup>27</sup> Stigling *et al* 2024/1: 837.

<sup>28</sup> South African Revenue Service Binding Ruling 393: 2023.

<sup>29</sup> [Consecutive asset-for-share transactions - Cliffe Dekker Hofmeyr](#) 03/07/2024.

<sup>30</sup> [Consecutive asset-for-share transactions - Cliffe Dekker Hofmeyr](#) 03/07/2024.

<sup>31</sup> [Consecutive asset-for-share transactions - Cliffe Dekker Hofmeyr](#) 03/07/2024.

<sup>32</sup> Please note that this ruling is only valid for one year.

<sup>33</sup> South African Revenue Service Binding Ruling 399: 2023.

of a section 42 transaction and later sold the aircraft within 18 months to replace it with a new one. This action triggered the anti-avoidance rules, which ring-fence capital gains and the recoupment of capital allowances. However, because the aircraft was replaced with a qualifying asset, the company qualified for replacement asset relief, meaning no capital gain or recoupment was realised and the anti-avoidance rules were not applied. SARS clarified that the anti-avoidance rules would only apply if a real capital gain or recoupment arose from the disposal. Since replacement asset relief nullified any gain, there was nothing to ring-fence or tax. This ruling demonstrates SARS' interpretation that the anti-avoidance provisions cannot be enforced when no taxable gain exists within the 18-month period following an asset-for-share transaction. However, it is important to note that SARS' ruling applies to specific cases and may not be relevant to all situations. Therefore, taxpayers considering similar transactions should seek professional advice to understand the potential tax consequences.<sup>34</sup>

## The need for asset-for-share transactions

### Corporate reorganisations:

Corporations frequently utilise section 42 to streamline their organisational structures. This provision allows for the transfer of assets between related entities, such as subsidiaries or holding companies, without triggering immediate tax liabilities. By exchanging assets for shares in a tax-neutral manner, companies can consolidate their operations, optimise resource allocation and align their corporate strategy with long-term goals.<sup>35</sup>

### Incorporation from sole proprietorships:

Sole proprietors often leverage section 42 when transitioning from sole proprietorship to incorporation. This process involves transferring business assets, such as equipment, intellectual property or real estate, to a newly formed company in exchange for shares. The transaction is structured to defer CGT and normal income tax that would otherwise be applicable on the transfer of these assets. This approach not only facilitates the incorporation process but also provides tax advantages by allowing the deferral of tax liabilities to a later date when the assets are eventually disposed of.<sup>36</sup> Furthermore, individuals holding significant assets, such as investment properties or valuable holdings, may opt to transfer these assets into a corporate entity they control. This strategic move can enhance estate planning by consolidating assets under a tax-efficient structure. Income generated from these assets within the corporate entity may also benefit from lower tax rates compared to individual tax rates, depending on the applicable tax regime.<sup>37</sup>

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<sup>34</sup> [Consecutive asset-for-share transactions - Cliffe Dekker Hofmeyr](#) 03/07/2024.

<sup>35</sup> [Section 42: Asset-for-share transactions - bdk Auditors | Chartered Accountants \(SA\)](#) 02/07/2024.

<sup>36</sup> [Section 42: Asset-for-share transactions - bdk Auditors | Chartered Accountants \(SA\)](#) 02/07/2024.

<sup>37</sup> [Asset-for-share transactions – South African Tax Guide \(sataxguide.co.za\)](#) 02/07/2024.

### Group restructuring:

Section 42 plays a crucial role in facilitating group restructuring<sup>38</sup> and internal asset transfers within corporate groups. Companies within the same group may wish to realign their asset portfolios or reorganise their subsidiaries. By utilising section 42, these transfers can occur on a tax-deferred basis, enabling companies to optimize their group structure without immediate tax consequences. This provision supports corporate flexibility and strategic realignment initiatives, ensuring tax efficiency while complying with regulatory requirements.<sup>39</sup>

### Tax efficiency strategies:

As an illustrative example, consider a scenario where a trust holds immovable property valued at R20 million, initially acquired for R10 million. In a traditional sale scenario, the trust would be liable for CGT at a rate of 36% on the gain, amounting to R3.6 million, in addition to transfer duties imposed on the buyer, approximately R2.4 million. However, by utilising section 42 through an asset-for-share transaction, the trust can transfer the property to a resident company at its original base cost of R10 million. This transaction structure allows the trust to defer capital gains tax until a future date when the company eventually disposes of the property. The deferral of tax liabilities under section 42 provides immediate cash flow advantages and enhances the overall tax efficiency of the transaction. Such strategies are pivotal in estate planning, minimising tax burdens, and optimising financial outcomes for stakeholders involved.<sup>40</sup>

## Possible pitfalls of an asset-for-share transaction

### Impact of deferred gains on property transfers

In an asset-for-share transaction, the transferor is treated as having transferred an asset to the acquiring company at its base cost (for capital assets) or tax cost (for trading stock). This treatment ensures that there is no immediate recognition of gain or loss for the transferor upon the transfer. Concurrently, the amount equal to the base cost or tax cost is added to the contributed tax capital of the acquiring company. Conversely, the transferor is deemed to have acquired shares in the acquiring company for a consideration equivalent to the allowable base cost expenditure of the transferred asset. If the transferor has previously claimed allowances related to the asset, no recoupment arises upon transfer; however, the acquiring company is precluded from claiming these allowances. Upon the eventual disposal of the asset by the acquiring company, any allowances previously claimed by the transferor are recouped. This deferral mechanism can be illustrated through an example:

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<sup>38</sup> Group restructuring refers to the process of where a companies within the same corporate group reorganize their structures or assets. This could involve transferring assets between subsidiaries, merging entities or realigning ownership stakes to better reflect the group's strategic goals.

<sup>39</sup> [Asset-for-share transactions – South African Tax Guide \(sataxguide.co.za\)](#) 02/07/2024.

<sup>40</sup> [Asset-for-share transactions – South African Tax Guide \(sataxguide.co.za\)](#) 02/07/2024.

### Practical example 1:

Mr Erasmus purchased a property for R2 million and later transferred it to EE Business (Pty) Ltd in exchange for shares valued at R2 million. Despite the property's current market value of R5 million, no immediate gain or loss is realized by Mr Erasmus. EE Business (Pty) Ltd acquires the property at Mr Erasmus' base cost, thereby increasing its contributed tax capital by R2 million.

If EE Business (Pty) Ltd subsequently sells the property for R5 million, it realizes a capital gain of R3 million. The shares' value in EE Business (Pty) Ltd reflects this property value, approximately R4.3 million considering future taxes on disposal. If Mr. Erasmus sells his shares in EE Business (Pty) Ltd, he would recognise a capital gain of R2.3 million, reflecting the deferred taxable gain on the property under section 42 relief. This outcome, resembling a deferral of gain, underscores the potential tax implications akin to the scenario where Mr Erasmus initially capitalised EE Business (Pty) Ltd with R2 million for property acquisition in 2005. However, specific circumstances may differ if Mr Erasmus transfers assets eligible for allowances to EE Business (Pty) Ltd. Therefore, taxpayers should carefully evaluate the strategic implications of using section 42 relief, particularly concerning the subsequent realization of share value through dividends or sales. Such considerations are crucial in devising an optimal asset and group structure strategy post-transaction.

### Addressing value shifting

When a company issues shares, it fundamentally alters its capital structure, potentially affecting the ownership interests of existing shareholders. This process can lead to dilution if the shares are issued at a value that does not accurately reflect their true worth. Such undervaluation often results in implicit transfers of value, particularly prevalent in transactions involving connected parties, such as transfers between family members or from an individual to a related trust. To address these potential tax avoidance strategies, anti-avoidance rules are enacted to ensure that these covert transfers are subject to appropriate taxation.<sup>41</sup> In terms of section 24BA and the Eighth Schedule, the Act defines value shifting arrangements (VSAs), where shares are issued in exchange for assets. These rules are designed to prevent taxpayers from manipulating the valuation of assets transferred to a company in exchange for shares, thereby shifting value between related parties without triggering tax consequences.

### Key provisions of section 24BA:

Excess asset value over issued shares: If the market value of the asset transferred to the company exceeds the market value of the shares issued in exchange, section 24BA(3)(ai) treats the difference as a deemed capital gain for the company. This capital gain is added to the company's expenditure deemed to have been incurred to acquire the asset, impacting its tax base (section 40C(a)(ii) or section 40CA(b) with section 41(2) of the Income Tax Act).

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<sup>41</sup> Stiglingh *et al* 2024: 808.

Excess issued shares value over asset: Conversely, if the market value of the shares issued exceeds the market value of the asset transferred, section 24BA(3)(b) deems the excess value to be a dividend in specie paid by the company. This amount is subject to dividends tax as per chapter 19 of the Income Tax Act.

### **Practical example 2:**

John, the founder of Interconnection (Pty) Ltd, wishes to transfer his shares in the company to the Smith Family Trust through a newly established entity, New Beginnings (Pty) Ltd. Before the transaction, the Smith Family Trust held all shares in New Beginnings (Pty) Ltd, acquired at nominal cost. In compliance with section 42 of the Act, John transfers his shares in Interconnection (Pty) Ltd to New Beginnings (Pty) Ltd in exchange for shares issued to him by New Beginnings (Pty) Ltd. Post-transaction, John holds 15% of the shares in New Beginnings (Pty) Ltd, while the Smith Family Trust holds the remaining 85%.

### **Tax Implications of the Transaction:**

#### **For John:**

Under section 42, John is deemed to dispose of his Interconnection (Pty) Ltd shares at their base cost, resulting in no immediate capital gain. The base cost of the New Beginnings (Pty) Ltd shares received by John remains R100, reflecting the original cost of his Interconnection (Pty) Ltd shares.

#### **For New Beginnings (Pty) Ltd:**

New Beginnings (Pty) Ltd is deemed to acquire John's Interconnection (Pty) Ltd shares at their base cost of R100. However, due to the application of Section 24BA, a deemed capital gain of R25.5 million arises because the market value of the Interconnection (Pty) Ltd shares transferred (R30 million) exceeds the market value of the shares issued to John (R4.5 million).

This deemed capital gain must be added to New Beginnings (Pty) Ltd's expenditure incurred to acquire the Interconnection (Pty) Ltd shares, impacting its tax position under the Act. The regulatory framework under section 24BA ensures that transactions involving the issuance of shares for assets are conducted at arm's length, particularly when related parties are involved. By addressing potential value shifts between parties without appropriate tax consequences, these provisions uphold tax integrity and fairness in corporate transactions.<sup>42</sup>

## **Estate Planning and Transfer of Properties**

In estate planning, the transfer of properties plays a crucial role in managing tax liabilities and preserving wealth for future generations.

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<sup>42</sup> Stiglingh *et al* 2024: 808.

**Practical example 3:**

Anthony Erasmus, having owned a primary residence and a beach house in Hermanus for 20 years since their purchase in 2004, faces tax planning decisions in 2014. The primary residence, initially acquired for R5 million, has appreciated to R7 million, while the beach house, purchased for R3 million, now valued at R4 million.

In 2014, Anthony utilised section 42 of the Act to transfer ownership of these properties to EE Properties (Pty) Ltd in exchange for 20% equity shares in the company. This strategic move affords tax advantages, as EE Properties (Pty) Ltd is deemed to have acquired the properties at their original purchase prices of R5 million and R3 million, respectively, and to have held them for 10 years for tax purposes.

Anthony Erasmus, in turn, acquires 100% equity shares in EE Properties (Pty) Ltd at a base cost of R8 million (R5 million for the primary residence plus R3 million for the beach house). Subsequently, he updates his will, intending to bequeath these shares equally to his two children upon his death, ensuring the properties' transfer without immediate tax liabilities.

Upon Anthony Erasmus's death in 2024, the properties' values are assessed as follows:

- Primary Residence: R10 million
- Beach House: R6 million

**Estate duty calculation if Anthony Erasmus still owned the properties at death:**

<b>ASSETS</b>	
Primary Residence	R 10 000 000
Beach House	R 6 000 000
<b>TOTAL</b>	<b>R16 000 000</b>
<b>LESS LIABILITIES (R 266 000)</b>	
Transfer Duty Primary Residence	(R100 904)
Transfer Duty Beach House	(R 78 096)
Master's Fees, Funeral & General Costs	(R 87 000)
<b>LESS CGT Payable at Death</b>	<b>(R 1 026 000)</b>
<b>LESS Executor's Fees @ 4,03%</b>	<b>(R 644 000)</b>
<b>LESS Primary Abatement</b>	<b>(R 3 500 000)</b>
<b>DUTIABLE ESTATE</b>	<b>R 10 564 000</b>
<b>Estate Duty Payable @ 20%</b>	<b>R 2 112 800</b>

**IF ANTHONY ERASMUS TRANSFERRED THE PROPERTIES IN 2014:**

<b>ASSETS</b>	
Shares in Company	R 16 000 000
<b>LESS LIABILITIES (R 87 000)</b>	
Transfer Duty (NONE)	
Master's Fees, Funeral & General Costs	(R 87 000)
<b>LESS CGT Payable at Death</b>	<b>(R 1 386 000)</b>
<b>LESS Executor's Fees</b>	<b>(R 644 000)</b>
<b>LESS Primary Abatement</b>	<b>(R 3 500 000)</b>
<b>DUTIABLE ESTATE</b>	<b>R 10 383 000</b>
<b>Estate Duty Payable @ 20%</b>	<b>R 2 076 600</b>

This approach initially appears neutral until potential future disputes among the children prompt the decision to sell the properties in 2024. Upon sale, EE Properties (Pty) Ltd will incur capital gains tax (CGT) and transfer costs.

### Detailed CGT Calculation:

Primary Residence: (Market Value – Base Cost = Gain/Loss)	R 10 million – R 5 million	= R 5 million
Beach House: (Market value – Base Cost = Gain/Loss)	R 6 million – R 3 million	= R 3 million
Total Capital Gain:	R 5 million + R 3 million	= R 8 million
Taxable Capital Gain (80% of Total Capital Gain):	0.8 x R 8 million	= R 6 400 000
CGT for Companies (27%), thus Tax Payable:	0.27 x R 6 400 000	= R 1 728 000
Transfer Costs:		= R 179 000
<b>TOTAL COSTS:</b>	<b>R 1 728 000 + R 179 000</b>	<b>= R 1 907 000</b>

Thus, what could have been a straightforward transfer to the children with estate duty implications of R2,112,800 will now involve additional costs totalling R3,983,600 due to CGT and transfer expenses incurred upon the sale by EE Properties (Pty) Ltd.

This detailed scenario illustrates the complex tax considerations and financial implications involved in estate planning and property transfers, emphasizing the importance of strategic planning and understanding of tax laws in preserving family wealth.

## Conclusion

Section 42 provides a strategic avenue for businesses and individuals to optimise their financial structures through asset-for-share transactions. This mechanism enables companies to streamline operations, allocate resources more effectively and plan for long-term strategic goals without the burden of immediate tax costs. However, the complexity of these transactions necessitates careful consideration of the requirements and potential pitfalls, including compliance with anti-avoidance rules, accurate asset valuation and understanding the tax implications of holding and eventually disposing of the assets.

The practical examples illustrate both the benefits and challenges, emphasizing the importance of professional advice in navigating these transactions to achieve optimal financial outcomes. By leveraging section 42 effectively, stakeholders can achieve significant tax efficiencies and strategic advantages but must remain vigilant to avoid unintended consequences and ensure compliance with the regulatory framework. By default, section 42 relief applies to qualifying asset-for-share exchanges, unless both parties agree in writing to opt out of this provision. This election allows them to avoid the automatic rollover of tax implications to the acquiring company. While the tax deferral is a major benefit, the decision to engage in a section 42 transaction comes with its own set of risks. One key concern is the potential for future tax liabilities, particularly if assets appreciate in value or if there is a change in the company's structure.

In conclusion, while section 42 transactions present opportunities for financial optimisation, the complexities involved require careful planning, strategic foresight and a thorough understanding of the tax implications. Financial advisers should be cautious when giving advice on section 42 transactions. It is essential that advisers ensure their clients fully understand the implications of such transactions, particularly regarding the potential long-term tax consequences. Advisers should also stay informed about any updates to tax laws that may impact section 42 transactions, ensuring their advice remains current and relevant.

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# Insuring Against Uncertainty: Business Protection Strategies for Debt and Death

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## Introduction

Businesses and debt are inherently intertwined. This article will discuss the importance of having a business contingency plan to protect a surety and their personal estate, utilising keyperson cover to repay debts and using loan account cover to protect the business in repaying its credit loan accounts. Additionally, the rationale behind taking on certain types of debt and how to protect against the adverse consequences of these debts in a tax-efficient manner are discussed.

## What is a surety?

Claasen defines a surety as one who takes on the responsibility of the principal debtor who still remains liable<sup>1</sup>. Therefore, a surety is a person who makes a promise or agreement that the financial obligations of the principal debtor will be fulfilled. If the principal debtor fails to meet their financial obligations, then the surety will be liable in the principal debtor's stead. The surety guarantees the loan. A member or shareholder of a close corporation or company often needs to sign as a surety or provide personal security for a business loan. This means they can face personal financial liability, and the debt must be recovered from their personal estates in three scenarios:

- (i) If the business cannot repay the loan during their lifetime.
- (ii) If they die or become permanently disabled and the business cannot repay the loan.
- (iii) If no one can replace them as surety or provide alternative security.<sup>2</sup>

## How can the business protect the surety?

The business can protect the surety through a business contingency plan. A business contingency plan is a strategy designed to manage and mitigate potential risks and disruptions that could impact a business's operations and financial stability. In the context of a loan, one component of a contingency plan might involve taking out an insurance policy on the life and disability of the member or shareholder who has guaranteed the loan. This is known as a contingent liability policy, which will be discussed further below. Additionally, having a replacement surety or alternative security, can also protect the surety or their deceased estate. For example, Sam is the surety and co-director of XYZ (Pty) Ltd. If she passes away, her co-director, Dean can replace Sam as the surety. That way Sam's personal estate will be protected as Dean will take over Sam's position as surety. Alternatively, the business could have grown in the time that Sam was director. It may be able to now provide collateral to secure the loan amount instead of relying on a suretyship.

## Contingent liability cover

### Tax implications of contingent liability cover

When taking out contingent liability cover, it is crucial to understand how life insurance policies are taxed upon the death of the policyholder. Generally, life insurance proceeds can be included in the deceased's estate, which means they may be subject to estate duty. However, certain exceptions exist that allow for the exclusion of these proceeds from the taxable estate. To benefit from these exclusions, specific legal requirements outlined in the Estate Duty Act must be met.

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<sup>1</sup> R. D. Claassen, Dictionary of Legal Words and Phrases, Lexis Nexis.

<sup>2</sup> Cloete S et al, Premiums and Problems, Edition 127, 2023, D49

According to section 3(3)(a) of the Estate Duty Act, the proceeds of any life insurance policy are considered deemed property in the deceased's estate, and therefore subject to estate duty. However, section 3(3)(a)(ii) of the Act outlines conditions under which certain life insurance policies may be excluded from the deceased estate, provided that the specified requirements are met:

- a) the policy was not effected by or at the instance of the deceased; and
- b) no premium on the policy was borne by the deceased; and
- c) no amount due under the policy has been or will be paid to the estate of the deceased; and
- d) no amount has been or will be paid to a relative of the deceased or a person wholly or partly dependent on him for maintenance, or to any family company.

SARS has indicated the difficulty in proving that the policy was not made at the instance of the deceased as required in (a) above.<sup>3</sup> To address this, a close corporation or company resolution that excludes the deceased from the decision-making process can be used as proof that the policy was not affected by the deceased. If the requirements are not met, an option is to factor in estate duty into the cover amount. This can be done by applying the following formula:

$$\text{Initial cover required} / (1 - \text{Estate Duty Rate}) = \text{Cover required}$$

Section 11(w)(ii)<sup>4</sup> sets out requirements for the premium on the policy to be tax deductible, namely:

- (i) the policy had been a long-term insurance policy of which the taxpayer (company) was the policy holder,
- (ii) the taxpayer had been insured against any loss by reason of the death, disablement or severe illness of an employee or director the taxpayer,
- (iii) the policy was a pure risk policy with no cash or surrender value,
- (iv) at the time of paying the premium, the company had owned the policy, and
- (v) no transaction, operation or scheme existed in terms of which any amount recoverable under the policy or an amount equivalent to or in lieu of such amount would have been made over by the taxpayer to or in favour of the employee, or a person connected to the employee, the employee's deceased estate, a dependent of the employee (whether partially or wholly dependent).<sup>5</sup>

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<sup>3</sup> SARS Reference Guide, Estate Duty Implications on Keyman Policies page 6.

<sup>4</sup> Income Tax Act 58 of 1962

<sup>5</sup> Section 11(w)(ii) Income Tax Act ; D26 Business Assurance Old Mutual Premiums & Problems 127 Edition.

Since the proceeds do not cover the company against operating expenses but are used to repay the capital, the premium would not be tax deductible. As it is a pure risk policy with no cash or surrender value, the proceeds will be paid out free from income tax.<sup>6</sup>

**For example**, if ABC (Pty) Ltd takes out a contingent liability insurance policy to cover a loan held by its director who stood as surety, ABC (Pty) Ltd cannot deduct the insurance premiums for tax purposes as the policy is not designed for covering business losses or expenses but for paying back the loan. However, the advantage is that when ABC (Pty) Ltd receives the policy proceeds, it would pay out free of income tax.

### Key person cover and repaying business debt

A keyperson policy is a company-owned policy on the life of a key employee, designed to protect the business from the sudden loss of that employee. The cover "guarantees that cash will be available to absorb any disruptions to the business, **protect existing credit facilities** [own emphasis] and provide the necessary funds for the recruitment and training of a replacement."<sup>7</sup> In the event that a keyperson dies or becomes disabled, the business may struggle to meet its debt obligations. Keyperson assurance provides a financial cushion, enabling the business to repay loans and maintain creditworthiness.<sup>8</sup>

### Tax Implications of a keyperson policy

Keyperson policies may qualify for an income tax deduction on the premiums under section 11(w)(ii),<sup>9</sup> as discussed under 'Tax implications of contingent liability cover', or the proceeds of the policy under section 10(1)(gH).<sup>10</sup> Section 10(1)(gH) exempts an amount, in the hands of an employer, received or accrued in respect of a policy of insurance where:

- (i) the policy relates to death, disablement or severe illness of an employee or director, or former employee or director, of the person that is the policyholder; and
- (ii) no amount of premiums payable in respect of the policy on or after 1 March 2012 is deductible from the income of that person for the purposes of determining the taxable income derived by the person from carrying on any trade.<sup>11</sup>

The business must assess whether it would be more advantageous to deduct the premiums on the policy or to receive the proceeds free of income tax. Section 3(3)(a)(ii) applies to both contingent liability cover and keyperson policies. The requirements of section 3(3)(a)(ii) can be noted above under Tax implications of contingent liability cover. If the requirements are met, then the keyperson policy will be excluded from the deceased estate.

<sup>6</sup> M Botha, Corporate and Personal Financial Planning 2023, 3.2.1.

<sup>7</sup> Cloete S et al, op cit D31.

<sup>8</sup> <https://www.capitalforlife.com/blog/key-man-insurance-policy> accessed on 14/07/24

<sup>9</sup> Income Tax Act 58 of 1962.

<sup>10</sup> Ibid.

<sup>11</sup> Cloete S et al op cit note 2 D23

## Loan account cover

This article has addressed methods to safeguard the business against external debt. The focus now shifts to internal debt, specifically debit and credit loan accounts within the business. Loan account cover ensures the business is protected in the event of the loan account holder's death.

**Debit loan accounts** refer to loans made by the company to shareholders, directors, or employees.<sup>12</sup>

**For example**, Robin is a shareholder at BAT Ltd. When he withdraws a large sum of money from the business for his personal use, the company creates a debit loan account, indicating that Robin owes the money to the company. This loan is shown as an asset in the books of the company and is a liability for the shareholder.<sup>13</sup> Robin has two options for clearing the debit loan account. In order to clear the debit loan account, he can bequeath a portion of his estate or an asset to a beneficiary with the condition that they take over the loan. This could also apply to bequests to a testamentary trust or charitable institution.<sup>14</sup> Alternatively, life cover payable to the estate can be used to settle the outstanding debt. This way the debt does not burden the estate or impact on the heirs.

**Credit loan accounts** are loans made by the shareholders to the company. Credit loans are recorded as a liability on the business's books and an asset for business owner. If the business owner passes away, their estate has a claim against the business to settle the loan. The estate may demand immediate repayment, which could place a financial strain on the business. Lack of funds could lead to operational disruptions, hindering the business's ability to meet its financial obligations and maintain smooth operations. In extreme cases, the business might need to liquidate assets to repay the loan, adversely affecting its long-term viability. Failure to repay loans can damage the business's creditworthiness<sup>15</sup>, making it difficult to secure future financing.

Companies experiencing liquidity issues may find themselves in a position where they are unable to repay a shareholder's credit loan account when necessary.<sup>16</sup> By taking out loan account cover, they will acquire the necessary liquidity and not put the company in a dire financial situation. Since the policy is effected by the shareholder and the shareholder also pays the premiums, it will be estate dutiable as it does not meet the requirements in terms of section 3(3)(a).<sup>17</sup> If a buy and sell agreement is in place, the credit loan account can be

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<sup>12</sup> Cloete S et al, Premiums and Problems 2024, D47.

<sup>13</sup> The Income Tax Effects of Members' Debit Loan Accounts, a lecture presented by Professor Phillip Haupt to the South African Institute of Professional Accountants (Western Cape). 23 August 2008. [www.hedron.co.za](http://www.hedron.co.za)

<sup>14</sup> Cloete S et al, op cit note 20 D46.

<sup>15</sup> Marco Carbajo, "Five Factors that Impact Your Business Credit" 23 May 2018, accessed on <https://www.sba.gov/blog/five-factors-impact-your-business-credit-on-13-july-2024>.

<sup>16</sup> A Goodall, The South African Financial Planning Handbook, 2023, 587.

<sup>17</sup> Estate Duty Act 45 of 1955.

included in the agreement ensuring that the amount owed by the company is paid off upon the loan account holder's death, thus relieving the business of this liability. As long as the requirement of section 3(3)(a)(iA) of the Estate Duty Act are met, the buy and sell cover will be free of estate duty.<sup>18</sup>

**The criteria for section 3(3)(a)(iA) are:**

- (i) the policy is taken out or acquired by a person who, on the date of the death of the deceased, was a partner of the deceased, or held a share or like interest in a company in which the deceased, on that date, held a share or like interest, and
- (ii) the policy was taken out or acquired with the purpose of acquiring the deceased's interest in the partnership, or with the purpose of acquiring the whole or a part of the deceased's share or like interest in the company or close corporation and any claim by the deceased against the company or close corporation, and
- (iii) no premium on the policy was paid or borne by the deceased.<sup>19</sup>

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<sup>18</sup> S Cloete et al, Premiums and Problems Edition 127 2023, D46.

<sup>19</sup> Ibid at B42.

## Conclusion

Effectively managing debt is crucial for ensuring the continuity of any business. Utilising contingent liability plans, keyperson insurance, loan account cover or including credit loans in a buy and sell agreement can help mitigate the financial risk associated with debt in the event of death or disability. Understanding the tax implications of these policies is essential for business planning and for protecting the business owner's individual estates. By utilising these tools, businesses can protect their assets, ensure continuity during unexpected events, and maintain tax efficiency and minimising the burden on heirs and estates.

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## Partners in Crime: Structuring of Contingent Liability Insurance in a Partnership

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### Introduction

In the world of business partnerships, failing to properly structure contingent liability insurance can lead to outcomes that are nothing short of disastrous—at least in terms of the financial fallout. Partners who neglect to secure adequate coverage may find themselves embroiled in financial turmoil where personal assets are at risk and business debts become insurmountable. This lack of foresight and planning can turn a seemingly straightforward partnership into a liability nightmare. Since partnerships are typically cheaper and easier to form than companies or close corporations,<sup>1</sup> they are often the preferred entity used by business owners. The question then is: “How can a partnership ensure that the debts and obligations are paid, should one of the partners pass away”?

This is where contingent liability insurance proves to be an effective business assurance method. It ensures that the remaining business partners have sufficient funds available to settle any outstanding financial obligations the business may have. Contingent liability insurance is often used by juristic entities to insure the lives of individual business owners who have signed surety for business debts. In the event of their death or disability, the policy pays to the business' bank account, which then settles the debt. But how can a partnership implement similar protection?

This article focuses on the importance of properly structuring contingent liability insurance within a partnership, highlighting the necessity for business owners to approach this aspect of their business with the seriousness that it deserves.

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<sup>1</sup> Old Mutual Premiums and Problems, 127th Edition, 2023, page D13.

## Understanding partnerships

A partnership is a business structure in which two or more individuals share ownership and management responsibilities. Each partner contributes to the business, participates in decision-making and shares in profits and losses. Unlike companies and close corporations, partnerships are not considered separate legal entities.<sup>2</sup> Instead, partners are jointly and severally liable for the obligations of the partnership, provided that the debts are incurred with the authority of the partnership. If the partnership debts cannot be met out of the partnership assets, creditors can sue the partners individually,<sup>3</sup> a concept known as unlimited liability.

Partnerships may dissolve for several reasons, including:<sup>4</sup>

- The expiry of the period for which the partnership was formed;
- The completion of the task for which it was formed;
- The entry of a new partner;
- The retirement of a partner;
- The insolvency of the partnership or a partner;
- The inability of the partnership to perform;
- Dissolution by mutual agreement or a court order;
- The death of a partner.

This article will specifically address the dissolution of a partnership at the death of a partner. Since partnerships terminate upon death, lacking a contrary agreement, each partner will receive his capital back upon dissolution and if there are any remaining funds after all claims against the partnership have been settled, the partner will also receive what they have risked in the business.<sup>5</sup>

There are both benefits and drawbacks to partners having unlimited liability. One benefit is that it encourages partners to take shared responsibility. However, a significant drawback is that a partner's personal estate could be at risk if the business faces financial difficulties. Therefore, those considering forming a partnership must weigh the advantages of having shared decision-making against the possible risks. One of the most significant legal implications of a partnership is that partners share both profits and losses and are joint owners. This is detailed in the partnership agreement, which should be properly structured to prevent misunderstandings. The agreement should outline each partner's responsibilities, how earnings will be divided, and how decisions will be made.

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<sup>2</sup> Christian Tabor-Raeside 'Navigating the Legal Waters: Understanding Partnerships in South African Company Law' available at <https://legalese.co.za/navigating-the-legal-waters-understanding-partnerships-in-south-african-company-law/>, accessed on 20 September 2024.

<sup>3</sup> M Botha et al, *The South African Financial Planning Handbook*, 2023, par. 13.3.

<sup>4</sup> *Old Mutual Premiums and Problems*, 127th Edition, 2023, page D8-9.

<sup>5</sup> *Ferreira v Fouche* 1949 1 SA 67 (T) 70; *Olivier v Stoop* (1978) 1 All SA 482 (T).

## Contingent liability insurance in a business structure

When a juristic entity makes use of contingent liability insurance, it is crucial to ensure that the policy used is correctly structured. This includes determining the appropriate policy owners, the correct life assured/lives assured, and the intended beneficiaries of the policy. The business insures the life of the member or shareholder who has signed surety or provided personal security for the loan effected by the business. The business pays the premiums, and an agreement is entered into between the business and the member or shareholder in terms of which the business undertakes to apply the proceeds of the policy to the repayment of the loan(s) giving rise to the personal guarantees given by the member or shareholder.<sup>6</sup>

When correctly structured, contingent liability insurance can offer tax advantages from an estate duty perspective. The proceeds of a contingent liability policy will form part of deemed property in the deceased's estate unless the requirements of section 3(3)(a)(ii) of the Estate Duty Act<sup>7</sup> are met, namely:

- (i) the policy was not effected by or at the instance of the deceased; and
- (ii) no premium on the policy was borne by the deceased; and
- (iii) no amount due under the policy has been or will be paid to the estate of the deceased; and
- (iv) no amount has been or will be paid to a relative of the deceased or a person wholly or partly dependent on him for maintenance, or to any family company.

In the case of a partnership, the partners take out a life insurance policy, each owning a proportionate share, to cover the full amount of the partnership's debts and liabilities. The debts are shared among the partners according to their agreed proportions. If the partnership's assets are insufficient to cover the claims of creditors, the partners' personal estates will be liable.<sup>8</sup> Therefore, if one of the partners passes away, the creditors can claim from both the estate of the deceased partner and the remaining partners.

Additionally, using a contingent liability agreement is crucial. This agreement outlines the rights and obligations of the life assured concerning the insurance policies, including what might happen to the policies if a life assured leaves the company. It also serves as the life assured's acknowledgement that the insurance policy is in effect.<sup>9</sup>

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<sup>6</sup> Old Mutual Premiums and Problems, 127th Edition, 2023, page D49.

<sup>7</sup> 45 of 1955.

<sup>8</sup> Old Mutual Premiums and Problems, 127th Edition, 2023, page D6.

<sup>9</sup> <https://agreementsonline.co.za/agreements/contingent-liability-insurance/>, accessed on 26 September 2024.

### Practical example

Andy and Matthew formed a partnership to start a gas refill business. They purchased a business premises along with all the necessary equipment for R4 000 000. They secured a bank loan of R4 000 000 at ABC Bank, for which they both signed sureties.

Andy and Matthew are aware that they are personally liable for any obligations incurred by the business if anything was to happen to either of them. They want to explore solutions to ensure that these obligations can be covered in the event of death.

To address this, they decided to take out separate contingent liability insurance to settle the business liabilities if either partner passes away. As equal partners, their policies are structured as follows:

#### Matthew's Policy:

<b>Owner:</b>	Matthew
<b>Life Assured:</b>	Andy
<b>Beneficiary:</b>	None (Payable to Matthew's estate)
<b>Life Cover:</b>	R4 000 000

#### Andy's Policy:

<b>Owner:</b>	Andy
<b>Life Assured:</b>	Matthew
<b>Beneficiary:</b>	None (Payable to Andy's estate)
<b>Life Cover:</b>	R4 000 000

However, since the partnership dissolves upon the death of either partner<sup>10</sup> and partners are jointly and severally liable, a creditor such as ABC Bank can claim repayment from either partner individually. This means the surviving partner could be held liable for the full business debts if the deceased partner's estate cannot cover it. Consequently, ABC Bank could claim the outstanding debt from the surviving partner's personal estate. Therefore, the financial risk extends not only to the deceased partner's estate but also to the estate of the surviving partner.

<sup>10</sup> Old Mutual Premiums and Problems, 127th Edition, 2023, page D6.

To mitigate this risk, the business' liabilities should be fully covered with properly structured contingent liability insurance. A solution is that Andy and Matthew must both be co-owners of each policy, each for the full amount of business liabilities. Both Andy and Matthew should also be beneficiaries of the proceeds of the policies.

The policies should therefore be structured as follows:

**Policy 1:**

<b>Owners (In their personal capacity):</b>	Andy & Matthew
<b>Life Assured:</b>	Andy
<b>Beneficiaries:</b>	Andy & Matthew
<b>Life Cover:</b>	R4 000 000

**Policy 2:**

<b>Owners (In their personal capacity):</b>	Andy & Matthew
<b>Life Assured:</b>	Matthew
<b>Beneficiaries:</b>	Andy & Matthew
<b>Life Cover:</b>	R4 000 000

By structuring the policies in this manner, both Andy and Matthew will be adequately covered if ABC Bank makes a claim for the repayments of the business liabilities after the dissolution of the partnership. This approach allows the surviving partner to focus on succession planning and maintaining business continuity without the burden of outstanding debts.

## Conclusion

Partners in a business partnership must understand the financial solutions available to insure the business's debts and obligations in the event of a partner death. Proper structuring of these policies is crucial to mitigate personal financial risk for each partner. As a financial planner or legal advisor, it is essential to grasp the intricacies of contingent liability policies to ensure that the client, as a business owner, is adequately insured and the best possible outcome is achieved for their business entities.

Business owners should be made aware of all available options and the consequences of each of these options. This includes considerations from tax, business structuring, and succession perspectives. By providing comprehensive advice and presenting all potential scenarios, you enable your clients to make informed decisions that support the long-term sustainability of their business.

In conclusion, financial advisers should consider the following key steps when dealing with business owners:

1. **Conduct regular reviews:** Continuously review and update insurance policies to accommodate changes in the business structure or financial situation.
2. **Consult with experts:** Advise clients to seek guidance from both financial and legal professionals to address complex matters and ensure adherence to regulatory requirements.
3. **Ensure detailed documentation:** Make certain that all agreements and policy documents are comprehensive and clearly articulated to prevent misunderstandings and legal conflicts.
4. **Develop contingency plans:** Create a thorough contingency plan that encompasses insurance coverage, succession planning, and strategies for managing unforeseen events.
5. **Foster effective communication:** Maintain transparent and ongoing communication with all partners regarding the terms and implications of insurance policies to ensure mutual understanding and alignment.

By adhering to these practices, financial advisers can assist business owners in protecting their financial interests and enhancing the stability and longevity of their partnerships

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