

## **UNDERSTANDING THE USE OF TRUSTS IN B-BBEE OWNERSHIP INITIATIVES**

### **About the Guide**

The Broad-Based Black Economic Empowerment (“B-BBEE”) Commission is an entity established in terms of the B-BBEE Act, as amended, to oversee the proper implementation of the B-BBEE Act. This guide is developed and distributed by the B-BBEE Commission to provide guidance on the treatment of Trusts when used as a vehicle to facilitate ownership for purposes of compliance with the objectives and requirements of the B-BBEE Act.

### **What is a Trust?**

A Trust generally refers to an arrangement in terms of which a person, often the Founder or Trustee, holds property or asset for the benefit of another, commonly known as a beneficiary, and can be for charity or estate planning, amongst other reasons. Under the B-BBEE Act, a Trust can be used to facilitate ownership by employees, communities or other similar collective groups.

### **Requirements for recognition of Trusts in ownership transactions**

For the purposes of achieving B-BBEE objectives, black people may hold their rights of ownership in a measured entity through some form of a vehicle such as a Trust. To ensure that black people effectively own, control and manage the ownership rights held through the Trust and to prevent avenues for circumvention of the B-BBEE Act by measured entities, the Codes of Good Practice provide rules for the Trusts. These rules apply to Trusts as well as to transactions that involve Broad-Based Ownership Schemes and Employee Share Ownership Programmes that are structured in a form of a Trust.

While Trusts can be used to facilitate ownership, the transaction in question must still meet the requirements for recognition of ownership, which comprises of excisable voting rights, economic interests and net value in the hands of black people as a result of direct or indirect participation in the measured entity. The measured entity may on an annual basis recognise points for as long as the black shareholders still hold rights of ownership in the entity.

## **Ways Trusts can be implemented in the B-BBEE Codes of Good Practice**

### ***Broad-Based Ownership Scheme***

Broad-Based Ownership Scheme refers to a collective ownership scheme constituted with the view to facilitating the participation of specified natural persons in the benefits flowing from the ownership by that scheme or by its fiduciaries of an equity interest in an entity, which could be in a form of a community or stokvel or group of enterprises. A Broad-Based Ownership Scheme may be created in a form of a Trust, and in that case it must meet both the rules for Broad-Based Ownership Scheme and for Trusts as set in the Codes of Good Practice.

Broad-Based Ownership Scheme must meet the following requirements:

<b><i>Nomination of Trustees</i></b>	At least 50% of the fiduciaries of the scheme must be independent persons having no employment with or direct or indirect beneficial interest in the scheme, at least 50% of the fiduciaries of the scheme must be black people with at least 25% being Black women and the chairperson of the scheme must be independent
<b><i>Black participants and portion of entitlement</i></b>	Codes Series 100, requires the trust to define participants and the portion of their entitlement to receive distribution of the economic interest. It is important for each participant to know in advance the portion of their entitlement, and during B-BBEE measurement, proof of payment

	<p>will be produced. The trustees do not have discretion with regard to changing the participants and their portion of entitlement.</p> <p>Beneficiaries cannot be selected each year to receive benefits in a form of dividends from the measured entity, for payment of their education, training or social upliftment projects which are matters that should be catered for under skills development corporate, social investments or socio-economic development</p>
<b><i>Trust proceeds</i></b>	<p>A trust is a broad-based scheme and must adhere to the requirements of both annexes 100 (B) and (D). the trust deed must provide guidance as to how the beneficiaries will receive the proceeds and must adhere to paragraph 1.1.7 of Annexe 100 (B) which states that 85% of the value of the benefits allocated to the trust must accrue to black people. This then means only 15% of the proceeds payable to the trust can be utilised for administrative and operational management of the trust.</p>
<b><i>Financial reports of the scheme</i></b>	<p>The trustees as the representatives of a trust have an oversight role over the financial reports of a trust. Thus, they have a duty to inform the participants on the status of such reports on an annual general meeting of the scheme.</p> <p>Further, the trustees must hold a meeting with the black participants for the purpose of updating them on the status of accounts of the trust. Paragraph 1.1.12 of Annex 100 (B) provides that the scheme fiduciaries must present the financial</p>

	<p>reports of the scheme to participants yearly at an annual general meeting of the scheme.</p> <p>On winding-up or termination of the trust, all accumulated Economic Interest must be transferred to the beneficiaries or to an entity representing the interest of the participants or class of beneficiaries.</p>
<b><i>Documents governing the scheme</i></b>	The Constitution of the scheme must be available on request to any participant in an official language in which that person is familiar.

### **Employee Share Ownership Programme**

Employee Share Ownership Programme refers to instances where employees are offered shares/stock/units options in an entity they work for, which may be at no cost or where they can purchase shares/stock/units at discounted or favourable price mostly as an incentive. Employee Share Ownership Programme may be created in a form of a Trust, and in that case it must meet both the rules for Employee Share Ownership Programme and for Trusts as set in the Codes of Good Practice

Employee Share Ownership Programme must meet the following requirements:

<b><i>Appointment of trustees</i></b>	At all times 50% of fiduciaries of the scheme must be appointed by the employees and this must be attained throughout the scheme's existence.
<b><i>Black participants and portion of entitlement</i></b>	The trust deed must state information relating to the portion of entitlement for each black participant. It is important for each participant to know in advance the portion of their entitlement, and during B-BBEE measurement, proof of payment will have to be produced. The trustees

	do not have discretion with regard to changing the participants and their portion of entitlement.
<b><i>Trust proceeds</i></b>	A trust which is established as an employee share ownership scheme, must adhere to the requirements of both Annexe 100 (C) and (D) of Code Series 100 and the trust deed must also provide guidance as to how the beneficiaries will receive the proceeds.
<b><i>Financial reports of the scheme</i></b>	The trustees as the representative of a trust have an oversight role over the financial reports of a trust. Thus, they have a duty to inform the participants on the status of such reports on an annual basis through meetings that are held. The trust deed must provide that the trustees will hold a meeting with black participants for the purpose of updating them on the status of accounts of the trust. Paragraph 2.5.4 of Annex 100 (C) provides that the scheme fiduciaries must present the financial reports of the scheme to participants yearly at an annual general meeting of the schemes.
<b><i>Participation by Black participants at the Measured Entity board</i></b>	In terms of paragraph 2.5.2 in Annexe 100 (C), the participants must take part in managing the scheme at a level similar to the management role of the shareholders in a company in which they hold shares. Represented by the trustees, the beneficiaries must be able

	<p>to take part in the decision taken by other shareholders in meetings through board active participation and exercisable voting rights.</p> <p>On winding-up or termination of the trust, all accumulated Economic Interest must be transferred to the beneficiaries or to an entity representing the interest of the participants or class of beneficiaries. Further, an employee share ownership scheme is a form of ownership and should not be confused with daily operations of the entity and its labour relations issues where dismissed, retrenched, deceased and incapacitated employees end up forfeiting their share/units as employment contracts and terms are not attached to their shareholding and should not be implemented as such.</p>
<p><b><i>Documents governing the scheme</i></b></p>	<p>The constitution of the scheme must be available on request to any participant in any official language in which that person is familiar.</p>

## **Trusts**

Where ownership is facilitated through a Trust, whether such Trust is a Broad-Based Ownership Scheme, Employee Share Ownership Programme, or just a Trust, the Trust must meet the Trust Rules set in the Codes of Good Practice. This means a Trust that is set up a Broad-Based Ownership Scheme or Employee Share Ownership Programme must meet the rules for Trusts and in addition to that, the

rules for Broad-Based Ownership Scheme or Employee Share Ownership Programme as the case may be.

The qualification criteria for the recognition of Trusts are as follows:

- the Trust Deed must define the beneficiaries and the proportion of their entitlement to receive distributions;
- a written record of the names of the beneficiaries or the use of a defined class of natural person satisfies the requirement for identification;
- a written record of fixed percentages of entitlement or the use of a formula for calculating entitlement satisfies the need for defining proportion of benefit;
- the Trustees must have no discretion on the above-mentioned terms; and
- on winding-up or termination of the trust, all accumulated Economic Interest must be transferred to the beneficiaries or to an entity representing the interest of the participants or class of beneficiaries.

### **Family Trusts**

Further, the Codes of Good Practice allow for establishment and recognition of family trusts to facilitate ownership. For a family Trust to receive B-BBEE recognition status, the trust deed must define the beneficiaries and the proportion of their entitlement to receive distributions. A written record of the names of the beneficiaries or the use of a defined class of natural person satisfies the requirements of defining beneficiaries; only the trustees have discretion on the operations and terms of the trusts. On winding-up or termination of the trust, all accumulated Economic Interest must be transferred to the beneficiaries or to an entity representing the interest of the participants or class of beneficiaries.

<p><b><i>Qualification for recognition of Family Trusts</i></b></p>	<p>The trust deed must define the beneficiaries and the proportion of their entitlement to receive distributions; a written record of the names of the beneficiaries or the use of a defined class of natural persons satisfies the requirement of defining beneficiaries; a</p>
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	<p>use of a formula for calculating entitlement satisfies the need for defining proportion of benefit.</p> <p>Only the trustees must have discretion on the above-mentioned; and</p> <p>On winding-up or termination of the trust, all accumulated Economic Interest must be transferred to the beneficiaries or to an entity representing the interest of the participants or class of beneficiaries</p>
<p><b><i>Documents governing the scheme</i></b></p>	<p>The measured entity must be in possession of a certificate issued by a competent person to the effect: that the Trust was created for a legitimate commercial reason which must be fully disclosed; and that the terms of the Trust do not directly or indirectly seek to circumvent the provisions of the Codes and the Act.</p>

However, there is a need at all times to make a distinction between a Trust for purposes of estate planning and/or avoiding payment of estate duty, and a trust that is established for purposes of B-BBEE in that the latter must adhere with the requirements of Annexe 100.

These trusts should not be used as an investment facilitation instruction for the benefit of the beneficiaries or have an element of passiveness when it comes to the treatment of beneficiaries, as opposed to active participation required from black participants under Code Series 100, irrespective of whether the shares are directly or indirectly held.

## **Minors or Children as beneficiaries or participants**

Further, we note that black children satisfy the definition of black people as per the B-BBEE Act, however, this does not mean that true empowerment will be achieved in instances where children are sighted as beneficiaries. Such participants are regarded as mere financial beneficiaries and not indirect shareholders through the trust, because they are not able to exercise voting rights in a manner that is consistent with real ownership, and only enjoy a financial benefit.

B-BBEE ownership is focused on changing ownership patterns of the means to the economy, through knowledge creation and economic interest, and there is no way B-BBEE can be accelerated through recognition of black children, as they have no capacity to act legally, and therefore cannot delegate or appoint proxies, thus fall short of meeting exercisable voting rights as one of the key requirements for ownership. Thus, including under-age children as beneficiaries will be regarded as circumvention of the B-BBEE Act as they have no capacity to exercise rights flowing from such ownership.

## **Conclusion**

Where measured entities create Trusts that have the effect of circumventing the B-BBEE Act, for instance by putting in place evergreen structures where shares never vests, ceding voting rights of participants to the measured entity or its appointed representatives, limiting involvement or active participation of beneficiaries in the measured entity through the Trustees or relevant fiduciaries, would amount to fronting practice and misrepresentation of the B-BBEE status where such Trusts have been recognised for B-BBEE points or presented as real black ownership.

Further, there is a clear distinction between Trusts established for aspects such as community projects or skills development or employee wellness benefits, no matter how beneficial they may be, such Trusts cannot be recognised for ownership purposes as they do not result in ownership and true empowerment for black people. Such Trusts can be recognised under the relevant elements of the Codes of Good Practice, and claiming them under ownership undermines the objectives of the B-

BBEE Act and thus amount to fronting practice and/or misrepresentation of the B-BBEE status.

If implemented correctly, Trusts have a potential of advancing transformation of the economy as they increase the number of black people owning, managing and controlling the productive assets and entities in the country. This will assist in broadening ownership as intended in the B-BBEE Act.

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