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Broad-based trusts – is the BBBEE commission moving the goal posts or simply applying the law?

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Recent statements by the Commissioner of the Broad-Based Black Economic Empowerment ("**BBBEE**") Commission, Ms Zodwa Ntuli, have resulted in much media attention and commentary on the use of broad-based trusts in BBBEE ownership structures. The Commissioner stated that the "vast majority" of transactions involving such trusts were not compliant with the law and did not constitute genuine and effective black ownership. She also stated that the beneficiaries of a broad-based trust must be clearly identifiable and able to exercise voting rights, must receive the same economic benefits as other shareholders and ultimately become the unencumbered owners of the shares in which they are invested.

The Codes of Good Practice ("**Codes**") issued in terms of the BBBEE Act sets out the basis on which the BBBEE ownership of a firm is measured. The Codes clearly permit the use of broad-based trusts and this is in fact incentivised as companies may score an additional 3 BBBEE ownership points if a broad-based trust (or an employee share ownership programme ("**ESOP**") has a 3% shareholding. The Codes however set out specific requirements, which must all be complied with if the broad-based trust will contribute BBBEE ownership points to a company. Failure to comply with all these requirements means the trust cannot contribute BBBEE ownership points.

The first Codes were issued in February 2007. The 2007 requirements for ESOPs differed from those for broad-based trusts, in that ESOPs were required to define the participating employees (either by name or the use of a defined class of natural person) and the proportion of their claim to receive distributions (either by way of fixed percentages or by using a formula). Most importantly, the trustees of an ESOP were not allowed to have any discretion regarding the definition of the participants and their claims to receive distributions. These requirements for ESOPs did not apply to broad-based trusts and as a result it became common for broad-based trusts to be structured as discretionary trusts, where the trustees would in their discretion select beneficiaries and decide on the amounts to be paid to the beneficiaries (usually on an annual basis). Many broad-based trusts were structured to qualify as public benefit organisations ("**PBOs**") in terms of section 30 of Income Tax Act (which allowed tax exemptions and other tax benefits for the trust) and to provide funding for various welfare, community, humanitarian, healthcare, educational, and development activities for the benefit of black people. According to a report issued by Intellidex in June 2017, R51,6 billion in value has been created specifically for charitable recipients through BBBEE transactions since 2002. A broad-based trust may benefit a broader base of black beneficiaries and this is arguably more in line with the objectives of the BBBEE Act than BBBEE transactions involving only a few black individuals.

However, with effect from 1 May 2015, the Codes were amended to require broad-based trusts to comply with the above requirements for ESOPs. The amendments to the 2007 Codes were issued on 11 October 2013 so over 18 months prior notice of the changes was given before they took effect. The effect of the changes was significant. Trustees of broad-based trusts could no longer select beneficiaries or decide the amount to be paid to each beneficiary. This may at least in part explain the Commission's argument that beneficiaries of broad-based trusts should be treated in the same way as ordinary shareholders as the 2015 changes require beneficiaries to have vested rights to receive distributions. Compliance with the requirements for PBOs in terms of the Income Tax Act also became more difficult, if not impossible, as a result of the 2015 changes. A company

could no longer score BBBEE ownership points based on the trust's shareholding unless the trust was amended to comply with the 2015 requirements.

The Commissioner's somewhat sweeping statement that the "vast majority" of broad-based trusts are "not compliant" may well be based on their non-compliance with the 2015 changes to the Codes. It would be helpful if the Commissioner would give more details to support her statement. In practice many pre-existing broad-based trusts were not updated and some broad-based trusts formed after 1 May 2015 do not comply with the 2015 changes. Several commentators have accused the BBBEE Commission of "moving the goal posts" or a "dramatic policy shift". Such criticism is unfair insofar as it relates to the non-compliance by broad-based trusts with the 2015 changes. These requirements have been in force for four years now and companies with non-compliant trusts in their ownership structures have had ample opportunity to rectify the position. The Commission is duty-bound to monitor and ensure compliance with the Codes as amended from time to time.

The Commissioner however also advised that for a broad-based trust to contribute BBBEE ownership points, the beneficiaries must exercise voting rights, receive the same economic benefits as other shareholders and ultimately become unencumbered owners of the shares in which they are invested. These statements are more contentious for the following reasons:

- The Codes clearly permit the use of trusts in BBBEE ownership structures. The legal nature of a trust under South African law is that the assets of the trust are owned by the trustees (in a fiduciary and not personal capacity) and not the beneficiaries. The trustees (and not the beneficiaries) are accordingly entitled to exercise voting rights attaching to shares owned by the trust (although the trust deed can require trustees to consult with and obtain directions from beneficiaries). Dividends and other distributions received from shares held by the trust accrue firstly to the trustees (in their fiduciary capacities) and not the beneficiaries although the beneficiaries must (in order to comply with the 2015 changes to the Codes) have vested rights to receive distributions from the trust;
- the Codes do not require beneficiaries of broad-based trusts to exercise the voting rights of shares owned by the trusts. In this regard, it is instructive that the Codes require that the participating employees in an ESOP must "manage the scheme at a level similar to the management role of shareholders in a company" and that participating employees must appoint at least 50% of the trustees. Significantly, these requirements do not apply to broad-based trusts, which are required to have an independent chairperson, 50% independent trustees, 50% black trustees and 25% black female trustees. This should be interpreted as a deliberate policy decision on the part of the Minister of Trade and Industry when he amended the Codes in 2015.

The Commissioner's statements are accordingly questionable. It is the trust (represented by the trustees in their fiduciary capacities), which is the shareholder in the relevant company not the beneficiaries. Furthermore, the Codes do not require that the beneficiaries of a broad-based trust must become the "unencumbered owners of the shares" owned by the trust. The Codes simply require that on winding-up or termination of the trust, all "accumulated Economic Interest" must be transferred to the beneficiaries or an entity with similar objectives. There is no requirement in the Codes that "unencumbered" shares must be acquired by beneficiaries of a broad-based trust; or that any debt incurred by the trust in acquiring shares must be repaid (although the Codes provide that a company may score additional "net value" BBBEE ownership points if the trust's acquisition debt for its shares is repaid over 10 years and the company's BBBEE rating will be downgraded by one level if a minimum "net value" score is not achieved).

The Commission (like business and advisors) are bound by the existing wording of the Codes. The Commission is not empowered to unilaterally amend or add new requirements for broad-based trusts and its interpretation of the Codes is not automatically legally binding. Only the Minister of Trade and Industry is empowered under the BBBEE Act to amend the Codes.

It is important that the unfortunate uncertainty caused by the recent debate about broad-based trusts is resolved as quickly as possible. BBBEE is a very important and complex issue for both foreign and local investors and, if it is to attract and promote investment in our economy, it is incumbent on the Government to ensure that the legal framework set out in the Codes is clear, unambiguous and commercially reasonable. Policy makers must also take into account that broad-based trusts have made a significant contribution to BBBEE and remain an important vehicle for promoting truly broad-based BBBEE in future.



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