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What you should know about B-BBEE ownership structures



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Various media reports surfaced recently quoting certain government officials and persons linked to the office of the Broad-Based Black Economic Empowerment (B-BBEE) Commission stating the practice by big corporates to use trusts in general and community trusts in particular “as a sophisticated new way of fronting in BEE deals”.

The existing B-BBEE Codes in terms of paragraph 3.1 of Code Series 001 make provision for a variety of entities as an indirect form of B-BBEE ownership. Some of those listed under paragraph 3.1 relate to trusts, *Broad-Based Ownership Schemes* (B-BOS) and Employee Share Ownership Programmes (ESOPs)

For each of these structures (trusts, B-BOS and ESOPs) the B-BBEE Codes provide for rules and criteria. (For more information, please *contact us* directly). Let's look at some of these structures in more detail.

B-BOS and ESOP structures

A B-BOS or ESOP structure can operate as an association of members, a non-profit company, a private company or a trust. The most popular way of housing a B-BOS or ESOP programme is by means of a trust because of the flexibility offered by the legal trust form. As the B-BBEE Codes provide for separate rules for trusts, a conventional B-BBEE trust subject to the rules of the B-BBEE Codes would qualify as an ownership entity even if it does not house a B-BOS or ESOP structure. Therefore, a trust, B-BOS or ESOP should not be confused as each on its own or as a combination would qualify as a B-BBEE ownership structure in terms of the B-BBEE Codes.

The reference to community trusts to promote fronting is confusing as it is uncertain what the position would be with non-profit companies or associations operating as community ownership structures. The general reference to trusts and "painting with a too broad trust brush" is therefore misleading as some trusts would operate as conventional trusts and others as B-BOS or ESOP structures, while some B-BOS or ESOP structures would not operate as a trust at all but as associations or non-profit companies.

Shareholding and fronting practices

There are also no statistics to indicate that *fronting practices* are less prevalent in other forms of B-BBEE ownership such as direct shareholding. Our experience shows that direct shareholding involves far more fronting activities than any other form of B-BBEE ownership. Trusts, B-BOS and ESOP structures are the primary broad-based empowerment vehicles to empower the youth, disabled employees, communities and the poor whom the B-BBEE policy and legislation aim to benefit.

Without these structures we would have to change legislation to narrow-based empowerment, thus confining benefits and wealth accumulation to the political elite, politically connected and "usual suspects".

It cannot be disputed that some institutions abuse the flexible legal form of a trust to circumvent the Act. These instances would in general be broad-based programmes where no black beneficiaries are identifiable in terms of the definition to benefit “poor black people” or “poor black people in rural areas” or “black youth education”. These are often referred to as "faceless” beneficiaries.

Often people with the necessary qualifications and skills who can be direct shareholders and are capable of managing their own equity are placed in a trust as a beneficiary. Our trust law describes a trust as a vehicle to benefit and protect the interest of the “poor and vulnerable”. Trustees are also often appointed without the necessary consideration of whom the beneficiaries are, their capabilities and the objective of the trust.

Operation of a Trust

Our law, and specifically the B-BBEE Codes, would always consider how the trust operates and not necessarily the legal form. This is embedded in the well-known principle of “substance takes precedence over legal form” (paragraph 2.1 of Code Series 000 of the B-BBEE Codes).

Despite the incorrect and incomplete reporting on trusts, the B-BBEE Codes make provision for trusts, B-BOS and ESOP structures as legitimate *B-BBEE ownership structures* on condition that they comply with the rules provided for in the B-BBEE Codes. Until such time as the rules are amended, these structures would legally qualify. The possible amendment of rules in future, if at all, would not affect existing structures and any new rules in future would only apply to structures established under the new rules. Our law and constitution are fairly clear on the retrospective nature of new legislation.

Conclusion

To conclude, fronting is not found in the legal form of a transaction or B-BBEE initiative but in the way it operates. A trust as legal form is not the culprit but rather those who abuse the operation of a trust. For the present and foreseeable future, trusts as a legal form would qualify as legitimate B-BBEE ownership structures in terms of the rules of the B-BBEE Codes, which serve as the primary vehicle to promote the broad-based objectives of the B-BBEE Act of 2003.

The Minister of Trade and Industry, Rob Davies, announced in May 2015 that it was not necessary to develop anti-fronting measures specifically for B-BOS and ESOP structures as the existing rules regulating fronting were sufficient to deal with such practices. This summarises the argument that a single structure cannot be singled out as the main fronting culprit as the rules apply generically to all B-BBEE initiatives.

As the industry leader, *SERR Synergy* would gladly assist business owners with matters relating to B-BBEE ownership structures.

About the Author: Gideon Gerber is one of the founding directors of SERR Synergy and an admitted High Court attorney with more than 30 years' experience in Business Structuring & Compliance, Training, Skills Development and Business Compliance in South Africa, the UK and Namibia. He obtained his Master's Degree in Law from the University of Pretoria with a research thesis on *BEE Fronting*. Gideon is a regular speaker at various B-BBEE seminars and writes articles for the Business Day and Landbouweekblad that concerns BEE Matters.

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