§ Law in Context

GRAHAM MOFFAT

Trusts Law

Text and Materials

fourth edition

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Trusts Law

With its unique contextual emphasis and authoritative commentary, *Trusts Law: Text and Materials* is a book that no serious undergraduate on trust courses can afford to be without.

The book is divided into four main parts: trusts and the preservation of family wealth; trusts and family breakdown; trusts and commerce; and trusts and non-profit activity. Within each of these parts, leading cases, statutes, and historical and research materials are placed alongside the narrative of the author's text to give emphasis both to general theories of trust concepts and to the practical operation of trusts. Attention is also given to important themes such as the developing relationship between trusts law and other areas of private law, particularly the law of restitution, and the trend towards greater integration between Equity and the common law.

This new edition takes account of all relevant judicial and legislative developments since the third edition and incorporates discussion of current law reform proposals such as those relating to the law of charity. It also expands discussion of key themes in current developments of the law especially those relating to (i) the tensions between Trusts Law and the Law of Restitution and (ii) the consequences of the still extant division between common law and Equity.

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Trusts Law
Text and Materials

Fourth edition

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Preface to the fourth edition

This book seeks to present the law of trusts in a different way from conventional texts. The underlying premise is that an investigation of the social and legal contexts in which trusts commonly appear, and of the functions which trusts perform within these contexts, is an essential prerequisite to a proper understanding of trusts law. Developments that have occurred in the relevant social and legal contexts since the first edition of this book have confirmed our conviction in the value of this approach. The bulk of the book is therefore again divided into four parts: trusts and the preservation of family wealth (Chapters 3–11); trusts and family breakdown (Chapter 12); trusts and commerce (Chapters 13–16); and trusts and non-profit activity (Chapters 17–20). The gathering pace of legal change has, however, impelled us to make extensive revisions and additions to the text. Prominent amongst the many statutory changes are the Trustee Act 2000 and the Pensions Act 2004 whilst key aspects of the Charities Bill 2004 have also been incorporated where possible. Important cases such as *BCCI v Akindele*, *Foskett v McKeown*, *Schmidt v Rosewood* and *Twinsectra v Yardley*, together with an outpouring of academic literature, have all in their different ways contributed to a continuing debate about trusts law, particularly in its relationship to other areas of the common law. The effect of these influences is evident in all four parts of the book.

Our approach requires that, within each part of the book, relevant rules of trust law are investigated usually only after the reasons why trusts are commonly created within the particular social and legal context – whether expressly by individuals or groups seeking to achieve particular purposes, or by court order – have first been studied. In the working out of this approach, express trusts and non-express trusts receive distinctly different treatment. Express trusts are depicted primarily as property-holding devices or 'institutions' which have been created, modified and refined by generations of practising lawyers in response to the particular purposes sought to be achieved by their clients. The law governing such trusts is presented as the judicial and, to a lesser degree, the legislative response to the aspirations of trusts lawyers and their clients (particularly as regards the rules determining whether novel forms of trust should be treated as valid) and to the numerous legal problems arising in the course of enforcement of valid trusts. The book shows how, in the main, this response has been supportive; otherwise English law would not include the highly sophisticated body of principles which we call trusts law. But circumstances in which judges or legislators have placed a check on the fulfilment of trust founders' objectives are also noted, along with the reasons why this should have occurred. In relation to non-express trusts, the focus of the book is chiefly on the relatively familiar theme that these contribute a quasi-remedial device for judicial innovation on grounds of 'equity'. But recourse to relevant contextual material paves the way for a discussion of how far 'equity' has in fact been achieved in specific social situations, and whether other express or implicit objectives – for example, legitimation of practices which might otherwise call for redress – are being pursued. The contexts in which these issues are most fully investigated are those of (1) family breakdown, where resulting and constructive trusts and proprietary estoppel have been prominent in a judicial search for some degree of 'equity' for non-earning (usually female) de facto spouses; and (2) commerce, where a battery of remedies, including a constructive trust, may be invoked in response to 'inequitable' behaviour by those in trust-like positions.

Although this way of classifying and analysing trusts law might seem to fragment the subject unduly, there is continued emphasis in the book on the unifying influence of the trust concept itself. The first chapter – 'Trusts introduced' – illustrates how the 'trust idea' in English law remains generally constant, despite having immense 'elasticity' (to quote Maitland), such as to render it useful in numerous social situations over several hundred years. This general proposition is reiterated later in the book. Nevertheless, there is a tension between fragmentation of the subject-matter of study and the notion of the 'trust idea' as a unifying feature. We suggest, however, that this reflects a source of tension within the subject itself, namely the competing influences on legal development of the claims of pure conceptual clarity as against pressures for pragmatic resolution of practical problems. An adequate understanding of trusts law requires that both these influences be taken into account by the student. Account also needs to be taken of one recent source of tension in the development of trusts law. A particular feature of our system of private law is the co-existence of overlapping jurisdictions. Circumstances can arise where the jurisdictions of the Law of Restitution, the Law of Trusts and even the Law of Tort can seem to overlap. It is at these points that tension can occur. We suggest that it is important to appreciate that efforts to minimise or remove any resulting dissonance may be a formative influence in current developments particularly in the area of remedies for breach of trust or other 'inequitable' conduct.

In form the book is not an orthodox text, nor a set of cases and materials of a familiar type, but something in between. Textual commentary increasingly predominates, but extracts – sometimes quite long – from leading cases, statutes and relevant historical and empirical materials are also included. We assume that teachers using the book for a full year undergraduate LL B course may want to indicate further cases and articles to be read. Many that are appropriate for this are mentioned in the text.

Many people have contributed to the production of this book. As regards the division of labour in this edition, John Dewar wrote Chapter 12 while Gerry Bean contributed Chapters 15 and 16. Graham Moffat bears responsibility for the remainder of the book. The intellectual debt owed to Michael Chesterman, the co-author of the first edition, is considerable, particularly in the areas of trust history and charity law, and is gratefully acknowledged. We are grateful to the new publishers of the Law in Context series for tolerating the extension of an already lengthy text, and for efficiently producing the index and tables of cases and statutes. The authors would also like to acknowledge the assistance of many trusts students, in responding over the years to ideas about trusts law put to them in the classroom and writing learned essays on trusts. Last and most important, as any writer knows, the gratitude owed to family tolerance cannot be overstated.

We have sought to take account of the law as at 1 March 2005.

Graham Moffat
Gerard Bean
John Dewar

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Abbreviations

Chesterman:	Chesterman *Charities, Trusts and Social Welfare* (1979)
Gardner:	Gardner *An Introduction to the Law of Trusts* (2nd edn, 2003)
Goff and Jones:	Goff and Jones *The Law of Restitution* (6th edn, 2002)
Hanbury and Martin:	Martin *Hanbury and Martin Modern Equity* (16th edn, 2001)
Hayton and Marshall:	Hayton and Marshall *Commentary and Cases on the Law of Trusts and Equitable Remedies* (11th edn, 2001)
Parker and Mellows:	Oakley *Parker and Mellows: The Modern Law of Trusts* (8th edn, 2003)
Pettit:	Pettit *Equity and the Law of Trusts* (9th edn, 2001)
Snell:	McGhee (ed) *Snell's Equity* (31st edn, 2004)
Underhill and Hayton:	*Underhill and Hayton: Law Relating to Trustees* (16th edn, 2003)

Useful websites

None of us can ignore the vast range of internet sources now available and most students will have access to online resources such as Westlaw and/or Lexis. Other general websites that the reader may find useful are: *www.bailii.org*; *www.austlii.org*; *www.wordlii.org*; *www.lawcom.gov.uk*; and perhaps most useful of all is the invaluable 'hub' or 'gateway' maintained by the law librarian at Kent University: *http://library.kent.ac.uk/library/lawlinks*. Two specific websites relevant to Trusts Law are those of the Trust Law Committee (www.kcl.ac.uk/depsta/law/tlc) and the Charity Commission (www.charity-commission.gov.uk).

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Trusts introduced

1. Introduction

A 'trust' in English law is in some measure the translation into legal terms of the word 'trust' as used in ordinary speech. Its conceptual starting-point is 'a confidence reposed in some other' (this phrase is from the sixteenth-century legal commentaries of Lord Chief Justice Coke). The 'confidence' so reposed gives rise to moral obligations to which the courts, aided by the legislature, have purported to develop legal parallels. Inevitably, the moral weight given to trust and trusteeship in ordinary usage – to be 'in breach' of a 'sacred trust' is a serious matter, with repercussions possibly in the next world as well as this one – has had a significant impact on both the scope and the content of trusts law principles. There are still some contexts in which it may be difficult to say whether the word 'trust' is used in a legal or purely moral sense.

Yet this is by no means the whole story of trusts law. In the early twentieth century the historian and jurist F W Maitland praised the trust (see *Equity* (2nd edn, 1936) p 23 and *Selected Historical Essays* (1936) p 129); he regarded 'the development from century to century of the trust idea' as 'the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence'. But this was not because the trust embodied basic ethical principles but rather because of its versatility. It was, he said, '"an institute" of great elasticity and generality; as elastic, as general as contract'. The trust had in fact become a 'lawyers' device', used chiefly within the domain of private property transactions and institutions, and capable of serving a wide variety of purposes. In 1934, one finds a left-wing American commentator suggesting that, whatever the merits underlying the moral principle that a trust should not be breached, the versatility of this lawyers' device was exploited in at least one context – the preservation of private family wealth – in a manner which had little to do with ethics (M Franklin (1933–34) 19 Tul LR 473 at 475):

> The trust is an effort to escape from the ever-deepening and ever-recurrent crises in capitalism. It is the confession of the upper middle class – the class that has most used the trust – that the contradictions in capitalism cannot be resolved. The risks of capitalism, therefore, must be minimised as much as possible through the employ of an astute, intelligent, ever-watchful class of professional managers of capital who are

> placed, because they are *élite*, beyond the control of the owner for consumption. But American lawyers do not have to be reminded that capitalism is so sick that even this device to protect the only class that benefits from capitalism has failed pathetically.

These generalisations betray their origin in post-Depression America (eg in the reference to capitalism's 'sickness'), but they illustrate well enough that, whatever its underlying moral base, the trust is by no means insulated from its social and political environment or from political controversy. The majority of those who consciously use the trust in a family context have been the minority of individuals and families who own capital to any significant extent. Moreover, the phrase 'professional managers of capital . . . beyond the control of the owner for consumption' suggests a significantly different role for trustees than is implicit in the phrase 'a confidence reposed in some other' or in other lawyers' descriptions of a trust (one of which is cited in the next section).

We refer in the previous sentence to 'description' of a trust because defining the trust, as opposed merely to describing it, has proved difficult. A sometimes overlooked facet of Maitland's assessment of the trust, that of development, highlights the difficulty. It was the process of trust development – more in response to pragmatism than principle – that so attracted him. This dynamic nature of the trust device necessarily makes attempts at definition, if by definition we mean stating the essence of a thing, a fraught exercise.

Ironically, however, at the very time Maitland was writing it appeared that the development process had reached a terminus. Although our understanding is inexact – the modern history of the trust has still to be fully documented – it does seem that the combined influence of the courts and treatise writers had, during the eighteenth and nineteenth centuries, completed the task of refining the family of concepts that constitute the trust. Accordingly what Maitland was holding up for inspection looked like a largely finished article with well-established features, though these features reflected the different functions that the trust had performed. However, the pace of fiscal, commercial and social change has quickened noticeably in the last half-century and, for reasons that will become apparent, 'development of the trust idea' is now firmly back on the agenda as attempts are again made to adapt the trust form to novel purposes.

Consequently, how far the principal subject of our study, the trust concept, can be said still to be in a process of development is a recurring theme in this book. At this stage, just one aspect of this need be introduced. We have just referred to 'the trust concept' but this singular notion may itself be misleading. If, with Maitland, we want to understand the process of development we need to consider whether in fact the 'trust concept' is but a collective term for describing a family tree of different trust ideas at various stages of development. Some branches will have grown to full maturity whereas others as yet have scarcely sprouted, and a process of incremental development, usually gentle but at times more dramatic, is still occurring. We should therefore be careful when meeting different types of trust not to assume that what is a central characteristic of one type of trust is a necessary element in all other types. Indeed we need to consider whether it is preferable to talk not of the law of trusts in the singular but of laws of trusts in the plural.

2. The nature of a trust in English law

One of the major traditional practitioners' texts on trusts law, *Lewin on Trusts*, gives the following description of a trust (17th edn, 2000) p 3:

> The word 'trust' refers to the duty or aggregate accumulation of obligations that rest upon a person described as trustee. The responsibilities are in relation to property held by him, or under his control. That property he will be compelled by a court in its equitable jurisdiction to administer in the manner lawfully prescribed by the trust instrument, or where there be no specific provision written or oral, or to the extent that such provision is invalid or lacking, in accordance with equitable principles. As a consequence the administration will be in such a manner that the consequential benefits and advantages accrue, not to the trustee, but to the persons called cestuis que trust, or beneficiaries, if there be any; if not, for some purpose which the law will recognise and enforce. A trustee may be a beneficiary, in which case advantages will accrue in his favour to the extent of his beneficial interest.

This is probably the most comprehensive of the 'definitions' of a trust to be found in standard legal works, derived incidentally from the judgment in an Australian case *Re Scott* [1948] SASR 193 at 196, but some additional comments must be made by way of elaboration.

(1) In most cases, a trust arises out of the conscious act or declaration of an individual or group of individuals. To this individual or group no single name is consistently applied: one finds 'founder', 'settlor', 'creator' and 'donor' (or their plurals, as the case may be). Where the trust is by will, 'testator' or 'testatrix' – being the words for describing the maker of a will, whether or not it contains a trust – acts as a substitute. A founder of a trust may be a trustee and/or a beneficiary under it (subject to point (3) below). Where a trust arises out of the conscious act or declaration of a 'founder' (as will be seen later, he or she need not actually use the word 'trust'), it is called an 'express trust'.

(2) Where there is no conscious act or declaration which creates the trust, it will owe its existence to legal rules (statutory and judge-made) which in certain defined situations impose trusts on individuals (so that they thereby become 'trustees') in respect of property owned by them or under their control. In such cases there is no founder of the trust, and the trust can be said to be an 'imputed' trust. 'Imputed' is not a recognised legal term in this context, but we will use it as a synonym for 'non-express'. As will be explained later, there are more specific (though somewhat confusing) sub-classifications: 'statutory', 'implied', 'resulting' and 'constructive' trusts.

(3) A trust can have any number of beneficiaries or founders. The same applies to trustees, subject to practical considerations and to legal rules which insist in some cases that the number of trustees must not exceed four (Trustee Act 1925, s 34(1)). The same

person (private individual or corporate body) may appear in any two or three of these roles, except that the law abhors the nonsense that a person should be sole trustee of property for himself or herself.

(4) The trust property may be any type of estate or interest recognised in property law, ranging from ownership of a car or a piece of land to 'intangible' property, such as a copyright.

(5) Although the Lewin definition refers to the property being 'held' by the trustee, 'or under his control', for practical purposes a trustee generally has legal title to the trust property. Where the trust property is an equitable proprietary interest – it may indeed be an interest under another trust – the trustee's title is equitable only.

(6) The 'consequential benefits and advantages' which accrue to beneficiaries may take the form of benefits in kind (eg occupation of land held on trust) or cash (eg income from shares). There is no rule that the entitlements of individual beneficiaries should be fixed in advance or that they should all receive benefit simultaneously; indeed, the allocation of benefits may be left to the trustee(s) (under a so-called 'discretionary trust') or to some third party, who may even have the power to exclude entirely beneficiaries listed or described in the trust deed. Furthermore it may be stipulated that interests arise only if a specified contingency is satisfied, and a trustee may have the duty or power to withhold all allocation of benefit within a specified period, ie to 'accumulate' income.

(7) In referring cryptically to 'some purpose which the law will recognise and enforce' the Lewin definition is speaking mainly of charitable trusts. Generally, a trust must have one or more persons as beneficiaries or potential beneficiaries, but if its terms require the trustee to administer the trust property for one or more purposes which fall within an artificial legal definition of 'charitable purposes', the trust may be valid even though it is expressed in terms of purposes rather than beneficiaries. There are some other narrowly defined situations where the failure to define beneficiaries is not fatal to a trust.

Most aspects of this general description of a trust will, of course, be further dealt with in the course of this book.

3. The trust's versatility

What aspects of the trust form give it the versatility so admired by Maitland, so that it has come to be employed for a wide variety of purposes over a long period of time? Very briefly, the secret of the trust's success is to be found in three things. First, in establishing a trust, a founder (or a court, in the case of 'imputed' trusts) can play a whole range of 'tricks' with three particular aspects of property ownership: nominal title, benefit and control. The founder (or the court) can juggle these around in a variety of ways. Second, the rights and obligations expressly created in a trust are fortified by effective equitable remedies and supplemented, so far as is necessary, by a substratum of detailed legal rules (as, indeed, is indicated in the Lewin definition). Third, in the areas where it is predominantly used, the trust performs its 'tricks' with property better, and has stronger legal reinforcement, than other competing legal institutions. We shall consider these factors under separate headings, giving some examples of trust dispositions under the first heading in order to illustrate what has been said so far and to show some of the common types of motive that underlie the present-day use of trusts.

4. Manipulating facets of ownership through trusts

(a) The trust's 'tricks'

The following are the most important of the trust's 'tricks' in this regard:

Trick no 1 Nominal ownership of property can be separated from benefit and the right of control.

Trick no 2 Benefits may be split amongst two or more beneficiaries, who may be entitled to shares, or successively, or contingently, according to the wishes of the founder of the trust (as set out in the trust) or any person(s) designated by him or her (which may include the trustees). In particular, where the trust property brings in income – such as rent or royalties or dividends – entitlement to income may be allocated separately from entitlement to capital (ie to the trust property itself). To have a 'contingent entitlement' means simply that the beneficiary must satisfy some requirement such as reaching a specified age before his or her interest will accrue to or 'vest' in him or her.

Trick no 3 Allocation of benefit may be put in suspense according to the wishes of the founder, or any person(s) designated by him (which may include the trustees).

Trick no 4 Some or all aspects of control and management of the trust property may be divorced from entitlement to benefit and reserved to the founder of the trust or conferred by him or her on the trustees or any other person.

Trick no 5 When trust property is 'converted' (eg land is sold, or money subject to the trust is invested in land or shares), the new property which is so acquired by the trustees is held by them subject to the trust.

Trick no 6 Where, for legal or practical reasons, the group of persons intended to benefit, directly or indirectly, from a disposition of property is too large to enable them to be constituted as co-owners holding legal title, the title can instead be transferred to an appropriately smaller number of trustees to be held on trust for the benefit of the intended beneficiaries, who still retain control.

The following examples illustrate how these 'tricks' can operate in practice (the principal relevant 'tricks' are referred to in parenthesis).

Example 1 (trick 1) Wisegirl completes a transfer of 10,000 £1 shares in Run Down plc in favour of Bear, Bull & Stag, her firm of brokers, instructing them to hold the shares as trustees (or 'nominees', as they are sometimes called in this context) for her son Whizz-kid. The shares will be registered in the company's share-register in the name of the brokers, but Whizz-kid is entitled to receive the dividends and any other benefits, and to instruct the brokers on all aspects of management, such as exercising the voting power attached to the shares and selling or otherwise dealing with the shares. He is 'the owner in all but name'.

Comment The chief advantage of this arrangement as against a simple transfer of the shares from Wisegirl to Whizz-kid is that the latter may hope to conceal his 'beneficial ownership' of the shares from the company. He may want to do this if (for instance) he is a financial entrepreneur who is thinking of attempting a take-over. Note, however, that s 212 of the Companies Act 1985 gives UK companies the right to ask any registered nominee shareholder to disclose the beneficial owner of shares. It has been estimated that for most UK registered public companies at least 80 per cent of their share register will comprise nominee names. (See generally Fulcrum Research *The Index of Nominees and their Beneficial Owners* (10th edn, 2002).) It is thought that the rights under this section are now used mainly by managements of companies which regard themselves as potential targets for a take-over bid (see Davies *Gower and Davies' Principles of Modern Company Law* (7th edn, 2003) pp 600–602).

Example 2 (trick 1) The solicitors' firm of Addmore & Charge receives £50,000 from Credulous, a client, in order to pay for Credulous's purchase of a house. By law this money must go into a client's 'trust account' at the firm's bank. In general, the solicitors are only entitled to deal with the money on Credulous's instructions (eg they will pay it to the seller of the house when they have Credulous's instructions to settle). This type of trust is often called a 'bare trust'.

Comment For practical reasons it is convenient to have the money lodged at the bank in the name of the solicitors, so that they can sign the necessary cheques, but for virtually all purposes it is still the client's money. In particular, if the solicitors go bankrupt, their creditors cannot get hold of the money to satisfy their claims: the client's claim prevails.

Example 3 (tricks 1, 2, 3 and 5) Stern provides in his will that Solemn and Sad, the executors and trustees thereof, should hold a house, 'Funfair', 32 Hootenanny Parade, Crazyville, on trust to permit his housekeeper Strict (if she should survive him) to occupy the same for the rest of her life and thereafter to sell the house and hold the proceeds thereof (with any income accruing thereto) on trust for his twin sons Serious and Sensible in equal shares when they attain the age of 25.

Comment Here benefit, in the form of actual occupation, and substantial control go first to Strict, but if on her death Serious and Sensible are not yet 25, there is a temporary suspension of benefit and a shift of control to the trustees, Solemn and Sad, in so far as they decide how to invest the proceeds of sale and whether to change the investments subsequently. In a sense, the 'dead hand' of Stern is also involved in control, because he has directed the retention and subsequent sale of the house and he may also have laid down stipulations as to the mode of investment of the proceeds, and other aspects of control. When the sons Serious and Sensible attain 25, they are entitled to require the benefit, which comprises both the trust investments and the income accumulated thereon since the proceeds of sale were first invested, to be transferred to them in equal shares. Ever since their acquisition, these investments have been held subject to the trust just as the land has, but the transfer to Serious and Sensible brings the trust to an end.

Overall, Stern has here provided for his dependants in a manner which he deems appropriate: his housekeeper has been assured of a place to live and his sons each receive a capital sum at an age when they are mature enough to make proper use of it and may well have an immediate need for it (eg in order to buy their own house). In the meantime, the trust investments have been competently managed.

Example 4 (tricks 1–5) In 1964, land and investments worth £1,000,000 are put into a 'Trust Fund' under a trust deed executed by Lucre, aged 56. He lists the following as the 'specified class': his mother (aged 80), his wife (aged 48), his three children (aged 25, 23 and 20) and his grandchildren, both existing (there is already one, aged 3 months) and to be born in the future. The trustees are his trusted and prudent friend Solomon and his solicitor Sheba. The key clause of the trust deed is as follows:

> The trustees shall stand possessed of the Trust Fund and the income thereof UPON TRUST for all or such one or more exclusively of the others or other of the members of the Specified Class if more than one in such shares and either absolutely or at such age or time or respective ages or times upon and with such limitations, conditions and restrictions and such trusts and powers (including discretionary trusts and powers over income and capital exercisable by any person or persons other than the Settlor or any Spouse of the Settlor whether similar to the discretionary trusts and powers herein contained or otherwise) and with such provisions (including provisions for maintenance and advancement and the accumulation of income for any period or periods authorised by law and provisions for investment and management of any nature whatsoever and provisions for the appointment of separate trustees of any appointed fund) and generally in such manner as the Trustees (being not less than two in number or being a corporate trustee) shall in their absolute discretion from time to time by any deed or deeds revocable or irrevocable appoint.

Comment The significant feature of this ‘discretionary trust’ is that it is still a trust even though no one in the specified class is entitled under the trust deed to claim a specific share of the trust capital or income or even to insist at any specific time that all or any part of the capital or income should be distributed. The question of entitlement (as well as choice of investments and other aspects of control) is left entirely to the trustees subject only to any limits specified by Lucre. In the result, Lucre has provided for three generations of his family and ensured competent management of the trust property – as Stern did in the preceding example – but there are three further advantages to be gained from Lucre’s trust:

(i) The trustees can allocate the benefit of the trust according to the *current* needs of the various beneficiaries. The comparative rigidity of Stern’s will trust in example 3 could lead to anomalies; for example, if one of his sons becomes a millionaire pop star by the age of 25 while the other is on the dole, there is no provision in the will for giving all or substantially all of the trust fund to the latter. Furthermore, so long as Lucre is still alive, he can exercise de facto influence over his trustees (who may be wholly ‘tame’) to respect his views in this regard. (NB: For a salutary warning of the perils of behaving as a ‘tame trustee’ see *Turner v Turner* [1983] 2 All ER 745 and generally Chapter 11.)

(ii) If any of Lucre’s beneficiaries go bankrupt, or are desperately trying to raise money to pay for the improvidence sometimes associated with the heirs of the wealthy, they have no ascertainable interest under the trust which their creditors can get hold of or which they themselves can sell or mortgage. To this extent, the trust remains immune from their creditors and acts as a ‘caretaker’ mechanism to protect them from their own improvidence or ill-luck.

(iii) According to the law, at the time of this trust’s fictitious establishment in 1964, the trust had notable tax advantages. In particular, estate duty would not have been payable in respect of the creation of the trust, being an inter vivos disposition, provided Lucre lived for seven more years; and on the subsequent death of Lucre’s mother or wife or indeed any of the beneficiaries, the existence of the trust would not have increased the estate duty payable on the deceased’s estate because the deceased beneficiary would have had no fixed interest in the trust fund, but merely an expectation of benefit. (By contrast, the value of Stern’s house would have been subject to estate duty twice, in his estate on his death, and in his housekeeper’s estate on her death.) Taxation of transfers of capital has changed since 1964, and the discretionary trust is no longer such an outright tax-saver (see Chapter 8), but it represents a classic case of tax avoidance through the use of trusts and its importance in this regard over many years has had a significant impact on the law of trusts.

Example 5 (trick 6) Due to complex conveyancing rules, established initially by the 1925 property legislation, land cannot be held under any form of co-tenancy by more than four persons. If seven people wish to hold land in joint tenancy or tenancy in common, it must be vested in trustees in trust for them. If the conveyance simply names the seven individuals as transferees, the first four named will be treated as trustees (holding a joint tenancy) for all seven by virtue of a statutory 'imputed' trust. The changes introduced by the Trusts of Land and Appointment of Trustees Act 1996 have considerably simplified the rules relating to 'trusts of land' but have not affected this basic formal position on co-ownership. The statute substituted one form of trust – the trust of land – for the two types – trust for sale and strict settlement – that existed under the 1925 legislation. The powers conferred on trustees by the 1996 Act are significantly wider than those under the earlier legislation. These powers will be referred to only briefly at appropriate points in the text because trusts of land and the 1996 Act are more appropriately studied and discussed in the general context of land ownership and control.

Example 6 (tricks 5 and 6) The trust is a convenient vehicle whereby funds contributed or deposited by or on behalf of a large and possibly fluctuating number of people may be put into investments (usually stock exchange securities) for their collective benefit by a small group of trustees and managers (see Chapter 13). Three examples of this collective investment function of the trust are of particular importance:

(i) The *bond or debenture trust*, whereby a single company solicits loans at fixed interest from the public, arranging for a trustee (usually a corporate body) to act as a nominal lender of the total amount subscribed, a conduit-pipe for interest and principal payments from the company to the individual investor and a watchdog for the investors' interests. It would in theory be possible for the borrower to issue bonds or debenture stock direct to the lenders/investors. This would involve the disadvantage of the borrower dealing direct with hundreds, perhaps thousands, of the lenders/investors. Arguably this would be wholly impracticable in the case of a secured debenture issue since each lender would acquire a security interest in the assets of the borrower. The interposition of a trustee as an intermediary avoids these difficulties and provides the advantages referred to previously (see eg Duffet (1992) 1 JITCP 23–30; and generally Hayton et al (2002) 17(1) JIBFL 23).

(ii) The *unit trust*, whereby under close statutory regulation a corporate 'custodian trustee' holds a fund gathered from the public in return for the issue of 'units' of the fund, and a corporate managing trustee invests this fund in whatever stock market securities seem best at any given time. Dividends and capital gains earned from the investment accrue for the benefit of current unit-holders (see Fan Sin, *The Legal Nature of the Unit Trust* (1998)).

(iii) The *private pension fund*, whereby money paid in on behalf of a company's employees by the company and, in most cases, by the employees themselves is invested by a small group of trustees (who may include one or more representatives from the employer's and the employees' respective 'sides') in order to provide pensions for the employees on their retirement.

Example 7 (Tricks 4 and 6) Where companies encounter trading difficulties and insolvency threatens it may be possible to refinance the business so as to keep it operating as a going concern. The claims of existing unsecured creditors will be of limited value to them in the event of insolvency. Those creditors may therefore be willing to subordinate their claims to the interests of potential later creditors such as banks who may then be willing to risk further injections of funds to keep the business afloat. A legal difficulty is that this runs counter to a principle of insolvency law that requires all unsecured creditors to be treated alike or 'pari passu' as it is known. Interposing a separate trustee between the company and the creditors can circumvent this problem by arranging that all of certain designated debts are owed to the trustee. The trust instrument, known as a 'subordination trust', can then specify the order in which the creditors will be able to claim in the event of the ultimate insolvency of the debtor company. The example described above is just one of many ways in which the trust can be employed as part of a commercial arrangement (see O'Hagan 'The Use of Trusts in Finance Structures' (2000) 8(2) JITCP 85; and the sources referred to under example 6(i)).

Example 8 (tricks 4 and 6) About three months after a coal-tip disaster at Aberfan on 21 October 1966, the massive fund collected by public appeals (it ultimately reached about £1,750,000) was transferred in the form of cash and investments to fourteen trustees. Under the trust deed, it was to be held and applied by them in accordance with the directions of a management committee (which initially comprised six of the trustees and nine other representatives of the local community) on the following trusts:

(i) for the relief of all persons who have suffered as a result of the said disaster and are thereby in need; and
(ii) subject as aforesaid for any charitable purpose for the benefit of persons who are inhabitants of Aberfan and its immediate neighbourhood (hereinafter called 'the area of benefit') on the Twenty First day of October One Thousand Nine Hundred and Sixty Six or who now are or hereafter become inhabitants of the area of benefit and in particular (but without prejudice to the generality of the last foregoing trust) for any charitable purpose for the benefit of children who were on the Twenty First day of October One Thousand Nine Hundred and Sixty Six or who now are or hereafter may become resident in the area of benefit.

Comment This was a charitable trust: ie the purposes elaborated in the clause just quoted fall within the 'legal definition of charity', so the devoting of benefit to purposes instead of benefit to potentially ascertainable people did not invalidate the trust. It was unusual in that the trustees – the nominal owners – and the management committee – those with the right to control – were separate groups: in charitable trusts the trustees usually perform both these functions. But the role played by the trust in centralising nominal ownership and control of the large amount of money contributed whilst benefit could be spread out amongst a whole community (with particular attention to those who had suffered most from the collapse of the coal-tip) was evident enough, and typified the use of the trust for charitable activity.

Example 9 (trick 6) The Bunker Golf Club, having over three hundred members, has its own golf course and a number of shares. These are formally vested in two trustees, Tee and Caddy, on trust to hold them for the benefit of the members of the club for the time being.

Comment A trust is used here not merely because of the rules of land law mentioned in example 5 but also because of the practical consideration that it would be grossly unwieldy to have all the members (who fluctuate from time to time) registered as legal owners of the land or the shares. Questions of control of this property are determined by the club's management body and membership in accordance with the constitution, to which all members have agreed to adhere when they joined the club (see Chapter 17).

Example 10 (tricks 1 and 5) X is the tenant under a lease of business premises on favourable terms. She asks Y, her estate agent, who negotiated the lease in the first place, to try to obtain a renewal for her. Y tells the lessors that X does not want a renewal, and manages, without telling X, to obtain a renewal for himself. X is entitled to claim that Y holds the lease as 'constructive trustee' for X, ie Y must treat X as the 'owner in all but name' and, if X so requires, must transfer the lease to her.

Comment This example falls within one of the categories of 'imputed' trusts. No one has consciously founded or created the trust, but in order to enforce the obligation binding Y, as X's agent, to act only in X's interests in negotiating the renewal, the law 'imputes' the trust in order to establish that Y's ownership of the renewed lease is nominal only, and the benefit and right of control belong wholly to X.

(b) Summary

This selected list of the trust's 'tricks' and the examples, fictitious and real, which illustrate them, give a general idea of the trust's versatility and of some of the common types of purpose which a trust's founder may have in establishing a trust. These purposes include concealing ownership, facilitating land conveyancing and other types of dealing in property, holding and controlling property for the sake of large groups of people (particularly in the fields of collective investment and charitable and other non-profit-orientated activity), providing for the founder's family in various ways over long periods of time (both before and after his or her death), protecting property from creditors and from the extravagance of individual members of the family, and cutting down tax liabilities, particularly on the transfer of private capital. In the case of 'imputed' trusts, the underlying purpose is to implement a judicial or legislative intent that, despite the absence of any express declaration of trust, a nominal owner of property should be treated in certain situations as holding the property for the benefit of someone else.

It will be observed that in some cases (eg examples 1 and 5), the trust is very short and simple; in others (especially 4, 6 and 7), a long and complex document, setting out detailed powers and duties, is required. Sometimes, the trust is ‘embedded in’, or very closely linked with, another legal concept or institution, such as a contract (9 – the Golf Club’s rules take effect contractually), one or more ‘powers’ (4) or a will (3). At times, the trust seems to be no more than a mechanical common-form device, fitting in a gap left by technical rules of property law (5); in other cases (eg 4) it will be consciously and deliberately tailor-made to suit an individual founder’s specific purposes. In other words, some founders of trusts have trusts thrust upon them, possibly without their realising it, others twist trusts to their own ends and yet others are somewhere in between.

The boundaries of the trust’s areas of use are also somewhat random. Why, for instance, should it be prominent in collective investment and non-profit-making activity, but not in ordinary commercial enterprise? If one wants to put property in the name of another but enjoy the benefits secretly, would not a contract with that person be just as good as a trust? To answer questions such as these, one has to know something of the type of protection and reinforcement which the law gives to trusts and something of the type of ‘tricks’ that other legal institutions arising in the domain of private property can perform. In a broad sense only, these are the respective preoccupations of the next two sections of this chapter.

5. Equity’s rules for enforcing trusts and supplementing their terms

The law of trusts consists chiefly of rules for the enforcement of obligations set out in trusts and rules which are designed to supplement these expressly imposed obligations. This does not cover the whole field of trusts law; there are also, for instance, rules for determining whether a valid trust has been properly created. At the risk of stating a commonplace, it must be emphasised that the ambit of the equitable rules that are briefly outlined below is not restricted to the enforcement of obligations associated with the trust. As will be seen at several points in this book, but particularly in Chapters 14 and 16, equitable rules and remedies have a much broader compass.

With regard to the rules concerning enforcement, a brief historical résumé is necessary here although we consider this topic more closely in Chapter 2. The rules were developed over a long period by a specific court, the Court of Chancery. This existed separately from the common law courts, in which, generally speaking, only common law titles to property were recognised. Chancery never formally denied such common law titles: it simply maintained that when owners of property under common law title held the property by virtue of a disposition which made them trustees thereof, they could be ordered by Chancery to exercise their rights of ownership for the benefit of those designated under the trust as beneficiaries.

The development of this parasitic relationship of the trust notion to common law ownership explains why, generally speaking, a trustee is the legal owner of the trust property. The existence of a trust does not take this ownership away from the trustee, but renders it nominal by entitling the beneficiaries to invoke remedies granted by Chancery in order to secure such entitlement (in terms of benefit from the property and control of it) as the trust confers on them.

The remedies thus initially granted to trust beneficiaries took the form of claims against trustees deriving from the trustees' breach of confidence in failing to abide by the trust (cf the 'moral basis' of trusts referred to in the opening paragraphs of this chapter). In the course of time these remedies became fairly extensive, so that nowadays trustees can be ordered (for example) to give accounts of their financial administration of the trust, to pay money out of their own pockets by way of compensation for damage to the trust or make restitution of profits which they have secretly made for themselves by virtue of their trusteeship, or to refrain from committing specified acts amounting to breach of trust. Concurrently, however, Chancery strengthened this arsenal of remedies by granting beneficiaries redress against third parties in appropriate circumstances. In particular, it developed the principle that, broadly speaking, any person who receives trust property from a trustee with 'notice' of the existence of the trust and/or without giving value for it should be taken to hold the property subject to the pre-existing trust. Even though a bona fide purchaser without notice of the trust is *not* thus bound, this aspect of Chancery's protection of the beneficiary enabled the beneficiary's interest to be treated as akin to a right of property. The same effect has emerged from rules empowering beneficiaries to dispose of their entitlement under a trust like any other item of property: they can even transfer it on a further trust so as to create a 'sub-trust'. It has spread also to 'imputed' trusts: thus, for instance, where X holds property on 'constructive trust' (or any other form of trust) for Y, Y's rights to the property usually prevail over X's creditors.

Paradoxically, whereas the founders of trusts have wide discretions as to the terms of the trust, the sequence of events whereby Chancery developed trust remedies did not confer on them any general right to compel the trustees to observe the trust. To this extent, a transfer on trust operates to sever the founders from their former proprietary rights. But there are mechanisms whereby they can retain specific aspects of control: they may, for example, reserve to themselves a power to revoke the trust, or to determine beneficial entitlement, or to dismiss the trustees and appoint new ones.

The supplementing of an express trust by rules of equity chiefly takes the form of defining a trustee's administrative duties and powers where these have not been spelt out. Chancery and the legislature have been assiduous in this respect. For example, the Trustee Acts 1925 and 2000 confer on trustees a wide range of miscellaneous powers, including selling or mortgaging trust property, insuring it, compromising debts or other claims which the trust is entitled to make, maintaining minor beneficiaries out of trust income and applying to the Chancery Division for advice. The

Trustee Act 2000 also contains provisions to facilitate the investment of trust funds and to stipulate the circumstances in which a statutory duty of care will apply to trustees. Most of these trusteeship powers and duties can, however, be abrogated, extended or modified in the trust instrument, and often are.

In the outcome, the extent to which a beneficiary's rights can be conceived as falling short of absolute ownership depends largely on two caveats:

(i) the extent to which powers of control and/or determination of beneficial entitlement are reserved to trustees or third parties; and
(ii) the importance to be attributed to the fact that a bona fide purchaser of the trust property for value and without notice may override the beneficiary, leaving him to pursue remedies against the trustee.

The first of these factors is very much at the discretion of the founder of the trust. The importance of the second factor depends largely on value-judgment: given that in most situations purchasers are 'on notice' if they could reasonably have been expected to ascertain the trust's existence, its practical significance is probably not great. The degree of control left to founders after creation of the trust is a flexible matter, but specific powers which they reserve to themselves will receive legal protection. On top of all this, extensive trusteeship duties and powers are laid down by the law in the absence of express provision in the trust. The sum total is an impressive barrage of rules ensuring that trustees cannot abuse with impunity their position as nominal owners, even though in formal terms at least their powers of management may be very wide. The state, chiefly through the Chancery offshoot of its judicial branch, has lavished plenty of care and attention on trusts.

6. When is a trust not a trust?

The opening chapter of a book on Trusts Law is not usually the place to come across Christmas cracker-like riddles. The reason for posing the riddle is to counter an impression that may be growing on the reader to the effect that there is no limit to the degree of separation of ownership, control and benefit that can be accomplished by use of a trust. The impression would be misleading. There must be some *genuine* separation of those features for a trust to be valid. Let us suppose my wife and I make a declaration of trust under which our house is to be held on trust for her and for my children. We continue to act as if we are absolute owners even to the extent of obtaining a loan from the bank on the security of the property to finance my business dealings. They turn out to be disastrous and the bank seeks to realise its security against 'my property'. With a flourish I produce the trust instrument, the existence of which I had omitted to inform the bank about, and which purports to show that I have no interest in the house at all. The bank will claim, probably successfully, that the declaration of trust is a 'sham' (see *Midland Bank v Wyatt* [1995] 1 FLR 696, discussed in Chapter 6 at p 286). Consequently the 'trust property' will still be beneficially owned by my wife and myself and available to some extent to meet the claims of my creditors. A more elaborate variant of a sham could arise where a settlor does genuinely transfer legal title in property to trustees but reserves to himself very extensive powers, for instance, to amend the terms of the trust, to appoint new trustees (including himself), to act as investment manager and to add or exclude beneficiaries and so on. If the trustees acquiesce in these arrangements and, in effect, act as a cipher for the settlor a court confronted with claims brought by creditors or by the Inland Revenue may decide that the trust is a sham. The outcome would be that the trustees hold the property on a bare trust for the settlor. (See generally on this topic Wadham (ed) *Willoughby's Misplaced Trust* (2nd edn, 2002); Brownbill [1993] 1 JintP 13; Duckworth [1999] JTCP 183; Mowbray [2000] PCB 1 at 28 and [2000] PCB 2 at 105; and Harris [2004] PCB 2 at 95).

And the answer to the riddle of course is: 'When it is a sham'.

7. The trust and 'competing' legal institutions

The material in the foregoing two sections shows that the trust – meaning here particularly the express trust – is potentially of use where it is desired to split the three facets of ownership referred to (nominal ownership, benefit and control) with the assurance that whatever arrangement is decided on will receive adequate protection from the courts. But English law also provides many other ways of permitting someone to deal with property for the benefit of another. When one then turns to ask whether the trust, in a given type of situation, is a *better* legal institution to use for this type of purpose than any other, a whole new range of issues is opened up. One has to consider the strengths and weaknesses of such other legal devices – contracts, bailments, conditions, etc – as appear to offer alternative means of reaching a similar result. These strengths and weaknesses reflect the different legal consequences that attach to each institution or, if you will, their different juridical natures. But in considering, as we do below, what aspects of their respective natures makes, for example, a contract or a trust better for a particular purpose, we should not lose sight of their functional similarities. To continue the contract-trust comparison, the origin of both is commonly a transaction between two persons, in the trust context settlor and trustee, and as Maitland acutely observed, it is impossible 'so to define a contract that the definition shall not cover at least three-quarters of all the trusts that are created' (*Equity* (2nd edn, 1936) p 54; see Langbein 'The Contractarian Basis of the Law of Trusts' (1995) 105 Yale LJ 625 for an intriguing contemporary resurrection, not to say embellishment, of the 'trust as contract' idea).

We must therefore emphasise that a trap to be avoided is one of believing that certain transactions can be achieved *only* by means of a trust and others *only* by means of contract, etc. Indeed on occasions the one set of facts may permit more than one conclusion. For example, informal domestic arrangements concerning payments for alterations to a house may be construed as creating either a debt or a trust. The situation is further complicated by the fact that the best way of achieving the desired result may be to use the trust in combination with other legal forms. Examples of this have already been given (see example 9 above).

This introductory section is no place to investigate these issues at length. But at this stage it is useful to consider what sort of factors may give the trust special prominence in particular types of property transaction, or alternatively may wholly or partly shut it out from use. This will be done by briefly comparing the trust with three other legal institutions – contracts, 'personal representation' with reference to a deceased's estate, and limited liability companies.

(a) Trust and contract

Let us consider the advantages and disadvantages of the trust and the contract in the 'secret ownership' situation illustrated in example 1 (p 6). If the arrangement is set up by contract alone – whether it be a contract between the brokers and Wisegirl, or the brokers and Whizz-kid, or all three – the major disadvantage from the point of view of Wisegirl and Whizz-kid is that, if the brokers were to sell or give the shares to a third party in breach of the contract, Whizz-kid's claim to the dividends, etc, would be overridden even though the third party knew all along about the contractual arrangement. One could evade this by dressing it up as a contract of agency between Whizz-kid (as principal) and the brokers (as agents), because if the brokers then gave the shares away or sold them to a third party who was on notice, Whizz-kid would have so-called rights of 'tracing' against the third party entitling him to claim the benefit of the shares. But, as we shall see, these rights only arise from a form of 'imputed' trust: in other words, agency smuggles the trust in by the back door. And there is the practical disadvantage that as Whizz-kid has to be made a party to the contract the simplicity of Wisegirl's transfer on trust is lost. The only possible advantage of using a contract is that Wisegirl herself (assuming she is a party) can easily sue the brokers if they play false, whereas the trust, it will be recalled, prima facie confers rights of action for breach of trust on the beneficiaries only. There are ways of combining the contract and the trust to achieve this result (eg the brokers could agree formally with Wisegirl to observe the trust in Whizz-kid's favour), but again the objective of simplicity has been lost.

If one alters the facts slightly, and makes Whizz-kid a bouncing baby or an unborn grandchild instead of a fast operator on the stock market, the trust's advantage over the contract is more obvious. Because Whizz-kid cannot contract with full capacity (if at all), no agency relationship will arise between the brokers and Whizz-kid, and in the absence of an express trust Whizz-kid has no claims in any circumstances against a third party who receives the shares.

This is not to say that every time the trust and the contract 'compete' to perform some property transaction, the trust always wins. Usually, in fact, it loses. The contract is adaptable to a far greater number of situations, simple and complex, than the trust and it permeates a considerably wider range of social situations than the property-holding milieu of the trust. But this example does show that, when it comes to making as watertight as possible an arrangement for separating facets of property ownership, the trust's special characteristics are likely to make it preferable.

(b) Trusteeship and 'personal representation'

The comparison of trusteeship with the position of 'personal representation' occupied by the executor or administrator of a deceased's estate raises a different issue. Put simply, the administration of a deceased's estate entails collecting all its assets, paying off its liabilities (in particular debts and inheritance tax) and distributing what remains to those entitled. Where the deceased has left a will which nominates someone to do this and this person accepts the office, he or she is an 'executor' or an 'executrix'; where the will makes no nomination, or there is no will, an 'administrator' or 'administratrix' is appointed by the court. The phrase 'legal personal representative' comprehends both these offices.

Clearly, personal representation has a good deal in common with trusteeship: the legal personal representative is a nominal owner of property who performs certain tasks in relation to it for the benefit of others – ie the beneficiaries under the will or the next of kin where there is no will. But, in contrast to the trust-contract comparison just described, one cannot consciously choose between trusteeship and personal representation with regard to property dissolution on death. This is because by law the tasks of administration fall wholly to legal personal representatives and are the only tasks required of them acting as such. In practice, the same individuals are often appointed to be executors and trustees: they act first as executors in administering the estate, then hold the remaining property as trustees of the trust(s) set out in the will (example 3 above – Stern's will – illustrates this process). Similarly, an administrator of an intestate estate becomes a trustee on 'statutory trusts' for the next of kin when administration is over. Thus, while personal representation and the trust are not alternative legal devices for achieving the same end, they have a similar fiduciary character, and are therefore assimilated by the law in a number of respects, for example, in having certain common powers and duties under the Trustee Acts 1925 and 2000. They are also closely associated in point of time. Indeed, fine legal distinctions have to be drawn to determine how the rules and practices to be followed by trustees and executors differ and when precisely an executor-cum-trustee exchanges an executor's hat for a trustee's hat (see generally Kerridge et al *Parry & Clark: The Law of Succession* (11th edn, 2002) pp 574–601). There is one significant distinction that needs to be mentioned and this relates to the interests of those entitled under the will or on intestacy, called legatees or devisees depending on the nature of the assets of the deceased's estate. It is generally accepted that they do not have any equitable ownership in the assets under the administration of the personal representative until the point of time when the personal representative changes hats (see *Stamp Duties Comr (Queensland) v Livingston* [1965] AC 694, where the issue of equitable ownership had implications for tax liability). Then they become beneficiaries with full equitable ownership. Until that time the equitable ownership can be said to be in suspense although, of course, legatees and devisees can call on the remedies that equity provides to ensure that the personal representatives comply with their fiduciary or 'trust-like' duties.

This brief comparison of trusteeship and personal representation helps to show that from a functional point of view the choice of alternatives when one is thinking about manipulating the distribution of one's property after death is between a will (which inevitably brings in administration) and an inter vivos trust (which virtually bypasses it so far as the property contained in it is concerned). But unless the mode of distribution is to be fairly simple, the will is likely to contain dispositions on trust, so it is not a matter of choosing between a will and a trust, but deciding whether or not to set up one's trust in a will. A comparison of examples 3 and 4 above (Stern's will trust and Lucre's inter vivos trust) illustrates this.

(c) Trust and company

We come now to the final comparison to be discussed in this chapter – trust and limited liability company. The similarity here is entirely at the level of function. At the theoretical level, a company is a 'separate legal entity' whereas a trust is not: it follows that, whereas in company law the company is the legal entity liable for its debts, the liabilities claimed against a trust are in the first instance payable by the trustee(s). In practical terms a company differs from a trust in its personalities – shareholders, directors, etc – its constituent documents, its mode of coming into being (by formal incorporation at Companies House), and in numerous other ways. But a brief historical glance at the way in which these two legal forms have vied with each other in performing a number of functions relating to private property-holding gives useful insights into the sort of circumstances that can bring the trust into prominence or push it into eclipse.

When in the mid-nineteenth century the company with limited liability became freely available, necessitating only a simple registration procedure, the trust had already for about 100 years been an essential ingredient in a form of business association – the so-called 'deed of settlement' company – adopted by many medium- and large-scale industrial and commercial firms (see further Chapters 2 and 13). It was also essential to virtually all forms of charitable activity (whether in the form of the charitable trust per se or as part of the legal set-up of unincorporated charitable associations) and to many other forms of collective non-profit-making activity. It could also be used to avoid liability for debts, though the method was cumbersome. To summarise, the trust operated here as a means of association for economic and social purposes.

By about 1910, things had changed drastically. Despite the trust's possible use for avoiding debts, the company form had made a wholesale take-over of commercial and industrial activity (save amongst firms which were too small to have ever needed the trust form anyway). This occurred chiefly because the company offered straightforward limited liability, a separate 'corporate entity' which could hold property and enter into contracts in its own name without the need to appoint and re-appoint trustees, and a ready-made demarcation of shareholders and directors. Yet, while ousted from this area, the trust had embarked on a still persisting competition with companies in the field of collective investment on the stock market. The unit trust (described above) has a functional counterpart in the so-called 'investment trust', which, despite its name, is actually a company set up to perform a similar function. Furthermore, as twentieth-century rises in estate duty and other taxes made tax planning an increasingly absorbing occupation for the rich and their lawyers, the choice between vesting family assets in a trust or a private company was within certain wealth ranges a very fine one, depending on the particular circumstances of the family. Then the Finance Act 1965 introduced capital gains tax, involving in effect a 'double-tax' system for companies and shareholders, and a panoply of anti-avoidance provisions directed at private wealth-holding companies: the pendulum then swung, sending trusts up and companies down. Subsequently, however, a gradual relaxation in the rules occurred, especially in Finance Acts 1972, 1978, 1980 and 1984 (see generally Ashton 'Does the Tax System Favour Incorporation?' [1987] BTR 256). With regard to charitable and other non-profit activity of a collective nature, the company limited by guarantee during all this period made inroads on the trust's dominance, though it is difficult to assess the extent of this.

Some of these developments will be referred to later in more detail, but this outline is enough to illustrate how the prominence of trust or company in a specific area often varies as a result of matters extraneous to trusts or company law, such as changes in tax law or even, in the case of the unit trust/investment trust 'competition', in investment experts' predictions of future stock market trends. Thus the trust-company comparison illustrates, better than any other similar comparisons, that the range of tasks assigned to trusts is very responsive to changes in its 'environment' – social, economic, legal – as well as to changes within trusts law itself, and that in this notion of a legal 'environment' one has to include the law governing other legal institutions having similar functions, such as companies. This is not to say that changes in trusts law itself are unimportant, and in the outcome it is the interaction of trusts law and its 'environment' that ultimately determines the shape of trusts and what they do. Tax considerations may even be such as to prompt the use of trust and company forms in harness, as with the emergence of the 'trading trust' in Australia (see eg Finn (ed) *Essays in Equity* (1985) ch 8; and Ford and Hardingham 'Trading Trusts, Rights and Liabilities of Beneficiaries' in Finn (ed) *Equity and Commercial Relationships* (1987)).

The company-trust comparison also helps to show how far the character of a trust as a 'reposing of confidence' based on moral law has been transcended by its functions as an instrument of private capital within capitalist society (cf the opening paragraphs of this chapter). In so far as it can operate as a basis of association, a legal mechanism for aggregating, organising and preserving wealth at one remove from those who actually enjoy the benefits, it performs roles akin to those of the company, though in a manner less overtly linked with capitalism. The company's capitalist orientations are clearer, partly because it functions primarily within industry and commerce (which the trust does not) and partly because it has no underlying basis of 'confidence' and 'trust' (in the moral sense) to divert attention away from its capital-holding functions. This is not to say that the company operates free from any trust-like or 'fiduciary' obligations. Those who control corporate wealth have had such obligations superimposed upon their roles as managers, both through statute and the common law, and may even be enforced by the device of 'imputed trust'. With the trust the fiduciary concept came first and the rest later, but the end result is similar in important respects.

There are other comparisons that one can draw between trusts and similar legal institutions. One of these – the comparison of trusts and powers – is dealt with in some detail later as part of the discussion of discretionary trusts (Chapter 5). The interaction of these two ideas is too complex and technical to be covered in an introductory chapter. Another – the comparison of trust and debt – is considered in a commercial and consumer context in Chapter 15. To compare trusts with bailments, or conditions attached to a gift or bequest, or equitable charges is useful from the point of view of clarifying the precise legal nature of a trust, but bears little relation to the general themes of this chapter. Accordingly, these comparisons will be mentioned briefly at later points where they tie in with discussion of the trust in historical or contemporary contexts.

8. Internationalising the trust

As has been seen, the distinctive juridical nature of the trust offers attributes that can make it functionally efficient for carrying out all manner of tasks in our common law system. The term 'common law' is used here in contrast with civil law systems. But, as we have also seen, the trust is not constrained in its operation by national boundaries. Indeed it has been said that trusts and trust-like devices are spreading 'across the globe – both following and promoting the globalisation of business activities and wealth transfers' (Dyer (1999) 32 Vand J Transnat L 989 at 1007). This feature is relatively unproblematic as regards legal recognition where other jurisdictions are also common law systems. But our immediate European neighbours and trading partners do not share the same legal heritage. In particular the trust form as understood in the common law world has not been adopted or, until recently, afforded recognition in civilian systems of law. To a degree this difference between legal systems provided some of the impetus for Maitland's writing on the subject of the trust. Today practical difficulties can arise as where property located within a civilian jurisdiction – let us say a Spanish holiday home – forms part of a deceased person's residuary estate held on trust for a surviving spouse. A difficulty then is that in principle under the civilian system the trustees would be viewed, applying trust law terminology, as the beneficial owners of the property. The fiscal consequences might be unwelcome.

It is to address some of the difficulties that can be posed by the absence of legal recognition of the trust that in 1984 'The Hague Trusts Convention', to give it its short title, was adopted and subsequently implemented in the UK by the Recognition of Trust Act 1987 (see generally Harris *The Hague Trusts Convention* (2002);

Hayton (1987) 36 ICLQ 260; and Dyer, above). Broadly speaking the Convention serves two functions for those states that ratify it. It provides rules by which the courts of those states can determine whose laws apply in any given instance to a trust with an international dimension. Second, for states where the trust is unknown in domestic law, it provides a mechanism for dealing with trusts issues that might come before its courts. To do this there has to be some consensus about what a trust is and in that regard Article 2 of the Convention provides the following definition.

> For the purposes of this Convention, the term 'trust' refers to the legal relationship created – inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.
>
> A trust has the following characteristics—
>
> (a) the assets constitute a separate fund and are not a part of the trustee's own estate;
> (b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
> (c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.
>
> The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust. (Article 2)

This definition necessarily avoids any reference to the 'equitable jurisdiction of the court' (cf *Lewin* at p 3 above), a problematic concept for a civilian system. There is one other point in particular to note about this definition. No attempt is made to define the nature of a beneficiary's interest, a wise omission given, as we shall see in Chapter 5, the difficulty of reaching a satisfactory conclusion on this issue even in a common law system.

The effects of the Convention must not be overstated. First, a state must choose to ratify the Convention but even then it does not affect the internal private law of the state. Second, the Convention does not introduce the trust into a legal system that does not have a trust concept but simply requires a signatory state to recognise trusts as a matter of private international law. The Convention does not therefore enable a settlor with assets in a civilian jurisdiction where there are so-called 'forced heirship' rules to avoid its laws on succession. Lastly, the Convention applies only to trusts created voluntarily and evidenced in writing (Article 3). The Convention has no purchase therefore with the type of trust that we consider next.

9. Imputed trusts

The comparisons drawn between the trust and other legal forms refer principally to those circumstances where a conscious decision is taken about the choice of legal form – the 'trust-twisting' end of the spectrum. But, as previously indicated,

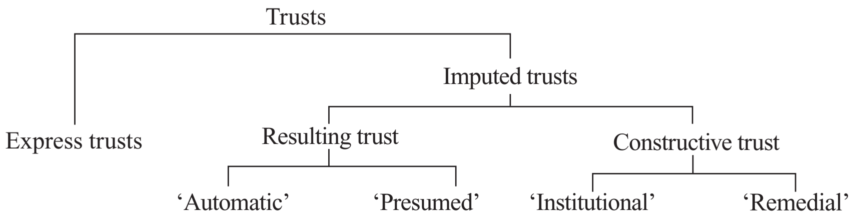

Figure 1.1 *A Trust typology.*

the trust obligation can come into existence not only through the expression of an intention on the part of the trust founder(s) (an 'express trust'), but also where the law imputes or imposes a trust – an 'imputed trust'. It is necessary to explore a little further the distinctions between and within these different trust types even at this introductory stage. The reader should be aware that there is no unanimously accepted classification of trust types and, more importantly, that they do not divide into watertight, mutually exclusive compartments.

We need to refer first, if only briefly, to the express-imputed distinction. No possibility of confusion can arise in the overwhelming number of situations, the trust founder's intention being made quite explicit in writing. But express trusts can be created informally, an intention to do so being inferred from the actions of the trust founder. In such circumstances the distinction between inferring an intention to create a trust and the court imputing a trust can be a very fine one indeed, as we shall see when 'intention' is discussed in detail in Chapter 4.

Within the categories of imputed trusts themselves, a further sub-classification of one type of imputed trust, resulting trusts, into 'automatic' and 'presumed' resulting trusts has until recently been generally accepted. The first type arises where an express trust fails for some reason: the trustees cannot of course take the property for their own use and so, as the name implies, the beneficial interest in the property 'results', or goes back to, the trust founder. As we shall see in Chapter 4 where we look at the rationale of this trust, reservations have been expressed about the appropriateness of the 'automatic' label; but for our immediate purposes, and in the absence of an accepted alternative, we will persevere with the present terminology. By way of contrast a 'presumed' resulting trust can arise where one person, A, gratuitously transfers property to another, B, in circumstances wherein equity adopts a rebuttable presumption that B then holds the property, not as beneficial owner, but on trust for A. This initially surprising presumption acquired a contemporary relevance in resolving property disputes where families break up, and the presumed resulting trust is discussed principally in that context (see Chapter 12). The second type of imputed trust, a constructive trust, is one imposed by operation of law irrespective (generally speaking) of the intention of the parties, and indeed quite possibly contrary to their intentions. Thus we have arrived at the classification set out in Figure 1.1.

Any impression of orderliness conveyed by this classification would be misleading for a number of reasons. We have not, for example, mentioned implied trusts. 'Implied trust' has been used, as we use imputed trust, as an umbrella term covering resulting trusts and constructive trusts; it has also been used to mean resulting trusts only, or presumed resulting trusts only, or even those express trusts where the intention has to be inferred from ambiguous language or conduct. We can only reiterate that there is no authorised classification, and that in the text we restrict ourselves to the categories of constructive trusts, of which more shortly, and resulting trusts, the latter being subdivided for present purposes into 'automatic' and 'presumed' although this terminology will be reassessed in Chapter 4 (see p 184).

A further reason why the appearance of an orderly structure would be misleading is that the linguistic confusion is in fact symptomatic of a more general conceptual uncertainty pervasive in imputed trusts. Two instances, one specific and one more general, illustrate the point.

Considering the specific example first, on occasions the courts have been less than scrupulous in distinguishing different forms of imputed trusts. In *Hussey v Palmer* [1972] 3 All ER 744, for example, the plaintiff, 'well over 70 and an old-age pensioner', paid £607 to a builder to erect an extra bedroom on a house belonging to her daughter and son-in-law for the plaintiff to live in. They quarrelled and the plaintiff left the house. Subsequently she sued to recover the £607. In the course of his judgment Lord Denning, the then Master of the Rolls, made the following observation (at 747):

> Although the plaintiff alleged that there was a resulting trust, I should have thought that the trust in this case, if there was one, was more in the nature of a constructive trust; but this is more a matter of words than anything else. The two run together. By whatever name it is described, it is a trust imposed by law whenever justice and good conscience require it. It is a liberal process, founded on large principles of equity, to be applied in cases where the defendant cannot conscientiously keep the property for himself alone, but ought to allow another to have the property or a share in it . . . [The trust] is an equitable remedy by which the court can enable an aggrieved party to obtain restitution.

Despite Lord Denning's view, it has conventionally been accepted until recently that whether a court imputes a 'presumed' resulting trust (as would have been the case in *Hussey v Palmer*) or, alternatively, a constructive trust, can have significant consequences. It was, for instance, thought to affect the proportion of 'the property or a share in it' that a successful plaintiff would be awarded as a remedy (see *Re Densham* [1975] 1 WLR 1519). The decision of the House of Lords in *Lloyds Bank plc v Rosset* [1991] 1 AC 107 has re-introduced a considerable degree of uncertainty about these matters (see generally Chapter 12 where they are explored in detail).

Our second instance of conceptual confusion concerns the circumstances in which a constructive trust will be imputed. The sweeping nature of the jurisdiction claimed by Lord Denning in *Hussey v Palmer*, for what he was to term elsewhere 'a constructive trust of a new model' (*Eves v Eves* [1975] 3 All ER 768 at 771), has been subject, perhaps unsurprisingly, to considerable academic and judicial criticism (see generally Chapter 12). Notions of 'justice and good conscience' can in the alternative be interpreted in terms of 'unpredictability and palm-tree justice'. Bagnall J in *Cowcher v Cowcher* [1972] 1 WLR 425, a case decided some six months before the hearing in *Hussey v Palmer*, captured the strong sense of unease in those who are uncomfortable with this sort of discretion being exercised in the area of property rights (at 430):

> I am convinced that in determining rights, particularly property rights, the only justice that can be attained by mortals, who are fallible and are not omniscient, is justice according to law; the justice which flows from the application of sure and settled principles to proved or admitted facts.

He went on to add that any developments in the law should be legitimate – 'by precedent out of principle' – 'since otherwise no lawyer could safely advise on his client's title and every quarrel would lead to a law suit'. The 'new model' was therefore sometimes contrasted unfavourably with the established or 'institutional' constructive trust whose incidence and consequences were thought to be more clearly defined. In *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, Lord Browne-Wilkinson summarised the distinction in the following manner (at 714–715):

> Under an institutional constructive trust, the trust arises by operation of law as from the date of the circumstances which give rise to it: the function of the court is merely to declare that such trust has arisen in the past. The consequences that flow from such trust having arisen (including the possibly unfair consequences to third parties who in the interim have received the trust property) are also determined by rules of law, not under discretion. A remedial constructive trust, as I understand it, is different. It is a judicial remedy giving rise to an enforceable equitable obligation: the extent to which it operates retrospectively to the prejudice of third parties lies in the discretion of the court. Thus for the law of New York to hold that there is a remedial constructive trust . . . gives rise to different consequences from holding that an institutional constructive trust arises in English law.

An example of an 'institutional constructive trust', although not an example that is an everyday occurrence, is where A leaves property in her will ostensibly to B but on an understanding reached between them that B will pass it on to C. If B, having acquired legal title to the property under A's will, were to claim that the property was his rather than C's a court might say that B holds it on constructive trust for C. Of course we might say that since this complies with A's original intention, why do we not call it an express trust? We will have to address that question in Chapter 4 when we examine this arrangement – called a secret trust – in some detail since the classification of the trust is a matter of debate. Consider next the case of D, a company director of XYZ plc who instead of obtaining a contract with ABC plc on behalf of XYZ plc as is her duty as a director – called a fiduciary duty – acquires the contract for her own use. A court might say that D holds the benefit of the contract on constructive trust for XYZ plc although here also there is a marked lack of unanimity as to whether the imputing of a constructive trust is the appropriate remedy (see Chapter 16 at p 846). In both these instances we might equally say that it would be 'unconscionable' for B and D to assert their own rights under the will and contract respectively to the detriment of those of C and XYZ plc. But unconscionability used in this sense has a narrow meaning, being determined, as Lord Browne-Wilkinson points out, by rules of law rather than judicial discretion. The practical point to emphasise here is that the circumstances when the institutional constructive trust can be imposed are thought to be more predictable, some would claim more principled, than those applicable to a remedial constructive trust. In fact, as is implicit in the opinion of Lord Browne-Wilkinson, there are a number of well-established instances where a constructive trust may be imposed, and these constitute the heartland of the subject (see Oakley *Constructive Trusts* (3rd edn, 1997) for a detailed categorisation).

The converse perception that the new model or remedial constructive trust is uncertain in application clearly carries weight, and the consequences for the interests of third parties of imputing a trust in the manner envisaged by Lord Denning cannot be lightly dismissed. Nevertheless, legal systems tend to need some leeway to infuse elements of 'fairness' and to recognise novel claims of right. Indeed such notions can be thought of as important legitimating mechanisms for a legal system (see Chesterman 'Equity in the Law' in Troy (ed) *A Just Society* (1981)). In any event, criticism notwithstanding, Lord Denning's prototype, or at least the desirability of an equivalent, has exhibited some resilience and, in a modified form, has re-entered academic and juristic debate as a 'remedial constructive trust'. The principal area of operation of this type of trust remains that of family property disputes, although its presence has also been felt in some areas of commercial activity. Nevertheless it must be conceded that a jurisdiction of this nature remains contentious in the extreme and we will therefore revisit this issue briefly at the end of section 10. of this chapter. For the moment it is sufficient to note that depicting the circumstances in which a constructive trust, of whatever type, will be imposed, defining the nature of that trust and, as importantly, determining the appropriate remedy are proving to be elusive goals (but see eg Elias *Explaining Constructive Trusts* (1990); Wright *The Remedial Constructive Trust* (1998); Waters *Constructive Trust* (1964); Millett [1999] 14 Amicus Curiae 4; Millett (1998) 114 LQR 399; Rickett and Grantham [1999] LMCLQ 111; Rickett (1999) 18(3) NZULR 305; and Birks 'Proprietary Rights as Remedies' in Birks (ed) *Frontiers of Liability* Vol II (1994) p 214). It is worth noting, however, that uncertainty and disagreement about the scope for the constructive trust is not a phenomenon that first emerged with Lord Denning's 'new model constructive trust'. On the contrary it appears that the roots of the difference in approach adopted in English trusts law to this issue as compared with that of the

US can be detected in contrasting analyses of this issue first evident in the mid-Victorian trusts law treatises (see Ibbetson *A Historical Introduction to the Law of Obligations* (1999) pp 281–284).

One problem in studying constructive trusts, therefore, is whether we can identify some unifying principle common, for example, to the trustee of an express trust who renews in his own favour a lease previously held for the trust, and to the 'secret trust' and to the company director who appropriates to herself a contract that she should have taken up on behalf of her company, other than a conclusion that constructive trusteeship may be imposed on all of them. A widely adopted approach is to examine in one chapter these and other circumstances in which a constructive trust has been imposed. This would certainly provide us with a mode of classification. It might also enable us to draw tentative conclusions about the nature of a constructive trust and to move towards identifying some common principle. This superficially attractive approach is, however, not without its dangers. It may provide an impression of coherence and certainty which one cannot confidently assert exists. Furthermore, if the categories as currently defined are construed as prescriptive rather than just descriptive, then devoting excessive deference to them may hinder our understanding of any incremental process of legal change.

This area of law remains in something of a ferment and there is controversy as to the direction and desirability of change, particularly when it occurs in a more overtly remedial fashion. However, as will be seen, notably in Chapter 12, various Commonwealth jurisdictions are developing different rationales for a 'remedial' form of constructive trust – unjust enrichment in Canada, versions of unconscionability in Australia and New Zealand, and estoppel as a juridical base in English law. We would suggest, however, that common to them all is an underlying problem that is intrinsic to this subject. Can the doctrines and practices of equity provide an adequate response to unconscionable conduct in a way that does not degenerate in the manner envisaged by Bagnall J in *Cowcher v Cowcher*? Although this book is predominantly concerned with the English law of trusts, at numerous points we refer to the different ways in which other Commonwealth jurisdictions are implicitly addressing that fundamental question. This is not comparison just for the sake of comparison; if, as some say, there is a cross-fertilisation of ideas between jurisdictions then we need to know something of what others do if we are to understand the responses of our own system and the processes of legal change.

This pattern of legal change returns us in a roundabout way to our family tree of trusts and to the emphasis that Maitland placed on the development of the trust idea and with which this introductory chapter began. The imputed trust branches are still developing and our preferred approach is therefore to forsake any claim to unity and instead fragment our treatment of imputed trusts in general and constructive trusts in particular. There are no chapters devoted specifically to resulting trusts or constructive trusts. Accordingly, whilst we still examine the constructive trust imposed on, for example, our trio of defaulting trustee, 'secret trustee' and disloyal company director described above, we do so in their respective family trust

(Chapters 4 and 9), commercial (Chapters 14 and 16) and, if we add property relations between cohabitating partners to the equation, family breakdown contexts (Chapter 12).

We cannot quite leave the topic there, however. The brief discussion above about imputed trusts might create the impression of an area of trusts law hermetically sealed, divorced from other legal doctrines. At the boundaries this is emphatically not the case. Indeed, the use by Lord Denning of the term 'restitution' and our reference above to 'unjust enrichment' hint at the existence of broader horizons beyond the boundaries of trusts law, as conventionally defined.

10. Marking the boundaries

The broader horizons and some of the accompanying doctrinal tensions were succinctly summarised by Lord Goff in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 at 685:

> Ever since the law of restitution began, about the middle of this century, to be studied in depth, the role of equitable proprietary claims in the law of restitution has been found to be a matter of great difficulty. The legitimate ambition of restitution lawyers has been to establish a coherent law of restitution, founded upon the principle of unjust enrichment; and since certain equitable institutions, notably the constructive trust and the resulting trust have been perceived to have the functions of reversing unjust enrichment, they have sought to embrace those institutions within the law of restitution, if necessary moulding them to make them fit for that purpose. Equity lawyers, on the other hand, have displayed anxiety that in this process the equitable principles underlying these institutions may become illegitimately distorted; and though equity lawyers in this country are nowadays much more sympathetic than they have been in the past towards the need to develop a coherent law of restitution, and of identifying the proper role of the trust within the rubric of the law, they remain concerned that the trust concept should not be distorted, and also that the practical consequences of its imposition should be fully appreciated. There is therefore some tension between the aims and perceptions of these two groups of lawyers, which has manifested itself in relation to the matters under consideration in the present case.

This is not the place to explore in any great detail those 'matters under consideration' in the case nor the kaleidoscope of opinion and comment that the case has generated. Suffice to say here that the factual matrix was relatively straightforward. The council and the bank were engaged in a financial market arrangement termed a 'swap agreement' whereby in effect the council received capital (£2.5m) 'up front' in return for making staged repayments over several years. These contractual arrangements became almost commonplace during the stringent controls on local authority finance during the 1980s as they provided local authorities with a means of raising funds for expenditure without, it was thought, infringing statutory controls. Then in 1992 in *Hazell v Hammersmith and Fulham London Borough Council* [1992]

2 AC 1 the House of Lords held that such swap agreements were ultra vires the local authorities. Westdeutsche, which had been repaid about half the capital by Islington London Borough Council, sought to recover the balance. The bank succeeded in its claim; the ground of recovery need not concern us save to note that it was at common law. One issue was left outstanding: interest was payable on the amount to be repaid but was this to be calculated as simple interest or compound interest? The legal significance of this was that on a common law claim simple interest only could be awarded whereas in equity in certain circumstances compound interest could be awarded against a trustee or other person in a fiduciary capacity. And therein lay a problem for Westdeutsche. If their lordships were not prepared to align the criteria for awarding interest so that the claim could be upheld on that basis alone – and they were not – could the bank establish that the local authority held the capital as a trustee? The House of Lords decided unanimously that there was no fiduciary relationship and held by a 3:2 majority that the bank was not entitled to compound interest (the minority judges of whom Lord Goff was one considered that compound interest could be awarded on other grounds).

One source of the tension referred to by Lord Goff was to be found in one of the core arguments advanced on behalf of the bank and based on the law of restitution. Before considering the particular argument advanced in the case it is necessary to comment very briefly on the law of restitution. At its most straightforward it can be said to be concerned with reversing the unjust enrichment gained by one person at the expense of another (see Birks *An Introduction to the Law of Restitution* (rev edn; 1989); *Unjust Enrichment* (2003); but cf for a different perspective Jaffey *The Nature and Scope of Restitution* (2000)). As is apparent from the words of Lord Goff in *Westdeutsche*, the law of restitution is a relative latecomer to the English legal scene. Many of the restitutionary claims were initially seen as a somewhat miscellaneous collection lying outside the established categories of contract and tort, hence the search for some explanatory principle, and the ambition, in Lord Goff's words, 'to establish a coherent law of restitution'. (Lord Goff, with Gareth Jones, was the original author of the path-breaking English law text on this subject, now in its 6th edition, Goff and Jones (eds) *The Law of Restitution* (2002).) The outcome of the 'search for coherence' is that the English law of obligations now constitutes a triumvirate of contract, tort and restitution rather than contract, tort and 'a miscellany of other claims'. The search did not rest there but, again as Lord Goff points out, also potentially brought within the ambit of the law of restitution aspects of the law of trusts. It is that conjunction of ideas that was to provide that core argument for the bank in *Westdeutsche*. Based on an argument developed by Professor Peter Birks ('Restitution and Resulting Trusts' in Goldstein (ed) *Equity: Contemporary Legal Developments* (1992)) it was claimed where there was any voluntary transfer of legal title with no evidence of any intention to make a gift – as where money is paid under a mistake or on a condition which is not subsequently satisfied – then a resulting trust should be presumed to operate at once to reverse the enrichment of the recipient. Put simply, in the context of *Westdeutsche*, the gist of the argument was that there was a void contract, that the bank in those circumstances had clearly not intended to make a gift to Islington London Borough Council who therefore held the legal title on resulting trust for the bank. To reiterate, the point of making the argument in these terms was to establish a claim in equity; there was no doubt, as already indicated, that the bank was entitled to recover the capital and simple interest under a common law action. To accept the resulting trust argument would, in the view of the House of Lords, have involved an extension of the scope of resulting trusts – beyond that outlined above at p 22 – which would involve 'a distortion of trust principles' (per Lord Browne-Wilkinson at 715; see Birks [1996] 4 RLR 4 for an initial response to the judgment).

The core trust principle identified by Lord Browne-Wilkinson was that 'Equity operates on the conscience of the owner of the legal interest' and therefore '[that owner] cannot be a trustee of the property if and so long as he is ignorant of the facts alleged to affect his conscience, i.e. until he is aware that he is intended to hold the property for the benefit of others' (at 705, but cf Swadling in Birks and Rose (eds) *Lessons of the Swaps Litigation* (2000) 242 at 257–264 where reservations are expressed about the authority for and implications of the proposition, particularly as regards the centrality accorded to 'conscience'). It would be remiss to pretend that there were not other pragmatic considerations at work in the outcome of the *Westdeutsche* case. Lord Browne-Wilkinson specifically refers to a concern that any extension of proprietary interests in personal property in the manner argued for on behalf of the bank would be bound to produce commercial uncertainty (at 705):

> If the bank's arguments are correct, a businessman who has entered into transactions relating to or dependent upon property rights could find that assets which apparently belong to one person in fact belong to another; that there are 'off balance sheet' liabilities of which he cannot be aware; that these property rights and liabilities arise from circumstances unknown not only to himself but also to anyone else who has been involved in the transactions. A new area of unmanageable risk will be introduced into commercial dealings. If the due application of equitable principles forced a conclusion leading to these results, your Lordships would be presented with a formidable task in reconciling legal principle with commercial common sense. But in my judgment no such conflict occurs. The resulting trust for which the bank contends is inconsistent not only with the law as it stands but with any principled development of it.

Some of the other legal implications of *Westdeutsche* will be considered at various points in this book as will the significance attached to the commercial consequences of legal change. For the moment we are concerned simply with some more general implications for our understanding of contemporary developments in the law of trusts. First, the case highlights a particular feature of our system of private law; there are potentially overlapping jurisdictions. The law of restitution and the law of trusts can be conceived of as occupying two eccentric circles. It is where the borders overlap that friction can occur. The friction arises in part because the 'search for a coherent law of restitution' can elide into a more ambitious and wide-ranging agenda of reclassification of private law. This book is not the place to engage in an analysis of the pros and cons of the restitution enterprise, not least because the scholarship deployed in the considerable literature on the subject now embraces a diversity of views, some of which have changed as the scholarship develops (see eg Burrows *The Law of Restitution* (2nd edn, 2002); Birks *An Introduction to the Law of Restitution* (rev edn; 1989) and *Unjust Enrichment* (2003); Virgo *The Principles of the Law of Restitution* (1999); Jaffey *The Nature and Scope of Restitution* (2000); and the iconoclastic approach of Hedley *Restitution: Its Division and Ordering* (2001)). There is no unanimity, for instance, about the precise relationship between the law of restitution and the reversal of unjust enrichment. This does not mean that we ignore the insights that are provided by restitutionary analyses. These are discussed at various points in the book, primarily in Chapters 11, 14 and 16 where the remedies that might be invoked for breach of trust take centre stage. Although to a lesser degree, consideration is also given to another boundary, that between trusts law and tort law, particularly where the competence and integrity of trustees and other fiduciaries is at issue. It is important in trying to understand the pace and direction of legal change that efforts to minimise or remove any resulting dissonance may be a formative influence in current developments. More prosaically it may also be helpful to be aware that linguistic purity is not always present in this area. Thus a common complaint of restitution lawyers is that the term 'restitution' is on occasion used when what is meant is that a person is receiving compensation or what a common lawyer might call 'damages'. Restitution, in contrast, involves the surrendering up of a benefit gained from another person.

There remains one 'bit-part actor' on the *Westdeutsche* stage that we have not yet mentioned. One of the underlying themes in the case was how far it was appropriate for a more extensive proprietary restitutionary remedy to be developed using trusts law. On this point, Lord Browne-Wilkinson commented (at 716):

> Although the resulting trust is an unsuitable base for developing proprietary restitutionary remedies, the remedial constructive trust, if introduced into English law, may provide a more satisfactory road forward. The court by way of remedy might impose a constructive trust on a defendant who knowingly retains property of which the plaintiff has been unjustly deprived. Since the remedy can be tailored to the circumstances of the particular case, innocent third parties would not be prejudiced and restitutionary defences, such as change of position, are capable of being given effect. However, whether English law should follow the United States and Canada by adopting the remedial constructive trust will have to be decided in some future case when the point is directly in issue.

The glimmer of light for such hopeful claimants, often seeking priority over other claimants in an insolvency, indicated by Lord Browne-Wilkinson's comments in *Westdeutsche* was, however, quickly put out by the Court of Appeal in *Re Polly Peck International plc (No 2)* [1998] 3 All ER 812 (see Chapter 16 at p 811 where the remedial constructive trust is considered in a comparative and commercial context).

Whether this rejection proves to be a temporary or permanent roadblock in English law is uncertain. A pragmatic objection to a remedial constructive trust is the possible consequences for the property interests of third parties, particularly creditors of a defendant. But, as Lord Browne-Wilkinson acknowledged in the extract above, in jurisdictions where the remedial constructive trust is employed as a response to unjust enrichment the courts have a wide discretion as to the remedy to be awarded. The interests of creditors can be taken into account. A more fundamental objection is encapsulated by the comments of Bagnall J in *Cowcher v Cowcher* (see above). That concern is the fear of unfettered discretion and accompanying lack of predictability of outcome or more prosaically 'palm tree justice'. Such concerns should not be discounted but, as we shall see at various points in the book, trusts law and equity are replete with concepts of an open-textured nature. We shall encounter inter alia the language of 'unconscionability', 'undue influence' and 'legitimate expectations'. None of these are any more susceptible to precise definition than, one might suggest, is the 'neighbourhood principle of negligence'. But nor does such terminology lead to the exercise of that unfettered discretion. One of our tasks is therefore to tease out the interpretation given to these terms in the different factual contexts in which they are deployed. We need not assume that the claims of 'unconscionability' will be treated with equal regard in such diverse contexts as family breakdown and corporate malfeasance. (See generally Birks (ed) *Frontiers of Liability* Vol 2 (1994) chs 13–17 for an excellent introduction to the remedial constructive trust.)

11. Focus on social contexts where trusts are used

Although, to repeat Maitland's words, the trust is a legal device 'of great elasticity and generality; as elastic, as general as contract', there are relatively few social contexts in which it has consistently been used to any significant degree. One may compare the position with contracts: the standard situations where these are commonly made are many and various. One thinks readily, for instance, of contracts of sale (relating to goods or land), contracts of hire or lease, contracts of employment, contracts of insurance, and the contract existing between members of a company or unincorporated association. There are many more categories of contract not on this list. By contrast, the contexts in which trusts, express or imputed, regularly make an appearance can be narrowed down to four, as follows:

(1) Preservation of family wealth The aggregation and management of invested wealth, chiefly for the benefit of members of a family, and usually involving some element of transmission of wealth from one generation to the next.

(2) 'Family breakdown' Imputed trusts are used to reach a just and fair result in the allocation of property between de facto partners on the break-up of their relationship. (Where the persons concerned have been married to each other, this aspect of their divorce is regulated by statute rather than trust principles.)

(3) Finance and commerce The trust impinges on financial and commercial activity in three important ways. First, it provides a medium for collective investment: examples are pension funds and unit trusts. Second, it is used on occasions as a device for securing commercial debt. Third, fiduciary law and doctrines of constructive trust form the basis for imposing standards of honesty and good faith on individuals engaged in business: in particular, on partners and company directors. (See Bryan 'Reflections on Some Commercial Applications of the Trust' in Ramsay (ed) *Key Developments in Corporate Law and Trusts Law* (2002); and in a US context Langbein 'The Secret Life of the Trust: The Trust as an Instrument of Commerce' (1997) 107 Yale LJ 165).

(4) 'Voluntary' activity 'Voluntary' – or, more precisely, non-profit – activity attracts the use of trusts where it is carried out *either* for welfare-oriented purposes which the law regards as 'charitable' *or* by an unincorporated association.

One further context where the trust plays a prominent part is in ownership of the family home. Where a home is in shared ownership, legal title is generally held, possibly to the puzzlement of the owners, on a statutory trust of land, now by virtue of the changes introduced in the Trusts of Land and Appointment of Trustees Act 1996. This arrangement is more usually and appropriately discussed in land law books (eg Gray *Elements of Land Law* (4th edn, 2005)).

The approach in this book is to examine the development and the present content of trusts law in conjunction with a study of each of the four contexts (1)–(4) above. The remainder of this book is accordingly divided into four parts.

The first of the four contexts – preservation of family wealth – has been in many respects the most important in terms of the development of trusts law. The trust notion was originally conceived and given legal recognition on account of the efforts of medieval conveyancers to protect the landholdings of their clients from certain forms of feudal taxation and to increase the range of dispositions of land which their clients could legally make on death. Most of the principles governing the creation, duration and administration of express trusts have been developed in this context of family wealth-holding. But each of the other contexts has provided an increasingly important basis for significant elaborations of trust doctrine.

2

The evolution of the private express trust

1. Introduction

As indicated at the end of Chapter 1, the trust concept originated in English law in medieval times, chiefly as a result of the efforts of conveyancers to preserve the landholdings of their clients from certain forms of feudal taxation and to increase the range of dispositions of land which their clients could legally make on death. The emergence of the trust concept at this time is intimately bound up with the assumption of jurisdiction in legal matters by the Lord Chancellor, on grounds of 'equity'. In time, as we will see, that jurisdiction became sufficiently pervasive and ordered so as to justify substituting an upper case 'E' in place of the lower case 'e'. The development of Equity in that manner involves matters that range far beyond those concerning the trust. Since it is the latter that is our prime concern, the roles are reversed here and Equity therefore appears in our story mostly as a member of the supporting cast only.

This chapter seeks to explain the development of major segments of trusts law – specifically, the law governing private express trusts – from these early beginnings until, approximately, the beginning of the twentieth century. It does so with particular reference to the trust transactions which served, in various ways, to aggregate and safeguard privately held wealth for the benefit of members of a family and to ensure the smooth transmission of wealth from one generation of a family to the next. Towards the end of the chapter, some general comments are offered on the historical role of private family trusts. The chapter concludes by returning to the broader topic of the relationship between Equity and other areas of the common law, a topic that has of late been attracting close academic and judicial scrutiny.

First, however, a general note of caution needs to be aired about our capacity 'to explain'. In this chapter, and elsewhere in this book, we are concerned with change over time. But Milsom's words of warning are apposite here ('"Pollock and Maitland": a Lawyer's Retrospect' (1996) 89 *Proceedings of the British Academy* 243 at 251):

> . . . since it is almost a function of law to hide change, few developments other than those made by explicit legislation can be pinned down and dated. The same rule works differently. The same word changes its meaning. The same action is put to a fresh

> purpose. The same situation is analysed in a new way. It follows that there will be few conclusions that are securely established as one can establish a regular historical fact.

Whether or not one thinks that Milsom's general proposition about secure conclusions can be applied to the history of the trust, the elements of legal change that he identifies certainly have a compelling resonance in this context. There is, as we shall see, explicit legislation which, together with a hardening of doctrine, has at times imposed constraints on the 'efforts of conveyancers'. But there has also been scope to manipulate rules and language which, when the social and economic climate is right, stimulated inventiveness. One modest conclusion can be drawn: we are dealing with a process of creating law that has often operated 'from the bottom up'.

2. Medieval 'uses' of land

(For general discussion of the origins of uses, see eg Milsom *Historical Foundations of the Common Law* (2nd edn, 1981) ch 9; Bean *The Decline of English Feudalism 1215–1540* (1968); Biancalana 'Medieval Uses' in Helmholz and Zimmermann (eds) *Itinera Fiduciae* (1998) 111; Fratcher 'Uses of Uses' (1969) 34 Miss LR 39; Holmes *The Estates of the Higher Nobility in 14th Century England* (1957) pp 41–84; Barton 'The Medieval Use' (1965) 81 LQR 562.)

The medieval forerunner of the modern trust was not called a trust, but a 'use'. The term 'use' is a corruption of the Latin phrase '*ad opus*'. The background to its emergence in the thirteenth century was a common law system of landholding based on feudal conceptions. As reconstructed by modern historians, with some divergences of opinion, a tenant of land under post-Conquest feudalism had the legal right to possess the land (known as 'seisin') and to receive some degree of patronage and protection from the lord from whom the land was held. In return, he was bound to render due homage and various services and 'incidents' (ie material benefits of different kinds) to the lord and, in the case of tenants lower down the scale, to submit to the lord's jurisdiction in the manorial courts. The system was based on the idea that no one was the absolute owner of land. Instead, chains comprising these two-way relationships of tenure stretched downwards from the king, who was the ultimate overlord. The chain might have only one link, in which case the tenant, a so-called 'tenant-in-chief', held directly of the king. Or there might be several links, in which case the tenant with actual seisin was the 'tenant in demesne' and the intervening persons, each of whom was both a lord of the tenant below him and a tenant to the lord above him, were called 'mesne lords'.

Feudal landholding was thus a complex amalgam of personal relationships – manifested particularly in the subordination of tenant to lord through homage, services and incidents – and proprietary rights.

The rise of uses represents a form of response to the decline of the major ingredients of feudalism and feudal landholding coupled with the retention and, indeed, strengthening of the so-called ‘incidents’ such as ‘relief’ (a sum payable to the lord when a tenant succeeded to the land on the death of a former tenant), and wardship (the lord’s right to guardianship of the ‘body’ of the heir and the lands themselves, including the profits arising from them, during the minority of a deceased tenant’s heir).

The process of decline of feudalism was reflected in a number of important changes in the feudal landholding system. Most of these reflected the break-up of personal bonds between lords and tenants of land. For example, in certain tenures money payments were increasingly substituted for ‘services’ such as the provision of armies and the furnishing of produce of labour. Furthermore, some time during the twelfth and thirteenth centuries, feudal tenants acquired the right to pass land on to their heirs (usually the eldest son) and to alienate it inter vivos without needing the consent of the lord. The lord thus lost control over the identity of his tenants.

As regards the second factor underlying the development of uses – that is, the retention and strengthening of feudal ‘incidents’ – the main reason why these incidents survived whereas the services became increasingly less important was that the value of the incidents kept pace with the times. Because the late Middle Ages saw some periods of rapid inflation, the value of services commuted into fixed sums of money became negligible. Incidents, being geared to such things as the profits from the land, did not suffer in this way. Incidents thus emerged as something like a modern landlord’s ‘premium’, or ‘key money’. More significantly, they constituted for the king, the supreme landlord, a form of taxation based on landholding. In a period marked by foreign wars and substantial centralisation of royal authority, this was of considerable significance.

The ‘use’ was a product of these various social changes. As already stated, it became prominent in the thirteenth century, though instances have been traced back to about 1200. It had apparent predecessors in other systems of law. Links have been suggested, for instance, with the Roman law concept of *fideicommissum*; with a Germanic form of executor called the ‘salman’; with the executor of a ‘testament’ of personal chattels recognised in the common law and ecclesiastical courts; and even with an Islamic legal concept called a ‘waqf’ (allegedly brought back to England by the Crusaders: see eg Avini (1996) 70 Tul LR 1139; Herman (1996) 70 Tul LR 2239).

Discarding ancient for modern terminology, the use was typically employed by medieval tenants of land as follows. A tenant P would convey his land to a group of trustees (say, Q, R and S) ‘to the use of’ himself as beneficiary, then to such uses as he should subsequently appoint. By his ‘last will’ (not to be confused with a will of chattels, which was then called a ‘testament’) or by prior instructions, he would indicate such uses. His eldest son might be designated the beneficiary as to most of his land, with the remainder being split up amongst his daughters, his younger sons, a monastery, parish or other church institution and (so far as necessary) creditors to whom he owed money at his death. This is no more than a typical example: in fact, the range of dispositions of benefit that a tenant could effect through uses was virtually unlimited. He could also give the trustees active duties; for example, ensuring that pecuniary legacies contained in his ‘testament’ were paid out of the rents and profits of his land.

This short description of the operation of the use is enough to show how closely it resembles the modern trust. It did, in fact, perform most of the same ‘tricks’ with land ownership as the trust now performs with ownership generally. In the historical context just described, these tricks served a number of different purposes.

First, and most significant politically, they brought about the evasion of feudal incidents. The incidents were all related to ‘seisin’, the common law right to possess. For example, it was when an heir acquired seisin by descent that a ‘relief’ could be exacted. Where uses were employed, seisin would be conferred upon the trustees. The number of these was kept at two or more, and the common law doctrine that on the death of a joint tenant his interest passes to the surviving joint tenant(s) was invoked with the result that the death of a sole tenant having seisin would scarcely ever occur. Thus, although the heir might still acquire some or all of the land on or after death, he did not do so by direct descent, but by transfer from the trustees.

Second, the range of dispositions available to a tenant increased considerably. In particular, he acquired a de facto power of devising – ie bequeathing – land to whomever he chose. Although feudalism had liberalised to the extent that a lord could not actively prevent the succession of an heir, this still meant that normally, on the death of a landowner, the eldest son was entitled at common law to take all the land. The landowner could only split up the land if he was prepared to alienate inter vivos. But uses gave the landowner the power to choose between strict primogeniture on his death, as required by the common law rules, or primogeniture modified as to provide for the rest of the family and for other purposes important to the tenant (as illustrated in the above example of a conveyance of uses) or indeed a total breakaway from primogeniture. If he wanted the land, or part of it, to pass to someone other than his heir, he did not have to make an out-and-out lifetime gift: instead, he had, in effect, a power of free disposition on death.

The remaining purposes to which uses were put can be briefly mentioned. Uses made secret conveyancing of land possible, whereas at common law a transfer of seisin had to take place by public act. They were employed to ensure that lands were looked after (ie by the trustees) while the tenant was fighting in the Crusades or in other wars, foreign or domestic. In so far as they were employed to confer the rents and profits of lands on Church institutions, they were, for a time, evading the policy of a statute purporting to prevent this. Finally, it was possible for a time to transfer land to trustees to one’s own use in order to put the land out of the reach of creditors.

In short, it is difficult to dissent from the conclusion of Sir Edward Coke that there were ‘two inventors of uses, fear and fraud; fear in times of troubles and civil wars to save their inheritances from being forfeited; and fraud to defeat due debts, lawful actions, wards, escheats, mortmains, etc’ (*Chudleigh*’s case (1594) 1 Co Rep 113b at 121b, as cited in Jones (1995) 54 CLJ 545).

The question now arises: how did these transactions involving uses come to receive legal protection and support even though it was the trustees who had title at common law to the fee simple or other estate conveyed at common law? The answer lies in the early beginnings of Chancery jurisdiction.

The early history of the jurisdiction is somewhat obscure but one catalyst in its development was the contemporary weakness of the common law. During the fourteenth and fifteenth centuries the common law courts had for a number of reasons – insufficient adaptability to new claims, limited range of remedies, complexity of pleadings – proved inadequate. The general remedy of statutory reform was not seen as the answer. Instead, those aggrieved could petition the Chancellor, who could order specific remedial measures on a variety of discretionary grounds in order to achieve justice in individual ‘hard cases’. Most early chancellors were ecclesiastics and this may account for the prominence that notions of ‘good faith’ and ‘conscience’ claimed in Chancery jurisdiction (see generally the essay by Helmholz ‘The Early Enforcement of Uses’ (1979) 79 Col LR 1503). Indeed the ‘decrees’ of the Chancellor were specifically addressed to a person’s ‘conscience’ – that is they sought to compel him to do what justice, or good conscience, or ‘equity’ required of him. The following passage from a legal history text fills out the picture as it applied to the trust (Baker *An Introduction to the History of English Law* (4th edn, 2002) p 102):

> If someone granted land to others on trust to carry out his wishes, he would find that at law the grantees were absolute owners who could not be compelled to obey him. Now it was not that the common law held . . . that a promise or trust could be broken; such [a] proposition would have been dismissed as absurd. Yet those were the results that followed from observing strict rules of evidence, rules which might exclude the merits of the case from consideration but which could not be relaxed without destroying certainty and condoning carelessness. For a . . . promisee or trustee to take unfair advantage of those strict rules was without question wrong; but it was a matter for their consciences rather than for the common law.
>
> The Chancery worked differently. The Chancellor was free from the rigid procedures under which such injustices sheltered. His court was a court of conscience in which defendants could be coerced into doing whatever conscience required in the full circumstances of the case.

It seems that Chancery intervention, at the instance of beneficiaries, to order trustees to abide by the terms of declared uses began about the end of the fourteenth century. This aspect of Chancery jurisdiction was firmly established by the mid-fifteenth century. About this time a proprietary flavour was added to the beneficiary’s rights. It was decided, for instance, that a beneficiary’s rights could be assigned. In addition, the Lord Chancellor was prepared to impute a use in several situations corresponding to modern imputed trusts. These developments were part of the integral change taking place in the Chancellor’s jurisdiction whereby a form of equitable corrective, or gloss, upon the operations of a pre-existing common law system began to evolve into a separate collection of legal principles.

The chain of causation here is important for our understanding of the process by which the use was developed and ultimately recognised. Holdsworth's claim that the use was a 'product of the equitable jurisdiction of the Chancellor' does not tell the full story (*A History of English Law* (3rd edn, 1945) p 418). Indeed it has been said by Bean to put the proverbial cart before the horse (*The Decline of English Feudalism 1215–1540* (1968) p 129): 'The Chancellor's jurisdiction in uses arose from the fact that [uses] *already existed* and fraudulent feoffees were becoming a serious nuisance' (emphasis added). In short this is but one example of law, in this instance in the form of Equity, being shaped by the experience of practice or, we might say, malpractice.

The use as it finally emerged did not resemble the modern trust in all respects. In particular, the beneficiary's 'quasi-proprietary' protection was still defective in certain respects and the principles governing a trustee's powers and duties were still to be developed. But in the fifteenth century one can discern the foundations of modern trusts law.

One can also glimpse possible reasons why Chancery's intervention was (as it still is) in favour of beneficiaries only, rather than at the instance of the creators of uses. A transaction of the type outlined above (a transfer of land to trustees to the use of the transferee for life, thereafter to such uses as he shall appoint) was typical, because it achieved the desired effect of a testamentary devise. Remedies granted in the name of the beneficiary operated not only to protect the creator as long as he lived – because he himself was the beneficiary during this period – but also to ensure observance of the trust when the creator was no longer alive to take action himself. By contrast, to have treated the transmission solely as a contract between the creator and the trustees, enforceable only by these parties, would have left the ultimate beneficiaries without any remedy. In any event, there was in the fifteenth century no general doctrine of contract law under which the contractual element in the transaction between creator and trustees could be invoked as a basis for enforcement of the trustees' duties. (But cf Jones 'Uses, Trusts and a Path to Privity' (1997) 56 CLJ 175–200; and see generally Palmer *The Paths to Privity* (1992) who identifies 1500–1680 as the 'formative period' of the privity of contract doctrine.)

During the fourteenth and fifteenth centuries, piecemeal attacks were made by the king on uses and their enforcement. But uses were, on the whole, tolerated, and were given Chancery protection. This seems strange because they proliferated enormously – covering, it has been said, the 'greater part' of English land in the late fifteenth century – and were employed particularly by large landowners holding on knight service in order to evade the particularly valuable incidents of wardship and marriage. The explanation must be that, during this period – particularly during the Wars of the Roses, the power of the king was too precarious and too dependent on particular groups of nobles to enable him to confront the majority of them on an issue such as this.

To conclude this discussion of the medieval period, a few words should be said about dispositions in the nature of a trust relating to personal property. Such dispositions attracted much less attention and controversy than uses of land. This is chiefly because personalty accounted for far less wealth than land. The most common forms of valuable chattels in private hands were family heirlooms, jewellery and the like, but these were not income producing. The overall market value of such articles in a noble family was a good deal less than that of the landed estate.

3. The Statute of Uses

England's period of 'absolutist' rule under the Tudor monarchy was the occasion for a royal onslaught on the evasion of feudal incidents through uses. There was a brief return to 'fiscal feudalism'. Some limited efforts in this direction occurred during the reign of Henry VII, but the changes wrought by his successor were more dramatic and more fundamental. In 1535, Henry VIII pushed through Parliament the most important single statute in the history of the trust's development: the Statute of Uses. (See eg Brown (1979) 9 Manitoba LJ 409; Barton (1966) 82 LQR 215; Simpson *A History of the Land Law* (2nd edn, 1986) ch 8.) This sought to undermine the conceptual basis of the use rather than merely to impose piecemeal restrictions upon it. It provided that, with certain important exceptions which are outlined below, the creation of a use should operate not to give the beneficiary various rights against the trustees (and others deriving title from them) which Chancery would protect, but actually to confer seisin – ie legal title – on the beneficiary to the exclusion of the trustees. This conversion of the beneficiary's equitable rights under the use into legal title was called 'executing' the use.

The prime aim of the statute was to recapture lost feudal incidents for a monarchy which was heavily involved in wars for religious and mercantile purposes. Henry VIII also sought to achieve this aim by a number of administrative measures, notably the establishment of a Court of Wards in 1540.

Generally speaking, the frontal attack which the statute launched upon uses was effective in reviving 'fiscal feudalism'. Henceforth the death of a sole beneficiary attracted all the relevant feudal incidents in all circumstances. But the statute was taken also to abolish the power of devise: that is, it was thought (probably mistakenly) that since a landowner who transferred his land to trustees to his own use for life would now die seised of the legal estate, the common law rule prohibiting devises would apply to him, and he could not prevent the land passing to his heir. Whatever their views about the re-imposition of feudal incidents, the landowning aristocracy's reaction to this apparent re-introduction of compulsory primogeniture was so strongly manifested that in 1540 Henry had to compromise significantly with them. The Statute of Wills, passed in that year, dealt with the question by providing that at common law all lands held on non-military tenure and two-thirds of lands held on knight service should be freely devisable. In the case of lands so devised, however, the Crown could levy all the incidents that would be due if the land in question had passed to the heir, except only for wardship rights in lands held by knight service. These would only apply to the one-third of lands not devisable. The consequence is that the Statute of Wills became the 'prime defence' against threats to the revenues of the Crown (see Jones 'The Influence of Revenue Considerations upon the Remedial Practice of Chancery in Trust Cases, 1536–1660' in Lobban and Brooks (eds) *Communities and Courts in Britain 1150–1900* (1997) p 99).

In the present context, two points about the two statutes are of particular importance. First, the Statute of Uses, along with the Statute of Wills, introduced into common law land transactions a degree of flexibility previously only attainable by creating uses. This marked a major step in the emancipation of the common law of land from its feudal antecedents, and its adaptation to the post-feudal concept that ownership of an estate in land should confer a more or less unlimited power to dispose of it, irrespective of the feudal overlord's wishes. Flexibility in the common law forms of disposition, particularly on death, became much greater. This diminished pro tanto the role of the use. Indeed, the use's earlier function as a symptom of developing change in the objectives and ethos of land disposition had been brought to its resolution. The social changes to which it bore witness, first as an extra-legal mechanism, then under the aegis of a new jurisdiction developed by Chancery, were now reflected in the common law.

Second, the categories of use not executed by the Statute of Uses provided the starting-point for the development of the modern equitable trust. The exceptions to the Statute of Uses can be grouped under three heads:

(1) Uses declared on property other than freehold estates in land Because the statute used the word 'seised', which is a technical term referring to the rights at law of the owner of a freehold estate in land, any use relating to a property interest not within this description was not covered. Thus uses declared on copyholds, leases and personal property were not 'executed', and remained effective in equity. This seems to have been the case even where the 'use' was concealed, as where for political reasons no mention of the true beneficiary appeared on the documents so that the lease appeared to have been granted to a leaseholder for his own benefit (see Jones 'Trusts for Secrecy' (1995) 54 CLJ 545). A not uncommon political reason for concealment in the latter half of the sixteenth century would be the fear of religious persecution.

(2) 'Active' uses Any use under which the trustee had active duties to perform – for example, paying specific debts out of the land, or managing it during the original owner's absence – was held soon after the statute to be outside its scope. Various reasons have been put forward for this: for example, that 'execution' of the use, with the consequent exclusion of the trustee, was incompatible with the duties required of the trustee, and that the statute was assumed to relate to those uses which effectively gave the beneficiary a proprietary right, as opposed to rights significantly qualified by the conferment of active duties on the trustees.

(3) 'A use upon a use' After the Statute of Uses, the courts were confronted at times with dispositions (sometimes drafted in error) of the form 'to A to the use of B to the use of C'. At first, they simply said that the first use was executed by the Statute and the second, being repugnant to it, was void (*Tyrrel*'s case (1557), but cf the interpretation of the case in Jones (1993) 14 Legal History 75). How then are we to explain what appears to be the position, namely that the Chancellor was prepared to intervene to enforce the trust in the form of a use upon a use possibly as early as 1560 but almost certainly towards the end of the sixteenth century? (See eg the report of *Bertie (Dowager Duchess of Suffolk) v Herenden* published by Baker in (1977) 93 LQR 33; and the discussion in Jones 'Trusts in England after the Statute of Uses: A view from the 16th Century' in Helmholz and Zimmermann (eds) *Itinera Fiduciae* (1998) pp 173–205.) There are few reported cases although Baker suggests that by the time of James I (1603–1625) 'deliberately created trusts were commonplace' (*An Introduction to English Legal History* (4th edn, 2002) p 291 fn 56; and see *Sambach v Daston* (1635) in Baker and Milsom *Sources of English Legal History: Private Law to 1750* (1986) pp 126–127). This seems odd since it would appear that for the Chancellor to have treated B as 'seised', under an executed use, but subject to an equitable use in favour of C would have established a simple way to evade the fiscal policy of the Statute. But what if, as noted above, it was the Statute of Wills that offered the 'prime defence' against depletion of the revenue? Then it may well be, as Jones suggests, that the answer is to be found in a concern to enforce the terms of the Statute *only* where the use upon a use was a 'revenue evasion mechanism' as, for instance, where the purpose was to enable land to be bought in the name of another or to create trusts of long terms of years (above, pp 181–183). In other cases where the fiscal rationale for the Statute was not threatened there was no reason for the Chancellor not to exercise a jurisdiction still premised at that stage on the claims of conscience.

Judicial attitudes continued to change, particularly after the Civil War and the Restoration. In 1660 (regularising a position already existing in 1645), the Tenures Abolition Act abolished the burdensome incidents of military tenure. For all practical purposes, the feudal tenures and their incidents were dead. Not surprisingly, Chancery confirmed soon afterwards that, where a 'use upon a use' was created, the second use would be enforced in equity. It thus became possible to create in the trust form all the forms of interest in land which previously could only have existed as legal or 'executed' interests (see Yale [1957] CLJ 72). One did so by simply using the formula 'to A to the use of B to the use of C' or simply 'unto and to the use of B to the use of C'. In both these cases, B took as trustee for C.

In the next section we consider in closer detail the social and economic changes, in particular those of the eighteenth and nineteenth centuries, that helped shape the modern law of trusts. But first, reference must be made to a critical change that was to occur towards the end of the seventeenth century in the appointing of Chancellors, a change that in one particular instance was to have a lasting impact on the law of trusts. Prior to 1673, whilst it was by no means unknown for lawyers to be appointed as Chancellor, legal 'qualification' or experience was not a prerequisite for the post. This changed with the appointment of Lord Nottingham as Chancellor in 1673. Thereafter only lawyers have held the office of Lord Chancellor. But it is the contribution of Lord Nottingham during the relatively brief period of office – he died in 1682 – to Equity and to the embryonic law of trusts that is of particular significance here (see *Prolegomena of Chancery and Equity* Yale (ed) (1965)). He developed a classification of trusts, was responsible for the doctrine that there can be no 'clog on the equity of redemption' and is believed to have drafted the Statute of Frauds 1677, which in revised form still provides significant formalities requirements for the creation of express trusts or transfer of equitable interests. His influence was also instrumental in confirming the proprietary nature of the trust rather than it being merely a chose in action, a possible interpretation even in 1648 (see *R v Holland* (1648) Style 20 at 21 for a somewhat ambiguous view; and Smith 'Transfers' in Birks and Pretto (eds) *Breach of Trust* (2002) pp 119–124 on the significance for the 'proprietary right' of eventually extending protection to bind innocent recipients of trust property). Moreover, however one may choose to analyse and interpret the reasons for the emergence of a 'rule against perpetuities' (see Chapter 6), it is evident that Lord Nottingham's role in formulating the rule in the *Duke of Norfolk's Case* (1683) 2 Swan 454 was decisive although it did subsequently require the House of Lords to confirm his formulation after his successor attempted to adopt a more restrictive rule in the case. There is also arguably a broader post-Restoration political significance to Lord Nottingham's tenure as Lord Chancellor in that the incorporation of the Chancery jurisdiction into the framework of a legal structure reflected a final break with the historical notion of it being part of monarchical authority. But it was the law of trusts as shaped primarily by Lord Nottingham and the further development of a more rigorous system of Equity by successor Chancellors such as Hardwick and Eldon that was to provide a foundation on which practitioners could work to respond to the pressures for change to be discussed next.

4. The emergence of the modern trust

(a) The causes of change

Recognition of the three significant gaps in the operation of the Statute of Uses referred to above paved the way for the emergence of the modern trust concept and the further development of trusts principles within the context of family settlements. It appears that the word 'trust' came to be used during the sixteenth century to mean, in effect, unexecuted uses which Chancery would enforce. For economic and social reasons, rather than purely legal ones, it was this form of disposition, rather than executed uses or other categories of common law interest in land, that ultimately became predominant within family settlements.

The root cause of this process of change – which is observable in particular during the seventeenth, eighteenth and nineteenth centuries – was a fundamental alteration in the nature of wealth-holding. England passed from being a chiefly agricultural society, where the bulk of private wealth took the form of land, to a society in which mercantile, industrial and financial wealth came to predominate. The Tudor period had seen the growth of opportunities for investing in joint stock companies which were engaged, often with a monopoly obtained under licence from the Crown, in large-scale foreign trading ventures. Investment in government stocks and various emerging forms of production was increasingly important in the eighteenth century. From the mid-eighteenth century onwards, the Industrial Revolution brought about a further shift in wealth from land towards industrial production, trade and finance.

It became possible to participate in the ownership of these forms of enterprise, and indeed in landed wealth, in an indirect way – that is to say, through security interests such as stocks, shares, bonds and mortgages. Various legal forms of business organisation – the partnership, the 'deed of settlement' company, and the statutory company – furnished vehicles for making such investment. But it was the limited liability company, made freely available in the mid-nineteenth century, that enabled an individual's or family's funds to be channelled easily into and out of industry and trade (and their ancillary services such as banking and insurance) through the medium of the stock market. Accordingly, while the maintenance of a landed estate remained a preoccupation of many wealthy and noble families, the acquisition, aggregation and preservation of stocks, shares and other types of investment asset became an alternative, and increasingly important, form of family wealth-holding activity. This was equally the case, if not more so, for the new wealth-holders created by the Industrial Revolution (see Rubinstein (1992) 34 Business History 69 and Thompson (1990) 43 Economic History Review 40 for contrasting views on the relative importance of land and other forms of wealth to the new entrepreneurial class).

These new forms of family wealth-holding shared an important feature: unlike the landed estates of noble families, the assets acquired constituted 'investments' in the fullest sense of the word. They were acquired not only for the purpose of earning income, but also on the basis that, when the selling-price and the circumstances were appropriate, they might in due course be sold and the proceeds re-invested. This meant that the persons who owned and controlled such investments had an active, managerial role to perform – that of choosing investments to buy and watching over them and deciding whether and when they should be sold. By contrast, the trustees of a landed estate did not, as a matter of course, contemplate the sale of the estate. Retention of the family domain was instead the raison d'être of the settlement and it was only in extraordinary circumstances, such as impending bankruptcy, that a sale of the home or any significant portion of the land would occur.

The suitability of the equitable trust, as opposed to the various forms of common law interest for the acquisition and management of investment assets within wealthy families, and for the transmission of these from one generation to another, flows directly from the scope of two of the three exceptions to the Statute of Uses. As already explained, the Statute did not apply to dispositions of personal property – and most categories of investment asset (stocks, shares, bonds, etc) fell within this category. (In due course, even freehold interests in land itself, including mortgages of land, were deemed by equity to be personalty, not realty, if they were comprised in a trust disposition which provided for the sale of the assets comprised in it. This is the so-called doctrine of conversion.) Similarly, the Statute did not apply to active trusts – and the holding of investment assets on terms that there might, in the ordinary course, be occasion to sell some or all of them and re-invest the proceeds obviously involves active, managerial functions.

One of the few academic lawyers to have described the emergence of trusts of investment assets summarises the process in these terms (Shattuck 'The Development of the Prudent Man Rule for Fiduciary Investment in the Twentieth Century' (1951) 12 Ohio State LJ 491 at 491–492):

> To be sure, a hundred or more years before the time of Victoria's death trusteeship had passed, somewhat nervously, from the concept of safe conduct of a specific *res* into the concept of maintenance of a stated set of values. During that transition the duty of the English trustee had transformed itself from the relatively restricted obligations related to care, custody and operation of family agricultural real estate and its appurtenances to the much more intricate task of trading in commercial and financial markets and to the attempted maintenance, through the life of the trust, of a value which had been stated to exist at the time of the opening inventory.

(For further discussion of this process of change, see Chesterman 'Family Settlements on Trust: Landowners and the Rising Bourgeoisie' in Rubin and Sugarman (eds) *Law, Economy and Society, 1750–1914: Essays in the History of English Law* (1984) p 124 at pp 145–64. Much of the present section is based on this discussion. See too Anderson 'Law, Finance and Economic Growth in England: Some Long-Term Influences' in Ratcliffe (ed) *Britain and Her World 1750–1914* (1975) p 101.)

Little is known of the forms which trusts of investments took as they started to become common in the eighteenth and nineteenth centuries. In the absence of detailed studies, one can but conjecture that the majority are likely to have been testamentary trusts or marriage settlements, there being no fixed incentive to create other forms of inter vivos trust until the advent of high rates of income tax and estate duty in the twentieth century. Most testamentary trusts contained life-interests for a surviving spouse with remainders for children, or life interests for children (whether or not in addition to a surviving spouse) with remainders for grandchildren. Interests in favour of children often provided for accumulations of income (usually with an accompanying power of maintenance) until the child's attaining majority or marrying beneath that age. Two rather more sophisticated forms of disposition which were also used – the protective trust and the discretionary trust – will be described shortly.

The significance for trusts law of this shift in the nature of family wealth-holdings – that is, from land (predominantly) to investment assets as well as land – can scarcely be overstated. Hitherto, trustees of private trusts had primarily been passive, nominal owners of the land comprised in the trust, with the principal managerial decisions (eg as to farming the land or letting it out to tenant farmers) being taken by the beneficiary who was currently in possession. But as trustees increasingly assumed management responsibilities, a new set of legal principles regulating trust administration had to be developed by the Court of Chancery. In addition, the presumption in trusts of investment assets that some or all of the trust property might in the normal course of events be sold, with re-investment of the proceeds, had a significant impact on basic aspects of the creation and duration of trusts.

(b) The changes in trusts law and practice

The emergence of trusts of investment assets accordingly influenced the shape of modern trusts law and practice in a number of vital respects. The following examples of changes in trusts law and practice during the eighteenth and nineteenth centuries illustrate this (see also Stebbings *The Private Trustee in Victorian England* (2002)):

(1) Investment guidelines The managerial responsibilities associated with investment compelled Chancery to develop investment guidelines for trustees. The trading and industrial ventures of the time were often speculative, in that there was always a prospect of substantial loss and the standard of protection for investors was primitive. Chancery therefore took the view that, unless otherwise authorised, trustees should not invest any cash in hand in investments other than government stock or (according to some judges) first mortgages of land. This laid the basis for a divergence, still existing, between 'trustee investments', which comprise 'safe' securities within a range specified by the law, and the wider investment powers which are often expressly conferred upon trustees by a clause in the trust instrument in order that they should not be confined to 'trustee investments' only. (These developments are reviewed more fully in Chapter 10.)

(2) Delegation Rules regarding delegation by trustees to brokers or other professional agents had to be laid down. As investment possibilities became widened by statute in the nineteenth century, there was increasing pressure to ensure that, unless one or more of the trustees had legal or financial skills, tasks requiring expertise in these areas were duly delegated.

(3) Professional and corporate trustees As an alternative to requiring continual reliance on professional agents, trustees possessing appropriate skills were often appointed. One modern historian, B L Anderson, places particular emphasis on the roles of solicitors in this regard. He describes these 'shadowy figures' as 'custodians of capital over a wide range of the population', since generally they were attorneys and financial intermediaries as well as trustees. In these capacities, they 'served the interests of "provident" rather than "pure" investors, the majority in a predominantly agrarian society; at the same time [they] were well placed to exploit

the lengthening investment horizons of the 18th century' ((1969) 11 Business History 11 at 20). A further stage in this development was the emergence of corporate trustees, which started somewhat hesitantly in the mid-nineteenth century, but got under way more firmly early in the twentieth century. A corporate trustee offered the prospect of both professional expertise in trust management and a solid backing of assets if this expertise fell so far short of expectations that an action for negligence could be brought by a beneficiary. The increasing use of professional and corporate trustees is discussed further in Chapter 9.

(4) Standards of skill and care The courts also had to reckon with the possibility that, in exercising their powers of management of the trust fund, trustees might cause serious losses through carelessness or incompetence. They might, for instance, lend out trust money on a mortgage where it was clear from the outset that the land mortgaged was of insufficient value to support the loan. Chancery developed the doctrine, still to be found in the modern law, that trustees should be liable, at the instance of beneficiaries, to restore any losses suffered by the trust in such circumstances if they failed to 'conduct the business of the trust in the same manner that an ordinary man of business would conduct his own' (*Speight v Gaunt* (1883) 22 Ch D 727 at 739 per Jessell MR). In applying this objective standard of skill and care, the fact that the trustees were managing, not their own funds, but funds which, in the eyes of equity, belonged to other people, was taken into account, so as to rule out speculative transactions (*Re Whiteley* (1886) 33 Ch D 347 at 355 per Lindley LJ).

(5) Standards of good faith It was recognised from the early days of enforcement of medieval uses that trustees were bound to act in a disinterested fashion. But it was not until the eighteenth century that the fiduciary character of executors or administrators holding the assets of a deceased's estate was established, or that unauthorised profits made by trustees or other fiduciaries through the use of their powers as such, or through opportunities becoming available to them because of their fiduciary office, could be claimed from them by the beneficiaries. Rulings to this effect – for example, the seminal decision in *Keech v Sandford* (1726) Sel Cas Ch 61 – were prompted by the consideration that trustees who were given the task of managing a changing 'fund' of investment assets were quite likely, on occasions, to encounter opportunities to make profits on the side.

(6) Premature termination of trusts In a trust of investment assets, there was no presupposition that the trust property should be inalienable. This raised the question whether a trust of this nature should continue when its beneficiaries, being all ascertained and of full age and sound mind, wished it to come to an end. If, for example, a trust of securities gave a life interest to A, with a remainder to B on his attaining 25, and with accumulation of income between A's death and B's attaining 25, could the trust be terminated by A and B together once B turned 21? A and B might prefer to exchange their respective rights to present income and future capital for immediate shares in the capital, which they could dispose of freely.

In *Saunders v Vautier* (1841) 4 Beav 115, Chancery was confronted with this tug-of-war between a trust founder's power to control the future treatment of his property and a beneficiary's claim to have his entitlement treated as a disposable right of property. In a brief judgment on simple facts, Langdale MR held in favour of the beneficiary. In circumstances explained more fully below (Chapter 7), this ruling mushroomed into a broad principle that where all beneficiaries (however numerous) are sui juris and ascertained, they can terminate a trust notwithstanding the opposing wishes of the founder, as expressed in the trust.

(7) Discretionary and protective trusts The notion that a beneficiary's primary entitlement under a trust of invested wealth was to monetary benefit only (instead of, or sometimes in addition to, occupation of land) paved the way for the development of discretionary trusts. In the early nineteenth century, the main function of these trusts seems to have been to act as a second limb in a trust device called the 'protective trust'. A 'principal beneficiary' – for example, the son of a rich merchant – was given a life interest in a trust fund, but this interest was expressed to be subject to premature termination if he tried to sell or mortgage it or if he went bankrupt. On such termination, a discretionary trust sprang up under which he and one or more specified persons (eg his wife and/or his children) were the beneficiaries. In the nineteenth century, recognition that this double-barrelled 'protective trust' was valid and effective to keep the beneficiary's life interest immune from prospective buyers, mortgagees and/or creditors, brought out some of the contradictions inherent in *Saunders v Vautier*. This time, the trust founder's 'caretaker' desire to exert his power of disposition so as to protect the life beneficiary from anticipated improvidence was upheld against the counter-argument that the beneficiary should be able to exercise his proprietary right of converting his interest under the trust into a capital sum which would then be used for 'active' entrepreneurial purposes. In the result, the beneficiary's interest under the trust obtained a degree of limited liability in respect of all his debts – whether incurred for business reasons or personal consumption or in any other circumstances – notwithstanding that limited liability, even for business debts, was not yet generally available.

Both protective trusts and discretionary trusts retain their potential for immunising family property from the creditors of its individual members (see Chapter 6). Furthermore, as explained in the next chapter, the function of the latter form of trust in the twentieth century has been drastically altered by the onset of inheritance taxation at high rates.

(8) Statutory intervention Many of the changes in trusts law outlined here were the consequence of judicial decisions. But Parliament also took a hand. The first general statute on trusts was the Trustee Act 1850. This was concerned chiefly with technical aspects of the transfer of property held by trustees. Subsequently, enactments in 1859, 1860, 1888 and 1889 regulated trustee investment; the Conveyancing Act 1881 dealt with the appointment and removal of trustees and the nature and

devolution of various trusteeship powers; and various aspects of beneficiaries' remedies against trustees and fellow beneficiaries were the subject of legislation in 1888 and 1896. The office of Public Trustee was established by the Public Trustee Act 1906.

The various statutory interventions were consolidated in the Trustee Act 1925 (replacing an earlier Act of 1893). A number of its provisions – for example, s 23 (power to employ agents) and s 33 (protective trusts) – directly reflect the historical developments in trusts law discussed in this section. The Trustee Act 2000 has modified and replaced several of the 1925 provisions – such as s 23 – but others – s 33 is one – remain in place.

5. Strict settlements of land and married women's property rights

In the preceding section, the development of family trusts of investment assets during the seventeenth, eighteenth and nineteenth centuries was given prominence because this form of trust is still 'alive and well' and the legal developments associated with it are of major importance in the modern law. But this is not to say that the trust concept ceased to be significant in the context of settlements of landed estates during the same period. Its chief role was in filling gaps in a much-used form of disposition of land – the strict settlement – which took effect primarily through interests recognised at common law (including 'executory' interests). Furthermore the trust, during this period, was also employed by Chancery as a means of permitting married women to hold property in their own right. This was by way of mitigation of a common law rule that, once a woman was married, her husband was the sole owner of property that would otherwise be hers.

These two aspects of the history of trusts receive relatively limited attention here because the circumstances which rendered them important have ceased to exist. The Settled Land Act 1882 undermined the principal purpose of strict settlements – that is, retention of landed estates within successive generations of a family – by conferring a power to sell settled land on the current life-tenant. Estate duties in the twentieth century also provided a strong disincentive to any form of long-term settlement of land. Similarly, equity's intervention on behalf of married women became more or less redundant when married women's property legislation, commencing in 1870, abolished the common law prohibition of separate ownership. Some brief comments on these two aspects of trusts history are, however, desirable, as they provide insights into the nature of some modern equitable doctrines.

(a) Strict settlements

The phrase 'strict settlement' describes a form of settlement of landed estates which was widespread amongst wealthy families in England between the late seventeenth and late nineteenth centuries. (See generally Chesterman 'Family Settlements on Trust: Landowners and the Rising Bourgeoisie' in Rubin and Sugarman (eds) *Law, Economy and Society* (1984) pp 127–145 and sources cited there.) The aims of the strict settlement have been much debated. Dynasticism was almost certainly a factor. From that perspective the principal aim was to inhibit to a significant degree, though not completely and irrevocably, any disposal of the family estates by the heirs or other immediate descendants of the settlor. But this was far from being the whole story. Habakkuk, for example, reminds us that 'the ambition of landowners to maintain the association between the male line and the ancestral estate was buttressed by the need to secure the fortunes of the wife and younger children' (*Marriage, Debt and the Estates System: English Landownership 1650–1950* (1994) p 64). He even concludes that 'In the long run . . . family provision proved a more durable support for the strict settlement than dynastic ambition'. What might be meant by 'family provision' is itself contentious. Spring, for instance, has argued that one purpose of the strict settlement was to subvert the more advantageous position under common law of heiresses and widows (*Land, Law and Family: Aristocratic Inheritance in England 1300–1800* (1993), but cf Cocks 'Unsettling Settlements' (1995) 16 Journal of Legal History 210–217). However one assesses the aims of the strict settlement, one secure conclusion can be drawn. It was highly pervasive: as much as one-half of England may, according to one estimate, have been tied up in strict settlements around the middle of the eighteenth century.

A strict settlement operated by means of a complicated series of life estates, estates in remainder and other limited interests taking effect mostly at common law. It could be set up at any time, but the most common events precipitating the creation of a settlement would seem to have been the coming of age or the marriage of the eldest son (or, where no sons existed, the eldest daughter) of a landowner, or the landowner's death. Generally speaking, there had to be a resettlement once in every generation if the constraints on disposal of the land were to be maintained. But the *paterfamilias*, who was likely to favour this, was usually in a position to compel his children to co-operate in renewing the settlement.

Strict settlements made a significant contribution to the consolidation and preservation of both the wealth and the political power of the landowning aristocracy (see eg Stone *An Open Elite? England 1540–1880* (1986)). Yet the frequency with which they actually had sufficient legal force to restrain the sale of lands by a current life-tenant who was determined to sell is a matter of historical controversy. (The extensive debates and literature on this subject are best approached through the excellent introductory survey by English and Saville *Strict Settlement: A Guide for Historians* (1983).) The following rather graphic statement of a leading historian of the late nineteenth century, Sir Frederick Pollock, whilst probably overstating the efficacy of strict settlements in restraining alienation of land, does indicate their autonomous nature (*The Land Laws* (3rd edn, 1896) p 117):

> There is nothing, perhaps, in the institutions of modern Europe which comes so near to an *imperium in imperio* [an empire within an empire] as the settlement of a great English estate. The settlor is a kind of absolute lawgiver for two generations; his will suspends for that time the operation of the common law of the land, and substitutes for it an elaborate constitution of his own making.

Reference to the settlor as 'absolute lawgiver' and to 'his will' omits a central player from the cast. The settlor was usually very reliant on the advice and directions of his lawyer, advice which Habakkuk suggests was 'naturally enough, biased towards maintaining the family settlement' (above, p 69). The lawyer was often therefore much more than simply a translator of intentions. The 'kind of law' that emerged was therefore likely to reflect the conventions in Chancery and the creative practices of conveyancers (see also Cocks at 216).

(b) Strict settlements and trusts

Because strict settlements operated chiefly by means of legal interests, the role played by trusts was ancillary only. Trustees were commonly appointed, but, to quote Pollock again (p 117):

> The trustees of a family settlement are something like the constitutional safeguards of a complex political system; their presence is, in ordinary circumstances, hardly perceived, but they hold great powers in reserve, which may be used with effect on an emergency.

The following trust dispositions were commonly found within the lengthy, complex provisions of a strict settlement:

(1) A trust 'to preserve contingent remainders' This was a crucial conveyancing device. It was invented to get around technical legal rules whereby a life-tenant in possession who purported to sell the fee simple might destroy subsequent interests by the settlement so as to defeat its purpose completely.

(2) A trust to pay portions, debts etc out of rents and profits of specific lands This form of trust had predecessors amongst medieval uses declared to operate on the landowner's death. When a landowner established it during his lifetime, as a means of forced saving, it had a new function: that of protecting the landowner against his own imprudence.

(3) A trust to manage the estate in times of financial crisis Under this disposition, which was one of the 'safety-valves' for the pressures on liquidity exerted by the strict settlement, the trustees became managers of family capital, with important discretionary powers exercised independently of the creator and beneficiaries of the trust. This power to manage the family's landed wealth, even to the extent of telling the current 'head of the family' to limit his own personal expenditure, gave an important dimension to trusteeship of land. It was comparable, within the limited circumstances in which it operated, to the managerial role being increasingly adopted by trustees of investment assets.

(4) A trust to secure a separate income to a wife Because the creation of a strict settlement on the marriage of an heiress often involved an element of bargaining with her forthcoming inheritance, equity's recognition of separate property interests for married women was crucial in ensuring that the heiress herself, and other members

of the family, did not completely lose the value of what they put into the settlement. But separate property rights for married women were also important in contexts other than strict settlement. They are accordingly given separate treatment in the next section.

This continuing association of trusts with a much-used and highly sophisticated form of common law settlement of land has left its mark on modern trusts law in two significant ways. These relate respectively to the question of remoteness of vesting of interests under trusts and the apportionment of benefit under trusts which differentiate between income beneficiaries and capital beneficiaries.

The validity of interests vesting at a future time – ie the issue of 'perpetuities' – was a crucial question for strict settlements. The courts accepted the strict settlement as valid in the late seventeenth century even though in the preceding decades many arrangements having a similar effect were struck down by the courts as 'tending to a perpetuity'. The eventual acceptance of the strict settlement may have been because the ties imposed by it were not wholly unbreakable; the process of resettlement that occurred once each generation allowed for some of the lands to be freed from the settlement. Alternatively, landowning Lord Chancellors and other rich lawyers may simply have followed an enhanced desire amongst most landowners to concentrate and preserve landholdings. In any event, a series of late seventeenth and early eighteenth century cases, notably Lord Nottingham's decision in the *Duke of Norfolk*'s case (1683), laid down what came to be known as the 'modern rule against perpetuities'. It is to the following effect: 'no interest is good unless it *must* vest, if at all, not later than twenty one years after some life in being at the creation of the interest'. This rule did not endanger the strict settlement: indeed validation of the strict settlement probably influenced its precise formulation. But it now belongs within trusts law as a whole (subject to statutory modifications). It applies to family trusts of investment assets and to virtually all other forms of trust (though in the case of charitable trusts there are limited exceptions). The significance of this enlargement of the scope of operation of the rule against perpetuities is explored in Chapter 6.

Apportionment of benefit amongst income and capital beneficiaries (eg life tenants and remaindermen) depends substantially on what is meant by 'income' and 'capital'. Trusts law definitions of these have derived from a supposition underlying strict settlements, ie that the income-producing asset, the land, was not to be sold. The profits produced year by year from this immovable asset – comprising substantially the rents paid by tenant farmers – were naturally treated as 'income' for a settlement beneficiary, without any attention being paid to changes in the value of the asset itself. Further aspects of this question are discussed in Chapter 10.

(c) Trusts for married women

As already explained, the common law treated married women as having no capacity to hold property in their own right. Any property held by a woman on her marriage became the property of her husband. Her only solace under the common law was that, if she survived him, she became entitled to a proportion of his property as 'dower'.

The inroads on these principles made by the law of trusts between the seventeenth century and the late nineteenth century – at which point legislation intervened – are outlined in the following extracts from Holcombe's study of the origins and the enactment of the legislation (Holcombe *Wives and Property* (1983) pp 37–42, 46–47; cf Staves *Married Women's Separate Property in England 1660–1833* (1990), where the ideological dimensions of the law are considered):

> Both the common law and equity proceeded upon the assumption that married women needed protection. The common law regarded a woman's husband as her guardian, under whose 'wing, protection and cover' she lived, moved, and had no legal being. But equity, generally considered to be 'the guardian of the weak and unprotected, such as married women, infants and lunatics', tended to view a woman's husband as 'the enemy', and against his 'exorbitant common-law rights the Court of Chancery waged constant war' (R H Graveson and F R Crane, *A Century of Family Law 1857–1957* (1957) p 140). As a result, the rules of equity relating to married women's property were diametrically opposed to the rules of the common law.
>
> One might argue that if the common-law rules of the identity of husband and wife reflected the sacramental view of marriage held in medieval times, then the opposite view of husband and wife in equity resulted from the breakdown of the doctrines and power of the Church in the Reformation and post-Reformation ages. . . .
>
> A more persuasive argument as to the origin of the equitable assumptions respecting husband and wife is that, just as the common law reflected the economic and social realities of the medieval period during which it developed, so equity reflected the changed realities of a time when the structure of the medieval society and economy began to crumble. The common law had always recognized an owner's right to dispose of personal property, and as conditions of landholding changed, with the abrogation of military land tenure and the legal recognition of testation with respect to land, the general rule of the law came to be freedom of disposition of all property, real as well as personal. The landed classes were alarmed, for freedom to dispose of property implied the dangerous ability of both sons and daughters to squander the family wealth if their actions could not somehow be controlled. At the same time there had appeared important new classes of society whose wealth, derived not from land but from commerce and industry, did not fit comfortably within the legal categories of real and personal property. These classes, too, were concerned to find protection for their property to prevent its being wasted by sons and daughters alike. And both the old landed aristocracy and the new aristocracy of the business world felt acutely the special need to protect the property of their daughters from the common-law rights of husbands, and to ensure that if there were no children of a marriage the property would not pass to their daughters' husbands but would return to their own families. It was in these circumstances that the wealthy classes turned to equity for the protection of their property that they could not find under the common law. . . .
>
> In practice the Court of Chancery allowed the creation of a special category of property, the so-called separate property or separate estate of married women. At law a

married woman could not own property, but in equity property could be settled upon her for her use under the management of a trustee who was responsible to the court for carrying out the terms of the trust. At first it was necessary to prove to the court's satisfaction that there was good reason for the creation of a trust, as, for example, that the husband was a wastrel or that the woman was separated from her husband. But soon equity came to accept without inquiry any trust created for a married woman. The separate property created by the trust would be protected by the Court of Chancery against a woman's husband and all other persons according to the wishes of the donor. Interestingly, a married woman's separate property in equity existed only during her marriage, for its existence was due to the need to protect it against her husband's common-law rights.

Separate property in equity could be of any kind – that is, property which at law would be categorized as real property, personal property, chattels real, and choses in action – and it could be created at any time by any person who was of full age and sound mind. Both before and after a woman's marriage she, her relatives, and her friends could settle property upon her for her separate use. . . .

Separate property could be created in several ways. The usual way was the drawing up of a written instrument setting forth the terms of the trust, either a deed or will disposing of property or a marriage settlement, a contract negotiated between the parties to a marriage or their families before the marriage took place. Such a contract was enforceable only in the courts of equity, for the common law, holding that husband and wife could not contract with each other, in effect voided contracts made by a man and woman who later married . . . Usually the document specifically named a trustee of the separate property, but the Courts of Chancery would validate the trust even if this was not done. In such a case the court recognized the husband as trustee for his wife, since under the common law the property would have been his to control, but he was required to deal with the property according to the terms of the trust and not treat it as being his own. . . .

The rights a married woman enjoyed with respect to her separate property varied, depending upon the way that property had been created. A written instrument settling property upon a woman often stated specifically what she could and could not do. For example, she might be expressly allowed to dispose during her lifetime of real property settled upon her or expressly barred from doing so, or she might be allowed or denied the right to dispose of her separate property by will, and so on.

To the feminists of Victorian times, the equitable rules relating to married women's property were naturally much more acceptable than were the rules of the common law. The law deprived married women of property, and thus deprived them of the rights and responsibilities of other citizens and subjected them to serious practical hardships. Equity allowed married women to have property, and thus ensured their independence and freedom of action. Under the law married women could have no legal existence separate from the husbands who controlled their property. In equity married women had an identity separate from their husbands because they controlled property.

At the same time feminists criticized the equitable rules applying to married women's property for two important reasons. First . . . equity did not recognize married women as having the same proprietary rights as other citizens, but accorded them special rights

> over certain property only. . . . The feminists' second major criticism of equity, and by far the more serious, was that . . . the relief it afforded from the provisions of the common law was not available to women who were not wealthy. The great majority of women in the country did not have property sufficient in amount and suitable in nature to be settled upon them as their separate property through the costly proceedings of the courts of equity. As A V Dicey summed up the situation (*Lectures on the Relation Between Law and Public Opinion in England During the 19th Century* (1920) p 383), 'There came . . . to be not in theory but in fact one law for the rich and another for the poor. The daughters of the rich enjoyed, for the most part, the considerate protection of equity, the daughters of the poor suffered under the severity and injustice of the common law.'
>
> When feminists denounced the common law and criticized equity, and called for thoroughgoing reform of the married women's property law, they had a large and sympathetic audience. This was so not because most people agreed with feminist demands for equality for women, but because legal reform generally was the order of the day and the Victorian conscience was troubled by the sufferings of women under the law as it then existed.

The Married Women's Property Act 1870 (amended in 1874) took the first step towards entitling married women to enjoy legal as well as equitable ownership of property. This task was more or less fulfilled by the Married Women's Property Act 1882 (repealing the earlier legislation), though this scarcely constituted the total reformation of the law that feminists had sought and remnants of earlier doctrines remained in the law for many years afterwards (see eg Shanley *Feminism, Marriage and the Law in Victorian England 1850–1895* (1989)). As the right of married women to hold their own property became thus established by statute, the special significance of equity's intervention to protect their interests faded away.

6. The role of trusts in English law

In this review of trusts law and family settlement during a period of 500 or so years prior to 1900, some important aspects of the role played by the trust concept within the law have become apparent. It is useful to identify these here, before consideration (in the next chapter) of the transformation of trusts law and practice brought about in the present century by the onset of high rates of inheritance and income taxation.

A noted US authority on trusts drew attention some 75 years ago to the capacity of trusts to 'pave the way' for reform of property law. His thesis, put shortly, is that where trusts lead, statutory reform may eventually follow.

> A W Scott (1922) 31 Yale LJ 457 at 457–458
>
> It was chiefly by means of uses and trusts that the feudal system was undermined in England, that the law of conveyancing was revolutionized, that the economic position of married women was ameliorated, that family settlements have been effected, whereby

> daughter and younger sons of landed proprietors have been enabled modestly to participate in the family wealth, that unincorporated associations have found a measure of protection, that business enterprises of many kinds have been enabled to accomplish their purposes, that great sums of money have been devoted to charitable enterprises; and by employing the analogy of a trust, by the intervention of the so-called constructive trust, the courts have been enabled to give relief against all sorts of fraudulent schemes whereby scoundrels have sought to enrich themselves at the expense of other persons. Many of these reforms in the English law would doubtless have been brought about by other means; but the fact remains that it was the trust device which actually was chiefly instrumental in bringing them to pass.

Whether or not one endorses in its entirety Scott's sweeping claim for the pervasive influence of the trust device, it is clear that significant legal change has occurred. Moreover, it has long been recognised that as part of this process lawyers were not just ciphers in some inevitable onward march of legal logic, itself deducible from a pre-ordained system of rules (see eg John Reeves's explanation of the haphazard recognition of the use in his *History of English Law* (1787), cited in Lobban *The Common Law and English Jurisprudence 1760–1850* (1991) at pp 50–56). On the contrary, they were frequently a creative force opportunistically fashioning developments in response to the perceived needs of their clients. Whilst we may see, in the long term, that the outcome has been major developments in the nature and form of the trust device itself or the stimulation of statutory reform, as with the Married Women's Property Acts, the process of legal change was, to adopt Anderson's phrase, one of 'controlled innovation' (*Lawyers and the Making of English Land Law 1832–1940* (1992) p 4), essentially practical and problem-solving in approach. But within this incrementalist method of legal change there lies another side to the picture of the trust as an agent of law reform. In Scott's words (pp 457–458):

> The trust has often served as a means of evading the law. Lord Bacon said that 'the special intent unlawful and covinous was the original of uses, though after it induced to the lawful intent general and permanent' *Reading on the Statute of Uses*, p 24. The line between evasion and reform is after all a difficult one to draw. The evasion which in the long run proves successful is usually a reform. Mr Justice Holmes, with characteristic discrimination, has said (*Bullen v Wisconsin* 240 US 635 (1916)):
>
>> 'We do not speak of evasion, because, when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits. When an act is condemned as an evasion what is meant is that it is on the wrong side of the line indicated by the policy if not by the mere letter of the law.'
>
> A trust is a device for enabling one to enjoy various rights, powers and privileges in respect to property greater than those enjoyed by owners of property, for enabling one to enjoy the benefits of ownership without subjection to all the duties and liabilities resulting from ownership. The question with which courts of equity have been

> compelled to struggle is how far it is possible to go without crossing the line which separates the legitimate use of the trust device from an illegal evasion of the letter or the policy of the law.

Thus Scott, whilst praising the trust for its reformist potential, also sounds a note of warning in this passage. He points out that the pressures for law reform through the use of the trust were often applied by property-owners who, with the help of their legal advisers, sought to avoid legal obligations, such as feudal 'incidents', or to escape the operation of restrictive legal rules, in each case with predominantly self-centred or family-centred motives. When 'reform' occurs on account of pressures such as these, the question to be asked is whether 'reform' is truly the right label.

There is a further proviso to be added here, not so much to challenge the broad sweep of the claim by Scott but to suggest that in some instances the influence claimed for the trust needs to be reappraised in the light of more recent research. Consider, for instance, the proposition that 'business enterprises of many kinds have been enabled to accomplish their purposes' by means of the trust. It is certainly the case that in the century before the mid-nineteenth century reforms in company law the trust was a key legal component of the unincorporated company. But it was not the only component. As Harris has illustrated in his account of the relationship between law, business organisation and the economy during early industrial capitalism, the unincorporated association was a complex legal phenomenon, developed in what he terms 'a learning-by-doing process' by attorneys and businessmen clients during the latter part of the eighteenth century (*Industrializing English Law* (2000) ch 6). It involved, apart from trusts law, the laws of agency, partnership and contract, the latter governing the contractual agreement between the members to form and regulate the company under a 'deed of settlement'. The trust potentially provided the means of compensating for the fact that the unincorporated company was not a legal entity. The property of the company would be vested in trustees who had standing to sue and be sued on behalf of the company and who were required to further the covenants set out in the deed of settlement (see also Cooke *Corporation, Trust and Company* (1950) pp 86–87).

Therein, as Harris persuasively argues, lay a number of difficulties relating both to the substance of trusts law at the time and to the procedures for its enforcement. The developments in trusts law described earlier in this chapter and concerning such matters as delegation, standards of skill and care, relieving trustees from liability mostly came about, or at least shifted from conjecture to certainty, in the latter half of the nineteenth century. These occurred too late to affect significantly the utility of the unincorporated company. Harris refers, for instance, to a popular trustees' guidebook from 1830 in which it is stated that 'carrying on trade or business for the object of a trust estate is a very hazardous expedient, for the trustee may easily make himself responsible for various losses' (Harding *Advice to Trustees*, pp 66–67, cited in Harris, above at p 154). As Harris then pointedly emphasises:

'this is exactly what trustees of unincorporated companies were expected to do.' Moreover, perceived weaknesses in substantive trusts law were compounded by the high costs and delays that accompanied Chancery litigation. The conclusion drawn by Harris is that whereas the trust was able to provide a solution for some of the problems posed for the unincorporated company 'it was of no service in many other, more commercial and managerial aspects of [its] activities' (at p 159). Notwithstanding 'the industrious work of imaginative lawyers and businessmen' the disadvantages of the unincorporated corporation were manifest when compared with the advantages offered by the joint stock company (but cf the more positive assessment of the significance of the part played by the trust in Cooke *op cit.*)

This illustration of the limits of the trust in a particular context paradoxically does not invalidate Scott's argument. That a legal form such as the trust has acted as an agent for law reform can be seen on the one hand as a positive virtue whilst on the other hand the fact that reform is considered necessary should remind us of the reality that the trust has functional limitations as well as strengths (see also the discussion in Chapter 1 at pp 18–20). The paradox here is that to some extent it was the limitations of trusts law allied to the failings of Chancery procedure that was the catalyst for reform, contributing, along with other contingencies, to a perception that reform of the law affecting business organisation was necessary.

But there is yet another dimension to an analysis of the role played by the trust in English law, one less obviously laudatory than that expressed by Scott and one that can be perceived as a virtue or a vice depending on the standpoint adopted. The following extract from an article by Cotterrell that adopts a more sociological perspective argues that the chief contribution of the trust concept has, broadly speaking, been to help in masking the extent of inequality within society. It does so by obscuring the link between private property – a key source of power – and its ultimate owners. When property is held on trust, under a modern family settlement, the beneficiaries appear to be purely passive, because management of the property is vested in the trustees. But they still enjoy the material benefits conferred by the property, and their rights in this regard are legitimated, so the argument runs, through the use of the label 'trust', with all its moral overtones, to describe the obligations owed to them by the trustees.

R Cotterrell (1987) 14 Journal of Law and Society 77 at 83–88

[The] property-form (the expression of relationships in terms of the concept of property) depends as a commonsense idea on our being able to conceptualise a 'person' owning a 'thing'. It is because of this conceptualisation that the separation of owner and owned is established with the consequence that the attributes of power are seen as separate from the owner and attached to the assets which are owned. . . .

As Maitland suggested long ago, it was, above all, the device of the trust which made it possible for English law to recognise many forms of property ownership by

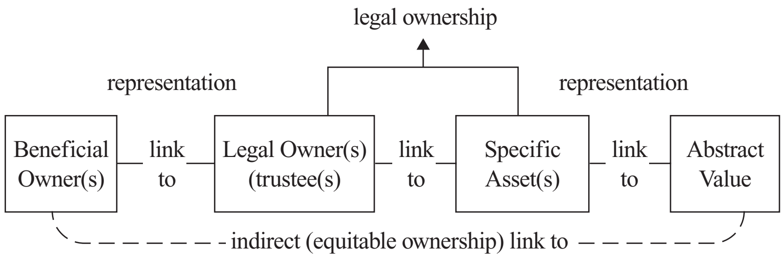

Figure 2.1 *Forms of ownership.*

collectivities without attracting some of the technical difficulties and ideological conflicts centred on aspects of the doctrinal problem of corporate personality in continental civil law systems. Today, however, adopting a critical perspective on doctrine, we can see more clearly how this doctrinal device of the trust has served to extend the ideological utility of the property-form. The trust makes possible the maintenance of permanent, easily identifiable property-owners (explicitly recognised as such by law) in the form of replaceable trustees, together with an indefinite range of beneficially entitled individuals or collectivities (for example, groups of children or other issue, classes of discretionary beneficiaries, members of associations, organisations and interest groups of numerous kinds) who, having beneficial entitlements guaranteed in equity, can share in property-power but remain invisible to law as property-owners as such. The limitations which the property-form as an ideological form imposes on the nature of the property-owner (that is, basically, that such an owner should be a clearly identifiable 'person' and not an indefinite collectivity) are overcome. Equally, the trust makes possible the creation of enduring objects of property ('things', clusters of value) in the form of funds which can be invested in various ways to preserve and enhance their value. In this way the trust greatly facilitates the concentration and preservation of capital – and thereby helps guarantee the power and security which the property-form embodies. The recognition of the trust fund, in many trusts, as the embodiment of *abstract value*, a 'cluster of value', rather than tangible assets (for example, land) is a sophisticated recognition in legal doctrine of the ideological nature of property as an embodiment of power. Ultimately what is important is not the particular assets which are owned at any given time but the abstract value of what is owned which determines the degree of power of the property-holder. Only in certain (usually family) trusts, in which what is being provided for beneficiaries is security of use of real or personal property or the preservation of specific assets rather than power as such, is the asset held in trust important in itself. In other cases all that is fundamentally important is the maintenance of the value which currently held trust assets represent.

The extension of the property-form which the trust allows can be illustrated as in Figure 2.1. What is made possible is an extension of . . . the nature and range of those who own and also of what can be owned.

The major ideological significance of this structure is the far greater flexibility in manipulation of property-power which is made possible by it, and a further 'disguising' in ideological forms of the nature of that power. An illustration of that disguising can easily be given. The trust form tends to disguise the actual nature of the power relationship between trustees and beneficiaries. The ideology of the trust is such that the legal owner (trustee) is the person who 'looks most like' an owner since she or he is the one who (usually) can carry out most of the ordinary legal transactions possible to an owner – sale, mortgage, lease, exchange, etc. The beneficiary under a trust is seen as passive. Typically the beneficiary cannot interfere in management of the trust property except by procuring the intervention of the courts (for example, in claiming breach of duty by the trustee). During the existence of the trust, control of capital typically rests with trustees. In discretionary and protective trusts, and in the exercise of powers of maintenance and advancement, the trustees may exert significant control over the situation of beneficiaries. Again, it is in some family trusts in which what is at stake is the property-security of dependants (the preservation of trust assets rather than use of the property-form as an instrument of power) that this control by trustees is often greatest!

This apparent power of trustees and passivity of beneficiaries is, however, misleading. It is the beneficiaries – often collectivities – unrecognised directly as legal owners who actually have access to the property-power embodied in the trust. This is ultimately admitted in, for example, the very strict rules governing trustees' duties with regard to investment, profit-taking by trustees and conflicts of duty and interest, and in the rule in *Saunders v Vautier*, which allows the trust device to be set aside if the beneficiaries so wish where all of them are identifiable persons having full legal capacity and hence easily recognisable as property owners within the orthodox commonsense conception. Yet the very fluidity of beneficial entitlements which the trust makes possible hides from view even more effectively than the property concept in its simple form the actual structure of power which private law guarantees and perfects.

How can this view of the ideological significance of property and trust help us to analyse trust law from a critical perspective? First, by looking at the trust in terms of its ideological significance in helping to exclude the element of power from recognition in legal doctrine we can begin to put the element of power back into our picture of law and its working. It is, indeed, impossible to understand law's relationship to power without analysing the way in which legal ideology is often able to exclude all recognition of private power . . .

A second reason for looking at the trust concept in terms of its ideological significance is that this emphasises that what appears as a highly technical and esoteric part of property law doctrine is actually a conception of wide influence in popular consciousness. The idea of fiduciary obligation of the trustee harnesses to legal doctrine a moral conception of great social significance and induces us to see the trust beneficiary not as the possessor of property-power but as a person meriting protection; a person to whom moral as well as legal obligations are owed. The trust-form, concentrating and guaranteeing property-power, not only fails to impose moral obligations on the powerful, but actually encourages us to think of *moral obligations owed to them* because of their beneficial entitlements.

On narrow technical grounds, it can be argued that this passage overstates the importance of the residuary powers of beneficiaries in controlling their trustees.

Termination of a trust under the rule in *Saunders v Vautier*, for instance, will often not be possible in practice particularly where the trust is a discretionary one with large numbers of beneficiaries spread over several generations. Similarly, challenging the investment decisions of trustees, even when they appear to be clearly misguided, is often very difficult, as where the investment power is conferred in wide discretionary terms by an express clause in the trust instrument. The reader may wish to consider these and other issues, which relate in broad terms to the 'balance of power' between trustees and beneficiaries, after reading the detailed treatment of them in the relevant chapters of this book (Chapters 9–11).

Turning to matters of ideology and power, whatever the present ideological significance of the trust device may be, its development has at times been marked by an ambivalent attitude on the part of the courts and the legislature towards the trust. Some nineteenth-century developments in rules about aspects of trust creation and management of trust property, suggest that 'fashionable considerations of economic liberalism and property rights' – the phrase is borrowed from Gardner's first edition of *An Introduction to the Law of Trusts* (1990) p 35 – may have tempered a facilitative presumption that people should be able to settle their property however they like. Yet it must also have been the case that many who endorsed laissez faire notions would have looked to the trust to provide security for their own families. Unfortunately the 'modern' history of trusts law is too undeveloped to allow anything other than tentative hypotheses to be advanced on these issues.

It is certainly the case that by 1900 the trust had become a flexible and highly sophisticated property-holding device which helped to maintain extensive private property ownership amongst wealthy classes. How far the moral concept of 'trust' in fact helped to legitimise the power attached to such ownership is, however, not easy to discern. This is in part because different modes of discourse are at work here. Gordon has suggested that 'despite the assiduous efforts of Marxist and legal realist critics, "property" is still to this day heard as univocally expressive of autonomy and liberty' ('Paradoxical Property' in Brewer and Staves (eds) *Early Modern Conceptions of Property* (1995) p 101). But we may need to distinguish here between the abstract appeal of 'property' as an idea and an everyman or everywoman appreciation of the trust as an everyday legal form. Of course it is conceivable, perhaps probable, that the notion of 'moral obligation owed to beneficiaries' and of a paternalist regard for the protection of them are constituents of a dominant discourse amongst the propertied and the legal fraternity. But a degree of scepticism may be called for as to whether the trust carries similar connotations for the propertyless or even the 'less-well-propertied'. Might we discover that 'the family trust' is inextricably harnessed in the public consciousness with 'tax avoidance' and, indeed, that that link engenders pejorative sentiments about the trust? (Although admittedly from a different context, consider the example of the NHS Trust where it is far from evident that deliberately attaching the label 'trust' rather than, let us say, 'corporation' to hospitals under the NHS reforms of various governments have made those reforms any more popular.)

It is in the dimension of taxation that the effectiveness of the trust in these matters of legitimation now needs to be tested. During the eighteenth and nineteenth centuries, the chief danger to private ownership which family settlements – particularly, settlements of land – sought to avert was the break-up of family estates by the spendthrift conduct of heirs who wished to sell off assets to pay current debts. By the mid-twentieth century, as we shall see, the emphasis had shifted to one of securing protection from ‘external’ attack – ie the levies imposed by the Inland Revenue. But the trust, having been developed over several centuries through the artifice of conveyancers and given full effect by both judges and the legislature, was sufficiently well-established as a legitimate mode of wealth-holding to present a formidable challenge to the tax imperatives of the twentieth century. How successfully the trust has been adapted, whether by judicial or statutory change, to confront this new challenge is a recurring theme in the remainder of this section of the book. In particular it will be necessary to consider whether the framers of tax laws have been constrained by a perceived need to treat the established doctrines of trusts law as more or less sacrosanct, and therefore to tailor tax laws to fit with them. If this were to be so, it would indeed represent a considerable tribute to the entrenched status of trusts doctrine and the ideological power of the legal concept of ‘trust’.

7. The jurisdiction of equity

(a) Equity and the common law

The principal focus of the chapter has been on the emergence, recognition and enforcement of the trust. At several points, however, mention has also been made of the development of Equity in general as a ‘gloss’ (Maitland *Equity* (2nd (Brunyate) edn, 1936) p 18) upon the operation of the common law system. But, it will be recalled, this was a gloss with teeth. While Equity might not have denied that a person held a legal title to property the Chancellor could order that person to deal with it for the benefit of the true owner in Equity. Failure to obey could constitute contempt of court for which the sanction of imprisonment might be imposed. Thus legal title was affirmed whilst, in effect, being subordinated to the interest of the owner in Equity by the imposition of a personal remedy against the holder of the legal title. As we have seen this became relatively non-contentious in the context of the recognition and enforcement of the trust or of ‘other confidences reposed in some person’. None the less the potential for conflict between two parallel legal structures is evident. That conflict came to a head in the early years of the seventeenth century ostensibly over a dispute about the validity of ‘common injunctions’ by which a party who had obtained judgment at common law could be restrained in Equity from enforcing it. It was recognised that if such injunctions were to be upheld, this would be decisive in resolving which jurisdiction was supreme. In the event an order in favour of Equity and the Chancery Court was made in 1616, effectively resolving the dispute although it may be that the demise of the two chief protagonists – through the death of the Chancellor Lord Ellesmere and the dismissal of the Chief Justice Coke – was at least as important in view of their personal and political rivalry (see Getzler 'Patterns of Fusion' in Birks *The Classification of Obligations* (1997) p 157 at pp 179–183; and Baker 'The Common Lawyers and the Chancery: 1616' in *The Legal Profession and the Common Law: Historical Essays* (1986). The outcome was reaffirmed in the Judicature Act 1873, s 25(11), and re-stated in the Supreme Court Act 1981, s 49(1): 'wherever there is any conflict or variance between the rule of equity and the rules of the common law with reference to the same matter, the rules of equity shall prevail' (confirmed in eg *Walsh v Lonsdale* (1882) 21 Ch D 9).

We must be clear about what supremacy for Equity came to mean. It did not leave each and every decision of the common law courts at the mercy of a discretionary intervention by the Chancellor, depending on his perception of what 'conscience' demanded. On the contrary, the importance of adhering to precedent became emphasised (see Winder (1941) 57 LQR 245–279). Consequently, from the latter part of the seventeenth century onwards, the content of the gloss was steadily refined in a manner that produced a body of more clearly defined equitable rules and principles. These in turn were to become almost as fixed and rigid as the rules of the common law, an outcome reflected in the much-quoted observation of Lord Eldon (*Gee v Pritchard* (1818) 2 Swan 402 at 414):

> The doctrines [of Equity] ought to be . . . made as uniform, almost, as those of the common law. . . . I cannot agree that the doctrines of this court are to be changed by every succeeding judge. Nothing would inflict on me greater pain in quitting this place than the recollection that I had done anything to justify the reproach that the equity of the court varies like the Chancellor's foot.

(b) The Judicature Acts 1873 and 1875

Almost contemporaneous with Eldon's periods as Chancellor (1801–1806, 1807–1827) reforms began to be introduced to the Court of Chancery in an attempt to counter the organisational weaknesses that had led to expense and delays and had on occasions resulted in injustice. By then it had become possible to perceive of Equity as a system, an incomplete system compared with the common law, but a system with its own court structure and defined rules and principles even though at every point it presupposed the existence of the common law (see Maitland, above, pp 16–17). The operation of two systems in separate courts with neither having the authority to grant the remedies of the other court was increasingly seen as tending to produce delay and confusion for the litigant. Despite further reforms which improved the position somewhat (eg Lord Cairns Act 1858 by which Chancery was given jurisdiction to award equitable damages where no other remedy was appropriate), pressure for wholesale restructuring increased. The outcome was the enactment of the Judicature Acts 1873 and 1875 by which the structure of the whole judicial system was finally reformed. These Acts abolished the previous individual courts and created a Supreme Court of Judicature but with separate divisions (originally five but now three comprising Chancery, Queen's Bench and Family Divisions). A key feature of the reforms was that under s 24 of the 1873 Act all judges were empowered, indeed placed under a duty, to give effect to both legal and equitable rights, obligations, liabilities, defences and remedies. In short the administration of the systems of law and equity became fused.

(c) Law and Equity: fusion or harmonisation?

Whilst the position as regards fusion of the administrative structure of the courts is clear, debate has subsequently developed as to whether there has been a *substantive* fusion of the common law and Equity. Certainly the contemporary perception was that fusion had occurred at the level of administration only. This was evident in parliamentary debate (*Hansard* 3rd Series, vol 216, 644–645, statement by the Attorney-General during the second reading of the Judicature Bill), in judicial statements (Jessell MR in *Salt v Cooper* (1880) 16 Ch D 544 at 549, but cf later ambiguous dictum in *Walsh v Lonsdale* (1882) 21 Ch D 9 at 14) and in Ashburner's famous metaphor: 'the two streams of jurisdiction, though they run in the same channel, run side by side, and do not mingle their waters' (*Principles of Equity* (2nd edn) p 18). This assessment is reinforced by the fact that the Judicature Acts were conceived as cautious measures, since previous parliamentary bills proposing a more thoroughgoing fusion of common law and equity had failed (Baker (1977) 93 LQR 529 at 530). It would be misleading, however, to give the impression that this outcome was achieved without controversy. The drafting of s 25(11) (see above) left sufficient uncertainty to permit a more radical interpretation of its meaning and intention, such that suspicion between the judges about the motives of some of their colleagues became evident. Baker refers, for instance, to the reported tension between Jessel MR, who was inclined to incorporate equitable doctrines into the common law, and his successor Lord Esher: '[He] is said to have complained openly that Jessel "had been sent to dragoon the Court of Appeal into substituting equity for Common Law, but that he (Esher) and his Common Law colleagues would not have it"' (*An Introduction to English Legal History* (4th edn, 2002) p 114, citing Underhill *Change and Decay* (1938) p 87).

A century later the controversy has re-emerged with the debate being conducted with even greater vigour. It cannot be denied that there is a significant line of authority that can be cited in support of a view that fusion has been more pervasive than was envisaged at the time of the Judicature Acts. A principal proponent of the idea of complete fusion was the late Lord Denning for whom the idea provided useful support to some of his efforts in law reform (see eg in *Errington v Errington and Woods* [1952] 1 KB 290 at 298; and extra-judicially in *Landmarks in the Law* p 86). Then in 1977 dicta in the House of Lords, in *United Scientific Holdings Ltd v Burnley Borough Council* [1978] AC 904, appeared to endorse the idea of complete fusion. A much quoted dictum of Lord Diplock can be seen as rejecting any distinctive existence for 'rules of equity': 'but to perpetuate a dichotomy between rules of equity and rules of common law which it was a major purpose of the Supreme Court of Judicature Act 1873 to do away with, is, in my view, conducive to erroneous conclusions as to the ways in which the law of England has developed in the last hundred years' (at 924). Lord Diplock proceeded to challenge directly the continuing relevance of Ashburner's metaphor (at 925):

> . . . by 1977 this metaphor has in my view become both mischievous and deceptive. The innate conservatism of English lawyers may have made them slow to recognise that by the Supreme Court of Judicature Act 1873 the two systems of substantive and adjectival law formerly administered by the Courts of Law and Courts of Chancery . . . were fused. . . . If Professor Ashburner's fluvial metaphor is to be retained at all, the waters of the confluent streams of law and equity have surely mingled now.

It is tempting to respond to this proposition with the comment 'it all depends on what you mean by fusion'. On the one hand Lord Diplock's analysis of the purpose of the Judicature Acts seems clearly to be flawed, at least as measured against most contemporary opinion (see above). Moreover there are numerous continuing distinctions between common law and Equity. The distinction between legal and equitable interests forms the conceptual underpinning of our law of property and trusts; the common law and equitable rules for payment of interest are different (*Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669) as are those for tracing, equitable tracing being available only where an initial fiduciary relationship can be identified unlike tracing at common law (*Re Diplock* [1948] Ch 465). These constitute just a few of the examples that could be listed and it is scarcely likely that Lord Diplock was in complete ignorance of them. On the other hand, however, if we approach the 'fusion' issue from a standpoint which looks to the mingling of the systems, it is equally evident that there has been a degree of synthesis, a synthesis which admittedly has been taken further in some Commonwealth jurisdictions than in English law (see eg Mason (1994) 110 LQR 238; Capper (1994) 14 LS 313 at 315–317; Martin [1994] Conv 13).

It may appear at this point that the debate about 'fusion' is largely a matter of determining whether it is or is not accurate to *describe* common law and Equity as fused. But much more is involved than a terminological quibble. There is a *prescriptive* dimension to the debate whereby considerations of a 'should' or 'ought' nature come to the fore. We would therefore suggest that an important conclusion to be drawn from the fusion controversy is that the shadow of history as regards the origin of particular remedies and rights should not *of itself* be allowed to dictate the progress of any further synthesis. It is perhaps significant that both Sir Anthony Mason (former Chief Justice of Australia and a strong advocate of the distinctive contribution of Equity) and Sir Peter (now Lord) Millett have felt able to endorse the comments of Somers J in *Elders Pastoral Ltd v Bank of New Zealand* [1989] 2 NZLR 180 at 193 (see respectively (1994) 110 LQR 240 at 242 and (1995) 9 TLI 35):

> Neither law nor equity is now stifled by its origin and the fact that one Court administers both has inevitably meant that each has borrowed from the other in furthering the harmonious development of the law as a whole.

The notion of harmonious development incorporates two distinct dimensions both of which can be viewed as contributing towards what we might term a 'harmonisation' rather than a 'fusion' of the substantive elements of common law and equity. One dimension of harmonisation takes us back briefly and at a level of generality to the origins of equity jurisdiction and the notion of unconscionability that we touched on in the previous chapter. Drawing on analysis of a number of discrete examples Sir Anthony Mason has suggested that 'the underlying values of equity centred on good conscience will almost certainly continue to be a driving force in the shaping of the law unless the underlying values and expectations of society undergo a fairly radical alteration' ((1994) 110 LQR 240 at 258; see also various essays in Youdan (ed) *Equity, Fiduciaries and Trusts* (1989); and, confusingly, Waters (ed) *Equity, Fiduciaries and Trusts* (1993)). This theme of the role of unconscionability as a value and as a creative force, and how it is to be interpreted in particular contexts, will also be considered in greater detail in those contexts at several points in the book (see in particular Chapters 4, 12 and 16). But Sir Anthony Mason's comments on the significance of 'good conscience' serve another function. They alert us to the fact that considerations of conscience – and morality? – are no longer the sole preserve of the doctrines of Equity. Indeed Worthington, for example, reminds us that as early as 1760 Lord Mansfield was able to say that the gist of the common law action for the recovery of 'money had and received' was that 'the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money' (*Moses v Macferlan* (1760) 2 Burr 1005 at 1012; cited in 'Integrating Equity and the Common Law' (2002) 55 CLP 223 at 231–235).

A second dimension of the 'harmonisation' proposition draws directly on the idea that contemporary developments in deciding on an appropriate remedy in a given case should not depend entirely upon the historical origins of remedies. This may require us in some instances to challenge our conventional wisdom. In *A-G v Blake (Jonathan Cape Ltd, third party)* [2001] 1 AC 268, for example, the House of Lords by a 4:1 majority rejected the prevailing orthodoxy that damages in contract were restricted solely to recoupment of financial loss. Instead their lordships held that it is now possible in certain rare circumstances for the equitable remedy of an account of profits earned by the breaker of the contract to be awarded to the victim of a breach of contract (see Chapter 14 at p 760). As Lord Nicholls observed in *Blake* (at 278 –280): 'In these choppy waters the common law and equity steered different course' with the consequence that 'the difference in remedial response appears to have arisen simply as an accident of history'. Conversely consider the principle that only equitable remedies can enforce purely equitable rights so that, for instance, common law damages cannot be awarded for breach of an equitable right. As we shall see in later chapters the rationale for this position has been challenged, most noticeably in the New Zealand Court of Appeal (see *Mouat v Clarke Boyce* [1992] 2 NZLR 559; *Aquaculture Corpn v New Zealand Green Mussel Co Ltd* [1990] 3 NZLR 299; *Day v Mead* [1987] 2 NZLR 443). In *Mouat v Clarke Boyce*, for instance, in a case concerning a claim for equitable compensation for breach of fiduciary duty, Sir Robin Cooke stated (at 566):

> For breach of these duties, now that common law and equity are mingled, the Court has available the full range of remedies, including damages or compensation and restitutionary remedies such as an account of profits. What is most appropriate to the particular facts may be granted.

A related question is whether common law concepts such as foreseeability and remoteness should apply equally to equitable compensation and common law damages (see *Canson Enterprises Ltd v Boughton & Co* (1991) 85 DLR (4th) 129). Whilst both at present share a causation requirement they may still differ, at least under English law, on these other points, a troubling matter to which we return in Chapter 11. It must therefore be emphasised that common law jurisdictions differ in their approaches to these matters. In particular New Zealand, as might be inferred from the words of Sir Robin Cooke, has shown greater liberality or, from a different standpoint, heresy in borrowing and adopting ideas from common law to equity and vice versa (but cf the comments of Sir Richard Scott V-C in *Medforth v Blake* [2000] Ch 86 in holding that a receiver-manager appointed by a mortgagee was subject to an 'equitable duty of care' (at 102): 'I do not . . . think it matters one jot whether the duty is expressed as a common law duty or as a duty in equity. The result is the same'). Thus, if following the New Zealand example with regard to remedies, 'common law' damages for mental distress might be recoverable for breach of fiduciary duty (*Mouat v Clarke Boyce*) and equitable compensation reduced on grounds of contributory negligence (*Day v Mead* [1987] 2 NZLR 443). Whether or not 'harmonisation' is desirable on any or all of these matters, and we do not *assume* that it is, is considered in more detail predominantly in the commercial contexts within which the issues have tended to arise (see Chapters 11, 14 and 16). What can be said here is that there is a siren attraction in aspects of the fusion debate. In particular who can reasonably resist the call that 'like cases should be treated alike'? As Burrows concludes in his important paper on this topic 'we should be able to say, at the start of the 21st century, "We do this at common law and we do the same in equity" rather than "We Do This at Common Law But That in Equity"' – the latter phrase being the title of his paper ((2002) 22(1) OJLS 1 at 16; see also by the same author *Hochelaga Lectures, Fusing Common Law and Equity: Remedies, Restitution and Reform* (2003)). Indeed to argue against 'treating like cases alike' could justifiably attract the charge of reasoning in an inequitable manner. As always, however, the devil is in the detail. Caution may therefore be needed in determining which instances are alike and furthermore how far, for instance, supposed rationales for the different common law and equitable remedies still carry persuasive weight (see on this point the comprehensive and reasoned opinions from the New South

Wales Court of Appeal in *Harris v Digital Pulse Pty Ltd* [2003] NSWCA 10). For that reason, to reiterate the point, consideration of some of these issues is deferred until the particular doctrines are considered at various points later in the book.

But there is one further and important point to emphasise about the prescriptive aspects of the fusion debate. The discussion above could convey the impression, to adopt a horticultural metaphor, that all that is required to resolve the 'fusion' debate is a relatively modest degree of pruning and perhaps some hoeing of straggling weeds that are restricting new growth. This conclusion would be misleading, although it has a certain seductive charm to 'tentative fusionists' such as the writer of this chapter. There is a more ambitious prescriptive agenda, one that involves fundamental landscaping so as to achieve a complete integration of equity and common law doctrines, the 'endgame of duality' in Professor Birks's phrase (see (2004) 120 LQR 344 at 345 in his review of the 2004 edition of *Meagher, Gummow and Lehane's Equity Doctrines and Remedies*, the arch-opponents of such an approach). For some proponents the integration idea is itself either part of a more ambitious project to re-order the categories of private law or is seen as being likely to bring about such a re-ordering as a necessary consequence of integration (see eg Worthington 'Integrating Equity and the Common Law' (2002) 55 CLP 223 and *Equity* (2003); Burrows *Hochelaga Lectures, Fusing Common Law and Equity: Remedies, Restitution and Reform* (2003); and, amongst the many significant contributions of Professor Birks, 'Definition and Division' in Birks (ed) *The Classification of Obligations* (1997); 'Equity in the Modern Law; An Exercise in Taxonomy' (1996) 26 UWALR 1; and the classifications adopted in Birks (ed) *English Private Law* (2000)).

It is beyond the scope of this book even to attempt an assessment of an ambitious project of that nature. What is of immediate conceptual interest is that it is envisaged that the trust – the express trust being in Worthington's words a 'hard case' for the integration project – would in some sense be dismantled, packaged up and parcelled off to different parts of the new landscape (see eg *Equity* ch 3 and pp 294–297). Three brief and somewhat random observations can be made about this proposition. First, as we saw in Chapter 1, the express trust is a somewhat strange conceptual hybrid of property and obligation. Doubtless it is possible from a conceptual standpoint to deconstruct the arrangement and relocate the various elements, some, for instance, into property law, others in contract and so on (cf Langbein 'The Contractarian Basis of the Law of Trusts' (1995) 105 Yale LJ 625 and the implications of the Contracts (Rights of Third Parties) Act 1999 enabling third parties to enforce contracts made for their benefit). What remain uncertain are the practical consequences of doing so. Would the functional flexibility offered by the trust be lost in the transformation? Should that worry us if, to ask a loaded question, tax avoidance arrangements were to be hampered (see eg Chapters 3 and 8)? The second observation is merely that at a time when civilian jurisdictions appear to be attracted to the trust concept it seems conceptually puzzling and economically questionable to discard a legal form in which legal practitioners in common law jurisdictions might be thought to have a competitive edge (see eg Hayton 'The Development of the Trust Concept in Civil Law Jurisdictions' (2000) 8 JTCP 159; Hayton (ed) *Modern International Developments in Trust Law* (1999) and the contributions by Dyer and Lupoi to a symposium on 'The International Trust' in (1999) 32 Vand J Transnat L at 967 and 989 respectively). Lastly, it is appropriate to return to the starting-point of the fusion debate, the Judicature Acts of 1873–75, not to refute the fusionist case but to confirm that its adherents have the correct target in their sights. Getzler succinctly sets out the problem in the following extract ('Patterns of Fusion' in Birks (ed) *The Classification of Obligations* (1997) 157 at p 158 – footnotes omitted):

> A final union of legal and equitable doctrine in one body of law may yet be impossible, simply because the historical and conceptual bases of legal and equitable actions are too distinct. The sticking point has always been the continued existence of the trust – indeed, it was regard for the trust that prevented full fusion being attempted when the Judicature Acts of 1873–75 were first drafted and debated.

Further comment is perhaps best avoided given the vested interest that this writer has in the status quo!

3

Taxation, wealth-holding and the private trust

1. Introduction

As Hubert Monroe lugubriously commented in a Hamlyn Lecture 'tax is scarcely a favourite topic' (*Intolerable Inquisition? Reflections on the Law of Tax* (1981) p 1). It is not difficult to endorse this sentiment particularly when applied to the taxation of trusts. In academic contexts the topic conventionally falls into a no-man's land between the separate domains of taxation and trusts. Yet even by the beginning of the twentieth century the incidence of taxation was influencing the development of the private express trust. Indeed, as will be seen later in this book, taxation or more appropriately the availability of relief from taxation, has exercised considerable influence on public types of trusts also – for example, pension funds and charities (see Chapters 13, 18 and 19). With respect to private trusts, however, it may be claimed that this influence has so increased that fiscal considerations now dominate trusts practice even if not directly the formal rules of trusts law. Whether trusts should be created, what types of trust should be adopted and where their administration should be located are all, in reality, decisions taken by property-owners only after careful consideration of the fiscal implications.

The claim that these implications predominate will be probed later in this chapter (see p 72) but at the very least the taxpayer is unlikely to be satisfied with a tax lawyer or accountant who merely clarifies the probable size of the tax bill based on existing property arrangements. The taxpayer will also wish to know how to rearrange affairs so as to reduce that tax liability. It is at this stage that the 'tricks' the trust can perform with property interests come into consideration. The tax planner needs a thorough understanding of both tax and trusts law and the interaction between the two, if comprehensive and effective advice is to be given to the client. This chapter has no pretensions to providing the detailed knowledge of those areas that the tax planner needs. Indeed, the attainment of such skills would impose demands of time and space beyond the scope of trust courses or textbooks (see for excellent introductions to tax topics Tiley *Revenue Law* (4th edn, 2000); and Whitehouse et al *Revenue Law: Principles and Practice* (22nd edn, 2004)). But this does not mean that the interrelation between tax and trusts can be left wholly unexplored.

An understanding of the tax landscape without necessarily knowing intimately the identity of each contour is useful for appreciating why a particular type of trust is used. Of comparable importance to this functional justification is the doctrinal consideration that certain major developments in trusts law may be explained best by reference to the stimulus of taxation. We have already seen in the context of pre-twentieth century family settlements how conveyancers, responding to the needs of settlors, gradually developed the trust concept and the developments were subsequently ratified by the courts. Out of this process emerged many of the detailed technical rules of trusts law. Since then settlors have continued to require the conveyancer to spin the intricate web of settlements to allocate property interests on the plane of time but now with a new dominant objective, the minimisation of tax. This has led to novel developments, particularly in the use of discretionary trusts (see Chapter 5), and the adaptation of existing concepts such as the power of advancement (see Chapter 7). These innovations have on occasion seemed to challenge firmly established rules of trusts law: sometimes the courts have responded rigidly, sometimes creatively. The underlying policy issue confronting the courts is what weight to attribute to the modernising demands posed by trust practice and the needs of trust users, as against the claims of apparently entrenched rules and doctrine. The connection between the tax influence and judicial pronouncement of a new rule is indirect and tenuous but none the less real. We must stress that the flexibility implicit in the developments being discussed here has a dual nature. The trust form with its capacity for fragmentation of ownership over time can facilitate flexible modes of property disposition. But as importantly trusts doctrine itself has a flexibility that has intermittently been demonstrated through judicial modification of technical legal rules and trusts concepts in response to new directions in trusts practice.

The conflict just referred to which emerges out of challenges to established rules takes essentially doctrinal form, although springing from practical considerations. There also exist conflicts more overtly about public policy which are equally deserving of the trust student's attention. One objective of taxation, particularly capital taxation, has at various times been to achieve some measure of wealth redistribution. One clear objective of the private express trust is to preserve wealth within the family. This potential conflict between a general aim of redistribution and a specific aim of wealth preservation causes difficulties for both fiscal policy formation and implementation. The challenge for fiscal policy formation is to achieve neutrality between outright and settled gifts. Is it possible for the parliamentary draftsman to resolve the problems posed, for example by the trust's fragmentation of property interests, without either favouring or penalising dispositions on trust? As regards attempts to implement policy decisions, these have inevitably involved the importation of property concepts into taxing statutes. What is not inevitable is that on occasion, as with the term 'interest in possession' in inheritance tax, no attempt is made to define the concept used. A problem of statutory interpretation for the courts therefore is whether to apply accepted property definitions or to identify a special meaning for the purposes of the tax statute. In deciding this apparently technical task of statutory interpretation do the courts consider the fiscal policy objectives, and indeed should they do so? As we shall see in subsequent chapters (eg Chapters 5 and 7) similar questions can be asked where courts are faced with pressures to modify trusts law.

Lastly, if fiscal policy concerning taxation of trusts is to be assessed adequately then the consequences of the use of the trust must be measured against the policy objectives. It is necessary to know in particular the extent to which disposition of property on trust has frustrated wealth redistribution by helping preserve wealth concentrations within families and free from the grasp of the Inland Revenue. This should be a simple task but it is complicated by a dearth of knowledge. Abel-Smith and Townsend writing in 1965 commented (*The Poor and the Poorest* p 9):

> Information about the rich is sparse. It has always been difficult to make scientific calculations of their true wealth and recent developments in tax laws and tax avoidance techniques have not made these calculations any easier.

The accuracy of this statement will be reviewed in the light of more recent data but it does highlight the twin functions of the trust. It is not only a key element of some tax avoidance techniques but it also operates to conceal concentrations of wealth. The lack of a precise measure of wealth concentration can itself contribute towards maintaining existing patterns of distribution by limiting awareness of wealth disparities and inhibiting pressure for change.

To summarise, the reasons for investigating the relationship between taxation and trusts are:

(1) The impact on trusts practice.
(2) The impact on trusts law, usually via the influence of trusts practice (see in particular Chapters 4, 5 and 7).
(3) The impact of the trust form on attempts to identify and counter tax avoidance.
(4) The impact of trusts concepts on interpretation of tax statutes (see Chapter 8).
(5) The combined impact of trusts and tax law on wealth distribution.

This chapter is primarily concerned with issues (1), (3) and (5) outlined above. Consideration of the detail of taxation of trusts is deferred until Chapter 8. By then we will have a closer familiarity with those elements of the trust which have provided such fertile ground for the tax planner.

Our initial approach to the subject has assumed that fiscal considerations predominate over any other motivation in trusts practice. But, as mentioned previously, the validity of this assumption needs to be examined.

2. Trust motivation and tax avoidance

(a) Trust founder's motives

An obsession with tax planning and the dominance of fiscal considerations has been sharply criticised by one North American writer who claims it is harmful and misrepresents the interests of those coming to lawyers seeking advice about their wills.

> Lawyers who deal with wills and so forth probably make a mistake when they let themselves be called estate planners. It is a fawning phrase, a piece of flattery for a man who is supposed to feel better when his mortgage and pension plan are called an estate. . . . There is deeper harm, too, beyond self-delusion – the harm that leaves us obsessed with manipulation and taxes, the professional fixation which diverts our observation from the here-and-now feelings of the men and women who consider death in the law office. . . . I don't believe that the rich only want to save taxes; I think that is what some lawyers and estate planners want them to want, for the same reason vacuum-cleaner manufacturers see the human condition in terms of dust and suction. (T L Shaffer *Death, Property and Lawyers* (1963) pp 1–2, 10)

The questioning of the assumption that fiscal factors dominate the thoughts of a trust founder is carried a stage further in the following extract where Friedman adopts a dual categorisation of trust types with the emphasis on non-fiscal motivations. As was demonstrated in Chapter 1, different trust types can achieve a variety of family purposes more efficiently than other available legal forms. The settlor's decision that the trust is the most appropriate property holding and transmission mechanism will not ignore tax implications, but the argument is that the choice is prompted first and foremost by family considerations.

> Laurence M Friedman 'The Dynastic Trust' (1964) 73 Yale LJ 547 at 547–549
>
> Private express trusts can be conveniently divided into two polar types, corresponding to two underlying purposes. The first, the most common type, can be called the *caretaker trust*. Trusts for the benefit of minor children, or incompetents, or old people, or people with little or no business experience are all caretaker trusts. The caretaker trust is usually short-term, spanning one lifetime or less. It exists to protect and serve the interests or needs of one or more particular beneficiaries.
>
> Much less common is the *dynastic trust*. In its extreme form it is rare indeed. The dynastic trust, as the phrase is here used, is a trust set up primarily to perpetuate the trust estate for as long a period as possible . . .
>
> The psychology of the private dynastic trust is less obvious than that of the caretaker trust. Why should the settlor prefer unseen and unborn great-grandchildren to his closest blood relations? Most people would rather hold property outright than in trust, if only for the right to control its ultimate disposition. Money is power; and principal more so than income. The settlor of the dynastic trust denies full power to his closest kin. But in so doing he extends his own power by projecting his wishes into a period that lasts long after his death, thus satisfying some sort of hunger for vicarious immortality.
>
> The dynastic trust is apparently more common today than a century ago. The great increase in national wealth has made its growth possible, though national wealth does not fully explain the prevalence of this form of trust. Modern tax laws have also had a great influence on long-term trusts. A well-drafted testamentary trust lasting

several generations is subject to only one estate tax, upon the death of the settlor. The intervening deaths of life beneficiaries do not constitute taxable events. But none of the tax savings accrues to the estate of the settlor himself. These savings redound to the benefit of later generations, while the immediate family gives up the right to enjoy unrestricted use of principal. In short, the dynastic trust saves taxes, but for itself, as an entity, rather than for the immediate income beneficiaries. It is commonplace to explain the modern long-term trust in terms of 'tax motives'; but these 'tax motives' are probably secondary, after the fact: the dynastic impulse comes first.(1)

Footnote 1
Frank H Detweiler has written: 'But how many times does a lawyer of our generation encounter a man with the supreme urge to keep his dead hand perpetually at the wheel of an existing or potential dynasty? . . . [M]ost of us would feel sure . . . that people of wealth in our day are far less likely than were their counterparts of a few generations ago to have their eyes fixed on providing a fortune for generations to come.' Detweiler sees a real 'decline of the dynastic impulse'. Long-term trusts are set up, he asserts, to avoid the crushing impact of taxes . . . Detweiler *The Owners' Control over Property Use and Disposition after his Death*, U Chi Law School Conf on Use and Disposition of Private Property 15, 21–22 (conference Series No 12, 1953). But Detweiler's reasoning is circular; long-term trusts are not set up for 'dynastic' reasons, but to save taxes in the long run. But why save taxes? It is probably more accurate to say that in addition to those who truly wish to found a dynasty (and of course this wish is not absent simply because a client does not articulate it baldly), there are many settlors today who, in the light of their financial circumstances, *prefer* having their estate pass relatively intact to grandchildren and great-grandchildren to seeing most of it go to the government, and that this preference is stronger than the desire to give financial autonomy (as opposed to security) to children.

The significance of Friedman's argument that tax motivations are irrelevant for caretaker trusts and only secondary for dynastic trusts is that our attitudes towards tax treatment of trusts may depend on whether tax avoidance motivations or pure trust motivations are perceived to predominate. The aura of benevolence and concern surrounding the idea of a caretaker motivation is a potent argument for encouraging a sympathetic approach from the tax legislator even to the extent of opening up loopholes in legislation. It is therefore important to assess the validity of Friedman's analysis which was based on the operation of the US federal tax system in 1964. A straightforward application to the UK context of his specific claims concerning tax motivations presents difficulties in three areas of taxation of transfer of property: life interests, discretionary trusts and inter vivos gifts (whether on trust or by outright gift).

Life estate In Friedman's example of the dynastic trust, dynastic motivations and tax advantages run parallel. Friedman recognises that 'a well-drafted testamentary trust lasting several generations is subject to only one estate tax, upon the death of the settlor. The intervening deaths of life beneficiaries do not constitute taxable events.' This favourable fiscal treatment on the death of the life tenant does not apply in England and, since the Tax Reform Act 1976, is no longer the position in the US. Instead, life estates are treated as if the property producing the income is owned by the life tenant. The capital is aggregated at death with other property owned absolutely by him and taxed accordingly. Contrary to the picture of trusts practice in the US portrayed by Friedman, a dynastic-style trust in England at a comparable time was becoming an endangered species. It had given way to alternative methods of transferring wealth including the discretionary trust.

Discretionary trust Friedman recognises that the terms 'caretaker' and 'dynastic' identify merely two polar types of motivation and that elements of both may be present in a complex mixture. A widely drawn discretionary trust such as that in *Example* 4 in Chapter 1 is particularly difficult to categorise. Whereas the label 'caretaker' could justify the wide discretion given to trustees over allocation of benefit, it is less satisfactory in explaining the potential duration of the trust. On the other hand, dynasticism may explain duration but the abdication to trustees of control over beneficial entitlement scarcely ensures that the settlor 'extends his own power by projecting *his* wishes . . . thus satisfying some sort of hunger for vicarious immortality'. A widely drawn discretionary trust adopting a statutory perpetuity period of 80 years thus seems to defy a simple categorisation in terms of trust motivation. Furthermore, it is questionable whether Friedman's view that 'tax motives are probably secondary' can be sustained for such trusts.

Inter vivos gifts An omission from Friedman's analysis is that it deals with testamentary dispositions only. In the absence of an effective lifetime gifts tax, estate taxes at death can be avoided simply by transferring property inter vivos. An assessment of whether trust or tax avoidance motivations predominate therefore needs to account for the timing of transfer of property in addition to the form of transfer. A study of wealth transfer in the USA suggests that the timing of gifts is significantly influenced by fiscal considerations:

R Barlow, H Brayer and J Morgan *Economic Behaviour of the Affluent* (1966) p 104

What particular reasons did you have for making the gifts at that time?

Tax considerations were the most frequently reported reason, with the needs of the donees mentioned less than half as frequently. The importance of tax considerations rose only moderately with income. They were mentioned by 40 percent of donors with incomes of $10,000 to $15,000 and by 57 percent of those whose incomes exceeded $300,000. Tax factors persisted as the dominant motive irrespective of whether the donees were children, grandchildren, or other relatives. The relevance of tax considerations may perhaps best be illustrated in the words of the respondents themselves. For example, donors answered the above question as follows:

> 'Only one reason – to avoid inheritance taxes. [He then added, perhaps as an afterthought] My love for my children prompted it.'
> 'Estate taxation.'
> 'Part of a long-range program to avoid inheritance taxes.'
> 'Because of high inheritance taxes – because of high income taxes.'
> 'It's a personal thing. It seems like an appropriate time. I felt I'd better do it while the spirit moved me, and at the time the securities had appreciated greatly so there were large taxable gains on them. The recipients were not in the tax bracket that I was, so that was the time to do it.'

No comparable study into individual motivations has been carried out in this country although a survey of accountants involved in tax planning revealed that many of their clients did not in practice adopt the most tax-effective method of arranging their affairs.

> Moral judgments, dislike of complexity, avarice, procrastination, unwillingness to spend, concern for public image, administrative complications, unpredictability of effects – all these militated against the adoption of tax avoidance schemes. (C T Sandford *Hidden Costs of Taxation* (1973) p 108)

The complexity of motivation suggested there lends some support to Friedman's sceptical approach. The extent to which financial self-interest predominates over other considerations in the attitudes of taxpayers towards their compliance with tax laws and, by inference, in their choice of legal form for their fiscal arrangements remains contentious (see generally Long and Swingen 'Taxpayer Compliance: Setting New Agendas for Research' (1991) 25 *Law and Society Review* 637). Nevertheless Friedman may still be criticised for inadequately distinguishing between a motivation to achieve a particular family objective and one for adopting a particular legal form out of several alternatives for achieving that objective. His approach does remind us, however, of the heterogeneous nature of the trust and trust founder's motives. This should then alert us to the potential problems posed by this heterogeneity for the devising of a system for taxing trusts which is both fair and effective.

(b) Tax avoidance, tax evasion and creatures of a similar hue

(1) Defining avoidance: lawyer vs economist

In the previous section we suggested that one reason for establishing whether tax avoidance is the principal motivation for creating a trust is that this may affect attitudes towards treatment of trusts under a tax regime. Implicit assumptions behind this approach are that tax avoidance has a precise meaning and furthermore that it is undesirable. This section examines these interlinked assumptions. Unfortunately, however, the problem of disentangling various motivations is compounded by the absence of an accepted definition of tax avoidance.

Conventionally, a sharp distinction has usually been drawn between 'tax evasion' and 'tax avoidance'. What is called 'tax evasion' is illegal and involves non-payment of taxes which the taxpayer is obliged by law to pay, or would be had he disclosed all relevant facts about his finances to the Inland Revenue. Tax avoidance, in contrast, is lawful and involves the arrangement of a taxpayer's financial affairs so that tax liability is removed or reduced. As Professor Wheatcroft ((1955) 18 MLR 209) once bluntly put it: 'tax avoidance is the art of dodging tax without actually breaking the law'. The distinction is pointedly demonstrated by the following example (Tiley *Revenue Law* (4th edn, 2000) p 85):

> If two people marry in order to reduce their tax burden they are practising tax avoidance; if they tell the Inland Revenue that they are married, when they are not, they are guilty of tax evasion and may well be prosecuted.

Two important features of this distinction must be emphasised. First, the essence of the distinction is that evasion commonly involves non-disclosure of relevant facts: 'the concealment of material facts, leading to an under-assessment, marks the point at which avoidance crosses the borderline and becomes evasion' (Keith Committee *Report of the Committee on Enforcement Powers of the Revenue Departments* (Cmnd 8822, 1983) p 162). However, in some complex tax-planning arrangements (see below p 83) what constitutes 'relevance' for the purposes of disclosure may itself be uncertain. Second, the distinction drawn here between avoidance and evasion is a legal one buttressed traditionally by a literalist approach to the interpretation of taxing statutes. A fundamental principle associated with literalism is that a taxpayer's liability to tax is decided solely by construing the language of the statute. As Rowlatt J said in *Cape Brandy Syndicate v IRC* [1921] 1 KB 64 at 71:

> . . . in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used . . .

In this approach, form not substance is the key to tax liability and the court stands apparently neutral between Crown and taxpayer, ignoring broad policy considerations and merits of individual cases alike. One consequence of this approach is that, in Lord Tomlin's words (*IRC v Duke of Westminster* [1936] AC 1 at 19):

> Every man is entitled if he can to arrange his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure that result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

This statement represents the high-water mark of judicial acceptance of the literalist approach. Recent judicial developments, to be considered shortly, suggest that the statement now needs to be applied with considerable caution and perhaps even to be disregarded. A further consequence of these developments is that the evasion/avoidance dichotomy is, to put the point at its lowest, being refined. This is not to say, however, that the sentiments exhibited in the judicial statements above lack support. A robust and, of its time, representative defence not merely of a formalist stance towards interpretation but also of the taxpayer's moral right to use the legislation to best advantage was included in the 1982 edition of a student tax textbook:

> *Pinson on Revenue Law* (15th edn, 1982) pp 685–686
>
> *Tax planning*
> Much nonsense is talked about tax avoidance. Politicians, unaware of its real nature, speak of it as a social evil to be legislated against. Others speak of avoidance as if it were a game of chess played annually with the Revenue. In fact, there is often more than one method of achieving a desired result in financial planning for business or the family and 'tax avoidance' is the result of selecting the method which is least costly in tax. Tax avoidance of this kind is not only unobjectionable: it is common sense. . . .
>
> . . . 'avoidance' may be no more than the result of choosing one of two equally acceptable methods of achieving a desired result. In the world of commerce the transactions are often . . . complex and the range of alternative methods is much wider; if one method is used, the tax is £x, and for another it is £y (or even £ nil), and the terms 'tax avoidance' or 'tax planning' conveniently describe the techniques by which the lawyer and accountant can so arrange a client's affairs as to achieve a reduction in the amount of tax he would otherwise have to pay. This is an important function, for the burden of tax is nowadays so great that taxation must be regarded as one of the major costs of production; and enterprising and productive schemes are often made possible only by intelligent tax planning. In other cases legislation is so hasty and ill-conceived, essential reforms are so long delayed, or the consequences of legislation – unforeseen by ill-informed or non-commercially-minded legislators – are so immoral, that taxpayers have to rely on the concoction of highly artificial schemes to avoid what would otherwise be a manifestly unjust or even absurd result.

Reliance on a seemingly straightforward dichotomy between 'lawful' tax avoidance and 'illegal' tax evasion has increasingly been viewed as leaving some troublesome issues untouched. Should, for instance, the personal motivations of taxpayers or the consequences of their actions for fiscal policy be legitimate considerations for tax law to consider? If so, does what might be termed a traditional literalist approach to interpretation provide a sufficiently precise formula for evaluating those considerations? These and other questions are raised in the two following readings that focus on the complex financial arrangements of the Vestey family, outlined in rather sensationalist fashion in the *Sunday Times* extract. The readings are also evidence that disagreements about the meaning to be attributed to 'avoidance' are not confined to academic circles, but can fuel popular debate.

> Philip Knightley 'Richest family in huge tax-dodge', *Sunday Times*, 5 October 1980
>
> The Treasury is losing millions of pounds a year in unpaid income tax and surtax because of a major loophole in the tax law. The loophole's existence has been revealed in a sensational . . . tax case in the House of Lords involving the Vesteys, Britain's richest family. [*Vestey v IRC* [1980] AC 1148; see Sumption [1980] BTR 4; and Boyd [1980] BTR 442.] During the case it emerged that the Vesteys – peers of the realm, old

Etonians, friends of the royal family, polo-players, deputy lieutenants of their county, pillars of the British establishment – have been exploiting this and other loopholes to avoid paying enormous amounts of income tax for more than 60 years.

The Vesteys, headed by Lord 'Sam' Vestey, 39, and his cousin Edmund, 48, run a world-wide empire in shipping, clothing, insurance, shops and meat – the Dewhurst chain of butcher shops is theirs. [*Note*: Dewhursts was put into receivership in 1995.] Inland Revenue decided that six members of the family, including Lord Vestey himself, were, over a four-year period, liable for income tax on £4.3 million and surtax on £7.3 million. But the Law Lords ruled – as they have done in the past in other Vestey cases – that the family need not pay a penny. [See eg *Vestey's Executors v IRC* [1949] 1 All ER 1108.]

The Vestey case, which covered 60 years of sophisticated tax-avoidance schemes, was extremely complicated. In brief: at one time a UK resident could transfer his assets to, say, Bermuda, and arrange for the income from those assets to be held by a trustee living there. He could further arrange that the trustee would pay him, out of the income, varying lump sums at irregular intervals. The lump sums would not be treated as income and so would not be liable for income tax.

Parliament plugged this loophole in 1936 with a new law which said: if a UK resident had the power to enjoy the income held by the trustee, then the Inland Revenue would consider that income to be the UK resident's and would tax him accordingly.

Tax-avoiders then got around this by arranging for the money to go, not to themselves, but to, say, their sons and daughters. But these 'passive beneficiaries', as the Inland Revenue calls them, were brought into the tax net by *Congreve v IRC* ([1948] 1 All ER 948). The House of Lords decided then that it did not matter who set up the tax-avoidance scheme in the first place, anyone who then benefited from it was liable for income tax.

The Law Lords' new decision has wrecked the 1948 one. They have decided that the law should apply only to the man who *originally* sought to avoid tax by transferring his assets abroad. His heirs, the passive beneficiaries, could collect the money free of income tax. Thus the Vesteys – and anyone else who is a passive beneficiary of an overseas trust – can go on receiving money in Britain free of tax.

The apparent gap revealed by the House of Lords decision in *Vestey v IRC* [1980] AC 1148 has subsequently been substantially closed (see now Income and Corporation Taxes Act 1988, s 740). Although doubtless complex in operation, the tax arrangements of the Vesteys were conceptually simple, yet provide a striking illustration of the potential of the trust form when linked to the attributes of the plane of time and of geographical location. The scheme used (i) separation of legal title to capital and income, (ii) the fragmentation of equitable title to capital and income among numerous beneficiaries in discretionary trusts, (iii) the location beyond the jurisdiction of the Inland Revenue of trustees and trust accounts, and thus legal title to trust assets and the income initially derived therefrom, and (iv) the plane of time to allow income to be accumulated within the trust fund and transmuted into capital. This last facet was particularly important for those beneficiaries resident in the

UK: irregular receipt of capital sums would be likely to escape the UK income tax net. Therefore, as Knightley explains, 'the money . . . is allowed to accumulate until, when directed by the manager, the trustees make "occasional and discretionary payments" to beneficiaries: the Vesteys' (*Sunday Times*, 12 October 1980). The following schedule of payments made between 1962 and 1966 illustrates the process:

Table 3.1

Dates	Beneficiary	Amount
9 July 1962	Lord Vestey	£123,000
29 October 1962	R A Vestey	£215,000
1 January 1963	Edmund Vestey	£700,000
1 January 1963	Lord Vestey	£800,000
1 January 1963	Mark Vestey	£200,000
18 November 1964	R A Vestey	£150,000
2 May 1966	Mrs Payne	£100,000
2 May 1966	Mrs Baddeley	£100,000
18 November 1966	Edmund Vestey	£220,000
	Total	£2,608,000

Bernard Levin, *The Times*, 28 October 1980

'I am', says a Tom Stoppard character, 'a man of absolutely no convictions whatever. At least, I think I am.' You will, I am sure, realise that the character in question was not based on me: rarely am I obliged to say with Belloc that

> The question's very much too wide,
> And much too round and much too hollow,
> And learned men on either side
> Use arguments we cannot follow.

But in this strange position I find myself today anent the Affaire Vestey. . . . The principle at the heart of the uproar is comparatively simple; for decades on end the Vesteys have fiddled their taxes on a stupendous scale, paying something like fourpence-ha'penny a year on an annual income so large the noughts alone could hardly be accommodated in the width of a column of *Times* print. And, it is argued, such behaviour is reprehensible, and therefore ought to be stopped; it is also argued that the behaviour is not reprehensible and therefore ought not to be stopped, and for good measure that it is reprehensible but nevertheless ought to be allowed to continue. And I do not find a decision nearly so easy as many of those who have given tongue on the subject appear to do.

Before trying to sort out my ideas on the subject I must make it plain that when I say the Vesteys have fiddled their taxes I do not mean that they have done so in any way 'contrary to the law'. If they had, there would be no argument, at any rate of a moral kind. The reason that there is an argument is precisely that what they have been up to is legal; the law made it possible for them to set up trusts abroad and so to arrange matters that the money was not taxable, and they took advantage of the possibilities the law opened to them, and enjoyed the fruits thereof.

Now before we go any further, I must point out if you confine the argument to the statement of it I have just made, what the Vesteys have done is exactly what you and I do. . . . We do not break the tax laws, but we take advantage of the concessions they allow us; we deduct from our return of taxable income such sums as were expended wholly, necessarily and exclusively for business purposes, we claim similarly to be relieved of taxation on our mortgage interest, we do the same for legally ordered maintenance payment. . . . In short and the vernacular, we are damned if we will pay a penny more in tax than the law compels us to, and we so arrange matters that what the law compels us to pay is reduced as far as our time and our accountants' ingenuity can manage. . . .

All this applies only if you accept the definition of tax-avoidance I offered in my last paragraph but one. What the Vesteys did takes the argument a step farther. They actively sought out, with the aid of a huge quantity of enormously expensive financial and legal advice, ways to get round the provisions of the tax laws without actually breaking them. And there is, obviously, some distinction between active and passive exploitation of the law, between deducting that which the law says plainly may legitimately be deducted, and finding ways to frustrate the intention of the law because the law is so constructed that it permits such frustration to be accomplished.

Here, of course, we are on marshy ground. What is 'the intention' of a law other than what it says? And who has ever heard of a law that did not have several ambiguities in it to keep the lawyers in fair round bells with good capon lined while the litigants wear a lean and hungry look? But to ask that question is not necessarily to admit that it has no answer. The law in this case . . . was certainly not intended, for a start, to enable the Vesteys to get away with such an enormous quantity of swag.

We need waste no time on some of the peripheral arguments advanced. Of course the Vesteys were able to get away with it only because they were so filthy rich to start with that they could set up a scheme far beyond the pockets of other taxpayers, but that is hardly a matter of principle, and if you think it is kindly to say precisely what level of income should be the dividing line between those who should, and those who should not, be allowed to avoid their taxes. On the other hand, there is also nothing in the argument . . . that because the British tax laws are inequitable, damaging to our economy and largely based on a hatred of success, anybody ought to be allowed to get out of complying with them if he legally can. The cure for a bad law is its amendment or repeal . . .

At this point we must consider the argument that law is morally neutral, so that nothing which is lawful should be thought impermissible. This is liberalism (in the nineteenth-century sense) in its purest form, and it strikes me as drivel in its purest form. There is no law forbidding parents to treat their children, for years on end, with indifference and contempt, providing they do not actually beat them too hard; but I would withhold admiration from such parents, and rather hope that others would do likewise.

It is perfectly possible to think of the Vesteys as what Sellar and Yeatman called the Roundheads – Right but Repulsive (as opposed to the Cavaliers, who were Wrong but

> Wromantic). What kind of moral view should inform our attitude to those who, while obeying the law, behave in a manner which we find unacceptable?
>
> Here, the ground becomes very marshy indeed. . . . [To] what extent should moral pressure ever be exerted against lawful behaviour? There are dangers, great dangers, in moral witch-hunts and moral lynch-law, and that is true even if the hunt and the lynching are conducted without any taint of hypocrisy, which is almost never the case . . .
>
> Now perhaps you can see why I confessed at the outset that I do not find this argument at all easy to decide upon. My instinct from the start has been to find the Vesteys' behaviour disgusting, but I am not nearly so confident as some that my instinct is necessarily worth following. But I have, in the course of arguing the case here, happened upon a formula which may work. In deciding whether to judge a lawful action by a moral light, can we not ask ourselves whether it is possible for anyone seriously to admire the action? Never mind whether we do or do not do so, is it reasonably possible?

Even if, intuitively, one might have sympathy for Bernard Levin's criterion – 'not reasonably possible to admire the action' – it is not easy to see how it could be incorporated into a workable statutory formula for distinguishing unacceptable arrangements from those that are acceptable. Morality is not the only possible tool of analysis. If we adopt an economist's perspective two key criteria in any definition of 'avoidance' would be the motive for, and the end-result of, a particular transaction or arrangement.

> C T Sandford *Hidden Costs of Taxation* (1973) pp 113–114
>
> *Defining and Minimising Avoidance*
> Amongst tax practitioners the generally accepted definition of avoidance . . . is any legal method by which a person can reduce his tax bill. But this definition can cover almost anything – in fact anything that an economist would include in an analysis of 'effective incidence'. I can legally reduce my income tax bill by buying a more expensive house (on which I get additional mortgage interest relief), getting married, having more children, taking out more insurance or simply stopping work. I can reduce estate duty [now Inheritance Tax] by buying a farm, sharing my estate with my wife more than seven years before I die, or spending my wealth on a trip round the world. I can reduce my tax bill by buying sweets instead of cigarettes when the Chancellor increases the tax on tobacco. . . .
>
> All these actions would come within the definition of avoidance yet they clearly cannot be treated on a par . . . We must surely make at least two categories of distinction, one relating to the taxpayer the other to the legislature. It is reasonable to confine 'avoidance' to action which results in the would-be avoider substantially achieving the objective to which the tax had become an obstacle. Let us give some examples. If a man ceases to buy cigarettes because of tobacco tax he has not achieved his pre-tax objective, ie to smoke. Buying sweets instead of cigarettes, therefore, is not avoidance. Again, if a taxpayer decides to use most of his wealth for a consumption spree because estate duty makes it not worth while saving for heirs, he is not 'avoiding' for he has abandoned his

> objective of passing property to heirs. On the other hand, if he reacts to estate duty by making inter vivos gifts (assuming he survives for seven years), this is avoidance; it has achieved, though by a more circuitous route, the objective of passing to heirs an intact property.
>
> Let us turn to the second aspect of our definition, the conditions relating to the legislature. A government may have one of three attitudes to a particular 'avoidance' measure – using the wide definition of avoidance. It may welcome it; the government may have deliberately offered a tax concession to promote some objective, eg tax concessions on mortgage interest . . . in order to encourage owner-occupation. Second, without having sought positively to encourage a particular 'avoiding' action the government may find it entirely acceptable as when an income tax payer reduces his tax liability by taking a wife or having children; or when a person on retirement transfers savings from a building society to some other form of investment in order to reclaim income tax. Third, the government may deplore certain actions as contrary to its intentions; the action is in accord with the letter of the law but not its spirit. Only actions in this third category should rank as 'avoidance'.
>
> We have reached the point in our argument where we have said that the term avoidance should be confined to actions by a taxpayer which enable him substantially to achieve the objective to which the tax had become an obstacle; and where the actions, while in accordance with the letter of the law were contrary to its intentions.

As an analytical tool the economist's approach as represented by Sandford has the initial attraction of restricting the term 'avoidance' to a more precise range of activity. However, as Sandford recognises, an approach which focuses on the intention of the legislature is itself problematic since 'the objective interpretation can only be found in the words the law uses' (p 114).

This does not, however, necessarily return us to the literalist stance on statutory interpretation as stated by Rowlatt J (see above, p 76). First, that approach must now be interpreted in the light of the decision in *Pepper v Hart* [1993] 1 All ER 42 that the court can look to parliamentary materials for guidance where (per Lord Browne-Wilkinson at 69):

> (a) legislation is ambiguous or obscure, or leads to an absurdity; (b) the material relied on consists of one or more statements by a minister or other promoter of the bill together, if necessary, with such other parliamentary material as is necessary to understand such statements and their effect; (c) the statements relied on are clear.

There are circumstances, however, where reference to *Hansard* for guidance on interpretation of a statute may be unavailing. The point in issue may not have been foreseen or considered by the legislature and therefore no legislative intent may be discernible. In addition, as Robinson and Sandford have argued elsewhere (*Tax Policy-Making in the United Kingdom* (1983)), inadequate pre-parliamentary preparation of fiscal policy, the constraints of the parliamentary timetable governing the passage of annual Finance Acts, and the influence of pressure groups often combine to produce a taxing provision which may not only be obscure but also diverges sharply from the initial proposal (see also Shipwright (ed) *Tax Avoidance and the Law* (1997) pp xxxviii–xxxix, and 65).

The difficulties posed by the process of statutory interpretation and the possible absence of any coherent policy objective are therefore relevant to the applicability of the economist's criteria, as defined by Sandford, to tax treatment of trusts. Before considering this in more detail, reference must be made to recent judicial developments which it is tempting to suggest appear to narrow the gap between the strict literalist approach of the lawyer to statutory interpretation and the more policy-oriented approach of the economist. Unfortunately judicial disarray, particularly in the House of Lords, concerning the correct approach for the courts to adopt in interpreting tax statutes renders illusory any hope of arriving at firm conclusions.

(2) A judicial compromise?

Occasionally the tax-avoidance methods recommended by the tax-planning industry, often involving highly artificial schemes, take on a complexity beyond the comprehension of many of its customers. Tax consultants may create a scheme which seeks to utilise certain provisions in a taxing statute in a series of transactions usually carried out via a number of steps with the sole or predominant purpose of reducing the client's tax bill. The schemes vary in complexity but their general nature was entertainingly described by Templeman LJ in *W T Ramsay Ltd v IRC* [1979] 3 All ER 213 at 215:

> The facts . . . demonstrate yet another circular game in which the taxpayer and a few hired performers act out a play; nothing happens save that the Houdini taxpayer appears to escape from the manacles of tax.
>
> The game is recognisable by four rules. First, the play is devised and scripted prior to performance. Secondly, real money and real documents are circulated and exchanged. Thirdly, the money is returned by the end of the performance. Fourthly, the financial position of the actors is the same at the end as it was in the beginning save that the taxpayer in the course of the performance pays the hired actors for their services. The object of the performance is to create the illusion that something has happened, that Hamlet has been killed and that Bottom did don an ass's head so that tax advantages can be claimed as if something had happened.
>
> The audience are informed that the actors reserve the right to walk out in the middle of the performance but in fact they are the creatures of the consultant who has sold and the taxpayer who has bought the play; the actors are never in a position to make a profit and there is no chance that they will go on strike. The critics are mistakenly informed that the play is based on a classic masterpiece called 'The Duke of Westminster', but in that piece the old retainer entered the theatre with his salary and left with a genuine entitlement to his salary and to an additional annuity.

The finer details of most of these schemes happily need not concern us beyond noting two particular points. First, although many of the schemes involve the use of trustees, frequently located 'offshore' in a tax-haven such as the Isle of Man, there is rarely any intention that they be impressed with any continuing obligations. To adopt an analogy with an earlier era, the trustees' role is passive rather than active. Second, the 'finer details' can render problematic the disclosure obligation which, it will be recalled, marks the border between evasion and avoidance. As mentioned above, avoidance schemes are rarely simple and usually incorporate several distinct legal transactions involving the use of separate companies, trustees and, sometimes, jurisdictions. It is here that what has been termed 'non-disclosing disclosure' – 'disclosing the relevant facts but doing so in a way which makes it difficult . . . to recognise the presence or extent of a taxable transaction' – can be effective (McBarnett (1991) 42 British Journal of Sociology 323 at 331). A corollary of the complexity of schemes therefore is that the Inland Revenue may find it difficult to fit the parts of the jigsaw puzzle together and thereby discover the underlying legal and economic substance of the arrangement. In one recent important case on tax avoidance, *IRC v McGuckian* [1997] 1 WLR 991, Lord Browne-Wilkinson notes that the solicitor/tax consultant 'took every step to obfuscate what had happened and obstruct the Crown in discovering the true facts' (at 994). In short, taxpayers and their advisers can quite lawfully be economical with the truth.

The success of 'off-the-peg' schemes involving a series of self-cancelling or circular transactions has been transitory. The Inland Revenue took the offensive and in a series of cases, *W T Ramsay Ltd v IRC* [1981] 1 All ER 865; *IRC v Burmah Oil Co Ltd* [1982] STC 30; and later *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 2 All ER 275, persuaded the House of Lords to neutralise such schemes. The outcome of these decisions is that where a scheme involves a series of separate legal transactions – in *Ensign* the scheme comprised seventeen documents all dated 14 July 1980 – the scheme should be viewed as a whole, the consequence of each separate transaction ignored and the position of the taxpayer in real terms be compared at the start and at the finish.

The relatively straightforward facts of a leading case *Furniss v Dawson* [1984] 1 All ER 530 illustrate both the potential scope of the new judicial approach and why it has provoked judicial disarray. It seemed that the *Ramsay* principle, as it is now known, could apply even to schemes where some 'loose ends' were left trailing, inadvertently or otherwise, provided that the following two essential ingredients were present: (i) a pre-ordained series of transactions and (ii) the insertion of steps with no commercial *purpose* other than the avoidance of liability to tax although they may have a business *effect*. The Dawsons (D) owned a UK private company which they agreed to sell to another company called Wood Bastow Holdings for £152,000. They (D) wished to *defer* a large capital gains tax bill which a direct sale would have incurred. To facilitate this they formed an Isle of Man company, Greenjacket, and transferred all the shares in the UK company to Greenjacket in exchange for shares in Greenjacket. This type of share-for-share exchange was exempt from capital gains tax (see now Taxation of Chargeable Gains Act 1992, s 135(1)). Greenjacket then sold the UK company shares to Wood Bastow for £152,000. Greenjacket retained the purchase money while the taxpayers (D) retained their shares in Greenjacket. However, although the purchase money had not been directly channelled to D by the time of assessment to tax, the Inland Revenue was still able to argue successfully in the House of Lords that Greenjacket's role in the transaction should be disregarded. When this is done, all that remains is a straight sale by the taxpayers (D) to Wood Bastow Holdings. The House of Lords concluded that the series of transactions in *Furniss* were pre-ordained and should therefore be viewed as one composite transaction. Lord Brightman concisely described the process (at 538):

> [It] was planned and executed with faultless precision. The meetings began at 12.45 pm on 20 December, at which time the shareholdings of the operating companies were still owned by the Dawsons unaffected by any contract of sale. They ended with the shareholdings in the ownership of Wood Bastow. The minutes do not disclose when the meeting ended, but perhaps it was all over in time for lunch.

The insertion of Greenjacket into the process constituted the necessary second ingredient. Again to quote Lord Brightman (at 543):

> that inserted step had no business purpose apart from the deferment of tax, although it had a business effect. If the sale had taken place in 1964 before capital gains tax was introduced, there would have been no Greenjacket.

The significance of the cases referred to above is that they contrast sharply with earlier judicial approaches to tax avoidance schemes. (See Wheatcroft (1955) 18 MLR 209; Flesch (1968) CLP 215; Stevens *Law and Politics* (1979) and *The English Judges* (2002); Millett (1982) 98 LQR 209). Indeed in *Ramsay*, counsel for the taxpayer had argued that the new approach marked a reversal of long-established principles of interpretation of taxing statutes. Lord Wilberforce responded (*W T Ramsay Ltd v IRC* [1981] 1 All ER 865 at 873):

> [The approach] does not introduce a new principle: it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation. While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. Such inability must result either in loss of tax to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process.

In *Furniss v Dawson* [1984] 1 All ER 530, Lord Scarman acknowledged in a clear if controversial opinion that the courts were indeed developing new principles (at 532):

> I am aware, and the legal profession (and others) must understand, that the law in this area is in an early stage of development. Speeches in your Lordships' House and judgments in the appellate courts are concerned more to chart a way forward between

> principles accepted and not to be rejected than to attempt anything so ambitious as to determine finally the limit beyond which the safe channel of acceptable tax avoidance shelves into the dangerous shallows of unacceptable tax evasion [sic].
>
> The law will develop from case to case. Lord Wilberforce in *Ramsay*'s case referred to 'the emerging principle' of the law. What has been established with certainty by the House in *Ramsay*'s case is that the determination of what does, and what does not, constitute unacceptable tax evasion is a subject suited to development by judicial process. Difficult though the task may be for judges, it is one which is beyond the power of the blunt instruments of legislation. Whatever a statute may provide, it has to be interpreted and applied by the courts and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found.

Where the boundaries of the new approach will finally be set remains uncertain but there are two points to be emphasised here. First, Lord Scarman's application of the term 'evasion' appears to blur the traditional distinction between avoidance and evasion based on criminality. But in fact it reflects a judicial rejection of the conventional avoidance-evasion dichotomy and a recasting of the traditional categories to recognise the existence of 'unacceptable tax avoidance'. In *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 2 All ER 275, Lords Goff and Templeman confirmed that a distinction could be drawn between, on the one hand, acceptable 'tax mitigation' – whereby the taxpayer takes advantage of the law to plan her financial affairs so as to minimise tax – and, on the other hand, 'unacceptable tax avoidance' characterised by Lord Goff (at 295) as involving:

> . . . the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed.

The second point to emphasise about the developing law is that post-*Furniss v Dawson* cases have done little to dispel a general air of uncertainty about both the scope of the *Ramsay* principle and current judicial attitudes to tax avoidance. *Furniss* left open such issues as the degree of certainty or timing necessary for a scheme to be pre-ordained, and whether the insertion of a step which is predominantly but not exclusively for tax purposes would fall within the scope of the *Ramsay* principle. These specific considerations have tended to shade into the broader issue of where to draw the line between acceptable 'strategic tax planning' or 'mitigation' and unacceptable tax avoidance.

Sharp divisions of opinion have emerged within the judiciary about these issues (see the extra-judicial comments of Lord Templeman in Shipwright (ed) *Tax Avoidance and The Law* (1997) ch 1; and cf Lord Oliver in Gammie and Shipwright (eds) *Striking the Balance: Tax Administration, Enforcement and Compliance in the 1990s* (1996)). The majority opinions of the House of Lords in *Craven v White* [1988] STC 476 and *Fitzwilliam v IRC* [1993] STC 502, decisions which favoured the taxpayer, seemed to reflect concern at the potential breadth and uncertain limits of the *Ramsay* principle as interpreted in *Furniss v Dawson*. Lord Oliver, with whom Lords Keith and Jauncey agreed in *Craven v White*, was at pains to reject a general proposition that 'any transaction which is effected for the purpose of avoiding tax on a contemplated subsequent transaction and is therefore "planned" is, for that reason, necessarily to be treated as one with that subsequent transaction and as having no independent effect' (at 503). In essence the decisions in *Craven* and *Fitzwilliam* sought to draw a distinction between 'pre-planned' and 'pre-ordained' tax-saving arrangements, with only the latter being liable to be overturned by the courts. To oversimplify, a pre-planned arrangement could be one in which, for instance, not every step in the process had been finalised from the start (*Craven v White*). There is no doubt that this approach signified something of a retreat from the position adopted in *Furniss*, whilst still ensuring that fully pre-ordained 'circular' or 'self-cancelling' schemes such as that in *Ramsay* would be unlikely to succeed. It was, of course, likely that tax planners would seek to introduce some formal degree of indeterminacy into their arrangements to circumvent this possibility.

The pendulum has since continued its momentum initially swinging back again seemingly in support of the Revenue position in the 5:0 defeat for the taxpayer in the House of Lords in *IRC v McGuckian* [1997] 1 WLR 991 (see Hoyle [1997] BTR 312; Tiley [1997] All ER Rev 465). All five Law Lords concurred in the result whereby an attempt to avoid a charge to income tax (and possible liability under a proposed wealth tax) by reconstituting income (a receipt of dividends) as a capital receipt failed. In the view of all the judges the arrangements fell clearly within the *Ramsay* principle. That much is uncontentious, the particular scheme carrying many of the hallmarks of the other 1970s arrangements so successfully challenged by the Inland Revenue.

Interestingly, however, the speeches of Lords Steyn and Cooke implicitly call into question the approach adopted in *Craven v White* ('a difficult case' per Lord Cooke at 1005). Lord Steyn, for instance, reviews the history of statutory interpretation of taxing statutes and concludes that Lord Wilberforce's speech (see above p 85) in *Ramsay* marked an intellectual breakthrough: 'The new development was . . . founded on a broad *purposive interpretation*, giving effect to the intention of Parliament. . . . And in asserting the power to examine the substance of a composite transaction the House of Lords was simply rejecting formalism in fiscal matters and choosing a more realistic legal analysis' (at 1000, emphasis added). Both Lords Steyn and Cooke also emphasise that the law is still in the process of being developed: '[It] is wrong to regard the decisions of the House of Lords since the *Ramsay* case as necessarily marking the limit of the law on tax avoidance schemes' (per Lord Steyn ibid, Lord Cooke at 1005; and cf Lord Scarman in *Furniss* see above p 85). It is not surprising that an Inland Revenue Consultation Paper on the possible introduction of a statutory general anti-avoidance rule (GAAR) incorporated to a considerable degree the *Ramsay* principle as restated in *McGuckian* (see Inland Revenue *A General Anti-Avoidance Rule for Direct Taxes* (1998) and cf the critical response by the Tax

Law Review Committee *A General Anti-Avoidance Rule for Direct Taxes: A Response* (1999)).

A further swing of the pendulum subsequently occurred in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311 where a unanimous House of Lords found in favour of the taxpayer (see Tiley [2001] BTR 153–158; Lord Templeman (2001) 117 LQR 575–588). The House accepted the proposition that it was necessary to adopt a purposive approach when construing taxation legislation but chose to draw the line at adopting what it regarded as a broader formulation of 'purposive interpretation' put forward by leading counsel for the Inland Revenue. Lord Hoffman commented that it did not look like a principle of construction but more like 'an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision. . . . This cannot be called a principle of construction except in the sense of some paramount provision subject to which everything else must be read. . . . But the courts have no constitutional authority to impose such an overlay upon the tax legislation . . .' ([2003] AC 311 at 325).

Unfortunately confusion has continued to grow apace despite, perhaps because of, the decision in *MacNiven*. Lord Hoffman suggested that an appropriate distinction to draw in construing taxation legislation was one between words usually importing 'commercial concepts' (such as 'loss' or 'disposal') and those referring to 'legal concepts' (such as 'conveyance' or 'sale'). The relevance of the distinction, according to Lord Hoffman, is that 'if a transaction falls within the legal description, it makes no difference that it has no business purpose. Having a business purpose is not part of the relevant concept' (at 334). Whilst a 'juristic' or we might say 'legalistic' approach to construction is appropriate for legal concepts 'a juristic analysis of the transaction, treating each step as autonomous and independent, might not be determinative' for commercial concepts, and inferentially this is where the *Ramsay* principle may apply. Doubts that Lord Hoffman's novel distinction between commercial and legal concepts was likely itself to provide a determinative solution have been borne out. In *Barclays Mercantile Business Finance Limited v Mawson* [2004] UKHL 51 the Appellate Committee (including Lords Steyn and Hoffman) refer in an agreed opinion to the distinction drawn by Lord Hoffman in *MacNive*n (at [38]):

> In the speech of Lord Hoffmann in *MacNiven* it was said that if a statute laid down requirements by reference to some commercial concept such as gain or loss, it would usually follow that elements inserted into a composite transaction without any commercial purpose could be disregarded, whereas if the requirements of the statute were purely by reference to its legal nature (in *MacNiven*, the discharge of a debt) then an act having that legal effect would suffice, whatever its commercial purpose may have been. This is not an unreasonable generalisation, indeed perhaps something of a truism, but we do not think that it was intended to provide a substitute for a close analysis of what the statute means. It certainly does not justify the assumption that an answer can be obtained by classifying all concepts *a priori* as either 'commercial' or 'legal'. That would be the very negation of purposive construction.

Discouraging though it may be to the reader seeking certainty it is difficult to dissent from the view of the editors of one text that 'the only conclusion to be drawn from this long line of cases is that there is no strong conclusion to be drawn' (Morse and Williams (eds) *Davies: Principles of Tax Law* (5th edn, 2004) p 45; see also McFarlane and Simpson 'Tackling Avoidance' in Getzler (ed) *Rationalizing Property, Equity and Trusts* (2003)). Nevertheless some tentative observations, if not conclusions, can be offered. First, and self-evidently, there remains some uncertainty as to where the borderline is to be drawn between strategic tax planning, or tax mitigation as it is sometimes called (see below), and unacceptable tax avoidance. It may be that the search for 'a bright line rule' to distinguish the acceptable from the unacceptable is fruitless in this context. Second, it has to be conceded that at least in part the uncertainty is not solely the result of conceptual complexity or scholarly disagreements over juristic matters. As mentioned above, it also reflects acute differences of opinion amongst the judiciary both as to the extent of their law-making function and where the balance should be struck between competing interests of the individual taxpayer, the Inland Revenue and indeed the generality of taxpayers (see in addition to the previously cited sources Lord Templeman (2001) 117 LQR 575–588; Lord Walker (2004) 120 LQR 412–427; and on the broader implications see Mumford *Taxing Culture* (2002) ch 7; and the contrasting approaches of Freedman [2004] BTR 332–357 and Simpson [2004] BTR 358–374). Of course, a state of uncertainty may of itself have a deterrent effect and inhibit the future development of artificial schemes.

Lastly, it is possible to view the *Ramsay* principle, whatever form it may finally take, as marking a step towards incorporating into a judicial definition of 'unacceptable tax avoidance' the key elements of the economist's definition – individual motivation and government objectives. Lord Nolan in *IRC v Willoughby* [1997] STC 995 referred to the distinction between 'tax avoidance' and 'tax mitigation' in the following terms (at 1003):

> [T]he hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.

By contrast Lord Hoffman in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311 doubted the usefulness of the distinction between avoidance and mitigation (at 335): 'The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not.' The distinction may be insufficiently subtle to capture the precise nature of what should and what should not be permissible given the difficulty at times in determining what Parliament did intend (see section (c) below and Lord Walker (2004) 120 LQR 412 at 419–424 for an alternative categorisation). On the other hand, the distinction does have the merit of exposing the flaws in an even more simplistic dichotomy, that of juxtaposing 'evasion' and 'avoidance'.

(c) Trusts and tax avoidance: a résumé

The applicability of the *Ramsay* principle, whatever its final form, or of those key elements in the economist's definition of tax avoidance to an analysis of trusts practice still presents difficulties. The uncertainties concerning settlors' motivations have already been commented on (see p 72), but also, as we have previously hinted, government objectives are not always clearly or easily identifiable. There is many a slip 'twixt party conference resolutions and Finance Acts. The possible objectives of the tax system as regards trusts will be examined in detail in the next section but a brief example demonstrates the scope for ambiguity that exists with specific legislation.

A distinct gap in the structure of estate duty, a form of death duty which existed in the UK up to 1974, was the absence of a tax on inter vivos – ie lifetime – gifts. Gifts made more than a certain period before death paid no estate duty. In addition, before the Finance Act 1969 estate duty was not usually chargeable on the value of property in a discretionary trust when one of the beneficiaries died (see Hawkins [1968] BTR 351). How, therefore, should we categorise the act of a settlor who placed property into a discretionary trust more than seven years before his death? The settlor avoided estate duty liability on both his own and beneficiaries' future deaths, thereby retaining the value of the property largely intact for future generations. This obviously seems to constitute highly successful tax avoidance if it is assumed that the policy objective of estate duty is being frustrated. But is the assumption justified? As regards inter vivos gifts Sandford reviews a range of possible explanations and concludes (*Hidden Costs of Taxation* (1973) p 116):

> A reasonable interpretation would be that the gifts *inter vivos* provision was intended to prevent as many gifts as possible from circumventing estate duty. But the logic of such a policy and the only way to close the avoidance loophole satisfactorily is to introduce a general gift tax. The only logical reason for not having a gift tax would seem to be the problems and cost of administering it.

What then of the discretionary trust aspect of our example? Did the failure of Parliament effectively to impose estate duty on the beneficiaries of discretionary trusts mean that governments were unaware of the practice, or could devise no effective method for assessing and imposing liability, or perhaps were neutral or were even covertly approving of the practice? Indeed, the estate duty regime may have involved what Simons (*Personal Income Taxation* (1938)), criticising the US income tax system, called (at p 219):

> . . . a subtle kind of moral and political dishonesty. One senses here a grand scheme of deception whereby enormous surtaxes are voted in exchange for promises that they will not be made effective. Thus the politicians may point with pride to the rates, while quietly reminding their wealthy constituents of the loopholes.

A more prosaic explanation is evident in the following comment from Lord Walker, writing extra-judicially: ‘Both in complex anti-avoidance provisions and in other more specific taxing provisions, parliament sometimes seems a bit inclined to throw in its hand, when it comes to the precise limits of their operation, and to leave that to the courts to work out’ ((2004) 120 LQR 412 at 425). The difficulty of identifying clear government objectives may inhibit any extensive application of the economist’s approach to legislative interpretation although the *Ramsay* principle does represent a step in that direction. But in fact the direct effect of the *Ramsay* principle, even as extended in *Furniss v Dawson*, is likely to be of limited application to trusts practice. The doctrine represents, in the trusts context, a judicial move to neutralise short-term manipulation of the division of legal and beneficial ownership as part of a series of transactions whose sole or, possibly, predominant motive is to avoid tax. Even where prompted by fiscal considerations, most examples of the use of the trust device seem likely to be viewed as tax mitigation rather than unacceptable avoidance (see eg the controversial decision of the House of Lords in *Fitzwilliam v IRC* [1993] STC 502). Attempts to reduce capital transfer tax liability by setting up a series of small discretionary trusts (see Chapter 8) or by so-called ‘channelling activities’ between spouses involving a very limited function for trustees may yet be attacked by the Inland Revenue but, to reiterate, the direct impact of the doctrine on ‘active’ trusts is likely to be limited.

Of greater relevance is the possibility that the courts will be encouraged, where competing interpretations of statutory language exist, to take more account of the broad policy objectives of specific fiscal legislation than may have been the case under a literalist approach to statutory interpretation (see *Inglewood v IRC* [1983] 1 WLR 366, and Chapter 8).

We have referred to the impact of the *Ramsay* principle in clarifying the meaning of tax avoidance and to its implications for litigation specifically involving interpretation of taxing statutes. There is also a more remote and less tangible aspect which relates to changes in judicial attitudes past and present. These changes remind us to be conscious of the absence of consistently homogeneous judicial views, in particular when considering the connection between tax law, trusts practice, and the development of the law of trusts. The hypothesis to be borne in mind therefore is that certain strands of this development cannot be satisfactorily understood within the boundaries of conventional trusts law doctrines, and that the courts were willing to sanction with varying degrees of alacrity certain changes in the law as a response to the needs of the users of trusts. This is not to claim that courts consciously favoured the taxpayer, indeed there are occasions when the opposite was demonstrably true (see *Re Weston’s Settlement* Chapter 7 below, but cf the comments of Venables QC on the surprising majority opinions in *Fitzwilliam*: ‘Their Lordships clearly had enormous sympathy with a landed aristocratic family seeking to preserve its estates’ in Shipwright (ed) *Tax Avoidance and the Law* (1997) p 62). Rather we should consider how far the processes of litigation and judicial decision-making in those cases where the Inland Revenue is *not* a party to the dispute have enabled the trust’s flexibility of form to be developed anew without regard to wider-ranging fiscal issues possibly affecting the economy as a whole. The speculative question remaining, therefore, is whether a putative recognition of 'unacceptable tax avoidance' in the sphere of tax litigation will, or should, spill over into the narrower realms of private trust litigation.

3. Taxes and the policies underlying them

(a) Purposes of taxation

Sandford's definition of tax avoidance has two elements, the taxpayer's motivation and the intention of the legislature. If analysis of this intention is to develop beyond merely reiterating in mantra-like fashion 'the intention of the legislature is what the language of the statute says it is', it is necessary to be aware of the objectives of a tax system. Before describing them and, also, what are termed the principles of a tax system, a word of warning is appropriate. Government policy on taxation is the object of much pressure-group activity – those seeking an internally consistent tax system based on rational argument are likely to be disappointed.

What we might call the old but classical analysis is that the sole function of taxation was to raise revenue to meet government expenditure. A contemporary and modified restatement of this position would be that 'the main reason government levies taxation is to provide for collective wants without creating inflation' (Sandford *Economics of Public Finance* (4th edn, 1992) p 111; and see generally Devereux *The Economics of Tax Policy* (1996)). Whilst the raising of revenue is a necessary function of taxation, it does not constitute a complete explanation of the purposes of a tax system. Taxation is also an instrument of economic policy. A realisation grew that at any constant given level of government expenditure increases in taxation would tend to reduce private demand for goods and services and counteract inflationary trends while decreases in taxation would tend to have the opposite effect. The effectiveness of Keynesian-inspired demand-management policies and the weight to be attached to fiscal rather than monetary measures of control has been extensively debated among both economists and politicians (see eg Worswick 'Fiscal Policy and Stabilization in Britain' in Cairncross (ed) *Britain's Economic Prospects Reconsidered* (1971); *Monetary Policy: Third Report from the Treasury and Civil Service Committee* 163 HC Official Report (1980–81); and generally James and Nobes *The Economics of Taxation* (7th edn, 2002) part 1; Mullard *The Politics of Public Expenditure* (2nd edn, 1993)). Indeed it is sometimes argued that fiscal changes have been motivated more by electoral considerations than demand-management ones – the so-called 'political business cycle' (see Nordhaus (1975) 42 Review of Economic Studies 169; Cullis and Jones *Public Finance and Public Choice* (2nd edn, 1998) ch 10). Nevertheless it is widely accepted that one function of taxation is to attempt to stabilise fluctuations in the economy. It can still just be claimed that the annual budget process is viewed 'not as a simple balancing of tax receipts against expenditure but as a sophisticated process in which the instruments of taxation and expenditure are used to influence the course of the economy' (Plowden Report *Control of Public Expenditure* 1961 (Cmnd 1432) para 10).

A tax system may also be used to pursue specific social policy objectives some with moral overtones – for example, to discourage the consumption of commodities such as tobacco or alcohol, or to encourage the growth of small businesses or altruism through giving to charity or generally to act as a regulatory instrument (see eg Ogus (1998) 61 MLR (6) 767–788). These economic, national accounting and 'public goods' objectives of taxation form the backcloth to our immediate concern which is with a subsidiary, and political although no longer politically fashionable, objective of a tax system, that of redistribution of wealth. By redistribution is meant the conscious effort to alter the present structure of wealth-holding rather than the automatic redistributive consequences that inevitably accompany the workings of any tax system where a taxpayer does not derive a benefit in collective goods and services equivalent to the tax paid.

(b) Principles of taxation

There exists a variety of taxes that can be selected to achieve any or all of these objectives. For example, to further a policy of redistributing wealth by directly taxing wealth-holdings a Chancellor of the Exchequer could impose a once-and-for-all capital levy on the net wealth of an individual or family; or impose an annual wealth tax; or tax only when property is transferred by the wealth-holder during life or on death, or indeed any permutation of these measures. The choice of method need not, however, be arbitrary. The decision about type and level of taxation and the appropriate fiscal treatment for trusts can be guided by established principles, dating back at least to Adam Smith's 'canons of taxation' first published in the *Wealth of Nations* (1776). Such principles are, however, capable of differing interpretations as the following cautionary comment by Sandford indicates (*Economics of Public Finance* (4th edn, 1992) p 112):

> It is impossible to postulate entirely satisfactory principles. Public finance is very much a part of *political* economy and political and ethical judgements cannot be wholly excluded from any statement of tax principles. Moreover, the principles themselves do not comprise a single mutually consistent system; they conflict with each other. Any tax system represents some sort of practical compromise.

The principles relevant to an assessment of wealth distribution and tax treatments of trusts are vertical equity ('ability to pay'), horizontal equity ('equality of treatment'), certainty and neutrality.

(1) Vertical equity

This principle concerns the way different people with different taxable capacity should be taxed. It is widely argued that vertical equity requires that taxes should be levied according to ability to pay, or as is occasionally and bluntly stated, that those with the broadest backs should carry the greatest burden. Unfortunately this simple formulation of the principle conceals considerable diversity of opinion. When comparing taxation of rich and poor, does vertical equity require proportional taxation, by which rich and poor pay the same proportion of their income or wealth in taxation? Alternatively does it require progressive taxation, by which the rich pay at a proportionately higher rate than the poor? Application, for example, of the law of diminishing marginal utility to the commodity of money provides support for a principle of progressive taxation. But even if one accepts the argument for progressive taxation, an unresolved issue is how steeply progressive the tax rates should be; how much more, proportionately, should the rich be taxed than the poor? If vertical equity implies progressivity this inevitably involves subjective value judgments about ability to pay and this element of subjectivity attracted the powerfully expressed criticism that 'the moment you abandon . . . the cardinal principle of exacting from all individuals the same proportion of their income or property, you are at sea without rudder or compass, and there is no amount of injustice or folly you may not commit' (McCulloch *A Treatise on the Principles and Practical Influence of Taxation and the Funding System* (1863) p 145).

The criticism is presumably reinforced by the subsequent emergence of redistribution as a conscious objective of the tax system.

(2) Horizontal equity

In contrast with vertical equity, horizontal equity has the appearance of objectivity. It requires that taxpayers who are equal in all relevant circumstances should pay equal amounts of tax. The objective simplicity is deceptive because in practice views differ about the basis of the relevant circumstances. Disputants may argue, for instance, about whether a tax should take account of household composition, or whether the individual or the family should constitute the tax unit. But there are circumstances where horizontal equity is clearly violated. Kay and King's study succinctly identifies them (*The British Tax System* (5th edn, 1990) p 41):

> In practice, horizontal equity is most frequently violated when administrative arrangements are unsatisfactory; when tax impinges heavily on some transactions but can be avoided on others; when tax is paid principally by the honest, or those without effective tax advisers or the readiness to reorganize their affairs so as to minimize their liabilities; when borderlines between activities . . . cannot be satisfactorily defined. . . . [Inequities of this kind] arose to a scandalous extent with the old estate duty and this has been true also of capital transfer tax and inheritance tax.

(3) Certainty

Certainty is a quality desired by both taxpayer and government. For the taxpayer the impact of any tax should not be arbitrary and the taxpayer's liability should be calculable in advance of any transaction. For the government certainty implies the ability to predict the probable revenue from taxes levied. Ideally simplicity should accompany certainty; a tax system should be sufficiently simple for a taxpayer not to need extensive legal or accounting advice. But the practice rarely measures up to the ideal. Criticism of the complexity and obscurity of tax statutes has a venerable pedigree (see Monroe *Intolerable Inquisition? Reflections on the Law of Tax* (1981) ch 2), but little progress has been made towards achieving clarity.

Complexity is not due to the perversity of parliamentary draftsmen but results from several influences. One already mentioned is that fiscal legislation is subject to special pleading from pressure groups. More fundamentally, the complexity reflects two interrelated features of our contemporary society with which those responsible for implementing policy objectives via taxation must cope. First, there is the ingenuity of tax avoiders which has invited a legislative response designed to render avoidance more difficult. The response, respecting the literalist method of interpretation historically adopted by the courts, has invariably been detailed which itself then encourages tax advisers to delve for further loopholes. The result of this continuous contest has not been intelligibility of taxing statutes. The second endemic feature and its consequence was identified by Gladstone as early as 1853 in a debate on the Finance Bill (127 Official Report (4th series) col 723, 27 May 1853): 'the nature of property in this country, and its very complicated forms, rendered it almost impossible to deal with it for the purpose of income tax in a very simple manner'. The comment is equally applicable to subsequent additions to the list of taxes such as estate duty and capital gains tax. The outcome appears to be that certainty of tax liability can only be purchased at the cost of considerable complexity.

The picture portrayed here may not prevail, at least in its extreme form, for much longer. One consequence of the *Ramsay* principle, presumably beneficial for taxpayer and Revenue alike, has been to add weight to the feasibility of rewriting tax statutes in a more simple manner (see Inland Revenue *The Path to Tax Simplification* (1995); and generally Salter (1997) 16 CJQ 294; (1998) 19 Statute LR 65; and see as an example of rewritten legislation the Capital Allowances Act 2001).

(4) Neutrality

This principle, which can also be termed 'economic efficiency', is that taxes should as far as possible avoid distortions of the market. In the context of tax and trusts the decisions of taxpayers to place property, for example, into trusts for children rather than make outright gifts to them should not be influenced by the size of the respective tax bills.

Neutrality appears to conflict with one objective of a tax structure previously mentioned, that of influencing behaviour in a particular direction, thereby distorting the operation of the market. In fact the conflict is more apparent than real since neutrality can be interpreted simply as requiring that distortions of free choice should reflect a conscious legislative policy. The consequence, as Kay and King note (*The British Tax System* (5th edn, 1990)), is that 'the neutral tax system, in effect,

Table 3.2

	1978–79£m	2002–03£m
Taxes on income		
Personal Income (including National Insurance contributions)	32,246 (63.2%)	154,078 (48.9%)
Company Income	2,692 (5.3%)	29,320 (9.3%)
Stamp Duties	433 (0.8%)	7,549 (2.4%)
Taxes on Capital		
Capital Transfer Tax and Inheritance Tax	360	2,354
Capital Gains Tax	353	1,596
Total of taxes on capital	713 (1.5%)	3,950 (1.3%)
Taxes on expenditure (eg VAT; excise duties)	14,948 (29.3%)	120,410 (38.1%)
TOTAL	51,032	315,307

Sources: Financial statement and budget report 1979–80; Inland Revenue Statistics 2004 tables 1.1, 1.2; ONS Blue Book: UK National Accounts 2003.

provides a bench-mark against which non-neutralities, intentional or otherwise, can be judged'.

(c) Tax structure

(1) The source of government revenue

The principles of taxation just referred to do not dictate that any specific tax structure be adopted. As the Meade Committee Report (*The Structure and Reform of Direct Taxation* (1978)) indicates, a range of possible tax structures exists, all of which are potentially compatible with the basic principles. This section briefly outlines the current UK tax structure, concentrating on the distinction between taxes on capital and income and their significance relative to the total annual tax revenue.

Taxes in the UK are formally categorised in terms of three tax bases: income, capital and expenditure. Table 3.2 identifies the source of tax revenue for the years 1978–79 and 2002–03.

Two points can be made about the figures (not adjusted for inflation) in Table 3.2. First, there has been a shift in the proportions attributable to taxes on income and expenditure (also termed 'direct' and 'indirect' taxes respectively). This reflects, to some extent, the contrasting philosophies of different governments. Second, taxes on personal income and expenditure are the predominant sources of revenue. In contrast, taxes on transfers of capital now provide only around one-fiftieth of total revenue and as such are of little consequence for the objectives of raising revenue or influencing the level of economic demand. The contribution from taxation on companies is, of course, particularly sensitive to the state of demand in the economy and its effect on corporate profits.

Despite their limited revenue importance, taxes on transfer of capital are of considerable significance to us for two reasons. First, they are the taxes levied on inter-generational transfers of wealth, and have influenced developments in trusts practice and law particularly since 1945. Second, the limited potential contribution of capital taxes to total tax revenue does not mean that they are similarly inconsequential for patterns of wealth distribution. The role of trusts practice in limiting the impact of these taxes and facilitating the continuing importance of inherited wealth is considered further below (pp 104 et seq).

(2) Capital and income: a problem of definition

The terms 'income' and 'capital' do not have universally accepted definitions and, in particular, legal and economic definitions are at variance. As regards income, it has been said (*Kay and King* p 96) that:

> . . . it may seem too trite to observe that to operate an income tax it is necessary to have a clear definition of what constitutes 'income', but the sad truth is that no single definition of income commands universal assent.

There is, in fact, no statutory definition of income. The Income and Corporation Taxes Act 1988 identifies in various Schedules sources of income to be taxed on an annual basis, but the sources are not exhaustive. Numerous examples of increases in a taxpayer's financial resources during a tax year fall outside the scope of the Act. Football pools, lottery or other gambling winnings are not classified as taxable income, nor are increases in the value of a taxpayer's capital assets such as shareholdings. The limited concept of income adopted for UK income tax contrasts with an economist's widely accepted definition of what is called 'comprehensive income'. Simons (*Personal Income Taxation* (1938) p 50) defined personal income as being:

> . . . the algebraic sum of (a) the market value of rights exercised in consumption and (b) the change in value of the store of property rights between the beginning and end of the period in question.

Severe administrative and valuation difficulties would hamper the use of this definition for tax assessment purposes (see Meade Committee *The Structure and Reform of Direct Taxation* (1978) ch 7), but the limited statutory definition also creates difficulties. It may become fiscally attractive to turn taxable investment income into non-taxable increases in the capital value of the income-producing assets. The problem is demonstrated by the following extremely simple example in the Meade Report (p 30):

> Consider two Government bonds both of which are issued at a price of £100, the difference being that on bond A the government undertakes to pay no interest but to redeem the bond at a price of £110 in a year's time, whereas on bond B the government

> undertakes to redeem the bond at its issue price of £100 in a year's time but meanwhile to pay £10 in interest on its borrowing. Is there no income but only gain in capital value on bond A, while there is income but no capital gain on bond B?

An attempt was made to counter this obvious gap in the tax structure and thereby to redress the balance between competing concepts of income by introducing a capital gains tax in 1965. In principle the object of this form of tax is to place on an equal footing assets such as A and B in the above example. A capital gains tax can be levied on an annual accrual basis, taxing the appreciation in asset values each year, or on a realisation basis, taxing the increase in value between the dates of acquisition and disposal. The UK version is a 'realisation' tax and stands on the borderline between income and capital taxation. Notwithstanding changes to tighten the scope of capital gains tax since 1965, there remain some circumstances where it is advantageous for the taxpayer to attempt to transmute income into capital (see eg *IRC v McGuckian* [1997] 1 WLR 991). Distinguishing between income and capital therefore still retains its importance for tax law, and also for trusts law because the conceptual confusion has left its imprint on the law governing trustees' duties of investment and impartiality (see Chapter 10).

Thus it is difficult to sustain a rigid distinction between concepts of income and capital, and even a tax on capital does not require that the tax be paid out of a stock of capital by disposing of assets. It merely indicates that the tax is assessed on the capital value of property. The tax itself may be paid out of the taxpayer's income, although a steeply progressive form of capital taxation based on the principle of vertical equity with wealth redistribution as its objective might well necessitate the disposal of capital assets.

Arguments based on vertical equity do not, however, provide the sole justification for capital taxes. A further consequence of the limited definition of income applicable to UK income tax is to strengthen a horizontal equity argument for capital taxation. As the then Chancellor Denis Healey expressed the point in the Green Paper on a proposed wealth tax (Cmnd 5704 (1974) p iii):

> . . . income by itself is not an adequate measure of taxable capacity. The ownership of wealth, whether it produces income or not, adds to the economic resources of a taxpayer so that a person who has wealth as well as income of a given size necessarily has a greater taxable capacity than one who has only income of that size.

(3) Taxation of capital

The main possible forms of capital taxation are summarised in Figure 3.1 below (derived from figure 9.1 in Sandford *Economics of Public Finance* (4th edn, 1992) p 215).

In the UK at present there are no taxes on wealth stock, although proposals for an annual wealth tax have been considered (see *Select Committee on a Wealth Tax* (HC

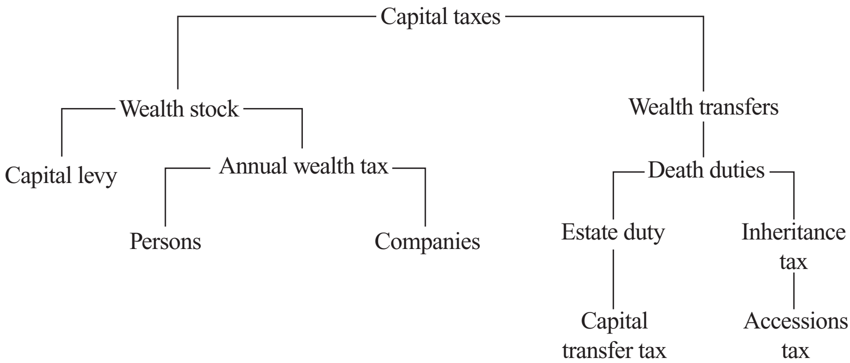

Figure 3.1 *Capital Taxes.*

Paper (1975) no 696–1). A capital levy is usually perceived as being an occasional or, indeed, once only measure.

In contrast, taxes on wealth transfer have a long lineage in the UK (see Chapter 2). Modern death duties have their origin in the Stamp Act 1694 and have an unbroken existence since. Death duties have proved a popular form of capital taxation with governments for essentially practical reasons. Valuation of assets is a major administrative difficulty for capital taxes but the problem is much reduced with death duties since only about 12 people in every 1,000 die each year. Valuation of the deceased person's assets is required in most circumstances for the administration of the deceased's estate. In addition to administrative convenience it can be argued that a death duty has a special attraction compared with other forms of capital taxation in that it taxes inherited wealth. The assumption is that there is less moral justification for inherited wealth than for that earned by an individual's own efforts. (Cf Bracewell-Milnes *Is Capital Taxation Fair?* (1974) and *Euthanasia for Death Duties: Putting Inheritance Tax out of its Misery* (2003) for robust criticisms of certain widely held assumptions on this subject.)

A duty imposed on death can be of a mutational or acquisitional character. A mutation duty, or estate duty, is in principle calculated according to the value of property changing hands on death irrespective of the destination of the property under the will or laws of intestacy. An acquisition duty or inheritance tax is calculated on the value of the benefit received by those entitled to the property on death irrespective of the size of the deceased's estate. A capital transfer tax and an accessions tax are respectively versions of estate duty and inheritance tax but incorporating lifetime gift taxes.

Before 1949 variants of both estate duty and inheritance taxes were to be found in the UK, but the latter were then repealed. In 1974 capital transfer tax (CTT) replaced estate duty. In 1986 substantial changes were introduced to CTT including renaming it, wholly misleadingly, as inheritance tax. It must be stressed that this inheritance tax is a form of estate duty (closely resembling the pre-1974 estate duty regime), and *not* an inheritance tax as described above.

4. Taxation and redistribution

(a) Introduction

It is beyond the scope of this book to discuss whether existing wealth distribution is unjust and should be altered. Instead it is accepted as a premise that redistribution on grounds of vertical equity has at various times, even if not now, been claimed to be a public policy objective. The more limited questions then to be assessed are how far large wealth-holdings are concentrated in trusts and whether the trust has been a significant contributing factor in frustrating redistributive policies. We do this in section 5. below. But to answer these questions adequately we need to know something about (1) the present concentration of wealth-holding and the persistence of inequality over time; and (2) the factors responsible for the persistence of inequality. We therefore consider these two issues in that order in this section. The process, however, is hampered by conceptual disagreements and statistical uncertainty. A particular difficulty to be confronted first is that the term 'wealth' permits a variety of definitions. There is, for instance, a distinction to be drawn between marketable and non-marketable wealth (see Figure 3.2 and for a detailed analysis see Royal Commission on Distribution of Income and Wealth (RCDIW) *Report No 5* (Cmnd 6999, 1977). Marketable wealth is usually considered as the most relevant measure for evaluating wealth distribution since it is closely linked to immediate command over economic resources. But it can be argued that even that measure fails to take account of all the potential benefits of wealth. Hobhouse (in Gore (ed) *Property: Its Duties and Rights* (1913) p 10) claimed that ownership of property has two functions: 'the control of things, which gives freedom and security, and the control of persons through things which gives power to the owner'.

Property-power can take the form of corporate power through the ownership or control of stocks and shares, and political power through control of productive assets and employment strategies of companies. For trust users, however, the security associated with property interests is an equally compelling value. Security here extends beyond straightforward economic entitlement to income or capital, and can be claimed to incorporate notions of protection, protection, that is, against too easy an incursion by the state into property-based entitlement (see Cotterrell (1987) 14 J Law and Society 77 at 87–88). As will be seen in Chapter 8, the weight to be attached to perceptions of property as security may become important when tax statutes and property concepts intermingle. Inevitably, a quantitative analysis of wealth-holding can give no estimate of the benefits, if any, to be derived from such elusive properties as power and security.

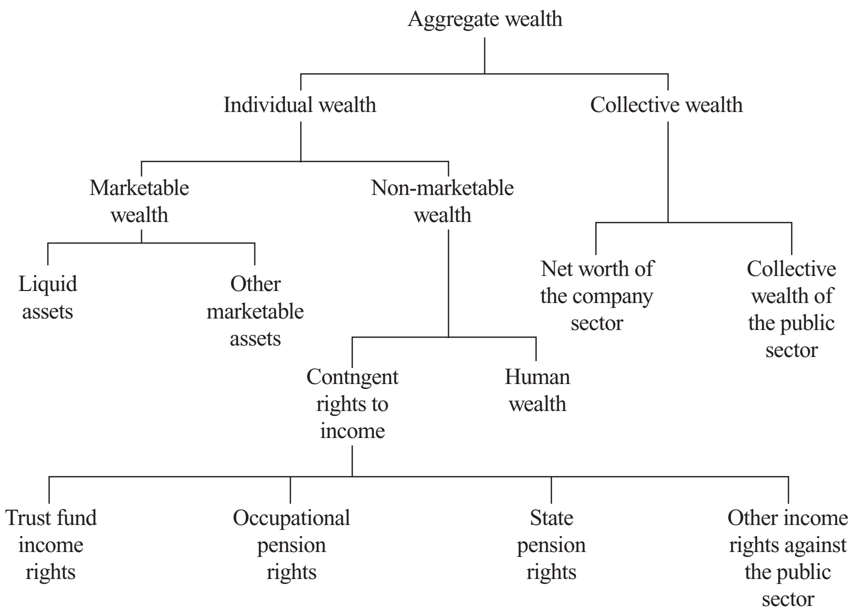

Figure 3.2 *Forms of wealth.*

(b) Wealth distribution and the importance of inherited wealth

Estimating wealth-holding in the UK is a complex statistical exercise producing somewhat uncertain results. A description of the basic method used, the estate multiplier method, and a review of criticisms of it are contained in a report by the RCDIW (*Report No 5* (Cmnd 6999, 1977) App C). Suffice to say here that there is no annual valuation of a taxpayer's wealth and that the main source for estimating wealth-holding is data collected by the Inland Revenue in administering inheritance tax.

Table 3.3 demonstrates the trend in distribution of marketable personal wealth this century. Different assumptions as to the appropriate definition of wealth would provide different wealth distribution statistics. For example in 1995 the estimated share of the top 1% of wealth-holders was 19% but if the values of occupational pension rights and state pension rights were to be included the figures would be reduced to 14% and 11% respectively. On the other hand if ownership of housing is excluded the results are even more skewed – for example, the shares of the most wealthy 1%, 5%, 10% and 25% increase to 33%, 58%, 72% and 86% respectively – suggesting that housing wealth is more evenly distributed.

Official Inland Revenue estimates are only available for the period from 1960 onwards. For earlier years reference has been made to the study carried out by Atkinson and Harrison (1978). The basis for their figures is not wholly compatible

Table 3.3 *Trends in the distribution of personal wealth of total adult population: selected years 1923–1995*

	Top 1%	Top 5%	Top 10%	Top 20%
1923	60.9	82.0	89.1	94.2
1938	55.0	76.9	85.0	91.2
1950	47.2	74.3	–	–
1959	41.4	67.6	–	–
1960	33.9	59.4	71.5	83.1
1966	30.6	55.5	69.2	83.8
1972	31.7	56.0	70.4	84.9
1976	24.9	46.2	60.6	77.6
1979	20	37	50	–
1988	17	37	50	–
1995	19	38	50	73 (Top 25%)
2002	23	43	54	72 (Top 25%)

Sources: Atkinson and Harrison (1978); RCDIW *Report No 7* (Cmnd 7595, 1979) Tables 4.4 and 4.5; *Inland Revenue Statistics* (2004) Table 13.5.

with that for present Inland Revenue estimates; consequently only general conclusions can be drawn about long-term trends. Despite this the main trend is striking. There occurred a substantial reduction in the share of total personal wealth of the top 1% of adult wealth-holders over the whole period, although until recently that share had remained almost constant for two decades. The apparent sharp reduction in wealth concentration between 1959 and 1960 is misleading and reflects a change in the method of collecting data from estates then.

Such statistical quirks apart, it is tempting to attribute the reduction in wealth concentration to high and effective rates of estate duty and income tax, but the inference to be drawn from the statistics is a subject of acute controversy (see Polanyi and Wood *How Much Inequality?* (1974); Atkinson and Harrison *Distribution of Personal Wealth in Britain* (1978); RCDIW *Report No 1: Selected Evidence* (Cmnd 6171, 1975)).

The decline in the share of the top 1% must inevitably be accompanied by a corresponding improvement in the shares of some groups lower down the wealth scale. But critics of the effectiveness of redistributive policies argue that, if housing is stripped out of the figures, the decline in inequality has been much less than a concentration on the share of the top 1% might suggest (see eg Harbury and Hitchens *Inheritance and Wealth Inequality in Britain* (1979); on the importance of investment in company securities for the top 1% of wealth-holders see Banks et al in Hill (ed) *New Inequalities* (1998) ch 13; Stark *A-Z of Income and Wealth* (1988)).

A 1973 RCDIW survey (*Report No 5*, Cmnd 6999) provides tentative support for the hypothesis that, despite an apparent trend towards greater equality in the distribution of wealth among individuals, distribution of wealth on a family basis has been largely untouched. The survey of a sample of estates valued in excess of £15,000 'confirms that inheritance operates primarily to retain wealth within the circle of relatives' (para 3.85).

But the fact that acquisition of wealth via inheritance is largely restricted to immediate family relationships tells us nothing about the value of inherited wealth relative to the value of personal wealth as a whole. The RCDIW survey estimated that total transmitted or inherited wealth accounted for about 25% of total wealth. Further support for the opinion that inheritance has played and continues to play the leading role in maintaining wealth inequalities comes from Harbury and Hitchens (*Inheritance and Wealth Inequality in Britain* (1979)). Their empirical study based on samples of rich males dying in 1956–57, 1965 and 1973 and rich women dying in 1973 cautiously concluded (at p 131) that:

> . . . it is not too far from the truth that something between two-thirds and four-fifths of those who died rich in the third quarter of the present century owed their wealth to inheritances and the rest to entrepreneurship and luck.

They add (at p 136):

> . . . it is difficult to avoid the conclusion that inheritance has been the most important single source of wealth inequality in the fairly recent past in twentieth-century Britain.

In the absence of firm data, it is not possible to advance any conclusions about the consequences of the uneven performance of the UK economy since the mid-1970s for the relative importance of inherited wealth. Whereas such familiar names as Branson, Sugar, Bowie and McCartney now feature in lists of the richest individuals in Britain, such evidence as does exist indicates that the impact of inheritance as a source of wealth remains unimpaired (see eg Dearden, Machin and Reed 'Intergenerational Mobility in Britain' (1997) 107 The Economic Journal at 47–66; 'The Young Rich' *Observer*, 25 April 1999).

(c) Estate duty: a voluntary tax?

This importance of inherited wealth reflects the fact that estate duty, the tax apparently most directed towards breaking up concentrations of wealth, became extremely easy to avoid. Indeed 'whenever a particularly large estate is reported in the press with the duty paid representing between 60 per cent and 80 per cent of the value of the estate, the deceased is regarded as eccentric' (Revell *The Wealth of the Nation* (1967) p 110).

In fact, as the estate duty returns demonstrate and the Sandford survey of accountants suggests (see p 75), many taxpayers did not seek to avoid estate duty. At the same time there existed numerous methods for those who wished to avoid or mitigate the burden of the tax. Sandford (*Taxing Personal Wealth* (1971) pp 80–89), for instance, in a review of the principal methods of avoidance estimated that the duty forgone was at least 50% of the actual estate duty yield. (See also Horsman (1975) 85 Economic Journal 516.) Our interest lies in particular with a combination of two of those methods, the trust and the lifetime gift.

The most obvious and simple way of avoiding estate duty was to transfer property before death – by a gift inter vivos. To prevent the absurdity of death-bed transfers avoiding estate duty, tax law treated gifts made within a certain period before death as passing at death. The period, initially three months, was gradually extended up to seven years but provided the donor survived for that period no duty was payable. Assuming the donor still had a considerable life expectancy, the outside risk of estate duty liability could be countered by insuring the donor's life.

Outright gifts suffer from the disadvantage that control over the property is lost. One attraction of the trust is that the beneficiaries' control over income and capital can be restricted while, potentially, the settlor's influence can be indirectly retained. Under an inter vivos settlement the provisions for imposing estate duty on the settlor who failed to survive for the necessary period were the same as for outright gifts. The advantage of using the trust lay in the potential for minimising future incidence of estate duty liability. In general an interest in a trust fund attracted estate duty only when the person who was the beneficial owner of the interest died. Where, however, a beneficiary had no enforceable claim as an individual on the income or capital of the fund, as with a discretionary trust, then no definable interest passed on the death of a beneficiary and no estate duty could be levied. It was to counter the perceived weakness of estate duty as a counter-weight to wealth concentrations that the Labour Government in 1974 introduced capital transfer tax, a combination, it will be recalled, of a lifetime gifts tax and estate duty. Its decline and demise are considered further in Chapter 8.

5. Trusts and wealth concentration

(a) A statistical gap: identifying the numbers and size of trusts

Any attempt to assess the extent to which the trust was used to avoid estate duty is hampered by a lack of information about wealth held in non-dutiable trusts. Estate duty statistics relating to the 1940s and 1950s for example suggested a decline in the importance of settled property relative to total dutiable property. These statistics, however, referred to dutiable trusts only and omitted two potentially important forms of settled property, the discretionary trust and the surviving spouse settlement. One possible explanation therefore for the apparent decline in the importance of settled property is that there was a substantial movement out of dutiable settlements into exempt settlements such as discretionary trusts. Indeed this might seem a rational response by wealth-holders to sharp increases in the rates of estate duty that occurred during this period. There is, however, no firm statistical evidence to support this supposition. Indeed it is in the very nature of things that evidence about exempt settled property is hard to come by. As Revell says ('Settled Property and Death Duties' [1961] BTR 177 at 180–181):

> *The practical problem*
> This mixture of statistical evidence and pure speculation is all that we have to go on in arriving at some estimate of the amount of settled property which is necessarily missing when one computes total wealth in the beneficial ownership of individual persons from the death duty statistics. Short of a complete census of all personal trusts it seems, indeed, that nobody can know the whole picture. It is common for property to be transferred into a discretionary trust subsequent to its formation, so that neither the solicitor drawing the trust nor the Revenue in examining it would know the ultimate value of the trust fund. . . .
>
> In the case of discretionary trusts, no firm information is ever likely to be forthcoming, but those whose professional business involves the establishment of trusts or the management of trust funds could provide some very useful assistance to the economist. Statements of opinion and personal observation of general trends could help to narrow considerably the area in which estimation is based entirely on guesswork.

A later study by Revell, based on a sample of corporate trustees and internal assessment by the Inland Revenue, attempted to remedy these deficiencies in information. His findings and other analyses which chart the rise in the popularity of trusts, in particular discretionary trusts, during the 1960s and early 1970s led the Inland Revenue to the following conclusion in its evidence to the Select Committee on the Wealth Tax ((1975) Evidence App 118 at para 15).

> There is firm evidence that the numbers of discretionary and accumulating trusts have increased very substantially in the period from 1960 to 1972, and what evidence exists on capital values, although subject to large margins of error, indicates a considerably faster growth than would be shown simply by the increases in market values. It can be concluded that but for the existence of such settlements there would have been a more marked reduction in the concentration of wealth.

According to later Inland Revenue estimates, by 1975 there existed some 310,000 non-discretionary trusts, or interest in possession trusts as they are now called, and 90,000 discretionary trusts with total capital values of £8.3 billion and £8.5 billion respectively, ie 6% of total personal wealth (Inland Revenue *CTT and Settled Property: A Consultation Document* (1980) App 1). However, if the hypothesis that users of trusts are sensitive to the prevailing fiscal climate is valid, then the introduction of CTT in 1974 could be expected to have resulted in a shift out of those trusts which were potentially most vulnerable to the new tax.

Subsequent studies, although still constrained by the statistical difficulty of identifying the number and value of trusts, indicate that the anticipated shift has occurred. The most recent available detailed study, conducted by Robson and Timmins for the Inland Revenue, indicated that by 1988 the number of UK-resident discretionary trusts and interest in possession trusts had fallen to approximately

55,500 and 203,000 respectively (*Discretionary Trusts* (1988)). In addition, it was estimated that potentially within the scope of UK tax laws there are now some 7,000 overseas trusts, a development positively encouraged by the suspension of exchange control in 1979. Of greater significance is the fact that the estimated value of property held in discretionary trusts (the figures for interest in possession trusts not being currently available) was £7.4 billion, a reduction of some 75% in real terms from the 1975 estimate. The unsurprising consequence of this decline was a comparable fall in the value of property held in discretionary trusts as a proportion of the total marketable wealth of individuals from around 3.5% in 1975 to around 1% just over a decade later. That proportion has remained broadly constant, although the nominal value of assets held in discretionary trusts in 2001–02 – the latest recorded year – was estimated to be £21 billion (*Inland Revenue Statistics 2004* Table 13.3).

(b) Attributing beneficial ownership in trust funds

Estimating the number and total value of trusts, and discretionary trusts in particular, does not resolve all the statistical uncertainties. Two important problems remain: (1) the attribution of ownership of trust funds, and (2) their importance for top wealth-holders relative to other forms of property. The method adopted by the Inland Revenue in attributing beneficial ownership of property within discretionary trusts is described by Dunn and Hoffman:

> 'The Distribution of Personal Wealth' *Economic Trends* (1978) no 301 p 101 at 110–111
>
> Allocation of excluded wealth
>
> *Discretionary trusts*
> These can be subdivided into:
>
> a. Accumulation and maintenance trusts
> b. Other discretionary trusts
>
> The former are for the benefit of minors to whom they have been attributed. The treatment of other discretionary trusts is more difficult. The benefits of these trusts are allocated by the trustees at their discretion so that it is difficult to specify to whom they should be attributed. On the other hand, to adopt a 'legalistic' viewpoint and attribute them to nobody but simply to the personal sector as a whole would give a picture of the distribution of personal wealth which is scarcely realistic.
>
> In order to add [the estimated figures on the numbers and size of these trusts] into the wealth estimates it is necessary to consider two sets of assumptions;
>
> i. the average number of beneficiaries per settlement;
> ii. the nature of the joint distribution of settled property and identified wealth.
>
> It is crudely estimated that, on average, accumulation and maintenance trusts can be attributed to two beneficiaries and other discretionary trust property to four beneficiaries.

Table 3.4 *'Non-dutiable trusts' as percentage of total personal wealth of top 1% of wealth holders in 1975*

	Percentages	£ billion
Discretionary trusts	7.9	4.6
Accumulation and Maintenance	2.5	1.5
Surviving Spouse	6.4	3.8
Total	16.8	9.9

Source: Dunn and Hoffman *Economic Trends* (1978) no 301 tables A and B.

> These assumptions were used to calculate two sets of estimates, labelled *a* and *b*. Of these, *a* implies that the beneficiaries have no other wealth – which assumption will minimise inequality of wealth – whilst *b* was chosen to maximise inequality by attributing the largest trusts, where possible, to the richest owners of free estate.
>
> For accumulation and maintenance trusts the problem of making assumptions on basis *b* was simplified by the almost complete absence of large holdings of free estate by minors in the estimates of identified wealth.
>
> The allocation of the property in other discretionary trusts is more difficult.
>
> The allocation of holders of other discretionary trust property to the highest wealth ranges is again constrained by the relatively small numbers there. A third (and very extreme) assumption has been tested – that each trust benefited one person. But the effect of this was almost identical with that of basis *b*. The estimates shown in all relevant tables take the average of bases *a* and *b*.

The difficulty of drawing firm conclusions from the data is compounded by the fact that the statistics refer to individual rather than family wealth. Robson and Timmins, for instance, find that between one-quarter and one-third of discretionary trusts had beneficiaries in the second generation of a family (ie grandchildren) but none in the current or first succeeding generations. This is not surprising since the trust is an ideal vehicle for such 'generation-skipping' transfers, as they are termed, one consequence of which is to facilitate wealth redistribution although predominantly on an inter-generational family basis.

Nevertheless tentative conclusions can be drawn about the importance of trusts for individual wealth holdings. According to RCDIW *Report No 7* (App D) the value of discretionary and surviving spouse trusts was 3.9% of total personal marketable wealth in 1975. But the wealth held in those trusts, particularly in discretionary trusts, was concentrated among top wealth-holders. From the Inland Revenue data presented by Dunn and Hoffman, it is possible to estimate for 1975 the proportional significance of non-dutiable trusts for personal wealth (see Table 3.4).

The concentration is even more significant for those with personal marketable wealth in excess of £100,000 in 1975, then comfortably within the top 0.5% of wealth-holders. The figures for discretionary trusts, accumulation and maintenance trusts and surviving spouse settlements rise to 10.5%, 3.3% and 9.8% (total 23.5%) respectively. It is simply not known whether these percentages or something near them are currently applicable. Robson and Timmins do not attempt to attribute beneficial ownership in the discretionary trusts covered by their 1988 research. Their study does demonstrate, however, that the distribution of trusts by asset value and income is, as with wealth-holding generally, highly skewed (*Discretionary Trusts* (1988) para 1.5). Thus 41% of the total income and 43% of the total assets of discretionary trusts were accounted for by slightly fewer than 3% of such trusts. This picture of a concentration of assets is broadly confirmed by Inland Revenue data based on returns from trustees of discretionary trusts that are liable to a ten-yearly 'periodic charge' to Inheritance Tax (see Chapter 8). Thus for 2001–02, the latest year for which reasonably reliable statistics are available, 60% of assets were held by 14% of discretionary trusts (*Inland Revenue Statistics 2004* Table 12.7).

6. Conclusion

The object of this chapter has been to introduce, in approximately equal measure, the motivations of those who create trusts, some interpretations of tax avoidance, basic principles and objectives of taxation and available statistical evidence on the impact of trusts on wealth distribution. The focus on wealth distribution has led us to emphasise the role of trusts in potentially countering the incidence of death duties and gift taxes. But it must not be overlooked that, for many, transferring property into trusts has had an equally important role historically in minimising their potential exposure to income tax liability (see eg the research by Stopforth [1990] BTR 225; [1991] BTR 86; [1992] BTR 88).

There is, however, a further dimension to the interplay between trusts and taxation which merits comment here, that is the role of lawyers. In both the previous and current chapters we have sought to emphasise the creative role of the lawyer in shaping the law from the bottom up, rather than just acting as a conduit for predetermined rules (see Lempert (1976) 2 Law and Society Review 173; Zemans (1983) 77 Am Pol Sci Rev 690). In the context of taxation, this role can involve more than passively acquainting clients with the fiscal consequences of a proposed course of action. In addition, lawyers, and indeed competing professionals such as accountants, can actively manipulate legal concepts, statutory language and rules of statutory interpretation in a fashion that operates within the letter but against the spirit of the law (see McBarnett (1991) 42 Br J Soc 323, and 'It's Not What You Do but the Way That You Do It' in Downes (ed) *Unravelling Criminal Justice* (1992)). The process of 'creative compliance', the term coined by McBarnett and her colleague Dr Whelan, is particularly apposite to an area such as tax law where, as we saw, certainty has since Adam Smith been regarded as a prime virtue. But certainty tends to encourage detailed prescriptive rules and, as McBarnett points out, 'creative compliance operates particularly effectively in the context of a rule-bound regime, where the words of the law can be treated as recipes for avoidance' ('When Compliance is not the Solution but the Problem' in Braithwaite (ed) *Taxing Democracy* (2003) pp 229–243 at p 230).

This perception of the nature of the lawyer's role in structuring the relationship between taxpayer and Inland Revenue raises contentious issues. One issue, of course, is that schemes can 'go wrong'. Then creativity can turn out not to be risk free. In a controversial criminal prosecution, *R v Charlton* [1996] STC 1418, CA, a number of tax professionals were convicted – and imprisoned – on charges of producing false accounts to the Inland Revenue (criticised by Venables QC in Shipwright (ed) *Tax Avoidance and The Law* (1997) pp 23, 28–45; but for another view Bridges [1998] NLJ 118 at 185 and 219). Yet here also 'creative compliance' by its very nature of purporting to comply with the letter of the law 'can claim to be "not illegal", to be quite distinct from non-compliance' (McBarnett in Braithwaite (ed), ibid, p 232). A related issue, although again only of indirect relevance to us, concerns the place of ethics in tax avoidance. In devising a tax avoidance scheme, or advising on its effectiveness, does the lawyer owe any obligation to anyone or any interest beyond that which is unquestionably owed to the client (see generally Cranston (ed) *Legal Ethics and Professional Responsibility* (1995) ch 1)? A more fundamental point, and one directly relevant to this chapter, concerns the implications of the creative role for the design and operation of the tax system. In particular it touches on the question as to whether the legislature should seek to provide for specificity in taxing statutes, with the possible opening up of a path to circumvention in the ways described earlier in this chapter, or opt for generality with a consequent reliance on judicial interpretation and Inland Revenue practice to fill in the gaps.

One mode of generality that the government has decided not to pursue at least for the present is the enactment of comprehensive anti-avoidance legislation in the form of a General Anti-Avoidance Rule (GAAR). Instead an alternative measure to counter what the government perceives as tax avoidance rather than tax mitigation was introduced in the Finance Act 2004, ss 19 and 306–319, and to a large degree focuses on the professionals who devise and market tax avoidance schemes (see Fraser [2004]BTR 4 at 282–296 and [2004] BTR 5 at 454–459; and the Tax Avoidance Schemes Regulations, SI 2004/1863; SI 2004/1864; and SI 2004/1865). Radical new provisions have been put in place intended to elicit information about the arrangements taxpayers enter into that are designed to, or have the effect of, reducing their tax liabilities. The new rules require 'promoters' (s 307) of tax schemes to disclose to the Inland Revenue any arrangements where 'the main benefit, or one of the main benefits, that might be expected to arise from the arrangements' is the obtaining for their clients of a tax advantage, a term defined widely so as to incorporate relief or deferral of tax or the avoidance of any obligation to deduct or account for any tax (s 319). The new disclosure rules are designed to provide the Inland Revenue with advance information about potential tax avoidance schemes and arrangements so that, where appropriate, speedy anti-avoidance legislation can be implemented (see Inland Revenue Practice Note PN3 (2 December 2004) for details of such measures introduced as a result of the operation of the new disclosure rules). It remains to be seen what effect this new approach allied to improved clarity and accuracy in tax statutes as a result of the Tax Law Re-Write programme will have on the tax avoidance industry.

Final conclusions, however, on all the above issues are better deferred until the more detailed examination of the taxation of trusts has been undertaken in Chapter 8. Here we simply pose for an interim assessment some problems suggested by the material.

(1) Why do people set up trusts?

(2) Is it misconceived to describe use of the discretionary trust under the estate duty regime as 'tax avoidance'? Consider this in particular in the context of the suggestion that 'the legislature in Great Britain has, possibly unconsciously, felt unable to close the loopholes in the tax structure since it was politically undesirable to reduce the rates' (Wheatcroft 'Proposals for a System of Estate and Gift Taxation – II' [1964] BTR 283 at 296).

(3) 'The claim that the trust has been a major force in frustrating redistributive policies rests largely on assertion and is not supported by the available evidence.' Do you agree? Does the evidence from the RCDIW and the data available to the Inland Revenue refute the further claim that the trust is an effective wealth-concealment mechanism? Would a 'complete census' of all private express trusts be desirable or practicable? (Eg what information would be required?)

(4) An issue that we do not address in this chapter is what unit of taxation (eg individual; + spouse; + children; + grandchildren) is most suitable either for measuring wealth distribution or for using as a tax base. As from 1991 the United Kingdom moved to a system of independent taxation for Income Tax. This is also broadly speaking the position for direct taxes on capital. Whatever the merits of independent taxation may be in terms of equality between men and women it is arguable that, in terms of measuring wealth-holdings, calculations based on individual wealth rather than 'family wealth' convey a distorted picture of wealth concentration. Note that no such deference to independence is evident in Social Security legislation, where assets and income of partners (and indeed other family members) can be taken into account when deciding entitlement to benefit (see Cockfield in Shipwright (ed) *Tax Avoidance and the Law* (1997) pp 341–347). There is an extensive body of literature on the question of the appropriate tax base for a Wealth Tax; see eg the still valuable study by the Canadian Royal Commission on Taxation Study No 10 *Taxation of the Family* (1966); *Green Paper on a Wealth Tax* (Cmnd 5704, 1974) paras 8–10; Sandford et al *An Annual Wealth Tax* (1975) ch 11.

(5) Tiley, referring to the uncertainties engendered by the recent shifts in judicial attitudes to tax avoidance, comments: 'If practitioners do not like it, they have to face the no more attractive alternatives of either detailed and relentless (and occasionally retroactive) legislation or a general anti-avoidance rule' ((1997) All ER Rev 467). In response to an initiative by the Chancellor of the Exchequer, Gordon Brown, the possibility of introducing a GAAR was the subject of a 1998 Consultation Document issued by

the Inland Revenue. The document favoured the adoption of a widely drawn GAAR applicable to the corporate sector only (ie corporation tax, petroleum revenue tax and income tax payable by companies). Other areas would continue to be subject to the judicially developed anti-avoidance principles discussed earlier in this chapter. The proposal provoked a wide-ranging debate, much of it critical of the detail if not the general principle of a GAAR (see Tax Law Review Committee *A General Anti-Avoidance Rule* (1999); Edge *The Tax Journal* 7 December 1998 pp 12–13; Appleton *The Tax Journal* 23 November 1998 pp 5–8; and see generally Masters [1994] BTR 647; Cooper (ed) *Tax Avoidance and the Rule of Law* (1997); and compare the contrasting positions of Freedman [2004] BTR 4 at 332–357 and Simpson [2004] BTR 4 at 358–374). It seems unlikely that any legislative initiative will be taken until the effectiveness or otherwise of the Finance Act 2004 disclosure requirements can be determined.

4

Creating the trust – I

1. Introduction

(a) The centrality of intention

When deciding how to give away property the owner of assets has a choice between outright gift or a gift in trust. Stripped to its essence the private trust, to reiterate a point made earlier, is a gift projected on the plane of time. However, the limited functional similarity of these two forms of gift, the absolute gift and the gift in trust, must not disguise the fact that they are conceptually distinct.

> Thus there are gifts, which are Legal, and, then again, there are trusts, which are Equitable. These are two distinct arrangements, not simply two types of benefaction, although it is not clear whether we treat them as distinct because we sharply distinguish wanting to make a gift to another, on the one hand, from wanting to make a trust for another, on the other hand, or because we pay attention to the historical distinction that gifts were creatures of Law, and trusts, creatures of Equity. But distinct they are, and so we think that there are separate requirements peculiar to each . . . (M Pickard 'The Goodness of Giving, The Justice of Gifts and Trusts' (1983) 33 U Toronto LJ 381)

In practice also there will usually be no difficulty in distinguishing the two forms since trusts are commonly created in writing, usually by deed, wherein the donor designates another person or group of persons as trustee(s). But neither writing nor the appointment of others as trustees is essential. A person can, for instance, unilaterally and orally declare himself to be trustee of property for the benefit of another. The absence of written evidence in such circumstances can lead to difficulty of interpretation in this area, particularly that of separating general intention from particular intention. By general intention is meant the intention on the part of the owner of assets to be a benefactor of some other person(s). Although both specific modes of giving, the outright gift and the declaration of oneself as trustee, do have as a common core that generalised intention to be a benefactor, the legal system discriminates between them. It purports to ignore the common generalised intention and concentrates instead on the particular intention, whether for instance to be a donor of an absolute gift or to be a trustee. And analytically these are very different.

> The giver means to be rid of his rights, the man who is intending to make himself a trustee intends to retain his rights but to come under an onerous obligation. The latter intention is far rarer then the former. Men often mean to give things to their kinsfolk, they do not often mean to constitute themselves trustees. An imperfect gift is no declaration of trust. (F W Maitland *Equity* (2nd edn, 1936) p 72)

As we shall see, it is the proposition contained in the final sentence that has tended to pose the problems of interpretation. The need to identify and respect a donor's particular intention is therefore central to much of the law and learning concerned with creating a valid trust. This approach assumes that a particular intention exists and can be discerned. But in some circumstances a donor may not advert to whether he intends to impose the obligations of trusteeship either on himself or others; rather he intends to benefit another with property, the method being at best a subsidiary consideration.

Out of the resulting uncertainty can arise disputes, intra-family disputes over 'who gets what', and recourse must then be made to rules about trust creation in an attempt to divine what the donor intended. There may, for instance, be circumstances when it is important to know whether the donor intended the donee to be subject to a binding legal obligation or simply a moral one. But where the donor has failed to make this clear, then almost by definition the nature of the intention is problematic. Consequently, a number of general questions need to be kept in mind when analysing and evaluating the legal rules about creation of trusts. What tools of construction does a court use in such circumstances if called upon to decide what the particular intention is? How open-textured is the concept of intention: are, for instance, evaluative judgments about the merits of individual cases or the extent of the court's jurisdiction being invoked under the cloak of intention? More fundamentally, is there sound justification in principle and policy for sustaining the clear division described by Maitland in the quotation above, and consequently adhering to a principle that 'Equity will not perfect an imperfect gift'? This is not entirely an academic question since some recent controversial cases appear to indicate a softening both of the 'clear division' and of the underlying principle.

It is, however, important to retain a sense of perspective about the extent of the problems of interpretation outlined here. The pathological cases resulting from such disputes can give an impression that the creation of a trust is an act fraught with uncertainty. This is not so; some rules of trust creation, particularly those associated with formalities, are bedevilled by complexity but the overwhelming majority of trusts are created without difficulty. Indeed, it can be argued that most of the cases leave scarcely any imprint on trusts practice. The trite question which then applies with particular intensity to this complex area of trusts law, is 'Why study them?' The mountaineer's response – because they are there – will not suffice, nor perhaps for the student will the fact that some cases have prompted extensive academic debate. A more pragmatic justification is that the cases illustrate par excellence three particular facets of trusts litigation, which can on occasion overlap. First, there are the pathfinder cases, those where rules are changed and the boundaries of trusts law pushed outwards to accommodate new practical uses of the trust form. Even then, as we shall see here and also in Chapter 5 where they principally occur, each party to the litigation is likely to argue that its position truly respects the settlor's intention. Second, there are the pathological cases already referred to where, for example, lack of clarity on the part of a donor allied to flexibility of a concept such as intention may provide extensive leeway for the exercise of discretion by the courts. As always the challenge is how to provide for the discretion without creating excessive uncertainty. Third, another class of pathological cases arises where attempts are made by settlors or the Inland Revenue respectively to avoid or impose tax liability. Here both sides deploy the full complexity of rules concerning trusts creation, the public law issue of fiscal liability being fought out over the terrain of private trusts law.

The fiscal element returns us to the problematic nature of intention but at a wider level than that encapsulated by Maitland's dichotomy. We equated general intention with 'intention to be a benefactor' but it will be recalled from Chapter 3 that the choice of the mode of benefiting – gift in trust or absolute gift – is often influenced by tax-planning considerations. The final section of this chapter is, therefore, devoted to a case study – the *Vandervell* litigation – which illustrates inter alia both the problematic nature of these different levels of intention and how decisions may be influenced by which level is afforded most weight by a court.

(b) Maxims of equity and trust creation

This is not primarily a book about Equity but the maxims or principles, such as 'Equity will not perfect an imperfect gift' referred to above, have directly influenced the development of the law concerning trust creation. Readers should consult one of the standard works on Equity such as Snell *Principles of Equity* (31st edn, 2004 – referred to hereafter as *Snell*) ch 3 for a detailed account of these maxims but brief reference is made here to those of particular relevance to this chapter. Other maxims will be considered at appropriate points in the book, as with 'Equality is Equity' in Chapter 5 and 'He who comes to Equity must come with clean hands' in Chapter 6.

(1) *Equity looks to the intent rather than the form.* Equity is concerned with the substance of a transaction rather than the form. The intention of a person can therefore be respected by permitting a trust to be created even though the word 'trust' is not uttered and does not appear in any document. But caution is necessary here since an emphasis on substance does not mean that statutory formalities can readily be ignored. Moreover there is a negative aspect to this 'impatience with mere technicalities' (*Snell* p 39). The signing and sealing of a deed is seen as a mere technicality and does not constitute consideration for the promise in Equity. Consequently, if I promise in a deed to transfer £1,000 to trustees in favour of A but then either fail to do so or decide not to do so then the promise will not be enforceable in Equity by A unless she has provided 'legal' consideration for the promise. In these circumstances the promise is voluntary only and the beneficiary A is termed a volunteer, hence the further maxim 'Equity will not

assist a volunteer' (see p 171 et seq). But how, it may be said, can trust beneficiaries who are usually volunteers have enforceable rights against trustees? The simple answer is that when the transfer of property to trustees takes place the trust is completed or 'constituted' and the beneficiaries now have a species of property interest that can be enforced against the trustees. An unenforceable hope or expectation hardens into a property right at this point (see further p 130).

(2) *Equity will not allow a statute to be used as an 'engine' or 'instrument' of fraud.* Equity will ignore a failure to comply with statutory formalities if to do otherwise would be to enable a person to achieve a fraudulent purpose by relying on that failure (see below p 120).

(3) *Equity regards as done that which ought to be done.* This maxim is closely associated with the equitable remedy of specific performance. Thus where there is a contract or other obligation that can be specifically enforced then Equity treats the parties as being in the position that they would occupy upon completion of the obligation. An illustration from a land law context is the well-known doctrine from the case of *Walsh v Lonsdale* (1882) 21 Ch D 9 whereby a specifically enforceable contract to grant a lease is treated as creating an equitable lease on the same terms. Similarly, and of more direct relevance to this chapter, a specifically enforceable contract to sell land or 'unique' personal property is specifically enforceable. The equitable maxim may then operate to transfer the equitable interest to the purchaser with the vendor being deemed to hold the legal title as constructive trustee pending completion of the contract. This is admittedly a somewhat unusual constructive trusteeship in that not only is there an absence of any element of improper conduct, but until the conveyance is completed the 'vendor-trustee' is fully entitled to protect his own interest in the property rather than that of the 'purchaser-beneficiary' (see generally *Hanbury and Martin* pp 326–328). As will be seen (p 126) this process can become a tool in the struggle between taxpayer and the Inland Revenue.

It must not, however, be overlooked that these and other so-called maxims of equity 'are not to be taken as positive laws of equity which will be applied literally and relentlessly in their full width but rather as trends or principles which can be discerned in many of the detailed rules which equity has established' (*Snell* p 27). There is a potential problem here. Which should prevail if, in a given fact situation, maxims clash or a maxim conflicts with a rule? Fortunately the siren-like attraction of the maxims is complemented by what Simon Gardner has described as 'a peculiarly Delphic quality' ('Two Maxims of Equity' (1995) 54(1) CLJ 60). In this they provide both a means by which the courts can exercise their discretion and a guide for interpreting that discretion.

2. Creating a trust: the requirements outlined

Our coverage of the requirements that must be satisfied for a valid express trust to be created is slightly unusual and so we provide below a brief but more conventional outline of those requirements as a reference point for the reader.

(a) Capacity to create a trust

In general the capacity to create a trust of property is co-extensive with the power to dispose of a legal or equitable interest in that property. Accordingly any person over the age of 18, unless suffering from mental incapacity, can create an express trust of any property which is capable of disposition (see *Hanbury and Martin* pp 78–79 for the consequences of mental abnormality on capacity to create a valid trust).

A minor cannot hold a legal estate in land (Law of Property Act (LPA) 1925, s 1(6)) and so cannot create a trust of land. As regards other property, including an equitable interest in land, a minor can create a trust but it is voidable; it can be repudiated on or shortly after attaining the age of majority, at present 18 (*Edwards v Carter* [1893] AC 360).

(b) The 'three certainties' must be present

These are usually stated to be 'certainty of words', 'certainty of subject-matter' and 'certainty of objects'. The authority commonly cited for the three-fold requirement is a dictum of Lord Langdale in *Knight v Knight* (1840) 3 Beav 148 at 173 (see also Lord Eldon in *Wright v Atkyns* (1823) Turn & R 143 at 157). As a broad description of the basic requirements, this categorisation is useful but it is misleading to think of it as identifying a set of precise principles (see Watkin 'Doubts and Certainties' (1979) 8 Anglo-American L R 123).

The expression 'certainty of words' is now more appropriately referred to as 'certainty of intention', which requires the existence of a specific intention to create a trust. This criterion in turn includes rules for determining whether a person intends to constitute himself as trustee, by conduct or otherwise; rules for determining whether 'precatory words' such as 'in full confidence' are intended to be legally rather than morally binding; and rules for deciding whether the use of the word 'trust' is decisive. In some commercial contexts the presence of an intention to create a trust may be particularly contentious (see Chapter 15).

Certainty of subject-matter also has an element of ambiguity since it refers to the requirement for certainty both of the particular property to be held on trust and the quantum of each beneficiary's interest in the trust (see Williams (1940) 4 MLR 20). It is even argued that this category may extend to include rules as to whether certain kinds of property right are capable of being held on trust. (See Heydon and Loughlan *Equity and Trusts* (5th edn, 1997) p 185.)

'Certainty of objects' referred originally to a requirement that the identity of beneficiaries should be stated with sufficient clarity, but now may extend to include the so-called beneficiary principle. This requires every valid non-charitable trust to have one or more beneficiaries and, consequently, trusts to achieve non-charitable purposes generally will be invalid.

The three groups of rules cannot be examined in complete isolation from each other. For example, in relation to certainty of words and certainty of subject-matter

Sir Arthur Hobhouse in *Mussoorie Bank v Raynor* (1882) 7 App Cas 321 at 333 stated:

> Uncertainty in the subject of the gift has a reflex action upon the previous words, and throws doubt upon the intention of the testator, and seems to show that he could not possibly have intended his words of confidence, hope, or whatever they may be – his appeal to the conscience of the first taker – to be imperative words.

(c) The necessary formalities must be observed

'Now as regards the formalities necessary to the constitution of a trust, there is extremely little law – trusts have not been hedged about by formalities' (*Maitland* p 56). Recent case law prevents our wholeheartedly accepting this description but it is still correct to state that an inter vivos trust of personalty can be created 'without deed, without writing, without formality of any kind by mere word of mouth'. In contrast evidence in writing is necessary for the creation of a trust of land and the requirements of the Wills Act must be complied with for testamentary trusts.

(d) The trust must either be completely constituted or supported by valuable consideration

The most common way of creating a trust is for the settlor (S) to convey property – land, chattels, money, shares – to trustees to hold on trust. This simple statement conflates two separate elements, the declaration that a trust is intended and the transfer of property to trustees. Both elements must be present for a trust to be validly created and until the property is conveyed to trustees the trust remains incompletely constituted. While the trust is in this state it cannot be enforced by the beneficiaries, nor indeed can the trustees compel S to make the transfer, unless consideration of a type recognised by equity has been furnished by either the trustees or the beneficiaries. The rules defining such consideration are different from those defining consideration at common law. Of course, if S declares that he will himself in future hold certain of his own property as trustee no transfer of the property is necessary and the trust is immediately constituted.

(e) The trust must not infringe the rules relating to perpetuity, inalienability and accumulation (see Chapter 6)

(f) The trust must not be intended to defraud creditors or otherwise be contrary to public policy (see Chapter 6)

A brief note of explanation is necessary to explain the slightly idiosyncratic treatment of the above issues adopted in this book.

The topic of 'complete constitution' is fragmented. The part relating to the formal requirements for effectual transfer of property is dealt with alongside formalities for creation of trusts in section 3(b) (p 120) while declaration of oneself as trustee is considered along with certainty of intention in section 4(a) (p 154). Some cases concerning the enforceability of voluntary covenants made by settlors with trustees have excited sustained academic attention. In our view many of the legal and policy arguments are concerned essentially with whether a gratuitous promise should be enforceable, although the legal form the argument takes has frequently revolved around the degree of intention necessary or desirable to create a trust. Accordingly this aspect of complete constitution is also considered, albeit briefly, in the section dealing with certainty of intention (see 4(c), p 171).

The 'certainty of objects' criterion is separated from the other two certainties and becomes a central focus of Chapter 5. The cluster of rules gathered together under the umbrella of 'certainty of objects' were initially more dictated by and concerned with the court's ability ultimately to control and enforce the trust obligation than with the centrality to be accorded to the settlor's specific intention, which is the predominant focus of the present chapter. However, in Chapter 5 we consider whether the emphasis on enforceability has been gradually weakened by a judicial desire to respect the intentions of would-be settlors.

First, however, we consider what formalities are necessary to create a trust.

3. Formalities

(a) Foreword: creation of trusts and dealings in equitable interests

A by now familiar method of creating a trust is for a settlor (S), having absolute beneficial ownership of property, to transfer property to trustees (T1, T2) to hold on trust for B. The property is commonly the legal title to specified assets such as land or shares. But let us assume for a moment that S possesses an equitable interest such as a life interest in a trust fund consisting of pure personalty, the benefit of which it is intended to transfer to B. There are various methods of dealing with equitable interests to achieve this objective. One of these would be for S, as the owner of the equitable interest, to declare himself or herself a trustee of that interest for B, creating what is termed a 'sub-trust'. But if this declaration of trust is construed as a disposition of the equitable interest, it will need to comply with the formalities specified for such dispositions in LPA 1925, s 53(1)(c) (see section 3 (b)(2) below). The formalities to be considered thus include both those applying to the creation of trusts and those applying to the disposal of equitable interests.

As a brief guide, we outline here in general terms the different formalities requirements applicable to the two modes of trust creation – trust by declaration of oneself as trustee and trust by transfer of property (and declaration of some other person(s) as trustee(s)).

Trust by declaration of oneself as trustee S, being owner of a relevant property interest, declares himself trustee for B:

(a) If the property is a legal interest, the only formal requirement is LPA 1925, s 53(1)(b) which concerns land or any interest in land (see section (b)(1) below).

(b) If it is an equitable interest, LPA 1925, s 53(1)(b) may apply, *but also* one must for the purposes of s 53(1)(c) scrutinise the transaction to see if *in substance* it is a 'disposition' rather than a 'sub-trust'.

Trust by transfer S transfers or takes steps to transfer the property interest to T1 and T2 as trustees for B. In general, the formalities are those prescribed by the rules governing the transfer of the relevant property interest (see 3(c) below: *Complete constitution of the inter vivos trust*). For example, transfers of shares in a company must be registered in accordance with the Stock Transfer Act 1963, s 1 and the company's articles.

The transfer must also comply, where appropriate, with the requirements of:

(i) Wills Act 1837, s 9 (see 3(d) below);
(ii) LPA 1925, s 53(1)(b);
(iii) LPA 1925, s 53(1)(c) applying to dispositions of equitable interests (see (b)(2) below).

Thus trusts by transfer, unlike trusts by declaration of oneself as trustee, can be created in two distinct temporal ways, one taking effect during the settlor's lifetime (an inter vivos trust), the other to come into effect on the death of the settlor (a testamentary trust).

The formalities required for the creation of trusts by transfer are best understood by considering separately their application to these two methods. However, before considering the detail of the relevant rules in the order just described, a preliminary question must be addressed: what function are the rules intended to perform? The specific justification for these rules will be considered in their individual contexts, but it is appropriate to emphasise here a more general function of formalities, one which can generate a tension in this area of law. An obvious yet important function of the formalities is to maximise certainty about the creation of a trust and its terms. Where the rules require some form of writing this is likely at least to reduce the scope for disputes about a person's intentions as compared with, for instance, an oral disposition of property. As importantly the process of complying with requirements to commit one's intentions to writing may concentrate the mind wonderfully and reduce the scope for ambiguity.

However great may be the attraction of a strict application of the rules in the interests of certainty, of estate planning and, indeed, of minimising litigation costs, there is a countervailing driving force potentially at work behind developments of the law in this area. That is the wish to respect where possible people's clearly discernible intentions about the disposition of their property. The tension generated presents us with the questions of how courts do and should respond to transactions which fail to comply with the formalities requirements, yet where a specific intention is manifestly clear? Is the price of failure to comply to be invalidity? Does the answer differ depending on whether non-compliance is a conscious act or accidental?

These general considerations should be borne in mind in seeking to understand and evaluate the formal requirements set out in the following pages.

(b) Creation of trusts and disposition of equitable interests: inter vivos formalities

(1) Declaration of trust

While most trusts are in practice declared in writing, whether with oneself or some other person(s) as trustee(s) there is no formality required where the property is pure personalty. Accordingly, a trust comprising such property may be declared by unsigned writing, orally, or by conduct.

Where the property is land or any interest in land, LPA 1925, s 53(1)(b) provides: 'a declaration of trust respecting any land or interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will'. Writing is required only as evidence of the intention to declare a trust, the declaration itself need not be in writing. The signature to the writing must be that of the beneficial owner of the property not any agent of his. The more rigorous writing requirements with regard to contracts to create a trust of any interest in land or to dispose of an equitable interest in land are now to be found in the Law of Property (Miscellaneous Provisions) Act 1989, s 2, repealing and replacing LPA 1925, s 40. Any such contract made after 26 September 1989 is now void unless *made in* writing (see Oakley (ed) *Megarry's Manual of the Law of Real Property* (8th edn, 2000) pp 148–154). The writing requirement in s 53(1)(b) applies to the creation of express trusts of land only since LPA 1925, s 53(2) provides that s 53 'does not affect the creation or operation of resulting, implied or constructive trusts'. Intriguingly s 53(1)(b) does not state any sanction for non-compliance and consequently it is generally assumed that the absence of signed writing renders the trust unenforceable not wholly void (see Youdan [1984] CLJ 306 at 320–322 for a concise discussion of this point).

The apparent mandatory nature of s 53(1)(b) is tempered by the existence of equitable doctrines, in particular the principle that 'Equity will not allow a statute to be used as an engine of fraud'. Section 53(1)(b) has its origins in the Statute of Frauds 1677 and the principle was developed subsequently to enable the courts to intervene where rigid application of the statute would promote the very fraud it was probably enacted to prevent.

> It is further established by a series of cases, the propriety of which cannot now be questioned, that the Statute of Frauds does not prevent the proof of a fraud; and that it is a fraud on the part of a person to whom land is conveyed as a trustee, and who knows it was so conveyed, to deny the trust and claim the land himself. Consequently, notwithstanding the statute, it is competent for a person claiming land conveyed to another to prove by parol evidence that it was so conveyed upon trust for the claimant, and that the grantee, knowing the facts, is denying the trust and relying upon the form of conveyance and the statute, in order to keep the land himself. (*Rochefoucauld v Boustead* [1897] 1 Ch 196 at 206)

It is not necessary for the conveyance itself to be fraudulently obtained for the principle to apply: 'The fraud which brings the principle into play arises as soon as the absolute character of the conveyance is set up for the purpose of defeating the beneficial interest' (*Bannister v Bannister* [1948] 2 All ER 133 at 136). One minor issue of dispute is whether the doctrine simply permits the express trust to be enforced or, alternatively, gives rise to a constructive trust to implement the terms of the agreement. The Court of Appeal judgment in *Rochefoucauld v Boustead* was explicit: 'the trust which the plaintiff has established is clearly an express trust . . . one which the plaintiff and defendant intended to create. The case is not one in which an equitable obligation arises although there may have been no intention to create a trust' (at 208; and see Swadling in Birks (ed) *Resulting Trusts: Practical Issues* (1999) for a valuable discussion of those two cases). The trend in more recent cases, however, has been to favour the constructive trust conclusion (see eg *Re Densham* [1975] 3 All ER 726; *Allen v Snyder* [1977] 2 NSWLR 685; *Lyus v Prowsa Developments Ltd* [1982] 2 All ER 953; *Ashburn Anstalt v Arnold* [1989] Ch 1; see further Elias, *Explaining Constructive Trusts* (1990) pp 106–113). This approach is more easily reconciled with s 53(1)(b) itself, from which constructive trusts are specifically excluded by s 53(2). Thus the impact, although not the formal requirement, of s 53(1)(b) is restricted to cases where the settlor declares himself trustee of his own land.

(2) Disposition of equitable interests

The basic modes of dealing with equitable interests in property were summarised by Romer LJ in *Timpson's Executors v Yerbury* [1936] 1 KB 645 at 664:

> Now the equitable interest in property in the hands of a trustee can be disposed of by the person entitled to it in favour of a third party in any one of four different ways. The person entitled to it: (1) can assign it to the third party directly; (2) can direct the trustees to hold the property in trust for the third party . . .; (3) can contract for valuable consideration to assign the equitable interest to him; or (4) can declare himself to be a trustee for him of such interest.

The validity of any of these modes of dealing then depends, for purposes of compliance with formalities, on whether it also constitutes a disposition of an equitable interest under LPA 1925, s 53(1)(c).

> A disposition of an equitable interest or trust subsisting at the time of the disposition, must be in writing signed by the person disposing of the same, or by his agent thereunto lawfully authorised in writing or by will. (LPA 1925, s 53(1)(c))

In addition s 53(1)(b) will apply where a declaration of trust of an equitable interest in land is made.

Section 53(1)(c) did not spring fresh-born into existence in 1925 but has its antecedents, like s 53(1)(b), in the Statute of Frauds 1677. Its principal function, then as now, appears to be that of protecting trustees (but cf *Gardner* p 81). The notion, which has some judicial support (see *Vandervell v IRC* [1967] 2 AC 291 at 311) is simply that trustees need to be able to determine who the beneficiaries are. A requirement that any transfer of beneficial interests must be in writing will plainly assist the process, although somewhat surprisingly no obligation is imposed on the transferor or transferee to inform the trustees that a transfer has occurred.

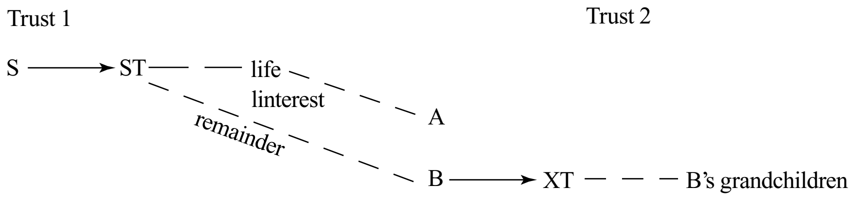

Figure 4.1 *Equitable ownership.*

Nevertheless, if the mere formality requirement were all that s 53(1)(c) effected then the scope of the section would possibly have remained unexplored. After all, accidental non-compliance would be rare in a transaction where lawyers are likely to have a formative hand and there is no incentive deliberately not to comply. However, fiscal considerations have intruded here also. Much of the case law concerning s 53(1)(c) is of recent vintage because, in Lord Wilberforce's words, 's 53(1)(c) . . . has recently received a new lease of life as an instrument in the hands of the Revenue. The subsection . . . is certainly not easy to apply to the varied transactions in equitable interests which now occur' (*Vandervell v IRC* [1967] 1 All ER 1 at 18).

Those varied transactions which attracted the Inland Revenue's attention included attempts to avoid stamp duty. Stamp duty is payable on instruments transferring property or an interest in property, not on the transaction itself, and is calculated ad valorem on the value of the interest transferred. The duty will thus be avoided if a transfer can be validly effected orally. But where this cannot be done and the writing requirements imposed by s 53(1)(c) are not complied with, the attempted transfer will be void. This provides an added incentive for the Revenue to use the section: if the taxpayer has failed to divest himself of the interest in the property he may become liable to assessment for income tax on any income accruing to the property. Two recent developments – one statutory, the other judicial – have combined, at least for fiscal purposes, to reduce the contemporary importance of the interpretation of s 53(1)(c). First, by virtue of the Finance Act 1985, s 82 transfers by way of gift are now subject to 50 pence duty only and not the ad valorem charge. Second, most stamp duty avoidance schemes of the type discussed here would now be likely to be caught by the *Ramsay* principle (see *Ingram v IRC* [1985] STC 835).

Before considering the various modes of dealing and their relationship to s 53(1)(c) two notes of warning are sounded. First, Lord Romer's classification is not exhaustive: recent cases have tended to produce ad hoc accretions to the basic categories. This cannot be said to have clarified the relationship between s 53(1)(c) and dealings in equitable interests. Second, it is important to consider, particularly for the purpose of applying s 53(1)(c), not simply the division between legal and equitable interests but the further sub-division between a 'bare' equitable interest and an equitable interest carrying beneficial rights.

The following example (see Figure 4.1), closely following that devised by Green (1984) 47 MLR 385 at 387, explains this distinction. Let us suppose that S, absolutely

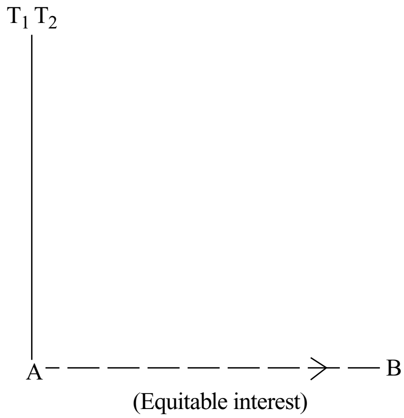

Figure 4.2.1 *Assignment by A direct to B.*

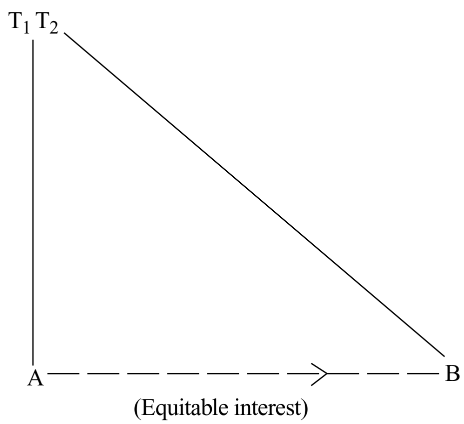

Figure 4.2.2 *Direction by A to trustees to hold on trust for B.*

entitled to property, creates a trust by declaring herself trustee (ST) of the property for A for life remainder to B. The beneficial interest in the property will become distributed between A and B, reflecting the actuarial values of their respective equitable interests (Trust 1). Let us further suppose that B then assigns his equitable interest in remainder to XT as trustee for his (B's) grandchildren. XT will now hold B's original equitable interest, but with the beneficial interest extracted from it and transferred to the grandchildren as equitable interests in the new trust (Trust 2). B might equally have achieved the same outcome by declaring himself to be trustee of his equitable interest for the grandchildren. This 'sub-trust', as that last alternative form of transfer is called, has prompted some subtle nuances of analysis of the scope of s 53(1)(c).

With these cautionary reservations in mind, the various modes of dealing with equitable interests and their relationship to s 53(1)(c) can now be examined (see Figures 4.2.1 and 4.2.2):

Direct assignment of the equitable interest to a third party (Figure 4.2.1) Trustees T1 T2 hold property on trust for A absolutely who assigns the interest to B. This is plainly a disposition within s 53(1)(c) and is void unless in writing.

Direction to trustees to hold property on trust for a third party (Figure 4.2.2) T1 T2 hold property on trust for A absolutely and A directs T1 T2 that in future they should hold the property in trust for B absolutely. This point arose in *Grey v IRC* where the House of Lords unanimously held that there was a disposition, with the consequence that the attempt to avoid stamp duty failed.

Grey v IRC [1959] 3 All ER 603 at 607
On 1 February 1955 Mr Hunter (H) transferred 18,000 shares to the appellant trustees (G) to hold as nominees for himself.

On 18 February 1955 H orally and irrevocably directed the trustees to divide the shares into six blocks of 3,000 shares each and to appropriate one block to each of six pre-existing settlements in favour of H's grandchildren.

On 25 March the trustees executed six deeds of declaration of trust – which H also executed to testify to the earlier oral direction – declaring that they had since 18 February held each block of shares on the trusts of the respective grandchildren's settlement.

The Revenue successfully argued (1) that the oral direction of 18 February was an attempted disposition of H's equitable interest which failed because it did not comply with s 53(1)(c), and (2) that the deeds of 25 March constituted the disposition and were subject to stamp duty.

> **Lord Radcliffe:** My Lords, if there is nothing more in this appeal than the short question whether the oral direction that Mr Hunter gave to his trustees on 18 Feb. 1955, amounted in any ordinary sense of the words to a 'disposition of an equitable interest or trust subsisting at the time of disposition', I do not feel any doubt as to my answer. I think that it did. Whether we describe what happened in technical or in more general terms, the full equitable interest in the eighteen thousand shares concerned, which at the time was his, was (subject to any statutory invalidity) diverted by his direction from his ownership into the beneficial ownership of the various equitable owners, present and future, entitled under his six existing settlements. But that is not the question which has led to difference of opinion in the courts below. Where opinions have differed is on the point whether his direction was a 'disposition' within the meaning of s 53(1)(c) of the Law of Property Act, 1925, the argument for giving it a more restricted meaning in that context being that s 53 is to be construed as no more than a consolidation of three sections of the Statute of Frauds, s 3, s 7 and s 9. . . .
>
> In my opinion, it is a very nice question whether a parol declaration of trust of this kind was or was not within the mischief of s 9 of the Statute of Frauds. The point has never, I believe, been decided and perhaps it never will be. Certainly it was long established as law that, while a declaration of trust respecting land or any interest therein required writing to be effective, a declaration of trust respecting personalty did not.

> Moreover, there is warrant for saying that a direction to his trustee by the equitable owner of trust property prescribing new trusts of that property was a declaration of trust. But it does not necessarily follow from that that such a direction, if the effect of it was to determine completely or pro tanto the subsisting equitable interest of the maker of the direction, was not also a grant or assignment for the purposes of s 9 and, therefore, required writing for its validity. Something had to happen to that equitable interest in order to displace it in favour of the new interests created by the direction; and it would be at any rate logical to treat the direction as being an assignment of the subsisting interest to the new beneficiary or beneficiaries or, in other cases, a release or surrender of it to the trustee. I do not think, however, that that question has to be answered for the purposes of this appeal. It can only be relevant if s 53(1) of the Law of Property Act, 1925, is treated as a true consolidation of the three sections of the Statute of Frauds concerned . . . But, in my opinion, it is impossible to regard s 53 of the Law of Property Act, 1925, as a consolidating enactment in this sense.

Lord Radcliffe suggests obiter that 'there is warrant for saying that a direction . . . prescribing new trusts was a declaration of trust'. The apparent conflation of 'direction' and 'declaration' implicit in that statement does not sit comfortably with Romer LJ's categorisation which distinguishes between them as being two different modes of disposing of an equitable interest in property. However, it is clear that whatever the descriptive label – be it 'direction' or 'declaration' – that is attached to an instruction such as that in *Grey*, there is a disposition for the purposes of s 53(1)(c).

The picture is much less clear where the 'declaration of trust' takes the form envisaged by Romer LJ's use of the term, ie where a person holding a legal or equitable interest declares herself to be a trustee of that interest (see following section).

Declaration by equitable owner of herself as trustee (sub-trust) Two separate forms of sub-trust fall to be considered here.

Assume that T1 and T2 hold property on trust for A absolutely. Consider first the position where A declares herself trustee of her equitable interest to hold for B for life, remainder to C. This is a declaration of trust, which may be oral if the property is pure personalty, but must be evidenced in writing under s 53(1)(b) if the property subject to the interest is land. It is widely accepted that no disposition requiring writing under s 53(1)(c) occurs since A still retains her equitable interest – although now devoid of beneficial content which has shifted to the equitable interests of B and C. In addition it can be argued that, unlike the example that follows, this is more than a bare trust since A has taken on herself an active role. (For a carefully structured argument that writing is required, necessarily implying that 'declaration' and 'disposition' are not mutually exclusive concepts, see Green (1984) 37 MLR 385 at 396–398.)

The second form of sub-trust arises where A declares herself trustee of her equitable interest for B absolutely. The position here as regards the writing requirement is uncertain. It is argued (*Hayton and Marshall* p 84) that what appears to be a declaration of trust results, in effect, in a disposition of A's entire equitable interest, which therefore requires writing within s 53(1)(c) whatever the nature of the property concerned: 'After all A is a simple bare trustee with no active duties to perform so that [s]he should drop out of the picture, [the original trustees] now holding for [B] instead of A: by A's action A's equitable interest has passed to [B]' (*Hayton and Marshall* p 84 following Upjohn J in *Grey v IRC* [1958] Ch 375 at 382 who accepted the notion of a sub-trustee 'disappearing from the picture' on declaration of a bare sub-trust). It may be argued, however, that this analysis in effect transforms a declaration of a sub-trust into an assignment, which is not giving full effect to A's specific intention.

An alternative analysis therefore is akin to that applicable to the first form of sub-trust: the declaration of trust creates a sub-trust under which the original trustees owe their trust duties to A who herself continues to hold the equitable interest – but again one devoid of any beneficial interest – as a bare trustee only in favour of B. After all, unlikely though it may be, there is presumably nothing to prevent the trustees still paying to A whatever she is entitled to under her equitable interest and leaving her to pay B. The implication of this alternative analysis would seem to be that no disposition of the equitable interest occurs under s 53(1)(c) (see eg Lord Cohen in *Oughtred v IRC* (below) but cf Green above who argues that such a declaration nevertheless constitutes a part disposal of A's equitable interest – the previously subsisting *beneficial* part of A's equitable interest – and should therefore still fall within s 53(1)(c)).

Assuming for the moment that s 53(1)(c) does not apply equally to the two forms of declaring a sub-trust, it is difficult to justify this, in our view, excessively technical outcome either in terms of the underlying rationale of s 53(1)(c) outlined previously (see p 119) or because distinguishing an active sub-trust (type 1 above) from a bare sub-trust (type 2 above) is not always straightforward.

Contract for valuable consideration to assign an equitable interest The application of trusts law principles to this mode of dealing and its relationship to s 53(1)(c) and s 53(2) has been beset with uncertainty although to some degree the Court of Appeal has recently clarified the position in *Neville v Wilson* [1996] 3 All ER 171.

Consider the example whereby T1 and T2 hold property on trust for A absolutely. A contracts with B to transfer her (A's) equitable interest to B. Such a contract does not itself amount to a disposition although it might be thought that subsequent completion of a contract by assigning the equitable interest would constitute a disposition under s 53(1)(c). But is any subsequent formal assignment necessary to complete the transaction? Earlier in this chapter we saw that where there is a specifically enforceable contract – for example, to sell land or 'unique' personal property – the equitable maxim 'Equity regards as done that which ought to be done' operates to transfer the equitable interest to the purchaser with the vendor being deemed to hold the legal title as constructive trustee pending completion of the contract. Do these same principles apply where the property concerned is itself an equitable interest? Would the position now be: T1 and T2 hold on trust for A who now holds on constructive trust for B? Assuming that a constructive trust of a rather specialised nature (see above p 115) is imposed, the question arises as to how A's equitable interest is transferred. Can the imposition of a constructive trust be viewed as bringing about an assignment? Furthermore is writing required under s 53(1)(c) or does s 53(2) apply?

These questions arose but were not fully resolved in *Oughtred v IRC* because the decision hinged on interpretation of the Stamp Act 1891.

Oughtred v IRC [1960] AC 206

Trustees held 200,000 shares in trust for Mrs Oughtred (O) for her life and then for her son Peter (P) absolutely. O also had absolute ownership of 72,700 shares in the same company. To ease potential estate duty liability on O's death, O and P *orally* agreed on 18 June 1956 that O would transfer to P her 72,700 shares in exchange for P's reversionary interest in the 200,000 shares.

On 26 June the agreement was implemented in three stages:

(1) O transferred her shares to P.
(2) A deed of release was executed by O, P and the trustees which recited the oral agreement that the shares were now held by the trustees in trust for O absolutely and that they were intended to be transferred to her.
(3) The trustees transferred the 200,000 shares to O absolutely.

The Revenue sought to levy ad valorem stamp duty in respect of the transaction which consisted of the sale of P's equitable reversionary interest. The document chosen as the appropriate instrument for assessing stamp duty was the transfer of the 200,000 shares at stage three. The taxpayers argued that this was a transfer of the bare legal title, and hence of nominal value and therefore liable only to a nominal duty of 50p. The beneficial ownership of the shares had, in their view, passed prior to the stage-three completion under the constructive trust which arose as a result of the specifically enforceable *oral* contract for the exchange of shares. At first instance Upjohn J accepted this argument.

But by a 3:2 majority (Lords Keith, Jenkins and Denning; Lords Radcliffe and Cohen dissenting) the House of Lords, affirming the Court of Appeal, upheld the assessment to ad valorem duty. On their view of the scope of the Stamp Act 1891, s 54, the question of whether an equitable interest in the settled shares had passed to O before stage three was immaterial. The majority did not therefore find it necessary to decide whether, under the oral agreement of 18 June, P became a constructive trustee of his reversionary interest in favour of O, and if so, whether that constructive trusteeship was exempt from the requirements of s 53(1)(c) by virtue of s 53(2). Lord Denning commenting on the relationship between s 53(1)(c) and s 53(2) expressed the following opinion without giving reasons (at 233): 'But I may say that I do not think the oral agreement was effective to transfer Peter's reversionary interest to his mother. I should have thought that the wording of s 53(1)(c) of the Law of Property

Act 1925 clearly made a writing necessary to effect a transfer; and s 53(2) does not do away with that necessity.'

Lord Radcliffe agreed with the reasoning of Upjohn J on the effect of s 53(2):

> **Lord Radcliffe** (at 227): The reasoning of the whole matter, as I see it, is as follows: On June 18, 1956 the son owned an equitable reversionary interest in the settled shares; by his oral agreement of that date he created in his mother an equitable interest in his reversion, since the subject-matter of the agreement was property of which specific performance would normally be decreed by the court. He thus became a trustee for her of that interest sub modo; having regard to subsection (2) of section 53 Law of Property Act 1925, subsection (1) of that section did not operate to prevent that trusteeship arising by operation of law.

An alternative analysis of the arrangement implicit in Lord Cohen's judgment is that the transaction was not formally completed and that the outcome of the 18 June and 26 June arrangements was to leave a bare equitable interest vested in Peter (P). P retained a mere shell, the kernel – the beneficial interest in the shares – having been extracted and transferred by the operation of a constructive trust. On this point Green has commented ((1984) 47 MLR 385 at 402):

> There would have been nothing unusual in this latter alternative prevailing. It is a common practice amongst those intent on avoiding *ad valorem* stamp duty to enter into a specifically enforceable agreement to transfer property which is left uncompleted: the promisee relying on his equitable proprietary right behind the bare trust thus established by his vendor. The documentary disadvantages of 'leaving the matter in contract' in this way are regularly seen as being outweighed by the stamp duty saving; and the purchaser always has the safety net of having a right to call for a conveyance if such becomes necessary at a later date.

Although dissenting, Lord Cohen did appear to agree with Lord Denning that s 53(2) would *not* have removed the requirement for writing under s 53(1)(c).

This latter point has continued to prove controversial although with one exception subsequent cases have tended to follow the approach adopted by Lord Radcliffe (*Re Holt's Settlement* [1969] 1 Ch 100 (see below p 327); *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 3 All ER 462; *Chinn v Collins* [1981] AC 533 at 548 per Lord Wilberforce but cf 'the exception' is dicta by Chadwick J in *United Bank of Kuwait plc v Sahib* [1997] Ch 107 at 129 who stated that he was 'far from persuaded' on the point). This trend was reaffirmed most recently by the Court of Appeal in *Neville v Wilson* [1996] 3 All ER 171. In that case shareholders of a private company J Ltd (J) claimed to have entered into individual oral agreements by which, inter alia, J's equitable interests in 120 shares in another private company (U Ltd) were to be distributed to the shareholders of J rateably according to their existing shareholdings. A key question before the Court of Appeal was whether the alleged agreements were ineffective because of the absence of writing required by s 53(1)(c). The court held that the effect of each individual agreement was to constitute the shareholder 'a constructive trustee for the other shareholders' (see Nolan (1996) 55 CLJ 436 and Milne (1997) 113 LQR 213 for critical comment on this conclusion). But did s 53(2) oust the writing requirement of s 53(1)(c)? The court reviewed the various opinions in *Oughtred* and concluded that it did (Nourse LJ at 182):

> Just as in *Oughtred v IRC* the son's oral agreement created a constructive trust in favour of the mother, so here each shareholder's oral or implied agreement created an implied or constructive trust in favour of the other shareholders. Why then should not sub-s (2) apply? No convincing reason was suggested in argument and none has occurred to us since. Moreover, to deny its application in this case would be to restrict the effect of general words when no restriction is called for, and to lay the ground for fine distinctions in the future. With all the respect which is due to those who have thought to the contrary [see Lords Denning and Cohen above], we hold that sub-s (2) applies to an agreement such as we have in this case.

There are four points to be made about this outcome. First, a consequence of the decision was to achieve the convenient result of avoiding an asset going to the Crown as *bona vacantia*. Second and relatedly, context may be a relevant consideration here and it is noticeable that most of the cases subsequent to *Oughtred* have not directly involved tax considerations. In the one case that did, *Chinn v Collins*, the consequence of adopting the constructive trust analysis was the defeat of a capital gains tax avoidance scheme. Third, as regards possible reasons for not applying s 53(2) to such 'constructive trusts' of equitable interests, it has been suggested that this provision 'was intended to embrace the kind of constructive trust which is imposed to prevent fraud [as in *Bannister v Bannister* [1948] 2 All ER 133] and did not envisage the anomalous constructive trust arising on a specifically enforceable contract for sale' (see *Hanbury and Martin* p 91). Our fourth point concerns reform: in 1979 one critic of the varying interpretations of s 53 commented: 'the complexity of the present position reflects no credit on the law and . . . the time has come for a long cool look' (Battersby (1979) 43 Conv 17 at 38). As part of its Seventh Programme of Reform the Law Commission proposed to initiate a review of the formality requirements for the creation of trusts. A Consultation Paper on the 'complex provision' was originally expected in 1999 but 'due to staffing shortages and the extent of the work that the team has had to do on other projects' the work has been delayed. Although it seems that a good deal of research has been undertaken there has been no further progress since 2001 and the Commission is currently concentrating its resources on the topics in the Eighth Programme of Reform (see Law Com No 259 (1999) pp 14–15; and Annual Report 2000 (Law Com No 268 (2001) para 5.9).

A miscellany The *Vandervell* litigation has teased out further difficulties for the application of s 53(1)(c) and s 53(2) and these are considered at p 188 et seq. But at the risk of some over-simplification the position reached by the cases can be summarised in the following proposition: if at the commencement of a transaction a person has a subsisting equitable interest and at the end no longer has that interest, then there has been a disposition within s 53(1)(c).

There are, however, two further modes of dealing with equitable interests which have been held not to require writing and that might be described as exceptions to the proposition. By way of conclusion to this section these are briefly outlined here. In *Re Danish Bacon Co Ltd Staff Pension Fund* [1971] 1 All ER 486, Megarry J very much doubted whether the section would apply to a nomination made under a staff pension fund where a member could nominate a person to receive moneys due in the case of death of the member before retirement. The reasoning here is that there was no subsisting equitable interest in property to come within s 53(1)(c) in that the employee was disposing of something that could never be his. Megarry J's opinion was approved in *Gold v Hill* [1999] 1 FLR 54 where the nomination took place under a life assurance policy. In similar vein s 53(1)(c) was held to be inapplicable to a disclaimer of an equitable interest. It was said that 'a disclaimer operates by way of avoidance and not by way of disposition' (*Re Paradise Motor Co Ltd* [1968] 1 WLR 1125 at 1143). There is no set form of words that constitutes a disclaimer and it is probably not essential to adopt the precise language employed by Mr Johns in the case: 'I have no **** shares. I want no **** shares and if I had any money to come of the bastard I wouldn't even take it' (at 1141). Finally on this topic, consideration of the applicability of s 53(1)(c) to variation of beneficial interests under the Variation of Trusts Act 1958 is deferred until Chapter 7 where the Act is examined in some detail.

(c) Complete constitution of the inter vivos trust

(1) *Milroy v Lord* and a 'bright line' rule

As stated previously, for an inter vivos trust by transfer of property to be perfectly created, it is necessary for the settlor both to state that the property is to be held on trust and to convey that property to the trustee. It is only when both these steps are implemented that the trust is completely constituted. If there is a failure to observe the formalities required to effect the transfer, the trust is incompletely constituted.

The formalities necessary to transfer the legal interest in property to trustees will vary according to the nature of the property. So, for example, legal estates in land must be transferred by deed (LPA 1925, s 52), copyright by writing (Copyright, Designs and Patents Act 1988, s 90(3)), shares by the appropriate form of transfer (Stock Transfer Act 1963, s 1) and personal chattels by delivery or deed of gift. Where the subject-matter of the intended trust is an equitable interest a correct transfer is also necessary and, as we have seen, a disposition of an equitable interest must be in writing (LPA 1925, s 53 (1)(c)).

The classic statement of what is meant by complete constitution and of the primary consequences of incomplete constitution is contained in the judgment of Turner LJ in *Milroy v Lord* (1862) 4 De GF & J 264:

> I take the law of this Court to be well settled, that, in order to render a voluntary settlement valid and effectual, the settlor must have done everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him. He may of course do this by actually transferring the property to the persons for whom he intends to provide, and the provision will then be effectual, and it will be equally effectual if he transfers the property to a trustee for the purposes of the settlement, or declares that he himself holds it in trust for those purposes . . . but, in order to render the settlement binding, one or other of these modes must, as I understand the law of this Court, be resorted to, for there is no equity in this Court to perfect an imperfect gift. The cases I think go further to this extent, that if the settlement is intended to be effectuated by one of the modes to which I have referred, the Court will not give effect to it by applying another of those modes. If it is intended to take effect by transfer, the Court will not hold the intended transfer to operate as a declaration of trust, for then every imperfect instrument would be made effectual by being converted into a perfect trust.

This judgment clearly identifies the two methods of constituting a trust: effective transfer of property to trustees and self-declaration of trusteeship. Turner LJ also reaffirmed the principle that outright transfers, transfers on trust and declarations of trust are separate modes of benefiting a person and, furthermore, that a failure to transfer property outright or to trustees cannot be remedied by construing the intended transfer as a self-declaration of trusteeship. The possibility that the existence of valuable consideration will 'rescue' the trust (see p 171 below) is not, however, mentioned.

(2) The 'rule' in *Re Rose*

Although the principles stated in Turner LJ's judgment in *Milroy v Lord* and indeed the decision itself appear to offer scant room for manoeuvre, subsequent cases (*Re Rose* [1949] Ch 78; confusingly *Re Rose* [1952] Ch 499; *Vandervell v IRC* [1967] 2 AC 291 but cf *Re Fry* [1946] Ch 312), again primarily involving transfer of shares, appear to have modified the rigid approach of *Milroy v Lord*. This modification is still more evident in two controversial recent cases, *T Choithram International SA v Pagarani* [2001] WLR 1 (PC) and *Pennington v Waine* [2002] 1 WLR 2075 (see further at p 135). The earlier decisions have themselves not gone uncriticised (see in particular McKay (1976) 40 Conv 139), the criticism focusing on subsequent interpretation of Turner LJ's stricture that 'the settlor must have done everything which, according to the nature of the property . . . was necessary to be done in order to transfer the property'. A particular difficulty arises out of the role of third parties in a transaction. This is best demonstrated by isolating the separate steps involved in a share transfer:

(i) the prescribed transfer form is signed by the transferor; and
(ii) delivered by the transferor, with share certificates, to the transferee;

(iii) the transfer form is signed by the transferee and delivered, with the share certificates, to the company;
(iv) the company registers the transfer.

Step (iv) is not necessarily a mere technicality. A private company's articles of association can provide directors with a power to refuse to register a transfer. An additional complication specific to share transfers is that practice is not consistent amongst companies. Thus whilst the articles of association of some companies require the signatures of both transferor and transferee for the transfer of *any* shares (see *Re Paradise Motor Co Ltd* [1968] 1 WLR 1125), others may require this only where shares are not fully paid – the signature of the transferor alone sufficing otherwise (see Companies Act Regulations 1985, SI 1985/805, Sch 1, Table A, para 23). Accordingly under company law it is possible for a donor to transfer shares to an intended donee without the latter playing any active role in the transaction. Moreover since 1996 it has been possible with most public companies to avoid the need for transfer forms and share certificates by using the CREST system to transfer shares electronically. Nevertheless, whether electronic transfer or the paper method is employed the fact remains that *at law* legal title passes only on registration (step (iv) above).

It is therefore clear that a transfer will be incomplete in law until step (iv) is completed. But, *Milroy v Lord* notwithstanding, could a transfer be valid *in equity* after steps (i) and (ii), or after steps (i)–(iii) and thus a trust be completely constituted? In reading *Re Rose* (below) consider in particular when the transfer was deemed to have been complete and by what means. Consider also why the issue was litigated and how a formalities requirement can become the means for assessing liability to tax.

Re Rose [1952] Ch 499 at 510

The settlor (Rose) R died on 16 February 1947 and estate duty then became payable on any inter vivos gift made subsequent to 10 April 1943. R had by voluntary deed executed two transfers of shares in a private company on 30 March 1943, one transfer being in favour of his wife beneficially, the other to trustees. On the same date the transfer forms were handed with the share certificates to the transferees. The directors of the company had the power to refuse to register any transfer but the transfers were registered on 30 June 1943. The Revenue claimed estate duty on the shares, it being argued that the legal title did not vest in the transferees until 30 June and hence the shares were to be treated as the property of R until that date.

Evershed MR (after quoting from Turner LJ's judgment in *Milroy v Lord*, see p 131) said:

> Those last few sentences form the gist of the Crown's argument and on it is founded the broad, general proposition that if a document is expressed as, and on the face of it intended to operate as, a transfer, it cannot in any respect take effect by way of trust . . . In my judgement, that statement is too broad and involves too great a simplification of the problem; and is not warranted by authority. I agree that if a man purporting to transfer property executes documents which are not apt to effect that purpose, the

court cannot then extract from those documents some quite different transaction and say that they were intended merely to operate as a declaration of trust, which ex facie they were not; but if a document is apt and proper to transfer the property – is in truth the appropriate way in which the property must be transferred – then it does not seem to me to follow from the statement of Turner LJ that, as a result, either during some limited period or otherwise, a trust may not arise, for the purpose of giving effect to the transfer. The simplest case will, perhaps, provide an illustration. If a man executes a document transferring all his equitable interest, say, in shares, that document, operating, and intended to operate, as a transfer, will give rise to and take effect as a trust; for the assignor will then be a trustee of the legal estate in the shares for the person in whose favour he has made an assignment of his beneficial interest. And, for my part, I do not think that the case of *Milroy v Lord* is an authority which compels this court to hold that in this case – where, in the terms of Turner LJ's judgment, the settlor did everything which, according to the nature of the property comprised in the settlement, was necessary to be done by him in order to transfer the property, – the result necessarily negatives the conclusion that, pending registration, the settlor was a trustee of the legal interest for the transferee.

The view of the limitations of *Milroy v Lord* which I have tried to express, was much better expressed by Jenkins J in the recent case which also bears the same name of *Re Rose* [1949] Ch 78 (though that is a coincidence). It is true that the main point, the essential question to be determined, was whether there had been a transfer eo nomine of certain shares within the meaning of a will. The testator in that case, Rose, by his will had given a number of shares to one Hook but the gift was subject to this qualification, 'if such shares have not been transferred to him previously to my death.' The question was, had the shares been transferred to him in these circumstances? He had executed (as had this Mr Rose) a transfer in appropriate form and handed the transfer and the certificate to Hook; but, at the time of his death, the transfer had not been registered. . . . Jenkins J considered the case of *Milroy v Lord*, and in regard to it he used this language; 'I was referred on that to the well known case of *Milroy v Lord* and also to the recent case of *Re Fry* [1946] Ch 312. Those cases, as I understand them, turn on the fact that the deceased donor had not done all in his power, according to the nature of the property given, to vest the legal interest in the property in the donee. In such circumstances it is, of course, well settled that there is no equity to complete the imperfect gift. If any act remained to be done by the donor to complete the gift at the date of the donor's death the court will not compel his personal representatives to do that act and the gift remains incomplete and fails. In *Milroy v Lord* the imperfection was due to the fact that the wrong form of transfer was used for the purpose of transferring certain bank shares. The document was not the appropriate document to pass any interest in the property at all.' Then he refers to *Re Fry* which is another illustration. In this case, as I understand it, the testator had done everything in his power to divest himself of the shares in question to Mr Hook. He had executed a transfer. It is not suggested that the transfer was not in accordance with the company's regulations. He had handed that transfer together with the certificate to Mr Hook. There was nothing else the testator could do. I venture respectfully to adopt the whole of the passage I have read which, in my judgment, is a correct statement of the law. If that be so, then it seems to me that it cannot be asserted on the authority of *Milroy v Lord*, and I venture to think it

> also cannot be asserted as a matter of logic and good sense or principle, that because, by the regulations of the company, there had to be a gap before Mrs Rose could, as between herself and the company, claim the rights which the shares gave her vis-à-vis the company, the deceased was not in the meantime a trustee for her of all his rights and benefits under the shares. That he intended to pass all those rights, as I have said, seems to me too plain for argument.

(The Court of Appeal confirmed that no estate duty was payable.)

The judgment supports the proposition that a trust will be completely constituted where a settlor has done everything within his own power to transfer property to the trustee. In the case of a share transfer this presumably arises after completion of steps (i) and (ii), although in *Re Rose* step (iii) had also been completed by the relevant date. The decision is not without its theoretical difficulties, however.

To establish that the transfer was valid in equity as from 30 March, the Court of Appeal was prepared to recognise that Rose held the shares as trustee for the period between delivery of the transfer and registration on 30 June. Did Rose intend to declare himself as trustee? If he did not, and it seems an unlikely eventuality, does the judgment necessitate a conclusion that an ineffective transfer was validated by treating it as a declaration of trust? Or is there a 'trust to complete the transfer'? (See Oakley *Constructive Trusts* (3rd edn, 1997) p 318 who suggests that these circumstances give rise to a constructive trust in the transferor; see also the different post hoc rationalisation by Lowrie and Todd (1998) 57 CLJ 46 drawing on the opinion of Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669.) Whatever the theoretical difficulties presented by *Re Rose*, and the reasoning has been sharply criticised by McKay ((1976) 40 Conv 139) and Hackney ('an arbitrary deviation from principle' (*Understanding Equity and Trusts* (1987) p 94), the proposition it supports – now commonly heralded (paradoxically in view of its pragmatic origin) as a 'rule' or even 'principle' – has received widespread acceptance in other instances where some act of registration is required to complete a transfer (see *Brown & Root Technology Ltd v Sun Alliance and London Assurance Co Ltd* [1996] Ch 51 – assignment of a lease; and *Mascall v Mascall* (1984) 50 P & CR 119 – transfer of registered land).

Despite the criticisms the decision in *Re Rose* has been described (*Hanbury and Martin* p 124) as 'eminently sensible . . . in a context in which the liability to tax may be affected by the date on which the transfer is treated as being effective'. If the difference between the decision in a case such as *Re Rose* and the straightforward application of principle is to be attributed to the attitude of the court to the merits of the case, it should be borne in mind that any form of estate duty which brings into charge to tax previous transfers within a specified period of death must necessarily have arbitrary results.

(3) A 'rule' or 'unconscionability': *Re Rose* revisited

The tension evident in *Re Rose* between responding to the perceived merits of the case and applying the basic underlying principle that equity will not come to the aid of a volunteer has resurfaced in two recent cases, *T Choithram International SA v Pagarani* [2001] WLR 1 (PC) and *Pennington v Waine* [2002] 1 WLR 2075. Both cases, invoking and possibly modifying further the rule in *Re Rose*, compel us to revisit that principle and cast still more doubts on the weight to be attached to the seemingly and oft-quoted bright line proposition first set down in *Milroy v Lord* by Turner LJ.

In *Choithram*, T Choithram Pagarani (TCP) a very successful and twice married businessman, having provided financially for his first wife and children, had determined to leave the balance of his wealth to charity. The mechanism for achieving this was intended to be via a gift to the Choithram International Foundation, a charity established under a trust deed executed by TCP in February 1992 shortly before his death. TCP was named in the deed as one of the trustees. Immediately after signing the deed it is clear, although recollections amongst those present differed as to the precise terminology used, that TCP made an oral declaration stating that he was giving 'all his wealth to the foundation'. Now the Foundation was not incorporated and therefore had no legal personality as such with the consequence that any transfer of shares could only be valid if made to the trustees of the Foundation. Unfortunately by the time of his death just a month later TCP had not executed any transfer of shares to the Foundation nor seemingly had he declared himself to be the trustee of the property. The question for the court was whether TCP's gift to the Foundation had been completed or did the assets remain as part of his personal estate that would devolve to certain family members already generously provided for. The trial judge and the Court of Appeal of the British Virgin Islands, adopting the reasoning of *Milroy v Lord* that posited just two alternative ways of perfecting a gift, namely (a) by a transfer of the gifted asset to the donee, accompanied by an intention in the donor to make a gift; or (b) by the donor declaring himself to be a trustee of the gifted property for the donee. They concluded that TCP had intended to transfer the property to trustees but had failed to vest title to the assets in *all* the trustees. Moreover it was not possible to construe the language used by TCP as constituting a declaration of himself as trustee, thereby satisfying option (b). The Judicial Committee of the Privy Council allowed the appeal on behalf of, in effect, the Foundation. Lord Browne-Wilkinson, giving the judgment of the court, argued that the facts of the case were novel and that consequently it fell between the two common forms of gift-making outlined in *Milroy v Lord.* Lord Browne-Wilkinson stated that the language used by TCP – 'I give to the Foundation' – could have only one meaning in the particular context (at 12):

> The foundation has no legal existence apart from the trust declared by the foundation trust deed. Therefore the words 'I give to the foundation' can only mean 'I give to the trustees of the foundation trust deed to be held by them on the trusts of the foundation trust deed'. Although the words are apparently words of outright gift they are essentially words of gift on trust.

At first glance this conclusion does not really resolve matters since it is arguable that it should be immaterial whether the gift is an outright gift or a gift on trust – a transfer of legal title to the assets is still required. But at no point had TCP ever purported to vest legal title in the whole body of trustees. This difficulty is circumvented in the opinion of the Committee by the fact that TCP had appointed himself to be one of the trustees:

> There can in principle be no distinction between the case where the donor declares himself to be sole trustee for a donee or a purpose and the case where he declares himself to be one of the trustees for that donee or purpose. In both cases his conscience is affected and it would be unconscionable and contrary to the principles of equity to allow such a donor to resile from his gift. Say, in the present case, that TCP had survived and tried to change his mind by denying the gift. In their Lordships' view it is impossible to believe that he could validly deny that he was a trustee for the purposes of the foundation in the light of all the steps that he had taken to assert that position and to assert his trusteeship. In their Lordships' judgment in the absence of special factors where one out of a larger body of trustees has the trust property vested in him he is bound by the trust and must give effect to it by transferring the trust property into the name of all the trustees.

This reasoning rather leaves some points in the air (see Rickett [2001] 65 Conv 515 but cf Hopkins [2001] CLJ 483). First, whilst there is no doubt that TCP had declared himself to be a trustee, it is less evident how legal title in the assets was transferred to him *in that capacity*. A possible inference to be drawn from the judgment is that the case must be treated as one of a declaration by TCP of himself as trustee rather than one of transfer to trustees. A difficulty with this proposition is that it does not fit comfortably either with the language used by TCP or with the conclusion on the facts reached by the lower courts. Second, if this is the explanation then notwithstanding the view of their Lordships that this case falls between the two options available in *Milroy v Lord* it is difficult to see why this could not be construed as failed transfer being validated as a declaration of trust. An alternative interpretation adopting the unconscionability point is that the trust obligation to which TCP was subject prior to his death was a constructive trust 'imposed' to prevent TCP resiling from his obligation to transfer the assets to all the trustees. Notwithstanding these considerations there is little doubt that the judgment enabled the general intention of TCP to leave his wealth to the Foundation to be implemented. And therein lies the attraction and potentially the risk of the approach exhibited by the court. It is evident that their lordships in *Choithram* are turning their face against what may be seen as overly rigid application of rules. In explanation Lord Browne-Wilkinson offers us a qualification or modern gloss of the maxim 'equity will not assist a volunteer' by adding that '[equity] will not strive officiously to defeat a gift' (at 12).

The sentiment underpinning the modified maxim and the siren-like lure of 'unconscionability' are evident in a decision of the Court of Appeal in *Pennington v Waine* [2002] 1 WLR 2075. The case is yet another instance of litigation about the beneficial ownership of property arising on the death of a donor where purported transfer of legal title had not yet been completed. The donor Ada Crampton was the beneficial owner of 1,500 of 2,000 issued shares in a private family company. At a meeting on 30 September 1998 with Pennington (P), a partner in the company's auditors, Ada indicated that she wished to transfer immediately 400 of her shares to her nephew Harold (H), the company secretary, seemingly with the intention that H should become a director and eventually have a 51% shareholding in the company. P prepared a share transfer form that Ada signed and returned to him. The form was placed 'on the company's file' and no further action was taken with regard to it prior to Ada's death in November 1998. On 15 October 1998 P wrote to H (i) enclosing a form for H to sign giving his consent to become a director and (ii) informing Harold about the 'transfer' of 400 shares to him, adding that this transfer required no further action on H's part. H signed and Ada countersigned the director's consent form. Prior to her death Ada executed a will on 10 November leaving H 620 shares, which, together with the 400 shares, would constitute a 51% shareholding. The will made no mention of the 400 shares. The question for the court was whether those 400 shares formed part of the residuary estate or were to be held on trust by Ada's trustees and executors for H absolutely. If the latter then how had this come about? Unlike *Choithram* there was no question in the case of there being a declaration of trust by Ada. Did then the purported gift satisfy the requirements of the principle in *Re Rose*? Had Ada done everything that she had to do so that in the words of Browne-Wilkinson LJ in *Mascall v Mascall* 'the donee [had] within his control all those things necessary to enable him to complete his title' ([1984] 50 P & CR 119 at 126). The Court of Appeal upheld the gift in equity notwithstanding its acceptance of the fact that Ada had *not* done everything in her power to transfer the shares to Harold, in that the transfer form had neither been sent to the company for registration nor delivered to H. Arden LJ, with whom Schieman LJ concurred, stated that there could be circumstances where delivery of, in this instance, the share transfer form would be unnecessary so far as the perfection of the gift in equity was concerned. The circumstances are those when it would be 'unconscionable' for the donor to purport to recall the gift and 'there can be no comprehensive list of factors which make it unconscionable for the donor to change his or her mind: it must depend on the court's evaluation of all the relevant considerations' (at 2090–2091). The relevant facts in this case, according to Arden LJ, were (ibid):

> [1] Ada made a gift of her own free will: . . . [2] She not only told Harold about the gift and signed a form of transfer which [3] she delivered to [P] to secure registration: [4] her agent also told Harold that he need take no action. [5] In addition Harold agreed to become a director of the Company without limit of time, which he could not do without shares being transferred to him.

Facts [1] to [3] merely establish that Ada had not complied with the *Re Rose* requirements in that the form had not been delivered to H. The finding of 'unconscionability' must therefore rest on facts [4] and [5] but, as critics of the judgment have almost universally pointed out, it is difficult to see why Ada's conscience should have been affected unless some detriment had been suffered by Harold (see eg Doggett [2003] CLJ 263; Ford [2002] 13(2) KCLJ 222; Ladds (2003) 17(1) TLI 35; Tijo and Yeo [2002] LMCLQ 296; Halliwell [2002] Conv 192). We are here moving close to the language of estoppel but it is doubtful that either [4] or [5] would constitute the sort of detrimental reliance associated with this concept (see below p 182). Moreover the judgments make no mention of estoppel, relying instead on a more general and arguably vague notion of 'unconscionability'. As if sensitive to the possible weaknesses of this position Arden LJ suggests in the alternative that a principle of benevolent construction – in a sense adopting Lord Browne-Wilkinson's dictum that 'equity should not strive officiously to defeat a gift' – could be applied. The problem of non-delivery of the share transfers could thereby be rectified by finding that the words used by P (constituting fact [4] above) should be construed as meaning that Ada and P became agents for H for the purpose of submitting the share transfer to the Company. On this reasoning delivery to H's agent and therefore in effect to H had been completed, bringing the case more closely within the letter of the rule in *Re Rose*.

(4) Comment

In both *Choithram* and *Pennington v Waine* the judgments of the Privy Council and Court of Appeal respectively involved a generous interpretation and application of the established equity doctrines or even as in *Choithram* a reformulation of them. In practical terms in neither of the recent cases nor indeed in *Re Rose* was the court faced with an attempt by a donor to resile from an intended gift. Indeed in all the cases the hypothetical question – 'would equity have permitted the donor to revoke the gift?' – could be answered in the negative safe in the realisation that the court was enabling their arguably accurate perceptions of the deceased donor's intentions to be implemented. But it was suggested at the start of our discussion on this topic that invoking unconscionability as a ground for the decisions is a risky enterprise. This is particularly so in *Pennington v Waine* where the notion of unconscionability acted as the starter motor for imposing the obligation of constructive trusteeship on Ada and her executors. At least in *Choithram*, if one accepts the reasoning of their Lordships in the Privy Council, the element of unconscionability derives from the finding that the donor would have been in breach of a pre-existing obligation as trustee.

There is little doubt that the courts have moved a considerable distance from the position delineated in *Milroy v Lord*. From the *Re Rose* cases onwards, with their addition of the magical words 'within his [the settlor's] power' to the classic statement of Turner LJ in *Milroy v Lord*, there has been an incremental softening of the application of the criteria set out in that case. It remains to be seen whether 'unconscionability' is capable of providing an operable test for determining the circumstances when '[equity] will not strive officiously to defeat a gift' or simply leaves us in a position of uncertainty. A pragmatic if somewhat unprincipled response is that fears that claimants could readily invoke 'unconscionability' as a ground to prevent erstwhile donors from ever changing their minds are probably groundless unless the detriment hurdle to be overcome by claimants is lowered even further.

It only remains to emphasise that a corollary of the 'rule' in *Re Rose* is that once the transferor has done 'everything in his power' to transfer title in the property, it is too late to resile from the decision. Thus in *Mascall v Mascall* (1985) 49 P & CR 119, a father planning to transfer registered land to his son completed the relevant parts of the transfer form and handed it to him. Before the son had submitted the document to the Land Registry to acquire title, father and son unfortunately fell out. To the chagrin of the father, the transfer was declared effective, *Re Rose* being cited as authority. The father had done all that he needed to, as the son could make the application to the Land Registry.

(d) Creation of trusts and disposition of equitable interests: testamentary formalities

(1) Wills Act

The Wills Act 1837, s 9, as amended by the Administration of Justice Act 1982, s 17, specifies the strict formalities necessary for effective disposition of property – including creation of trusts – by will.

> **9. Signing and attestation of wills**
> No will shall be valid unless –
>
> (a) it is in writing, and signed by the testator, or by some other person in his presence and by his direction; and
> (b) it appears that the testator intended by his signature to give effect to the will; and
> (c) the signature is made or acknowledged by the testator in the presence of two or more witnesses present at the same time; and
> (d) each witness either –
>   (i) attests and signs the will; or
>   (ii) acknowledges his signature, in the presence of the testator (but not necessarily in the presence of any other witness), but no form of attestation shall be necessary.

Section 1 of the Act states that 'the word "will"' includes 'a testament . . . and any other testamentary disposition'. An attempt to create a testamentary trust by an instrument which does not comply with the requirements of s 9 will fail because the purported will itself is void. Furthermore, once a valid will is made any subsequent changes must also conform to the above requirements. Consequently, any provision, whether embodied in a will or incorporated into it by reference, purporting to reserve to the testator a power to alter the will without observing the necessary formalities is also void (*Re Edwards* [1948] Ch 440).

(2) Secret trusts

In view of the above it is initially puzzling to discover that if a testator (T) leaves property by his will perhaps to a trusted friend (A) absolutely and beneficially but T, while alive, has informed A that the property is to be held on specified trusts then, provided A accepts the trust, it is enforceable. Alternatively T may leave property to A with a direction in the will that it is to be held on trust, and details of the trust are not contained in the will but have been communicated to A before or at the time of the will. Here too the trust is enforceable.

These two methods of imposing a trust obligation, labelled secret trusts and half-secret trusts respectively, appear to conflict directly with s 9 of the Wills Act. Originally the existence of a conflict was implicitly accepted since the validity of secret trusts was initially based on an application of the maxim ‘Equity will not permit a statute to be used as an instrument of fraud’ (see *McCormick v Grogan* (1869) LR 4 HL 82 per Lord Hatherley LC and Lord Westbury). The modern analysis, as we shall see, is that there exists no conflict between s 9 and secret and half-secret trusts because such trusts are considered to operate outside the will: ‘the whole basis of secret trusts . . . is that they operate outside the will, changing nothing that is written in it, and allowing it to operate according to its tenor, but then fastening a trust on to the property in the hands of the recipient’ (per Megarry V-C in *Re Snowden* [1979] 2 All ER 172 at 177). None the less it is difficult to deny that these trusts create a gap in the apparent stringency of the law concerning formalities for testamentary dispositions and are therefore in conflict with its policy. It is said (*Pettit* p 94) that ‘it would be inappropriate and indeed misleading’ to discuss the rules relating to secret and half-secret trusts in a section concerned with formalities. In our contrary view the recognition and operation of such trusts are best evaluated in the context of the policy considerations which require formalities to be observed.

Before identifying the requirements for secret and half-secret trusts it is worth reflecting on the reasons why testators should seek to rely on these devices. A will admitted to probate is a public document open to inspection by any member of the public. Such exposure will not necessarily appeal to some testators, who may therefore wish to keep their testamentary dispositions secret. In particular a testator may wish to keep a disposition secret from a narrower public, the other members of the family. And the classic historic reason for secrecy is said to be the wish of testators to provide for mistresses or illegitimate children or other persons or causes considered unwise to acknowledge publicly. This does not do full justice to the device which certainly in its sixteenth-century origins provided a means to protect property against the consequences of religious persecution (see eg *Bertie (Duchess of Suffolk) v Herenden* (1560) in Baker (1977) 93 LQR 33). These were trusts that depended on trust since, as Jones has pointed out: ‘That they should come to litigation was unthinkable when they were created: . . . Should the trustees fail, unless the circumstances were changed which had given rise to the need for the trust in the first place, nothing could be done’ (‘Trusts in England after the Statute of Uses: A view from the 16th Century’ in Helmholz and Zimmermann (eds) *Itinera Fiduciae* (1998) pp 173–205 at p 205). Understandably therefore there is a temptation to treat secret trusts as something of an historical anachronism. On the other hand the findings of recent research suggest that any sounding of the death knell of the secret trust may be premature. In a representative sample survey of probate practitioners conducted in 2001, 54% of respondents rejected the view that secret trusts were obsolete (Meager 'Secret Trusts – Do they have a future' [2003] 67 Conv 203–214). Moreover 16% of the sample had been involved in the creation of fully secret trusts and a further 20% in half-secret trusts. Whilst, given the persistence of human frailty, the classic historical reason for creating secret trusts still exists the survey identifies a quite diverse range of other purposes including somewhat dubious attempts to conceal beneficial ownership from the state. The survey also tends to support the proposition that today it is more likely that the indecisive rather than secretive testator will use a secret trust. A will can be made leaving property to a trusted friend or a co-operative solicitor while retaining the ability to decide subsequently on the ultimate distribution of the property, thus avoiding compliance with the formalities required by the Wills Act. Whether this is a desirable policy to pursue will be considered below after examining the requirements for valid secret and half-secret trusts and their theoretical basis.

(3) Requirements for fully secret trusts

These were summarised by Brightman J in *Ottaway v Norman* [1971] 3 All ER 1325 at 1332:

> It will be convenient to call the person on whom such a trust is imposed the 'primary donee' and the beneficiary under that trust the 'secondary donee'. The essential elements which must be proved to exist are: (i) the intention of the testator to subject the primary donee to an obligation in favour of the secondary donee; (ii) communication of that intention to the primary donee; and (iii) the acceptance of that obligation by the primary donee either expressly or by acquiescence. It is immaterial whether these elements precede or succeed the will of the donor.

Communication to the secret trustee, which can be made through an authorised agent, must take place and the trust obligation be accepted during the lifetime of the testator although the acceptance can be either express or implied (*Wallgrave v Tebbs* (1855) 2 K & J 313, silence on the part of the trustee being construed as acceptance; *Moss v Cooper* (1861) 1 John & H 352). It follows that, where the proposed trustee does not learn of the existence of a proposed trust until after the testator's death, the trust is unenforceable and the trustee can retain full beneficial ownership of the property. A nice question is whether communication to, and acceptance of the obligation by, one or some only of two or more persons apparently beneficially entitled to property can bind them all. Perrins has persuasively argued ((1972) 88 LQR 225), contrary to orthodoxy (*Re Stead* [1900] 1 Ch 237), that the innocent recipient of an apparent gift should be bound by the secret trust only if the gift was induced by the promise of the knowing recipient.

Furthermore, the full details of the trust must be communicated. If a secret trustee is informed by the testator only that the property is to be held on trust but not advised of the terms of the trust, the property must then be held by the secret trustee on resulting trust for residuary devisees or legatees, if any, and otherwise, or if the trust property is residuary property, for those entitled on intestacy. It was accepted by Lord Wright MR in *Re Keen* [1937] Ch 236 that, by a quaint analogy with a ship sailing under sealed orders, there would be adequate communication and acceptance if the details of the trust were put in writing and placed in the trustee's possession in a sealed envelope even though marked 'Not to be opened until after my death'.

Secret trusts are not restricted to circumstances where, in reliance on a promise, the testator then makes a gift in favour of the secret trustee or leaves an existing disposition unrevoked. A secret trust can also arise where, in reliance on a promise to implement the trust by the person entitled on intestacy, no will is made (*Stickland v Aldridge* (1804) 9 Ves 516).

The usual method of implementing the secret trust is by the trustee making an inter vivos transfer of the trust property to the designated beneficiary but it has been held (see *Ottaway v Norman* [1971] 3 All ER 1325 and *Re Young* [1951] Ch 344) that the doctrine can apply where the obligation on the secret trustee is to make a will leaving specified property to the intended beneficiary of the secret trust.

The description above from *Ottaway v Norman* of the 'essential elements' of a secret trust leave out of account the matter of 'constitution'. When does the trustee take the legal title to the property so that the trust is 'completely constituted'? The answer would seem to be that the property vests in the secret trustee – or legatee where the trust relies on the operation of the insolvency rules – only when the will or intestacy rules take effect on the death of the settlor. This analysis is certainly consistent with the position that the trust, like the will itself, can be revoked at any time before death (see eg *Re Cooper* [1939] Ch 811 and *Kasperbauer v Griffith* [2000] WTLR 333 per Peter Gibson LJ and Harman LJ). An implication of the analysis, one might have thought, is that if the secret beneficiary predeceases the settlor then the gift would lapse. Certainly in the case of a will itself if a legatee or devisee predeceases the testator the gift lapses and becomes part of the residuary estate. It is therefore surprising to discover that in *Re Gardner (No 2)* [1923] 2 Ch 230 Romer J held that the estate of a deceased beneficiary was entitled to the designated share of the trust property. The decision has been much criticised, Hayton, for instance, aptly commenting 'that the authority of *Re Gardener* [sic] is . . . very doubtful indeed' (*Hayton and Marshall* at p 119; for a full discussion of this issue see Kincaid 'The Tangled Web: the relationship between a secret trust and the will' [2000] 64 Conv 420 at 431–434; Pawlowski and Brown [2004] Conv 388–398).

An obvious potential source of difficulty is proving the existence of a secret trust. The cautious testator will doubtless at least ensure both that the beneficiary is notified of the secret trust and that documentary evidence of the trust is available. 'A good practical precaution is for the testator to have a document signed by the intended trustee put into the possession of the secret beneficiaries' (*Hayton and Marshall* p 104). The cautious trustee also may wish to have suitable evidence available. Thus in circumstances where a bequest is made to a solicitor on a secret trust the Law Society recommends that 'solicitors should preserve the instructions from which the will was drawn and should also see that the terms of [the] secret trust are embodied in a written document signed or initialled by the testator' (Law Society *The Guide to the Professional Conduct of Solicitors* (8th edn, 1999) p 319).

If a dispute does arise the standard of proof is the ordinary civil standard of proof – the balance of probabilities – that is required to establish the existence of any ordinary trust (*Re Snowden* [1979] 2 All ER 172 at 179, but *contra Ottaway v Norman* [1971] 3 All ER 1325 at 1333). Where fraud is involved there is authority that a higher standard will be required (*Re Snowden*). But as Rickett has argued ((1979) 38 CLJ 260), if the real justification for the enforcement of secret trusts is that courts wish to carry out the revealed intentions of the testator, then fraud is irrelevant: 'What matters is the existence of a trust, and this is established by the ordinary method' (at 263). Debate about identifying the appropriate standard of proof therefore tends to obscure the point that the key question the court must face (as in *Re Snowden*) is whether the facts are sufficient to identify an intention to create a binding trust obligation or merely a more nebulous and unenforceable moral one. Yet where testators have failed to make their wishes legally precise one is again confronted with the problematic nature of intention and whether a specific intention can be divined by a sifting of the facts, no matter how scrupulous. From this perspective the secret trust represents simply a specialised forum for the application of certainty of intention rules. For this reason further consideration of *Re Snowden* and *Ottaway v Norman* is postponed until p 160 where these rules and their application are discussed.

(4) Requirements for half-secret trusts

It will be recalled that under a half-secret trust the will expressly states the existence of a trust but not the details of beneficial entitlement. Consequently, any conflict as to entitlement is not between the secret trustee and the prospective beneficiary of the trust since it is not possible for the trustee to claim property beneficially. Rather, where a half-secret trust fails, the trustee will still hold the property in trust, but on a resulting trust for the residuary devisees or legatees or for those entitled on intestacy.

As regards the requirements for validity, the principal distinction between fully secret and half-secret trusts lies in the criteria for communication and acceptance of the trust. The weight of judicial dicta now seems clearly to accept that communication and acceptance of a half-secret trust must occur before or at the time of the execution of the will (*Blackwell v Blackwell* [1929] AC 318; *Re Keen* [1937] Ch 236). Subsequent communication or acceptance even if during the testator's lifetime will therefore be ineffective. Indeed, most recently in *Re Bateman's Will Trusts* [1970] 3 All ER 817 Pennycuick V-C accepted that 'it is really clear and not in dispute that once one must construe the direction (to trustees) as admitting of a future letter then the direction is invalid . . . ' . The justification for this approach was stated by Viscount Sumner in *Blackwell v Blackwell* to be: 'to hold otherwise would indeed be to enable the testator to "give the go-by" to the requirements of the Wills Act'.

The adequacy of this reasoning will be considered in the next section. Finally, a particular evidentiary distinction, inapplicable to fully secret trusts, is that evidence as to the alleged half-secret trust is inadmissible if it is inconsistent with the terms of the will (*Re Keen*).

(5) The theoretical basis of secret trusts

An historical justification, and one accepted by the House of Lords in 1869, for the enforcement of secret trusts is found in the doctrine of fraud: it would be a fraud on the part of the legatee to rely on the failure to comply with the statutory formalities necessary to create a testamentary trust and thus retain beneficial ownership of the property. This explanation was not without its difficulties as regards both the ultimate destination of trust property and the validity of half-secret trusts.

R H Maudsley 'Incompletely Constituted Trusts' in R Pound (ed) *Perspectives of Law* (1964) pp 254–256

Fraud would, no doubt, be a very adequate reason to prevent (the legatee) from taking beneficially, but the fact that [he] cannot take beneficially does not necessarily mean that the 'secret beneficiary' can take; unjust enrichment would be avoided by declaring a resulting trust for the estate. In this type of situation, however, both American and English courts hold that the beneficial interest goes forward to the intended beneficiary. This is so in England whether the question arises *inter vivos* or under a will, and little thought has been given to the question whether the beneficial interest goes forward to the beneficiary or back to the estate . . . [cf Hodge [1980] Conv 341 who argues against the resulting trust solution, on the basis that the fraud is on the secret beneficiary as well as the testator].

It has just been assumed that, once fraud prevents the legatee from taking, the beneficiary is entitled. We therefore seek some rational justification for projecting forward the beneficial interest. Such a situation makes interesting and relevant the theory that the trust is declared *inter vivos*, independently of the will and that, being incompletely constituted until the death, it is constituted by the vesting in the trustee of the ownership of the property.

This theory is all the more attractive when semi-secret trusts are under consideration. Semi-secret trusts present greater difficulties, for two reasons at least; if they were upheld on the same basis as fully secret trusts, they would provide a testator with an invitation to reserve to himself the power to make a subsequent unexecuted codicil; and secondly, and more particularly, there is no possibility of personal fraud by the trustee and no obvious excuse therefore for the intervention of equity to save a disposition from the impact of the statute. It is sometimes said that the statute operates in fraud of the intended beneficiaries [see Lord Buckmaster in *Blackwell v Blackwell* [1929] AC 318 at 328; and Hodge, above]; but that would apply to every statute or rule of law which stultifies the intention of a testator or grantor, and equity does not claim to interfere in every case. Equity must find another reason to interfere; or ignore the situation completely. The latter course is unattractive since fully secret trusts are protected; it makes sense to no one, except perhaps to equity lawyers, to say that a trust is enforced if property is given 'to A', but is ignored if the property is given 'to A upon trust'.

In *Blackwell v Blackwell* [1929] AC 318 the House of Lords confirmed that fully secret and half-secret trusts are enforced on the same principles and operate outside the will, thus avoiding conflict with the Wills Act 1837. Some subsequent decisions of the courts are certainly consistent with this analysis. In *Re Young* [1951] Ch 344, for instance, a beneficial interest under a secret trust was upheld even though the beneficiary was a witness to the will. The normal rule (Wills Act 1837, s 15) that a witness to a will forfeits any beneficial interest arising under that will was held inapplicable by Danckwerts J (at 350):

> [the person] does not take by virtue of the gift in the will, but by virtue of the secret trusts imposed upon the [trustee] who does in fact take under the will.

The reasoning in *Blackwell*, however, is not without its inconsistencies.

Blackwell v Blackwell [1929] AC 318
The case concerns the validity of a half-secret trust created by a testator, John Blackwell, who wished to provide for a lady and her illegitimate son. The testator by a codicil gave £12,000 to five persons upon trust, the income to be applied 'for the purposes indicated by me to them'. The trust had been accepted prior to the execution of the codicil. The residuary legatees (including the testator's widow) claimed that no valid trust had been created on the basis principally that parol evidence was inadmissible to establish 'the purposes'. The House of Lords unanimously upheld the validity of the trust.

Viscount Sumner, commenting first on the relationship between fully secret trusts and the Wills Act, observed:

> . . . in the bare case of a legacy absolute on the face of it, I do not see how the statute-law relating to the form of a valid will is concerned at all, and the expressions, in which the doctrine has been habitually described, seem to bear this out. For the prevention of fraud equity fastens on the conscience of the legatee a trust, a trust, that is, which otherwise would be inoperative; in other words it makes him do what the will in itself has nothing to do with; it lets him take what the will gives him and then makes him apply it as the court of conscience directs, and it does so in order to give effect to wishes of the testator which would not otherwise be effectual.

After referring to a 'current of decisions' (including *Re Fleetwood* (1880) 15 Ch D 594 and *Re Huxtable* [1902] 2 Ch 793) upholding half-secret trusts, Viscount Sumner continued:

> It seems to me that, apart from legislation, the application of the principle of equity which was made in *Fleetwood*'s case and *Huxtable*'s case was logical, and was justified by the same considerations as in the case of fraud and absolute gifts. Why should equity forbid an honest trustee to give effect to his promise, made to a deceased testator, and compel him to pay another legatee, about whom it is quite certain that the testator did not mean to make him the object of his bounty? In both cases the testator's wishes are

> incompletely expressed in his will. Why should equity, over a mere matter of words, give effect to them in one case and frustrate them in the other? No doubt the words 'in trust' prevent the legatee from taking beneficially, whether they have simply been declared in conversation or written in the will, but the fraud, when the trustee, so called in the will, is also the residuary legatee, is the same as when he is only declared a trustee by word of mouth accepted by him. I recoil from interfering with decisions of long standing, which reject this anomaly, unless constrained by statute. . . .

Viscount Sumner discussed the relationship between the equitable principle and the Wills Act, s 9, and concluded that:

> . . . The effect, therefore, of a bequest being made in terms on trust, without any statement in the will to show what the trust is, remains to be decided by the law as laid down by the courts before and since the Act and does not depend on the Act itself.
>
> The limits, beyond which the rules as to unspecified trusts must not be carried, have often been discussed. A testator cannot reserve to himself a power of making future unwitnessed dispositions by merely naming a trustee and leaving the purposes of the trust to be supplied afterwards, nor can a legatee give testamentary validity to an unexecuted codicil by accepting an indefinite trust, never communicated to him in the testator's lifetime. To hold otherwise would indeed be to enable the testator to 'give the go-by' to the requirements of the Wills Act, because he did not choose to comply with them. It is communication of the purpose to the legatee, coupled with acquiescence or promise on his part, that removes the matter from the provision of the Wills Act and brings it within the law of trusts as applied in this instance to trustees, who happen also to be legatees . . .

The decision in *Blackwell v Blackwell* does not equate secret and half-secret trusts for all purposes. Dicta in the judgment of Viscount Sumner indicate that communication of the details of a half-secret trust must take place before or at the time of the date of the will. The continuing distinction has been widely criticised (*Hayton and Marshall* p 109; *Hanbury and Martin* p 159 but cf Perrins [1985] Conv 248). It should be noted that the approach adopted to this matter by the English courts does not reflect universal practice, as is evidenced by the law in Ireland and many US jurisdictions (see Mee 'Half-secret Trusts in England and Ireland' [1992] Conv 202 and Restatement of Trusts para 55 (c) (h)). There is also Australian authority that communication of a half-secret trust need take place only before the death of the settlor rather than before the execution of the will (*Ledgerwood v Perpetual Trustee* [1997] 41 NSWLR 532).

Consider the following points:

(1) Viscount Sumner's explanation for the 'continuing distinction' – 'a testator cannot reserve to himself a power of making future unwitnessed dispositions by merely naming a trustee and leaving the purposes of the trust to be supplied afterwards' – does not seem consistent with his view that both secret and half-secret trusts operate outside the will and independently of the Wills Act. Moreover the very objective that he seeks to

forestall, as set out in his explanation above, can be achieved by means of a fully secret trust. After all the terms of the trust there can be altered without legal formality after execution of the will. It is therefore difficult to see a policy rationale for retaining the 'continuing distinction' (but cf Wilde [1995] Conv 366 who suggests that stricter rules are appropriate for half-secret trusts since they are invariably drawn up by solicitors which process should involve awareness of the formal rules).

(2) It is not necessary when creating trusts, other than secret trusts, either that the trustees' consent to their appointment be sought or that details of the trust be communicated to them in advance. A person is, after all, free subsequently to decline the trusteeship, and such a refusal does not affect the validity of the trust itself; the principle that equity will not allow a trust to fail for want of a trustee would apply. Why, therefore, should communication and acceptance, at whatever stage, be deemed essential for a valid secret trust? Doubtless it is a commonsense precaution but a legal answer appears to reside, and is implicit in the language used by Viscount Sumner in *Blackwell*, in the notion of reliance on the promise of the trustee. This explanation then seems at least as consistent with a rationale for validating secret trusts based on prevention of fraud or unconscionable behaviour as on fulfilling a testator's expressed wishes. The picture, however, is clouded by residual uncertainty about the consequences of a disclaimer of the legacy or devise by the proposed trustee after the death of the testator. In *Re Maddock* [1902] 2 Ch 220 at 231 Cozens-Hardy LJ was of the view that the trust would fail in the case of a fully secret trust, seemingly on the basis that it depends upon the existence of a personal obligation binding 'the trustee'. On the other hand dicta of Lord Buckmaster in *Blackwell* suggests that the fully secret trust would be upheld in such circumstances (at 328): 'I entertain no doubt that the court having once admitted the evidence of the trust, would interfere to prevent its defeat'. How do you think this matter should be resolved and upon what criteria? Note that it is generally assumed that in the event of a disclaimer by the trustee in a half-secret trust the equitable principle referred to above will operate to save the trust, probably with the testator's personal representative stepping into the shoes of the disclaiming trustee.

(3) We have seen that the *modern* justification for enforcing secret trusts is that they are not testamentary dispositions and that they operate outside the will in the sense that the communication and acceptance of the obligation occur inter vivos and all that the will does is to transfer legal title in the subject-matter of the trust to the secret trustee. Now it is arguable that this analysis represents an ex post facto rationalisation of their enforcement since there is authority that the original explanation was to prevent fraud by the 'trustee'. Moreover the modern explanation has not gone unchallenged. Let us accept (i) that testamentary gifts must comply with the formalities of the Wills Act, and (ii) that a proposed testamentary gift has two distinguishing features. These are that it is revocable at any time up until the death of the testator and that it remains undefined and ineffective ('ambulatory') until the testator's death, the effect being that the testator can still deal with his property as he wishes during his lifetime. Let us further accept that a secret trust is only completely constituted on the transfer of legal title to the 'trustee' on the testator's death, and is only intended to become operative from that time. Until then the trust is revocable, for instance by amendment to the will. The problem for the 'dehors (outside) the will' theory is to explain satisfactorily the

position whereby secret trusts share at least some of the characteristics of testamentary gifts whilst not complying with the formalities of the Wills Act.

Critchley, for instance, argues that the 'dehors' theory is implausible ('Instruments of Fraud, Testamentary Dispositions, and the Doctrine of Secret Trusts' (1999) 115 LQR 631). She emphasises the point that the Wills Act, s 9 applies to *any* testamentary disposition and that secret trusts are testamentary dispositions because they exhibit the key indicia of such dispositions, namely they are revocable and, notwithstanding *Re Gardner No 2* [1923] 2 Ch 230, ambulatory. She therefore concludes (at 641): '[T]he *dehors* theory seems to be fatally flawed. In essence, the mistake is to confuse "outside the will" with "outside the *Wills Act*". The *dehors* theory needs – and fails – to demonstrate the truth of the latter and too often ends up resting merely upon the former, which is wholly inadequate as a justificatory argument.' Critchley persuasively identifies some difficulties with the dehors theory but, as she acknowledges and as we have already seen, an avoidance of fraud justification for enforcing secret trusts is also not compelling in every instance (see Maudsley p 144 above and Critchley above at 646–653). Whilst the fraud theory may support the enforcement of a fully secret trust where a trustee actively seeks to deny the trust and keep the property, it remains problematic, even in the more extensive formulation advocated by Critchley, in most other instances of fully secret or half-secret trusts.

(4) 'The conclusion (affirmed in *Blackwell v Blackwell*) that secret trusts operate outside the will is simply a pragmatic compromise that seeks unsatisfactorily to reconcile equitable principles, the policy of the Wills Act and professional practice.' Do you agree?

(6) The juridical conundrum

One issue left unresolved, indeed until recently almost untouched by the courts (see Burgess (1972) 23 NILQ 263; Sheridan (1951) 67 LQR 314), is the juridical nature of fully secret and half-secret trusts. The majority of textbook opinion (eg *Hanbury and Martin* – somewhat ambivalently – p 168; *Pettit* p 125; Oakley *Constructive Trusts* (3rd edn, 1997) p 130; and *Parker & Mellows* p 132; cf *Snell* p 559) leans towards treating fully secret and half-secret trusts as express trusts. The conclusion rests principally on the basis that the trust has been expressly declared by the initial communication to and acceptance by the trustee and is then constituted by the transfer of the property to the trustee and hence not imposed by the court. On the other hand, Sheridan ((1951) 67 LQR 314) has suggested that although half-secret trusts are express, fully secret trusts are constructive. There is a danger of circularity of reasoning here in so far as one's conclusion simply comes to reflect the prior analysis as to how secret trusts are enforced, ie on a 'fraud' or a 'dehors the will' theory.

In any event is the disagreement of any practical importance? It can be argued that the question is not merely reflective of an academic desire to pigeonhole secret trusts conceptually. If they are express trusts, is writing required under LPA 1925, s 53(1)(b) if the subject-matter of the trust is land? In contrast a constructive trust of land is exempt from the formalities requirements by virtue of LPA 1925, s 53(2).

Yet even if secret trusts are express trusts it can be argued that secret trusts of land should still be enforced despite the absence of writing through application of the original explanation of their validity, prevention of fraud. The absence of writing to comply either with the Wills Act or LPA 1925, s 53(1)(b) would then be disregarded by application of the maxim that equity will not permit a statute to be used as an instrument of fraud (see above p 120).

In *Ottaway v Norman* [1971] 3 All ER 1325, a fully secret trust of land was upheld without written evidence, but frustratingly there was no discussion either of the categorisation of secret trusts or of the relevance of any of the LPA requirements (see also *Brown v Pourau* [1995] 1 NZLR 352; discussed by Rickett [1996] Conv 302). Brightman J was content with the observation that 'the basis of the doctrine of secret trust is the obligation imposed on the conscience of the primary donee'. As Oakley points out (p 129), *Ottaway v Norman* 'might be thought to suggest, if only by virtue of the silence of the courts, that fully secret trusts are not express trusts'. But *Ottaway v Norman* cannot be conclusive. Dicta in a more recent judgment by Nourse J in *Re Cleaver* [1981] 2 All ER 1018, a case concerning mutual wills – a mode of property disposition analogous to secret trusts – advance a constructive trust conclusion. Whilst we do not discuss mutual wills in detail (see *Hanbury and Martin* pp 319–326; *Hayton and Marshall* pp 121–129; Pearce and Stevens *The Law of Trusts and Equitable Obligations* (3rd edn, 2002) pp 343–359) a brief note of explanation here should help point out both their similarities with and distinctions from secret trusts, and put Nourse J's analysis in perspective.

Mutual Will The term 'mutual will' describes the arrangement whereby two people (usually (H)usband and (W)ife), having mutually agreed that they wish the same person(s) to have their property after they (H and W) are both dead, leave their respective properties to each other ('the mutual wills') – so that the survivor will benefit from all the property – with a remainder gift to the agreed ultimate beneficiaries. The fact that similar or even identical wills are made is a relevant but not decisive factor in establishing the existence of mutual wills: there must be evidence of a precise agreement to make and not to revoke the mutual wills (see *Re Goodchild* [1997] 1 WLR 1216, CA on the possible evidentiary difficulties in establishing that an agreement is to be legally and not just morally binding on the survivor). It is, however, not essential that the parties should leave the property the subject of the agreement to each other. The mutual wills doctrine has been applied in circumstances where the two testators had agreed to leave the property to particular beneficiaries rather than to each other (*Proctor v Dale* [1993] 4 All ER 129).

What clearly distinguishes a mutual will conceptually from a secret trust is that before the death of the first testator the agreement is a contractual one between two testators: 'without it the property of the second testator is not bound, whereas a secret trust concerns only the property of a person in the position of the first testator' (*Re Goodchild decd* at 1224 criticised by Harper [1997] Conv 182). The complication for the mutual wills agreement is that an existing will is always revocable either by specific act or, as in *Re Goodchild decd*, automatically on remarriage. Revocation would, of course, constitute a breach of the original agreement. If some such breach of the mutual wills agreement were to occur during the testators' joint lifetimes – for instance, by H revoking his will without informing W but then predeceasing her – one might expect W to seek a remedy, if such is available, in damages from H's executors for breach of contract (but cf *Bigg v Queensland Trustees Ltd* [1990] 2 Qd R 11; see generally Youdan (1979) 29 U Toronto LJ 390 and Rickett (1991) 54 MLR 581).

The problem that particularly concerns us here, however, occurs where the contractual arrangement is infringed by the survivor revoking his or her will and executing a new will with different terms and benefiting another beneficiary. It has been assumed that the privity rule prevents the original beneficiary obtaining a contractual remedy against the survivor or his or her estate (see *Hanbury and Martin* p 321 for an assessment of the impact of *Beswick v Beswick* [1968] AC 58 on the availability of a contractual remedy). The impact of the Contracts (Rights of Third Parties) Act 1999 in these circumstances is yet to be determined but it may now be possible for the beneficiary to enforce the contract in his or her own right. If that is not so then it is here that the trust comes into the reckoning as an element of the mutual wills doctrine: the executors of the new will must hold the property, the subject-matter of the agreement, on a constructive trust for the original named beneficiary.

It is from this base that Nourse J attempted to build a broader statement of principle:

Re Cleaver [1981] 2 All ER 1018 at 1025

> . . . these cases of mutual wills are only one example of a wider category of cases, for example secret trusts, in which a court of equity will intervene to impose a constructive trust . . . The principle of all these cases is that a court of equity will not permit a person to whom property is transferred by way of gift, but on the faith of an agreement or clear understanding that it is to be dealt with in a particular way for the benefit of a third person, to deal with that property inconsistently with that agreement or understanding. If he attempts to do so after having received the benefit of the gift equity will intervene by imposing a constructive trust on the property which is the subject matter of the agreement or understanding. I take that statement of principle, and much else which is of assistance in this case, from the judgment of Slade J in *Re Pearson Fund Trusts* (21 October 1977, unreported: the statement of principle is at p 52 of the official transcript). The judgment of Brightman J in *Ottaway v Norman* is to much the same effect.
>
> I would emphasise that the agreement or understanding must be such as to impose on the donee a legally binding obligation to deal with the property in the particular way and that the other two certainties, namely those as to the subject matter of the trust and the persons intended to benefit under it, are as essential to this species of trust as they are to any other.

No reasoning is advanced for extending a constructive trust conclusion to include secret trusts although subsequently the Court of Appeal have cited the opinion of Nourse J with approval (*Kasperbauer v Griffith* (1997) [2000] WTLR 333). Indeed, one might question whether a formal certainty of objects test, even in its modern very liberal form as applied to express trusts (see Chapter 5), would normally be seen as a requirement for the imposition of a constructive trust (see Rickett [1996] Conv 302)). The classification issue remains unresolved. Yet paradoxically *Re Cleaver* may lend even greater point to Burgess's comment that '. . . it is, perhaps, significant that the courts, when discussing secret trusts, have refrained from attempting to put them into any of the recognised categories of express or constructive trusts' ((1972) 23 NILQ 263 at 268). Notwithstanding Nourse J's constructive trust classification, the breadth of the principle he expounds is equally applicable to express *and* constructive trusts. Might we even hypothesise that the previous judicial unwillingness to categorise secret trusts into an express/constructive dichotomy was symptomatic of a broader reluctance to allow the formal categories deduced from basic principles of trusts law to constrain the courts' ability to 'do justice'? If this were the case, then an apparent conceptual vacuum would nevertheless provide flexibility to impose trust obligations through the most appropriate mechanism in individual cases.

We will return to this point at the end of section 4. of this chapter but some support for this interpretation might be gleaned from another legal institution *donatio mortis causa* or 'gift made in contemplation of death'.

Donatio mortis causa (DMC) A DMC does not fit comfortably either with the formalities requirements for testamentary gifts, or with the maxim that equity will not perfect an imperfect gift. Indeed the latter proposition can be turned on its head provided that the three essential requirements for a valid DMC are met. The requirements, as recently stated by Nourse LJ in *Sen v Headley* [1991] 2 All ER 636 at 639 (following the approach adopted in *Snell's Equity* (29th edn, 1990) pp 380–384) are as follows:

> First, the gift must be made in contemplation, although not necessarily in expectation, of impending death. Secondly, the gift must be made upon the condition that it is to be absolute and perfected only on the donor's death, being revocable until that event occurs and ineffective if it does not. Thirdly, there must be a delivery of the subject matter of the gift, or the essential indicia of title thereto, which amounts to a parting with dominion and not mere physical possession over the subject matter of the gift.

The bare facts of *Sen v Headley* pointedly illustrate both the nature of a DMC and the potentially competing policy considerations facing a court where its assistance is needed to complete the gift. The plaintiff Mrs Sen had had a close relationship with the deceased, Mr Hewett, for over thirty years. Three days before his death – he was terminally ill with inoperable cancer – he told the plaintiff that his house was to be hers adding: 'You have the keys. They are in your bag. The deeds are in the steel box.' The Court of Appeal accepted that possession of the sole key which provided access to the deeds satisfied the requirements for delivery of the essential *indicia* of title to the house. Mrs Sen's claim that a valid DMC had been made was contested by one of the deceased's relatives who would be entitled to the property under the intestacy rules. The Court of Appeal, contrary to previous authority which doubted whether land could be the subject-matter of a DMC (*Duffield v Elwes* (1827) 1 Bli NS 497, [1824–34] All ER 247 and *Bayliss v Public Trustee* (1988) 12 NSWLR 540), upheld Mrs Sen's claim, in effect imputing a constructive trust to perfect her full legal and equitable title.

The practical consequence of this controversial decision (see Sparkes (1992) 43 NILQ 35, cf Thorneley (1991) 50 CLJ 404 and Halliwell [1991] Conv 307), is that a death-bed gift of a house, reportedly worth in excess of £300,000, could apparently be validated by a few terse words and the placing of a key into the donee's handbag (see also 'the sterile appeal' in *Woodard v Woodard* [1996] 1 FLR 399, CA – a valid DMC of an Austin Metro by handing over a set of keys). But as Nourse LJ commented, in acknowledging the anomalous nature of the DMC doctrine, 'A *donatio mortis causa* of land is neither more nor less anomalous than any other. Every such gift is a circumvention of the Wills Act 1837' (at 647). There is, however, certainly nothing novel in legal systems disregarding strict application of formalities in such circumstances. Indeed as the name *donatio mortis causa* indicates the doctrine can trace its origins to Roman law.

In policy terms the examples of the doctrines of mutual wills and of DMC indicate respectively a willingness within the legal system, on the one hand, to counter fraud broadly defined and, on the other, to sidestep formalities in the interests of facilitating the wishes of donors. The question that remains is whether the policy rationales for these examples are equally applicable in the case of secret trusts.

(7) Secret trusts and the policy of the Wills Act

The judicial and dominant academic rationalisation for fully secret and half-secret trusts, that they operate outside the will, leaves unresolved the apparent conflict with policy relating to testamentary dispositions. It may be as Friedman suggests ('The Law of the Living, the Law of the Dead: Property, Succession and Society' [1966] Wis LR 340) that 'the law of succession governs the orderly transfer of economic interests from generation to generation'. But, as Friedman points out, within the broad sweep of that objective the law regarding formalities may hope to perform a number of subsidiary functions (at 367):

> The formalities of executing a will are useful ones. They impress the testator with the solemnity of his acts; they ensure a standard written document; they eliminate most of the dangers of forgery and fraud; they encourage the use of middlemen (lawyers) who can help plan a rational, trouble-free disposition of assets.

What countervailing policy justification can there be for permitting what is potentially a significant gap in the operation of the law relating to testamentary dispositions (see generally for a discussion of the benefits and detriments of formality requirements, Critchley, 'Taking Formalities Seriously' in Bright and Dewar (eds) *Land Law: Themes and Perspectives* (1998))? Prevention of fraud can be advanced but this would be achieved negatively by merely preventing 'the secret trustee' from benefiting without enforcing the secret trust. It might even be argued that secret trusts generally are consistent with most of the functions identified by Friedman. After all non-compliance with a statutory formality does not mean that the transaction itself was entered into casually or informally. Yet Sheridan writing in 1951 had no doubts as to the merits of a more positive proposition ((1951) 67 LQR 314 at 328): 'the desire of a testator for secrecy is as much indulgeable as the desire of the State to ensure the existence of reasonable evidence of these dispositions. The trouble with the Wills Act is that it tries to provide for the evidence without making allowance for the secrecy.' The trouble with this explanation, as Gardner has pointed out (pp 92–93) is that there are other more efficient methods of achieving one's objective than a secret trust, such as setting up a bank account in the beneficiary's name. Meanwhile the plain fact remains that, unlike a *donatio mortis causa* or mutual wills, acceptance of secret trusts in principle allows any testator, not accidentally but in a deliberate and considered fashion, to circumvent the formalities of the Wills Act. But perhaps we should not be too alarmed. Although constituting a rather lame policy justification for continuing to recognise secret trusts, the probability is that few testators wish to rely on them and hence they do not constitute a serious threat to the practice of formal will-making.

Even if an argument based fundamentally on freedom of testation is accepted as justifying secret trusts, it is not clear that it is adequate to support the present law in all its detail. For example, unlike half-secret trusts, details of a fully secret trust can validly be communicated to a secret trustee after the date of the execution of the will. The shakiness of the reasoning in *Blackwell v Blackwell* supporting this continuing distinction has already been referred to, and a considerable body of academic opinion supports the extension of the fully secret trust rule to half-secret trusts (see eg *Snell* at p 111 cited with approval obiter in *Gold v Hill* [1999] 1 FLR 54 at 63). The inappropriateness of the 'continuing distinction' is reinforced by the fact that it will not always be clear whether a secret or half-secret trust is intended (see eg a decisive difference of opinion in *Jankowski v Pelek Estate* (1996) 131 DLR (4th) 717 (Manitoba CA) as to whether a direction that the residuary estate be paid to 'my . . . Executor to deal with as he may in his discretion [sic] decide upon' constituted a fully secret (per Kroft and Helper JAs) or a half-secret trust (per Huband JA dissenting)). But alignment of rules can be achieved in two ways. It can be argued that the present fully secret trust rule on communication potentially encourages the indecisive rather than the secretive testator. Consequently, an alternative view is that the half-secret trust rule requiring communication before or at the time of the will should be extended to fully secret trusts. (See Watkin [1981] Conv 335 for a full discussion of the implications of this proposition; but cf Wilde [1995] Conv 366.)

4. Intention to create a binding trust obligation

(a) Certainty of intention

The hallmark of an express trust is the existence of an intention to create a binding trust obligation. To reiterate the point made previously, a generalised intention to benefit a person is in principle insufficient. There must be a specific intention to benefit by way of trust, ie to create a property interest having the attributes of a trust as conceived in equity. Hence the apparently straightforward requirement of certainty of intention. Where trusts are created in writing and based on legal advice there is unlikely to be any uncertainty as regards the obligation intended. But this clear picture becomes clouded where the maxim 'Equity looks to intent rather than the form' applies. No particular form of words is required for the creation of a trust, indeed 'a trust can be created by the most untechnical of words' (Maitland *Equity* (2nd edn, 1936) p 65) or may even be inferred from conduct. Conversely the use of the expression trust is not always conclusive evidence of a trust's existence (see *Stamp Duties Comr (Queensland) v Jolliffe* (1920) 28 CLR 178, including the dissenting judgment of Isaacs J on this point). In the remarkable 'Ocean Island Case', *Tito v Waddell (No 2)* [1977] 3 All ER 129, Megarry V-C held that the expression 'trust' in documents and Mining Ordinances did not create a trust enforceable in the courts, but rather what he called a 'trust in the higher sense', meaning a non-enforceable government obligation.

Although a simple statement of principle concerning certainty of intention can be formulated, an obvious problem is the practical application of the stated requirement to varied fact situations. The problem is particularly pressing where those whose words or conduct are being analysed may be unsophisticated as far as knowledge of the principles of equity and the law of trusts is concerned. Indeed it is not unknown for professionally drafted wills, settlements and even commercial agreements to suffer from obscurity and ambiguities. A question that will then confront the courts is what sort of obligation, if any, was a particular transaction intended to impose?

In each case the court must examine the language used and, where admissible, extrinsic evidence to identify the relevant intention. Lord Upjohn in *Re Gulbenkian's Settlements* [1970] AC 508 aptly summarised the task of the court as being 'by the exercise of its judicial knowledge and experience . . . , innate common sense and desire to make sense of . . . expressed intentions, however obscure and ambiguous the language . . . , to give reasonable meaning to that language if it can do so without doing violence to it' (at 522). None the less positive identification of a specific intention may remain elusive. Can it then be argued that on occasion the court identifies the legal category most appropriate to achieving a 'desirable solution' and affirms the existence of an intention to achieve that objective? If so, the weight to be attached to particular language or conduct may depend on the circumstances in which the existence of a trust obligation is being pleaded. Thus a rigorous standard has been applied to one legally sophisticated constituency, The Law Society: ‘It would, indeed, be surprising if a society of lawyers, who above all might be expected to make their intention clear in a document they compose, should have failed to express the existence of a trust, if that was what they intended to create’ (*Swain v Law Society* [1982] 2 All ER 827 at 840 per Lord Brightman). Also a particular approach may be adopted where the context is commercial rather than familial, although even here the court may be faced with problems of interpretation. In *Don King Promotions Inc v Warren* [1998] 2 All ER 608 (aff’d [1999] 2 All ER 218, CA), the court took into account what the parties – the well-known boxing promoters Don King and Frank Warren –‘as a matter of business common sense [must] have intended to achieve’ in deducing that they had intended the benefit of certain contractual arrangements to be held on trust for their, subsequently dissolved, partnership (see Tettenborn [1998] LMCLQ 498; and Chapter 15 on intention in other commercial contexts). In that case the court was driven somewhat surprisingly to rely on inferences drawn from agreements that ‘though apparently professionally prepared . . . [are] by common consent badly drafted and replete with obscurities and inconsistencies’ ([1998] 2 All ER 608 at 624).

Even within intra-family conflicts, however, the specific legal context in which doubts about intention surface may demand different emphases to be attached to similar language and conduct. Our study of certainty of intention is therefore subdivided here into precatory words, declaration of trust and intention in the context of secret trusts.

(1) Precatory words (‘Words in a will . . . expressing a desire that a thing be done’, OED)

Problems over clarity of language have most often arisen with wills where a testator has used terms expressing confidence, wish, belief, hope or request that a legatee will use a gift in a particular way. It is widely agreed that in early cases courts readily held that such ‘precatory words’ imposed a trust obligation. It is now a fruitless exercise to attempt to categorise these cases, particularly as a change of attitude and approach occurred during the second half of the nineteenth century and the courts became more circumspect in identifying a trust obligation. As regards earlier cases, James LJ commented in *Lambe v Eames* (1871) 6 Ch App 597 at 599: ‘in hearing case after case cited, I could not help feeling that the officious kindness of the Court of Chancery in interposing trusts where in many cases the father of the family never meant to create trusts, must have been a very cruel kindness indeed’.

The modern judicial approach, as evidenced in *Re Adams and the Kensington Vestry* (below) is to have regard to the language of the will as a whole to ascertain the testator’s intention. Although in principle there is no presumption in favour of or against an intention to create a trust, the weight of decisions suggests a more sceptical approach to construing precatory words as exhibiting that intention.

Re Adams and Kensington Vestry (1884) 27 Ch D 394
The testator gave all his property to his wife 'in full confidence that she will do what is right as to the disposal thereof between my children, either in her lifetime or by will after her decease'. Cotton LJ (holding that the wife took the property absolutely) said (at 409):

> . . . it seems to me perfectly clear what the testator intended. He leaves his wife his property absolutely, but what was in his mind was this: 'I am the head of the family, and it is laid upon me to provide properly for the members of my family – my children: my widow will succeed me when I die, and I wish to put her in the position I occupied as the person who is to provide for my children.' Not that he entails upon her any trust so as to bind her, but he simply says, in giving her this, I express to her, and call to her attention, the moral obligation which I myself had and which I feel that she is going to discharge. The motive of the gift is, in my opinion, not a trust imposed upon her by the gift in the will. He leaves the property to her; he knows that she will do what is right, and carry out the moral obligation which he thought lay on him, and on her if she survived him, to provide for the children. . . . I have no hesitation in saying myself, that I think some of the older authorities went a great deal too far in holding that some particular words appearing in a will were sufficient to create a trust. Undoubtedly confidence, if the rest of the context shews that a trust is intended, may make a trust, but what we have to look at is the whole of the will which we have to construe, and if the confidence is that she will do what is right as regards the disposal of the property, I cannot say that this is, on the true construction of the will, a trust imposed upon her. Having regard to the later decisions, we must not extend the old cases in any way, or rely upon the mere use of any particular words, but, considering all the words which are used, we have to see what is their true effect, and what was the intention of the testator as expressed in his will.

The modern approach does not mean that precatory words can never be interpreted as creating a trust (see *Re Steele's Will Trusts* [1948] Ch 603). Indeed, in apparent sharp contrast to *Re Adams and Kensington Vestry*, the House of Lords (Lord Lindley dissenting) held in *Comiskey v Bowring-Hanbury* [1905] AC 84 that there was no absolute gift where the will devised property to the testator's wife 'in full confidence that she will make such use of it as I should have made myself' and at her death 'devise it to such one or more of my nieces as she may think fit'. An additional clause in mandatory terms – 'in default of any disposition by her . . . I hereby direct that all my estate and property acquired by her under my will shall at her death be equally divided among my nieces' – is significant, however, and confirms that it is the document as a whole that must be construed to identify a specific intention. This approach to construction reinforces the point made in *Mussoorie Bank Ltd v*

Raynor (1882) 7 App Cas 321 (see above, p 117) as to the link between rules relating to certainty of intention and certainty of subject-matter.

(2) Declaration of trust

A person can create a trust by declaring himself trustee of property. Aside from the formal requirements where land or equitable interests are involved, no special form of words is required. The settlor 'need not use the words "I declare myself a trustee", but he must do something which is equivalent to it, and use expressions which have that meaning. . . .' (*Richards v Delbridge* (1874) LR 18 Eq 11 at 14 per Jessel MR). It is even possible for the conduct of parties to indicate an intention to be bound by the trust obligation.

Paul v Constance [1977] 1 All ER 195

Constance (C) and his wife Bridgett (the defendant) separated in 1965. In 1967 C met the plaintiff Mrs Paul (P). From December 1967 they lived together as man and wife in the plaintiff's house until C's death in 1974. In 1969 C, who was a fitter, was injured at work and in 1973 was awarded £950 damages. C and P decided to pay the money into a bank deposit account. When C told the manager that he (C) and P were not married, the manager said: 'Well [the account] will be in your name only then?' C said: 'Yes'. Between then and C's death three small deposits of joint bingo winnings were made and the one withdrawal of £150 was divided between C and P after part of it had been used to buy Christmas presents and food. C died intestate and Bridgett, as administratrix of C's estate, closed the account. P commenced proceedings claiming that C had held the bank account on trust for himself and P jointly.

> **Scarman LJ:** A number of issues were canvassed at the trial, but the only point taken by the defendant on her appeal to this court goes to the question whether or not there was, in the circumstances of this case, an express declaration of trust. It is conceded that if there was the trust would be enforceable. . . . Counsel for the defendant has taken the court through the detailed evidence and submits that one cannot find anywhere in the history of events a declaration of trust in the sense of finding the deceased man, Mr Constance, saying: 'I am now disposing of my interest in this fund so that you, Mrs Paul, now have a beneficial interest in it.' Of course, the words which I have just used are stilted lawyers' language, and counsel for the plaintiff was right to remind the court that we are dealing with simple people, unaware of the subtleties of equity, but understanding very well indeed their own domestic situation. It is right that one should consider the various things that were said and done by the plaintiff and Mr Constance during their time together against their own background and in their own circumstances.
>
> Counsel for the defendant drew our attention to two cases, both of them well enough known (at any rate in Lincoln's Inn, since they have been in law reports for over 100 years), and he relies on them as showing that, though a man may say in clear and unmistakable terms that he intends to make a gift to some other person, for instance

his child or some other members of his family, yet that does not necessarily disclose a declaration of trust; and, indeed, in the two cases to which we have been referred the court held that, though there was a plain intention to make a gift, it was not right to infer any intention to create a trust.

The first of the two cases is *Jones v Lock* ((1865) 1 Ch App 25). In that case Mr Jones, returning home from a business trip to Birmingham, was scolded for not having brought back anything for his baby son. He went upstairs and came down with a cheque made out in his own name for £900 and said, in the presence of his wife and nurse: 'Look you here, I give this to baby', and he then placed the cheque in the baby's hand. It was obvious that he was intending to make a gift of the cheque to his baby son but it was clear, as Lord Cranworth LC held, that there was no effective gift then and there made of the cheque; it was in his name and had not been endorsed over to the baby. Other evidence showed that he had in mind to go and see his solicitor, Mr Lock, to make proper provision for the baby boy, but unfortunately he died before he could do so. *Jones v Lock* was a classic case where the intention to make a gift failed because the gift was imperfect. So an attempt was made to say: 'Well, since the gift was imperfect, nevertheless, one can infer the existence of a trust.' But Lord Cranworth LC would have none of it.

In the other case to which counsel for the defendant referred us, *Richards v Delbridge* (1874) LR 18 Eq 11, the facts were that a Mr Richards, who employed a member of his family in his business, was minded to give the business to the young man. He evidenced his intention to make this gift by endorsing on the lease of the business premises a short memorandum to the effect that:

> 'This deed [ie the deed of leasehold] and all thereof belonging I give to Edward . . . [ie the boy] from this time forth with all the stock in trade.'

Jessel MR, who decided the case, said that there was in that case the intention to make a gift, but the gift failed because it was imperfect; and he refused from the circumstances of the imperfect gift to draw the inference of the existence of a declaration of trust or the intention to create one. The ratio decidendi appears clearly from the report. It is a short passage, and because of its importance I quote it:

In *Milroy v Lord* (1862) 4 De GF & J 264), Lord Justice Turner, after referring to the two modes of making a voluntary settlement valid and effectual, adds these words: 'The cases, I think, go further, to this extent, that if the settlement is intended to be effectuated by one of the modes to which I have referred, the Court will not give effect to it by applying another of those modes. If it is intended to take effect by transfer, the Court will not hold the intended transfer to operate as a declaration of trust, for then every imperfect instrument would be made effectual by being converted into a perfect trust.' It appears to me that that sentence contains the whole law on the subject.

There is no suggestion of a gift by transfer in this case. The facts of those cases do not, therefore, very much help the submission of counsel for the defendant, but he was able to extract from them this principle: that there must be a clear declaration of trust, and that means there must be clear evidence from what is said or done of an intention to create a trust or, as counsel for the defendant put it, 'an intention to dispose of a property or a fund so that somebody else to the exclusion of the disponent acquires the beneficial interest in it'. He submitted that there was no such evidence.

When one looks to the detailed evidence to see whether it goes as far as that – and I think that the evidence does have to go as far as that – one finds that from the time that Mr Constance received his damages right up to his death he was saying, on occasions, that the money was as much the plaintiff's as his. When they discussed the damages, how to invest them or what to do with them, when they discussed the bank account, he would say to her: 'The money is as much yours as mine.' The judge, rightly treating the basic problem in the case as a question of fact, reached this conclusion. He said:

> 'I have read through my notes, and I am quite satisfied that it was the intention of [the plaintiff] and Mr Constance to create a trust in which both of them were interested.'

In this court the issue becomes: was there sufficient evidence to justify the judge reaching that conclusion of fact? In submitting that there was, counsel for the plaintiff draws attention first and foremost to the words used. When one bears in mind the unsophisticated character of Mr Constance and his relationship with the plaintiff during the last few years of his life, counsel for the plaintiff submits that the words that he did use on more than one occasion, namely 'This money is as much yours as mine', convey clearly a present declaration that the existing fund was as much the plaintiff's as his own. The judge accepted that conclusion. I think he was well justified in doing so and, indeed, I think he was right to do so. There are, as counsel for the plaintiff reminded us, other features in the history of the relationship between the plaintiff and Mr Constance which support the interpretation of those words as an express declaration of trust. I have already described the interview with the bank manager when the account was opened. I have mentioned also the putting of the 'bingo' winnings into the account, and the one withdrawal for the benefit of both of them.

It might, however, be thought that this was a borderline case, since it is not easy to pin-point a specific moment of declaration, and one must exclude from one's mind any case built on the existence of an implied or constructive trust; for this case was put forward at the trial and is now argued by the plaintiff as one of express declaration of trust. It was so pleaded, and it is only as such that it may be considered in this court. The question, therefore, is whether in all the circumstances the use of those words on numerous occasions as between Mr Constance and the plaintiff constituted an express declaration of trust. The judge found that they did. For myself, I think he was right so to find. I therefore would dismiss the appeal.

[Bridge, Cairns LJJ agreed.]

Disputes about the existence of the necessary intention to declare a trust are most likely to occur where an attempt is made to have an incomplete transfer of property construed as a declaration of trust. There was no doubt that Constance intended to benefit Mrs Paul but did the court construe a general intention to benefit as a specific intention to benefit by way of trust thereby blurring the distinction between gift and declaration of trust? Consider in particular the following criticism:

> Why was there 'no suggestion of a gift by transfer'? Surely C may have intended a gift to himself and P jointly. The result in *Jones v Lock* would probably have been the same if Jones had said 'This cheque is as much baby's as mine', instead of 'I give this to baby'. But is *Paul v Constance* distinguishable from that variation of *Jones v Lock*? (Heydon and Loughlan *Equity and Trusts* (5th edn, 1997 p 132)

It may be, as Gardner has argued (*An Introduction to the Law of Trusts* (2nd edn, 2003) pp 52–53) that the contrasting decisions in *Paul v Constance* and *Jones v Lock* are attributable to changing judicial attitudes towards discovering a declaration of trust in what Lord Cranworth LC in *Jones v Lock* labelled as 'loose conversations of this sort' ((1865) 1 Ch App 25 at 29). None the less, whereas in *Jones v Lock* there was no doubt that Jones 'really had the intention of settling something on the child', his *specific intention* was to implement this by altering his will. Doubtless he would have done so had he not died on the very day of his appointment with his solicitor. The fact remains, however, that wills are revocable and inter vivos trusts usually are not. Should this distinction have any relevance in cases such as these?

(3) Secret trusts

As with cases involving precatory words, the initial question where the existence of a secret trust is at issue may be whether the testator intended the legatee or devisee to be bound by a legal or a moral obligation. 'The real question is what did the testator intend should be the *sanction*? Was it to be the authority of a Court of Justice, or the conscience of the devisee?' (*McCormick v Grogan* (1867) IR 1 Eq 313 at 328 per Christian LJ cited in *Re Snowden* (see below)).

Two recent cases illustrate how contrasting approaches may affect the outcome.

Re Snowden [1979] 2 All ER 172

The testatrix (S), an elderly widow, by her final will made on 10 January 1974, six days before her death, left her residuary estate to her brother Bert absolutely. Six days after her death Bert also died, all his estate being bequeathed to his only son. There was evidence that the testatrix had been undecided about the final disposition of her estate among her nearest relatives, who, apart from her brother, were five nephews and nieces, and that she relied on her brother to implement her wishes as regards disposal of the residuary estate.

The evidence rested principally on four documents recording what was said on three separate occasions. First there was an attendance note of 31 August 1973 by S's solicitor recording the discussions that took place the previous day with S. The note stated that 'you weren't quite clear at the moment how you would deal with things, but you thought that the easiest way would be to leave legacies to the nephews and nieces, and then leave it to Bert to split up the remainder as he thought best'.

Second, there was a statement by the solicitor dated 22 February 1974 amplifying the attendance note:

> She thought the easiest way would be to leave legacies to her nephews and nieces and others of different amounts to suit their needs and her wishes for them, and for what was left to be divided between her nephews and nieces equally. She said she would like the residue to be left to Bert and he could see everybody and look after the division for her. She turned to him and said 'You would see to it for me wouldn't you Bert'. He replied, 'Of course dear if you want me to'.

Finally, there were two affidavits by a solicitor and legal executive dated 21 November 1977 and 1 December 1977 recording what was said on 10 January 1974. These stated that the testatrix wanted 'to be fair to everyone', that her brother 'would know what to do', that he agreed 'to deal with everything for her' and 'that he was perfectly aware of how S wished him to distribute the money that would fall to him under the residuary gift when she died'.

> **Megarry V-C:** Now it seems perfectly clear that the will was executed by the testatrix on the basis of some arrangement that was made between her and her brother regarding the gift of residue to him. The question is what that arrangement was. In particular, did it impose a trust, or did it amount to a mere moral or family obligation? If it was a trust, what were the terms of that trust? Although these questions are distinct, they are obviously interrelated to some degree. The more uncertain the terms of the obligation, the more likely it is to be a moral obligation rather than a trust: many a moral obligation is far too indefinite to be enforceable as a trust . . .
>
> I cannot say that there is no evidence from which it could be inferred that a secret trust was created. At the same time, that evidence is far from being overwhelming . . .

After reviewing prior authority on standard of proof, Megarry V-C continued:

> I therefore hold that in order to establish a secret trust where no question of fraud arises, the standard of proof is the ordinary civil standard of proof that is required to establish an ordinary trust. I am conscious that this does not accord with what was said in *Ottaway v Norman* [1971] 3 All ER 1325, but I think the point was taken somewhat shortly there, and the judge does not seem to have had the advantage of having had cited to him the authorities that I have considered. For those reasons I have overcome my hesitation in differing from him. I cannot therefore dispose of the case summarily on the footing that a high standard of proof has plainly not been achieved, but I must consider the evidence in some detail to see whether the ordinary standard of proof has been satisfied. The initial question, of course, is whether the brother was bound by a secret trust, or whether he was subject to no more than a moral obligation.
>
> In considering this, I have found considerable assistance in two passages in the judgment of the Court of Appeal in Ireland in *McCormick v Grogan* (1867) IR 1 Eq 313 delivered by Christian LJ. Speaking of the testator in that case, he said:
>
>> '. . . the real question is, what did he intend should be the sanction? Was it to be the authority of a Court of Justice, or the conscience of the devisee? In my opinion, expressly and exclusively the latter.'

Then later he said that if we could look into the thoughts of the testator as they were when he was writing the will and the letter that he left with it –

> 'I am persuaded that what we should find there would be a purpose to this effect – to set up after his decease, not an executor or a trustee, but as it were a second self, whom, while he communicates to him confidentially his ideas as to the distribution of his property, he desires to invest with all his own irresponsibility in carrying them into effect.'

I think that the approach made by Christian LJ is of general application in this type of case. . . .

The general picture which seems to me to emerge from the evidence is of a testatrix who for long had been worrying about how to divide her residue and who was still undecided. She had a brother whom she trusted implicitly and who knew her general views about her relations and her property. She therefore left her residue to him in the faith that he would, in due time and in accordance with her general wishes, make in her stead the detailed decisions about the distribution of her residue which had for so long troubled her and on which she was still undecided. He was her trusted brother, more wealthy than she, and a little older. There was thus no need to bind him by any legally enforceable trust; and I cannot see any real indication that she had any thought of doing this. Instead, she simply left him, as a matter of family confidence and probity, to do what he thought she would have done if she had ever finally made up her mind. In short, to revert to the language of Christian LJ, I cannot see any real evidence that she intended the sanction to be the authority of a court of justice and not merely the conscience of her brother. I therefore hold that her brother took the residue free from any trust.

Ottaway v Norman [1971] 3 All ER 1325

The testator Harry Ottaway (T) and his housekeeper Miss Hodges (H) had lived together as man and wife for over thirty years in T's bungalow. William Ottaway (O), T's son by his late wife, was a frequent visitor. The evidence of O, the plaintiff, was that on one of his early visits T told O in H's presence that if H survived him (T) she should have the bungalow for the rest of her life but that she should leave it to O on her death. H agreed to this. By his will made in 1960 T left the bungalow 'together with all furniture, fixtures and fittings' to H in fee simple. He also left H a legacy of £1,500 and the residuary estate he gave on trust to be divided equally between H and O. T died in October 1963. Immediately after T's death H made a will leaving all her property to O.

Subsequently H developed a close friendship with the defendant, a Mr Norman (N) and his wife, and made a new will in 1966 appointing N as executor but making no alteration to the beneficial dispositions. But in 1967, after disagreement between H and O over plans for alterations to the bungalow, H executed a new will by which she left the bungalow to N and his wife, and her residuary estate to O and N in equal shares. H died in 1968 and the plaintiff sought a declaration that N held the bungalow on a secret trust. The claim was subsequently amended to include money received by H under T's will.

> **Brightman J:** Counsel for the defendant invited me to reject the evidence of the plaintiffs that any such obligation as is alleged was imposed on Miss Hodges. He does not accuse the plaintiffs of deliberate lying but submits that their bitter disappointment at losing the bungalow has created in their mind an exaggerated picture of what really occurred; and that they have not discharged the heavy burden of proof which lies on them. Counsel further submitted that I ought to conclude that Mr Harry Ottaway merely indicated to Miss Hodges how he expected and hoped that she would dispose of the property, not how he required her to dispose of it. He pointed out to me a number of reasons for discounting the evidence of the plaintiffs. For example, it had on at least two occasions been brought to the notice of Harry Ottaway by his son that it would be possible for him to alter his will by creating an express trust to take effect on Miss Hodges's death. Why, therefore, should Harry Ottaway have relied on a secret trust? I believe that the suggestion of an express trust was not pursued because certainly Harry Ottaway, and I think also William Ottaway, had complete confidence that Miss Hodges would do what she had been told. Again it was said that the plaintiffs seemed remarkably uncertain as to the precise obligation imposed on Miss Hodges. First the obligation was confined to the house: later it comprised also the contents and money.
>
> . . . [I do not think] that there is much significance in the initial omission of any reference to the furniture and furnishings of the bungalow. In common parlance and in this sort of context they can readily go without saying.
>
> . . . [H]aving heard the evidence I have no doubt in my mind that I have received an accurate account of all essential facts from Mr and Mrs Ottaway. I find as a fact that Harry Ottaway intended that Miss Hodges should be obliged to dispose of the bungalow in favour of the plaintiffs at her death, that he communicated that intention to Miss Hodges and that Miss Hodges accepted the obligation. I find the same facts in relation to the furniture, fixtures and fittings which passed to Miss Hodges under cl 4 of Harry Ottaway's will. I am not satisfied that any similar obligation was imposed and accepted as regards any contents of the bungalow which had not devolved on Miss Hodges under cl 4 of Harry Ottaway's will.
>
> I turn to the question of money. In cross-examination William Ottaway said the trust extended to the house, furniture and money:
>
>> 'Everything my father left to Miss Hodges was to be in the trust. The trust comprised the lot. She could use the money as she liked. She had to leave my wife and me whatever money was left.'
>
> In cross-examination Mrs Ottaway said that her understanding was that Miss Hodges was bound to make a will giving her and her husband the bungalow, contents and any money she had left. 'She could please herself about the money. She did not have to save it for us. She was free to spend it.' It seems to me that two questions arise. First as a matter of fact what did the parties intend should be comprised in Miss Hodges's obligation? All money which Miss Hodges had at her death, including money which she had acquired before Harry's death and money she acquired after his death from all

> sources? Or, only money acquired under Harry's will? Secondly, if such an obligation existed would it as a matter of law create a valid trust? [On the second question see below p 167 under 'certainty of subject-matter'.] I accept that the parties mentioned money on at least some occasions when they talked about Harry Ottaway's intentions for the future disposition of Ashcroft. I do not, however, find sufficient evidence that it was Harry Ottaway's intention that Miss Hodges should be compelled to leave all her money, from whatever source derived, to the plaintiffs. This would seem to preclude her giving even a small pecuniary legacy to any friend or relative. I do not think it is clear that Harry Ottaway intended to extract any such far-reaching undertaking from Miss Hodges or that she intended to accept such a wide obligation herself. Therefore the obligation, if any, is in my view to be confined to money derived under Harry Ottaway's will. If the obligation is confined to money derived under Harry Ottaway's will, the obligation is meaningless and unworkable unless it includes the requirements she shall keep such money separate and distinct from her own money. I am certain that no such requirement was ever discussed or intended. If she had the right to mingle her own money with that derived from Harry, there would be no ascertainable property on which the trust could bite at her death. This aspect distinguishes this case from *Re Gardner*.
>
> There is another difficulty. Does money in this context include only cash or cash and investments, or all moveable property of any description? The evidence is quite inconclusive. In my judgment the plaintiff's claim succeeds in relation to the bungalow and in relation to the furniture, fixtures and fittings which devolved under cl 4 of Harry Ottaway's will subject, of course, to normal wastage and fair wear and tear, but not to any other assets.

The absence of comment in *Ottaway v Norman* on the constructive trust/express trust debate about the status of secret trusts has already been referred to and aspects of the judgment have been criticised as being inconsistent with the requirement of certainty of subject-matter. But there is a more fundamental issue concerning intention, and *Re Snowden* and *Ottaway v Norman* can be usefully compared in this context.

Consider the following points:

(1) The statement that 'Harry Ottaway intended that Miss Hodges should be obliged to dispose of the bungalow . . . and that Miss Hodges accepted the obligation' does not necessarily resolve the matter of intention. The further question to be considered, but seemingly not addressed in the case, is whether the sanction was to be 'the authority of a Court of Justice, or the conscience of the devisee' (cf *Re Snowden* and see also *Brown v Pourau* [1995] 1 NZLR 352 where the obligation was described (at 373) as at best 'a familial or moral obligation'). With this point in mind, how satisfactory do you find Brightman J's treatment of the fact that Harry Ottaway rejected the advice to use an express trust to achieve his objective?

(2) 'Uncertainty in the subject of the gift has a reflex action upon the previous words, throwing doubt on the testator's intention' (*Mussoorie Bank Ltd v Raynor*). What should have been the relevance, if any, of this dictum to the facts in *Ottaway v Norman*?

(3) It is a nice question as to whether a stronger indication of an intention to benefit by way of trust was present in *Ottaway v Norman* than in *Re Snowden*, particularly since the standard of proof in *Ottaway* was pitched, in principle, at a higher level. Notwithstanding the decision in *Ottaway*, determining whether a trust-like obligation is intended is always likely to be a problem where informality is present. In *Gold v Hill* [1999] 1 FLR 54, for instance, in a situation described by Carnwath J as analogous to a secret trust, the nominee under an insurance policy on the life of one Gilbert was told by Gilbert 'over drinks before dinner' at a hotel: 'If anything happens to me you will have to sort things out – you know what to do – look after Carol and the kids. Don't let that bitch [Gilbert's wife] get anything.' The general intention was clear but was there a trust? Notwithstanding an apparent lack of clarity as to the terms of the trust, the court affirmed that the nominee was to hold the proceeds of the policy on trust for Carol for her 'to apply those monies for the benefit of herself and her children'.

(4) Do you think the judgment in *Re Snowden* would or should have been the same if the brother, Bert, had survived and asked for directions as to whether he was bound by a 'secret trust'?

(b) Certainty of subject-matter

(1) Existing property (ie property existing at the time when the trust is intended to take effect)

A purported trust will be void if the property intended to form the subject-matter of the trust obligation cannot be clearly identified. Expressions such as 'the bulk of my residuary estate' (*Palmer v Simmonds* (1854) 2 Drew 221) are too uncertain. The other end of the uncertainty spectrum is to be found in *Boyce v Boyce* (1849) 16 Sim 476 where the property was certain but the individual entitlement was not. There a testator devised 'all my houses' – probably two but the report is ambiguous on the point – on trust to convey one to the eldest daughter Maria 'whichever she may think proper to choose' and the others to another daughter, Charlotte. Maria predeceased the testator without making any choice. The Vice-Chancellor held that the gift to Charlotte failed since there could be no certainty as to which house should be held on trust for her. Both properties were therefore held on resulting trust for the testator's heir, his grandson.

Boyce v Boyce might be thought to be a somewhat extreme case but it is the harbinger of a comparable contemporary problem. Consider the position where a company (G) invites investors to purchase gold bullion, for future delivery if and when required by them, but which in the meantime will be stored in safe-keeping as part of G's overall stock of bullion. Can there then be a valid trust if G purports to declare itself trustee of, let us say, 50 gold bars out of a total stock of 200 identical bars? Until G has segregated and appropriated 50 specific bars for B it seems that the trust will fail because it cannot be said with certainty which 50 gold bars are the subject-matter of the trust obligation (*Re Goldcorp Exchange Ltd* [1995] 1 AC 74, PC, discussed Birks [1995] RLR 83; see also *Re London Wine Co (Shippers) Ltd* [1986] PCC 121 'consignments of wine'). On the other hand if, in our example, G had declared that it held the bullion on trust for itself and B as tenants in common in their respective proportions (one-quarter and three-quarters), the trust would have been valid. The intention to hold 50 gold bars on trust for B is not the same as an intention to hold a one-quarter share of the *undivided* total and ascertained bullion. Litigation on this issue has tended to occur in the context of insolvency where prepaying purchasers of a particular quantity of goods from an identified bulk of those goods have sought, usually unsuccessfully, to achieve some measure of protection through establishing a proprietary interest in the goods (see Chapter 15, where these issues are considered more fully, and also the Sale of Goods (Amendment) Act 1995 which, in 'identified bulk' circumstances in an insolvency, now provides some protection for purchasers via the 'tenancy in common' mechanism; noted Burns [1996] MLR 260; Ulph [1996] LMCLQ 93).

In view of the above line of reasoning it is therefore somewhat surprising that the Court of Appeal in *Hunter v Moss* [1994] 1 WLR 452, confirming a decision of the High Court ([1993] 1 WLR 934), held that a declaration of trust of, in effect, 50 out of 950 shares in one company was not void for uncertainty of subject-matter – segregation or appropriation of particular shares being considered unnecessary as all the shares carried identical rights. But how is this case different from our gold bullion example? It must be said that the conceptual basis for the distinction is not very satisfactory and admittedly the case was argued and decided before the decision in *Goldcorp* was delivered on 25 May 1994 (see *Underhill and Hayton* p 79; Hayton (1994) 110 LQR 335, but cf Jones [1993] Conv 460; Martin (1996) Conv 223; and Clarke (1995) 48 CLP 117). In the High Court emphasis seems to be placed on the fact that *Hunter v Moss* is concerned with intangible assets – shares that were identical – whereas *Re London Wine* and earlier authorities involved tangible assets – chattels that may not necessarily be identical (see at 940 in *Hunter v Moss* where the judge provides as an illustration a consignment of the same wine and vintage but where some cases may have deteriorated and others not). This ground for distinguishing the authorities, although not explicitly endorsed in the Court of Appeal, has subsequently been adopted in another case concerning a trust of a particular number of shares (*Re Harvard Securities Ltd (in liquidation)* [1997] 2 BCLC 369 at 383; see Worthington [1999] JBL 1 and Goode [2003] LMCLQ 379; see also the judgment in Hong Kong of Yuen J in *Re C A Pacific Securities Ltd* [2000] 1 BCLC 494). In fact in the Court of Appeal Dillon LJ simply distinguished *Re London Wine* observing that it 'was a long way from the present case' in that '[it] involved the appropriation of chattels and when the property in chattels passes' and 'was not concerned with a declaration of trust' ([1994] 1 WLR 452 at 458). There is an alternative and pragmatic basis for the distinction. Unlike the cases cited in argument in *Hunter v Moss* there was, in that case, no question of unsecured creditors attempting to establish priority in an insolvency. It may be significant that in the absence of a third-party/creditor dimension, a key question in the High Court in *Hunter* seemed to be whether 'the court could, if asked, make an order for the execution of the purported trust' (at 945). Lastly, it should be noted that a further practical consequence of the decision in *Hunter v Moss* was to prevent an employer, the defendant, from resiling from a 'promise' to provide the plaintiff employee with the shares the subject-matter of the dispute. One might therefore conclude that by discovering that there was an intention to create a trust and that the conceptual problems with certainty of subject-matter could be circumvented, the court was enabling the original intentions of the parties to the dispute to be implemented and the 'unjust' consequences of the subsequent 'falling out' that led to the litigation to be avoided.

The very different and much earlier case of *Sprange v Barnard* (1789) 2 Bro CC 585 illustrates another dimension of the certainty problem, yet also exhibits a concern with enforcement. A testatrix gave £300, invested in joint stock annuities, to her husband 'for his sole use and at his death the remaining part of what is left, that he does not want for his own wants and use to be divided between' a brother and sisters. No trust arose since it was uncertain what property would be left on the death of the husband who accordingly took the property absolutely. The potential uncertainty of subject-matter may have cast doubt on the intention of the testatrix, but *Sprange v Barnard* suggests a concern as much with enforcement – 'it appears to me to be a trust which would be impossible to be executed' – as with intention.

Sprange v Barnard and later cases appeared to establish firmly that 'if property were bequeathed essentially to X to pass on whatever was left at his death to Y, then this would normally be treated as an absolute gift to X but, in an exceptional case, the court in context might be able to find that the property had to be held on trust for X for life, remainder to Y absolutely' (*Underhill and Hayton* p 81). The apparent certainty of this stance, based fundamentally on enforceability, is challenged by the observations of Brightman J in *Ottaway v Norman* as regards the possibility of a secret trust of the money:

> I am content to assume for present purposes but without so deciding that if property is given to the primary donee on the understanding that the primary donee will dispose by his will of such assets, if any, as he may have at his command at his death in favour of the secondary donee, a valid trust is created in favour of the secondary donee which is in suspense during the lifetime of the primary donee, but attaches to the estate of the primary donee at the moment of the latter's death. There would seem to be at least some support for this proposition in an Australian case to which I was referred: *Birmingham v Renfrew*.

Birmingham v Renfrew (1937) 57 CLR 666 is a leading Australian authority on mutual wills (see above p 149). The purpose, and possibility, of a 'floating' or 'suspended' trust is explained in the judgment of Dixon J (at 689):

> The purpose of the arrangement for corresponding [ie mutual] wills must often be . . . to enable the survivor during his life to deal as absolute owner with the property passing under the will of the party first dying. That is to say, the object of the transaction is to put the survivor in a position to enjoy for his own benefit the full ownership so that,

> for instance, he may convert it and expend the proceeds if he chooses. But when he dies he is to bequeath what is left in the manner agreed upon. It is only by the special doctrines of equity that such a floating obligation, suspended, so to speak, during the lifetime of the survivor can descend upon the assets at his death and crystallise into a trust.

There is, however, one immediate and obvious practical problem with the ingenious solution. What can we identify as the obligations of the primary donee vis-à-vis the property during his or, usually, her own lifetime? Does the following observation of Dixon J satisfactorily resolve problems of enforceability?

> No doubt, gifts and settlements inter vivos, if calculated to defeat the intention of the compact, could not be made by the survivor and his right of disposition inter vivos is therefore not unqualified.

These words were adopted in *Re Cleaver* [1981] 2 All ER 1018 by Nourse J who added (at 1024): 'no objection could normally be taken to ordinary gifts of small value'. It is tempting to suggest that problems-a-plenty could lay in wait in determining whether the obligation undertaken has been breached, yet the absence of litigation on this aspect of mutual wills is striking (see eg Mitchell (1951) 14 MLR 140–142; Hodkinson [1982] Conv 228; and Oakley *Constructive Trusts* (3rd edn, 1997)). In conclusion, notwithstanding Nourse J's reaffirmation in *Re Cleaver* that the requirements of certainty of subject-matter are 'as essential to this species of trust as they are to any other' we suggest that it is not easy to reconcile the 'floating' or 'suspended' trust either with the conceptual requirement that the subject-matter of a trust must be certain or with the sort of practical concern with enforceability expressed in a case such as *Sprange v Barnard*. None the less the status of the trust is well established in the mutual wills context.

It only remains to add that if there is no identifiable property at all then there can be no subject-matter and therefore no trust. In *Hemmens v Wilson Browne (a firm)* [1995] Ch 223 a document purporting to give one party a right to call on the other party for a payment of £100,000 at any time did not create a trust because there was no identifiable fund from which to form the subject-matter of a trust (see also *MacJordan Construction Ltd v Brookmount Erostin Ltd (in receivership)* [1992] BCLC 350).

(2) Future property

'The scope of the trusts recognised in equity is unlimited. There can be a trust of a chattel, or of a right or obligation under an ordinary legal contract, just as much as a trust of land' (Lord Shaw in *Lord Strathcona Steamship Co Ltd v Dominion Coal Co Ltd* [1926] AC 108 at 124). A recent illustration of the breadth of this proposition is *Don King Productions Inc v Warren* [1998] 2 All ER 608 where Lightman J, specifically citing the dicta of Lord Shaw, held that even though a purported assignment of a contract involving the rendering of personal services would, by its nature, be ineffective at law this would not prevent the *benefit* of the contract being held on trust assuming the intention to do so could be identified (affirmed by the Court of Appeal [2000] Ch 291 but cf Tettenborn [1999] LMCLQ 352). It is thus unquestionably correct that the subject-matter of a trust can be as varied as the range of property interests that exist. But 'exist' is a key word here. It is only existing property – for example, negotiable instruments, money, chattels, interests in land whether in possession or remainder – that can form the subject-matter of a trust. Future property, or 'mere expectancy', cannot, and a voluntary declaration of trust of future property will therefore be ineffective: 'As it is impossible for anyone to own something that does not exist, it is impossible for anyone to make a present gift of such a thing to another person, however sure he may be that it will come into existence and will then be his to give' (*Norman v Federal Comr of Taxation* (1963) 109 CLR 9 per Windeyer J). Often-quoted examples of future property are copyright in songs not yet written (*Performing Right Society v London Theatre of Varieties* [1924] AC 1), or the hope of inheriting under the will of a still living testator or on intestacy (*Re Lind* [1915] 2 Ch 345) or of acquiring book debts arising in a business (*Tailby v Official Receiver* (1888) 13 App Cas 523). Plainly, therefore, this is quantitatively a minor restriction on the scope of the trust. But it must not be overlooked that although a gift – a voluntary assignment – of future property is ineffective, an assignment for valuable consideration is treated as a contract to assign and therefore valid.

Circumstances can arise, however, where it is difficult to distinguish future property from existing vested or contingent rights to obtain property at some future time.

Williams v IRC [1965] NZLR 395 (New Zealand Court of Appeal)
Williams, the appellant, held a life-interest under a trust and was entitled to trust income. He executed a voluntary deed whereby he assigned 'to the assignee for the religious purposes of the Parish of the Holy Trinity for four years the first £500 of the net income which shall accrue to the assignor personally while he lives in each of the said four years from the [specified trust] . . . '. The Commissioner assessed Williams to income tax on the trust income, it being argued that the assignment was ineffective and Williams had failed to dispose of his interest in the £500. The New Zealand Court of Appeal rejected the appeal:

> **Turner J:** What then was it that the assignor [Williams] purported to assign? What he had was the life interest of a *cestui que trust* in a property or partnership adventure vested in or carried on by trustees for his benefit. Such a life interest exists in equity as soon as the deed of trust creating it is executed and delivered. Existing, it is capable of immediate assignment. We do not doubt that where it is possible to assign a right completely it is possible to assign an undivided interest in it. The learned Solicitor-General was therefore right, in our opinion, in conceding that if here, instead of purporting to assign 'the first £500 of the income', the assignor had purported to assign (say) an undivided one-fourth share in his life estate, then he would have assigned an existing right, and in the circumstances effectively.

> But in our view, as soon as he quantified the sum in the way here attempted, the assignment became one not of a share or a part of his right, but of moneys which should arise from it. Whether the sums mentioned were ever to come into existence in whole or in part could not at the date of assignment be certain. In any or all of the years designated the net income might conceivably be less than £500; in some or all of them the operations of the trust might indeed result in a loss. The first £500 of the net income, then, might or might not (judging the matter on the date of execution of the deed) in fact have any existence.
>
> We accordingly reject Mr. Thorp's argument that what was here assigned was a part or share of the existing equitable right of the assignor. He did not assign part of his right to income; he assigned a right to a part of the income, a different thing. The £500 which was the subject of the purported assignment was £500 *out of the net income*. There could be no such income for any year until the operations of that year were complete, and it became apparent what debits were to be set off against the gross receipts. For these reasons we are of opinion that what was assigned here was money; and that was something which was not presently owned by the assignor. He had no more than an expectation of it, to arise, it is true, from an existing equitable interest – but that interest he did not purpose to assign . . .

[Counsel for the appellants argued in the alternative that if the document were not effective as an assignment it was effective as a declaration of trust.]

> . . . [It] is useless to seek to use this device in the circumstances of the present case. Property which is not presently owned cannot presently be impressed with a trust any more than it can be effectively assigned; property which is not yet in existence may be the subject of a present agreement to impress it with a trust when it comes into the hands of the donor; but equity will not enforce such an agreement at the instances of the *cestui que trust* in the absence of consideration (*Ellison v Ellison* (1802) 6 Ves 656).

(3) Certainty of beneficial interest

The quantum of beneficial interest to be taken by a beneficiary must be certain. Although technically correct, this bald statement is potentially misleading because of two methods of remedying uncertainty. First is the discretionary trust: a settlor can confer a discretion on trustees to apply the trust fund among a class of persons, for example, on trust for such of my children and in such shares as my trustees shall in their absolute discretion decide. Second, in certain circumstances the court will assume that property is to be divided equally among beneficiaries, applying the maxim – 'Equality is equity' (but cf *Boyce v Boyce* above). Both these possibilities demonstrate the overlap between certainty of subject and certainty of object and are considered further in the next chapter.

Third, there may be circumstances where the language used permits a generous interpretation of what is meant by certainty. In *Re Golay's Will Trusts* [1965] 2 All ER 660, a testator's direction to executors 'to let Tussy . . . receive a reasonable income from my . . . properties' was somewhat surprisingly upheld. Ungoed-Thomas J decided that 'reasonable income' provided 'an effective determinant of what the testator intends'. He concluded that 'the court is constantly involved in making such objective assessments of what is reasonable and is not to be deterred from doing so because subjective influences can never be wholly excluded' (at 662).

(c) Incomplete constitution and the role of intention

(1) Incompletely constituted trusts, contracts and conceptual complexity

In this section we consider attempts that have been made to circumscribe the rule that incompletely constituted trusts are not enforceable. But the route to understanding has been obscured by the entanglement of two distinct concepts, those of common law contract and equitable trust. And the concepts are very different. Contract is a vehicle for the exchange of reciprocal obligations; it is a bargain which, under the common law system, by definition excludes a gift. In contrast the benefiting of a person by means of a trust is usually the equitable equivalent of a common law gift – transactions wholly voluntary as between settlor and beneficiary and donor and donee respectively. A consequence of its voluntary nature is that if a settlor agrees to create a trust but changes his mind between the making of the promise and delivery of property to trustees, the trust is incompletely constituted and in principle the beneficiary has no remedy against the settlor. The beneficiary is a volunteer and the maxim 'Equity will not assist a volunteer' applies. The long-standing rule was clearly expressed by Lord Eldon in *Ellison v Ellison* (1802) 6 Ves 656 at 662: 'If you want the assistance of the court to constitute you *cestui que trust*, and the instrument is voluntary, you shall not have that assistance' but he added that where the property is completely transferred to trustees 'though it is voluntary . . . the equitable interest will be enforced by this court'.

The entanglement referred to above begins where a transaction takes the following form: A contracts with B to the effect that B will do something for the benefit of C. C is not a party to the contract and since it has long been the common law rule that only the parties to a contract can sue on it, C is left helpless if B refuses to perform the contract and A is unable or unwilling to compel B to do so. As will be seen below the common law privity of contract doctrine has now been significantly modified by the Contracts (Rights of Third Parties) Act 1999. But, statutory reform aside, could a remedy be obtained by arguing that, expressly or impliedly, A and B had contracted on the basis that A was to be a trustee of the benefit of B's promise for C? C can then sue as a beneficiary of a completely constituted trust, the subject-matter of the trust being the benefit of the promise, a chose in action. This argument met with some initial success but the courts became increasingly reluctant to support this transparent device to evade the privity of contract doctrine and demanded clear evidence of what was, of course, rarely present, an intention to create a trust. By contrast in Australia the possibility and benefit of a trust solution, at least in the rather specialised context of insurance contracts, seems to be viewed more sympathetically (see eg the judgments, in particular Deane J, in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 80 ALR 574; and generally Dwyer (1995) U

Tas LR 143; Jaconelli [1998] Conv 88)). None the less the prevailing approach in English law remains that clearly stated by du Parcq LJ in *Re Schebsman* [1944] Ch 83 at 104:

> Unless an intention to create a trust is clearly to be collected from the language used and the circumstances of the case, I think that the court ought not to be astute to discover indications of such an intention.

Although traces of the argument are to be found in the context of incomplete constitution, in this specific context the issue has now decamped to the realm of contract law (see Treitel *Law of Contract* (11th edn, 2003) pp 646–651; and the Law Commission Report No 242 *Privity of Contract: Contracts for the Benefit of Third Parties* (Cm 3329, 1996) implemented in the Contracts (Rights of Third Parties) Act 1999).

We have mentioned that a beneficiary has no remedy where a settlor changes his mind after the making of a promise to create a trust and decides not to transfer the property to trustees. But consider the position if A formally promises in a deed ('covenants') to transfer property to B to hold on trust for C but does not then perform the promise. The trust is not fully constituted but can it be argued that B holds the benefit of the covenant or the right of action on it on trust for C, so that A's promise can be enforced? If so this 'is a trust which like a starter motor ensures that the main trust is completely constituted' in the trustees (Waters *The Law of Trusts in Canada* (2nd edn, 1984) p 59). There is a clear parallel with the contractual example given previously and, as we shall see in section (2) below, the legal form the argument takes also revolves around whether the requisite specific intention to create a trust is present. Furthermore, the parallel extends to the policy argument that is cloaked by the issue of intention: what we are essentially concerned with is whether a court should enable a promisee who has given no value for the promise to enforce it.

There is a further policy issue, one fundamental to the trust and with fiscal implications, but one which receives insufficient attention in the substantial academic debate surrounding incompletely constituted trusts. A significant attraction of the trust, as we saw in Chapter 3, is that its capacity to fragment ownership on the plane of time can facilitate extensive flexibility of property disposition. An underlying policy consideration that should therefore not be overlooked when reading the following sections is how far trusts law and principles of equity do or should encourage ever more abstract property forms.

Before considering the conceptual and policy problems posed by the enforceability of covenants to settle we can briefly note that the creation of an express trust, while usually a wholly voluntary transaction, can result from a bargain between the parties: A in return for some promise by B undertakes to transfer property to trustees (T1 and T2) on trust for B. What then is B's position if A subsequently declines to transfer the property to T1 and T2? The trust is incompletely constituted but there is a crucial difference from the voluntary arrangement. Now B has provided consideration and is not a volunteer and so can enforce the promise; equity will compel A to carry out the undertaking and transfer the property to T1 and T2. But what is 'consideration' in this context? The principle developed by equity is that *either* there must be valuable consideration in the common law sense, furnished by a trustee or a beneficiary, *or* the beneficiary must be able to bring himself or herself within what has been called the scope of marriage consideration. We have previously referred (see Chapter 2) to the role that marriage settlements, now rarely encountered, were intended to fulfil in the nineteenth century in protecting a wife and children from economic domination by the husband, and marriage was described as 'the most valuable consideration imaginable' (*A-G v Jacobs-Smith* [1895] 2 QB 341 at 354). A trust made before and in consideration of marriage, 'an ante-nuptial settlement', is regarded as being made for value as is a trust created after marriage if made in pursuance of an ante-nuptial agreement. Indeed, the courts 'after considerable conflict of judicial opinion' (*Snell* p 127) extended the scope of consideration beyond the parties to the marriage to include the issue of the marriage, issue in this context including children and grandchildren. But there the courts drew the line. Next of kin were not within the marriage consideration and thus were 'volunteers' in the eyes of equity.

To summarise, an incompletely constituted trust can be enforced at the behest of beneficiaries as an agreement to create a trust provided that valuable or marriage consideration has been furnished.

(2) Covenants to settle and enforceability

It was common in marriage settlements for the promise with trustees to be made by covenant, ie promise in a deed under seal (under Law of Property (Miscellaneous Provisions) Act 1989, s 1, deeds no longer require a formal seal). But what difference if any does the addition of the formalities of a deed make to the promise to create a trust? It represents adequate consideration at common law, but not in equity. Can it assist the volunteer beneficiary, such as next of kin in a marriage settlement where there are no children? Or if not the volunteer beneficiary, can the trustee enforce the covenant? The following excellent account by *Hayton and Marshall* succinctly summarises the possibilities at p 248.

> COVENANTS TO SETTLE OR TRANSFER PROPERTY
>
> If A covenants to pay £11,000 or transfer 1,000 ICI ordinary shares or transfer his unique fifth dynasty Ming vase to B, a volunteer, then B has a chose in action enforceable at law against A, the deed's formalities supplying the consideration. However, equity does not regard the deed's formalities as consideration and so treats B as a volunteer and 'equity will not assist a volunteer'. Thus B cannot obtain specific performance of the Ming vase covenant but will have to be satisfied with common law damages, as for the £11,000 covenant or the 1,000 ICI shares covenant, specific performance never being available in such cases where money compensation is itself adequate. Equity, however, will not frustrate a volunteer suing at law (*Cannon v Hartley* [1949] Ch 213) and so

> B may recover as damages £11,000 or the money equivalent of the shares or the Ming vase.
>
> Since B has a chose in action this is property that he himself as beneficial owner can settle on trusts whether declaring himself trustee of it, or assigning it to trustees on trusts, for C for life, remainder to D.
>
> If A covenants with B to transfer £60,000 to B as trustee with express or implied intent that B shall hold the benefit of the covenant upon trust for C and D if they attain 21 years of age, then A has created a completely constituted trust of the benefit of the covenant held by B as trustee, so this may be enforced by C and D, though volunteers, just as trusts are ordinarily enforceable by volunteers (*Fletcher v Fletcher* (1844) 4 Hare 67).

The formalising of a promise by means of a deed of covenant will therefore *not* assist enforcement by the volunteer beneficiary directly, unless it can be shown that a trust of the benefit of the covenant was intended. We have already seen that during the twentieth century the courts began to exhibit a sceptical attitude towards construing precatory words as being intended to impose obligations of trusteeship. In similar vein the courts have been reluctant to detect any implied intention to create a completely constituted trust of the benefit of a covenant. But we also mentioned previously the possibility of trustee enforcement and here the common law appears to offer a convenient escape from the conclusion that the covenant itself is otherwise unenforceable. Although, as Hayton points out, the equitable remedy of specific performance is not available to a covenantee, equity not regarding the deed's formalities as consideration, a common law action for damages can be pursued. Could not the trustees (B) with whom the covenant is made therefore sue the covenantor/settlor (A) for breach of covenant, recover substantial damages and hold them in trust for the volunteer beneficiaries (C and D)? There are difficulties with this solution. As Hayton points out (at p 253):

> [One] difficulty is that *ex hypothesi* B does not hold the covenant on trust for C [and D] so that he must either hold the covenant for his own benefit or by way of resulting trust for A and it is clear that he is not intended to hold the covenant beneficially. If, therefore, the covenant and the right to damages for breach of covenant are held on resulting trust for the settlor, A, then surely so must any damages for breach of covenant.

Assuming the conclusion that the resulting trust is unavoidable to be correct (cf Rickett (1979) 32 CLP 1 and (1981) 34 CLP 189) then patently it is a pointless exercise for B to sue A for damages which would then be held on resulting trust for A himself. A second difficulty with a solution premised upon enforcement by trustees is the weight of authority, admittedly at first instance, against it.

The case law on the issue (*Re Pryce* [1917] 1 Ch 234; *Re Kay's Settlement* [1939] Ch 329; *Re Cook's Settlement Trusts* [1965] Ch 902) is distinctly discouraging to trustees who may consider suing. It now seems clear that the courts will not support volunteers seeking to compel trustees to sue, and further, where the court's discretion is sought by trustees, will instruct them not to sue. The decisions and the specific reasoning (or lack thereof) in the cases have engendered an extensive academic debate (Elliott (1960) 76 LQR 100; Hornby (1962) 78 LWR 228; Barton (1975) 91 LQR 236; Meagher and Lehane (1976) 92 LQR 427: cf Davies [1967] ASCL 387; Lee (1969) 85 LQR 213). Although there is no direct authority were trustees, rather than seeking the court's direction, to attempt to bring an action, it seems doubtful that it would succeed (see *Re Ralli's Will Trust* [1964] Ch 288 at 301–303 'trustees might be constrained by the court not to do so' (cf Elliott (1960) 76 LQR 100)).

(3) Covenants of future property: a problem?

Nothing in the cases cited above necessarily undermines the proposition that if there exists a completely constituted trust of the *benefit* of the covenant this can be enforced by the trustees on behalf of the beneficiaries or by the beneficiaries themselves even if volunteers. But doubt, both judicial (*Re Cook's Settlement Trusts*) and academic (eg Lee (1969) 85 LQR 213 and Davies [1967] ASCL 387 at 392), has been expressed as to this possibility where the subject-matter of the covenant is 'after-acquired', or other future property (see also *Re Plumptre's Marriage Settlement* [1910] 1 Ch 609; *Pullan v Koe* [1913] 1 Ch 9). In a marriage settlement it was usual for the parties to covenant to add to the settlement property which might subsequently come into their possession – hence 'after-acquired property'. It is certainly correct, as we have seen, that future property cannot be assigned or be the subject-matter of a trust (*Williams v IRC*). But it has been argued that 'a covenant to pay a sum to be ascertained in the future is just as good a chose in action as a covenant to pay a specified sum, and it creates legal property of value. The trust *res* is the benefit of the covenant, the chose in action; not the property which will be obtained by its performance' (*Hanbury and Martin* p 135; Barton (1975) 91 LQR 236 at 238; Meagher and Lehane (1976) 92 LQR 427 at 428).

If authority were needed to support this proposition it can be found in *Davenport v Bishopp* (1843) 2 Y & C Ch Cas 451, a case involving a covenant to transfer an unspecified sum at some future time. The academic affirmation of principle should be contrasted with the following judgment of Buckley J.

Re Cook's Settlement Trusts [1965] Ch 902

By an agreement made in 1933 between Sir Herbert Cook and his son, Sir Francis Cook, property including certain pictures from a very valuable collection became the absolute property of Sir Francis. The agreement provided that Sir Francis should resettle some of the property and covenant with the trustees of the settlement that in the event of certain pictures (including a Rembrandt) being sold 'during the lifetime of Sir Francis the net proceeds of sale shall be paid to the trustees' to be held on the resettlement trusts in favour of Sir Francis's children. Sir Herbert died in 1939. Sir Francis married several times and there were two living children. In 1962 Sir Francis gave the Rembrandt to his wife who wished to sell it. The trustees sought directions as to whether, if the Rembrandt were sold, they should seek to enforce the covenant.

> **Buckley J:** Counsel appearing for Sir Francis, has submitted, that, as a matter of law, the covenant is not enforceable against him by the trustees of the settlement; . . . counsel submits that the covenant was a voluntary and executory contract to make a settlement in a future event and was not a settlement of a covenant to pay a sum of money to the trustees. He further submits that, as regards the covenant, all the beneficiaries under the settlement are volunteers with the consequence that not only should the court not direct the trustees to take proceedings on the covenant but also that it should positively direct them not to take proceedings. He relies on *Re Pryce* [1917] 1 Ch 234, and *Re Kay's Settlement* [1939] Ch 329.
>
> Counsel for the second and third defendants [the children] have contended that, on the true view of the facts, there was an immediate settlement of the obligation created by the covenant, and not merely a covenant to settle something in the future. It was said, as counsel for the second defendant put it, that, by the agreement, Sir Herbert bought the rights arising under the covenant for the benefit of the *cestuis que trust* under the settlement and that, the covenant being made in favour of the trustees, these rights became assets of the trust. He relied on *Fletcher v Fletcher*, (1844) 4 Hare 67; *Williamson v Codrington* (1750) 1 Ves Sen 511; and *Re Cavendish Browne's Settlement Trusts* (1916) 61 Sol Jo 27. I am not able to accept this argument. The covenant with which I am concerned did not, in my opinion, create a debt enforceable at law, that is to say, a property right, which, although to bear fruit only in the future and on a contingency, was capable of being made the subject of an immediate trust, as was held to be the case in *Fletcher v Fletcher*. Nor is this covenant associated with property which was the subject of an immediate trust, as in *Williamson v Codrington*. Nor did the covenant relate to property which then belonged to the covenantor, as in *Re Cavendish Browne's Settlement Trusts*. In contrast to all these cases, this covenant on its true construction is, in my opinion, an executory contract to settle a particular fund or particular funds of money which at the date of the covenant did not exist and which might never come into existence. It is analogous to a covenant to settle an expectation or to settle after-acquired property. The case, in my judgement, involves the law of contract, not the law of trusts. . . . Accordingly, the second and third defendants are not, in my judgement, entitled to require the trustees to take proceedings to enforce the covenant.

(The picture was subsequently sold for 760,000 guineas – *The Times*, 20 March 1965, p 10.)

Unfortunately, for those seeking clear judicial guidance *Re Cook's Settlement Trust* is ambiguous. It is uncertain whether Buckley J held that the covenant was a 'mere expectancy' which could not form the subject-matter of a trust, or whether there was simply no intention to create a trust of the benefit of the covenant. Moreover *Davenport v Bishopp* was not cited in the judgment. Uncertainty, therefore, still surrounds the status of covenants to settle future property. But *Re Cook's Settlement Trusts* does not undermine the basic proposition that the benefit of a covenant to settle *existing property* can be the subject-matter of a trust where the necessary intention is present.

What remains more questionable is the identification of the necessary intention. In the early case of *Fletcher v Fletcher* (1844) 4 Hare 67, the often-cited authority for the basic proposition just referred to, evidence of intention was very thin, assuming that the intention in question is that of the covenantor and not the covenantee (see Maudsley in Pound (ed) *Perspectives of Law* (1964) and Feltham (1982) 98 LQR 17 for consideration of this latter point). It is significant that *Fletcher v Fletcher* was decided at a time when courts were quite eager to construe precatory words as revealing an intention to create a trust. This was also before the full development of privity of contract doctrine with the resulting sceptical approach to attempts to circumvent privity by invoking a 'trust of a promise'. It must be doubted whether a modern court would reach the same result about the relevant intention.

One question is whether it would even be necessary for a modern court to trouble itself with such matters in light of the enactment of the Contracts (Rights of Third Parties) Act 1999, a point considered in the next section.

(4) Enforceability and the Contracts (Rights of Third Parties) Act 1999

It must be emphasised at the outset that in the absence of any consideration, whether provided by potential trustees or beneficiaries, a promise to create a trust remains just that, a voluntary promise to act. The settlor retains the freedom to resile from the promise.

But to revert to our earlier example what if in the immediate context A covenants with B to transfer £10,000 to be held on trust for C and D who, not having provided any consideration, are 'volunteers' in the eyes of equity? Under the 1999 Act the position of any third party or beneficiary of any contract entered into on or after 11 May 2000 is fundamentally altered (see generally Andrews [2001] 60(2) CLJ 353–381; Merkin (ed) *Privity of Contract* (2000)). Section 1(1) provides that a third party – C or D in our case – will acquire a right to 'enforce a term of the contract' if either of two limbs of an 'intention' test are satisfied. Under s 1(1) this test will be satisfied (i) where A and B have expressly stated that the contract term is to be so enforceable (s 1(1)(a)) or (ii) where a term of the contract purports to confer a benefit on the third party unless 'on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party' (s1(1)(b), (2)). Unfortunately the meaning of the term 'enforce' is not elaborated on although under s 1(5) it is stated that '. . . there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief shall apply accordingly)'. In our example under the terms of the statute C and D would be treated as parties to the covenant and able to sue for damages. This largely replicates the position under the pre-existing case law whereby if a volunteer beneficiary was also a party to the deed she was able to sue upon it for common law damages (*Cannon v Hartley* [1949]

Ch 213). But because the beneficiary in that case was a volunteer she would not have been able to obtain the equitable remedy of specific performance.

There is some doubt as to how far that equitable remedy is available under s 1(5). Leaving the example of a covenant to one side for the moment, s 1(5) would appear to mean that where a contract between A and B is supported by consideration then the third party can obtain the equitable remedy of specific performance of the contract in the circumstances where 'the rules . . . apply', for example, where the subject-matter is such that an award of damages would not be appropriate. After all under the terms of the legislation the volunteer third party is to be treated 'as if he had been a party to the contract'. This outcome does, however, depend on there being consideration to support the agreement. To this extent at least the legislation would seem to create an exception to the maxim that 'equity does not assist a volunteer'. But what then is the position of the volunteer beneficiary of a covenant since at equity a covenant is not regarded as satisfying the consideration requirement even though at common law the covenant does meet this requirement? It can be argued that all that the legislation does is to treat the volunteer beneficiary as if she were a party to the deed, enabling her to sue for damages but, by analogy with *Cannon v Hartley*, not to obtain specific performance of the covenant (see *Hanbury and Martin*, p 130). An alternative starting-point for analysis is to ask whether there is a sound legal policy reason for adopting a position whereby the only third party who cannot seek specific performance of a contract or covenant is the volunteer beneficiary of the covenant. An answer may simply be that the 1999 Act deals essentially with the issue of privity and does not purport to alter, for instance, the requirement that a contract be supported by consideration nor what constitutes consideration under the rules of equity. The matter cannot be seen as settled, however, and the outcome may depend on how much weight should be given in the immediate context to the post-*Choithram* version of 'equity will not assist a volunteer'.

(5) Covenants, intention and legal policy

The question remains: 'Should the covenantor be made to implement his undertaking on behalf of the volunteers or not?' The response that this matter has been resolved by the Contracts (Rights of Third Parties) Act 1999 is tempting but possibly misleading. The 1999 Act is not retrospective and therefore does not affect pre-existing covenants and to that extent the previous learning has continuing relevance. More importantly there remain some uncertainties about the interpretation of the statute. Aside from those already discussed there is an argument that the law as represented by cases such as *Re Pryce* and *Re Kay's Settlement* is unaffected by the statutory change. Gardner, for instance, points out that the third party's right to enforce a covenant is only as strong as the right of the promisee or covenantee (s 1(5)) and also under s 3(2) the promisor or covenantor will have the same defence as would be available if 'the proceedings had been brought by the promisee' (*An Introduction to the Law of Trusts* (2003) p 74). It will be recalled that under the old much-criticised law, as represented by cases such as *Re Pryce*, it was at the very least doubtful whether the court would permit a trustee-covenantee to enforce the covenant and obtain an award of damages where this would have the effect of sidestepping the 'equity will not assist a volunteer maxim' and thereby enable volunteer-beneficiaries to obtain by indirect means what they could not obtain by directly enforcing the covenant themselves. Gardner concludes that 'under the 1999 Act, the beneficiary should likewise be unable to enforce it'. Accepting this as a tenable if literalist interpretation of the Act, one might nevertheless question whether a purposive construction of the statute might not lead to a different conclusion. After all the whole tenor of the Act is to assist the volunteer third party and thereby undermine to some degree the equitable maxim. It would be strange therefore if the courts were to interpret the Act in a way that supported cases whose reasoning has been questioned and whose rationale is rendered almost otiose by the Act.

This indirectly returns us to the question of legal policy. A more liberal approach to voluntary covenants for the benefit of third parties is adopted in the US where the *Restatement of Trusts* (2nd edn) para 26n prescribes that 'in the absence of evidence of a different intention, the inference is that the promisee immediately becomes trustee of his rights under the promise' (also see Feltham (1982) 98 LQR 17 who supports this presumption; cf *Underhill and Hayton* pp 170–172, for a contrary argument where the covenant relates to future property).

But the acceptability of this or other presumptions depends, to reiterate the point, on what is perceived as desirable policy. This in turn depends on what justification if any can be advanced for enforcing gratuitous promises, where the intended beneficiary has suffered no detriment and placed no reliance on the promise. And judgment on this issue needs to take account of the form of the promise – the covenant.

Is the existence of a covenant a sufficient reason in itself for permitting enforcement by or at the behest of volunteers? Concentration on the form of the promise shifts the focus from the status of the third party as volunteer to the intention of the promisor. Does the act of formally promising in a covenant to settle property for volunteer third parties indicate an intention to be bound to them by that promise? On this it has been said, in relation to the no longer applicable requirement of a seal, that 'the affixing and impressing of a wax wafer – symbol in the popular mind of legalism and weightiness – was an excellent device for inducing the circumspective frame of mind appropriate in one pledging his future' (Fuller (1941) 41 Col LR 799 at 800). But the result of circumspection must be an intention to make an irrevocable promise if it is to be assumed that the benefit of a covenant is to be held by the promisee on trust for third parties. Are there circumstances in which a settlor who goes through the ritual of covenanting to settle property would wish to retain the choice whether or not subsequently to transfer the property? (See Feltham (1982) 98 LQR 17 at 18–19.)

Given this range of policy choices, it is initially surprising, and unfortunate for those seeking an articulation of policy premises, that the outcome of a dispute involving a covenant to settle property may depend on wholly fortuitous circumstances, as occurred in *Re Ralli's Will Trust* [1963] 3 All ER 940. In this case a testator left his residuary estate on trust (the 1892 settlement) for his widow (W) for life with remainder to his two daughters Helen (H) and Irene (I) in equal shares. By a marriage settlement in 1924 H covenanted to assign her reversionary interest to the trustees of the settlement (the 1924 settlement) on trust, as events turned out, for I's children who were mere volunteers. H had not assigned the reversionary interest before her death in 1956. H pre-deceased W, who died in 1961, whereupon the reversionary interest fell into possession. The plaintiff (P), who was I's husband and the sole surviving trustee of the 1924 settlement was also the sole surviving trustee of the 1892 settlement, having been appointed a trustee in 1946. Should then P as trustee of the 1892 settlement pay H's share of the residue to her personal representatives or, as trustee of the 1924 settlement, retain it for the beneficiaries, I's children? Had the trusts of the 1924 settlement become completely constituted by the chance acquisition of the *legal estate* by P in his capacity as trustee of the 1892 settlement? Buckley J, on the facts, was able to hold that H had made a prior effective declaration of trust of the reversionary interest but went on to consider the 'complete constitution' point (at 946–948).

> **Buckley J:** In my judgement the circumstance that the plaintiff holds the fund because he was appointed a trustee of the will is irrelevant. He is at law the owner of the fund and the means by which he became so have no effect on the quality of his legal ownership. The question is: for whom, if anyone, does he hold the fund in equity? In other words, who can successfully assert in equity against him disentitling him to stand on his legal right? It seems to me to be indisputable that Helen, if she were alive, could not do so, for she has solemnly covenanted under seal to assign the fund to the plaintiff and the defendants can stand in no better position. It is, of course, true that the object of the covenant was not that the plaintiff should retain the property for his own benefit, but that he should hold it on the trusts of the settlement. It is also true that, if it were necessary to enforce performance of the covenant, equity would not assist the beneficiaries under the settlement, because they are mere volunteers; and that for the same reason the plaintiff, as trustee of the settlement, would not be bound to enforce the covenant and would not be constrained by the court to do so, and indeed, it seems, might be constrained by the court not to do so. As matters stand, however, there is no occasion to invoke the assistance of equity to enforce the performance of the covenant. It is for the defendants to invoke the assistance of equity to make good their claim to the fund. To do so successfully they must show that the plaintiff cannot conscientiously withhold it from them. When they seek to do this, he can point to the covenant which, in my judgement, relieves him from any fiduciary obligation that he would otherwise owe to the defendants as Helen's representatives. In so doing the plaintiff is not seeking to enforce an equitable remedy against the defendants on behalf of persons who could not enforce such a remedy themselves; he is relying on the combined effect of his legal ownership of the fund and his legal right to enforce the covenant . . .
>
> Had someone other than the plaintiff been the trustee of the will and held the fund, the result of this part of the case would, in my judgement, have been different; and it

> may seem strange that the rights of the parties should depend on the appointment of the plaintiff as trustee of the will in 1946, which for present purposes may have been a quite fortuitous event. The result, however, in my judgment, flows – and flows, I think, quite rationally – from the consideration that the rules of equity derive from the tenderness of a court of equity for the consciences of the parties. There would have been nothing unconscientious in Helen or her personal representatives asserting her equitable interest under the trusts of the will against a trustee who was not a covenantee under cl 7 of the settlement, and it would have been unconscientious for such a trustee to disregard those interests. Having obtained a transfer of the fund, it would not have been unconscientious in Helen to refuse to honour her covenant, because the beneficiaries under her settlement were mere volunteers; nor seemingly would the court have regarded it as unconscientious in the plaintiff to have abstained from enforcing the covenant either specifically or in damages, for the reason, apparently that he would have been under no obligation to obtain for the volunteers indirectly what they could not obtain directly. In such circumstances Helen or her personal representatives could have got and retained the fund. In the circumstances of the present case, on the other hand, it is not unconscientious in the plaintiff to withhold from Helen's estate the fund which Helen covenanted that he should receive: on the contrary, it would have been unconscientious in Helen to seek to deprive the plaintiff of that fund, and her personal representatives can be in no better position. The inadequacy of the volunteers' equity against Helen and her estate consequently is irrelevant, for that equity does not come into play; but they have a good equity against the plaintiff, because it would be unconscientious in him to retain as against them any property which he holds in consequence of the provisions of the settlement.
>
> For these reasons I am of opinion that in the events which have happened the plaintiff now holds the fund in question on the trusts of the marriage settlement, and I will so declare.

Just as a narrow, one might say fortuitous, event would have decided the case, had the issue discussed above been relevant, similarly a narrow meaning is attributed to conscience here. This is not conscience in any broad sense of 'fairness' but conscience in the precise sense that it would be 'unconscientious' for the personal representatives of H, standing in her place, to establish their claim by breaking the promise made to the covenantee/trustee. In short conscience follows legal form here.

Wherever the balance of policy argument concerning enforcement of voluntary covenants in general by third parties may lie, additional considerations arise where the subject-matter of the covenant is future property. Gardner, for instance, seeks to explain (pp 74–78) what he perceives to be the 'doctrinally dubious' decisions of the turn of the twentieth century (eg *Re D'Angibau* (1880) 15 Ch D 228; *Re Pryce* [1917] 1 Ch 234) in terms of a shift in judicial policy. He suggests that these are attributable to an emerging judicial scepticism towards the institution of marriage settlements, a scepticism reflecting, in Gardner's view, the influence of economic liberalism. Lee ((1969) 85 LQR 213) too has argued, although with a very different doctrinal analysis of the cases, that the recognition of marriage consideration in family settlements, thus permitting enforcement of covenants to settle after-acquired property, represented a breach with equitable principle explicable purely on contemporary public policy grounds. With the virtual disappearance of marriage settlements 'the reasons of public policy belong to a closed chapter of legal history' (at 227). Conversely it is said (Barton (1975) 91 LQR 236 at 246) that the restrictive approach evident in the later cases has imposed 'quite arbitrary limitations upon the employment of that very useful device, the trust'. Whereas these disagreements may reflect fundamental differences about the applicability of the relevant principles of equity and trusts law, they also, as we have previously suggested, have broader public policy implications. Acceptance of the enforceability of voluntary covenants to settle after-acquired property could materially increase the scope of the trust to facilitate dispositions of property rights over time. It is an open question whether the additional flexibility is necessary or desirable. (See eg Lindsay and Ziegler 'Trust of an Interest in a Discretionary Trust – Is it Possible?' (1986) 60 ALJ 387.)

(6) Exceptions to the maxim 'Equity will not assist a volunteer'

These are briefly summarised here for reference purposes only (cf *Hanbury and Martin* pp 142–148; *Pettit* pp 115–122, where the exceptions are considered at greater length):

(i) The rule in *Strong v Bird*. Where a donor (A) has attempted to make a gift inter vivos to the donee (B) but the gift is not completed through failure to comply with the necessary formalities, then, if B is subsequently appointed as A's executor or administrator the vesting of the legal title in B is treated as completing the gift. A gift can include, as indeed was the case in *Strong v Bird*, the release of a debt. For the rule to apply there must have been a continuing intention on the part of the donor to complete the gift during his lifetime. The consequence of the rule is that the claims of the beneficiaries under the will or on an intestacy are overridden. Whilst it is possible to view the rule as an illustration of the exceptions to the maxim, it would seem equally plausible to locate the rule alongside cases such as *Re Rose* (above p 132) and *Re Ralli's Will Trust* as illustrations of 'widened circumstances in which equity is willing to find that a transfer has in fact been completed' however fortuitous or accidental that act of completion might be (see Pearce and Stevens *The Law of Trusts and Equitable Obligations* (3rd edn, 2002) p 182).

(ii) *Donatio mortis causa* (see above p 151 and generally Borkowski *Deathbed Gifts – The Law of Donatio Mortis Causa* (1999)).

(iii) Proprietary estoppel. It is now well established that in circumstances where a promisor makes some promise to a volunteer promisee as to future rights over property and the promisee acts to their detriment in reliance on the promise, then the promisor will be prevented ('estopped') from going back on the promise. The approach taken by the courts to raising a 'proprietary estoppel' and awarding an appropriate remedy are examined in some detail in Chapter 12 since it is most often in the context of property disputes between partners that the boundaries of the doctrine are being established. It is sufficient to note for the moment that it is yet another legal context in which all the elements of the doctrine are permeated by 'the fundamental principle that equity is concerned to prevent unconscionable conduct' (per Robert Walker LJ in *Gillett v Holt* [2001] Ch 210 at p 225).

(iv) There is a statutory exception to the maxim although here again it can equally be interpreted as a completion of an imperfect gift. We saw earlier in the chapter that a minor cannot hold a legal estate in land (LPA 1925, s 1(6)). An attempt to convey a legal estate in land to a minor operates as a declaration that the land is held in trust for the minor (Trusts of Land and Appointment of Trustees Act 1996, Sch 1, para 1 replacing Settled Land Act 1925, s 27).

(d) Intention to create a binding trust obligation: conclusion

We observed earlier that a feature distinguishing a gift by trust from an absolute gift, and one central to the concept of an express trust, is the intention to subject oneself to or impose on some other the obligations of trusteeship. Without this there is no express trust. Of course in the vast majority of cases settlors impose trusteeship on others or themselves because that is what they want to do. It might even be claimed that if courts were to permit third parties to enforce voluntary covenants they would be implementing the covenantor's implied intention previously frustrated by strict application of principles of equity. The technique adopted might involve what Lord Diplock has termed 'a juristic subterfuge' (in *Swain v Law Society* [1982] 2 All ER 827 at 832) construing the presence of a specific intention. Many of the rules we have been considering in this section are what might be labelled 'rules of construction' directed towards identifying the intention of the donor or settlor. Yet the borderline cases that arise are frequently just that because clear words of intention do not exist, and the uncertainties of behaviour and language open up leeway for the courts.

Where there is leeway there is temptation to use the vagueness generated by notions of intention to do justice by imposing trust obligations. The result is that some people might get trusts imposed not because they want them but because they 'deserve' them. Although *Paul v Constance* presents some difficulties for technical analysis, probably few would disagree that Mrs Constance's claim was lacking in merit. Similar sentiments might be expressed about the merits of discovering the requisite 'intention' in *Gold v Hill* (see p 165) or even in the commercial context of *Don King Productions Inc v Warren* [1998] 2 All ER 608 (see also *Rowe v Prance* [1999] 2 FLR 787 where on limited evidence the court 'identified' an intention to create an express trust of 'our houseboat'; criticised in Baughen [2000] Conv 58)). But Hackney's warning on the temptation to do justice is apposite: 'encroachment on the proper sphere of moral regulation is a constant danger' ('The Politics of Chancery' (1981) 34 CLP 113). Thus the courts might easily slip into the assumption that the imposition and acceptance of obligations necessarily involves 'binding legal obligations'. *Ottaway v Norman* and *Re Snowden* plainly demand to be considered and contrasted in this light (see Hackney [1971] ASLC 384 at 384–385, for a critical assessment of the 'merits' in *Ottaway v Norman*). But leeway does not imply unfettered discretion. Consequently, although there are occasions where the borderlines between gift, promise to declare a trust and declaration of trust become blurred, there is scant evidence, *Paul v Constance* notwithstanding, that equity will yet perfect 'imperfect gifts' by construing them as 'declarations of trust', or readily recognise a 'voluntary covenant to create a trust' as implying a 'present declaration of trust' (but cf *Pennington v Waine* at p 137 and the uncertain ambit of unconscionability applied in that case).

One final point calls for speculation. Intention, we said earlier, is one of the hallmarks of an express trust; it is at the heart of the fundamental distinction between express trusts and constructive trusts imposed by the courts. In *Paul v Constance* Scarman LJ observed that 'one must exclude from one's mind any case built on the existence of an implied or constructive trust'. Possibly *Paul v Constance* was argued that way because the facts did not fit within any recognised category which would have supported the imposition of a constructive trust, although it is interesting to speculate on the consequences had the property in *Paul v Constance* been an owner-occupied house (cf Chapter 12, p 581). Irrespective of this the court was able to find the necessary intention and so, at a conceptual level, the fundamental distinction remains undisturbed. But is the flexibility provided by 'intention' such that on admittedly rare occasions, the distinction cannot be sustained in substance? Discovering 'intention' or deeming it to be present can then become one of the mechanisms by which the courts pursue the original jurisdiction of Chancery: doing justice in the interests of 'good conscience'.

5. Trusts creation and resulting trusts

A key performer in the *Vandervell* saga, which concludes this chapter, is a resulting trust. This point in the chapter therefore provides a convenient and appropriate forum for introducing the resulting trust in more detail, particularly as Megarry J subjected the concept to detailed analysis in the course of the *Vandervell* litigation. Subsequently doubt has been cast on elements of that analysis (see below) and debate about the theoretical basis for resulting trusts has proliferated. Nevertheless in our view the functional categorisation developed by Megarry J still has descriptive and analytical merit and provides an appropriate starting-point for understanding the nature of current controversies in this area of the law.

We have already briefly encountered two occasions when a resulting trust can occur: where the share of beneficial interests in a trust fund is uncertain and where an alleged half-secret trust is not established. In both cases, as the express trust fails and as the trustee plainly cannot take beneficially, the equitable interest in the property must reside somewhere and it goes back, or 'results back', to the transferor. Such a resulting trust can arise in a wide variety of circumstances. Further examples occur if there is a failure to dispose completely of the beneficial interest such as where A transfers property to trustees on trust for B for life but fails to dispose of the equitable remainder, or for B on attaining age 25 and B does not. These are all instances of trust failure and have been categorised as automatic resulting trusts – being imputed automatically to fill in the gap in beneficial ownership. Failure to create a trust effectively will not always bring about a resulting trust (see *Re Vandervell's Trusts (No 2)*, below). Accordingly, where in circumstances such as those in *Re Snowden* there is a failure of certainty of intention to impose a legally binding obligation of trusteeship the person in whom legal title to property is vested holds it for himself absolutely.

A second and distinct form of resulting trust, a 'presumed resulting trust', is briefly outlined below and examined in some detail in Chapter 12 (*Imputed trusts and family breakdown*). It is in that context that the relevant presumption has been most clearly articulated and criticised. In principle the presumption is said to reflect the implied intention of the transferor (A) of property that the transferee should hold it on trust for A's benefit. As will be seen in Chapter 12 the presumption is rebuttable.

The rationale underpinning the automatic resulting trust could also be argued to be respect for presumed intention. It envisages the settlor saying 'I would like the property returned to me if for some unforeseen reason my original gift fails'. This may seem a safe and sensible assumption for the law to make and is now consistent with current judicial thinking although slightly at variance with that of Megarry J in *Re Vandervell's Trusts (No 2)*. Moreover in the context of tax law, as the *Vandervell* litigation demonstrates, a resulting trust is a cruel kindness and probably the least desirable result for the unfortunate, unwise or ill-advised settlor.

Re Vandervell's Trusts (No 2) [1974] 1 All ER 47 at 68

Megarry J: It seems to me that the relevant points on resulting trusts may be put in a series of propositions . . . The propositions are the broadest of generalisations, and do not purport to cover the exceptions and qualifications that doubtless exist. Nevertheless, these generalisations at least provide a starting point for the classification of a corner of equity which might benefit from some attempt at classification. The propositions are as follows.

(1) If a transaction fails to make any effective disposition of any interest it does nothing. This is so at law and in equity, and has nothing to do with resulting trusts.
(2) Normally the mere existence of some unexpressed intention in the breast of the owner of the property does nothing: there must at least be some expression of that intention before it can effect any result. To yearn is not to transfer.
(3) Before any doctrine of resulting trust can come into play, there must at least be some effective transaction which transfers or creates some interest in property.
(4) Where A effectually transfers to B (or creates in his favour) any interest in any property, whether legal or equitable, a resulting trust for A may arise in two distinct classes of cases . . .

    (a) The first case is where the transfer to B is not made on any trust. If, of course, it appears from the transfer that B is intended to hold on certain trusts, that will be decisive, and the case is not within this category; and similarly if it appears that B is intended to take beneficially. But in other cases there is a rebuttable presumption that B holds on a resulting trust for A. The question is not one of automatic consequences of a dispositive failure by A, but one of presumption: the property has been carried to B, and from the absence of consideration and any presumption of advancement B is presumed not only to hold the entire interest on trust, but also to hold the beneficial interest for A absolutely. The presumption thus establishes both that A is to take on trust and also what that trust is. Such resulting trusts may be called 'presumed resulting trusts'.

(b) The second class of case is where the transfer to B is made on trusts which leave some or all of the beneficial interest undisposed of. Here B automatically holds on a resulting trust for A to the extent that the beneficial interest has not been carried to him or others. The resulting trust here does not depend on any intentions or presumptions, but is the automatic consequence of A's failure to dispose of what is vested in him. Since ex hypothesi the transfer is on trust, the resulting trust does not establish the trust but merely carries back to A the beneficial interest that has not been disposed of. Such resulting trusts may be called 'automatic resulting trusts'.

(5) Where trustees hold property in trust for A, and it is they who, at A's direction, make the transfer to B, similar principles apply, even though on the face of the transaction the transferor appears to be the trustees and not A. If the transfer to B is on trust, B will hold any beneficial interest that has not been effectually disposed of on an automatic resulting trust for the true transferor, A. If the transfer to B is not on trust, there will be a rebuttable presumption that B holds on a resulting trust for A.

This characterisation of the circumstances that can give rise to a resulting trust was broadly endorsed by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 All ER 961 but with the addition of the following significant reservation about Megarry J's apparent dismissal of the role of 'intentions or presumptions' in 'automatic resulting trusts' (at 991):

> Both types of resulting trust are traditionally regarded as examples of trusts giving effect to the common intention of the parties. A resulting trust is not imposed by law against the intentions of the trustee (as is a constructive trust) but gives effect to his presumed intention. Megarry J in *Re Vandervell's Trusts (No 2)* suggests that a resulting trust of type B [4(b) above] does not depend on intention but operates automatically. I am not convinced that this is right. If the settlor has expressly, or by necessary implication, abandoned any beneficial interest in the trust property, there is in my view no resulting trust: the undisposed-of equitable interest vests in the Crown as bona vacantia: see *Re West Sussex Constabulary's Widows, Children and Benevolent (1930) Fund Trusts* [1970] 1 All ER 544.

At first glance these comments, made obiter, do no more than provide a modest gloss to Megarry J's classification by emphasising that the rationale for the 'automatic' resulting trust is rooted in what the law presumes the intention of the settlor to have been (see our comments above). Now this is, in our view, something of a fictional intention and it is difficult to escape from an analysis that functionally the law *is* imputing a trust almost in default to fill a gap in beneficial ownership. What the comments of Lord Browne-Wilkinson do emphasise, however, is that if the settlor has expressly or impliedly abandoned any beneficial interest in the trust property then the gap will be filled in a different manner, ie the bona vacantia option. We would suggest, however, that only on rare occasions will such an intention be revealed or discovered. The law does not readily assume abandonment of property. Consider, for instance, the recent case of *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399 where a clause in a pension trust deed stating that 'no moneys which at any time have been contributed by the Company . . . shall in any circumstances be repayable to the Company' did not prevent the Privy Council from holding that a resulting trust should be imposed in relation to surplus funds arising when the trust was found to be void (the ownership of surplus funds is discussed further in Chapters 13 (pension schemes) and 17 (unincorporated associations)). The explanation provided in the case by Lord Millett for this conclusion has, however, placed the interpretation of 'intention' at the forefront of theoretical discussion about the rationale for the resulting trust (at 1412, emphasis added):

> Like a constructive trust, a resulting trust arises by operation of law, though unlike a constructive trust it gives effect to intention. But it arises whether or not the transferor intended to retain a beneficial interest – he almost always does not – since it responds to the *absence of intention on his part to pass a beneficial interest to the recipient*. It may arise even where the transferor positively wished to part with the beneficial interest as in *Vandervell v IRC* [1967] 2 AC 291.

'Intention' here plays an almost negative role in that the focus is on the absence of intention to benefit the recipient or transferee. The onus is on that person to rebut the presumption that the transferor had no intention to benefit him or her. This formulation has certain advantages. One is that it highlights what Professor Birks identifies as 'a fine but important distinction between intent creative of rights as in an express trust . . . and intent conceived as a fact which, along with others, calls for the creation of rights by operation of law' (*An Introduction to the Law of Restitution* (1989) p 65). A second feature of the formulation is that it comfortably encompasses the fact situations in both 'automatic' and 'presumed resulting' trusts and, more particularly, may provide a more compelling rationale for the type of resulting trust in *Vandervell v IRC*. There are, however, disadvantages associated with the 'absence of intention to benefit' approach. First, strictly speaking, the opinion of Lord Millett in *Air Jamaica*, being that of the Privy Council, is of persuasive authority only and in so far as it conflicts with that of Lord Browne-Wilkinson in *Westdeutsche*, the latter must be preferred. Second, the formulation has the capacity to be over-inclusive in the sense that it predicates a position whereby a resulting trust might be possible whenever the recipient of property was not intended to take it beneficially. For some this is a positive attribute that can lead to a more extensive role for the resulting trust within the law of restitution in so far as it might provide a claimant with a proprietary interest rather than being left to a personal remedy alone (see in particular Chambers *Resulting Trusts* 1997). As was mentioned briefly in Chapter 1 at p 29 concern at the practical implications of such a development, particularly as regards creating a new class of secured creditors, underpinned its rejection by the majority in the House of Lords in *Westdeutsche*.

Where does this leave us? At the risk of over-simplification the basic proposition remains that resulting trusts arise by operation of law in the case of gifts – 'presumed resulting trusts' – and of trusts that fail but they may be displaced by evidence of a contrary intention on the part of the donor or settlor. Reverting back to the Megarry classification we are left with the following proposition: the classification still has descriptive value subject to the caveat, following Lord Browne-Wilkinson, that the label 'automatic resulting trust' is slightly misleading whilst reflecting what in most instances the law is in practice doing. There is one further point to note here concerning the weight to be attached to the analysis of Lord Browne-Wilkinson in *Westdeutsch*e. Swadling persuasively points out that the twofold analysis of Megarry was foreshadowed in the opinions of Lords Wilberforce and Upjohn in *Vandervell v IRC* [1967] 2 AC 291, the first stage of the *Vandervell* litigation (see 'Property' in Birks and Rose (eds) *Lessons of the Swaps Litigation* (2000) p 242 at pp 270–271). Lord Upjohn summarised the position this way (at 313, emphasis added):

> If A intends to give away all his beneficial interest in a piece of property and thinks he has done so but, by some mistake or accident or failure to comply with the requirements of the law, he has failed to do so, either wholly or partially, there will, *by operation of law*, be a resulting trust for him of the beneficial interest of which he had failed effectually to dispose.

This statement, arguably part of the ratio of the decision in the case, is, to put the point at its lowest, certainly more consistent with the Megarry classification of two types of resulting trust, one based on presumption and the other that operates irrespective of there being any intention, than that of Lord Browne-Wilkinson. This reinforces our view that in the absence of a suitable alternative label – might 'default resulting trust' do? – we should continue with the Megarry nomenclature whilst recognising that it is a not wholly accurate label of convenience, particularly if one is applying the analysis of Lord Browne-Wilkinson (cf Rickett and Grantham (2000) 116 LQR 15 at 19 who propose that 'the resulting trust and its foundational presumptions operate . . . simply as a series of default rules').

6. The *Vandervell* saga

(a) The background

Mr Guy Anthony Vandervell (V) was chairman, managing director and principal shareholder of a successful engineering company, Vandervell Products Ltd (VP).

Almost all the voting shares in the company were owned by V and a further 100,000 non-voting shares in the company were held by NP Bank Ltd on a bare trust for V absolutely. The only other substantial shareholder was a private trustee company, Vandervell Trustees Ltd (VT) which acted as trustee (1) of a 1949 settlement for V's children and (2) of a retirement and profit-sharing fund for employees of VP.

In 1958 V decided to provide the Royal College of Surgeons (RCS) with £150,000 to fund a chair in pharmacology.

The method agreed upon was that V should arrange for the transfer of the 100,000 non-voting shares to RCS and that VP should declare dividends on these shares to provide the necessary money. As part of the arrangement it was agreed that RCS should grant an option to VT to repurchase the shares for £5,000. This method had the following advantages:

(i) dividend income could be passed direct to RCS without being taxed in V's hands,
(ii) the RCS as a charity would probably be able to recover from the Inland Revenue income tax deducted at source from the dividends,
(iii) the declaration of dividends might help V to avoid a surtax assessment (an additional income tax levied then on high incomes) in respect of undistributed profits of VP which might have been deemed under the tax statutes to be part of V's income, and
(iv) a saving of future estate duty liability otherwise payable if V had retained ownership of the shares.

The subsequent litigation which arose out of the straightforward (sic) exercise occupied 38 days in court and resulted in two trips to the House of Lords and a further final visit to the Court of Appeal. The cases provide in Lord Reid's words 'an illustration of the folly of entering into an important transaction of an unusual character without first obtaining expert advice regarding tax liabilities which it may create' (*Vandervell v IRC* [1967] 1 All ER 1 at 3). More pertinently the cases also involve discussion of several of the issues canvassed in this chapter: the requirements for a valid declaration of trust, the ambit of LPA 1925, s 53(1)(c) concerning the disposition of equitable interests, the circumstances in which a resulting trust will be imposed and the present appropriateness of one rationale of the resulting trust – that it is helping to achieve the settlor's specific intention.

The legal issues raised are best examined in two stages relating to the periods 1958–61 and 1961–65.

(b) Stage 1: 1958–1961

In 1958 V instructed NP Bank to transfer the 100,000 non-voting shares to RCS and, as agreed, RCS granted the option by deed to VT. Unfortunately for V, as it later transpired, there was nothing 'in the deed to indicate whether the shares to be acquired on the exercise of the option were to be held by [VT] beneficially or on trust, and, if so, what trust. It was, indeed, too short and too simple' (per Megarry J *Re Vandervell's Trusts (No 2)* [1974] 1 All ER 47 at 54). Between 1958 and October

1961 VP declared dividends amounting to approximately £157,000, net of income tax, on the shares now owned by RCS.

In September 1961 the Inland Revenue assessed V to surtax on the dividends claiming that he had not divested himself absolutely of all interest in the shares.

Vandervell v IRC [1967] 1 All ER 1, HL
The Inland Revenue supported the assessment on two separate grounds.

(1) *The formalities argument.* The Revenue argued that the transfer by NP Bank to RCS transferred only a bare legal title to the shares and that the beneficial ownership remained in V (Vandervell) because he had not effected a disposition of his equitable interest in the shares in writing as required by LPA 1925, s 53(1)(c). The House of Lords unanimously rejected this argument.
(2) *The resulting trust argument.* The Revenue claimed that because there had been no declaration of the trusts of the option (see above) VT must hold the option (*not* the shares) on resulting trust for V. Consequently under Income Taxes Act 1952, s 415 (repealed in 1971) V had failed to divest himself completely of all interest in the shares.

The House of Lords by a 3:2 majority (Lords Upjohn, Pearce and Wilberforce; Lords Reid and Donovan dissenting) upheld the assessment to tax.

> **Lord Upjohn (Lord Pearce** concurring) (*on the formalities argument*): The object of the section [s 53(1)(c)], as was the object of the old Statute of Frauds, is to prevent hidden oral transactions in equitable interests in fraud of those truly entitled, and making it difficult if not impossible, for the trustees to ascertain who are in truth the beneficiaries. When the beneficial owner, however, owns the whole beneficial estate and is in a position to give directions to his bare trustee with regard to the legal as well as the equitable estate there can be no possible ground for invoking the section where the beneficial owner wants to deal with the legal estate as well as the equitable estate.
>
> I cannot agree with Diplock LJ ([1966] Ch 261 at 287) that prima facie a transfer of the legal estate carries with it the absolute beneficial interest in the property transferred; this plainly is not so, eg, the transfer may be on a change of trustee; it is a matter of intention in each case. If, however, the intention of the beneficial owner in directing the trustee to transfer the legal estate to X is that X should be the beneficial owner, I can see no reason for any further document or further words in the document assigning the legal estate also expressly transferring the beneficial interest; the greater includes the less. X may be wise to secure some evidence that the beneficial owner intended him to take the beneficial interest in case his beneficial title is challenged at a later date but it certainly cannot, in my opinion, be a statutory requirement that to effect its passing there must be some writing under s 53(1)(c).
>
> Counsel for the Crown admitted that where the legal and beneficial estate was vested in the legal owner and he desired to transfer the whole legal and beneficial estate to another he did not have to do more than transfer the legal estate and he did not have to comply with s 53(1)(c); and I can see no difference between that case and this.

> As I have said, that section is, in my opinion, directed to cases where dealings with the equitable estate are divorced from the legal estate. . . . To hold the contrary would make assignments unnecessarily complicated; if there had to be assignments in express terms of both legal and equitable interest that would make the section more productive of injustice than the supposed evils it was intended to prevent.
>
> [*on the resulting trust argument*] There are, as I see it, three possibilities. 1. That the trustee company was intended to take [the option] as trustee for the children's settlement of Dec 30, 1949. 2. That the trustee company should take beneficially, the taxpayer relying on his three friends and advisers, Messrs Robins, Green and Jobson, the directors and holders of all the shares in the trustee company, to carry out his wishes which from time to time should be intimated to them in the way of a gentleman's agreement, but having no power at law to enforce them. 3. That the trustee company should hold as trustee on such trusts as he or the trustee company should from time to time declare.
>
> My Lords, this question is really one of inference from primary facts, but having regard to the way in which the matter has developed I should be reluctant to differ from the courts below . . .
>
> I agree with the conclusions of the Court of Appeal [1966] Ch 261 and Plowman J that the intention was that the trustee company should hold on such trusts as might thereafter be declared.
>
> That is sufficient to dispose of the appeal, but one question was debated in the Court of Appeal, though not before your lordships, and that is whether the option was held by the trustee company on such trusts as the trustee company in its discretion should declare or as the taxpayer should declare. Once it is established that the trustee company held solely as trustee that, as the Court of Appeal held, matters not. The taxpayer could at any time revoke that discretion, if he had vested it in the trustee company.

On the formalities argument the decision can be described as convenient since V could have required his nominees NP to transfer the legal title in the shares to himself and then transferred the then unified legal and equitable interests to RCS without any need to comply with s 53(1)(c). V simply took a short-cut. It does appear that in everyday practice where nominees hold shares or securities it is not unusual for instructions to be given orally or, nowadays, electronically. But the question remains: does this rationalisation adequately explain how V's separate equitable interest could be transferred outside s 53(1)(c)? (See further Jones (1966) 24 CLJ 19; Spencer (1967) 31 Conv 175; Strauss (1967) 30 MLR 461; and for a recent interpretation invoking the doctrine of overreaching see Nolan [2002] 61(1) CLJ 169, although the author concedes (at 172) that 'the concept was nowhere applied in the case').

On the resulting trust point, in the opinion of the majority the failure to specify for whom VT was to hold the benefit of the option led to the conclusion that 'possibility 3' (above) applied. The inevitable result then of the initial failure to identify the beneficiaries of the option was succinctly stated by Lord Wilberforce (at 329): ‘But the equitable, or beneficial, interest cannot remain in the air: the consequence in law must be that it remains in the settlor . . .’

(c) Stage 2: 1961–1965

In response to the assessment to tax, VT on 11 October 1961, with V’s full oral agreement, exercised the option and paid RCS £5,000, the money being drawn from the funds of the children’s settlement. Then on 2 November 1961 VT’s solicitors informed the Revenue of the exercise of the option writing that ‘consequently [the] shares [in VP] will henceforth be held by [VT] upon trusts of the children’s settlement’. Between 1962 and 1964 V arranged for VP to declare dividends amounting to £769,580 net. On 19 January 1965 (the first day of the Court of Appeal hearing in *Vandervell v IRC*) V executed a deed of release by which he transferred to VT all ‘rights, title, or interest (if any)’ which he had retained in the option, the shares or the dividends, expressly declaring that the trustee company was to hold them on the trusts of the children’s settlement.

V died on 10 March 1967 having made no provision in his will for his children, saying expressly that this was because he had already provided for them by the settlement.

Between July and October 1967 V’s executors were assessed to surtax on the dividends declared between 1962 and 1964 on the grounds that V was beneficial owner of the shares until 19 January 1965. The executors, faced with a substantial tax bill, felt obliged to institute proceedings against VT, the trustees of the children’s settlement, claiming that they (the executors) were entitled in effect to the dividends. An attempt to have the Inland Revenue joined as a party in the proceedings was unsuccessful (*Vandervell Trustees Ltd v White* [1970] 3 All ER 16, HL).

The litigation then proceeded, ‘without the presence of the Revenue – whose claim . . . has caused all the trouble’ (Lord Denning in *Re Vandervell’s Trusts (No 2)*). Judgment for the executors would effectively result in the Inland Revenue’s claim being upheld. The executors succeeded before Megarry J ([1974] 1 All ER 47) on the basis that, following the exercise of the option, the shares were held on resulting trust for V absolutely subject only to a lien for £5,000 in favour of the children’s settlement.

Megarry J explained his conclusion on this point as follows:

> That issue is, in essence, whether trustees who hold an option on trust for X will hold the shares obtained by exercising that option on trust for Y merely because they used Y’s money in exercising the option. Authority apart, my answer would be an unhesitating no. The option belongs to X beneficially, and the money merely exercises rights which belong to X. Let the shares be worth £50,000 so then an option to purchase those shares for £5,000 is worth £45,000, and it will be seen at once what a monstrous result would be produced by allowing trustees to divert from their beneficiary X the benefits of what they hold for him merely because they used Y’s money instead of X’s.

The trustees' appeal against the decision was unanimously upheld – although with some hesitation on the part of Stephenson LJ – in the Court of Appeal (*Re Vandervell's Trusts (No 2)* [1974] 3 All ER 205, CA).

The judgments, which have been widely criticised (Clark (1974) 38 Conv 405; Hackney (1974) ASCL 528; Harris (1975) 38 MLR 557; Battersby (1979) 43 Conv 17; Green (1984) 47 MLR 385), present considerable difficulties of interpretation. We can only touch on a couple of the problems here – a close reading of the full judgments and criticisms of them is necessary for a more thorough understanding. Although there are distinct differences of emphasis in the judgments (cf Green above, who argues these are of substance), very broadly the Court of Appeal rejected the executors' claim because new trusts over the shares had been declared by VT (declaration of trust point) which displaced V's resulting equitable interest in the option without the need for compliance with s 53(1)(c) (the formalities point). Lord Denning MR and Lawton LJ were also prepared to hold that Vandervell was by his conduct estopped from denying the children's beneficial interest in the shares, but unfortunately they do not satisfactorily deal with the reasons given by Megarry J for rejecting the estoppel argument (see *Green* at p 418).

An indication of the conceptual difficulties associated with the formalities and declaration of trust points can be discerned in the following comments of Stephenson LJ:

> It is difficult to infer that [Mr Vandervell] intended to dispose or ever did dispose of something he did not know he had until the judgment of Plowman J in *Vandervell v IRC*, which led to the deed of 1965, enlightened him, or to find a disposition of it in the exercise by the trustee company in 1961 of its option to purchase the shares. And even if he had disposed of his interest, he did not dispose of it by any writing sufficient to comply with section 53(1)(c) of the Law of Property Act 1925.
>
> But Lord Denning MR and Lawton LJ are able to hold that no disposition is needed because (1) the option was held on such trusts as might thereafter be declared by the trustee company or Mr Vandervell himself, and (2) the trustee company has declared that it holds the shares in the children's settlement. I do not doubt the first, because it was apparently the view of the majority of the House of Lords in *Vandervell v IRC*. I should be more confident of the second if it had been pleaded or argued either here or below and we had had the benefit of the learned judge's views on it . . . I see, as perhaps did counsel, difficulties in the way of a limited company declaring a trust by parol or conduct and without a resolution of the board of directors, and difficulties also in the way of finding any declaration of trust by Mr Vandervell himself in October or November 1961, or any conduct then or later which would in law or equity estop him from denying that he made one.

(1) *Declaration of trust point.* The acts of the trustees that were deemed in the Court of Appeal sufficient to constitute a declaration of trust were (i) the use of the children's settlement money, (ii) payment of dividends to the children's settlement, and (iii) trustees' notification to the Inland Revenue. It has been suggested that 'the

second and third merely indicate what the trustees thought the position to be [ie no intention to declare a trust existed], while the first ignores [V's] beneficial ownership of the option' (*Hanbury and Martin* p 128; and see the judgment of Megarry J above). Moreover acts (ii) and (iii) occurred after the exercise of the option by the trustees. Trustees cannot usually declare a trust whether by conduct or otherwise but the House of Lords had already held in *Vandervell (No 1)* that 'the option was held by the trustee company on such trusts as the trustee company in its discretion should declare or as the taxpayer should declare'. Assuming VT were able to declare trusts 'by conduct' (as was arguably the case in *Paul v Constance* see p 157) are the above criticisms valid?

(2) *Formalities point.* Lord Denning suggests that 'a resulting trust for the settlor is born and dies without any writing at all'. Under LPA 1925, s 53(2) writing is not required for 'creation or operation of resulting . . . trusts'. Can 'operation' be said to include 'termination'?

Assume it is correct, as *Vandervell (No 2)* implies, that where trustees (eg VT) hold property on a resulting trust for a beneficiary (V) until V or VT declare new trusts then s 53(1)(c) does not apply to a declaration by VT. Should s 53(1)(c) apply where the declaration is made by V and if not, on what basis can *Vandervell (No 2)* be reconciled with *Grey v IRC* (above p 157)?

(3) *The 'hard case' point.* When all the technical arguments have been thoroughly aired it is still apparent that the Court of Appeal in *Vandervell (No 2)* was influenced by the perceived merits of the case and that a 'hard case' be avoided if possible. References to the lack of merit of the claims of Vandervell or his executors should not blind us to the fact that in substance it was the claim of the Inland Revenue that was being tested.

In evaluating the 'hard case' argument consider the following questions: (i) What intention(s) did Vandervell have in deciding to transfer the shares from his own beneficial ownership? (ii) Why was the particular mode of transfer adopted? (iii) Are the merits of the Inland Revenue's case the same for both periods? If not, why not?

Finally, should the hardship of the case be a consideration if tax liability is in issue? (See generally Chapter 3, and see Hackney [1981] CLP 113 at 125.)

(d) Epilogue

One outcome of *Re Vandervell's Trusts (No 2)* was that the Revenue withdrew the assessment to surtax for the period 1962–64. En route the *Vandervell* saga provided an example of the perils of shaky advice – allegedly 'through an imperfect knowledge of the law of trusts' (per Lord Wilberforce, *Vandervell v IRC* [1967] 1 All ER 1 at 13) – a comprehensive analysis of the principles of resulting trusts, a further illustration of the flexibility of 'intention to create a trust' and an example of judicial pragmatism in the Court of Appeal judgment in *Re Vandervell's Trusts (No 2)* of which it has been said: 'it is improbable that the result would have survived the crueller scrutiny of the House of Lords' (Green (1984) 47 MLR 385 at 420). A lasting legacy is the addition of a further gloss on the accepted learning on dealings in equitable interests. Quite what the constituents of the gloss are is not easy to state. *Vandervell v IRC* clearly supports a proposition that LPA 1925, s 53(1)(c) does not apply where the beneficial owner (A) directs a bare trustee (T) to transfer the legal estate to a third party (B) with the intention that B will also acquire the beneficial interest. *Re Vandervell's Trusts (No 2)* is much more obscure and one commentator despairingly concluded (Harris (1975) 38 MLR 557 at 603) that 'a "hard case" may have been avoided; but as to what law the decision may have made, only clarification in future decisions will reveal'.

5

Creating the trust – II

1. Introduction

On one level this chapter is simply concerned with completing the description of the necessary requirements for creating a valid express trust. This process provides a snapshot of the present rules relating to 'certainty of objects' and the 'beneficiary principle' whilst simultaneously identifying unresolved problems and teasing out inconsistencies. But as in other areas of law, the rules have not remained static and change here has been dramatic. Indeed in the last thirty or so years the courts have turned the world of 'certainty of objects' upside down and this dynamic aspect of law-making also deserves attention. A second level of study, therefore, is to examine the shifts that have occurred and to understand the how and why of change.

However, the starting place for this study has to be traced back much further, to the decision in *Morice v Bishop of Durham* (1804) 9 Ves 399. There Sir W Grant summarised the court's approach as follows:

> There can be no trust, over the exercise of which this Court will not assume a control; for an uncontrollable power of disposition would be ownership, and not trust. If there be a clear trust, but for uncertain objects, the property, that is the subject of the trust, is undisposed of, and the benefit of such trust must result to those, to whom the law gives the ownership in default of disposition by the former owner. But this doctrine does not hold good with regard to trusts for charity. Every other trust must have a definite object. There must be somebody, in whose favour the Court can decree performance.

This statement laid a firm foundation both for a certainty of objects requirement – the beneficiaries of a trust must be capable of being ascertained – and for its offshoot the beneficiary principle – every non-charitable trust must have a human beneficiary. It also strongly suggests that the reason for the requirements is rooted in the ability of the court to control a trust. Lord Eldon LC reaffirmed this link between control and requirements for trust validity when *Morice v Bishop of Durham* was appealed ((1805) 10 Ves 522 at 539–540):

> As it is a maxim, that the execution of a trust shall be under the control of the court, it must be of such a nature, that it can be under that control; so that the administration of it can be reviewed by the court; or, if the trustee dies, the court itself can execute

> the trust: a trust therefore, which, in case of maladministration could be reformed; and due administration directed; and then, unless the subject and the objects can be ascertained, upon principles, familiar in other cases, it must be decided, that the court can neither reform maladministration, nor direct a due administration.

The courts adopted a restrained view of their capacity to reform and administer a trust. It was not open to a court to act randomly or at its own discretion: any issue had to be justiciable. This in turn required the settlor to supply clear criteria by which the court, if called upon to do so, could execute the trust. From this requirement of enforceability based on justiciability, it seemed to follow logically that in a discretionary trust it would be inappropriate for a court to choose between competing claims or needs of beneficiaries. Consequently if called upon to administer or enforce the trust, the court would rely on the maxim 'Equality is equity' and order that property be distributed accordingly (*Kemp v Kemp* (1795) 5 Ves 849). Equal distribution amongst all beneficiaries clearly demands that they are all identifiable. Accordingly, if it could be said at the inception of the trust that it would not be possible to draw up a complete list of the potential beneficiaries then the purported trust would be void for uncertainty.

Whereas this line of reasoning provides an explanation for the emergence of a particular certainty of objects criterion, it is less apparent that it does so for the beneficiary principle, which has fully evolved only more recently. In fact this principle did not achieve complete recognition by the courts until Roxburgh J's judgment in *Re Astor's Settlement Trusts* [1952] Ch 534. Although the primary justification for the beneficiary principle can be located in the perceived needs of enforceability as expressed in *Morice v Bishop of Durham*, its pedigree is uncertain. Indeed it has been suggested (McKay (1973) 27 Conv (NS) 420 and 421) that the statement cited above by Sir W Grant in *Morice v Bishop of Durham* 'was often construed as indicating that the objects must be certain, rather than certain *and* human'. And there exist a few cases, now usually categorised as anomalous and not to be followed, where trusts for non-charitable purposes have been upheld. These have chiefly to do with the upkeep of animals or of monuments (see below, p 246). Over time, however, a gloss to the reasoning emerged, the emphasis shifting to stress the absence of anyone who could positively enforce the trust. Indeed the seeds of this 'enforceability' proposition are actually in the last sentence of the quote from Sir W Grant in *Morice* (above). The point was summarised by the Privy Council in *Leahy v A-G for New South Wales* [1959] AC 457 at 478: 'A trust may be created for the benefit of persons as *cestuis que trust* but not for a purpose or object unless the purpose or object be charitable. For a purpose or object cannot sue, but, if it be charitable, the Attorney-General can sue to enforce it.' Because of the meritorious aspects of charitable trusts, the state, under long-established rules, supplies a 'nominal claimant' (in the person of the Attorney-General) to enforce them (see Chapter 20): no such benefit is conferred on non-charitable trusts.

At the start of this section we mentioned the element of change, and the lines of reasoning outlined above have not proved immutable. There has been a significant shift in the perception of the court's ability to enforce and control a trust, a shift which accompanied a radical change in the certainty of objects requirement. Consequently, today it is possible confidently to state that the degree of certainty required will depend on what the settlor wants the trustees to do: the obligations about whom to pay, when to pay and how much to pay are recognised as being different for fixed trusts and discretionary trusts. The shift in judicial perceptions raises important questions. What is the engine of this change and is its momentum exhausted? In one sense the driving-force is to be found in a judicial willingness, albeit not universal, to be innovative. But this trite conclusion begs the pre-existing questions as to how did the issues get litigated and why there has been pressure on seemingly firmly established rules.

The absence of empirical research in this area is striking but one hypothesis is to look for a simple market solution of demand and supply. Creative lawyers responded to their clients' commercial and fiscal needs by seeking out and applying new mechanisms. Resting quietly on the legal supermarket shelf was one rather old mechanism, the discretionary trust: its earlier use was chiefly in the context of protective trusts (see Chapter 6). Lawyers took it down, dusted it off and turned it to new uses. But, as it transpired, these new uses raised fundamental issues for the law of trusts. Consequently pressure from the bottom up produced a novel challenge to the established law on certainty of objects. Arguably the judicial responses to this challenge have generated a conceptual revolution that has in turn raised questions both about the legitimacy and appropriateness of the beneficiary principle, and about where the balance of power should lie between the court, trustees and beneficiaries in controlling a trust. This last aspect is touched on in this chapter but is considered further in Chapter 11.

The occasioning of legal change via judicial innovation, even over an extended period, necessarily involves a shift, in Milsom's revealing phrase (*Historical Foundations of the Common Law* (2nd edn, 1981) p 8), from 'eyes-down' application of existing rules to an 'eyes-raised' appreciation of the implications of change. But implications for whom and in relation to what? Legal change in this context does not merely concern the principles and practice of the law of trusts but also has consequences for the effectiveness of fiscal policy. Can conflict about the desirability and direction of change be categorised as falling solely within the realm of regulating intra-family property relations, and as being between established but questionable trusts law principles and a purposive response to the demands raised by trust users? If so, proponents of change may argue this is 'lawyers' law' peculiarly suitable for judicial development. But what if those demands of trust users sprang from a desire to increase the flexibility of settlements, in the process requiring a relaxation of certainty of objects requirements, as a bulwark against increasing encroachment of Inland Revenue demands? Should not the broader fiscal policy implications of such legal development be a consideration? Or conversely can it be argued that it is not the function of the courts to allow the constraints of one public policy factor to 'hobble the common law in all classes of disputes' (per Lord Devlin in *Rookes v Barnard* [1964] AC 1129 at 1218 when considering a judicial innovation that out-flanked statutory protection afforded to strike organisers). The inference here is that if compensating adjustments in the interests of fiscal policy are considered necessary, then that is the function of legislation.

Yet we must be wary of any simple conclusion that a linear development can be traced between the post-1945 rise in the use of discretionary trusts for fiscal reasons and changes in certainty of objects requirements in trusts law. The relationship is both more complex and fluid, in part because the source of pressure for change was commercial as well as fiscal. The numbers of occupational pension schemes and employee benefit funds, of which discretionary trusts are frequently an integral element, sharply increased in the 1950s and 1960s, and prompted considerable litigation. The empirical question to be borne in mind therefore is how far a judicial decision arrived at in response to pressure in one sphere has provided the catalyst for possible unanticipated further development in the other sphere.

To understand and analyse the changes that have occurred in the rules concerning certainty of objects and the beneficiary principle, it is essential to appreciate that a settlement (or trust instrument) comprises a complex arrangement of trusts and what are termed powers. A digression into the nature of powers and the distinction between trusts and powers is therefore a necessary preliminary step to a study of those rules.

2. Trusts and powers

(a) Trusts and powers distinguished

A power is an authority to deal in certain ways with property where the person authorised does not own the property and indeed may not have any entitlement to it or proprietary interest in it. We shall meet powers at several points in this book. For instance, when the administration of trusts and the control of trustees are examined it will be seen that trustees are given – sometimes by statute, sometimes by the settlor – administrative powers such as powers of investment and delegation, power to appoint new trustees and others more mundane such as power to insure trust property.

In contrast there also exist powers of appointment, that is powers to select who are to be beneficial recipients of property or of benefits (such as income) accruing to property. It is these powers, which are equitable and must now operate behind a trust, that concern us here. The terminology applying to powers of appointment should be noted. The giver of a power is called the donor, the recipient the donee, and those who may (but not necessarily will) benefit from the exercise of the power are termed the objects of the power. When the power is exercised the donee becomes the appointor and those benefiting, the appointees. Where a donee dies without

(1) T1 and T2 shall hold the trust fund upon the trusts of this settlement

(2)	(3)	(4)	(5)	(6)	(7)
£5,000, income therefrom to W for life, capital to such of A, B, C as W shall in her absolute discretion appoint. ... In default of appointment to A, B, C in equal shares.	£5,000, income therefrom to W for life, capital to A, B, C in equal shares.	£5,000, income therefrom to W for life, capital to such of A, B, C as W in her absolute discretion may appoint.	£5,000 to be distributed among such of A, B, C, and in such proportions as my trustees shall think fit.	(a) £10,000, the income therefrom to be accumulated for a period of 21 years. (b) T1 and T2 may pay income arising in any one year to such of groups A-E as they think fit. (c) Capital and accumulated income to X, Y, Z in equal shares.	(a) £10,000 to apply the income therefrom for a period of 21 years for such of groups A-E as T1 and T2 think fit. (b) T1 and T2 may accumulate income and add it to capital. (c) Capital and accumulated income to X, Y, Z in equal shares.
Life interest with special power of appointment over capital.	Life interest with fixed-interest trust of remainder.	as per (2) or a 'trust power'	Discretionary trust	(a) Trust to accumulate (b) + mere power of appointment (c) Fixed interest trust	(a) Discretionary trust to distribute (b) + power of accumulation (c) Fixed interest trust

Figure 5.1 *Trusts and powers.*

exercising a power of appointment the property will devolve to those persons named as taking 'in default of appointment'. As the label implies, they are simply the people designated in the trust instrument as being entitled to the property if no appointment is made by the donee of the power. Although certainly not necessary, it is quite possible for the objects of the power and the takers in default of appointment to be the same people (see Figure 5.1, example (2)).

Powers of appointment are classified as general, special and intermediate (or hybrid) powers. A general power is one exercisable in favour of anyone in the world including the donee. It follows that to give a donee a general power is tantamount to making an outright gift. But as Rudden and Lawson note, 'since there is no obvious advantage to be gained by giving a person a general power to appoint to an interest instead of giving him the interest itself, general powers are not often met with in practice' (*An Introduction to the Law of Property* (2nd edn, 1982) p 101). Much more common is a special power: this is exercisable among named individuals or a class such as one's own children or the employees of a company. The fact that the donee may also qualify as an object of the power does not affect its status. As the name implies an intermediate (or hybrid) power falls in between a general and a specific power. This means that it is exercisable in favour of anyone *except for* specified individuals or classes. An example would be a power to appoint to anyone in the world except the donor and the donor's spouse.

Powers of appointment will often, but not necessarily, be given to trustees. For example a husband H may wish to leave property on trust for his widow W for life and then to their children A, B and C, but to give to W the authority to decide upon the children's shares. H can give W a special power of appointment amongst A, B and C, coupled with a 'gift over' in default of appointment to A, B and C, in equal shares in case W should fail to exercise the power (Figure 5.1, example (2)). But equally the power could be given to the trustees T1 and T2 to exercise. Either variant of example (2) may be compared with example (3) in Figure 5.1, where H has already decided that the property should be held by T1 and T2 on trust for W for life with remainder to A, B and C in equal shares. The comparison highlights a key distinction between trusts and powers. A trust obligation is imperative; in example (3) T1 and T2 must distribute the property in the manner specified. The exercise of a power, however, is discretionary – W is under no obligation to appoint in example (2) – and the existence of a gift over in default affords clear recognition of this. A gift over in default would be incompatible with the imperative duties imposed by a trust obligation. Regrettably, however, from the standpoint of ease of identification, the *absence* of a gift over is not decisive. The question whether there is a power or a trust is then one of construction of the language used, which may be ambiguous (see eg *Re Leek* [1967] Ch 1061). If there is no gift over and the disposition is construed as a power which has not been exercised, there will be a resulting trust of the property for the donor's estate (subject to the possibilities discussed in section (c) below).

(b) Trusts and powers compared: discretionary trusts and powers of appointment

A similarity between trusts and powers appears, and confusion begins to creep in, where a settlor decides to give his trustees discretion as to the allocation of property vested in them. He might authorise them to allocate amongst some only of the specified objects (if they so wish), but with the intention that this discretion *must* be exercised. This constitutes a discretionary trust (see Figure 5.1, example (5)). As already mentioned the imperative nature of the trust obligation marks a sharp conceptual distinction between a discretionary trust and a power of appointment but their predominant feature – the exercising of a discretion in selection – is similar. Examples (2) and (5) in Figure 5.1 are linguistically and conceptually distinguishable but the language used is not always so clear (cf example (4) considered below, p 203). Then questions will arise as to whether the particular provision in the trust instrument confers a power on the trustees to allocate benefit or imposes a duty on them to do this.

The potential difficulties are amply demonstrated by the extensive litigation on this issue (see Harris (1971) 87 LQR 31 where the cases are listed under footnotes 2 and 3). Indeed in the leading case of *McPhail v Doulton* [1970] 2 All ER 228, the High Court and a majority of the Court of Appeal considered that the disputed provision constituted a power of appointment, whereas the House of Lords unanimously agreed that it was a trust. Lord Wilberforce commented (at 240):

> . . . that what to one mind may appear as a power of distribution coupled with a trust to dispose of the undistributed surplus, by accumulation or otherwise, may to another appear as a trust for distribution coupled with a power to withhold a portion and accumulate or otherwise dispose of it. A layman and, I suspect, also a logician, would find it hard to understand what difference there is. [See Figure 5.1, examples (6) and (7).]

Why, then, if the distinction can be so obscure, does it matter? Whether a person is the object of a power held by trustees or the beneficiary of a discretionary trust makes little practical difference in terms of that person's entitlement to benefit; what, if anything, is received will depend on the exercise of someone else's discretion. There is, however, an essential difference. If a mere power is not exercised within the time stipulated (expressly or by implication) the property goes to those entitled in default of appointment. Their identity may be indicated by a gift over, as explained above, and may be wholly different from the objects of the power itself. On the other hand, if the benefits accruing under a discretionary trust are not allocated amongst the beneficiaries within the time and in the manner stipulated, the trustees are in breach of trust and the court can itself even take over the task of allocating benefit. Any such allocation will be amongst the stipulated class of beneficiaries. Furthermore, the distinction between a trust and power did have one particular practical consequence. The validity of an instrument could depend on whether the language created a trust or a power because the certainty of objects requirement was considered stricter for trusts than for powers.

Two similar cases, *Re Saxone Shoe Co Ltd's Trust Deed* [1962] 2 All ER 904 and *Re Sayer Trust* [1956] 3 All ER 600, demonstrate the problem. In both cases company benefit funds were established by trust deeds for, inter alia, 'employees and their dependants'. In *Re Sayer* the deed provided that 'the management committee is empowered to make payments' (a valid special power) whereas the deed in *Re Saxone* stated that 'the fund shall in the discretion of the directors be applicable . . .' (trust). The consequence was that the discretionary trust in *Re Saxone* was void under the then prevailing certainty of objects test for trusts, which required that all the possible beneficiaries be ascertainable. The inclusion of 'dependants' made this impossible. This 'list certainty' requirement, as it is called, did not extend to powers, a more liberal certainty of objects test being applied there. Where categorisation depends on such constructional niceties, arbitrariness is always a possible result. This outcome may be thought particularly unfortunate where both types of disposition are intended to achieve broadly the same objective. As Harris recognised:

> ' . . . [such arrangements] are always in substance much more like one another (being complex settlements) than they are like either simple trusts to distribute property in equal shares immediately . . . or simple powers to appoint conferred on donees in whom the property is not vested . . .' ((1971) 87 LQR 31 at 42).

Comparing examples (6) and (7) in Figure 5.1 with examples (2) and (3) illustrates this point. Furthermore a single will or settlement may contain a number of distinct dispositions – some trusts, some powers (see Figure 5.1) – which may be closely linked, as, for instance, in clauses (a), (b) and (c) in example (6). Yet, in analysing, each disposition must in general be taken separately.

As we shall see, the certainty tests for discretionary trusts and powers have been brought closer to each other by later decisions, so the implications of this question of characterisation are in practice less important.

(c) Trusts, powers and 'trust powers'

One fertile source of confusion, now also of limited practical significance, arose in the context of some family trust cases with a narrowly defined class of objects, such as children or other close relatives, amongst whom a selection was authorised to be made. Consider the position where property is held by T1 and T2 on trust for W for life then for such of A, B and C as W in her absolute discretion may appoint (Figure 5.1, example (4)). In practice the precise nature of W's discretion will be immaterial as long as it is exercised. But let us suppose that W dies without having exercised the discretion. There is no express gift over in default of appointment and the trustees, or the court if called upon, are therefore left to decide whether a trust or power was intended to be conferred on W. The consequences are different: if a trust, then some distribution amongst A, B and C must occur; if a power, then A, B and C are mere objects of a power who have no claim to the property, which will revert to the settlor's estate on a resulting trust. When faced with this conundrum the courts have on occasion resorted to what has been termed 'a trust power', in effect a trust in default of appointment, and authorised distribution of the property amongst the objects of the power.

Whilst some fine distinctions as to the nature of the 'trust' have been drawn in the cases (see in particular *Wilson v Duguid* (1883) 24 Ch D 244; and generally Unwin (1962) 26 Conv 92; Hopkins (1971) 29 CLJ 68; Bartlett and Stebbings [1984] Conv 227), it is clear that the courts infer the existence of a trust so as to implement the settlor's perceived general intention in favour of the specified class (see eg *Burrough v Philcox* (1840) 5 My & Cr 72 at 92). The inference of a trust power where there is no gift over in default expressed in the instrument is, however, a question of construction: there is no 'inflexible and artificial rule of construction' in favour of a trust power (*Re Combe* [1925] Ch 210 at 216, and see also *Re Weekes' Settlement* [1897] 1 Ch 289; and Hopkins, above at p 78). It may be that the courts have been more willing to imply a trust power where the objects are the settlor's children but the cases are not numerous. Where a trust power is imposed the courts generally apply the maxim 'Equality is equity' and order equal division amongst the objects.

It was this judicial preference for equal division and its corollary the 'list certainty' test of objects which proved so inappropriate for employee welfare trusts and the modern family discretionary trust, with a wide range of relations and other persons specified as beneficiaries. Such trusts, expressly or implicitly, authorise trustees to select *some only* of the beneficiaries (indeed, *one only* is possible) to receive benefit. In these circumstances equal distribution, as Lord Wilberforce recognised in *McPhail v Doulton* (see below), is probably the last thing the settlor wishes. Consequently, as will be seen, validating these new types of discretionary trust required a rejection of the claim that a court, if called upon to administer a discretionary trust, could do so only by authorising equal distribution amongst all the beneficiaries.

(d) Conclusion

Unfortunately one legacy of the 'trust power' referred to above has been to exacerbate a confusion of terminology that is rife in the cases and literature (see Bartlett and Stebbings [1984] Conv 227). What we have termed 'trust power' may also be called 'power in the nature of a trust' or 'power coupled with a duty'. To compound confusion it will be seen subsequently that in *McPhail v Doulton* [1970] 2 All ER 228 the term 'trust power' is treated as synonymous with 'discretionary trust'.

Clarity is not advanced by turning to powers of appointment. Whether special or intermediate, these are often labelled collectively as 'mere powers' or 'bare powers'. And when they are conferred on a trustee the expressions 'power collateral' or 'fiduciary power' may be encountered.

In the text we attempt to simplify the position and use the term 'discretionary trust' to describe an *imperative* duty to exercise a discretion to allocate benefit, given to trustees by settlors; and 'mere powers' as the collective title for powers of appointment given to trustees or to other donees.

3. Certainty of objects

(a) The developing law: discretionary trusts and mere powers

(1) The re-emergence of the discretionary trust

The discretionary trust did not evolve specifically as a tax-effective means of holding family property. Settlements on discretionary trusts had been known to conveyancers for generations, particularly as a crucial element in what came to be termed a protective trust (see Chapter 6). The function of the discretionary trust in that context was to protect the capital and income of the fund and consequently the beneficiaries from the results of the latter's improvidence. This was achieved by the simple artifice of giving the trustees a discretion to decide on the allocation of the income, so that no beneficiary had any right to a specific share of the trust income. A bankrupt beneficiary's creditors could establish no better right to the income than the beneficiary himself. The potential effectiveness of the discretionary trust as a tax-avoidance mechanism was therefore plain. By keeping vague the rights of beneficiaries of a trust, those rights are made more difficult to tax. In addition the discretionary trust offered an appealing flexibility to provide for unexpected eventualities, be they familial or fiscal. Cozens-Hardy Horne writing in 1957 (BTR 256) could comment that 'under modern conditions the Inland Revenue has been substituted for the trustee in bankruptcy, in the minds of settlors and their advisers, as the villain whose evil designs must be thwarted'.

But the discretionary trust could also usefully be turned to the more specifically commercially based functions described in the Introduction to this chapter. Much subsequent litigation was to centre on the validity of such trusts when drafted as private discretionary trusts. Leading twentieth-century decisions on the definition of 'charitable purposes' (see Chapter 19) made it more difficult to achieve these aims through charitable trusts. Grbich aptly summarised these developments in the following way: 'practitioners were forced by revenue stimuli and the practical necessity of business reality into the flexible realms of discretionary trusts' ((1974) 37 MLR 643 at 656). A question to be resolved was whether the flexibility was compatible with the prevailing certainty of objects requirements.

(2) The breakthrough: *Re Gestetner Settlement* [1953] Ch 672 and 'mere powers'

The settlement in question 'made by one Sigmund Gestetner, a man of great wealth' (per Harman J at 681) on 4 April 1951, contained trusts of capital and income for such members of a 'specified class' as the trustees should think fit; and in default of appointment for a residuary class comprising the settlor's children. The latter were also members of the wide 'specified class'. In short there was a discretionary settlement comprising a mere power of appointment in favour of a wide class with a gift in default to a narrow class whose membership would at all times be ascertainable. The width of the specified class was striking: it comprised four named individuals; any person living or thereafter born who was a descendant of the settlor's father or uncle; any spouse, widow or widower of any such person; five charitable bodies; any former employee of the settlor or his wife or widow or widower of such employee; any director or employee of Gestetner Ltd, or of any company of which the directors of Gestetner Ltd were also directors. The last category was of potentially enormous width. As Harman J expressed it (at 683) 'any of the six directors of Gestetner Ltd. . . . may take on tomorrow a new directorship which brings in a new stream of possible objects of the trustees' bounty . . .'. It was, not surprisingly, accepted that the 'specified class' was not one which was ascertainable at any given time.

The litigation, which was to have considerable tax-planning significance, arose only indirectly as a result of Inland Revenue intervention. The trustees paid £262 10s to one of the named charities who then sought to recover from the Inland Revenue the tax deducted at source. The Inland Revenue rejected the claim contending that the trusts were void for uncertainty. The trustees then sought the direction of the court. Such direction was necessary because, as was pointed out by counsel for the settlor's children (at 680) and accepted by the learned judge (at 685), 'it is surprising that there is no authority in cases or in textbooks, on what is the duty of trustees who have a discretionary power of (this) kind'. There was, however, authority (*Re Park* [1932] 1 Ch 580 and *Re Jones* [1945] Ch 105) to support the proposition 'that a power may be good although it is exercisable in favour of an indefinite class' (per Harman J at 685). But the two supporting cases were those where the powers of appointment had been given to donees who were not trustees. The question for decision was therefore novel. Counsel for the Inland Revenue Commissioners who were represented at the hearing emphasised the importance of the decision, and argued that (at 681) 'it would be quite contrary to the principles of trust law to allow a vague trust of this kind to be valid'.

Harman J recognised that trustees, unlike other donees of powers, were under a duty (at 688) 'to consider at all times . . . whether or no they are to distribute any and if so what part of the fund, and if so, to whom they should distribute it', but also considered that 'there is not any duty to distribute the whole of any income or capital'.

This distinction between 'duty to distribute' and 'duty to consider' was decisive in Harman J's opinion and, in the absence of clear authority, his approach was inclined towards respecting the settlor's intention if possible (at 688):

> **Harman J:** The settlor had good reason, I have no doubt, to trust the persons whom he appointed trustees; but I cannot see here that there is such a duty as makes it essential for these trustees, before parting with any income or capital, to survey the whole field, and to consider whether A is more deserving of bounty than B. That is a task which

> was and which must have been known to the settlor to be impossible, having regard to the ramifications of the persons who might become members of this class.
>
> If, therefore, there be no duty to distribute, but only a duty to consider, it does not seem to me that there is any authority binding on me to say that this whole trust [sic] is bad. In fact, there is no difficulty, as has been admitted, in ascertaining whether any given postulant is a member of the specified class. Of course, if that could not be ascertained the matter would be quite different, but of John Doe or Richard Roe it can be postulated easily enough whether he is or is not eligible to receive the settlor's bounty. There being no uncertainty in that sense, I am reluctant to introduce a notion of uncertainty in the other sense, by saying that the trustees must worry their heads to survey the world from China to Peru, when there are perfectly good objects of the class in England. Consequently, I am not minded to upset the scheme put forward by the settlor on the ground indicated, namely, that of uncertainty. There is no uncertainty in so far as it is quite certain whether particular individuals are objects of the power. What is not certain is how many objects there are; and it does not seem to me that such an uncertainty will invalidate a trust [sic] worded in this way. I accordingly declare the trust [sic] valid.

Note Harman J's description of the whole disposition as a 'trust'. On our terminology it would be a power of appointment vested in settlement trustees, coupled with a gift over on trust in default of appointment.

The creative aspect of this decision was quickly recognised: 'the case breaks entirely new ground on the relationship of powers, particularly hybrid powers, and trusts' ((1953) 17 Conv 240). Its considerable practical significance was also commented on in the periodical literature.

R E Megarry (1953) 69 LQR 309 at 310

> The practical importance of the *Gestetner Case* is that in recent years there has been a marked movement away from settlements conferring defined interests on each beneficiary towards settlements which confer wide discretionary powers and powers of appointment. An important reason for this is that if a beneficiary dies, estate duty will normally be payable, whereas no estate duty is payable solely by reason of the death of one of the mere objects of a power or discretionary trust. For this and other reasons, such powers and trusts have been much favoured in recent years, although there has been one school of thought which has refused to countenance such devices on the ground that any uncertainty as to those who constitute the objects may invalidate the entire scheme. The *Gestetner Case* may go far towards meeting these objections.

It can be argued that the expectation of all involved in the operation of a settlement such as that in *Gestetner* was that the default trust was unlikely ever to become operative, but served primarily as a necessary formal requirement of the settlement. The real intention was that the money, be it capital or income, should be distributed amongst the objects of the power of appointment just as much as if they were beneficiaries of a discretionary trust to distribute.

The practical importance of *Gestetner* was to be enhanced by a subsequent Court of Appeal decision on the certainty test for discretionary trusts to distribute.

(3) The advance checked: the *Broadway Cottages* case

In the course of his judgment in *Re Gestetner Settlement* Harman J, drawing a distinction between a discretionary trust to distribute and a mere power to do so, observed, obiter, that: 'if it is the trustee's duty to distribute the fund among a number of people, his task being to select which of those people shall be the objects of his bounty, then . . . there is much to be said for the view that he must be able to review the whole field in order to exercise his judgement properly' (at 685).

An opportunity for the point to be settled followed shortly in *IRC v Broadway Cottages Trust* [1955] Ch 20. By a settlement made in 1950 a settlor directed a sum of £80,000 to be held on trusts, inter alia, to apply the income for the benefit of all or any members of a wide class of beneficiaries including a charity, Broadway Cottages Trust. Here again the validity of the trust was only brought into question when the Inland Revenue refused to grant the charity exemption from income tax on income received from the settlement. The instrument was held by Wynn-Parry J at first instance to have created a trust for distribution of the income which was void for uncertainty. This decision was upheld in the Court of Appeal where it was conceded that it would be impossible at any given time to obtain a complete list of the beneficiaries though the description was sufficiently precise to say whether anyone was or was not within the description (ie the test for mere powers was satisfied).

Jenkins LJ, in giving the judgment of the Court of Appeal, based it squarely on the policy and principle as stated by Lord Eldon in *Morice v Bishop of Durham*. The taxpayers had pointed out that there was no practical difficulty in executing the trust, but the court was not swayed, although it was agreed that 'the argument had an attractive air of common sense'. Instead Jenkins LJ specifically adopted the 'list certainty' test, formulated in an earlier case (*Re Ogden* [1933] Ch 678), that 'a trust for such members of a given class of objects as the trustees shall select is void for uncertainty unless the whole range of objects eligible for selection is ascertained or capable of ascertainment'.

(4) Certainty unsatisfactory

The consequence of *Re Gestetner Settlement* [1953] Ch 672 and *IRC v Broadway Cottages Trust* [1955] Ch 20, was that different tests of certainty of objects were to be applied depending on whether, as a matter of construction, the particular disposition was held to fall either into the category of 'trusts' or into that of 'powers of appointment'. That its validity might depend on fine distinctions of language in frequently complex settlements containing a wide variety of 'trusts' and 'powers' was at the very least a pitfall for the unwary or ill-advised (though of course people establishing these settlements usually employ top-quality legal advice).

On the fiscal front this clearly posed an immediate danger since, if the certainty of objects requirement was not satisfied, a resulting trust might arise with potentially onerous income tax or estate duty consequences for the settlor. But from a tax-planning perspective there was potentially a further fiscal problem lurking below the horizon for those settlors who utilised a trust to distribute rather than rely on a mere power. Might the death of a beneficiary give rise to an estate duty liability? During the 1960s the House of Lords on two occasions mentioned this possibility (*Public Trustee v IRC* [1966] AC 520 and *Gartside v IRC* [1968] 1 All ER 121; see Hawkins [1968] BTR 351 for a detailed analysis of this question). As Lord Reid expressed it, 'you can say with absolute certainty that the individual rights of the beneficiaries when added up or taken together will extend to the whole income. You can have an equation $x + y + z = 100$, although you do not yet know the value of x or y or z. And that may lead to important results where the trust is of that character' (*Gartside v IRC* at 127). A doctrinal reason for the 'list certainty' requirement for discretionary trusts was thought to be linked to the function of the court: in default of distribution the court could not step in and exercise the trustees' discretion but would have to rely on the maxim 'Equality is equity'. The potential threat of the application of this maxim for estate duty liability was clear, as was the lesson to be drawn from it for tax planners. Maximum use should be made of mere powers and powers of accumulation.

The decision in *IRC v Broadway Cottages Trust* [1955] Ch 20 was also a minefield for benevolent fund trusts and pension schemes. In this commercial context the consequences of the 'fine distinction' in *Re Saxone* [1962] 2 All ER 904 and *Re Sayer Trust* [1956] 3 All ER 600 have already been referred to. But the potential seriousness of the problem went much wider than those individual cases which were litigated. The point was robustly expressed by W A Phillips, a pensions specialist ('Perils of Pension Scheme Trustees' (1967) 111 SJ 27 January 62):

> . . . hundreds of thousands of employed persons believe that their pension schemes provide a 'death in service' benefit, under a discretionary trust which, on examination, is found to be void for want of a completely ascertainable object because it includes 'dependants' among the possible beneficiaries without adequately, or at all, defining them.
>
> In a non-contributory scheme there is a resulting trust of the death benefit to the employer, who doubtless will pay out the money ex gratia to the intended beneficiary, incidentally avoiding estate duty . . . But an ex gratia payment, made at the employer's option, is not what the rules of the scheme purport to provide.
>
> In many schemes defective in this respect the trustees go on year after year gaily paying out the death benefit to the widow or the children, and it is not until a difficulty arises in locating anyone who the trustees feel comes within the discretion that legal advice is sought and the trustees learn to their dismay that they have repeatedly made payments *ultra vires*.

Almost from the time of confirmation of the 'list certainty' standard in *Broadway Cottages*, judicial misgivings were expressed about it. These misgivings increased (see Hopkins (1971) 29 CLJ 68 at 73, 83) as the courts were called upon to consider a series of cases centring on the discretionary trust-mere powers dichotomy and involving widely drawn classes of beneficiaries. Indeed, in the Court of Appeal itself, in 1961, Lord Evershed MR commented that 'the courts have quite plainly been . . . reluctant to hold (and if I may say so, naturally reluctant to hold) that a settlement which has been deliberately made is and was from the start invalid for uncertainty' (*Re Hain's Settlement* [1961] 1 WLR 440 at 447). Cross J subsequently endorsed this view, stating that he shared Lord Evershed's 'evident distaste . . . for the *Broadway Cottages* principle' (*Re Saxone* [1962] 2 All ER 904 at 914).

It is apparent with the benefit of hindsight that there existed fertile ground to support a change in the law. But when the opportunity arose sharp divisions in judicial opinions were exposed. Two judgments in the House of Lords in 1968 and 1970 concerning the trust deeds of Calouste Gulbenkian and Bertram Baden reshaped, and to some extent clarified, the certainty of objects requirements for mere powers and discretionary trusts respectively.

(b) Mere powers, certainty of objects and *Re Gulbenkian's Settlement Trusts*

The primary issue arising in *Gulbenkian* concerned the validity of an idiosyncratically drafted mere power containing among its objects 'persons with whom Nubar Gulbenkian may from time to time be employed or residing'. The power was similar in terms to one declared void for uncertainty in *Re Gresham's Settlement* [1956] 1 WLR 573. The trustees of the Gulbenkian settlement therefore took out a summons for direction in 1961. On a wider issue, doubt had emerged about the meaning to be attributed to the certainty criterion established in *Re Gestetner* [1953] Ch 672. Would a mere power be valid if it could be said with certainty that at least one person fell within the class of objects, or was it necessary to be able to say whether any given individual (not simply one) fell inside or outside the class?

The Court of Appeal held that the disputed clause in Calouste Gulbenkian's settlement was valid but in so doing Lord Denning MR and Winn LJ approved a 'one-person' certainty of objects criterion which required merely that, in Lord Denning's words: 'if the trustees can say of any particular person that he is clearly within the category, the gift is good' ([1968] Ch 126 at 134). Moreover Lord Denning, obiter, added his voice to those critical of the *Broadway Cottages* 'list certainty' test, suggesting that discretionary trusts should be 'brought into line' with mere powers.

The House of Lords unanimously agreed with the Court of Appeal that the disputed clause was not void for uncertainty. Lord Upjohn, giving the principal judgment, accepted that although 'difficult and borderline cases' may occur in applying the description of the class to individual cases, the court if called upon could resolve them by reference to the language in the instrument and the surrounding circumstances. If this appeared to loosen the certainty test, their Lordships (Lord Donovan reserving his opinion) also tightened it by rejecting the 'one-person' test proposed by Lord Denning. In addition the latter's plea for alignment of the certainty tests for trusts and powers was firmly rejected. Four members of the House expressly approved obiter, the 'list certainty' test for trusts (Lord Reid dissenting).

The reasoning of the majority with regard both to Lord Denning's 'one-person' test and his plea for alignment is expressed in the following extract from Lord Upjohn's judgment.

> *Re Gulbenkian's Settlement Trusts* [1968] 3 All ER 785 at 792, HL
>
> **Lord Upjohn:** I propose to make some general observations on this matter.
>
> If a donor (be he a settlor or testator) directs trustees to make some specified provision for 'John Smith', then to give legal effect to that provision it must be possible to identify 'John Smith'. If the donor knows three John Smiths then by the most elementary principles of law neither the trustees nor the court in their place can give effect to that provision; neither the trustees nor the court can guess at it. It must fail for uncertainty unless of course admissible evidence is available to point to a particular John Smith as the object of the donor's bounty.
>
> Then, taking it one stage further, suppose the donor directs that a fund, or the income of a fund, should be equally divided between members of a class. That class must be as defined as the individual; the court cannot guess at it. Suppose the donor directs that a fund be divided equally between 'my old friends', then unless there is some admissible evidence that the donor has given some special 'dictionary' meaning to that phrase which enables the trustees to identify the class with sufficient certainty, it is plainly bad as being too uncertain. Suppose that there appeared before the trustees (or the court) two or three individuals who plainly satisfied the test of being among 'my old friends' the trustees could not consistently with the donor's intentions accept them as claiming the whole or any defined part of the fund. They cannot claim the whole fund for they can show no title to it unless they prove they are the only members of the class, which of course they cannot do, and so, too, by parity of reasoning they cannot claim any defined part of the fund and there is no authority in the trustees or the court to make any distribution among a smaller class than that pointed out by the donor. The principle is, in my opinion, that the donor must make his intention sufficiently plain as to the objects of his trust and the court cannot give effect to it by misinterpreting his intention by dividing the fund merely among those present. Secondly, and perhaps it is the most hallowed principle, the Court of Chancery, which acts in default of trustees, must know with sufficient certainty the objects of the beneficence of the donor so as to execute the trust. Then, suppose the donor does not direct an equal division of his property among the class but gives a power of selection to his trustees among the class; exactly the same principles must apply. The trustees have a duty to select the donees of the donor's bounty from among the class designated by the donor; he has not entrusted them with any power to select the donees merely from among known claimants who are within the class, for that is constituting a narrower class and the donor has given them no power to do this.
>
> So if the class is insufficiently defined the donor's intentions must in such cases fail for uncertainty. Perhaps I should mention here that it is clear that the question of certainty must be determined as of the date of the document declaring the donor's intention (in the case of a will, his death). Normally the question of certainty will arise because of the ambiguity of definition of the class by reason of the language employed by the donor,

but occasionally owing to some of the curious settlements executed in recent years it may be quite impossible to construct even with all the available evidence anything like a class capable of definition (*Re Sayer Trust* [1957] Ch 423), though difficulty in doing so will not defeat the donor's intentions (*Re Hain's Settlement* [1961] 1 All ER 848). But I should add this: if the class is sufficiently defined by the donor the fact that it may be difficult to ascertain the whereabouts or continued existence of some of its members at the relevant time matters not. The trustees can apply to the court for directions to pay a share into court.

But when mere or bare powers are conferred on donees of the power (whether trustees or others) the matter is quite different. As I have already pointed out, the trustees have no duty to exercise it in the sense that they cannot be controlled in any way. If they fail to exercise it then those entitled in default of its exercise are entitled to the fund. Perhaps the contrast may be put forcibly in this way: in the first case it is a mere power to distribute with a gift over in default; in the second case it is a trust to distribute among the class defined by the donor with merely a power of selection within that class. The result is in the first case even if the class of appointees among whom the donees of the power may appoint is clear and ascertained and they are all of full age and sui juris, nevertheless they cannot compel the donees of the power to exercise it in their collective favour. If, however, it is a trust power, then those entitled are entitled (if they are of full age and sui juris) to compel the trustees to pay the fund over to them, unless the fund is income and the trustees have power to accumulate for the future.

Again the basic difference between a mere power and a trust power is that in the first case trustees owe no duty to exercise it and the relevant fund or income falls to be dealt with in accordance with the trusts in default of its exercise, whereas in the second case the trustees *must* exercise the power and in default the court will. It is briefly summarised in 30 Halsbury's Laws (3rd Edn), p 241, para 445:

> '. . . the court will not . . . compel trustees to exercise a purely discretionary power given to them; but will restrain the trustees from exercising the power improperly, and if it is coupled with a duty . . . can compel the trustees to perform their duty'.

It is a matter of construction whether the power is a mere power or a trust power and the use of inappropriate language is not decisive (*Wilson v Turner* (1883) 22 Ch D 521 at 525).

So, with all respect to the contrary view, I cannot myself see how, consistently with principle, it is possible to apply to the execution of a trust power the principles applicable to the permissible exercise by the donees, even if the trustees of mere powers; that would defeat the intention of donors completely.

But with respect to mere powers, while the court cannot compel the trustees to exercise their powers, yet those entitled to the fund in default must clearly be entitled to restrain the trustees from exercising it save among those within the power. So the trustees, or the court, must be able to say with certainty who is within and who is without the power. It is for this reason that I find myself unable to accept the broader proposition advanced by Lord Denning MR and Winn LJ. . . .

The *Gulbenkian* judgment firmly establishes that the test for certainty of objects for mere powers is 'whether it can be said with certainty that any given individual is or is not a member of the class'. As we shall see shortly, interpreting this test has in turn created problems. As regards the certainty of objects requirement for discretionary trusts, Lord Upjohn's judgment can be interpreted as implying that the court could not execute a 'trust power', as he calls it, where all the beneficiaries were not ascertainable because to do so would flout the settlor's specific intention, and, possibly, because the exercise of the discretion was not a justiciable issue. Although obiter, his comments on the appropriate test for 'trust powers' might have been thought for practical purposes to have settled this point. This was not to be so, for little more than twelve months later the House of Lords gave its judgment on Bertram Baden's deed in *McPhail v Doulton* [1970] 2 All ER 228.

(c) Discretionary trusts, certainty of objects and *McPhail v Doulton*

Bertram Baden, Chairman and Managing Director of Matthew Hall and Company Ltd, with some 1,300 employees, had by deed established the Matthew Hall Staff Trust Fund.

Clause 9(a) of Bertram Baden's trust deed provided as follows: 'the trustees shall apply the net income of the fund in making at their absolute discretion grants to or for the benefit of any of the officers and employees or ex-officers or ex-employees of the company or to any relatives or dependants of such persons in such amounts at such times and on such conditions (if any) as they think fit'. The trustees were not obliged to exhaust the income of any year and there was provision for accumulation of undistributed income. Given the width of the class of objects, the validity of the trust appeared to depend on whether trustees were given a discretionary power, or a duty of distribution. Mr Baden died in 1960 and a little over two years later, by which time the fund was worth £163,000, the executors challenged the validity of the trust deed. Accordingly the trustees then issued an originating summons to determine whether the deed was void for uncertainty. Goff J at first instance ([1967] 1 WLR 1457) held that the instrument created a mere power which was not void for uncertainty. Despite the apparent mandatory nature of 'shall apply' the Court of Appeal (Russell LJ dissenting) agreed with this. But to do so they adopted a constructional presumption to the effect that where competing interpretations of a provision are evenly balanced the court should prefer the one producing validity rather than invalidity (the doctrine of *ut res magis valeat quam pereat*). As to the distinction causing all the trouble, that between mere powers and discretionary trusts for purposes of certainty, Harman LJ confessed that 'it . . . is an absurd and embarrassing result brought about by a line of cases in recent years stemming I am sorry to say from my own decision in *Re Gestetner* . . .' (*Re Baden's Deed Trust* [1969] 2 Ch 388 at 397).

The executors appealed to the House of Lords. There were two changes in the panel from that hearing the *Gulbenkian* case. Lords Upjohn and Donovan were replaced by Viscount Dilhorne and Lord Wilberforce. The House unanimously reversed the Court of Appeal in holding that the disposition was a discretionary trust. But by a 3:2 majority (Lords Hodson and Guest dissenting, both of whom had concurred in Lord Upjohn's judgment in *Gulbenkian*) the House assimilated the certainty of objects test for discretionary trusts to that for mere powers.

McPhail v Doulton [1970] 2 All ER 228
What might be called the orthodox view was expressed as follows by Lord Hodson (dissenting):

> In my opinion a mere power is a different animal from a trust and the test of certainty in the case of trusts which stems from *Morice v Bishop of Durham* is valid and should not readily yield to the test which is sufficient in the case of mere powers.
>
> The unhappy results which may follow from incompetent drafting may be, in the case of an instrument held to impose a trust, that it is so much waste paper whereas in the case of an instrument differing perhaps on the face of it very little from the invalid trust instrument a good gift of a power to benefit objects may emerge. Thus it is said in order to avoid fine distinctions the test should be the same for both. One persuasive argument used is that, in applying the principle that where there is a trust the court must be in a position to exercise it, the court cannot exercise the trustees' discretion in the event of their failing to do so. The discretion being conferred on and exercisable by the trustees alone the court cannot do other than authorise a distribution in equal shares. This, in cases comparable with the present, must lead to a result tending towards absurdity and makes the strict test of certainty open to serious criticism. . . . For myself I do not deny that there is force in the argument based on the absurdity of an equal division especially as it has not always been accepted.
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> In what are called the relations cases, *Moseley v Moseley* (1673) Cas temp Finch 53; *Clarke v Turner* (1694) Freem Ch 198 and *Warburton v Warburton* (1702) 4 Bro Parl Cas 1, the court did exercise its own discretionary judgment against equal division. Similarly, in a different context the same principle was applied in *Richardson v Chapman* (1760) 7 Bro Parl Cas 318 where it appears from the reported argument that the court decreed the proper act to be done not by referring the matter to the trustee's discretion but by directing him to perform as a mere instrument the thing decreed. These cases may be explained as cases where there were indications which acted as pointers or guides to the trustees and enabled the court to substitute its own discretion for that of the trustees.
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> This practice, however, has fallen into desuetude and the modern, less flexible, practice has it appears been followed since 1801 when Sir Richard Aden MR in *Kemp v Kemp* (1795) 5 Ves 849 stated that the court now disclaims the right to execute a power and gives the fund equally. The basis of this change in policy appears to be that the court has not the same freedom of action as a trustee and must act judicially according to some principle or rule and not make a selection giving no reason as the trustees can. The court, it is said, is driven in the end to the principle that equity is equality unless, as in the relations cases, the court finds something to aid it. Where there is no guide given the court, it is said, has no right to substitute its own discretion for that of the designated trustees. I regret that the court is driven to adopt a non possumus attitude in

cases where trustees fail to exercise a trust power. . . . I have had the advantage of reading a speech which has been prepared by my noble and learned friend Lord Wilberforce whose opinion particularly on this topic is of very strong persuasive power. I cannot, however, bridge the gulf which still I think yawns between us. If one bases oneself, as I do, on the passage from Lord Eldon LC's judgment in *Morice v Bishop of Durham* as defining the features of a trust, it is, in my opinion, impermissible to sanction, in the case of an uncertain disposition in the sense of the passage quoted, the authorisation by the court of a scheme of distribution such as he suggests. I cannot accept that this is justified by stating that a wider range of enquiry is called for in the case of trust powers than in the case of powers (meaning 'mere' as opposed to 'trust powers'). To adopt this solution is I think to do the very thing which the court cannot do. As was pointed out by my noble and learned friend Lord Upjohn in the *Gulbenkian* case:

> 'The trustees have a duty to select the donees of the donor's bounty from among the class designated by the donor; he has not entrusted them with any power to select the donees merely from among claimants who are within the class, for that is constituting a narrower class and the donor has given them no power to do this.'

I have read and reread the speech of my noble and learned friend, Lord Wilberforce, with, I hope, a readiness to change my mind and to temper logic with convenience, but having given the best consideration I can to the problem, I still adhere to the view I have previously expressed in the *Broadway Cottages* case and in the *Gulbenkian* case as to the requirements for certainty in the case of the objects of a trust.

It was Lord Wilberforce (with whom Viscount Dilhorne and Lord Reid agreed) who broke new ground:

Lord Wilberforce: It is striking how narrow and in a sense artificial is the distinction, in cases such as the present, between trusts or, as the particular type of trust is called, trust powers, and powers. It is only necessary to read the learned judgments in the Court of Appeal to see that what to one mind may appear as a power of distribution coupled with a trust to dispose of the undistributed surplus, by accumulation or otherwise, may to another appear as a trust for distribution coupled with a power to withhold a portion and accumulate or otherwise dispose of it. A layman and, I suspect, also a logician, would find it hard to understand what difference there is.

It does not seem satisfactory that the entire validity of a disposition should depend on such delicate shading. And if one considers how in practice reasonable and competent trustees would act, and ought to act, in the two cases, surely a matter very relevant to the question of validity, the distinction appears even less significant. To say that there is no obligation to exercise a mere power and that no court will intervene to compel it, whereas a trust is mandatory and its execution may be compelled, may be legally correct enough, but the proposition does not contain an exhaustive comparison of the duties of persons who are trustees in the two cases. A trustee of an employees' benefit fund, whether given a power or a trust power, is still a trustee and he would surely consider in either case that he has a fiduciary duty; he is most likely to have been selected as a suitable person to administer it from his knowledge and experience, and would consider he has a responsibility to do so according to its purpose. It would be a complete misdescription of his position to say that, if what he has is a power unaccompanied by an imperative trust to distribute, he cannot be controlled by the court unless he exercised it capriciously, or outside the field permitted by the trust (cf *Farwell on Powers*, 3rd edn, p 524). Any trustee would surely make it his duty to know what is the permissible area of selection and then consider responsibly, in individual cases, whether a contemplated beneficiary was within the power and whether, in relation to other possible claimants, a particular grant was appropriate.

Correspondingly a trustee with a duty to distribute, particularly among a potentially very large class, would surely never require the preparation of a complete list of names, which anyhow would tell him little that he needs to know. He would examine the field, by class and category; might indeed make diligent and careful enquiries, depending on how much money he had to give away and the means at his disposal, as to the composition and needs of particular categories and of individuals within them; decide on certain priorities or proportions, and then select individuals according to their needs or qualifications. If he acts in this manner, can it really be said that he is not carrying out the trust?

Differences there certainly are between trusts (trust powers) and powers, but as regards validity should they be so great as that in one case complete, or practically complete ascertainment is needed, but not in the other? Such distinction as there is would seem to lie in the extent of the survey which the trustee is required to carry out; if he has to distribute the whole of a fund's income, he must necessarily make a wider and more systematic survey than if his duty is expressed in terms of a power to make grants. But just as, in the case of a power, it is possible to underestimate the fiduciary obligation of the trustee to whom it is given, so, in the case of a trust (trust power), the danger lies in overstating what the trustee requires to know or to enquire into before he can properly execute his trust. The difference may be one of degree rather than of principle; in the well-known words of Sir George Farwell (*Farwell on Powers*, 3rd edn, p 10) trusts and powers are often blended, and the mixture may vary in its ingredients.

[Lord Wilberforce agreed that clause 9(a) constituted a trust and then considered what test of certainty was appropriate.]

The respondents invited your Lordships to assimilate the validity test for trusts to that which applies to powers. Alternatively, they contended that in any event the test laid down in the *Broadway Cottages* case was too rigid, and that a trust should be upheld if there is sufficient practical certainty in its definition for it to be carried out, if necessary with the administrative assistance of the court, according to the expressed intention of the settlor. I would agree with this, but this does not dispense from examination of the wider argument . . .

Assuming, as I am prepared to do for present purposes, that the test of validity is whether the trust can be executed by the court, it does not follow that execution is impossible unless there can be equal division. As a matter of reason, to hold that a principle of equal division applies to trusts such as the present is certainly paradoxical.

Equal division is surely the last thing the settlor ever intended; equal division among all may, probably would, produce a result beneficial to none. Why suppose that the court would lend itself to a whimsical execution? And as regards authority, I do not find that the nature of the trust, and of the court's powers over trusts, calls for any such rigid rule. Equal division may be sensible and has been decreed, in cases of family trusts for a limited class, here there is life in the maxim 'equality is equity', but the cases provide numerous examples where this has not been so, and a different type of execution has been ordered, appropriate to the circumstances.

[Lord Wilberforce then considered the 'relations' and other cases referred to in Lord Hodson's judgment (above) and continued:]

In the time of Lord Eldon LC, the Court of Chancery adopted a less flexible practice; in *Kemp v Kemp* Sir Richard Arden MR commenting on *Warburton v Warburton* ('a very extraordinary case') said that the court now disclaims the right to execute a power (ie a trust power) and gives the fund equally. But I do not think that this change of attitude, or practice, affects the principle that a discretionary trust *can*, in a suitable case, be executed according to its merits and otherwise than by equal division. I prefer not to suppose that the great masters of equity, if faced with the modern trust for employees, would have failed to adapt their creation to its practical and commercial character . . .

When the *Broadway Cottages Trust* case came to be decided in 1955, these ['relations'] cases were put aside as anomalous, but I think they illustrate the flexible manner in which the court, if called on, executes trust powers for a class. At least they seem to prove that the supposed rule as to equal division does not rest on any principle inherent in the nature of a trust. They prompt one to ask why a practice, or rule, which has been long followed and found useful in 'relations' cases, should not also serve in regard to 'employees', or 'employees and their relatives', and whether a decision which says the contrary is acceptable.

[Lord Wilberforce then reviewed *Re Ogden* [1933] Ch 678 and *Re Gestetner* [1953] Ch 672 and considered that neither case was strong authority against assimilating the tests.]

So I come to *IRC v Broadway Cottages Trust*. This was certainly a case of trust, and it proceeded on the basis of an admission, in the words of the judgment, 'that the class of "beneficiaries" is incapable of ascertainment'. In addition to the discretionary trust of income, there was a trust of capital for all the beneficiaries living or existing at the terminal date. This necessarily involved equal division and it seems to have been accepted that it was void for uncertainty since there cannot be equal division among a class unless all the members of the class are known. The Court of Appeal applied this proposition to the discretionary trust of income, on the basis that execution by the court was only possible on the same basis of equal division. They rejected the argument that the trust could be executed by changing the trusteeship, and found the relations cases of no assistance as being in a class by themselves. The court could not create an arbitrarily restricted trust to take effect in default of distribution by the trustees. Finally they rejected the submission that the trust could take effect as a power; a valid power could not be spelt out of an invalid trust.

My Lords, it will have become apparent that there is much in this which I find out of line with principle and authority but, before I come to a conclusion on it, I must examine the decision of this House in *Re Gulbenkian's Trusts* on which the appellants placed much reliance as amounting to an endorsement of the *Broadway Cottages* case. But is this really so? . . . . [As] a matter of decision, the question now before us did not arise or nearly arise. However the opinions given were relied on, and strongly, as amounting to an endorsement of the 'complete ascertainment' test as laid down in the *Broadway Cottages* case.

My Lords, I comment on this submission with diffidence, because three of those who were party to the decision are present here today, and will express their own views. But with their assistance, and with respect for their views, I must endeavour to appraise the appellants' argument. My noble and learned friend Lord Reid's opinion can hardly be read as an endorsement of the *Broadway Cottages* case. It is really the opinion of my noble and learned friend Lord Upjohn which has to be considered. Undoubtedly the main part of that opinion, as one would expect, was concerned to deal with the clause in question, which required careful construction, and with the law as to powers of appointment among a numerous and widely defined class. But having dealt with these matters the opinion continues with some general observations. I have considered these with great care and interest; I have also had the advantage of considering a detailed report of the argument of counsel on both sides who were eminent in this field. I do not find that it was contended on either side that the *Broadway Cottages* case was open to criticism – neither had any need to do so . . . It is consequently not surprising that my noble and learned friend Lord Upjohn nowhere expresses his approval of this decision and indeed only cites it, in the earlier portion, insofar as it supports a proposition as to powers. Whatever dicta therefore the opinion were found to contain, I could not, in a case where a direct and fully argued attack has been made on the *Broadway Cottages* case, regard them as an endorsement of it and I am sure that my noble and learned friend, had he been present here, would have regarded the case as at any rate open to review. In fact I doubt very much whether anything his Lordship said was really directed to the present problem. I read his remarks as dealing with the suggestion that trust powers ought to be entirely assimilated to conditions precedent and powers collateral.

[Lord Wilberforce then referred to passages in Lord Upjohn's speech extracted above at 211.]

[Lord Upjohn's] reference to defeating 'the intention of donors completely' shows that what he is concerned with is to point to the contrast between powers and trusts which lies in the facultative nature of the one and the mandatory nature of the other, the conclusion being the rejection of the 'broader' proposition as to powers accepted by two members of the Court of Appeal. With this in mind it becomes clear that the sentence so much relied on by the appellants will not sustain the weight they put on it. This is:

> 'The trustees have a duty to select the donees of the donor's bounty from among the class designated by the donor; he has not entrusted them with any power to select the donees merely from among known claimants who are within the class, for that is constituting a narrower class and the donor has given them no power to do this'.

What this does say, and I respectfully agree, is that, in the case of a trust, the trustees must select from the class. What it does not say, as I read it, or imply, is that in order to carry out their duty of selection they must have before them, or be able to get, a complete list of all possible objects.

So I think that we are free to review the *Broadway Cottages* case. The conclusion which I would reach, implicit in the previous discussion, is that the wide distinction between the validity test for powers and that for trust powers, is unfortunate and wrong, that the rule recently fastened on the courts by the *Broadway Cottages* case ought to be discarded, and that the test for the validity of trust powers ought to be similar to that accepted by this House in *Re Gulbenkian's Settlements Trusts* for powers namely that the trust is valid if it can be said with certainty that any given individual is or is not a member of the class.

Assimilation of the validity test does not involve the complete assimilation of trust powers with powers. As to powers, I agree with my noble and learned friend Lord Upjohn in *Re Gulbenkian's Settlement* that although the trustees may, and normally will, be under a fiduciary duty to consider whether or in what way they should exercise their power, the court will not normally compel its exercise. It will intervene if the trustees exceed their powers, and possibly if they are proved to have exercised it capriciously. But in the case of a trust power, if the trustees do not exercise it, the court will; I respectfully adopt as to this the statement in Lord Upjohn's opinion. I would venture to amplify this by saying that the court, if called on to execute the trust power, will do so in the manner best calculated to give effect to the settlor's or testator's intentions. It may do so by appointing new trustees, or by authorising or directing representative persons of the classes of beneficiaries to prepare a scheme of distribution, or even, should the proper basis for distribution appear, by itself directing the trustees so to distribute. The books give many instances where this has been done and I see no reason in principle why they should not do so in the modern field of discretionary trusts (see *Brunsden v Woolredge* (1765) Amb 507; *Supple v Lowson (*1773) Amb 729; *Liley v Hey* (1842) 1 Hare 580, and *Lewin on Trusts* (16th edn, 1964, p 630)). Then, as to the trustees' duty of enquiry or ascertainment, in each case the trustees ought to make such a survey of the range of objects or possible beneficiaries as will enable them to carry out their fiduciary duty (cf *Liley v Hey*). A wider and more comprehensive range of enquiry is called for in the case of trust powers than in the case of powers.

Two final points: first, as to the question of certainty, I desire to emphasise the distinction clearly made and explained by Lord Upjohn, between linguistic or semantic uncertainty which, if unresolved by the court, renders the gift void, and the difficulty of ascertaining the existence or whereabouts of members of the class, a matter with which the court can appropriately deal on an application for directions. There may be a third case where the meaning of the words used is clear but the definition of beneficiaries is so hopelessly wide as not to form 'anything like a class' so that the trust is administratively

> unworkable or in Lord Eldon LC's words one that cannot be executed (*Morice v Bishop of Durham*). I hesitate to give examples for they may prejudice future cases, but perhaps 'all the residents of Greater London' will serve. I do not think that a discretionary trust for 'relatives' even of a living person falls within this category.

The case was remitted to the High Court to decide whether the deed satisfied the newly adopted test for certainty of objects.

Consider the following points:

(1) Both the majority and minority judgments (the latter citing Lord Upjohn's argument from *Gulbenkian*) stress the importance to be attached to the 'settlor's intention'. Whose explanation of that intention do you find more compelling?
(2) Lord Wilberforce comments on Lord Upjohn's judgment in *Re Gulbenkian* as follows: 'I doubt very much whether anything his Lordship said was really directed to the present problem.' Do you agree?
(3) If the trustees of a discretionary trust of the type illustrated in *McPhail* fail to distribute the relevant funds as required, how should the court go about executing the trust? Given that the maxim 'Equality is equity' *cannot* be applied (because there is no 'list certainty') how far must the court go in (a) enquiring as to the identity of persons within the class of objects; (b) formulating guidelines for distribution; (c) determining who may properly be excluded from benefit? Are tasks such as these appropriate for a court? (See further section (d)(3) below.)

Whilst Lord Wilberforce's judgment assimilates the certainty of objects test for discretionary trusts ('trust powers') and mere powers it leaves outstanding a number of problems which are considered in the next section.

(d) Certainty of objects: some unresolved problems

(1) Certainty of objects and fixed trusts

One teasing academic question is whether the 'criterion certainty' test approved in *McPhail* extends to a fixed trust such as to T1 and T2 on trust for A, B, C, D and E in equal shares or some other fixed shares. The question is probably academic because it could arise only where the beneficiary class is one similar to that in *McPhail v Doulton*, and in practice it is unlikely in the extreme that a fixed-interest gift would be made to such a class.

The accepted view is that a fixed-interest trust will be void unless at inception it is clear that all the beneficiaries are ascertained or capable of being ascertained when the time for distribution of capital or income arrives. An orthodox explanation is 'that if trust property is to be divided among a class of beneficiaries in . . . fixed shares, the trust cannot, in the nature of things, be administered unless the number and identity of beneficiaries are known' (*Hanbury and Martin* p 103). 'In the nature of things' must mean that the court, if called upon to administer the trust, must implement the settlor's specific intention and this can only be done if a complete list can be compiled at the appropriate time. The argument seems self-evident but it has been suggested that Lord Wilberforce intended the new test to apply to all trusts (see *Parker and Mellows* (5th edn, 1983) p 79 but note that the current editor shares the more generally accepted view set out above (8th edn, 2003) p 64). Whilst Lord Wilberforce does occasionally use the umbrella term 'trust' rather than the more precise 'trust power', the trust at issue in *McPhail v Doulton* was a discretionary trust and his Lordship's argument is directed towards this.

Nevertheless Lord Wilberforce did agree that 'a trust should be upheld if there is sufficient practical certainty in its definition for it to be carried out, if necessary with the administrative assistance of the court, according to the expressed intention of the settlor'. Bearing in mind the ambiguous nature of intention, does this statement support or reject a liberalisation of the 'list-certainty' test for fixed-interest trusts? (See Matthews [1984] Conv 22, for a view that list certainty is not required for fixed-interest trusts; cf Hayton and Martin [1984] Conv 307.)

(2) The test applied: *Re Baden (No 2)*

The test of certainty of objects for mere powers and discretionary trusts established in the two House of Lords' decisions is whether 'it can be said with certainty that any given individual is or is not a member of the class'. Unfortunately what at first glance appears a perfectly simple test has been shown to have unexpected nuances requiring clarification. One potential source of misunderstanding lies in what might be termed the different elements of the certainty requirement. It will be recalled that Lord Wilberforce endorsed the distinction, drawn by Lord Upjohn in *Re Gulbenkian* [1968] 3 All ER 785, between 'linguistic or semantic uncertainty which, if unresolved by the court, renders the gift void and the difficulty of ascertaining the existence or whereabouts of the members of the class'. The latter is usually termed 'evidential uncertainty' although, as Emery has emphasised, a further distinction can be drawn between 'evidential uncertainty' (the availability of evidence to identify a person as a member of the class) and 'ascertainability' (identifying the whereabouts or continued existence of persons *clearly* members of the class ((1982) 98 LQR 551 at 556–557; cf Matthews [1984] Conv 22 at 29, fn 61). Conceptual certainty (as linguistic or semantic certainty is usually termed) 'refers to the precision of language used by the settlor to define the classes of person whom he intends to benefit' (*Emery* p 552) and difficulties may arise where the draftsman uses vague language. Terms such as 'employees', 'my parents', 'my children' present no difficulty but moving along the continuum 'relatives', 'dependants', 'old friends', may be encountered. Are these expressions precise enough to satisfy the demands of 'conceptual certainty'?

The latent problems surfaced when Bertram Baden's Trust Deed was remitted to the High Court to decide on its validity. Brightman J held ([1972] Ch 607) that the disputed terms 'relatives' and 'dependants' were not too uncertain and upheld the deed. Undaunted the executors appealed. The case was by now taking on Vandervellian proportions, costs having amounted to £54,000 although the value of the fund had risen in the decade since the commencement of the litigation to £463,000, perhaps accounting for the executors' enthusiasm for the battle. The Court of Appeal unanimously agreed that the deed was valid, but differed about the meaning of the certainty test, in particular the relevance of the words 'or is not' in the phrase: 'the trust is valid if it can be said with certainty that any given individual is *or is not* a member of the class'. Megaw and Sachs LJJ, adopting a broad definition of relatives ('descendants of a common ancestor'), both held that it was immaterial that there might be a substantial number of persons of whom it was impossible to say whether they were within or without the class. Sachs LJ's view was that provided the class was conceptually certain, other difficulties were evidentiary only and could be resolved by the court. Megaw LJ held that the test would be satisfied provided a 'substantial' number of persons were clearly within the class. Stamp LJ was more troubled, however. He was of the opinion that it was necessary to be able to say positively of any given person that he was either within *or outside* the class. A category of 'Don't knows' was not permissible. Consequently Stamp LJ was only able to validate the trust by construing 'relatives' narrowly to mean 'next of kin'. All however agreed that the term 'dependants' was sufficiently certain in its context.

> *Re Baden's Deed Trusts (No 2)* [1972] 2 All ER 1304
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> **Sachs LJ:** The [next] point as regards approach that requires consideration is the contention strongly pressed by counsel for the defendant executors, that the court must always be able to say whether any given postulant is *not* within the relevant class as well as being able to say whether he is within it. . . . As counsel for the defendant executors himself rightly observed, 'the court is never defeated by evidential uncertainty', and it is in my judgment clear that it is conceptual certainty to which reference was made when the 'is or is not a member of the class' test was enunciated. (Conceptual uncertainty was in the course of argument conveniently exemplified, rightly or wrongly matters not, by the phrase 'someone under a moral obligation' and contrasted with the certainty of the words 'first cousins'.) Once the class of persons to be benefited is conceptually certain it then becomes a question of fact to be determined on evidence whether any postulant has on enquiry been proved to be within it; if he is not so proved then he is not in it. That position remains the same whether the class to be benefited happens to be small (such as 'first cousins') or large (such as 'members of the X Trade Union' or 'those who have served in the Royal Navy'). The suggestion that such trusts could be invalid because it might be impossible to prove of a given individual that he was *not* in the relevant class is wholly fallacious – and only the persuasiveness of counsel for the defendant executors has prevented me from saying that the contention is almost unarguable.
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> **Megaw LJ:** It is said that those words ['or is not'] have been used deliberately, and have only one possible meaning; and that, however startling or drastic or unsatisfactory the result may be – and counsel for the defendant executors does not shrink from saying that the consequence is drastic – this court is bound to give effect to the words used in the House of Lords' definition of the test. It would be quite impracticable for the trustees to ascertain in many cases whether a particular person was *not* a relative of an employee. The most that could be said is: 'There is no proof that he is a relative'. But there would still be no 'certainty' that such a person was not a relative. Hence,

so it is said, the test laid down by the House of Lords is not satisfied, and the trust is void. For it cannot be said with certainty, in relation to any individual, that he is not a relative.

I do not think it was contemplated that the words 'or is not' would produce that result. It would, as I see it, involve an inconsistency with the latter part of the same sentence: 'does not fail simply because it is impossible to ascertain every member of the class'. The executors' contention, in substance and reality, is that it *does* fail 'simply because it is impossible to ascertain every member of the class'.

The same verbal difficulty, as I see it, emerges also when one considers the words of the suggested test which the House of Lords expressly rejected . . . The rejected test was in these terms: '. . . it is said to be necessary . . . that the whole range of objects . . . shall be ascertained or capable of ascertainment'. Since that test was rejected, the resulting affirmative proposition, which by implication must have been accepted by their Lordships, is this: a trust for selection will not fail simply because the whole range of objects cannot be ascertained. In the present case, the trustees could ascertain, by investigation and evidence, many of the objects; as to many other theoretically possible claimants, they could not be certain. Is it to be said that the trust fails because it cannot be said with certainty that such persons are not members of the class? If so, is that not the application of the rejected test; the trust failing because 'the whole range of objects cannot be ascertained?'

In my judgment, much too great emphasis is placed in the executors' argument on the words 'or is not'. To my mind, the test is satisfied if, as regards at least a substantial number of objects, it can be said with certainty that they fall within the trust; even though, as regards a substantial number of other persons, if they ever for some fanciful reason fell to be considered, the answer would have to be, not 'they are outside the trust', but 'it is not proven whether they are in or out'. What is a 'substantial number' may well be a question of common sense and of degree in relation to the particular trust: particularly where, as here, it would be fantasy, to use a mild word, to suggest that any practical difficulty would arise in the fair, proper and sensible administration of this trust in respect of relatives and dependants.

I do not think that this involves, as counsel for the defendant executors suggested, a return by this court to its former view which was rejected by the House of Lords in the *Gulbenkian* case. . . . The essence of the decision of the House of Lords in the *Gulbenkian* case, as I see it, is *not* that it must be possible to show with certainty that any given person is or *is not* within the trust; but that it is not, or may not be, sufficient to be able to show that one individual person is within it. If it does not mean that, I do not know where the line is supposed to be drawn, having regard to the clarity and emphasis with which the House of Lords has laid down that the trust does not fail because the whole range of objects cannot be ascertained.

Stamp LJ: . . . There are . . . in my judgment serious difficulties in the way of a rejection of counsel for the executors' submission.

The first difficulty, as I see it, is that the rejection of counsel's submission involves holding that the trust is good if there are individuals – or even one – of whom you can say with certainty that he is a member of the class. That was the test adopted by and the decision of the Court of Appeal in the *Gulbenkian* case where what was under consideration was a power of distribution among a class conferred on trustees as distinct from a trust for distribution: but when the *Gulbenkian* case came before the House of Lords that test was decisively rejected and the more stringent test on which counsel for the defendant executors insists was adopted. Clearly Lord Wilberforce in expressing the view that the test of validity of a discretionary trust ought to be similar to that accepted by the House of Lords in the *Gulbenkian* case did not take the view that it was sufficient that you could find individuals who were clearly members of the class; for he himself remarked, towards the end of his speech as to the trustees' duty of enquiring or ascertaining, that in each case the trustees ought to make such a survey of the range of objects or possible beneficiaries as will enable them to carry out their fiduciary duty. It is not enough that trustees should do nothing but distribute the fund among those objects of the trust who happen to be at hand or present themselves. Lord Wilberforce, after citing . . . from the speech of Lord Upjohn in the *Gulbenkian* case put it more succinctly by remarking that what this did say (and he agreed) was that the trustees must select from the class, but that passage did not mean (as had been contended) that they must be able to get a complete list of all possible objects. I have already called attention to Lord Wilberforce's opinion that the trustees ought to make such a survey of the range of objects or possible beneficiaries as will enable them to carry out their fiduciary duty, and I ought perhaps to add that he indicated that a wider and more comprehensive range of enquiry is called for in the case of what I have called discretionary trusts than in the case of fiduciary powers. But, as I understand it, having made the appropriate survey, it matters not that it is not complete or fails to yield a result enabling you to lay out a list or particulars of every single beneficiary. Having done the best they can, the trustees may proceed on the basis similar to that adopted by the court where all the beneficiaries cannot be ascertained and distributed on the footing that they have been: see, for example, *Re Benjamin* [1902] 1 Ch 723. What was referred to as 'the complete ascertainment test' laid down by this court in the *Broadway Cottages* case is rejected. So also is the test laid down by this court in the *Gulbenkian* case. Validity or invalidity is to depend on whether you can say of any individual – and the accent must be on that word 'any', for it is not simply the individual whose claim you are considering who is spoken of – that he 'is or is not a member of the class', for only thus can you make a survey of the range of objects or possible beneficiaries.

If the matter rested there it would in my judgment follow that, treating the word 'relatives' as meaning descendants from a common ancestor, a trust for distribution such as is here in question would not be valid. Any 'survey of the range of objects or possible beneficiaries' would certainly be incomplete, and I am able to discern no principle on which such a survey could be conducted or where it should start or finish. The most you could do, so far as regards relatives, would be to find individuals who are clearly members of the class – the test which was accepted in the Court of Appeal, but rejected in the House of Lords in the *Gulbenkian* case.

[Stamp LJ construed relatives to mean 'nearest blood relatives' and upheld the trust on that basis.]

The judgments of Megaw and Sachs LJJ can be said at the very least to support the narrow proposition that there is a presumption that if a candidate cannot positively establish that he is within the class, the application can automatically be placed in the reject tray. But not surprisingly, given the divergence of approach manifested in the Court of Appeal, the judgments have not gone uncriticised and have prompted further academic speculation on the meaning of the test. (See Hopkins [1973] CLJ 36 at 38; Hayton [1972] 36 Conv 351 at 354; *Underhill and Hayton* pp 68–70 but, cf Emery (1982) 98 LQR 552 at 576–578.)

Consider the following points:

(1) It is suggested variously that Sachs LJ's 'robust, practical approach' fails to consider or, rather, sidesteps the problems of conceptual certainty; that Megaw LJ's judgment represents an attempt to reintroduce the test rejected by the House of Lords in *Gulbenkian* – that a mere power will be valid even if there is only one or a few persons who are within the class – and that his qualifying criterion of 'a substantial number' introduces uncertainty into the certainty of objects test.

Do these criticisms take adequate account of a possible tension between a literal interpretation of the 'criterion certainty' test and Lord Wilberforce's view mentioned previously that 'a trust should be upheld if there is sufficient practical certainty in its definition for it to be carried out . . . according to the expressed intention of the settlor'?

(2) '*Baden (No 2)* suggests that the courts will tolerate a degree of conceptual uncertainty in a discretionary trust to distribute; the degree of tolerance will increase with the width of the beneficial class.' Do you agree?

(3) Would Megaw LJ's approach enable a court to validate 'a trust (or mere power) in the same language as that in *McPhail v Doulton* but to which there was added "any other person to whom I may be under a moral obligation . . ." which [phrase] is, let it be assumed, conceptually uncertain' (*Hanbury and Martin* p 113)? Questions of construction may be important here; if the clause is interpreted as creating one class rather than two or more distinct classes then it seems likely that the court will not uphold the gift (see *Re Wright's Will Trusts* (29 July 1982) reported in (1999) 13 TLI (1) 48–51). In that case the testatrix gave her residuary estate on trust 'to use as at [the trustees'] absolute discretion for such people and institutions they think have helped me or my late husband including among others [certain named ecclesiastical corporations and six charities including the Police Dependants Trust, the Donkey Sanctuary, and the RSPCA]'. It was accepted that there was no evidence that, for example, the Donkey Sanctuary or the Police Dependants Trust, had ever helped the testatrix or her husband. At first instance therefore, and notwithstanding the words 'including among others', the Vice-Chancellor treated the disposition as creating two distinct classes of beneficiaries, one uncertain – those who may have helped – and the other – the named institutions – certain. He upheld the gift as a valid discretionary trust among the named institutions. On appeal the Court of Appeal held that the testatrix had created one trust and one class of beneficiaries, that it was not possible to allocate any particular part of the fund to the named charities and that therefore the trust was void for uncertainty.

(3) The duty to survey

The key to Stamp LJ's dissatisfaction with his colleagues' acceptance of a widely defined class of 'relatives' lies in his assessment of the trustees' obligations in implementing the trust to distribute. Concern with this issue is understandable. Removal of 'list certainty' and the acceptance of 'criterion certainty' enhances the importance of the duty to survey the class. This was expressly recognised by Lord Wilberforce in *McPhail v Doulton* – 'a wider and more comprehensive range of inquiry is called for in the case of trusts . . . than in the case of powers'. But the content of this duty to survey is rather nebulous. Megarry V-C attempted to expound the trustees' duties in *Re Hay's Settlement Trusts* ([1981] 3 All ER 786 at 793):

> The trustee must not simply proceed to exercise the power in favour of such of the objects as happen to be at hand or claim his attention. He must first consider what persons or classes of persons are objects of the power within the definition in the settlement or will. In doing this, there is no need to compile a complete list of the objects or even to make an accurate assessment of the number of them: what is needed is an appreciation of the width of field, and thus whether a selection is to be made merely from a dozen or, instead, from thousands or millions. . . .
>
> Only when the trustee has applied his mind to the size of the problem should he then consider in individual cases whether, in relation to other possible claimants, a particular grant is appropriate. In doing this, no doubt he should not prefer the undeserving to the deserving; but he is not required to make an exact calculation whether, as between deserving claimants, A is more deserving than B.

As is to be expected, such guidelines leave a penumbra of doubt in between the extremes of surveying the whole field and making individual decisions. Should trustees of a benefit fund for present and past employees advertise for claimants? If so, where, how frequently and how widely? Can trustees rely on existing knowledge of the fund amongst employees? Could trustees be challenged if they merely asked the trade union representatives of employees to nominate deserving candidates, or alternatively if they restricted benefits to meeting education fees of the children of managerial employees? More generally, if the duty to survey is so nebulous is there any justification for retaining the theoretical distinction between discretionary trusts and powers on this point? (See Grbich (1974) 37 MLR 643 at 649–650.) Perhaps all that can be said about the practical operation of the new test is that, so far as the writers are aware, there are no cases of trustees being unable to operate within the new framework.

(4) Administrative unworkability: a continuing distinction between discretionary trusts and mere powers?

Lord Wilberforce provided a hostage to fortune at the very end of his judgment in *McPhail v Doulton* [1970] 2 All ER 228 at 247, when he appeared to re-introduce a distinction between discretionary trusts and mere powers in the shape of an 'administrative unworkability' criterion applying to the former, plainly separate from conceptual and evidential uncertainty:

> There may be a third case where the meaning of the words used is clear but the definition of beneficiaries is so hopelessly wide as not to form 'anything like a class' so that the trust is administratively unworkable or . . . one that cannot be executed. I hesitate to give examples . . . but perhaps 'all the residents of Greater London' will serve.

It is unclear whether 'administrative unworkability' was meant to refer to practical problems of surveying a wide class, or to administrative futility where a fund is deemed small in relation to the size of the class, or to undesirability of granting large numbers of people locus standi to enforce the trust (see generally Hardcastle [1990] Conv 24). Indeed the criterion has been strenuously criticised (see McKay (1974) 38 Conv 269) as resting on no satisfactory basis. Among the bases reviewed and rejected by McKay is one implied in Lord Wilberforce's words 'the ability of the court to execute the trust'. If trustees default or refuse to act or come to the court for directions the court must ultimately be able 'to execute the trust'. Amongst the various alternatives to equal distribution outlined by Lord Wilberforce (see p 216 above, and Hopkins (1971) 29 CLJ 68 at 92–101 for an extended analysis), was the possibility, 'should the proper basis for distribution appear', that the court could direct the trustees to distribute the fund (see *Re Locker's Settlement Trusts* [1978] 1 All ER 216 where, however, the trustees were permitted to exercise their discretion out of time). Can it therefore be argued that the exercise by the court of this residual yet fundamental function requires that there be properly justiciable criteria to guide the court?

> The distinction is based on the quite discrete reason that the court cannot exercise the trust because the settlor has purported to impose an obligation but has failed to give the court enough objective criteria to enforce it. The court will execute a trust to exhaust a fund, and be very flexible in doing so, but it cannot write an instrument for the settlor. It may be that the instrument as a whole or admissible extrinsic evidence will give the court some criteria to appoint by. But if there are no such criteria, the exhaustive discretionary trust will be held void. It is void because there is not enough information to enable a court to frame an order which executes the obligation without resorting to guesswork. (Y Grbich 'Baden: Awakening the Conceptually Moribund Trust' (1974) 37 MLR 643 at 652)

If Lord Wilberforce's 'administrative unworkability' criterion is based on the court's residual function to execute the trust, the requirement can be seen as a judicial compromise, ie as an attempt to meet the criticisms of the dissenting minority in *McPhail v Doulton.*

In fact the criterion has been applied only once to invalidate a trust. In 1985, West Yorkshire Metropolitan County Council, threatened with abolition by the government, proposed to settle £400,000 on trust to spend the capital and income within two years 'for the purpose' of benefiting 'any or all or some of the inhabitants' of West Yorkshire (about two-and-a-half million people) by, inter alia: (i) assisting economic development within the county; (ii) providing assistance for youth, community and ethnic or other minority groups; and (iii) informing interested persons or bodies of the consequences of the proposed abolition of Metropolitan County Councils. The proposed trust was held administratively unworkable ostensibly because the class of beneficiaries was 'far too large' (*R v District Auditor, ex p West Yorkshire Metropolitan County Council* [1986] RVR 24; see Harpum (1986) 45 CLJ 392). Whilst the class of beneficiaries bears a superficial similarity to Lord Wilberforce's example – 'all the residents of Greater London' – the West Yorkshire local authority had, as the court accepted, every reason for wishing to benefit the inhabitants. Moreover, criteria were provided to guide the trustees in executing the trust. The case is an unsatisfactory authority because, as the court acknowledged, its decision was reached without the benefit of full argument on the academic comment and criticism of Lord Wilberforce's dictum. In the absence of that full argument on the administrative unworkability point, the rationale for the requirement remains obscure.

We have assumed so far that the requirement applies to discretionary trusts only, but Lord Wilberforce's rather guarded comment left the door fractionally open to the question: 'Might "administrative unworkability" also be a disqualifying factor for mere powers held by trustees?' The question has arisen in the context of settlors seeking to use widely drawn 'intermediate' powers to permit trustees to add persons to the primary class of beneficiaries. Such powers provide maximum flexibility for dealing with future tax changes or changes in personal circumstances. In *Blausten v IRC* [1972] Ch 256 a power to appoint anyone other than the settlor into a specified class of beneficiaries was validated by the Court of Appeal. But it was upheld only because the trustees' power to include any person was subject to the settlor's written consent, and so the settlor had put 'metes and bounds' on the exercise of the power. Yet subsequently in *Re Manisty's Settlement* [1973] 2 All ER 1203, Templeman J upheld a similar 'intermediate' power but one without the qualifying limitation regarded as necessary in *Blausten*. Templeman J expressed the view that a power cannot be invalid merely because it is wide in ambit but he did appear to accept that a 'special' power in favour of a class 'that negatives any sensible intention on the part of the settlor' (at 1211) would be void as being 'capricious' – 'the residents of Greater London' making a reappearance now as a capricious class.

The confused picture emerging from these conflicting views was examined in some detail in *Re Hay's Settlement Trusts* [1981] 3 All ER 786, where Megarry V-C held valid an intermediate power to appoint to anyone in the world other than the settlor, her husband or the trustees. The purported exercise of the power in appointing to a discretionary sub-trust for that same class of objects was, however, held invalid as infringing a rule prohibiting unauthorised delegation of powers by a trustee. Megarry V-C was also inclined obiter to hold the sub-trust void on grounds of administrative unworkability.

Re Hay's Settlement Trusts [1981] 3 All ER 786

Megarry V-C: It is plain that if a power of appointment is given to a person who is not in a fiduciary position, there is nothing in the width of the power which invalidates it per se. . . . The difficulty comes when the power is given to trustees as such, in that the number of objects may interact with the fiduciary duties of the trustees and their control by the court.

[The Vice-Chancellor reviewed the authorities on the duties of a trustee specific to a mere power and summarised them as follows:]

. . . the duties of a trustee which are specific to a mere power seem to be threefold. Apart from the obvious duty of obeying the trust instrument, and in particular of making no appointment that is not authorised by it, the trustee must, first, consider periodically whether or not he should exercise the power; second, consider the range of objects of the power; and third, consider the appropriateness of individual appointments. I do not assert that this list is exhaustive. . . .

On this footing, the question is thus whether there is something in the nature of an intermediate power which conflicts with these duties in such a way as to invalidate the power if it is vested in a trustee.

[The Vice-Chancellor then considered *Blausten v IRC*:]

It seems quite plain that Buckley LJ considered that the power was saved from invalidity only by the requirement for the consent of the settlor. The reason for saying that in the absence of such a requirement the power would have been invalid seems to be twofold. First, the class of persons to whose possible claims the trustees would be duty-bound to give consideration was so wide as not to form a true class, and this would make it impossible for the trustees to perform their duty of considering from time to time whether to exercise the power.

I feel considerable difficulty in accepting this view. First, I do not see how mere numbers can inhibit the trustees from considering whether or not to exercise the power, as distinct from deciding in whose favour to exercise it. Second, I cannot see how the requirement of the settlor's consent will result in any 'class' being narrowed from one that is too wide to one that is small enough. Such a requirement makes no difference whatever to the number of persons potentially included: the only exclusion is still the settlor. Third, in any case I cannot see how the requirement of the settlor's consent could make it possible to treat 'anyone in the world save X' as constituting any real sort of a 'class', as that term is usually understood.

The second ground of invalidity if there is no requirement for the settlor's consent seems to be that the power is so wide that it would be impossible for the trustees to consider in any sensible manner how to exercise it, and also impossible for the court to say whether or not they were properly exercising it. With respect, I do not see how that follows. If I have correctly stated the extent of the duties of trustees in whom a mere power is vested, I do not see what there is to prevent the trustees from performing these duties. It must be remembered that Buckley LJ, though speaking after *Re Gulbenkian's*

> *Settlement* and *Re Baden* had been decided, lacked the advantage of considering *Re Baden (No 2)*, which was not decided until some five months later. He thus did not have before him the explanation in that case of how the trustees should make a survey and consider individual appointments in cases where no complete list of objects could be compiled. . . .
>
> From what I have said it will be seen that I cannot see any ground on which the power in question can be said to be void. Certainly it is not void for linguistic or semantic uncertainty; there is no room for doubt in the definition of those who are or are not objects of the power. Nor can I see that the power is administratively unworkable. The words of Lord Wilberforce in *Re Baden* are directed to discretionary trusts, not powers. Nor do I think that the power is void as being capricious. In *Re Manisty's Settlement* Templeman J appears to be suggesting that a power to benefit 'residents in Greater London' is void as being capricious 'because the terms of the power negative any sensible intention on the part of the settlor'. In saying that, I do not think that the judge had in mind a case in which the settlor was, for instance, a former chairman of the Greater London Council . . . [t]his consideration does not apply to intermediate powers, where no class which could be regarded as capricious has been laid down. Nor do I see how the power in the present case could be invalidated as being too vague, a possible ground of invalidity considered in *Re Manisty's Settlement*. Of course, if there is some real vice in a power, and there are real problems of administration or execution, the court may have to hold the power invalid: but I think that the court ought not to be astute to find grounds on which a power can be invalidated. . . . a power should not be held void on a peradventure.

Re Hay's Settlement Trusts does then lend tentative support to two propositions: (1) a criterion of administrative unworkability applies to discretionary trusts but not to mere powers; (2) there may be a criterion of 'capriciousness' that will invalidate 'special fiduciary powers' (ie special powers vested in trustees) but not 'intermediate fiduciary powers' (see Figure 5.2). If administrative unworkability is based on some notion of justiciability rather than the size of the class or administrative inconvenience, it is difficult to see how it differs from capriciousness, and both savour of being judicial 'safety nets' to cope with some unforeseen eventuality. One can only speculate as to whether the same safety-net concern explains the otherwise confusing and rather cryptic closing comments of Megarry V-C alluding to 'real vice in a power' and 'real problems of administration or execution'.

(5) A miscellany

What at first sight appears to be conceptual uncertainty may be remedied by the existence of a provision incorporating the opinion of a third party. For example, assuming the term 'Jewish faith' to be conceptually uncertain (see *Clayton v Ramsden* [1943] 1 All ER 16 but cf *Re Tuck's Settlement Trusts* [1978] 1 All ER 1047), a gift to 'persons of the Jewish faith' would be void whereas a gift to 'persons of the Jewish faith as defined by the Chief Rabbi' would be certain and valid. Where difficulty could arise is if such a gift is made to 'persons of the Jewish faith and if any doubt shall arise the decision of the Chief Rabbi shall be conclusive'. It may be argued that here the reference to Jewish faith is akin to the first example given above, and so is conceptually uncertain; and that, if conceptual uncertainty cannot be resolved by the court, a fortiori it cannot be resolved by reference to a third party (see *Underhill and Hayton* p 71). Whilst technically and logically correct, is it likely that a court operating in a post-*McPhail v Doulton* spirit would strain to draw this fine distinction and hence invalidate the gift? (See *Re Tuck's Settlement Trusts*, in particular the judgment of Eveleigh LJ; *Re Tepper's Will Trusts* [1987] 1 All ER 970; and Hackney (1976) ASCL pp 427–428 for an acute assessment of the probable limits of permissible uncertainty.) The rhetorical nature of that question may, however, be considered excessively complacent in view of the approach of the Court of Appeal in *Re Wright* (see above p 225). Fox LJ states that: 'It is no use the trustees saying, "X in our view helped the testatrix". The problem is one does not know what the testatrix meant by "help".' It seems that *Re Tuck* was not cited to the court.

Finally, there is one rather precarious surviving anomaly of the re-alignment of certainty of objects test. It will be recalled that in *Re Gulbenkian* the House of Lords (Lord Donovan dissenting) rejected the 'one person test' for certainty of objects for mere powers. It still survives in one particular context. Where there is a condition precedent or description attached to individual gifts (eg £1,000 to each of the sons of A who shall be an adherent of the doctrine of the Church of England), something akin to the individual certainty test seems to apply. The disposition is valid if one or more of A's sons clearly qualify even though there is difficulty in knowing whether other sons qualify (see *Re Barlow's Will Trusts* [1979] 1 All ER 296; but cf McKay [1980] Conv 263 and Emery (1982) 98 LQR 551 at 566–567).

(e) Conclusion

(1) *McPhail v Doulton*: an engine for change

From one perspective *McPhail v Doulton* can be seen simply as completing a tidying-up process in the rules concerning certainty of objects, by removing the 'narrow and artificial' distinction between discretionary trusts and mere powers. From another perspective *McPhail v Doulton* marks the culmination of a process of legal change initiated by the 'special powers' case of *Re Gestetner*, albeit requiring en route the reversal of a century-and-a-half of Chancery law and practice. The implications of this reversal are potentially far-reaching for trusts law and subsequent developments have demonstrated that the process of change is not exhausted.

On the one hand, at least in the commercial context of pension fund trusts, the 'narrow and artificial' distinction between discretionary trusts and mere powers has been somewhat elided. In *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587 (discussed in Chapter 13), Warner J accepted that there can exist powers of appointment which are 'fiduciary in the full sense' and under which the duties owed by the trustees to the objects of the power are essentially no different from those owed to the beneficiaries of a discretionary trust. It followed, and here Warner J broke new ground, that *all* the remedies identified in *McPhail v Doulton* as available to the court to control and enforce the administration of a discretionary trust should be equally available in the case of fully fiduciary powers of appointment. In *Mettoy*, for instance, the judge indicated that, if necessary, he would himself be able to decide on an appropriate scheme of distribution. This is a far cry indeed from Lord Upjohn's view in *Gulbenkian* as to the rights of the objects of a power of appointment and the remedies available to them. (Gardner (1991) 107 LQR 214 suggests that the assimilation of remedies might result in the 'administrative unworkability' criterion being applied to 'fiduciary powers'. But see below (and Chapter 13) on our doubts about the full applicability of propositions in pensions cases to the family trust context.)

On the other hand, Megarry V-C's dicta in *Re Hay* simultaneously confirming and limiting the scope of the criteria of 'administrative unworkability' and 'capriciousness' are evidence of a gap existing between discretionary trusts and intermediate powers: indeed a 'narrow and artificial' distinction between the two is now re-appearing as a yawning chasm in terms of the breadth of discretion permitted by them. Yet this can also be seen as evidence of the discontinuous nature of legal change hinted at in the Introduction to this chapter. A criterion of 'administrative unworkability' might have been thought to impose limits on the flexibility of beneficial entitlement available to settlors. McKay, for instance, has argued ((1974) 38 Conv 269 at 284) that '[administrative unworkability] represents an unwarranted threat to settlors wishing to confer wide discretions upon their trustees' (cf Grubb [1982] Conv 432; and Grbich (1974) 37 MLR 643 at 651–654). But the new offshoot sprouting in the 'intermediate powers' cases of *Manisty* and *Blausten* initially reflecting a fiscal cum familial rather than commercial source of pressure for change, casts doubt on this proposition.

(2) Certainty uncertain and the 'black hole' trust

The new offshoot reaches its zenith in what has become known colloquially as 'black hole trusts' (see generally Hayton (1999) 7(2) JITCP 69; Matthews (2002) PCB (1) 42–54 and (2) 103–110). As their name implies one of the intentions of setting up such trusts is to exploit to the full one of the attributes of the trust form, namely concealment of beneficial ownership, not only from the world at large but even from 'the beneficiaries' themselves. In fact a feature of such a trust is that it will contain a class of named beneficiaries comprising just a limited number of legal persons only some of whom, or maybe even none of whom, are intended to benefit. In one Jersey case, for instance, *Re Gea Settlement* (1992) 13 TLI 188 the named beneficiaries were 'Save the Children Fund, RNLI, and RSPCA' who in theory would ultimately be entitled to the trust fund. In practice there is no intention in such cases that an outcome of that nature should arise. Instead trustees are likely to be given a discretion under an intermediate power of appointment, the exercise of which will often depend on the settlor's wishes as confidentially imparted to the trustees or to a 'protector' (see below p 252). As a further cloak of concealment the identity of the true settlor in the sense of the person providing most of the trust fund may also be concealed behind some corporate figurehead who may have contributed only a nominal amount to the trust fund. With many, probably most, trusts of this sort the funds are held in offshore trusts usually in territories with which the settlor has no substantial connection. As Lord Walker noted in one such case *Schmidt v Rosewood Trust Limited* [2003] 2 WLR 1442 (PC) 'These territories . . . are chosen not for their geographical convenience . . . but because they are supposed to offer special advantages in terms of confidentiality and protection from fiscal demands (and sometimes from problems under the insolvency laws, or laws restricting freedom of testamentary disposition, in the country of the settlor's domicile)' (at p 1444). This is not to say that such trusts are completely free of legal risk. The temptation for a settlor to remain in total control of the trust property is evident but can result in the trust being held to be a sham with the Vandervellian-type outcome that legal ownership may be deemed still to rest with the settlor (see eg *Rahman v Chase Bank (CI) Trust Co* (1991) JLR 103; and Chapter 6 where the sham trust is discussed in the context of insolvency). If such temptations can be avoided and the trusts are valid then we have come a long way indeed from the argument of counsel for the Inland Revenue in *Re Gestetner* [1953] Ch 672 that 'it would be quite contrary to the principles of trust law to allow a vague trust of this kind to be valid' (at 681). This relatively recent offshore innovation raises in peculiarly acute form the new questions about a certainty of objects requirement in trusts law first posed by cases such as *Manisty* and *Blausten*.

(3) From 'certainty' to 'accountability and control'

On a purely practical level, the question must now be whether there exists any limit at all to the flexibility of beneficial entitlement that can be achieved in a settlement by a combination of trusts and intermediate powers. On the conceptual level the corollary of this question is whether a 'certainty of objects' test is now a misnomer: is it more appropriate to ask what degree of uncertainty will be tolerated by the courts? (See Watkin (1979) 8 Anglo-Am L R 123.) After *Baden (No 2)* the only substantive limits on this uncertainty are to be found in the residual disqualifying factors of 'administrative unworkability' and 'capriciousness' for discretionary trusts and special powers respectively. Moreover, if *Re Hay* is correct neither of these disqualifying factors apply to intermediate powers of appointment. Yet whilst both these requirements may operate in theory as disqualifying factors at inception, the current judicial approach leans towards upholding dispositions wherever possible, on the premise that this most closely reflects the settlor's wishes. Indeed, even the supposed principle of non-delegation of testamentary power, once seen as a potential curb on the scope of intermediate powers of appointment conferred by will, has recently been firmly and convincingly rejected by English courts as being 'a chimera, a shadow cast by the rule of certainty, having no independent existence' (*Re Beatty's Will Trusts* [1990] 3 All ER 844 at 849; the testatrix had instructed her trustees to distribute, inter alia, £1.5m among 'such persons as they think fit'; see also *Re Nicholls* (1987) 34 DLR (4th) 321 but cf the earlier decision of the High Court of Australia in *Re Tatham* (1951) 81 CLR 639).

Types of disposition	*Fixed interest trust*	*Discretionary trust*		*Special power*	*Intermediate or hybrid power*	*General power* (cannot be given to trustee)
Extent of trustee's discretion	Distribute according to proportions stipulated in trust investment.	(Unusual) Distibute after deciding proportions amongst beneficiaries *without excluding any*.	Distribute after deciding proportions amongst *objects, with power to exclude some of them*.	Distribute according to discretion amongst class, or make no distribution at all.	Distribute to anyone except specified group, or no distribution.	Distribute to anyone (including doneee of power).
Certainty test	Pre-*McPhail* rule for trusts ('list certainty')		Post-*McPhail* rule for trusts ('criterion certainty') and ('administrative unworkability')	Post-*McPhail* rule for powers ('criterion certainty' but no criterion of 'administrative unworkability'). *Semble* 'capriciousness' criterion for special power. (*Re Manisty's Settlement*)		

(Note: This figure which simplifies the propositions, must be read in conjunction with the text.)

Figure 5.2 *Certainty of objects.*

Such control as exists must now, therefore, primarily be sought not at the creation of the instrument but when the discretion it confers is subsequently exercised. Yet almost any appointment by a trustee armed with intermediate powers of unlimited width will fall within the boundaries of the power and by definition cannot be attacked as an 'excessive execution of the power'. The autonomy of trustees is thus sharply increased; and an increase seeming to register the final victory for settlor's intention over enforceability as a guiding principle in this area of trusts law. But we have attempted in this chapter to stress the dynamic aspect of trusts law and, as Harris argued ((1971) 87 LQR 31 at 57) '[trustees] . . . are subject to rules of equity which will be developed to accommodate the new kinds of confidence which settlors, under changing social conditions, impose upon trustees'. One example of this dynamism is to be found in *McPhail v Doulton* itself where the majority rejected the constraints imposed by a narrow perception, derived from *Morice v Bishop of Durham*, of the court's ability to control and execute a trust. Another is the approach to 'enforceability and control' exemplified in cases such as *Mettoy*, although it may be premature to assume that such decisions will necessarily be applied to their fullest extent in the domain of the family trust (see Moffat (1993) 56 MLR 471, but cf Martin [1991] Conv 364 and Gravells (1992) 3 Canterbury LR 67). In any event, should we now expect to witness an emerging judicial willingness to invoke a more extensive jurisdiction to control the subsequent exercise of trustees' discretions? Will the courts be persuaded to intervene to control trustees, even under intermediate powers, who act 'capriciously, that is to say, act for reasons which . . . could be said to be irrational, perverse or irrelevant to any sensible expectation of the settlor' (per Templeman J in *Re Manisty's Settlement* [1973] 2 All ER 1203 at 1210). If so, an apparent loosening of judicial control via the broadening of a certainty of objects test may paradoxically result ultimately in an extension of that control. How far such a development would involve rewriting much of the law on trustees' powers and duties will be considered in more detail in Chapter 11.

If restructuring is to occur, the ripples from *McPhail v Doulton* will be spreading way beyond the boundaries of the certainty of objects test for discretionary trusts. It will support a contention that there has been a fundamental shift in the centre of gravity of trusts law with trustees' duties 'coming to take the place once reserved as sacred to equitable beneficial interests' (Davies [1970] ASCL 189). This in turn raises questions about the rationale of the beneficiary principle (see section 5. below). First, however, it is necessary to consider just what the nature of a beneficial interest now is.

4. The nature of a beneficiary's interest

(a) The 'great debate'

Analysing the nature of a beneficiary's interest under a trust is a vexatious question which something over half a century ago aroused acute controversy among leading legal scholars (see Waters (1967) 45 Can BR 219 for a review of the controversy). Our focus here, concentrating on the interest of a beneficiary under a discretionary trust, is much narrower for two reasons. One practical reason is that it is the very nature of this interest – an interest that in a material sense leaves the property ownerless – which stimulated the widespread adoption of the discretionary trust for tax planning. The second reason is that the requirement for a beneficial interest – a property interest – to exist provides an important conceptual prop to the beneficiary principle. An understanding of the nature of a beneficial interest at its most elusive, ie under a discretionary trust, may therefore help us to evaluate arguments about the need for a beneficiary principle. But to grasp the importance of recent developments an appreciation of the causes and consequences of that earlier debate are helpful.

The central issue then was whether a beneficiary's rights under a trust were better classified as *in rem* – a proprietary right enforceable against persons generally in respect of particular property – or *in personam* – usually understood as a right of action against a person, for example, a trustee. In fact the debate was founded on a premise that rights must be squeezed into one box or another. That premise and its consequences were sharply criticised in a comment that subsequently received judicial approval in *CSD v Livingstone* (1960) 107 CLR 411 at 449.

> It is a moot question whether the whole discussion raised by the arbitrary classifications borrowed from Roman law and distorted to fit in with new facts is not a mere academical tourney with no real bearing upon the practice of the law, and, being faulty in hypothesis and unsatisfactory in result, would be better abandoned altogether. (R W Turner *The Equity of Redemption* (1931) p 152)

Neither of the classifications is wholly appropriate. W W Cook's savage contemporary criticism (*Introduction to Hohfeld: Fundamental Legal Conceptions* (1923)) of the attempt to fit the range of 'legal rights, privileges, powers and immunities' into a dichotomous framework has if anything gained in strength over the intervening years:

> The analysis . . . has treated a very complex aggregate of legal relations as though it were a simple thing, a unit. The result is no more enlightening than it would be were a chemist to treat an extraordinary complex chemical compound as if it were an element.

That the debate occurred at all reflected the extent to which the idea of 'trust' had developed since its inception. Equity's initial view of a beneficiary's interest was that it amounted to nothing more than a right to compel the trustee to perform the trust or make good any loss arising from breach of trust – very much a right *in personam.* Subsequent developments extended the scope of this right to the extent that it became enforceable against everyone except the bona fide purchaser for value of legal title to the trust property.

A brief digression will help demonstrate how this simple personal right of enforcement has acquired a proprietary hue. Suppose a trustee T misappropriates trust property and sells it to P. With the proceeds T purchases shares in XYZ. According to principles developed comparatively early in the history of trusts law the beneficiary B has two remedies against T. B can sue T personally to require T to reimburse the trust fund or alternatively assert a proprietary right to follow, or 'trace' as it is called, the trust fund via the proceeds of sale into the shares and require that the shares be transferred into the trust fund. These two remedies will usually suffice but suppose further that T is insolvent and there is no property against which B's claim can be enforced. B may then, in certain circumstances, have recourse to a personal claim against P or a proprietary claim against the trust property in P's possession, except of course where P was a bona fide purchaser (see Chapter 11).

But developments went beyond this remedial stance and towards establishing a beneficial interest in the trust property itself. Under the rule in *Saunders v Vautier* (see Chapter 7) a beneficiary who is of full age, and sound mind and alone entitled to the trust fund can terminate the trust, thus obtaining the trust property. This development reached its apogee in *Baker v Archer-Shee* [1927] AC 844. Lady Archer-Shee's income tax liability as a UK resident depended in part on the nature of her life interest in a settled fund in New York. The trustees, after meeting local taxes and expenses, retained the balance of the income, obtained from dividends, in New York. The taxpayer was liable to tax only if she could be regarded as the beneficial owner of the dividends as they arose. It was argued to the contrary on her behalf that her only right as a beneficiary was to seek the court's assistance to compel the trustees to perform the trust. The House of Lords by a 3:2 majority, criticised by Hanbury (1928) 44 LQR 468 as being incompatible with equitable principle, rejected this argument. In Lord Wrenbury's words, '[Lady Archer Shee's] right is . . . an equitable right in possession to receive during her life the proceeds of the shares and stocks of which she is tenant for life. Her right is not to a balance sum, but to the dividends subject to deductions . . .' (at 866). It is evident from the judgment that Lord Wrenbury was conscious of the fiscal implications of deciding the case differently.

In the previous edition of this book we prematurely asserted that the debate had been largely abandoned. It now shows signs of reinvigoration in a wholly different contemporary context, namely litigation about beneficial ownership of second homes in countries such as France and Spain. The primary issue is jurisdictional. Should cases be heard in England, often the domicile of one of the parties, or in the courts of the countries where the properties are located? Article 16(1) of the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters 1968 confers exclusive jurisdiction 'in proceedings which have as their object rights *in rem* in immovable property' on the courts of the state in which the property is located. A key question then is whether a claim relating to a beneficial interest in land held under a trust is an action *in rem*. In *Webb v Webb* Case C-294/92 [1994] 3 WLR 801 a father who had purchased a flat in Antibes in his son's name sought (i) a declaration in the High Court that the son held the property as trustee under a resulting trust, and (ii) an order that legal ownership should be vested in the father. The European Court of Justice, to whom the case was referred, confirmed the High Court decision ([1992] 1 All ER 17) rejecting the argument on behalf of the son that the action was one *in rem* within the meaning of Article 16(1) (see the critical comments by Birks (1994) 8 TLI no 4 at 99 but cf MacMillan [1996] Conv 125). The opposite conclusion was arrived at by Rattie J in *Re Hayward (deceased)* [1996] 3 WLR 674, a case technically distinguishable in terms of the parties and the pleadings but one involving comparable substantive issues of beneficial ownership (see Stevens [1998] Conv 145; and also *Ashurst v Pollard* [2001] 2 All ER 75 where *Webb v Webb* was applied).

The position reached is hardly satisfactory but to some degree may reflect the difficulty of characterising, under a civilian system, the proprietary effect of equitable property interests. In a sense we are back to the problem of trying to squeeze into two inappropriate boxes an interest that is something more than *in personam* but is less than what a civilian would recognise as an ownership right *in rem* 'the holder of rights *erga omnes* that is to say rights effective against the whole world' (per Advocate-General Darmon in *Webb v Webb* at 816B). However indecisive it may seem, there is in our view still much to be said for the opinion that the interest of a beneficiary needs to be treated, at least for the purposes of this debate, as sui generis (see eg *Pettit* p 80) rather than attempting to force it into some inadequate straitjacket.

(b) Equitable ownership and the discretionary trust

Harris has tentatively suggested ((1971) 87 LQR 31 at 47) that what emerged from, inter alia, the developments in the certainty of objects rules described above was 'a distilled dogma of property law that equitable ownership is after all ownership and must be located somewhere'. A fixed-interest trust presents no difficulty for such a schema; a beneficiary's interest can easily be treated as having a proprietary character. But if it is thought necessary that legal ownership vested in trustees must be balanced by identifiable equitable ownership, then the discretionary trust presents problems. Where all the members of the class are identifiable then it is possible to posit that the class collectively owns the equitable interest and even that the class as a whole, if adult and under no disability, can terminate the trust (see *Re Smith* [1928] Ch 915). But the reasoning falters when faced with the permissible width of the beneficial class in a modern discretionary trust. Following *McPhail v Doulton*, this class may include persons who are not, nor ever will be, identifiable. Nevertheless, might one not argue that a class even of that nature in a sense possesses the whole of the equitable interest in the trust fund? Yet even if in a spirit of conceptualist consistency, or 'distilled dogma', one accepts the proposition it is difficult to see that it carries any practical consequences. This is particularly so given the rejection of the proposition in a tax context (see *Gartside v IRC* below).

We would suggest that the more pertinent question to be asked is: 'does a beneficiary of a discretionary trust have an "interest" in the trust property and, if so, what is the nature of that interest?'

(c) Cheese, the nature of the beneficiary's interest and discretionary trusts

It is essential at the outset to appreciate that the term 'interest' may encompass a variety of different meanings depending on the context. 'It is a fallacy to talk of an interest as if it were a piece of cheese' (Bagnall QC in *Re Holmden's Settlement Trusts* [1966] Ch 511 at 526). The following questions are in point:

(1) Can an individual object establish a right as against the trustee to any trust property or force the trustee to allocate?
(2) Can an individual object establish a right as against the rest of the world to any trust property?
(3) Has an individual object locus standi to ask the court to restrain the trustee, for example, from making an ultra vires appointment?
(4) If individual objects do not enjoy any of these rights, do they enjoy them collectively as a class?

The fact that a 'yes' answer may be given to some of these questions is not sufficient to establish a basis for assessing tax on the footing that the beneficiary has an interest. This was confirmed by Lord Wilberforce in *Gartside v IRC* [1968] 1 All ER 121 at 134 (a case of a 'non-exhaustive discretionary trust', ie income could be either distributed or accumulated):

> No doubt in a certain sense a beneficiary under a discretionary trust has an 'interest': the nature of it may, sufficiently for the purpose, be spelt out by saying that he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity. . . . But that does not mean that he has an interest which is capable of being taxed by reference to its extent in the trust fund's income: it may be a right with some degree of concreteness or solidity, one which attracts the protection of a court of equity, yet it may still lack the necessary quality of definable extent which must exist before it can be taxed.

The House of Lords in *Gartside* rejected the Revenue argument that as any one beneficiary might receive all the income, he or she should be treated as entitled to the whole income, and estate duty charged accordingly upon the whole of the undistributed capital of the fund on his or her death. Instead the House of Lords made it clear that such beneficiaries neither individually nor collectively have any 'interest' extending to the whole or any definable part of the income of the fund. The same proposition was subsequently confirmed in *Sainsbury v IRC* [1970] Ch 712, for 'exhaustive discretionary trusts' ie those where the trustees were obliged to distribute the whole of the income.

While these judgments firmly establish the negative proposition that a discretionary object's interest is insufficiently precise to be taxed, the positive rights attaching to a beneficiary's interest were not set out in any detail. More recently Walton J summarised these rights as they apply to objects of a mere power in *Vestey v IRC (No 2)* [1979] 2 All ER 225 at 235:

> What 'rights' are . . . conferred on any individual potential beneficiary? In my judgment, the only relevant rights which are conferred on such a beneficiary are: (i) the right to be considered by the person exercising the power when he comes to exercise it; (ii) the right to prevent certain kinds of conduct on the part of the person so exercising the power, e.g. by distributing part of the assets to persons not within the class; and (iii) the right to retain any sums properly paid to him by the trustees in exercise of their discretionary powers. But beyond that he has no relevant 'right' of any description. . . . Indeed, no individual has any power over any part of the income whatsoever. The most relevant right is, indeed, the third; but a right to retain what is properly paid to you is simply the negative right of being afforded a complete defence to any claim for repayment, and no more. Prior to actual payment, to which there is no right whatsoever, the recipient has no right to the money at all.
>
> One may, indeed, contrast the situation in the present case with a situation where trustees are obliged to distribute income year by year under the terms of their trust deed among a certain class in such shares and proportions as they may think fit, a case in which each potential beneficiary is very much more likely in ordinary parlance to have power to enjoy the income than the present case. Even in such a case no individual potential beneficiary has any relevant right whatsoever, although collectively, they undoubtedly do have a right which, if they are all sui juris, they may collectively enforce.

The above description was specifically approved by the House of Lords on appeal ([1979] 3 All ER 976 at 983 per Lord Wilberforce). Where the disposition is a discretionary trust the trustees must distribute the relevant income or capital within a reasonable period after the time stipulated in the trust instrument. Although the duty to distribute can be enforced by a beneficiary this gives no greater entitlement to a definite portion of the income than that of the object of a mere power. This is not to say that legislation cannot ever attribute ownership or effective control to a beneficiary of a discretionary trust (see eg the application of Matrimonial Causes Act 1973, ss 23, 24 in *Browne v Browne* [1989] 1 FLR 291).

For the purposes of trusts law, however, the result, as Pettit with a fine sense of understatement has noted, is that 'it is very difficult to explain where the equitable interest lies in the case of discretionary trusts' (p 74; see also Everton [1982] Conv 118 at 119). There is a certain convenient attraction in Pettit's suggestion that 'perhaps the true view is that the beneficial interest is in suspense until the trustees exercise their discretion'. Yet this formula addresses only the proprietary element inherent in the notion of 'an interest'. There is no suggestion that any of the 'rights' described by Walton J are in suspense yet even here we may, as the next section hypothesises, be compelled to reassess the strength of even these rights.

(d) From 'equitable interest' to 'equitable right' and beyond

We have reached a position where we know that Equity came to recognise that a beneficiary under a trust possessed a form of property interest in the shape of equitable ownership. As with other species of property, that interest too is alienable: it can be bought, sold, assigned, mortgaged, and bequeathed in a will. But as is evident in the analysis of Walton J in *Vestey v IRC (No 2)* these rights to dispose of or to alienate that one associates with property ownership become almost meaningless in any practical sense for the individual beneficiary in the context of the modern discretionary trust. It is then no surprise that we are forced to turn the spotlight on to trustees' duties and the capacity of beneficiaries to hold them to account if we are to understand what equitable rights the beneficiary has. And our language has slipped from that of property – equitable ownership – to that of obligation – enforcement of duties through the exercise of rights by beneficiaries. As we shall see in later chapters establishing exactly what rights the beneficiaries should be able to exercise to enforce accountability of trustees is a matter that is still attracting the courts' attention. There we could leave the matter albeit with the trite conclusion that although the property rights element of beneficiaries' interests – equitable ownership of a trust fund – may be difficult to attribute at any given time, it is possible to ascribe a raft of equitable rights to each and every beneficiary of a trust. Yet this conclusion may underestimate the extent to which settlors, with the assistance of their advisers, are able to exploit the flexibility of the trust form, and thereby pose new challenges for trusts doctrine.

It will be recalled that one of the aims of the 'black hole trust' is to minimise the transparency of the trust so as to render beneficial ownership opaque. Another aim might be to retain either directly or indirectly control over the administration and ultimate destination of the trust fund. One technique is to appoint a person known as a protector or enforcer. The title of 'enforcer' or more often 'protector' is usually given to persons who will commonly hold both negative powers – for example, requiring their consent to certain transactions – and positive powers – for example, to appoint or remove trustees – as well as the authority to enforce the trust almost as if a beneficiary. But beneficiaries, trustees or settlors they are not! The precise nature of their powers and duties in relation to the enforcement of express trusts is best considered alongside analysis of control and accountability in trusts for persons (see Chapter 11).

A still more ambitious tactic may be to relieve the trustee of any obligation to inform beneficiaries or possible objects of a power of the existence of their 'interest' and, almost as a corollary, to deny them rights to any information from the trustees. If we also decide that it would be desirable to place the right to hold trustees to account exclusively in the hands of an enforcer or protector we are entering some rather shoaly waters. Attempts to strip beneficiaries, or possibly also objects of powers, of the legal capacity to hold trustees to account raise fundamental questions about the nature of trusts. At present this would be a step too far. How can there be a trust if the trustees cannot be held to account by beneficiaries? As Millett LJ has said: 'If the beneficiaries have no rights enforceable against the trustees there are no trusts' (*Armitage v Nurse* [1998] Ch 241 at 253). In response, it may be contended that as long as there is some person – an enforcer or protector – who has the authority to hold trustees to account then the 'obligation' element of the trust is satisfied. It is unquestionably the case that the shift from an emphasis on the centrality of equitable ownership to one where 'enforceability' comes to the fore does pose difficulties for determining where, logically, one should draw the line in determining what is the irreducible core content of a trust. (See generally on this question Hayton (2001) 117 LQR 96; Hilliard (2003) 17(3) TLI 144; but cf Matthews in Hayton (ed) *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (2002) p 203 and Parkinson [2002] 61(3) CLJ 657.) As will be seen in the next section the context in which debates about some of these matters has arisen is the present scope of and justification for one of the necessary requirements for the creation of a valid express trust, compliance with the beneficiary principle.

For the moment it is simply necessary to emphasise that many of the initiatives being outlined here are manifested predominantly in offshore jurisdictions with their own statutory framework and interpretations of trust law. The change of jurisdiction does not detract from the conceptual challenge but we need to appreciate that the response to the challenge may be influenced by the practical implications of the increasing internationalisation of trusts practice. We cannot assume that every jurisdiction will answer these fundamental questions with identical perceptions of conceptual purity. Nor can we assume that the conceptual framework of the English law of trusts will remain immune.

5. The beneficiary principle in modern trusts law

(a) Introduction

It will be recalled that one eventual product of *Morice v Bishop of Durham* was the beneficiary principle. Both the policy justification and the authority for the principle have come under scrutiny since *McPhail v Doulton*. In particular the recognition there of the remedies available to a court if called upon to execute a trust (eg by directing a scheme of distribution) questions the validity of any continuing narrow approach to those problems of enforceability which are at the heart of the beneficiary principle. Grbich, for instance, has claimed that *McPhail v Doulton* 'authoritatively extended [a] common sense remedial approach to discretionary trusts. It does not take much crystal-ball gazing to see the impact this extension will have on all the old sterile purpose trust and unincorporated association debates' (Grbich (1974) 37 MLR 643 at 656; see also Harris (1971) 87 LQR 31 and Everton [1982] Conv 118 at 121–125).

The 'sterile debates' revolve around two particular problems posed by the beneficiary principle. First, on the boundaries of the law of charitable trusts it may operate to invalidate a 'purpose trust' which falls outside the legal definition of charitable purpose thereby demarcating the border between private and public trusts; and, second, it can frustrate a donor's attempt to make a gift to a non-charitable unincorporated association. Some practical and conceptual consequences of these problems are considered further in Chapters 17 and 18, and also in Chapter 15 where the apparent departure from a strict application of the beneficiary principle in the commercial context of a 'Quistclose' trust is examined. Nevertheless, the beneficiary principle still stands as one of the formal requirements for the validity of a private express trust and it is convenient to consider here how firmly established it is in principle.

(b) The principle established

The student becomes accustomed to meeting rules and then immediately being introduced to the qualifying exceptions. However, it has been said that so great are the number of exceptions to the beneficiary principle that it was open to doubt as to which was the rule and which the exception (see Leigh (1955) 18 MLR 120 at 127), and the principle did experience only fluctuating recognition in the century following *Morice v Bishop of Durham*. It made a brief appearance in early editions of *Lewin on Trusts* but disappeared after its apparent firm rejection by North J in *Re Dean* (1889) 41 Ch D 552 – a case concerning a trust for the maintenance of horses and hounds. The modern line of authority began with dicta of Lord Parker in *Bowman v Secular Society Ltd* [1917] AC 406, received further support from Harman J in *Re Wood* [1949] Ch 498 and was then affirmed by Roxburgh J in *Re Astor's Settlement Trusts*, where the justifications for the rule were, for the first time since *Morice v Bishop of Durham*, fully considered.

In 1945 Viscount Astor and his son David settled substantially all the shares of Observer Ltd (proprietors of the *Observer* newspaper). The income of the settled fund was to be applied for a number of non-charitable purposes including: (i) the maintenance of good understanding between nations; (ii) the preservation of the independence and integrity of newspapers; and (iii) the protection of newspapers from being absorbed or controlled by combines.

Re Astor's Settlement Trusts [1952] Ch 534

Roxburgh J: Mr Jennings and Mr Buckley have submitted that [the trusts] are void on two grounds: (1) that they are not trusts for the benefit of individuals; (2) that they are void for uncertainty.

Lord Parker considered the first of these two questions in his speech in *Bowman v Secular Society Ltd* [1917] AC 406 and I will cite two important passages. The first is: 'The question whether a trust be legal or illegal or be in accordance with or contrary to the policy of the law, only arises when it has been determined that a trust has been created, and is then only part of the larger question whether the trust is enforceable. For, as will presently appear, trusts may be unenforceable and therefore void, not only because they are illegal or contrary to the policy of the law, but for other reasons.' The second is: 'A trust to be valid must be for the benefit of individuals, which this is certainly not, or must be in that class of gifts for the benefit of the public which the courts in this country recognise as charitable in the legal as opposed to the popular sense of that term.'

. . . I will first consider whether Lord Parker's propositions can be attacked from a base of principle.

The typical case of a trust is one in which the legal owner of property is constrained by a court of equity so to deal with it as to give effect to the equitable rights of another. These equitable rights have been hammered out in the process of litigation in which a claimant on equitable grounds has successfully asserted rights against a legal owner or other person in control of property. Prima facie, therefore, a trustee would not be expected to be subject to an equitable obligation unless there was somebody who could enforce a correlative equitable right, and the nature and extent of that obligation would be worked out in proceedings for enforcement. This is what I understand by Lord Parker's first proposition. At an early stage, however, the courts were confronted with attempts to create trusts for charitable purposes which there was no equitable owner to enforce.

[Roxburgh J explained the Attorney-General's role in enforcing charitable trusts.]

But if the purposes are not charitable, great difficulties arise both in theory and in practice. In theory, because having regard to the historical origins of equity it is difficult to visualise the growth of equitable obligations which nobody can enforce, and in practice, because it is not possible to contemplate with equanimity the creation of large funds devoted to non-charitable purposes which no court and no department of state can control, or in the case of maladministration reform. Therefore, Lord Parker's second proposition would prima facie appear to be well founded. Moreover, it gains no little support from the practical considerations that no officer has ever been constituted to take, in the case of non-charitable purposes, the position held by the Attorney-General in connexion with charitable purposes, and no case has been found in the reports in which the court has ever directly enforced a non-charitable purpose against a trustee. Indeed where, as in the present case, the only beneficiaries are purposes and an at present unascertainable person, it is difficult to see who could initiate such proceedings. If the purposes are valid trusts, the settlors have retained no beneficial interest and could not initiate them. It was suggested that the trustees might proceed ex parte to enforce the trusts against themselves. I doubt that, but at any rate nobody could enforce the trusts against them. This point, in my judgment, is of importance, because in most of the cases which are put forward to disprove Lord Parker's propositions the court had indirect means of enforcing the execution of the non-charitable purpose.

Let me then sum up the position so far. On the one side there are Lord Parker's two propositions with which I began. These were not new, but merely re-echoed what Sir William Grant had said as Master of the Rolls in *Morice v Bishop of Durham* as long ago as 1804: 'There must be somebody, in whose favour the court can decree performance.' The position was recently restated by Harman J in *Re Wood* [1949] Ch 498, 501: 'A gift on trust must have a cestui que trust,' and this seems to be in accord with

> principle. On the other side is a group of cases relating to horses and dogs, graves and monuments – matters arising under wills and intimately connected with the deceased – in which the courts have found means of escape from these general propositions and also *Re Thompson* [1934] Ch 342 and *Re Price* [1943] Ch 422 which I have endeavoured to explain. *Re Price* belongs to another field. The rest may, I think properly be regarded as anomalous and exceptional and in no way destructive of the proposition which traces descent from or through Sir William Grant through Lord Parker to Harman J. Perhaps the late Sir Arthur Underhill was right in suggesting that they may be concessions to human weakness or sentiment (see *Law of Trusts*, 8th edn, p 79). They cannot, in my judgment, of themselves (and no other justification has been suggested to me) justify the conclusion that a Court of Equity will recognise as an equitable obligation affecting the income of large funds in the hands of trustees a direction to apply it in furtherance of enumerated non-charitable purposes in a manner which no court or department can control or enforce. I hold that the trusts here in question are void on the first of the grounds submitted by Mr Jennings and Mr Buckley.
>
> The second ground upon which the relevant trusts are challenged is uncertainty. If (contrary to my view) an enumeration of purposes outside the realm of charities can take the place of an enumeration of beneficiaries, the purposes must, in my judgment, be stated in phrases which embody definite concepts and the means by which the trustees are to try to attain them must also be prescribed with a sufficient degree of certainty.

[Roxburgh J held that many of the purposes were uncertain and, in response to a suggestion that the trustees be allowed to perform those purposes that were stated with sufficient certainty, commented:]

> But how . . . could I decree in what manner the trusts applicable to income were to be performed? The settlement gives no guidance at all. Mr Hunt suggested that the trustees might apply to the court ex parte for a scheme. It is not, I think, a mere coincidence that no case has been found outside the realm of charity in which the court has yet devised a scheme of ways and means for attaining enumerated trust purposes. If it were to assume this (as I think) novel jurisdiction over public but not charitable trusts it would, I believe, necessarily require the assistance of a custodian of the public interest analogous to the Attorney-General in charity cases, who would not only help to formulate schemes but could be charged with the duty of enforcing them and preventing maladministration. There is no such person. Accordingly, in my judgment, the trusts for the application of income during 'the specified period' are also void for uncertainty.
>
> But while I have reached my decision on two separate grounds, both, I think, have their origin in a single principle, namely, that a court of equity does not recognise as valid a trust which it cannot both enforce and control. This seems to me to be good equity and good sense.

The Court of Appeal in *Re Endacott* [1960] Ch 232 endorsed Roxburgh J's general approach and in particular his refusal to follow the 'anomalous and exceptional' cases. In Harman LJ's words these decisions were (at 250) 'perhaps merely occasions when Homer has nodded' and 'stand by themselves and ought not to be increased in number, nor indeed followed, except where the one is exactly like the other'.

The adequacy of a doctrinal analysis which portrays the anomalous and exceptional cases as representing a breach with an established beneficiary principle, remains open to question, however. Cotterell, for instance, suggests that *Re Dean* was consistent with the interpretation placed upon *Morice v Bishop of Durham* in other nineteenth-century cases ('Some Sociological Aspects of the Controversy Around the Legal Validity of Private Purposes Trusts' in Goldstein (ed) *Equity and Contemporary Legal Developments* (1992) p 302 at p 325; cf the classic conventional analysis of Gray (1902) 15 Harvard LR 509). On this view, it is the change of judicial approach evident in the modern cases that needs to be explained. It may simply be that a perceptible shift in the objects of purpose trusts, from their very limited scope in the early cases, towards purposes more contentious (*Bowman v Secular Society Ltd*), more abstract (*Re Astor*) and more eccentric (*Re Shaw* [1957] 1 WLR 729) engendered an intuitive judicial scepticism about the utility of facilitating a broad category of non-charitable purpose trusts.

In any event, since *Re Astor* the contemporary rationale for the principle is conventionally couched in terms of 'enforceability and control'. Indeed the so-called anomalous cases are usually termed 'trusts of imperfect obligation' because of doubts as to the trustees' duty to perform the trust. They have been classified in the following manner (Morris and Leach *The Rule Against Perpetuities* (2nd edn, 1962) p 310; and see generally *Hanbury and Martin* pp 368–373; *Parker and Mellows* pp 82–85):

(1) trusts for the erection or maintenance of monuments or graves;
(2) trusts for the saying of masses if they are not charitable;
(3) trusts for the maintenance of particular animals; and
(4) miscellaneous cases.

Following *Re Endacott* it is clear that these 'concessions to human weakness or sentiment' will not be extended further and, subject to what is discussed in (c) below, trusts for non-charitable purposes are likely to fail unless contained within these narrow boundaries.

(c) The principle undermined?

Implicit in the beneficiary principle is the notion that non-charitable trusts can be divided into trusts for persons and trusts for purposes. This demarcation, however straightforward in theory, is not easy to apply where a combination of persons and purposes appears. Examples are a trust for the purpose of educating A's children or a trust to maintain two old ladies during their lives (see *Re Abbott Fund Trusts* [1900] 2 Ch 326). Are they trusts for purposes, with an indication of who is to benefit by the fulfilment of the purpose, or trusts for persons with the purpose merely signifying the motive for the gift? Should validity depend on whether there exists someone factually capable of enforcing the trust? These issues were confronted in *Re Denley's Trust Deed*, where land was conveyed to trustees by H H Martyn & Co Ltd 'to be maintained and used . . . for the purpose of a recreation or sports ground primarily for the benefit of employees . . . and secondarily for the benefit of such other . . . persons (if any) as the trustees may allow to use the same . . .' (Clause 2(c)). By clause 2(d) the employees were entitled to the use and enjoyment of the land.

Re Denley's Trust Deed [1969] 1 Ch 373 at 382

Goff J: Mr Mills has argued that the trust in clause 2(c) in the present case is either a trust for the benefit of individuals, in which case he argues that they are an unascertainable class and therefore the trust is void for uncertainty, or that it is a purpose trust, that is, a trust for providing recreation, which he submits is void on the beneficiary principle, or, alternatively, that it is something of a hybrid, having the vices of both kinds.

I think there may be a purpose or object trust, the carrying out of which would benefit an individual or individuals, where that benefit is so indirect or intangible or which is otherwise so framed as not to give those persons any locus standi to apply to the court to enforce the trust, in which case the beneficiary principle would, as it seems to me, apply to invalidate the trust, quite apart from any question of uncertainty or perpetuity. Such cases can be considered if and when they arise. The present is not, in my judgment, of that character, and it will be seen that clause 2(d) of the trust deed expressly states that, subject to any rules and regulations made by the trustees, the employees of the company shall be entitled to the use and enjoyment of the land. Apart from this possible exception, in my judgment the beneficiary principle of *Re Astor's Settlement Trusts*, which was approved in *Re Endacott* [1960] Ch 232 – see particularly by Harman LJ (at 250) – is confined to purpose or object trusts which are abstract or impersonal. The objection is not that the trust is for a purpose or object per se, but that there is no beneficiary or cestui que trust. The rule is so expressed in *Lewin on Trusts*, 16th ed (1964), p 17, and, in my judgment, with the possible exception I have mentioned, rightly so. In *Re Wood* [1949] Ch 498 Harman J said: '. . . a gift on trust must have a cestui que trust. . . .'

Again in *Leahy v A-G for New South Wales* [1959] AC 457 Viscount Simonds, delivering the judgment of the Privy Council, said (at 478):

> 'A gift can be made to persons (including a corporation) but it cannot be made to a purpose or to an object: so also,' – and these are the important words – 'a trust may be created for the benefit of persons as cestuis que trust but not for a purpose or object unless the purpose or object be charitable. For a purpose or object cannot sue, but, if it be charitable, the Attorney-General can sue to enforce it.'

Where, then, the trust, though expressed as a purpose, is directly or indirectly for the benefit of an individual or individuals, it seems to me that it is in general outside the mischief of the beneficiary principle.

[Goff J referred to *Re Harpur's Will Trusts* [1962] Ch 78; *Re Aberconway's Settlement Trusts* [1953] Ch 647 and *Re Bowes* [1896] 1 Ch 507, all of which he considered supported his view.]

The trust in the present case is limited in point of time so as to avoid any infringement of the rule against perpetuities and, for the reasons I have given, it does not offend

> against the beneficiary principle; and unless, therefore, it be void for uncertainty, it is a valid trust.
>
> As it is a private trust and not a charitable one, it is clear that, however it be regarded, the individuals for whose benefit it is designed must be ascertained or capable of ascertainment at any given time: see *IRC v Broadway Cottages Trust*.

[It was conceded that the class of employees was ascertainable and Goff J held that the provision as to 'other persons' constituted a power and was not void for uncertainty.]

> There is, however, one other aspect of uncertainty which has caused me some concern; that is, whether this is in its nature a trust which the court can control. . . .

[Goff J quoted Lord Eldon's words from *Morice v Bishop of Durham* above p 196.]

> The difficulty I have felt is that there may well be times when some of the employees wish to use the sports club for one purpose while others desire to use it at the same time for some other purpose of such natures that the two cannot be carried on together. The trustees could, of course, control this by making rules and regulations under clause 2(d) of the trust deed, but they might not. In any case, the employees would probably agree amongst themselves, but I cannot assume that they would. If there were an impasse, the court could not resolve it, because it clearly could not either exercise the trustees' power to make rules or settle a scheme, this being a non-charitable trust: see *Re Astor's Settlement Trusts*.
>
> In my judgment, however, it would not be right to hold the trust void on this ground. The court can, as it seems to me, execute the trust both negatively by restraining any improper disposition or use of the land, and positively by ordering the trustees to allow the employees and such other persons (if any) as they may admit to use the land for the purpose of a recreation or sports ground. Any difficulty there might be in practice in the beneficial enjoyment of the land by those entitled to use it is, I think, really beside the point. The same kind of problem is equally capable of arising in the case of a trust to permit a number of persons – for example, all the unmarried children of a testator or settlor – to use or occupy a house or to have the use of certain chattels; nor can I assume that in such cases agreement between the parties concerned would be more likely, even if that be a sufficient distinction, yet no one would suggest, I fancy, that such a trust would be void.
>
> In my judgement, therefore, the provisions of clause 2(c) are valid.

Consider the following points:

(1) Goff J suggests that a trust such as that in *Re Denley* falls outside the 'mischief of the beneficiary principle'. What do you think that he considers the 'mischief' to be?

(2) Did Goff J consider that a factual interest in the carrying out of a trust was sufficient to provide the employees with locus standi to enforce the trust, or did he consider them to be 'licensees' under clause 2(d)? (See McKay (1973) 37 Conv (NS) 420 at 426–428.) Goff J indicates that even though (i) the beneficiary principle is satisfied, (ii) the class to be benefited is sufficiently certain, and (iii) there is no infringement of

the rule against perpetuities, the trust may still be invalid if the court cannot control it – citing Lord Eldon's judgment from *Morice v Bishop of Durham* as authority. Assuming that there is a distinct class of 'persons/purposes' trusts (but see (3) below) is Goff J identifying an additional requirement for validity, analogous to that of 'administrative unworkability' subsequently adopted in *McPhail v Doulton*?

(3) Vinelott J commented on the *Denley* case in *Re Grant's Will Trusts* [1979] 3 All ER 359 at 368 (see generally Chapter 17) as follows:

> That case on a proper analysis . . . falls altogether outside the categories . . . of purpose trusts. I can see no distinction in principle between a trust to permit a class defined by reference to employment to use and enjoy land in accordance with rules to be made at the discretion of trustees on the one hand, and, on the other hand, a trust to distribute income at the discretion of trustees among a class, defined by reference to, for example, relationship to the settlor. In both cases the benefit to be taken by any member of the class is at the discretion of the trustees, but any member of the class can apply to the court to compel the trustees to administer the trust in accordance with its terms.

This interpretation or explanation of *Re Denley* views the case as simply a trust for individuals and not a purpose trust at all. If one accepts the orthodoxy that there must always be a 'beneficiary' and not just some person with locus standi to act as an enforcer, then it would seem necessary to interpret *Re Denley* in that manner (see in particular the support for the analysis of Vinelott J by Matthews in Oakley (ed) *Trends in Contemporary Trust Law* (1996) 1 and Millett QC (as he then was) (1985) 101 LQR 269 at 281–282, but note the latter's puzzling reference to *Denley* as being concerned with 'the upkeep of a *garden* [emphasis added] for the use of employees'). It is, however, not easy to reconcile this interpretation of *Re Denley* with either the facts of the case or the judgment of Goff J. Moreover Vinelott J's observation that he can see no distinction between the 'two classes of cases' that he refers to is puzzling. One form of discretion is of an administrative nature – 'making rules for the use and enjoyment of land by all those employees able to benefit'– whereas the other – 'discretion to distribute income among a class' – is plainly dispositive.

This is not simply a dispute about labelling: if a mixed persons-purposes trust is recognised as something distinct from a trust for persons only, then whilst the enforcement powers of the members of the classes may be identical their beneficial entitlement may not be. In particular there would seem to be no reason for applying the rule in *Saunders v Vautier* (see Chapter 7) to such a trust (see also *Re Osoba* [1978] 2 All ER 1099; noted Rickett (1978) 37 CLJ 219). To do so could potentially allow the 'persons' if they were all agreed to defeat the purpose and claim the trust property. It is at least open to doubt whether that outcome would have been envisaged by Goff J as a corollary of his decision (see (4) below). On the other hand, using a widely drawn class of objects under the post-*McPhail v Doulton* certainty of objects test for discretionary trusts would (i) largely negate the likelihood of this outcome, and (ii) reinforce the possibility of an extremely flexible trust (but cf the failure on grounds of administrative unworkability of the trust in *R v District Auditor, ex p West Yorkshire Metropolitan County Council* [1986] RVR 24).

(4) It will be recalled that in *Re Denley's Trust Deed* Goff J referred to *Re Bowes*, a case that he submitted supported his conclusion. In *Re Bowes* money directed to be expended in the planting of trees on an estate part of settled land was held to belong to the owners of the estate absolutely. This is really an illustration of a principle of construction laid down in *Re Sanderson's Trusts* in the following terms: 'If a gross sum be given, or if the whole income of the property be given, and a special purpose be assigned for that gift, the court always regards the gift as absolute, *and the purpose merely as the motive of the gift* . . .' (per Page Wood V-C (1857) 3 K & J 497 at 503; emphasis added; see also *Re Andrew's Trust* [1905] 2 Ch 48 and *Re Osoba* [1979] 1 WLR 247). Whilst it may have been a useful case to pray in aid of the decision that Goff J wished to reach we would suggest that cases such as *Re Bowes*, on the face of it for a purpose but where the purpose is construed as a motive for the gift, are of a different order to *Re Denley*. In *Re Denley* in our view there was no question of the employees having any right to call for the trust property, even if they were all agreed on this.

(5) *McPhail v Doulton* [1970] 2 All ER 228 may affect the rationale for the beneficiary principle that 'equity does not recognise a trust which it cannot both enforce and control' (per Roxburgh J in *Re Astor*) in three further ways:

(i) Does the acceptance in *McPhail v Doulton* of a jurisdiction for the court to execute a trust more flexibly if called upon to do so suggest that a similar approach could be applied to a trust with purposes such as those in *Re Astor*?

(ii) If the beneficiary principle is based on the premise that 'a trustee would not be expected to be subject to an equitable obligation unless there was somebody who could enforce a correlative equitable right' (per Roxburgh J), to what extent does the difficulty of identifying the equitable ownership in a discretionary trust undermine the principle?

(iii) If a consequence of *McPhail v Doulton* was to elevate 'the effecting of a settlor's intention' over 'the demands of strict enforceability', could this preference equally justify a relaxation of the beneficiary principle (eg to permit enforcement by those with a factual interest in the performance of the trust)? (Cf Harris (1971) 87 LQR 31 at 56–57; and McKay (1973) 37 Conv 420 at 434–435.) One requirement of 'strict enforceability' is that there must be someone with a *positive* interest in enforcing the trust. It is not considered sufficient that there may exist some person, such as a residuary legatee or next-of-kin, who would be entitled to the trust property were the trust to fail. Such persons would certainly have standing to complain if the trust property were misapplied, but what incentive would they have if the remedy were to be, for instance, the appointment by the court of new trustees to carry out the purpose? Certainly in those anomalous trusts to maintain graves or animals for a limited period, those ultimately entitled to the property have a material interest in the trust *not* being performed. As Waters points out, there will be more for them to receive if they 'allow the grave to be overgrown with weeds or the animals to die of neglect' (*Law of Trusts in Canada* (2nd edn, 1984) p 509).

(6) In some jurisdictions the requirement for positive enforcement has been satisfied formally by creating a statutory enforcement mechanism (see (d) 'A protector postscript' below).

(7) Gardner, has expressed scepticism about the merits of the enforceability principle (*An Introduction to the Law of Trusts* (2nd edn, 2003) pp 260–264). In the absence of legislation he propounds a more radical solution, suggesting that the arguments against recognising a category of valid though unenforceable trusts 'seems less supportable than the contrary view' (p 264). In effect this proposition places a premium on the integrity of trustees, but, as Gardner points out (p 263), 'compliant trustees regard their legal duties as such and try to perform them properly, irrespective of their enforceability' and 'most trustees seem to be compliant'. Assuming that Gardner's proposal deftly sidesteps the reasons advanced in *Re Astor* for the requirement of strict enforceability, would recognition of 'unenforceable trusts' nevertheless inevitably blur the conceptual distinction between trusts, powers and absolute ownership?

(8) Even if the courts were to be inclined to hold that an abstract purpose trust, such as that in *Re Astor*, could overcome or circumvent the requirements of enforceability, another obstacle to validity, one of policy, would still remain. It is improbable that the courts would be prepared to countenance *any* purpose trust no matter how eccentric. Instead the courts would be likely to exercise their discretion so as to invalidate trusts for 'useless' or 'capricious' purposes (as in *Brown v Burdett* (1882) 21 Ch D 667 – rooms of a house to be sealed up for 20 years; and the remarkable wills of the M'Caigs of Oban dedicated to constructing artistic towers and statuary on their estates, *M'Caig v University of Glasgow* 1907 SC 231 and *M'Caig's Trustees v Kirk-Session of United Free Church of Lismore* 1915 1 SLT 152). Indeed, a judicial reluctance to countenance non-charitable purpose trusts of a public nature (such as those in *Re Astor* or the *West Yorkshire* case) can be advanced as providing a plausible policy explanation for maintaining the beneficiary principle (see Harpum (1986) 45 CLJ 392). Contemporary liberalisation of the definition of charitable purposes (see Chapter 19) in the direction of recognising as charitable many, perhaps most, non-contentious purposes of a beneficial nature could paradoxically reinforce the adoption by the courts of a restrictive approach.

(9) In conclusion, write the Court of Appeal judgment if there had been an appeal in *R v District Auditor, ex p West Yorkshire Metropolitan County Council* (noted above p 227 and see Harpum (1986) 45 CLJ 392).

Lest the speculative discussion above has tended to blur the 'is' and the 'ought', the result of *Re Astor's Settlement Trusts* [1952] Ch 534, supplemented by judgments of the Court of Appeal in *Re Endacott* [1960] Ch 232 and the Privy Council in *Leahy v A-G for New South Wales* [1959] AC 457, is that the beneficiary principle is firmly established and could only be overturned by legislation or the House of Lords.

Lastly there is a venerable body of literature (Ames (1892) 5 Harv LR 389; cf Gray (1902) 15 Harv LR 67; Scott (1945) 58 Harv LR 548), suggesting that an instrument purporting to create a purpose trust may sometimes be validated by construing the trust as a power. This possibility, however, seems effectively to have been frustrated by the Court of Appeal in *IRC v Broadway Cottages Trust* [1955] Ch 20 at 36: 'We do not think that a valid power is to be spelt out of an invalid trust' (followed in *Re Endacott* [1960] Ch 232).

(d) A 'protector' postscript

Reference is made above to the possibility of sidestepping by statutory means the limitations of the beneficiary principle. A pioneer in this regard was Bermuda with the Bermudan Trusts (Special Provisions) Act 1989 which facilitates the creation of purpose trusts. Bermuda is no longer a special case; the 1990s saw such a proliferation of statutory purpose trust regimes that settlors and their advisers can now choose from one of twenty or so different offshore locations if they wish to establish some form of purpose trust (see eg Baxendale-Walker *Purpose Trusts* (1999); Duckworth *STAR Trusts* (1998)). One feature common to almost all of these regimes is that specific provision is made for some person to enforce the trust. As we noted previously the title of 'enforcer' or more often 'protector' is usually given to such persons. Bermuda itself has taken one further step with the Trusts (Special Provisions) Amendment Act 1998. Under s 12B(2) the range of persons who can enforce the trust has been extended beyond 'the enforcer' to include 'any other person whom the court considers has sufficient interest in the enforcement of the trust' (see Anderson [1999] PCB 4 at 219).

Our immediate concern, however, is with the how and why of these contemporary developments. A principal objective of purpose trusts established under these regimes is to render beneficial ownership as remote and undetectable as possible. Not surprisingly such trusts with their attendant financial costs are not likely to be concerned with the erection of monuments or the maintenance of pets. Instead the belief is that they can be used to achieve a variety of purposes ranging from facilitating tax-efficient family provision to structuring commercial transactions through a purpose trust to achieve 'off balance sheet' arrangements, invisible to regulators, creditors and competitors alike (see eg Matthews 'The New Trust: Obligations Without Rights?' and Waters 'The Protector: New Wine in Old Bottles' in Oakley (ed) *Trends in Contemporary Trust Law* (1996) chs 1 and 4 respectively; and generally Baxendale-Walker, ch 10). As Matthews summarises the position: 'the offshore trusts jurisdictions saw that there was a need for a vehicle that could truly be said to belong to no one beneficially, and which could be slotted into complicated commercial transactions without difficulty' (at p 28).

Yet in a sense the reaction of the offshore jurisdictions represents simply the response of the market to the demand for a product. And there is nothing new in this development. An underpinning theme of this chapter has been the creativity of the practitioner responding to the perceived needs of the client. As stated earlier in this chapter, one illustration in our view was the re-emergence of the discretionary trust and its adaptation to tax-planning and commercial ends. In the example of the new 'purpose trusts' we see again a 'bottom-up' development, but this time incorporating the dimensions of geographical location and legal jurisdiction to complement the fragmentation of ownership and control. It remains to be seen whether the various statutory evasions of the beneficiary principle do succeed in subverting the conceptual purity of the notion that under any division of ownership it must be possible to locate both legal and equitable property ownership. It also remains to be seen whether this particular manifestation of globalising trends will prove to be inscrutable to national fiscal and regulatory regimes. (See generally the reservations expressed by Matthews (above) and his debate with Duckworth about the Cayman Islands Special Trusts (Alternative Regime) Law 1997 in Matthews (1997) 11 TLI no 3 at 67 and (1998) 12 TLI no 2 at 98 and Duckworth (1998) 12 TLI no 1 at 16 and (1999) 13 TLI 158.)

6

Trusts and public policy

1. Introduction

An express trust satisfying the requirements of formality, certainty and complete constitution will be valid unless it contravenes certain overriding limitations which stem broadly speaking from public policy considerations. These limitations can be grouped for convenience into three categories. One category is concerned with attempts to defeat the creditors of settlors or beneficiaries by means of the trust. A second category comprises a loose class of prohibitions which cluster under the umbrella of public policy but are primarily concerned not to undermine accepted notions of morality and family solidarity. Trusts which might tend to interfere with the sanctity of marriage, for example, will be held void. The final category of limitations concerns the plane of time: while the law may place few restraints on the types of interest a settlor can create and the conditions to which they may be subject, restrictions are imposed through rules of perpetuity, accumulations and inalienability on the duration of trusts.

These limitations and their respective policy justifications form the subject-matter of this chapter.

At first sight, however, it must seem rather odd to devote a chapter to trusts and public policy, when a recurrent theme in the book is to weigh the rules of trusts law against non-legal policy considerations and to assess how the development of those rules has been influenced by such considerations. And in a sense, as the description above implies, this is a chapter of convenience: as a focus of study, it assembles discrete issues about limits to the creation of trusts around an organising theme, namely the relationship of those issues to aspects of public policy. The term 'aspects', however, gives a clue to a further reason for the chapter, extending beyond convenience. Public policy is merely a shorthand term devoid of content unless we identify the particular policy under consideration (eg 'freedom of disposition' or 'protection of creditors'), the values inherent in it, and the interests that any particular policy advances. Indeed the rules discussed in this chapter do not reflect any one public policy. Public policy is a unifying theme only in so far as it prompts us in each of the discrete areas to consider, for instance, how closely the rules are aligned with a particular policy and which one amongst conflicting policies do the rules support. Furthermore, since policy is not immutable, are the legal rules responsive to change or do changes in economic and social circumstances leave us with a rule without a reason?

(a) Public policy and freedom of disposition

In concentrating on specific policy arguments it is also important to recognise that at the heart of a liberal property system lies a basic paradox which impinges in varying degrees on all the categories of limitations described above. The point may be put shortly, if rather simply, as follows. If in a pure liberal or market society the market is to carry out its function of allocation of resources amongst various uses, property must be freely alienable. This seems to require individual freedom of disposition of property, so a pure market society will require a system of property law designed to sustain freedom of disposition. But if freedom of disposition conferred on a person disposing of property means that he or she can regulate the circumstances in which, and the extent to which, the recipients can deal with the property, the recipients do *not* have freedom of disposition. In this sense unrestricted freedom of disposition cannot logically be permitted and fully maintained. The paradox can be summarised as follows: 'if the donor of a property interest tries to restrict the donee's freedom to dispose of that interest, the legal system in deciding whether to enforce or void that restriction, must resolve whose freedom it will protect, that of the donor or that of the donee' (Alexander 'The Dead Hand and the Law of Trusts in the Nineteenth Century' (1985) 37 Stanford LR 1189).

How the state resolves this conflict between competing 'freedoms' is a theme underlying much of the policy discussion in this chapter. It is as well to clarify here that references to 'resolution' of the conflict by the state do not imply that legal development faithfully reflects reasoned responses, whether in statute or common law. The influence of legal formalism, or more specifically in this context what has been pejoratively labelled as 'scholasticism', must also be considered, as the following section illustrates.

(b) Limitations in gifts, public policy and legal logic

(1) Conditions precedent and subsequent

A donor may wish not only to restrict a donee's freedom of disposition but also to influence the donee's behaviour in other ways by attaching conditions to the property interest. A brief digression is necessary to identify two of the types of condition that a donor may seek to impose; a condition precedent and a condition subsequent (see Oakley *Megarry's Manual of the Law of Real Property* (8th edn, 2002) pp 41–45 for a comprehensive account). An understanding of conditions and the criteria against which their validity is tested provides us with insights into a significant aspect of the interplay between formal legal reasoning and public policy in this area.

A condition precedent exists where A gives property to B but subject to a condition that the interest is not to commence (vest) until the occurrence of some event.

An example is a transfer of property on trust for B if and when B qualifies as a civil engineer. In contrast a condition subsequent operates to terminate an already existing interest, for example, to cite a quaint example of Victoriana, property is held on trust for B so long as B does not marry a domestic servant (*Jenner v Turner* (1880) 16 Ch D 188). B's present enjoyment of the interest will be brought to a premature end if the condition is infringed. Both of the above illustrations involve dispositions on trust but this is not essential; a gift subject to a condition can be free-standing. Also the obligation imposed can be stated in positive terms. Thus, in more contemporary vein, an elderly parent might give a house or flat to, for instance, her daughter on condition that she looks after the parent in the premises (see eg *Ellis v Chief Adjudication Officer* [1998] 1 FLR 184). Here again if the condition is valid but is infringed, as for instance by evicting the hapless parent, the daughter's interest in the property would terminate.

The caveat about validity is important. There are limits on the conditions that can be imposed. One mentioned briefly in the previous chapter is that the condition must satisfy the requirement of certainty (*Re Barlow's Will Trusts* [1979] 1 All ER 296). In our 'aged parent' example the condition – 'that the daughter would look after the parent in the flat' – was held by the Court of Appeal in *Ellis* not to be too uncertain. Otton LJ interpreted it to mean that the parent was to remain in the home 'for so long as they both agreed or it was reasonably practicable to do so'. It should be noted, *Ellis* notwithstanding, that the certainty test for conditions subsequent has been stated to be stricter than that for conditions precedent (see *Re Tuck's Settlement Trusts* [1978] 1 All ER 1047; *Blathwayt v Baron Cawley* [1976] AC 397 at 425). This distinction is unfortunate as it is not always easy to distinguish between the two types of condition. Indeed Lord Denning was prompted in a typically robust statement in *Re Tuck's Settlement Trust* to deplore both the dichotomies on the grounds that 'they serve in every case to defeat the intention of the settlor' (at 1052). The way the settlor's intention is defeated is that the condition is void if uncertain. The consequence is that where a condition subsequent is void the interest becomes absolute and not subject to premature termination. In *Ellis*, for instance, had the condition been uncertain and therefore void, the daughter would have retained the flat leaving the mother to find alternative accommodation and reliant on Social Security. With conditions precedent a further distinction is drawn, that between realty and personalty (see *Re Elliott* [1952] Ch 217). Where realty is concerned the complete gift fails if the condition is void, whereas with personalty in contrast the gift normally takes effect, the condition being effectively ignored. Of course, conditions may also be void on grounds of immorality, illegality or being otherwise contrary to public policy.

A further ground for holding a condition subsequent, though not a condition precedent, void was if it purported to take away the freedom of alienation. The reason for this seems to have originated from a view that general restraints on alienation were seen as 'repugnant' to the nature of a fee simple, it being argued that one of the incidents of ownership is a right to sell or otherwise dispose of the property. In other words the condition would be void not because it was contrary to public policy but because alienability as a matter of legal logic could not be severed from the nature of the property interest. The incipient circularity of this doctrine and its underpinning reasoning was savaged by Glanville Williams ((1943) 59 LQR 343 at 346):

> The proposition is not one of empirical fact but one of law. Hence when one asserts that the power to alienate cannot be divorced from a fee simple *because* it is of the essence of a fee simple that it can be alienated, one is not really giving a reason for the rule, though appearing to do so; one is simply expressing the same rule over again by a different linguistic formula.

The point of Williams's criticism was that a criterion of repugnancy should be replaced by one of public policy. This would not necessarily result in different substantive decisions but spurious logic could be dispensed with and decisions opened up to informed scrutiny.

The concept of alienability as an inherent characteristic of property was not restricted, however, to the estate of a fee simple. Significantly for present purposes it was extended to other interests classified as proprietary. The outcome is that in a gift on trust to A for life, a condition subsequent that 'if A shall seek to charge or otherwise dispose of the interest or shall become bankrupt then A's interest will cease', will be void. A's interest will therefore not be subject to premature termination, an outcome that A might be expected to approve. But A's reaction would be premature since it overlooks the consequences of insolvency law. As will be seen in section 2. (Family Trusts and Creditors) below if A were to become bankrupt his creditors would be able to step into A's shoes and claim his interest in the trust fund.

Before considering further some legal and policy implications of this outcome it is necessary briefly to introduce a linguistic and logical curiosity.

(2) A conundrum for public policy? The determinable interest

We could leave the explanation of conditions precedent and subsequent there but for a difficulty which the existence of a species of property interest called a 'determinable interest' raises for an understanding of this area of legal logic. A determinable interest is one which will automatically terminate on the occurrence of some specified event. Such dispositions do not fall foul of the rule against 'repugnancy'. Accordingly a gift on trust for A for life or until A seeks to charge or otherwise dispose of the interest or becomes bankrupt, is a valid gift. A possesses a determinable interest that will cease on the occurrence of the determining event or 'limitation'.

But where, you may say, lies the difference between the example of the determinable interest and the previously mentioned condition subsequent? Such distinctions as exist are to be found in language and concept. Considering language first, 'the distinction is between a grant "to A *but if* he alienates then to B", (a condition) . . . and a grant "to A *until* he alienates, and then to B" (a limitation) where the gift to A comes to an end if he purports to alienate it' (*Williams* p 352).

The conceptual difference can be inferred from the linguistic: 'a limitation marks the bounds of the estate, a condition defeats the estate before it attains its boundary' (per Oakley *Megarry's Manual of the Law of Real Property* (8th edn, 2002) p 42). That different legal consequences in this context can follow from a wafer-thin linguistic distinction has prompted the criticism that it is 'little short of disgraceful to our jurisprudence that in reference to a rule professedly founded on considerations of public policy' such a verbal distinction can be admitted (*Re King's Trusts* (1892) 29 LR Ir 401 at 410), a sentiment endorsed by Pennycuick V-C in *Re Sharp's Settlement Trusts* [1972] 3 All ER 151 at 156: but cf Rattie J in *Re Trusts of the Scientific Investment Pension Plan* [1998] 3 All ER 154 at 158: 'The distinction is not a particularly attractive one, being based *on form rather than substance*' [emphasis added]).

This well-established distinction would be of merely minor historical interest for our purposes but for two points of concern. One is that a determinable interest provides the basis of the protective trust, the device concerned with the protection of a beneficiary's income interest from creditors. This legal device, in essence just a particular form of express trust, is discussed in section 2(b) below. The other point of concern is that worrying reference to 'considerations of public policy'. Justification of the distinction on grounds of public policy does pose difficulties where the consequences that flow from deciding whether a clause imposes a condition subsequent or alternatively a limitation in the form of a determinable interest can be diametrically opposite. If, however, the distinction between the two is rooted in the 'scholasticism' or 'logic', spurious or otherwise, of the doctrine of repugnancy then it seems that a cornerstone of one area of the law ostensibly regulating competing claims of settlors, beneficiaries and creditors will have owed little to policy considerations.

2. Family trusts and creditors

(a) Trusts, insolvency and public policy

The arrival of an economic recession can be a harbinger of forthcoming financial disaster for individuals, families and companies. But the mutability of family fortunes does not rest solely on the crests and troughs of economic waves.

W B Yeats 'Meditations in Time of Civil War – My Descendants' *The Tower* (1928)

And what if my descendants lose the flower
Through natural declension of the soul,
Through too much business with the passing hour,
Through too much play, or marriage with a fool?
May this laborious stair and this stark tower
Become a roofless ruin that the owl
May build in the cracked masonry and cry
Her desolation to the desolate sky.

But might the mundane processes of law, in this context the trust, shield the property-owner and family from these uncertainties, economic or otherwise? If competence of descendants is a concern, placing property into trust to be invested and managed by trustees obviously reduces the autonomy of beneficiaries as compared with absolute ownership. Capital is thereby protected from destruction at the hands of present beneficiaries since the only property interest that the latter are likely to possess during the trust's existence is an entitlement to income. Supposition that the austere spectre portrayed by Yeats is an anachronism today has recently been confounded in the courts. In *Hambro v Duke of Marlborough* [1994] Ch 158 the 'unbusinesslike habits and the lack of responsibility' allegedly shown by the Marquis of Blandford, heir to the Marlborough Estates including Blenheim Palace, led the court to approve a resettlement whereby the interest of the Marquis was varied without his consent to a life interest only (see further Chapter 7 on variation of trusts).

Creating an interest in income rather than providing control over capital does not achieve full security. Where the beneficiary has a life interest this can be charged or otherwise disposed of. Indeed an interest can be sold on the auction market in London through specialist firms of auctioneers and valuers. In short, that interest is itself alienable. Consequently, in the event of a beneficiary's bankruptcy, that interest, because it is alienable, passes to the trustee in bankruptcy for the benefit of the beneficiary's creditors. It is here that the device of the protective trust can come into play by performing a 'now you see it, now you don't' conjuring trick. It provides for the beneficiary's entitlement to income to determine upon the happening of one of a number of contingencies, including bankruptcy. The income of the trust fund then ceases to belong to the beneficiary and is removed out of the direct reach of creditors, whilst at the same time being preserved for the family. It is notable that the resettlement in *Hambro v Duke of Marlborough* was in a form whereby the trust fund was to be held 'on protective trusts for the marquis for life'. The protective trust is examined in section (b) below.

If property-owners can so adapt the trust form to attempt to protect their accumulated capital and their successors from the consequences of the latter's improvidence, it may seem but a short step to using the trust to protect themselves also from economic misfortune. The attempts of settlors to defeat their own creditors are considered in section (c).

But as Keeton has pointed out, these twin desires of property-owners to conserve their wealth and to protect their successors from the consequences of improvidence 'run directly counter to the policy of practically all systems of law that property should be available for the satisfaction of its owners' liabilities' (Keeton *Modern Developments in the Law of Trusts* (1971) p 190). The policy of English law in relation to a bankrupt's assets is stated with stark simplicity in Halsbury's Laws of England (3(2) Halsbury's Laws (4th edn, 2002) para 390):

> The object of bankruptcy law is that all the property comprised in the bankrupt's estate should be realised by the trustee in bankruptcy and divided amongst the bankrupt's creditors.

In fact this statement is deceptive if taken at face value. Insolvency law is not designed to operate solely for the benefit of creditors, but is intended to strike a balance between their interests and those of debtors. Where the balance should be struck was one of the issues considered by the Insolvency Law Review Committee under the chairmanship of Sir Kenneth Cork ('The Cork Report').

Report of the Insolvency Law Review Committee (Cmnd 8558, 1982) paras 23–25

> 23. Society facilitates the creation of credit, and thereby multiplies the risk of insolvency. We consider that it is incumbent upon society to provide machinery which, in the event of insolvency, is adequate to ensure a fair distribution of the insolvent's assets amongst his creditors. While it will always remain essential to punish the dishonest or reckless insolvent, it is also important to devise a system of law to deal compassionately with the honest though unfortunate debtor who is often no more than a bewildered, ill-informed and overstretched consumer. The system must enable the insolvent to extract himself from a situation of hopeless debt as quickly and as cheaply and with as little fuss as possible.
> 24. In the complex world of credit, the legislature and, through the legislature, society has always striven hard to maintain a just balance between the creditor on the one hand and the debtor on the other. Over the centuries this balance has shifted first one way and then the other. In considering where it should be today, it must be remembered that it is the creditor who possesses the capital – which, in the aggregate, is the capital of society as a whole – to which the debtor seeks access for purposes beneficial first to himself, secondly to the creditor in providing him with a market for his capital and, thirdly, to society as a whole.
> 25. The economic and social implications of these relationships require a legal framework which gives the creditor confidence to extend credit, while at the same time does not encourage the potential debtor to act recklessly or irresponsibly.

The reference to 'society as a whole' suggests that insolvency policy should incorporate a dimension which reaches beyond just the interests of debtors and creditors. The conclusion arrived at in the Cork Report reflects this consideration:

> THE BASIC OBJECTIVES OF INSOLVENCY LAW
>
> 192. The law of insolvency takes the form of a compact to which there are three parties: the debtor, his creditors and society. Society is concerned to relieve and protect the individual insolvent from the harassment of his creditors, and to enable him to regain financial stability and to make a fresh start. It accords him this relief in return for:
>
> (a) Such contribution, not only from the realisation of his assets but also from his future earnings, as can reasonably be made by him without reducing him and his family to undue and socially unacceptable poverty and without depriving him of the incentive to succeed in his fresh start . . .

The Insolvency Act (IA) 1986 implemented many of the Cork Report recommendations. Some are relevant to issues discussed in this chapter whereas discussion of others will be considered in the Commerce and Family Breakdown parts of this book respectively.

The working of insolvency law and policy as reflected in the IA 1986 came under scrutiny in a quite wide-ranging review and consultation process conducted during 2000. The outcome was a Government White Paper published in 2001 that recommended only a shift in emphasis rather than any major change in the law of personal insolvency (Department of Trade and Industry *Insolvency – A Second Chance* (Cm 5234) paras 1.10–1.20). The objective, stated in language reminiscent of the Cork Report, was to enhance an individual's ability 'to make a fresh start'. The two principal proposals affecting personal insolvencies were to provide for the automatic discharge of most bankrupts after a maximum of 12 months rather than three years and to reduce the number of restrictions that are automatically imposed on bankrupts. These have now been enacted in Pt 10 of the Enterprise Act 2002 but the modifications to the legal framework do not in our view materially alter the terms of debate about the relationship between insolvency law and policy and trust law. To that extent the analysis set out in the Cork Report remains relevant and indeed arguably still provides the guidelines for government policy on personal insolvency.

One important question to be considered in the following pages, therefore, is how far the law of trusts can be said to operate in a fashion consistent with the policy objectives of insolvency law. But in our assessment of the appropriateness of the balance at present struck by the law of trusts, and by insolvency law so far as it impinges on the use of the trust, it is necessary to consider a fourth interest – respect for the settlor's or testator's wishes. Consequently in some circumstances the ground of debate about conflicts of interest shifts, as will be seen, from an emphasis on that between beneficiaries and their creditors, to that between settlor and beneficiaries' creditors.

First, however, we need to understand how the technique of the protective trust may operate to frustrate the claims of a beneficiary's creditors.

(b) Protective trusts

(1) The development of the protective trust

In 1811 Lord Eldon firmly established in *Brandon v Robinson* (1811) 18 Ves 429 that a condition restraining alienation could not validly be imposed on an equitable life interest. In this case one Thomas Goom was the beneficiary of an equitable life interest subject to a condition 'to the intent that the [dividends, interest and produce thereof] should not be grantable, transferable or otherwise assignable . . .'. Goom became bankrupt and his assignee claimed the benefit of the life interest. Lord Eldon ruled in favour of the assignee. The decision in effect carried over into the law of trusts the land law rules against restraints on alienability based on the doctrine of repugnancy. But the Lord Chancellor simultaneously firmly entrenched the determinable interest, which did not offend that doctrine, within the law of trusts (at 434):

> There is no doubt, that property may be given to a man, until he shall become bankrupt. It is equally clear, generally speaking, that if property is given to a man for his life, the donor cannot take away the incidents to a life estate: and, as I have observed, a disposition to a man, until he shall become bankrupt, and after his bankruptcy over, is quite different from an attempt to give to him for his life, with a proviso that he shall not sell or alien it. If that condition is so expressed as to amount to a limitation, reducing the interest short of a life estate, neither the man nor his assignees can have it beyond the period limited.

It has been suggested that 'the resulting parity between trust and property doctrines was a partial fulfilment of Eldon's objective more completely to assimilate equity and law' (Alexander (1985) 37 Stanford LR 1189 at 1199). In so far as the assimilation carried with it the repugnancy doctrine, which while striking down conditions subsequent restraining alienability did not invalidate determinable interests, it laid the foundations of the protective trust.

In the half-century following *Brandon v Robinson* there were numerous attempts to devise schemes for placing income and capital beyond the reach of creditors. Some failed because they were drafted as conditions rather than determinable interests, but the key to success was ultimately discovered in the granting of a dispositive discretion to trustees. By the mid-nineteenth century the device of adding a discretionary trust in favour of the beneficiary and his family to take effect on termination of the prior determinable interest was validated.

Why did the courts recognise a device which in practice clearly enabled a settlor to frustrate the claims of the beneficiary's creditors? Various possible explanations have been identified (see Chesterman 'Family Settlements on Trust: Landowners and the Rising Bourgeoisie' in Rubin and Sugarman (eds) *Law, Economy and Society* (1984) pp 156–157): forfeiture provisions represented a legitimate exercise of the settlor's or testator's *jus disponendi*; there were moral grounds for protecting widows and the young from their own improvidence or inexperience in financial matters; even, given the unpleasant nature of bankruptcy in mid-Victorian Britain, that fear of loss of income would be a deterrent to erstwhile spendthrifts. (See generally, McGregor *Social History and Law Reform* (1981) ch 5; Cohen (1982) 3 Journal of Legal History 153; the factual background to a leading case *Rochford v Hackman* (1852) 9 Hare 475; and classically Charles Dickens *Little Dorrit* and *Pickwick Papers*.) In fact the search for an explanation couched in policy terms may be fruitless. As late as 1888, Kay J in *Re Dugdale* (1888) 38 Ch D 176 was stating (at 182) that 'the liability of an estate to be attached by creditors on a bankruptcy or judgment is an incident of the estate, and no attempt to deprive it of that incident by direct prohibition would be valid'. This is no more than a re-assertion of the repugnancy doctrine and the task for the draftsman 'was to discover what forms of indirect prohibition would not infringe this general principle' (Keeton *Modern Developments in the Law of Trusts* (1971) p 190). A determinable interest did not: it could not be attacked on formal legal grounds. In the event, whether through legal formalism or unarticulated policy considerations or both, the judiciary approved the combination of the determinable life interest followed by the discretionary trust.

What emerged therefore was a protective trust with a tripartite structure:

(i) a determinable interest;
(ii) a forfeiture provision specifying the determinable event; and
(iii) a discretionary trust springing up at forfeiture.

This became a standard conveyancing clause in widespread use and received statutory acceptance in the Trustee Act 1925 (TA), s 33, which provided a statutory formula for the protective trust.

(2) The Trustee Act 1925, s 33

Although settlors may still construct their own formulations if felt desirable, s 33 enables them to incorporate the statutory formula into a trust instrument by simply using the shorthand phrase ‘on protective trusts for’, for example, my daughter. The section will apply even where a different form of words is used, provided a settlor’s intention is sufficiently clear. In *Re Wittke* [1944] Ch 166 a gift of income ‘upon protective trusts for the benefit of my sister’ was sufficient to incorporate s 33, it being inferred that the sister was intended to take a life interest (see also *Re Platt* [1950] CLY 4386; CLC 10917 (‘for a protective life interest’)). That it is a question of construction is apparent from a comparison of *Re Wittke* and *Re Trafford’s Settlement* [1985] Ch 32. In the latter case the words ‘upon protective trusts’ were contained in a clause which also included a direction that the income should be held on an immediate discretionary trust during the life of the settlor. The latter cannot exist concurrently with a determinable life interest, so the court accepted that the reference to protective trusts was merely descriptive of the intention of the trust.

Trustee Act 1925, s 33

(1) Where any income, including an annuity or other periodical income payment, is directed to be held on protective trusts for the benefit of any person (in this section called ‘the principal beneficiary’) for the period of his life or for any less period, then, during that period (in this section called the ‘trust period’) the said income shall, without prejudice to any prior interest, be held on the following trusts, namely:

(i) Upon trust for the principal beneficiary during the trust period or until he, whether before or after the termination of any prior interest, does or attempts to do or suffers any act or thing, or until any event happens, other than an advance under any statutory or express power, whereby, if the said income were payable during that period, he would be deprived of the right to receive the same or any part thereof, in any of which cases, as well as on the termination of the trust period, whichever first happens, this trust of the said income shall fail or determine;
(ii) If the trust aforesaid fails or determines during the subsistence of the trust period, then, during the residue of that period, the said income shall be held upon trust

for the application thereof for the maintenance or support, or otherwise for the benefit, of all or any one or more exclusively of the other or others of the following persons (that is to say) –

(a) the principal beneficiary and his or her wife or husband, if any, and his or her children or more remote issue, if any; or

(b) if there is no wife or husband or issue of the principal beneficiary in existence, the principal beneficiary and the persons who would, if he were actually dead, be entitled to the trust property or the income thereof or to the annuity fund, if any, or arrears of the annuity as the case may be;

as the trustees in their absolute discretion, without being liable to account for the exercise of such discretion, think fit.

(2) This section does not apply to trusts coming into operation before the commencement of this Act, and has effect subject to any variation of the implied trusts aforesaid contained in the instrument creating the trust.

(3) Nothing in this section operates to validate any trust which would, if contained in the instrument creating the trust, be liable to be set aside.

Several aspects of the structure of s 33 merit comment. First, it operates subject to any modifications that a settlor may impose (see s 33(2)) such as varying the class of persons entitled under the discretionary trust. Next, it is evident that a shorter period than a life interest can be selected (s 33(1) 'life or for any less period'). Accordingly it seems that a settlor can establish a series of protective trusts in favour of the same beneficiary. As Megarry points out ((1958) 74 LQR 182 at 184)

> Hitherto the normal course of drafting has been to give a life interest simply 'on protective trusts', with or without variations. The result is that a single mistaken act by the beneficiary may deprive him of his determinable life interest and reduce him for the rest of his life to the status of merely one of the beneficiaries of a discretionary trust. *Re Richardson* [1958] 1 All ER 538 suggests that there may be advantages in setting up a series of protective trusts, eg one set until the beneficiary is twenty-five, another from twenty-five to thirty-five, a third from thirty-five to forty-five, and another for the rest of his life. The result would be that a youthful indiscretion at, say, twenty-two, would not irretrievably condemn the beneficiary to the mere hopes of a beneficiary under a discretionary trust, dependent upon the exercise of the trustees' discretion, but would give him a fresh start when he was twenty-five. Again, a bankruptcy at the age of thirty would not *per se* mean that when he was twice that age he would still have not an income as of right, but a mere hope of a well-exercised discretion. Indeed, instead of relating the stages to the age of the beneficiary, they might be related to a period of time (eg five years) after the occurrence of any event which had made the initial trust pass from Stage 1 to Stage 2 (ie from determinable interest to discretionary trust).

The final point to note is the width of the forfeiture clause (s 33(1)(i)). This covers much more than bankruptcy or attempted assignment of the whole interest and includes any event which deprives the principal beneficiary of his right to receive any part of the income. The construction that the courts have imposed on this definition of forfeiture is considered briefly in the next section.

(3) Forfeiture

Bankruptcy of the principal beneficiary or attempted alienation of the life interest will obviously bring about a forfeiture under s 33. A plethora of other diverse circumstances has been held to cause a forfeiture, some in cases involving s 33, others in cases based on express provisions. Examples are a trustee impounding part of the income of the principal beneficiary to make good a breach of trust committed at the beneficiary's instigation (*Re Balfour's Settlement* [1938] Ch 928); an order for sequestration of income (*Re Baring's Settlement Trusts* [1940] Ch 737); and the bankruptcy of the principal beneficiary occurring before the trust came into operation (*Re Walker* [1939] Ch 974). On the other hand an authority to trustees to pay dividends on trust shareholdings to creditors for a period during which no dividend was declared did not bring about a forfeiture (*Re Longman* [1955] 1 All ER 455 – involving an express forfeiture class more narrowly drawn than s 33). Other cases where no forfeiture occurred include *Re Greenwood* [1901] 1 Ch 887 'a garnishee order', and *Re Oppenheim's Will Trusts* [1950] Ch 633 'appointment of receiver where the life tenant was of unsound mind'.

Perhaps all that need be said is that in every case it is a question of construction of either s 33 or an express clause whether the particular occurrence should cause a forfeiture.

But cases most often get litigated because there is a penumbra of doubt. Is there any identifiable judicial preference as to the desirability of forfeiture where doubt exists? Russell LJ considered that 'where permissible, forfeiture clauses are to be narrowly construed' (*General Accident, Fire and Life Assurance Corpn Ltd v IRC* [1963] 3 All ER 259 at 265; for similar sentiments see *Re Greenwood* [1901] 1 Ch 887 at 891 and *Re Pozot's Settlement Trusts* [1952] 1 All ER 1107 at 1110). Considered as an abstract proposition, the consequence of forfeiture is to deprive a life tenant of a property right, an entitlement to the income of the fund, and replace it with an inferior claim, that of being merely one object of the trustees' discretion. It might therefore follow that the court should not lightly find a forfeiture to have occurred. But in reality, forfeiture may be precisely what settlor, life tenant and immediate family all desire. This will plainly be so where bankruptcy is the determining event. However, as we have seen, forfeiture is not restricted to the occurrence of bankruptcy, and there may be occasions when the principal beneficiary is opposed to forfeiture. Consider in particular the interests involved in two cases concerning the rearrangement of income entitlement upon divorce. In *General Accident, Fire and Life Assurance Corpn Ltd v IRC* [1963] 3 All ER 259 the Court of Appeal held that an order of the Divorce Court (see now Matrimonial Causes Act 1973, s 24(1)), altering a marriage settlement so as to redirect income from a husband's protected life interest to the wife, did not effect a forfeiture, the husband retaining entitlement to the balance of the income. This contrasts with the earlier case of *Re Richardson's Will Trusts* [1958] Ch 504 where an order made in the Divorce Court that the principal beneficiary's interest should be charged with an annual sum of £50 maintenance caused a forfeiture. The sequence of events in *Re Richardson* should be noted, however. The order was made on 3 June 1955, the principal beneficiary's interest was to become absolute on 24 October 1955, his thirty-fifth birthday, and he was adjudicated bankrupt on 27 August 1956. One consequence of forfeiture was thus to deprive the trustee in bankruptcy of both income and capital. It is argued that the cases can be reconciled on a narrow ground of construction of s 33 (see Crane (1962) 26 Conv 517) but two wider questions must be considered.

Should such court orders override the operation of s 33? Are they within the 'mischief' of the section? The competing considerations are precisely summarised by Hanbury and Martin *Modern Equity* (16th edn, 2001) pp 198–199:

> The broader ground of the [*General Accident*] decision, that this situation has no relevance to the real purpose of protective trusts, would seem to apply to the charge in *Re Richardson's Will Trusts* as much as to the diversion of part of the income in the *General Accident* case. It is submitted that the principle of the *General Accident* case is sound. As Donovan LJ said (at 262): '. . . the section is intended as a protection to spendthrift or improvident or weak life tenants. But it can give . . . no protection against the effect of a court order such as was made here. Furthermore, if such an order involves a forfeiture much injustice could be done'. . . . *Re Richardson's Will Trusts* was not mentioned; but an earlier case on the Matrimonial Causes Act 1859 in favour of forfeiture, *Re Carew* (1910) 103 LT 658, was overruled. It is tempting to say that *Re Richardson's Will Trusts* is wrong; but it should be noted that in that case, as in *Re Carew*, the decision in favour of forfeiture forwarded the broad policy of section 33; for the forfeiture in those cases allowed the discretionary trusts to operate when otherwise the trustee in bankruptcy would have claimed the interest.

An analogy can be drawn between the consequences that flow from an order under s 24 of the Matrimonial Causes Act 1973 and one made under s 57 of TA 1925. This is an overriding section whose provisions are read into every trust and hence TA 1925, s 33 trusts are subject to the court's jurisdiction to make an order under TA 1925, s 57 (see p 313), no forfeiture thereby being caused (see *Re Mair* [1935] Ch 562). But it should also be noted: (1) that *Re Richardson* was specifically followed in *Edmonds v Edmonds* [1965] 1 All ER 379n (see also [1993] SJ 17 September p 919) where an attachment of earnings order to secure a maintenance payment brought about a forfeiture, the *General Accident* decision not being cited; and (2) one consequence had forfeiture occurred in the *General Accident* case would have been a reduction in estate duty liability.

(4) Applying the income

The effect of forfeiture is to activate the discretionary trust, and the trustees must then apply the income for the benefit of the discretionary class. 'Putting it in a negative way, [trustees] are not entitled, regardless of the needs of the beneficiaries, to retain in their hands the income of the trust estate' (*Re Gourju's Will Trusts* [1943] Ch 24 at 34 per Simonds J).

Given the requirement of prompt application of income how should the trustees exercise the discretion? Can they continue to pay income to the principal beneficiary? Can they use the income to buy goods or provide services for the principal beneficiary? To what extent, if at all, can payments to the principal beneficiary's spouse or children be claimed by an assignee or trustee in bankruptcy?

A series of cases (*Re Coleman* (1888) 39 Ch D 443, CA; *Re Bullock* (1891) 64 LT 736; *Re Ashby* [1892] 1 QB 872) at the end of the nineteenth century established certain basic guidelines, and these were succinctly summarised in *Re Smith* [1928] Ch 915 at 919:

> **Romer J:** Where there is a trust to apply the whole or such part of a fund as trustees think fit to or for the benefit of A, and A has assigned his interest under the trust, or become bankrupt, although his assignee or his trustee in bankruptcy stand in no better position than he does and cannot demand that the fund shall be handed to them, yet they are in a position to say to A: 'Any money which the trustees do in the exercise of their discretion pay to you passes by the assignment or under the bankruptcy.' But they cannot say that in respect of any money which the trustees have not paid to A or invested in purchasing goods or other things for A, but which they apply for the benefit of A in such a way that no money or goods ever gets into the hands of A.

This statement requires some amplification. A distinction can be drawn between those rare cases where a beneficiary has assigned an interest without incurring a forfeiture and those where a forfeiture occurs. An example of the former is *Re Coleman* where one of four beneficiaries, JSC, assigned his interest under a discretionary trust. The Court of Appeal confirmed that where the trustees have notice of a valid assignment they must not pay money to or purchase goods for the principal beneficiary. If they do so, payment would have been made to the wrong person and the trustees would be liable to the assignee. Of course, as recognised in *Re Smith*, the assignees have no better claim to benefit from the trust than the assignor and the trustees need not pay them anything at all. Where a forfeiture of the original interest occurs, there can be no objection in principle to the trustee making payments to the principal beneficiary but now as one of the class under the newly arisen discretionary trust. In practice, however, a trustee in bankruptcy might be able to claim the income from the beneficiary by virtue of statutory insolvency law (see below).

The other point left uncertain by *Re Smith* is the extent to which trustees may exercise their discretion to apply income for the benefit of the principal beneficiary. Again there would seem to be no objection in principle under trusts law to a view expressed by Kekewich J in *Re Bullock* (1891) 64 LT 736 (at 738): 'I am unwilling to fetter the trustees' discretion which was intended to be and ought to be construed as large . . . [The trustees] certainly may . . . spend the whole or any part of the income in maintenance, using that word in its most general and widest sense; . . . the discretion is vested in them . . . and so long as they exercise it honestly – that is, as men of ordinary business habits and prudence, and with due regard to all the circumstances of the case – the court will not interfere with them.' No attention is paid here to the implications for the *creditors* of interpreting the trustees' power broadly.

(5) Assets, income and the Insolvency Act 1986

Where it is bankruptcy of the principal beneficiary that brings about a forfeiture, the above principles must be considered in the context of insolvency law. In particular, the property of a bankrupt divisible among his creditors includes not only property belonging to him at the commencement of the bankruptcy but also 'after-acquired property' – property which is acquired by or devolves upon the bankrupt between bankruptcy and discharge.

Of course the bankrupt is not left to face the world totally devoid of all income and property during this time. In reading the following extracts from the Cork Report and the relevant sections of the Insolvency Act 1986 (IA), consider in particular the resources that are permitted to be retained by the bankrupt to meet personal and family needs, the policy objectives of insolvency law and the relationship between TA 1925, s 33 and IA 1986.

Report of the Insolvency Law Review Committee (Cmnd 8558, 1982)

The insolvent's surplus income

591. It has been almost the rule in the past to think in terms of 'selling up' the debtor and dividing the proceeds amongst the creditors as the main, if not the only, means of debt recovery. We believe that, in principle, far more emphasis should in future be placed on the prospect of the debtor's ability to pay his debts out of surplus future income. This is not to say that the existing assets are to be ignored or that a debtor's earning capacity is to be made available for payment until the debts are paid in full however long that may take; the debtor must in no circumstances become the slave of his creditors. This shift in emphasis should, nonetheless, enable a more realistic and a more humane attitude to be taken than previously regarding the position of the debtor and his family.

Exempt Property and Family Assets

1094. A primary aim of insolvency proceedings is the realisation of the debtor's property for the benefit of his creditors. . . .

1096. A further aim of the bankruptcy code is to enable the individual debtor to achieve his rehabilitation as a useful and productive member of society. Certain assets necessary for this purpose are accordingly exempted from vesting in his trustee and are allowed, on the contrary, to be retained by the debtor.

[The committee made the following recommendations about potentially exempt property comprising (i) tools and equipment, and (ii) clothing and furnishings.]

TOOLS AND EQUIPMENT

1101. . . . [We] recommend that the exemption should relate to 'tools and equipment', and that it should be construed widely enough to include the equipment indispensable for trades, professions and callings of all kinds. The exemption should for example, be capable of including books and, in exceptional cases, a motor vehicle. The exemption should not include an excessive quantity, nor items which are unnecessarily elaborate or valuable if they can be replaced by more ordinary and serviceable articles.

1102. . . . A balance should . . . be struck between the special needs of the debtor and the rights of the creditors. We recommend that the exemption of tools and equipment should be confined to those necessary for, and used by the debtor in his employment, trade, profession or calling, as a result of which surplus income is capable of being provided for the benefit of his creditors.

CLOTHING, FURNISHINGS AND OTHER PERSONAL ASSETS

1109. We are all agreed that a debtor should be entitled to retain sufficient clothing, bedding, furniture and household equipment to satisfy the basic domestic needs (as a reasonable man would interpret them) of himself and his family. Any item which is not essential, or is exceptionally valuable, for that purpose should be available for his creditors and sold if the sale would produce any worthwhile benefit to them.

1113. We recommend that there should be no monetary limit and that the debtor should be permitted to retain such items as the trustee agrees fall within the criteria set out above, with recourse to the Court by the debtor or any creditor aggrieved by the trustee's decision.

Working within this legislative framework the duty of the trustee in bankruptcy is to obtain title to the assets of the bankrupt and realise these for the benefit of creditors. As regards 'after acquired income' the trustee in bankruptcy can apply to the court under IA 1986, s 310 for an income payment order (IPO) under which a proportion of the bankrupt's income is also made available for creditors. Under the original terms of the IA 1986 IPOs ran only until the automatic discharge of the bankrupt, usually three years after the date of the bankruptcy order. The reduction of that period by the Enterprise Act 2002, s 279 from three years to 12 months for 'non-culpable bankrupts' has been accompanied by a change in the rules for IPOs. In the interests of keeping the balance between the position of creditors and the bankrupt person IPOs will last for a period of up to three years from the date of the IPO irrespective of the date of discharge of the bankrupt (s 259, amending IA 1986, s 310).

Insolvency Act 1986, s 283(1), (2), (3), (6); s 306; s 307(1), (2), 310(2)

283(1) . . . a bankrupt's estate for the purposes of any of this Group of Parts comprises –

(a) all property belonging to or vested in the bankrupt at the commencement of the bankruptcy.

(2) subsection (1) above does not apply to –

(a) such tools, books, vehicles and other items of equipment as are necessary to the bankrupt for use personally by him in his employment, business or vocation;
(b) such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his family. . . .

(3) Subsection (1) does not apply to –

(a) property held by the bankrupt on trust for any other person . . .

(6) This section has effect subject to the provisions of any enactment not contained in this Act under which any property is to be excluded from a bankrupt's estate.

306(1) The bankrupt's estate shall vest in the trustee immediately on his appointment taking effect or, in the case of the official receiver, on his becoming trustee.
(2) Where any property which is, or is to be, comprised in the bankrupt's estate vests in the trustee (whether under this section or under any other provision of this Part), it shall so vest without any conveyance, assignment or transfer.

307(1) Subject to this section and s 309, the trustee may by notice in writing claim for the bankrupt's estate any property which has been acquired by, or has devolved upon, the bankrupt since the commencement of the bankruptcy.
(2) A notice under subsection (1) above shall not be served in respect of –

(a) any property falling within subsections (2) or (3) of section 283 above;
(b) any property which by virtue of any other enactment is excluded from the bankrupt's estate; or
(c) . . . any property which is acquired by, or devolves upon, the bankrupt after his discharge.

310(2) the court shall not make an income payments order, the effect of which would be to reduce the income of the bankrupt below what appears to the court to be necessary for meeting the reasonable domestic needs of the bankrupt and his family.

Consider the following points:

(1) The principle laid down in *Re Smith* suggests that if the trustees of a discretionary trust apply funds 'for the benefit of' a bankrupt beneficiary, the creditor has no recourse unless the beneficiary actually receives goods or property. This could pave the way for luxury benefits – for example, an extended holiday at the Ritz – well in excess of the limits implicit in s 283(2) and s 310(2). Cf the comment of Scott (*Law of Trusts* (4th edn, 1987) s 155(1), p 161): 'The distinction thus drawn between payments to the beneficiary and applying trust funds for his benefit seems to be arbitrary and without any sound basis in public policy.'
(2) Would it constitute a breach of trust for trustees to exercise their discretion under TA 1925, s 33(1)(ii) to provide income or goods to the bankrupt principal beneficiary in excess of the levels permitted by IA 1986, s 283(2), if the trustee in bankruptcy

were successfully to claim any excess? In exercise of their discretion, could trustees pay income direct to the principal beneficiary's trustee in bankruptcy? Note, however, that in *Re Rayatt* [1998] 2 FLR 264, doubtless to the chagrin of creditors, private school fees of £844 per month were held to be reasonable expenditure under s 310(2) due in part to the disruption that would otherwise be caused to the child's education.

(3) The Ontario Law Reform Commission (*Report on the Law of Trusts* (1984)) recommended that draft clause 52 below be included in any new Trustee Act for the province.

> 52(1) Where property is held on trust for a person, in this section called 'the protected beneficiary', for an interest that is determinable on a claim being made by a creditor or trustee in bankruptcy against the income payable to the protected beneficiary, such a claimant may apply to the Court for payment of his claim, and the Court may order the payment of the claim out of income arising from the trust until the interest but for the determinability would have terminated.
>
> (2) If it is established to the satisfaction of the Court that any successive beneficiary, including any beneficiary of a discretionary trust, as to the income or capital of the trust, has derived any benefit from any debt incurred by the protected beneficiary, payment of which is being sought by the creditor, the Court may order that the whole or part of the capital of the trust be released from the trust to meet, in whole or in part, the claim of the creditor or trustee in bankruptcy of the protected beneficiary.
>
> (3) On an application under this section, the Court may allow the protected beneficiary to receive, whether or not at the further discretion of the trustees, such income as in the opinion of the Court will provide reasonable maintenance for the beneficiary and his dependants.

Note that the clause as it stands would affect only protective trusts. Presumably a suitably advised settlor could opt to use a discretionary trust to shelter property from the creditors of the beneficiaries. This possibility led one critic of the proposal to suggest that 'the settlor has been denied a risk management tool that was previously available to him without much else having been achieved' (Rossiter [1986] Estates and Trust Quarterly (3), 229–250 at 249). Would you recommend the modification of the TA 1925 along similar lines to those in Draft Clause 52?

(4) In principle, insolvency law treats the family as a unit for the purposes of assessing needs but does not aggregate the income or capital of individual members when measuring resources. This raises the question whether the assets of the bankrupt's spouse should be pooled with those of the bankrupt to meet the creditor's claims, and if so, whether in relation to (a) business debts, (b) consumption debts, or (c) both. The Cork Report robustly rejected a proposal that all the assets of the spouse should be pooled with those of the bankrupt and made available to meet the claims of creditors, in so far as they relate to trading or business debts:

> Para 1229. We reject this proposal as an unjustified interference with individual property rights, which would produce an unfair result in many cases, and which in many respects would be a reversion to outmoded concepts of matrimonial property which have long since been abandoned. . . . We regard the proposal as entirely out of line with modern attitudes to the proprietary rights of husband and wife.

Is this approach, based essentially on individual rights of property, consistent with:

(i) 'the protective trust which on forfeiture transmutes an individual property interest in income into a family property entitlement'; or

(ii) a conception of family life within which women are viewed increasingly as equal economic partners: 'married women are not single women. They live with and for their husbands in a unit known as the family, which it is the policy of the law to cherish and support' (Lord Scarman *Women and Equality before the Law* (1971) p 8, and see Freedman et al *Property and Marriage: an Integrated Approach* (1988) Institute for Fiscal Studies)?

(5) A TA 1925, s 33 protective trust is not the only statutory mechanism that can prevent a trustee in bankruptcy from gaining immediate title to a bankrupt's property under IA 1986, s 306. An accrued pension entitlement is often a bankrupt's most valuable asset and has on occasion proved an attractive target for the trustee in bankruptcy. In *Kilvert v Flackett* [1998] 2 FLR 806, for instance, a lump sum pension payment of some £50,000 was successfully claimed by the trustee in bankruptcy under an IPO, although the case is arguably incorrectly decided in that it treats a capital payment – the lump sum – as if it were an income stream. The Pensions Act 1995, ss 91–95 provides that a person's entitlement to, or an accrued right in, an occupational pension does not form part of the bankrupt's estate for the purposes of the IA 1986. This protection has now been extended as from 29 May 2000 by the Welfare Reform and Pensions Act 1999, s 11 to include rights which a bankrupt may have under any Inland Revenue approved pension, not just occupational schemes. In practice, even prior to the legislative initiatives, many pension trust deeds contained a forfeiture clause to the effect that the pension rights may be forfeited on bankruptcy leaving the trustees with discretion to pay any 'forfeited benefits' to the bankrupt, to his or her spouse, to a widow or widower or to any dependants. The analogy with the discretion under TA 1925, s 33 is evident.

But why should pension rights be relatively immune from the claims of creditors? Aside from the obvious riposte that might cite TA 1925, s 33 as justification, one possible rationale for the protection of accrued pension rights may lie in a policy argument that pensions are intended to provide financial security for pensioners and their families. We will return to this point when considering briefly the status of the family home in an insolvency (see below).

(6) In conclusion, would you agree that 'there is no incompatibility between the protective trust and insolvency law. Both are primarily directed towards enabling a debtor to regain financial stability and make a fresh start'?

(6) Insolvency and the family home

A full evaluation of a 'fresh start' policy and of the capacity of the trust form to put assets beyond the reach of a beneficiary's creditors would need to take account of the treatment under insolvency law of co-owned property, in particular the family home. Acute questions of policy and principle arise here. On the one hand, unpaid creditors will want to recoup their losses from what may well be the most valuable available asset. On the other hand, homelessness with its attendant consequences may be inflicted on possibly innocent family victims of the bankrupt's financial failure. Faced with this dilemma the Cork Report concluded that it would be 'consonant with present social attitudes to alleviate the personal hardship of those who are dependant on the debtor but not responsible for his insolvency, if this can be achieved by delaying for an acceptable time the sale of the family home' (para 1116). The present law of bankruptcy affords some recognition to these recommendations but it is debateable how far the provisions of IA 1986, s 335A, to be discussed shortly, 'delay for an acceptable time the sale of the family home'.

The questions raised by this issue run much wider than the specific focus adopted in this chapter (see eg Dewar in Bright and Dewar (eds) *Land Law Theories and Perspectives* (1998) pp 336–345), but the limited nature of legislative and judicial protection for the family home under insolvency law throws into sharp relief some conceptual and policy inconsistencies. In particular it is apparent that the interests of the family and, one may say, principles of property law are subordinated to the interests of creditors.

Under Trusts of Land and Appointment of Trustees Act 1996, s 14 (replacing LPA 1925, s 30 as from 1 January 1997) 'any person who . . . has an interest in property subject to a trust of land' can apply for an order to sell the land. The court has a wide-ranging discretion under s 14(2) as to the order it may make and, with one significant exception, s 15 sets out the criteria to govern the exercise of the discretion. It is the exception that concerns us here. It takes effect in a case where insolvency intervenes and the beneficial interest of a bankrupt spouse in the property vests in the trustee in bankruptcy who thereby becomes a 'person interested' for the purposes of s 14. Where the applicant under s 14 is a trustee in bankruptcy different considerations to those under s 15 apply. The court must then exercise its discretion applying criteria now contained in Insolvency Act 1986, s 335A (previously in s 336).

Section 335A(2) provides that where an application for a sale of property is made the court shall make such order as it thinks just and reasonable having regard to:

(a) the interests of the bankrupt's creditors;
(b) where the application is made in respect of land which includes a dwelling house which is or has been the home of the bankrupt or the bankrupt's spouse or former spouse,
  (i) the conduct of the spouse or former spouse, so far as contributing to the bankruptcy,
  (ii) the needs and financial resources of the spouse or former spouse, and
  (iii) the needs of any children; and
(c) all the circumstances of the case other than the needs of the bankrupt.

The omission of any reference in s 335A to 'the purposes for which the property is held' as a criterion for the court to consider (cf its inclusion in TLATA 1996, s 15(1)(b)) seems to confirm that in a bankruptcy the interests of the creditors take clear precedence over fulfilling the purposes for which the property was purchased. Its omission effectively lays to rest the prospect of the court being able to take into account the 'collateral purpose' of the trust in the exercise of its discretion under s 335A (cf the Court of Appeal decision in *Abbey National plc v Moss* [1994] 1 FLR 307 under the LPA 1925, s 30 (Hopkins (1995) 11 LQR 72); Cretney [1994] Fam Law 255; Clarke [1994] Conv 331).

Of more significance is the sting in the tail of the section; s 335A(3) requires that where an application for sale is made after the end of the period of one year from the bankruptcy 'the court shall assume, unless the circumstances of the case are exceptional, that the interest of the bankrupt's creditors outweigh all other considerations'. Dicta in a Court of Appeal decision in *Re Citro* [1991] Ch 142 indicated that, in interpreting s 336(5) (the predecessor of s 335A), the courts were to apply the same test as had evolved in case law under LPA 1925, s 30. The legislative history of the requirement of 'exceptional circumstances' in s 336(5) leaves it unclear as to whether this was in fact the legislature's intention (see Cretney (1991) 107 LQR 177 and 'Insolvency and Family Law' in Rajak (ed) *Insolvency Law Theory and Practice* (1993) pp 71–82). The outcome, however, if the Court of Appeal decision in *Re Citro* is an accurate indication, is a stringent test indeed. At first instance in that case, which concerned the bankruptcy of two brothers who ran a garage business as partners, appreciation of the hardship that would be caused to the family, including educational difficulties for the children and an absence of suitable alternative accommodation, led Hoffman J to order a postponement of sale until the youngest child in each family reached the age of 16 (the youngest then being twelve and ten respectively). By a majority, the Court of Appeal reversed the decision because the circumstances of the cases were not 'exceptional', substituting a postponement for six months only. As Nourse LJ reluctantly if resignedly accepted (at 157) '[such] circumstances, while engendering a natural sympathy in all who hear of them, cannot be described as exceptional. They are the melancholy consequences of debt and improvidence with which every civilised society has been familiar . . .' (see also *(Trustees) Bowe v Bowe* [1998] 2 FLR 439 at 446 – 'disruption, unhappiness and possibly extreme inconvenience to the family' not to be treated as exceptional for the purposes of s 336(5)).

In the light of *Re Citro*, circumstances sufficiently 'exceptional' to justify postponement of sale seemed unlikely to be very common (cf *Re Holliday* [1981] Ch 405; *Re Gorman* [1990] 1 WLR 616; and see Hall [1991] CLJ 45). However, a number of more recent cases clarifying what constitutes 'exceptional circumstances' can be interpreted as representing a slight shift in emphasis from that evidenced in *Re Citro*. In *Judd v Brown* [1998] 2 FLR 360 a wife's serious illness – a sudden and serious attack of ovarian cancer requiring extensive surgery and chemotherapy – was held by Harman J to constitute 'an exceptional circumstance' which would have justified refusing to grant an order for possession and sale (the order was refused on other grounds). In *Re Raval* [1998] 2 FLR 718 the likely detrimental effect on the wife's health – a paranoid schizophrenic – of an immediate forced move amounted, inter alia, to exceptional circumstances that justified the suspension of an order for sale and possession for one year (see also *Claughton v Charalambous* [1999] 1 FLR 740 – the wife of the bankrupt was aged 60, suffered from, inter alia, chronic renal failure, had reduced life expectancy and the home was fitted with a chair-lift; and *Re Bremner* [1999] 1 FLR 912 where the exceptional circumstances were the emotional needs of the wife, aged 74, as sole carer of the 79-year-old bankrupt who was terminally ill with inoperable cancer; sale was postponed until three months after his death). Notwithstanding cases such as these it is still difficult to dissent from the view that the effect of the amended 1986 legislation, as one leading text suggests, 'seems likely to be that the bankrupt's family will in practice be given one year's grace but (in the absence of truly exceptional circumstances) no more before sale' (Cretney and Masson *Principles of Family Law* (7th edn, 2002) p 150).

What remains uncertain in this area is whether the implementation as from 2 October 2001 of the Human Rights Act 1998 will materially alter the interpretation of 'exceptional circumstances' under s 335A. Article 8(1) of the European Convention states that 'everyone has the right to respect for his private and family life, his home and his correspondence'. These rights are qualified by para 2 which provides that: 'There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of . . . the protection of the rights and freedoms of others.' The rights and freedom of others clearly encompasses the rights of the creditors of the bankrupt. In *Barca v Mears* [2005] EWHC 2170 Strauss J, whilst accepting that in the general run of cases the creditor's interests will outweigh all other considerations (as they did in the case itself), suggested that a shift in emphasis in the interpretation of s 335A might nevertheless be necessary to achieve full compatibility with the Convention rights: '[it is] questionable whether the narrow approach as to what may be "exceptional circumstances" adopted in *Re Citro* is consistent with the Convention' (at [39]; see Dixon [2005] Conv 161–167 and, in the different context of the enforcement of an unqualified property right under the Housing Act 1985, *Harrow LBC v Qazi* [2004] 1 AC 983).

The approach taken under English law is not the only one possible. Other jurisdictions (eg New Zealand, Canada, the US) have introduced legislation which seeks to strike a different balance between the legitimate commercial interests of creditors and the competing claims of families to residential security 'at a special time of crisis' (see the discussion in Gray *Elements of Land Law* (4th edn, 2005) pp 1148–1150; and Gravells (1985) 5 OJLS 132 at 140–143). By way of comparison with English law Gray points out that in New Zealand, for instance, legislation was enacted 'with the express object of promoting the stability and permanence of family life as a higher social end than that represented by commercial security for the creditor' (at 1150).

Leaving to one side the policy issue here, there remains a question about consistency of approach. Is insolvency law consistent in permitting a forced sale under s 335A of a jointly owned house, yet rejecting the pooling of family assets, let us assume including income available under a protective trust, to meet the claims of creditors (see Clarke 'Insolvent Families' in *Rajak* pp 83–92)?

(7) American and English approaches compared

Concluding his note on the series of protective trusts set up in *Re Richardson's Will Trusts* [1958] Ch 504, Megarry commented that 'England lacks the device of the spendthrift trust in the American sense, but it is far from clear that the fullest possible use is being made of the existing machinery of protective and discretionary trusts' ((1958) 78 LQR 182 at 184).

The spendthrift trust is the outcome of US law making a sharp conceptual break with English trusts law. In the USA two significant nineteenth-century decisions (*Nichols v Eaton* 91 US 716 (1875) and *Broadway National Bank v Adams* 133 Mass 170 (1882)) firmly established, contrary to Lord Eldon's view in *Brandon v Robinson* (1811) 18 Ves 429, that restraints on alienability of an equitable life estate were valid. A spendthrift trust is one that contains a restraint against both voluntary and involuntary alienation. Accordingly the trustees must pay the trust income to even a bankrupt beneficiary and in principle the beneficiary's creditors have no rights against the trust income or capital. In practice several states in the USA (see Bogert *The Law of Trusts and Trustees* (revd 2nd edn, 1992) ss 222–227) have moved towards allowing creditors some degree of statutory access to trust income. Indeed it has been suggested that the consequence of statutory reform is that 'in those American jurisdictions where there are statutory limits to the immunity of the beneficiary's interest from creditors' claims, the position of the creditor is substantially better than that of English creditors against a beneficiary under a protective trust' (Keeton *Modern Developments in the Law of Trusts* (1971) p 200). The very popularity of spendthrift trusts stimulated pressure for statutory intervention on behalf of creditors. It has been estimated that in 1968, for instance, the capital value of spendthrift trusts totalled US $140 billion, with an annual protected income of US $5.6 billion (Bushman (1968) 47 *Oregon Law Review* 304; see also Chester *Inheritance, Wealth and Society* (1982) p 125). Apart from the statistical data, the continuing popularity in the US of spendthrift trusts and other asset protection trusts is exemplified by the existence of specialist journals and texts such as the *Asset Protection Journal* and Osborne and Schurig's four-volume 1995 treatise *Asset Protection: Domestic and International Law and Tactics* (see also the specialist practitioners' papers prepared by Tansill SH032 ALI-ABA 345 and Osborne and Catterall SH069 ALI-ABA 1713 for the American Law Institute-American Bar Association symposia in 2002 and 2003 respectively).

Consequently it is not surprising, given this pressure, that the public policy arguments about 'protecting spendthrifts' have historically been widely canvassed in the US (see Hirsch (1995) 73 Washington University LQ 1–93 for an overview that draws upon the disciplines of economics and cognitive psychology). At an early stage the banner of individualism and freedom of disposition was fulsomely flourished on both sides of the barricades. Miller J in *Nichols v Eaton* posed the rhetorical question (at 727): 'Why a parent . . . who . . . wishes to use his own property in securing the object of his own affection, as far as property can do it, from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self-protection, should not be permitted to do so, is not readily perceived.' But a robust early critic of the spendthrift trust, John Chipman Gray, castigated this sentiment as being opposed to the fundamental principles of common law, 'that it is against public policy that a man "should have an estate to live on, but not an estate to pay his debts with"', and continued 'it is not the function of the law to save the foolish and the vicious from the consequences of their own vice and folly. [The fundamental principle] is a wholesome doctrine, fit to produce a manly race, based on sound morality and wise philosophy' (*Restraints on the Alienation of Property* (1895) p 243).

Implicit in these conflicting views is the paradox mentioned at the start of this chapter (p 255). Recognising the irresolvable nature of this debate, Griswold, the writer of the classic work on spendthrift trusts, reasoned that 'there is no syllogistic basis for the spendthrift trust' (*Spendthrift Trusts* (1947) p 634) and therefore the justification had to be found in public policy.

> It is obvious that there are competing factors. There are situations in which spendthrift trusts admittedly serve a useful function. Where they are created of moderate amount for the benefit of widows or for people who are really unable to manage their own affairs there can be little reason to argue against them in a regime of private property. The difficulty comes not so much from the existence of spendthrift trusts as from their generally unrestrained extent. The arguments for and against such trusts may in a large measure be reconciled by legislation expressly authorising them of a fixed and moderate amount, while allowing creditors to reach all income in excess of the specified amount. (E Griswold *Spendthrift Trusts* (1947) p 639)

More recently the terms of the policy debate in the US have taken on renewed vigour with the focus shifting to challenge the maxim, most forcefully expressed in Scott's treatise (Scott and Fratcher *The Law of Trusts* (4th edn, 1987) § 156.2, at 176), that one cannot create a spendthrift trust for oneself (see Danforth (2002) 53 Hastings LJ 287, but cf Sterk (2000) 85 Corn LR 1035). Indeed Griswold had foreshadowed this development suggesting that '[W]e may well question the soundness of a rule which allows a man to hold the bounty of others free from the claims of his creditors, but denies the same immunity to his interest in property which he has accumulated by his own effort' (at 361).

Turning to the protective trust in England one looks in vain for any discussion of the policy implications for debtor-creditor or settlor-beneficiary relationships let alone the philosophical considerations. The Ontario Law Reform Commission (*Report on the Law of Trusts* (1984)), when considering and rejecting the introduction of a statutory protective trust into a revised Trustee Act, was forced to comment (p 363):

> In view of the long struggle in the United States over the spendthrift trust between those who believe the donor should be able to impose restrictions upon his donee as he pleases, and those who feel that creditors should be paid their just due, it is surprising that the protective trust, particularly where such trusts run in series, should never have been questioned in those jurisdictions that provide statutorily for this device.

The Cork Report followed this trend: the protective trust receives no mention. The 2001 White Paper – *Insolvency: A Second Chance* (Cm 5234) – continues in this tradition! It is tempting to conclude that this apparent policy lacuna exists because the trust is no longer used by settlors, or because if it is used it presents no practical problems for creditor-debtor relationships. It is to be hoped that the reason for its absence from discussion is not solely formal, ie the protective trust is irrelevant to considerations of a bankrupt's status since technically the bankrupt has no entitlement to income or capital once forfeiture has occurred.

There is, however, one legislative straw in the wind to be found in the protective trust's treatment under inheritance tax (IHT), which suggests that the device is in use and is still favourably regarded. Under the original intended legislation in the Finance Bill of 1975 there were no special provisions relating to protective trusts. This would have resulted in IHT becoming payable on forfeiture of the protected life interest (an interest in possession) and the then penal discretionary trust regime applying (see generally, Chapter 8). Accordingly changes were introduced during the passage of the Bill. For IHT purposes the discretionary trust is treated as 'transparent' and the principal beneficiary's interest is regarded as nominally still subsisting 'in possession' with the consequence that no IHT charge arises on forfeiture (IHTA 1984, s 88; *Cholmondeley v IRC* [1986] STC 384). This privileged treatment is equally available to non-statutory protective trusts provided they are 'of like effect' to TA 1925, s 33 trusts. (This indicates that attempts to adopt a wider discretionary class than that specified in the statute would have undesirable fiscal implications.) Such an amendment would not have been thought necessary if protective trusts were only rarely used.

Consider the following questions:

(1) To what extent are policy arguments about the spendthrift trust relevant to protective trusts?

(2) Do you agree with the following claim: 'The protective trust stands as a monument to the victory of legal formalism over substantive reality. What is more surprising is that legislators have also allowed themselves to be blinded by such formalism'?

(c) Attempts to safeguard property from the creditors of the trust founder

(1) Common law

It has long been recognised that property-owners might try to hinder or defeat their own actual or potential creditors by means of absolute gifts or by transferring property into trust, and statutory restraints have been imposed to nullify such attempts. The current provisions are to be found in the IA 1986 (see sections 3.

and 4 below). But, where the statute is inapplicable, does the general law of trusts prevent settlors using trusts to protect themselves from creditors?

In general property cannot be put into protective trusts so as to protect settlors against the consequences of their own bankruptcy. The attempted limitation against bankruptcy will be void as against the trustee in bankruptcy (*Re Burroughs-Fowler* [1916] 2 Ch 251 is but one of many cases affirming this proposition). This does not mean, however, that the settlement itself is void or that the limitation will be ineffective against an *individual creditor* as opposed to the generality of creditors represented by a trustee in bankruptcy.

Re Detmold (1889) 40 Ch D 585

As part of a marriage settlement a husband's own property was held on trust to pay the income to him 'during his life, or till he shall become a bankrupt . . . or shall suffer something whereby the [income] . . . would through his own act, default or by operation of law . . . become . . . payable to some other person'. If the husband's determinable interest became forfeit the trustees were to pay the income to the wife during her life. An individual creditor obtained an order appointing himself receiver of the income due from the trust fund. Subsequently the husband was adjudicated bankrupt.

> **North J:** The question is, whether the life interest given by the settlement to the wife is now subsisting, or whether it is invalid as against the trustee in the bankruptcy of the husband.
>
> A settlement by a man of his own property upon himself for life, with a clause forfeiting his interest in the event of alienation, or attempted alienation, has never, so far as I know, been defeated in favour of a particular alienee; it has only been defeated in favour of the settlor's creditors generally, on the ground that it would be a fraud on the bankrupt law. Under the trust of this settlement the wife is now clearly entitled to the income, if the prior life interest given to the husband has legally come to an end.

[North J held that the order appointing a receiver terminated the husband's life interest.]

> The trustee in the bankruptcy is also bound by that order, because the bankruptcy did not commence until the 29th of July. Before that date the husband had done an act, had suffered something, by which the right to receive the income had become vested in another person, and, therefore, the gift over in favour of the wife had taken effect. It is said that a gift over of a man's own property in the event of his bankruptcy is void, and no doubt that is so. But it has been held that a gift over in the event of a voluntary assignment by him is valid. This was established by *Brooke v Pearson* (1859) 27 Beav 181 and *Knight v Browne* (1861) 30 LJ Ch 649 and I think the principle of those decisions applies to an involuntary alienation by operation of law in favour of a particular creditor. . . . In my opinion, those authorities show that the limitation of the life interest to the settlor was validly determined by the fact that, in consequence of the order appointing the receiver, he ceased to be entitled to receive the income. This took place before the commencement of the bankruptcy, and, therefore, the forfeiture is valid as against the trustee in the bankruptcy.

[The common law position is preserved for statutory protective trusts by TA 1925, s 33(3); see p 264.]

Despite *Re Detmold*, if property-owners wish to protect themselves effectively against the consequences of a bankruptcy a determinable interest will not suffice but in principle a discretionary trust will. While statutory anti-avoidance provisions for income tax now make that option less attractive fiscally (see Chapter 8), counsel in *Re Trafford's Settlement* [1985] Ch 32 could point to standard conveyancing works which showed that 'a settlor to protect his own income against loss under a future bankruptcy was advised to create an immediate discretionary trust' (at 36). In effect the settlor must omit the first stage of the protective trust, moving straight to the second stage discretionary trust, with the same consequences for the trustee in bankruptcy as previously described.

The remainder of this section is concerned with certain statutory restraints applying generally to transfers of property (not just transfers on trust) which may have been entered into so as to defeat claims by the transferor's creditors. But the basic principle still holds; where statute does not intrude, a discretionary trust can provide an effective means of protecting a person's property from creditors.

(2) The statutory provisions: a case for reform

Until 1986 the relevant provisions were LPA 1925, s 172, and Bankruptcy Act 1914, s 42. The former rendered voidable any disposition intended to defraud creditors. Where a debtor had been adjudged bankrupt, s 42 enabled certain voluntary dispositions entered into within a specified period prior to an act of bankruptcy, whether or not with intent to defraud, to be voided by the trustee in bankruptcy. In particular s 42 was intended to prevent assets being put into the hands of the debtor's family or associates in order to preserve them from the claims of the transferor's creditors. Whilst the provisions inevitably overlapped, their objectives were different. Section 172 was designed to protect creditors from fraud: 'The principle on which the statute . . . proceeds is this, that persons must be just before they are generous, and that debts must be paid before gifts can be made' (*Freeman v Pope* (1870) 5 Ch App 538 at 540 and see Cork Report para 1202).

The bankruptcy code, on the other hand, is intended to achieve a pari passu distribution of the bankrupt's assets between all the creditors, not just any who are the objects of an intent to defraud. The latter have no priority.

Whilst the Cork Report endorsed these basic objectives, certain aspects of the prevailing law were criticised and the Report recommended its replacement by a new statutory framework. The government broadly accepted these particular recommendations (*A Revised Framework for Insolvency Law* (Cmnd 9175, 1984)) and the old law was replaced by a new statutory framework in IA 1986. The LPA 1925, s 172 provision is replaced largely by IA 1986, ss 423 and 424, whilst the bankruptcy provisions are now to be found principally in ss 339–342.

(3) Transactions 'with intent' to defeat creditors: Insolvency Act 1986, ss 423, 424

423(1) This section relates to transactions entered into at an undervalue; and a person enters into such a transaction with another person if –

(a) he makes a gift to the other person or he otherwise enters into a transaction with the other on terms that provide for him to receive no consideration;
(b) he enters into a transaction with the other in consideration of marriage; or
(c) he enters into a transaction with the other for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by himself.

(2) Where a person has entered into such a transaction, the court may, if satisfied under the next subsection, make such order as it thinks fit for –

(a) restoring the position to what it would have been if the transaction had not been entered into, and
(b) protecting the interests of persons who are victims of the transaction.

(3) In the case of a person entering into such a transaction, an order shall only be made if the court is satisfied that it was entered into by him for the purpose –

(a) of putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or
(b) of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make.

(4) . . .
(5) In relation to a transaction at an undervalue, references here and below to a victim of the transaction are to a person who is, or is capable of being, prejudiced by it; and in the following two sections the person entering into the transaction is referred to as 'the debtor'.

424(1) An application for an order under section 423 shall not be made in relation to a transaction except –

(a) in a case where the debtor has been adjudged bankrupt . . . by the official receiver, by the trustee of the bankrupt's estate or the liquidator . . . or (with the leave of the court) by a victim of the transaction;
(c) in any other case, by a victim of the transaction.

(2) An application made under any of the paragraphs of subsection (1) is to be treated as made on behalf of every victim of the transaction.

The Cork Committee's recommendations were directed principally towards clarifying and modernising the language of the law rather than substantially altering its structure. Regrettably clarification has not brought brevity but the increased length is in part a consequence of specifying in some detail (s 425) the wide discretionary remedies available to the court 'for restoring the position to what it would have been'. These include requiring any property transferred as part of the transaction to be vested in the applicant.

Before considering the substance and effect of s 423 the requirements as to locus standi (s 424(1)) should be noted. Whereas applications for an order will usually be made by a creditor or trustee in bankruptcy, the language of the section extends to include a person merely capable of being prejudiced by a transaction, thus resolving a previously unsettled point (see *Cadogan v Cadogan* [1977] 3 All ER 831, CA). Section 424(2) in effect introduces a species of imposed class action, in that any application made must be treated as made on behalf of every person who may be prejudiced by the transaction.

Any applicant wishing to attack a transaction must be able to establish that it satisfies the twin requirements of s 423. It must constitute a transaction at an undervalue (s 423(1)) *and* have been entered into with the intent specified in s 423(3). Note that where a person has been adjudicated bankrupt, the trustee in bankruptcy will in most circumstances prefer to institute proceedings under IA 1986, ss 339–342 ('the bankruptcy provisions') since there is no need to establish intent under those provisions.

Transaction at an undervalue (s 423(1)) The concept of a 'transaction at an undervalue' is fundamental to the operation of both the 'intent to defeat creditor' jurisdiction and the bankruptcy provisions (see s 339, below p 287). The definition adopted in both instances is substantially the same and includes both gifts on trust and outright gifts. General questions of interpretation are considered here whilst specific matters concerning bankruptcy are dealt with at p 289 below.

As recommended by the Cork Report (para 1216), marriage is no longer treated as valuable consideration (s 423(1)(b)) and the latter concept is itself more closely restricted by s 423(1)(c). The key element in the definition of 'transaction at an undervalue' lies in sub-s (1)(c), particularly in the phrase 'significantly less than'. What is required is a comparison between the consideration provided by the transferor and that provided by the other party. And the object of the comparison is to prevent an outcome whereby insolvent persons can succeed in reducing their net assets to the detriment of their creditors: 'Such reduction is achieved by a mismatch between that which is disposed of and that which is received' (*Re Thoars* [2002] EWHC 2416 at [13]).The problem lies in the measuring, particularly where the transaction involves some repackaging of property interests.

In *Agricultural Mortgage Corpn plc v Woodward* [1996] 1 FLR 226 the defendant farmer mortgaged his land, worth £1m with vacant possession, to the plaintiff mortgagee as security for a loan of £700,000. He fell into arrears and just before the date set by the mortgagee for repaying some £850,000 the farmer granted a tenancy of the property to his wife at a fair market rent. The effect was to reduce the freehold value of the farm to less than £500,000. There was no doubt that the purpose of the transaction was to prevent the mortgagee obtaining the property with vacant possession. Yet the plaintiff's action to have the tenancy agreement set aside was dismissed at first instance on the grounds that the agreement did not involve a transfer at an undervalue. The Court of Appeal reversed the decision principally on the basis that, in addition to the benefit of the tenancy itself, there were the following valuable benefits or 'consequences' of the tenancy:

(i) the safeguarding of the family home;
(ii) the acquisition of the farming business free from its previous creditors; and
(iii) the benefit of the surrender value of the tenancy.

The last named – a 'ransom position' – was seen as particularly significant since 'the plaintiff would have had to negotiate with and no doubt pay a high price to [the wife] before it could obtain vacant possession of the farm, and sell it for the purpose of enforcing its security . . .' (at 235). Sir Christopher Slade, giving the principal judgment of the Court, concluded (at 236):

> . . . when the transactions are viewed as a whole the benefits which the first defendant thereby conferred on [Mrs Woodward] were significantly greater in value, far greater in value, in money or money's worth than the value of the consideration provided by her. To hold otherwise would seem to me to fly in the face of reality and common sense.

The reference to 'reality and common sense' is revealing. It is evident that the court in searching for a practical answer was not attracted by the possibility of the claims of a creditor-mortgagee being defeated and the purpose of s 423 being subverted in this manner (see also *Barclays Bank plc v Eustice* [1995] 1 WLR 1238 where comparable if more complex transactions, again involving a 'ransom position' and carried out with the benefit of legal advice, were held to constitute 'a strong prima facie case' of transactions at an undervalue). The calculation as to whether or not there has been a mismatch in value between what is disposed of and what is received is not made easier by the fact that the value of property transferred may fluctuate. In principle the valuation has to be made at the date of the transaction but in making the 'mismatch calculation' it is permissible to take into account to a limited degree *ex post facto* developments. The extent to which such developments must be 'certain' before they can be considered remains itself uncertain partly because it is a question of fact to be determined on the totality of the evidence in any given case (see eg *Phillips v Brewin Dolphin Bell* [2001] WLR 143, HL; *Re Thoars* [2002] EWHC 2416; Ho (2003) 8(2) JIBFL 43 and (2001) 6 JIBFL 263).

Intent: 'For the purpose of' (s 423(3)) The very essence of s 423(3) is to be found in the requirement that a transaction was entered into 'for *the* purpose of . . .' [emphasis added].There is an immediate problem with that formulation. What if there is more than one purpose for making a 'transaction at an undervalue'? In *Chohan v Saggar* [1992] BCC 306 Evans-Lombe QC, following the opinion of Lord

Oliver in *Brady v Brady* [1989] AC 755, stated that the word 'purpose' 'must be construed bearing in mind the mischief against which the section in which that word appears is aimed' (at 321). The judge then continued by concluding that in the context of s 423 'It would defeat [the] purpose [of s 423] if it were possible successfully to contend that if the owner was able to point to another purpose, such as the benefit of his family, friends or the advantage of business associates, the section could not be applied' (cited with approval by the Court of Appeal in *Royscott Spa Leasing Ltd v Lovett* [1994] NPC 146 and *Barclays Bank plc v Eustice* [1995] 1 WLR 1238). Where the transaction at an undervalue takes the form of a gift on trust then one might have to add 'estate planning' to the above list, there being no obvious reason why this particular purpose should be privileged (see in a context of corporate tax avoidance *Aiglon v Gau Shan* [1993] 1 Lloyd's Rep 164 and Miller [1998] Conv 362 at 373). But where more than one purpose is pleaded is it also necessary to establish which is the dominant purpose? In *Royscott Spa Leasing Ltd v Lovett* Sir Christopher Slade, obiter, rejected the 'dominant purpose' criterion preferring instead the proposition that what 'has to be established . . . is substantial purpose, rather than the stricter test of dominant purpose' (see Miller at 368–372 for a discussion of this point).

Although the authorities have been in some disarray on this issue the Court of Appeal in *Inland Revenue Comrs v Hashmi* [2002] WTLR 1027 has confirmed that the 'substantial purpose' criterion is to be preferred to those of 'sole purpose' or 'dominant purpose' (see Keay [2003] 67 Conv 272 who argues that any attempt to impose a qualifying epithet to the statutory language will work to the detriment of creditors in a way unwarranted by the wording of s 423(3)). In *Hashmi* Arden LJ added, however, that it is necessary to distinguish between a purpose and a consequence. She summarised the position as follows (at 1035):

> [Section 423] does not require the inquiry to be made whether the purpose was a dominant purpose. It is sufficient if the statutory purpose can be properly be described as a purpose and not merely as a consequence . . . [I]t will often be the case that the motive to defeat creditors and the motive to secure family protection will co-exist in such a way that even the transferor himself may be unable to say what was uppermost in his mind.

After using 'a homely example' based around posting letters and simultaneously walking one's dog to demonstrate the possible combinations of purposes and consequences Arden LJ concluded:

> [F]or something to be a purpose it must be a real substantial purpose; it is not sufficient to quote something which is a by-product of the transaction under consideration, or to show it was simply a result of it . . . or an element which made no contribution of importance to the debtor's purpose of carrying out the transaction under consideration. [T]rivial purposes must be excluded.

There remains one further matter to be resolved under s 423. Is the test for establishing the required 'intention' a subjective or an objective one? The meaning of 'intent to defraud' was extensively litigated under the old legislation, not least because it was rarely possible to prove the presence of intent by direct evidence. Reliance was inevitably placed on drawing inferences from the surrounding circumstances. Whether the inferences could then be said to amount to an irrebuttable presumption of intent to defraud caused sharp differences of judicial opinion (cf *Freeman v Pope* (1870) 5 Ch App 538 at 541, and *Re Wise* (1886) 17 QBD 290 at 298).

The Cork Report had urged that it be made clear that 'intent may be inferred whenever this is the natural and probable consequence of the debtor's actions, in the light of the financial circumstances of the debtor at the time, as known, or taken to have been known to him' (para 1215). Confusingly s 423 retains the subjective element of intent ('for the purpose of'), but sidesteps the issue of whether and in what circumstances inferences should be drawn. Arden LJ in *Inland Revenue Comrs v Hashmi* confirms that it is open to the court 'to draw inferences which are appropriate' but without further clarifying the point (see also *Beckenham MC Ltd v Centralex Ltd* [2004] 2 BCLC 764 applying *Hashmi*). It is probably correct to say that the mere fact that creditors have been defeated or prejudiced is not sufficient per se to establish intention. Beyond that, perhaps all that can usefully be said is that it is now, as it probably always was, a question of fact to be decided in the light of the circumstances. Furthermore, as was thought to be the position under LPA 1925, s 172, the surrounding circumstances are capable of establishing a presumption that the requisite purpose was present. The onus will then be on the transferor or settlor to satisfy the court that this was not so. (See *Moon v Franklin* (1990) Independent, 22 June, where the court was unpersuaded by the insolvent's claim that a gift of £65,000 to his wife was 'an expression of gratitude for all the help and support you have given me'.)

What are the surrounding circumstances? Little is to be gained now by a recital of earlier case law and the most relevant circumstances are likely to be the financial position of the settlor and the time of the transaction. Where a person owing debts but who is still solvent (ie assets exceed personal liabilities) transfers property at an undervalue with the result that 'what remains in the hands of the debtor barely if at all covers the debt' (per Schiemann LJ in *Barclays Bank plc v Eustice* op cit, at 1248) then the inference that the purpose of the transaction falls within s 423(3) is likely to be strong. The inference will be still stronger if the transfer takes place at a time when action by the creditor prejudiced is anticipated or even probable should certain events occur. In *Inland Revenue Comrs v Hashmi*, for instance, in setting aside a declaration of trust over an interest in freehold property the judge held that the settlor, at the time of declaring the trust, 'was sitting on a "potential financial bomb" although there was no inevitability that it would ever explode' (at 1033).

Matters may not always be quite so straightforward [sic]. Consider, for instance, the position of a person who is intending to set up in business and is solvent with no immediate probability of insolvency occurring, and who then settles property on a spouse or on discretionary trusts, but subsequently finds that the business venture fails.

Re Butterworth, ex p Russell (1882) 19 Ch D 588
Charles Butterworth (B) had for many years been a successful baker in Manchester. He proposed to purchase a grocery business, a trade in which he had no experience, but before doing so he settled most of his property on his family. The grocery business was unsuccessful but B sold it six months later for the same price he had paid for it. He continued with his baker's business but was declared bankrupt when this failed three years later. The Court of Appeal held that the settlement was made with 'intent to defraud' and could be set aside, albeit by the creditors of the previously successful bakery business.

> **Jessell MR** [at 598]: The principle of *Mackay v Douglas* ((1872) LR 14 Eq 106), and that line of cases, is this, that a man is not entitled to go into a hazardous business, and immediately before doing so settle all his property voluntarily, the object being this: 'If I succeed in business, I make a fortune for myself. If I fail, I leave my creditors unpaid. They will bear the loss.' That is the very thing which the statute of Elizabeth was meant to prevent. The object of the settlor was to put his property out of the reach of his future creditors. He contemplated engaging in this new trade and he wanted to preserve his property from his future creditors. That cannot be done by a voluntary settlement. That is, to my mind, a clear and satisfactory principle.

Consider the following points:

(1) The 'principle of *Mackay v Douglas*' as elaborated in *Re Butterworth* was applied in the context of s 423 in *Midland Bank plc v Wyatt* [1995]1 FLR 697, where a purported declaration of trust of the equity in the family home in favour of, inter alia, two daughters was set aside. A proposition to the effect that the principle should apply 'only where the settlor is about to enter into a business involving a high degree of risk either as a sole practitioner or as a partner' was firmly rejected (cf *Law Society v Southall* [2002] BPIR 336: no evidence at the time of the gift that the donor was in financial difficulties or was conducting a risky business). In *Wyatt* the defendant's 'contemplated fabrics business' had good prospects and was set up as a limited liability company nine months after the purported declaration of trust. The company was put into receivership some three-and-a-half years later. Note, however, that at no time was the bank, or indeed a business partner, made aware of the purported declaration of trust over the property upon the security of which the bank had loaned money to Wyatt. Note also that an alternative ground for the decision of the court was that the trust declaration, even though executed with the benefit of legal advice, was 'a sham or pretence' – there was 'no intention to endow his children with an interest in the property' – and therefore void and unenforceable. A sham transaction is one where, to paraphrase the definition relied on in *Wyatt*, the document executed is intended to give to third parties or to the courts the appearance of creating legal rights and obligations different to the actual legal rights and obligations that it is intended to create. The consequence in *Wyatt* was that the beneficial interest in the property never left the husband and on this ground also the bank was entitled to enforce its security over the husband's interest.

(2) Is the 'principle of *Mackay v Douglas*' an anachronism, given the availability of limited liability status under the Companies Act 1985 (but consider: (i) s 24 as regards minimum membership for carrying on business; (ii) the liability of wrongful trading under IA 1986, s 214; and (iii) erstwhile creditors may insist on personal guarantees of company debts)? Is the fact that a family's liabilities may extend to include consumption debts as well as business debts a relevant consideration?

(3) Section 423(3) speaks of 'putting assets beyond the reach of *a* person' rather than '*any* person' (as under the previous law in LPA 1925, s 172). Can it be argued that the new formulation is intended to restrict the scope of the section to an identifiable creditor, rather than 'any' potential creditor? The point was not raised in *Midland Bank plc v Wyatt*.

(4) One presumably unintended quirk of the enactment of s 423 deserves comment. A transaction for valuable and adequate consideration does not constitute a 'transaction at an undervalue' (s 423(1)(c)). One consequence is that on a strict interpretation of the sub-section such a transaction made *with the intent of* prejudicing the interests of creditors could now be valid even where the transferee has knowledge of the intent. Indeed, this was the outcome at first instance in *Agricultural Mortgage Corpn plc v Woodward* (see above) but would not have been so under LPA 1925, s 172 (see *Lloyds Bank Ltd v Marcan* ([1973] 3 All ER 754). The Court of Appeal in *Woodward* was able to sidestep this problem by finding that the transaction was, in fact, at an undervalue. Different considerations apply where an individual is adjudged bankrupt. Such a transaction may then be open to challenge as representing a 'fraudulent' or 'voidable' preference (see Cork Report paras 1241–1277; Insolvency Act 1986, s 340).

(5) Is there any inconsistency of philosophy in a system of law that permits s 423 to co-exist with the protective trust (TA 1925, s 33)?

(6) How would you advise a candidate in a local authority election who wishes to safeguard her personal assets by placing them in trust? She is standing in a 'safe seat' for a party whose policies on local authority finance conflict with those of the existing government; there is a possibility that the local authority may decide to defy the government and that consequently she could be surcharged by the District Auditor and, if unable to pay, be adjudicated bankrupt.

(4) Bankruptcy and transactions at an undervalue: Insolvency Act 1986, ss 339, 341

339(1) Subject as follows in this section and sections 341 and 342, where an individual is adjudged bankrupt and he has at a relevant time (defined in section 341) entered into a transaction with any person at an undervalue, the trustee of the bankrupt's estate may apply to the court for an order under this section.
(2) The court shall on such an application, make such order as it thinks fit for restoring the position to what it would have been if that individual had not entered into that transaction.
(3) For the purposes of this section and sections 341 and 342, an individual enters into a transaction with a person at an undervalue if –

(a) he makes a gift to that person or he otherwise enters into a transaction with that person on terms that provide for him to receive no consideration,
(b) he enters into a transaction with that person in consideration of marriage, or
(c) he enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the individual.

341(1) Subject as follows, the time at which an individual enters into a transaction at an undervalue . . . is a relevant time if the transaction is entered into . . .

(a) in the case of a transaction at an undervalue, at a time in the period of 5 years ending with the day of the presentation of the bankruptcy petition on which the individual is adjudged bankrupt,
(b) . . .
(c) . . .

(2) Where an individual enters into a transaction at an undervalue . . . at a time mentioned in paragraph (a) . . . of subsection (1) (not being, in the case of a transaction at an undervalue, a time less than 2 years before the end of the period mentioned in paragraph (a)), that time is not a relevant time for the purposes of section 339 . . . unless the individual –

(a) is insolvent at that time, or
(b) becomes insolvent in consequence of the transaction . . . ;
but the requirements of this subsection are presumed to be satisfied, unless the contrary is shown, in relation to any transaction at an undervalue which is entered into by an individual with a person who is an associate of his (otherwise than by reason only of being his employee).

(3) For the purposes of subsection (2), an individual is insolvent if –

(a) he is unable to pay his debts as they fall due, or
(b) the value of his assets is less than the amount of his liabilities, taking into account his contingent and prospective liabilities.

Section 339 removes many of the curiosities of language so criticised in the Cork Report and reaffirms the vulnerability of settlements created by a property-owner who is subsequently adjudicated bankrupt. A trustee in bankruptcy may in certain circumstances apply for an order, inter alia, to vest in the trustee (s 342(1)(a)) any property transferred in 'a transaction at an undervalue' which includes gifts on trust as well as outright gifts. The statute in effect preserves the pre-existing position that the settlement is not void from inception but merely liable to be upset at the aegis of the trustee in bankruptcy. This will be so irrespective of the settlor's intention when making the settlement.

For a settlement to be upset it must fall within the two requirements of ss 339 and 341. First, and a prerequisite, is that there must be a 'transaction at an undervalue' (s 339(3)), as there will almost always be in the case of a voluntary settlement. The second requirement concerns the time when the settlement is made. The effect of s 341 is to distinguish between the case where a settlor is adjudged bankrupt within two years of the date of the settlement, and that where the settlor becomes bankrupt between two and five years after the creation of the settlement (s 341(1)(a)). In the first instance the solvency of the settlor is an irrelevant consideration: the transaction may still be set aside. In the second instance, however, the settlement will be valid unless at the date of the settlement the settlor was insolvent, as defined by the extremely wide criteria of s 341(3).

Transactions at an undervalue Gifts or transfers of property between family members are vulnerable to challenge by a trustee in bankruptcy. In particular where one spouse is adjudicated bankrupt, prior acquisition by the other spouse of an equitable share in the family home during the period specified under s 341(1), can be set aside to the extent that the share exceeds the value of his or her financial contribution to the acquisition (see *Re Densham* [1975] 1 WLR 1519, and generally Chapter 12). Indeed, even a transfer of property made in compliance with a property adjustment under the Matrimonial Causes Act (MCA) 1973 provides no protection against a subsequent application by the trustee in bankruptcy under s 339 (IA 1986, Sch 14 amending MCA 1973, s 39). It is therefore somewhat surprising that a transfer of property under a compromise of a claim for a property adjustment order under MCA 1973, s 24 may escape the grasp of a trustee in bankruptcy. This was certainly the position under the Bankruptcy Act 1914, s 42(1) which excluded from its scope 'any settlement . . . made in favour of a purchaser . . . in good faith and for valuable consideration'. In *Re Abbott* [1982] 3 All ER 181 the Divisional Court accepted that under a compromise which involved a payment of £9,000 from her subsequently bankrupt husband, 'there was no transfer of a proprietary interest by the wife to the husband as part of the bargain . . . there was a compromise of (a right) not measurable in money terms' (at 185). But neither of these elements was held to prevent the compromise from constituting valuable consideration under s 42(1). This outcome arguably left Mrs Abbott financially better off than if the same property arrangement had been ordered by the court under the Matrimonial Causes Act 1973, s 24, since under such a court order she would not have been 'a purchaser for valuable consideration' and the property transfer order could have been set aside by the trustee in bankruptcy (see Griffiths [1983] Conv 240; Hand [1983] Conv 219 at 225–228; Matrimonial Causes Act 1973, s 39).

Under IA 1986, s 339(3)(c), however, consideration (i) must not be 'significantly less than the value, in money or money's worth of the consideration provided' by the bankrupt, and (ii) must be capable of being measured in money or money's worth (see *Re M C Bacon Ltd* [1990] BCLC 324 where a bank's forbearance to sue was viewed as being not susceptible to valuation). Notwithstanding the change in language and the introduction of the notion of 'significant undervalue', it appears

Table 6.1

	S 339	S 423
1. Bankruptcy	Only applied where individual is adjudged bankrupt.	Applies irrespective of bankruptcy.
2. Locus standi	Only trustee in bankruptcy can apply	'Any person prejudiced'.
3. Intent of settlor	No need to establish 'intent'.	'Intent' is a prerequisite.
4. Time of transaction	Must have occurred not more than 5 years before bankruptcy.	No statutory time limit.

that *Re Abbott* is still applicable 'to the extent that it decides that a compromise of a claim to a provision in matrimonial proceedings is capable of being consideration in money or money's worth' (*per* Ferris J in *Re Kumar* [1993] 2 All ER 700 at 711). However, because under s 339, unlike the old law, the value of the consideration must be assessed, it is apparent that the terms of any compromise, in particular its financial credibility, will be minutely scrutinised by the court in assessing whether the 'consideration' offered by the bankrupt's spouse is adequate (see *Re Kumar* at 712–716 and Ferris [1993] Conv 310). Any anticipated protection offered by cases such as *Re Abbott* may therefore be illusory.

(5) Conclusion

The scope of the jurisdiction available under IA 1986, ss 339 and 423 overlap to some extent and Table 6.1 summarises their relationship to four separate factors.

These statutory provisions and the common law restraint are, generally speaking, effective in favour of creditors of *settlors*. But creditors of *beneficiaries* are also potentially prejudiced by discretionary trusts and even more so by protective trusts. Provided the settlor remains solvent, the Insolvency Act provisions have nothing to 'bite on'. Consequently it can be claimed that trusts law provides its own form of 'limited liability' for beneficiaries' property and for their families. How far this outcome is attributable to the ideological appeal of 'caretaker motivations' or to perceptions about the aims of insolvency law or simply to the logical consequences of a narrow legal formalism, as described earlier in this chapter, is an issue suitable for speculation if probably incapable of resolution.

(6) Bankruptcy and offshore jurisdictions

At several points in this book we emphasise that the dimension of 'location' is one factor that can contribute to the attractions of the trust to its potential clientele. Fiscal advantages are not the only ones associated with offshore jurisdictions. It is possible at some expense to take advantage of favourable 'asset protection trust' legislation, which is drafted so as to provide more extensive protection to settlors than that available under domestic legislation such as the IA 1986 provisions (see

Matthews (1995) 6 KCLJ 62 at 62–88; and generally O'Sullivan *Asset Protection Trusts* (2000); and Thomas in Glasson (ed) *The International Trust* (2002) ch 7). The features of the legislation vary but might (i) exclude future creditors thereby reversing the 'principle of *Mackay v Douglas*'; (ii) allow transactions to be set aside only within a short period of their being made (eg one year); and (iii) refuse to enforce judgments from other jurisdictions. In addition some jurisdictions may increase the burden of proof on claimants to show, for instance, 'beyond reasonable doubt' that the principal intent of the settlement was to defraud the claimant creditor and that the settlement rendered the settlor insolvent (see the Cook Islands legislation, International Trusts Act 1984, ss 13B and 13D; and Duckworth (1999) 32 Vand J Trans L 879 at 930–932). The attraction is evident but there are pitfalls. In the UK a bankrupt will be guilty of an offence (IA 1986, s 357) if in the five years before the bankruptcy he entered into certain defined transactions unless he can prove that he had no intent 'to defraud or conceal his state of affairs' (s 352) from creditors.

Asset protection trusts of this nature appeal to a wider constituency than the individual wealthy citizen. Comparable arrangements may be adopted by transnational corporations particularly where they are concerned about the possible implications of fiscal or political change (see Wiggin 'Asset Protection for Multinational Corporations' and Schoenblum 'The Adaptation of the Asset Protection Trust for Use by the Multinational Corporation: the American perspective' in McKendrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (1992) at pp 195 and 217 respectively).

3. Other purposes contrary to public policy

(a) General

When considering this 'loose class of prohibitions' a distinction needs to be drawn between those cases where the validity of a trust is itself in issue and those where a particular restriction, usually in the form of a condition precedent or subsequent, is challenged. The consequences of conditions precedent or subsequent being invalid have already been described (see p 256) and can be contrasted with the result where the whole trust is void on grounds of public policy. Then the property will be held on resulting trust for the settlor or, where the trust arises under a will, fall into the residuary estate of the testator. If by some chance the property is itself the residuary estate, or if there is no residuary gift, it will become property undisposed of by the will and devolve accordingly, ie broadly speaking in accordance with the provisions of the law on intestate succession (see Kerridge *Parry and Clark: The Law of Succession* (11th edn, 2002) ch 2).

We consider only briefly here the relation between public policy and certain restrictive conditions inserted in settlements, and consequently scarcely touch on the extensive case law that has accumulated in this general area (see eg *Pettit* pp 205–213 for a more extensive account). Where a condition fails for being too uncertain there is, of course, no need to take the further step of considering whether the condition is void as being contrary to public policy.

Public policy in this context has operated over a narrow area, arguably reflecting the prevailing social mores, family traditions and the economic realities of marriage, during the periods in which the rules emerged. The rules are directed primarily at discouraging attempts to undermine the institution of marriage and at protecting the interests of children. Accordingly conditions intended to prevent marriage altogether or to encourage separation or divorce are generally considered to be void. The simplicity of the picture is complicated a little by two refinements. The first involves our old friend the determinable interest. A determinable gift – to A until marriage to B – will be valid, it being construed as merely demonstrating an intention to provide support until marriage and, placing faith in love's disdain for things material, not to discourage marriage altogether (*Re Lovell* [1920] 1 Ch 122). Second, the tensions induced by the demands of freedom of disposition reappear since this also is a value prized by public policy. Accordingly, a compromise has been struck whereby partial restraints on marriage are prima facie valid, subject to the formal requirement that where the property is personal, there must be an express gift over if the condition is to be effective. Partial restraints have generally been directed towards discouraging marriage with particular individuals or persons of particular religious faith or nationality.

Where the interests of children are involved, public policy has intervened to invalidate conditions designed to interfere with the proper exercise of parental duties (*Re Sandbrook* [1912] 2 Ch 471). But here again the law draws back from too intrusive a stance. It was argued in *Blathwayt v Baron Cawley* [1975] 3 All ER 625 that a clause providing for the forfeiture of the interest of a child if he became a Roman Catholic should be void because it might undesirably influence his parents in bringing him up. This was firmly rejected by the House of Lords. In Lord Wilberforce's words (at 637): 'To say that any condition which in any way might affect or influence the way in which a child is brought up, or in which parental duties are exercised, [is invalid] seems to me to state far too wide a rule.'

(b) Racial and religious discrimination

One further area in which settlors and testators have attempted to exercise their freedom of disposition is religion. Conditions imposing restrictions on choice of religion have been the source of much litigation. These have never been held contrary to public policy although the strict requirement of certainty for conditions subsequent has on occasions proved fatal (*Clayton v Ramsden* [1943] AC 320). The most recent judicial pronouncement came in the final round of litigation on the will of Robert Blathwayt where the House of Lords commented obiter on the present function of public policy. (See *Re Morrison's Will Trusts* [1939] 4 All ER 332 and *Re Blathwayt's Will Trusts* [1950] 1 All ER 582 for the earlier reported contests.)

Blathwayt v Baron Cawley [1975] 3 All ER 625 at 634, HL

Clause 9 of the testator's will, made in 1934, declared inter alia that 'if any person who under the trusts . . . shall become entitled . . . shall (a) Be or become a Roman Catholic . . . then . . . the estate limited to him shall cease. . . .' The House of Lords unanimously agreed that Clause 9 was not void for uncertainty nor as being contrary to public policy on the ground of impermissible discrimination, nor on the grounds that it might undesirably influence the child's parents as to the child's upbringing.

The case is extracted on the discrimination point only.

> **Lord Wilberforce:** . . . it was said that the law of England was now set against discrimination on a number of grounds including religious grounds, and appeal was made to the Race Relations Act 1968 which does not refer to religion and to the European Convention of Human Rights of 1950 which refers to freedom of religion and to enjoyment of that freedom and other freedoms without discrimination on ground of religion. My Lords, I do not doubt that conceptions of public policy should move with the times and that widely accepted treaties and statutes may point the direction in which such conceptions, as applied by the courts, ought to move. It may well be that conditions such as this are, or at least are becoming, inconsistent with standards now widely accepted. But acceptance of this does not persuade me that we are justified, particularly in relation to a will which came into effect as long ago as 1936 and which has twice been the subject of judicial consideration, in introducing for the first time a rule which would go far beyond the mere avoidance of discrimination on religious grounds. To do so would bring about a substantial reduction of another freedom, firmly rooted in our law, namely that of testamentary disposition. Discrimination is not the same thing as choice: it operates over a larger and less personal area, and neither by express provision nor by implication has private selection yet become a matter of public policy.
>
> **Lord Cross:** Turning to the question of public policy, it is true that it is widely thought nowadays that it is wrong for a government to treat some of its citizens less favourably than others because of differences in their religious beliefs; but it does not follow from that that it is against public policy for an adherent of one religion to distinguish in disposing of his property between adherents of his faith and those of another. So to hold would amount to saying that although it is in order for a man to have a mild preference for one religion as opposed to another it is disreputable for him to be convinced of the importance of holding true religious beliefs and of the fact that his religious beliefs are the true ones.

The present UK anti-discrimination legislation is the Race Relations Act 1976. Religious discrimination is not covered by the Act, although the distinction between religion and race is not straightforward. (See *Mandla v Dowell Lee* [1983] 2 AC 548 (HL) where Sikhs were held to be an ethnic group, but cf *Dawkins v Department of the Environment* [1993] IRLR 284 where the Court of Appeal concluded that Rastafarians did not constitute an ethnic group separate from the rest of the Afro-Caribbean community.)

Race Relations Act 1976, ss 1, 3

1. Racial discrimination

(1) A person discriminates against another in any circumstances relevant for the purposes of any provision of this Act if –

(a) on racial grounds he treats that other less favourably than he treats or would treat other persons; . . .

3. Interpretation

(1) In this Act, unless the context otherwise requires –

'racial grounds'; means any of the following grounds, namely colour, race, nationality or ethnic or national origins.

The Act makes 'discriminatory' behaviour unlawful only in certain specified situations such as employment, education and the provision of goods and services, ie broadly speaking in the public domain. Thus the Act does not apply, for instance, 'to employment for purposes of a private household' (s 4(3)). Nor it would therefore appear does the statute apply to the creation of private express trusts.

Lord Wilberforce refers to the European Convention on Human Rights in his opinion in *Blathwayt v Baron Cawley*. Since that judgment the Human Rights Act 1998 has been passed and, in effect, incorporates most Convention rights into our law. As from 2 October 2000, the implementation date of the Act, it has been 'unlawful for a public authority to act in a way which is incompatible with a Convention right' (s 6(1)). Amongst the Convention rights are Article 8(1) – 'everyone has the right to respect for his private life and family life, his home and his correspondence' – and Article 9(1) – 'Everyone has the right to freedom of thought, conscience and religion; this right includes freedom to change his religion or belief and freedom . . . to manifest his belief in worship, teaching, practice and observance'. Both Articles are subject to qualifications in Articles 8(2) and 9(2) respectively which specify, inter alia, that the rights can be subject to such limitations as 'are necessary in a democratic society . . . for the protection of the rights and freedom of others'. Trustees of private trusts are not 'a public authority' and, formally at least, the Act does not appear to affect the rights of settlors to exercise their freedom of disposition in a manner such as that in *Blathwayt v Baron Cawley*. But courts are 'public authorities' for the purposes of the Act. Can it then be argued that courts should not recognise as valid clauses such as that in *Blathwayt* on the grounds that they are incompatible with a Convention right? There are a number of difficulties with the proposition. One is that it is premised on a highly contentious argument to the effect that the Act affects rights and remedies in private law disputes (see eg Hunt [1998] PL 423; Phillipson (1999) 62 MLR 824: Buxton LJ (2000) 116 LQR 48, but cf Wade (2000) 116 LQR 217). Second, it may be argued that such a clause in any event is protected by the qualifications referred to above concerning 'the protection of the rights and freedoms of others'. Finally it can be contended that an individual's freedom, for instance, 'to manifest one's religion or belief' is not prevented although it may be made more costly if it incurs, through the operation of a forfeiture clause, the loss of a financial benefit previously enjoyed.

Consider the following questions:

(1) Even if not directly prohibited under a statute or by a Convention right would a forfeiture clause inserted in a settlement made after 1976 seeking to prevent a beneficiary from marrying a person of either a specific religious or racial group be void on grounds of public policy? Consider whether such clauses would operate over the 'larger and less personal area' referred to by Lord Wilberforce.
(2) Do Lord Cross's comments (above) apply with equal force to racial discrimination?
(3) 'It is sophistry to argue that the creation of discriminatory forfeiture clauses is a valid exercise of private property rights but that their subsequent enforcement requires the active intervention of the state judicial machinery and this intervention (ie to enforce a claim) would be contrary to state public policy.' Do you agree?
(4) The opposing poles of valid or void need not be the only options for 'discriminatory forfeiture clauses'. Would it both be consistent with legal principle and a practical compromise for the courts to recognise a species of condition which is valid but unenforceable?

(c) A statutory limitation on freedom of testation

In principle English law, unlike many civil law systems, imposes no general restrictions on testators' freedom to bequeath their property as they wish. There are no specific statutory directions as to the proportion of property, for instance, that must be given to one's descendants. But we have seen that the freedom of settlors to attach restrictive conditions to gifts can occasionally be reined in by the courts. But a testator may wish to exercise testamentary freedom by adopting a still more radical option. What if a will makes no or inadequate provision for a testator's family or dependants? To protect their interests public policy has intervened here also, in the form of the Inheritance (Provision for Family and Dependants) Act 1975. The statute enables the court in its discretion to order that provision be made out of a deceased person's estate where, whether by will or on intestacy, 'reasonable financial provision' has not been made for the applicant (s 2(1), and see Sachs [1990] Conv 45). The court is given wide powers by the statute, similar to those in the Insolvency Act, to undo the effects of dispositions by the deceased up to six years before death, and made with the intention of defeating an application for financial provision under the statute (s 10(2)). In this instance the necessary intention, and it need not be the sole intention, is to be determined on the balance of probabilities (s 12(1)).

It is probable that the very existence of the jurisdiction influences the content of wills since advisers almost always inform clients of the risks of failing to make proper provision for the five categories of persons defined in s 1(1) (see eg Masson [1994] Conv 360 at 367–368). Most reported litigation centres around the fifth category, 'any person who immediately before the death of the deceased was being maintained, either wholly or partly, by the deceased' (see eg *Bishop v Plumley* [1991] 1 All ER 236; Bridge [1991] CLJ 42). It has been common for cases here to involve cohabiting relationships but since 1 January 1996 cohabitants who were living as the husband or wife of the deceased in the same household in the two years preceding death can claim reasonable financial provision without having to establish dependency (Law Reform (Succession) Act 1995, s 1).

(d) Statutory limitation on dispositions to defeat the claims of a spouse

An approach broadly comparable to that described above is adopted under the Matrimonial Causes Act (MCA) 1973, s 37. This enables the court to set aside certain dispositions, including those made by trust, entered into with the intention of defeating a claim by a spouse for financial relief. Where the disposition was made within three years before the date of the application there is a rebuttable statutory presumption (s 37(5)) that the disposition was made with the necessary intent. Otherwise the intent to defeat the claim must be affirmatively proved.

4. Trusts, illegality and public policy: a case for reform?

Notwithstanding the existence of statutory provisions such as IA 1986, s 423 or MCA 1973, s 37 there remains a temptation for property-owners to attempt to safeguard their assets from the claims of others such as creditors or spouses. In the context of the insolvency provisions, for instance, an individual may transfer property to some other person, usually a family member, with the intention of recovering it once the threat from the creditors has passed (as in eg *Gascoigne v Gascoigne* [1918] 1 KB 223). If the transaction remains undiscovered by creditors and the parties to the transaction remain on good terms then the attempt may prove successful and the property be restored. But what if the parties fall out? Can the transferor lawfully recover the property?

One potential means of recovery will be for the transferor to claim that he or she retains an equitable interest in the transferred property under a presumed resulting trust. It will be recalled (see *Re Vandervell's Trusts (No 2)* [1974] 1 All ER 47; Chapter 4 and see further Chapter 12) that where A transfers property to B then, in the absence of any bargain, B is presumed to hold the property on resulting trust for A. This presumption is, not surprisingly, rebuttable by evidence, for instance, to the effect that A's intention was to make a gift to B (see eg *Tinker v Tinker* [1970] P 136). Moreover, the presumption may in some cases, primarily those where certain family relationships are present, be displaced by a competing presumption of advancement, ie the intent of A to make a gift to B is presumed. In English law the latter presumption is probably limited to gifts from (i) father to child, and (ii) husband to wife, but not vice versa. Nor is there any presumption of advancement between more remote family relationships or between cohabiting couples of whatever sexual orientation. How then should the courts respond to attempts to recover assets whether in the context of insolvency or otherwise (cf *Re Emery's Investments' Trusts* [1959] Ch 410 'tax evasion'; *Tinsley v Milligan* [1993] 3 All ER 65 'social security fraud'; *Lowson v Coombes* [1999] Ch 373 'avoidance of claims under Matrimonial Causes Act 1973, s 37'; *Khan v Ali* [2002] 5 ITELR 232 'alleged mortgage fraud')? Should the outcome depend, for instance, on such factors as whether the illegal purpose has to any degree been carried out or whether the illegal purpose has to be relied upon to establish the claim? Should the deterrence of illegality be a consideration?

In *Tinsley v Milligan* the House of Lords by a bare majority decided that reliance could be placed upon doctrines of property law, including the competing presumptions of resulting trust and advancement, to enforce a claim. Unfortunately this 'property doctrine approach' is uncertain in scope and effect, a point illustrated by *Tinsley v Milligan* itself and by a subsequent case *Tribe v Tribe* [1996] Ch 107. In the former case a lesbian couple purchased a house together intending to share ownership of it. They agreed that legal title to the house should be put in the name of one of them, Tinsley (T), so that the other, Milligan (M), would be able to make various fraudulent social security claims. After some years the relationship broke down and T moved out of the residence. At about the same time M, as it was put, 'made her peace' with the DSS and continued to draw benefit, this time lawfully. The litigation arose when T sought an order for possession claiming ownership of the property. M counterclaimed that T held the property on a 'presumed' resulting trust for them in equal shares. In response T contended that an equitable maxim 'he [sic] who comes to equity must come with clean hands' should be strictly applied; the presence of the illegal scheme should therefore prevent M from establishing her equitable interest in the property. Lord Browne-Wilkinson (with whom Lords Jauncey and Lowry concurred) stated that a party to illegality could still seek to enforce an equitable interest as long as he or she could establish that interest without relying on his or her own illegality.

> **Lord Browne-Wilkinson** (at 87): Where the presumption of resulting trust applies, the plaintiff does not have to rely on the illegality. If he proves that the property is vested in the defendant alone but that the plaintiff provided part of the purchase money, or voluntarily transferred the property to the defendant, the plaintiff establishes his claim under a resulting trust unless either the contrary presumption of advancement displaces the presumption of resulting trust or the defendant leads evidence to rebut the presumption of resulting trust. Therefore, in cases where the presumption of advancement does not apply, a plaintiff can establish his equitable interest in the property without relying in any way on the underlying illegal transaction.

On the facts of the case, whereas M could without any need for further explanation point to her financial contribution to the purchase of the property to establish her equitable interest, it was T who had to rely in evidence on the illegal purpose to support her 'clean hands' contention.

One problem with the majority opinion in *Tinsley v Milligan* is that the outcome appeared to depend on the type of relationship between transferor and transferee. What if the relationship is such that the presumption of advancement would apply to a transfer of property? In those circumstances it seems likely that the transferor's claim to establish full ownership of or a share in the property would fail. As Lord Browne-Wilkinson explained (at 87): '[In] such a case, unlike the case where the presumption of resulting trust applies, in order to establish any claim the plaintiff has himself to lead evidence sufficient to rebut the presumption of gift and in so doing will normally have to plead, and give evidence of, the underlying illegal purpose' (see eg *Shephard v Cartwright* [1955] AC 431). It would seem to follow that if a father puts property in the name of a son to defraud creditors he will be unable to recover the property ('presumption of advancement') but if the roles were reversed the son could recover ('presumption of resulting trust').

The consequences of this distinction between the presumptions were at issue in *Tribe v Tribe* [1996] Ch 107. There the plaintiff, the father of the defendant and the majority shareholder in a family company, was himself the tenant on a full repairing lease of two shop premises that the company occupied. It seemed likely (i) that he would be obliged to meet the cost of major repairs to the properties, and (ii) that he would have to sell his shares to do so. The plaintiff therefore transferred his shareholding to his son with the intention of deceiving his creditors and thereby protecting his assets. In the event no repairs were carried out and the judge found as a fact that there was no evidence of any creditor(s) being deceived. The son subsequently refused to return the shares to the father. It was argued on the son's behalf that the presumption of advancement applied and that the father could only rebut this by relying on the evidence of the illegal purpose, which evidence, under the 'reliance principle' as stated in *Tinsley v Milligan*, had to be disregarded. The Court of Appeal whilst accepting that it was bound by that 'general rule' held that there was an exception to it – 'the withdrawal exception': 'In a property transfer case the exception applies if the illegal purpose has not been carried into effect in any way' (per Nourse LJ at 121, citing as support a decision of the High Court of Australia, *Perpetual Executors and Trustees Association of Australia Ltd v Wright* (1917) 23 CLR 185; cf *Collier v Collier* [2002] EWCA 1095 CA where the presumption of advancement from a father to daughter could not be rebutted because the father had carried through a transaction intended to defeat creditors). Nourse LJ added that it was no 'objection to the plaintiff's right to recover the shares that he did not demand their return until after the danger had passed and it was no longer necessary to conceal the transfer from creditors. All that matters is that no deception was practised on them' (at 122; cf Enonchong [1996] RLR 78; Rose (1996) 112 LQR 386; Virgo (1996) 55 CLJ 23).

Consider the following points:

(1) *Tribe v Tribe* does not alter the fact that in English law where property is transferred for an illegal purpose that is carried through (as in *Tinsley v Milligan*) the outcome of an application to regain the property will depend significantly on the presumption applicable. This distinction is generally seen as being indefensible. (See generally Berg [1993] JBL 513; Cohen [1994] LMCLQ 163; Enonchong (1994) 14 OJLS 295; Goo (1994) 45 NILQ 378; Halliwell [1994] Conv 62; Stowe (1994) 57 MLR 441; Davies in

Oakley (ed) *Trends in Contemporary Trust Law* (1996) ch 2). The Court of Appeal has consistently applied the decision of the majority in *Tinsley v Milligan*, as it is bound to do, but not without voicing its criticism of the formalistic and restrictive nature of what we have termed the 'property doctrine' approach. In *Lowson v Coombs* [1999] Ch 373 Robert Walker LJ was critical of the importance attached to the presumption of advancement 'cogently criticised as being out of date in modern social and economic conditions . . . and as being uncertain in its scope' (at 385; see also comments of Nourse LJ in *Silverwood v Silverwood* (1997) 74 P & CR 453 at 458–459 and Cotterill [1999] LMCLQ 465).

Note that in *Nelson v Nelson* (1995) 132 ALR 133 a majority of the High Court of Australia rejected a test of enforceability based on the 'property doctrine' approach applied in *Tinsley v Milligan* – 'wholly unjustifiable on any policy ground' (at 166 per Dawson J) – in favour of an approach that held that an equitable right would be unenforceable *only* where the policy of the statute being circumvented was infringed. In *Nelson* the court held that, unlike the position in English law, a presumption of advancement could arise between mother and daughter. It further held that this did not bar the mother from asserting an equitable interest in property transferred to her daughter for an illegal purpose that had been carried into effect (cf *Tribe v Tribe*). The majority of the court tempered this outcome by making recognition of the mother's interest conditional on her surrendering to the government an amount equal to the benefit that she had unlawfully acquired from it. (See Creighton (1997) 60 MLR 102; Maclean (1997) 71 ALJ 185; Phang (1996) 11 JCL 53.)

(2) In *Tinsley v Milligan* [1993] 3 All ER 65 Lord Goff (with whom Lord Keith concurred) would have held in favour of the plaintiff, Tinsley, by applying the maxim or principle that a court of equity will not assist a claimant who does not come to equity with 'clean hands' (see generally Pettit [1990] Conv 416). On this view the fact that Milligan had engaged in the transfer for an illegal purpose would mean that the court would refuse to assist her 'even though the claimant can prima facie establish [her] claim without recourse to the underlying fraudulent or illegal purpose' (at 75). The principal distinction between the majority and the minority opinions in the case concerned the question whether in the particular context – ie the enforcement of property interests acquired in pursuance of an illegal transaction – the application of the equitable principle had become aligned with the less rigid common law rules governing claims under an illegal contract. The reasons of legal policy underpinning the majority opinion are evident in the opinion of Lord Browne-Wilkinson (at 90–91):

> In my judgment . . . the fusion of the administration of law and equity has led the courts to adopt a single rule (applicable both at law and in equity) as to the circumstances in which the court will enforce property interests acquired in pursuance of an illegal transaction, viz the *Bowmaker* rule (see *Bowmakers Ltd v Barnet Instruments Ltd* [1945] KB 65). . . . I therefore reach the conclusion that . . . as the law has developed the equitable principle has become elided into the common law rule. . . . The time has come to decide clearly that the rule is the same whether a plaintiff founds himself on a legal or equitable title. . . .

Care is needed in interpreting references to 'fusion' in these observations. The alignment that emerges from *Tinsley v Milligan* can be seen as an illustration of what in Chapter 2 was referred to as a process of 'harmonisation' (see p 63). By this we mean that differences between law and equity, particularly as regards the nature and scope of remedies, seem likely to be increasingly subject to challenge where the justification for the difference appears to rest predominantly on historical origins. This proposition of course begs the question as to what might constitute justification and, as importantly, in what direction 'harmonisation' should take place (see eg the reasoning of Millett LJ in *Tribe v Tribe* [1996] Ch 107 at 134 which advances a unifying principle – difficult to reconcile with the *Tinsley v Milligan* majority – based on a distinction between executed and unexecuted illegal schemes and which would marginalise the importance of the presumptions of resulting trust and advancement).

(3) The Court of Appeal in *Tinsley v Milligan* (Ralph Gibson LJ dissenting) argued for the adoption of a flexible 'public conscience' test which could openly address policy considerations: 'the court must weigh, or balance, the adverse consequences of granting relief against the adverse consequences of refusing relief. The ultimate decision calls for a value judgment' ([1992] Ch 310 at 319). The House of Lords unanimously rejected that test but the Law Commission has subsequently published a Consultation Paper in 1999 (*Illegal Transactions: The Effect of Illegality on Contracts and Trusts*; Consultation Paper No 154; see Enonchong [2000] RLR 82 and Buckley (2000) 20 LS 156). The provisional recommendation of the paper is that the existing 'technical and complex rules' should be replaced by a discretion given to the courts (para 1.19):

> In exercising its discretion a court should consider: (i) the seriousness of the illegality involved; (ii) the knowledge and intention of the party seeking to enforce the illegal transaction, seeking the recognition of legal or equitable rights under it, or seeking to recover benefits conferred under it; (iii) whether refusing to allow standard rights and remedies would deter illegality; (iv) whether refusing to allow standard rights and remedies would further the purpose of the rule which renders the transaction illegal; and (v) whether refusing to allow standard rights and remedies would be proportionate to the illegality involved.

Plainly in any given case not all these criteria will point towards the same outcome. A value judgment would then have to be made in deciding what weight to attach to each criterion. Which, if any, of the criteria do you regard as most important for a context in which, let it be assumed, it is public policy to deter illegality such as attempts to defeat the claims of creditors? Applying these criteria what decision would you have reached in *Tinsley v Milligan* and *Tribe v Tribe*, and on what basis?

The Law Commission is currently proposing to publish a further Consultation Paper on whether the existing law can be simplified through judicial decisions or whether legislation is required (Annual Report 2002/03, Cm 5937, paras 4.6–4.7).

(4) There is one further minor puzzling matter to resolve. In *Tinker v Tinker* [1970] P 136 a husband bought a house and put it in his wife's name hoping to avoid any risk of the property being taken by creditors in case his business failed, although on the facts the

business was not in financial difficulty. In *Tribe v Tribe* Millett LJ comments on *Tinker* as follows (at 131): 'It is, of course, perfectly legitimate for a person who is solvent to make a gift of his property . . . to his wife in order to protect her against the possibility of [his] future business failure. It was not, therefore, a case of illegality at all.' Whilst it may be correct that such a transaction is not of itself illegal it is surely misleading to claim that the transaction is 'perfectly legitimate'. At the very least a transaction such as that is difficult to reconcile with the principle of *Mackay v Douglas* and IA 1986, s 423 (see above p 286)?

5. Public policy and perpetuities

(a) Introduction

At the start of this chapter we referred to the fundamental paradox of freedom of disposition. In confronting this paradox it can be claimed that the rule against perpetuities has achieved a satisfactory practical compromise by balancing the competing claims of successive generations (see Morris and Barton Leach *The Rule against Perpetuities* (2nd edn, 1962) and *Second Restatement of Property: Donative Transfers* (1983) p 8). In this part of the chapter we probe the merits of this claim and in doing so implicitly raise the question of the need for a rule against perpetuities. There is, however, a further paradox here: the paradox is that the topic has tended to be studied, if at all, in the context of land law where it has little contemporary relevance (but see *Parker and Mellows* pp 238–254 and Watt, *Trusts and Equity* (2003) pp 194–206). The origins of the 'modern rule' are controversial particularly as regards any causal relationship to alienability of land (see in particular Simpson *A History of the Land Law* (2nd edn, 1986) ch IX; Haskins (1977) 126 U Pa LR 19 and (1983) 48 Miss LR 451 and references therein). But whether or not it was in fact concerned to further alienability of land, legislation commencing with the Settled Land Act 1882 has long since permitted land to be sold irrespective of the existence of future interests. These can now only exist behind a trust. Yet today there are other types of property rights, often arising in commercial transactions, such as options, right of first refusal and grants of future easements which were never within the original contemplation of the Rule but are now caught by it, often in an inconsistent manner. The Law Commission has consequently responded to the perceived practical difficulties that the rule poses for commercial transactions involving such rights by recommending that the rule should cease to apply either to them or to pension schemes (*The Rules Against Perpetuities and Excessive Accumulations* Report 251(HC 579, 1998) para 1.15 (hereafter 1998 Report)). It is therefore primarily in the context of testamentary and inter vivos trusts of, in principle, freely alienable mixed property that a justification for the continuing existence of the rule must now be found.

In the context of a chapter primarily concerned with public policy constraints on freedom of disposition our main focus is policy-orientated: 'Does the idea of an inter-generational compromise itself provide a satisfactory justification for the rule's application to modern trusts of mixed investments?' We therefore do no more here than briefly restate the outlines of the rule, the present defects of the common law rules and of the statutory modifications not being considered.

The rule is also of interest for a different although related reason, the ability of a rule to survive the disappearance of the social and economic pressures that dictated its formulation. As the Manitoba Law Reform Commission recognised (Report 49 *The Rules Against Accumulations and Perpetuities* (1982) p 22), this phenomenon need not occasion surprise:

> Once the rule is adopted by the courts, the very inductive growth of the common law through stare decisis ensures that a rule's existence becomes indelible. Attention is focused on its operation and how property dispositions and transactions are to be affected by it. The conveyancer has no reason for considering why the rule should be, or should be as it is; his task is to know the rule so well that he can reduce to the smallest possible dimension its effects on his client's wishes. The judge also is rarely likely to be concerned with the policy behind such a rule at this; his task is to determine if, and how, it applies to the issue before him, given the precedents brought to his notice, and the emphasis on technique and logical deduction which, he finds, characterises those precedents. Not until two hundred years after its commencement did any legislature become interested in its existence, and then the only concern was to remove some obvious excesses or contemporary inconveniences of a rule, which was by then luxuriant in growth, complex to an extreme, and hallowed by time. Few in the legislatures understood it, there was a vague sense that on the whole something like it was probably necessary, and lawyers who worked with it would naturally think in terms of a 'tune up' as all that was required.

This portrayal of an insular process of legal development leads us therefore to the further question of whether the rule has become an instance of that phenomenon mentioned in the Introduction to this chapter, 'a rule without a reason'.

(b) The 'rules' outlined

(1) The rule against perpetuities (See Burn *Modern Law of Real Property* (16th edn, 2000) ch 14; Oakley *Megarry's Manual of the Law of Real Property* (8th edn, 2002) ch 6.) The very title of the rule arguably qualifies as a misdescription on two grounds. First, Simpson has rightly pointed out that 'the rule *against* perpetuities . . . must be understood as *permitting* them within limits' and thus 'the contemporary oddity of the rule lies not in what it prevents, but in how much it allows' ((1979) 24 Jur Rev 1 at 17). Second, the rule is concerned with the commencement of interests rather than their duration; the rule strikes at the remote vesting of property interests. The classic statement of the rule reflects these considerations: 'no interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest' (Gray *The Rule against Perpetuities* (4th edn) p 201). In substance it permits the testator 'to give life estates to his wife and children . . . (and) to provide for unborn grandchildren during their minority' (Simes (1954–5) 103 U Pa LR 707 at 729). A significant weakness of the common law rule was

its emphasis on remote possibilities – if a contingent interest *might* vest outside the perpetuity period it was void even if the probability was that it would vest within the period. A statutory response to this problem came with the enactment in 1964 of the Perpetuities and Accumulations Act. The Act sought to deal with this problem in two ways: (i) it permitted the settlor to specify a perpetuity period not exceeding 80 years in preference to a 'life in being plus 21 years' perpetuity period (s 1); (ii) it introduced the system of 'wait and see' under which an interest would only be void where it became evident that it could not possibly vest within the perpetuity period (ss 2 and 3). The changes applied only to instruments creating future interests after 25 July 1964 which left the common law rule intact for earlier instruments.

The Law Commission in its 1998 Report has recommended that there should in the future be one fixed perpetuity period of 125 years. This period was selected for two reasons: (i) it is seemingly consistent with the longest period that could be obtained under the present 'life in being plus 21 years' criterion; and (ii) it gives some recognition to the views of those who preferred abolition of the rule (*1998 Report* para 8.13). If implemented the proposal will, subject to minor exceptions, apply only prospectively although there will be provision for some existing trusts to opt in to the longer period (see generally Sparkes (1998) 12 TLI (3) 148–157). Whilst the government has indicated that it intends to implement these proposals in relation to perpetuities this will require primary legislation when parliamentary time allows. At the time of writing there is no immediate likelihood of this happening (see Lord Chancellor's Department Consultation Paper on the partial implementation of the Law Commission Report, September 2002, para 4).

(2) The rule against inalienability This companion rule, also known as the rule against perpetual trusts, is directed principally at non-charitable purpose trusts (see Chapters 5 and 17). If the capital fund must be kept intact (ie inalienable) so that the income produced can be used for specific purposes for longer than the perpetuity period, the trust will be void irrespective of the applicability of the beneficiary principle. The assets contained in the fund will of course be fully alienable, but the rule is directed at eventually freeing the fund for alternative uses. This rule is unaffected by the 1998 Law Commission Report.

(3) The rule against accumulations A feature common to many trusts is that trustees will be given a discretion to accumulate income for specified periods (see eg the disputed clauses in *McPhail v Doulton* in Chapter 5). At common law, income could be accumulated for a period not exceeding the perpetuity period. Statutory restrictions, provoked initially in response to a will by one Peter Thelluson, were first introduced in 1800 to counter what were regarded as excessive accumulations (Keeton *Modern Developments in the Law of Trusts* (1971) ch 17). The principal objection then and subsequently is said to be economic; during an accumulation period neither capital nor income can be spent on consumption (see Simes *Public Policy and the Dead Hand* (1955) p 99).

In its present form the rule permits accumulation only for the periods specified by LPA 1925, ss 164, 165 and the Perpetuities and Accumulation Act 1964, s 13. The broad effect of s 164 is to limit accumulations to any one of four periods: the life of the settlor (obviously only for inter vivos settlements), 21 years from the death of the settlor or testator, and two alternative periods of certain specified minorities. These available periods created problems for tax-planning in inter vivos settlements. In particular the fact that an accumulation of income during a settlor's lifetime had to cease at his death meant that a passing of property occurred which attracted estate duty (*Re Bourne's Settlement* [1946] 1 All ER 411). Accordingly, the Perpetuities and Accumulations Act 1964, s 13 introduced two further periods of accumulation as recommended by the fourth report of the Law Reform Committee (*The Rule against Perpetuities* (Cmnd 18, 1956)): (i) 21 years from the date of the making of the disposition; (ii) the duration of the minority of a person in being at that date. (See also on the tax-planning considerations Law Reform Committee paras 5–9, 55–57; Hawkins [1968] BTR 351; and contemporary tax-planning sources, eg Potter and Monroe *Tax Planning with Precedents* (5th edn, 1966).)

The Law Commission has recommended the abolition of the rule: 'we have been unable to find any coherent reason for limiting accumulations to some shorter period than the perpetuity period' (*1998 Report* para 10.12). In particular the Commission contends (i) that there is no evidence that abolition will have any adverse impact, and (ii) there is little likelihood of settlors creating trusts with a 'duty' to accumulate income for the duration of the perpetuity period. In September 2002 the government indicated in the Lord Chancellor's Department Consultation Paper referred to above that it proposed to implement the Law Commission proposal by means of a Regulatory Reform Order (paras 12–20). The effect would be that the full perpetuity period would also be the upper limit for accumulations, as was the case under the common law before 1800. The reform is extolled as being deregulatory in nature and as essentially increasing the freedom of settlors to dispose of their property as they wish.

Aligning the Rule against – should we now say 'of' – Accumulations with the remoteness of vesting rules assumes that these rules themselves can be justified, a point to which we now turn.

(c) The 'dead hand' and the rule against perpetuities: a rule without a reason?

In 1956 the Law Reform Committee considered (para 4) that: 'the necessity for placing some time limit on the vesting of future interests . . . (is) beyond argument', and consequently no justification for maintaining the rule, as opposed to reforming it, was advanced. Subsequently Morris and Barton Leach, both of whom were involved in the preparation of the Law Reform Committee Report (see para 2), reviewed the various justifications advanced for retaining a rule against remoteness of vesting (*The Rule against Perpetuities* (2nd edn, 1962) pp 13–18).

They consider and reject arguments that the rule prevents an undue concentration of wealth, that it prevents capricious dispositions, that it facilitates control of wealth by the living rather than the dead, or that it prevents a tying-up of capital. The authors are more persuaded, however, by a justification based on 'compromise'.

> Morris and Leach *The Rule against Perpetuities* (2nd edn, 1962) pp 17–18
>
> Another reason for the Rule suggested by Professor Simes seems to the present authors far more realistic. It is that 'the Rule against Perpetuities strikes a fair balance between the desires of members of the present generation, and similar desires of succeeding generations, to do what they wish with the property which they enjoy'. It is a natural human desire to provide for one's family in the foreseeable future. The difficulty is that if one generation is allowed to create unlimited future interests in property, succeeding generations will receive the property in a restricted state and thus be unable to indulge the same desire. The dilemma is thus precisely what it has been throughout the history of English law, namely, how to prevent the power of alienation from being used to its own destruction. In this idea of compromise between two competing policies – freedom of disposition by one generation and freedom of disposition by succeeding generations – the Rule against Perpetuities seems to the present authors to find its best justification.

[Morris and Leach briefly review the contemporary (1962) fiscal attractions of discretionary trusts and conclude:]

> If there were no Rule against Perpetuities, such trusts could be made to last for ever; there would be no need to limit their duration to that of the perpetuity period. But it seems most unlikely that they would in fact do so, since for one reason or another a time would come, well within the perpetuity period, when it would be thought advisable to divide up the capital or resettle it in some other way.
>
> The Rule against Perpetuities undoubtedly has produced many hard cases where some unskilled or unfortunate draftsman has inadvertently broken the Rule although no threat to the public interest can be shown to have existed. Still, the present authors conclude that on the whole the Rule does more good than harm, though the policy considerations underlying it are much weaker than they were 300 or 100 years ago.

The 'compromise' formula has subsequently been adopted by the Law Commission as the justification for retaining the Rule (1998 Report, paras 1.9 and 1.17). The Law Commission had concluded that an alternative justification of economic efficiency could not be relied upon because the lack of empirical evidence made the competing economic arguments too uncertain. Indeed it appears that even if retention of the Rule could be proved to have economic disadvantages the Commission would have recommended retention of the Rule on the basis that the claims of intergenerational justice were 'strong enough to outweigh any possible adverse economic effect' (para 2.32).

Consider the following points:

(1) Neither Morris and Leach nor Simes nor the Law Commission in the 1998 Report explain *why* the particular compromise that the rule strikes is 'fair' (see Gallanis (2000) 59(2) CLJ 284 for a critical assessment of the Commission's philosophy). What justification is there for that compromise (eg consider which succeeding generations in

theory lose their freedom of disposition over property comprised in a settlement in circumstances where the period allowed by the rule – possibly up to 125 years – is exploited to the full)?

(2) Do Morris and Leach accept that the rule is *necessary* to achieve the approved 'compromise'?

(3) Maudsley (*The Modern Law of Perpetuities* (1979) p 221) appeared to accept that estate duty and Inheritance Tax had in practice deterred over-ambitious settlors but considered nevertheless that a rule should be retained: 'those who argue for its abolition would, I suggest, think again, if it became the practice to set up trusts for great-great-grandchildren, or more remote issue'. The evidence on the likelihood of this occurring is mixed. The Law Commission received indications from some firms of solicitors that there remain many wealthy people who would be happy to take advantage of an abolition of the rule (Law Commission Consultation Paper 133 *The Rules against Perpetuities and Excessive Accumulations* (1993) para 5.38). On the other hand evidence from Scotland, described as a 'perpetuities-free zone' by a leading Scots lawyer, is that 'in practice the maximum duration of trusts . . . was about 100 years' (1998 Report para 2.37). Is concern for possible, if unlikely, future attempts to set up dynastic trusts a satisfactory reason for retaining a rule against perpetuities? Should the rule be retained as a statement of principle about appropriate limits to freedom of disposition even if it were shown to have no practical effect on the decisions of settlors?

The almost universal consensus (see *Maudsley* App D p 247) that reform and not abolition was the appropriate method for dealing with perpetuity problems, real or imaginary, was broken in 1983. A majority report of the Manitoba Law Reform Commission (Report 49 *The Rules against Accumulations and Perpetuities* (1982)) rejected reform and recommended abolition, a recommendation which was implemented in the Perpetuities and Accumulation Act 1983 (see Deech (1984) 4 OJLS 453; Glenn (1984) 62 Can BR 618). No deleterious effects have been noted so far although there is no evidence of other Canadian provinces rushing to follow the Manitoba example (cf Gallanis (2000) 59(2) CLJ 284 at 288–289 who notes that several US jurisdictions have either abolished or created substantial exceptions to the Rule).

The Manitoba report introduced an additional and apparently compelling reason for abolition. It concluded that even if the function of balancing the interests of successive generations is considered desirable, the rule is irrelevant to this. The reason is that the rule in *Saunders v Vautier* and variation of trusts legislation give the courts a wide discretion to break up existing trusts. Both these elements are considered in detail in Chapter 7, and the relationship between them and the justifications for a rule against perpetuities are briefly reviewed at the end of that chapter.

7

Flexibility in relation to beneficial entitlement

1. Introduction

In the previous chapter we saw how the rule against perpetuities formally limits the time over which a settlor's freedom of disposition can be exercised. But it is implicit that, within that time and subject to the other public policy restraints mentioned in Chapter 6, a settlor is substantially free to dictate in the trust instrument both beneficial entitlement and the mode of trust administration. Plainly there would be little point in this freedom if the settlor's instructions could be ignored or altered at the whim of beneficiaries or trustees. Consequently, a fundamental principle of the law of trusts is that of fidelity to the settlor's intentions: trustees must faithfully implement that intention as identified through the trust instrument. The settlor is the law-maker, the trustees are the administrators of that law who must not deviate from the terms of the trust. In principle, therefore, the courts will not readily approve any deviation: 'As a rule, the court has no jurisdiction to give, and will not give, its sanction to the performance by trustees of acts with reference to the trust estate which are not, on the face of the instrument creating the trust, authorised by its terms' (*Re New* [1901] 2 Ch 534 at 544 per Romer LJ).

But neither settlors nor their advisers are imbued with the wisdom of Solomon, and they may fail to provide for unexpected developments such as unanticipated changes in investment patterns. A settlor conferring only restricted powers of investment on trustees may leave them ill-equipped to respond to economic change and unable to maintain the trust fund's value. A still more serious encroachment on a settlor's plans affecting beneficial entitlement may come from fiscal changes, such as occurred post-1945 with the sharply increased nominal burdens of income tax and estate duty (see Chapter 8). These latter changes spawned the rapid expansion in the 1950s and 1960s of the use of the discretionary trust, which proved such an elusive moving target for the Inland Revenue. But many trusts, most prominently but not exclusively those containing life interests, were stationary targets. Was it, however, possible for the trustees, beneficiaries or the court to reduce exposure to tax liability by rearranging the line of beneficial interests laid out by the settlor?

The challenge to trusts law was plain. Could established rules and concepts be adapted to promote the sought-after flexibility in beneficial entitlement? In certain circumstances (see p 309) beneficiaries can themselves terminate the trust and thereby indirectly achieve flexibility, but, in the absence of express authority in the trust instrument, trustees could do nothing. Moreover there existed persuasive authority, long predating the emergence of the dominant fiscal considerations, that rejected any general jurisdiction on the part of the court: 'I decline to accept any suggestion that the court has any inherent jurisdiction to alter a man's will because it thinks it beneficial. It seems to me that is quite impossible' (*Re Walker* [1901] 1 Ch 879 at 885 per Farwell J).

What therefore emerges is a further example of the tensions encountered previously between trust principles, based on respect for the settlors' intentions, and the pressures placed on those principles by practitioners responding, in this instance, to the threat posed to the financial interests of beneficiaries by changing fiscal conditions. There is one additional source of tension not necessarily related to fiscal considerations. Let us suppose that the beneficiaries of a will trust decide that they would prefer to distribute the estate in a manner that would be strongly disapproved of by the testator. Notwithstanding the above dictum from *Re Walker* there are circumstances where this variation of beneficial interests may be achieved with the consent of the courts who indirectly will then be faced, in yet another form, with resolving the competing property claims of successive generations (see generally Chapter 6). This chapter is concerned primarily with the resolution of these tensions through a mixture of judicial and statutory responses, and with the implications of those responses for the allocation of authority within the trust institution as between settlors, trustees, beneficiaries and the courts.

Whilst referring to tensions between 'retaining fidelity to settlor's intention' and 'responding to needs for change' it must not be overlooked that settlors, in addition to granting powers of appointment, have long been able to arm trustees with authority over income and capital by means of powers of 'maintenance' and 'advancement' respectively (Trustee Act 1925 (TA), ss 31 and 32). The exercise of these powers too can achieve some alterations of beneficial entitlement and accordingly we consider the scope of those powers in this chapter.

First, however, a brief digression is called for to explain the approach adopted in this chapter with particular regard to our study of trust variation. It will quickly become apparent that this chapter is not concerned exclusively with exposition of the current statutory and common law framework that facilitates the flexibility of beneficial entitlement. On the contrary there is in addition a specific historical focus, one that concentrates primarily on the doctrinal developments and legislative background to a remarkable statute, the Variation of Trusts Act 1958. The statute is remarkable in that it was enacted almost completely uncontentiously by a Private Members' Bill whilst at one and the same time offering potentially impressive benefits to settlors and beneficiaries of private trusts and incurring significant detriment to the Exchequer in terms of tax revenue forgone. The question is how to explain this phenomenon. The answer, as will be seen, is not straightforward. Claims of manipulation and self-interest are not compelling; indeed there is scant evidence of any overt manoeuvring of that ilk. Instead more subtle responses invoking the concerns of trust practice and practitioners, a particularistic interpretation of formal legal doctrine, a perception of an issue as being peculiarly 'lawyers' law' all jostle for position in this story. In post-modern parlance it is the nature of the discourse that is to be understood in seeking to explain how legal change was brought about.

Readers will decide for themselves whether, of itself, that perspective provides sufficient reason for what is, in some modest degree, a case study of events almost half a century ago. But there is another rather more oblique reason for the approach adopted to our study of the Variation of Trusts Act 1958. The processes of change and reform in trusts law and the attempts to achieve ever greater flexibility of beneficial entitlement did not come to a halt in 1958. Indeed they have taken on an added urgency with the extension of trusts doctrines into ever more diverse areas of practice, many involving an international dimension. It is our contention that an understanding of the pressures for and the processes and consequences of the 1958 legislation can help provide insights into those current developments and contribute towards an analytical framework for interpreting them.

2. Premature termination of trusts

(a) The 'rule' in *Saunders v Vautier*

Under the rule in *Saunders v Vautier* (below) a beneficiary of full age (ie over 18) and sound mind and entitled to the entire equitable interest can require the trustees to transfer the trust property to him and thus terminate the trust.

Saunders v Vautier (1841) 4 Beav 115
A testator W bequeathed £2,000 East India stock on trust to accumulate the dividends until V should attain the age of 25, and then to transfer the capital and accumulated dividends to V. V attained 21 and claimed to have the whole fund transferred to him.

> **Lord Langdale MR:** I think that principle has been repeatedly acted upon; and where a legacy is directed to accumulate for a certain period, or where the payment is postponed, the legatee, if he has an absolute indefeasible interest in the legacy, is not bound to wait until the expiration of that period, but may require payment the moment he is competent to give a valid discharge.

On a subsequent hearing before the Lord Chancellor it was argued on behalf of W's residuary legatees that V's interest was contingent on his attaining 25. The Lord Chancellor held that the interest was vested although the enjoyment was intended to be postponed, and he ordered the transfer.

The case itself stands for a quite narrow proposition which, as pointed out elsewhere (Chesterman in Rubin and Sugarman (eds) *Law, Economy and Society: Essays in the History of English Law 1750–1914* (1984) ch 1), derived directly from a principle in the law of wills and originating in the practice of the ecclesiastical courts. A rule of much wider application subsequently emerged during the nineteenth century. This extended to include cases, whether under testamentary or inter vivos trusts, with two or more beneficiaries, and also to beneficiaries entitled in succession. For instance, a testator bequeaths property on trust for his wife W for life then to their adult children X, Y and Z in equal shares. W and the three children may subsequently agree on a fair method of distribution of the capital and require the trustees to distribute it accordingly. The above example refers to fixed entitlements to income and capital but the rule has been further extended to include, it would seem, a discretionary trust under which all the beneficiaries can be listed.

Re Smith [1928] Ch 915
A fund was held by the Public Trustee on trust to pay at the trustee's discretion the whole or any part of the income or capital for the benefit of Mrs Aspinall (A). Any surplus income was to be accumulated and the accumulations and remainder were to pass on A's death to her three children in equal shares. All the children attained the age of majority. Subsequently A, her two surviving children and the legal representatives of a deceased child mortgaged their interests under the trusts to the Legal and General Assurance Company. The Public Trustee sought the court's discretion as to whether he was obliged to pay the whole of the income to the company until the mortgage was discharged.

> **Romer J:** It will be observed . . . that the whole of this [fund] is now held by the trustees upon trusts under which they are bound to apply the whole income and eventually pay over or apply the whole capital to Mrs Aspinall and the three children or some or one of them. So far as the income is concerned they are obliged to pay it or apply it for her benefit or to pay it or apply it for the benefit of the children. So far as regards the capital they have a discretion to pay it and to apply it for her benefit and, subject to that, they must hold it upon trust for the children. Mrs Aspinall, the two surviving children and the representatives of the deceased child are between them entitled to the whole fund. In those circumstances it appears to me, notwithstanding the discretion which is reposed in the trustees, under which discretion they could select one or more of the people I have mentioned as recipients of the income, and might apply part of the capital for the benefit of Mrs Aspinall and so take it away from the children, that the four of them, if they were all living, could come to the Court and say to the trustees: 'Hand over the fund to us'. It appears to me that that is in accordance with the decision of the Court of Appeal in a case of *Re Nelson* (1916 reported [1928] Ch 920n) and is in accordance with principle. What is the principle? As I understand it it is this. Where there is a trust under which trustees have a discretion as to applying the whole or part of a fund to or for the benefit of a particular person, that particular person cannot come to the trustees, and demand the fund; for the whole fund has not been given to him but only so much as the trustees think fit to let him have. But when the trustees have no discretion as to the amount of the fund to be applied, the fact that the trustees have a discretion as to the method in which the whole of the fund shall be applied

> for the benefit of the particular person does not prevent that particular person from coming and saying: 'Hand over the fund to me'. That appears to be the result of the two cases which were cited to me: *Green v Spicer* (1830) 1 Russ & M 395; *Younghusband v Grisborne* (1844) 1 Coll 400.
>
> Now this third case arises. What is to happen where the trustees have a discretion whether they will apply the whole or only a portion of the fund for the benefit of one person, but are obliged to apply the rest of the fund, so far as not applied for the benefit of the first named person, to or for the benefit of a second named person? There, two people together are the sole objects of the discretionary trust and, between them, are entitled to have the whole fund applied to them or for their benefit. It has been laid down by the Court of Appeal in the case to which I have referred that, in such a case as that you treat all the people put together just as though they formed one person, for whose benefit the trustees were directed to apply the whole of a particular fund.

[The court directed that the Public Trustee was bound to pay the income to the company during the lifetime of Mrs Aspinall, or until the mortgage was discharged.]

Re Smith emphasises the collective rights of beneficiaries. An accompanying rule is that a single beneficiary entitled to an absolute interest in a fixed share of a trust fund consisting of divisible personalty, can, if *sui juris*, generally ask for outright transfer of his or her share of the property (see *Stephenson v Barclays Bank* [1975] 1 All ER 625). But, not surprisingly, the rights of the individual beneficiary are less extensive than, and may be subordinated to, the rights of the beneficial interest holders as a body. In *Lloyds Bank plc v Duker* [1987] 3 All ER 193, for instance, a beneficiary (W) was entitled to 46/80 of a testator's residuary estate, which included 999 out of 1,000 shares in a private company, W's notional shareholding therefore being 574. Possession of those shares, giving a majority shareholding, would be more valuable to W than receiving 46/80 of the proceeds of the sale of the 999 shares as a bloc. It was held, however, that the duty to maintain a fair balance between the interests of all beneficiaries took precedence. W could not, therefore, claim the 574 shares but had to be content with a proportionate share of the total proceeds of sale.

(b) The explanation for and limits of the rule

The Court of Appeal in *Re Nelson* [1928] Ch 920n commented that 'the principle . . . is that where there is what amounts to an absolute gift, that absolute gift cannot be fettered by prescribing a mode of enjoyment' (at 921). This reflects an opinion reiterated at greater length on numerous occasions (see eg *Gosling v Gosling* (1859) John 265 at 272 per Page Wood V-C) and is in substance our old and somewhat dubious friend the repugnancy doctrine (see Chapter 6). This formalist justification for the rule in *Saunders v Vautier* also supported a more pragmatic explanation. If attempts to impose conditional restraints on alienation were ineffective as being repugnant to the nature of the interest, it followed that the beneficiary had a definable property interest that could prima facie be sold or assigned in return for a capital sum. This would in practice defeat, albeit indirectly, the particular aim of the trust-founder to postpone receipt of the benefit. The court was quick to recognise and acknowledge that this reality underlay the rule in *Saunders v Vautier* (see *Curtis v Lukin* (1842) 5 Beav 147 at 156). The decisions may also have been influenced by a nineteenth-century feeling that capital should be 'active', ie freely available for entrepreneurial use beyond the limits possible for trustee investment.

That the rule is the product of a doctrine of free alienability, and not a fundamental prerequisite of a law of trusts, is demonstrated by the diametrically opposite approach of the American courts. Their rejection of *Brandon v Robinson* (see Chapter 6), reflecting the pre-eminence of the settlor's property rights, ultimately also resulted in a rejection of the rule in *Saunders v Vautier*. What emerged instead was a 'material purpose' doctrine: where the terms of a trust revealed a particular purpose on the part of a settlor or testator there could be no termination of a trust where that would defeat the purpose. (*Claflin v Claflin* 20 NE 454 (1889) discussed in Friedman (1964) 73 Yale LJ 550 at 586–592. See also Second Restatement of the Law of Trusts: s 337 (1959); Alexander (1985) 37 Stanford LR 1189 at 1202–1204.)

If developments from the original rule in *Saunders v Vautier* had rested solely on the repugnancy doctrine, a rule of much narrower scope than that subsequently recognised in *Re Smith* would have resulted (see Cantlie (1986) 25 Manitoba LJ 135 at 153–154 for a view that there are really two distinct rules with different consequences for the validity of dispositions). There was, after all, no repugnancy in the nature of the interests being considered in *Re Smith*. The rule in *Saunders v Vautier* is therefore now conventionally explained as being based on the beneficiaries' equitable ownership of trust property – in Harris's telling phrase 'fidelity to the settlor's intention ends where equitable property begins' (*Variation of Trusts* (1975) p 2). But as the American developments of the spendthrift trust (see Chapter 6) and material purpose doctrine demonstrate, where equitable property begins is a question admitting various responses.

Nevertheless there is now no doubt that in English law the rule in *Saunders v Vautier* supports the proposition that beneficiaries if of full age and sound mind can dissolve a trust. But the limits to the rule must be noted. As Lord Maugham summarised the position in *Berry v Green* [1938] AC 575 at 582, 'the rule has no operation unless all the persons who have any present or contingent interest in the property are *sui juris* and consent'. Accordingly where there are beneficiaries who are under age, unborn or even whose identity is unknown then the rule cannot be used to terminate a trust. Two obvious examples where this would be the case are (1) where there are interests in succession and one of the remaindermen is under 18, and (2) a protective trust. A further illustration of the limits to the rule arises from the relaxation of the test for certainty of objects. A discretionary trust can now conceivably exist without it being possible to list, and therefore obtain the necessary consent of, all potential beneficiaries.

By way of conclusion to discussion of the rule it is emphasised that the search for its rationale is not solely a matter of historical concern. It is relevant to analysis of the statutory scope for varying trusts discussed in the following section. Moreover, we might also ask whether the rule can be assumed to apply to all forms of private trusts. Should it, for instance, apply to a *Re Denley*-type of mixed persons-purposes trust discussed in Chapter 5? (See Hackney *Understanding Equity and Trusts* (1987) pp 72–73.) To give a positive response could in effect mean that the rights of beneficiaries to enforce a purpose could be transformed into rights of immediate ownership. The consequence would be to frustrate the trust-founder's intentions and to render nugatory the conceptual development apparently envisaged in *Re Denley*.

3. Variation of trusts

(a) Introduction

In the present century the rule in *Saunders v Vautier* has become a route to success in minimising taxation of beneficial interests not only by direct use of the rule, but also because the existence of the rule has provided both a theoretical starting-point and a policy justification for the Variation of Trusts Act 1958 (VTA). Yet the practical reality was that the rule in *Saunders v Vautier* was available to be used by beneficiaries in only a small minority of trusts (see the limitations described in section 2 above and the Sixth Report of the Law Reform Committee *The Court's Power to Sanction Variation of Trusts* (Cmnd 310, 1957) paras 6 and 7, below p 319). Thus the pre-1958 issue was how to remodel beneficial interests in other circumstances.

There existed certain elements both of a statutory and an inherent judicial jurisdiction to vary trusts. These are now of limited significance but we consider them briefly here because, in combination with the rule in *Saunders v Vautier*, they provided the springboard for arguments favouring the wider jurisdiction granted in the VTA 1958. These prior jurisdictions can be divided into those concerned with acts done in the administration of a trust and those relating to altering beneficial interests.

(b) Pre-1958 jurisdiction

(1) Administration

The court has long-established inherent jurisdictions known as 'conversion', 'salvage' and 'emergency', which enable the court to authorise departures from the trust instrument (see Harris *Variation of Trusts* (1975) pp 9–11). TA 1925, s 57(1) in effect subsumes these within a broad statutory jurisdiction which now enables the court to permit trusts to effect any transaction 'in the management or administration of any property vested in the trustees' where the transaction is 'in the opinion of the court expedient, but the same cannot be effected by the reason of the absence of any power for that purpose' in the trust instrument.

The purpose of s 57(1) has been said to be 'to ensure that trust property should be managed as advantageously as possible in the interests of the beneficiaries . . . but it was no part of the legislative aim to disturb the rule that a court will not re-write a trust . . .' (*Re Downshire Settled Estates* [1953] Ch 218 at 248 per Evershed MR). Indeed it is quite clear that the section is concerned with administration and does not permit the court to reshape beneficial interests under the trust.

As regards the problem posed by changing investment conditions, s 57 seems wide enough to have enabled the courts to enlarge investment powers but there is little reported evidence of their doing so. Until recently the jurisdiction seems to have been exercised only in favour of applications by charitable organisations (*Mason v Farbrother* [1983] 2 All ER 1078; Sladen (1983) 80 LSG 2845), but in *Anker-Petersen v Anker-Petersen* (1990) [2000] WTLR 581 the court held that it is appropriate to use s 57 to widen investment powers provided that the beneficial interests are not directly affected). With the introduction of very wide powers of investment both under the Trustee Act 2000 and under express investment clauses in trust deeds the need to apply to the court to enlarge investment powers is likely to be increasingly rare.

(2) Beneficial interests

Under the Settled Land Act 1925 (SLA), s 64(1), the court can authorise a tenant for life of settled land to effect any transaction concerning it which could be for the benefit of the settled land or the settlement's beneficiaries and which could have been validly effected by an absolute owner. Section 64(1) was presumed initially to be limited to administrative matters but s 64(2) defines 'transaction' in broad terms. Accordingly, the Court of Appeal in *Re Downshire Settled Estates* [1953] Ch 218 recognised 'transaction' to be a 'word of the widest import as is emphasised . . . by the terms of the second subsection which make the meaning of the word comprehend (*inter alia*) any application of capital money and any compromise or other dealing or arrangement' (at 252 per Evershed MR). The result, as Harris points out (p 21), 'was that s 64 enabled the court to authorise the tenant for life to make an arrangement with the trustees and with other adult beneficiaries under the settlement which completely remodelled the beneficial interests . . .' (see eg *Raikes v Lygon* [1988] 1 WLR 281). The immediate purpose of the remodelling in *Re Downshire* was to avoid a claim for estate duty on the settlement (comprising land valued at £400,000 and capital worth £700,000), which would have arisen on the life tenant's death. In *Hambro v Duke of Marlborough* [1994] Ch 158 (see Cooke [1994] Conv 492) the court adopted a novel and very broad interpretation of the jurisdiction when, inter alia, varying an adult beneficiary's interest against his will.

Whereas s 64(1) did provide a pre-1958 avenue for rearranging beneficial interests so as to avoid tax, it is limited in scope, applying only where the trust corpus includes settled land. This jurisdiction will gradually diminish even further in importance now that the creation of settlements under the SLA 1925 are prohibited by Trusts of Land and Appointment of Trustees Act 1996, s 2(1).

Maintenance Where a settlor has directed that trust income be accumulated, the court has an inherent jurisdiction to allow the expenditure of that income on the maintenance of beneficiaries. The settlor's instructions are ignored, the court presuming that a settlor 'did not intend that children should be left unprovided for or in a state of such moderate means that they should not be educated properly . . .' (*Re Collins* (1886) 32 Ch D 229 at 232 per Pearson J). This jurisdiction of necessity involves a variation of beneficial entitlement but its practical importance is minimal since most trust deeds specify express powers of maintenance or incorporate the statutory formula (TA 1925, s 31). In addition a seemingly little used statutory power (TA 1925, s 53) enables the court to authorise disposal of property to which a minor beneficiary is entitled in order to provide funds for his 'maintenance, education or benefit'. Under this section the court has authorised the sale of an infant's reversionary interest to a life tenant, with the object of reducing estate duty, provided that the proceeds were resettled on the minor and not paid outright to him (*Re Meux* [1957] 2 All ER 630; cf *Re Heyworth's Contingent Reversionary Interest* [1956] 2 All ER 21).

Compromise Settlements are not always drafted with complete clarity. Where disputes arise about the rights of beneficiaries the court has an inherent jurisdiction to approve a compromise on behalf of infant and unborn beneficiaries. It became the practice for judges of the Chancery Division to adopt an extended meaning of 'compromise' so as to approve arrangements varying beneficial interests usually with the aim of minimising tax liability. A genuine dispute was not considered necessary: all that was required was some suitable bargain between the beneficiaries. The practice was generally exercised in chambers, and thus rarely reported. But did the jurisdiction exist to permit the practice?

The issue came before the Court of Appeal in three consolidated appeals (*Re Downshire Settled Estates*; *Re Blackwell's Settlement Trusts* and *Re Chapman's Settlement Trusts* [1953] Ch 218). The Court of Appeal unanimously agreed that the *Blackwell* and *Downshire* schemes came within the definition of 'compromise'. But in the *Chapman* case the court divided over the definition. The majority, in disapproving the *Chapman* scheme, held that the inherent jurisdiction should be limited to 'compromise' but that 'the word compromise should not be narrowly construed so as to be confined to compromises of disputed rights' ([1953] 1 All ER 103 at 113). In characteristically robust fashion the minority judge Denning LJ accepted the argument for an unlimited inherent jurisdiction for the court to approve variations of beneficial interests on behalf of infant and unborn beneficiaries (at 132):

> He [that is Lord Hardwicke] proceeded on the broad principle that the court had power to deal with the property and interests of infants or other persons under disability in a manner not authorised by the trust whenever the court was satisfied that what was proposed was most advantageous for them provided, of course, that everyone of full age agreed to it. I hope to show that that is the true principle today.

The decision on the *Chapman* scheme was appealed. The House of Lords unanimously affirmed the Court of Appeal decision. However, in sharp contrast to both the above views, the majority of the House of Lords (Lord Cohen dissenting) held that the court had power to approve arrangements varying beneficial interests only where a 'genuine dispute' about rights of beneficiaries existed.

Chapman v Chapman [1954] 1 All ER 798 at 801, HL

Lord Simonds (considering the argument for an unlimited jurisdiction):

My Lords, I am unable to accept as accurate this [Denning LJ's] view of the origin, development and scope of the jurisdiction of the Court of Chancery. I do not propose to embark on the arduous task of tracing to its sources this peculiar jurisdiction. Many volumes have been devoted to it and I have refreshed my memory by reference to some of them. Nowhere can I find any statement which would support the broad proposition for which the appellants contend. Moreover, the law reports contain many cases in which the scope of the jurisdiction has been discussed, every one of them a work of supererogation if its scope was unlimited.

In my opinion, the true view that emerges from a consideration of this jurisdiction through the centuries is not that at some unknown date it appeared full-fledged and that from time to time timid judges have pulled out some of its feathers, but rather that it has been a creature of gradual growth, though with many set-backs, and that the range of its authority can only be determined by seeing what jurisdiction the great equity judges of the past assumed and how they justified that assumption. It is, in effect, in this way that the majority of the Court of Appeal in the present case have approached the problem, and, in my opinion, it is the right way. It may well be that the result is not logical and it may be asked why, if the jurisdiction of the court extended to this thing, it did not extend to that also. But, my Lords, that question is as vain in the sphere of jurisdiction as it is in the sphere of substantive law. We are as little justified in saying that a court has a certain jurisdiction, merely because we think it ought to have it, as we should be in declaring that the substantive law is something different from what it has always been declared to be, merely because we think it ought to be so. It is even possible that we are not wiser than our ancestors. It is for the legislature, which does not rest under that disability, to determine whether there should be a change in the law and what that change should be.

[Lord Simonds then briefly outlined the inherent jurisdictions of 'conversion', 'maintenance' and 'salvage'.]

This brings me to the question which alone presents any difficulty in this case. It is whether this fourth category, which I may call the compromise category, should be extended to cover cases in which there is no real dispute as to rights and, therefore, no compromise, but it is sought by way of bargain between the beneficiaries to re-arrange the beneficial interests under the trust instrument and to bind infants and unborn persons to the bargain by order of the court. My Lords, I find myself faced at once with a difficulty which I do not see my way to overcome. For though I am not, as a rule, impressed by an argument about the difficulty of drawing the line since I remember the answer of a great judge that, though he knew not when day ended and night began, he

> knew that midday was day and midnight was night, yet, in the present case, it appears to me that to accept this extension in any degree is to concede exactly what has been denied. It is the function of the court to execute a trust, to see that the trustees do their duty and to protect them if they do it, to direct them if they are in doubt, and, if they do wrong, to penalise them. It is not the function of the court to alter a trust because alteration is thought to be advantageous to an infant beneficiary. It was, I thought, significant that learned counsel was driven to the admission that, since the benefit of the infant was the test, the court had the power, though in its discretion it might not use it, to override the wishes of a living and expostulating settlor, if it assumed to know better than he what was beneficial for the infant. This would appear to me a strange way for a court of conscience to execute a trust. If, then, the court has not, as I hold it has not, power to alter or re-arrange the trusts of a trust instrument . . . I am unable to see how that jurisdiction can be conferred by pleading that the alteration is but a little one.

[Lord Morton concurred, and concluded his judgment with the following comment:]

> I would add . . . that if the court had power to approve, and did approve, schemes such as the present scheme, the way would be open for a most undignified game of chess between the Chancery Division and the legislature. The alteration of one settlement for the purpose of avoiding taxation already imposed might well be followed by scores of successful applications for a similar purpose by beneficiaries under other settlements. The legislature might then counter this move by imposing fresh taxation on the settlements as thus altered. The beneficiaries would then troop back to the Chancery Division and say, 'Please alter the trusts again. You have the power, the adults desire it, and it is for the benefit of the infants to avoid this fresh taxation. The legislature may not move again.' So the game might go on, if the judges of the Chancery Division had the power which the appellants claim for them, and if they thought it right to make the first move. I would dismiss the appeal.

Chapman v Chapman powerfully re-affirmed the principle of respect for the intention of the settlor as expressed in the terms of the trust instrument. In fact the settlors in the case, both of whom were alive, favoured the scheme presented to the court for approval, but as Lord Morton pointed out (at 818) 'the wishes of the grandparents, as settlors, are entirely irrelevant on the question of jurisdiction. By settling the property on certain trusts they have put it out of their power to alter these trusts, however much they may wish to do so.' It was this gap between non-legal social fact and the limits of formal precedent-based doctrine that Denning LJ had attempted to bridge in the Court of Appeal. But *Chapman v Chapman* was decided at a time when, it has been argued by Robert Stevens, judgments of the House of Lords were reflecting a tendency towards 'substantive formalism' (*Law and Politics* (1979) pp 341–354, 374–375, and see also Paterson *The Law Lords* (1982) pp 132–133). For example, there is scarcely a hint to be found in Lord Simonds's judgment that he personally favoured the unlimited jurisdiction being argued for (this appears from his comments at 210 HL Official Report (5th series) col 377, 30 June 1958). In contrast Lord Morton's doubts as to the appropriateness of 'undignified games of chess' are clear but his was a lone voice on the taxation issue in this judgment (see *Stevens* 374–375 on Morton's isolated position amongst his colleagues concerning judicial approaches in tax litigation).

The practical consequence of *Chapman v Chapman* was sharply to diminish the possibilities of varying or terminating trusts for tax-planning purposes. Three years on, in January 1957, the question of whether the powers of the court to sanction variations of trust should be altered was referred to the Law Reform Committee (LRC). The Committee Report was completed in November 1957 (Cmnd 310) and the principal recommendation was that the court be given the virtually unlimited jurisdiction to sanction changes which it in fact exercised before *Chapman v Chapman*. A private member's bill implementing the recommendation was introduced in December 1957 and enacted without opposition in July 1958 as the Variation of Trusts Act.

(c) The roads to 1958

(1) The Law Reform Committee Report

Before briefly examining the arguments advanced by the LRC, the general terms of reference of the Committee and its membership merit comment. The Lord Chancellor's Law Reform Committee, to give its full title, was appointed by Lord Simonds in 1952 with the following terms of reference:

> to consider, having regard especially to judicial decisions, what changes are desirable in such legal doctrines as the Lord Chancellor may from time to time refer to the Committee.

The Committee comprised judges (five), practising lawyers (seven) and academics (three) 'who meet, on average, once a month in the latter part of the afternoon, and have no full-time staff of their own' (Blair (1982) 1 Civil Justice Quarterly 71; the numbers in parentheses indicate the 1954 membership of the LRC).

> *The Court's Power to Sanction Variation of Trusts* no 6 (Cmnd 310, 1958)
>
> 2. We received memoranda from –
> The Institute (a body representing conveyancers in practice at the Bar),
> The Law Society,
> Mr Lindsay Jopling of the Chancery Bar,
> Master Wheatcroft, and
> The Inns of Court Conservative and Unionist Society.
>
> 3. The authors of these memoranda unanimously agreed that the present state of the law, particularly since the decision in *Chapman v Chapman*, presents gross anomalies which have certainly no logical justification and are difficult to justify on any other grounds.
>
> . . .

5. In the course of the last twenty years or so it has become increasingly clear that the traditional type of settlement has not the flexibility which modern conditions demand. The primary object of the old-fashioned settlement was to preserve the settled property for future generations. . . . If the capital can only be invested in trustee investments, heavy losses may be suffered in a period of inflation; if all the income is payable to one beneficiary, it may be largely absorbed in tax; if capital cannot be paid to beneficiaries but must be retained until the death of a life tenant, it may be largely swallowed up in death duties while some member of the family who has urgent need of capital for some reasonable purpose cannot be paid it. Accordingly, a settlement today is generally drawn on much more flexible lines. There is usually an unlimited power of investment and the trustees are usually given power to make capital payments to beneficiaries at any time; sometimes, indeed, they are empowered to distribute the whole fund in this way and to vary the destination of income among a class of beneficiaries at their discretion.

6. As the disadvantages of the old type of settlement became apparent, it was natural that in some cases the beneficiaries under such settlements or their legal advisers should ask themselves whether their provision could not be varied for the advantage of all concerned. So far as the beneficiaries were adults they could, of course, make such arrangements as they chose, but *nearly always* [emphasis added] some beneficiaries are infants and other potential beneficiaries are unborn or unascertained. The only way, therefore, in which the trusts could be varied was to ask the Court to sanction on behalf of infants and potential beneficiaries some re-arrangement of the provisions of the settlement which was for their benefit as well as for the benefit of the adult beneficiaries and to which they would (if well advised) have agreed if they could. . . .

7. The circumstances which made such re-arrangements of beneficial interests desirable varied, of course, in different cases. But it is perhaps worth noting that a common reason for applications to the Court was the fact that under the settlement in question the life interests were 'protected'. Even if the remaindermen were ascertained and of full age, the possibility that the life interest might be forfeited and a discretionary trust come into existence, some of the objects of which would be unascertainable persons, prevented any dealing with the capital being carried out by agreement between the beneficiaries.

. . .

9. The decision in *Chapman v Chapman* has not, of course, stopped beneficiaries under old-fashioned settlements from wishing to have the trusts of their settlements varied. But it has created distinctions between cases in which the trusts can be varied and cases in which they cannot be varied which have nothing to do with the merits of the proposed variations.

[The LRC refers in paras 10 and 11 to the inherent 'compromise' jurisdiction (as modified by *Chapman v Chapman*); TA 1925, s 57 and SLA 1925, s 64.]

12. The position, therefore, today is that so far as the terms of the settlement in question are ambiguous or so far as it comprises land, whether settled or held on trust for sale, or the proceeds of sale of land held on trust for sale, the Court will probably

be able to approve on behalf of infant or potential beneficiaries a variation of the trusts which is agreed to by the adult beneficiaries and which can be shown to be for the advantage of the infant or potential beneficiaries; but that, on the other hand, if the terms of the settlement in question are free from ambiguity and the settlement consists entirely of personalty (not being proceeds of land held on trust for sale) the Court will have no power to approve a variation of the trusts, however desirable it may be in the interests of the infant and potential beneficiaries that they should be varied.

13. We think it is clear that the present situation is unsatisfactory. It cannot be right that the question whether the Court can sanction changes in trusts on behalf of infants or potential beneficiaries should depend on the entirely irrelevant considerations upon which it depends today. In our view the only satisfactory solution of the problem is to give the Court the unlimited jurisdiction to sanction such changes which it in fact exercised in the years immediately preceding the decision in *Chapman v Chapman*. The fact that the Judges who held that the jurisdiction should be limited could not agree on the place at which the line should be drawn goes far, we suggest, to show that no line should be drawn at all. We think there is much force in the views expressed by Lord Cohen and the majority of the Court of Appeal to the effect that a compromise of disputed rights alters the rights of the beneficiaries just as much as an alteration of undisputed rights. On the other hand, we agree with the majority of the House of Lords when they say that the distinction which the Court of Appeal drew, and which Lord Cohen approved, between the *Downshire* and *Blackwell* cases on the one hand and the *Chapman* case on the other is no real distinction at all. Logically, there is no satisfactory stopping place short of an unlimited jurisdiction.

14. Nor is the matter simply one of logic. Justice alone, in our view, demands that the Court should have an unlimited jurisdiction. In the case of lunatics the Court of Protection has jurisdiction to sanction any disposition of the patient's property which the Court considers that the patient, if of sound mind and well advised, would make himself, including dispositions designed to lessen fiscal burdens (see *Re CWM* [1951] 2 KB 714). Similarly, if a husband and wife are divorced, the Divorce Court can sanction variations in their marriage settlement which are designed to prevent the trust fund being diminished by taxes or death duties (see *Thomson v Thomson* [1954] P 384). Why should an infant whose parents are happily married be in a worse position than a lunatic, or an infant whose parents are divorced? Why should an infant who is interested in land be better off than one who is interested in personalty? Why should it not be possible to arrange the affairs of all infants to their best advantage? Why should anyone be prevented from arranging his affairs to his best advantage by reason of some potential beneficiary who (if he ever acquires an interest) would be equally benefited by the arrangement?

15. As we read the speeches in the House of Lords in *Chapman v Chapman*, it was the fact that there were no adequate precedents for the jurisdiction claimed, rather than any conviction that the Court ought not to have such a jurisdiction, that moved their Lordships to deny its existence. . . . If a settlor objected to a proposed variation of

> the trusts, he would nearly always have some good grounds for doing so which would almost certainly incline the Court to refuse to sanction the proposed scheme. If, on the other hand, the settlor's objections are merely captious, it is right that the Court should have power to override them. When he makes the settlement, the settlor parts with his beneficial interest in the property, and he ought not to retain any right to veto changes in his dispositions which the Court considers to be desirable in the interests of his beneficiaries. Nor is it likely that any Judge of the Chancery Division would give his sanction on behalf of infants or potential beneficiaries under a settlement to any scheme of a kind which, as a citizen and a taxpayer, he would not think it right to enter into with regard to his own property. The fact that some adults enter into tax avoidance schemes of questionable character is no ground for refusing the Court jurisdiction to sanction on behalf of infants dispositions of their property which are beneficial to them and are morally unobjectionable.
>
> 16. We would add that, so far as concerns those cases where the object of a variation is to lessen the impact of taxes or death duties, we can see no valid reason why the Court should not be able to do on behalf of persons who are not *sui juris* or are not ascertained what the law allows to be done by persons who are *sui juris*. It appears to us that the legislature, while taking great care to prevent anyone from escaping the payment of taxes or duties by methods of which it disapproves, has shown no intention of adopting a policy of preventing the freer circulation of money and its division between the members of a family rather than its concentration in the hands of a few, so long as this is done by methods which are not forbidden by statute.

(2) The Variation of Trusts Bill

The sponsors of the Variation of Trusts Bill relied almost exclusively on the arguments for change advanced by the LRC and these raised no controversy. The quite brief debates concentrated on drafting amendments and the appropriateness of hearing applications in open court. Although tax avoidance was specifically considered, an almost unanimous consensus (but see Sir L Ungoed-Thomas and Lord Simonds's views below) was that the LRC Report adequately dealt with any doubts about the tax avoidance consequences of varying trusts.

Mr F P Crowder, a practising barrister, surprisingly presented the measure as 'a dull Bill' and as being primarily a technical tidying-up measure (579 HC Official Report (5th series) col 773, 6 December 1957):

> Looked at generally by a layman, this is a short and simple Bill and amounts to nothing more or less than a tidying-up Bill. I can say, as the leading article of *The Times* said this morning [6 December], that it will be accepted by the whole of the legal profession, I imagine without opposition.

Mr Crowder referred to Lord Morton's reservations in *Chapman v Chapman* about the development of 'an undignified game of chess' but doubted that the latter's fears would be realised: '[Lord Morton] was placing too great a stress on something which might happen occasionally here and there and too great an exaggeration on how, with commonsense and fairness, these matters are likely to work out' (col 774).

In slight contrast the principal Labour opposition spokesman Sir L Ungoed-Thomas (a then practising member of the Chancery bar, subsequently appointed as a judge in the Chancery Division), whilst supporting the Bill, stressed that it should be recognised as being primarily concerned with tax avoidance. He emphasised that a consequence of enacting the Variation of Trusts Bill would be to place the courts in precisely the position contemplated by Lord Morton: 'We must not just pooh-pooh Lord Morton's objection, but face it quite squarely and say whether, in spite of his substantial objection, we are or are not in favour of the principle in the Bill' (col 793).

As a private member's bill its success depended in part on a sympathetic government attitude, particularly in view of the possible fiscal consequences (see generally Marsh and Read *Private Member's Bills* (1988)). The government position conveyed by the Solicitor-General, was that the Bill's advantages, as described in the LRC Report, overwhelmingly outweighed the disadvantage that there was a risk to the Revenue which might 'involve some Revenue loss'. He concluded (cols 799–800):

> I prefer not to indict this as a tax avoidance Bill but rather to call it a 'fair restrictions for all' Bill. It will place persons not *sui juris* in a parallel position as regards adult persons for the purpose of invoking the jurisdiction of the courts. The more we look at it, the more it is apparent that both justice and logic require that the law be changed in the way this Bill will change it . . . and so the Government think that on balance, and despite its disadvantages, the Bill should be accepted by the House.

The Bill passed unopposed through all its stages in both Houses. One slight check to its smooth progress occurred in the House of Lords. Viscount Simonds (as he had since become) strongly supported the Bill – '[the avoidance of tax] is an object from which I, for one, do not dissent in any way' (210 HL Official Report (5th series) col 377 30 June 1958) but expressed concern that not all Chancery judges would have identical views about the propriety of schemes whose main purpose was tax avoidance. In the interests of clarity and certainty he urged that the Bill be amended to state that 'it shall not be an objection to the exercise [of the court's jurisdiction] that a main purpose or consequence of its exercise is . . . to avoid the exigibility of tax which would otherwise be exigible'. Although remaining unconvinced, Viscount Simonds did not press the amendment when the Lord Chancellor responded (cols 380–382) that there was no real uncertainty since Chancery judges would apply the reasoning described in the LRC Report paras 15 and 16 (see above, p 320).

The Bill was enacted as the VTA in July 1958 and its structure, which closely follows the recommendations of the LRC Report, and operation are examined in the next section.

Consider the following points:

(1) The LRC accepted the view that 'a compromise of disputed rights alters the rights of beneficiaries just as much as an alteration of undisputed rights' (para 13 above). Lord Morton had argued that 'where rights are in dispute and the court approves a compromise it is not altering the trusts, for the trusts are, ex hypothesi, still in doubt and unascertained'. Whose view do you find more persuasive?
(2) Does the LRC (para 15 above) deal adequately with Lord Morton's concern about 'an undignified game of chess'? (See Waters [1960] CLP 36 at 57–58 and Mitchell (1954) 17 MLR 473 at 474–475.) How convincing is the LRC's analysis of 'tax avoidance' and 'tax evasion' in paras 15 and 16 (cf the discussion in Chapter 3)?
(3) The LRC places considerable emphasis on the anomalies in the capacity of the courts to approve variations. It is evident, however, that there were 'nearly always' (para 6) minor or unascertained beneficiaries who could not legally consent, thereby preventing adult beneficiaries achieving, in effect, a variation under the rule in *Saunders v Vautier*. The usual method of removing an anomaly is to bring it into line with the majority position. Does the LRC stand this methodology on its head? Does the LRC establish its claim that '*logically* [our emphasis] there is no satisfactory stopping place short of an unlimited jurisdiction' (para 13)?
(4) The LRC emphasises that compared with contemporary settlements, increasingly then in the form of discretionary trusts, 'traditional settlements' lacked flexibility. Should the VTA therefore have had retrospective effect *only*?
(5) Was the LRC primarily concerned with the interests of 'minor beneficiaries' or 'adult beneficiaries' or both equally?
(6) 'The general impression [of the work of the LRC] is one of modernisation by way of simplification and elimination of anomalies, rather than by the creation of fresh rights or adjustment of the whole thrust of a given field of law' (Blair (1982) 1 Civil Justice Quarterly 71 at 77). Does this description apply to the LRC Report on trust variation?
(7) Westergaard and Resler in their analysis of power in a capitalist society refer to the non-manipulative exercise of power, a process they label as 'non-decision making' (Westergaard and Resler *Class in a Capitalist Society* (1976) pp 147–149, 246–247; see also Lukes *Power: a Radical View* (1974) chs 3 and 7).

Westergaard and Resler *Class in a Capitalist Society* (1976) p 147

But more is involved [in 'non-decisions'] than the capacity of a well-placed group to 'mobilize bias' or 'pre-empt decisions' . . . by actively preventing particular policy alternatives from being considered. That description certainly applies, for example, when officials or executives without formal powers of policy making – civil servants, say, or middle-level managers in business – are in a position so to prepare the ground that they present their 'masters' with no choice, or only quite a limited choice, between different courses of action. This entails more or less direct and deliberate manipulation. It does not cover the situation of which the essential feature is common acceptance of certain basic premises, which nobody directly engaged in dispute, bargaining or advice considers it realistic to challenge and which automatically rule out a wide range of

> alternative policies. This is a foreclosure of options without manipulation. None is needed here, on or off stage, so long as the unspoken agreement about premises holds.

It is tempting to characterise the law reform process culminating in the VTA 1958 as an illustration of non-decision making in the sense portrayed by Westergaard and Resler. Yet might even this type of analysis overstate the extent to which any non-legal policy considerations could have been a *conscious* factor in the decision-making processes? By 'conscious factor' we mean conscious in the Westergaard and Resler sense of ruling out alternative policy solutions simply because of a 'common acceptance of certain basic premises' which nobody considered it 'realistic to challenge'. In the example of the VTA 1958 the proposition might be that the commonly accepted basic premise, evident in the terms of reference of the Law Reform Committee (see above p 318), is that this was an area of legal doctrine and one that required 'tidying up' by a doctrinal response. In sum was this legal reform a matter of legal discourse alone where alternative policy solutions did not even enter peoples' consciousness let alone be rejected by common agreement as unrealistic? Even if one is persuaded to categorise the decision-making process along the lines just described this does not quite conclude matters. For erstwhile critics there remains a further issue on which to reflect: what 'range of alternative policies', if any, could have been countenanced by the Law Reform Committee?

(d) The Variation of Trusts Act 1958

> 1(1) Where property, whether real or personal, is held on trusts arising, whether before or after the passing of this Act, under any will, settlement or other disposition, the court may if it thinks fit by order approve on behalf of –
>
> (a) any person having, directly or indirectly, an interest, whether vested or contingent, under the trusts who by reason of infancy or other incapacity is incapable of assenting, or
> (b) any person (whether ascertained or not) who may become entitled, directly or indirectly, to an interest under the trusts as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who would be of that description, or a member of that class, as the case may be, if the said date had fallen or the said event had happened at the date of the application to the court, or
> (c) any person unborn, or
> (d) any person in respect of any discretionary interest of his under protective trusts where the interest of the principal beneficiary has not failed or determined,
>
> any arrangement (by whomsoever proposed, and whether or not there is any other person beneficially interested who is capable of assenting thereto) varying or revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts:

> Provided that except by virtue of paragraph (d) of this subsection the court shall not approve an arrangement on behalf of any person unless the carrying out thereof would be for the benefit of that person.

(2) In the foregoing subsection 'protective trusts' means the trusts specified in paragraphs (i) and (ii) of subsection (1) of section thirty-three of the Trustee Act 1925, or any like trusts, 'the principal beneficiary' has the same meaning as in the said subsection (1) and 'discretionary interest' means an interest arising under the trust specified in paragraph (ii) of the said subsection (1) or any like trust.

[Subsections (3)–(6) omitted.] Applications are made by originating summons under RSC, Ord 93, r 6 (Civil Procedure Rules 1998, Sch 1 and see Heward *Chancery Practice* (1983) pp 186–189, on parties to the application and procedure generally).

(1) The Act in outline

Essentially the Act confers on the court the de facto pre-*Chapman v Chapman* jurisdiction. It enables the court to approve arrangements varying or revoking trusts, or enlarging trustees' administrative powers on behalf of the classes specified in s 1(1). The jurisdiction provides a 'very wide and, indeed, revolutionary discretion' whether to approve an application in any particular case (*Re Steed's Will Trusts* [1960] Ch 407 at 421 per Evershed MR; cf the words of Farwell J in *Re Walker* above, p 308). The discretion is subject only to the proviso in s 1(1) that, where the application is made on behalf of any person within subsections (a), (b), and (c), the arrangement must be for the benefit of each individual person. The meaning of benefit is considered in detail in the next section.

The intention of the Act is to enable the court to approve arrangements on behalf of beneficiaries who cannot give their own consent, as is made clear for those who are unborn or who are minors or mentally disabled in sections 1(1)(c) and 1(1)(a) respectively. More difficult to discern is the meaning to be attributed to the phrase 'any person who may become entitled . . . to an interest' and to the proviso in s 1(1)(b) – commencing at 'so however . . .' (see *Harris* pp 33–41). The proposition that 'interest' should be interpreted in a lay rather than in its technical legal sense was rejected in *Knocker v Youle* [1986] 2 All ER 914 (see Luxton (1986) 136 NLJ 1057). The consequence is that those who already have an interest, whether vested or contingent and no matter how remote, do not come within the scope of the subsection. (Cf Riddall [1987] Conv 144 who argues that 'interest' should be interpreted as referring to vested interest only, hence those with a contingent interest would come within the class on whose behalf the court can give approval under s 1(1)(b).) In *Knocker v Youle*, for instance, the outcome was that adult cousins with very remote contingent interests, some of whom lived in Australia and whose consent it was not practicable to obtain, did not come within s 1(1)(b). The court could not therefore consent to a variation on their behalf, although it could do so under s 1(1)(a) for any cousins who were minors.

Who then does fall within the scope of s 1(1)(b)? Among the classes that can come within the subsection are presumptive next of kin of a living person or a potential future spouse. But the effect of the proviso within s 1(1)(b) must not be overlooked. In *Re Suffert's Settlement* [1960] 3 All ER 561 the prospective next of kin were three adult cousins. They comprised the class who may have become entitled to the property had the life tenant died intestate – ie 'the said event had happened' – at the date of the application to the court. The proviso therefore applied and thus the court could not consent on their behalf (cf *Re Moncrieff's Settlement Trusts* [1962] 3 All ER 838n where the prospective entitlement of the next of kin depended on two deaths occurring, not one).

In short the VTA 1958 does not permit the court to dispense with the consent of persons, whether with vested or contingent interests, who are ascertained and sui juris. The sole exception arises under subsection (d); here the consent of even adult and ascertained beneficiaries with contingent discretionary interests under a protective trust is not required. Indeed the arrangement need not even be for their benefit. The wide VTA 1958 jurisdiction largely supersedes those jurisdictions mentioned earlier, although s 1(6) preserves the powers conferred in SLA 1925, s 64 and TA 1925, s 57. And in one respect s 57 is technically of wider scope than the VTA since a transaction can be approved under s 57 provided in the opinion of the court only that it is 'expedient', the consent of all beneficiaries not being required (see *Mason v Farbrother* [1983] 2 All ER 1078).

Apart from the meaning of 'benefit' – to be discussed shortly – and the complexities of s 1(1)(b), two other particular problems of interpretation are created by the statute. First, in applying the phrase 'varying or revoking' in s 1(1) does the court have the jurisdiction to approve what is in truth a complete resettlement? The short answer is 'no', Wilberforce J accepting in *Re T's Settlement Trusts* that where an arrangement 'though presented as a variation, . . . is in truth a complete new resettlement . . . I do not think that the court can approve [it]' ([1964] Ch 158 at 162). There the proposed variation would have transferred an 'irresponsible' daughter's share of a trust fund (to which she was shortly to become absolutely entitled) to new trustees to be held on protective trusts for her life. Subsequently Megarry J (*Re Holt's Settlement* [1968] 1 All ER 470; *Re Ball's Settlement* [1968] 2 All ER 438) accepted that a dividing line should be drawn but proposed what has been termed a 'substratum' test for deciding whether an arrangement is a 'variation' or a 'resettlement'. In Megarry J's view 'where an arrangement does not change the substratum yet effectuates the purpose of the trust by other means, it may still be possible to regard that arrangement as merely varying the original trusts, even though the means employed are wholly different and even though the form is completely changed' (*Re Ball's Settlement* [1968] 2 All ER 438 at 442). Harris caustically comments 'that a resettlement by any other name smells more sweet' (*Variation of Trusts* (1975) p 67) and there is no evidence that this distinction has caused any practical difficulty. It is questionable whether this 'distinction without a difference' is warranted by the language or intent of the VTA (see generally *Harris* pp 63–68).

The second problem requiring brief comment concerns the way a variation takes effect. Does the order of the court or the arrangement that the order approves vary the trust? Dicta of Lord Reid in *Re Holmden's Settlement Trusts* [1968] 1 All ER 148 at 151 seem conclusive:

> Under the [VTA 1958], the court does not itself amend or vary the trusts of the original settlement. The beneficiaries are not bound by variations because the court has made the variation. Each beneficiary is bound because he has consented to the variation . . . the arrangement must be regarded as an arrangement made by the beneficiaries themselves. The court merely acted on behalf of or as representing those beneficiaries who were not in a position to give their own consent and approval.

Previous practice had been to treat the order of the court as varying the trust (*Re Hambleden's Will Trusts* [1960] 1 All ER 353n), it being assumed that this dispensed with the need for any other instrument in writing. But a conclusion that the court merely provided the approval on behalf of minor beneficiaries posed a problem of formalities. How could the equitable interests of consenting adult beneficiaries be disposed of without any instrument in writing as required by LPA 1925, s 53(1)(c) (see Chapter 4)? Were many of the variations made since 1958 therefore void? The effect of the section was considered at length by Megarry J in *Re Holt's Settlement* [1968] 1 All ER 470 at 474–476 (decided before *Re Holmden* was reported), who also decided that it was the arrangement not the court order which varied the trusts. What then of s 53(1)(c)? The explanations, accepted largely on grounds of convenience by Megarry J, are succinctly summarised by Pettit (p 491) as follows:

> First, that by conferring an express power on the court to do something by order, Parliament in the Act of 1958 had provided by necessary implication an exception to s 53(1)(c). Secondly that where, as on the facts [in *Re Holt*], the arrangement consisted of a specifically enforceable agreement made for valuable consideration, the beneficial interest would have passed to the respective purchasers on the making of the agreement. This would be a case of constructive trust excluded from the operation of s 53(1)(c) by sub-s (2).

The 'constructive trust' argument, adopting the reasoning of Lord Radcliffe in *Oughtred v IRC* [1959] 3 All ER 623, was not easily reconcilable with the majority decision in that case, Lord Radcliffe being a dissentient. The outcome and the reasoning in *Re Holt* seem less dubious in the light of the adoption by the Court of Appeal in *Neville v Wilson* [1996] 3 All ER 171 of Lord Radcliffe's dictum in *Oughtred* (see Chapter 4, p 128; and Harris (1969) 33 Conv 197–199).

(2) Meaning of 'benefit'

'The word benefit . . . is . . . plainly not confined to financial benefit, but may extend to social or moral benefit' (*Re Holt's Settlement* [1968] 1 All ER 470 at 479 per Megarry J). In that case Megarry J approved a variation postponing the absolute vesting of children's interests in income and capital from the age of 21 to 30 – technically a financial detriment – and concurred with the sentiment of their mother that 'children should be reasonably advanced in a career and settled in life before they are in receipt of an income sufficient to make them independent of the need to work' (at 479; and see *The Independent* 16 February 1999, vesting in possession of entitlement to £1m capital sum and annual income of £250,000 for the son – then aged 14 – of the Duke of Northumberland postponed from age 18 to 25). In fact the whole arrangement in *Re Holt* involved substantial savings of, inter alia, estate duty and the financial advantages of the arrangement were overwhelming, removing any need to balance financial detriment against moral or social benefits. Nevertheless financial benefit, while not a prerequisite (see *Re C L* [1968] 1 All ER 1104), has been the benefit most frequently, indeed almost universally, relied on in arrangements submitted for approval under the VTA 1958.

Although our concern here is with the meaning of 'benefit', s 1(1) in theory places a dual function on the court: it must decide where necessary that 'benefit' exists and then 'may if it thinks fit' approve the proposed arrangement. No indication is given in the statute as to what should influence the exercise of this 'residual' discretion but two factors in particular merit consideration: (i) the settlor's intention; and (ii) tax avoidance. (See *Harris*, ch 4 for a detailed analysis identifying separate factors.)

Settlor's intention In one early reported case, *Re Steed's Will Trusts* [1960] Ch 407, the Court of Appeal stated that in exercising its discretion the court should consider not only the person on whose behalf its consent was sought but 'is bound to look back at the scheme as a whole, and when it does so, to consider, as surely it must, what really was the intention of the benefactor' (at 421 per Evershed MR). In that case a testator had wished to provide for his housekeeper (G) but had apparently been concerned that there was a danger of her 'being, to use a common phrase, sponged upon by one of her brothers'. Accordingly he left the property to her upon protective trusts. G asked the court to remove the protective element from her life interest with the result that she would then, in effect, be absolutely entitled to the trust property. The application to the court was necessary as, although G was 53, unmarried and with no intention of marrying, its approval was required on behalf of any future husband, described as a 'spectral spouse', as a contingent discretionary beneficiary under s 1(1)(d). There is no requirement under sub-s (1)(d) for the court to consider the matter of benefit and the court refused to sanction the arrangement because to do so would undermine the 'intention and desire of the testator' that G should not be exposed to the risk of being 'sponged upon'.

What *Re Steed* does not resolve is how the balance might be struck when the settlor's intention appears to conflict with benefit for those on whose behalf the court's approval is sought. This issue came before the courts in *Re Remnant's Settlement Trusts* (1970) and in *Goulding v James* (1997).

Re Remnant's Settlement Trusts [1970] 2 All ER 554

The children of two sisters, Mrs Hooper ('Dawn') and Mrs Crosthwaite ('Merrial'), were contingent beneficiaries of a trust consisting of two funds valued at £39,000 and

£23,000 respectively. The trust contained a forfeiture clause which would operate in respect of any of the children who practised Roman Catholicism or who were married to a Roman Catholic at the time of vesting, with an accruer provision in favour of the children of the other sister. Dawn's children were Protestant while Merrial's children were practising Catholics. Although Dawn's children stood a substantial chance of taking Merrial's children's share under the accruer clause, both sisters asked the court to approve an arrangement which (i) deleted the forfeiture clause, and (ii) provided for £10,000 to be set aside on accelerated trusts for each sister's children.

> **Pennycuick J:** . . . [Leaving] other considerations apart, the deletion of the forfeiture provisions must be detrimental to [Mrs Hooper's children]. However, that is by no means the end of the matter. In the first place they are being given an accelerated interest in £10,000. Then there are the non-financial considerations which seem to me to loom large in this matter.
>
> The three considerations set out by Mrs Crosthwaite, and elaborated by counsel, are these: first, that the forfeiture provisions represent a deterrent to each of the Hooper children from adopting the Roman Catholic faith should she be minded to do so; secondly, that they operate as a deterrent to each of the Hooper children in the selection of a husband when the time comes; and thirdly, that the forfeiture provisions represent a source of possible family dissension. I am not sure that there is very much weight in the first of those considerations because there is no reason to suppose that any of these children has any particular concern with the Roman Catholic faith. On the other hand, I do think that there is a very real weight in the second and in the third consideration. Obviously a forfeiture provision of this kind might well cause very serious dissension between the families of the two sisters. On the best consideration I can give it I think that the deletion of the forfeiture provisions on the terms contained in the arrangements including the provision for acceleration in £10,000, should be regarded as for the benefit of the three Hooper children.
>
> I have not found this an easy point, but I think that I am entitled to take a broad view of what is meant by 'benefit', and so taking it, I think that this arrangement can fairly be said to be for their benefit.
>
> It remains to consider whether the arrangement is a fair and proper one. As far as I can see, there is no reason for saying otherwise, except that the arrangement defeats this testator's intention. That is a serious but by no means conclusive consideration. I have reached the clear conclusion that these forfeiture provisions are undesirable in themselves in the circumstances of this case and that an arrangement involving their deletion is a fair and proper one.

Neither *Re Tinker's Settlement* [1960] 3 All ER 85n (see Cotterrell (1971) 34 MLR 98), where the position was strikingly similar to that in *Re Remnant* but with a different conclusion, nor *Re Steed's Will Trusts* (above) were cited in *Re Remnant* (criticised by McPherson J in *Re Christmas' Settlement Trusts* [1986] 1 Qd R 372 as extending the notion of benefit to an extent that could not be fairly justified).

The importance to be attached to the trust-founder's intention was reduced still further in *Goulding v James* [1997] 2 All ER 239 (see Luxton (1997) 60 MLR 719) where the court's approval to a variation was sought on behalf of certain minors (great-grandchildren of the testatrix). The testatrix (F) left her residuary estate to her daughter J (aged 59) for life with remainder to her (F's) grandson M (aged 32) contingent on his attaining the age of 40. Provision was made for the estate to devolve upon F's great-grandchildren should M predecease his mother (J) or die before attaining the age of 40. J and M proposed an arrangement whereby 10% of the residuary estate should be put into a trust fund for the great-grandchildren with the balance being split immediately into equal capital payments for J and M. The great-grandchildren's interest under the existing will was actuarially valued at 1.85% of the value of the residuary estate. There was therefore no question, unlike *Re Remnant*, of there being any element of financial detriment to any of the great-grandchildren.

At first instance Laddie J rejected the application principally because evidence produced to the court demonstrated that the proposed arrangement 'was the complete opposite of what was provided for in the will and the settled intention of [F]' ([1996] 4 All ER 865 at 870). It appeared that the testatrix distrusted her son-in-law (J's husband), and her grandson (M) had not 'settled down'. The Court of Appeal reversed the decision and approved the arrangement. Giving the leading judgment Mummery LJ emphasised that the discretion of the court to approve an arrangement is fettered only by the proviso in s 1(1) which prevents 'the court from approving an arrangement which is not for the benefit of the classes referred to in [s 1(1)](a), (b) or (c)' ([1997] 2 All ER 239 at 249). This does not mean that where there is financial benefit approval automatically follows; the arrangement as a whole has to be considered and this involves 'a practical and business-like consideration of the arrangement, including the total amount of the advantages which the various parties obtain, and their bargaining strength' (above, citing Ungoed-Thomas J in *Re Van Gruisen's Will Trusts* [1964] 1 All ER 843n at 844). Mummery LJ emphasised that the function of the court is to act almost as a 'statutory attorney' for the beneficiaries who cannot act for themselves and that the intentions and wishes of the testatrix in the case 'had little, if any, relevance or weight to the issue of approval on behalf of [those beneficiaries] whose interest in residue was multiplied five-fold under the proposed arrangement' (at 252).

Two particular questions arise. First, whatever the merits of the legal logic in *Goulding v James* may be, how is the case distinguishable from *Re Steed*? Mummery LJ pointed to the specific facts of the latter case 'that explained and justified the court's refusal of approval' – the protective trust and the reason for it, the opposition of the trustees to the application, the legal fact that no question of benefit falls to be considered under s 1(1)(d). One can but speculate as to the outcome had the life interest in *Goulding v James* been held on protective trusts. As to our second question, what considerations would persuade a court to exercise its discretion to withhold approval in a case where there is a financial benefit for those beneficiaries on whose behalf approval is sought? In *Goulding v James* Sir Ralph Gibson, concurring with Mummery LJ suggested that if the arrangement constituted 'a dishonest or inequitable or otherwise improper act' on behalf of the adult beneficiaries then such evidence would be relevant as to 'whether the court should "think fit" to approve it on behalf of minor or unborn persons' (at 252). That vague formula simply leads to another question: in what circumstances, if any, should a tax-saving motivation for a variation be a ground for a court refusing to approve the application?

Tax avoidance In *Re Weston's Settlements* [1968] 3 All ER 338, the settlor, Stanley Weston, applied to the court for orders (i) under TA 1925, s 41 (see Chapter 11) appointing new trustees to two settlements created in 1964, and (ii) under VTA 1958 to have the settlements, each valued at about £400,000, transferred to Jersey thereby avoiding a liability to capital gains tax of about £163,000. The settlor claimed that his family (comprising himself, his wife, one son Robert aged 25, and his wife and their child aged two, and another son Alan aged 19, and still a minor), who had moved to Jersey in 1967, intended to make it their permanent home.

Stamp J refused to approve the applications stating that he was 'not persuaded that this application represents more than a cheap exercise in tax avoidance which I ought not to sanction, as distinct from a legitimate avoidance of liability to taxation' ([1968] 1 All ER 720 at 725; see Bretten (1968) 32 Conv 194). The subsequent appeal by the trustees was dismissed (see Harris (1969) 32 MLR 320; Baker (1969) 85 LQR 15; Crane (1968) 32 Conv 431).

Re Weston's Settlements [1968] 3 All ER 338 at 342

> **Lord Denning MR:** The court has power to approve a variation or revocation of the trust, if it thinks fit, on behalf of infants or unborn persons. The statute gives no guide as to the way in which this discretion should be exercised. It provides: 'The court may *if it thinks fit* by order approve.' Likewise with the appointment of new trustees, the Trustee Act 1925 gives no guide. It simply says the court may appoint new trustees 'whenever it is expedient'. There being no guidance in the statutes, it remains for the court to do the best it can.
>
> Two propositions are clear: (i) in exercising its discretion, the function of the court is to protect those who cannot protect themselves. It must do what is truly for their benefit; (ii) it can give its consent to a scheme to avoid death duties or other taxes. Nearly every variation that has come before the court has tax avoidance for its principal object: and no-one has ever suggested that this is undesirable or contrary to public policy.
>
> I think it necessary, however, to add this third proposition: (iii) the court should not consider merely the financial benefit to the infants or unborn children, but also their educational and social benefit. There are many things in life more worthwhile than money. One of these things is to be brought up in this our England, which is still 'the envy of less happier lands'. I do not believe it is for the benefit of children to be uprooted from England and transported to another country simply to avoid tax. It was very different with the children of the Seale family, which Buckley J considered (see *Re Seale's Marriage Settlement* [1961] 3 All ER 136). That family had emigrated to

Canada many years before, with no thought of tax avoidance, and had brought up the children there as Canadians. It was very proper that the trusts should be transferred to Canada. But here the family had only been in Jersey three months when they presented this scheme to the court. The inference is irresistible: the underlying purpose was to go there in order to avoid tax. I do not think that this will be all to the good for the children. I should imagine that, even if they had stayed in this country, they would have had a very considerable fortune at their disposal, even after paying tax. The only thing that Jersey can do for them is to give them an ever greater fortune. Many a child has been ruined by being given too much. The avoidance of tax may be lawful, but it is not yet a virtue. The Court of Chancery should not encourage or support it – it should not give its approval to it – if by so doing it would imperil the true welfare of the children, already born or yet to be born.

There is one thing more. I cannot help wondering how long these young people will stay in Jersey. It may be to their financial interest at present to make their home there permanently, but will they remain there once the capital gains are safely in hand, clear of tax? They may well change their minds and come back to enjoy their untaxed gains. Is such a prospect really for the benefit of the children? Are they to be wanderers over the face of the earth, moving from this country to that, according to where they can best avoid tax? I cannot believe that to be right. Children are like trees: they grow stronger with firm roots.

The long and short of it is, as the judge said, that the exodus of this family to Jersey is done to avoid English taxation. Having made great wealth here, they want to quit without paying the taxes and duties which are imposed on those who stay. So be it. If it really be for the benefit of the children, let it be done. Let them go, taking their money with them, but, if it be not truly for their benefit, the court should not countenance it. It should not give the scheme its blessing. The judge refused his approval. So would I. I would dismiss this appeal.

Harman LJ: Now, the linchpin of the scheme is not to be carried out under the Variation of Trusts Act, 1958, at all. It is essential that the court should exercise its powers under the Trustee Act, 1925, either by appointing new trustees out of the jurisdiction, or giving leave to the existing trustees to make the appointment. It is not suggested that the present trustees are unsuitable or that any difficulty has arisen in the administration of the trusts. The scheme is entirely conditioned by the wish to avoid the incidence of capital gains tax. For this purpose it is essential that the affairs of the trust should be administered from outside the United Kingdom and that this should be done by appointing two persons so resident as trustees. It is proposed that these trustees should then be empowered while still trustees of the English settlements to revoke the whole of the trusts of those instruments and to transfer the assets to themselves as trustees of two settlements framed, it is said, so as to conform with the Jersey law.

Now, this law has never had any experience of trusts and so far as appears, the courts of Jersey have never made an order executing the trusts of a settlement. There is not, it appears, any Trustee Act in Jersey at all, and the effect of this last transaction must, so far as I can see, having nothing to recommend it from a trust point of view.

> Under the circumstances the judge was entitled to consider whether the court 'should think fit' to accede to the scheme. The judge professed himself unsatisfied, and I think he was entitled to take that view. It is true that he expressed some dislike of tax avoidance of this sort, and in that he may have been mistaken, but he was in my opinion well justified in not being satisfied that a transfer of the whole trust to Jersey is expedient . . .
>
> These are English settlements and they should I think remain so unless some good reason connected with the trusts themselves can be put forward. I am of opinion, therefore, that the judge was entitled in the exercise of his discretion to say that to use the powers of the Trustee Act, 1925, in this way was not justified and I would dismiss the appeal.

Consider the following points:

(1) Was the application in *Re Weston* refused: (a) because the transfer was not for the benefit of the minor or unborn beneficiaries; or (b) because the appointment of trustees under TA 1925, s 41 was not expedient; or (c) as an exercise of a residual discretion under s 1(1) to counter 'illegitimate tax avoidance'?

(2) 'There is no legal justification for refusing to sanction a scheme under the VTA 1958 because the sole object of the scheme is to avoid UK taxation.' Does this statement accurately reflect the language of the statute and its purpose, assuming the latter can be discerned from the LRC Report and parliamentary debates?

(3) Lord Denning MR appears to suggest that a substantial financial gain can be outweighed by the alleged benefit of developing 'firm roots' in 'this our England, the "envy of less happier lands"'. Is the decision in *Re Weston*, and indeed that in *Re Remnant*, an undesirable example of judicial paternalism?

(4) The immediate tax saving in *Re Weston* would have been that of capital gains tax (CGT). Although the evidence is not wholly persuasive it is possible to view *Re Weston* as a precursor of the hostile judicial attitude towards artificial CGT-avoidance schemes that was to emerge a decade later. (Review Chapter 3, and see Flesch [1968] CLP 215, for a contemporary review of shifting judicial attitudes.)

Lastly, it must be stressed that benefit under the VTA 1958 is essentially a question of fact in every case. The overwhelming majority of applications have been trouble-free, with actuarial evidence providing the basis for an assessment of benefit, and insurance provision to cater for the element of risk where appropriate (see the example *Re Robinson's Settlement Trusts* [1976] 3 All ER 61). Seen from this vantage point *Re Remnant* and *Re Weston* appear as isolated cases, which nevertheless demonstrate that where competing benefits must be balanced there may be substance in the opinion of Cotterrell ((1971) 34 MLR 96 at 98) that 'the measure of [benefit] is simply what the court says it is'.

(3) A *Re Weston* postscript: trust exporting

Since *Re Weston* was decided the climate in the Channel Islands and in numerous other attractive offshore locations has been deemed more congenial for exporting trusts. *Re Seale's Marriage Settlement* [1961] 3 All ER 136 (distinguished in *Re Weston*) has since been followed in *Re Windeatt's Will Trusts* [1969] 2 All ER 324 where a transfer of trust assets to Jersey was approved, the beneficiaries having lived there for 19 years. The scope was extended further still in *Re Chamberlain* (unreported, but noted by Morcom 'Trust Exporting' (1976) 126 NLJ 1034) where approval was given to a transfer of a trust to Guernsey with a consequent CGT saving. The beneficiaries had long ceased to be domiciled in the UK, the principal beneficiaries and remaindermen being resident in France and Indonesia respectively. *Re Weston's Settlements* perhaps stands at least as a warning that applications under the VTA 1958 may be unsuccessful where beneficiaries are still resident in or only recently removed from the UK. Indeed in a more recent case, Millett J, commenting on circumstances where the court might be asked to exercise a discretion of its own in appointing foreign trustees, indicated that 'the court is unlikely to assist [applicants] where the scheme is nothing more than a device to avoid tax and has no other advantages of any kind' (*Richards v The Hon AB Mackay* (1987) reported in (1997) 11 TLI (1) 22; noted in [1990] Offshore Tax Planning Review 1 by R Bramwell QC). The judge accepted, however, that where trustees were exercising their own discretion, as under TA 1925, s 36(1) (see Chapter 11) or under a power in the trust instrument and merely seeking the authorisation of the court for their own protection, the role of the court is a more limited one:

> [The court] is concerned to ensure that the proposed exercise of the trustees' power is lawful and within the power and that it does not infringe the trustees' duty to act as ordinary, reasonable and prudent trustees might act, but it requires only to be satisfied that the trustees can properly form the view that the proposed transaction is for the benefit of beneficiaries or the trust estate. In my judgment, where the trustees retain their discretion, as they do in the present case, the court should need to be satisfied only that the proposed transaction is not so inappropriate that no reasonable trustee could entertain it.

This view was subsequently endorsed by Vinelott J in *Re Beatty's Will Trusts (No 2)* (1991) (reported in (1997) 11 TLI (3) 77). There, however, the specific reason for seeking a declaration similar to that in *Richards v The Hon AB Mackay* was the avoidance of future CGT tax liability that would arise when certain of the beneficiaries, one of whom was non-resident and another who was about to become so, obtained interests in possession in the trust fund. It is nevertheless difficult to see circumstances other than perhaps those peculiar to a case such as *Re Weston* where exporting a trust for fiscal reasons would ever constitute 'a transaction so inappropriate that no reasonable trustee could entertain it'. In any event in *Richards v The Hon AB Mackay* there was no immediate tax liability to cloud the picture and the reason given by the trustees for the new appointment of a capital sum to the Bermudan trustees was couched in more general terms. In the words of Millett J (at 24):

> The main object of the proposal is not to gain a tax advantage but to obtain greater flexibility and diversification, with the concomitant additional protection to the trust estate which would result from spreading the risks by hiving off up to 25% of the trust fund and causing it to be the subject of an overseas settlement.

Re Weston and the other cases cited above merely touch the fringes of trust exporting, which is widely believed to have expanded substantially after the suspension of exchange control on 24 October 1979. Indeed it is said that one of the most important reasons why some individuals resident in the UK have set up trusts offshore is to enable their assets to be free of the restrictions that might accompany any future re-introduction of exchange control, however unlikely that prospect may be (see eg Matthews *Trusts: Migration and Change of Proper Law* (1997) para 11.3). In *Richards v The Hon AB Mackay* itself the trustees specifically identify ‘a change in economic conditions that required the introduction of exchange controls’ as one of the risks to be guarded against and therefore one of the reasons for exporting the funds. One of the other possible risks to be guarded against, aside from the matter of exchange controls, is a change in the UK tax regime. Concern about avoidance of CGT, the tax at issue *sotto voce* in *Re Weston*, by means of exporting trusts prompted a legislative response. Finance Act 1991, ss 83–87 (now Taxation of Chargeable Gains Act 1992, ss 80–84) imposes an exit charge, based on a deemed disposal and reacquisition of the trust assets, whenever (after 19 March 1991) the trustees of a settlement cease to be ordinarily resident in the UK (see Chapter 8 and generally Venables *Non-Resident Trusts* (5th edn, 1992)). The trustees and the court in *Re Beatty's Will Trusts (No 2)* demonstrated a fine sense of timing in so far as judgment was given just 19 days before the implementation of the provisions in the Finance Act 1991.

Settlors who are not deterred either from exporting trusts or from setting up new trusts overseas will have received further encouragement from the unanimous adoption by member states at the Fifteenth Session of the Hague Conference on Private International Law in 1984 of a draft Convention on the Law Applicable to Trusts and on their Recognition (see now Recognition of Trusts Act 1987). This establishes common conflict of law principles with reference to trusts (see Chapter 1 at p 20). The effect will be to reduce the unpredictability of what may happen if the courts of signatory states, in particular those whose domestic law does not recognise the trust, become involved with trusts because, for example, trustees or beneficiaries are resident there, or trust funds are invested there (Hayton (1987) 36 ICLQ 260; Gaillard and Trautman (1987) 35 AJCL 307; Dyer (1999) 32 Vand J Transnat L 989; and see generally *Hayton and Marshall* ch 12). In practice most transfers of assets are made to the many offshore jurisdictions who ‘are falling over themselves to provide international trust services’ (*Matthews* p xiii). The concern expressed in early cases about the risks associated with appointing trustees in jurisdictions with little experience of trusts law (cf Harman LJ in *Re Weston*) now carries much less weight.

(4) The VTA 1958 in use

The VTA 1958 has been described as 'that most generous of revenue give-aways' (Chesterman in *Rubin and Sugarman* (eds) p 155). But tax saving is not the only motive for varying trusts (cf *Re Steed's Will Trusts* [1960] Ch 407), and between 1958 and the enactment of the Trustee Investments Act 1961 the courts approved numerous applications seeking wider investment powers. (See eg *Practice Note* [1959] 2 All ER 47; Price [1960] BTR 42 at 43–47; *Trustees of the British Museum v A-G* [1984] 1 WLR 418 signalled a renaissance of this jurisdiction.) But as has been judicially acknowledged tax-saving has been the principal objective for most applications (see most recently *Gibbon v Mitchell* [1990] 1 WLR 1304 and McCall (1996) PCB 389–398). The full amount of tax saved is impossible to discover although exhaustive researches through Chancery records 'of a jurisdiction invoked thousands of times over forty years' (per Mummery LJ in *Goulding v James* [1997] 2 All ER 239 at 246) might prove revealing. The alternative is to rely on an eclectic group of sources ranging from *The Times* (11 April 1959) – most applications being either unreported or occasionally reported in *The Times* – and the writings of taxation specialists (eg Wheatcroft [1964] BTR 283 at 295–296) to the work of interested economists. Revell, for example, writing in 1961 (BTR 177) attributed the apparent decline of dutiable settled property in the 1950s, in part to the breaking of existing trusts (at 180):

> This is a point on which we have no definite information at all, but it is widely believed that one of the reactions to the post-war increases in the rates of death-duty was the breaking of dutiable trusts during the lives of the life-tenants. The breaking of trusts if it were sufficiently widespread, could give rise to sharp drops in the proportion of dutiable settled property such as that which occurred during the 1950s.

There is no doubt that the heyday of trust-breaking occurred under the old estate duty regime but it is an error to assume that the VTA 1958 has no contemporary relevance (see *Gibbon v Mitchell* [1990] 1 WLR 1304 at 1306 and McCall (1996) 6 PCB 389–398). As ever it is predominantly contemporary tax provisions that either encourage or deter variations. On the one hand, changes to inheritance tax and CGT in the 1980s re-established variation – including even the traditional partition between tenant for life and remainderman – as a part of the tax-planner's armoury. On the other hand, the more severe restrictions imposed in Finance Act 1989 on a particular form of relief from CGT – hold-over relief – may in some circumstances discourage premature termination of a trust.

Variation also has a useful role to play in rearranging a deceased's estate. It may be highly desirable for fiscal purposes to vary trusts taking effect on a person's death (see eg Venables et al *Tax Planning Through Wills* (3rd edn, 1987); Owen (1999) PCB 237–244). Indeed this was the reason for the application to the court in *Goulding v James* and it is believed that the VTA 1958 jurisdiction is widely used for this purpose. Inheritance Tax Act 1984, ss 17 and 142 provides that where, within two years of a person's death whether testate or intestate, any disposition of the deceased's property is varied by an instrument in writing then the variation is not a transfer of value, and it takes effect as if it had been effected by the deceased (see also Taxation of Chargeable Gains Act 1992, s 62(6) whereby such a variation is not a disposal for CGT purposes).

(e) Conclusion

Harris has described the LRC Report and, impliedly, the VTA 1958 as representing 'a triumph for the doctrine of equitable property over the doctrine of fidelity to settlors' intentions' (*Variation of Trusts* (1975) p 5). This observation is correct both at a formal conceptual level – the settlor's specific intention as contained in the terms of the trust is defeated – and substantively, since the settlor has no right to veto changes which the court considers desirable in the interests of beneficiaries.

But can it be argued that applications under the VTA 1958 usually further rather than frustrate a general intention of the settlor to preserve family wealth? Posner (*Economic Analysis of Law* (1977)) states that the dilemma posed between enforcing the settlor's or testator's intention and modifying the terms of the instrument is a false one: 'A policy of rigid adherence to the letter of the donative instrument is likely to frustrate both the donor's purposes and the efficient use of resources' (p 390). He suggests further that:

> . . . since no one can foresee the future, a rational donor knows that his intentions might eventually be thwarted by unpredictable circumstances and may therefore be presumed to accept implicitly a rule permitting modification of the terms of the bequest in the event that an unforeseen change frustrates his original intention.

This rationalisation cannot justify decisions such as *Re Remnant* [1970] 2 All ER 554 and *Goulding v James* [1997] 2 All ER 239, nor indeed the rule in *Saunders v Vautier*. Yet this only serves to illustrate the paradox of *Saunders v Vautier*. A rule which permits beneficiaries to defeat the settlor's express intention simultaneously provides an important theoretical prop to a statute which can be claimed to sustain the settlor's general purpose.

Finally, we return briefly to a consideration of the rule against perpetuities and its relation to the variation of trust jurisdiction. The Manitoba Law Reform Commission argued that an expansive variation of trusts jurisdiction would render the rule unnecessary. The English Law Commission commented on this possibility in Consultation Paper no 133 (1993) as follows:

> para 5.27. The courts have construed 'benefit' widely but nevertheless it seems unlikely that they would consent to a variation which would deprive a beneficiary of his interest where the purpose of the variation is only to ensure that certain interests under the trust vest forthwith or within a specified period. However, it is possible that if the rule against perpetuities were to be abolished the courts might take a less restrictive view of their duty, in the interests of the good administration of the trust.

Notwithstanding the possibility canvassed in that last sentence, it can be argued that a justification for retaining the rule against perpetuities is to set 'metes and bounds' to the range of beneficial interests for which the court must find some benefit if it is to authorise a variation in the terms of the trust. The scope of the VTA 1958 would otherwise be unduly restricted (see Deech (1984) 4 OJLS 454; Glenn (1984) 62 Can BR 618). This justification is truly paradoxical. A rule – the rule against perpetuities – supposedly justified on the grounds of allowing freedom of disposition to successive generations (see Chapter 6, p 304) in fact provides a key element in undermining the freedom of disposition of the original settlor or testator. In *Goulding v James* Mummery LJ observes that 'the nature of the jurisdiction under the 1958 Act is such that even the most carefully planned and meticulously drafted intentions of a settlor or testator are liable to be overridden by an arrangement agreed between sui juris beneficiaries and by sanction of the court' (at 251). This is a very different state of affairs from that envisaged by Farwell J in 1901 (see above, p 308).

4. Flexibility in relation to capital entitlement and the power of advancement

(a) Introduction

Consider the following two examples. Property is given to trustees to hold (1) for A for life with remainder to B; or (2) for B if she reaches 30 or marries before that date. B's interest in (1) is vested and in (2) contingent yet in neither example does B have any present entitlement to trust property, irrespective of her present financial needs. As a counter to this type of inflexibility it has long been the practice for settlors to empower trustees to apply a specified portion of the trust capital for the 'advancement', as it is termed, of beneficiaries in positions such as those in the above examples. Before 1926 flexibility would have been achieved by an express power but TA 1925, s 32 now provides a statutory power of advancement which applies automatically to every trust in so far as 'a contrary intention is not expressed in the instrument' (TA 1925, s 69(2)). The contrary intention may be expressly stated or be inferred from the terms of the trust instrument. (See *Re Evans' Settlement* [1967] 1 WLR 1294 – direction 'to advance up to £5,000' – and *IRC v Bernstein* [1961] Ch 399 – a direction 'to accumulate income during the settlor's lifetime'.)

(b) The statutory power of advancement

Trustee Act 1925, s 32

32(1) Trustees may at any time or times pay or apply any capital money subject to a trust, for the advancement or benefit, in such manner as they may, in their absolute discretion, think fit, of any person entitled to the capital of the trust property or of any share thereof, whether absolutely or contingently on his attaining any specified age or on the occurrence of any other event, or subject to a gift over on his death under any specified age or on the occurrence of any other event, and whether in possession or in remainder or reversion, and such payment or application may be made notwithstanding that the interest of such person is liable to be defeated by the exercise of a power of

> appointment or revocation, or to be diminished by the increase of the class to which he belongs:
>
> Provided that –
>
> (a) the money so paid or applied for the advancement or benefit of any person shall not exceed altogether in amount one-half of the presumptive or vested share or interest of that person in the trust property; and
> (b) if that person is or becomes absolutely and indefeasibly entitled to a share in the trust property the money so paid or applied shall be brought into account as part of such share; and
> (c) no such payment or application shall be made so as to prejudice any person entitled to any prior life or other interest, whether vested or contingent, in the money paid or applied unless such person is in existence and of full age and consents in writing to such payment or application.
>
> The section does not apply to capital money under the Settled Land Act 1925 (s 32(2) as substituted by the Trusts of Land and Appointment of Trustees Act 1996, Sch 3 para 3(8)).

As is the case with mere powers of appointment (see Chapter 5), trustees are under no obligation to exercise the power of advancement. But as will be seen in more detail in Chapter 11 the reference to 'absolute discretion' (s 32(1)) does not mean that the power can be exercised in an irresponsible fashion. The trustees must consider whether in their opinion the advancement proposed is for the benefit of the beneficiary in question. In *Re Pauling's Settlement Trusts* [1964] Ch 303, CA on several occasions trustees advanced capital nominally to children, all of whom were over 21 and at their own request, but in full knowledge that the money would be used directly to benefit the parents – the improper purpose – not the children, as by buying a house for the father in the Isle of Man and reducing the mother's bank overdraft. Intriguingly the trustees had been advised by counsel that since, as far as the trustees were concerned, they were advancing the money to the children for their own absolute use then it was up to the children how they used the money. The members of the Court of Appeal were not impressed by this proposition. Willmer LJ put the point in the following manner (at 334):

> [I]f the trustees make the advance for a particular purpose which they state, they can quite properly pay it over to the advancee if they reasonably think they can trust him or her to carry out the prescribed purpose. What they cannot do is prescribe a particular purpose, and then raise and pay the money over to the advancee leaving him or her entirely free, legally and morally, to apply it for that purpose or to spend it in any way he or she chooses without any responsibility on the trustees even to inquire as to its application.

It is unclear quite what the trustees are able to do if upon inquiry they discover that the money advanced is to be used or even has been used for a different purpose to that originally stated by the advancee. The Appeal Court expressly left open the question whether the trustees could seek to recover the 'misapplied' money. It may therefore be that the trustees are left with the exercise of moral persuasion alone.

Although the power may be regarded as being concerned with trust administration it is also capable of altering the quantum of beneficial entitlement as well as the timing of receipt of benefit. Consider the position where £30,000 is held on trust for such of A, B and C who attain the age of 30, and, if more than one, in equal shares, and the trustees advance £5,000 (ie one-half a presumptive share) to A aged 22 who subsequently dies before reaching 30. The exercise of the power effectively reduces the shares that B and C could have anticipated (£15,000 each) had no advancement been made by the date of A's death. Furthermore s 32 applies even where the interest in capital – the section does not apply where a beneficiary has only an interest in income – is defeasible by the exercise of powers of appointment or revocation or liable to be diminished by an increase in members of the class to be benefited (eg birth of an additional child).

The proviso in s 32(1) imposes two important limitations on the statutory power:

(i) The requirement that not more than half the presumptive share may be advanced. This has been interpreted as follows: where a complete half-share is advanced to A, no further advancement can be made from the balance of A's share of the fund even if the remaining capital fund subsequently appreciates in value (see *Re Marquess of Abergavenny's Estate Act Trusts* [1981] 2 All ER 643). The consequences of inflation are studiously ignored so that advancements are only brought into account (s 32(1)(b)) on a cash basis, although the Law Reform Committee (23rd Report *The Powers and Duties of Trustees* (Cmnd 8733, 1982)) recommended that an index-linked or fractional basis be adopted (paras 4.43–4.47).
(ii) The requirement of consent of persons with prior interests. But the consent of objects of a discretionary trust is not required (*Re Beckett's Settlement* [1940] Ch 279).

It should be noted, however, that the settlor may choose to extend the power of advancement, for example, by authorising the advance of the whole of the beneficiary's share or by excluding the requirement for consent. (But cf *Henley v Wardell* (1988) Times, 29 January, where a power in a will giving 'absolute and uncontrolled discretion' to advance all the capital was not in itself sufficient to override the requirement for the life tenant's consent.) There is also the possibility of applying to the court for an order under the VTA 1958 to authorise the trustees to exceed the 'one-half of presumptive share' restriction. In *D (a child) v O* [2004] 3 All ER 780 the court held that it was for the benefit of a 12-year-old child, who was solely entitled to her share of the fund, to release up to her full presumptive share to pay school fees. The report is silent on the question of whether there was any other person with primary responsibility for payment of the fees (see also *Fuller v Evans* [2000] 1 FCR 494 below at p 353).

(c) 'Advancement or benefit'

In *Pilkington v IRC* [1964] AC 612, HL, two settlements were the subject of litigation. Under Trust A, a testator left property on protective trust for his nephew Richard

Godfrey Pilkington (RGP) for life. RGP had three children, one of whom, Penelope (P), was born in 1956. RGP held a power of appointment in favour of his children and remoter issue. In default of appointment the property would be held in trust for such of his children as attained 21 in equal shares. P's interest in the fund was therefore both contingent and defeasible.

Subsequently, RGP's father 'Guy', a trustee of trust A, proposed to create a trust (Trust B) in favour of P (then aged two). The trustees were to have power to apply the income for P's maintenance until she reached the age of 21 and to accumulate and capitalise any surplus income. If P attained 21 the trustees were to pay the income to her until the age of 30 when she would become absolutely entitled to the fund. If P were to die under 30 leaving children, then the fund was to be held on trust for such children at 21. There was a further family default trust. Under Trust B, P could not receive any capital entitlement unless and until she attained the age of 30.

Guy paid £10 to the trustees of Trust B. The trustees of Trust A then sought the directions of the court as to whether they could lawfully advance one-half of P's expectant share under Trust A (about £7,600) to the trustees of Trust B. The Inland Revenue were added as defendants by order of the Court of Appeal.

The application raised a number of difficult questions:

(1) It was not contested that substantial savings of estate duty and income tax could be anticipated, and that these constituted a 'benefit'. The Revenue argument was that this was not a benefit contemplated by s 32, and that although the language of s 32 was wide it did not permit trustees to postpone the vesting of an interest in capital. The Court of Appeal, in refusing to approve the application, in fact held that benefit had to be related to a beneficiary's 'own real or personal needs' ([1961] Ch 466 at 481).

(2) Whether, notwithstanding limited authority to the contrary, s 32 should be restricted so as to exclude a resettlement?

Pilkington v IRC [1964] AC 612, HL

> **Viscount Radcliffe** (describing the origins of s 32): The word 'advancement' itself meant in this context the establishment in life of the beneficiary who was the object of the power or at any rate some step that would contribute to the furtherance of his establishment. Thus it was found in such phrases as 'preferment or advancement' (*Lowther v Bentinck* (1874) LR 19 Eq 166, 'business, profession, or employment or . . . advancement or preferment in the world' (*Roper-Curzon v Roper-Curzon* (1871) LR 11 Eq 452) and 'placing out or advancement in life' (*Re Breeds' Will* (1875) 1 Ch D 226). Typical instances of expenditure for such purposes under the social conditions of the nineteenth century were an apprenticeship or the purchase of a commission in the army or of an interest in business. In the case of a girl there could be advancement on marriage (*Lloyd v Cocker* (1860) 27 Beav 645). Advancement had, however, to some extent a limited range of meaning, since it was thought to convey the idea of some step in life of permanent significance, and accordingly, to prevent uncertainties about the permitted range of objects for which moneys could be raised and made available, such

words as 'or otherwise for his or her benefit' were often added to the word 'advancement'. It was always recognised that these added words were 'large words' (see Jessel MR in *Re Breeds' Will*) and indeed in another case (*Lowther v Bentinck*) the same judge spoke of preferment and advancement as being 'both large words' but of 'benefit' as being the 'largest of all'. So, too, Kay J in *Re Brittlebank* (1881) 30 WR 99 at 100. Recent judges have spoken in the same terms – see Farwell J in *Re Halsted's Will Trusts* [1937] 2 All ER 570 at 571 and Danckwerts J in *Re Moxon's Will Trusts* [1958] 1 WLR 165 at 168. This wide construction of the range of the power, which evidently did not stand upon niceties of distinction provided that the proposed application could fairly be regarded as for the benefit of the beneficiary who was the object of the power, must have been carried into the statutory power created by s 32, since it adopts without qualification the accustomed wording 'for the advancement or benefit in such manner as they may in their absolute discretion think fit'.

So much for 'advancement', which I now use for brevity to cover the combined phrase 'advancement or benefit'. It means any use of the money which will improve the material situation of the beneficiary. It is important, however, not to confuse the idea of 'advancement' with the idea of advancing the money out of the beneficiary's expectant interest. The two things have only a casual connection with each other. The one refers to the operation of finding money by way of anticipation of an interest not yet absolutely vested in possession or, if so vested, belonging to an infant: the other refers to the status of the beneficiary and the improvement of his situation. The power to carry out the operation of anticipating an interest is not conferred by the word 'advancement' but by those other words of the section which expressly authorise the payment or application of capital money for the benefit of a person entitled. . . .

I think, with all respect to the commissioners, a good deal of their argument is infected with some of this confusion. To say, for instance, that there cannot be a valid exercise of a power of advancement that results in a deferment of the vesting of the beneficiary's absolute title (Miss Penelope, it will be remembered, is to take at 30 under the proposed settlement instead of at 21 under the will) is in my opinion to play upon words. The element of anticipation consists in the raising of money for her now before she has any right to receive anything under the existing trusts: the advancement consists in the application of that money to form a trust fund, the provisions of which are thought to be for her benefit. . . .

I have not been able to find in the words of section 32, to which I have now referred, anything which in terms or by implication restricts the width of the manner or purpose of advancement. It is true that, if this settlement is made, Miss Penelope's children, who are not objects of the power, are given a possible interest in the event of her dying under 30 leaving surviving issue. But if the disposition itself, by which I mean the whole provision made, is for her benefit, it is no objection to the exercise of the power that other persons benefit incidentally as a result of the exercise.

[Viscount Radcliffe referred to *Lowther v Bentinck* and *Re Kershaw's Trusts* (1868) LR 6 Eq 322.]

Nor in my opinion will it be bad merely because the moneys are to be tied up in the proposed settlement. If it could be said that the payment or application permitted by section 32 cannot take the form of a settlement in any form but must somehow pass direct into or through the hands of the object of the power, I could appreciate the principle upon which the commissioners' objection was founded. But can that principle be asserted? Anyone can see, I think, that there can be circumstances in which, while it is very desirable that some money should be raised at once for the benefit of an owner of an expectant or contingent interest, it would be very undesirable that the money should not be secured to him under some arrangement that will prevent him having the absolute disposition of it. I find it very difficult to think that there is something at the back of section 32 which makes such an advancement impossible. Certainly neither Danckwerts J nor the members of the Court of Appeal in this case took that view. Both Lord Evershed MR and Upjohn LJ [1961] Ch. 466, 481, 486, explicitly accepted the possibility of a settlement being made in exercise of a power of advancement.

[Viscount Radcliffe referred to *Re Halsted's Will Trusts* [1937] 2 All ER 570 and *Re Ropner's Settlements Trusts* [1956] 1 WLR 902.]

The truth is, I think, that the propriety of requiring a settlement of moneys found for advancement was recognised as long ago as 1871 in *Roper-Curzon v Roper-Curzon* ((1871) LR 11 Eq 452) and, so far as I know, it has not been impugned since. Lord Romilly MR's decision passed into the textbooks and it must have formed the basis of a good deal of subsequent practice. True enough, as counsel for the commissioners has reminded us, the beneficiary in that case was an adult who was offering to execute the postnuptial settlement required: but I find it impossible to read Lord Romilly's words as amounting to anything less than a decision that he would permit an advancement under the power only on the terms that the money was to be secured by settlement. That was what the case was about. If, then, it is a proper exercise of a power of advancement for trustees to stipulate that the money shall be settled, I cannot see any difference between having it settled that way and having it settled by themselves paying it to trustees of a settlement which is in the desired form.

It is not as if anyone were contending for a principle that a power of advancement cannot be exercised 'over the head' of a beneficiary, that is, unless he actually asks for the money to be raised and consents to its application. From some points of view that might be a satisfactory limitation, and no doubt it is the way in which all advancement takes place in the great majority of cases. But, if application and consent were necessary requisites of advancement, that would cut out the possibility of making any advancement for the benefit of a person under age, at any rate without the institution of court proceedings and formal representation of the infant: and it would mean, moreover, that the trustees of an adult could not in any circumstances insist on raising money to pay his debts, however much the operation might be to his benefit, unless he agreed to that course. Counsel for the commissioners did not contend before us that the power of advancement was inherently limited in this way: and I do not think that such a limitation would accord with the general understanding. Indeed its 'paternal' nature is well shown by the fact that it is often treated as being peculiarly for the assistance of an infant. . . .

I have not yet referred to the ground which was taken by the Court of Appeal as their reason for saying that the proposed settlement was not permissible. To put it shortly,

> they held that the statutory power of advancement could not be exercised unless the benefit to be conferred was 'personal to the person concerned', in the sense of being related to his or her own real or personal 'needs' ([1961] Ch 466, 481). Or, to use other words of the learned Master of the Rolls (Ibid 484), the exercise of the power 'must be an exercise done to meet the circumstances as they present themselves in regard to a person within the scope of the section, whose circumstances call for that to be done which the trustees think fit to do'. Upjohn LJ (Ibid 487) expressed himself in virtually the same terms.
>
> My Lords, I differ with reluctance from the views of judges so learned and experienced in matters of this sort: but I do not find it possible to import such restrictions into the words of the statutory power which itself does not contain them. First, the suggested qualification, that the considerations or circumstances must be 'personal' to the beneficiary, seems to me uncontrollably vague as a guide to general administration. What distinguishes a personal need from any other need to which the trustees in their discretion think it right to attend in the beneficiary's interest? And, if the advantage of preserving the funds of a beneficiary from the incidence of death duty is not an advantage personal to that beneficiary, I do not see what is. Death duty is a present risk that attaches to the settled property in which Miss Penelope has her expectant interest, and even accepting the validity of the supposed limitation, I would not have supposed that there was anything either impersonal or unduly remote in the advantage to be conferred upon her of some exemption from that risk. . . .
>
> To conclude, therefore, on this issue. I am of opinion that there is no maintainable reason for introducing into the statutory power of advancement a qualification that would exclude the exercise in the case now before us. It would not be candid to omit to say that, though I think that that is what the law required. I am uneasy at some of the possible applications of this liberty, when advancements are made for the purposes of settlement or on terms that there is to be a settlement.

[Lords Hodson, Jenkins and Devlin concurred with Viscount Radcliffe's judgment.]

Lord Reid confessed to being only reluctantly persuaded by Viscount Radcliffe's reasoning that s 32 could be applied:

> It may be that one is driven step by step to hold that the power conferred by section 32 . . . must be interpreted as including power to resettle such money on an infant in such a way as will probably confer considerable financial benefit on her many years hence if she survives. But that certainly seems to me far removed from the apparent purpose of the section and considerably beyond anything which it has hitherto been held to cover.
>
> Nevertheless I am compelled to recognise that there is no logical stopping place short of that result. You cannot say that financial benefit from avoidance of taxation is not a benefit within the meaning of the section. Nor can you say that the section only authorises payments for some particular or immediate purpose or that the benefit must be immediate and certain and not future or problematical. And again you cannot say that the beneficiary must consent to the course which the trustees have decided is for his benefit for that would rule out all payments where the beneficiary is under age.

> I have more difficulty about the resettlement . . . But I think that the cases show that it is too late now to say that this power can never authorise trustees to convey funds to new trustees to hold for new trust purposes: to say that might endanger past transactions done on the faith of these authorities.
>
> I realise that this case opens a wide door and that many other trustees may seek to take advantage of it. But if it is thought that the power which Parliament has conferred is likely to be used in ways of which Parliament does not approve then it is for Parliament to devise appropriate restrictions of the power.

[Their Lordships, however, all held that the intended advancement was analogous to the exercise of a special power of appointment and would be void as infringing the rule against remoteness of vesting. See Perpetuities and Accumulations Act 1964, s 3.]

Pilkington v IRC establishes that 'benefit' in s 32 is a concept of enviable width. It has subsequently been decided in an admittedly most unusual case (*Re Clore's Settlement Trusts* [1966] 1 WLR 955) that even relieving the beneficiary of a self-confessed moral obligation to make payments to charity could constitute benefit. But the *Pilkington* case does leave in its wake teasing analytical and comparative problems.

Consider in particular the following points:

(1) It is unresolved whether, in the absence of express authority in the trust instrument, the power of advancement can be used to settle property on discretionary trusts. Two potential obstacles are 'benefit' and 'delegation'.

> *Benefit* The question is whether the possibility of achieving a greater tax saving by settling on a discretionary trust, rather than a fixed interest trust, could compensate a beneficiary for the uncertainty as to whether the trustees would look kindly on him or her in determining how to exercise their discretion.
>
> *Delegation* Viscount Radcliffe in the *Pilkington* case rejected an argument that s 32 did not permit trustees to delegate their power of advancement (at 639):
>
> I think that the whole issue of delegation is here beside the mark. The law is not that trustees cannot delegate; it is that trustees cannot delegate unless they have authority to do so. If the power of advancement which they possess is so read as to allow them to raise money for the purpose of having it settled, then they do have the necessary authority to let the money pass out of the old settlement into the new trusts. No question of delegation of their powers or trusts arises. If, on the other hand, their power of advancement is read so as to exclude settled advances, *cadit quaestio*.

This is relevant to the discretionary trust point because advancement into a new settlement that includes discretionary trusts would appear to involve the delegation of dispositive discretion to the new trustees. But, as pointed out by Hanbury and Martin (p 597, quoting Kiralfy (1953) 17 Conv 285 at 289), it is generally assumed that 'dispositive (as opposed to administrative) discretions . . . cannot be delegated without express authority'. This point appears 'not to be covered by Lord Radcliffe's dictum'.

Parker and Mellows (p 704), however, interpret that dictum to mean that 'the statutory power, or an express power to the like effect, will be construed as being sufficiently wide' to authorise an advancement into a discretionary trust. Obviously this is a matter of interpretation upon which opinions can differ. The fact that it is possible for a valid advancement to be made where the beneficiary takes no *direct* benefit in the sum advanced, as in *Re Clore*, tends to support the proposition that an advancement into a discretionary trust can be a valid exercise of the power. On the other hand *Re Clore* is a somewhat unusual case and is less persuasive when compared with a purported advancement into a discretionary trust where the original beneficiary is, let us say, a member of a widely drawn class such as that in *McPhail v Doulton*. This beneficiary might in practice then not only never receive any *direct* benefit in the shape of payment from the trust but also, unlike *Re Clore*, there would be no evident *indirect* benefit accruing.

To some extent one's conclusion on this issue may depend upon whether the power of advancement is viewed as being concerned with 'administrative' or 'dispositive' discretions. What is your view in the light of the reasoning in *Pilkington*?

(2) To what extent does the power of advancement provide an alternative method for varying trusts? Is there any similarity in the approaches adopted by the House of Lords in *Chapman v Chapman* and *Pilkington v IRC* to the issues raised in the respective cases? It is striking that no mention of the power of advancement appears in the LRC Report *The Court's Power to Sanction Variation of Trusts* (Cmnd 310, 1957). Would the expansive interpretation of 'advancement' eventually adopted in *Pilkington* have supported or subverted the reasoning of the LRC?

(3) E P Thompson ('The Grid of Inheritance: A Comment' in Goody et al *Family and Inheritance* (1976)) has argued that one function of eighteenth- and nineteenth-century inheritance practices – the 'grids of inheritance' – was '[to devise] rules and practices by which particular social groups project forwards provisions and (as they hope) guarantees of security for their children' (p 358). In particular he refers to a 'third, complementary, grid for the propertied classes: that of interest, preferment to office, purchase of commissions, reversions to sinecures, placings within the Church and so on. . . . Along this grid the lesser gentry sought to secure the future of their families'. In so far as the power of advancement is one of the 'rules and practices' referred to by Thompson, the interpretation of 'benefit' in *Pilkington* can at first impression be seen as effecting a transformation in the application of that power as compared with its historical usage. Yet in terms of the function that the power might be said to fulfil – part of the grid of inheritance – has the interpretation of benefit merely ensured continuity, albeit reflecting the contemporary context of tax avoidance as a path to financial security?

(4) Does *Pilkington* sufficiently protect beneficiaries against advancements made just before their interest falls into possession but having the effect of postponing their entitlement for some significant period? Should there be some explicit restriction on this way of using powers of advancement?

5. Flexibility in relation to income entitlement and the power of maintenance

(a) Introduction

We referred previously (p 315) to the court's inherent maintenance jurisdiction as being based on the presumption that a settlor 'did not intend children should be left unprovided for . . . or not be educated properly . . .'. This paternal concern for infants also has an extensive statutory history. In 1860 Lord Cranworth's Act (23 and 24 Vict C 145) authorised payments for 'the maintenance or education' of infants. The modern formulation in TA 1925, s 31 (see below) now extends the purposes for which payment from trust income may be made to include the benefit of an infant. But, as with the power of advancement of capital, also characterised as being 'peculiarly for the assistance of an infant' (*Pilkington v IRC* [1964] AC 612 at 638), the paternal nature of the power of maintenance is now conjoined with tax considerations when settlors consider whether, and how, to incorporate it in the trust instrument. Indeed, the accumulation and maintenance settlement, much favoured under inheritance tax (see Chapter 8), is built principally around the statutory power (see Brown (1994) 8 TLI (2) 49).

As with s 32, the statutory power in s 31 is read into every trust instrument unless a contrary intention is expressed in the instrument (TA 1925, s 69(2)). A contrary intention will be discerned if the application of s 31 'would be inconsistent with the purport of the instrument' (*IRC v Bernstein* [1961] 1 All ER 320 at 325). This will be the case with a direction to accumulate the income. Also, an express power of maintenance will exclude the statutory provision to the extent that they are inconsistent. In short, s 31 supplies 'a code of rules governing the disposal of income . . . where a settlor or testator has made dispositions of capital and either (a) being an unskilled draftsman has not thought about income, or (b) being a skilled draftsman, has been content to let the statutory code apply' (*Re Delamere's Settlement Trusts* [1984] 1 All ER 584 at 587 per Slade LJ). But, to reiterate the point, the pre-eminent rule is that the settlor's intention prevails.

(b) The statutory power of maintenance

Trustee Act 1925, s 31(1)

> 31(1) Where any property is held by trustees in trust for any person for any interest whatsoever, whether vested or contingent, then, subject to any prior interests or charges affecting that property –
>
> (i) during the infancy of any such person, if his interest so long continues, the trustees may, at their sole discretion, pay to his parent or guardian, if any, or otherwise apply for or towards his maintenance, education, or benefit, the whole or such part, if any, of the income of that property as may, in all the circumstances, be reasonable, whether or not there is –

(a) any other fund applicable to the same purpose; or

(b) any person bound by law to provide for his maintenance or education; and

(ii) if such person on attaining the age of [18 years] has not a vested interest in such income, the trustees shall thenceforth pay the income of that property and of any accretion thereto under subsection (2) of this section to him, until he either attains a vested interest therein or dies, or until failure of his interest:

Provided that, in deciding whether the whole or any part of the income of the property is during a minority to be paid or applied for the purposes aforesaid, the trustees shall have regard to the age of the infant and his requirements and generally to the circumstances of the case, and in particular to what other income, if any, is applicable for the same purposes; and where trustees have notice that the income of more than one fund is applicable for those purposes, then, so far as practicable, unless the entire income of the funds is paid or applied as aforesaid or the court otherwise directs, a proportionate part only of the income of each fund shall be so paid or applied.

(2) During the infancy of any such person, if his interest so long continues, the trustees shall accumulate all the residue of that income [by investing it, and any profits from so investing it] from time to time in authorised investments, and shall hold those accumulations as follows:-

(i) If any such person –

(a) attains the age of [18 years], or marries under that age, and his interest in such income during his infancy or until his marriage is a vested interest; or

(b) on attaining the age of [18 years] or on marriage under that age becomes entitled to the property from which such income arose in fee simple, absolute or determinable, or absolutely, or for an entailed interest;

the trustees shall hold the accumulations in trust for such person absolutely, but without prejudice to any provision with respect thereto contained in any settlement by him made under any statutory powers during his infancy, and so that the receipt of such person after marriage, and though still an infant, shall be a good discharge; and

(ii) In any other case the trustees shall, notwithstanding that such person had a vested interest in such income, hold the accumulations as an accretion to the capital of the property from which such accumulations arose, and as one fund with such capital for all purposes, and so that, if such property is settled land, such accumulations shall be held upon the same trusts as if the same were capital money arising therefrom;

but the trustees may, at any time during the infancy of such person if his interest so long continues, apply those accumulations, or any part thereof, as if they were income arising in the then current year.

[Subsections 3–5 omitted. The age of majority was reduced from 21 to 18 by the Family Law Reform Act 1969 for instruments made on or after 1 January 1970; see for the implications on existing settlements *Begg-MacBrearty v Stilwell* [1996] STC 413. The words in parentheses in s 31(2) were substituted by Trustee Act 2000, s 40(1), Sch 2, Pt II, para 25.]

A preliminary point to be established is whether a 'person' has any entitlement to income out of which sums may be expended on maintenance. Where this entitlement exists, the 'code of rules' in s 31 regulates three distinct issues:

(i) the application of income accruing to vested and contingent interests during a beneficiary's minority (s 31(1)(i));
(ii) the application of income when a beneficiary attains the age of 18 (s 31(1)(ii)); and
(iii) the destination of income not expended on maintenance but accumulated during a beneficiary's minority (s 31(2)).

The preliminary question as to entitlement will be considered first and then each of the three further issues will be considered in turn.

(1) Availability of income for maintenance

The apparent universality of s 31(1) – 'any property', 'any person', 'any interest whatsoever' – can be misleading. In particular the picture is complicated by the treatment of interests to which a contingency is attached. Section 31(1) applies to a contingent interest only if it 'carries the intermediate income of the property' (s 31(3)), ie where any income earned between the date of the gift and the time when the interest vests belongs to the beneficiary. The general position is that both vested gifts and inter vivos contingent gifts carry the 'intermediate income' unless a contrary intention appears (eg where the income is directed by the settlor to be paid to someone other than the donee of the gift). For instance, an inter vivos gift of shares on trust for A if she attains 18 will carry the intermediate income, so that any dividend on the shares will accrue to A's interest.

The complications emerge where 'deferred' (or 'future') and contingent testamentary gifts are involved. A deferred gift is one which is limited to take effect at a specified time, or on the occurrence of a specified event, and may be either vested – to A on the death of B – or contingent – to A five years after the death of B if A attains the age of 21.

Whether deferred or contingent testamentary gifts carry the intermediate income involves the application of complex rules, some based on case law and some on statute (LPA 1925, s 175). Regrettably the subject is excessively technical and almost wholly devoid of conceptual coherence (see *Re McGeorge* [1963] 1 All ER 519 per Cross J). Surprisingly, the LRC in its report, *The Powers and Duties of Trustees*, did not appear to consider whether any change in the law was desirable.

Figures 7.1 and 7.2 summarise the effects of the rules concerning testamentary *contingent* or *deferred* gifts only. (✓) signifies that the gift carries the intermediate income; (×) that it does not.

(2) Applying the income

One notable aspect of the flexibility generated by the 'paternalist' nature of s 31(1) lies in the treatment of a minor's vested interest in income. In a trust for A (a minor) for life, with remainder to B, A's apparent absolute entitlement to income is

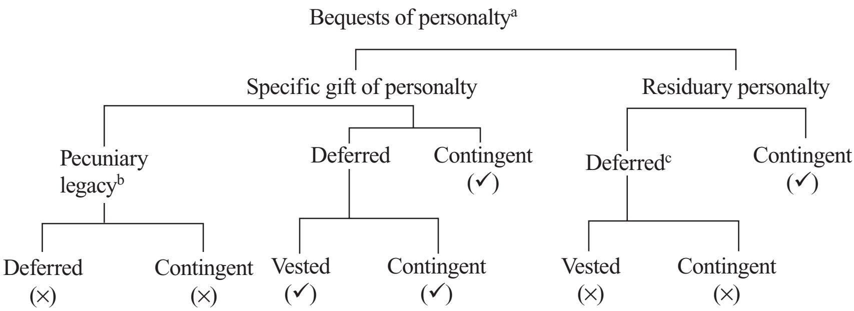

Figure 7.1 *Bequests of personalty.*

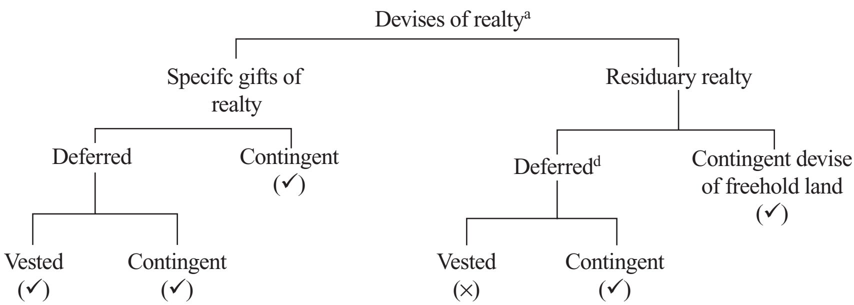

Figure 7.2 *Devises of realty.*

Notes: (a) A devise is a gift of realty by will. A bequest is a gift of personalty by will.
(b) The proposition concerning contingent or deferred pecuniary legacies is subject to limited exceptions – in particular where the testator is a parent of the minor, or some person in loco parentis – when intermediate income will be carried.(See *Hanbury and Martin* p 591; *Pettit* p 466.)
(c) See *Re McGeorge* [1963] 1 All ER 519 at 522–523 for an explanation of the differential treatment of deferred specific gifts and deferred residuary gifts.
(d) See *Snell* p 768, for comment on the 'odd' treatment of deferred residuary devises.

transformed. The section not only gives the trustees discretion whether to apply income for the maintenance of A but places them under a duty (s 31(2)) to accumulate any income not so applied during a beneficiary's minority. (The application of the accumulated income when beneficiaries attain the age of 18 is considered in section 4 below.) Whether any income is applied for the maintenance of a minor beneficiary is a matter for the trustees' discretion which must be consciously and not automatically exercised. (See *Wilson v Turner* (1883) 22 Ch D 521 for the consequences of automatic payment to the parent of a minor.)

The proviso in s 31(1) lays out the criteria to be considered by the trustees and requires in particular that maintenance be drawn proportionately from different funds where more than one fund is available yet less than the total income is needed. The proviso is in practice frequently excluded but the LRC rejected suggestions that it be repealed, arguing that the principle of proportionality was sound and that it should be left to settlors to deviate from that by specific provision in the trust instrument (paras 4.38–4.40).

(3) Application of income arising after age 18

The statutory power to maintain is exercisable only in favour of a minor beneficiary. What then is to happen to the income of a beneficiary who attains the age of 18 but has only a contingent interest in the trust property (eg to A if she attains 25)? The section here works a further 'trick' with beneficial entitlement: s 31(1)(ii) intervenes to accelerate part of the beneficiary's interest by requiring the trustees to pay the whole of the income (arising from the trust property and the accumulations) to the beneficiary.

Contingent entitlement to the capital is unaltered, so that if the beneficiary fails to satisfy the contingency (eg A dies at age 21) the gift fails. But in the interim A will have benefited by receipt of the income.

The subsection does not apply where a person has a vested interest in income, even if liable to be divested (see *Re McGeorge* [1963] 1 All ER 519), or where a contrary intention is expressed as with a direction to accumulate (see *Re Turner's Will Trusts* [1937] Ch 15).

(4) The destination of accumulated income

Section 31(2) requires the trustees during the minority of a beneficiary to accumulate the residue of any income not expended on maintenance, although during this period the accumulations may still be applied as if they were income. What then is to happen to any surplus accumulation when the beneficiary attains 18?

A beneficiary who satisfies either of the conditions in s 31(2)(i) will be entitled to the accumulations. Not surprisingly, where a beneficiary had a vested life interest during her minority, she will satisfy the condition in s 31(2)(i)(a) and be entitled to the accumulation. This will also be the outcome under s 31(2)(i)(b) where a beneficiary becomes entitled to the capital from which the income was derived at age 18 or earlier marriage – obtaining a life interest will not suffice. The word 'absolutely' there applies to personalty only, and *Re Sharp's Settlement Trusts* [1972] 3 All ER 151 decides that where a vested interest in personalty is liable to be defeated by the exercise of a power of appointment, the entitlement is not 'absolute' (cf the position of a determinable interest in realty: see Hayton (1972) 36 Conv 436).

In every other case the accumulations are added to the capital. This will be so both for an interest in capital contingent on attaining an age greater than 18 (eg to A if she attains 21) – see s 31(2)(i)(a) – and for a life interest which does not vest until the age of 18 or later (eg to A for life if she attains 18) – see s 31(2)(i)(b).

The effect of s 31(1) on a minor's apparently vested interest in income has already been discussed (see section 2 above). Section 31(2) goes one step further.

Where a minor has a vested interest in income (eg a life interest) and dies before attaining the age of 18 it would seem that any accumulations should form part of the beneficiary's estate, but this is not so (see TA 1925, s 31(4), however, regarding accumulated income from a vested annuity). Instead the accumulations accrue to the capital as if the interest were contingent on attaining age 18. In *Stanley v IRC* [1944] KB 255 the Court of Appeal held that under s 31(2) a beneficiary's rights over accumulated income 'are, whatever their technical description, precisely what they would have been if they had been expressly made contingent' (at 262). The effect of the section is to engraft 'on the vested interest originally conferred on the infant . . . a qualifying trust of a special nature which confers on the infant a title to the accumulations if and only if he attains [18] or marries' (at 261).

For all practical purposes during the beneficiary's minority a vested interest becomes a contingent interest, with considerable fiscal significance. The income is treated as that of the trust for income tax purposes and broadly no income accumulation can be attributed to the beneficiary or the settlor. Furthermore the accumulation when paid to the beneficiary on attaining 18 will take the form of capital not income. It is these features deriving from s 31 which render an accumulation settlement so potentially attractive for tax purposes in the appropriate circumstances (see Chapter 8; and Thomas *Taxation and Trusts* (1981) ch 4). Paternalism is attractively enhanced by fiscal advantage.

As with s 31 generally, the provisions of s 31(2) are also subject to any contrary intention expressed in the trust instrument. Whilst therefore the mere fact that there is a vested interest in income clearly cannot, consistently with s 31(2)(i)(a), demonstrate a contrary intention, an appointment by trustees of income to a minor beneficiary 'absolutely' has been held sufficient (see *Re Delamere's Settlement Trusts* [1984] 1 All ER 584, CA, criticised by Griffiths [1985] Conv 153).

(c) Conclusion

The power of maintenance supplied by TA 1925, s 31, initially seems merely to fulfil a limited auxiliary task of trust administration. It has the 'caretaker' purpose of ensuring that, subject to adequate trust income, minors may be maintained, educated or otherwise benefited. Yet in achieving this, considerable flexibility of beneficial entitlement is introduced. A beneficiary's contingent interest in capital may be supplemented at age 18 by a vested but defeasible interest in income, while a minor's vested interest in income under the terms of a trust is effectively converted into a contingent interest both as regards income and accumulations. Furthermore, concentration on the 'caretaker' quality of the power should not obscure the consideration that the adoption, omission or alteration of s 31 and the subsequent exercise of trustees' discretion to maintain will be influenced by income tax and inheritance tax implications. (See Chapter 8. Note in particular that s 31(1)(ii) can create an interest in possession for inheritance tax purposes.)

Finally, although the power of maintenance is rooted in a paternal concern for minors, is the statutory power consistent with or in conflict with the legal obligation of parents to maintain their children? Section 31(1) is hardly a ringing endorsement of the latter and stands in sharp contrast to the words of Langdale MR in the early case of *Douglas v Andrews* (1849) 12 Beav 310 under the now almost redundant inherent jurisdiction: 'However large a child's fortune may be, whilst the father is of ability to maintain the child, he must perform his duty, and no part of the child's fortune is to be applied for that purpose' (at 311). There is some evidence that the apparent strictness of this prohibition tended to be mitigated in practice by taking account of particular family circumstances (see eg *Pettit* 469 on the inconsistency of approach in early nineteenth-century cases). Moreover it must not be forgotten that both under s 31(1) and, usually also, specific maintenance powers in trust deeds, the decision to apply the income is at the 'sole discretion' of the trustees, a discretion with which the courts will be reluctant to interfere assuming it is exercised bona fide (see generally Chapter 11 on controlling trustee discretions). The recent case of *Fuller v Evans* [2000] 1 FCR 494 provides confirmation, if it were needed, that as long as trustees exercise their discretion in the best interests of the minor beneficiaries the fact that this may incidentally benefit, in that case, the settlor/parent is not a prohibiting factor. Lightman J held that the trustees were not precluded from exercising the power of maintenance to pay children's school fees (the children were aged 14 and 12) even though this would 'incidentally' relieve the father from the legal obligation under a consent order in divorce proceedings to pay such fees until the children were 17. That obligation was 'no more than a consideration to which due weight must be given' by the trustees (at 498). No mention is made in the case of the possibility, depending on whether s 31(2) applies, that if the income of the trust fund was accumulated – the settlement provided for an accumulation period of 21 years – rather than expended on school fees then on attaining the relevant age the accumulations could be 'held on trust for the beneficiary absolutely'. Perhaps all that need be said by way of conclusion is that, as with its interpretation under variation and advancement, the concept of 'benefit' is capable of demonstrating what our economist colleagues might term 'elasticity'.

8

The taxation of private trusts

1. Tax planning and the trust

What to the legislator and parliamentary draftsman can appear as a trust problem may simultaneously be to the tax adviser a means of achieving a tax-planning objective. In this first section we re-emphasise the peculiar facets of the trust that create this situation.

The basis of the trust's attraction for tax-planning is founded on the fundamental division of ownership between nominal title, benefit and control.

> P A Lovell 'Reflections on a Unified Estate and Gift Tax Regime' [1974] BTR 141 at 157–158
>
> The trust as a device depends for its success on the correct interplay between three basic concepts: the ownership of property, the management of the same, and the beneficial interests therein and enjoyment thereof, . . .
>
> Discretionary trusts, . . . are . . . problematic for, whilst ownership and management are vested in the trustees, the property is, in a material way, ownerless; the interest in possession is absent and the distribution of the benefits accruing from the trust property are distributable, subject to any powers of accumulation extant, at the discretion of the trustees.
>
> . . . Even in those trusts where a beneficial interest in possession in income has been created, it may nevertheless be possible to combine such income enjoyment with an element of capital expectancy. Thus a beneficiary may be given a right to income at the same time as the trustees are given a power, should such be considered appropriate, to apply the capital, by outright transfer or otherwise, for the benefit of the same income beneficiary.

A threefold predicament is therefore presented to our hypothetical legislator. First, a taxable event must be identified but, having done this, two problems remain to be resolved. These are:

(i) what to tax (eg property in one trust, or aggregated with other settled property, or aggregated with property owned absolutely); and
(ii) against whom to assess tax (eg the settlor, the trustees or the beneficiaries).

Compounding these difficulties are two additional elements that contribute to the flexibility provided by the trust form. One is that the trust can facilitate the exploitation of the artificial division – artificial at least to the economist – that both tax law and trusts law draw between capital and income (see generally Chapter 10). But to accomplish the conjuring trick of turning income into capital and vice versa, a further dimension, that of time, is necessary. 'The private trust' in Lawson and Rudden's simple yet memorable description (*The Law of Property* (1982) p 55) 'is basically a gift projected on the plane of time and, meanwhile, in need of management.' That the plane of time is itself a valuable resource is a fact long recognised by both proponents and opponents of tax-planning.

R Venables *Tax Planning Through Trusts* (1983) pp 125–126

The basic advice which should be given to anyone who is likely to amass wealth which he does not wish the state to inherit is to make gifts during his lifetime, to give early, to give regularly and to give assets away before they have risen in value.

One difficulty of implementing the foregoing advice is that there may be no suitable donees in existence to whom the donor may wish to make his gifts. He may as yet have no issue, or his issue may be of tender years. While his issue may be adult, he may not, for a variety of reasons, wish them to have the absolute ownership of property, nor even, perhaps, a secure, unearned income. Further, the donor may be prepared to divest himself of the right beneficially to enjoy gifted assets but may wish to retain the power which comes from the control of them . . . Subject only to certain limitations of perpetuity, certainty and legality, ownership of capital can be divorced from that of income, and the decision as to the ultimate beneficial ownership of the capital and income can be postponed for many years. The trust is the ideal mechanism for giving away property when one has no one in particular to whom to give it.

By divorcing control of the trust assets from beneficial ownership, the trust enables power to remain with the trustees, of whom the settlor may be one, or, indeed, the only one. Such power is, of course, responsible power, but need be no less wide than that of, say, the politician or the civil servant and equally gratifying to the person in whom it is reposed. Moreover, the ability in the due exercise of one's discretion to control the entitlement of beneficiaries to capital or income may bring a satisfaction scarcely less than that of an absolute owner to give or withhold at his caprice.

R Titmuss *Income, Distribution and Social Change* (1962) pp 68–69

. . . we now have to consider the relativities of time and kinship . . . The individuals who constitute [different classes] at different points in time have, in consequence and for various historical and cultural reasons, different sets of attitudes, behaviour and propensities in relation to getting, spending and hoarding. They are conditioned, as Keynes said, by different anticipations of the future and by 'all sorts of vague doubts and fluctuating states of confidence and courage' (*The Lessons of Monetary Experience* (1937) p 151).

What we wish to underline are the possible effects on the income distribution statistics caused by different degrees of command over resources-in-time by different

> income classes. Any definition of 'resources' would, to be realistic, have to include much more than income actually received and statutorily recorded for a specified period. It would have to embrace the possession of stored wealth, command over certain other people's income-wealth, expectations of inheritance from the past and untaxed gains in the future, power to manipulate and use the critical educational, occupational and nuptial keys to wealth advancement, and much else besides.
>
> Here we are only concerned with a limited part of the wider notion of a *masse de manoeuvre* in command over resources-in-time. This we may conveniently describe as the power and opportunity to rearrange income-wealth over time . . .
>
> The degree to which individuals have the knowledge, the opportunity and the expertise to rearrange and spread their income over time varies greatly. These characteristics are much more likely to be found among those at the top of the conventional income distribution table than among those at the bottom . . . The one characteristic these rearrangements all have in common . . . is that they have their source in social relationships. Income-wealth is rearranged over time on a family or wider kinship basis. A different conspectus of time and a different view of economic man as a taxable unit are thus introduced to complicate the statistical problems of measuring inequality.

The advantage that time as a resource can confer is not dependent solely on the trust but, as Venables recognises, the trust is the mechanism par excellence for exploiting it.

The final element that needs to be mentioned is mobility. People can be geographically mobile and, more importantly, so can property. The relative ease or difficulty with which trust assets can be transferred abroad and held by trustees safe from the Inland Revenue's grasp, while leaving settlor or beneficiaries still resident in the UK, is potentially crucial to the effectiveness of a redistributive tax regime. The advantage of mobility is greatly enhanced by the mobility of intangible property, particularly shares and other securities (excluding real property mortgages). Shares can be transferred by simply changing the registry at which they are held. Mobility was, as we saw in Chapter 3, the kernel of both the long-term tax-planning of the Vesteys and the short-term, off-the-shelf capital gains tax avoidance schemes. Tax avoidance is not the only possible motive for seeking to move ownership of assets offshore. Some offshore jurisdictions permit types of purpose trust which are usually thought to be void under English law, although even here tax considerations can form part of the reason for seeking to create such trusts (see Chapter 5 at p 252). But in most instances it is the tax considerations that will predominate whether they are simply to avoid the impact of existing taxes or to protect against the consequences of any future possible tax changes.

A legislative counter-attack to mitigate the fiscal consequences of such initiatives involved the enactment of widely drawn anti-avoidance provisions and special rules for offshore trusts. We do not examine this aspect of taxation and trusts in any detail. (See generally Whitehouse *Revenue Law* (22nd edn, 2004) chs 13, 22 and 30; Clarke *Offshore Tax Planning* (11th edn, 2004).) Suffice to say that a significant inhibition on the export of resident trusts – those where the settlor was a UK resident when the trust was created – was the pre-1979 requirement of Bank of England consent. The suspension of exchange controls in 1979 is widely believed to have stimulated the creation of new offshore trusts and the export of existing trusts. Concern about the extent of tax being avoided by this means eventually prompted a legislative response directed in particular at attempts to avoid Capital Gains Tax (CGT), a tax first introduced in 1965 (see further below at p 365). We saw in Chapter 7, for instance, that one of the motives behind the attempt in *Re Weston's Settlement* [1968] 3 All ER 338 to transfer the trust to Jersey was to avoid a charge to CGT. The various subsequent attempts to avoid this tax and the regular legislative responses that these have attracted at the behest of the Inland Revenue aptly illustrate the potential complexity of the problems involved. As with resident trusts it is necessary for taxpayers, their advisers and the legislator to take into account the possible taxation liability of the settlor, the trustees and the beneficiaries. But here it is the interplay of these relationships allied to the concepts of location and time – who is resident where and when? – that creates the opportunity for avoidance and the problem for the legislator. One response was that with effect from 19 March 1991 an 'export' charge to capital gains tax was levied on UK trusts where the trustees and trust administration are moved offshore (see Taxation of Chargeable Gains Act 1992 (TCGA), ss 80–84). Moreover as from 17 March 1998, in a further anti-avoidance measure, gains realised by overseas trustees have been made attributable to UK-resident beneficiaries irrespective of the domicile and residence of the settlor when the trust was set up (Finance Act 1998, s 130; see McCutcheon [1998] BTR 479). This measure was intended to bring into the tax net gains realised by trusts either exported or set up offshore before 1991.

The outcome of these and other initiatives is that there are now four sets of special rules affecting the offshore dimension of settlements. The rules apply to: (i) the migration offshore of the trust; (ii) the disposal of a beneficial interest by a UK resident beneficiary under a non-resident trust – the disposal of a beneficial interest under a UK resident trust does not give rise to a charge to CGT; (iii) the example referred to above where gains realised by a non-resident trust can be attributed to UK beneficiaries – usually only the trustees are liable for CGT under a UK resident trust; and (iv) under very widely drawn provisions the attribution of gains under a non-resident trust to a settlor who has an interest under the trust and comes within certain domicile and residence requirements (TCGA 1992, s 86 and Sch 5). Almost needless to say the rules are complex and offer what Tiley describes as 'sophisticated responses to sophisticated schemes and so reinforce a climate in which sophistication can be attempted' (*Revenue Law* (4th edn, 2000) p 1080). It must not be overlooked that the 'sophistication' must also in practice take account of the two other principal relevant taxes, income tax and inheritance tax.

This simple outline of the flexibility offered by the trusts device merely hints at the complexity which manipulation of the various elements or resources described above can achieve.

2. The taxation of trusts: an introduction

In the previous section we surveyed those peculiar facets of the trust and its environment that pose such conceptual problems for the would-be tax legislator, and consequent drafting difficulties for the parliamentary draftsman. The response to the challenge posed by the trust has usually taken the form of extremely complex legislation. Our principal concerns are to review how the tax system copes with the trust and its accompanying tax-saving potential, and whether the principle of fiscal neutrality (see Chapter 3) is or can be respected. Consequently, we examine only selected aspects of tax law as it affects trusts. (For more detailed explanation of the taxation of trusts reference should be made to one or more of the texts on tax law such as Tiley *Revenue Law* (4th edn, 2000); Whitehouse et al *Revenue Law – Principles and Practice* (22nd edn, 2004); or for a less detailed overview Morse and Williams *Davies: Principles of Tax Law* (5th edn, 2004).)

Complexity may be an inevitable consequence of legislative attempts to counter tax-avoidance techniques but comprehensibility of legislation has not been made easy by the apparently piecemeal approach to it that has been applied. As the Meade Committee noted (*The Structure and Reform of Direct Taxation* (1978) p 401): 'as each new tax has been introduced, a system of taxing trusts has been invented without, it seems, very much thought about how the new tax would fit in with other taxes'. The terms 'settlement' and 'settled property', for example, are prominent in the structure of income tax (IT), capital gains tax (CGT) and inheritance tax (IHT) yet have a different meaning under each tax (see Thomas *Taxation and Trusts* (1981) ch 5 for a critical assessment of the various uses of 'settlement'). Possible reforms, in particular the integration of IT and CGT treatment of trusts and their closer alignment with the taxation of individuals, were canvassed in an Inland Revenue consultative document, published in 1991 (*The Income Tax and Capital Gains Tax Treatment of UK Resident Trusts* (1991); see Venables (1992) 13 Fiscal Studies 106). The government decided not to implement the principal proposals, apparently because of their differential impact on different classes of beneficiaries (see 221 HC Official Report (6th series) written answers col 326, 18 March 1993).

In December 2003, at the request of the government, the Inland Revenue initiated a consultation process with 'trust professionals' as a prelude to introducing a revised IT and CGT system for trusts. The government adopted as its premise that trusts have an important role to play in society. Unsurprisingly it also wants, if possible, 'a tax system for trusts that does not provide artificial incentives to set up a trust but, equally, avoids artificial obstacles to using trusts where they would bring significant non-tax benefits' (Inland Revenue *Modernising the Tax System for Trusts: A Consultation Document* (August 2004) p 4). As will be seen below changes simplifying the taxation regime for trusts of small value and trusts for the vulnerable are being introduced to take effect from 6 April 2005. Amongst other proposals are those that would attempt to address the type of definitional problem referred to above by adopting certain common definitions, for instance, of 'a settlement', for IT and CGT and by introducing commonality of treatment for those trusts in which the settlor has either retained or is deemed to have retained an interest. The overall strategy appears to be to simplify and harmonise the current regimes for the two taxes rather than attempt to introduce a completely new system. The government recognises, however, that some of the proposals may open up the possibility of fresh avenues for tax avoidance. The sting in the tail of the proposals therefore is the warning that those who seek to use trusts to avoid tax may find that new anti-avoidance provisions may turn out at least as rigorous and complex as under the present system. Whether the desire for simplicity can be married to effective anti-avoidance measures remains to be seen. For the moment the starting-point for the tax legislator is to decide which of two possible methods of taxing trusts to adopt. The Meade Committee labelled these as *personification* – taxing the trust itself as a separate entity – and *transparency* – taxing by reference to the circumstances of the beneficiary as if the trust did not exist. Consistency of approach, however, has not been achieved. In reading the following description of taxation of trusts under IT, CGT and IHT consider the factors that have until now inhibited the attaining of a common approach.

3. Income tax (IT)

(a) Taxation of the individual

Lord Macnaghten drolly but inaccurately stated that 'income tax, if I may be pardoned for saying so, is a tax on income' (*LCC v A-G* [1901] AC 26 at 35). There is, however, no statutory definition of income – just a system of six schedules (A–F) identifying sources of income (Income and Corporation Taxes Act (ICTA) 1988). For the taxpayer to be assessed for IT the Inland Revenue must show that the income falls within one of those schedules. But establishing that income is assessable is only a first step. Income tax, *pace* Lord Macnaghten, is chargeable on taxable income, and that is not the same as income. Reliefs and allowances (such as the single person's allowance, currently £4,895 (2005–06), and payments to approved pension schemes) may be deducted in arriving at taxable income. An individual is then taxed on that figure at the basic and higher rates of tax prescribed annually in the Finance Act (FA). At present (2005–06) tax is levied on an individual's taxable income at, with one exception, the following rates:

10%	£1–£2,090 (starting rate)
22%	£2,091–£32,400 (basic rate)
40%	Excess over £32,400 (higher rate)

The one exception concerns income from savings. The rates of IT applicable to savings income, other than dividends, is 20% for income that would otherwise be liable to the basic rate and 40% above that. The rates applicable to dividends paid by UK companies are 10% and 32.5% respectively. The lower rates (Schedule F rates) reflect the fact that, in effect, both the company and the individual are paying tax on profits that are distributed as dividends.

(b) Taxation of the trust

Where income accrues to a trust the method of taxation is part personification and part transparency. Reflecting this hybrid approach income tax is imposed by a two-tier process, first on trustees and then, where appropriate, on beneficiaries. A modification to this structure has been introduced by the Finance Act 2004 for trusts for the 'most vulnerable'. This category includes two types of trust, those set up for the benefit of individuals with a disability and those set up for minor children on the death of a parent (see Inland Revenue *Modernising the Tax System for Trusts: A Consultation Document* (August 2004) ch 1). The intention is that the trustees should be able to elect for 'transparency' so that the trust will be taxed with effect from 6 April 2004 on the basis of the vulnerable beneficiary's circumstances.

(1) Trustees

Each trust is personified for IT purposes. At this stage the identity of the beneficiary ultimately entitled to the income is irrelevant and the trust income is treated as that of the trustees. Of course, trustees are not entitled to the income beneficially but for the purposes of IT liability they are 'entitled' in the sense that they are able to sue and claim receipt of income. Moreover, although the trust is personified trustees are not 'technically individuals' for IT purposes (see Tiley *Revenue Law* (4th edn, 2000) p 559; and Farrand [1977] Conv 5 on the absence of authority for this generally accepted rule). Thus the personal tax circumstances of the trustees themselves are irrelevant to the assessment to IT, as indeed at the initial stage of assessment are for the present those of the beneficiaries. The method of taxation of trust income consequently differs from and, in most respects, is simpler than that applicable to individuals. In general, all the income arising from trust assets is taxable, there being no allowance for administrative expenses, nor are personal or other allowances applicable. A further consequence of trustees not technically being 'individuals' for IT purposes is that they are not liable to tax at the higher rate or, come to that, the lower rate since these are applicable to individuals only. Therefore, whether trust income is £500 or £50,000, only the basic rate of tax (22% in 2005–06) is levied, with one important exception contained in ICTA 1988, s 686(2) and, as from 6 April 2005, one minor modification to the exception.

ICTA 1988, s 686(2)

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(2) This section applies to income arising to trustees in any year of assessment so far as it

(a) is income which is to be accumulated or which is payable at the discretion of the trustees or any other person (whether or not the trustees have power to accumulate it) and
(b) is not (before being distributed) either –
  (i) the income of any person other than the trustees, or
  (ii) treated for any of the purposes of the Income Tax Acts as the income of a settlor, and
(c) is not income arising under a trust established for charitable purposes only . . .

A special rate of tax (the rate applicable to trusts or RAT in shorthand) is charged on the income (net of certain administrative expenses) of trusts where, broadly speaking, no person is currently entitled to the income of the trust fund. The effect (in 2005–06) is to increase the total rate of IT chargeable to trustees in these circumstances to 40% or 32.5% on dividends (an increase from the rates of 34% and 25% respectively charged in previous years). The purpose of s 686 is to reduce the attractiveness of accumulation trusts and discretionary trusts as effective tax shelters where income can be generated and accumulated while being taxed at the trustees' rate only, rather than the rate appropriate to individual beneficiaries. One objective of the reforms proposed by the government to modernise the tax treatment of trusts is to reduce the burdens on smaller trusts. As one element of that policy – the modification referred to above – a new basic rate band for all trusts liable to the RAT is being introduced from 6 April 2005. It will apply to the first £500 of income taxable at the RAT, the overall consequence being that around one-third of trusts currently liable to tax at the RAT will no longer pay the RAT on any of their income because their total income will fall below the £500 threshold (see Inland Revenue *Modernising The Tax System for Trusts: A Consultation Document* (August 2004) ch 2).

A source of tension in the tax treatment of trusts, previously referred to, lies in the relationship between general principles of trusts law and the language of taxing statutes. Expenses which are 'properly chargeable' to income by statute or case law, although not deductible against the trustees' liability to tax at the basic rate, may be deducted in arriving at the amount of income chargeable at the 'rate applicable to trusts' (ICTA 1988, s 686(2AA), (2A), (2B)). The words 'properly chargeable' have prompted litigation which demonstrates how this interpretational problem can be accentuated by the capacity of settlors to modify the application of those general principles. Trusts law draws a distinction between trust expenses attributable to income and those attributable to capital. An example of the latter can be a premium paid on a life assurance policy. It is, however, within the power of a settlor to authorise trustees by the terms of the trust deed to pay income expenses out of capital or vice versa.

In *Carver v Duncan* [1985] 2 All ER 645, trustees had paid premiums on life assurance policies intended to cover possible IHT liability in the event of the early death of the settlor. The trustees were empowered to pay the premiums out of income and they did so. It could therefore be said that trustees 'properly' paid the premiums out of income in the sense of not being in breach of trust. But were the expenses 'properly chargeable' to income under s 686(2)(d) (the forerunner of s 686(2AA)? Lord Diplock, the sole dissenting voice in the House of Lords, considered that they were. In contrast the reasoning of the majority, as reflected in the judgment of Lord Templeman (at 654), was that: 'although a settlor may provide that capital expenses shall or may be paid out of income, the settlor cannot alter the nature of those expenses.' In the opinion of the majority 'properly chargeable' in s 686(2)(d) refers to the position under the basic principles of trusts law, not the position as modified in the terms of a trust deed by a settlor.

(2) Beneficiaries

A beneficiary to whom trust income is distributed or who is entitled to trust income as it arises, whether distributed or not, will be subject to IT on it (*Baker v Archer-Shee* [1927] AC 844). The transparent approach is adopted to this second tier of income taxation of the trust, and therefore it is the tax status of the beneficiary that is decisive. Trust income will already have been taxed in the hands of trustees at the basic rate and, where appropriate, the additional rate. Whether, therefore, more tax is payable, or, indeed, a refund allowable will depend on the beneficiary's income from other sources.

When submitting a tax return the beneficiary must account for both the income received and the tax already paid by the trustees, ie the amount to be declared is increased to the original gross figure. Thus, if the basic rate is 22%, a receipt of £780 will be 'grossed up' to £1,000. If the beneficiary's marginal rate of tax – the rate applicable to each additional pound of trust income – is higher than the basic rate then the beneficiary will be liable for the additional tax. A beneficiary entitled to the trust income with a marginal rate of 40% would therefore be liable to pay £400 IT on grossed-up trust income of £1,000, against which can be credited the tax of £220 already paid by the trustees. On the other hand, a similar beneficiary whose rate of tax is nil will also receive a credit for the tax paid by the trustees and can therefore recover this amount from the Inland Revenue. The procedure is more complicated where trust administration expenses are involved. In effect the beneficiary will not be entitled to such proportion of the tax credit as is attributable to administration expenses incurred by the trustees (*Macfarlane v IRC* (1929) 14 TC 532).

Where beneficiaries have no entitlement to the trust income but merely a right to be considered, as in a discretionary trust, only income distributed to them is liable to tax in their hands. Here also, for the purposes of assessing liability, the net payment received by a beneficiary must be grossed-up but now at basic and additional rates. The tax credit received by a beneficiary is increased correspondingly. The effect of the higher rate applicable to income of accumulation or discretionary trusts is therefore to encourage trustees to distribute income to those with lower marginal rates of tax so that some or all of the tax paid by the trustees can be recovered by the beneficiary concerned.

(c) Anti-avoidance measures

The imposition of the additional rate of tax on accumulation and discretionary trusts is not the only anti-avoidance measure, and indeed it would be inadequate if it were so. Unless further restrictions were imposed it would be a simple matter for a wealthy taxpayer whose marginal rate of tax on income was 40% (and until as recently as 1988 could have been 60%) to place income-producing assets in a trust where the income would be taxed at only 22% or, until the increase in 2004–05 in the rate applicable to trusts to 40%, 34%. If that income were then to be paid to the settlor's spouse or children, or accumulated so as to be subsequently returned to the settlor or spouse as capital, a substantial reduction in income tax liability would have been achieved. As a consequence of these capital accumulation and income-splitting possibilities a series of anti-avoidance provisions was enacted over a period of some sixty years. This piecemeal development led to overlapping provisions and the rules were simplified in the Finance Act 1995. Some existing provisions were repealed and replaced by new anti-avoidance provisions. The rules are all now contained in ICTA 1988, Pt XV (as amended by the 1995 Act) and apply to all 'settlements'. Notwithstanding the continued use of the term 'settlement', so redolent of Jane Austen and the notions of estates, there is nothing very nineteenth century about its very wide-ranging definition. It includes 'any disposition, trust, covenant, agreement, arrangement or transfer of assets' (s 660G(1) and see the still relevant previous case law, eg *Crossland v Hawkins* [1961] Ch 537; *IRC v Mills* [1975] AC 38; and *Butler v Wildin* [1989] STC 22). To give just one example, an outright gift of a National Savings certificate to a child would be a 'transfer of an asset' and therefore within the definition of a settlement (*Thomas v Marshall* [1953] AC 543).

The statutory provisions cover three distinct areas:

(i) where the settlor or spouse retain an interest in the settlement (s 660A);
(ii) where an unmarried minor child of the settlor receives a benefit from the settlement (s 660B); and
(iii) where the settlor or spouse or minor child have received a capital payment from the settlement (ss 677–678).

The anti-avoidance technique adopted is quite simple, even if the detailed implementation remains complex. The settlement is treated not so much as transparent as like a mirror. Thus under ICTA 1988, s 660A all income arising under the settlement is deemed to be that of the settlor unless it can be shown that it arises from property in which the settlor has no interest. In deciding whether that exclusion is satisfied another deeming provision comes into play: a settlor is to be regarded as having an interest in property if that property or any derived property is, or will or may become, payable to or applicable for the benefit of the settlor or his spouse *in any circumstances whatsoever* (s 660A(2)). It seems that, as with the pre-1995 rules, if the settlor is to avoid a charge to tax there must be no power of revocation which could benefit the settlor or spouse, no discretion or power to benefit the settlor or spouse and no reversionary interest to the settlor. A settlor, for instance, is treated as having an interest in settled property from which his or her spouse is capable of benefiting unless the benefit derives from an outright gift to the spouse (see also s 660A(8) that provides an exception for certain settlements made by one party to a marriage to the other on the break-up of the marriage). The potentially sweeping nature of these anti-avoidance provisions is best illustrated by the fact that it was one of its now 'repealed and replaced' provisions (s 683) that ensnared the hapless Mr Vandervell (see Chapter 4).

The same 'mirror' approach is adopted where property is settled in favour of the settlor's infant unmarried children – a definition extending to stepchildren and illegitimate children. Here also any income arising under the settlement and which is paid to or for the benefit of any unmarried minor child of the settlor will be treated as that of the settlor (s 660B, but subject to a de minimis exception of £100). There is, however, one important and surprising exception to this. Where income is accumulated under a capital settlement in favour of the settlor's unmarried minor child, the income is not after all treated as that of the settlor. Instead the tax regime described above (section (b)) applies and the trustees will be liable to basic and additional rate tax. But if any income is distributed to the infant unmarried beneficiary or is used for the child's maintenance, education or benefit then the s 660B 'mirror' takes effect. Furthermore, the possibility of trustees accumulating the income and then using it, for example, to pay the beneficiary's education fees has been countered. Section 660B(2) provides that such a capital payment out of the settlement fund will be treated as the income of the settlor to the extent it can be matched against any available undistributed income in the fund (ie income left after payments to any other beneficiaries and payments of expenses properly charged to income).

It must be stressed that s 660B applies only where the settlor is the parent of the unmarried minor beneficiary. Consequently generation-skipping capital settlements by grandparents still provide income tax advantages, since distributed income will be treated as that of the beneficiaries, not of the parents. In addition the inheritance tax treatment of such settlements can be favourable.

The logic of the legislative purpose of s 660B remains obscure. The section, as was its predecessor, is designed to counter income-splitting and so prevent high-rate taxpayers maintaining their infant children partly at the expense of the Inland Revenue. But somewhat confusingly, as Williams and Morse once perceptively noted in relation to the accumulations provision (*Introduction to Revenue Law* (2nd edn, 1985) p 171): 'it seems that . . . the legislature is saying: "But we don't mind parents building up a nest-egg for the child's future."' The alignment of the rate applicable to trusts and the higher rate of IT at 40% reduces, at least for the present, the attractions for parents of this type of settlement.

The third occasion when the anti-avoidance measures come into play is where a capital sum is paid by trustees out of accumulated income to the settlor or spouse.

That capital sum is to be treated as the income of the settlor (ICTA 1988, s 677). The definition of capital sum is widely drawn, extending to include, for instance, loans to the settlor, payments to third parties and even payments made to the settlor or spouse in breach of trust.

4. Capital gains tax (CGT)

(a) General

CGT is an attempt to compensate for the inability of the limited definition of income adopted for IT purposes to tax increases in the capital value of assets. It seeks to charge tax to individuals on the disposal of 'chargeable assets', the tax being based, in principle, on the difference between the value at date of acquisition and value at date of disposal. The disposal can be by sale, gift, exchange or generally any method whereby the owner of an asset derives a capital sum from it. This could even include, for instance, insurance money paid for damage or destruction of an asset (TCGA 1992, s 22). An early criticism of the tax was that no allowance was made for the consequences of inflation on asset values and CGT could be levied on paper as well as real gains. This criticism has now largely been countered by the introduction of an indexation allowance, whereby the original cost of an asset is notionally uprated in line with the increase in the Retail Price Index. The consequence is that the present CGT system now taxes only non-inflationary gains which have arisen since 1982.

The method of charging tax was originally that an individual was taxed at a flat rate on the annual total of chargeable gains less allowable losses. CGT was formerly charged at a flat rate of 30%, but in 1988 the then Chancellor (Nigel Lawson) introduced changes which sought to align the rates of income tax and CGT for each individual. As from the 1999–2000 tax year, however, CGT rates were aligned with the IT rates applicable to savings rather than earned income. Consequently a taxpayer's chargeable gains are now, in effect, treated as the top slice of that person's taxable income and the appropriate rate of tax on savings is then applied to the chargeable gain. The effect is that for most taxpayers CGT is now charged at a taxpayer's marginal rate of income tax (the 'marginal rate' being the rate charged on each extra pound earned by the taxpayer). The apparent severity of this approach is modified by the fact that there is an annual exemption which in 2005–06 is £8,500, ie only realised gains in excess of this figure are taxable.

The structure of CGT has fluctuated considerably since its introduction in 1965. During the 1980s, for instance, it was possible to postpone the payment of CGT on lifetime gifts, usually until the asset was eventually sold or otherwise disposed of for value. The relief, termed 'hold-over relief', which was introduced in FA 1980, s 79, initially applied to disposals between individuals only but was subsequently extended to include disposals by or to trustees (FA 1981, s 78; FA 1982, s 82). One consequence of the availability of hold-over relief was that if a series of gifts of an asset occurred, the gains could be cumulatively held over. In 1989, s 79 was repealed on the ground that the relief was increasingly being used as a simple form of tax avoidance. Relief is, however, still available in some circumstances where property is transferred into a discretionary trust (TCGA 1992, s 260), or where business assets are settled on trust or disposed of by trustees, other than by an arm's-length sale (s 165).

(b) Trusts

(1) Introduction

Although, unlike the position with IT, there is no definition of settlement as such, settled property is defined as 'any property held in trust' (TCGA 1992, s 68). There are certain specified exceptions to this (s 60) including where trustees hold property for a beneficiary who is absolutely entitled to the property as against the trustees. Then, even though a bare trust exists (as in the example of Whizz-kid in Chapter 1), the property is not 'settled property' for CGT purposes and is treated as belonging to the beneficiary. Apart from these limiting exceptions trusts are personified under CGT. Transparency would require the attribution of gains to beneficiaries in circumstances where their identification might prove difficult and the actuarial valuation of their respective interests in trust capital a highly artificial exercise. Under the solution adopted for CGT, trustees are treated as a single body of persons, the retirement and appointment of individual trustees of a settlement therefore generally having no tax effect. As from 1998–99 the rate at which gains are taxed became the same for all trusts, the relevant rate being the IT rate applicable to discretionary trusts (40% in 2005–06). The increase in the rate from 34% to 40% in 2005–06 has removed one obstacle to achieving parity of treatment with property owned outright. Previously the taxable gains of an interest in possession trust (34%), for instance, could be taxed more lightly than those of an individual (maximum rate of 40%). As the Inland Revenue noted in its 1991 consultation document: 'this is difficult to justify and offers obvious scope for mitigating tax liabilities' (para 6.10). The status of trustees is not, however, quite equated to that of individuals. Plainly if an equal annual exemption were allowed, tax avoidance by fragmenting capital into numerous trusts each gaining the benefit of an annual exemption would be possible. To counter this, an annual exemption of only half the rate applicable to individuals is provided (2005–06 £4,250) and there are rules intended to prevent the same settlor getting the benefit of more than one trust exemption by setting up numerous trusts simultaneously (TCGA 1992, Sch 1).

(2) The charge to CGT

A charge to CGT may arise:

(i) on the creation of a settlement;
(ii) on gains accruing to trustees as a result of actual disposal of chargeable assets; and
(iii) on gains arising where a deemed disposal takes place.

Creation of the settlement The creation of a settlement inter vivos, whether revocable or irrevocable, is deemed to be a disposal of assets by the settlor (TCGA 1992, s 53) and a chargeable gain, or loss, will result. Liability for CGT lies with the settlor rather than the trustees. As mentioned above, hold-over relief is now available only where assets are transferred to a discretionary trust – IHT may be chargeable on such a transfer – or more generally where the assets comprise business property.

Actual disposals by trustees Trustees are chargeable to CGT on gains accruing to the trust when they dispose of chargeable assets in the course of administering the trust. The charge to tax is calculated on the normal principles applicable to individuals but with the smaller annual exemption limit mentioned above. Trustees will most commonly incur CGT liability on actual disposals when switching the trust's investments.

Deemed disposals by trustees Deemed disposals occur on two principal occasions though only one of these will create a chargeable gain.

Where a life-interest in possession terminates on the death of the life-tenant but the property continues to be settled property – for example, to A for life remainder to B contingently on attaining 25 and A dies before B reaches 25 – there is a deemed disposal and re-acquisition of the assets of the trust fund by the trustees at the prevailing market value. But, consistent with normal CGT principles and with the treatment of a non-settled property on the death of an individual, no chargeable gain arises (TCGA 1992, s 72). There is therefore an uplift in the base value of the property but without incurring any charge to CGT.

The second category of deemed disposal occurs whenever a beneficiary becomes absolutely entitled to any portion of the settled property (TCGA 1992, s 71(1)). Whether there is an appointment of trust assets to a beneficiary, or the trustees retain the property as bare trustees under s 60, they are deemed by virtue of s 71 to have disposed of the assets of the fund and immediately re-acquired them at their market value. Any gain will be chargeable to CGT unless the deemed disposal was triggered by the death of a life-tenant. Then, as in the previous paragraph and consistent with CGT principles, there is no charge to CGT and an uplift occurs in the base value of the property for any future gain.

It is in the context of 'deemed disposals' that the withdrawal of general hold-over relief may have most impact. It will, for instance, have the effect of increasing the costs either of terminating a settlement or resettling property. Moreover, it brings back into the spotlight a conceptual difficulty associated with the interpretation of the phrase 'absolutely entitled as against the trustees' in TCGA 1992, s 71(1). It is now clear that 'absolutely entitled' does not just mean 'absolutely and beneficially entitled'. On the contrary, where trustees appoint property to new trusts, under a power of advancement, for instance, the trustees of the new settlement (who may be the same persons as the trustees of the original settlement) *may* become absolutely entitled to that property as against the previous trustees and a deemed disposal arise under TCGA 1992, s 71(1), with a resultant charge to CGT (see *Hoare Trustees v Gardner* [1978] 1 All ER 791). The outcome will depend on whether the new trusts remain part of the existing main settlement, as sub-trusts, or constitute a new settlement, since only in the latter instance will a deemed disposal occur. Whether property has been made subject to the trusts of a new settlement is a question of fact which must apparently be answered 'according to the view which would be taken of the transaction by a person with knowledge of trusts who uses language in a practical and commonsense way' (per Hoffman J in *Swires v Renton* [1991] STC 490 at 499; see also Lord Wilberforce in *Roome v Edwards* [1981] 1 All ER 736).

Exactly when a resettlement occurs for the purposes of s 71(1) remains uncertain, although the courts have indicated that this will not be the position unless the power exercised by the trustees expressly or implicitly authorises them to remove assets from the original settlement into a new settlement. In this connection a distinction was drawn in *Bond v Pickford* [1983] STC 517, CA between a power in the narrower form (such as a power of appointment) and a power in the wider form (typically a power of advancement). The former type of power may allow trustees to define or vary the beneficial interests but it will not allow them to remove assets from the trust or delegate their powers and discretions. It is consequently 'difficult to imagine any appointment within the scope of [a narrow] power which could be construed as the creation of a new settlement' (per Hoffman J in *Swires v Renton* at 499). Unfortunately it does not follow that every exercise of a power in the wider form to appoint property into new trusts will constitute a resettlement. An Inland Revenue Statement of Practice (SP 7/84), accurately summarising the present position, indicates that there will *not* be a resettlement if (i) the appointment is revocable, or (ii) the trusts declared are non-exhaustive (ie the assets could revert to the original settlement), or (iii) the trustees of the original settlement still have duties in relation to the assets in the new trusts. Beyond this guidance, all that can rather unhelpfully be said is that each case must depend on its facts and the intention of the parties, viewed objectively, will be an important consideration (see *Swires v Renton* [1991] STC 490; Inland Revenue *The Income Tax and Capital Gains Tax Treatment of UK Resident Trusts* (1991) ch 9; Walker [1991] BTR 129).

Lastly, as mentioned previously, since 19 March 1991 there is also a deemed disposal by the trustees where the trust is exported so that trustees cease to be resident in the UK (TCGA 1992, s 80(2)). The fiscal effect is similar to that which arises when a beneficiary becomes absolutely entitled to the whole or any part of the trust property (TCGA 1992, s 71(1)).

5. Inheritance tax (IHT)

(a) Introduction: estate duty to inheritance tax – a return journey?

Death duties have a long history in the UK but the last quarter of the twentieth century witnessed particularly sharp changes of direction in this form of capital taxation. Moreover, given the absence of any political consensus on the issue, the longevity of any particular tax structure seems doubtful. It is, therefore, both useful for purposes of comparison and necessary for an understanding of the present and possible future tax treatment of trusts to trace how the present framework of tax law regulating transfers of capital emerged (see Sandford *Taxing Personal Wealth* (1971) for an informative account of the history of death duties).

From 1894 to 1974 the main, and from 1949 the sole, death duty in the UK was estate duty. Two interlinking features dominated the history of estate duty during this period. These were the ever-increasing nominal burden of estate duty and the growth of avoidance.

From its inception estate duty incorporated a progressive rate structure, ie the rate of tax increased with the value of the estate. In 1894 the rates varied between 1% and 8%, and in future years the rate schedule consistently grew steeper. By 1914 the maximum rate had risen to 20%, by 1919 to 40%, by 1939 to 60% and by 1949 to 80%. The rates remained broadly at this high level thereafter. Furthermore the effects of continuous inflation increased the nominal burden of the tax after the Second World War. Under a progressive rate schedule, if no allowance is made for inflation by changing the rate structure of the tax, the result is to push the same real value of estates into ever higher tax brackets. Sandford has estimated, for instance, that an estate valued at £100,000 in 1949 and paying duty at 45% would have been equivalent to an estate valued at £195,000 in 1967, but the rate of duty on the latter would have been 55%. The absence of indexation increased the incentive to take advantage of the numerous loopholes and concessions. Attempts were made to nullify these, for example, by extending the length of the period before death within which gifts were made taxable. Also steps were taken in FA 1969 to counter the avoidance potential of discretionary trusts. Consequently, on the death of a beneficiary of a discretionary trust, a proportion of the value of that fund based on the beneficiary's share of the income of the fund in the seven preceding years, was attributed to the deceased's estate. The effectiveness of these responses to avoidance is questionable. They did nothing to still the criticisms of estate duty based on grounds both of horizontal equity ('fairness') and vertical equity ('ability to pay') (see Chapter 3).

A range of alternatives was extensively canvassed with opinion divided between the competing merits of inheritance-based or donor-based systems. (Amongst those favouring a donor-based system were Wheatcroft (ed) *Estate and Gift Taxation* (1965) and Prest *Public Finance* (1967). Those favouring an inheritance-based system included Meade *Efficiency, Equality and the Ownership of Property* (1964) and Sandford, Willis and Ironside *An Accession Tax* (1973).) Eventually in 1974 a Labour government introduced a donor-based lifetime gifts tax with the title 'capital transfer tax' (CTT). The distinguishing characteristic of CTT as compared with estate duty was the extension to include lifetime gifts on a cumulative basis, rather than to those made only within seven years of death. The principle of cumulation is simply that the rate of tax on any gift, or on an estate left at death, is determined by the amount of taxable transfers previously made during the cumulation period.

When cumulation is added to a steeply progressive rate schedule the potential for a severely redistributive tax is apparent.

Yet it was soon claimed that CTT was even less effective than estate duty as an attack on inequality of wealth distribution. The reason in the opinion of one sharp critic (Sutherland 'Capital Transfer Tax: An Obituary' (1981) Fiscal Studies 51) is that 'CTT has become, as estate duty was, a voluntary tax'. This assessment depends on the assumption that wealth-holders would utilise fully the various concessions made available after the introduction of CTT (see Robinson and Sandford *Tax Policy-Making in the United Kingdom* (1983) for a detailed account of the policy process involved). Among the more important concessions were:

(i) the granting of business and agricultural property relief so that for tax purposes the value of the property transferred could be reduced by up to 50% (now 100% in some circumstances);
(ii) the increase in the tax threshold greater than that required to keep pace with the rise in the Retail Price Index; and
(iii) the abandonment in 1981 of the principle of lifetime cumulation and the substitution instead of a cumulation period of ten years.

In consequence it was theoretically possible at 1985–86 tax rates for a married couple – transfers of property between spouses generally being 'exempt transfers' – to pass on to heirs over an 11-year period £334,000 free of CTT. These figures take no account of the possible eligibility of the assets transferred for business or agricultural property relief. When it is appreciated that an individual with sufficient wealth to fund such a transfer would then have been among the top 1% of wealth-holders in the UK the limited nature of the revenue-raising and redistributive potential of CTT is apparent.

Then in 1986 further significant changes to the structure of CTT were introduced. To the chagrin of tax purists the title of the tax was misleadingly altered to inheritance tax (IHT), a name commonly associated with a receipt-based or accessions tax, whereas the result of the changes was in substance a return to a form of estate duty. Indeed the new structure is an unwieldy amalgam of estate duty and CTT rules. The major alteration to CTT is that the tax charge on lifetime gifts between individuals is abolished as is a charge on gifts into certain trusts. But, as with estate duty, you must make sure you live for seven years after making the gift if tax is to be avoided altogether, since gifts made up to seven years before the transferor's death are chargeable. At that point, however, IHT breaks with estate duty by retaining the principle of cumulation, albeit in a modified form based on a seven-year cumulation period. Consequently, where a transferor dies within seven years of making a gift, that gift will be brought into the tax net *and* will, in some circumstances, itself be cumulated with certain other transfers made within the seven years previous to that particular gift. One further and important modification concerns the tax rate structure. Unlike the position under estate duty and CTT there is no longer any progressive rate structure.

As from 6 April 2005 IHT rates chargeable on estates at death are as follows:

Lower Limit (£)	Upper Limit (£)	Rate of tax (%)
0	275,000	Nil
275,001	–	40

Note that the rate of tax charged on chargeable lifetime transfers (eg into a discretionary trust) is half that applicable on death (ie 0% if the transfer is below the threshold or 20%).

None of the initial reforms to CTT or subsequent concessions related specifically to transfers of property into trusts or to the problems of taxing trusts under a gifts-tax regime. But CTT did introduce a radical scheme for taxing trusts, particularly discretionary trusts. From our standpoint a significant feature of IHT is that it retains many of the CTT rules for charging tax on trust property. The scope and adequacy of the existing approach is considered in section (c) below.

(b) Inheritance tax in outline

FA 1986 effects the change from CTT to IHT entirely by way of amendment to the Capital Transfer Tax Act 1984 – or Inheritance Tax Act (IHTA) 1984 as it may now be called (FA 1986, s 100) – 'superimposing new complexities on old, without proper consolidation' as one critic caustically commented (*Financial Times*, 11 August 1986). We adopt the new title and refer throughout to IHT (although the substantive changes to the tax – for example, seven-year cumulation period – only came into effect from Budget Day 1986) except where specific reference is being made to the situation under CTT. Our concern with complexities of the tax is kept to a minimum and we do no more here than sketch in the conceptual scheme, which remains substantially unamended from CTT (see generally the comprehensive treatment in Whitehouse et al *Revenue Law – Principles and Practice* (22nd edn, 2004) chs 23–30).

IHTA 1984, s 1, declares: 'IHT shall be charged on the value transferred by a chargeable transfer.' A chargeable transfer is 'a transfer of value which is made by an individual but is not an exempt transfer' (s 2(1)). The keys to understanding the structure of the tax lie in the terms 'value transferred', 'transfer of value' and 'exempt transfer'. To these three elements we must now add a new concept 'the potentially exempt transfer' (IHTA 1984, s 3A(1)). This is an inter vivos transfer of value made by an individual which constitutes a gift either (i) to another individual, or (ii) into accumulation and maintenance trusts or disabled trusts, or (iii), after 17 March 1987, into interest in possession trusts. A 'potentially exempt transfer' (PET), as the name implies, is essentially a gift in a state of limbo for tax purposes. If seven years elapse with the transferor still alive it becomes an 'exempt transfer', and it is only if the transferor dies within that period that the gift becomes a 'chargeable transfer' (s 3A(4)). As regards 'exempt transfers' in general, the most common exemptions are gifts up to £3,000 each year and transfers of property between spouses (IHTA 1984, Pt II).

The two remaining elements of the tax to be considered are 'transfers of value' and 'value transferred'.

IHTA 1984, s 3(1) defines a transfer of value as:

> a disposition made by a person as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition; and the amount by which it is less is the value transferred by the transfer.

IHT operates as a death duty by virtue of deeming a transfer of value to have been made immediately before a person's death, the value transferred being equal to the value of the estate (IHTA 1984, s 4(1)).

Central to an understanding of the operation of IHT is that it is the reduction in the value of the transferor's estate – the diminution principle – that represents the value transferred. This will often be the same as the value by which a transferee's estate is increased but need not necessarily be so, as for example where a transfer of 2% of a company's shares from A to B (A holding 51% and B 5%) results in a loss of control of the company by A but not the acquisition of control by B. The diminution principle becomes particularly important where the transferor rather than the transferee pays the tax. Then the tax itself becomes taxable because the transferor's estate is diminished not just by the value of the property transferred but also by what has to be paid to the Inland Revenue. The process is known as grossing-up and in principle operates as described previously in the context of income tax (see p 362). In short, if the transferor wishes to put £100,000 into the hands of the transferee he must calculate what sum after deduction of tax will leave £100,000 clear.

One further consequence of a reversion towards an estate duty structure of taxation has been the re-introduction of 'reservation of benefit' rules (FA 1986, s 102 and Sch 20). These rules are intended to prevent a donor obtaining a tax advantage by making a gift as a PET, while effectively retaining an interest in the property given. The effect of the rules is that where a gift with reservation of benefit is made, the transfer has no immediate IHT consequences. Instead, the gifted property will be deemed to be a part of the donor's estate immediately before his death and taxed according to its value at that time (s 102(3)). The rules are closely based on earlier estate duty legislation and cases decided under that regime have, to some extent, provided relevant guidance. Thus it seems that a settlor, for instance, will be treated as having reserved a benefit if he is a remunerated trustee (*Oakes v Comr of Stamp Duties for New South Wales* [1953] 2 All ER 1563), or one of a class of objects of a discretionary trust, irrespective of whether he receives anything (*Gartside v IRC* [1968] 1 All ER 121).

The implementation of the rules provides yet another illustration of the ways in which property interests can be manipulated to exploit loopholes in the legislation which can in turn lead to unanticipated consequences. The Finance Act 1999 closed a loophole in s 102 whereby it was possible to dispose of property by gift whilst applying 'the highly sophisticated English land law' to retain a right to residence in the property (see Finance Act 1999, s 95, reversing the decision of the House of Lords in *Ingram v IRC* [1999] 1 All ER 297: 'Section 102 does not prevent people from deriving benefit from the object in which they have given away an interest. It applies only where they derive benefit from that interest' per Lord Hoffman at 304). Undaunted, taxpayers, their advisers and promoters of avoidance schemes returned to the fray. They were no doubt encouraged by the fact that the rate of increase in the value of house prices outpaced the inflation-linked annual rise in the IHT threshold thereby enhancing the attractiveness of taking estates outside the scope of IHT. Vos aptly summarised the position: 'The attraction of saving 40% inheritance tax on the value of the house and so increasing the amount which they can pass on to their heirs is sufficient to persuade [taxpayers] to put aside their concerns and to enter into tax planning arrangements which can be complicated, inflexible, costly to implement and which may ultimately not succeed. Compared with the amount of tax at stake, however, these disadvantages can pale into insignificance' ([2003] PCB 6 379–390 at 379). A number of schemes were marketed mostly exploiting the fact that the 'gift with reservation' rules (Finance Act 1986, s 102(5)) do not apply to inter-spouse transfers. The schemes would commonly involve some combination of a trust creating a life or lesser interest for the settlor's spouse and one or more discretionary trusts with the settlor as one of the discretionary beneficiaries. The consequence was that although the settlor would de facto remain in occupation of the property the transfer of property was taken outside the scope of the gift with reservation rules in s 102 (see eg *IRC v Eversden* [2003] STC 822).

The Inland Revenue responded in the Finance Act 2003 to counter such schemes but this did not prevent still more novel schemes being marketed to clients – estimated at 30,000 by the Inland Revenue – to try to achieve the ends sought by the taxpayer. In 2004 the Inland Revenue sharply changed tack and in effect accepted that it was possible to give away assets yet still benefit from them without the assets entering the estate for IHT purposes. Instead an unexpected and controversial riposte from the Inland Revenue was to introduce with effect from 6 April 2005 a free-standing charge to income tax – a 'pre-owned assets tax' – on the deemed value of the benefit the taxpayer gains from enjoyment of the formerly owned assets (Finance Act 2004, Sch 15; see Chamberlain [2004] BTR 5 at 486–493; Whitehouse [2004] PCB 3 at 128). In the case of residential property, for instance, a 'market rent' will provide the basis for the valuation whilst for other assets a specified percentage of the capital value will be used. There is a de minimis threshold of £5,000 but above that a rate of 40% will be charged. Although the point scarcely needed stating in light of the measure proposed, the Paymaster General, Dawn Primarolo, in the Standing Committee on the Finance Bill emphasised that the government wanted 'to send a clear message that artificial avoidance of that kind is not acceptable. Those who devise and market such schemes and the people who take advantage of them, need to understand that and not assume that avoidance is risk-free' (18 May 2004, col 238).

(c) Settled property: a new approach to taxing capital transfers

Under CTT, a disposition and chargeable transfer of value would usually arise when property was first transferred into a settlement and would be taxed on basic CTT principles in the same way as outright gifts.

IHT breaks with this approach. Gifts into accumulation and maintenance trusts or interest in possession trusts are, like outright gifts, 'potentially exempt transfers'. In contrast gifts into discretionary trusts are 'chargeable transfers' – ie the CTT approach is retained although now with the modified cumulation period of seven years. The following simple example illustrates the consequence of this differential approach:

(1) A makes a transfer of value of £275,000 into an accumulation and maintenance trust. This is a PET and no IHT is payable unless A dies within seven years and the transfer does not enter the cumulative total.
(2) A makes a similar transfer into, for example, a discretionary trust which is a chargeable transfer that exceeds the nil rate threshold by £12,000 and IHT of £2,000 (at 2004–05 rates) is immediately chargeable even if A should survive for seven years.

One clear consequence is to reduce (but not remove) the fiscal attractiveness of making gifts into discretionary trusts. Remember, however, that the rate of tax applicable to such inter vivos chargeable transfers is half that payable on death (ie 20% rather than 40%).

Once the trust has been created most of the special rules for settled property first introduced under CTT continue to apply. A fundamental weakness of estate duty as it applied to settled property had been that property held on discretionary trusts was not normally dutiable. The approach now adopted under IHT to correct this is to divide settled property broadly into two categories and tax them by different methods. The basic distinction drawn is between settled property where some person is beneficially entitled to an interest in possession (eg a life-interest) and settled property in which there is no interest in possession (eg a discretionary trust). But out of the second category is then carved a further group of settlements that receive favourable tax treatment – 'favoured trusts' – for example, accumulation and maintenance settlements.

The principle underlying the settled property provisions is that 'in general the charge to tax should be neither greater nor smaller than the charge on property held absolutely' (*White Paper on Capital Transfer Tax* (Cmnd 5705, 1974) para 17). This principle of parity was broadly accepted by both Conservative and Labour governments but '[it] is clearly very difficult to apply in the case of discretionary trusts' (*CTT and Settled Property: A Consultative Document* (1980) para 4.1.2). The difficulty led to disagreement about how to obtain parity and, following a 1980 review of the treatment of settled property (see the consultative document), the discretionary trust provisions were partially restructured in FA 1982. The present increased fiscal attractiveness under IHT of making either outright gifts or gifts into accumulation and maintenance and interest in possession trusts seems to tip the scales against discretionary trusts, but they can still fulfil a very useful tax-planning function (see below, p 394). Whether the present structure of IHT satisfies the parity principle or, indeed, whether parity is a realisable or desirable goal will be assessed after we have examined the IHT treatment of the different trust types.

(d) Interest in possession trusts

(1) The charge to IHT

Where there is an interest in possession, the method of imposing IHT liability stems directly from that applicable to estate duty. The trust is regarded as transparent, the person entitled to the income being treated as beneficially owning the relevant portion of the trust capital (IHTA 1984, ss 49(1), 50(1)). This is, of course, a fiction since the life-tenant has no entitlement to capital. Nevertheless, if A is the tenant of a settled fund worth £100,000, for IHT purposes it is as if she owns the capital of the fund, and if A has an interest in half the fund, it is as if she owns half the capital and so on. Two important consequences flow from this method of attributing ownership. First, since the capital is regarded for IHT purposes as belonging to the life-tenant it therefore forms part of her total estate and when a chargeable event affecting the settled property occurs it is the beneficiary's rate that determines the IHT payable. The second consequence is that no charge to IHT arises if capital is distributed to A, since she is receiving merely what she is already deemed to own, and there is no fall in the value of her total estate. It should also be noted that since life-tenants have the full value of the capital attributed to them, reversionary interests are generally excluded from the charge to IHT (see IHTA 1984, s 48(1) for exceptions to this rule). If holders of reversionary interests were treated as owning a proportion of the capital also, the total valuation would exceed 100% and an element of double taxation would arise.

Consistent with attempting to achieve parity with property owned absolutely, a charge to IHT can arise on the death of the deemed beneficial owner. On the other hand, a termination or disposal of an interest in possession during the income beneficiary's lifetime (eg by surrendering or assigning the interest) will be a PET provided that it is in favour of (F(No 2)A 1987, s 96):

(i) an individual, either absolutely or under a new interest in possession trust,
(ii) an accumulation and maintenance trust, or a trust for a disabled person.

A disposition into a discretionary trust is, however, not a PET and a charge to IHT may, therefore, arise immediately.

The following simple example demonstrates the operation of IHT, and the processes of aggregation and cumulation, in interest in possession settlements.

Example 1

Property is held on trust for A for life, remainder to B and C in equal shares absolutely. A has made one previous chargeable lifetime transfer of £50,000 on 5 April 1991.

Table 8.1

		Gross £	Cumulative Total £
(1)	5 April 1991: A transfers £50,000 at a NIL rate of tax	50,000	50,000
(2)	5 April 1997: A transfers £60,000 (PET)	60,000	50,000
(3)	30 June 1997: Deemed chargeable transfer by A of £70,000	70,000	120,000
(4)	5 April 1998: Gift (1) above drops out of cumulative total	–	70,000
(5)	1 July 2004: A dies more than 7 years after dispositions (2) and (3) (Disposition (2) has thus become an 'exempt transfer' while disposition (3) drops out of the cumulative total which, therefore, stands at NIL)		
(6)	Chargeable death estate: £250,000 (free estate) + £80,000 (trust fund) = £330,000		
(7)	Calculate IHT [2004–05 tax bands are used at the death rate (40%) on bands between NIL and £330,000 = £26,800]		
(8)	Convert to estate rate to find IHT attributable to settled property (tax ÷ estate) × 100, ie (26,800 ÷ 330,000) × 100 = 8.1%		
(9)	IHT attributable to settled property: £80,000 × 8.1% = £6,480		

On 5 April 1997 A makes an outright gift of £60,000 to his daughter – a 'potentially exempt transfer' under IHT which therefore does not enter the cumulative total of transfers. On 30 June 1997 trustees, with A's consent, advance the sum of £70,000 from the capital of the trust fund to a discretionary trust, the latter's trustees paying the IHT (not shown here) on this 'chargeable transfer'. A dies on 1 July 2004 leaving a 'free estate' (ie non-settled property) worth £250,000. At the time of A's death the value of the trust fund is £80,000. The interest in the trust fund is treated as part of A's estate on his death, and IHT is charged on the trust fund at the estate rate (ie the average rate appropriate to the value of the whole estate). The trustees should pay the tax attributable to the settled property. Note that the consequence of aggregating the settled property with the free estate is to increase the estate rate, thereby causing a higher percentage charge on the free estate. (See Table 8.1.)

(2) The meaning of an 'interest in possession'

The concept of 'interest in possession' is one familiar in property and trusts law. It is also central to the working of the IHT regime for settled property. Regrettably, however, the phrase 'beneficially entitled to an interest in possession' is nowhere defined in the legislation. Did this absence of definition therefore mean that the recognised property and trusts law interpretation of 'interest in possession' also applied for the purposes of IHT? The Inland Revenue's published view ([1976] BTR 418) was that:

> . . . an interest in [possession in] settled property exists where the person having the interest has the *immediate entitlement* (subject to any prior claims by the trustees for expenses or other outgoings properly payable out of income) to *any income* produced by that property as the income arises; but . . . a discretion or power, in whatever form, which can be exercised *after income arises so* as to withhold it from that person negatives the existence of an interest in possession. For this purpose a power to accumulate income is regarded as a power to withhold it, unless any accumulation must be held solely for the person having the interest or his personal representatives.
>
> On the other hand the existence of a mere power of revocation or appointment, the exercise of which would determine the interest wholly or in part (but which, so long as it remains unexercised, does not affect the beneficiary's immediate entitlement to income) does not . . . [in the Board's view] prevent the interest from being an interest in possession.

The House of Lords considered the meaning of 'interest in possession' in *Pearson v IRC* [1980] 2 All ER 479 and by a 3:2 majority, reversing unanimous Court of Appeal and Chancery Division judgments, broadly endorsed the Inland Revenue view. Central to the case was the meaning of trusts law concepts and their applicability to the fiscal legislation.

The facts of *Pearson* are quite simple. The settlor, Sir Richard Pilkington, created a trust in 1964 primarily for the benefit of his three daughters, including one Fiona, on attaining the age of 21. By the end of February 1974 all were over 21 and both capital and income of the trust fund was then held for them in equal shares. Their entitlement, however, was subject to (i) a power of appointment in favour of a wider class, and (ii) a power to accumulate income for a maximum period of 21 years. The trustees who had regularly accumulated the income exercised the power of appointment in favour of Fiona to give her an irrevocable interest in £16,000. This clearly constituted an interest in possession. But the Inland Revenue, in line with its published stance, argued that no prior interest in possession had subsisted in the trust because of the existence of the power of accumulation, and therefore CTT (of £444.73) was assessed on the distribution.

Fox J ([1979] 1 All ER 273) and a unanimous Court of Appeal ([1979] 3 All ER 7) rejected the Inland Revenue's claim. Fox J defined an interest in possession as 'a present right to present enjoyment', an interpretation accepted by the Court of Appeal and by at least one of the majority judges, Viscount Dilhorne, in the House of Lords. Where the majority of their Lordships differed from all the other judges was in their application of the test.

Compare Fox J's and Lord Russell's analysis of the consequences of the power of accumulation with that of Viscount Dilhorne:

> *Pearson v IRC* [1979] 1 All ER 273 at 281
>
> **Fox J:** The position as to the trustees' power of accumulation, as I understand it, is this. The power is purely permissive. The trustees are not bound to exercise it.

> If they do exercise it, they must do so within a reasonable period after the income has arisen: see *Re Allen-Meyrick's Will Trusts* [1966] 1 All ER 740 and *Re Locker's Settlement Trusts* [1978] 1 All ER 216.
>
> The result, it seems to me, is that the daughters would be entitled as of right to income of their shares in each of the following circumstances: (a) if the trustees decide not to accumulate that income; (b) if the trustees fail to agree as to whether they should accumulate or not; (c) if the trustees, having allowed a reasonable period to elapse after receipt of income, have reached no decision whether to accumulate or not. In each of those cases the daughter will be entitled to the income as of right. She will be entitled to it, not because the trustees have decided to give it to her (as would be the case of . . . the discretionary objects in *Gartside v IRC* [1968] 1 All ER 121) but because she is entitled to it in right of what is, beyond doubt, her interest in the trust fund. She is entitled to it by reason of her vested interest . . . In *Gartside v IRC* the beneficiaries got nothing unless the trustees decided to give it to them. In the present case the daughters are absolutely entitled to income unless the trustees decide to accumulate that income.
>
> There are thus substantial differences between this case, on the one hand, and . . . *Gartside v IRC* on the other. A consequence of the fact that what the daughters take they take in right of their interests is that, as between the daughters, the trustees have no discretion at all. If the trustees decide not to accumulate they cannot divert income away from one daughter and give it to another. The income is captured by the vested interests.

Pearson v IRC [1980] 2 All ER 479 (Viscount Dilhorne, Lords Keith and Lane; Lords Salmon and Russell dissenting)

> **Viscount Dilhorne**: All we have to decide is whether, on reaching 21, Fiona and her sisters acquired interests in possession in settled property. In other words had they then a present right of present enjoyment of anything?
>
> As to that, there are, it seems to me, two possible conclusions. The first is that, the power of appointment under cl 2 not having been exercised, the three sisters on reaching that age acquired interests in possession defeasible should the trustees decide to exercise their power to accumulate income. They were then entitled absolutely to the capital and income of the trust fund in equal shares subject to the exercise of that power. The second is that they never secured an interest in possession for they never acquired on reaching that age the right to the enjoyment of anything. Their enjoyment of any income from the trust fund depended on the trustees' decision as to the accumulation of income. They would only have a right to any income from the trust fund if the trustees decided it should not be accumulated or if they failed to agree that it should be or if they delayed a decision on this matter for so long that a decision then to accumulate and withhold income from the sisters would have been unreasonable.
>
> As I read their judgments, the courts below took the first view. Reluctant as I am to differ from judges so experienced in the law relating to trusts, I find myself unable to agree with them. Fox J held that ([1979] 1 All ER 273 at 278):
>
> > ' . . . the interest of a person who is entitled to the income of property subject only to a power in the trustees to accumulate is in possession . . . it is a present interest, giving a present right to *whatever is not accumulated*.' (My emphasis.)

In *Gartside v IRC* [1968] 1 All ER 121 at 128, an estate duty case, Lord Reid said:

> '"In possession" must mean that your interest enables you to claim now whatever may be the subject of the interest. For instance, if it is the current income from a certain fund your claim may yield nothing if there is no income, but your claim is a valid claim, and if there is any income you are entitled to get it; but a right to require trustees to consider whether they will pay you something does not enable you to claim anything. If the trustees do decide to pay you something, you do not get it by reason of having the right to have your case considered; you get it only because the trustees have decided to give it to you.'

That case concerned a discretionary trust where payment was made to the beneficiaries at the discretion of the trustees. Here the three sisters' entitlement to income was subject to the trustees' power to accumulate. On reaching 21 they had no valid claim to anything. If there was any income from the settled property, they were not entitled to it. Their right to anything depended on what the trustees did or did not do and the receipt of income by them appears to me to have been just as much at the discretion of the trustees as was the receipt of income by the beneficiaries in the *Gartside* case.

It was recognised by the trustees that, if cl 3 had created a trust to accumulate subject to which the trust fund was to be held in trust for the three sisters absolutely on their attaining 21, they would not have secured an interest in possession on reaching that age. It makes all the difference, so it was said, that the trustees were not under a duty to accumulate but only had power to do so if they thought fit. I am not able to accept this for in neither case can it in my opinion be said that the sisters on attaining that age secured the right to the present enjoyment of anything.

Fox J in the course of his judgment distinguished . . . *Gartside v IRC* [1968] 1 All ER 121 from the present case on the ground that [there] 'the beneficiaries got nothing unless the trustees decided to give it to them' whereas in the present case the sisters 'were absolutely entitled to income unless the trustees decided to accumulate' ([1979] 1 All ER 273 at 281). I do not think that that is the case. I do not read the trust deed as providing that. Clause 3(a) gives the trustees power to accumulate as they think fit and the sisters' entitlement depends on whether that power is exercised. If it were the case that the deed did so provide, then I would agree that the sisters had a defeasible interest in possession. Such an interest may be terminated by the exercise of a power of revocation or of an overriding power of appointment such as that contained in cl 2 in this case. The existence of such a power does not prevent the holding of an interest in possession prior to the exercise of the power, and, until it is exercised, the holder of the interest has a present right of present enjoyment.

A distinction has in my opinion to be drawn between the exercise of a power to terminate a present right to present enjoyment and the exercise of a power which prevents a present right of present enjoyment arising.

Lord Russell (dissenting): The crucial question in my opinion, lies in the well-known distinction between a trust and a power, a distinction recognised by this House in *McPhail v Doulton* and there only regretted as a distinction which might lead in a given case to invalidity of the disposition. [This] is clearly a case of a mere power to accumulate, as distinct from a trust to accumulate unless and to the extent to which the

> trustees exercised a power to pay allowances to the sisters or any of them. The sisters were able to say that as income accrued on the £16,000 they were then entitled to that income, subject to the possibility that the trustees might *subsequently divert* it from them by a decision to accumulate it. (Indeed but for the cl 2 power of appointment, and the possibility until the death of the settlor in December 1976 of the birth of further children, they were notwithstanding the power of accumulation, entitled to claim transfer of the £16,000.) . . . The case is distinguishable from the case of a discretionary trust of income among a class, as in *Gartside v IRC*.

The reasoning of the majority judgment has been criticised in part as being purportedly based on misconceptions about principles of property law and the differences between trusts and powers. (See Thomas *Taxation and Trusts* (1981) pp 180–194; Tiley (1980) 39 CLJ 256; cf Murphy (1980) 43 MLR 712.) Yet one explanation advanced for the majority judgment is that it is a 'policy decision' plain and simple.

> Ultimately, perhaps all we can and need say about *Pearson* is that it is a straightforward 'policy decision'.
>
> . . . Had *Pearson* been decided differently, it might have opened up the way for the rehabilitation of the discretionary trust in a new form and to other methods of tax avoidance. Trustees would have enjoyed not just the benefits of the interest in possession regime but also the flexibility of a discretionary trust as regards distribution of income. Moreover, accumulation of income would have been possible for beneficiaries over the age of 25 without endangering the 'interest in possession status' of the trust (which is only possible now for 'under 25s' under an accumulation and maintenance trust). Amending legislation would no doubt have followed. The majority of the House of Lords, however, simply refused to aid and abet in a decision which defeated legislative policy, despite the fact that the problem at issue had been manifest when CTT was introduced and that the government had simply refused to do anything about it. (G W Thomas *Taxation and Trusts* (1981) p 193)

The 'flexibility of a discretionary trust' would have been obtained by virtue of the combined effect of the power of accumulation and overriding power of appointment. As explained by Murphy ((1980) 43 MLR 712 at 715): 'The existence of the accumulation power means that the trustees can divert all of the trust income and capitalise it. Once capitalised, it is subject to the overriding power and thus can be appointed away from the daughters.'

Consider the following points:

(1) It might be said that the minority judges sought to apply principles of property and trusts law whereas the majority pragmatically considered only the practical consequences for IHT of the operation of those principles. Indeed it has been suggested ((1981) 97 LQR 3) that *Pearson* 'marks a significant departure from the normal approach to the taxation of settlements whereby the fiscal provisions are construed in the light of and superimposed on traditional concepts of trust and property law'. Does the division of settlements for IHT purposes into only two categories necessitate such

a 'novel' approach? What inference, if any, as to the judicial approach to be adopted in defining an interest in possession should be drawn from the absence of a statutory definition of the concept?

(2) Thomas suggests (p 194) that 'the application of the trust/power distinction – which is, after all, fundamental to the law of trusts in general, defining as it does the extent and nature of a trustee's obligation and of the beneficiary's rights and interests – would have made for a more coherent and comprehensible conclusion'. Do you agree that, post-*McPhail v Doulton,* the trust/power distinction is 'fundamental' in this context? Which approach in *Pearson* do you consider to be more consistent with the reasoning of Lord Wilberforce in *McPhail v Doulton* (see Chapter 5) – that of the House of Lords majority or the minority (including Fox J)?

(3) If a power of accumulation prevented an interest in possession arising, should the existence of a power 'to apply income towards the payment of any taxes, or other costs or outgoings, which would otherwise be payable out of capital' have the same effect? The Inland Revenue contended that the *existence* of the power was a further reason why there was no interest in possession prior to the appointment in favour of Fiona. Viscount Dilhorne, drawing a distinction between administrative and dispositive powers, held obiter, without giving reasons, that such a power fell on the administrative side of the line and hence would not have invalidated an interest in possession. Note, however, that the power could by its terms be used not just to pay trust management expenses (clearly 'administrative') but could also be applied to other expenses and taxes (eg CGT and IHT charges) which would normally be payable out of the capital of the fund (arguably 'dispositive'). In any event Viscount Dilhorne's observations were obiter and it seems that the Inland Revenue is still adhering to the position it adopted in *Pearson.* Consequently such clauses are best avoided! (See *Thomas* pp 186–189; Jopling [1982] BTR 105 at 110–113; and *Miller v IRC* [1987] STC 108.)

(e) Discretionary trusts

(1) The structure of the charging provisions

The term 'discretionary trust' does not appear in IHTA 1984. Instead the umbrella term used to identify settlements with no interest in possession is 'relevant property'. 'Relevant property' is defined in IHTA 1984, s 58(1) as 'settled property in which no qualifying interest in possession exists', other than those trusts specified in s 58 as receiving favoured treatment such as accumulation and maintenance settlements.

The method of taxing 'relevant property' contrasts sharply with the transparency approach adopted for settlements with an interest in possession. In general each settlement is personified, although settlements created before 27 March 1974 (pre-CTT settlements) are treated slightly differently from those created after that date. The basic principle for pre-CTT settlements is that each trust is treated as if it is a separate person with no record of previous chargeable transfers, ie all connection with the settlor is severed. For post-CTT settlements, however, the settlor's record of previous chargeable transfers at the commencement of the settlement is crucial in determining the rate of tax charged. This approach might be more aptly regarded as part personification and part mirror-image.

Personifying the trust, however, would not in itself be sufficient to solve the problem of identifying a taxable event in the life of a discretionary trust. For example, if the basis of the charge to tax were to be when capital is distributed from the trust it would be possible to postpone a charge until the termination of the trust at the end of the perpetuity period. This could be some eighty years or even longer if an appropriate 'lives in being' clause was selected. The premise underlying the approach eventually adopted is that property owned outright is charged to IHT once a generation, ie approximately every thirty years. In an attempt to achieve parity the solution therefore arrived at is (i) to impose a charge to IHT on the settlor when property is first settled; (ii) to impose a tax of 30% of a normal IHT charge at lifetime rates on the settled property every ten years (the periodic charge), and (iii) to impose a charge whenever property in the settlement ceases to be 'relevant property', usually termed an interim or exit charge. Hence if the trust terminates or property is distributed to beneficiaries or an interest in possession is appointed in any portion of the fund, an IHT charge will be imposed to the extent of the property ceasing to be held on discretionary trusts. But why, it might be wondered, opt for a ten-year periodic charge? The justification is apparently a pragmatic compromise (*CTT and Settled Property* (1980) para 4.4.4):

> The present system is in effect a compromise between imposing a full charge once a generation – which would be less equitable than the present system – and achieving maximum equity by a system of annual charges – which would produce considerably more work for both the Revenue and taxpayers. This compromise does not seem unreasonable.

The three key elements, therefore, in the taxation of 'relevant property' discretionary trusts are the timing of the charge to tax, the property to be taxed and the rate of tax to be charged.

(2) The timing of the charge and the property to be taxed

The periodic charge is to be levied on the tenth anniversary of the commencement date of a settlement and on every subsequent ten-year anniversary. The charge is imposed on the value of 'relevant property' comprised in the settlement immediately before the anniversary date (IHTA 1984, s 64).

Example 2

On 1 May 1994 A, having made previous chargeable transfers of £75,000, settles £50,000 on discretionary trusts. On 1 May 2004, the ten-year anniversary, the value of the fund is £200,000 and that is the amount chargeable to tax.

The exit charge is in general a proportion of the previous periodic charge. Special provisions operate where a chargeable event occurs before the first ten-year anniversary although the basic principle of calculation is the same. The exit charge is levied on the amount by which 'relevant property' is reduced by the chargeable event.

This, in effect, follows basic IHT principles and consequently, unless the transferee pays IHT, the value will have to be grossed-up to calculate the tax.

Example 3

Taking the facts of Example 2; on 1 May 2005 a life-interest in £20,000 is appointed to a beneficiary who pays the tax. No grossing-up is necessary, so the amount chargeable to tax is £20,000. The relevant proportionate charge (see p 385) will be four-fortieths.

(3) Calculating the tax: settlements created after 27 March 1974 (post-CTT trusts)

Once the amount on which tax is chargeable is known, the next step is to discover the *rate* of tax applicable. The calculation is somewhat complex and it is necessary to appreciate that the calculation of the rate of tax to be charged is based on a purely hypothetical transfer. Only when that rate has been determined is it applied to the value of 'relevant property' in the settlement. The rate of tax is 30% of the effective rate which would be charged on the hypothetical chargeable transfer. The following step-by-step explanation given by Whitehouse has the merit of explaining both the method of calculation and the anti-avoidance reasons for its complexity.

> Whitehouse et al *Revenue Law – Principles and Practice* (22nd edn, 2004) p 589
>
> Calculation of the rate of IHT
>
> Half rates [ie the lifetime rate] are used and . . . the calculation depends upon a hypothetical chargeable transfer.
>
> *Step 1.* Calculate the hypothetical chargeable transfer which is made up of the sum of the following:
>
> (1) the value of relevant property comprised in the settlement immediately before the anniversary;
> (2) the value, immediately after it was created, of property comprised in a 'related settlement'; and
> (3) the value, at the date when the settlement was created, of any non-relevant property then in the settlement which has not subsequently become relevant property.
>
> Normally the hypothetical chargeable transfer will be made up exclusively of property falling within category (1). [Categories] (2) and (3), which affect the rate of IHT to be charged without themselves being taxed, are anti-avoidance measures. Related settlements are included because transfers made on the same day as the creation of the settlement are normally ignored and, therefore, an IHT advantage could be achieved if the settlor were to set up a series of small funds rather than one large fund. Non-relevant property in the settlement is included because the trustees could switch the values between the two portions of the fund.
>
> *Step 2.* Calculate tax at half rates on the hypothetical chargeable transfer by joining the table at the point reached by:

(1) the chargeable transfers of the settlor made in the *seven* years before he created the settlement; and
(2) chargeable transfers made by the settlement in the first *ten* years . . .

Discretionary settlements will, therefore, have their own total of chargeable transfers with transfers over a ten-year period being cumulated (contrast the seven-year period itself for individuals). The unique feature of a settlement's cumulation lies in the inclusion (and it never drops out) of chargeable transfers of the settlor in the seven years before the settlement is created.

Step 3. The IHT is converted to a percentage and 30% of that rate is then taken and charged upon the relevant property in the settlement.

The highest rate of IHT is 20% (half of 40%). The highest effective rate (anniversary rate) is, therefore, 30% of 20%, ie 6%. Where the settlement comprises business property qualifying for 50% relief, this effective rate falls to 3% and assuming that the option to pay in instalments [see IHTA 1984, s 227] is exercised, the annual charge over the ten-year period becomes a mere 0.3%. If the property qualifies for 100% business or agricultural property relief, there is no charge.

Example 4 (2004–05 rates and threshold (£263,000) are assumed to apply throughout)

Take the facts of Example 2 (namely, settlor's previous chargeable transfers £75,000; value of fund on 1 May 2004 is £200,000). In addition, assume A had created a second settlement of £31,000 on 1 May 1994, ie the same day as the creation of the discretionary trust.

(1) Value of 'relevant property' to be taxed is £200,000.

(2) Calculate hypothetical chargeable transfer:	£
Value of relevant property (as above)	200,000
Property in related settlement	31,000
	231,000

(3) Settlement's cumulative IHT total:	£
Settlor's previous chargeable transfers	75,000
Chargeable transfers by trustees in first ten years	NIL
	75,000

(4) Calculate IHT payable at half rates (ie lifetime rate) on hypothetical chargeable transfer:
Tax at lifetime rate (20%) on transfers from £75,000 to £306,000 (£75,000 + £231,000) = £8,600

(5) Calculate effective rate of tax:

$$\frac{\text{Tax paid}}{\text{Hypothetical chargeable transfer}} = \frac{\pounds 8{,}600}{\pounds 231{,}000} \times 100 = 3.72\%$$

(6) 30% of effective rate of tax = 1.12%

(7) Remember that the rate of 1.12% is then applied only to the value of the *relevant property* to find IHT payable on the ten-year anniversary
£200,000 × 1.12% = £2,240

The calculation of any subsequent exit charge is more straightforward since no hypothetical transfers are involved. The rate of charge is the appropriate fraction of the rate charged on the previous ten-year anniversary (IHTA 1984, s 69(1)). Conveniently, each ten-year period is divided into forty quarters and the appropriate fraction is:

$$\frac{\text{number of quarters completed since last ten-year charge}}{40}$$

Continuing Example 4, trustees appoint a life-interest in £20,000 on 1 May 2005. Assuming no grossing-up, the IHT exit charge will be:

£20,000 × 1.12% × 4/40 = £22.40

It is emphasised that the above are straightforward examples. Special rules apply where, for instance, property is added to a settlement. The same basic principles of calculation apply to settlements created before 27 March 1974, although special rules do apply which can result in less tax being charged (see IHTA 1984, ss 66–68, and Hutton and Ferrier *UK Taxation of Trusts* (14th edn, 2004) ch 13).

(f) Accumulation and maintenance trusts

(1) Introduction

Some settlements in which there is no interest in possession are nevertheless excluded by IHTA 1984, s 58(1) from the definition of 'relevant property' and receive favoured treatment for IHT purposes. The most important, conceptually and numerically, are accumulation and maintenance trusts ('A and M trusts') – broadly meaning trusts for minors where there is no interest in possession (see p 387 for a comprehensive description). Where a trust falls within the conditions specified for 'A and M trusts' in IHTA 1984, s 71 it is relieved from the normal tax charges on 'relevant property'.

The creation of an 'A and M trust', being a PET, will now not usually incur an IHT charge. Thereafter, there is no periodic charge, and no exit charge when a beneficiary obtains an interest in possession or becomes absolutely entitled to the settled property (IHTA 1984, s 71(4)(a)). Furthermore, no charge is imposed on the death of a beneficiary before attaining the specified age (see s 71(1) below). In effect 'A and M trusts' are treated as transparent: once the trust has been created the settled property is thereafter treated as belonging to the beneficiary (or beneficiaries).

One well-known guide to tax-planning (*Potter and Monroe's Tax Planning* (9th edn, 1982), written before the shift to IHT, explained the favoured treatment in terms of both social desirability and parity between gifts to adults and gifts on trust to infants (at pp 65–66):

> It is usually thought undesirable to give minors property absolutely or even to give them a right to the income of the property. On the other hand, it is normally desirable that the income should be available to be used for their maintenance, if required. The most usual type of trust for minors or young persons is thus an accumulation and maintenance trust. This means, broadly, that the income is accumulated until the beneficiary attains a specified age which, if s 31 of the Trustee Act 1925 applies, as amended by the Family Law Reform Act 1969, will be the age of 18, but the trustees are empowered to use the income (including the accumulated income) for the maintenance of the beneficiary. Until the beneficiary reaches the age at which he becomes entitled to income, there will clearly be no interest in possession. Unless a special provision were made for this type of trust, it would be liable to the periodic charge and to a further charge when the minor or young person became entitled to the settled property, either absolutely or for an interest in possession. Because of the undesirability of forcing settlors to give minors or young persons an interest in possession purely for fiscal reasons, the legislature has quite wisely conferred a special exemption on this type of trust . . . Of course, to prevent such trusts being abused they must comply with stringent conditions.

(2) Definition

The stringent conditions designed to counter avoidance attempts are specified in IHTA 1984, s 71(1) and (2). If the settled property ceases to satisfy these conditions, or if the trustees make a disposition reducing the value of the settled property an exit charge calculated under special rules will be imposed (IHTA 1984, s 71(3)).

> 71 Accumulation and maintenance trusts
>
> (1) Subject to subsection (2) below, this section applies to settled property if –
>
> (a) one or more persons (in this section referred to as beneficiaries) will, on or before attaining a specified age not exceeding twenty-five, become beneficially entitled to it or to an interest in possession in it, and
> (b) no interest in possession subsists in it and the income from it is to be accumulated so far as not applied for the maintenance. education or benefit of a beneficiary.
>
> (2) This section does not apply to settled property unless either –
>
> (a) not more than twenty-five years have elapsed since the commencement of the settlement or, if it was later, since the time (or latest time) when the conditions stated in paragraphs (a) and (b) of subsection (1) above became satisfied with respect to the property, or
> (b) all the persons who are or have been beneficiaries are or were either –
> (i) grandchildren of a common grandparent, or
> (ii) children, widows or widowers of such grandchildren who were themselves beneficiaries but died before the time when, had they survived, they would have become entitled as mentioned in subsection (1)(a) above.

As regards s 71(1)(b) there must be no interest in possession in the settled property and if such an interest arises the trust ceases to be an 'A and M trust' for IHT purposes. The same section directs how the income of the trust is to be used. The income must either be used for the benefit of a beneficiary – as under the power to maintain in Trustee Act 1925, s 31 from which the term 'maintenance, education or benefit' is taken (see Chapter 7) – or it must be accumulated.

It is intended that the benefit of the 'A and M trust' should be restricted to the minors of one generation only. Section 71(2) therefore provides that if property is settled for the benefit of the settlor's children and grandchildren the trust can last for only 25 years as an 'A and M trust' (s 71(2)(a)), since there is no grandparent common to all the beneficiaries, as required by s 72(1)(b).

The key to the restricted nature of the 'A and M trust' is s 71(1)(a) and dispute has arisen about the meaning of 'will' in that section. Plainly, absolute certainty is not possible since the beneficiary might die before becoming entitled to an interest in possession. But if absolute certainty is not necessary, what degree of certainty will suffice? The context for this issue is provided by the capacity of the trust-form to be made almost infinitely flexible as regards certainty of beneficial entitlement. The use of appropriately worded powers of revocation and appointment open up the possibility of creating what is in form an 'A and M trust' but in its operation might more closely resemble a discretionary trust. Should, therefore, the inclusion in a trust of wide powers of revocation and re-appointment, possibly to benefit a person at an age exceeding 25, prevent a trust from satisfying s 71(1)(a)? The competing interpretations are summarised together with respective policy justifications in the following extract from *CTT and Settled Property* (1980) para 4.8.7, and were the subject of litigation in *Inglewood v IRC* [1983] 1 WLR 366.

> The Inland Revenue's view is that (with some exceptions) the word 'will' means that a person will *inevitably* become entitled. The alternative view is that the condition will be satisfied if the trusts operating at the time the test has to be applied provide that a person will become entitled – ie the conditions can be satisfied even though the trusts are revocable so that it is in fact uncertain who will benefit or when. It has been suggested that, whatever the correct interpretation of the present legislation, the second view gives a fairer result. But this seems open to question. The essence of the present relief is that it is available where there is a commitment for property to devolve on a person before he attains the age of 25. Under the alternative view the relief would be available in a case where, in the event, that never happened (and perhaps was never intended to happen).

Inglewood v IRC [1983] 1 WLR 366 (Oliver, Fox and Robert Goff LJJ)

Fox LJ (delivering the judgment of the court): . . . Suppose that property is held upon trust for A, a minor, absolutely upon attaining the age of 25 but subject to a power in the trustees to revoke that trust and to appoint the property to other persons in such manner as the trustees determine. Can it be said, having regard to the power of revocation, that A 'will' become entitled to the property on attaining 25? [Fox LJ outlined the changes wrought by the introduction of CTT, set out the terms of the trust deed including the power of revocation and re-appointment and then turned to consider the arguments advanced by the appellant trustees.]

. . . [The] word 'will' may be capable of such a construction as the trustees put on it in the present case, and we think it necessary therefore to examine the implications of the rival constructions to see what light they throw upon the matter and whether what appears to us to be the clear prima facie meaning of the language used is displaced.

The trustees contended that the Crown's construction cannot be made to fit sensibly into the legal structure with which paragraph 15 [now IHTA 1984, s 71] must necessarily be dealing and is really destructive of the paragraph altogether. If the Crown are right, it was said, how does one accommodate the provisions of paragraph 15 to the facts that (a) a beneficiary's interest may be lawfully disposed of by him after he attains 18 and before it vests in possession; (b) his interest may be taken away from him on bankruptcy; (c) his interest may be prevented from vesting in him by reason of an order made under the Variation of Trusts Act 1958, or under the statutory jurisdiction of the Family Division on divorce or an order made by the Court of Protection in the event of his incapacity to manage his affairs; or (d) he may die before attaining a vested interest. As to the last of those, it seems to us that the contingency is inherent in the provisions of paragraph 15 itself. The paragraph applies where a person will on or before attaining a specified age not exceeding 25 become entitled to an interest in possession in settled property. The paragraph is dealing with contingent interests. A trust cannot be excluded from the operation of the paragraph because of the possible happening of an event inherent in the contingency which brings the trust within the paragraph in the first place. In our view, therefore, there is no substance in this point. As to the other matters we think that the answer is this. Paragraph 15(1) provides that 'This paragraph applies to any settlement where . . .'. In our opinion 'where' means 'whereby'. Accordingly, we think the paragraph is concerned only with provisions which are contained in the settlement itself. That would include not only the express provisions of the settlement but also any which are incorporated by statutory provision. None of the matters to which we have referred in (a), (b) and (c) can be so described. They are the consequence which cannot be avoided of the operation of the general law on property interests. They are extraneous to the settlement and are not provisions of the settlement itself.

The trustees, however, took a further and more substantial objection to the Crown's case. They pointed to the statutory power of advancement conferred by s 32 of the Trustee Act 1925. By s 69(2) of that Act the settlor can exclude or vary the statutory power as he thinks fit. Accordingly where it is not excluded it must, we think, be regarded as simply a provision of the settlement. If property is held upon trust for a beneficiary contingent on his attaining a specified age, the statutory power enables one half of the capital to be applied for the benefit of the person contingently entitled to the property. The word 'benefit' is very widely construed . . .

[Fox LJ referred to *Re Pilkington's Will Trusts* [1964] AC 612; *Re Hampden Settlement Trusts* [1977] TR 177 and *Re Clore's Settlement Trusts* [1966] 1 WLR 955 (see Chapter 7).] Very few settlements provide that the statutory power is not to apply

– though some extend the power or contain express advancement provisions more extended than the statutory power. The trustees contended that the statutory power is, as to one moiety of the settled property, no different from a special power of appointment which enables the trustees to revoke the primary trusts and to resettle upon trusts under which persons may take at ages in excess of 25. On the Crown's view it is said that paragraph 15 would be excluded as to one half. It is no doubt true that, for the purpose of the rule against perpetuities, the statutory power should be equated with a special power. But it is, in our opinion, quite unreal in relation to paragraph 15 to equate it to a power of revocation. A power of advancement is not given for the purposes of revoking the primary trust and resettling the trust property. Its purpose is auxiliary. It is given as an aid to enable the trust property to be used for the fullest benefit of the beneficiary and, as such, is a normal adjunct of any trust for a person contingently on attaining a specified age. We would observe that in cases of the *Re Hampden* and *Re Clore* type, which are rare anyway, it is a prerequisite to the transaction that the trustees should be satisfied that it is 'for the benefit' of the beneficiary who is advanced. To that extent it is similar to an administrative power. Its purpose, like an administrative power, is to aid the beneficial trusts and not to destroy them . . .

The result, in our opinion, is this. The word 'will' in paragraph 15 does import a degree of certainty which is not satisfied if the trust can be revoked and the fund re-appointed to some other person at an age exceeding 25. But a power of advancement has been for so long such a normal provision in a settlement for a person contingently on attaining a specified age, and since its sole purpose is to enable the trust property to be applied for that person's benefit before he attains the specified age, it would be artificial to regard the trust as not satisfying the provisions of the paragraph. A trust for A if he attains 25 is within the paragraph. It is impossible to see any rational ground why a trust for A if he attains 25 and with a power of advancement should not satisfy it also – more particularly since the exclusion of a power of advancement in such a case must be rare indeed . . . Our conclusion regarding the power of advancement is that while the prima facie meaning of paragraph 15(1)(a) is clear it must be interpreted in the context of the practical application of the law of trusts. The statutory power of advancement is so commonly incorporated in trusts that paragraph 15(1)(a) must be read so as to accommodate that and not so as to withdraw the benefit of the paragraph from a trust containing such a power. We would not regard the much-used extension of the statutory power from a moiety to the whole as in any different position.

[Counsel for the plaintiff identified a number of anomalous cases which, on the Inland Revenue's construction, fell outside para 15.]

We accept that these examples, and others which can be given, demonstrate the existence, on the Crown's construction, of hard cases. But this is often so in statutes which lay down conditions for the applicability of a section. Illogicalities and hardships may occasionally result . . .

Looking at the whole matter more widely it appears to us unlikely that Parliament can have intended that a trust should have the benefit of paragraph 15 if it was subject

> to a power of revocation which could be exercised for the benefit of other persons at ages exceeding 25. The Finance Act 1975 plainly continued and extended the policy of the Finance Act 1969 of reducing the fiscal advantages enjoyed by discretionary trusts. It did that by imposing the discretionary trust regime. That regime was burdensome on trusts for persons contingently upon attaining a specified age – which are necessarily very common because it is undesirable to give capital to persons absolutely at too early an age. Paragraph 15 was enacted accordingly. Existing trusts could be converted into paragraph 15 trusts at low rates of tax under the provisions of paragraph 14. Parliament, having decided on assistance for contingent trusts, would, it seems to us, in the context of this legislation, be likely to confine it within fairly strict boundaries. In particular, it seems to us, highly unlikely that the benefit of paragraph 15 was intended to be available to what were, in effect, discretionary trusts, by reason of the existence of wide powers of revocation and re-appointment, merely by the device of a primary trust for a person at 25 which could be revoked at any time.

The Court dismissed the appeal.

(3) The unduly favoured trust?

The impact of the introduction of IHT is briefly considered below, but the status of 'A and M trusts' under CTT (ie before 18 March 1986) still merits consideration. It exemplifies the elusiveness of parity and the confusion induced by the existence of the diversity of motivations on the part both of the settlor and the legislature. The justifications for bestowing favourable treatment were stated to be social desirability and the achievement of parity between property held by adults and property held for minors. Indeed these twin justifications are formally acknowledged by the Inland Revenue.

> *CTT and Settled Property* (1980)
>
> 4.8 . . . These (special) reliefs meet the point that it is inappropriate to give property absolutely to infants and that to put the property into settlement is therefore the appropriate way of providing for the next generation, whether the provision is made by a parent or grandparent . . .
>
> 4.8.2. It follows that a gift to a minor would involve a double charge to tax, first when the gift was made and second when the property came out of the discretionary trust and the special reliefs were introduced in order to obviate this double charge.

Two criticisms of this general approach to the CTT treatment of 'A and M trusts' can be made.

First, it can be inferred from the social desirability justification that the 'A and M trust' fulfils a caretaker function reflecting concern that minors be adequately protected. It does achieve this but it would be misleading to attribute its popularity solely to caretaker motivations. Thomas, writing before the introduction of IHT, identifies other considerations (*Taxation and Trusts* (1981) pp 131–132).

> Accumulation and maintenance settlements are – and are likely to remain – popular vehicles for the transfer of assets from one generation to the next. The cost of creating such a settlement can be relatively low. Suppose, for instance, that two grandparents each transfer £[3,000] a year (exempt) into such a trust, and another £1,000 a year as normal expenditure out of income (also exempt). Over 18 years, the total transferred is £[126,000], which with prudent management, should amount to considerably more. Add to this an exempt first transfer of £[263,000] and the fund becomes quite large. Even relatively low sums – say, £500 a year each – would produce £18,000 plus interest over 18 years, so there is considerable scope for tax-planning to suit individual or family circumstances.
>
> Such trusts are also excellent vehicles for holding certain types of property. For instance, shares in a newly formed company, whose value is now low but likely to increase, could be settled on the founder's children or grandchildren (with the benefit of a power to vary the beneficiaries' entitlement while they remain under 18). Insurance policies can be, and often are, written in favour of such trusts . . .
>
> Once created, trust income can be capitalised free of higher rate tax and (provided all pitfalls are avoided) without being attributed to the parent. This is clearly of benefit to many, despite the imposition of the additional rate on accumulated income . . .
>
> It is clear from this that, if full advantage is to be extracted from the fiscal laws, the form of the accumulation and maintenance trust is crucial. Tax law, not trust law – and certainly not the settlor's desires – will dictate what ought or ought not to be done.
>
> [The figures have been altered to reflect 2004–05 IHT thresholds.]

A second criticism is that the premise – 'to put property into settlement is the appropriate way for providing for the next generation' – is an inappropriate basis for measuring parity. An alternative mode of provision is for the adults responsible for minors to retain absolute ownership of capital, to maintain and educate them out of taxed income and ultimately to transfer capital either absolutely or by means of an interest in possession when the potential beneficiary attains the age of responsibility, be it 18, 21, 25 or even later, perhaps by will, if considered socially desirable. The criticism is not that 'A and M trusts' are undesirable – indeed because of intrinsic trust-type merits they can be a convenient method of providing for minors – but that a different basis of comparison for achieving parity is necessary. The appropriate basis of comparison therefore is *not* with an absolute gift or appointment of a life interest to a notional adult when the 'A and M trust' *begins*. Instead it is with similar dispositions at the time an interest in possession or absolute entitlement to settled property arises at the *termination* of the 'A and M trust'. The claim is that under CTT parity was not achieved. A growth in the value of the capital could take place within the tax shelter provided by the 'A and M trust' and escape the charge to CTT which would have been levied if the property were retained in beneficial ownership by the settlor until the children reached the age of majority.

The introduction of IHT simultaneously appears to bring parity of treatment closer while reducing the fiscal advantages described above. After all, ownership of property can now be retained by a transferor and transferred outright, or into an interest in possession trust, as a potentially exempt transfer (PET) free of IHT liability when the recipient attains an age of responsibility. The 'A and M trust' still has an important advantage over the interest in possession trust, namely that on disposal/termination there is complete IHT exemption for the former, whereas on an interest in possession trust disposal/termination can only be a PET. Furthermore, the 'A and M trust' still retains its attractiveness as a tax shelter against either the return of CTT or even a settlor's untimely death. Note, however, that the 'A and M trust' is afforded privileged status for IHT purposes only. So far as IT and CGT are concerned, general principles apply in the normal way.

(g) Inheritance tax and trusts: conclusion

(1) Tax, time and trusts

CTT was the tax that was going to cause 'howls of anguish from the 80,000 rich people' (Denis Healey speaking at the 1973 Labour Party Annual Conference). In fact any howls have been muted: the yield to the Inland Revenue from CTT/IHT, after adjustment for inflation, had fallen in the two decades following the introduction of the tax by between 50–65%. On the other hand, the anticipated IHT yield for 2004–05 is £2,900m, an increase in real terms of around 50% since 1998–99. Any 'howls of anguish' are not to be heard so much from the top 5% of wealth-holders but are more likely to be forthcoming from those who have seen the increase in value of their home bring them potentially within the scope of IHT. The decline in the impact of CTT/IHT on those at whom it was originally targeted in large part reflects the many changes the tax has undergone under both Labour and Conservative governments in its comparatively brief existence. Yet it is the possibility of such changes, whether resulting from pressure-group activity or a new government with a different fiscal philosophy, that reinforces the trust's value as a mechanism able to utilise the plane of time. The removal, even if it were to prove temporary, of a transfer tax on lifetime gifts to individuals or into 'A and M trusts' and interest in possession trusts provides an opportunity for substantial tax-free transfers of wealth to the next generation. The influence of the time element is also demonstrated by the fall and rise of the discretionary trust coincident with changes in the prevailing tax regime. The CTT provisions in the FA 1975 affecting discretionary trusts were seen as penal. Thomas (*Taxation and Trusts* (1981)), for example, concluded that (p 79):

> [the] complex and punitive provisions enacted in the Finance Act 1975 have imposed considerable disadvantages on the discretionary trust: its value as a method of tax avoidance has been severely curtailed; and a settlor attracted by the non-fiscal advantages of such a trust will now have to be prepared to suffer heavy tax penalties.

The severity of the regime was mitigated by generous transitional provisions (FA 1975, Sch 5, para 14) presumably intended to encourage the termination of existing discretionary trusts. But not all advisers considered that termination was necessarily the most prudent policy – inactivity was also a tenable option. Hepker and

Whitehouse (*Capital Transfer Tax* (1975)) counselled against precipitate decisions for the following political and financial reasons (p 135):

> For one thing the wealth tax may well redress the balance to some extent by giving discretionary trusts favourable treatment. For another there is bound to be a General Election before October 1979. It may therefore be wise to leave pre-27 March 1974 discretionary trusts intact until the position is clearer. The schedule of transitional relief ranges from 90% down to 80% between 27 March 1974 and 31 March 1980 and then on 1 April 1980 disappears, so that a policy of wait-and-see will involve very little loss of relief.

[The period of transitional relief was extended to 1 April 1982 by F(No 2)A 1979 and subsequently to 1 April 1983.]

In fact, a substantial shift of property out of discretionary trusts, at least to the estimated value of £2 billion, did occur between 1975 and 1980, of which approximately half was transferred into 'A and M trusts' (*CTT and Settled Property* (1980) App 2). Although the total number of discretionary trusts (which includes 'A and M trusts') has reduced from an estimated high of 90,000 in 1975, recent Inland Revenue statistics indicate that there are now nearly 70,000 such trusts and the number is increasing (see Inland Revenue Consultation Document *The Income Tax and CGT Treatment of UK Resident Trusts* (1991) para 2.6; Robson and Timmins *Discretionary Trusts* (1988)). Changes in the cumulation period and the IHT regime for discretionary trusts in FA 1981 and 1982 respectively gave a new lease of life to the discretionary trust, although it can no longer perform the amazing vanishing tricks so effectively demonstrated on the estate duty stage. Whilst IHT now encourages outright transfers of property, the potential of the discretionary trust both as a tax shelter for assets with high growth prospects and as a value-splitting device has not completely disappeared.

> Particularly since the reforms introduced by the Thatcher government, the discretionary trust, properly tailored, can be a splendid vehicle for the preservation of wealth in the family for a century or more with no, or comparatively insignificant, liability to [IHT]. No beneficiary will have any right of any value in the settled property and thus no [IHT] will be exigible on his death. If a donor makes a series of discretionary trusts each of small initial value at a time when he has only a very modest history of chargeable transfers of value still liable to be cumulated in calculating the tax on a present gift, the level of tax on the trusts themselves can be entirely manageable. (R Venables *Tax Planning Through Trusts* (1983) p 127)

This capacity of the trust to shelter assets from tax by combining fragmentation of ownership and control with exploitation of the plane of time can prove particularly valuable for family companies. Yet even here the chameleon character of the trust is evident; in the hypothetical example below, caretaker, dynastic and tax mitigation purposes are all present. Moreover, as will be seen, subsequent changes in the reliefs available serve only to enhance the attractiveness of the hypothetical strategy outlined in the 1990 edition of Sherring's text (see Hutton and Ferrier *UK Taxation of Trusts* (14th edn, 2004) para 15.18 for an updated example using 2004–05 IHT thresholds).

T Sherring *Taxation of UK Trusts* (1990) pp 116–117

FAMILY COMPANIES

15.10 The rules for the valuation of shares in family companies are of long standing. They date back to the invention of estate duty in 1894 and have remained virtually unchanged since. Therefore, it would seem reasonable to expect these rules to be the basis of fiscal valuation for some time to come. These rules favour small minority holdings, each owned by a different taxpayer as compared with influential holdings. This means that the 50% business property relief is abandoned but the 30% relief should be available (ie on holdings of 25% or less).

EXAMPLE

An entrepreneur aged 30 feels that he has financial responsibility not only for his wife and one-year old child, but also for his parents who live on social security and on gifts from him. He wishes to start a new company with £3,000. He has made no previous chargeable transfers and can give away £3,000 within his annual exemption. He makes six settlements each of £500 on discretionary trusts for his father, mother, wife, his present child and any further children born in the next 30 years. After his death, his widow can benefit. The trustees of the settlements subscribe the entire £3,000 share capital of his new company. He dies at the age of 60 when IHT rates, etc are the same as in 1989/90 [ie IHT threshold of £118,000]. The company could be worth, say, £2,500,000 on a take-over. One-sixth of its shares, put on the market as a single parcel would be worth, say, £165,000. Therefore the total settled shares are:

(a) worth £2,500,000, and
(b) valued at £990,000 (ie £165,000 × 6)

and each settlement can distribute its holdings, without tax as follows:

	£
Valuation of 500 shares	165,000
Less: 30% business property relief	49,500
	115,500
5 related settlements valued at commencement	2,500
Chargeable to inheritance tax	118,000
Inheritance tax is NIL.	

There will, in the meantime, have been three ten-year charges but there can have been no tax unless the valuations on those occasions exceeded £165,000 [ie before business property relief]. An equally satisfactory result could probably have been obtained by the use of accumulation and maintenance settlements had it not been for the desire to protect the older generation.

Although not relevant to the above example, the retention of hold-over relief for CGT purposes on gifts into discretionary trusts can further enhance their attraction as a medium for transferring property. Provided that the gift into a discretionary trust falls below the IHT threshold [£275,000 in 2005–06], it will avoid payment of both IHT and CGT, whereas a similar gift into, for instance, an interest in possession trust may be liable for CGT – no hold-over relief being available (see Inland Revenue Consultation Document *The Income Tax and CGT Treatment of UK Resident Trusts* (1991) paras 6.35–6.37). Thus parity of treatment is not achieved here either. The consequence of a combination of CGT hold-over relief and IHT reliefs for business and agricultural property is that, as Sherring put it (para 15.14), 'entrepreneurial families now have an infinite variety of plans open to them to prevent death causing a financial crisis'. This perceptive conclusion is confirmed by changes made in 1992 and 1996 which enhanced the generous fiscal treatment for family businesses. As from 10 March 1992, the business property reliefs of 50% and 30% referred to above were increased to 100% and 50%. Then in 1996 the relief for all minority shareholdings in unquoted companies was increased to 100% for transfers of value or other chargeable events occurring after 6 April 1996. The effect of these cumulative changes is to take most family businesses and farms outside the IHT tax net altogether. But there is no guarantee that this scale of relief will always be available. Here again the trust has a part to play: 'If it is feared that the new reliefs will be withdrawn by a future government, a gift of property on to flexible trusts under which the donor retains control as trustee should be considered' (Whitehouse et al *Revenue Law: Principles and Practice* (22nd edn, 2004) p 545).

The element of time is not without its dangers for tax planning: time is an asset resting on a potentially insecure foundation. Its value is dependent in part on the absence of retrospective tax charges. By retrospective charge is meant one that applies to events taking place before the date on which the tax change was announced. It is commonly asserted, however, that retrospective amendment of liability to tax is as reprehensible as retrospective criminalisation. If, for example, lifetime cumulation periods were to be re-introduced for IHT, the not unreasonable assumption of tax planners is that it would only apply prospectively. It is, though, a nice question whether the introduction of the income tax charge on 'pre-owned assets' to counter IHT avoidance – a 'retroactive' not a 'retrospective' change in the words of the Paymaster General – offends against the principle. Consider also the position where the Inland Revenue seeks to challenge in the courts an existing practice by taxpayers; the concept of retrospectivity becomes blurred. The development, for example, of the *Ramsay* doctrine by the House of Lords is self-confessedly the exercise of a law-reforming function (see Lord Roskill [1984] CLP 247; and generally Chapter 3). The de facto retrospective consequences for taxpayers who purchased 'off-the-peg' CGT avoidance schemes in the 1970s have been drastic. The Inland Revenue expected eventually to recover at least £400m from the general body of the purchasers of the schemes overturned in *Chinn v Collins* [1981] AC 533 and *W T Ramsay Ltd v IRC* [1981] 1 All ER 865 alone (34 HC Official Report (6th series) written answers cols 18–19, 13 December 1982; see also Millett (1982) 98 LQR 209 who refers to unofficial estimates that the decisions would yield the Exchequer 'in excess of £1,000m in tax from pending cases alone' and Tutt *The Tax Raiders: The Rossminster Affair* (1985) ch 9). Had Parliament legislated to counter such avoidance schemes, it is unlikely that the legislation would have had retrospective effect.

In Chapter 3 we suggested that the *Ramsay* principle may have only limited impact on conventional trusts practice. Indeed, whether the doctrine applies at all to IHT is uncertain. In *Fitzwilliam v IRC* [1993] 3 All ER 184, where an IHT avoidance scheme – a close relative of the unsuccessful scheme in *Furniss v Dawson* – was surprisingly upheld, Lord Browne-Wilkinson reserved his opinion on this point. He emphasised, instead, the availability of what at first glance appears to be a catch-all 'associated operations' rule (now IHTA 1984, s 268). 'Associated operations' are defined by s 268 to include – 'any two operations of which one is effected with reference to the other, or with a view to enabling the other to be effected or facilitating its being effected, and any further operation having a like relation to any of those two, and so on'. Lord Browne-Wilkinson commented obiter that this provision 'amounts to a statutory statement, *in much wider terms* [our emphasis], of the *Ramsay* principle which deals with transactions carried through by two or more operations which are interrelated' (at 221, and see *IRC v Macpherson* [1988] STC 362 where although upholding the Revenue's case the House of Lords set limits to the scope of the provision). The Inland Revenue may even have suspected a touch of irony in Lord Browne-Wilkinson's comments in *Fitzwilliam v IRC* since it had abandoned an argument based on s 268 at first instance in favour of a *Ramsey*-type proposition! There is thus some uncertainty about which, if either, of the anti-avoidance mechanisms might be applicable. Consider, for example, the IHT advantages of spouses making full use of their separate individual annual exemptions and nil rate of tax bands to transfer property: could the transfer of money from one spouse to another (an exempt transfer) knowing that it will subsequently be transferred into a waiting settlement be caught by the *Ramsay* principle or the statutory provision if the Inland Revenue decided to challenge the practice? To date it seems that the Inland Revenue has chosen to attack inter-spouse transfers only in blatant tax-avoidance cases (see eg Tiley *Revenue Law* (4th edn, 2000) pp 1170–1773). Most straightforward use of the trust in medium- to long-term tax-planning therefore seems unlikely to be affected by either of the anti-avoidance mechanisms referred to here.

This view is reinforced by the most recent decision on the meaning of the 'associated operations' provision which illustrates its limits and would appear to confirm the effectiveness of the type of arrangement described by Sherring (see above p 394). In *Rysaffe Trustees Co (CI) Ltd v IRC* [2003] STC 536 the settlor had made five identical or 'mirror' discretionary settlements on separate days, each comprising an initial sum of £10 and with the same beneficiaries and trustees (see Wood [2003] BTR 275–283). Private company shares were subsequently added to each trust. The Revenue argued that together they constituted one settlement on the basis that the several transfers were associated operations and so amounted to a single disposition for tax purposes. In rejecting the Revenue's argument on this point Park J, whose judgment was upheld by the Court of Appeal, commented that whilst the definition of associated operations is quite wide, 'the practical operation of the associated operations provision is comparatively limited. It is not some sort of catch-all anti-avoidance provision which can be invoked to nullify the effectiveness of any scheme or structure which can be said to have involved more than one operation and which was intended to avoid or reduce IHT'. It is not easy to reconcile this interpretation with the comments, admittedly brief and obiter, of Lord Browne-Wilkinson in *Fitzwilliam v IRC*.

(2) Parity: an unrealisable goal?

We have already questioned whether fiscal 'parity' between property owned absolutely and settled property has been achieved for 'A and M trusts' under IHT. A further question relevant to all trusts is whether complete 'parity' is ever attainable (see generally Inland Revenue Consultation Document *The Income Tax and CGT Treatment of UK Resident Trusts* (1991)). Trusts give birth to forms of property-holding with no parallel amongst simple outright transfers. There will often be an element of value judgment in determining which situation of outright transfer most closely resembles any given transfer on trust, so as to decide what basis to select for achieving 'parity'. The history of the IHT treatment of discretionary trusts is evidence of this. The pre-1982 regime was widely criticised as being excessively penal. Indeed it was claimed (Sherring *Capital Transfer Tax* (1982) p 4) that 'virtually no such settlements were made from 1974 to 1982'. Whether the present revised structure, even with its hypothetical 30-year charge, has established parity is equally questionable.

Even the long-established approach to taxing interests in possession can be criticised as providing a practical solution but not one that achieves parity. The criticism is that since the life-tenant was never the owner of the capital, nor did she control it during her lifetime, it is inequitable to tax the full value of the capital on the life-tenant's death. Instead, it is sometimes suggested that when an interest in possession changes hands, the value of the interest itself should be taxed rather than the value of the underlying capital. (See *CTT and Settled Property* (1980) para 3.2.2 for alternative suggestions of a somewhat similar nature.) However, as the Inland Revenue point out, there are valuation difficulties with this approach (above, para 3.2.3):

> First . . . the values of all the interests in a settlement do not add up to the value of the underlying capital. Second, the interests can be reduced to a minimal value by creating powers to override or terminate them. Third, a limited interest would in practice normally be taxable only when it ceased on its owner's death, at which time it would have no value. While it might be possible to overcome these difficulties, the resulting system would undoubtedly be far more complex than the present one.

In short, practical compromise is preferred to a probably unattainable parity.

6. Conclusion

In devising an appropriate tax regime for trusts our erstwhile legislator is exhorted to adhere to the principle of neutrality, usually interpreted as requiring parity of treatment between property owned absolutely and that held in trust. Furthermore, to satisfy the requirement fully, parity must be sustained across the complete range of taxes and over time – a monumental demand. In several instances in this chapter we have questioned whether parity has been achieved but a more pressing preliminary question must be asked. Is neutrality of treatment desirable? The reasons for adopting neutrality as the principal criterion are couched in terms of economic efficiency and horizontal equity. The economic justification is that individual taxpayers' decisions about how to hold or dispose of property should not be distorted by taxation. Whether neutrality then requires parity is a nice point. Where, for example, some non-fiscal benefit such as protection of a minor's property from their own or others' depredation is obtained by placing the property in trust, should a tax charge be proportionately higher than that on property owned absolutely by the minor which does not have the same protection? Alternatively, if such provision is considered socially desirable should not tax laws favour trust property as against property owned absolutely? In either case neutrality, in the sense of parity of treatment, would be infringed but by conscious choice rather than unconsidered accident.

A more fundamental attack on neutrality is implicit in the following comment by Sinfield on the value of time as a 'resource' ('Analysis in the Social Division of Welfare' (1978) 7 J Social Policy 129 at 150): 'to dismiss the effects of public policy as simply non-egalitarian, or at best neutral in effect and so irrelevant to the analysis of structural inequalities, is to miss the significance of the time dimension . . .'. The point of this criticism in relation to tax treatment of trusts is that neutrality assumes that a comparison can be drawn between property owned absolutely and that held in trust. The difficulty of achieving neutrality, given, for instance, the flexibility of beneficial entitlement provided by discretionary trusts, is extensively recognised but the criticism runs wider than this. To expand the point made in the previous section, the criticism is that, in practice, the trust provides a mode of disposition of property *over time* which has no comparable basis in absolute ownership. For example under CTT the combined use of the nil rate band, the ten-year cumulation period and the annual exemption was equally available for property placed into trust or distributed absolutely. But it was the availability of the trust as a wealth-holding medium which enhanced the attractiveness of those provisions and facilitated the gaining of maximum advantage from them. How useful for the donor would these have been in the absence of the trust? Venables' pithy comment precisely summarises the advantage: 'the trust is the ideal mechanism for giving away property when one has no one in particular to whom to give it' (*Tax Planning Through Trusts* (1983) p 126).

Neutrality, however, is not the sole guide for the legislator. Simplicity and intelligibility are also to be commended. One naive MP once requested of Mr Gladstone that 'tax laws ought to be made intelligible to all persons who had not received a legal education'. Perhaps today we should be satisfied if such laws were intelligible to all who have received a legal education. But intelligibility and simplicity although closely related must not be confused. Intelligibility is primarily a matter of craftsmanship and is always to be hoped for, whereas simplicity of tax structure is likely to prove much more elusive.

The present system of taxing trusts is complicated by the absence of consistent treatment of individual trust-types across different taxes. The Meade Committee (*The Structure and Reform of Direct Taxation* (1978)), applying the categorisations of 'transparency' and 'personification' in respect of IT, CGT and CTT, summarised the position in the following way (p 405):

> *Interest in possession trusts* are transparent for all taxes except CGT, when they are only partly transparent;
>
> *Discretionary trusts* are personified for all three taxes, although the rate of [CTT/IHT] for post-CTT trusts takes the settlor's record of chargeable transfers into account.
>
> *Accumulation and maintenance trusts* are transparent for [IHT] but not recognised – and so treated in the same way as discretionary trusts – for either IT or CGT purposes.

In the opinion of the Committee there would be a considerable benefit if a more simplified system were introduced adapting the same categorisation for all taxes. For example, it suggested that for discretionary trusts the settlor's circumstances could be taken into account for income tax purposes (as now applies for IHT) so that any undistributed income could be charged as if it were the highest part of the settlor's income. Different proposals, but with comparable objectives, at least for IT and CGT, have been advanced by the Inland Revenue (Consultative Document *The Income Tax and CGT Treatment of UK Resident Trusts* (1991) especially ch 4, criticised by Venables (1992) 13 Fiscal Studies 1 at 106). Inconsistency does not exist in regard just to categorisation. It is also present at the level of definition, as noted previously with regard, for example, to the definitions of 'settlement' and 'settled property'. Here again criticism is rife and pleas for a more simple and coherent approach abound (see eg Thomas *Taxation and Trusts* (1981); Walker [1980] BTR 277; and with a broader focus Sabine [1991] BTR 177 and Special Committee of Tax Law Consultative Bodies *Tax Law after Furniss v Dawson* (1988) parts IV and V). The most recent proposals presented for consultation are intended to address at least some of the more tractable of these issues. Thus it is proposed that there should be common definitions of 'trust' and 'settlor-interested trust' for IT and CGT, with the former being based on the existing IHT definition of a 'settlement' (Inland Revenue *Modernising the Tax System for Trusts* (August 2004) paras 7.2–7.4).

But simplicity may only be purchased at a price. Doubtless as Thomas suggests (p 199) 'a simple, straightforward, and consistent approach to the taxation of settlements may well be possible in theory' but the attainment of other objectives 'may lead inevitably to complexity and constant change'. The objective most likely to frustrate a search for simplicity is the wish to counter the tax avoidance potential of the trust (see eg *Inland Revenue* (1991) para 4.8; and *Inland Revenue* (August 2004) para 7.31). When to this is added the attaining of neutrality, complexity seems an inescapable consequence. In part this is because legislators have been constrained by, inter alia, three related factors: (1) the perceived predominance of a literalist approach to interpretation of taxing statutes; (2) the flexibility of modes of property dispositions made available by property concepts and so ably exploited by the ingenuity of tax avoiders and their advisers; and (3) the additional level of complexity created by the mobility of capital and the availability of fiscally sympathetic offshore jurisdictions. A fourth factor, that of 'support for the competitiveness of the UK economy', ought perhaps to be added to the list. It is specifically identified in the 2004 Consultation Document (p 5) as being a criterion by which any new measure should be evaluated although without further elaboration, of which there is none, its meaning in this context is obscure. Broadly, the legislative response has been to anticipate possible developments while subsequently blocking loopholes on an ad hoc basis when exposed. The public law of taxation has conventionally been adapted to the private ordering of property law (see eg the interpretation of the arrangements in *Ingram v IRC* [1999] 1 All ER 297). The task of anticipating developments is likely to be made easier by the introduction in the Finance Act 2004 of the obligation on those who devise and market tax avoidance schemes to give advance notification to the Inland Revenue (see Chapter 3 at p 109). Whether this will eventually facilitate the introduction of less detailed legislation is uncertain.

Recent developments suggest that any view that complexity is inevitable may yet need reappraisal. The judicial development of the *Ramsay* principle implicitly questions the need for complex anti-avoidance legislation. In 1984, the then Chief Secretary to the Treasury, Peter Rees QC, MP – a case of poacher turned gamekeeper given his role in the 1970s tax avoidance schemes (see eg Tutt *The Tax Raiders* (1985); Gillard *In the Name of Charity* (1987)) – appeared to accept that some simplification of tax legislation might be possible (58 HC Official Report (6th series) col 254, 10 April 1984):

> Taken with the decision in *Ramsay*'s case, it is now clear that the widespread assumption based on the *Duke of Westminster*'s case in the 1930s – that the courts will always look at the form rather than the substance of a transaction or various transactions – is no longer valid . . . The principle in *Furniss v Dawson* should lead, in future, to greater simplicity in our tax system . . . and will, I hope, enable us in time to prune out provisions which owe their existence to the complexities of a high rate – some might say a confiscatory rate – tax system with a multiplicity of special reliefs.

In practice, simplicity may be difficult either to attain or sustain if it is understood to depend upon more open-ended legislation such as a 'general anti-avoidance rule' (GAAR) and the exercise of judicial discretion to distinguish economic substance from legal form. Such a development is likely to encounter vehement opposition (see eg McBarnett and Whelan 'The Elusive Spirit of the Law: Formalism, and the Struggle for Legal Control' (1991) 54 MLR 848). Moreover opinions differ about the effectiveness of a GAAR (see eg Freedman [2004] BTR 332–357 and Simpson [2004] BTR 358–374; and generally Cooper (ed) *Tax Avoidance and the Rule of Law* (1997); Shipwright (ed) *Tax Avoidance and the Law* (1997). In any event, this issue is in our view only tangential to tax treatment of trusts and of secondary importance compared with the potential threat to trusts practice that an extension of the strategy apparently adopted for trusts under IHT might pose.

Thomas, in a critical comment on the House of Lords majority judgment in *Pearson v IRC,* suggests (p 193) that 'in truth the 1975 [Finance] Act attempted to force all settlements into (basically) two distinct categories, whereas the trust lawyer's world is more complicated than this. Hybrid trusts which partake of the nature of both types abound . . . *Pearson* provided the House of Lords with the opportunity . . . to bring home to the craftsman of the 1975 Act that every possible contingency had not been foreseen and catered for'.

Whether as a result of lack of foresight or by conscious design, can FA 1975 be seen in retrospect as signalling the emergence of a new approach to the taxation of trusts? Under this approach those trusts that are to be encouraged or are more susceptible to equal treatment with property owned absolutely would be isolated within narrowly defined statutory guidelines – as with 'A and M trusts' in IHTA 1984, s 71, and, with effect from April 2005, trusts for the 'most vulnerable' (*Inland Revenue* (August 2004) ch 1). For those settlements not conforming to those guidelines any pretence at neutrality would be discarded and a penal regime imposed, effectively discouraging their use. This could ultimately encourage simplicity of tax structure – although the pre-1982 CTT provision for discretionary trusts stands as a monument to complexity – but at the cost of a considerable impact on trusts practice and the sacrifice of 'neutrality'. No longer would every possible contingency be catered for: trusts practice and ultimately the trust form would be subordinated to the demands of fiscal legislation. It must be emphasised that there is no suggestion of such an approach in the 'modernisation' proposals brought forward in 2004 by the Inland Revenue.

If such a solution to the legislative problem posed by the trust were to be adopted it would have profound implications which range far beyond the merely technical level of identifying and implementing an effective method of taxing trusts. It would impinge directly on the conflict that lies at the heart of the tax-trusts conundrum, that between a redistributive function of tax law and the wealth preservation and concealment functions of the private family trust. There are deep ideological waters here. The trust can be portrayed as the embodiment of private property rights, incorporating, in particular, the notion of 'property as security – as a form of protection' (Cotterrell (1987) 14 J Law and Society 77 at 87). Indeed the history of the private trust could be interpreted as a struggle to achieve security for property in an otherwise insecure material world – one thinks here, for instance, of the use, the marriage settlement, the power of advancement. At a fundamental level therefore the proposed solution for taxing trusts could be seen to entail a substantial restriction in the exercise of private rights in property, by de facto limiting the range of dispositions that could be accomplished by using the trust. But this does not dispose of the question. What has to be considered is whether the solution strikes an appropriate balance between the competing claims of public law, in the sense of advancing goals of the state, and private law, in the role of preserving an area of autonomy for ordering private affairs. It is a nice question whether the introduction of the statutory disclosure obligation on promoters of tax avoidance schemes, potentially diminishing to some degree the wealth concealment function of the trust, should also be seen as interfering with the claims of personal autonomy.

Simmonds summarised the dilemma in his challenging discussion of the implications for doctrinal legal science of the tension between private and public law domains (*The Decline of Judicial Reason* (1984) p 127):

> If not taken away altogether, the owner's rights to use his property are increasingly restricted by public law. Some restriction is inevitable and proper within any society. But it is one thing to restrict the exercise of private rights in order to protect the rights of others, and another to restrict private rights so as to advance public goals, government plans, development programmes, and so forth. At the present day, private rights are treated as objects of administration, rather than as a frame within which public law must operate.

From one perspective, therefore, the institution of the private family trust is an instrument for frustrating any policy of wealth redistribution and a mere technical device suitable for restriction. A very different view, almost a celebratory paeon, is trenchantly stated by Venables (p 126):

> [The trust's] flexibility is such that it can be adapted to meet the multifarious needs of a free society. It is ideal for a state in which it is conceived that the law is made for man and not man for the law. It must be the envy of poorer, continental systems of jurisprudence created by and for more authoritarian regimes than are tolerated in England.

Making due allowance for hyperbole in this statement, it is nevertheless at the more fundamental level of conflicting political theories that solutions to the trust-tax problem need ultimately to be tested.

Paradoxically, if private property rights associated with the trust are to be treated as objects of administration and subordinated to public policy goals, the influence that most stimulated twentieth-century developments in the private family trust – taxation – would also be responsible for its restriction and decline.

Consider the following points:

(1) 'The objective of achieving fiscal neutrality between settled property and property owned absolutely is as undesirable as it is unattainable.' Discuss.

(2) Is the 'A and M trust' *unduly* favoured by tax law? Would you describe the 'A and M trust' as a 'caretaker trust', a 'dynastic trust', a 'tax avoidance device' or none of these?

(3) '*Inglewood v IRC* [1983] 1 WLR 366 exposes the difficulty of drafting a statute to counter the flexibility of disposition provided by the trust form. The Court of Appeal upheld the legislative intent but only through bypassing trust concepts rather than interpreting the statute to fit them.' Discuss. Do you agree with Fox LJ that, as regards the power of advancement, 'its purpose, like an administrative power, is to aid the beneficial trusts and not to destroy them'? (Cf *Pilkington v IRC* [1964] AC 612; see Chapter 7 at p 341.)

(4) 'The discretionary trust has no function to perform, other than tax avoidance, which cannot adequately be achieved by "interest in possession" or "A and M trusts".' Do you agree?

(5) Do the IT, CGT and IHT provisions for 'A and M trusts' and discretionary trusts support or undermine the propositions concerning the ideological significance of the trust, as considered in Chapter 2 (p 57)?

9

An introduction to trustees and trusteeship

1. Introduction

One of the first decisions to be taken by a settlor or testator creating a trust concerns the selection of the trustees. Who should be appointed: the settlor himself or herself, a family friend, a professional person – probably an accountant or solicitor – or a corporate trustee such as a trust department or trust subsidiary of a bank, or indeed some combination of these? The decision is of the greatest importance. Not only may the trustees be empowered to decide beneficial entitlement but also they will be responsible for trust administration including preserving the value of the trust fund through effective investment. Decisions about whom to appoint assume the existence of people or organisations willing to serve as trustees. After all, people cannot be forced to become trustees of express trusts, and if appointed may immediately disclaim or subsequently retire (see Chapter 11). It may therefore be important that the law, in seeking to oversee the exercise of trusteeship, does not unduly discourage potential trustees.

This chapter and the next two are concerned predominantly with the benefits and burdens of trusteeship. First, this chapter focuses on the nature of trusteeship with particular reference to a possible source of tension created between, on the one hand, a concept of trusteeship rooted in moral obligation and, on the other, one which perceives trusteeship as a managerial function to be financially rewarded. In this context we concentrate in particular on the principle that trustees should not adopt a position where their personal interests, most notably in securing some financial reward for themselves, may conflict with their duties to the beneficiaries. Then in Chapter 10 some of the significant powers and duties respectively conferred and imposed upon trustees in the management of trust property are considered. Finally, in Chapter 11 the emphasis shifts to the issue of control: can the settlor, the court or beneficiaries effectively regulate the exercise by trustees of these powers and duties? What remedies are available to beneficiaries when things go wrong? Also in Chapter 11 we discuss the statutory and common law provisions relating to appointment and removal of trustees. Discussion of this topic, variously described as technical and dull, is deferred until then because the authority to appoint and/or remove trustees can provide a key mechanism in seeking to control the trust and hold trustees accountable. Before commencing the study of selected aspects of trust administration and control a preliminary step is to consider whether there exists an accepted model of trusteeship which guides the development of the relevant legal rules.

2. Trusteeship: Moral obligation and a profit motive

(a) A model of trusteeship

The function or office of trustee is conventionally described as being an onerous one: 'there is much to be said about the duties and obligations of a trustee, little of his rights' (Law Reform Committee (LRC) 23rd Report *Powers and Duties of Trustees* (Cmnd 8733, 1982) para 1.2). A starting place for understanding why trusteeship should be described in this manner is the fact that trusteeship is a fiduciary relationship, arguably the fiduciary relationship par excellence. In *Bristol and West Building Society v Mothew* [1998] 1 Ch 1 Millett LJ, basing himself on the seminal work of Paul Finn (*Fiduciary Obligations* (1977)), offered the following description of the obligations attaching to a fiduciary relationship (at 18):

> A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. The core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations.

But the allegedly onerous nature of trusteeship is not attributable solely to the fiduciary content of the obligation. To this we must add duties associated with competent and personal administration of the trust. In principle the fundamental obligation of the trustee as holder of property belonging beneficially to others is to administer it without financial reward solely for their benefit in accordance with the terms of the trust. Moreover it is axiomatic that a trustee should not deviate from the terms of the trust unless authorised. Donovan Waters has suggested (*Law of Trusts in Canada* (2nd edn, 1984) p 690) that this basic obligation of administering property for others has resulted in the courts imposing three 'substratum' duties on all trustees:

> First, no trustee may delegate his office to others; secondly [the fiduciary element], no trustee may profit personally from his dealings with the trust property, with the beneficiaries, or as a trustee; thirdly, a trustee must act honestly and with that level of skill and prudence which would be expected of the reasonable man of business administering his own affairs.

This description, barely twenty years old, already stands in need of some reconsideration in light of recent statutory changes but it is still a valid indicator of the type of conduct and level of competence to which in principle trustees are expected to aspire. With the exception of the standard of skill and prudence these strict duties with their unforgiving standards – Lord Chancellor Cottenham once deemed any man who would accept a trusteeship a second time fit only for a lunatic asylum (Law Times, 17 June 1854, p 125) – were firmly settled by the Court of Chancery by the close of the eighteenth century.

The standard of skill and prudence is more an outcome of the full rise to prominence within trusts of the notion of a trust fund of investments. This change in the type of trust property prompted an extension of the trustees' functions. (See Chapter 2 and generally Chesterman 'Family Settlements on Trust: Landowners and the Rising Bourgeoisie' in Rubin and Sugarman (eds) *Law, Economy and Society* (1984).) In the nineteenth century well-advised settlors and testators began to confer ever-wider administrative powers on trustees. In particular, as a trust of investments did not presuppose the retention of particular assets, the trustees needed powers to sell assets where appropriate and reinvest the proceeds, and this active managerial role called for legal controls. Guidelines had to be developed for determining, inter alia, the types of investment that could legitimately be retained by trustees, or that could legitimately be bought by the trustees with the proceeds of any property sold by them or with any other cash coming into the trust funds. It was also necessary to determine which aspects (if any) of the process of sale or reinvestment trustees could properly delegate to expert agents such as valuers, estate agents, solicitors and brokers, and what overall standards of skill and care should be required of the trustees in their handling of investments. In the last quarter of the nineteenth century the courts in a series of cases (in particular *Speight v Gaunt* (1883) 9 App Cas 1, *Learoyd v Whiteley* (1887) 12 App Cas 727, and *Rae v Meek* (1889) 14 App Cas 558) adopted standards which tested the competence of trustees' administration of a trust against the standard of that familiar legal creation, the reasonable man, or, as he came to be called in this context, the ordinary prudent man of business.

The image of trusteeship that emerges from this initial description of its basic duties is one of disinterested devotion to the gratuitous administration of a friend's or relative's property – and a burden undertaken usually out of a sense of obligation. But this is a one-dimensional picture only. To an increasing extent professional persons, such as solicitors or accountants, or trust corporations are appointed as trustees and will act only where express provision is made for their remuneration. This practical reality is now reflected in the Trustee Act 2000 whereby trust corporations and trustees 'who are acting in a professional capacity' are entitled to receive 'reasonable remuneration' for services provided to the trust (see section 4 below). Moreover they are likely to seek to limit or exclude any liability for negligent administration or investment. Seen from this perspective trusteeship is more akin to a contractual market-based relation: in Mitchell Franklin's phrase (see Chapter 1, p 1) trustees appear as 'professional managers of capital' administering another's property in exchange for a fee. Thus there are various reasons that can explain the willingness of people to become trustees. Many act on grounds of friendship or loyalty whilst others do so for reward. The consequence is that 'human goodwill and the profit motive between them can be relied upon to produce a supply of people prima facie willing to become trustees' (Gardner *An Introduction to the Law of Trusts* (2nd edn, 2003) p 228).

(b) The influence of the traditional model

It is a commonplace to observe that there can exist a divergence between form, here the image of trusteeship, and reality. Whilst it is relevant to inquire as to the extent of the divergence – whether, for instance, substratum duties can be modified or excluded by settlors either voluntarily or at the insistence of trustees – it is equally germane to explore the continuing importance of that image of trusteeship. Does it, for instance, inhibit judicial or statutory responses to new problems revealed by contemporary trusts practice? Or, on the contrary, is the elegant structure of rules that has been erected on the foundations of the substratum duties, being eroded by those responses?

Speculative allusions to a clear distinction between 'trusteeship as onerous obligation' and 'trusteeship as market-oriented enterprise' must not, however, be taken to imply that all trust rules or indeed trusteeship in practice must fall neatly into one or other category. As Friedman has argued ((1964) 73 Yale LJ 547 at 592):

> Private non-charitable trusts . . . differ greatly in size, type, and function, and they run all the way from great dynastic estates to pitiful sums set aside for orphans. It is no more likely that there is one optimal policy for 'trusts' than that there is one such policy for 'corporations'.

The virtues and vices of the two images of trusteeship must therefore be measured against different trust types and the perceived needs of present and future trust users. One of our objectives here, as in earlier chapters, is to assess how trusts law has adapted to the changes we have outlined.

(c) The decline of gratuitous trusteeship

G W Keeton 'The Selection of Trustees' in *Modern Developments in the Law of Trusts* (1971) pp 13–14

> The typical trustee of the eighteenth century, it has been suggested, was the country landowner, who managed his estate thriftily, stood high in the estimation of the county, and almost certainly took his place on the Bench at Quarter Sessions. If we think of Addison's Sir Roger de Coverley we shall not be far wrong. By the second half of the nineteenth century he has changed greatly. He has become a professional man, or a member of some well-established firm. He may sit upon one or two boards of directors, but if he does it will only be after a careful scrutiny of the company's business, and it will be with the intention of exercising the same vigilance in supervising the conduct of the company's affairs as he exercises in his own. Though he may be generous in his private affairs, he will be careful even to the point of parsimony in the expenditure of

public money, and he will possess to a marked degree that nice and unheated judgment which, in the nineteenth century, was such a striking characteristic of the English upper middle class business man, with a public school background. In fact, if one wishes to see a full-length portrait of the ideal trustee of this period it is to be found in the pages of *The Forsyte Saga,* in Galsworthy's Man of Property, Soames Forsyte.

Keeton's portrait of an 'ideal-type' trustee can be seen as the mirror image of the model of disinterested trusteeship outlined previously. Yet by the end of the very period Keeton is describing, a number of factors – economic and social change, problems of trustee competence and availability, evidence of human frailty – were beginning to undermine both the model of trusteeship and type of trustee. As regards frailty, loss of trust funds through fraud, even if not prevalent, had become a matter for concern. A Select Committee on Trusts Administration, appointed at the behest of Sir Howard Vincent, a prominent campaigner for the creation of a Public Trustee, reported in 1895 that 'the evidence puts it beyond question that large sums of money are annually misappropriated by private trustees . . . and those who suffer are chiefly the poorer and more helpless' ((1895) 99 LT 67; see Edmunds and Lowry in Birks and Pretto (eds) *Breach of Trust* (2002) ch 9). Contemporaneously with the demand for security of funds, a potential market for the services of trustees was expanding because of more widespread wealth-holding and use of wills (see Marsh *Corporate Trustees* (1952) pp 67–69). This was occurring, however, at the very time that the imposition of rigorous legal standards on trustees was seemingly discouraging private individuals from taking on the 'burden' of trusteeship. When to these developments is added the consideration that effective management of trust funds increasingly demanded specialist knowledge, the scope for the extension of professional and corporate trusteeship is apparent. Eventually a 20-year campaign, strenuously opposed initially by the solicitor side of the profession, culminated in the creation of the office of Public Trustee in 1906 (see Offer *Property and Politics* (1981) pp 54–55; and Polden (1989) J Legal History 228 at 231–234).

The subsequent general growth of corporate trusteeship is briefly summarised in the Report of the Committee of Enquiry into the Public Trustee Office (see also *Marsh* and the report of an earlier inquiry, Cmd 9755 (1956)).

Cmnd 4913, 1972 paras 5–6

5. 'The Office [of Public Trustee] was set up under the Public Trustee Act 1906, the Attorney General having given as its main raison d'être the difficulty of inducing private persons to accept the onerous responsibilities of a trustee, and the losses incurred by beneficiaries as a result of incompetence or dishonesty on the part of private trustees.

6. . . . in the early years of the Office the Public Trustee had very little competition. Although there existed before 1906 a number of companies whose memoranda and articles of association permitted them to undertake trust administration, they did so only to a negligible extent. After 1906 banks and insurance companies began to take on trust work but the Public Trustee suffered little at first from their competition. . . . From

> 1920 onwards, the competition of other corporate trustees . . . had an ever-increasing effect on the business of the Public Trustee. The Committee gave statistics showing that by 1949 the Public Trustee had 20,226 cases under administration; by 1955 this figure had fallen to 17,732. They concluded that the trustee facilities then offered by the banks and insurance companies, and the protection afforded by the Law Society against defalcations by solicitors, made up a very different picture from that which presented itself in 1906; had similar conditions existed at that time, there would have been little occasion for the creation of the Office of Public Trustee.

(d) Present demography of trusteeship

The enjoinder of one writer to 'take into account trusts as they are' and to 'count them and classify them, and study their nature' (Friedman (1964) 73 Yale LJ 547 at 592) is impossible to satisfy given present availability of information. This is particularly so where identity and type of trustee are at issue. The most that can be achieved here is to assemble the few available pieces of the jigsaw.

In 1980 the Association of Corporate Trustees (ACT) produced figures establishing that their members administered 103,048 trust funds with a total value of £4,955 million. (See Thomas *Taxation and Trusts* (1981) p 1; and the survey of three clearing banks conducted by Revell and Lovering *Exempt Settled Property* RCDIW Research Paper no 3 (1979) which broadly confirms this estimate.) These figures reflected the expansion of corporate trusteeship in the 1960s and 1970s into 'what one might loosely term the "mass market" of rather smaller trusts which used to be managed by [amateur] trustees before life became so complicated' *(Revell and Lovering* p 8). A more recent informal estimate derived from a questionnaire-based survey of some ACT members suggests that there has been a decline in the numbers of trusts administered by members to 36,190 trusts with an asset value of £4,015m (Frost 'Private Trusts – A survey of the market' (1997) 3 TACT). Clearly the estimates depend on the representative nature of the responses and Frost emphasises that the data needs to be treated with some caution. Nevertheless the figures do give a general indication of the involvement of corporate trustees. To these figures we can add the gradually declining number of trusts administered by the Public Trustee Office. In 2003–2004 this stood at 1,386 with an estimated asset value of £271 million, representing almost a halving of the numbers since 1984 (*Annual Report of the Official Solicitor and Public Trustee Office 2003–2004*). This estimate of trusts administered by corporate trustees and the Public Trust Office probably accounts for only 15–20% of all trusts, even allowing for post-1974 reduction in numbers of discretionary trusts. (See Chapter 3 and Inland Revenue *The Income Tax and Capital Gains Tax Treatment of UK Resident Trusts* (1991) para 2.6.) Of the remaining trusts it is at least probable that a substantial proportion have professional trustees appointed. Indeed the clearing banks surveyed by Revell and Lovering all agreed that very large trusts, discretionary trusts and trusts containing mainly agricultural estates or unlisted shares were more likely than other types of trusts to be administered by non-corporate professional trustees. The reason is thought to be that such trustees will be less inhibited in taking risks, perhaps even involving a breach of trust, in the interests of beneficiaries.

Broadly speaking, therefore, trusteeship in practice is still divided among the following three different types of trustee although there is a perceptible trend towards professionalisation:

(1) unprofessional unpaid trustees of the 'family friend' type;
(2) paid, often professionally qualified, trustees such as solicitors or accountants; and
(3) corporate trustees such as specialist trust companies (eg the long-established Law Debenture Corporation) and trustee departments of banks or insurance companies who advertise themselves as such.

The types of trustee are not mutually exclusive: it is not uncommon for a combination of professional and non-professional trustees to be appointed so that the trust may benefit from professional expertise whilst retaining a family or friendship link.

(e) Trustee Act 2000: a summary

As mentioned above, and as will be discussed in more detail in section 6(2) below, the law on remuneration of trustees was significantly modified by the Trustee Act 2000. But the scope of the Act runs much wider than that. The evolving social and economic role which trusts now fulfil allied to the changing nature of trusteeship all contributed to a growing awareness of the need to reform the law of trusts and the Act is the culmination of a long history of proposals in that direction. Several of the reforms in the Act were first considered in 1982 in the Twenty-third Report of the Law Reform Committee (LRC) *The Powers and Duties of Trustees*. No action was taken on their recommendations. Then in November 1995 the Law Commission embarked on a review of the powers and duties of trustees which led in June 1997 to the publication of a Consultation Paper *Trustees' Powers and Duties* (LCCP No 146). In the interim in May 1996 the Treasury published its own Consultation Document on the investment powers of trustees but attempts to modify the law on trustee investment by means of an order under the Deregulation and Contracting Out Act 1994 were frustrated when Parliament was dissolved in 1997. Subsequently in July 1999 the Law Commission and the Scottish Law Commission jointly published their report on *Trustees' Powers and Duties* (1999) Law Com No 260, Scot Law Com No 172. The outcome was the Trustee Act 2000, which came into force on 1 February 2001 and implements, with minor modification, the changes in relation to the law of England and Wales recommended in the Law Commission Report (see for overviews of the Act, Garton (2001) 15(1) TLI 34; and Panesar (2001) 12(5) ICCLR 151). The principal change is the creation of a new and wider statutory power of investment to replace the limited power under the Trustee Investments Act 1961. In addition to these measures relating to trust investment powers (ss 3–7) and those dealing with trustee remuneration (ss 28–33) the Act contains a range of 'new' powers largely replacing more limited ones in the Trustee Act 1925 for trustees to appoint nominees and custodians, to delegate certain of their functions and to insure trust property (ss 11–27). The new powers are intended to facilitate the better administration of trusts and are complemented by a new safeguard for beneficiaries in the form of a statutory duty of care (ss 1–2) which will apply to trustees in the exercise of their new wider powers under the Act. With the exception of trustee remuneration, which is discussed in this chapter, the principal new statutory powers are considered in detail in Chapter 10 in the context of our study of the management of the trust.

It only remains here to emphasise that in one key respect the law of trusts remains largely unaltered. It is still open to settlors and their advisers to write their own law in the trust instrument. In short statute law still remains primarily default law.

3. Trusteeship and trustees: an introduction

(a) Trustees: capacity and numbers

In principle any person able to hold property, including a limited company or other corporation, may be a trustee. Even an infant may become a trustee, for example under a resulting trust (eg *Re Vinogradoff* [1935] WN 68), but not by express appointment. The Law of Property Act (LPA) 1925, s 20 declares such an appointment void.

Similar latitude is exhibited with respect to the number of trustees. At present the general rule is that the number may be unlimited, one being sufficient and any greater number permissible. The sole exception is in most trusts of land where the Trustee Act (TA) 1925, s 34 (as amended by the Trusts of Land and Appointment of Trustees Act 1996) imposes a maximum of four (see s 34(3)(a) for the limited exceptions). The LRC in its 1982 Report recommended (para 2.2) that 'where the settlor makes no specific provision about numbers, the number of trustees should be limited to four regardless of the nature of the trust property, on the ground that when the number of trustees exceeds four, costs, administrative inconvenience and delays are increased'.

As regards the minimum number, whereas a single trustee is possible it is also undesirable (unless a corporate trustee) because maladministration or misappropriation of funds is made easier. Also, although there need be only one trustee to hold land, at least two trustees are needed to sell land (again unless the sole trustee is a corporate trustee) since this number is necessary to give a valid receipt for capital money (TA 1925, s 14(2)).

(b) Special types of trustee

(1) Public Trustee

The office of Public Trustee, 'the father-figure of the modern corporate trustee' (Sladen *Practical Trust Administration* (3rd edn, 1993) p 317), has experienced a chequered existence since its foundation in 1906. The need for the provision of a public body which could be considered by testators as a safe appointment as executor in a will or codicil, or as trustee of a trust, has over time been eroded by the availability of alternative suitably qualified professional help in the private sector. Its abolition was recommended by a Committee of Enquiry (Cmnd 4913) in 1972, and although subsequently reprieved the existence of the office as an independent administrative entity ended in 1986 with the passage of the Public Trustee and Administration of Funds Act 1986 (see Polden (1989) 10 *Journal of Legal History* 228). The 1986 statute amalgamated the activities of the Public Trustee with, inter alia, those of the Court Funds Office and located them within the Lord Chancellor's Department, where, after July 1994, it operated with the status of an executive agency. In fact the principal areas of activity then undertaken by the Public Trust Office, as it was renamed, were those concerned with the property and affairs of mental patients. Indeed, it was largely in that connection that the overall financial performance of the Public Trust Office became the subject of two quite critical reports by the National Audit Office (*Looking After the Financial Affairs of People with Mental Incapacity* HC (Session 1993–94) 258; *Protecting the Financial Welfare of People with Mental Incapacity* HC (Session 1998–99) 206). Subsequently a quinquennial review of the Public Trust Office was carried out in 1999 and led to substantial changes. A key change in jurisdiction was that the Mental Health functions were transferred to a new organisation, the Public Guardianship Office (PGO) sited within the Court of Protection. Organisationally the offices of Public Trustees and Official Solicitor to the Supreme Court were in effect merged as from April 2001 and one person now formally holds both offices. In practical terms the trust division of the Public Trust Office was merged with those parts of the office of the Official Solicitor which remained after the formation of the Children and Family Court Advisory and Support Service. It must be emphasised that even though one person may be appointed to hold both offices, the Official Solicitor and the Public Trustee continue to have separate corporate functions (see www.offsol.demon.co.uk/ospttrust.htm for a full account of the current allocation of responsibilities between the two offices).

As regards the legal framework the Public Trustee is a corporation sole; he can act alone or jointly with others and may be appointed as an ordinary trustee, a custodian trustee or as a judicial trustee (see below, p 414). He may not act as the trustee of a religious or charitable trust (Public Trustee Act 1906, s 2(5)) and may only carry on a business owned by the trust for a time not exceeding 18 months for the purpose of winding it up (s 2(4) and Public Trustee Rules 1912, r 7)). Consistent with the concern for security which was a factor in establishing the office, any liability for breach of trust is covered by the state (s 7). The principal specialised function now is to act as a trustee of 'last resort', meaning broadly where there is no one else suitable, able or willing to act and an injustice would result if the Public Trustee did not accept the post. Whilst the Public Trustee may decline to accept business he may not, unlike any other corporate trustee, do so solely on the grounds 'of the small value of the trust property' (s 2(3)). Given this restrictive approach towards soliciting or accepting business it is not surprising, as noted in section 2(d) above, that the number of trusts administered by the Public Trustee is declining.

(2) Trust corporation

(See generally Keeton *Modern Developments in the Law of Trusts* (1971) pp 18–26, and the early study by Marsh *Corporate Trustees* (1952), still an unrivalled source on the development of corporate trusteeship.) The trust department of a bank or insurance company usually springs to mind when thinking of a trust corporation but the term has a wider meaning, extending to include any corporation appointed by the court or 'entitled by rules made under [s 4(3)] of the Public Trustee Act 1906 to act as a custodian trustee' (TA 1925, s 68(18)). Where a bank or insurance company wishes to act as trustee it must therefore fulfil certain now not very onerous conditions set out in the Public Trustee (Custodian Trustee) Rules 1975, SI 1975/1189). The key requirements are:

1. The company must be incorporated either in the UK or some other member state of the EU.
2. The company is authorised by its constitution to undertake the business of acting as a trustee, and of acting as a personal representative in England and Wales.
3. It must have an issued capital of not less than £250,000 (or its equivalent in the currency of the state of incorporation), of which not less than £100,000 must have been paid up in cash.
4. The company must have at least one place of business in the UK, no matter where it is incorporated.

The basic financial requirements in the third condition above, which were intended to provide a measure of protection to beneficiaries, are now totally inadequate to do so. The value of assets in any one trust may exceed by many times the amount of the minimum required paid up capital. Moreover, as pointed out in *Parker & Mellows* (p 546) the test is as to the amount of the issued share capital of the company, and not as to its asset value. Thus, if a company had issued shares to the extent of £250,000, it would still be eligible to be a trust corporation even if it had by improvidence lost all its shareholders' funds. In fact, and notwithstanding the type of criticism made in *Parker and Mellows*, it is debatable whether onerous capital adequacy requirements are necessary for firms, including corporate trustees, involved in investment business. An alternative view is that a combination of insurance and strict separation of clients' accounts should provide adequate protection. (See Franks and Mayer *Risk Regulation and Investor Protection* (1989) for survey data and a summary of the debate.) In addition to the above requirements, if, as is likely, a corporate trustee also wishes to carry on in the UK the business of investing trust funds, it must be authorised to do so under the provisions of the Financial Services and Markets Act 2000 and comply with the regulations implementing the single European market in investment services (see Sabalot and Everett *The Financial Services and Markets Act 2000* (2004) ch 4).

Lastly, as regards fee-charging, a trust corporation will usually not agree to act unless it is able to charge fees, usually on a fixed ad valorem scale, for its services. Where a trust instrument contains no express charging clause authorising such remuneration a trust corporation can now, under the terms of the Trustee Act 2000, s 29 (see p 425 below), charge 'reasonable remuneration' out of the trust funds for any services that it provides to or on behalf of any private trust.

(c) Special forms of trusteeship

(1) Custodian trustees

The concern for the security of trust funds that underlay the creation of the office of Public Trustee was carried a step further in s 4 of the Public Trustee Act 1906; it introduced the possibility of functionally dividing ordinary trusteeship between custodian and managing trustees. The relationship between the two is comprehensively defined in s 4(2) (see generally Maurice (1960) 24 Conv 196). As their respective titles imply, custodian trustees act as passive holders of trust property and related documents of title whilst the active management and exercise of all powers and discretions rests with managing trustees. Appointment to the statutory office of custodian trustee is not restricted to the Public Trustee but extends to include both trust corporations and, for limited purposes, a diversity of other corporate bodies (see Public Trustee (Custodian Trustee) Rules 1975, SI 1975/1189, as amended by SI 1976/836, SI 1981/358, SI 1984/109, SI 1985/132 and SI 1994/2519). An advantage of the division of functions, in addition to that of enhanced security, is convenience. The title to trust property remains vested in the custodian trustee thus saving the trouble and expense of transferring title to property where changes occur, perhaps because of death or retirement from the trust, among managing trustees.

Despite these apparent advantages it seems that the scheme of custodian trusteeship is not in widespread use in family trusts. The converse is the case in the commercial area. For example, pension scheme trustees extensively use the services of custodian trustees. Indeed the practice of custodianship, or 'global custody' as it is known in the financial services sector, now constitutes an essential cog in the operations of investment fund management globally (see the *Financial Times* Global Custody Survey published annually in July).

(2) Judicial trusteeship

A judicial trustee is some person or corporation appointed to act as trustee by the court under the provisions of the Judicial Trustee Act 1896. The object of the jurisdiction has been stated to be the provision of 'a middle course in cases where the administration of the estate by the ordinary trustees had broken down and it was not desired to put the estate to the expense of a full administration. In these circumstances, a solution was found in the appointment of a judicial trustee who acts in close concert with the court and under conditions enabling the court to supervise his transactions' (*Re Ridsdel* [1947] Ch 597 at 605 per Jenkins J).

Accordingly, the appointment is more likely to occur following an application from an existing trustee or beneficiary, although it can be made on the application of a person creating or intending to create a trust (see Judicial Trustee Rules 1983, SI 1983/370). The procedure has not been extensively used and is only likely to be invoked where there is excessively complex litigation (see *Re Diplock* [1948] Ch 465) or where gross mismanagement of the trust has occurred – 'trouble-shooting accountants are often appointed to sort out the muddled situation' (*Hayton and Marshall* p 577, and see [1993] SJ 760 at 760–761 commenting on the appointment of judicial trustees in a pensions case *McDonald v Horn* (1993) Times, 12 October, Ch D). When appointing a judicial trustee the court decides on an appropriate level of remuneration (see Judicial Trustee Rules 1983, r 11(1)(a); *Practice Direction* [2003] All ER (D) 93).

(3) Nominees and bare trusts

We saw in Chapter 1 that one of the tricks for which the trust's division of ownership between legal and equitable title can be used is to conceal beneficial ownership of a shareholding (see Example 1 at p 6). This was, of course, also the mechanism in *Vandervell v IRC* [1967] 1 All ER 1 by which National Provincial Bank held legal title to the shares in Vandervell Products on trust for Mr Vandervell absolutely (see Chapter 4, p 189). Whilst the 'nominee' or 'bare trustee' – for present purposes the titles are synonymous – will receive, for instance, the dividends and execute any transfer of title this will be done solely for the principal's benefit and in conformity with the latter's instructions. In short the beneficiary is owner in all but name. A corollary of this position is that a bare trustee has no active duties to perform. The overall position was summarised in an Australian case *Herdegen v Federal Comr of Taxation* (1988) 84 ALR 271 by Gummow J in the following manner (at 281): '[bare trustees] have no interest in the trust assets other than that existing by reason of the office and legal title as trustee and who never have had active duties to perform or who have ceased to have those duties, such that in either case the property awaits transfer to the beneficiaries or at their direction.'

It would be a mistake, however, to think of nominees solely in terms of tricks and subterfuge. An increasingly important functional use of nominees will be to act, in effect, as the delegates of trustees for the purpose of facilitating share dealings particularly as a dematerialised mode of share transfer takes over (Ford (1997) 11 TLI (1) 18–19; and see generally Chapter 10).

4. Trustees' duties and powers: an outline

(a) Trustees' duties

We have previously referred to the three substratum duties imposed on trustees in administering a private express trust and to the possible modification of those duties through the new powers made available to trustees in the Trustee Act 2000. To these duties must be added those associated with each individual trust. Thus, for instance, where the retention of capital in the trust fund over a period of time is necessary, trustees must ensure that the trust fund is at all times in a proper state of investment (see Chapter 10). Also the trustees must act impartially where there are different classes of beneficiary, for example, those entitled to income and capital respectively, not favouring one against the other unless authorised to do so by the trust instrument (see Chapter 10). In addition there are a number of subsidiary but practically important duties associated with the acceptance and administration of the office of trusteeship. With one exception (a duty of disclosure of information: see Chapter 11) these are not significant for our purposes and a brief outline only is provided here.

On appointment trustees should familiarise themselves with the terms of the trust and ensure that the appointment was properly made. It would be both inconvenient and expensive for the trust if acts of administration were found to be invalid because of an improper appointment, or if a breach of trust, such as payment to the wrong beneficiary, were to occur because of ignorance of the trust terms. Therefore, to protect trust property trustees should bring it under their control by ensuring where appropriate that the legal title to the property is transferred to them. If appointed to an existing trust, a trustee should find out from the current trustees about the past and present business of the trust. In particular the new trustee must be alert to the possibility of an undetected previous breach of trust and be prepared to initiate action to remedy it. New trustees who fail to inquire are unwise as well as being in breach of duty. If loss is caused to the trust fund they risk being held liable, not for participating in the original breach of trust but for failing in their own duty of inquiry. However, 'a new trustee is not expected to act like a bloodhound straining to sniff out some breach of trust; in the absence of suspicious circumstances he may assume that the previous trustees have properly discharged their duties' (*Parker and Mellows* p 565, citing *Re Straham* (1856) 8 De GM & G 291).

Once these initial duties have been complied with the trustees can turn their attention to the duties involved in the day-to-day administration of the trust. A number of express and statutory powers, such as those of maintenance and advancement (see Chapter 7), are usually conferred on trustees and provide the machinery for administering the trust. Here the duty of trustees, as with mere powers of appointment (see Chapter 5), is to consider whether to exercise any such powers. If they do decide to act, a further duty, except in the case of charitable trusts, is that they must act unanimously – the majority cannot bind the minority (see eg *Boardman v Phipps* [1967] 2 AC 46) – unless the terms of the trust instrument, or the court, otherwise direct (see *Cowan v Scargill* [1985] 1 Ch 270).

The detection of breaches of trust rests largely with the beneficiaries and as 'policemen' they will wish to be kept informed about the trust's administration. Not surprisingly, therefore, trustees are under a duty to keep proper financial accounts and records of the trust's administration, and, within limits, to make information available to the beneficiaries (see Chapter 11).

(b) Trustees' powers

In so far as trustees' administrative powers are intended to facilitate effective management of the trust, one of the most teasing decisions facing settlors concerns the width of the powers to be conferred on trustees. This is as true of the administrative discretions as it is of the dispositive discretions considered in Chapter 5. For instance, how much freedom in the choice of investments should settlors bestow on trustees? Should they seek to minimise risk by limiting the trustees' discretion to mere selection amongst secure investments, or should they grant a wide discretion to invest speculatively in the hope of greater financial return? In practice the development of the investment market during the last hundred years and more recent economic circumstances, in particular the effects at various times of inflation, have encouraged the conferment of extremely wide powers which, until the broadening of investment powers in the Trustee Act 2000, far exceeded those statutorily available to settlors (see generally Chapter 10). Prior to this legislative change the inclusion in trust deeds of broad powers of investment beyond those statutorily available constitutes merely one example of the tendency for the statutory powers automatically available to trustees to be supplemented or even replaced by express powers in the trust instrument. Nevertheless, the automatic statutory powers, first introduced to reduce the length and detail of trust instruments, still provide a common core of powers applicable to private express trusts.

In addition to the statutory powers of maintenance and advancement conferred on trustees by TA 1925, s 31 and s 32 respectively (see Chapter 7), Pt II of the statute confers other general powers of administration on trustees. These powers, which we do not consider in any detail, permit trustees to sell trust property at auction (s 12), to raise money by mortgaging or selling trust assets (s 16) and, inter alia, in s 15, to 'compromise, compound, abandon, submit to arbitration, or otherwise settle any debt, account, claim, or thing whatever relating to . . . the trust' (s 15(f)). Section 15 also exempts trustees from liability for any loss caused by an act done by them under the wide powers provided by the section so long as they have complied with the new statutory duty of care set out in TA 2000, s 1(1) and Sch 1. Previously trustees had been protected if they had merely acted 'in good faith'. The power for trustees to insure trust property against risks of loss or damage is contained in a revised s 19, as substituted by TA 2000, s 34(1). Formerly the power to insure had been limited but now the power to insure is unrestricted seemingly both as to the risks to be insured and the level of cover to be obtained (s 19(1)(a)). Section 19 is also subject to the statutory duty of care (TA 2000, Sch 1, para 5) and arguably a failure to insure adequately would be in breach of the duty.

Of far greater significance to the effective management of the trust are the new statutory powers to employ agents and, within certain parameters, to delegate the exercise of discretions (TA 2000, ss 11–27). These powers are mentioned here for the sake only of completing the overall picture as they are considered in detail in the context of trust management in Chapter 10.

(c) Duties and powers: a synthesis

The conceptual distinction between a duty and a power is clear: a duty is an obligation, a power an authority to act. But functionally in trust administration the two operate in harness. Consider, for example, the duty of trustees to ensure that the trust fund is maintained in a proper state of investment. This obligation is without content until the proper state of investment is identified by referring to the trustees' power of investment. But the exercise of that power must in principle then comply with the duties of trusteeship. Thus, to continue with the example, the authorisation provided by an apparently unlimited power of investment will be interpreted as being subject to the 'substratum' duties (see *Waters* p 690). Consequently, the duty not to delegate requires that in principle a decision to sell or buy specific investments must be the trustees' own, not that of a third party no matter how expert (unless the power to delegate asset management duties has been exercised under TA 2000, s 15); the duty to avoid a conflict of interest requires that a trustee should not be a purchaser of trust property for himself; and the duty to display a reasonable level of skill and care means that trustees may be liable for loss caused by honest but foolish investment decisions.

This synthesis, however, is subject, as always, to the capacity of the settlor, or even in certain circumstances all the beneficiaries, to release the trustees from observance of the duties the courts have sought to impose on trustees for the protection of beneficiaries. The paramount nature of the law laid down by the settlor in the trust instrument must therefore never be overlooked.

5. Conflict of interest and duty

In enforcing the duties imposed on trustees courts have been seen at their strictest where a conflict may arise between trustees' personal interests and their position as trustees. This attitude can be traced back to the seminal case of *Keech v Sandford* (1726) Sel Cas Ch 61 (discussed in Chapter 16) but has been frequently asserted since then. Just one amongst the numerous judicial affirmations of a strict approach is Lord Herschell's statement in *Bray v Ford* [1896] AC 44 at 51 that it is 'an inflexible rule of a Court of Equity that a person in a fiduciary position . . . is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict'.

The reason for the rule is manifest. The trustees' obligation is to manage the trust solely for the benefit of the beneficiaries, and if the trustees' own interests conflict with theirs, then temptation exists. If, for example, trustees purchase property belonging to the trust or charge fees for carrying out the tasks of trusteeship then there may be a temptation to pay a less than market price or to charge exorbitant fees.

In this chapter we concentrate on how the courts have attempted to prevent such conflicts of interest occurring, or subsequently at least to control their outcome. To continue with the examples, an attractively simple response for a court determined to discourage the advancement of self-interest might be to say that any purchase of trust property should be set aside or that trustees must account to the trust for any fees paid. But profit for the trustees is not synonymous with loss for the trust. Let us suppose that the market price was paid or that the fees were reasonable. Should the court still apply those same remedies thus adopting an approach that exclusively emphasises a policy objective of deterrence?

The implications for a fiduciary of the strict approach are spelled out by Waters (*Law of Trusts in Canada* (2nd edn, 1984) p 710):

> whether the [fiduciary] was honest and well-intentioned or otherwise, whether or not he harmed the interests of his principal by his activities, and whether in the circumstances what he did was not unreasonable, are irrelevant issues. Once he is found . . . to be involved in activities which would result or have resulted in his own profit, and to have been so involved when he ought to have been in a position to give the exclusive benefit of his attentions to his principal, then he is in breach of the rule.

An alternative approach would be for the court merely to prevent any unfair gain from being retained by the fiduciary. The court would retrospectively assess, for instance, the fairness of the price paid or the level of fees charged, whereupon the good faith of the fiduciary and the absence of harm caused to the principal's interest would be relevant considerations.

The courts of equity in the nineteenth century, particularly under the early guiding influence of Lord Eldon, favoured the deterrent approach. This was in large measure because of concern over evidentiary difficulties facing a court in determining a trustee's motives where a possible conflict existed (*Ex p Lacey* (1802) 6 Ves 625; *Ex p James* (1803) 8 Ves 337, discussed in *Holder v Holder*: see below, p 437). But even then the strictness of the rule was mitigated where the nexus between the type of personal activity undertaken by a trustee and the interests of the trust was considered too remote. In this chapter we consider in particular the current variable application of the conflict of interest rule and which of two approaches, the prophylactic one placing priority on deterrence or the remedial one emphasising fairness and 'retrospective adjustment', can now be said to predominate in the approach of the courts.

The alert reader will have noted that Lord Herschell's statement (above) was not restricted to trustees but instead referred to 'a person in a fiduciary position'. Similarly Waters's comments were directed towards the implications of the conflict of interest rule for 'fiduciary agents'. It cannot be stressed too strongly that the category of 'fiduciary agents' extends beyond the confines of trustee-beneficiary to include well-recognised commercial relationships such as solicitor-client, company director-company, partner-co-partner. Indeed it has been said that the class of fiduciary relationships is never closed (*English v Dedham Vale Properties Ltd* [1978] 1 All ER 382 at 398 per Slade J, and see generally Finn 'The Fiduciary Principle' in Youdan (ed) *Equity, Fiduciaries and Trusts* (1989)). The determinants of when commercial relationships in particular are treated as fiduciary and how far the conflict of interest rule, with its origins in the trustee-beneficiary relationship, applies to them are considered at length in Chapter 16. It is sufficient at the moment to draw attention to the oft-quoted (eg Sealey [1962] CLJ 69 at 71) warning of Fletcher Moulton LJ in *Re Coomber* [1911] 1 Ch 723 at 728:

> Fiduciary relations are of many different types: . . . and the courts have again and again . . . interfered and set aside acts which, between persons in a wholly independent position, would have been perfectly valid. Thereupon in some minds there arises the idea that if there is any fiduciary relation whatever any of these types of interference is warranted by it. They conclude that every kind of fiduciary relation justifies every kind of interference. Of course that is absurd. The nature of the fiduciary relationship must be such that it justifies the interference.

The warning reflects the fact that, even if the restrictive bonds on trustees may now be loosening, the fiduciary relationship that has historically most justified interference is that of trustee-beneficiary. In Scott's memorable phrase, 'In some relations the fiduciary element is more intense than in others; it is peculiarly intense in the case of a trust' ('The Trustee's Duty of Loyalty' (1936) 49 Harv LR 521). To emphasise the point, it is the fiduciary element in the trust with which this chapter is concerned; consideration of the broader fiduciary context is deferred until Chapter 16.

The factual circumstances in which a conflict of interest may arise for a trustee are many and varied, but the following broad categories of activity can be identified for the purposes of analysing how the conflict principle operates in this particular context.

(1) Direct remuneration earned for acting as trustee (section 6).
(2) Indirect remuneration earned by virtue of trusteeship (section 7).
   – director's fees
   – commission and analogous profits.
(3) Dealings with the trust property or beneficiaries (section 8).

However, just as there is no comprehensive definition of a fiduciary so there is no one accepted method of compartmentalising these various activities. This particular categorisation is adopted here partly because it enables us to concentrate on the 'bringing of trusteeship to the marketplace' but also because the fiduciary obligation in the several categories may be of varying 'intensity'.

6. Trustees and direct remuneration

(a) Introduction

Given the developments described in section 2 above, it is unsurprising that the fundamental rule, one element of Waters's second substratum duty, to the effect that a trustee is not entitled to receive payment for acting as trustee has come under increasing scrutiny and criticism. As recently as 1990 the rule's rigour was evident in the following statement from *Snell* (p 162):

> trustees . . . are generally entitled to no allowance for their care and trouble. This rule is so strict that even if a trustee or executor has sacrificed much time in carrying on a business as directed by the trust, he will usually be allowed nothing as compensation for his personal trouble or loss of time.

As already indicated, this fundamental rule is substantially modified by the Trustee Act 2000, ss 28, 29 whereby trust corporations and trustees 'who are acting in a professional capacity' are entitled to receive 'reasonable remuneration' for services provided to the trust (see section (b)(2) below). Even were this not the position the non-remuneration rule does not mean that trust administration is therefore cost-free. Trustees are statutorily empowered (TA 2000, s 11, and see further Chapter 10) to employ paid agents (eg stockbrokers, solicitors) to carry out specialist functions and the fees of such agents are chargeable to the trust fund not the trustees (TA 2000, s 32). Furthermore there is a well-established right, now confirmed in TA 2000, s 31(1), that trustees are entitled to be indemnified out of trust property against out-of-pocket expenses 'properly incurred when acting on behalf of the trust'. The entitlement will not normally extend to the payment of any interest on the expenditure incurred (see *Foster v Spencer* [1996] 2 All ER 672 where it was held that no interest was payable on 'ordinary costs and expenses accrued in a piecemeal fashion' (at 678)). 'Properly incurred' arguably reflects the position established under previous legislation and case law. The expenditure must therefore be reasonable and proper in the circumstances of the trust. Judicial scepticism can be expected to remain the prevailing attitude towards ingenious expenses claims such as those in *Malcolm v O'Callaghan* (1835) 3 Myl & Cr 52. In that case a trustee's efforts to reclaim the costs of several trips to Paris to attend a court hearing concerning the trust were unsuccessful since his attendance was not deemed necessary in a case turning on matters of French law alone. A trustee's right of indemnity is one against the trust estate and not normally against the beneficiaries (but see *Hardoon v Belilios* [1901] AC 118 – trustees as nominees – and generally Hughes (1990) 64 ALJ 567 for exceptions to this rule).

Notwithstanding these modifications what reasons are there for a general rule of non-remuneration? An oft-cited explanation is that advanced by Lord Talbot LC in *Robinson v Pett* (1734) 3 P Wms 249 at 251:

> a trustee, executor or administrator, shall have no allowance for his care and trouble: the reason for this seems to be . . . if allowed, the trust estate might be loaded, and rendered of little value. Besides, the great difficulty there might be in settling the quantum of such allowance, especially as one man's time may be more valuable than that of another; and there can be no hardship in this respect upon any trustee, who may choose whether he will accept the trust, or not.

As Bishop and Prentice have pointed out ((1983) 46 MLR 289 at 304) there are three separate justifications here. First, trustees may be tempted to undertake unnecessary work in administering the trust so as to earn more fees; second, valuing the trustee's services presents difficulties; and third, persons are free to refuse the office of trustee.

The current relevance of these justifications has been the subject of debate and doubt but the last named – ie the voluntary nature of the office – paradoxically indicates one reason why the rule is now almost the exception. Professional and corporate trustees will not agree to act unless provision is made for their remuneration.

In some other jurisdictions, for example, many states in the US, the non-remuneration rule is reversed and corporate trustees are statutorily authorised to receive remuneration at prescribed rates. It is therefore not surprising that this matter came under review by law reform bodies in the UK. In its 1982 Report the LRC considered and rejected a proposal to introduce a comparable (statutory) provision into English law (paras 3.46–3.47). The LRC considered that 'it would be difficult to frame a universally applicable provision which would not be open to abuse', that settlors or testators might be unaware of what they would be taken to 'have agreed to' and that a standard clause would 'encroach too far upon the general principle that a trustee should not profit from his trust'. These conclusions were criticised by Parry [1984] Conv 275 who concluded that the changed social and economic climate called for increased professionalism on the part of trustees and that 'if a professional is appointed to undertake this function, which the [LRC] itself describes as an "onerous one" then he should be entitled to reasonable remuneration for his services' (at 285). Subsequently the Law Commission returned to the issue in its review of the law on Trustees' Powers and Duties (Report No 260 (1999)). It concluded that the LRC approach was too cautious and that a combination of defects in the current law and practical considerations made it desirable to introduce a statutory default charging clause (paras 7.5–7.7), a recommendation implemented in the Trustee Act 2000.

We have mentioned previously that for descriptive purposes trustees can be placed into one or other of three categories: corporate trustees, other professional trustees and lay trustees. A similar type of categorisation is adopted for the purposes of charging provisions of the Trustee Act 2000. These distinguish between a trust corporation, a trustee acting in a professional capacity and a 'lay trustee'. The Act (s 39(1)) adopts as the definition of a trust corporation that contained in the Trustee Act 1925, s 68(18) (see section 3(b)(2), above p 413). A 'lay trustee' is then defined under the Act in negative terms as being a person who 'is not a trust corporation and does not act in a professional capacity' (s 28(6)). The key definition in the Act for the purposes of the statutory charging provisions is therefore that of 'acting in a professional capacity' and is provided in s 28(5):

> [A] trustee acts in a professional capacity if he acts in the course of a profession or business which consists of or includes the provision of services in connection with –
> (a) the management or administration of trusts generally or a particular kind of trust, or
> (b) any particular aspect of the management or administration of trusts generally or a particular kind of trust, and the services he provides to or on behalf of the trust fall within that description.

It should be noted that the emphasis is on the nature of the business undertaken as the defining element of 'professional capacity' for statutory purposes. On this definition a person who is a professional and takes on trusteeship not as part of their business but as an individual will be characterised as a lay trustee, irrespective of whether he or she is a Chancery barrister or a chartered accountant or a professional footballer. For this reason at least it seems likely that many trust deeds will continue to contain more widely drawn express charging clauses such as that set out in the next section.

Notwithstanding the statutory changes introduced by the Trustee Act 2000 the starting-point for discussion, and for the law, remains that a trustee is entitled to remuneration only where it can be established that the case falls within one of the following 'exceptions' to the general rule: (1) authorisation in the trust instrument; (2) authorisation by statute; (3) agreement with beneficiaries; (4) litigation work by solicitor-trustees; and (5) authorisation by the court. Each of these 'exceptions' will be considered in turn.

(b) Remuneration: the rules

(1) Authorisation in the trust instrument

A charging clause included in a trust instrument can authorise payment of remuneration to the trustees. Traditionally such clauses have been strictly construed against the trustee. Thus a solicitor-trustee who was authorised to charge for 'professional services' only was allowed no recompense for 'time and trouble' on work which could have been undertaken by someone other than a solicitor (see *Re Chalinder and Herington* [1907] 1 Ch 58). Now under TA 2000, s 28(2) where there is an express charging clause trustees, in the absence of any contrary indication in the trust instrument, are 'to be treated as entitled' to receive payment even for 'services which are capable of being provided by a lay trustee'. The entitlement applies only where the trustee is a trust corporation or is 'acting in a professional capacity' as defined in the Act (see above). Thus s 28(2) does not purport to amend the common law position on strict construction that in principle would therefore still seem to apply where the trustee does not come within the scope of s 28. Consequently, more widely drawn charging clauses, similar to the following example, are still likely to be commonly inserted in trust instruments:

> Any Trustee being a solicitor accountant or other person engaged in any profession business or trade shall be entitled to be paid all usual professional or business or trade charges for business transacted time expended and acts done by him or any employee or partner of his in connection with the trusts hereof including acts which a trustee not being in any profession business or trade could have done personally.

Some early authorities tended to suggest that a widely drawn clause such as that cited here should only be adopted under the express instructions of a settlor fully informed as to its effect. This would not have seemed unreasonable where the non-remuneration rule so clearly held sway. It is at least questionable whether this view should be sustained given the approach in s 28(2) and in a context where default statutory charging clauses have been introduced (see (2) below). In practical terms, however, it is likely that the implications of such a clause would be fully explained to clients and indeed one text book suggests such clauses and their effects *should* be specifically drawn to the attention of the client (*Parker and Mellows* p 723; and see the delphic comments of Vinelott J in *Re Orwell's Will Trusts* [1982] 1 WLR 1337 at 1340: 'it has been said that a wider form of charging clause . . . ought not to be included except under express instructions given by the client himself with full knowledge of its effect'). The reference in a charging clause to 'usual . . . charges' imposes a limit on the trustee's freedom to decide on the level of charge although where the fees are those normally charged by the particular professional person it is likely that they will be treated as falling within the scope of a clause such as that set out above. In the case of a solicitor-trustee the beneficiaries can insist on having the charges assessed by a court official, a taxing master.

There are different methods for calculating the charge to be levied on the trust. A solicitor will normally charge at an hourly rate. Other professionals, corporate trustees and the Public Trustee charge fees, on a published ad valorem basis, subject in every case to the addition of Value Added Tax at the rate in force when the fee becomes due (17.5% in 2005–06). The following example is of the fees currently charged (wef 1 April 2003) by the Public Trustee:

Acceptance Fee

in respect of the first £50,000	1.25%
in respect of any excess over £50,000	0.5%

Administration Fee

This fee is due annually on 1 April on the capital value of funds under administration. The fee rates are as follows:

in respect of the first £30,000	2.25%
in respect of any excess over £30,000 up to £150,000	1.75%
in respect of any excess over £150,000 up to £375,000	1.25%
in respect of any excess over £375,000 up to £2,500,000	0.75%
in respect of any excess over £2,500,000	0.25%
Minimum fee £60	

Other Activity Fees

An income collection of 5% is charged on the gross amount of income actually received by the Public Trustee. There is no fee on the income paid direct from source to a beneficiary.

A reasonable fee may be charged according to the work involved for various duties particularly those of an unusual, complex or exacting nature resulting in the normal fee charged being insufficient.

Withdrawal Fee

A withdrawal fee is due on the retirement of the Public Trustee or on the distribution or withdrawal of trust property. It is calculated at a percentage rate on the capital value of the funds at the relevant time. In the case of retirement of the Public Trustee the percentage rate is twice the effective rate of the Administration Fee due immediately prior to the retirement and in all other cases 4 times the effective rate subject in either case to a maximum of 7.5%.

No withdrawal fee is charged where the Public Trustee retires and the total value of the trust does not exceed £10,000.

One further change introduced by the Act is to alter the presumption about the status of an express charging clause. Any payment to which a trustee is entitled under the clause in respect of services is for two purposes to be treated as remuneration for services and not as a gift (s 28(4)). One purpose is related to s 15 of the Wills Act 1837 whereby gifts to an attesting witness are void (s 28(4)(a)). Trustees can now undertake work in connection with testamentary trusts and be safe in the knowledge that they can be paid even where they witness the will under which the trust is created. The second purpose is also concerned with wills and their administration. In relation to the administration of an estate a trustee's charges are to be treated, for deaths occurring on or after 1 February 2001, as an expense of administering the estate and not as a pecuniary legacy as was the previous position. The practical effect of this change is to grant priority to the trustee's entitlement over the interests of the will beneficiaries and thereby reduce the risk that the trustees might be unable to obtain their fees in the event of some unanticipated claim on the estate. Both changes had been recommended by the Law Commission which stated that the reasons for treating professional charging clauses as 'a gift' were largely historical and 'closely related to the outmoded view of trustees as "gentlemen amateurs"' (Report No 260, para 7.19).

(2) Remuneration authorised by statute

The Trustee Act 2000 introduces new provisions concerning remuneration of trustees that apply only where there is no provision 'about entitlement to remuneration' in the trust instrument or in any other statutory provision (TA 2000, s 29(5)). This legislative approach therefore adopts the established practice in trusts law of providing statutory default provisions only. Under s 29(1) a trustee who is a trust corporation but is not a trustee of a charitable trust is entitled to receive 'reasonable remuneration out of the trust funds for any services' it provides to or on behalf of the trust. Similar provision giving entitlement to 'reasonable remuneration' is made in s 29(2) for 'a trustee who acts in a professional capacity' (s 29(2)(a)) but 'who is not a trust corporation, a trustee of a charitable trust or a sole trustee' (s 29(2)(b)). But s 29(2) contains a proviso not present in s 29(1) that the entitlement arises only 'if each other trustee has agreed in writing' that the trustee acting in a professional capacity 'may be remunerated for the services'.

There are several points to note about the new statutory provision. One is that the exclusion of trustees of charitable trusts from the scope of s 29 reflects the fact that other policy considerations are thought to be posed by such trusts (see the discussion in Chapter 20 at p 1033). The Secretary of State is nevertheless empowered to make regulations for the remuneration of such trustees (s 30) although at the time of writing no such regulations have been put before Parliament. A second and unsurprising point to note is that, as with the interpretation of charging clauses under s 28, a trustee under s 29 is to be entitled to remuneration even if the services in question are capable of being provided by a lay trustee. Third, the proviso in s 29(2) requiring the agreement in writing of other trustees to the remuneration is intended to act to some extent as a safeguard for beneficiaries. The Law Commission considered that as a matter of principle where there was no express charging clause 'trustees should actively consider whether one of their number should be remunerated' and 'whether this would be to the advantage of the trust' (see for a full review Report No 260 (1999) paras 7.10–7.12 and, for the reasons justifying the non-application of the proviso to trust corporations, see para 7.17). Lastly, a key issue to be addressed might be thought to be the meaning of 'reasonable remuneration'. This is defined not altogether helpfully in s 29(3) as meaning 'in relation to the provision of services by a trustee, such remuneration as is reasonable in the circumstances for the provision of those services' to or on behalf of the trust. It remains to be seen just how the courts will interpret this wording. It does though seem probable that trust corporations and trustees acting in a professional capacity are likely to insist on the inclusion of express charging clauses thereby, by virtue of s 29(5), avoiding disputes with beneficiaries as to what constitutes 'reasonable remuneration' coming before the courts.

In addition to the new statutory framework there remain some more long-standing statutory provisions whereby remuneration can be authorised. The Public Trustee, if appointed, is authorised to charge fees on a scale fixed by Treasury Order irrespective of any provision in the trust instrument (Public Trustee Act 1906, s 9, and see Public Trustee (Fees) Order 1999, SI 1999/855). Other statutory provisions are as follows: (i) TA 1925, s 42 which gives the court full discretion when appointing a corporation to be a trustee, usually as a replacement trustee, to authorise such remuneration as the court thinks fit; and (ii) Judicial Trustee Act 1896, s 1(5) enables the court to assign remuneration to a person it appoints as a judicial trustee.

(3) Remuneration agreed by contract with beneficiaries

Where all the beneficiaries are sui juris they can contract to pay the trustee. These contracts are not thought to be very common and if not 'fair and reasonable' will be viewed with suspicion by the courts and are likely to be set aside (see also *Pettit* p 438 where the possibility of the contract being invalid on the ground of insufficiency of consideration is mooted).

(4) Remuneration for litigation work by solicitor-trustees

Even in the absence of an appropriate charging clause the 'curious exception . . .' which is known as the rule in *Cradock v Piper* (1850) 1 Mac & G 664 (LRC, para 3.42) enables a solicitor-trustee, who has acted for *both* himself and a co-trustee, to charge costs for work done in an action or matter in court. The costs incurred for so acting must not, however, exceed the expense that would have been incurred if the solicitor-trustee had acted for the co-trustee only. (See *Parker and Mellows* p 735; and Bishop and Prentice (1983) 46 MLR 289 at 306, on the rather dubious justification for the distinction between litigation and other work; see also Stebbings (1998) 19 Legal History (3) 189 and *The Private Trustee in Victorian England* (2002) pp 38–39 where it is argued that the limitation to litigation costs alone was 'a subsequent and theoretically unsound development' and one probably not anticipated by Lord Cottenham LC in the case itself.) Given the provision in the Trustee Act 2000, s 29 that, even in the absence of an express charging clause, a trustee acting in a professional capacity can claim reasonable remuneration, the scope for the curious exception to apply would seem to be limited. Indeed it would seem to be relevant only to the somewhat improbable circumstance of an express charging clause being interpreted as being too narrow to entitle a solicitor-trustee to pay himself for work done for the trust.

(5) Inherent jurisdiction and the non-remuneration rule

The court has an inherent jurisdiction to authorise remuneration although this seems potentially to conflict with the non-remuneration rule. The stricture that 'the jurisdiction should be exercised only sparingly and in exceptional circumstances' (per Upjohn J in *Re Worthington* [1954] 1 All ER 677 at 678) needs now to be considered in the light of the Court of Appeal judgment in *Re Duke of Norfolk's Settlement Trusts* (below).

Re Duke of Norfolk's Settlement Trusts [1981] 3 All ER 220, CA

Under the terms of a 1958 trust the Schroder Executor and Trustee Company (SETCO) was authorised to charge fees at its scale then in force. Subsequently SETCO claimed under the 'inherent jurisdiction' (i) extra remuneration (£25,000) for exceptional and unforeseen work involved in a central London property redevelopment scheme; (ii) similar sums for additional work in re-organising the trusts on the introduction of Capital Transfer Tax (CTT) in 1975; and (iii) to operate a revised scale of charges in the future, because the trust company's fees were low compared with those of similar institutions and SETCO was incurring a substantial and continuing financial loss. The adult beneficiaries did not oppose the application.

In the High Court ([1978] 3 All ER 907) Walton J approved the first claim but rejected that in relation to CTT as the work was not beyond the scope of any duty which the trustee could reasonably have been expected to perform. Walton J also held that there was no inherent jurisdiction to approve any revision in scale fees.

The trustees appealed in respect of the scale fees point only.

> **Fox LJ**: In my opinion the judge took too narrow a view of the inherent jurisdiction. There is, in my judgment, no doubt that the court has an inherent jurisdiction to authorise payment of remuneration to trustees . . .
>
> The question is the extent of that jurisdiction. There can, in my view, be no doubt that there is an inherent jurisdiction on the appointment of a trustee to direct that he be remunerated . . .
>
> Indeed, it is not really in dispute at all. In the present case, however, what is sought is the increase of remuneration authorised by the trust instrument. The judge said that there had never been a case in which that was done, unless it was *Re Codd* [1975] 2 All ER 1051n, [1975] 1 WLR 1139, where the matter was not argued. I feel much doubt whether that proposition is in fact correct. Most cases relating to trustees' remuneration are dealt with in chambers and are not reported. My own impression, and, I understand, that of Brightman LJ also, is that since the early 1950s orders have been made in chambers, under the inherent jurisdiction, authorising increases in remuneration given by the trust instrument. But I do not rely on that. I will approach the matter as one of principle and on the reported cases. If it be the law, as I think it clearly is, that the court has inherent jurisdiction on the appointment of a trustee to authorise payment of remuneration to him, is there any reason why the court should not have jurisdiction to increase the remuneration already allowed by the trust instrument?
>
> Two reasons are suggested. First, it is said that a trustee's right to remuneration under an express provision of the settlement is based on a contract between the settlor and the trustee which the trustee is not entitled to avoid, the benefit of that contract is to be regarded as settled by the trust instrument for the benefit of the beneficiaries. I find that analysis artificial. It may have some appearance of reality in relation to a trustee who, at the request of the settlor, agrees to act before the settlement is executed and approves the terms of the settlement. But very frequently executors and trustees of wills know nothing of the terms of the will until the testator is dead; sometimes in the case of corporate trustees such as banks, they have not even been asked by the testator whether they will act. It is difficult to see with whom, in such cases, the trustees are to be taken as contracting. The appointment of a trustee by the court also gives rise to problems as to the identity of the contracting party.
>
> The position, it seems to me, is this. Trust property is held by the trustees on the trusts and subject to the powers conferred by the trust instrument and by law. One of those powers is the power to the trustee to charge remuneration. That gives the trustee certain rights which equity will enforce in administering the trust. How far those rights can properly be regarded as beneficial interests I will consider later. But it seems to me to be quite unreal to regard them as contractual. So far as they derive from any order of the court they simply arise from the court's jurisdiction and so far as they derive from the trust instrument itself they derive from the settlor's power to direct how this property should be dealt with . . .
>
> I come to the second objection. It is said that the right to remuneration is a beneficial interest in the trust property and can only be varied by an order under the Variation

of Trusts Act 1958 or (in accordance with the principles established in *Chapman v Chapman* [1954] AC 429) under a compromise of a dispute as to beneficial interests or by way of salvage.

I do not doubt that, to some extent, the right of a trustee to remuneration is to be regarded as a beneficial interest . . .

But accepting that a trustee's right to remuneration may for certain purposes be treated as a beneficial interest in the trust property, I do not think that it comes within the principle laid down in *Chapman v Chapman* as to the general ability of the court under its inherent jurisdiction to vary beneficial interests . . .

Chapman v Chapman, it seems to me, was concerned with the power of the court to authorise variations in beneficial interests as such. The present problem is different. It is concerned not with beneficial interests as such, but with the administration of the trust fund. When the court authorises payment of remuneration to a trustee under its inherent jurisdiction it is, I think, exercising its ancient jurisdiction to secure the competent administration of the trust property just as it has done when it appoints or removes a trustee under its inherent jurisdiction . . .

There remains the question whether, on principle and authority, we can properly infer that the jurisdiction does exist. As to principle, it seems to me that, if the court has jurisdiction, as it has, on the appointment of a trustee to authorise remuneration though no such power exists in the trust instrument, there is no logical reason why the court should not have power to increase the remuneration given by the instrument. In many cases the latter may involve a smaller interference with the provisions of the trust instrument than the former.

[Fox LJ referred to *Bainbrigge v Blair* (1845) 8 Beav 588; *Re Masters* [1953]1 All ER 19; and *Robinson v Pett* (1734) 3 P Wms 249.]

I conclude that the court has an inherent jurisdiction to authorise the payment of remuneration of trustees and that that jurisdiction extends to increasing remuneration authorised by the trust instrument. In exercising that jurisdiction the court has to balance two influences which are to some extent in conflict. The first is that the office of trustee is, as such, gratuitous; the court will accordingly be careful to protect the interests of the beneficiaries against claims by the trustees. The second is that it is of great importance to the beneficiaries that the trust should be well administered. If therefore the court concludes, having regard to the nature of the trust, to the experience and skill of a particular trustee and to the amounts which he seeks to charge when compared with what other trustees might require to be paid for their services and to all the other circumstances of the case, that it would be in the interests of the beneficiaries to increase the remuneration, then the court may properly do so . . .

I would allow the appeal . . .

[Brightman and Cumming-Bruce LJJ concurred with Fox LJ's judgment. Brightman LJ pointed to what he saw as the illogicality of adopting a narrow version of inherent jurisdiction (at 231):]

If the court has an inherent power to authorise a prospective trustee to take remuneration for future services, and has a similar power in relation to an unpaid trustee

> who has already accepted office and embarked on his fiduciary duties on a voluntary basis, I have some difficulty in appreciating the logic of the principle that the court has no power to increase or otherwise vary the future remuneration of a trustee who has already accepted office. It would mean that, if the remuneration specified in the trust instrument were lower than was acceptable to the incumbent trustee or any substitute who could be found, the court would have jurisdiction to authorise a substitute to charge an acceptable level of remuneration, but would have no jurisdiction to authorise the incumbent to charge precisely the same level of remuneration. Such a result appears to me bizarre, and to call in question the validity of the principle on which it is supposedly based.

It therefore seems that, in the appropriate circumstances, payment may be authorised under the inherent jurisdiction either prospectively or retrospectively, and the jurisdiction extends to increasing the level of remuneration beyond that authorised in the trust instrument. Consider, however, the following points:

(1) Should the court authorise an increase in remuneration to corporate trustees who appear to have made a bad bargain? (See Kenny (1982) 79 LS Gaz 217; Hodkinson [1982] Conv 231; Bishop and Prentice (1983) 46 MLR 289 at 307–309). Consider, in particular (i) the significance of the professional charging clause cited at p 423 being, in effect, index-linked, unlike SETCO's fixed scale of fees, and (ii) whether TA 2000, s 29(3) – 'reasonable remuneration' – is or should be a material consideration.
(2) Can the courts under their inherent jurisdiction intervene to reduce a scale of fees which is higher than that charged by other corporate trustees (see Hodkinson [1982] Conv 231 at 234–235)?
(3) In a previous edition of this book we suggested that 'the decision in the *Duke of Norfolk*'s case establishes that there is now no logical stopping-place short of a presumption that professional trustees will always be entitled to reasonable remuneration, unless the contrary is clearly expressed in the trust instrument'. This is the outcome broadly reflected in TA 2000, s 29. Note, however, that in the *Duke of Norfolk*'s case all sui juris beneficiaries had consented to the SETCO proposals. There is no corresponding statutory requirement in TA 2000, s 29. Should there have been? Should the prior agreement of all sui juris beneficiaries be a precondition to judicial approval of an increase in trustee remuneration under the inherent jurisdiction?
(4) Note that in some circumstances lay trustees may also be awarded remuneration. In *Foster v Spencer* [1996] 2 All ER 672 an application by lay trustees to be remunerated for work that 'was wholly outside their contemplation when appointed' and that made 'great demands' on their time and expertise was approved. The trustees had over a period of some twenty years managed to resolve difficulties associated with selling, on behalf of the members, a club cricket ground for development. An application for future remuneration was refused even though the trustees indicated an unwillingness to continue unless remunerated. The court reaffirmed the underlying principle that remuneration would only be ordered where 'necessary for the good administration of the trusts' and that the remaining duties – 'to determine the beneficial interests

by an originating summons to the court' – were neither onerous nor required special expertise on the part of the trustees (at 682).

(5) The inherent jurisdiction of the court to authorise remuneration can also be exercised in favour of fiduciaries other than trustees. Indeed, in the appropriate circumstances the court may even exercise its discretion so as to remunerate those who have committed some breach of trust. This extension of the inherent jurisdiction is considered further in Chapter 16 in the context of 'those appropriate circumstances' (see p 848).

7. Trusteeship and indirect remuneration

(a) Director's fees

(1) The problem

It is not uncommon for trustees to find themselves holding blocks of shares which give them partial or even complete control of a company. Where the trust holds a majority shareholding, the trust instrument may authorise trustees to appoint themselves directors of the company and retain any fees paid to them in that capacity (*Re Llewellin's Will Trusts* [1949] Ch 225); a concise modern formulation is: 'The Trustees may make arrangements to remunerate themselves for work done for a company connected with the Trust Fund' (Kessler *Drafting Trusts and Will Trusts* (5th edn, 2000) p 312). But the trust instrument may be silent on this point. Can the trustees nevertheless use the voting rights that may attach to the shareholding to secure their own appointment as trustees, and if so to retain fees paid to them in their capacity as directors of the company?

(2) A rule

Contrasting views were expressed in two early cases. In *Re Francis* (1905) 92 LT 77, Kekewich J assumed, the point not being argued, that in the absence of express authorisation in the will, trustees were accountable to the trust for remuneration received as directors. *Re Francis* was then not cited in *Re Dover Coalfield Extension Ltd* [1908] 1 Ch 65, CA, where two directors of one company (A) were appointed as directors of another company (B), in which A held shares, in order to protect A's interests. Subsequently, so as to comply with the articles of B which required directors to acquire 1,000 shares within one month of appointment, A transferred the necessary shares to each of the two directors but to be held on trust for A. It was not disputed that dividends accruing to the shares became trust property but what of the directors' fees? It was held that the director-trustees could retain these. The decision has been explained (see *Re Gee* [1948] Ch 284 at 294 per Harman J) on the basis that the trustees there had become directors before they held any trust shares and, although they could only continue as directors by virtue of the shareholding, it was not by virtue of the use of the shares that they either became entitled or continued to earn their fees (see also *Re Orwell's Will Trusts* [1982] 1 WLR 1337). Yet dicta by Warrington J in *Re Dover Coalfield Extension Ltd* suggested a still more liberal approach. He doubted that a director's remuneration was 'profit' for which a trustee should be held accountable at all: ‘it is payment for the work which the director does on behalf of the company of which he is a director, and the ratio between the value of the work and the amount of the remuneration is settled by the contract between those two parties’ (at 83). This can be argued to represent an attempted modification of the rule in favour of one permitting reasonable remuneration, yet the modification, if that is what it was, was not followed in subsequent cases.

In *Re Macadam* [1946] Ch 73, under the articles of a company, trustees had power by virtue of their office to appoint two directors. They appointed themselves and were held liable to account for the remuneration they received. Cohen J summarised the position in the following way (at 82): ‘the root of the matter really is: Did he acquire the position in respect of which he drew the remuneration by virtue of his position as trustee? . . . although the remuneration was remuneration for services as director of the company, the opportunity to receive that remuneration was gained as a result of the exercise of a discretion vested in the trustees, and they had put themselves in a position where their interest and duty conflicted.’ The conflict which concerned Cohen J is clear enough. Where trustees are given a power to appoint directors, or can employ the voting power of the trust shareholding to the same end, their duty to the trust is to ensure that the best persons are appointed; their interest as potential recipients of remuneration is to choose themselves for the job.

Subsequently in *Re Gee* [1948] Ch 284 Harman J broadly followed Cohen J’s approach, and indeed pointed out that it was not only positive use by trustees of their powers that was relevant but also that (at 295):

> A trustee who has the power, by the use of trust votes, to control his own appointment to a remunerative position, and refrains from using them with the result that he is elected to the position of profit, would also be accountable.

But Harman J is also at pains to emphasise the limits of the rule. It does not, for example, disentitle a trustee who owns shares beneficially from voting those shares in his own interest, nor does it disentitle directors who subsequently become trustees from continuing to receive their fees. Nor will it affect director-trustees where the terms of the trust authorise trustees to appoint themselves as directors. Nor it appears will it prevent a trustee from appointing a company that he controls to carry out work on behalf of the trust and then pay fees to it for doing so, provided that a charging clause can be construed as authorising the appointment, as was the case in *Re Orwell’s Will Trusts* [1982] 1 WLR 1337. This approach concentrates essentially, in the absence of any express authorisation, on the independence of the appointment – did the trustees’ acts or omissions materially affect the appointment – and represents a step away from a strict rule. But is the emphasis still unnecessarily prophylactic?

> . . . it clearly suffers from being a formula in an area where facts are infinitely variable. For example, the highly competent director becomes a trustee of a trust holding considerable stock in a private company which is being poorly directed. He employs

> his power to acquire a directorship, and thereafter proceeds to make the company successful. He surrenders his fees as director. In another case an elderly trustee is invited by the board to become a director, the object being to placate trust beneficiaries. The trustee contributes little or nothing to board decisions. He retains his fee. (D Waters *The Law of Trust in Canada* (2nd edn, 1984) p 735)

(3) A solution

The court, under an inherent jurisdiction of uncertain pedigree (see Green (1982) 45 MLR 211 at 213), is able to authorise a director-trustee to retain a director's fee even if strictly liable to account to the trust. The position was considered in *Re Keeler's Settlement Trusts* [1981] 1 All ER 888, where clause 4 of the settlement envisaged the appointment of trustees as directors of certain companies. However, the standard professional charging clause in the settlement did not indicate what was to happen to the fees of a director-trustee. The court reviewed the extent of its jurisdiction both to authorise the retention of fees already received and to empower director-trustees to retain fees in the future. On both points Goulding J closely followed the approach adopted by Walton J in *Re Duke of Norfolk's Settlement Trusts* [1979] Ch 37.

> *Re Keeler's Settlement Trusts* [1981] 1 All ER 888 at 893
>
> **Goulding J**: None of the authorities cited gives explicit guidance on the court's anticipatory jurisdiction to allow a director-trustee to retain future remuneration for his own benefit. In my opinion, however, the court does possess such jurisdiction, exercisable in harmony with the principles that Walton J found applicable to the court's jurisdiction to authorise the remuneration of a trustee for his duties as such. They are set out at [1978] 3 All ER 907 at 924–925. In adapting them by analogy to the particular anticipatory jurisdiction now under examination, and remembering the different source of the remuneration, I am accordingly of opinion that this must be treated as an exceptional jurisdiction, to be exercised sparingly, and that the court will only exercise it (save perhaps in some wholly exceptional case) if satisfied that it is plainly expedient in the interests of the trust for the directorship in question to be held by a trustee, and that the additional duties imposed on the trustee are such that he cannot fairly be expected to undertake them without retaining an appropriate remuneration. The appropriate remuneration must be determined by the court in the interest of the trust; it will not necessarily be the whole of that paid by the company for the director's services . . .

[Goulding J then turned to consider the question of remuneration already received:]

> The test I have taken from the judgment of Walton J is whether any exceptional effort or skill was shown in acquiring the remuneration. That was his formulation in the *Duke of Norfolk*'s case [1978] 3 All ER 907 at 921–922. He paraphrased it by speaking (at 925) of –
>
> > 'those cases where the trustees are held to be accountable for profits which they have made out of the trust, but are in general allowed to keep that proportion of

> the profits so made (doubtless, in many cases, the whole) which results from their own exertions above and beyond those expected of a trustee . . .'
>
> I do not think that any and every effort or skill applied by a trustee in executing the office of a company director is to be regarded as exceptional or unexpected for this purpose, certainly not in the present case, where it is made perfectly clear by cl 4 of the settlement that a trustee may be proposed for appointment as a director of any company in which the trustees have an interest. The director-trustee, in my judgment, may in a proper case be allowed to retain reasonable remuneration for effort and skill applied by him in performing the duties of the directorship over and above the effort and skill ordinarily required of a director appointed to represent the interests of a substantial shareholder. The latter is something that a prudent man of business would in general undertake in the management of his own investments, and so in my view is in general an exertion reasonably expected of a trustee.

Consider the following points:

(1) *Re Keeler* was decided prior to the Court of Appeal judgment in the *Duke of Norfolk* case. What is the impact, if any, of the latter judgment on the criteria applied by Goulding J?

(2) Can it now be said that, even in the absence of authority in the trust instrument, director-trustees are *in effect* required to disgorge only those fees which are unreasonable in comparison with the work done? (See Green (1982) 45 MLR 211; Shindler [1981] Conv 237; Hodkinson [1982] Conv 231 at 235; and for a comparative assessment of English and US approaches see Hughes (1980) 30 U Toronto LJ 151 at 171–178.)

(b) Commission and analogous profits

The opportunities for trustees to earn commissions or analogous profits are numerous. A solicitor-trustee, for instance, may also hold an appointment as an agent for an insurance company and receive commission on insurances placed with that company. Can the solicitor insure trust property with the company and retain the commission for himself or herself? Comparable opportunities exist for corporate trustees. Banks possess savings departments and pay interest on deposit accounts; they frequently manage in-house unit trusts which solicit investments from the public at large. Can a bank trust department place trust money in the bank's deposit account, or invest trust funds by purchasing bank-managed units or even bank shares?

Prima facie both solicitor and bank would be making a profit directly by the use of their position as trustees and a strict application of the rule prohibiting a conflict of duty and interest would result in both being held accountable. Whilst there is clear authority (*Williams v Barton* [1927] 2 Ch 9) supporting the application of the strict approach the trust instrument can, and often does, authorise trustees to retain commissions and banks to deposit trust funds with itself as banker (see eg *Space Investments v Canadian Imperial Bank* [1986] 1 WLR 1072). As Lord Templeman pointed out in *Space Investments* specific authority can modify the general rule: 'Although as a general rule, a trustee is not allowed to derive a benefit from the trust property, that general rule may be altered by the express terms of the trust instrument (at 1075; see also the dictum of Lord Herschell in *Bray v Ford* above at 338; and Mowbray (1996) 10 TLI (2) 49). In any event one consequence of the Financial Services Act 1986 (now the Financial Services and Markets Act 2000), and an additional check, is that commission arrangements for many professional trustees will also have to comply with such regulations as are promulgated by the relevant professional body or regulatory organisation.

8. Dealings with the trust fund or beneficiaries

(a) Introduction: 'self-dealing' and 'fair-dealing' rules

In administering a trust there may be opportunities for a trustee to purchase either trust property or even a beneficiary's interest under the trust. The temptation for the trustee is obvious. In either case the trustee's own interest in obtaining a good bargain could conflict with a duty to the trust or to the beneficiary to obtain the best price. Equity has developed two rules to regulate the potential conflict – the 'self-dealing' rule and the 'fair-dealing rule' – succinctly summarised by Megarry V-C in *Tito v Waddell (No 2)* [1977] 3 All ER 129 at 241:

> The self-dealing rule is . . . that if a trustee sells the trust property to himself, the sale is voidable by any beneficiary ex debito justitiae, however fair the transaction. The fair-dealing rule is . . . that if a trustee purchases the beneficial interest of any of his beneficiaries, the transaction is not voidable ex debito justitiae, but can be set aside by the beneficiary unless the trustee can show that he has taken no advantage of his position and has made full disclosure to the beneficiary, and that the transaction is fair and honest.

Both rules are considered in turn below although, as Megarry V-C pointed out, their common origin lies in the determination of equity to prevent trustees from abusing their position or profiting from their trust: 'the shepherd must not become a wolf.'

(b) 'Self-dealing' rule and the purchase of trust property

The long-established rule was most forcibly stated by Lord Eldon in two leading cases *Ex p Lacey* (1802) 6 Ves 625 and *Ex p James* (1803) 8 Ves 337. The strictness of his approach and the rationale for it are apparent in the following passage from *Ex p James* (at 344):

> This doctrine as to purchases by trustees, assignees, and persons having a confidential character, stands much more upon general principle than upon the circumstances of any individual case. It rests upon this, that the purchase is not permitted in any case, however honest the circumstances, the general interests of justice requiring it to be destroyed in every instance; as no court is equal to the examination and ascertainment of the truth in much the greater number of cases.

Subsequent cases have confirmed that considerations such as the honesty of the trustee, the fairness of the price, the fact that the sale takes place at a public auction are all irrelevant (see in particular *Wright v Morgan* [1926] AC 788 and, in the context of a director and his company, *Aberdeen Rly Co v Blaikie Bros* (1854) 1 Macq 461). The purchase is voidable within a reasonable time at the option of a beneficiary. Not surprisingly the courts have been prepared to extend the rule to counter attempts at circumvention. The rule cannot therefore be evaded, for example, by a trustee selling to nominees, or to a partnership of which he is a member (*Re Thompson* [1985] 2 All ER 720), or to a company of which the trustee is a major shareholder (*Silkstone and Haigh Moor Coal Co v Edey* [1900] 1 Ch 167) or possibly even where the shareholding is sufficiently large to be capable of influencing the trustee's decision (*Movitex v Bulfield* [1988] BCLC 104 at 122 per Vinelott J). The self-dealing rule has also been held in *Kane v Radley-Kane* [1999] Ch 274 to apply to a personal representative. In that case the widow of the deceased, who was entitled to a statutory legacy of £125,000, transferred into her own name, without the sanction of the court or the consent of the beneficiaries – her three stepsons – shares then valued at £50,000 that had been part of her husband's intestate estate worth in total only £93,000. Some three years later she sold the shares for £1,131,438. At the request of one of the beneficiaries Sir Richard Scott V-C held the transaction void: 'There is no doubt that, in appropriating . . . the shares to herself in or towards satisfaction of the £125,000 statutory legacy due to herself, Mrs Radley-Kane was effecting a transaction in which her duty [to the other beneficiaries in the intestate estate] and interest were in conflict' (at 280).

Where an improper sale has occurred there are a number of remedies available to the beneficiaries. In addition to a right to have a sale set aside – a right also effective against a subsequent purchaser from the trustee with notice of the circumstances – beneficiaries may opt instead to claim any profit where a trustee has subsequently resold at a profit. Alternatively if the property has not already been resold the beneficiaries may themselves prefer to have a resale ordered and to retain a higher price rather than have the property reconveyed. Whatever the preferred remedy, once beneficiaries become fully aware of the circumstances, they should not delay for an unreasonably long period in implementing proceedings or they will be deemed to have acquiesced in the purchase under the equitable doctrine of laches (see Chapter 11, p 577).

Part of the rationale for the rule, however, is that trustees should not *put* themselves in a position of conflict. Consequently, where they are placed in that position by a conscious decision of a settlor or testator the rule will not apply (*Sargeant v National Westminster Bank plc* (1990) 61 P & CR 518, CA). Thus the trust instrument may expressly permit purchase by trustees, although they will still be subject to the fiduciary obligation to pay the best possible price. In addition, where all beneficiaries are sui juris and have full knowledge of all the facts, they also can authorise the transaction although, given the stringency of the equitable standards that apply to such a sale, there must be some doubt as to the future marketability of property purchased in this manner (see eg *Parker and Mellows* p 348). For that reason any trustee wishing to purchase trust property is well advised to seek the prior approval of the court to the purchase. It seems, however, that this will not be granted where a beneficiary objects, unless all other avenues of selling the property have been exhausted (see *Tennant v Trenchard* (1869) 4 Ch App 537; and Heward *Chancery Practice* (1983) p 173).

Apart from these almost standard exceptions, it might be thought that the rule had been so firmly established by Lord Eldon's judgments, reinforced by the later authorities, as to be beyond serious question. But a dispute between two members of the Holder family over the purchase of two farms raised questions about the extent of the rule and its justification.

Holder v Holder [1968] 1 All ER 665
A testator appointed his widow, a daughter and a son, Victor, who was a tenant of two farms owned by the testator, as his executors. After the testator's death, Victor purported to renounce his executorship but not before he had performed some minor acts of administration which prevented the renunciation being effective. The two other executors put the two farms up for sale at an auction and Victor successfully bid for them through an agent. Another son sought to have the transaction set aside.

> **Harman LJ**: It was admitted at the Bar in the court below that the acts of . . . [Victor] were enough to constitute intermeddling with the estate and that his renunciation was ineffective. On this footing he remained a personal representative even after probate had been granted to his co-executors and could have been obliged by a creditor or a beneficiary to re-assume the duties of an executor. The judge decided in favour of the plaintiff on this point because [Victor] at the time of the sale was himself still in a fiduciary position and, like any other trustee, could not purchase the trust property. I feel the force of this argument, but doubt its validity in the very special circumstances of this case. The reason for the rule is that a man may not be both vendor and purchaser; but [Victor] was never in that position here. He took no part in instructing the valuer who fixed the reserves or in the preparations for the auction. Everyone in the family knew that he was not a seller but a buyer. In this case [Victor] never assumed the duties of an executor. It is true that he concurred in signing a few cheques for trivial sums and endorsing a few insurance policies, but he never so far as appears interfered in any way with the administration of the estate. It is true he managed the farms, but he did that as tenant and not as executor. He acquired no special knowledge as executor. What he knew he knew as tenant of the farms.
>
> Another reason lying behind the rule is that there must never be a conflict of duty and interest, but in fact there was none here in the case of [Victor], who made no secret throughout that he intended to buy. There is of course ample authority that a trustee cannot purchase.

[Harman LJ cited, inter alia, the passage from Lord Eldon's judgment in *Ex p James* quoted at p 435 above.]

These are no doubt strong words, but it is to be observed that Lord Eldon was dealing with cases where the purchaser was at the time of sale acting for the vendors. In this case [Victor] was not so acting: his interference with the administration of the estate was of a minimal character, and the last cheque that he signed was in August before he executed the deed of renunciation. He took no part in the instructions for probate, nor in the valuations or fixing of the reserves. Everyone concerned knew of the renunciation and of the reason for it, namely that he wished to be a purchaser. Equally, everyone including the three firms of solicitors engaged assumed that the renunciation was effective and entitled [Victor] to bid. I feel great doubt whether the admission made at the Bar was correct, as did the judge, but assuming that it was right, the acts were only technically acts of intermeddling and I find no case where the circumstances are parallel. Of course, I feel the force of the judge's reasoning that if [Victor] remained an executor he is within the rule, but in a case where the reasons behind the rule do not exist I do not feel bound to apply it. My reasons are that the beneficiaries never looked to [Victor] to protect their interests. They all knew he was in the market as purchaser; that the price paid was a good one and probably higher than anyone not a sitting tenant would give. Further, the first two defendants alone acted as executors and sellers: they alone could convey: they were not influenced by the third defendant [Victor] in connexion with the sales.

I hold, therefore, that the rule does not apply in order to disentitle [Victor] to bid at the auction, as he did.

Danckwerts LJ: The principle that a trustee cannot purchase part of the trust estate goes back to the statement of it by Lord Eldon LC in 1802 in *Ex p Lacey*. Lord Eldon stated the principle in the most severe form. The reason given by Lord Eldon, that it is impossible to ascertain what knowledge the trustee may have seems less persuasive in the light of Bowen LJ's famous dictum that 'the state of a man's mind is as much a fact as the state of his digestion', and the almost daily experience of any judge engaged in ascertaining the knowledge and intentions of a party to proceedings. The principle is repeated in *Ex p James*. The subject is dealt with in Snell's *Equity* (26th edn) at p 259, where it is pointed out that the true rule is not that a trustee may not purchase trust property; it is that a purchase of trust property by a trustee is voidable within a reasonable time at the instance of any beneficiary . . . It is said that it makes no difference, even though the sale may be fair and honest and may be made at a public auction (see Snell's *Equity* p 260); but the court may sanction such a purchase and, if the court can do that (see *Snell* p 219), there can be no more than a practice that the court should not allow a trustee to bid. In my view it is a matter for the discretion of the judge.

Sachs LJ: It is moreover a matter which may well be open to argument whether the above rule is, in any event, nowadays quite as rigid as was postulated by counsel for the plaintiff. It is clear that the court has jurisdiction to allow a trustee to bid for trust property . . . and in addition it was conceded at the Bar that procedure exists by which a trustee or an executor can obtain the leave of the court in appropriate circumstances to purchase such property: and I understand that such leave has been given even where a beneficiary has objected.

Moreover I agree with Danckwerts LJ in his comments on that part of the foundation of the rule which stems from the alleged inability of a court to ascertain the state of

> mind of a trustee: and am inclined to the view that an irrebuttable presumption as to the state of his knowledge may no longer accord with the way in which the courts have now come to regard matters of this type. Thus the rigidity of the shackles imposed by the rule on the discretion of the court may perhaps before long be reconsidered as the courts tend to lean more and more against such rigidity of rules as can cause patent injustice – such as was done in *Cockerell v Cholmeley* (1830) 1 Russ & M 418. The rule, after all, appears on analysis to be one of practice as opposed to one going to the jurisdiction of the court.

The implications of the decision in *Holder v Holder* are assessed at the end of section (c).

(c) 'Fair-dealing' rule: dealings with a beneficiary including purchase of the beneficial interest

Here the less strict approach outlined by Megarry V-C in *Tito v Waddell (No 2)* applies. Equity has recognised that a trustee may be in a position to exercise influence or to exploit professional skill or superior knowledge to strike a bargain advantageous to himself. Consequently any transaction between a beneficiary and a trustee is carefully scrutinised and a standard higher than the 'higgling of the market' is set. The onus is on the trustee to show in general that no advantage was taken of the position of trusteeship, and in particular that an adequate price was paid and that all available information was given to the beneficiary (see Lord Eldon in *Coles v Trecothick* (1804) 9 Ves 234 at 247).

The contemporary application of both the self-dealing and the fair-dealing rule is most prevalent in fiduciary relationships other than that of trustee-beneficiary. The impact of equity's approach is apparent, for example, in the statutory provisions which now regulate dealings between company director and company and which place emphasis on full disclosure (see Companies Act 1985, s 317 and also Article 85 of Table A Articles of Association; and *Movitex Ltd v Bulfield* [1988] BCLC 104; see also Chapter 13 for the relevance of the rules to trusteeship in pension schemes).

Consider the following points:

(1) Was *Holder v Holder* wrongly decided?

(2) In *Re Thompson's Settlement* [1985] 2 All ER 720 (see Sherrin (1986) 1 Trust Law and Practice 66) contracts for sale of two leases of farms, owned by a trust, to a company and to a partnership of which two trustees were respectively a majority shareholder (and managing director) and a partner were held unenforceable. Vinelott J, affirming the traditional approach, distinguished *Holder v Holder* in the following manner: 'The reason why, in the words of Harman LJ, the "self-dealing" rule did not apply [in *Holder v Holder*] was that Victor, though he might technically have been made an executor notwithstanding the purported renunciation, had never acted as executor in a way which could be taken to amount to acceptance of a duty to act in the interests of the beneficiaries under his father's will' (at 730). Does *Holder v Holder* therefore constitute only a limited exception to the 'self-dealing' rule or does it indicate a pragmatic move

towards a 'fair-dealing' rule? If the latter, do you think that the Court of Appeal in *Holder v Holder* gave sufficient weight to the problems of detection and proof that might occur?

(3) 'The basic theoretical distinction between dealings with the "corpus" and dealings with the beneficiary is that, in the former, the fiduciary's power is one of control, while in the latter his power is one of influence.' (Shepherd *Law of Fiduciaries* (1981) p 156.) Are 'control' and 'influence' sufficiently different in practice to justify two distinct rules?

(4) In cases where litigation occurs the facts are rarely sufficiently straightforward to fit neatly within the rules. In *Public Trustee v Cooper* [2001] WTLR 901, for instance, two of the trustees of trust funds and the funds themselves held substantial shareholdings in a brewery company, in the case of at least one of the funds primarily for the benefit of the company's employees. A take-over bid was received that was favourable from the standpoint of the shareholders but less so for the employees who consequently were opposed to the sale of the shareholdings of the trust funds. The trustees sought directions from the court on a number of points, one of which concerned the implications of the possible conflict of interest affecting the two trustees. The potential conflict was not one of 'self dealing' or 'fair dealing' but it was clearly in the personal interest of the trustees for the takeover to succeed whilst, on the facts, it was held to be also in the interests of the trust funds. But Hart J commented on the possible courses of action open to trustees in such situations (emphasis added):

> Where a trustee has such a private interest or competing duty, there are, as it seems to me, three possible ways in which the conflict can, in theory, *successfully be managed*. One is for the trustee concerned to resign. . . . Secondly, the nature of the conflict may be so pervasive throughout the trustee body that they, as a body, have no alternative but to surrender their discretion to the court. Thirdly, the trustees may honestly and reasonably believe that, notwithstanding a conflict affecting one or more of their number, they are nevertheless able fairly and reasonably to take the decision. In this third case, it will usually be prudent, if time allows, for the trustees to allow their proposed exercise of discretion to be scrutinised in advance by the court, in proceedings in which any opposing beneficial interests are properly represented, and for them not to proceed unless and until the court has authorised them to do so. If they do not do so, they run the risk of having to justify the exercise of their discretion in subsequent hostile litigation and then satisfy the court that their decision was not only one which any reasonable body of trustees might have taken but was also one that had not in fact been influenced by the conflict.

Although a different factual and legal context to either *Holder v Holder* or *Re Thompson's Settlement* the notion of 'managing' such conflicts is redolent more of the former than the latter. As Simpson, in a careful analysis of this area of conflicts of interest, has pointed out in relation to the third 'leg' of Hart J's analysis 'This amounts to an application of the "fair dealing" rule, but the consequences are imposed, not as an application of the "fair dealing" rule, but instead as the most appropriate manner in which to manage a conflict between duty and interest in the face of competing considerations . . .' ('Conflicts' in Birks and Pretto (eds) *Breach of Trust* (2002) pp 75–94 at p 87).

9. Conflicts of interest and duty: the wider picture

'The self-dealing rule is founded on and exemplifies the wider principle that "no one who has a duty to perform shall place himself in a situation to have his interests conflicting with that duty"' (per Vinelott J in *Movitex Ltd v Bulfield* [1988] BCLC 104 at 117, citing Lord Cranworth in *Broughton v Broughton* (1855) 5 De GM & G 160 at 164). Contemporary developments in corporate structures and in provision of financial services are increasing the situations in which such conflicts can occur. Even in the context of trusteeship itself, the potential for conflict has expanded in concert with the changing nature of and role for trustees. Consider, for instance, the position of a bank acting as trustee of a discretionary trust where one of its customers, whose account is overdrawn, is also a beneficiary of the trust. The temptation to favour that beneficiary unduly is obvious, as is the potential conflict between the bank's duties to the trust and its own financial interest. Yet there is some authority that such a potential conflict is not a decisive objection to a bank being appointed as trustee (*Re Northcliffe's Settlements* [1937] 3 All ER 804).

It is apparent, moreover, that the reach of the 'wider principle' stretches beyond the type of duty versus self-interest conflict just described (the 'no conflict' rule). Thus it is also often contended that a fiduciary should not place himself in a position where duties to one beneficiary can conflict with duties to another (the 'undivided loyalty' rule). In the same way that many illustrations of the application of the 'no conflict' rule occur in fiduciary relationships other than that of trustee-beneficiary, so also is this the position with the 'undivided loyalty' rule (eg being appointed a director for two competing companies or a firm of solicitors acting for both parties in litigation).

One consequence of the type of commercial and financial development referred to here is to raise afresh questions both about the nature and scope of fiduciary relationships in general, and about how contemporary conflicts of interest and duty can be either prevented or regulated. In addressing these questions, however, we need to be sensitive to a warning uttered by Lord Selborne in *Barnes v Addy* (1874) 9 Ch App 244 at 251: '[There is] no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them.' Much recent development in these doctrines and in the remedies applicable to breaches of duty has tended to occur in contexts other than that of trustee-beneficiary. It is our view that the developments are therefore better analysed within those usually commercial contexts, in particular Chapter 13 (Trusts in commerce: the regulation of occupational pension schemes) and Chapters 16 (Fiduciary relationships, commerce and constructive trusts). Only then will we be able to decide whether the 'fiduciary element' in the trustee-beneficiary relationship remains, to quote Scott again, 'peculiarly intense'.

10

Aspects of the management of trusts

1. Introduction

Management is a convenient umbrella term under which cluster a diversity of trustee tasks. In the case of those trusts not confined simply to the holding and retaining of legal title to designated property, the task dominating all others is that of protecting and indeed enhancing the value of the trust fund through effective investment. But trustees cannot just behave as individuals might with their own funds to invest. The courts of equity, in refining the obligations of trusteeship, have imposed a range of duties upon trustees, some of which impinge directly on the management of the trust fund. In this chapter we therefore consider, in addition to the duty of investment, the duties to act impartially between beneficiaries and not to delegate the trust. There is a complex interaction between these three topics. For example, on the one hand the variety of investments available to trustees suggests a need for expert help, and the process of investment-reinvestment itself necessarily involves some delegation of functions to intermediaries such as real estate valuers, stockbrokers, bankers and solicitors. On the other hand, in principle trustees have until recently been required to reserve to themselves the *exercise* of their discretions over investment decisions, especially with regard to the duty of impartiality. This long-held principle of non-delegation of discretions seemed increasingly to be at odds with a changing economic and social environment. In particular, fundamental changes in the way that investment business was being transacted contributed to a growing perception that there was a need to reform the law on trustees' powers and duties. Various proposals for reform were advanced from 1982 onwards (see Chapter 9 at p 410) and culminated in the Trustee Act 2000. As regards powers of investment and delegation conferred on trustees, the Trustee Act 2000 has introduced important statutory modifications to the pre-existing common law and statutory framework. These broaden substantially the statutory default powers conferred on trustees to invest trust assets and in addition permit trustees to delegate more extensively the investment management function. These changes and the resulting legal framework are considered in sections 3 and 5 of this chapter. First, however, it is necessary to consider a major fundamental innovation in the Trustee Act 2000, the enactment in s 1 of a statutory duty of care applicable to, inter alia, the new default powers of investment and delegation.

2. Duty of care

(a) From the 'prudent man' to a statutory duty of care

(1) Introduction

There are two particular questions to be considered about the new statutory duty of care contained in Trustee Act 2000, s 1. What is the standard and why was it felt necessary to adopt a statutory duty? Interpretation of the standard will be considered in section (b) below (see p 445) but in our view that task requires some appreciation of the reasons why the pre-existing legal framework was considered in need of reform. After all the introduction of the statutory duty does not mean that before the commencement date of 1 February 2001 trustees enjoyed a carefree existence with no obligation to exercise skill and care in the management of the trust. Aside from the long-established fiduciary obligations, Chancery developed during the nineteenth century what came to be termed the 'prudent man of business standard', a commercial standard against which the competence and diligence of trustees was to be measured (see Chapter 2, p 45 and the detailed accounts in Stebbings *The Private Trustee in Victorian England* (2002) ch 5; and Getzler 'Duty of Care' in Birks and Pretto (eds) *Breach of Trust* (2002) ch 2). Trustees were expected to 'conduct the business of the trust in the same manner that an ordinary man of business would conduct his own' (*Speight v Gaunt* (1883) 22 Ch D 727 at 739 per Jessell MR). Did this then mean that there was one common standard applicable to all types of trustee and to all types of trust management activities? Unfortunately the answers to these questions became uncertain as the case law developed during the twentieth century.

(2) A variable 'prudent man' standard?

With regard to types of trustee the traditional view was that a common standard of skill and care applied to all trustees irrespective of whether they acted gratuitously or for payment (see *Jobson v Palmer* [1893] 1 Ch 71). This was first judicially doubted by Harman J in *Re Waterman's Will Trusts* [1952] 2 All ER 1054 at 1055: 'I do not forget that a paid trustee is expected to exercise a higher standard of diligence and knowledge than an unpaid trustee and that a bank which advertises itself largely in the public press as taking charge of administration is under a special duty.' This sentiment received firm endorsement from Brightman J in *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139. He explained the reasons for the different standards in the following manner (at 152):

> I am of opinion that a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management. A trust corporation holds itself out in its advertising literature as being above ordinary mortals.

> With a specialist staff of trained trust officers and managers, with ready access to financial information and professional advice, dealing with and solving trust problems day after day, the trust corporation holds itself out, and rightly, as capable of providing an expertise which it would be unrealistic to expect and unjust to demand from the ordinary prudent man or woman who accepts, probably unpaid and sometimes reluctantly from a sense of family duty, the burdens of a trusteeship. Just as, under the law of contract, a professional person possessed of a particular skill is liable for breach of contract if he neglects to use the skill and experience which he professes, so I think that a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have.

This explanation left a number of points unexplained. First, what is the basis for imposing the higher standard? Is it the public professing of a specialist expertise, or that trust management is undertaken for a fee, or that a particular level of competence is to be expected from a professional trustee? The implications of these distinctions become clearer if we recall the threefold characterisation of trustees into unpaid amateur, paid professional – for example, solicitor – and corporate trustee. If the basis for liability is merely receipt of remuneration (must it be any level or a market rate?) then arguably there should be only two standards of skill and care – the amateur and the professional. But if professed or expected skill is relevant are professional non-corporate trustees something of a 'hybrid' (see Shindler (1980) 44 Conv 155 at 158)? Should a still different standard be applicable to them, and if so, what should it be? For instance, should a professional who proclaims no specialist trust expertise but assumes the administration of a trust, at a fee but merely to accommodate a client, be held to the same standard as a fellow professional specialising in estate and trust administration? There have even been suggestions (see Paling (1973) 37 Conv 48) that the ordinary prudent man of business standard was itself inappropriate for unpaid trustees and that they should be required to exercise only the degree of skill and care which they are accustomed to exercise in the management of their own affairs.

(3) Delegation, the duty of care and an agenda for reform

These uncertainties as to what the legal position was and, indeed, should be were compounded in the context of one particular managerial function, the exercise of the power of delegation. The specific difficulty arose over the matter of trustee liability for the acts or omissions of delegates in circumstances where trustees had exercised the limited statutory powers of collective delegation under the Trustee Act 1925. The relationship between s 23(1) and s 30(1), both now repealed by the Trustee Act 2000, became a matter of some uncertainty and debate, particularly as a consequence of a controversial judgment by Maugham J in *Re Vickery* [1931] 1 Ch 572 (see Potter (1931) 47 LQR 331; Holdsworth (1931) 47 LQR 463; Jones (1959) 22 MLR 381; Paling (1975) 126 NLJ 56; Stannard [1979] Conv 345). Notwithstanding the long-standing academic controversy on this matter the Law Reform Committee

(LRC) in its 1982 Report commented that 'the paucity of cases indicates that the present law creates little difficulty in practice and no witness has given us any example of any problems' (23rd Report, *Powers and Duties of Trustees* (Cmnd 8733) para 4.9). Nevertheless, when in November 1995 the Lord Chancellor's Department agreed that trustees' powers and duties should be part of the Law Commission's Trust Law programme, it was inevitable that the subject of the standard of skill and care and its material scope would form a necessary part of the review. In light of the long-standing criticisms of ss 23 and 30 it is not surprising that the Law Commission felt able to conclude that the sections did not form a coherent whole, were widely thought to be insufficiently demanding when compared with the common law and that it was 'necessary to replace them with a clearer and more appropriate duty of care that will apply to both the selection and supervision of agents by trustees' (*Trustees' Powers and Duties* (1999) Law Com No 260, Scot Law Com No 172, para 3.10). Significantly the Law Commission also decided to take the opportunity offered by the perceived need to replace the provisions to recommend 'that there should be a single statutory duty of care with which trustees must comply when carrying out certain prescribed functions'. Equally significantly the Law Commission decided to address any lingering uncertainty as to the standards applicable to different types of trustee by recommending that the statutory duty of care should expressly incorporate a subjective element. These recommendations were adopted and implemented in the Trustee Act 2000, s 1.

(b) A statutory duty of care: Trustee Act 2000, s 1

> (1)(1) Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular –
>
> (a) to any special knowledge or experience that he has or holds himself out as having, and
>
> (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

It should be noted that the new statutory duty of care applies *only* to the functions specified in Sch 1 to the statute, irrespective of whether those functions arise under a default statutory provision or by a corresponding express clause in a trust instrument. The specified functions include: the exercising of *any* power of investment, including the new duties under Trustee Act 2000, ss 4 and 5 to review investments and obtain advice; the exercise of any power in relation to land, including the acquisition of land; the appointment and review of 'agents, nominees and custodians'; the power to insure; and the exercise of any powers of compromise. The statutory duty does not apply therefore to dispositive powers of trustees such as discretion to select from a class of beneficiaries, or even statutory powers of advancement and maintenance. Furthermore the statutory duty of care applies only to the *exercise* of a power specified in the Schedule but not to the prior decision about whether or not to exercise it at all. There is no intention to alter what has historically been a more abstentionist role for the courts in this regard; in the words of the Law Commission 'the general rule is that the courts will not interfere in the absence of bad faith on the part of trustees, even though [the courts] may take the view that the trustees are not acting judiciously' (*Trustees' Powers and Duties* (1999) Law Com No 260, para 3.3. and see Chapter 11 at p 522 for a full discussion of judicial control of trustees' discretions).

The statutory formulation of the duty of care mirrors precisely the final recommendation of the Law Commission (para 3.25) and, with its reference to 'reasonable in the circumstances', is akin to the 'reasonableness' standard employed in the tort of negligence. This formula was not the only option. The Commission had set out a series of other possible standards in its 1997 Consultation Paper (Consultation Paper No 146, paras 6.45–6.55). In the subsequent 1999 Report two of the possible options – 'acting in good faith' and 'being vicariously liable for all acts and defaults of agents' – were rejected for being respectively too undemanding and too rigorous. A third possibility – listing a series of specified criteria – was viewed as impracticable given all the different managerial functions that were to be subject to the duty of care. The two further options considered by the Commission were the 'prudent person of business standard' – in effect the common law position – and the 'reasonable in the circumstances' standard now contained in s 1. The Commission noted that 'there may, in fact, be little difference between the two alternatives' because '[the prudent person test] may already recognise a gradation as to the standards expected according to whether the trustee is an unpaid layman, a paid professional, or a professional trustee who holds him or herself out as such' (*Trustees' Powers and Duties* (1999) Law Com No 260, para 3.24). Nevertheless the Commission considered that it was desirable for the avoidance of doubt '[to express] the subjective element of the test on the face of the statute' (above).

It is tempting to conclude that the new statutory duty of care is no more than a codification of the common law 'prudent man' standard. Regrettably the more detailed formulation of the duty of care in Trustee Act 2000, s 1 and Sch 1 still leave open some uncertainties of interpretation and application.

Consider the following points:

(1) There seems little doubt that the incorporation of the subjective element in the duty of care was intended by the Law Commission to reflect the opinion that 'the level of care and skill which is reasonable may *increase* if the trustee has special knowledge or skills . . . or if the trustee is acting in the course of a business or profession (para 3.24, emphasis in the original text). Notwithstanding this view, can the fact that one of the 'circumstances' specified in s 1 refers to the personal qualities or characteristics of a particular trustee (see s 1(a)) support a proposition that 'it may be that the unintelligent or unworldly trustee owes a lower statutory duty of care . . . than that of the prudent man of business under the pre-existing law?' (See Oakley (ed) *Parker*

and Mellows, The Modern Law of Trusts (8th edn, 2003) p 574. We suggest that it is difficult to reconcile that proposition with either the tenor of the language used in s 1(a) – '*special* knowledge and experience' – or the fact that one of the options originally offered by the Law Commission containing the phrase 'the skills which the trustees actually have' was specifically rejected on grounds of excessive subjectivity (see para 3.24, footnote 51). Nevertheless the possibility cannot be completely ruled out that the phrase 'in all the circumstances' could lead to an outcome whereby a non-professional trustee who acts honestly but ineptly might be held to have satisfied the statutory test but not the prudent man threshold required by the common law test. We must also await clarification on the areas of uncertainty mentioned previously (see p 444) such as whether a professional who proclaims no specialist trust expertise but assumes the administration of a trust merely to accommodate a client will be held to the same standard as a fellow professional specialising in estate and trust administration. Also should the standard differ depending on whether or not a fee is charged, s 1 making no specific reference to remuneration although arguably this may be inferred from the reference to 'acting in the course of a business or profession'? By way of postscript it should be noted that under the previous common law test there was no concrete example where a difference in standards expected of lay and professional trustees was decisive. *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] 1 All ER 139 was the only reported case directly dealing with the issue and there Brightman J considered that (at 153) 'the bank failed in its duty whether it is judged by the standard of the prudent man of business or of the skilled trust corporation'. In both *Re Waterman's Will Trusts* [1952] 2 All ER 1054 and *Nestlé v National Westminster Bank plc* [1993] 1 WLR 260 the banks escaped liability. (For a review with reference to earlier US and Commonwealth experience, see Ontario Law Reform Commission *Report on the Law of Trusts* (1984) vol 1, pp 29–35.)

(2) Any possible distinctions between the statutory duty of care and the common law test would be immaterial if the statutory duty had completely replaced the common law rule. That does not appear to be the position. The Explanatory Notes prepared by the Lord Chancellor's Department and published with the Act state that:

> 'The duty will take effect in addition to the existing fundamental duties of trustees (for example to act in the best interests of the beneficiaries and to comply with the terms of the trust) but will exclude any common law duty of care which might otherwise have applied' (see para 10).

However, nowhere in the Trustee Act 2000 is there any provision purporting to abolish the common law rule as opposed to replacing it in the several functions specified in Sch 1. In principle where the statutory duty does not apply then presumably the common law prudent man test will still hold sway. That standard will therefore continue to apply in certain situations not specified in Sch 1 such as where the trustees are exercising a power under a trust deed to carry on a business. This may also be the case with the obligation to inquire into or intervene in the affairs of a company in which the trust has a controlling or majority interest in so far as not covered by the obligation under Trustee Act 2000, s 4(2) to keep the trust investments under review, an obligation caught by Sch 1 (see *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] 1 All ER 139; and *Re Luckings Will Trusts* [1968] 1 WLR 866). To reiterate, these distinctions between those powers specified in Sch 1 and those that are not will be immaterial if it transpires that there is no difference between the statutory duty and the common law duty of care.

(3) The underpinning philosophy of the Trustee Act 2000 can be viewed as one of liberalisation of the law to facilitate a more effective administration of trusts. To this end wider statutory powers, in particular of investment and delegation, have been conferred on trustees (see sections 3 and 5 of this chapter). As will be seen, each of these powers has specific safeguards attached to them in an effort to ensure that trustees act properly in exercising the powers in the sole interests of the beneficiaries. The general statutory duty of care in s 1 is intended to underpin and reinforce the specific safeguards. But as is the case with most other statutory provisions affecting trustees this is default law. The statutory duty of care may be modified or excluded 'in so far as it appears from the trust instrument that the duty was not meant to apply' (Trustee Act 2000, Sch 1, para 7).

Moreover the Trustee Act 2000 has nothing to say about trustee exemption clauses. Even where the statutory or common law duty of care is not complied with, the liability of a trustee for loss cannot be taken for granted as there is an important way of avoiding such liability. Corporate or professional trustees will often ensure that the instrument appointing them excludes liability arising from improper investment or limits it to cases of 'wilful default'. If valid to the full extent, such clauses may even have the effect of reversing the hierarchy of standards of skill and care so that the unpaid trustee may be subject to a higher standard than the paid professional. This important issue, now the subject of a Law Commission consultation paper, goes to the heart of control of trusteeship and is discussed in that context in Chapter 11. Also discussed in Chapter 11 is the jurisdiction under Trustee Act 1925, s 61, whereby the court can relieve a trustee from liability if 'he has acted honestly and reasonably, and ought fairly to be excused'. Both of these features must be borne in mind when evaluating the impact on trusteeship of standards of skill and care.

3. Investment

(a) Introduction

It is a fundamental principle that trustees must invest trust funds under their control. Their investment policy can have a profound effect on the real benefit obtained from the trust by beneficiaries. One task for the law of trusts is therefore to provide legal rules to set a framework for trust investment policy, or at the very least to provide a mechanism to enforce a settlor's own prescribed investment plan. The rules need to take account of a number of special factors, which potentially differentiate the investment position of trustees from that of a private individual.

First and most obviously, trustees are not investing for themselves but on behalf of, probably, several beneficiaries. Individuals may be as reckless or as circumspect as they please in selecting their own investments. But in a leading nineteenth-century case Lindley LJ stressed that 'the duty of a trustee . . . is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide' (*Re Whiteley* (1886) 33 Ch D 347 at 355, CA). The conclusion that a more cautious investment policy should therefore be adopted was most graphically stated by Lord Watson on appeal in the House of Lords (*Learoyd v Whiteley* (1887) 12 App Cas 727 at 733):

> Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard.

Whilst the prudent man of business standard, like the 'reasonable man' of negligence, can appear timeless in its formulation, a question to be considered in this chapter is whether the liberalising provisions of the Trustee Act 2000 have rendered that prudent man standard irrelevant. It is certainly the case that contemporary investment practice, particularly the principles of portfolio investing, may require some reappraisal of what we understand by 'hazard'. Nevertheless it would be premature to assume that the new statutory power of investment under the Trustee Act 2000 permits trustees to disregard altogether matters of 'hazard' and the requirements of prudence.

A second distinctive feature of trustee investment is that trustees frequently have to consider the interests of both those beneficiaries entitled to income and those to capital. Because one duty of trustees is to deal fairly with both interests, trustees must remain conscious of the need to obtain a satisfactory income return, while not endangering the capital. This balancing consideration has led to the formation of a number of rules intended to enforce impartiality of treatment. These rules and proposals for their reform are considered in section 4 of this chapter.

Third, trustees must act exclusively in the best interests of the beneficiaries, best interests usually meaning 'their best financial interests' (per Megarry V-C in *Cowan v Scargill* [1984] 2 All ER 750 at 760). Trustees are therefore generally not permitted, at least in the context of family trusts, to subordinate considerations of financial return to non-financial criteria, be they ethical or moral or political. The only significant, albeit limited, modification to the apparent strictness of this position is for charitable trusts: there it has been recognised that 'rare cases' can occur where trustees can decide, even at the risk of financial detriment, not to invest in a manner which might either conflict with the objects the charity is seeking to achieve – for example, a cancer or temperance charity refusing to invest in tobacco or brewery shares respectively – or alienate potential donors (*Harries v Church Comrs for England* [1992] 1 WLR 1241 at 1246–1247; see Nobles [1992] Conv 115). The nature of 'socially responsible investing', as the practice is sometimes called, and the rules of trusts law as they affect it are considered further in section b(5) below. Non-financial criteria are potentially of greater significance in the context of pension fund investment, and this issue is therefore also considered in that context in Chapter 13.

A fourth feature with which rules regulating trustee investment must be concerned is that of protection: protection of beneficiaries from unwise (or unscrupulous) trustees and of trustees from excessive liability for loss. Grosh outlines some possible implications for investment regulation.

> By legal limitation of acceptable trustee investments, the risk of unduly speculative investments and of self-dealing by the trustee can be reduced. To the extent that trustees in fact cannot be trusted, the beneficiaries may be protected by legal limitation on the investments which their trustees are permitted to make. This same sort of legal limitation can provide security from risk of liability for the trustee, who is given clear directions as to the propriety of his investments. There must be reasonably clear limitations on the trustee's liability for loss; and the trustee must have freedom from liability based solely on a loss in value of the investment. Few would wish to be trustees if they were held to be guarantors of the safety of the fund. Limits to trustee liability for loss can be set either by use of a list of investments which are proper, or by setting of standards for trustee conduct with regard to investment. (D Grosh 'Trustee Investment: English Law and the American Prudent Man Rule' (1974) 23 ICLQ 748)

English trust law has historically favoured a statutory 'list system' albeit one reinforced by common law standards of prudence. That approach has been fundamentally altered by the new powers of investment given to trustees under the Trustee Act 2000.

Finally, to the list of factors can be added that of complexity of investment. The proliferation of available investments and development of techniques of analysis have transformed investment into a technical, even specialised, function. This specialisation then prompts us to appraise the rules of trusts law which determine how far and in what manner trustees are empowered to delegate investment decisions.

Before examining how the overall legal framework regulates investment by trustees, we first briefly consider the forms of investment potentially available and then the development of trust investment law (sections 3(b) and (c) respectively).

(b) The investment marketplace

(1) Types of investment

For present purposes investments can be broadly categorised into two types. The first is where the investor loans capital at a rate of interest; here there exist a variety of both borrowers and forms of loan. The other type of investment is where the investor through the purchase of shares obtains part-ownership of a company but more significantly seeks to participate in the profits: such investment has a greater risk-bearing element. An alternative categorisation is to classify investments into two polar types, those that primarily yield income and those that provide capital growth. However, some investments, such as equities, will be purchased in anticipation of achieving both. Whichever categorisation is adopted, investments can usefully be assessed in terms of the following characteristics which will be of concern to trustees:

(1) whether the income return is fixed or variable;
(2) whether the capital value is liable to fluctuation;
(3) the degree of security of investment capital; and
(4) whether the investment return is free of tax.

The following colloquial guide categorises the main types of investment available to trustees in terms of the above characteristics. (See generally, Brett *How to Read the Financial Pages* (5th edn, 2003); Arnold *The Financial Times Guide to Investment* (2004); and the *Financial Times Wealth Course* (1998) for excellent introductions to this subject. For more detailed reading, Briston *The Stock Exchange and Investment Analysis* (3rd edn, 1975); Rutterford *Introduction to Stock Exchange Investment* (2nd edn, 1993); Redhead *Introduction to Financial Investment* (1995); and Gleeson *People and their Money* (1981), although now becoming rather dated provide contrasting approaches that are reasonably accessible to the non-numerate.)

Which? January 1986

Guide to main types of investment

1. No risk of losing your capital, but rate of interest can change

Main investments. Most bank and building society investments, National Savings investment account, National Savings income Bonds [National Savings Guaranteed Equity Bonds].

How they work. The money you invest earns interest. The amount of capital you invest can't fall or rise. There are two risks; first, if inflation is greater than the rate of interest you can earn, the *real value* of your investment falls – ie it becomes worth less in terms of what you can actually buy with the money. Secondly, you get the going rate of interest. That's good if interest rates rise. But if interest rates fall, the return on your investment falls too . . .

2. No risk of losing your capital and interest rate fixed

Main investments. Bank term deposits, National Savings Certificates, Savings Bonds and Capital Bonds, local authority loans, insurance company income and growth bonds.

How they work. You usually invest for a fixed period of time and get a return which is guaranteed at the time you invest. The main risks are, first, that if inflation is higher than the return you can get, the real value (ie buying power) of your investment will fall; and, secondly, that you won't benefit from any increase in the general level of interest rates . . .

3. A choice of fixed or variable return (with fluctuating capital value)

Main investments. British government stocks (commonly called 'gilt-edged securities' or just 'gilts'), local authority stocks.

How they work. These are mostly fixed-interest investments (ie they pay a fixed amount of income), usually issued for a fixed period of time. (There are some undated stocks.)

If you hold a stock until the end of this fixed period, the government or local authority buys it back from you at a fixed price – so you know, at the time you invest, exactly what return you'll get. Used in this way, stocks can be regarded as a fairly safe investment, as long as you don't need your money back early.

(With undated stocks no redemption date is specified – as the borrower need never pay off the debt.)

But you don't have to hold the stocks for the fixed period, because you can buy and sell them on the Stock Exchange. (And as with shares, the prices of stocks fluctuate as once you have bought some stock, the value of your investment can vary widely.)

The prices at which you can buy and sell will determine the overall return you get. For stocks already issued, prices largely depend on the expectation that interest rates generally will change. If general interest rates are likely to rise, the price of the stocks will tend to fall. If general interest rates are likely to fall, the price will tend to rise . . . Stocks are issued for a wide range of periods. Traditionally, they are divided into short-dated (with a life of five years or less), medium-dated (with a life of more than five years up to 15 years) and long-dated (with a life of more than 15 years) . . . The price of longer-dated stocks tends to fluctuate more widely than that of shorter-dated stocks.

One further distinction is that there are high-coupon stocks (the 'coupon' is the income the stock pays out annually) – [eg Treasury 9% 2004–8 will provide £9 per annum for £100 nominal investment] – and low-coupon stocks. The latter – [eg Treasury 4% 2004–09] – pay out a relatively small income so the return is made up largely of tax-free capital gain. [These differences in return are reflected in the purchase price of the stock. Thus at the time of writing the purchase price of 4% Treasury 2004–08 is £96.32 per £100 nominal value whereas Treasury 9% 2004–09 would cost £114.76 for the same nominal value of stock.] There's no guarantee with conventional stocks that your return will outpace inflation.

What they are suitable for. Stocks are extremely versatile investments which can be used in a number of ways:

– a guaranteed sum at a future date – if you hold the stock to the end of its life
– a regular income – choose stocks with a 'high coupon' (ie paying out a relatively large income)
– speculating for a capital gain – if you're willing to take a bit of a gamble on how their prices will change.

Note. The corporate equivalent of 'gilts' for the investor are debentures and preference shares. A debenture is a form of loan capital and in its simplest form, is an agreement to pay a fixed rate of interest and to repay the capital by a fixed date. Most debentures are secured by a charge against the assets of the company. Preference shares are shares in a commercial company which carry a fixed rate of interest. Being dependent on adequate profit levels (and since they are not secured by a charge on the company's assets) preference shares are a less secure investment than debentures.

As with gilts both debentures and preference shares can be traded on the Stock Exchange and so their capital values can fluctuate.

4. An inflation-proofed return

Main investments. Index-linked National Savings Certificates, index-linked British government stocks, [Index-linked corporate bonds].

How they work . . . These investments whose value is linked to changes in the Retail Price Index, largely protect your money against inflation. The main risk is that if interest rates are significantly higher than inflation, you'll miss out on the higher return you could have got from more conventional investments.

5. Going for growth in the value of your capital (with or without income)

Main investments. Shares, unit trusts, investment trusts, investment-type life insurance.

How they work and risks. The value of your capital can rise or fall. You invest in the hope that it will rise. Some of these investments provide a regular income as well.

Ordinary shares. When you buy a share you are buying a stake in the company which issued it. Over the long-term, share prices tend to reflect the expected future stream of profits of the company.

A company's share price will be influenced by things like profit forecasts, new product launches, strikes and so on. For the market as a whole, important factors include economic recessions and recoveries, Government policies, inflation expectations, interest rates, and so on. For companies relying on profits made abroad, the exchange rate will be particularly important. Note that share price movements try to anticipate events.

Unit trusts. Buying units in a unit trust gives you – along with many other investors – a stake in a large number of shares and other investments managed by the unit trust company. There are many unit trusts and they often specialise in particular types of investments or markets – eg UK shares, Japanese shares, recovery stocks and so on.

Investment trusts. These too invest in a range of different investments, so buying into an investment trust gives you a stake in a ready-made spread of shares. Like unit trusts, they offer a range of investment strategies with many specialising in particular markets. But investment trusts are themselves companies quoted on the Stock Exchange and you buy and sell shares in them just as you would with any other company.

OEICS. (Open Ended Investment Companies) are pooled investment vehicles, in company form and to that extent similar to investment trusts. They are the norm internationally and the UK is now coming into line in an effort to open these foreign markets to UK companies. For most people, OEICs are easier to understand than either unit or investment trusts because they are quoted at a single price rather than with separate 'buy' and 'sell' prices.

What they are suitable for.

– Income – choose shares generally paying high dividends, or unit trusts, investment trusts, OEICS and insurance investments designed to provide an income.
– Capital growth – over the long-term, shares and investments linked to them have tended to produce good returns, and to beat inflation. But prices can fall, so direct

> investment in shares, and unit-linked investments, are not suitable if you can't face the risk, nor for money you need at short notice.

Whereas the above account describes the generally available range of investments, there are other types of investment, some highly speculative. Thus antiques, good wine or even land may be purchased with the object of achieving pure capital growth, ie with no expectation of income yield. Moreover, in the last decade or so an explosive growth in new types of financial instruments such as derivatives – ie 'contracts' the value of which are related to the underlying value of, for instance, shares or commodities or currencies – has occurred (see Coopers & Lybrand's Rivett and Speak (eds) *The Financial Jungle* (1987); Hudson, *The Law of Financial Derivatives* (3rd edn, 2002); and Hudson (ed) *Modern Financial Techniques, Derivatives and Law* (1999)). The practice of 'securitisation' – involving the provision of cash in exchange for a right to a future income stream from assets – and the employment of 'hedge funds' are other examples of this development. The global hedge fund market, for example, is estimated to have doubled between 1999 and 2004 and is estimated to be worth $800 billion worldwide. Whatever the attractions and efficacy of these innovations in financial instruments may be for large institutional investors such as pension funds, for private family trusts these instruments would be difficult to reconcile with Lord Watson's injunction to avoid investments attended with hazard. After all it has been estimated that one-fifth of single hedge funds – ie those that invested narrowly in a particular market – failed in 2003, and the collapse in 1998 in the US of the Long Term Capital Management hedge fund threatened to destabilise that country's banking system (see eg Farrow, *Sunday Telegraph* 18 April 2004). Moreover it was trading in derivatives that led to the collapse in 1995 of Britain's oldest merchant bank, Barings, and bankrupted Orange County, California (see Crawford 'A Fiduciary Duty to Use Derivatives?' (1995) 1 Stan J L Bus & Fin 307 for the background to financial scandals in the US connected with trading in derivatives).

A very different and less high-risk innovation is the tracker fund that seeks to marry modern portfolio investment theory (see below, p 462) with advances in computer technology. Tracker funds, recently popularised by Richard Branson with his Virgin Tracker Fund, are unit trusts that aim to reproduce rather than beat the performance of a stock market index such as the FTSE 100 or the Financial Times All Share index. Tracker funds tend to have low running costs because management basically involves following a computer programme with a correspondingly reduced need to hire expensive investment experts to mull over the pros and cons of individual shares.

(2) Investment returns: the evidence

Investment is not restricted by national boundaries. There are counterparts to the conventional types of investment described above in many other countries and, as Table 10.1 illustrates, these can prove very rewarding. But Table 10.1 also contains a salutary reminder that investment is not risk-free. Whereas the table demonstrates

Table 10.1 *Yearly average return from different investments where income tax has been payable at the basic rate.*

	Period of investment			
	End-1971 to end-1974 % per annum	mid-1970 to mid-1985 % per annum	mid-1980 to mid-1985 % per annum	1926–1985 % per annum
Return needed to match inflation	12.4	11.6	7.2	5.1
Bank deposit account	7.3	5.3	6.2	5.7
Building society ord. share account	6.4	7.3	9.3	Not available
UK shares	(−23.1)	14.7	20.1	11.0
British govt. stocks	(−10.0)	8.9	12.0	5.2
US shares valued in £s	(−7.0)	14.4	27.3	27.3

Sources: *Financial Times* 17 February 1986; *Which?* January 1986 (For a detailed analysis of the period 1919–1966 see Merrett and Sykes 'Return on Equities and Fixed-Interest Securities' (1966) *District Bank Review* June, p 29.)

that in the short term (mid-1980 to mid-1985), in the medium term (mid-1970 to mid-1985) and in the long term (1926 to 1985), the average annual return on shares has generally exceeded the rate of inflation, it also shows that it is possible for sharp losses to be recorded (1971 to 1974). Indeed timing is all-important in investment. If, for instance, you had invested £1,000 in shares at the end of 1968, you would not have started to see a real return on your investment until 1983 (see the *Observer* 20 January 1997 citing the findings of Hughes *BZW Equity-Gilts Study 1997*).

The roller-coaster ride of the UK economy since 1987 – from stock market crash in October 1987 via a major recession in 1990–91 to record share price levels in 1999 at the height of the dot.com boom followed by a sharp reversal since then – serves only to reinforce the note of caution implicit in Table 10.1. On 31 December 1999, for instance, the market value of equity shares quoted on the London Stock Exchange was £1,820 billion whereas three years later on 31 December 2002 the market value was £1,167 billion, a decline of around one-third. A modest recovery in share prices has occurred since then but at an estimated market value of £1,255 billion on 31 December 2003 share prices had only just recovered to those reached at the end of 1997. The consequence in terms of investment returns to different types of investment for the year ending 31 December 2004 is captured in Table 10.2.

One response to the particular set of figures in Tables 10.1 and 10.2 is to reassert the frequently made claim that in the long run investment in equities will always outperform gilts and corporate bonds. Well it may, but that very much depends on the time frame chosen and the timing of acquisition and disposal of investments. In that regard trustees, at least of private trusts, must have regard to the terms of

Table 10.2 *Real investment returns by asset class (% per annum)*

Last	2004	2002	10 years	20 years	50 years	105 years
Equities	8.8	(−24.5)	5.0	7.2	6.3	5.1
Gilts	3.6	6.7	6.5	6.1	1.7	1.1
Corporate Bonds	3.3	6.6	8.5	–	–	–
Index-Linked	4.9	5.1	5.3	4.1	–	–
Cash	1.1	1.1	3.0	4.2	1.9	1.0

Source: Barclays Capital Equity-Gilt Study 2003 and 2004

the trust instrument and the needs of the beneficiaries and may therefore have less flexibility than large financial institutional investors.

(c) Commerce, the courts and the development of trustee investment law

(1) Speculation v security

The present principled stance of the law that investment should be characterised by some degree of prudence and that any return belongs to the beneficiaries is not the only possible one. Indeed, it only emerged following the traumas caused by the 'bursting' of the South Sea Bubble in 1720. (See generally for detailed accounts of this notorious share scam and the speculative mania that accompanied it Carswell *The South Sea Bubble* (1993); and Balen *A Very English Deceit* (2002).) Even Chancery masters had indulged in the orgy of investment speculation that preceded the crash, using funds which had been paid into court. In the sober aftermath, the Chancery court resolved to limit severely the range of investments to which funds paid into court could be committed (see Heward (1983) 4 J Legal History 46). In a step of major importance, it also insisted that, without express authorisation from the settlor, testator or beneficiaries, a trustee holding cash or other property with a duty or power (express or implied) to convert it and invest the proceeds was confined to the range of investments prescribed for funds paid into court. Even if an unprescribed investment was made in good faith and seemed safe, a trustee would be liable for any loss resulting from it (eg *Hancom v Allen* (1774) 2 Dick 498). There thus emerged the concept of 'authorised investments' to which trustees, if not otherwise authorised by the trust deed or the beneficiaries, must adhere in making trust investments if they are to avoid liability for loss.

Having determined by the late eighteenth century that (i) the yields on trust investment belonged to the trust, not the trustees, and (ii) that such investment was prima facie to be confined to categories prescribed by law, Chancery and the legislature had also, in dealing with the emergence of trusts of investments, to prescribe the contents of this list. For a considerable period the only form of investment unequivocally accepted by Chancery was government stock. Even first mortgages of land were thought by some judges to be unsuitable (*ex p Calthorpe* (1785) 1 Cox

Eq Cas 182), and although there were dicta to the opposite effect (*Knight v Earl of Plymouth* (1747) 1 Dick 120 at 126; *Pocock v Reddington* (1801) 5 Ves 794 at 800), it was left to s 32 of the Law of Property Amendment Act 1859 to confirm that mortgages of land could be a legitimate form of trustee security. (See Offer *Property and Politics* (1981) p 144 on the extensive mortgage investment by trustees.) In the course of the nineteenth century, other limited categories of safe investment, such as local government stock, colonial stock, shares in a number of specified statutory public utility companies, and, under restrictive conditions, even debentures and preference shares of railway companies were added to the authorised list (see generally Stebbings *The Private Trustee in Victorian England* (2002) ch 5).

These authorised investments were consolidated in the Trustee Act (TA) 1925 and although there were some minor additions (see Keeton *Modern Development in the Law of Trusts* (1971) p 51) the list was not extended, as was being urged, to permit investment in company ordinary shares. Responding to criticism the Lord Chancellor appointed a committee in 1926 to consider whether any revision was necessary. Whilst the report (*Trustee Securities Committee* (Cmd 3107, 1928)) asserted that 'it cannot be suggested that there is any need felt by trustees for a wider range' (para 20), there seems little doubt that the committee was influenced by the government's determination to have trust money channelled in its direction and thus protect its programme of debt funding (see Marsh *Corporate Trustees* (1952) p 223; *Keeton* p 51).

Equity investment therefore remained unauthorised by statute until 1961, despite both clear evidence that those trusts restricted to the legal lists were substantially disadvantaged and dissatisfaction with the status quo. (See *The Committee on the Law and Practice relating to Charitable Trusts* (Cmd 8710, 1952) para 289; Latham (1954) 7 CLP 139 at 153; Law Reform Committee (LRC) 6th Report, *Court's Power to Sanction Variation of Trusts* (Cmnd 310, 1957) para 5.) A significant factor during part of this period was that equities provided greater protection than fixed-interest securities against the effects of inflation on capital and income. It has been estimated that the average net real return (measured by taxed dividends/interest and capital appreciation) for fixed-interest securities fell from 8.3% in the period 1919–1939 to a net yearly loss of –5.7% for 1946–66. In contrast the same average return for equities over the same periods fell only from 11.4% to 6.2% (see Briston *The Stock Exchange and Investment Analysis* (1975) p 174).

Concentration on the formal statutory structure to identify the manner of trustee investment can, however, provide a distorted picture for two reasons. First, a recurrent theme in the history of trustee investment is the evasion of the statutory lists by trustees, possibly through ignorance but also with the encouragement and consent of beneficiaries (see Chesterman 'Family Settlements on Trust: Landowners and the Rising Bourgeoisie' in Rubin and Sugarman (eds) *Law, Economy and Society* (1984) p 161; *Offer* p 112). Second, and most significant, is that the courts left the door ajar for the settlor or testator to authorise trustees to invest outside the statutory list. How prevalent the practice was is not known but by the end of the First World War widely drawn investment clauses permitting investment in equities were becoming more common. Thus Marsh, drawing on the experience of corporate trustees, could comment in 1952 that 'The tendency for increased powers of investment in trust instruments to counter the lack of flexibility in the legal lists has become more and more general since the [nineteen] thirties' (*Corporate Trustees* (1952) pp 226–227; see also *Keeton* ch 7; and Revell *The Wealth of the Nation* (1967) pp 135, 138–141 for statistical confirmation of the prevalence of the wide investment clauses). The irony is that the determination of the Chancery courts to channel trust funds into secure investments and the state's reluctance to extend the list of authorised investments contributed to the widespread use of clauses giving the broadest investment discretion to trustees.

In 1961 legislation appeared to catch up with the practice of conveyancers and the Trustee Investments Act (TIA) 1961 significantly widened the range of authorised investments. In so far as the pre-1961 statutory list of authorised investments reflected a risk-aversion strategy, the major criticism had been that it was based on nominal values of investments and ignored the corrosive effect of inflation on real capital value and income returns. As Table 10.1 illustrates, in the medium- and long-term investment in equities has tended to provide a more effective 'hedge' against inflation than fixed-interest securities, and the TIA 1961 represented a belated recognition of this proposition. The most significant feature of the TIA 1961 was that it empowered trustees to invest up to 75% of the trust fund in equities which satisfied certain requirements. (The proportion was increased in 1996 from 50% by Treasury Order.) But the TIA 1961 attempted to marry increased investment discretion for trustees with a continuing concern for security. Thus whilst the statute conferred a wider statutory power of investment on trustees, it also required them to obtain and consider advice and, as mentioned above, restricted the proportion of the trust fund that could be invested in more speculative investments.

Whatever may have been its merits in 1961, the TIA itself in due course became the target of criticism. Evidence submitted to the Law Reform Committee (LRC) 'made it clear that in the vast majority of cases the Act is either modified or wholly excluded in the trust instrument . . .' and that 'the frequent exclusion of the Act renders it largely irrelevant in current financial conditions' (23rd Report *The Powers and Duties of Trustees* (Cmnd 8733, 1982) paras 3.16–3.17). Indeed it was suggested that in practice the 1961 statute most commonly applied only to: (i) older trusts; (ii) trusts made without professional advice (eg trusts under home-made wills); and (iii) statutory trusts that arise on intestacy (see HM Treasury *Investment Powers of Trustees* (1996) p 4). The Law Commission in its 1999 report agreed with the criticisms that the need to conform to the Act's requirements increased 'administrative and dealing costs', that as a method of regulating the degree of exposure to risk the requirement to divide a trust fund into two parts – narrow range and wider range – was 'crude and administratively burdensome' (*Trustees' Powers and Duties* (1999) Law Com No 260, para 2.17), and that the definition of 'wider range' investments was itself unduly restrictive. As was seen in Chapter 7 it was possible to apply to the courts under the Variation of Trusts Act 1958 to grant wider investment powers but this was an expensive option. The consequence, so it was argued, was that the return to any trust employing a widely drawn power of investment would significantly exceed that of a trust of similar size encumbered by the statutory default provisions. Indeed the comparative performance of two such trust funds is cited as evidence of this proposition. One constrained by the TIA 1961 showed capital growth of 113% and 334% over ten and 20 years respectively whilst the comparable returns on the freely invested fund were 354% and 666% (para 2.18 and footnote 33). In our view such figures need to be treated with caution since, as was seen earlier in this chapter, the timing of acquisition and disposal of assets can quite dramatically affect the rate of return.

Nevertheless, in the light of the response to its Consultation Paper, it was not surprising that the Law Commission recommended that trustees should be given the very wide default powers of investment now contained in the Trustee Act 2000, s 3 (see below p 470). It must not be overlooked, however, that underpinning the new default power are the same twin concerns that have exercised the courts and the legislature for at least the last half-century. Where should the balance be struck between 'the desirability of conferring the widest possible investment powers . . . appropriate for the trust' and 'the need to ensure that trustees act prudently in safeguarding the capital of the trust' (para 2.19)?

(2) Express powers of investment (I): Interpretation of investment clauses

It is trite law to observe that the meaning of an express investment clause is a matter to be determined by construing its language. But it is arguable that over the years interpretation has reflected prevailing judicial views on investment. Consistent with the nineteenth-century judicial penchant favouring security over speculation, express investment clauses were narrowly construed (cf Gardner *An Introduction to the Law of Trusts* (1990) who suggests (at pp 31–36) that the influence of economic liberalism can be discerned in late nineteenth-century judicial pronouncements on investment of trust property). In 1882 a clause authorising trustees to invest 'on such securities as they might think fit' was interpreted without demur as merely giving a discretion to select from among authorised securities (*Re Braithwaite* (1882) 21 Ch D 121; and for a clear statement of a restrictive approach see *Re Maryon-Wilson's Estate* [1912] 1 Ch 55 at 66–67). But in an effort to circumvent restrictionism settlors and draftsmen continued to devise, and trustees to accept, ever more explicitly worded and widely drawn clauses.

A less restrictive judicial view was applied to such a clause in *Re Wragg*.

Re Wragg [1919] 2 Ch 58

The trustees sought the court's direction as to whether a clause in the testator's will authorised the purchase of real estate as an investment.

> **Lawrence J**: Clause 10 of the will is relied upon as authorising the trustees to invest in the purchase of real estate. By that clause the testator authorises his trustees to invest any moneys forming part of the trust estate in or upon such investments 'of whatever nature and wheresoever' as his trustees should in their absolute and uncontrolled discretion think fit to the intent that they should have the same full and unrestricted powers of investing as if they were absolutely entitled to the trust moneys beneficially. It has been suggested that . . . the trustees in this case can only select such investments as are authorised by law for the investment of trust funds. . . . In my opinion it must depend in each case upon the construction of the particular instrument whether the investments authorised are confined to what are strictly trust investments or not . . . In my judgment if real estate can properly be called 'an investment' there cannot be any reasonable doubt that under the investment clause in this case the purchase of real estate is authorised. I can hardly conceive that any language could have been used which would have given a wider meaning to the word 'investments' then the language which the testator has used in this clause . . .

The more liberal approach to questions of construction was subsequently confirmed by Jenkins J in *Re Harari's Settlement Trusts* [1949] 1 All ER 430. After considering 'a representative collection of the authorities', Jenkins J concluded that he was left free 'to construe [the] settlement according to what I consider to be the natural and proper meaning of the words used in their context, and, so construing the words "in or upon such investments as to them may see fit", I see no justification for implying any restriction' (at 434).

It is tempting to conclude that the introduction of the much wider default investment power in the Trustee Act 2000 has rendered redundant any discussion of express investment clauses and of the judicial approach to their interpretation. In fact it is probable that settlors and their advisers, particularly in inter vivos trusts, will continue to confer even more extensive unrestricted investment powers on trustees than those thought to be permitted by the Act. To some extent this preference for express investment clauses reflects a degree of uncertainty as to what meaning is to be attributed to the term 'investment'.

(3) Express powers of investment (II): Meaning of investment

The interpretation of investment clauses also must be assessed in the context of the meaning applied to 'invest'. Those who buy works of art, or antique furniture or wine in anticipation of an increase in the value of the assets, might be said to be investing even though none of those assets produce income. The judicial definition of 'invest' in trusts law has been more limited. In *Re Wragg*, for instance, Lawrence J observed (at 64) that the word 'invest' includes 'as one of its meanings "to apply money in the purchase of some property from which interest or profit is expected and which property is purchased in order to be held for the sake of income which it will yield"'. Thus it is not surprising that an investment clause giving 'absolute discretion' to trustees was held not to authorise the lending of money where the only security was the personal promise of the borrower to repay (*Khoo Tek Keong v Ch'ng Joo Tuan Neoh* [1934] AC 529, PC). But if strictly applied, this 'definition' of income would, in the absence of express authorisation, prevent the purchase of a pure capital growth investment.

Furthermore, as a general rule trustees of personal property were not permitted to purchase land as an investment, unless the trust instrument so provided. Indeed, it was held that even under an express power to purchase land, purchase of a house not to produce income but solely for the purpose of conferring a benefit on a life-tenant by allowing her to occupy the house, would not be an investment (*Re Power* [1947] Ch 572; see also *Re Peczenik's Settlement Trusts* [1964] 1 WLR 720 at 723 – property acquired 'merely for use and enjoyment' not an investment). The Trustee Act 2000, s 8 has now statutorily reversed these general constraints on purchase of land. This in effect extends to all trustees the same powers regarding the purchase of land as are made available to trustees of land (including trustees of the proceeds of sale of land) under the Trusts of Land and Appointment of Trustees Act 1996, ss 6 and 17. The statutory power in s 8 may be exercised to purchase land by way of investment, for occupation by a beneficiary, or for 'any other reason' (see below at p 470).

What the Trustee Act 2000 does not do, however, is to offer us a statutory definition of 'investment'. In this it follows the recommendation of the Law Commission: 'The notion of what constitutes an investment is an evolving concept, to be interpreted by the courts' (*Trustees Powers and Duties* para 2.28, footnote 56). And the Law Commission is unquestionably correct when it observes that the criterion of 'profit' referred to in *Re Wragg* above can nowadays take the form of capital appreciation rather than just income yield. Judicial support for that stance can be found in *Harries v Church Commissioners* [1992] 1 WLR 1241 where Sir Donald Nicholls V-C states (at 1246): 'Where property is held [as an investment], prima facie the purposes of the trust will be best served by the trustees seeking to obtain therefrom the maximum return, whether by way of income or capital growth, which is consistent with commercial prudence.' The fact remains that rather than rely on judicial interpretation of an evolving concept settlors and their advisers may wish to make explicit the breadth of the investment powers they wish to confer on trustees. It must be emphasised that decisions of the court do not establish that a settlor may not authorise trustees to 'invest' as he or she wishes; instead they set certain boundaries to the acceptable prima facie meaning of investment, and if settlors wish their trustees to venture further then the investment clause must give specific authority.

Consider how far the following model investment clause modifies the judicial restrictions on the meaning of 'investment':

> Money to be invested under the Trusts hereof may be applied or invested in the purchase of or at interest upon the security of such stocks funds shares securities or other investments or property of whatsoever nature and wherever situate (including the purchase or improvement of a freehold or leasehold dwelling-house situate in the United

> Kingdom or elsewhere and of any chattels for enjoyment *in specie* by any beneficiary hereunder who would be entitled to or to whom or to or for whose maintenance education or benefit the Trustees could for the time being pay appropriate or apply the net income, if any, thereof) and whether involving liabilities or not or upon such personal credit with or without security as the Trustees in their absolute discretion shall think fit and to the intent that the Trustees shall have the same powers in all respects as if they were absolute owners beneficially entitled.

Before we review the current default investment provisions in the Trustee Act 2000 it is necessary to consider the possible influence of two relatively recent additions to the agenda on trustee investment. Both may entail some reassessment of the meanings of 'investment' and 'duty of care'. Those two contrasting developments are the rise to prominence of the principles of portfolio investing and, from a less market-driven perspective, the pressure for trustees to take account of non-financial criteria when adopting an investment strategy.

(4) Trustee investment and modern portfolio theory

If pressed to capture in one phrase the spirit of the prudent man rule as traditionally understood we might respond with the oft-quoted words from an early Massachusetts decision: 'Do what you will, the capital is at hazard' (*Harvard College v Amory* (1830) 26 Mass (9 Pick) 446 at 461 per Putnam J). A principal objective of modern portfolio theory is to minimise the degree of hazard. It seeks to achieve this by distinguishing between three different types of risk: market risk, industry risk and firm risk. Market or, as it is sometimes termed, systemic risk refers to those risks that are common to most securities. Thus the value of securities in the market might be particularly susceptible to political events or to aspects of the general economic climate such as changes in interest rate or the rate of inflation. By contrast, 'industry risk' is more limited in that it is specific to firms operating in a particular industry. A ban on smoking in all public places might be expected adversely to affect all tobacco companies. Still more specific is 'firm risk' where particular events impact on a single firm only. The contrast between 'industry' and 'firm' risks is exemplified in an example employed by John H Langbein: 'Thus if we take the international oils for example, we recall that all the producers suffered from the 1973 Arab oil embargo (industry risk), but only Exxon incurred the liabilities from the great Alaskan oil spill of March 1989 (firm risk)' ('The Uniform Prudent Investor Act and the Future of Trust Investing' [1996] 81 Iowa LR 641 at 647). Whilst not necessarily invalidating the theoretical model, the division between different categories of risk can become blurred. The example of the 1973 oil embargo – an 'industry' risk – is evidence of this in that one consequence of the embargo was a significant global economic downturn – a 'market' or 'systemic' risk – that contributed to the poor performance of the stock market in 1974 (see table 10.1 at p 455).

This caveat aside, the basic proposition of modern portfolio theory is that an appropriately diversified portfolio of shares can minimise 'industry' and 'firm' risks.

The following two extracts illustrate the basic framework of the theory (Pozen) and an important implication for trustee investment (Langbein).

R Pozen 'Money Managers and Securities Research' (1976) 51 NYULR 923 at 928, 940

Economists have developed an extensive body of portfolio theory and empirical evidence on the stock markets. According to portfolio theory, it is a reasonable approximation to characterise every investment by two measures – expected return and risk. Expected return is usually defined as the weighted average of all possible returns from an investment: Risk is usually defined as the average amount of variation among all the possible returns from an investment. As a general rule, risk and return are positively correlated. An investment with a low risk, like a United States savings bond, usually has a low return. An investment with a high risk, like a speculative stock, usually has a high return.

Portfolio theory generally assumes that investors are 'risk averse': they will avoid investments with increased risks unless compensated by appropriate increases in expected returns. This assumption of risk aversion is probably realistic for most investors . . .

The basic principle of diversification is that the overall construction of the portfolio, rather than the selection of individual securities, should be the focus of investment decisions. To the extent that the individual securities in the portfolio react differently to the same future events, the aggregate risk of a portfolio of securities is lower than the average of the risks of the individual securities. To take a simplified example, suppose a portfolio consists of two shares of stock – one from Company A that manufactures oil heaters, the other from Company B that manufactures gas heaters. If only oil prices increase, the stock of Company A will decline but the stock of Company B will rise. Conversely if only gas prices increase, the stock of Company A will rise but the stock of Company B will decline. Since the price movement of each share of stock is offset by the price movement of the other share of stock, the aggregate risk of this portfolio will be lower than the average of the risks of both shares.

J H Langbein and R A Posner 'Market Funds and Trust – Investment Law' [1976] American Bar Foundation Research Journal 1 at 6

A. Portfolio Design

The trustee's investment decision involves two conceptually distinct steps. One is evaluating specific assets that might be included in the trust. The other is combining specific assets to form the trust's portfolio, the package of assets constituting the corpus of the trust. The great emphasis of the law of trusts has been on the first step; less attention has been paid to the design of the portfolio. Yet from the beneficiary's standpoint – which is, of course, the relevant standpoint – what counts is the performance of the portfolio rather than the performance of its individual components. If the value of the portfolio rises from $500,000 to $600,000, what does it matter to the beneficiary whether this increase resulted from a uniform 20 per cent increase in the value of all of the assets in the portfolio or from larger gains in a few of the assets partially offset by losses in others? Conversely, if the portfolio has declined in value, it is of small comfort to the

> beneficiary to know that one of the components did spectacularly well rather than that all had declined. From the beneficiary's standpoint, the portfolio is the relevant security.

There is little doubt that in at least two respects the prudent man standard as conventionally understood was incompatible with modern portfolio theory. One requirement of the prudent man standard was that trustees should avoid investments, even if within the authorised class, which in Lord Watson's words 'are attended with hazard'. Indeed in the leading case *Learoyd v Whiteley*, although a mortgage on a freehold brickfield was within the trustees' investment authority, because the particular property was a wasting asset the security was of a 'peculiarly hazardous nature' and investment in it therefore constituted a breach of trust. Second, the historic assumption of the prudent man rule was that each investment should be separately evaluated, rather than considered as part of a portfolio of investments. It is evident with the benefit of hindsight that there was an increasing disjuncture between those two aspects of the prudent man standard and the widespread acceptance of the tenets of portfolio investing amongst the investment community generally. When the opportunity arose through the pleadings in *Nestlé v National Westminster Bank plc* (29 June 1988), the court was prepared to modify the prudent man standard to reflect the basic 'diversification' tenet of portfolio theory ((1996) 10 TLI 113; see also Ford (1996) TLI (4) 102). Hoffman J stated that 'modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation'. Writing extra-judicially Lord Nicholls has endorsed this approach, at least in its application to a large fund although the reasoning behind his conclusions seem more generally applicable ((1995) 9 TLI (3) 71 at 76):

> Traditional warnings against the need for trustees to avoid speculative or hazardous investments are not to be read as inhibiting trustees from maintaining portfolios of investments which contain a prudent and sensible mixture of low-risk and higher-risk securities. They are not to be so read, because they were not directed at a portfolio which is a balanced exercise in risk management.

It would, however, be unwise to assume that trustees now have carte blanche to ignore the hazardous nature of an individual investment. The distinction they must now draw 'is between a prudent degree of risk on the one hand, and hazard on the other' (*Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 at 150). In *Bartlett* a speculative property-development project was considered too hazardous for trustees, although acceptable to the board of a wealthy company. Where the balance lies between 'prudence' and 'hazard' is likely to depend to some degree on the characteristics of the trust fund. In *Trustees of the British Museum v A-G* [1984] 1 All ER 337, Megarry V-C, approving an application under the VTA 1958 to widen the range of authorised investments, commented that a material consideration is the size of the fund: 'A fund that is very large may well justify a latitude of investment that would be denied to a more modest fund; for the spread of investments possible for a larger fund may justify the greater risks that wider powers will permit to be taken' (at 343). Whilst such comments fall short of endorsing speculative investments it may be inferred that whether an investment is labelled 'hazardous' is a reflection both of the characteristics of the individual investment and the size of the fund: the larger the fund, the greater the degree of risk that is considered reasonable in respect of a particular investment.

(5) Investment and non-financial criteria

If trustees are to be expected to follow the tenets of modern portfolio theory in exercising their powers of investment then, at first glance, this would seem to exclude any consideration of non-financial criteria or, as it is more commonly termed, 'social investing'. Yet, as mentioned in the Introduction to this section of the chapter (see p 449), the appropriateness of a stance that would appear to exclude consideration of such criteria from the deliberations of trustees is not beyond question. (See generally Lord Nicholls (1995) 9 TLI 71; McCormack (1998) 19 Co Law (2) 39; Irish and Kent (1994) 8 TLI 10; and amongst the considerable US literature Salisbury (ed) *Should Pension Assets be Managed for Social/Political Purposes* (1980); Ravikoff and Curzan (1980) 68 Calif LR 518; Curzan and Pelish (1980) 93 Harv LR 670; cf Langbein and Posner (1980) 79 Mich LR 72.) Before examining the legal response to 'social investing' it is necessary to clarify what is understood by that term and also the different ways in which trustees might employ non-financial criteria in decision-making. Whilst the following account is concerned with social investing in the context of pension schemes, the categorisation employed, if not all the implications, is equally applicable to other trust types.

> J D Hutchinson and C G Cole 'Legal Standards Governing Investment of Pension Assets for Social and Political Goals' (1979–80) 128 U Pa LR 1344 at 1344–1345
>
> The issue of social investing has proven elusive of analysis, in part because of its protean character. Depending on the context, social investing may take different, sometimes philosophically inconsistent, forms. A policy of social investment may be designed to benefit the participants incidentally by improving the community in which they live, or it may be designed to ameliorate some regional, national, or even international problem. A social-investment program may involve a selfless sacrifice of the participants' interests in order to aid some other, less fortunate segment of society, or it may be part of a calculated strategy to enhance the political and economic strength of the participants.
>
> The techniques for implementing a policy of social investing may also vary widely: from a policy of excluding future investments in particular companies, to the affirmative selection of certain preferred investments, to the divestiture of undesirable investments. In each of these situations, moreover, the relative weight given to economic and social factors may be different: social considerations may dictate investment policy, or they may be invoked only as a guide when all other characteristics are comparable.

> Most of the diverse practices discussed in the context of 'social investing' can be classified within one of three basic categories: (1) totally neutral investment policies; (2) socially sensitive investment policies; or (3) socially dictated investment policies.
>
> 'Totally neutral investment policies' focus solely on the financial aspects of investment alternatives. Fiduciaries would analyse the traditional investment considerations, such as the plan characteristics (design, funding, etc), risk/return considerations, liquidity, and diversification. Within this frame of reference, it may be that labor-relations practices, compliance with environmental or safety standards, or other policies could affect the financial stability and profitability of a company whose securities are being analysed. If the fiduciary performing the financial analysis of the investment activity has a sound empirical basis for considering these factors, then their use is defensible on purely financial grounds. The fiduciary does not override basic financial investment considerations for the sake of a social objective, nor does he temper judgements on comparable alternatives by focusing on non-investment factors. The question of 'social investing' never arises in this setting, and we need not confuse the legal analysis applicable to 'social investing' by belabouring such practices.
>
> 'Socially sensitive investment policies' include those investment practices in which the investing fiduciary analyses traditional investment considerations such as plan characteristics, risk/return factors, liquidity, and diversification. Once this analysis is completed, however, the fiduciary then selects among financially comparable investment alternatives by considering other factors . . .
>
> There remains the question, however, whether the investment is being undertaken 'solely in the interest' of plan participants and beneficiaries. It is at this point that certain 'socially sensitive' investment policies that consider non-financial factors may pass legal muster, while others may not . . . Certain policies that are intended to serve the interests of plan participants, in their capacity as participants, may be employed. On the other hand, policies that cannot be related in some plausible fashion to the primary interests of plan participants, but instead serve the interests of the employer, union, or third parties, may well violate this standard of loyalty.
>
> 'Socially dictated investment policies' are those investment practices and policies which either (1) permit the sacrifice of safety, return, diversification, or marketability; or (2) are undertaken to serve some objective that cannot be related to the interests of plan participants and beneficiaries in their capacity as such. When a plan fiduciary sacrifices traditional investment quality, he faces the substantial risk of violating the prudence standard.

This issue was first litigated in the UK in *Cowan v Scargill* [1985] Ch 270, a case concerning the investment policy of the mineworkers' pension fund. The National Union of Mineworkers (NUM) and the National Coal Board each nominated half of the trustees. The investment strategy required the unanimous approval of trustees but the NUM nominees refused to agree to an investment plan submitted by a panel of investment advisers in so far as the plan conflicted with the stated policy of the union executive on the investment of the pension fund (see further Chapter 13 at p 661 where more detailed consideration is given to the relevance of non-financial criteria to pension fund investment). In particular the NUM and its nominees objected to new and continuing investments overseas and to investments in energy resources competing with coal.

The initial response of the court when faced with this issue seemed straightforwardly premised on fundamental principles of trust law. Megarry V-C summarised the position as follows (at 287–288):

> The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries. This duty of the trustees towards their beneficiaries is paramount. They must, of course, obey the law; but subject to that, they must put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In the case of a power of investment, as in the present case, the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question; and the prospects of the yield of income and capital appreciation both have to be considered in judging the return from the investment.
>
> This leads me to the second point, which is a corollary of the first. In considering what investments to make trustees must put on one side their own personal interests and views. Trustees may have strongly held social or political views. They may be firmly opposed to any investment in South Africa or other countries, or they may object to any form of investment in companies concerned with alcohol, tobacco, armaments or many other things. In the conduct of their own affairs, of course, they are free to abstain from making any such investments. Yet if under a trust investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reason of the views that they hold.

Megarry V-C acknowledged that there might be rare instances when this stance might be modified even where the only object of the trust was to provide financial benefits. The somewhat unlikely scenario is posited of a trust where all the actual and potential beneficiaries are adults with very strict views on moral and social matters, condemning all forms of alcohol, tobacco and popular entertainment, as well as armaments. In these circumstances 'it might not be for the "benefit" of such beneficiaries to know that they are obtaining rather larger financial returns under the trust by reason of investments in those activities than they would have received if the trustees had invested the trust fund in other investments. The beneficiaries might well consider that it was far better to receive less than to receive more money from what they consider to be evil and tainted sources' (ibid).

There are two other instances where the apparent rigour of Megarry V-C's approach may not apply. One, most obviously, is where the trust instrument itself requires, let us say, the trustees to avoid investments in armaments manufacturers. The other instance can occur in the context of charitable trusts where particular investments may be incompatible with the purpose of the charity. The facts of the case in which the latter issue was aired, *Harries v Church Commissioners for England* [1992] 1 WLR 1241, were rather atypical in that the purpose of the fund to be invested was to some extent closer to that of a pension fund. Almost 85% of the income of the fund was absorbed by stipends for serving clergy, pensions for retired clergy and much of the housing cost for both groups. In short it might be argued that the investment policy of the Church Commissioners should be driven by purely financial considerations. In contrast the then Bishop of Oxford and other clergy sought a declaration that the Commissioners should not select investments that would be incompatible with the purpose of 'the promotion of the Christian faith through the Church of England' even if this involved some risk of financial detriment. Sir Donald Nicholls V-C declined to grant the remedy sought, holding that the Commissioners' policy was not erroneous in law in that they were only prepared to take non-financial considerations into account to the extent that they did not 'significantly jeopardise or interfere with accepted investment principles'. In short the Church Commissioners appeared to follow what, applying the Hutchinson and Cole categorisation, could be termed a 'socially sensitive' investment policy. Nevertheless, in the judgment the Vice-Chancellor considered whether there were any circumstances where financial criteria could be subordinated to other criteria (at 1246–1247):

> In most cases the best interests of the charity require that the trustees' choice of investments should be made solely on the basis of well-established investment criteria, having taken expert advice where appropriate and having due regard to such matters as the need to diversify, the need to balance income against capital growth, and the need to balance risk against return.
>
> In a minority of cases the position will not be so straightforward. There will be some cases, I suspect comparatively rare, when the objects of the charity are such that investments of a particular type would conflict with the aims of the charity. Much-cited examples are those of cancer research charities and tobacco shares, trustees of temperance charities and brewery and distillery shares, and trustees of charities of the Society of Friends and shares in companies engaged in production of armaments. If, as would be likely in those examples, trustees were satisfied that investing in a company engaged in a particular type of business would conflict with the very objects their charity is seeking to achieve, they should not so invest. Carried to its logical conclusion the trustees should take this course even if it would be likely to result in significant financial detriment to the charity. The logical conclusion, whilst sound as a matter of legal analysis, is unlikely to arise in practice. It is not easy to think of an instance where in practice the exclusion for this reason of one or more companies or sectors from the whole range of investments open to trustees would be likely to leave them without an adequately wide range of investments from which to choose a properly diversified portfolio.
>
> There will also be some cases, again I suspect comparatively rare, when trustees' holdings of particular investments might hamper a charity's work either by making potential recipients of aid unwilling to be helped because of the source of the charity's

money, or by alienating some of those who support the charity financially. In these cases the trustees will need to balance the difficulties they would encounter, or likely financial loss they would sustain, if they were to hold the investments against the risk of financial detriment if those investments were excluded from their portfolio. The greater the risk of financial detriment, the more certain the trustees should be of countervailing disadvantages to the charity before they incur that risk.

Another circumstance where trustees would be entitled, or even required, to take into account non-financial criteria would be where the trust deed so provides.

No doubt there will be other cases where trustees are justified in departing from what should always be their starting point. The instances I have given are not comprehensive. But I must emphasise that of their very nature, and by definition, investments are held by trustees to aid the work of the charity in a particular way: by generating money. That is the purpose for which they are held. That is their raison d'être. Trustees cannot properly use assets held as an investment for other, viz non-investment, purposes. To the extent that they do they are not properly exercising their powers of investment. . . . I should mention one other particular situation. There will be instances today when those who support or benefit from a charity take widely different views on a particular type of investment, some saying that on moral grounds it conflicts with the aims of the charity, others saying the opposite. One example is the holding of arms industry shares by a religious charity. There is a real difficulty here. To many questions raising moral issues there are no certain answers. On moral questions widely differing views are held by well-meaning, responsible people. This is not always so. But frequently, when questions of the morality of conduct are being canvassed, there is no identifiable yardstick which can be applied to a set of facts so as to yield one answer which can be seen to be 'right' and the other 'wrong'. If that situation confronts trustees of a charity, the law does not require them to find an answer to the unanswerable. Trustees may, if they wish, accommodate the views of those who consider that on moral grounds a particular investment would be in conflict with the objects of the charity, so long as the trustees are satisfied that course would not involve a risk of significant financial detriment. But when they are not so satisfied trustees should not make investment decisions on the basis of preferring one view of whether on moral grounds an investment conflicts with the objects of the charity over another. This is so even when one view is more widely supported than the other.

Whilst the leading cases cited here appear to support a quite restrictive view of the acceptability of 'non-financial criteria' it is tempting to conclude that a more nuanced view can be detected at least as regards 'socially sensitive' investing. This is partly because the very breadth of investment opportunities in the market is so extensive as to enable trustees, as Lord Nicholls writing extra-judicially has noted, 'to give effect to moral considerations, either by positively preferring certain investments or negatively avoiding others, without thereby prejudicing beneficiaries' financial interests' ((1995) 9(3) TLI 71 at 75; see also Megarry V-C in *Cowan v Scargill* [1985] 1 Ch 270 at 297: 'If the investment in fact made is equally beneficial to the beneficiaries, then criticism would be difficult to sustain in practice, whatever the position in theory'). More prosaically as will be seen in section e(1) below, actually proving that a particular investment policy has caused a loss to the fund is far from a straightforward matter.

In any event it should not be assumed that an investment policy that satisfies social goals necessarily results in even short-term financial detriment. Although ethically managed unit trusts are of relatively recent vintage, having only been available in the UK since 1984, there is evidence of sustained performance producing financial returns roughly equivalent to the performance of the FTSE All-Shares index over a comparable period (*The Ethical Investor* July–August 1998, pp 1–2; see also McCormack (1998) 19 Co Law (2) 39 at 48–49). For example if we select the period prior to the downturn in stock market values in 1999, the most longstanding ethical fund grew 933% between 1984 and 1998, compared to the average for the UK equity sector of 735%. The overall comparative performance of the sectors tends to endorse this assessment. In a report published in November 2002, UK stockbrokers West LB Panmure comment: 'Although the observation period is not long enough to be able to draw final conclusions, a simple performance comparison already shows that the frequently voiced hypothesis of a systematic return disadvantage of ethical/SRI is clearly not supported by the present data.' This positive performance of the ethical sector has continued even in the period of relative decline in share values since 1999. In July 2001, the FTSE4Good Index series was launched to measure the performance of companies that meet globally recognised corporate responsibility standards, and to facilitate investment in those companies. Analysis of the performance of the FTSE4Good Global Index over the past five years when compared directly with the FTSE100 index of the UK's most highly capitalised shares shows the two indices moving in a fairly close relationship but also highlights past periods of outperformance by the ethical index (see www.ftse.com/ftse4good, and generally www.ethicalinvestors.co.uk; and www.Eiris.org).

It must be emphasised, however, that the sums invested in ethical funds remain modest – at £4.2 billion at the end of 2003 compared with £251 billion in all UK retail funds – and this necessarily limits the weight to be attached to the empirical data. Indeed, for those who remain unpersuaded of either the virtue or the economic value of ethical investing solace might be found in a proposition based on analysis of a US index, the S & P 500. The proponent of the proposition, C Warder, argues that whilst vices such as alcohol, tobacco and gambling may be deemed socially irresponsible, in the investment world in a depressed market such as that operating since 1999 these stocks continue dramatically to outperform the S & P 500 (*The Wages of Sin* (2004)).

(d) Powers of investment and the Trustee Act 2000

(1) The scope of the statutory power

The Trustee Act 2000 confers on trustees the extensive statutory powers of investment recommended by the Law Commission. In particular s 3(1) provides that 'a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust'. The 'general power of investment', as this new power is called (s 3(2)), is subject to the qualification that investments in land are not permitted other than by way of 'loans secured on land' (s 3(3)). This restriction is rendered more apparent than real by virtue of s 8(1) of the Act, which states that:

> 8(1) A trustee may acquire freehold or leasehold land in the United Kingdom –
>
> (a) as an investment,
> (b) for occupation by a beneficiary, or
> (c) for any other reason.

This initially confusing drafting arrangement involving ss 3 and 8 is attributable partly to the perceived need to give trustees powers to purchase land other than for investment reasons (s 8(1)(b) and (c)). It will be recalled that a weakness of the investment powers as interpreted in the cases was that the purchase of land for the purpose of providing property for occupation by a beneficiary, now provided in s 8(1)(b), did not qualify as an 'investment' (*Re Power* [1947] Ch 572). This restriction on the powers of trustees was removed by the Trusts of Land and Appointment of Trustees Act 1996, s 6(3), but only for trusts of property that included land or the proceeds of sale of land. TA 2000, s 8 simply extends to all trusts, including those where the property is only personalty, those same powers in relation to the acquisition of land.

Subject to certain exceptions, the general power of investment applies to all trusts 'whether created before or after' the commencement of the Act (s 7(1)) and 'in addition to powers conferred on trustees otherwise than by [the Act]' most obviously by a trust instrument (s 6(1)(a)). The exceptions just referred to are those where a separate statutory regime applies. The general power of investment does not therefore apply to pension trusts, to unit trusts or to certain common investment or deposit schemes for charities (see TA 2000, ss 36–38). As is common with most other statutory powers conferred on trustees, the new power of investment is a default power. It is therefore subject to 'any restriction or exclusion imposed by the trust instrument' (s 6(1)(b)) whether created before or after the 2000 Act. It should, however, be noted that restrictions or exclusions contained in a trust instrument made *before* 3 August 1961, the commencement date of the TIA 1961, are to be ignored (TA 2000, s 7(2)). To do otherwise would in effect resurrect restrictions in the trust instrument that had been overcome by the now repealed s 1(3) of the TIA 1961.

Finally, on a point of interpretation, care will be needed in applying s 6(1)(a) and (b) to investment clauses drafted *after* 3 August 1961 and intended to grant wider powers than those available under the TIA 1961. How, for instance, should we construe a power in a trust instrument permitting trustees to 'invest in any shares quoted on the London Stock Exchange' – ie a power more extensive than that under the TIA 1961 but more restrictive than the TA 2000, s 3 power? Should this be interpreted as 'a restriction' on the general power of investment? To do so would not seem to be in keeping with the liberalising approach of the legislation. It therefore seems probable that any restriction or exclusion will need to be explicitly worded if it is to have effect. The Explanatory Notes accompanying the TA 2000 suggest that an express power 'to invest in shares quoted on the London Stock Exchange but not in shares of X plc' would take effect as the general power of investment subject *only* to the restriction on investing in X plc.

(2) Varying investment clauses

As was mentioned in Chapter 7, one of the purposes of applications to the court under the Variation of Trusts Act (VTA) 1958 was to amend restricted powers of investment. Indeed TIA 1961, s 15 expressly provided that the statute was not to affect the VTA jurisdiction. Nevertheless a line of cases commencing with *Re Kolb's Will Trusts* [1962] Ch 531 supported the opinion that the powers of investment in the 1961 Act should 'be taken to be prima facie sufficient and ought only to be extended if, on the particular facts, a special case for extending them can be made out' (at 540). Subsequently in several cases in the 1980s involving substantial trust funds the courts came to accept that the investment powers under the TIA 1961 had themselves become outdated (see eg *Mason v Farbrother* [1983] 2 All ER 1078; *Trustees of the British Museum v A-G* [1984] 1 All ER 337; *Steel v Wellcome Custodian Trustees Ltd* [1988] 1 WLR 167). Indeed in *Trustees of the British Museum v A-G* [1984] 1 All ER 337 Megarry V-C viewed the *Re Kolb* rule as 'one that should no longer be followed since conditions have changed so greatly in the last 20 years' (at 342). But the Vice-Chancellor was also careful to leave open the way for resuscitation of the rule if the recommendations for reform of the TIA 1961 proposed in 1982 by the Law Reform Committee were enacted.

As we have just seen, by virtue of s 7(1) of the Trustee Act 2000 trustees' powers of investment have been generally widened even as regards trusts that were created before the Act came into force. It would seem to follow that the future demand to vary investment powers in a trust deed will be very limited. But what stance should the court take if presented with a request to vary the investment powers by, for instance, removing a restriction imposed by the settlor in the trust instrument? After all s 6(1)(b) specifically recognises the possibility of such restrictions. In such circumstances it is unclear when, if ever, the courts would consider it to be appropriate to vary the powers of investment. It may be that the courts would decide to resurrect the *Re Kolb* rule in some guise so that a 'special case' justifying the variation would have to be made out. We say 'in some guise' because strictly speaking the rule would not apply as trustees would not be seeking an extension of investment powers beyond the scope of the Trustee Act 2000 but rather the removal of an exclusion so as to give full rein to the statutory power. The wider the scope of the 'restriction or exclusion' the easier it may be to establish that its removal or modification would satisfy the 'benefit' requirement of the VTA 1958. As was the case prior to the Trustee Act 2000, the same criteria in evaluating any proposed alteration would apply whether the proposal is made under the VTA 1958 or TA

1925, s 57. Note that it has been suggested that on grounds of cost and convenience applications to vary investment powers should usually be submitted under s 57 (see *Anker-Petersen v Anker-Petersen* [1991] 16 LS Gaz R 32 (see also [1998] 12 TLI 166) referring, inter alia, to the fact that, unlike the VTA 1958, the consent of each adult beneficiary is not required and the court can consider the interests of each category of beneficiary collectively rather than individually).

(3) Safeguards and the duties of trustees: Introduction

It will be recalled (see p 459) that the Law Commission accepted that statutory safeguards for the protection of beneficiaries should balance the introduction of wider statutory powers of investment. To that extent caution is necessary in interpreting the wording of TA 2000, s 3(1) that 'a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust'. Absolute owners of property can be as reckless as they wish in determining what degree of risk to tolerate. But trustees are not absolutely entitled to the assets and are subject to certain constraints in the investment policy that they follow. First, it must not be overlooked that trustees remain subject to the general duties that the law imposes to act in the best interests of the beneficiaries and to avoid any conflict between their duties as trustees and their own personal interest. Trustees must also act impartially; hence an investment policy should seek to balance the interests of income and capital beneficiaries (see section 4 of this chapter). More specifically trustees remain subject to the statutory duty of care when exercising their powers of investment whether statutory or otherwise. In addition to these generic and pervasive duties the Trustee Act 2000 imposes two specific duties on trustees in the performance of their investment function – a duty to have regard to what is termed 'standard investment criteria' (s 4) and a duty to obtain and consider advice (s 5). But as the Law Commission acknowledged neither of these duties is new, the TIA 1961, s 6 providing a statutory precedent for both.

(4) Trustee Act 2000, s 4 and the 'standard investment criteria'

TA 2000, s 4(1) lays down that a trustee 'must have regard to the standard investment criteria' in two sets of circumstances. One is where the trustee is exercising *any* power of investment, whether arising under the statutory default power or otherwise. The other circumstance is where the trustee is carrying out the obligation imposed by s 4(2), that is 'from time to time to review the investments of the trust and consider whether . . . they should be varied'. The point here quite simply is that the investment duties of trustees do not end with the initial decision to invest: more is required than a strategy of 'buy and hold'. The fund must be managed and in the process the trustees must decide when to retain and when to realise investments. Section 4(2) is in effect a codification of the common law position as set out in *Nestle v National Westminster Bank plc (No 2)* [1993] 1 WLR 1260: '[A] trustee . . . must undertake periodic reviews of the investments held by the trust' (at 1282 per Leggatt LJ).

The standard investment criteria to which the trustee 'must have regard' are set out in s 4(3):

(3) The standard investment criteria, in relation to a trust, are –

(a) the suitability to the trust of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind, and
(b) the need for diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust.

The precise relationship between the 'standard investment criteria' and the general duty of care in s 1 is not made explicit in the Act. It may be that in exercising their investment functions trustees will have to have regard to matters other than the criteria of s 4(3) but those criteria will be central to the process of investment decision-making.

The definition of the criteria is very similar to the requirements of TIA 1961, s 6(1) and raises similar issues of interpretation. What is clear is that the 'criteria' accord with the tenets of modern portfolio theory particularly as regards diversification. What is also clear is that references in s 4(3) to 'suitability' and 'circumstances of the trust' remind trustees that selection of the portfolio needs to take account of factors other than the risk/return calculus of the investments under consideration. Nevertheless whilst the language of s 4(3) is precise in directing the attention of trustees to particular issues it still leaves room to speculate on the meaning of 'suitability' or what are relevant 'circumstances of the trust'. It can be said with some confidence that a factor – a 'circumstance of the trust' – relevant to the need for diversification (s 4(3)(b)) will be the size of the trust fund. One can say with equal confidence that suitability includes consideration of both the type of investment – for example, fixed-interest securities or ordinary shares – and the specific investment of that type – for example, Tesco or Powergen shares. Beyond that the picture is less clear, but consider the following assessment of the 'suitability' requirements in s 4(3)(a), and in particular whether a trustee who failed to take full account of the fiscal considerations mentioned would be in breach of the duty of care.

Oakley (ed) *Parker and Mellows The Modern Law of Trusts* (8th edn, 2003) p 603

The sort of problem with which trustees will be faced in relation to [s 4(3)(a)] is whether, and to what extent, present income should be sacrificed in the interests of future growth; in this respect much will depend on arriving at a decision on the actual needs of the beneficiaries, the expected duration of the trust, and, today, the beneficiaries' tax position.

The way in which these factors have to be considered is shown by taking [two] examples:

(a) If trustees are holding property on trust for a minor beneficiary when he attains 18 in, say 2008, they might invest in a government stock maturing in that year and therefore redeemable then at its highest value, just in time for the proceeds to be paid to the beneficiary with the additional advantage that the increase in its capital value will be exempt from capital gains tax . . .

(b) . . .

(c) If the beneficiary to whom the trustees are obliged to pay . . . the income of the trust has only a small total income, the trustees might endeavour to invest at least part of the fund in a security which produces a high income so far as they consider this consistent with their duties to the remainderman. But they should not select just any security which produces a high income, or even just any security which produces a high income and is considered particularly safe. A beneficiary with a small total income will only have to pay income tax of 10 per cent on this income. . . . However, the tax liability may well be higher in respect of income from foreign companies and there will certainly be no possibility of any foreign tax being recovered. Consequently, in these circumstances the trustees must look for a company which has virtually the whole of its activities in England, so that the minimum amount of tax will ultimately be payable.

(5) Exercising the power of investment: seeking advice

The other principal statutory safeguard for beneficiaries is the advice requirement contained in TA 2000, s 5:

> (5)(1) Before exercising any power of investment, whether arising under this Part or otherwise, a trustee must (unless the exception applies) obtain and consider proper advice about the way in which, having regard to the standard investment criteria, the power should be exercised.
>
> (2) When reviewing the investments of the trust, a trustee must (unless the exception applies) obtain and consider proper advice about whether, having regard to the standard investment criteria, the investments should be varied.
>
> (3) The exception is that a trustee need not obtain such advice if he reasonably concludes that in all the circumstances it is unnecessary or inappropriate to do so.
>
> (4) Proper advice is the advice of a person who is reasonably believed by the trustee to be qualified to give it by his ability in and practical experience of financial and other matters relating to the proposed investment.

Several points should be noted about the advice requirements in this section.

First, the section does not absolve a trustee from the obligation to exercise independent judgment; the trustee must 'obtain and consider', not blindly follow the advice. Nevertheless it will be difficult to establish a breach of trust where a trustee bona fide acts on proper advice. The outcome may be different where the trustees act against the advice given even if they do so in good faith. This point was considered in the context of the common law prudent man standard of care by Sir Robert Megarry V-C in *Cowan v Scargill* [1984] 2 All ER 750 at 762:

> **Megarry V-C**: That duty includes the duty to seek advice on matters which the trustee does not understand, such as the making of investments, and on receiving that advice to act with the same degree of prudence. This requirement is not discharged merely

> by showing that the trustee has acted in good faith and with sincerity. Honesty and sincerity are not the same as prudence and reasonableness. . . . Accordingly, although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition to being sincere he is acting as an ordinary prudent man would act.

Second, s 5(2) merely confirms that the advice requirement must also be satisfied when complying with the obligation under s 4(2) to keep the investment of the trust under review.

Third, as with the 'standard investment criteria' of s 4(3), the provisions have their origins in and bear some similarity to those of the TIA 1961. The new provisions are, however, more extensive yet also more flexible. Thus the obligation to 'obtain and consider' advice is now unqualified in that it applies to the exercise of any power of investment yet also provides for an exception where the trustee 'reasonably concludes . . . that it is unnecessary or inappropriate to do so'. In fact this exception was foreshadowed in a draft 1997 deregulation order that would have modified the TIA 1961 provisions in a similar manner. No statutory guidance is given as to when the exception applies but relevant considerations might be, for instance, (i) where the trust fund is small, so that fulfilling the advice requirement might be disproportionately costly or (ii) where one or more of the trustees might possess the appropriate skill or knowledge. Whilst, unlike the position under the TIA 1961, there is no statutory requirement that any advice received should be in writing it would be a sensible precaution and arguably best practice for trustees to insist that any advice is put in writing.

Fourth, s 5(4), clarifying 'proper advice', must be read in the light of the Financial Services and Markets Act 2000. That Act prohibits (s 19) any person from carrying on an investment business – and this includes the giving of investment advice – unless duly authorised (s 31). The fact that a person is qualified to give financial advice does not necessarily mean that their expertise will be appropriate to the circumstances of the trust. If the trustees are proposing to invest in land they will need to consult an adviser with expertise in the valuation of land rather than an adviser whose specialist expertise is in the area of corporate bonds.

It is convenient to mention briefly here the repeal by the TA 2000 of TA 1925, ss 8 and 9 which contained broad guidelines for trustees investing in mortgages. Section 8 relieved trustees from charges of breach of trust where the terms of the section, which related broadly to the competence of advice and permissible size of loan, were complied with, whilst s 9 limited the quantum of liability where breach occurred. The nineteenth century was the heyday of investment by trustees in mortgages and this type of investment is much less common for trustees now, although still specifically authorised under TA 2000, s 3(3). Where trustees do wish to invest in mortgages the general guidelines regarding duty of care, standard investment criteria and advice will apply as with any other investment. It may, however, be advisable for cautious trustees to pay regard to the pre-1925 authorities with their suggested limitations on trustees' powers to invest in mortgages. It was, for instance, considered inadvisable although not impermissible for trustees to lend on the security of anything other than a first mortgage of freehold or leasehold land (see *Chapman v Browne* [1902] 1 Ch 785). The TA 2000 is silent on these matters but it may be difficult for trustees to argue that they have satisfied the duty of care if they invest in a second mortgage and the trust fund suffers a loss because, for instance, the first mortgagee exercises the power of sale leaving little or nothing for the second mortgagee.

(e) Investment management, risk and liability for loss

(1) Trustees as investors

Investment involves risk. The expectation of profit must be counterbalanced by the possibility of loss and, as experience shows (see p 454), the timing of decisions as to when to retain and when to realise investments can be a crucial factor in determining success or failure. The value both of classes of investment and of individual investments within the class will fluctuate. The inherent uncertainty of the outcome of the investment process poses difficult questions for the law on trustee investment. In what circumstances should trustees be held liable for losses that are incurred by a poor performing portfolio of investments? Should the answer depend not on the portfolio return itself but on whether appropriate processes were followed by trustees? Assuming that it can be shown that a breach of trust has caused a loss – and this may be a bold assumption in light of the decision in *Nestlé* (see below) – how should the quantum of the loss be established?

These questions are not new. In a leading nineteenth-century case the Court of Appeal had to consider in what circumstances trustees should be liable for a notional or realised loss through retaining an asset which is depreciating in value.

Re Chapman [1896] 2 Ch 763 at 774–776, CA
The plaintiffs claimed that the trustees were liable for a loss in the value of mortgage securities.

> **Lindley LJ:** . . . the mortgages are still unrealised; and it is now unfortunately true that, with one or two exceptions, they cannot be realised except at a great loss; and the real question is whether the trustees are liable for this loss. A mortgage security is unlike an ordinary investment, inasmuch as it consists of a debt which can be enforced by action, and also of a security which can be realised by sale or foreclosure. A trustee of a mortgage security is, therefore, liable for loss sustained by his wilful default in not obtaining payment in either of these ways. But a trustee is not a surety, nor is he an insurer; he is only liable for some wrong done by himself, and loss of trust money is not per se proof of such wrong.

[Lindley LJ considered and rejected the argument that the trustees should either have sued the mortgagor for payment or foreclosed.]

> The only other mode of realising would have been sale; but not a single person is called to say that it would have been a prudent or judicious step to try and sell. On the other hand, there is evidence that it would not; and it is clear that, unless the mortgaged property had been sold whilst the securities were good, sales, even if effected at all, would have resulted in serious loss. There is no rule of law which compels the court to hold that an honest trustee is liable to make good loss sustained by retaining an authorised security in a falling market, if he did so honestly and prudently, in the belief that it was the best course to take in the interest of all parties. Trustees acting honestly, with ordinary prudence and within the limits of their trust, are not liable for mere errors of judgement. Any loss sustained by the trust estate under such circumstances falls upon and must be borne by the owners of the property – ie, the cestuis que trust – and cannot be thrown by them on their trustees, who have done no wrong, though the result may prove that they possibly might have done better.
>
> The case is an important one not only to the trustees of this particular will, but to trustees of mortgages generally. Owing to the great fall in the value of agricultural land trustees of mortgage securities have been placed in a position of great difficulty. To throw on the trustees the loss sustained by the fall in value of securities authorised by the trust, wilful default, which includes want of ordinary prudence on the part of the trustee, must be proved; but it is not proved in this case.

The judgments in *Re Chapman* display an acute awareness that the decline in the value of mortgages in that case merely reflected a general economic malaise affecting parts of the agricultural sector in the last quarter of the nineteenth century, which brought in its train lower profits, lower rents and lower capital values. (See Mathias *The First Industrial Nation* (1969) pp 397–398; and Saul *The Myth of the Great Depression 1873–1896* (2nd edn, 1985) pp 34–36.) A similar approach to trustee liability was applied by United States courts in the aftermath of the 1929 stock market crash. In Massachusetts, for instance, it seems that not a single trustee was held liable for losses so caused (see Grosh (1974) 23 ICLQ 748 at 758). The sentiments evident in *Re Chapman* and the American authorities were reiterated in *Jones v AMP Perpetual Trustee Company NZ Ltd* [1994] 1 NZLR 690. Thomas J reviewed the authorities and concluded (at 707) that it was 'not inherently negligent for a trustee to retain stock in a period of declining market values and that there was no "magic percentage" of decline which, when reached, necessitated a sale'.

Whether the protection offered by the principle in *Re Chapman* is equally available where the notional or realised loss on an investment runs counter to the general market trend is an unanswered question. Inevitably much must depend on individual circumstances, including nowadays the extent to which any such loss would be seen as reflecting a reasonable exposure to risk in an investment portfolio. But the reader may care to reflect on the hypothetical liability of trustees who held shares in any of those major UK companies which went into liquidation or experienced severe financial crises (eg, Alfred Herbert (1980); Polly Peck (1991); Ferranti (1993); GEC-Marconi (2000)) in the last two decades. At what stage in the decline of a previously secure company does a prudent investment become imprudent, and can the retention of an investment which is at present paying no dividend and showing a capital loss be justified by a belief in its eventual recovery? Here again an important consideration will be whether the trustees obtained and considered advice if appropriate, whether under TA 2000, s 5 or as part of the general statutory duty of care.

A variant of this problem, and a consequence of inflation, is whether a trustee is under any obligation to preserve the real value of the trust fund rather than merely seek to protect the nominal value of the fund through securing the safety of trust assets. The nineteenth-century cases do not comment on what was to become a twentieth-century problem. But in *Nestlé v National Westminster Bank plc* [1993] 1 WLR 1260, CA, the courts were confronted with a claim that the defendant bank had failed to meet the prudent man standard in its management of a trust fund over a period of more than sixty years. The plaintiff's claim was that a fund worth £269,000 in 1986, when she became solely entitled, should with proper investment management have been worth over £1m. Notwithstanding that the bank had (i) failed to seek advice on, and indeed had misunderstood, the terms of the investment clause, and (ii) had apparently omitted to conduct regular reviews at least between 1927 and 1959, the claim failed. To establish liability it was also necessary to prove that 'through one or other or both of those causes, the trustees made decisions they should not have made or failed to make decisions which they should have made' (per Staughton LJ at 1276). It is a formidably difficult burden to establish that 'no prudent trustee' (at 1281), if properly appraised as to the full scope of the clause, would over a period of sixty years have made the investment decisions complained of. Leggatt LJ concluded that 'by the undemanding standard of prudence the bank is not shown to have committed any breach of trust resulting in loss', adding, however, that 'no testator, in the light of this example, would choose this bank for the effective management of his investment' (at 1285).

Even a shorter time-span may not materially alter this position. Consider, for instance, the poor performance of trust funds managed by the Public Trustee for some thalidomide victims. (See *Guardian* 23, 25 and 26 August 1981.) In one case, for instance, £13,518 invested in 1971 in authorised investments produced total interest in the next seven years of £2,882, ie less than 3% per year. During the same period the Retail Price Index had risen by 147% and an investment even in building society shares would have produced some £10,000 in interest. The Lord Chancellor, who investigated newspaper complaints, concluded, following advice, that no action for breach of trust or negligence could be sustained in such circumstances. (See also the recent criticisms of the Public Trustee Office by the National Audit Office: *Protecting the Financial Welfare of People with Mental Incapacity* HC (Session 1998–99) 206.) It still remains to be determined, however, whether a comparable 'shortfall' resulting from speculative zeal as opposed to excessive caution would be similarly viewed.

The present state of the law was aptly summarised by Leggatt LJ in *Nestlé* (at 1284): '[Performance] is to be judged not so much by success, as by absence of proven default.' That summary by Leggatt LJ leaves outstanding one rather puzzling aspect of the *Nestlé* litigation. It might be argued that there was 'proven default'. One might be prepared generously to accept that the misunderstanding of the investment clause could be categorised, employing Lindley LJ's language from *Re Chapman*, as 'a mere error of judgment'. It is more difficult to see how a failure to conduct periodic reviews of the investments could be consistent with the 'prudent man of business' standard particularly given the opinion of Leggatt LJ in *Nestlé* that '[A] trustee . . . must undertake periodic reviews of the investments held by the trust' (at 1282; see now the specific statutory requirement in TA 2000, s 4(2)). It must be emphasised, however, that even if there were 'proven default' it would still have to be shown that, but for the particular breaches of trust, the losses would not have occurred (see the comments of Staughton LJ above).

(2) Trustees as shareholders

One conclusion that can be drawn from the litigation is that trustees who wish to avoid any risk of liability should ensure that adequate procedures for supervision of investments are put in place. In the normal course of supervision a periodic review only is required but this 'watching-brief' may be inadequate where the trust has a controlling shareholding as will often be the case in a private company. How active a role should trustees then be expected to adopt, assuming the shareholding is an expressly authorised investment?

In *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 the bank as trustee of the Bartlett family trust had a controlling interest in a private family company with assets in rented properties. The board of directors of the company wished to extend its activities into property development, partly to ensure ultimately a favourable public quotation. The bank indicated that it did not object to this policy provided the income position of the life-tenants was protected. The board then embarked on two development projects at sites at Guildford and the Old Bailey, London. However, planning permission was refused for the latter, and consequently the trust suffered a large loss as a result of depreciation in the company shares. The property development would have been too speculative for direct investment by trust fund moneys. But, applying the prudent man of business standard, what course should the trustees have adopted where their investment was a controlling interest in the company undertaking the development? Brightman J, holding the bank liable for the loss, rejected an argument that where the trustees believed the directors to be of high calibre they need 'probe only if and when alerted'.

> **Brightman J:** What the prudent man of business will not do is to content himself with the receipt of such information on the affairs of the company as a shareholder ordinarily receives at annual general meetings. Since he has the power to do so, he will go further and see that he has sufficient information to enable him to make a responsible decision from time to time either to let matters proceed as they are proceeding or to intervene if he is dissatisfied. This topic was considered by Cross J in *Re Lucking's Will Trusts* [1967] 3 All ER 726.

[Cross J said (at 732–733) that the prudent man ‘ensures that he is represented on the board’ and that ‘in the same way trustees holding a controlling interest ought to ensure so far as they can that they have such information as to the progress of the company’s affairs as directors would have’.]

> I do not understand Cross J to have been saying that in every case where trustees have a controlling interest in a company it is their duty to ensure that one of their number is a director or that they have a nominee on the board who will report from time to time on the affairs of the company. He was merely outlining convenient methods by which a prudent man of business (as also a trustee) with a controlling interest in a private company, can place himself in a position to make an informed decision whether any action is appropriate to be taken for the protection of his asset. Other methods may be equally satisfactory and convenient, depending on the circumstances of the individual case. Alternatives which spring to mind are the receipt of the copies of the agenda and minutes of board meetings if regularly held, the receipt of monthly management accounts in the case of a trading concern, or quarterly reports. Every case will depend on its own facts. The possibilities are endless. It would be useless, indeed misleading, to seek to lay down a general rule. The purpose to be achieved is not that of monitoring every move of the directors, but of making it reasonably probable, so far as circumstances permit, that the trustees or (as in *Re Lucking’s Will Trusts*) one of them will receive an adequate flow of information in time to enable the trustees to make use of their controlling interest should this be necessary for the protection of their trust asset, namely the shareholding. The obtaining of information is not an end in itself, but merely a means of enabling the trustees to safeguard the interests of their beneficiaries.

Having been put on notice, what safeguarding action would it be appropriate for trustees to take, bearing in mind that disposal of the shareholding will rarely be a desirable or practicable possibility? As Brightman J describes it (at 151), ‘appropriate action will no doubt consist in the first instance of inquiry of and consultation with the directors, and in the last but most unlikely resort, the convening of a general meeting to replace one or more directors’.

The full sad tale of the failed development project is too lengthy to relate here (yet should be read to form an assessment of the trustees’ conduct). Consider, however, in particular whether the interpretation of the prudent man of business standard in *Bartlett* (above) is imposing an unreasonable administrative burden on corporate or professional trustees. On this point it may be unwise, in any event, to assume that settlors would wish to have professional trustees or trust corporations represented on the board of a family company or taking a close interest in its affairs. There may therefore be a mutuality of interest in incorporating a clause in a trust deed which relaxes the obligations implicit in the *Bartlett* and *Lucking* cases. (See, for instance, the example in Kessler *Drafting Trusts and Will Trusts* (5th edn, 2000) p 80: ‘The trustees are under no duty to inquire into the conduct of a company in which they are interested, unless they have knowledge of circumstances which call for inquiry’.)

Note also that Brightman J's comments in *Bartlett* are made in the context of a case involving a corporate trustee, and it is uncertain how extensive the administrative burden should be for the unpaid trustee.

Finally, if trustees are appointed as directors of a company they may also be held liable (as trustees) for breach of trust for their conduct in the management of the company. In *Re Lucking's Will Trusts* [1967] 3 All ER 726 a trust held 70 per cent of a company's shares and one of the trustees (L), who was also a substantial shareholder, was a director while the managing director (D) was an 'old and trusted friend' of his. The latter (D) over a period of years improperly withdrew some £15,000 from the company's bank account, subsequently became bankrupt and the debt could not be recovered. In consequence, the value of the trust's shareholding was reduced. L had developed the practice as director of signing blank cheques for D – ironically because he trusted D completely. The practice continued even after it became apparent that D was overdrawing from the company's account. L was held liable for breach of trust involving a negligent failure to supervise D's drawings from the bank account.

(f) Investment and the Trustee Act 2000: A panacea for all ills?

(1) Trustee Act 2000 and 'the small family trust'

It will be recalled that over twenty years ago the Law Reform Committee (LRC) had castigated the Trustee Investments Act 1961 as 'tiresome, cumbrous and expensive in operation with the result that its provisions are now seen to be inadequate' (23rd Report *The Powers and Duties of Trustees* (Cmnd 8733, 1982) para 3.17). For most modern trusts this criticism was immaterial, the trust instrument usually conferring wide investment discretion on the trustees. But, as the Law Commission was later to point out, such a discretion is seldom included in trusts and wills made without professional advice (*Trustees' Powers and Duties* (1999) Law Com No 260 at para 2.3). The response in the Trustee Act 2000, as we have seen, was to confer the widest possible investment powers on trustees coupled with safeguards. One of the safeguards was an obligation to 'obtain and consider' advice except where the trustee 'reasonably concludes . . . that it is unnecessary or inappropriate to do so'. In 1982 the LRC had taken a different stance on the question of advice. It recommended a reform agenda combining freedom with guidance. The guidance element was reflected in the LRC's recommendation that investments should be divided into those which could be made without advice – such as gilts, unit trusts and investment trusts – and those such as equity investments which should be made only with advice. The Committee explained its reasons in the following manner:

> 3.20 Although a general freedom to invest within the framework of what may loosely be described as a duty of care has its attractions and might reflect current practice where the present law is excluded, we think that such a solution would create considerable difficulties, particularly for smaller trust funds. Further we think that in any event the law should continue to provide some guidance and indeed protection for trustees.

In 1997 the Delegated Powers Scrutiny Committee of the House of Lords commenting on a Treasury proposal (the Draft Regulation (Trustee Investments) Order 1997) to introduce an advice requirement very similar to that now contained in TA 2000, s 5, noted that:

> 73. The Treasury argues that necessary protection for beneficiaries and trustees will be maintained under the proposal. As the explanatory memorandum states 'trustees of larger funds will tend to obtain advice as a matter of course. To require the trustees of smaller funds to seek advice regardless of circumstances would continue to require them to incur unnecessary costs to the detriment of beneficiaries.'

Whilst this may be a persuasive response to an argument advocating a compulsory advice requirement it is less convincing where the question of statutory guidance is concerned. Neither the Treasury proposal nor TA 2000, s 5 contains the guidance argued for by the LRC in 1982. It can be argued that in the absence of any statutory guidance as to the type of investment that may be safely selected without advice, prudent trustees might be well advised always to seek advice if only for their own protection. Indeed are there any circumstances now when an amateur trustee of a 'small trust' should exercise the power of investment without getting the benefit of professional advice (cf Latham (1994) 3 Nottingham LJ 95)? If this were to be the outcome then paradoxically one consequence of the new law might be to *increase* the administrative costs of trusts of small funds, unless the advice resulted in countervailing enhanced investment returns.

(2) The Trustee Act 2000, the 'prudent man of business' and modern portfolio theory: an interim conclusion

The objective 'prudent man of business standard' emerged at the end of the nineteenth century in the wake of concern about trustee defalcation and in an unstable economic climate. Its adoption can be seen as serving the twin functions of protecting beneficiaries from the idiosyncrasies of particular trustees and promoting higher standards of trustee conduct and competence (see Paling (1973) 37 Conv 48). In fact it is not easy to identify positively what the standard required. Indeed, at its adoption the formula attracted the sceptical stricture that 'the only rule really is what the courts think a prudent trustee ought to do' (Sir H Davey QC, counsel in *Learoyd v Whiteley* (1887) 12 App Cas 727 at 729). Nevertheless the standard, based initially on a concern to preserve the trust capital, inevitably resulted in an emphasis on security and the avoidance of risk. But investment conditions can change and the changes posed a challenge for the prudent man standard. Was it flexible enough to adjust to contemporary developments in investment theory and practice such as those described in this chapter? To an extent that question became redundant with the passage of the TA 2000 with its implicit acceptance of the major tenets of modern portfolio theory, namely the need to diversify and to evaluate risk and return in terms of the overall performance of the investment portfolio. There are, however, a number of questions posed for trustee investment law by the new statutory default regime that have yet to be resolved.

Consider the following points:

(1) There is now no doubt that, whether under the prudent man of business standard or the default statutory power of investment, trustees are authorised to balance 'risk of loss' against 'rate of return' within a total portfolio approach. In *Nestlé v National Westminster Bank plc* (29 June 1988, but not reported until (1996) 10 TLI 112), Hoffman J comments that 'an investment which in isolation is too risky and therefore in breach of trust may be justified when held in conjunction with other investments' (at 115). In *Trustees of the British Museum v A-G* [1984] 1 All ER 337, Megarry V-C, approving an application under the VTA 1958 to widen the range of authorised investments, commented that a material consideration in assessing the justification is the size of the fund: 'A fund that is very large may well justify a latitude of investment that would be denied to a more modest fund' (at 343). These comments may mean that trustees need no longer be bound by the strictures of Lord Watson in the House of Lords in *Learoyd v Whiteley* (1887) 12 App Cas 727 to the effect that 'it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise *to avoid all investments of that class which are attended with hazard*' (at 733, emphasis added). They may equally mean, as suggested earlier in this chapter, that whether an investment is labelled 'hazardous' is a reflection both of the characteristics of the individual investment and the size of the fund: the larger the fund, the greater the degree of risk that is considered reasonable in respect of a particular investment. On the other hand, it is open to question whether such comments can be stretched so far as to endorse, at least for trustee investment, the view of portfolio theorists that few, if any, investments are imprudent per se. The only issue for the portfolio theorist is whether the investment makes the portfolio as a whole imprudent. It is possible that the implementation of modern portfolio theory to trustee investment will enhance the returns to beneficiaries. On the other hand, if we accept that prudence is to be measured only by the performance of the portfolio as a whole this may make the monitoring of performance more problematic both for beneficiaries and the courts. Determining whether a particular investment is per se speculative or hazardous may be relatively straightforward. The matter becomes more complex if the question is whether the specific investment makes the portfolio as a whole imprudent. Jeffrey Gordon, in exploring the implications of portfolio theory for the prudent man rules in the US, summarises the position in the following manner: '[The] portfolio theory model complicates the determination of prudence, both as a matter of theory among financial economists and as a matter of proof before a court. . . . Courts will be called upon to evaluate complicated strategies, not simply specific investments viewed in isolation. Instead of referring to a list of imprudent investments . . . courts will have to evaluate conflicting expert testimony. Courts may fear that portfolio theory will serve as a smokescreen for trustee incompetence' ((1987) 62 NYUL Rev 52 at 93). This evocation by Gordon of potential pitfalls returns us to a residual question that troubled the nineteenth-century courts and one that is left open by the relatively unconstrained default powers of investment now conferred on trustees. Can that grant of discretion be sufficiently monitored so that incompetent or faithless performance by trustees will be adequately deterred?

(2) In *Nestlé v National Westminster Bank plc* [1993] 1 WLR 1260, CA Leggatt LJ states that 'the importance of preservation of a trust fund will always outweigh success in its advancement. Inevitably a trustee in the bank's position wears a complacent air, because the virtue of safety will in practice put a premium on inactivity' (at 1284). How one interprets 'preservation' in an investment context is crucial; in *Nestlé* the *nominal* value of the funds had increased approximately five-fold to £269,903 from 1922 to 1986 whereas it was argued that in real terms 'if the equity portion of the fund as it stood in 1922 (74%) had been invested so as to achieve no more than the index, the fund as a whole would have been worth over £1.8m' (at 1275). Is the approach suggested by Leggatt LJ compatible or incompatible with a portfolio theory of investment? Consider in particular whether a distinction should be drawn between pre- and post-*Nestlé* investment performance. After all, trustees are now on notice that a portfolio approach has received both judicial endorsement and implicit statutory acceptance. (See in particular the protracted and very expensive litigation instigated by Unilever Pension Fund in 2001 to recover compensation from Merrill Lynch Investment Managers for underperformance in the investment of the pension fund. The case was settled out of court and substantial compensation paid: *Financial Times*, 7 December 2001.)

(3) Trustees cannot reduce their liability to make good losses arising from wrongful investment by 'setting off' a profit earned on one transaction against a loss made on another even if both are unauthorised. A fortiori unauthorised losses cannot be set off against authorised profits. The justification for the rule is clear: any gains made belong to the beneficiaries and are not the trustees' to set against their own personal liability. But the rule does not apply where the gain and loss are part of the same unauthorised transaction. The difficulty lies in deciding what constitutes a single transaction. (See *Hanbury and Martin* p 658 for a comparison of two leading nineteenth-century cases *Dimes v Scott* (1828) 4 Russ 195 and *Fletcher v Green* (1864) 33 Beav 426.) It will be recalled that in *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139 there were two property-development projects, and although the Old Bailey project was a financial disaster, a substantial profit was made on the Guildford development. In allowing the bank's claim for 'set off', Brightman J commented on the rule as follows (at 155):

> The general rule as stated in all the textbooks, with some reservations, is that where a trustee is liable in respect of distinct breaches of trust, one of which has resulted in a loss and the other in a gain, he is not entitled to set off the gain against the loss, unless they arise in the same transaction. . . . The relevant cases are, however, not altogether easy to reconcile. All are centenarians and none is quite like the present. The Guildford development stemmed from exactly the same policy and (to a lesser degree because it proceeded less far) exemplified the same folly as the Old Bailey project. Part of the profit was in fact used to finance the Old Bailey disaster. By sheer luck the gamble paid off handsomely, on capital account. I think it would be unjust to deprive the bank of this element of salvage in the course of assessing the cost of the shipwreck.

At a minimum, these words endorse the proposition that individual gains or losses that emerge from unauthorised investments in pursuit of a common, but wrongful, investment policy can be set against each other in assessing trustee liability (see generally Chapter 11 on measuring trustee liability). How far the notion of a 'policy' can be stretched remains to be answered; would, for example, a set off be allowable where a policy of property development involved one hazardous project and one of 'reasonable risk'? In practice, however, acceptance of a portfolio approach (see (1) above) is likely further to limit the scope of any prohibition against set off. This consequence appears to have been recognised by Hoffman J in *Nestlé* where in a footnote to the passage cited in (1) it is commented that 'this is not to say that losses on investments made in breach of trust can be set off against gains in the rest of the portfolio but only that an investment which in isolation is too risky and therefore in breach of trust may be justified when held in conjunction with other investments' ((1996) 10 TLI 112 at 124, footnote 3). Similarly in the US the Official Comment on the draft Uniform Prudent Investment Act, issued by the Uniform Law Commission in 1994, states: '[t]he riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust's portfolio'. (See Langbein (1994) 8 TLI (4) 123; and generally Langbein (1996) 81 Iowa LR 641; Aalberts and Poon (1996) 34 American Business LJ (1) 39; and for a wide-ranging analysis of the implications of modern portfolio theory for the prudent man principle in the US, Gordon (1987) 62 NYUL Rev 52.)

(4) 'The prudent man of business standard as applied to authorised investments, can be criticised for merely setting minimum standards of performance, penalising only the grossly incompetent, and offering no inducement to seek a high financial return. Consequently it can be argued that "under modern conditions a settlor's best protection for the trust fund would seem to lie in the quality of persons he or she selects as trustees".' Are the criticism and the conclusion well founded? (See eg Watt and Stauch [1998] Conv 352 but cf *Re Mulligan (Deceased)* [1998] 1 NZLR 481.)

4. Impartiality and investment

(a) Introduction

We have previously referred in rather sweeping fashion to the principle that trustees must act impartially between beneficiaries in their dealings with trust affairs. In particular it has been suggested that, where there are successive beneficiaries, the trustees must not favour either the life-tenant or remainderman. In the immediate context of investment this should require that an investment portfolio be so balanced as to support the successive interests equally. But the duty of impartiality runs wider than merely investment, arising also in the context of trust expenses. There is, for example, a general rule that all outgoings of a recurrent nature (such as rates and income taxes) which relate broadly to property benefiting the income beneficiary should be met out of income, whilst those incurred for the benefit of the whole estate (such as obtaining investment advice or paying endowment assurance policy premiums) should be borne by the capital (see generally *Underhill and Hayton* pp 563–571). This is subject to the proviso that the trust instrument may itself indicate how trust expenses should be allocated (see *Carver v Duncan* [1985] AC 1082).

In fact any broad statement implying universal application of the principle of impartiality is potentially misleading for two reasons. First, and as always, a settlor or testator may choose to modify its application by providing that a disproportionate weight be attributed to the interests of different beneficiaries. Thus trustees may be instructed, for instance, to retain a high-income yielding security which suffers a capital depreciation, thus favouring the life-tenant as against the remainderman. It may even be the case that trustees can themselves make such judgments 'if they consider it would be fair to do so' (*Nestlé v National Westminster Bank plc* (1996) 10 TLI 112 at 115 per Hoffman J). How far it is appropriate for the court to make this sort of judgment is a matter to which we will return (see below p 497). Second, as will be seen below, the implementation of the general principle takes the form of specific rules which impinge only on certain aspects of investment practice whilst leaving others seemingly untouched. The rationale for such selective intervention rests on certain questionable assumptions about the settlor's or testator's implicit intentions.

It is clear, however, that when exercising their discretion in choosing investments trustees must not select with the intention of prejudicing an individual or class of beneficiary in order to benefit another (see *Raby v Ridehalgh* (1855) 7 De GM & G 104, as the classic authority). But trust property coming into the trustees' hands will not necessarily consist of cash which must then be invested to obtain an income return. On the contrary the settlor may place specific property (eg shares in a private company) into trust, or a testator may leave a residuary estate comprising various forms of personalty on trust. If the settlor has made clear an intention that the trust property should be converted and the proceeds re-invested then that intention will prevail. But if no such intention is expressed or can be inferred, then unless the specific rules just referred to apply, the law has seemed to be that trustees are placed under no duty to realise the trust property and reinvest the proceeds so as to balance competing interests of beneficiaries. Accordingly, where the rules do not apply it is axiomatic that the tenant for life receives merely the net income, however low or high it may be, while the remainderman is entitled eventually only to the capital irrespective of the degree of capital appreciation or depreciation that may occur to the particular investment.

The inevitability of this outcome needs to be reconsidered in the light both of the new approach to trustee investment envisaged by the Trustee Act 2000 and recent decisions such as that in *Nestlé*. Indeed, it might have been thought that the new Act would specifically address the appropriateness of the rules determining the duties of conversion and apportionment. In fact during the passage of the Bill the matter was raised indirectly in the course of debate concerning the implications for charitable endowments of the rigid distinction between capital and income receipts. Responding to the points raised the Lord Chancellor acknowledged that the law of apportionment was in 'some disarray' but suggested that the issues should be dealt with as a whole rather than 'in a piecemeal fashion' as an amendment to the Trustee Bill (*Hansard* (HL) 14 April 2000, vol 612, col 396). The outcome was a reference to the Law Commission to examine, inter alia, (i) the circumstances in which trustees may or must make apportionments between the income and capital of the trust fund, (ii) the circumstances in which trustees must convert and re-invest trust property, and (iii) the rules which determine whether money or other property received by the trustees is to be treated as income or capital. The Law Commission in July 2004 published a Consultation Paper *Capital and Income in Trusts: Classification and Apportionment* (No 175). This is not the first time that reform in this area has been canvassed. Recommendations for reform of the rules of apportionment and of the classification of trust receipts as income or capital have previously been proposed by the Trust Law Committee (*Capital and Income of Trusts* (1999) www.kcl.ac.uk/depsta/law/tlc/) and, in 1982, by the Law Reform Committee (*The Powers and Duties of Trustees*, 23rd Report, Cmnd 8733).

(b) The 'annual harvest' and some problems of capital and income

Before considering the scope and limitations of the rules implementing the principle of impartiality it should be appreciated that they are premised on a legal concept of capital and income whose relevance under modern investment conditions merits close consideration. The origin and elements of the legal concepts are highlighted in Flower's comparison of them with those of the economist.

> J Flower 'A Note on Capital and Income in the Law of Trusts' in H C Edey and B S Yamey (eds) *Debits, Credits, Finance and Profits* (1974) pp 85–87

> The courts developed a concept of capital which is fundamentally different from that used by the economist as exemplified by the famous definition of Hicks: 'Income is the maximum amount the individual can consume in a week and still expect to be as well off at the end of the week as he was at the beginning' (JR Hicks *Value and Capital* (1938) p 172).
>
> Suppose that X's capital at the start of 1972 is £20,000; under the Hicksian definition he will have maintained his capital, as measured by disposable wealth, intact if he finishes the year with assets worth £20,000 (given constancy of the general price level). Any increase will be income. The composition of the assets is immaterial – only their total value is taken into account.
>
> The lawyer's normal concept of capital in the context of a trust is different. To him, if X's capital at 1 January 1972 was 1,000 shares in a company, X will have maintained his capital intact if he finishes the year with the same 1,000 shares. If he sells some shares, the money that he receives in exchange is regarded as the equivalent capital asset. Any increase in the value of the assets whether realised or unrealised is not part of income. If a capital asset is sold for a value greater than its initial value, the extra value has indeed to be recorded, but it is called a 'capital gain' to differentiate it from income.
>
> Lawyers have thus tended to regard a capital asset as a res or a 'thing'. Seltzer in a fascinating chapter has traced this concept to the practice of entailing landed estates in eighteenth-century England (L H Seltzer *The Nature and Tax Treatment of Capital*

Gains and Losses (1951) ch 2). The person to whom a life-interest in the estate was granted, was entitled to receive the income of the estate but had no right to spend the capital. The courts often had to decide what was in fact the income of the estate and therefore belonged to the life-tenant, as opposed to what was capital. Not unnaturally they took the view that the capital was the land itself and the income was the annual harvest. The life-tenant was entitled to the annual harvest, which could be disposed of without affecting the physical existence of the land.

Over the next two hundred years estates came to consist more and more of financial securities – shares, bonds, etc – but the courts applied the same principles to these assets as to land. The capital to be maintained was the bond itself, not its money value. A rise or fall in the market value of the bond did not change the physical character of the bond; it was not therefore regarded as an element of income. If the bond were sold, the entire proceeds of the sale retained the character of a capital asset as did any assets acquired with the money. Any surplus arising on the sale was of course capital; the life-tenant had no right to it. It was described as a capital gain to emphasise this point. Thus the practice developed of recording capital gains when they were 'realised', ie on the sale of the assets. Unrealised capital gains were ignored. The income of the bond was its annual 'harvest' – that 'which is periodically detached and periodically recurs', ie the annual interest payment.

The reason for the courts adopting the res principle seems to have been largely pragmatic. To have applied a Hicksian 'value' principle consistently and accurately would have required regular revaluations of all the assets of the estate. This would not only have entailed considerable extra work but would have provided endless opportunities for disputes between life-tenants and remaindermen. . . .

There is clearly a world of difference between the lawyer's and the economist's concept. The lawyer's realised capital gain would be classified by an economist as income if it were expected; it would be a capital gain from the point of view of economic analysis only in so far as it was unexpected, and this concept, unlike the lawyer's, would have nothing to do with respective property rights. Many of the lawyer's capital gains can be clearly shown to be expected. A person who in December 1972 buys £100 of 3 per cent Savings Bonds at 89 which are due to be redeemed at 100 in 1975 is clearly expecting to make a gain on redemption of £11. The economist would regard this as income, the lawyer would call it a capital gain.

The gap identified by Flower between legal and economic concepts is theoretically narrowed in some cases, to be discussed shortly, where either trusts law or the trust instrument imposes a duty on trustees to convert trust property and reinvest in authorised investments. Where there is such a duty to convert, a companion set of rules require trustees to apportion between capital and income beneficiaries the gains of wealth derived from the original property pending conversion (see *Flower* pp 88–91 for detailed explanation and calculation).

The reservation implicit in 'theoretically narrowed' (above) is necessary because the duty to apportion is in practice nearly always excluded (see below). But even were this not so the area of application of the rules is very limited, leaving numerous circumstances where the consequences of investment decisions by trustees can have a very significant effect on the respective entitlements of income and capital beneficiaries.

A still more fundamental objection to the way the established rules operate is that trustees do not always have control over the form in which profit is received by them. For instance, successful companies do not usually distribute all their profits annually. A company may therefore subsequently be able to choose under its articles of association whether to issue retained profits in the form of dividends (and hence 'income' to the trust fund) or alternatively to capitalise the profits by issuing additional ('bonus') shares to shareholders. If the latter course is adopted the general rule is that the new shares are to be treated by the trustees as an accretion to the capital of the trust fund, although the income beneficiary will of course benefit from any future dividends declared on those shares (*Bouch v Sproule* (1887) 12 App Cas 385; *Hill v Permanent Trustee Co of New South Wales Ltd* [1930] AC 720; *Re Outen's Will Trusts* [1963] Ch 291; Goodhart (1975) 39 Conv 355). A further complication is that no distinction is drawn in company law between the distribution of profits derived from current trading and those that accrue from a realisation of the company's capital assets. In both cases the profits are available for distribution to shareholders by way of dividend and hence as a receipt of income to the trust fund. Whilst for trust law purposes this is appropriate as regards trading profit, realisation of capital assets is more naturally considered as accruing to capital. Yet under trust law all dividend payments must be treated as income. Application of company law principles in this manner therefore fails to hold a fair balance between the interests of income and capital beneficiaries. Moreover, as the Law Commission notes, the courts will usually 'consider themselves to have no jurisdiction to order apportionment to remedy this imbalance' (*Capital and Income in Trusts: Classification and Apportionment* (No 175) para 2.44). In short trusts law is usually subordinated to company form.

The appropriateness of this approach becomes ever more difficult to sustain in novel fact situations where corporate practice and corporate law devise ever new ways of rearranging capital to achieve commercial or tax advantages. The problem posed by the rule in *Bouche v Sproule* was at the forefront of litigation arising out a demerger whereby ICI plc transferred its bioscience activities to a newly created holding company called Zeneca Group plc. The ICI shares formed part of the capital of the fund. The question was whether the Zeneca shares issued to ICI shareholders to compensate for the loss of part of the ICI undertaking should be treated as income or capital receipts. The authorities, following and developing the rule in *Bouche v Sproule*, pointed clearly in favour of treating the Zeneca shares as income. Sir Donald Nicholls V-C felt that such a solution would not accord with the economic realities of the situation: 'No one would imagine that the Zeneca Group shares could sensibly be regarded as income' (*Sinclair v Lee* [1993] Ch 497 at 504). The Vice-Chancellor drew a somewhat formalistic distinction between a 'direct' demerger and an 'indirect' demerger – the latter being the situation in *Sinclair v Lee* – and was thereby able to avoid on narrow technical grounds applying the rule in *Bouche v Sproule*. It is evident, however, that this distinction was adopted solely to avoid what the Vice–Chancellor considered to be an otherwise unsatisfactory outcome: 'I am acutely conscious of the danger of doing more harm than good by the apparent departure from established principles so as to reach a fair conclusion in a particular case. Nevertheless, in my view an application of existing principles in their full width would produce a result in this case which would, frankly, be nothing short of absurd' (at 515; see comment in *The Lawyer*, 11 May 1993, p 10; see also Duffield (1995) 9 TLI 55).

One way of avoiding absurdity is to ignore a rule and the Law Commission suggest 'that in many cases trustees (especially those who are not legally advised) will, as a matter of practice, allocate in accordance with common sense rather than [in compliance with the strict rules]' (para 2.47). This is hardly a satisfactory position and one question is whether a general duty of impartiality may provide a more appropriate solution. Before considering this as a possible reform we need to consider more closely the present scope of the duty to act impartially.

(c) The scope of the duty to act impartially

(See generally Phillips (1977) 10 U Queensland LJ 83 at 88–94; Scane (1984) 62 Can BR 577.)

(1) The investment process

It must not be overlooked that investment is a two-step process. First, the decision to realise and convert existing investments must be taken and only then can the discretion to select from among the range of authorised alternative investments be exercised. There is no doubt that in taking the second step trustees must attempt to maintain an even hand between conflicting interests. But the general duty of impartiality is heavily qualified by the limited scope of the rules regulating the first step – the duties to convert and apportion. It must be emphasised that these rules are not only limited in formal scope but in practice are also commonly excluded. We therefore concentrate here on the principles involved rather than their detailed implementation (see generally *Hanbury and Martin* pp 553–564; *Parker and Mellows* pp 653–671).

(2) The rules of conversion and apportionment

Duty to convert A settlor or testator may expressly or impliedly impose in a settlement or will a duty to sell or to convert and reinvest, in which case the trustees' duty depends upon the precise terms of the trust. Otherwise such a duty arises only in the case of a bequest of residuary personalty for persons entitled in succession when the rule in *Howe v Earl of Dartmouth* (1802) 7 Ves 137 will apply. The rule is therefore of limited application. It does not apply (i) to property settled inter vivos; (ii) to devises of real estate, whether specific or residuary; nor (iii) to specific as opposed to residuary bequests (see Bailey (1943) 7 Conv 128 and 191).

The requirements of the rule were summarised in the 1982 Report of the Law Reform Committee (*The Powers and Duties of Trustees*, 23rd Report, Cmnd 8733) para 3.28):

> Where . . . [the rule] does apply, wasting investments (eg royalties in respect of copyright) which are not permanent and may be of reduced or no value at the death of the life-tenant, to the prejudice of the remainderman, and all hazardous or speculative investments, a term which covers all unauthorised investments, are directed to be converted to protect the interests of the remainderman. Reversionary or other non-income-producing property is directed to be converted into income-bearing investments in order to protect the tenant for life who might otherwise get nothing at all from those parts of the trust property. In all cases, however, the duty to convert is based upon an implied or presumed intention of the testator so that where he has indicated that the property should be enjoyed in kind the rule will not be applied. [*Macdonald v Irvine* (1878) 8 Ch D 101.]

One effect of wider investment powers conferred on trustees by TA 2000, s 3 is to extend the range of 'authorised' investments thereby significantly reducing the circumstances in which the rule has any application. This development therefore raises afresh questions about the appropriateness of the rule as a means of achieving its underlying objective of securing a fair balance between beneficiaries entitled to income and those entitled to capital.

A general duty of impartiality? A note of caution must be sounded here about the apparent certainty of the statement that, in the absence of express instruction in the instrument and following *Howe v Earl of Dartmouth,* a duty to convert can never be applicable to inter vivos trusts. The rationale for not implying any such duty is that, in contrast to residuary gifts in wills, the settlor has intentionally appropriated the particular investments to the trust. There is some evidence, however, that this presumption may be losing its hold.

In the Canadian case of *Re Smith* [1971] 1 OR 584 (affd [1971] 2 OR 541), a corporate trustee of an inter vivos trust, in effect deferring to the wishes of the settlor who was also the remainderman, refused the life-tenant's request to sell low income-yielding authorised investments (paying 2% per annum compared with widely available rates of 7% to 10%) but with a high capital growth rate. Although the trust company was empowered by the trust instrument to retain the investments the court ordered its removal stating ([1971] 1 OR 584 at 589): 'Unless there is some provision in the trust agreement which prevents the trustee from [maintaining an even hand], it seems . . . inescapable that the trustee is in breach of his well-recognised duty' by refusing to exercise the power to invest in securities which would produce a reasonable return for the life-tenant. Cullity in a comment critical of the decision concluded ((1972) 50 Can BR 116 at 120):

> Although the finding is not altogether free from ambiguity it does appear to represent more than a decision that the trustee had failed to exercise its discretion: it appears rather as a finding that a conversion and reinvestment should have been made. The even-hand rule was thus treated as governing the way in which the discretion whether to convert or retain ought to have been exercised.

Somewhat intriguingly none of the judgments in *Re Smith* make reference to *Howe v Earl of Dartmouth* and the present status of the case as authority is debatable, even in Canada (see Ontario Law Reform Commission *Report on the Law of Trusts Volume I* (1984) pp 280–281 for a concise summary, and Scane (1984) 62 Can BR 577).

Duty to apportion The duty to apportion pending conversion arises whether there is a duty to convert under an express trust for conversion (*Gibson v Bott* (1802) 7 Ves 89) or under the rule in *Howe v Earl of Dartmouth.* A series of somewhat elaborate rules exists governing apportionment 'which well-drafted trust instruments routinely exclude' (*Capital and Income in Trusts: Classification and Apportionment* (No 175) para 3.39).

The following is a brief summary of the objectives of the more important of the rules.

(i) Wasting, hazardous or unauthorised investments: the theoretical assumption is that such investments provide the life-tenant with a high income at the risk of capital loss. The object of apportioning the income is to ensure that he receives only a yield equivalent to that currently available from authorised investments (fixed in 1924 at a now unrealistic 4%) and that any surplus is added to the capital. The yield of 4% is not only unrealistic in most contemporary circumstances but also out of line with the interest rates applied by the courts in other contexts (see eg *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, but cf *Re Berry* [1962] Ch 97, the last reported case on this issue).

(ii) Future or reversionary property: This rule applies where that part of the trust fund governed by a duty to convert comprises a reversionary interest or other future property producing no income. When the property is sold – the trustees may have deferred sale in the interest of the trust as a whole – the proceeds must be apportioned, part to capital for the remainderman and part to income for the tenant for life (the rule in *Re Earl of Chesterfield's Trusts* (1883) 24 Ch D 643). This rule is intended to compensate the life-tenant for loss of income from the future property while it remains unconverted.

(iii) The rule in *Allhusen v Whittell* (1867) LR 4 Eq 295: the life-tenant under a will is entitled to the income earned after the testator's death. The testator may, however, leave debts which may not be paid immediately. In the meantime the life-tenant receives income from capital in fact required for the payment of those debts, whereas in fairness she should receive the income from the net estate only. The rule – intended to provide for the life-tenant's income to make a contribution – is complex, the calculations required cumbersome, and since in most cases only small sums of money are involved, it is invariably excluded in well-drafted wills.

(3) Summary

By way of recapitulation it can be said:

(i) subject now to the significant qualification posited by *Re Smith* there is no obligation to convert existing investments unless the rule in *Howe v Earl of Dartmouth* applies or there is an express duty to convert in the trust instrument usually in the form of a trust for sale – a power to sell not being sufficient;

(ii) where conversion takes place the trustee must attempt 'to be fair' when considering the choice of investments; and

(iii) the apportionment rules designed to achieve fairness between successive beneficiaries are frequently either expressly excluded or ignored in practice This is because they are perceived both as unduly complex and more importantly largely irrelevant under modern investment conditions.

(b) Reform and the principle of impartiality

(1) The Law Commission Consultation Paper

As we have noted the reference to the Law Commission by the Lord Chancellor in 2000 is but the latest in a series of official and quasi-official reviews of the rules that have as their rationale the principle that trustees must be impartial in their management of the trust. The almost universal response of the several reviews has been that the rules are complicated, unsatisfactory in their impact and are frequently excluded or even ignored. To this catalogue of criticisms can now be added the further charge that the advancement of the cause of portfolio investment theory in the Trustee Act 2000 will be frustrated in so far as 'the current law as it appertains to classification and apportionment makes it impossible to realise all the potential benefits of that theory' (*Capital and Income in Trusts: Classification and Apportionment* (No 175) para 1.9). The argument is that the rules based on the traditional distinction drawn by trusts law between capital and income are preventing trustees from realising the larger economic returns that might have been achievable were the Hicksian or economist's definition of capital and income adopted.

In response to these various pressures for reform the Law Commission has advanced several key proposals for consultation. Unsurprisingly the Commission restates the centrality of the 'duty of impartiality' or, as it is sometimes called, the duty to 'keep a fair balance'. This duty to be even-handed in the treatment of different classes of beneficiaries therefore underpins the specific proposals.

As regards the equitable rules of apportionment the Law Commission proposals closely follow the earlier recommendation of the LRC to the effect that the existing rules should be abrogated (paras 5.83–5.88). Similarly the Commission proposes that the duty to convert trust property under the rule in *Howe v Earl of Dartmouth* should be abrogated. On the other hand, where a settlor expressly creates a trust for sale (without a power to postpone sale) then the Commission proposal is that trustees should continue to be under a duty to convert the trust property and reinvest the proceeds (paras 5.89–5.91). But what of the position where there is an inter vivos settlement or the trust fund at its inception is comprised of authorised investments, or realty? Should the law still assume, as has been the case, that the settlor intended that such gifts were intended to be enjoyed in specie and that there is therefore no implied obligation to convert so as to achieve a 'fair balance'? The Commission proposes what is tantamount to a reversal of those assumptions and, it might be added, an endorsement of the result in *Re Smith* by suggesting that trustees should be subject to the duty to hold a fair balance except in so far as the settlor in the trust instrument expressly, or by necessary implication, excludes or modifies that duty (see paras 5.19–5.31).

In place of the 'old' rules, and as a necessary adjunct to the proposed duty to 'keep a fair balance' the Law Commission proposes the introduction of a statutory power of allocation for trustees. The proposed power would enable trustees to achieve the underlying objective of maintaining a balance between capital and income beneficiaries by empowering the trustees to allocate receipts or expenses between income and capital. The Commission also proposes a replacement of the existing rules on classification of distributions by corporate entities, based as they currently are on company law principles, by new rules deemed more appropriate for trustee-shareholders (see paras 5.3–5.18). Devising rules that can adjust to every new complexity in corporate manoeuvres to achieve commercial benefits is probably impossible and so the Commission has also proposed that any consequential problems of imbalance could be overcome by the proposed power of allocation. It is therefore evident that the content and scope of that proposed power is central to the reform agenda. It is not possible to explore all the ramifications of the Law Commission proposals here but three particular points merit brief comment. They are (i) the continuing relevance of a capital-income distinction; (ii) the scope of an obligation to act fairly; and (iii) the effectiveness of methods of enforcing a general duty of impartiality.

(2) Capital and income reconsidered

Empowering trustees to convert income into capital and vice versa enables them to hold an even hand more easily. It overcomes the limitations imposed on allocation of receipts and outgoings by the lawyer's concepts of capital and income. To an extent settlors are already able to achieve this by direction in the trust instrument. For example, a settlor concerned that the income produced for a life-tenant may prove inadequate can either direct trustees, or provide them with a discretion, to supplement income out of capital. There is an income tax pitfall here, however, in that payments of a recurrent nature will be treated as the income of the beneficiary (*Brodie's Will Trustees v IRC* (1933) 17 TC 432 at 438–439; *Lindus and Hortin v IRC* (1933) 17 TC 442; cf *Stevenson v Wishart* [1986] STC 74). However, the conferment of such a discretion interferes with the capital-income distinction at the allocation of receipts and outgoings stage only, and does not directly confront the more fundamental issue, that of the rigidity imposed on trustees' investment policy by that distinction.

A more radical proposal to sever investment decisions from the influence of the legal concepts of income and capital is the 'unitrust' or 'percentage trust'. In a unitrust trustees manage a single fund with the investment objective being an increase of the total fund. All receipts of whatever nature are paid into the one fund and all outgoings of whatever nature are paid out of the fund. Whether the source of the increase is income or capital appreciation is irrelevant since there is no separate allocation to capital or income. A method of calculation of the life-tenant's interest under a unitrust is described by one American proponent as follows:

> E M David 'Principal and Income – Obsolete Concepts' [1972] Pennsylvania Bar Association Quarterly 247
>
> Each year there would be distributed to the life-tenant an amount equal to a stipulated percentage of the current market value of the entire combined fund. The percentage would be one defined by the testator or grantor. It might be a fixed percentage or one related to economic factors, such as prime rate of interest. It would not be related to the purchasing power of the dollar, since hopefully that would be reflected in the current value of the combined fund. If a fixed percentage rate is stipulated, as would probably be most common, the rate should be determined by taking the projected income, adding the projected appreciation, deducting an amount to cover the estimated loss due to the decline in the value of the dollar through inflation and also deducting a reasonable reserve for possible principal losses. It might be suggested that this calculation involves a good deal of judgement if not actual guesswork. Nevertheless, it is surely better than giving the trustee the option of paying the life-tenant any amount between 1 per cent and 8 per cent with no guidance as to which figure he is to approach. It is better to pay a stated rate than to pay 'income' which now means little in terms of rate of return.

The capital beneficiary will of course receive the balance of the fund at the termination of the life-tenant's interest. The unitrust is not without its own difficulties, in particular those of liquidity of assets, cost and timing of valuation of assets and taxation treatment. Indeed a criticism of the unitrust voiced in the US is that 'it has little to offer except complexity of administration, since a draftsman can already achieve similar results by use of "invasion of capital" clauses and provision for interest-free loans'. (See 'The Trust Income Plan – A Solution for the Life-Tenant?' (1984) 190 The Accountant, 3 May, p 11; Wolf (1997) 32 Real Property Probate and Trust Journal 45; Dobris (1997) Real Property Probate and Trust Journal 255; Manns (1998) 28 VUWLR 611.)

The Law Commission in its Consultation Paper steers an agnostic path – it seeks views on the pros and cons of promoting such trusts – but identifies two potential problems. One is the lack both of awareness of and legal expertise in the percentage trust in England and Wales. The second difficulty lies in the current tax system for trusts which is based exclusively at present on the traditional concepts of capital and income. The alternative method of achieving a 'total return' investment approach, and one favoured by the Law Commission is, as indicated above, to confer on trustees a statutory power to allocate trust receipts and expenses between income and capital (paras 5.39–5.55).

(3) The duty to maintain a fair balance

The Law Commission proposes that a statutory power of allocation would be available to trustees only in so far as necessary to discharge the duty to maintain a fair balance. Any proposal invoking a notion of fairness inevitably invites the question: What criteria are we to employ in determining fairness? In *Nestlé v National Westminster Bank plc* ((1996) 10 TLI 112), for instance, Hoffman J, responding to the argument that the investment policy of the trustee had unfairly favoured the life-tenant, comments (at 115):

> The trustees have in my judgement a wide discretion. They are for example entitled to take into account the income needs of the tenant for life or the fact that the tenant for life was a person known to the settlor and a primary object of the trust whereas the remainderman is a remoter relative or stranger. . . . It would be an inhuman law which required trustees to adhere to some mechanical rule for preserving the real value of the capital when the tenant for life was the testator's widow who had fallen upon hard times and the remainderman was young and well off.

Similar sentiments were expressed by Staughton LJ in *Nestlé* in the Court of Appeal ([1993] 1 WLR 1260 at 1279): 'If the life-tenant is living in penury and the remainderman already has ample wealth, common-sense suggests that a trustee should be able to take that into account, not necessarily by seeking the highest possible income at the expense of capital but by inclining in that direction.'

An appeal to common sense as an adjudicating factor is fraught with risk. Indeed the Law Commission, rejecting the notion that balance should be defined by reference to a statutory list of relevant factors, proposes instead that 'the meaning of "balance" should be a matter of common sense informed by the common law' (para 5.57). However, the Law Commission does *not* think that the personal circumstances of beneficiaries should be a relevant factor in the exercise of the statutory power of allocation.

Consider the following points:

(1) Which of the following statements (both drawn substantially from the Law Commission Consultation Paper) regarding the relevance of personal circumstances to the question of 'a fair balance' do you find more persuasive:

> The instinctive response of many trust lawyers [to the *Nestlé* approach is] that it would be unconscionable or inequitable not to shift the balance of the trust fund to reflect the personal circumstances of the beneficiaries. It is said that trustees should

> know about and take an interest in the beneficiaries' personal circumstances and that equity should do what is 'right' (para 5.73); *or*
>
> The *Nestlé* approach equates the idea of administering a trust fund 'impartially' with administering it 'fairly' (in the sense of meritoriously). Introducing the concept of fairness makes the beneficiaries' entitlements dependent upon a much wider range of moral considerations which otherwise have no place within a fixed interest trust. . . . If trustees are able to take into account personal circumstances, they would have a power akin to an indirect dispositive discretion for which the settlor has (possibly for good reason) made no provision in the terms of the trust (para 5.76).

(2) Under a trust for successive beneficiaries does the discretion given to trustees to select from a wide range of authorised investments in effect transform what appears as an administrative power to manage wealth into a significant dispositive power?

(4) Enforcing a general duty of impartiality

Adopting a statutory power of allocation in preference to clearly defined rules, even of limited application, so as to help satisfy a general duty of impartiality potentially poses a problem of control. Faced with a comparable issue in its 1982 Report the LRC proposed that trustees should not be liable for breach of the duty of impartiality if they acted in good faith. The Committee nevertheless recommended that 'any beneficiary should be entitled to apply to the court for an order directing the trustee either to make or adjust an apportionment' provided that the beneficiary could demonstrate that 'the trustees' exercise of their discretion had substantially prejudiced [the beneficiary's] interest' (23rd Report, *The Powers and Duties of Trustees* (Cmnd 8733, 1982) para 3.37). The LRC concluded that 'bearing in mind the vast choice of investments available to trustees, in practice it would be exceptional for [the court] to conclude that they had not held an even balance'. It would be surprising, as the Law Commission notes in its Consultation Paper, if a similarly wide margin of appreciation were not to be accorded to trustees exercising the proposed power of allocation before the courts would hold that trustees were in breach of their duty to maintain a balance. Consequently the Commission proposes simply that a statutory power of allocation should be subject to review by the courts on the same basis as any other discretionary power (*Capital and Income in Trusts: Classification and Apportionment* (No 175) paras 5.80–5.82). It remains an open question whether either the recommendation of the LRC or the proposal of the Law Commission strikes an appropriate balance between the conflicting pressures of preserving a wide investment discretion for trustees, avoiding the imposition of unduly onerous accounting obligations on them and protecting the interests of the beneficiaries (cf the facts of *Nestlé v National Westminster Bank plc* [1993] 1 WLR 1260).

5. Delegation

(a) Introduction: from prohibition to the Trustee Act 2000

Where the office of trusteeship is described as one of personal confidence, this reflects the moral element of the obligation. The person creating the trust is in effect saying to the trustee, 'I trust you to implement my instruction' and where discretion is given, 'I trust you to decide matters'. Trusts law, recognising and seeking to enforce the personal nature of the obligation undertaken by a trustee, initially adopted a principle of non-delegation: 'trustees who take on themselves the management of property for the benefit of others have no right to shift their duty on other persons' whether third-party agents or co-trustees (per Langdale MR in *Turner v Corney* (1841) 5 Beav 515 at 517). Yet even when 'there was nothing in any way incongruous in expecting a member of the landowning class to devote considerable time and skill to the gratuitous administration of the property of a neighbour, and incur heavy liability if his judgment proved erroneous' (Keeton *Modern Developments in the Law of Trusts* (1971) p 11), there existed tasks which required specialised expertise. But any proposed retreat from a principle of non-delegation poses two questions. In what circumstances should a trustee be able to delegate? How far should a trustee be held personally liable for loss caused by the agent's errors or dishonesty?

One answer to the first question emerged as early as 1754 when the strict application of the non-delegation principle was tempered by the impact of conventional business practice. It was established by Lord Hardwicke LC in *ex p Belchier* (1754) Amb 218 that trustees could employ skilled agents to carry out specialised tasks – in that case the sale of tobacco by auction – on the ground of 'legal or moral necessity', the latter meaning in the normal course of affairs. Changes in the nature of trust property allied to increasing specialisation and professionalisation of business, financial and legal functions increased the pressures on trustees to delegate. Moreover, the courts recognised that 'in the administration of a trust a trustee cannot do everything for himself, he must to a certain extent make use of the arms, legs, eyes and hands of other persons' (per Bowen LJ in *Speight v Gaunt* (1883) 22 Ch D 727 at 762). The leading case, *Speight v Gaunt* (1883) 9 App Cas 1, HL in effect confirmed that the principle of non-delegation had been modified so that trustees could employ agents where a prudent man of business would do so. Subsequently the TA 1925, s 23(1) so widened the scope of delegation that the duty not to delegate became transmuted into a power to delegate. But despite these developments the influence of the 'personal confidence' standard remained and a distinction was still drawn between the employment of agents and the delegation of discretion. The position was concisely summarised in the 29th edition of Snell *Principles of Equity* (1990) p 267: 'a power to employ agents to do specified acts is not power to authorise agents to decide what acts to do.'

The distinction identified in that edition of *Snell* is increasingly difficult to justify and sustain in modern investment conditions. The scope of the power of delegation came under review by the Law Commission which concluded that fundamental changes in the way that investment business was being conducted established a strong case for reform (*Trustees' Powers and Duties* Consultation Paper No 146 (1997). In particular the Commission pointed to the increasingly complex range of investment opportunities available requiring specialist fund management expertise, to major changes in share dealing and settlement mechanisms on the London Stock Exchange and to the introduction (in 1996) of dematerialised holding and transfer of title to securities under the CREST system (a computer-based system for the electronic transfer of and settlement of trades in securities on the London Stock Exchange; see Consultation Paper No 146, paras 2.24–2.26). Indeed in its subsequent 1999 report the Commission went so far as to suggest that the then existing prohibitions 'far from promoting the more conscientious discharge of the obligations of trusteeship . . . may force trustees to commit breaches of trust in order to achieve the most effective administration of the trust' (*Trustees' Powers and Duties* (1999) Law Com No 260, para 4.6). These material reasons for recommending change were complemented by one of long-standing pedigree, ie a concern to minimise the administrative burdens of trusteeship so as not to deter potential trustees. It was therefore not surprising that in the 1999 Report the Commission recommended a major extension of the power to delegate administrative duties and discretions (Pt IV). It must be emphasised that the Law Commission was concerned with delegation of *administrative* duties and discretions and not the exercise by trustees of their *dispositive* discretions; as the Consultation Paper put it: 'The distribution of trust property is one of the most essential functions of trusteeship . . . trustees should be expected to perform it unless the settlor has provided to the contrary' (para 1.15).

Turning now to the second question – the extent of the trustee's liability for the acts and defaults of agents – the answer came also to reflect the prudent man of business standard. Where the appointment of an agent was justified, the trustee was held bound to display proper care in the selection of the agent – not employing an agent to act outside the scope of his business (*Fry v Tapson* (1884) 28 Ch D 268) – and in supervision of the agent's work (*Speight v Gaunt* (1883) 9 App Cas 1 per Earl of Selborne LC at 14–15). A statutory indemnity clause (Law of Property Amendment Act 1859, s 31) which relieved trustees from liability for loss arising out of an agent's acts or defaults unless the loss happened through the trustee's wilful default received a parallel interpretation: '[the clause] does not substantially alter the law as it was administered by Courts of Equity, but gives it the authority and force of statute law . . .' (*Re Brier* (1884) 26 Ch D 238 at 243 per Earl of Selborne LC). Subsequent interpretation of this clause (in the now repealed TA 1925, s 30(1)) and reconciling it with other sections of the TA 1925 created confusion as to both the standard of liability and the apparent symmetry of common law and statute law. As was discussed earlier in this chapter, the Law Commission recommended the introduction of a statutory duty of care and the position now is that a trustee's liability when delegating will be determined by the application of the new statutory duty of care in TA 2000, s 1.

(b) Trustees' powers of delegation and the Trustee Act 2000

(1) Introduction

The Law Commission recommendations concerning trustees' powers of delegation were implemented in the Trustee Act 2000, Pt IV. As with other default provisions of the 2000 reforms the new wide powers of delegation conferred on trustees apply to all trusts whenever created (TA 2000, s 27), are additional to any express powers to appoint agents and are subject to any restrictions or exclusions imposed by the trust instrument (TA 2000, s 26). The most significant feature of the new powers, unlike the position prior to the TA 2000, is that it is now possible for trustees to delegate their power of investment (ss 11–15). Another important innovation, linked to the objective of facilitating greater efficiency in trust administration, is to confer on trustees the powers to vest trust property in nominees and to employ custodians (ss 16–23). In a sense this innovation reverses the position at common law whereby trustees placing trust property in the hands of a third party when they have not been expressly empowered to do so would commit a breach of trust and be liable for any loss caused as a result. This new power is considered further in section b(4) below.

It is important to emphasise that the new statutory regime in Pt IV is concerned with delegation of functions by trustees as a collective body. There are important distinctions between this aspect of delegation and delegation of functions by an individual trustee. The latter jurisdiction, which is still governed by TA 1925, s 25 and Trustee Delegation Act 1999, s 1, is considered briefly at the end of this part of the chapter. There are also important distinctions between charitable trusts and private trusts as to the functions that can be delegated. Those aspects of the new default powers that relate solely to charitable trusts are therefore considered in the context of the regulation and administration of charitable trusts in Chapter 20.

(2) The scope of the power to appoint agents

The key questions confronting any reform of the law on delegation are what functions should be delegable, to whom and on what terms. The omission of the 'when can trustees delegate?' question from that agenda simply reflects the fact that there is no change from the previous position under now repealed TA 1925, s 23(1). Trustees can still appoint an agent to exercise 'any or all of their delegable functions' whether or not there is any necessity for them to do so even if they could readily have performed the function themselves.

Indeed it must be emphasised that the new Act says nothing about the duty of trustees in deciding whether or not to exercise the power to delegate. Trustees are therefore, with one exception, under no statutory duty of care at this stage of the delegation process. The sole exception is under the Trusts of Land and Appointment of Trustees Act 1996, s 9A(1) where the statutory duty of care in the TA 2000 is stated to apply in relation to decisions by trustees of land as to whether to delegate to a beneficiary. That exception aside, it would appear that trustees do not need to demonstrate, for instance, that it is reasonably necessary to delegate a particular management function to agents. The Law Commission was of the view that any legal control over the trustees' decisions as to *whether* to exercise their discretions should be left to the inherent jurisdiction of the courts although, as the Commission note: '[the courts] will not generally interfere with a discretionary power if the trustees are unanimous as to its exercise' (para 3.3 and see further Chapter 11 of this book at pp 522–533). None of this may matter if it is a case of a lay trustee delegating certain management functions to professionals. But should a professional trustee be allowed to employ at the trust's expense an agent to do what, it may be argued, the trustee is already being paid to do? The Law Reform Committee (LRC) in its 1982 Report thought not; it recommended that the trust be charged *only* where the charges and expenses of delegation 'are reasonably incurred, taking into account the trustee's knowledge, qualifications and experience and the level of remuneration received by him' (23rd Report *The Powers and Duties of Trustees* (Cmnd 8733, 1982) para 4.6). Whether, as a longstop means of control, the court could or should invoke the generic duty of trustees 'to exercise their powers in the best interests of the beneficiaries' as a means of impugning an 'unreasonable' or 'unnecessary' appointment of an agent is a matter that may yet have to be addressed.

The delegable functions What then are the delegable functions? The underlying rationale of the approach adopted by the Law Commission was that a distinction should be drawn between administrative powers that would be delegable and distributive (or dispositive) powers that would not. The Commission was concerned, however, that a straightforward unqualified statutory distinction between the two different types of power might have enabled trustees to delegate their powers under TA 1925, s 36 to appoint and remove trustees in certain circumstances (see Chapter 11 at p 516). Delegation of a power such as that was rightly considered to be inappropriate unless expressly authorised in the trust instrument. The method of implementing the desired distinction between those powers that should be delegable and those that should not is therefore to permit trustees to appoint an agent to exercise any or all of the trustees' delegable functions (TA 2000, s 11(1)). Those delegable functions are then defined in s 11(2) as 'any function other than' the following four exceptions listed in the subsection:

(a) any function relating to whether or in what way any assets of the trust should be distributed,
(b) any power to decide whether any fees or other payment due to be made out of the trust funds should be made out of income or capital,
(c) any power to appoint a person to be a trustee of the trust, or

(d) any power conferred by any other enactment or the trust instrument which permits the trustees to delegate any of their functions or to appoint a person to act as a nominee or custodian.

To give an obvious example of a power that cannot be delegated, trustees cannot delegate their discretion to appoint between the objects of a discretionary trust.

The agent As to who can be appointed as an agent, some guidance is provided by TA 2000, s 12. No beneficiary can be appointed as an agent thus avoiding possible conflicts of interest arising (s 12(3)). On the other hand, an existing trustee, assuming he or she is not also a beneficiary, can be appointed as agent (s 12(1)) as indeed can a nominee and/or custodian for the trustees (s 12(4)). The only other specific provision in the section is that two or more persons may not be authorised to exercise the same function unless they are to exercise the function jointly (s 12(2)). It must not be overlooked, however, that any exercise of the power to employ agents under s 11 is subject to the statutory duty of care in TA 2000, s 1.

The terms of appointment Turning next to the terms on which an agent may be appointed, s 14 (1) empowers the trustees to 'authorise a person to exercise functions as their agent on such terms as to remuneration and other matters' as they may determine. This sweeping discretion is qualified in three ways. First, remuneration of agents, nominees and custodians is regulated by TA 2000, s 32, which applies irrespective of whether the appointment is made under the statutory power or by a term of the trust instrument. Section 32(2) provides that where the appointment provides for remuneration (s 32(2)(a)), such remuneration can be paid out of the trust fund provided that 'the amount does not exceed such remuneration as is reasonable in the circumstances for the provision of those services' (s 32(2)(b)). In addition the trustees may reimburse out of the trust fund agents, nominees or custodians for expenses properly incurred in exercising the functions delegated to them (s 32(3)).

The second restriction to be considered here refers to what the statute categorises in s 13 as 'Linked functions etc.'. Where an agent is authorised to exercise a function to which specific duties or restrictions would apply if the trustees themselves were exercising the function, then those duties or restrictions will apply equally to the agent, regardless of the terms of the agency agreement (s 13(1)). Somewhat unusually s 13 itself contains an example in the following terms: 'a person who is authorised under section 11 to exercise the general power of investment is subject to the duties under [TA 2000] section 4 in relation to that power' those duties being the standard investment criteria (see above p 473). There is a limitation within s 13 in that if the 'duty or restriction' referred to in s 13(1) relates to obtaining advice then the agent need not comply with this requirement 'if he is the kind of person from whom it would have been proper for the trustees . . . to obtain advice' (s 13(2)). There is one further specific qualification to the scope of s 13. An agent authorised under TA 2000, s 11 to exercise any function relating to land subject to the trust is *not* obliged to consult with and possibly give effect to the wishes of beneficiaries with interests in possession in that land, an obligation imposed on trustees by Trusts of Land and Appointment of Trustees Act 1996, s 11(1) (see s 13(3), (5)). Trustees may not exploit this dispensation and they therefore cannot appoint an agent on terms that would enable them to avoid their own obligations to carry out such consultations with the relevant beneficiaries (TA 2000, s 13(4)).

The third and potentially most contentious restriction on the terms of appointment is to be found in s 14 itself.

Trustee Act 2000, s 14(2), (3)

(2) The trustees may not authorise a person to exercise functions as their agent on any of the terms mentioned in subsection (3) unless it is reasonably necessary for them to do so.
(3) The terms are –

   (a) a term permitting the agent to appoint a substitute;
   (b) a term restricting the liability of the agent or his substitute to the trustees or any beneficiary;
   (c) a term permitting the agent to act in circumstances capable of giving rise to a conflict of interest.

The statute provides no assistance as to the meaning of reasonable necessity. The context in which the term is most likely to be subject to scrutiny is that of investment management and here the operation of the market is likely to be a significant factor. The Law Commission recognised that as regards all three terms – sub-delegation under s 14(3)(a), exclusion of liability (s 14(3)(b)) and conflicts of interest (s 14(3)(c)) – trustees may in practice have little option in the appointment of fund managers but to accede to their standard terms of appointment (see in particular *Trustees' Powers and Duties*, paras 4.25–4.29). The recommendations of the Commission reflected this analysis and are encapsulated in the 'reasonable necessity' approach adopted in s 14(3). The Explanatory Notes to the TA 2000 equally reflect this perception of the significance of the market place. Referring to the limitations of the pre-2000 law on sub-delegation and the modifications of s 14(3)(a) the Note suggests that '[t]his [limitation] is no longer appropriate in modern conditions where the appointment of a fund manager will often be essential to the efficient and effective management of the assets of the trust' (para 61). The Note on s 14 concludes with the following observation (para 61):

> As the standard terms of business of fund managers generally require limits on liability and the ability to act despite a conflict of interest, the ability to appoint a manager would amount to little in practice if trustees were unable to accept such terms.

The fact that trustees may have to accept such terms does not, we would suggest, obviate the need to survey the market for the best deal available. Trustees may well discover that all professional fund managers will incorporate exclusion clauses in their standard terms and conditions. Indeed this is quite probable since the Institute of Fund Managers standard terms of engagement produced prior to the TA 2000 included an exclusion clause as well as clauses permitting sub-delegation and conflicts of interest (see Wilson (2003) 2 PCB 91 at 94; and generally on agreements with investment managers Hayton (1990) 106 LQR 88–93). It does not necessarily follow that their scale fees will be identical or that their investment performance will be uniform. Might there be circumstances where trustees are required to demonstrate that notwithstanding their compliance with s 14(3) their selection of fund manager nevertheless satisfied the statutory duty of care requirement?

(3) Delegation and the asset management function

The Law Commission recognised that reliance solely on the duty of care and the reasonable necessity requirement of s 14(3) as safeguards for beneficiaries would not be satisfactory where what the Commission termed 'the asset management function' was to be delegated. Accordingly the Commission made specific recommendations for additional requirements to be imposed where trustees wished to delegate that function. These recommendations are implemented in s 15 of the Act and are principally directed at establishing what we might term 'a paper trail'.

Section 15(5) defines the asset management functions of trustees as comprising:

(a) the investment of assets subject to the trust,
(b) the acquisition of property which is to be subject to the trust, and
(c) managing property which is subject to the trust and disposing of, or creating or disposing of an interest in, such property.

This definition is clearly sufficiently broad to encompass the appointment of an agent to manage a portfolio of investments (s 15(5)(a)) but also extends to include such activities as appointing an agent to sell trust property (s 15(5)(c)). Section 15(1) provides that trustees may not authorise an agent to exercise any of the above asset management functions unless by an agreement in or evidenced in writing. Nowhere in s 15 is it stated that its provisions apply only to a delegation under the Trustee Act 2000 and the section would therefore seem to apply to any delegation of the asset management function whether under the Act or, for instance, under the terms of the trust instrument. A key part of the delegation process under s 15 is that trustees must prepare a policy statement that must itself be in writing or witnessed in writing (s 15(4)). The policy statement should give written guidance to the agent as to how the asset management functions should be exercised (s 15(2)(a)) and the guidance must be formulated 'with a view to ensuring that the asset management functions will be exercised in the best interests of the trust' (s 15(3)). The s 15(1) written agreement between the trustees and the agent must then include a term to the effect that the agent will comply with that policy statement or any subsequent revision of it. The origins of this requirement are to be found in a comparable arrangement imposed on trustees of pension schemes by s 35 of the Pensions Act 1995 (see Chapter 13 at p 658). The contents of any policy statement are likely to depend on the type of trust and size of the trust fund but would be expected to include reference to such matters as types of investment and the balance between capital growth and income yield, and whether certain types of investment should be excluded and on what grounds.

One question not addressed in the Act is whether professional trustees who are part of a financial conglomerate whose activities embrace a diverse range of financial roles should be permitted to delegate the investment management function of a trust to an associated investment management company. The convenience of doing so is obvious and the trust instrument may specifically permit it but otherwise it is arguable that there exists a potential conflict of interest (see generally McCormack (1999) 20 Co Law 1 at 3–13). The trustee company would be in a position where there might be a conflict between its duty to the trust to obtain the best terms and its financial interest, possibly indirect, in placing the business with its associated company. The matter has yet to come before the English courts but a decision in a Hong Kong case held that there is no absolute prohibition on a trustee delegating its investment management functions to a wholly owned subsidiary. The question to be determined in the view of the court was whether there was a 'real possibility of conflict arising' and if there was no such risk then delegation was permissible. The question of whether a risk exists was held to be one of fact and degree in any given case (see *HSBC (HK) Ltd v Secretary of Justice* (2000–01) 3 ITELR 763, and comment by Wilson [2003] PCB 2, 91 at 91–93).

(4) Nominees and custodians

At common law trustees have a duty to take such steps as are reasonable to secure and retain control of trust property. Thus, as mentioned previously (see above p 501) trustees placing trust property in the hands of a third party when they have not been expressly empowered to do so would commit a breach of trust and be liable for any loss caused as a result. It therefore followed that in the absence of express authority trustees could neither vest legal title to property in nominees nor place trust documents in the custody of a custodian. To some degree these restrictions acted as a safeguard for beneficiaries, particularly against the risk of loss through fraud. Changes in the rules of the Stock Exchange regarding share dealing and the introduction of the electronic CREST system for the dematerialised holding and transfer of title to shares and securities posed problems for trustees. Could they both comply with the rules of trusts law and gain the benefits of the modern investment practices facilitated by the sort of changes to the system of dealing in shares and securities just described? The Law Commission was of the view that they could not. It therefore recommended that trustees should be given new statutory powers to employ nominees and custodians.

The TA 2000 now confers on trustees the power to appoint (i) a nominee in relation to such assets as the trustees may determine (s 16(1)) and (ii) a custodian again of such assets as the trustees may determine (s 17(1)). A custodian is defined as a person who 'undertakes the safe custody of the assets or of any documents or records concerning the assets' (s 17(2)). Where the assets of the trust include securities payable to a bearer, s 18(1) of the Act imposes a *duty* on the trustees to appoint a person to act as a custodian of the relevant securities unless the trust instrument or any enactment provides otherwise (s 18(2)). In all three of the above instances the appointment must be in or evidenced in writing. None of ss 16–18 applies where the trust already has a custodian trustee. The Act imposes certain limitations (s 19) on who may be appointed as nominees or custodians but in most instances this will not create problems, the appointee satisfying the requirements by virtue of being a 'person who carries on a business which consists of or includes acting as a nominee or custodian' (s 19(2)(a)). Section 20 of the Act governs the terms of appointment and remuneration of nominees and custodians. It is identical in all material respects to s 14 and the same considerations as affect the operation of that section will apply here also (see above at p 503).

(5) Delegation and the liability of trustees

It is important to emphasise at the outset that any obligations or responsibilities of trustees do not cease simply when an appointment is made under ss 11, 16, 17 or 18. While any agent, nominee or custodian continues to act for the trust, the trustees must keep the arrangement under review and consider whether there is any need to exercise any power of intervention that they might have, even to the extent of revoking the authorisation or appointment (s 22(1) and (4)). Here, as in other instances, this obligation is subject to any contrary intention in the trust instrument (s 21(3)). A similar review requirement applies to the delegation of asset management functions under s 15 of the Act (s 22(2) and (3)).

It is also important to emphasise that trustees' liability for their own acts or omissions in delegating functions to agents, nominees and custodians is determined exclusively by application of the statutory duty of care under TA 2000, s 1 and Sch 1 (see section 2 of this chapter for discussion of the duty of care). The duty of care applies to a trustee 'when entering into arrangements' under any of ss 11, 16, 17 or 18 to appoint any agent, nominee or custodian and also when carrying out any of the review duties under s 22. Under Sch 1, para 3 'entering into arrangements' is defined as including (a) selecting the person who is to act, (b) determining the terms of the delegation and (c) the preparation of a policy statement where the asset management function is delegated under s 15 of the Act.

An issue that was the subject of doubt and controversy under the pre-2000 law was whether and to what extent trustees could be held 'vicariously liable' for the acts or defaults of agents. The matter is now put beyond doubt. Section 23 of the Act states that 'a trustee is not liable for any act or default of any agent, nominee or custodian unless [the trustee] has failed to comply with the duty of care applicable to him under paragraph 3 of Schedule 1'. Trustees are therefore not to be held liable merely because the agent, nominee or custodian does some act that causes a loss to the trust. The liability of trustees, to reiterate the point, is determined by reference to their own conduct and the application of the duty of care to that conduct.

At the time of writing there had been no reported case law on the interpretation of the new statutory duty of care. But a key authority from a somewhat earlier era, *Fry v Tapson* (1884) 28 Ch D 268, illustrates the risk to which trustees are exposed if they employ an agent to carry out functions outside the scope of the agent's usual business. Trustees were considering investing trust money on a mortgage, as they were authorised to do. They in effect delegated to their solicitor the selection of a surveyor to value the land against which the mortgage was to be secured. Unfortunately not only did the nominated surveyor lack knowledge of the local area where the land was situated but also he was the agent of the potential mortgagor in that he would receive commission if the mortgage was granted. In fact he overvalued the property, the money was lent and a loss ensued when the mortgagor became bankrupt. The trustees were held liable to make good the loss suffered by the trust fund. The legal position was aptly summarised by Kay J: 'If the trustee employs an agent to do that which is not the ordinary business of such an agent, and he performs that unusual task improperly, and loss is thereby occasioned, the trustee would not be exonerated' (at 280). Whilst this case involved an early application of the prudent man of business standard there is no reason to think that similar conduct would not equally fall foul of the new statutory duty of care.

Finally, it should be noted that even if the trustees exceed their powers in the authorisation or appointment of a person as agent, nominee or custodian their failure in this regard does not invalidate the authorisation or appointment (TA 2000, s 24).

(6) Individual delegation

We have seen that initially the common law applied a principle of non-delegation in part because the office of trusteeship was viewed as being one of personal confidence. Whilst this position became modified as regards the delegation of administrative functions there was no break with the principle that the exercise of discretions could not be delegated. But guiding principles of trust law can in many instances be subordinated to the express wishes of settlors. The position therefore has never been that delegation of discretions is not possible: 'The law is not that trustees cannot delegate: it is that trustees cannot delegate unless they have authority to do so' (per Lord Radcliffe, *Pilkington v IRC* [1964] AC 612 at 639). In practice true delegation of trustees' discretions could be achieved either under authority bestowed by the settlor in the trust instrument or under TA 1925, s 25. The object of s 25 is to enable an individual trustee to delegate his or her trusts, where for some reason and for a relatively short period of time, he or she is unable to perform the trusts. Indeed at its inception the statutory power could be invoked only during the absence of a trustee overseas. Since then s 25 has been amended by the Powers of Attorney Act 1971 and more recently by the Trustee Delegation Act 1999, s 5. The overall effect has been to extend and clarify the scope of the jurisdiction.

Trustee Act 1925, s 25(1), (2), (3)

(1) Notwithstanding any rule of law or equity to the contrary, a trustee may, by power of attorney, delegate the execution or exercise of all or any of the trusts, powers and discretions vested in him as trustee either alone or jointly with any other person or persons.
(2) A delegation under this section –

(b) continues for a period of twelve months or any shorter period provided by the instrument creating the power

(3) The persons who may be donees of a power of attorney under this section include a trust corporation [*but not (unless a trust corporation) the only other co-trustee of the donor of the power*].

The italicised words in s 25(3) were removed by the Trustee Delegation Act 1999 with the consequence that there is now no statutory restriction as to who may be a donee of the power of attorney. The delegation must be made by deed and written notice of the delegation must be given to the other trustees and to any person entitled to appoint new trustees (s 25(4)). Section 25(4) makes clear, however, that failure to comply with those requirements will not prejudice the interests of any person dealing with the donee. Section 25 has its limitations, the principal one being that the trustee donor of the power of attorney 'shall be liable for the acts or defaults of the donee in the same manner as if they were the acts or defaults of the donor' (s 25(7)). As we have seen in the previous section, this automatic vicarious liability compares unfavourably with the position of trustees who employ agents under the powers of collective delegation provided by the Trustee Act 2000.

(7) Delegation: a miscellany

There are two particular contexts – pension scheme trusts and trusts of land – where alternative statutory arrangements have been introduced to facilitate delegation of certain powers.

The Pensions Act 1995, s 34 gives pension scheme trustees new powers of delegation in relation to investment. These are discussed in Chapter 13. Note, however, that other powers of delegation under the TA 2000 do apply to trustees of pension schemes although subject to certain modifications. For the protection of pension scheme members, pension trustees are expressly prohibited from delegating any function to the scheme employer (TA 2000, s 36(6)).

As regards trusts of land, the Trusts of Land and Appointment of Trustees Act 1996, s 9 empowers trustees of land to delegate any of their functions relating to land 'to any beneficiary or beneficiaries of full age and beneficially entitled to an interest in possession in the land' (s 9(1)). The limited class of persons to whom functions can be delegated primarily reflects the objective of allowing trustees of land, where that land is held for successive interests (the strict settlement under the 1925 legislation), to give the current life-tenant of the land control of its management. The Trustee Act 2000 instituted some changes to the provisions of the 1996 Act dealing with trustees' liability for any default of the beneficiary-delegate. A new section (9A) has been inserted in the 1996 Act to the effect that the duty of care under s 1 of the TA 2000 applies to trustees of land in deciding *whether* to delegate any of their functions under s 9 of the 1996 Act (see TA 2000, s 40(1), Sch 2, Pt II). Once the delegation has been made the duty of care is similar to that applicable to delegation by trustees more generally. Thus it applies equally to the trustees' obligation to keep the arrangement under review and to consider whether there is any need to exercise any power of intervention that they may have (s 9A(3) and (5)). This reverses what appeared to be the position under the now repealed s 9(8) of the 1996 Act whereby trustees of land were jointly and severally liable for any act or default of the 'beneficiary-delegate' in the exercise of the function delegated 'if, but only if, the trustees did not exercise reasonable care in deciding to delegate the function . . .'. From this language it had seemed that once trustees had made the appointment they were under no further obligation to supervise the conduct of the delegate (see the critical comment by Kenny [1997] Conv 372).

(8) A postscript

In the previous edition of this book we suggested that trusts law as it affected the power of delegation by trustees had still to come to terms with the fact that trusteeship had developed from a quasi-managerial role in special situations (strict settlements) to a fully managerial role on a day-to-day basis (most trusts of investments) and even in some instances into mere director-like supervision of specialist management by others. The re-writing in the Trustee Act 2000 of the law on delegation and also on powers of investment compels a reappraisal of the claim. As the Law Commission pointed out in its Report the reforms were seen in part as a necessary response to the fundamental changes in the way that investment business was being transacted in a new era of liberalisation of the investment markets. And the underpinning philosophy of the Trustee Act 2000 can itself be interpreted as one of liberalisation of the law so as to facilitate a more effective administration of trusts and the generation of improved economic performance for the benefit of beneficiaries. The model of trust fund management implicit in the new legal framework is one of trustees delegating, one might even say sub-contracting, the management to investment specialists. The financial object might be said to minimise the risk of loss and increase the prospects of gain in the investment market. It can therefore be argued that trust law has now come to terms with a new model of trusteeship in the sense that the new Act has brought the law into line with much contemporary trusts practice.

There is little doubt that the reforms have been widely welcomed as was evidenced by the 'very positive response' from a large majority of those who responded to the Consultation Paper (*Trustees' Powers and Duties*, para 1.12 and Appendix D). It would be churlish not to acknowledge the numerous positive elements of the new legal framework as described in this chapter but equally it would be remiss not to raise some reservations about the appropriateness of certain aspects of the new default powers of delegation from a regulatory standpoint.

The question is whether the appropriate balance is struck between conferring greater freedom for trustees in their administration of the trust and securing adequate protection of the interests of beneficiaries. If one takes the standpoint of the Law Commission the very question is misconceived. In the Consultation Paper the Law Commission sought to emphasise that the purpose of the law was facilitative rather then regulatory: 'The reforms which we propose are intended to do no more than facilitate the administration of trusts by providing wider default powers for trustees. It is not our intention that they should in some sense be regulatory' (para 6.22). This is not to say that the Commission was unaware of the risks that accompany greater managerial freedom for trustees particularly where delegation of investment management functions to agents was concerned: 'We have also been very mindful of the tension between the advantages and the dangers of allowing trustees wide powers of delegation.' The danger being adverted to here is principally financial. There are costs involved with delegation. The process might involve higher transaction costs, such as agents' fees, and even at least theoretically an increase in the risk of loss through the acts or omissions or even fraudulent conduct of agents. The stance adopted by the Commission was that the weighting of the balance between advantages and dangers should in large degree be left to settlors (at para 6.23): 'It should be emphasised that we are recommending what the *default* powers of delegation should be. It would remain open to a settlor (as it is under the present law) to extend or restrict those powers.'

It might be argued that for trust funds of any significant size settlors initially and trustees subsequently should be allowed to be the best judges of what is best for the trust fund. But not all trusts have funds in the order of several millions, or even, billions, of pounds. There are many family trusts on a more modest scale and one suspect that it is trusts such as these that are quite likely to adopt the 'default regime'. What is a small or modest trust is necessarily a relative matter and data on private family trusts needs to be treated with caution. Nevertheless according to Inland Revenue estimates of property held in discretionary trusts and derived from information submitted to the Revenue for the purposes of calculating the ten-year charge to IHT on such trusts, there are in 2002–03 67% of trusts with assets between £250,000 and £499,999 and 20% with assets less than £250,000 (*IR Statistics 2004*, Table 12.7). Whether the interests of beneficiaries in trusts such as these are best served by the light regulatory approach adopted in the default powers of the TA 2000 remains an open question.

11

Trusteeship, control and breach of trust

1. Introduction

In the previous two chapters we considered, inter alia, the relationship between trusts law and contemporary trusteeship, including the management of the trust and the powers and duties of trustees associated with that function. One emerging consideration was how far does or should the law seek to intervene to limit the autonomy that settlors might confer on trustees in their management of the trust? In this chapter we focus on the means of controlling trustees, the scope of beneficiaries' rights and the effectiveness of remedies available to them. The appointment and removal of trustees and the control over the exercise of their discretion, issues central to an assessment of trustee autonomy in managing the trust, are considered in sections 2 and 3, whilst the measure of trustee personal liability for breach of trust forms the subject-matter of section 4. Beneficiaries are not restricted to a reliance on the personal liability of trustees as a means of securing recompense for some breach of trust. There may be circumstances where beneficiaries wish to take advantage of the proprietary remedies that the law provides where some breach of trust has occurred. In section 5 we briefly introduce the proprietary remedies that may be available to a beneficiary where the personal remedy against trustees proves inadequate. The full range of the proprietary remedies that equity makes available in cases of breach of trust or where there is some breach of fiduciary duty are considered in detail in Chapter 14.

The by now familiar starting-point for our study is the changing nature of trusts practice. We have previously examined in some detail the responses of settlors and their advisers to twentieth-century commercial and fiscal pressures, and have emphasised the accelerating trend, particularly post-1945, in favour of enlarging trustees' discretions. This process became apparent in discretions over both the management of property (eg widely drawn investment clauses) and the allocation of benefit (eg the discretionary trust). But the willingness of the courts to countenance these developments and to uphold dispositions wherever possible (see eg *Re Hay's Settlement Trusts* [1981] 3 All ER 786) potentially opens a Pandora's Box of questions concerning control of trustees' behaviour. As we pointed out in Chapter 5 one consequence of these developments is that such control as exists must now primarily be sought not at the creation of the trust instrument but when the discretion it confers is subsequently exercised. At a general level, can the courts square the circle of simultaneously approving the formal minimisation of beneficiaries' individual interests in the trust corpus – until recently so necessary for tax-planning purposes – while providing adequate methods for enforcement of trustees' redefined obligations? To reiterate – and the point cannot be emphasised enough – it is the exercise of a discretion conferred by the trust instrument that may now be more susceptible to legal challenge. Specifically, how far, if at all, should the courts be prepared to develop trusts law so as to ensure closer monitoring of the exercise of trustees' discretions? Should they be prepared to advise uncertain trustees on how they may exercise those discretions?

In fact prior to the important Privy Council decision in *Schmidt v Rosewood Trust* [2003] 2 WLR 1442 concerning rights to disclosure of information from trustees recent litigation on these issues within the family trust has been sparse (although see *Re Locker's Settlement Trusts* [1978] 1 All ER 216; *Turner v Turner* [1983] 2 All ER 745; *Murphy v Murphy* [1999] 1 WLR 282). Indeed the introduction of inheritance tax prompted a move by settlors away from the use of discretionary trusts into accumulation and maintenance trusts or even outright gifts although discretionary trusts have taken on a fresh lease of life in offshore trusts. But these most recent practical shifts in trusts fashion represent changes in emphasis rather than direction and do not alter the fact that modern trustees still retain a substantial measure of administrative and dispositive discretion compared with their predecessors. Of course in one sense it is still accurate to state that the enforceability of the beneficiary's rights against the trustees represents the heart of the trust concept, retaining the conceptual link with the original moralistic basis of Chancery intervention – to protect the 'reposing of trust or confidence in some other'. But that trust or confidence now commonly passes substantial authority to trustees and we need to ask how autonomous this process has rendered them. Can, for instance, beneficiaries limit trustees' managerial discretion by directing them as to investment policy? Can a beneficiary effectively challenge the trustees' exercise of a dispositive discretion? Are trustees obliged to give even a hearing to a beneficiary or to give reasons for a decision? What information about the management of the trust's affairs are beneficiaries entitled to? These last two questions are of particular practical importance. If beneficiaries can be kept in ignorance about trust affairs, their ability to challenge trustees will be restricted.

When assessing the extent of trustee autonomy in the light of such questions, it must not be overlooked that where trustees are in breach of trust, as for instance by investing in a hazardous and speculative enterprise, the courts have extensive powers to impose liability on trustees and, incidentally, also to grant them relief where appropriate. Yet even this assertion of ultimate judicial control must be viewed in the contemporary context of widespread professional trusteeship. Clauses seeking to limit or exclude liability for loss to the trust fund are now commonplace. If they are valid to the full extent then this factor lends added weight to the description of trustees, advanced over half a century ago, as being 'professional managers of capital who are placed . . . beyond the control of the owner for consumption' (Franklin (1933–34) 8 Tul LR 473 at 475).

Before turning to examine the law in detail, there are several important qualifications to be made here about the substance of that law, as conventionally interpreted. First, it is in our view unwise to assume that some judicial decisions about the rights of beneficiaries and the obligations of trustees made in the commercial context of pension schemes (see Chapter 13) will necessarily apply in full force to family trusts, and, of course, vice versa. Support for a view that it may on occasion be necessary to distinguish family trusts from commercial trusts can be drawn from comments made obiter by Lord Browne-Wilkinson in *Target Holdings Ltd v Redferns* [1995] 3 WLR 352. In *Target Holdings*, a case involving a breach of trust occurring in the course of a somewhat suspect mortgage arrangement, Lord Browne-Wilkinson warned that 'it is . . . wrong to lift wholesale the detailed rules developed in the context of traditional trusts and then seek to apply them to trusts of a quite different kind' (at 362). He added that 'it is important, if the trust is not to be rendered commercially useless, to distinguish between the basic principles of trust law and those specialist rules developed in relation to traditional trusts which are applicable only to such trusts and the rationale of which has no application to trusts of quite a different kind' (ibid). As will be seen when we look more closely at the case (see below at p 550) this proposition has its critics and there is an alternative slant that can be placed on the comments of Lord Browne-Wilkinson. This is that it is necessary in applying the rules of trust law to distinguish between a bare trust, such as that applicable in *Target Holdings* itself, and a trust where the trustees have active duties of management and administration to perform. The decision in *Target Holdings* also raises another contemporary theme relevant to developing our understanding of the law. That theme concerns what we termed in Chapter 2 'harmonisation' of the common law and equity. In this chapter that theme occurs in the context of considering whether differences in criteria for assessing compensation for breach of trust and common law damages are being elided.

Our final prefatory comment again concerns a development first introduced in an earlier chapter (Chapter 5), ie the appointment of a 'protector' or 'enforcer'. Although mentioned there primarily in the context of purpose trusts, protectors can also be appointed in other trusts and be armed with extensive powers, for instance, to direct trustees in the exercise of their powers and discretions, both administrative and dispositive. The protector is also often given power to dismiss trustees, to appoint new trustees and even, for instance, to authorise breach of the self-dealing rule. In practice protectors are likely to be encountered principally in offshore trusts. The existence of this relatively novel addition to the trusts ensemble then raises, as we shall see, difficult and at present unresolved questions about their accountability, if any, to beneficiaries (see for an overview of the issues Waters 'The

Protector: New Wine in Old Bottles?' in Oakley (ed) *Trends in Contemporary Trust Law* (1996) ch 4).

2. Appointment and removal of trustees

However extensive the discretion formally granted to trustees may be, this would be largely illusory if the trustees could easily be removed at the whim of the settlor or beneficiaries, and more malleable persons appointed. First, we therefore consider the jurisdiction to appoint and remove trustees.

(a) The role of the settlor

A settlor or testator normally appoints the first trustees. Indeed, in an inter vivos trust the settlor may appoint himself, particularly as nowadays such an appointment does not appear to have any fiscal drawbacks. (Neither the income tax nor capital gains tax anti-avoidance provisions in ICTA 1988, Pt XV and TCGA 1992, s 77 respectively are brought into effect by the appointment and in relation to inheritance tax; see [1986] Simons Tax Intelligence 606.) Thereafter, however, the trustees must act independently. They are not to be the settlor's cipher. In practice, trustees, when exercising their discretions, might be tempted to defer to the wishes of a settlor attempting to retain de facto control over property while surrendering beneficial ownership of it. But if the trustees do so they run the risk of being held in breach of trust.

Complexity may arise where a settlor seeks to reserve to himself a power in the trust instrument to appoint or remove trustees. The inclusion of a power of removal is seemingly not common and tends to be discouraged both on grounds of principle – being inconsistent with a trustee's independence – and for practical reasons (see Kessler *Drafting Trusts and Will Trusts* (5th edn, 2000) p 108). Indeed, even if a settlor incorporates a power of removal in the trust instrument any attempt to remove trustees on the ground of failing to comply with the settlor's wishes is unlikely to be upheld by a court if challenged by the threatened trustees. The purported exercise would arguably constitute an invalid exercise of the power. It is, however, not unusual in an inter vivos settlement for a settlor to retain the right of appointment of future trustees during his lifetime, either by inserting an express power to that effect in the trust instrument or, more commonly, by nominating himself as the person to exercise the statutory power of appointment (Trustee Act (TA) 1925, s 36(1)(a), see below). Settlors may hope that such powers will help curtail the independent exercise of discretion by trustees, but in principle trustees' discretion must be exercised in the interests of beneficiaries *only*, not those of the settlor.

Formally, therefore, in the absence of any special provision the settlor retains no right to appoint or remove trustees once the trust has been created.

(b) Appointment of new or additional trustees

The TA 1925 and the Trusts of Land and Appointment of Trustees Act (TLATA) 1996 provide a detailed, if complex, code of rules to facilitate the appointment, replacement and retirement of trustees.

(1) Trustee Act 1925, s 36

The statutory power of appointment, which applies unless a contrary intention appears in the trust instrument, is nowadays usually regarded as adequate by settlors. The section has a dual function. First, it enables an outgoing trustee to be replaced where the circumstances outlined in s 36(1) apply. Second, it empowers the appointment of additional trustees provided only that, following the appointment, the total number of trustees does not exceed four and that the appointor may not appoint himself – the subsection (s 36(6)) requiring the 'power to be exercised in favour of "another person or persons"' (cf s 36(1) below; see *Re Power's Settlement Trusts* [1951] Ch 1074). The Law Reform Committee (LRC) recommended the removal of this restriction (23rd Report *The Powers and Duties of Trustees* (Cmnd 8733, 1982) para 2.6).

Trustee Act 1925, s 36(1)

(1) Where a trustee, either original or substituted, and whether appointed by a court or otherwise, is dead, or remains out of the United Kingdom for more than twelve months, or desires to be discharged from all or any of the trusts or powers reposed in or conferred on him, or refuses or is unfit to act therein, or is incapable of acting therein, or is an infant, then subject to the restrictions imposed by this Act on the number of trustees –

(a) the person or persons nominated for the purpose of appointing new trustees by the instrument, if any, creating the trust; or
(b) if there is no such person, or no such person able or willing to act, then the surviving or continuing trustees or trustee for the time being, or the personal representatives of the last surviving or continuing trustee;

may, by writing, appoint one or more other persons (whether or not being the persons exercising the power) to be a trustee or trustees in the place of the trustee so deceased remaining out of the United Kingdom, desiring to be discharged, refusing, or being unfit or being incapable, or being an infant, as aforesaid.

The circumstances described in s 36(1) permitting replacement of trustees are largely self-explanatory. The exceptions are 'unfitness' and 'incapacity', there being little authority on the meaning to be attributed to those terms. A number of nineteenth-century decisions (see eg *Re Lemann's Trust* (1883) 22 Ch D 633) indicate that 'incapacity' refers to personal incapacity, such as physical or mental infirmity, whereas 'unfitness' appears to relate more to deficiencies commonly attributed to character. For instance bankruptcy is probably sufficient ground to constitute unfitness, although the position is not clear (see *Re Wheeler and De Rochow* [1896] 1 Ch 315), particularly where the bankrupt trustee is free from moral blame (*Re Bridgman* (1860) 1 Drew & Sm 164). Section 36(1)(a) and (b) establishes a hierarchy for exercising the statutory power. The person(s) nominated has (have) pre-eminence and the power devolves upon the classes named in s 36(1)(b) only where there is no express nominee or where the nominee is unable or unwilling to act.

Section 36(1) and the hierarchy established under it now have to be read subject to the jurisdiction introduced by TLATA 1996, s 19. Section 19, which applies to trusts of personalty as well as to trusts of land, confers a power on beneficiaries to give a written direction to one or more trustees to retire and to direct the appointment of new trustees, subject to the statutory limitation on numbers of trustees not being exceeded (see Chapter 9 p 411). The beneficiaries may give joint or separate directions but their directions must be unanimous both as to the trustee(s) to retire and as to the person(s) if any to be appointed as new trustee(s) (s 21). Moreover exercise of the jurisdiction is not limited to the circumstances specified in s 36 above. However, there are several reasons why the powers conferred on the beneficiaries under this jurisdiction may, in practice, prove to be less sweeping than at first glance appears. First, the power given is, in a sense, an extension of the rule in *Saunders v Vautier* (see Chapter 7) in so far as all the beneficiaries must be in agreement, of full age and capacity and collectively entitled to the trust property. The powers to direct retirement and/or appointment of trustee(s) therefore cannot be exercised where there is a minor beneficiary nor may they be exercised where the trust instrument expressly nominates a person for the purpose of appointing new trustees (s 19(1)(a)). Moreover the statutory powers can be excluded by settlors and testators if they do not wish beneficiaries to be able to exercise this degree of control (s 21(5)–(8)) and it is understood that this is commonly done.

(2) Appointment by the court: Trustee Act 1925, s 41

Section 41(1) provides, inter alia, that:

> The court may, whenever it is expedient to appoint a new trustee or new trustees, and it is found inexpedient, difficult or impracticable so to do without the assistance of the court, make an order appointing a new trustee or new trustees either in substitution for or in addition to any existing trustee or trustees, or although there is no existing trustee.

Despite the wide discretion it seems that the court will not act where the power provided by s 36(1) can be exercised. An application to the court is most likely where those with the power to appoint new trustees cannot agree, or where there is doubt about an issue such as 'unfitness' or 'incapacity'. Section 41 gives no indication as to the criteria the court should apply but some guiding principles emerged in *Re Tempest* (1866) 1 Ch App 485 at 487:

> **Turner LJ**: The following rules and principles may, I think, safely be laid down as applying to all cases of appointments by the court of new trustees.
>
> First, the court will have regard to the wishes of the persons by whom the trust has been created, if expressed in the instrument creating the trust, or clearly to be collected from it. I think this rule may be safely laid down, because if the author of the trust has in terms declared that a particular person, or a person filling a particular character, should not be a trustee of the instrument, there cannot, as I apprehend, be the least doubt that the court would not appoint to the office a person whose appointment was so prohibited, and I do not think that upon a question of this description any distinction can be drawn between express declarations and demonstrated intention. . . .
>
> Another rule which may, I think, safely be laid down is this – that the court will not appoint a person to be trustee with a view to the interest of some of the persons interested under the trust, in opposition either to the wishes of the testator or to the interests of others of the cestuis que trusts. I think so for this reason, that it is of the essence of the duty of every trustee to hold an even hand between the parties interested under the trust. Every trustee is in duty bound to look to the interests of all, and not of any particular member or class of members of his cestuis que trusts.
>
> A third rule which, I think, may safely be laid down is – that the court in appointing a trustee will have regard to the question, whether his appointment will promote or impede the execution of the trust, for the very purpose of the appointment is that the trust may be better carried into execution.

Turner LJ also referred to the difficulty where a proposed appointee is not wanted by existing trustees or further where they refuse to act with the person. He considered that the court ought not necessarily to refrain from appointing the person since to do so 'would be to give the continuing or surviving trustee a veto upon the appointment of the new trustee' (at 490). Instead the court should first see whether the existing trustees' objections were well founded. In contrast, and although s 41 is silent on the point, the court will not appoint a new trustee against the wishes of the persons who have statutory power to appoint, apparently even if requested to do so by a majority of the beneficiaries (*Re Higginbottom* [1892] 3 Ch 132).

Modern instances of the use of the court's jurisdiction under s 41 have involved the appointment of persons resident abroad as trustees. We have seen previously (Chapter 7 at p 333) that in some circumstances the courts might adopt a restrictive approach to requests to authorise such appointments under s 41. Thus in *Re Whitehead's Will Trusts* [1971] 1 WLR 833 the view was expressed that it would not generally be 'right or proper' for the court to use the statutory power unless the beneficiaries have a real and substantial connection with the country where the proposed trustees are resident (cf *Re Weston's Settlements* [1969] 1 Ch 223). The approach now seems to be much more liberal although it has been said that 'the court is unlikely to assist [applicants] where the scheme is nothing more than a device to avoid tax and has no other advantages of any kind' (*Richards v The Hon AB Mackay* (1987) reported in (1997) 11 TLI (1) 22 per Millett J). However, where trustees are exercising their own discretion (eg as under TA 1925, s 36(1)), and are seeking only a declaratory authorisation from the court for their own protection, the position now is that authorisation will be withheld only where the proposed transaction is 'so inappropriate that no reasonable trustee could entertain it' (followed in *Re Beatty's WT (No 2)* (1997) reported in (1997) 1 TLI (3) 77). A desire to avoid tax will seemingly not make it inappropriate.

(3) The position of the beneficiaries

The judgment in *Re Higginbottom* subordinated the wishes of the majority of beneficiaries to those of the trustee. But is this still the result if all the beneficiaries are sui juris and in agreement? There is no doubt that under the rule in *Saunders v Vautier* they can terminate the trust. Can they therefore also compel trustees, acting under s 36, to appoint as trustee the beneficiaries' own nominee? The answer at common law is clear; they cannot.

Re Brockbank [1948] Ch 206 at 208–209

Vaisey J: This case involves a question which is said to be novel. It is possible, I think, that the reason for the novelty is that the courage required for the raising of it has hitherto been lacking ...

It is said that where all the beneficiaries concur, they may force a trustee to retire, compel his removal and direct the trustees, having the power to nominate their successors, to appoint as such successors such persons or person or corporation as may be indicated by the beneficiaries, and it is suggested that the trustees have no option but to comply.

I do not follow this. The power of nominating a new trustee is a discretionary power, and, in my opinion is no longer exercisable and, indeed, can no longer exist if it has become one of which the exercise can be dictated by others. But then it is said that the beneficiaries could direct the trustees to transfer the trust property either to themselves absolutely, or to any person or persons or corporation, upon trusts identical with or corresponding to the trusts of the testator's will. I agree, provided that the trustees are adequately protected against any possible claim for future death duties and are fully indemnified as regards their costs, charges and expenses ...

It seems to me that the beneficiaries must choose between two alternatives. Either they must keep the trusts of the will on foot, in which case those trusts must continue to be executed by trustees duly appointed pursuant either to the original instrument or to the powers of s 36 of the Trustee Act, 1925 and not by trustees arbitrarily selected by themselves; or they must, by mutual agreement, extinguish and put an end to the trusts with [disadvantageous fiscal] consequences ...

The claim of the beneficiaries to control the exercise of the defendant's fiduciary power of making or compelling an appointment of the trustees is, in my judgment, untenable. The court itself regards such a power as deserving of the greatest respect and as one with which it will not interfere ...

It is tempting, but would be slightly misleading, to state that TLATA 1996, s 19 in effect reverses *Re Brockbank*. It does so but only where the limitations on the scope of s 19 (see above) do not apply, namely there must be no minor beneficiaries, no express power of nomination in the trust instrument and no exclusion of s 19.

Re Brockbank has a broader significance in that it appears to support the principle that beneficiaries cannot dictate how trustees shall exercise their discretionary powers (see below, p 524). However, the following comments of Romer LJ in *Butt v Kelson* [1952] 1 All ER 167 at 172, a case where the trust fund comprised shares in a private company of which the trustees were directors by virtue of the trust's shareholding, are difficult to reconcile with this principle:

> The beneficiaries are entitled to be treated as though they were the registered shareholders in respect of trust shares with the advantages and disadvantages (eg restrictions imposed by the articles) which would be involved in that position and that they could compel the trustee directors, if necessary, to use their votes as the beneficiaries – or as the court, if the beneficiaries themselves are not in agreement – should think proper . . .

It should be noted, however, that the point of principle was not in fact argued in the case, nor was *Re Brockbank* cited to the court (cf also *Re George Whichelow Ltd* [1954] 1 WLR 5 where the approach in *Butt v Kelson* was not followed, and *Holding and Management Ltd v Property Holding and Investment Trust plc* [1989] 1 WLR 1313 where *Re Brockbank* was affirmed obiter but without discussion).

There is one further section of TLATA 1996 that to a limited degree can impinge on the direct relationship between trustees of land and beneficiaries. Section 11 of the Act requires trustees, in exercising any function in relation to land subject to the trust, to consult the beneficiaries of full age and beneficially entitled to an interest in possession in the land. Furthermore the trustees should, so far as is consistent with the 'general interest of the trust', give effect to the wishes of the beneficiaries or, if they cannot all agree, to the wishes of the majority calculated by the value of their respective interests. The obligation to consult can be excluded by the settlor (s 11(2)) and does not apply to any property other than land. Moreover it is clear that a purchaser or mortgagee of the land is under no obligation to see that the requirements of s 11(1) have been complied with (s 16(1)).

(c) Retirement and removal of trustees

(1) Retirement

Under the Companies Act 1985, s 293 directors of public companies must offer themselves for retirement at age 70. No such provision exists in the Trustee Act 1925. Nevertheless, if beneficiaries and a trustee are locked in disagreement the wretched trustee need not remain yoked in harness until death or trust termination brings blessed relief: trustees can no more be compelled to remain in office than they can be forced to become trustees in the first place. A trustee who wishes to be discharged from all or some of the duties under a trust can be replaced by a newly appointed trustee (TA 1925, s 36(1)). In addition TA 1925, s 39 enables a trustee to retire, without being replaced, where the following requirements are satisfied:

(i) there remain two or more individual trustees or a trust corporation, and
(ii) the remaining trustees and anyone named in the trust instrument as having power to appoint new trustees consent to the retirement, and
(iii) the retirement is effected by deed.

Independently of statute a trustee can also retire (1) under an express power although the combined effect of ss 36 and 39 has rendered such powers unnecessary, or (2) by authority of the court exercising its inherent jurisdiction.

Retirement does not, however, provide escape from liability: trustees remain liable for breaches of trust committed during their trusteeship. Furthermore, they should exercise care in the manner of their departure. Trustees who retire knowing, or perhaps even only suspecting, that their retirement will facilitate a breach of trust by their successors or the continuing trustees, run the risk of being held jointly liable where loss occurs (*Head v Gould* [1898] 2 Ch 250, where Kekewich J observed (at 273) that 'you must shew . . . clearly . . . that the breach of trust . . . was contemplated by the former trustee').

(2) Removal of trustees

We have already seen that TLATA 1996, s 19 introduced a novel jurisdiction whereby beneficiaries can direct a trustee or trustees to retire. The procedure for implementing the retirement follows closely that set out in TA 1925, s 39 (above). However, the jurisdiction under s 19 is potentially subject to a number of limitations (see above, p 517). A last resort, therefore, for beneficiaries dissatisfied with trustees but unable to use the s 19 power is to seek their removal by the court. As we have seen, TA 1925, s 36(1) permits the forcible removal of a trustee who remains out of the United Kingdom for more than twelve months, or who refuses to act or is unfit or incapable of acting. The court also has an inherent jurisdiction to remove trustees as part of the process of administering the trust. But what circumstances will justify removal? General, if extremely vague, guidelines were set out by Lord Blackburn in *Letterstedt v Broers* (1884) 9 App Cas 371 at 387, PC:

> In exercising so delicate a jurisdiction as that of removing trustees, their Lordships do not venture to lay down any general rule beyond the very broad principle . . . that their main guide must be the welfare of the beneficiaries. Probably it is not possible to lay down any more definite rule in a matter so essentially dependent on details often of great nicety.

Lord Blackburn had previously quoted from a contemporary treatise (Story's *Equity Jurisprudence*) to the effect that not every breach of trust warranted removal: 'But the acts or omissions must be such as to endanger the trust property or to shew a want of honesty, or a want of proper capacity to execute the duties, or a want of reasonable fidelity' (at 385). Subsequently in *Re Wrightson* [1908] 1 Ch

789, Warrington J declined to remove trustees even though they had invested in unauthorised investments and a minority of beneficiaries wished them to be removed. He observed (at 803) that:

> . . . disagreement between the cestuis que trust and the trustees, or the disinclination on the part of the cestuis que trust to have the trust property remain in the hands of a particular individual is not a sufficient ground for the removal of the trustees. You must find something which induces the court to think either that the trust property will not be safe, or that the trust will not be properly executed in the interests of the beneficiaries.

In fact the trust in question had only a little time to run and replacement of trustees would have been uneconomical.

Whilst friction between beneficiary and trustee will not therefore usually provide sufficient ground for the court's intervention, hostility between trustees is likely to be viewed more seriously. Trustees are generally required to act unanimously and if they cannot agree to do so then the welfare of the beneficiaries would seem threatened (see *Re Consiglio Trusts* [1973] 3 OR 326 where all the trustees were removed and replaced by a trust corporation).

Finally, even where trustees act unanimously and in what they and the majority of beneficiaries consider to be the latter's best interests, this will not render them immune from challenge by a dissatisfied beneficiary if the acts are unlawful (*Clarke v Heathfield (No 2)* [1985] ICR 606). This trite proposition, a minor ripple of the 1984 National Union of Mineworkers' (NUM) strike, none the less illustrates the limits to trustee and beneficiary autonomy. The NUM rules required the trustees of the union's funds to obey 'the lawful orders and directions' of the union's National Executive Committee. The trustees, acting on instructions but as it transpired unlawfully, refused to repatriate union funds which had been sent abroad to frustrate a sequestration order. The court removed the trustees on the grounds, inter alia, of thwarting the orders of the court and endangering union funds.

There are special statutory provisions relating to suspension, disqualification and removal of trustees in pension schemes and in charitable trusts. These measures are discussed at the appropriate points in Chapters 13 and 20 respectively.

3. Controlling trustees' discretion

(a) Trusts, powers and discretions

We saw in Chapter 10 in the context of the exercise of the power to delegate that under the Trustee Act 2000 trustees do not need to demonstrate that it is reasonably necessary to delegate a particular management function to agents. Rather the Law Commission was of the view that any legal control over the trustees' decisions as to *whether* to exercise their discretions should be left to the inherent jurisdiction of the courts although, as the Commission note, '[the courts] will not generally interfere with a discretionary power if the trustees are unanimous as to its exercise' (Report No 260 *Trustees' Powers and Duties* (1999) para 3.3). Hanbury and Martin succinctly summarise the position as follows: 'The basic principle governing trustees is that, while duties must be discharged, the exercise of discretions needs only to be considered' (p 524). Accurate though this statement is, we need to probe a little more extensively into the relationship between duties and discretions in this context. In this section of the chapter we therefore consider whether and to what extent the courts are willing to intervene in the decisions of trustees as to the exercise of discretions conferred on them.

First, however, an overlap both in language and practice between trusts, powers and discretions needs to be disentangled. By definition a power, whether for example a mere power of appointment or a power of advancement or maintenance, confers a discretion on trustees. But equally the carrying out of trustees' duties may require the exercise of a discretion, as where an exhaustive discretionary trust imposes a duty on trustees to distribute income but with a discretion as to the selection of the persons to benefit. As Cullity has observed ([1976] Can BR 229 at 237): 'Exactly the same relationship will often exist between administrative duties and discretionary powers as, for example, in the common case of a trustee's duty to invest proceeds of sale in investment to be selected by him at his discretion.' But as was seen in Chapter 5, the fact that the execution of both trusts and mere powers may involve an element of discretion does not mean that both are subject to precisely the same degree of judicial control.

The continuing basic difference remains that where trustees have a duty imposed on them then they must exercise any discretion attached to it. Consequently if the discretion is not exercised, the court, if called upon, will enforce it (*Re Locker's Settlement Trusts* [1977] 1 WLR 1323 and (1978) 42 Conv 166). In contrast, trustees need only consider whether or not to exercise a mere power, with the consequence that where, for example, the power relates to the distribution of income it will lapse after a reasonable period (see *Re Allen-Meyrick's Will Trusts* [1966] 1 WLR 499) and the income will devolve on those entitled in default of appointment. Furthermore, as we also saw in Chapter 5, a continuing distinction, albeit one of uncertain application, between discretionary trusts and mere powers of appointment is that in exercising the discretion 'a wider and more comprehensive range of inquiry is called for' in the former (*McPhail v Doulton* [1971] AC 424 at 457).

One further distinction to be mentioned is between those circumstances where the power is held in a personal capacity and where it is held in a fiduciary capacity. Where the power is held in a personal capacity, the donee need not consider whether to exercise the power at all and may even 'release' it. A decision by the donee of the power to release it may be taken for one of any number of reasons ranging from the familial to the fiscal. In *Re Mills* [1930] 1 Ch 654, for instance, the donee released the power of appointment so as to create an indefeasible interest in those entitled in default of appointment. Where, however, the power is held by the donee in a fiduciary capacity the donee cannot release the power unless authorised to do so in the trust instrument (see *Re Wills Trusts Deeds* [1964] Ch 219). Determining the capacity in which the power is held by a donee therefore has important implications. Thus in *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 a power held by a company not as trustee but as employer was nevertheless construed as being held in a fiduciary capacity, thereby enabling the court to intervene on behalf of the members of the pension scheme ('the beneficiaries'; see further Chapter 13 at p 672).

Moving beyond these distinctions it is the scope for challenging the exercise of a discretion whether under a trust or a power that concerns us here, although, as will be seen, the borderline between non-exercise of a discretion and its improper exercise may at times be difficult to discern.

There is one further consideration to mention. Trustees might exercise their discretion bona fide but either mistakenly or without appreciating the full implications of their decisions. The latter may be of particular concern where the tax position of the beneficiaries or the settlor is adversely affected. Of course the immediate response is to suggest that in such circumstances an action for negligent breach of trust may lie against the erring trustees. An alternative response, owing much to the ingenuity of practitioners, has been to plead the operation of a rule purported to have been established in the case of *Re Hastings-Bass* [1975] Ch 25. In effect the court is being asked in these circumstances, often at the behest of all the directly affected parties, to undo the error by declaring the decision void or voidable. Whether the court should be prepared to assist the trustees in such circumstances and by what means is a matter of some contention. The current position and the accompanying points of controversy are considered in section c below. First, however, we consider the extent to which beneficiaries can challenge the exercise of discretion by trustees other than under the still uncertain extent of the rule in *Hastings-Bass*.

(b) Exercising the discretion

Before considering whether a court can or should interfere in the exercise of a discretion, the perhaps trite point must be restated, subject to any uncertainty prompted by *Butt v Kelsen* (see p 520), that it is the trustees' discretion, not that of the settlor or beneficiary, that must be exercised. The point is illustrated in *Turner v Turner* [1983] 2 All ER 745, which also provides a good example of an attempt by a settlor to divest himself of property ownership for tax-planning purposes while retaining de facto control. There, a power of appointment was conferred on three trustees – the settlor's elderly father, sister-in-law and her husband – none of whom had, in the words of Mervyn Davies J, 'any experience or understanding of trust matters' (at 747). The settlor said in his evidence that he considered himself to be the 'captain of the ship' (at 750) and the trustees, not appreciating that even during the settlor's lifetime they still had a discretion to exercise, willingly signed deeds of appointment when requested to do so by the settlor. Not surprisingly when the trustees sought the court's directions the appointments were held invalid and set aside.

It is necessary to enter a note of caution here lest it be assumed too readily that the exercise of a discretion by trustees is for them and them alone. It is possible, indeed by no means uncommon in offshore trusts, for 'a protector' to be appointed in the trust deed. The protector can be given a variety of functions, one of which might be that the exercise of any powers of appointment held by trustees will be subject to the consent of the protector. In effect the protector has the power of veto over the decisions of the trustees. This development then potentially raises questions about the status of protectors – are they necessarily fiduciaries? – and the degree of accountability and control, if any, to which they are subject (see eg Waters in Oakley (ed) *Trends in Contemporary Trust Law* (1996) ch 4; Duckworth 'Protectors – Fish or Fowl?' (1996) PCB 169; Waters (2000) 8(4) ITCP 237). It is doubtful that a generic answer can be given to such questions. Much will depend as ever on the interpretation of the powers conferred on the protector by the trust instrument and on the law of the jurisdiction within which the administration of the trust is located.

But where trustees exercise their own discretion can the court interfere? The high-water mark of judicial non-interventionism is to be found in the nineteenth-century case of *Gisborne v Gisborne* (1877) 2 App Cas 300, HL, where a testator had conferred on trustees 'uncontrollable authority' over subsequent disposition of income. The consequence in Lord Cairns's view was that, 'Their discretion and authority always supposing that there is no mala fides with regard to its exercise, is to be without any check or control from any superior tribunal' (at 305).

The subsequent application of this approach to an administrative discretion was demonstrated in *Tempest v Lord Camoys* (below), although the language of the judgment indicates a potentially greater scope for judicial intervention than that in *Gisborne v Gisborne*. Trustees were given an absolute discretion to sell and buy land, and also to raise money by mortgage for the purchase of land. One trustee wished to exercise the discretion to purchase property but the co-trustee would not agree and the court refused to order him to do so.

Tempest v Lord Camoys (1882) 21 Ch D 571 at 578, CA

Jessell MR: It is very important that the law of the Court on this subject should be understood. It is settled law that when a testator has given a pure discretion to trustees as to the exercise of a power, the Court does not enforce the exercise of the power against the wish of the trustees, but it does prevent them from exercising it improperly. The Court says that the power, if exercised at all, is to be properly exercised . . .

But in all cases where there is a trust or duty coupled with the power the Court will then compel the trustees to carry it out in a proper manner and within a reasonable time. In the present case there was a power which amounts to a trust to invest the fund in question in the purchase of land. The trustees would not be allowed by the Court to disregard that trust, and if Mr Fleming had refused to invest the money in land at all the Court would have found no difficulty in interfering. But that is a very different thing from saying that the Court ought to take from the trustees their uncontrolled discretion as to the particular time for the investment and the particular property which should

> be purchased. In this particular case it appears to me that the testator in his will has carefully distinguished between what is to be at the discretion of his trustees and what is obligatory on them.
>
> There is another difficulty in this case. The estate proposed to be purchased will cost £60,000, and only £30,000 is available for the purchase, and the trustees will have to borrow the remaining £30,000. There is power to raise money by mortgage at the absolute discretion of the trustees, and assuming that such a transaction as this is within the power, and that the trustees can mortgage the estate before they have actually bought it, there is no trust to mortgage, it is purely discretionary. The Court cannot force Mr Fleming to take the view that it is proper to mortgage the estate in this way; he may very well have a different opinion from the other trustee. Here again the Court cannot interfere with his discretion.

[Brett and Cotton LJJ delivered concurring judgments, the latter however rather elliptically observing (at 580):]

> No doubt [the Court] will prevent trustees from exercising their discretion in any way which is wrong or unreasonable. But that is very different from putting a control upon the exercise of the discretion which the testator has left to them.

A similar approach was manifested towards a duty of selection in the earlier case of *Re Beloved Wilkes' Charity* (1851) 3 Mac & G 440. Trustees had a duty to select a boy from only certain named parishes to be educated to be a minister of the Church of England, provided that a suitable candidate could be found there. In fact the trustees selected a boy (C) from another parish apparently after C's brother, himself a minister, had approached one of the trustees on C's behalf. The trustees refused to give any reasons for their choice but stated that they had considered the candidates impartially. The Lord Chancellor refused a request to set aside the selection and appoint instead a boy from one of the named parishes. He summarised the court's jurisdiction as follows (at 448):

> The duty of supervision on the part of this Court will thus be confined to the question of the honesty, integrity, and fairness with which the deliberation has been conducted, and will not be extended to the accuracy of the conclusion arrived at, except in particular cases. If, however, . . . trustees think fit to state a reason, and the reason is one which does not justify their conclusion, then the Court may say that they have acted by mistake and in error, and that it will correct their decision; but if, without entering into details, they simply state, as in many cases it would be most prudent and judicious for them to do, that they have met and considered and come to a conclusion, the Court has then no means of saying that they have failed in their duty, or to consider the accuracy of their conclusion.

Although the courts resolutely refused to intervene in the above cases, the outlines of a residual judicial discretion can be identified. What, for example, will constitute an 'improper' exercise of a power and when will trustees' deliberations be deemed 'unfairly' conducted? In *Klug v Klug* [1918] 2 Ch 67, a refusal by one trustee, the beneficiary's mother, to approve the exercise of a power of advancement (trustee unanimity being required for the valid exercise of a power) was overruled because, in Neville J's words, 'she has not exercised her discretion at all' (at 71). In fact the mother's refusal to approve the capital advance had apparently been motivated by displeasure at her daughter's marrying without her consent. It is not a large step to recharacterise the court's intervention here as being on the grounds that the trustee was exercising a discretion (ie deciding not to advance capital) but doing so by taking irrelevant considerations into account. In similar vein one can point to the rule in *Re Hastings-Bass* [1975] Ch 25 concerning the effect of a mistaken exercise of discretion and which is discussed in section c below. Another circumstance analogous to the improper motive or irrelevant consideration of *Klug v Klug* is where trustees exercise a discretion for an improper purpose, as in *Re Pauling's Settlement Trusts* [1964] Ch 303, CA, a case also involving the power of advancement (see also *Re Smith* [1971] 1 OR 584). There, on several occasions trustees advanced capital nominally to children, all of whom were over 21 and at their own request, but in full knowledge that the money would be used directly to benefit the parents – the improper purpose – not the children, as by buying a house for the father in the Isle of Man and reducing the mother's bank overdraft.

The concept of improper purposes must logically also apply to trustees' pure dispositive discretions if only because of the restraint imposed by the doctrine of 'fraud on a power'. This doctrine, which we briefly outline here for the purposes of clarification and comparison only, applies to mere powers of appointment whether or not held by trustees (see generally Maclean *Trusts and Powers* (1989) ch 3; and Thomas *Powers* (1998)). The word 'fraud' needs to be treated with caution here: 'The equitable doctrine of "fraud on a power" has little, if anything, to do with fraud' (*Medforth v Blake* [2000] Ch 86 at 103 per Sir Richard Scott V-C). It means no more than an improper use of the power. The exercise of a power will always be invalid if it exceeds the limits imposed by the donor (eg by appointing to D when A, B and C are the only objects). But the 'fraud' referred to also includes circumstances where the appointment is prima facie sound but is made for an improper motive. In the words of one of the many strict formulations of the doctrine: 'a party must fairly and honestly execute [the power] without having any ulterior object to be accomplished. He cannot carry into execution any indirect object or acquire any benefit for himself, directly or indirectly' (Lord St Leonard in *Duke of Portland v Lady Topham* (1864) 11 HL Cas 32 at 55).

A distinction is drawn, however, between purpose and effect. The mere fact that someone other than an object of a power benefits indirectly from its exercise does not invalidate the appointment; there must also be an *intent* to benefit that person. In the modern context litigation has usually occurred where, as part of an attempted arrangement to vary trusts for fiscal reasons, a life-tenant holder of a power of appointment wishes to appoint to certain beneficiaries so that the property can subsequently be divided amongst both parties. A strict application of the doctrine intended to protect the objects would be likely to invalidate the appointment, perhaps to the financial detriment of some of the objects of the power. But whether the ulterior purpose is present is a question of fact or inference and examples both of strict and benevolent interpretation can be found in modern cases. (See *Re Brook's Settlement* [1968] 1 WLR 1661; cf *Re Wallace's Settlements* [1968] 1 WLR 711; see also Cretney (1969) 32 MLR 317; Monroe [1968] BTR 424; Grbich (1977) 3 Monash U LR 210; and for a somewhat surprising valid use of a power in the context of a divorce settlement *Netherton v Netherton* [2000] WTLR 1171.)

To summarise: a failure by trustees to consider whether to exercise a discretion will be a breach of trust, and we have identified in addition several overlapping reasons which can enable a court to intervene to control trustees' positive exercise of their discretions. Even where a discretion is couched in the widest terms, as in *Gisborne v Gisborne*, its exercise can be attacked on grounds of mala fides. And, in so far as not included within the 'notoriously elastic' meaning of that term (see Cullity (1975) 25 U Toronto LJ 99 at 103), exercise for an improper purpose or based on improper or irrelevant considerations will be equally invalid. But although these limitations modify trustee autonomy they do not obviously ascribe to the court any jurisdiction to intervene merely because the court considers the trustees' particular decision injudicious. Can then the courts intervene, whether or not a discretion is described as 'uncontrollable', where they consider trustees to have acted honestly but unreasonably?

We already know that 'capricious' exercise of a dispositive discretion would be improper (see *McPhail v Doulton* [1971] AC 424 at 456, and *Re Manisty's Settlement* [1974] Ch 17 where it was described as meaning 'irrational, perverse or irrelevant to any sensible expectation of the settlor' (at 26)). Turning to administrative discretions such as those concerned with powers of investment, the reservations expressed by Cotton LJ in *Tempest v Lord Camoys* (above) have subsequently been interpreted by Slade LJ as meaning: 'even a power expressed in terms that it should be exercisable at the trustee's absolute discretion, was subject to the implicit restriction that it should be exercised properly within the limits of the general law' (*Bishop v Bonham* [1988] 1 WLR 742 at 753). The implication is that widely drawn clauses conferring absolute discretion on trustees will not *in themselves* be effective to exclude, for instance, the fundamental duties of prudence and impartiality (see *Boe v Alexander* (1988) 41 DLR (4th) 520 at 527; but see below p 568 on clauses purporting to limit or exclude liability).

More tenuously a majority of the House of Lords in a Scottish appeal, although reserving their opinion on the appropriateness of the test, did consider whether trustees had 'acted in a manner that no reasonable trustee acting within the bounds of the duty laid on him by the testator could possibly act' (*Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896). A more cautious exposition of the circumstances where a court might intervene to control the exercise of a discretion was given in that case by Lord Reid (at 905):

> If it can be shown that the trustees considered the wrong question, or that, although they purported to consider the right question they did not really apply their minds to it or perversely shut their eyes to the facts or that they did not act honestly or in good faith, then there was no true decision and the court will intervene.

We use the word 'tenuous' about the implications of the judgment because (i) counsel for the respondents conceded that 'reasonableness' was the appropriate test, and (ii) the propositions in the case would not necessarily apply to the English law of trusts. Nevertheless in *Scott v National Trust* [1998] 2 All ER 705 at 717 Robert Walker J specifically adopted Lord Reid's words as representing a clear statement of the principle to be applied even where trustees are expressed as having an absolute discretion, although in that case in the context of charity law (see also Chapter 20). However clear the language used by Lord Reid may be, we are now moving even further into realms of uncertainty with terminology and concepts redolent of judicial review in administrative law. As with that area of the law, the key question is not 'Can the court intervene?' but 'In what circumstances will the court consider it appropriate to do so?' To that question must be added in the present context the further one 'What form would that intervention take?'

(c) The rule in *Re Hastings-Bass (dec'd)*

Questions such as those just posed have come to the fore as a consequence of the recent rise to prominence of the rule in *Re Hastings-Bass (dec'd)* [1975] Ch 25. At issue in the case was the validity of the exercise in 1958 of a power of advancement to set up a sub-trust comprising a life interest and remainders over, all with the overall intention of reducing estate duty liability. It became apparent following the decision of the House of Lords in *Pilkington v IRC* [1964] AC 12 (see Chapter 7) that the remainders over were void for infringing the rule against perpetuities, but was the life-interest valid? If so, the saving of estate duty sought would be achieved. Intriguingly, in view of the subsequent use to which the rule has been put, it was counsel for the Inland Revenue in *Re Hastings-Bass* who advanced the proposition that the exercise of the power of advancement by the trustees should be void because of their mistaken view as to the effect of the rule against perpetuities. It was in response to this proposition that Buckley LJ set out, in a negative formulation, what has become known as the rule in *Re Hastings-Bass* (at 41):

> Where by the terms of a trust . . . a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect that he intended, unless (1) what he has achieved is unauthorised by the power conferred on him, or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account.

The rule in *Re Hastings-Bass* really relates to point 2 above, point 1 simply reiterating the doctrine of fraud on a power. The terminology of point 2 is analogous to the previously mentioned dicta of Lord Reid in *Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896 which is itself analogous to the language of 'Wednesbury unreasonableness' or 'irrationality' by which administrative decisions of public bodies may be challenged. Notwithstanding these conceptual and linguistic similarities the circumstances in which reliance is now sought to be placed on the rule tend to be somewhat different from those where beneficiaries are seeking to challenge the exercise of a discretion or power by trustees with which they disagree. On the contrary in some recent cases it may be trustees, beneficiaries and, indeed, settlors who wish to seek the court's approval to undo a decision made in good faith by trustees yet misunderstanding the *consequences* of their decision.

The door left ajar by the Court of Appeal in *Re Hastings-Bass* was initially pushed further open in the context of pensions litigation (*Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587; *Stannard v Fisons Pension Trust Ltd* [1991] PLR 225; *AMP (UK) plc v Barker* [2000] 3 ITELR 414). Here, for reasons explored in greater detail in Chapter 13 but reflecting a perception of the special nature of the right of pension scheme members to hold trustees to account, the courts have demonstrated a willingness to review trustees' decisions arguably more extensively than had been thought to be the case in a family trust context. Thus Lawrence Collins J in *AMP (UK) plc v Barker*, following the earlier Court of Appeal decision in the Court of Appeal in *Stannard v Fisons Pension Trust*, confirmed that the test to be applied in determining when the court could interfere was whether the trustees *might* not have acted as they did rather than they *would* not have acted as they did (at [90]).

It is, however, predominantly in a few key cases where tax consequences have been either misunderstood or not foreseen that practitioners have sought to take advantage of the opportunity offered by the rule and in so doing extend its scope (see *Green v Cobham* [2000] WTLR 1101; *Abacus Trust Company (Isle of Man) v NSPCC* [2001] WTLR 953; *Breadner v Granville-Grossman* [2001] Ch 523; *Abacus Trust Company (Isle of Man) v Barr* [2003] Ch 409; *Burrell v Burrell* [2003] EWHC 245). Decisions in these cases at first instance have not been consistent. Indeed Sir Robert Walker, as he then was, suggested in a lecture in 2002 that the law 'is in considerable doubt and disarray' ((2002) 13 KCLJ 173 at 183).

To gain a full appreciation of recent developments and of the inconsistent reception given to the rule in *Re Hastings-Bass* would require a detailed examination of the key cases. Here we can do no more than outline the cause of the disarray and the contentious issues raised by current use of the rule (for more detailed analysis see Walker (2002) 13 KCLJ 173–185; Hilliard (2002) 16(4) TLI 202–213 and [2004] Conveyancer 208–223; Nugee (2003) PCB 3 at 178–187). There are three principal issues to consider. These are (i) the nature of the mistake that brings the rule into consideration, (ii) whether, where the rule applies, the decision of the trustees is void or voidable and (iii) whether there should be differing interpretations of the rule in different contexts.

The first issue concerns the nature and seriousness of the error required to prompt the court's intervention. In two cases, *Green v Cobham* and *Abacus Trust Company (Isle of Man) v NSPCC*, the exercise of the powers had the direct legal effect intended – respectively the appointment of new trustees and the appointment of an interest to a charity – but also brought about the unforeseen and unwanted consequence of a capital gains tax liability. In *Abacus* the power of appointment had been exercised too early thereby wrecking the tax avoidance arrangement whilst in *Green v Cobham* the number of non-resident trustees was reduced with potential capital gains tax consequences described by counsel as 'catastrophic'. In both cases the rule was applied – there is little doubt that in those cases had the trustees realised the consequences of their decisions they 'would' have acted differently. On the other hand, in *Breadner v Granville-Grossman* [2001] Ch 523 Park J declined to adopt a 'natural and logical development' of the rule so as to enable the court to make *positive* decisions in the sense of holding 'that a trust takes effect as if the trustees had done something which they never did at all' (at 543). But the judge also commented more generally about the development of the rule. He acknowledged that the rule was at an early stage of development and that its limits had not been established and suggested that (at 543): '[t]here must be some limits. It cannot be right that, whenever trustees do something which they later regret and think that they ought not to have done, they can say that they never did it in the first place' (see *Underhill and Hayton*, pp 697–698 strongly endorsing the dicta of Park J; Walker (2002) 13 KCLJ 173–185, but cf Hilliard (2002) 16(4) TLI 202–213 and [2004] Conveyancer 208–223). Moreover, whilst not directly criticising the decision in *Green v Cobham*, Park J stated that 'there must be limits to how far the courts will allow the principle in *In Re Hastings-Bass* to rescue trustees from the consequences of their tax-planning misjudgements' (at 553).

At this point the competing positions as to the scope of the rule appeared to revolve around the question of whether or not a mistake by the trustees had to be 'fundamental' for the rule to apply (see generally Sheehan 'What is a Mistake' (2000) 20 LS 538 at 538–545). The uncertainty engendered by the contrasting case authorities has been compounded by the decision of Lightman J in *Abacus Trust Company (Isle of Man) v Barr* [2003] Ch 409. The judge rejected the proposition that a fundamental mistake was a prerequisite and also an alternative suggestion that the rule in *Re Hastings-Bass* could apply whenever there had been a mistake, no matter how it arose. Instead Lightman J adopted the position that the rule applied only where the exercise of the discretion involved a breach of the trustees' fiduciary duty to consider properly how to exercise their discretion – what is 'proper consideration' in this context may itself prove contentious (see Green (2003) 17 TLI 114). Unfortunately, even assuming consideration of tax consequences is an aspect of that duty, it is far from clear that this new approach resolves the matter. It is difficult, for instance, to identify any breach of fiduciary duty in a case such as

Green v Cobham where the negative fiscal consequences that eventually arose out of the appointment of new trustees could not possibly have been foreseen at the time of the appointment. What is clear, however, if this approach is to be followed is that an inconvenient outcome will not suffice for the rule in *Re Hastings-Bass* to be applied: 'In the absence of any such breach of duty the Rule does not afford the right to the trustee or any beneficiary to have a decision declared invalid because the trustee's decision was in some way mistaken or has unforeseen and unpalatable consequences' (at [24]).

The reference to 'invalidity' of a decision brings to the fore the second of our contentious issues. Where the rule in *Re Hastings-Bass* is applied does it render the decision void or voidable? Here also there is a divergence of view in the cases. In *AMP (UK) plc v Barker* the view is taken that the application of the rule renders the exercise of the discretion by trustees void. If this is the position then formidable difficulties may be posed where a lengthy period has elapsed between the exercise of the discretion and the application to the court – 22 years in *Breadner v Granville-Grossman* where, however, Park J declined to apply the rule commenting that 'it would be . . . unacceptable . . . to upset some action by trustees . . . on the basis of which many intervening decisions and actions have been taken (at 553). On the other hand, Lightman J in *Abacus Trust Company (Isle of Man) v Barr* reached the opposite conclusion holding that the appointment made some ten years before the application to court was voidable. If this is the current legal position – and it was part of the ratio of Lightman J's decision – then it must be recognised that the consequence of applying the rule in *Re Hastings-Bass* in this way may be desirable but differs from other situations where a power or discretion is exercised improperly such as under the doctrine of fraud on a power. There the exercise of the power is declared void. If it is now the case that the exercise of a discretion, rather than being void, is potentially voidable under the rule in *Re Hastings-Bass* there is as yet very little guidance from the cases as to what criteria the court should apply in shaping any order that it might make to rectify the decision of the trustees.

The third contentious aspect of the rule takes us back to what can be interpreted as a twin-track process of development by way of, on the one hand, pensions cases and, on the other hand, private family trust litigation. The dilemma is whether interpretation and/or application of the rule in *Re Hastings-Bass* should vary depending on the context and if so in what direction. It can be argued that, notwithstanding the decision in *Breadner v Granville-Grossman*, the trend in the 'tax' cases referred to above has been towards adopting an interpretation comparable to that in the pensions area. This in effect broadens the jurisdiction of the court to 'interfere' with the trustees' decisions, although in the tax context in private trusts 'facilitate a variation of a decision' might often be a more appropriate phrase. The underlying legal and policy question remains one of whether some limit should be placed on the use of the rule to, in Park J's words, 'rescue trustees from the consequences of their tax-planning misjudgements'. (See Walker (2002) 13 KCLJ 173–185; and compare the contrasting views of Nugee (2003) PCB 3 at 178–187 and Hilliard (2002) 16(4) TLI 202–213; and [2004] Conveyancer 208–223.)

By way of summary here one can only reiterate that, pending further consideration at appellate level, the law remains, in Lord Walker's words, 'in considerable doubt and disarray'.

(d) Beneficiaries' access to information

(1) Introduction

There is a fundamental conceptual and practical obstacle confronting an aggrieved beneficiary who wishes to challenge the decisions of trustees. A beneficiary is unlikely to be fully informed of the reasons for trustees' decisions or of the process of decision-making. Moreover where, for instance, the trustees' decision involves the exercise of a discretion they seemingly cannot be compelled to give the reasons for their decision, although if they volunteer the reasons the court can examine their adequacy (see *Re Londonderry's Settlement* [1965] Ch 918; *Wilson v The Law Debenture Trust Corpn plc* [1995] 2 All ER 337; *Karger v Paul* [1984] VR 161; and dicta in *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405 and (1993) 67 ALJ 703). Given this apparent constraint, what information are beneficiaries entitled to if they suspect that trustees have been negligent or indulged in fraud or other improper conduct?

We have seen previously that a fundamental obligation of trusteeship is the duty of the trustees to account to the beneficiaries for their (the trustees') stewardship of the trust. The recent Privy Council decision in *Schmidt v Rosewood* [2003] 2 WLR 1442 has thrown fresh light on two issues central to the accountability of trustees and the right of beneficiaries to seek access to information about the stewardship of the trust. One issue concerns the scope of the obligation – 'To whom is it owed by the trustees?' – whilst the other is about the nature of the right to information – 'Is it a proprietary right of beneficiaries or merely an aspect of the court's inherent jurisdiction to supervise the administration of trusts?' Both of these matters are considered below as are the criteria that the court may apply in determining what information should be disclosed.

It is convenient first, however, to outline briefly a basic building block of the obligation of trustees to account for their stewardship of the trust, the duty of trustees to keep accounts and records.

(2) Duty to keep accounts and records

Trustees are under a duty to keep accurate accounts of trust property and on request to allow a beneficiary or her solicitor to inspect the accounts and supporting documents. This obligation includes providing details of investments and allowing access to title deeds, share certificates or other documents concerning trust property. A beneficiary is not, however, entitled to free copies of documents, although it is accepted practice, certainly for professional trustees, to provide a copy of the accounts without charge (see Sladen *Practical Trust Administration* (3rd edn, 1993) p 240). Whilst there is no duty to have accounts audited, trustees have a statutory power to have an audit conducted by an independent accountant provided it is not more than once in every three years, unless the nature of the trust or any special dealings with trust property make a more frequent audit reasonable (TA 1925, s 22(4)).

Furthermore, under a rarely used jurisdiction a beneficiary can insist on accounts being investigated or audited by any solicitor or accountant acceptable to the trustees, or, if agreement cannot be reached, by the Public Trustee, but not within twelve months of a previous investigation unless the court approves (Public Trustee Act 1906, s 13(1), (5); recommended for repeal by the LRC para 4.48).

So that trustees can comply with the duty to provide information to beneficiaries about matters affecting the trust and trust property, it is advisable, indeed usual, for them to keep a trust diary or minute book. Decisions taken in administration of the trust and possibly minutes of trustees' meetings are recorded although, as we see in the next section, trustees may wisely choose to be selective in the information minuted.

(3) The right to seek disclosure

To whom is the obligation owed?: McPhail v Doulton revisited

Schmidt v Rosewood [2003] 2 WLR 1442 brought to the forefront of debate questions about control of trustees that, since the path-breaking majority decision of the House of Lords in *McPhail v Doulton* [1971] AC 424, had lain largely dormant, at least as far as family trusts were concerned (cf in the context of the rights of members of pension schemes *Mettoy Pension Trustees v Evans* [1990] 1 WLR 1587). It may be recalled that the majority of their Lordships in *McPhail v Doulton* rejected the constraints imposed by a narrow perception, derived from *Morice v Bishop of Durham* (1805) 10 Ves 522, of the court's ability to control and execute a trust. Subsequently, partly for tax reasons and partly because of residual uncertainty as to the validity in discretionary trusts of expressions such as 'relatives' and 'dependants', settlors conferred on trustees ever wider dispositive discretions based commonly on a combination of discretionary trusts (or trust powers) and mere powers of appointment, often in the form of an intermediate (or hybrid) power. It must be borne in mind that one object of this exercise was to make the ultimate beneficial ownership in a trust as diffuse and difficult to ascertain as possible. The nub of the 'largely dormant' issue is what rights of enforcement against trustees, if any, are available to the objects of a mere power.

The two 'similar but not identical' trust instruments at issue in *Schmidt v Rosewood* reflected the influences and traits referred to above, with the added dimension of the trusts being administered from the Isle of Man and their provenance being not altogether clear. The trust instruments contained a number of errors and omissions, to the extent that the Privy Council accepted counsel's submission that the settlement had been 'cobbled together' (at [18]). The appellant, who was seeking access to trust accounts and other information from the trustees, was Vadim Schmidt the son of Vitali Schmidt who appeared to be, at least in substance (the matter was in some doubt), a co-settlor of the two trusts, the Angora Trust and the Everest Trust set up in 1992 and 1995 respectively. Vitali, who died unexpectedly and intestate in 1997, was at the time a senior executive director of Lukoil, the largest oil company in Russia. Vitali was also the initial named 'protector' in the 1992 trust. The trustee at the time of the litigation was Rosewood Trust Ltd, an Isle of Man-registered corporate trustee. The named default beneficiaries in both trusts were a charity, the Royal National Lifeboat Institution, and, inter alia, Vitali Schmidt and other senior executives of Lukoil. In both trusts there was an overriding power of appointment, exercisable with the written consent of the protector. In addition the 1995 trust contained an intermediate power to add to the class of beneficiaries anyone in the world apart from a very small class of excluded persons, a clause similar to that upheld in *Re Manisty's Settlement* [1974] Ch 17.

In respect of both trusts the father had written letters to the trustees indicating that in the event of his death prior to the termination of the trust his 'share' or 'portion' was to be held on trust for his son Vadim. The trustees maintained that the letters were no more than the expression of wishes and therefore devoid of legal effect. Consequently, on this view, no actual interest in either trust ever vested in Vadim. Indeed under the 1995 trust Vadim was no more than the object of the intermediate power of appointment and, the trustees argued, as such had no rights to the disclosure of the trust information that he was seeking. The Court of Appeal in the Isle of Man supported this view and firmly rejected the proposition advanced by the appellant Vadim that there was no distinction to be drawn in this area between the rights of 'beneficiaries' and those of the objects of a power (*Rosewood Trust v Schmidt* [2001] WTLR 1081). Reversing that decision, the Privy Council accepted the proposition advanced on behalf of the appellant, at least for the purposes of disclosure of information. Lord Walker, giving the judgment of the Privy Council, referred extensively to the reasoning of Lord Wilberforce in *McPhail v Doulton* and also to the fiscal and conceptual influences on the widespread adoption of intermediate powers, and stated (at [66]; and see the perceptive case comment of Davies (2004) 120 LQR 1–7):

> There is therefore in their Lordships' view no reason to draw any bright dividing-line either between transmissible and non-transmissible (that is, discretionary) interests, or between the rights of an object [sic] of a discretionary trust and those of the object of a mere power (of a fiduciary character). The differences in this context between trusts and powers are (as Lord Wilberforce demonstrated in *McPhail v Doulton*) a good deal less significant than are the similarities.

Disclosure of information: 'proprietary right' or 'inherent jurisdiction'?

The appearance of the word 'therefore' in the above extract is significant. In reaching their conclusion the Privy Council had to address the central proposition in the argument of counsel for the trustees to the effect that 'no object of a mere power could have any right or claim to disclosure, because he had no proprietary interest in the trust property' (at [43]). Arguably that proposition reflected the long-established leading authority in the English case law *O'Rourke v Darbishire* [1920] AC 581 where Lord Wrenbury stated (at 626):

> If the plaintiff is right in saying that he is a beneficiary, and if the documents are documents belonging to the executors as executors, he has a right to access to the documents which he desires to inspect upon what has been called in the judgments in this case a proprietary right. The beneficiary is entitled to see all the trust documents because they are trust documents and because he is a beneficiary. They are in a sense his own.

The Committee of the Privy Council preferred to adopt the approach emerging from more recent Commonwealth case law that saw the matter as part of the court's inherent jurisdiction to supervise trusts (see *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405; *Attorney-General of Ontario v Stavro* (1994) 119 DLR (4th) 750; and also Hayton in Oakley (ed) *Trends in Contemporary Trust Law* (1996) p 52). Lord Walker summarised the opinion of the Committee as follows (at [50]–[51]):

> Lord Wrenbury's observations . . . are a vivid expression of the basic distinction between the right of a beneficiary arising under the law of trusts (which most would regard as part of the law of property) and the right of a litigant to disclosure of his opponent's documents (which is part of the law of procedure and evidence). But the [Committee] cannot regard it as a reasoned or binding decision that a beneficiary's right or claim to disclosure of trust documents or information must always have the proprietary basis of a transmissible interest in trust property. . . . Their Lordships consider that the more principled and correct approach is to regard the right to seek disclosure of trust documents as one aspect of the court's inherent jurisdiction to supervise, and if necessary to intervene in, the administration of trusts. The right to seek the court's intervention does not depend on entitlement to a fixed and transmissible beneficial interest.

Having established the right in principle of the appellant to seek disclosure the case was referred back to the Isle of Man court for the decision to be applied. The subtle way in which the Committee deals with the earlier and seemingly conflicting English authorities (in particular *Re Cowin* (1886) 33 Ch D 179; *O'Rourke v Darbishire* [1920] AC 581; and *Re Londonderry's Settlement* [1965] Ch 918) is probably sufficient to ensure that *Schmidt v Rosewood*, although a decision of the Privy Council and not strictly binding, will be followed in the English courts (see also *Daraydan Holdings v Solland International* [2004] EWHC 622 where Lawrence Collins J held that the High Court and Court of Appeal can follow Privy Council decisions even where they depart from previous Court of Appeal decisions). Nothing, however, can disguise the fact that a quite radical shift has taken place, particularly in view of Lord Walker's comment that 'no beneficiary (and least of all a discretionary object) has any entitlement as of right to disclosure of anything which can plausibly be described as a trust document' (at [67]; and see Pollard (2003) 17(2) TLI 90; McCall (2003) PCB 5, at 358; Wilson (2004) PCB 3 at 161; and Lightman J (2004) PCB 1 at 23–40). Essentially a proprietary right to disclosure, admittedly of uncertain dimensions, has been supplanted with a right contingent on the exercise of judicial discretion. It is necessary, however, to consider just how much difference this shift will make to the practice of trustees and the courts. One immediate effect is that the debate that exercised the court and commentators as to whether or not a particular document was a trust document and therefore trust property can be discarded (see eg *Re Londonderry's Settlement*; and Megarry (1965) 81 LQR 192). The removal of the proprietary right basis for disclosure renders the issue largely redundant.

Disclosure of information and 'inherent jurisdiction': some practical implications
Whilst *Schmidt v Rosewood* has significantly rewritten the law on the right to seek disclosure from trustees, it must not be overlooked that the fundamental obligation of the trustees is unaltered, that is to account to the beneficiaries for their stewardship of the trust. It would be strange therefore if a judgment essentially concerned with extending to the objects of a mere power the right to seek disclosure were to lead to an outcome whereby a court would refuse, for instance, to permit a beneficiary with a transmissible interest – such as a life tenant – to inspect trust accounts. Notwithstanding Lord Walker's comment rejecting any notion of 'entitlement as of right', one might expect the court at least to start from a presumption in such a case that documents should be made available unless there is some good reason for refusing access.

On the other hand an area where the court's discretion is most likely to come to the fore is where an order for disclosure is sought by the object of a mere power or by a beneficiary of a discretionary trust. Then the court will have to undertake a balancing exercise. An important element in this assessment will be whether the claimant can establish a likelihood that at some stage they have a reasonable chance of obtaining some part of the trust property. In *Schmidt v Rosewood* itself, for instance, Lord Walker stated that although the appellant was 'a possible object of a very wide power . . . [he is] an object who may be regarded (especially in view of the letter [from his father]) as having exceptionally strong claims to be considered' (at [69]). In *Schmidt v Rosewood* the appellant was seeking full disclosure of trust accounts and information as to the whereabouts of assets in excess of US$105m received by the two settlements between their creation and 1998. In somewhat similar vein a beneficiary of a discretionary trust who was one of four children of the settlor and where the number of potential beneficiaries was 'pretty limited' was granted an order against his father, the defendant, that the names and addresses of trustees should be disclosed (*Murphy v Murphy* [1999] 1 WLR 282; see Mitchell (1999) 115 LQR 206). It is noteworthy, however, that in respect of some other discretionary trusts where the class of beneficiaries was much wider and the plaintiff's claims to any share correspondingly weaker, disclosure was refused by the judge.

(4) Disclosure of information and the decision-making process of trustees

In neither *Schmidt v Rosewood* nor *Murphy v Murphy* were the claimants seeking information to satisfy idle curiosity or even simply to ensure that the trustees were handling the trust affairs competently, although in *Schmidt v Rosewood* there is a suggestion that alleged overcharging by trustees may be at issue. The information sought was in essence a first step towards attempting to establish that they [the claimants] should benefit personally from the trusts to a greater degree. In other words at some point the claimants might wish to challenge the decisions of the trustees. It is at this point that the 'right' to seek disclosure may on occasion conflict with the principle that trustees are not obliged to give reasons for the exercise of their discretions. Where trust correspondence or records (eg a trust diary) indicate the reasons, is the obligation of trustees to disclose or not? Whilst this issue is of considerable practical significance to aggrieved beneficiaries, it is also the paradigmatic case for assessing where power resides in the trustee-beneficiary relationship. Whilst much of the argument before the Court of Appeal in the leading case of *Re Londonderry's Settlement* revolved around the now disapproved 'proprietary right' to disclosure and its relationship to a definition of trust documents, the judgments do explore in some detail the problems posed by the conflict between accountability of trustees and their autonomy of decision-making.

Re Londonderry's Settlement [1965] Ch 918, CA

The settlor's daughter, Lady Walsh (W) was, in default of appointment, an income beneficiary under a discretionary trust and also a member of a class amongst whom trustees had power to appoint capital subject to the consent of certain other persons known as 'appointors'. In 1962 the trustees decided to terminate the trust by distributing the capital but W objected to the amount that the trustees proposed to give her. W asked the trustees to provide her with copies of various documents but they supplied only copies of (1) previous appointments of capital and (2) trust accounts. W remained dissatisfied and the trustees sought the court's directions as to which, if any, of the following documents they were bound to disclose:

> (a) the minutes of the meetings of the trustees . . .; (b) agenda and other documents (if any) prepared for the purposes of the meetings of the . . . trustees or otherwise for the[ir] consideration . . .; (c) correspondence relating to the administration of the trust property or otherwise to the execution of the trusts of the settlement and passing between (i) the individuals for the time being holding office as trustees of or appointors under the settlement; (ii) the trustees and appointors on the one hand and the solicitors to the trustees on the other hand; (iii) the trustees and appointors on the one hand and the beneficiaries on the other hand.

Plowman J ordered disclosure and the trustees appealed:

> **Harman LJ:** I have found this a difficult case. It raises what in my judgement is a novel question on which there is no authority exactly in point although several cases have been cited to us somewhere near it. The court is really required here to resolve two

principles that come into conflict, or at least apparent conflict. The first is that, as the defendant beneficiary admits, trustees exercising a discretionary power are not bound to disclose to their beneficiaries the reasons actuating them in coming to a decision. This is a long-standing principle and rests largely, I think, on the view that nobody could be called on to accept a trusteeship involving the exercise of a discretion unless, in the absence of bad faith, he were not liable to have his motives or his reasons called in question either by the beneficiaries or by the court. To this there is added a rider, namely that if trustees do give reasons, the court can consider their soundness.

It would seem on the face of it that there is no reason why this principle should be confined to decisions orally arrived at and should not extend to a case, like the present, where, owing to the complexity of the trust and the large sums involved, the trustees, who act subject to the consent of another body called the appointors, have brought into existence various written documents including, in particular, agenda for and minutes of their meetings from time to time held in order to consider distributions made of the fund and its income. It is here that the conflicting principle is said to emerge. All these documents, it is argued, came into existence for the purposes of the trust and are in the possession of the trustees as such, and are, therefore, trust documents, the property of the beneficiaries, and as such open to them to inspect ...

[Harman LJ referred to the opinions of their Lordships in *O'Rourke v Darbishire* [1920] AC 581 and continued:]

In my judgment category (a) mentioned in the notice of appeal, viz, the minutes of the meetings of the trustees of the settlement; and part of (b) viz, agenda prepared for trustees' meetings, are, in the absence of an action impugning the trustees' good faith, documents which a beneficiary cannot claim the right to inspect. If the defendant is allowed to examine these, she will know at once the very matters which the trustees are not bound to disclose to her, namely, their motives and reasons. Trustees who wish to preserve their rights in this respect must either commit nothing to paper or destroy everything from meeting to meeting. . . .

I would hold that, even if documents of this type ought properly to be described as trust documents, they are protected for the special reason which protects the trustees' deliberations on a discretionary matter from disclosure. If necessary, I hold that this principle overrides the ordinary rule. This is in my judgment no less in the true interest of the beneficiary than of the trustees. Again, if one of the trustees commits to paper his suggestions and circulates them among his co-trustees, or if inquiries are made in writing as to the circumstances of a member of the class, I decline to hold that such documents are trust documents the property of the beneficiaries. In my opinion such documents are not trust documents in the proper sense at all. On the other hand, if the solicitor advising the trustees commits to paper an aide-memoire summarising the state of the fund or of the family and reminding the trustees of past distributions and future possibilities, I think that must be a document which any beneficiary must be at liberty to inspect. It seems to me, therefore, that category (b) in the notice of appeal embraces documents on both sides of the line.

As to [category] (c) . . . I cannot think that communications passing between individual trustees and appointors are documents in which beneficiaries have a proprietary

> right. On the other hand, as to category (c) (ii), in general the letters of the trustees' solicitors to the trustees do seem to me to be trust documents in which the beneficiaries have a property. As to category (c) (iii), I do not think letters to or from an individual beneficiary ought to be open to inspection by another beneficiary.

[Danckwerts LJ agreed with Harman LJ:]

> **Salmon LJ:** . . . The settlement gave the absolute discretion to appoint to the trustees and not to the courts. So long as the trustees exercise this power with the consent of persons called appointors under the settlement, and exercise it bona fide with no improper motive, their exercise of the power cannot be challenged in the courts – and their reasons for acting as they did are accordingly immaterial. This is one of the grounds for the rule that trustees are not obliged to disclose to beneficiaries their reasons for exercising a discretionary power. Another ground for this rule is that it would not be for the good of the beneficiaries as a whole, and yet another that it might make the lives of trustees intolerable should such an obligation rest on them: . . . Nothing would be more likely to embitter family feelings and the relationship between the trustees and members of the family than that the trustees should be obliged to state their reasons for the exercise of the powers entrusted to them. It might indeed well be difficult to persuade any persons to act as trustees were a duty to disclose their reasons, with all the embarrassment, arguments and quarrels that might ensue, added to their present not inconsiderable burdens . . .

In a subsequent note ((1965) 81 LQR 192) Megarry commented (at 196), 'It seems safe to say that the last of *Re Londonderry's Settlement* has not been heard' and the case left several issues in an unsatisfactory state, not all of which have yet been resolved.

First, it is difficult to reconcile the decision with the rules of Court procedure governing pre-trial discovery of documents. Indeed the final order of the court in the case was made 'without prejudice to any right of the defendant to discovery in separate proceedings' against the trustees. Can the beneficiary use litigation as a 'fishing expedition' by alleging bad faith or some other improper conduct on the part of the trustee and obtain discovery of documents, whether trust documents or not? The court's dilemma is clearly set out by Megarry:

> Will the courts permit the bonds of secrecy to be invaded by the simple process of commencing hostile litigation against the trustees? It is not easy to see how the courts can prevent this. True, questions of relevance may obviously arise; but on discovery the test of relevance is wide. The classical statement is that of Brett LJ: an applicant is entitled to discovery of any document 'which may fairly lead him to a train of inquiry' that may 'either directly or indirectly enable the party requiring the affidavit either to advance his own case or to damage the case of his adversary' (*Compagnie Financière et Commerciale du Pacifique v Peruvian Guano Co* (1882) 11 QBD 55 at 63).

If the decision in *Re Londonderry* is in part based on a principle of confidentiality, it seems inconsistent to allow that principle to be overridden by an order for discovery where some improper conduct is alleged but not where a beneficiary is making