Aims and objectives

After reading this chapter you should:

- Understand and appreciate the main stages in the growth of equity, the development of the trusts concept and the evolution of the law of equity, a body of rules created by the Court of Chancery, initially presided over by the Lord Chancellor.
- Understand that the origins of equity and of the trust lay in overcoming shortcomings of the common law.
- Understand and appreciate that the initial flexibility of equity resulted in uncertainty and unpredictability and that this led, in the late seventeenth and eighteenth centuries, to a body of precedent used in deciding cases, while preserving the discretionary nature of equity.
- Explain how the conflicts between equity and the common law were addressed.
- Explain the nature of a beneficial interest.
- Critically evaluate the various attempts to define the trust and identify the key elements of a trust, particularly of an express private trust.
- Identify the main types of trusts both private and public.
- Appreciate that the trust is a powerful and flexible concept.
- Understand that tax avoidance or reduction is a reason for the creation of many trusts (or the form that the trust takes) and appreciate that the main taxes that are relevant are income tax, capital gains tax and inheritance tax.

The title of this book is *Trusts and Equity*. It deals with the most important principles and doctrines of equity and the main equitable concepts. It covers the trust at length. Maitland, in his *Selected Historical Essays*, said: ‘If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer to give than this, namely, the development from century to century of the trust idea.’ As Maitland points out above, the ‘greatest and most distinctive achievement’ of English law is not merely the ‘invention’ of the trust but also the fact that the concept has been developed and refined over time to meet new demands and to provide new solutions to problems. It is this ability to adapt to new needs and circumstances which has led to the trust being so widely and inventively
used. The trust was created and developed by equity and in order to appreciate the modern law of trusts it is necessary to outline the evolution of equity and the manner in which the trust concept has grown.

As Maitland indicates, the trust is the invention of English law and while it is a feature of other systems of law based on the common law, it is not normally found in civil law systems.

Although this book concentrates on the trust, it must not be thought that this is all that equity is, or has been, concerned with. Its field is very wide, and equitable jurisdiction includes certain probate business, patents, trade marks, copyright, the appointment of guardians for minors, partnership matters, companies and mortgages.

Equity has also developed a number of ‘equitable’ remedies, such as specific performance, the injunction and the remedy of account. Remedies will be discussed in Chapter 18.

Many of the concepts developed by equity are now, at least partially, covered by statutes which usually draw on the principles and rules developed by equity and also introduce additional material. One example where statutory intervention has taken place is in the area of trusts, where, in particular, the Trustee Act 1925 and the Trustee Act 2000 now contain a good deal of the relevant law.

### Development of equity

#### Origins

The word ‘equity’ has a wide range of meanings and to many people it is a synonym for ‘fairness’ or ‘justice’. To a lawyer, however, equity has a very special and narrow meaning: that body of rules developed and applied by the Court of Chancery. This court was presided over by the Chancellor and the rules were developed under his authority.

The origins of equity lie in the deficiencies of the common law. The common law had gaps where a remedy was not available or where a remedy was available but was not appropriate to the particular loss of a plaintiff. The Chancellor was responsible, among other things, for the issue of writs and all actions had to be commenced by the issue of a royal writ. If there was no writ appropriate to a claim there could be no action and thus no remedy. To some extent the severity of this was tempered by the Chancellor’s willingness to develop new writs but this came to an end when the Provisions of Oxford 1258 stopped the issue of writs to cover new forms of action without the consent of the King in Council.

Another problem of the common law lay where a plaintiff may have had a common law remedy but he was prevented from enforcing it because of the power or influence of the other party to the case. Or a plaintiff might be the victim of the corruption of the jury which heard his case.

Additionally, the common law was preoccupied with formality. For example, if two parties tried to enter into a verbal contract which was required, at common law, to be in writing the result would be that the common law would not recognise the contract nor grant any remedies on it. This was the case whatever the situation, whatever the merits of the case and irrespective of how the parties had behaved. In some of these situations equity would step in and provide a remedy despite the lack of formality.

The original role of equity was often as a ‘gloss on the common law’. Equity might well provide a remedy where the common law provided none or provide a more suitable
remedy than the common law. Equity might also intervene to ensure that the available common law remedy was actually enforceable. In other words, equity worked alongside the common law and provided different solutions to problems.

If a subject believed that the common law would not provide an appropriate solution to his case he could petition the King and the Council asking that justice be done and that a remedy should be ordered. It was considered that a residuum of justice resided in the King, and petitions were directed at tapping into this as a last resort if the common law had not provided justice. These petitions were referred to the Chancellor and eventually the Chancellor was petitioned directly. Cases brought before the Chancellor were called suits. The Chancellor was making decrees by the end of the fifteenth century. The Chancellor was a very important figure, perhaps second only to the King, not least because he was responsible for issuing the royal writs. The Chancellor was, in effect, at the head of the common law and what he did was to ensure that the common law worked in an acceptable way. Initially, he was not creating a separate system but was dealing with the faults of the common law.

It was not until the end of the fourteenth century that it could be said that a Court of Chancery, in any real sense, came into being. Up until that time the Chancellor simply responded to petitions by issuing a decree without the procedures usually associated with a court hearing. It was only very gradually that equity developed and came to be regarded as a separate and in some ways a rival system of law.

Originally, Chancellors, though generally well versed in the law, particularly the canon law, were ecclesiastics rather than lawyers. They were sometimes referred to as the keepers of the King's conscience. Early decisions tended to be idiosyncratic and to be based on the ideas, beliefs and conscience of each particular Chancellor. So it was said that equity varied with the length of the Chancellor's foot. In other words the decision in any particular case would be relatively unpredictable and uncertain. This may be an acceptable approach in single isolated cases but the uncertainty meant that the rights of individuals were impossible to assess without the trouble and expense of going to court.

Introduction of rigidity

The appointment of Lord Nottingham as Chancellor in 1675 marked the start of the systemisation of equity. He was responsible for setting down the principles upon which equity operated, thus moving away from the era of idiosyncratic, unpredictable decisions. He also laid out the boundaries within which equity functioned. Lord Nottingham was also instrumental in developing the law of trusts. The next important Chancellor was possibly Lord Hardwicke, who was first appointed in 1737. Lord Hardwicke further developed the principles of equity and many of his decisions demonstrated the fine balance that had to be held between certainty and the flexibility needed to allow both 'justice' in a particular case and also the evolution of the law. Lord Hardwicke often emphasised the function of equity to provide a remedy in the case of unconscientious conduct.

The last great Chancellor involved in the development of equity into a modern system of law was Lord Eldon, who was first appointed in 1801. Lord Eldon was twice Chancellor, for a total of almost a quarter of a century. He stressed that decisions must be based on precedent (perhaps applied in a flexible and creative manner) and he consolidated the principles previously developed. Since the Chancellorship of Lord Eldon the principles and scope of equity have gradually evolved, adapting to new and changing situations.
Lord Nottingham has been described as the father of equity, while Lord Hardwicke was responsible for laying down the general principles upon which equity operated. Lord Eldon was the consolidator, who worked on the application of the rules and principles of equity which he inherited from Lord Nottingham and Lord Hardwicke.

Gradually, decisions began to be based on precedent. This development took place at the same time as lawyers began to be appointed as Chancellors and eventually a body of law evolved which was as fixed and rigid as the common law. This move towards a more predictable, precedent-based system started at the end of the seventeenth century and coincided with the refinement of the reporting of cases heard in the Chancery courts.

Trusts, which began to be developed to address family/domestic matters, gradually began to be used in a commercial/business context and here certainty and effective law reporting were particularly important.

Conflicts between equity and the common law

The general approach of equity was to follow the common law unless there was a sound reason to do otherwise. So, equity recognised and protected those estates in land and those interests in land that were recognised and protected by the common law. In fact, as well as recognising the common law estates, equity recognised other estates too.

But in a legal system where two bodies of law existed there were bound to be occasions when there was a conflict. If conflicts arose between equity and the common law, equity would use the common injunction, which had the effect of preventing the common law action from proceeding or preventing the common law judgment from being enforced. This was clearly not acceptable to the common lawyers and for many years there was very active conflict. This was not resolved until the reign of James I when it was decided that equity should prevail.

The Supreme Court of Judicature Act 1873 s 25(11) provided that in cases of conflict between the rules of equity and the rules of the common law, equity shall prevail (now the Senior Court Act 1981 s 49).

Nature of the Chancellors’ interventions

There are a number of very important underlying principles which relate to the ways in which equity intervened.

Equity acts in personam

The main remedy available at common law is damages. Equity, however, acted against the person and ordered him to do something. For example, a decree of specific performance ordered a party to a contract to fulfil his promises. An injunction ordered that something was not done or, sometimes, that something was done. Other equitable remedies are rescission, rectification and account. If the order of the court is not obeyed then imprisonment may follow.

Equitable remedies are discretionary

A common law remedy can be claimed as of right. For example, if a breach of contract is proved the victim can demand an award of damages. However, the award of an equitable remedy is at the discretion of the court. The victim of a breach of contract to transfer property can only ask the court to exercise its discretion and award a decree of specific performance ordering the transfer of the property. There are now clear principles governing the exercise of the discretion and these will be discussed in detail in Chapter 18.

See Chapter 18 p. 505 for a discussion of equitable remedies.
The *bona fide* purchaser

Whereas a legal right may be said to be enforceable against anyone in the world, an equitable right is enforceable against anyone except a *bona fide* purchaser of the legal estate for value and without notice of the prior equitable rights. (This principle is of less importance following the introduction of registration of rights over land but is nevertheless a basic principle of equity.)

**Judicature Acts 1873–75**

It is clear that although equity started life as mere supplement to the common law it developed into a separate system. Equity was administered by the Courts of Chancery, which were separate from the common law courts. This caused many problems. For example, it was often necessary to use both the common law courts and the court of equity in the same dispute. There were some improvements but it was not until the Supreme Court of Judicature Acts 1873–75 that the position changed significantly. This legislation provided for the creation of one single Supreme Court to replace the separate courts that existed previously. The Courts of Exchequer, Queen’s Bench, Chancery, Common Pleas, Probate, Admiralty and the Divorce Court were abolished. In their place was one court, divided, for convenience only, into three Divisions of the High Court (Queen’s Bench, Chancery and the Probate, Divorce and Admiralty Divisions, the latter being renamed the Family Division in 1970). In practice, matters are allocated to the most appropriate Division but in fact any Division can adjudicate on any matter and both common law and equitable remedies can be awarded in any Division. As mentioned above, it was specifically provided that, if there was a conflict between the rules of the common law and the rules of equity, equity shall prevail (Supreme Court of Judicature Act 1873 s 25(11); now the Senior Courts Act 1981 s 49).

There is no doubt that this legislation merged the administration of the two systems of law. There is, however, some debate as to whether the two systems of law themselves have been fused into one. Ashburner, in *Principles of Equity*, expressed his view by saying that ‘the two streams of jurisdiction, though they run in the same channel, run side by side and do not mingle their waters’. There have been judicial and academic statements to the effect that there is a fused system of law. For example, in *United Scientific Holdings Ltd v Burnley Borough Council* [1977] 2 WLR 806, Lord Diplock said: ‘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 courts of law and Courts of Chancery (as well as those administered by Courts of Admiralty, Probate and Matrimonial Causes) were fused.’

The prevailing view appears to be that, although the two systems operate closely together, they are not fused. In *MCC Proceeds Inc v Lehman Brothers International (Europe)* [1998] 4 All ER 675, Mummery LJ said that the substantive rule of law was not changed by the Judicature Acts. These were intended to achieve procedural improvements in the administration of the law and equity in all courts, not to transform equitable interests into legal titles or to sweep away the rules of the common law.

However, Lord Browne-Wilkinson, in *Tinsley v Milligan* [1993] 3 All ER 65, appears to take a different view. He said:

More than 100 years has elapsed since the fusion of the administration of law and equity. The reality of the matter is that, in 1993, English law has one single law of property made up of legal estates and equitable interests.
The distinction still remains between equitable and common law remedies. There remain important differences between common law and equitable rights.

**Evolution of the trust**

Tracing the development of the trust by equity is to discover a series of problems looking for answers: the answers being provided by the trust. It is a concept which began as the solution to some relatively simple and straightforward problems and then just grew and grew. Its great merit was and still is its adaptability, its ability to evolve and solve new and different problems.

The modern trust has its origins in the *use* (from the Latin *ad opus*) which was developed as the response of equity to the shortcomings of the common law.

The development of the trust began even before the Norman Conquest in 1066, when land was transferred ‘to the use’ of other people or purposes. At first the problems for which uses provided a solution were often short term and rooted in a family or domestic setting, rather than in a business or commercial context. For example, the owner of land was planning to be away for some time (perhaps on a crusade) and he transferred the land to a friend (the transferee) who it was understood would take the land not for his own benefit but would hold it for the family of the owner. Often the arrangement was to last only until the owner returned. In most cases there would be no problem: the friend would honestly and faithfully carry out his promise and would ensure that the benefits of the land flowed to the family. However, there were occasions when the promise was not kept or a disagreement arose over the manner in which the land was administered. In such cases the common law would recognise only the ownership of the transferee. The family was considered to have no rights in the land at all. In other words, the family had absolutely no legal redress if the transferee simply ignored his promise and administered the land for his own benefit. The promise was binding in honour only and the family had to hope that a wise choice had been made and that the transferee was a man of honour.

In the fourteenth and fifteenth centuries the Chancellor began to protect the family and would order the transferee to carry out the terms of his promise. As equity acts *in personam*, the protection took the form of ordering the transferee to act in a particular way to accord with the terms of his agreement. Soon, however, equity allowed the family to enforce their rights not only against the original transferee but also against third parties who had received the property from the original transferee. However, it was always accepted by equity that the legal owner of the property was the transferee. So, gradually, over a period of many years, the attitude of the Chancellor evolved into the recognition of separate rights of the family, and eventually it was accepted that two types of ownership could exist in property at the same time. One was recognised by the common law and the other by equity.

The terminology used was that the transferee (now called the trustee) was known as the ‘feoffee to uses’ and the people for whom he held the property (now called the beneficiaries) were called the ‘cestuis que use’.

Another classic reason for employing the use was to enable property to be held for an individual or body which was not itself allowed to hold property. For example, Franciscan friars took vows of poverty and were not allowed to hold property and so land would be conveyed to an individual to hold to the use of the community of friars.
Again, the use was applied in order to sidestep the common law prohibition on disposing of land by will. The would-be testator would transfer the land during his lifetime to a number of his trusted friends and then nominate to whose use they were to hold the land after his (the transferor’s) death, and in the meantime until his death the property would be held for the transferor. Again, the use was being employed to overcome what many saw as a defect of the common law.

However, perhaps the most common application of the use was to avoid feudal dues. It will be recalled that since the Norman Conquest the Crown owns all land. Under the feudal system all land was held under the Crown in exchange for the provision of money or services. The Crown granted estates in land to certain lords who in turn could allow others to hold from them, again in return for money or services.

Over a period of time the obligations to provide services were converted into money, but with the effect of inflation these payments lost their value and were often not collected. The Tenures Abolition Act 1660 abolished most of the remaining dues.

However, although the dues became less and less important there were incidents which often attached to land and which could be very valuable. A lord was entitled to a payment if land was held by a minor, and if a tenant died without leaving an heir the lord was entitled to the land under the right of escheat. It was common to employ the use to avoid these feudal incidents. If a tenant feared that he might die leaving his minor son as his heir he might decide to transfer the land to some trustworthy adults who would hold to the use of the son. If the tenant died before the heir was adult, no feudal dues were payable as the land was, according to the rules of the common law, held by the adults.

It is clear that, since all land was held from the Crown, it was the Crown which suffered most from the employment of uses to avoid the feudal dues.

The response of Henry VIII to this loss of revenue was the Statute of Uses 1535 which was initially intended to apply to all uses but was, in the event, modified so that it affected only some of them. The Statute was one of the first examples of anti-tax avoidance legislation. The Statute simply executed uses to which it applied. If, for example, land was held by Arthur to the use of Ben, the Statute of Uses caused the use to be executed or ignored, and the feoffee to uses disappeared and the legal estate was considered to be vested in the cestui que use. The end result was that the legal estate was vested in Ben, the cestui que use. When Ben died feudal dues would become payable. In this way the Statute of Uses prevented the avoidance of taxes on the death of Ben.

The Statute did not apply to uses where the feoffee to uses had active duties to perform such as the collection and distribution of profits from the land. Nor did the Statute apply if the property subject to the use was held only for a term of years.

For some time the Statute was effective in restricting uses to active uses or uses covering only a period of years but attempts to have recourse to the passive use, which was the use normally employed to avoid feudal dues, were no longer profitable.

This remained the situation until about 1650 when a device known as a use upon a use was found to be an effective way round the Statute. The solution involved a double use. Land would be transferred to Arthur to the use of Ben to the use of Charles. It was eventually accepted that only the first use was executed under the Statute of Uses leaving the second use intact. The phraseology altered and the second use began to be described as a trust and the common form was to transfer land ‘unto and to the use of Ben in trust for Charles’. The effect was that the legal estate was vested in Ben, and Charles owned the land in equity. Eventually the terminology was refined even more and land would simply be conveyed to Ben on trust for Charles.
Definition/description of the trust

A trust is very difficult if not impossible to define, but its essential elements are reasonably easily described and readily understood. There have been very many attempts to produce a definition of a trust but such definitions are either long, amounting to descriptions rather than definitions, or shorter but susceptible to criticism. It is not considered worthwhile either to attempt yet another definition or to criticise existing definitions; rather the concept of a trust will be described.

If a settlor, Simon, transfers property to trustee 1 and trustee 2 (Tim and Tom) to hold on trust for Ben, the legal ownership of the property is vested in Tim and Tom and the equitable (or beneficial) ownership is vested in Ben. It will be recalled that this division of ownership was the invention of equity and is the basis of the trust. Tim and Tom hold the property not for their own benefit but for the benefit of Ben. Tim and Tom’s technical, legal, ownership brings only burdens and responsibilities which can make their position very onerous. The duties and responsibilities of Tim and Tom will be imposed by the settlor, by statute and by the general law of trusts. The beneficial ownership which rests with Ben brings with it, as the name suggests, the positive advantages of ownership. Any income which the trust property generates will belong to Ben. Any profit made from the trust property will accrue for the advantage of Ben.

Generally speaking, it is not possible to create trusts for purposes rather than to benefit human beneficiaries (see page 184). The most important exception to this general rule against purpose trusts is the charitable trust which will be dealt with at length in Chapter 9. Charitable trusts cannot be enforced by beneficiaries because there are none, but are enforced by the Attorney-General. It is also possible to have a trust for a purpose which is to provide a direct benefit to a group of people. For example, in *Re Denley* [1968] 3 All ER 65, the court found that a valid private trust came into existence when land was given to be used as a sports field primarily for the benefit of the employees of a specified company.

In most trusts the settlor will transfer the trust property to others to hold as trustees but it is perfectly possible for a trust to be created by the owner of the property declaring that he holds it henceforth on specified trusts for the beneficiaries. (see Figures 1.1 and 1.2.)

It is also possible for a settlor to be a beneficiary under a trust he has created. For example, Arthur might decide to transfer a block of shares to a trustee to hold on trust for himself for life and then the remainder for his son, George.

Any property may be the subject matter of a trust and although the nature of the property may affect the formalities for setting up or running the trust the essential elements remain constant whatever the type of property involved. Property both real and personal can be the subject matter of a trust. The property may be tangible or intangible. Shares in companies (chooses in action) can as readily be trust property as land or money. It is even possible to create a trust of an interest under an already existing trust. This is called a sub-trust. An example of the breadth of the categories of property that may be the subject matter of a trust is *Don King Productions Inc v Warren* [1998] 2 All ER 608, in which contracts expressed to be non-assignable were the subject matter of a valid trust. The case concerned two partnership agreements which were intended to deal with the boxing promotion and management interests of two leading promoters. One of the agreements stated that the two parties would hold all promotion and management agreements
DEFINITION/DESCRIPTION OF THE TRUST

relating to the business for the benefit of the partnership. Some of the promotion agreements and all the management agreements contained non-assignment clauses. However, none of the contracts (promotion and management) contained a prohibition on the partners declaring themselves as trustees. The Court of Appeal upheld the decision of Lightfoot J at first instance ([1999] 2 All ER 218). Further discussion of transfer formalities may be found at pages 94–6.

If the trustees, Tim and Tom, deal with the trust property in a way that is contrary to the terms of their trust this will constitute a breach of trust, and Ben (the beneficiary) will be able to seek various remedies through the courts, including damages. If trust property has improperly been transferred to a third party it may be possible for Ben to ‘follow’ or trace the trust property into the hands of third parties and recover it.

Figure 1.1 Creating trusts
In this case, Lord Browne-Wilkinson made a number of points that relate to the underlying nature of the trust and of equitable interests:

(i) Equity operates on the conscience of the owner of the legal interest. In the case of a trust, the conscience of the legal owner requires him to carry out the purposes for which the property was vested in him (express or implied trust) or which the law imposes on him by reason of his unconscionable conduct (constructive trust).

(ii) Since the equitable jurisdiction to enforce trusts depends upon the conscience of the holder of the legal interest being affected, he 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 in the case of an express or implied trust, or, in the case of a constructive trust, of the factors which are alleged to affect his conscience.

(iii) In order to establish a trust, there must be identifiable trust property. The only apparent exception to this rule is a constructive trust imposed on a person who dishonestly assists in a breach of trust who may come under fiduciary duties even if he does not receive identifiable trust property.

**Westdeutsche Landesbank Girozentrale v Islington London Borough Council** [1996] 2 All ER 961

**Figure 1.2 Creating trusts**
Lord Browne-Wilkinson places a good deal of emphasis on trusts being founded on the conscience of the supposed trustee. This, except in the case of constructive trusts, requires the supposed trustee to have knowledge of the fact that he is to hold property on trust and not beneficially. In such cases the fact that the ‘trustee’ had no relevant knowledge would mean that there is no reason why his conscience should be affected. This case will be referred to in other points of this book and, in particular, will be discussed at pages 246–48.

A statutory provision which is helpful in appreciating the nature of a trust is contained in the Recognition of Trusts Act 1987 (enacting the terms of the Hague Convention on the Recognition of Trusts). The provision focuses on the characteristics of the concept rather than attempting a definition. Article 2 provides:

For the purpose 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 part of the trustee’s own estate;
(b) title to the trust assets stands in the name of the trustee or another person on the behalf of the trustee;
(c) the trustee has the power and 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.

(As will be discussed later, the statement that trusts may be for ‘a specified purpose’ requires qualification. See Chapter 8 Purpose trusts, and Chapter 9, Charitable trusts.)
in a particular situation. The debate has been especially lively in the context of the interest of a beneficiary under a trust. The main dispute is as to whether his interest can be described as a right in personam or a right in rem. One difficulty is that these concepts, rights in personam and rights in rem, are used with different meanings by different commentators in different situations. However, in the context of the analysis of the nature of the interest of a beneficiary under a trust, it should be recalled that these rights were developed by equity acting in personam and every beneficiary will have a chose in action, a right against the trustee to compel the due administration of the trust. But the evolution of the protection provided by equity eventually gave the beneficiary the right to trace the trust property into the hands of third parties (except into the hands of a bona fide purchaser of the legal estate for value without notice of the equitable interest). This, it has been argued, means that the beneficiary has a right in rem, a right against the property itself. This is a right of a proprietary, rather than a personal, nature. The problem then is to decide if the right of the beneficiary is actually a right in rem or simply a right that is almost, but not quite, a right in rem! The fact that the right is not enforceable against the whole world (it cannot be enforced against the bona fide purchaser of the legal estate for value without notice) is said by some to mean that the right cannot be a right in rem as enforceability against the whole world is a key requirement of such a right. This may well be an unsound argument as in a number of cases a person who owns the legal estate in property (the possessor of a right in rem) is unable to enforce the right against the whole world.

There is some evidence from statutory provisions that equitable interests are interests in property. For example, under tax law, one who is entitled to shares under a trust is considered to be the owner for the purpose of liability to income tax on the dividends (Baker v Archer-Shee [1927] AC 844). Lord Tomlin said in Archer-Shee v Garland [1931] AC 212, commenting on Baker v Archer-Shee:

I do not think that it can be doubted that the majority of your Lordships' House in the former case Baker v Archer-Shee founded themselves upon the view that according to English law . . . [the beneficiary] had a property interest in the income arising from the securities . . .

It is also possible to find support for this view in the judgment of Lord Browne-Wilkinson in Tinsley v Milligan [1993] 3 All ER 65. Having said that it was more than 100 years since the administration of law and equity was fused (see discussion of the Judicature Acts 1873–75 earlier in the chapter) he said:

The reality of the matter is that, in 1993, English law has one single law of property made up of legal estates and equitable interests. Although for historical reasons legal estates have differing incidents, the person owning either type of estate has a right of property, a right in rem, not merely a right in personam.

The best conclusion may be to say that a beneficiary does have a proprietary right against the trust property but that it is not identical to the proprietary right of the owner of a legal interest.

An additional source of difficulty is that a person is sometimes described as having an equity or an equitable right when that person possesses something of a different nature to the rights of a beneficiary under a trust. Often these rights, initially created by the Court of Chancery, are called ‘mere equities’ to distinguish them from equitable interests proper. They are rights which, in most cases, are not assignable, and the benefit of a mere
equity cannot run with the property. It is sometimes said that a mere equity is the right to seek an equitable remedy.

Equities are often categorised as proprietary rights. While the purchaser of an equitable interest without notice takes free of any equities, only the purchaser of the legal estate without notice takes free of equitable interests. The right to rescission on the ground of fraud or undue influence, the right to have a document rectified and the right to the consolidation of mortgages are examples of mere equities. The right of a deserted wife to occupy the matrimonial home was thought to fall within this category but in National Provincial Bank Ltd v Ainsworth [1965] 2 All ER 472, the House of Lords categorised this as a personal right against the husband.

**Bona fide purchaser principle**

When the concept of the trust was being developed by equity, one of the problems that had to be addressed was what were the rights of the beneficiary if the trustee transferred trust property to a third party in breach of trust. The solution that equity imposed is not surprising when it is recalled that the courts proceeded on the basis of principles of conscience. If the trustee transferred the trust property to a purchaser who was acting in good faith, who gave value for the property and who had no notice of the equitable interests existing in the property, equity saw no reason why the purchaser should be treated as having acted unconscionably and so there was no reason why equity should allow the claim of the beneficiary to prevail. It can be said that the claims of the beneficiary and of the third party are equally valid and that in such a case the equitable maxim 'where there is equal equity, the law prevails' is applicable to protect the third party. In other words, the purchaser's legal estate is allowed to prevail over the equitable interest of the beneficiary.

An example of the *bona fide* purchaser rule in action is to be found in *MCC Proceeds Inc v Lehman Brothers International (Europe)* [1998] 4 All ER 675. Macmillan Incorporated (M) was a company taken over and controlled by Robert Maxwell and members of his family. The company placed shares in Berlitz International Inc, a wholly owned subsidiary, together with the share certificates in the name of Bishopsgate Investment Trust plc (a nominee company controlled by Robert Maxwell). An agreement declared that Bishopsgate held the legal title to the shares as nominees for M, which retained the beneficial ownership in the shares. The agreement stated that Bishopsgate would immediately transfer the shares to M on M's written demand. Bishopsgate then, in breach of trust, pledged the certificates with the defendants as collateral under a stock-lending scheme. M knew nothing of this. The defendants were unaware of the interest of M. The shares were later sold by the defendants. The Court of Appeal said that, as the defendants were *bona fide* purchasers of the legal interest in the shares and had no notice of the claim of M or of the breach of trust by Bishopsgate, the interest of M was overreached and the defendants took free of any interest of M.

The *bona fide* principle is obviously important but it is limited. It does not apply if the trust property is acquired by a volunteer or by a purchaser of an interest other than the legal interest. In this context the consideration provided can either be money or money’s worth or marriage consideration, which is recognised by equity, but not the common law, as being consideration. In these cases the claim of the beneficiary prevails and he is able to assert his rights against the third party. These situations are resolved by applying the maxim ‘when the equities are equal the first in time prevails’.
The *bona fide* principle only applies if the purchaser has no notice of the equitable interests. Notice can include actual and constructive notice. A person has constructive notice of matters of which he would have known had he made those inquiries which a reasonable man would have made. A purchaser will also be fixed with notice of facts known to his agents (e.g. his solicitor). This is called imputed notice.

### Impact of the 1925 property legislation

The 1925 property legislation attempted to make the transfer of real property simpler and is important in the area of trusts for two reasons.

#### Fewer legal estates

The Law of Property Act 1925 s 1 reduced the number of legal estates to two. These are the fee simple absolute in possession and the term of years absolute. Any other estate can now exist only in equity. For example, any future or life interests cannot exist as legal interests but can be equitable interests.

#### Modification of the *bona fide* principle

The importance of the *bona fide* purchaser principle was much reduced as a result of the 1925 property legislation. In many cases the *bona fide* principle was replaced with registration. Many equitable interests are registrable and registration is deemed to be actual notice to all persons. In other words, whether a third party takes subject to, or free from, an equitable interest depends on whether or not the interest has been correctly registered. If the interest has not been registered then a purchaser takes free of it even if he has actual knowledge: *Midland Bank Trust Co Ltd v Green* [1981] 1 All ER 153.

There were a number of difficulties with the *bona fide* principle which it was hoped would be overcome by registration. For example, the owner of an equitable interest could find that he had lost his interest, through no fault of his own, to a *bona fide* purchaser for value who had no notice of the equitable interest. Under a system of registration the owner of the equitable interest is able to protect himself by registering the interest. Purchasers could never be absolutely certain that they had undertaken a thorough enough investigation in order to take free of any interest which had not been revealed by their searches. The system of registration means that the purchaser simply has to inspect the register to know what interests will bind him.

The provisions relating to unregistered land were contained in the Land Charges Act 1925 (now the Land Charges Act 1972). Registered land is dealt with by the Land Registration Act 2002.

### Classification of trusts

There are several ways in which trusts can be classified, all of which have some value (see Figure 1.3). However, it is not proposed to discuss every possible method of classification but rather to concentrate on some of the more important categorisations. The reason for discussing classification at this point is primarily to introduce a number of terms and ideas which will be encountered throughout the book.
By method of creation

This method classifies trusts according to their method of creation. The majority of trusts discussed in this book are express trusts, i.e. trusts in which the settlor expresses an intention to create the trust. In the course of the book a number of trusts will be encountered which come into being without the express intention of the settlor.

Express trusts

These trusts are the product of the express and expressed intention of the settlor to create a trust. It may be that the potential settlor has not expressed himself as clearly as he might and that the court has to decide if a trust is actually intended; nevertheless, if the court finds that a trust is intended, it will be an express trust.

Resulting trusts

This type of trust comes into being when a settlor has set up a trust but the beneficial interest (or part of it) results or returns to the settlor. An example would be if a settlor transfers property to trustees but fails to name or describe the beneficiaries.

Another illustration of a resulting trust occurs if property is bought and conveyed into the name of someone else. Again, if property which is owned is conveyed into the name of another a resulting trust may arise. In both of these cases the person in whose name the property stands holds it on resulting trust for the purchaser or owner. In both of the examples in this paragraph a resulting trust will exist unless it can be proved that the transferor intended to make a gift to the transferee. For completeness it should be added that there are some situations (e.g. husband transferring property or having property conveyed into the name of his wife, and father transferring property or having property conveyed into the name of his child) where the presumption of advancement displaces the presumption of resulting trust and the law presumes that a gift was intended and so in these cases there will be a resulting trust only if the presumption of gift is rebutted.

Many resulting trusts may also be argued to arise as the result of the presumed intention of the settlor and are described as implied trusts. For further discussion, see Chapter 10.

Figure 1.3 Types of trust
Constructive trusts

It is generally agreed that in the main these trusts are imposed by the courts in response to fraudulent or unconscionable conduct. They are imposed irrespective of the intention of the trustee and in many cases it is clear that a trust was the last thing that the trustee contemplated. For example, a constructive trust may arise if property is transferred as the result of an individual exerting undue influence over another. Clearly, the intention of the person obtaining the property is to keep it for himself; nevertheless the court is very likely to decide that he holds it on a constructive trust for the person from whom the property was obtained. Another example of a constructive trust arises where a volunteer obtains trust property or trust property is sold to a purchaser who has notice of the trust. In either case if the property was transferred in breach of trust it will be held on constructive trusts for the beneficiaries under the original trust.

There is a wide range of other situations where the courts have been willing to impose constructive trusts but the accepted view is that in order to impose a constructive trust in a given case the courts need to find that the situation comes within the accepted, existing circumstances where a constructive trust can be imposed. In other words, although the courts are seeking to remedy unacceptable conduct they must work within the limits defined by precedent cases. There are a number of issues still at large in the area of constructive trusts.

First, the courts do not currently claim the power to impose a constructive trust every time there appears to be an injustice looking for a remedy. In *Eves v Eves* [1975] 3 All ER 768, Lord Denning did, however, assert the courts had such a power when he described a ‘new model’ of constructive trust. In *Hussey v Palmer* [1972] 3 All ER 744, he said it was a constructive trust which may be imposed ‘whenever justice and good conscience require it’. He said that this would enable the courts to provide a remedy allowing the aggrieved party to obtain restitution. This, in many ways, reflects the American view that constructive trusts are a remedial institution. The American courts will impose a constructive trust when they perceive an unjust enrichment in order to allow the benefit to be reclaimed by the person at whose expense it was obtained. In English law the constructive trust has traditionally been regarded as just another type of trust which comes into being in a different way from other trusts. At root it is just another form of the accepted ‘normal’ institutional trust. The view of Lord Denning has been rejected in a number of cases both on the ground of the uncertainty that such a power would bring and also because in many cases a constructive trust might be accompanied by unforeseen and unconsidered consequences. For example, the imposition of a constructive trust on a piece of property will remove it from a trustee’s creditors in the event of his later bankruptcy. This appears to many to be a rather unacceptable by-product of a desire to give one aggrieved individual a remedy, the burden of which will be felt by the remainder of the trustee’s creditors.

So it may be said that the remedial nature of the constructive trusts in the event of a finding of unjust enrichment is not presently accepted in the domestic courts although it is possible to argue that recent Commonwealth decisions indicate that this is a possible avenue of development for the near future. For further discussion of constructive trusts see Chapter 11.

Statutory trusts

A number of statutes impose trusts. Perhaps the most important examples of these statutory trusts arise in the context of the 1925 property legislation. The Law of Property Act
CLASSIFICATION OF TRUSTS

1925 ss 34–36 imposed a statutory trust for sale whenever land is co-owned. Also the Administration of Estates Act 1925 s 33 imposed a statutory trust for sale on the property of a person dying intestate.

The Trusts of Land and Appointment of Trustees Act 1996 (which came into force in January 1997) modifies that law in both these situations. Where property is co-owned the property will be held on a trust of land under which there is a power (not a trust) to sell coupled with a power to retain (Schedule 2 paragraphs 3 and 4). Property not effectively left by will is, under the Trusts of Land and Appointment of Trustees Act 1996, held on trust under which the personal representatives have a power of sale (Schedule 2 paragraph 5).

By type of beneficiary

Private trusts

Most of the trusts discussed in this book are private trusts in that they are set up to benefit either a single individual or a class of specified people.

Public trusts

These trusts are intended to benefit the public at large or at least a section of it. One of the commonest examples of a public trust is the charitable trust. One of the conditions for validity as a charitable trust is that it bestows a benefit on the public or a section of the public. Charitable trusts are discussed in Chapter 9.

By nature of beneficiaries’ interest

Fixed trusts

In a fixed trust the settlor states in the trust instrument the exact interest or share that each of the beneficiaries is to have. For example, if the settlor, Sam, transfers property to trustees to hold for his two children, Ben and Bill, equally, he has created a fixed trust. The shares of Ben and Bill have been precisely defined by Sam. The result of creating a fixed trust is that the beneficiaries have the beneficial ownership of property. Bill, for example, will be the owner of an interest equal to his share in the trust.

Discretionary trusts

Under such a trust the trustees are given the discretion to decide the extent to which beneficiaries are to benefit. For example, Sam may decide to transfer property to trustees to hold on a discretionary trust for his two children, Bill and Ben, giving the trustees the discretion to decide how Bill and Ben are to benefit from the income and the capital of the trust fund. Neither Bill nor Ben has any interest in the trust property. A discretionary trust may be exhaustive or non-exhaustive. Under an exhaustive trust the trustees are under an obligation to distribute the trust property; their discretion extends only to deciding which of the beneficiaries are to benefit and the extent of their individual benefit. If the trust is a non-exhaustive trust the trustees also have a discretion to decide how much of the trust property is to be distributed as well as determining what is to be allocated to which beneficiary.
CHAPTER 1 GROWTH OF EQUITY AND THE EVOLUTION OF THE TRUST

According to trustees’ duties

Simple trusts

A simple or bare trust exists where the trustees have no active duties to perform. The trustees are simply the holders of the legal estate. An example of a simple trust is if property is transferred into the name of a mere nominee for the ‘real’ or beneficial owner.

Special trusts

These are trusts where the trustees do have positive active duties to perform. Unlike the simple trust, the trustees have a responsibility which goes beyond merely holding the legal estate. This type of trust can be divided into ministerial and discretionary trusts according to the duties which the trustees have. If the trustees have merely routine, administrative duties, such as the collection of rent from trust property and holding it on a fixed trust, a ministerial trust will exist. By contrast a discretionary trust will exist if the trustee has to exercise his discretion or judgment in fulfilling his duties. For example, a trust which requires the trustees to make decisions as to whether or not to sell trust property will be classed as a discretionary trust.

By whether the trust property is vested in the trustees

This is a classification often used in textbooks but in fact is not a way of classifying trusts at all. It does in fact distinguish between trusts and non-trusts. If the trust property is vested in the trustees the trust is said to be completely constituted. This constitution can take place either by the property being legally transferred to the trustee or by the settlor declaring himself to be a trustee over the property. In either case, assuming no other vitiating factor exists, the trust will be completely constituted with the very important consequence that the beneficiaries have enforceable rights against the trustee and the trust property. If the trust is not constituted, because the trust property has not been transferred to the trustee (or the settlor has not effectively declared that he holds the property as a trustee), there will be no trust. All that will exist is the promise of the ‘settlor’ that he will create the trust. This promise may be a contractual promise or perhaps contained in a covenant. The would-be beneficiaries cannot sue on the promise unless they have provided consideration. As few would-be beneficiaries provide consideration this means that in the majority of situations the ‘settlor’ can ignore his promise and refuse to constitute the trust.

Distinction between a trust and other concepts

It is often important to decide in a given situation whether a trust or some other concept has been created. There are several concepts which, at least superficially, are similar to a trust and it is necessary to identify the characteristics of each of these concepts in order to be able to verify that it is a trust which is being considered and not something else.

Contract and Quistclose trusts

It is sometimes difficult to decide if a trust or a contract has been created. Of course the concepts are in theory totally different but in practice there is a grey area where classification causes problems, particularly in the area of debts.
DISTINCTION BETWEEN A TRUST AND OTHER CONCEPTS

Example

A situation where it could be difficult to determine if a trust or a contract exists might arise in the following example. Simon may transfer some shares to Tim and Tom with the object that the dividends on the shares will be applied for the benefit of Ben. There are (at least) two possible mechanisms that could be adopted to achieve this purpose but the legal implications of each would be different. There could be a contractual relationship between Simon, Tim and Tom under which Tim and Tom agree to look after Ben, or Simon could be the settlor of property, vesting the legal title to the shares in Tim and Tom who hold on trust for Ben.

The origins of the concepts are different, trusts being a creature of equity whereas contract was a development of the common law. This distinction is, however, of very little use in attempting a classification. It is probably most useful to examine the characteristics of the two concepts and then to see which most closely resembles the issue being considered.

Perhaps the most important feature of a contract is that it is usually the product of an agreement between the parties whereas a trust can be and often is the result of a unilateral decision by the settlor. No one’s agreement or consent is needed to create a trust and indeed it is quite possible that no consultation takes place between the trustees, the beneficiaries and the settlor.

In the law of contract the common law doctrine of privity prevents enforceable rights being acquired by those not parties to the agreement. However, in the law of trusts beneficiaries always obtain enforceable rights whether or not they are parties to the agreement creating the trust. This is perhaps the single most important characteristic of the trust and has been used as the basis of attempts to circumvent the contractual rule of privity of contract. It has been argued that it is possible to contract as the trustee for a third party and that a trust is created of the promise. This would then entitle the beneficiary to enforce the promise if the trustee will not. It is beyond doubt that it is possible to create trusts of promises but the difficulty in this attempt to override the privity rule is that in order for a trust to exist there must be a clear intention to create a trust. In many contractual situations it has proved impossible to satisfy the courts that this intention existed. This attack has been of very limited success and is generally thought to have an unpromising future.

The common law doctrine of privity of contract has been modified by the Contracts (Rights of Third Parties) Act 1999 under which a non-contracting party is able to enforce a contractual term if the contract expressly allows him to do so or a term purports to confer a benefit on him (unless the contracting parties intended otherwise). The Act applies to contracts made after 11 May 2000. If the Act applies to contracts to create trusts (the wording of section 1(1)(b) and section 1(1)(3) seems to apply to beneficiaries under a trust) third parties will have a right to a remedy. But, the right given under the Act is a common law remedy in contract. In some cases this may not be of much help, where the third party wishes to assert a right in equity. To the extent that the Act does apply it will reduce the need to seek ways of circumventing the rule of privity of contract and thus the need to seek the aid of the trust.

Another distinction between the two concepts is that a contract creates rights which are merely personal whereas a trust creates property rights. The remedy for a breach of contract is the personal remedy of damages. A breach of trust renders the trustee personally...
CHAPTER 1 GROWTH OF EQUITY AND THE EVOLUTION OF THE TRUST

liable to compensate the trust for any loss suffered but additionally proprietary remedies may be available. See page 456 for further discussion of personal liability and page 465 for further discussion of proprietary remedies.

Particular problems of classification occur if Arthur, for example, transfers money to Ben. If the transaction simply creates a debt then the rights of both parties are regulated by the law of contract and, subject to the terms of the contract, the debtor is under an absolute liability to repay the loan. The fact that he no longer has the money is irrelevant. He may have had the money stolen or the money may have been lost as the result of an unfortunate investment but nevertheless the obligation to repay remains. If the debtor becomes bankrupt Arthur will have to reclaim the money as one of Ben’s creditors and will be competing with all the others to whom Ben owes money. So it is probable that Arthur will be unable to recover more than a small proportion of what Ben owes to him.

However, if the transfer of the money creates a trust the position is rather different. It may well be that, if the money is lost without any fault on Ben’s part, he will not be liable to repay. Also, the money will be ‘safe’ if Ben becomes a bankrupt as property held as a trustee does not pass to the trustee in bankruptcy and is not available to the general creditors. Instead, the property remains available (only) to the beneficiaries under the trust.

However, confusion may arise from the fact that a loan and a trust may exist side by side! This is often regarded as an opportunity for a well-advised lender to protect himself against the possible bankruptcy of the borrower. While this is obviously advantageous to the lender in question it is disadvantageous to other creditors as it removes a possible source of funds against which they could claim.

**Barclays Bank v Quisclose Investments Ltd [1968] 3 All ER 651**

In this case the House of Lords found no problem in finding that there was both a debt and a trust involved in the same transaction. A company, Rolls Razor Ltd, declared a dividend but there were no funds from which to make the payment to shareholders. A loan was negotiated from Quisclose Investments Ltd which was made on the condition that ‘this amount will only be used to meet the dividend due’. The cheque was paid into a separate account with Barclays Bank and the bank agreed that the money was only to be used to fund the dividend payments. Rolls Razor Ltd went into liquidation before the dividend was paid and the question that the House of Lords had to decide was whether a trust had come into being with the lender as the beneficiary, because if it had the lender would be able to reclaim the money. If only a debt existed the lender would have no special claim and would have to compete with all the other creditors. The House of Lords held that the essence of the bargain between the lender and the borrower was that the money would not become part of the general assets of the borrower but that it should be used only to pay the dividend and for nothing else. If for some reason the money was not used to pay the dividend the parties intended that it should be returned to the lender. The fact that the loan was to be ‘only’ for the purpose of paying the dividend could only mean, in the view of the House of Lords, that if the money was not so used it was to be returned to the lender. The way in which this intention would be implemented was via the creation of a trust. The money was received on trust to apply it to the payment of the dividends and when that purpose failed the money was held on trust for the lender. The initial trust, in favour of those entitled to a dividend, was described as the ‘primary trust’ by the House of Lords. The trust in favour of the lender that arose when the purpose was not carried through and which then replaced the primary trust was described as the ‘secondary trust’.
DISTINCTION BETWEEN A TRUST AND OTHER CONCEPTS

See also below and pages 73, 89 and 248 for further discussion of Quistclose trusts.

In Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd [1985] 1 All ER 155, the court found that a trust had been created in respect of a debt that already existed and Peter Gibson J accepted that those who were intended to benefit had the right to enforce the trust but were not beneficiaries under the trust in the normal sense of the word.

In Re Kayford [1975] 1 All ER 604, the court decided that a trust had been created when deposits for goods ordered by post were placed in a special 'Customers’ Trust Deposit Account’. In this case the trust was imposed by the debtor whereas the trust was imposed by the creditor in Barclays Bank v Quistclose Investments Ltd (1968). But in both cases the intention was that the money was to be used for the prescribed purpose and no other. It appears that this is the vital element that the court will look for before deciding that a trust has been created. This is the key factor to establish that the money was not intended to form part of the general assets of the borrower. It seems that while the setting up of a special fund, as happened in both Quistclose and Re Kayford, does help to establish that the money was not to become part of the funds of the borrower, it is not essential to create the separate fund in order to persuade the court that a trust has been created. Re Kayford sounded a warning as to the possible restriction of the principle when it was said that different considerations may arise in the case of trade purchasers.

The case of Re Challoner Club Limited (1997) The Times, 4 November, is an example where the court was not willing to find a Quistclose trust on the ground that the terms of the proposed trust were not sufficiently certain. A club (operating through a company) was in financial difficulties and its members agreed to pay extra contributions, and the board was empowered to take steps to ensure the continuation of the club.

The board stated: ‘As members will naturally want to know the position regarding the payments being made for subscriptions and donations, the position is that a separate bank account has been brought into being for these monies. They will remain in that account until the club’s future is decided.’

Lloyd J said:

The difficulty, it seems to me, that is faced by the argument in favour of a trust is to know what the terms of the trust are. In Re Kayford it was clear what was the event on which the company was able to draw on the money in the special customers’ trust deposit account, namely the company satisfying the order in respect of which the payment was made.

In the other cases that were cited to me... again it was clear that there was an event on which the payment would become, as it were, unconditional.

In the instant case the circumstances in which the payment would become unconditional were referred to in a number of different ways. During argument counsel submitted that the purpose of the payment – and the only purpose for which the payment could be used – was to help the club in the event that it was able to continue. Then counsel put it slightly differently in that the money could only be spent for the saving of the club. In a circular of 24 September the phrase ‘the money in the special account will not be touched until the future is known’ was used. In an affidavit, the phrase ‘these donations are in an escrow account and are only available to the club if it is able to utilise the monies to survive’ was used.

Lloyd J said:

If these monies were to be held on a valid and binding trust, it must have been possible to spell out with certainty the circumstances in which the money became available to the club to be used for its general purposes; and conversely the circumstances failing which their
being satisfied the money became repayable to the member who had provided the money. It seems to me that what the directors were doing was entirely commendable in attempting to segregate the fund and to create a ring-fenced fighting fund or rescue fund, but it seems to me that they did not succeed in that attempt because there is no adequately precise definition of the circumstances in which the company was to be able to use the money.


The result was that the funds were available for the creditors of the club generally, and not only to the members as would have been the case had a trust been established.

R v Common Professional Examination Board, ex p Mealing-McLeod (2000) The Times, 2 May, is a more recent, although it would appear straightforward, example of a Quistclose trust being found by the Court of Appeal.

A litigant was required to pay money into court as security for costs in relation to an action against the Common Professional Examination Board. She borrowed £6,000 from Lloyds Bank. Clause 2(c) of the loan agreement stated: ‘You must use the cash loan for [the] purpose specified . . . You will hold that loan, or any part of it, on trust for us until you have used it for this purpose.’

In the event the action was settled. The issue was who was entitled to the £6,000 paid into court. The litigant was already indebted to the Board in respect of the costs of earlier cases to the extent of about £20,000. The Board wished to be able to set the £6,000 against the £20,000 debt.

The court held that a Quistclose trust had been created with respect to the £6,000.

Roch LJ stated that in Quistclose, Lord Wilberforce had based the finding of the ‘Quistclose’ trust on the mutual intention of the parties and that the essence of the agreement in that case was that the sum borrowed should not become part of the assets of the company. It was intended that the loan should be usable only for a particular purpose – the payment of a dividend to the shareholders. If the money was not so used then the clear consequence was that the money should be repaid to the lender (under a resulting trust).

Roch LJ considered that in the instant case the language used in clause 2(c) was imperative. It was clear that the parties to the loan intended that the money should be subject to a trust (which did not end when the money was paid into court). The loan agreement – either expressly or by implication – provided that if the money was not used to satisfy an order for costs then the money would be held on a resulting trust to repay to the bank. If the appeal had failed and the money had been used to satisfy an order for costs, the matter would be one of loan only and not of trust. It was held that the bank was entitled to be repaid the £6,000.

The case of Twinsectra Ltd v Francis John Yardley [1999] Lloyd’s Rep Bank 438 involved another, though perhaps unusual, example of a Quistclose trust. The following account relates only to the Quistclose issue in the case and it is debatable whether or not the decision on this point is correct. Twinsectra provided funds to companies owned by Yardley. The purpose of the loan was to acquire specific property. Yardley’s solicitor would not give Twinsectra an undertaking that the funds would be released for that particular purpose only. However, the solicitor passed his client on to a second solicitor, who did give the undertaking. On the basis of the undertaking, Twinsectra transferred the funds to the second solicitor. The funds were then paid to Yardley’s companies on the direction of the first solicitor. The first solicitor knew that the funds were not going to be used for the specified purpose. Some of the funds were used by the second solicitor to settle the first solicitor’s bill for work done for Yardley. As soon as Twinsectra found out about the fraud, they started an action against Yardley in deceit and in contract, and against
the first solicitor for knowing receipt and knowing assistance. Success of the claims against the first solicitor depended on finding a breach of trust or fiduciary relationship by the second solicitor. Part of the finding of the Court of Appeal was that there was a *Quistclose* trust under which the second solicitor owed Twinsectra a duty not to release the money save for the agreed, specified, purposes. The trust arose through a combination of factors: the agreed specific purpose and paying the funds into a separate bank account. When the first solicitor instructed the second solicitor to release some of the funds, he had acted dishonestly. The first solicitor was thus liable for knowing receipt of that part used to pay his bill and for knowing assistance in respect of the rest of the fund.

The difference between *Twinsectra* and *Quistclose* was that in *Twinsectra* the funds were wrongly applied, whereas in *Quistclose* the purpose for which the loan had been obtained could not be achieved and the funds remained unused. Potter LJ stated that the interest of the lender arose under a ‘quasi’ trust. Under this trust the lender’s rights were (he said) only to prevent the fraudulent use of the fund. So long as the primary purpose was capable of being carried out, the equitable interest in the fund was in suspense. If the purpose had failed (as in *Quistclose*), there would be a resulting trust under which the lender would hold the equitable interest. But here the money had been misapplied. Potter LJ said that in this situation the equitable interest passed to the transferee. It may be argued that this may not be correct. It may be argued that, in cases of misapplication (just as in cases of the failure of the purpose), the secondary (resulting) trust should have sprung up.

The House of Lords (*Twinsectra Ltd v Yardley and Others* [2002] 2 All ER 377) unanimously confirmed the Court of Appeal decision that a trust did exist. However, four of the Law Lords did not mention *Quistclose* in their judgments – although, to be fair, only two of them delivered judgments of any length.

The *Quistclose* case raises several issues and problems. As will be seen in Chapter 8, the law does not generally permit trusts for purposes as opposed to trusts with human beneficiaries, yet the trust in this case appears to be a trust for a purpose – to pay a dividend. Perhaps the shareholders in Quistclose were the beneficiaries. If so, what would be their rights? Perhaps the trust resembles that accepted as valid by Goff J in *Re Denley* [1968] 3 All ER 65 under which ascertainable human ‘beneficiaries’ received a sufficiently direct and tangible benefit so as to give them a *locus standi* to enforce the trust. This was the attitude taken by Megarry V-C in the unreported case of *Re Northern Development (Holdings) Ltd* (6 October 1978) which was discussed by Peter Gibson J in *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] 1 All ER 155. Again it is not clear exactly what rights such ‘beneficiaries’ would have under the trust. Such beneficiaries clearly would not obtain a full beneficial interest. What they do have is the right to compel due administration of the trust. By this means the trust can be controlled by the courts.

What would have happened if the loan had been used for the intended purpose? Presumably the relationship would be that of creditor/debtor and the lender would rank as a ‘normal’ creditor. In *Re EVTR* [1987] BCLC 646, Dillon LJ opined that in such a case the lender would indeed be in the position of an unsecured creditor.

*Freeman v Customs and Excise Commissioners sub nom: Margareta Ltd (in liquidation)* [2005] EWHC 582 is a case on *Quistclose* trusts. Although it does not appear to make any new points, it is an illustration of when *Quistclose* trusts arise and the effect of such a trust.

A company had sold a property to a purchaser for £3.96 million plus VAT if payable. The purchaser was not willing to pay VAT to the company before it had been decided if, in fact, VAT was payable. An agreement was made under which money to cover the possible
VAT bill was held by the company’s solicitors on terms set out in a letter from the solicitors which stated that the VAT money would be held by the firm until a VAT invoice had been issued and the appropriate payment to the commissioners had been negotiated and paid. The solicitors advanced the money to an accountant to deal with the VAT issue. The accountant misappropriated the money. As a result VAT due was not paid and as a consequence of this the company was wound up following a petition by the commissioners. Was there a *Quistclose* trust?

The court stated that a *Quistclose* trust does not arise unless the person advancing money clearly intended to restrict the freedom of the recipient to dispose of the money being advanced to discharging the stipulated purpose, *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 applied. In the instant case, it was clearly intended that the money should not be at the free disposal of either the solicitors or the company. In the circumstances, the solicitors could only have received the money as trustees and the company had no beneficial interest in it.

Thus it was decided that the money was held on a *Quistclose* trust. Money recovered from the accountant (who was acting as the agent of the solicitors) was payable to the Customs and Excise Commissioners to cover the VAT liability. It was not available for distribution on the liquidation of the company.

A more recent, first instance, decision – *Templeton Insurance Ltd v Penningtons Solicitors LLP* [2006] All ER (D) 191 – is an illustration of the advantages that a *Quistclose* trust can bring to lenders of money.

A company agreed to provide funds for the purchase of land. It was planned that the land would be quickly sold and that the company would take a share of the profit. The company insisted that a solicitors’ undertaking was provided under which the solicitors undertook to use all reasonable efforts to buy the land and that the money would be placed in its client account. The solicitors further undertook that, if the purchase was delayed, the money would be placed in an interest bearing account. In the event the purchase price was less than half of what had been provided by the company. Some of the money was used for purposes that were not connected to the land purchase.

It was clear that the parties had not intended that the solicitors would be free to dispose of the funds without restriction. It was clear that the solicitors were to have limited use of the funds for the stated purpose.

The money was thus held on a *Quistclose* trust and so it was a breach of trust when part of the money was used for purposes unconnected with the land purchase. The company successfully claimed compensation and a proprietary interest in the balance in the solicitors’ client account.

The solicitors conceded (following an earlier hearing) that when the money was paid over by the company it was held by them on trust for the company with the company retaining beneficial ownership. There was a resulting trust in the company’s favour only subject to a power for the solicitors to use money to buy the land. As the solicitors’ use of the money was limited, when they used part of the funds for purposes unrelated to the purchase it was a breach of trust. Thus the company was entitled to judgment for the sums listed in its particulars and for the balance held in the client account.

**Nature of a *Quistclose* trust**

It is not absolutely clear from *Quistclose* what type of trust came into existence. Express or resulting? Discussions in *Westdeutsche Landesbank v Islington London Borough Council* [1996] 2 All EK 961 and *Twinsectra* may help to throw some light.
In *Westdeutsche Landesbank v Islington*, Lord Browne-Wilkinson regards the trust as a resulting trust and the generally agreed analysis is that it is such a trust, rather than, for example, a constructive trust that arises when the help of the court is sought by the borrower.

In *Twinsectra*, although other Law Lords did not, Lord Millett did discuss *Quistclose* and subjected the issue to detailed analysis. Although Lord Millett did agree with the Court of Appeal that a trust was created he disagreed on the Court of Appeal’s analysis of the trust that was created.

On the ‘loan/trust’ issue, Lord Millett said:

Money advanced by way of loan normally becomes the property of the borrower. He is free to apply the money as he chooses, and save to the extent to which he may have taken security for repayment the lender takes the risk of the borrower’s insolvency. But it is well established that a loan to a borrower for a specific purpose where the borrower is not free to apply the money for any other purpose gives rise to fiduciary obligations on the part of the borrower which a court of equity will enforce. [In other words a ‘*Quistclose*’ trust is created.]

The lender pays the money to the borrower by way of loan, but he does not part with the entire beneficial interest in the money, and in so far as he does not it is held on a resulting trust for the lender from the outset . . . it is the borrower who has a very limited use of the money, being obliged to apply it for the stated purpose or return it. He has no beneficial interest in the money, which remains throughout in the lender subject only to the borrower’s power or duty to apply the money in accordance with the lender’s instructions. When the purpose fails, the money is returnable to the lender, not under some new trust in his favour which only comes into being on the failure of the purpose, but because the resulting trust in his favour is no longer subject to any power on the part of the borrower to make use of the money.

In other words, the ‘primary trust’ that Lord Wilberforce described in *Quistclose* is not really a trust at all. The lender retains a right or interest in the money. If the purpose fails, the lender’s claim is rooted in the resulting trust (see below).

Lord Millett emphasised that in order to create a trust, it was not necessary for the parties to explicitly think or believe that they were creating a trust. Subjective intentions are not relevant. What is needed is that the parties enter into an arrangement that has the effect of creating a trust. He went on to say that arrangements of the kind made in the instant case are not intended to provide security for repayment of the loan, but to prevent the money from being applied otherwise than in accordance with the lender’s wishes.

Lord Millett stated that the essence of a *Quistclose* trust is not that there is merely a situation where money is paid for a particular purpose. The key question in every case is whether the parties intended the money to be at the free disposal of the recipient.

In the present case, Lord Millett said, the undertakings were crystal clear. The money was taken on the basis that it would be used solely for the acquisition of property and for no other purpose; and was to be retained by the firm until so applied. Any payment otherwise than for the acquisition of property would constitute a breach of trust.

Lord Millett then examined the nature of the *Quistclose* trust and the several competing theories.

Having referred to Lord Wilberforce’s judgment in *Quistclose*, he said that the passages suggest that there are two successive trusts – a primary trust for payment to identifiable beneficiaries, such as creditors or shareholders, and a secondary trust in favour of the
lender arising on the failure of the primary trust. In many ways this is the normally accepted analysis.

However, Lord Millett raised a number of problems with this solution and said: ‘... there are formidable difficulties in this analysis, which has little academic support. What if the primary trust is not for identifiable persons, but as in the present case to carry out an abstract purpose? Where, in such a case, is the beneficial interest pending the application of the money for the stated purpose or the failure of the purpose?’

Lord Millett listed and discussed four possible solutions – (i) in the lender; (ii) in the borrower; (iii) in the contemplated beneficiary; or (iv) in suspense – before stating that in his view solution (i) is correct.

Like all resulting trusts, the trust in favour of the lender arises when the lender parts with the money on terms which do not exhaust the beneficial interest. It is not a contingent reversionary or future interest. It does not suddenly come into being like an eighteenth-century use only when the stated purpose fails. It is a default trust which fills the gap when some part of the beneficial interest is undisposed of and prevents it from being ‘in suspense’.

It is open to doubt as to who can enforce the Quistclose type of trust but it seems probable that only the provider of the money may enforce.

**Bailment**

If goods are delivered to a bailee they will be held for a particular purpose after which they will be re-delivered to the bailor. Depositing goods for repair or for safe keeping are examples of bailments.

There is a clear but superficial similarity between a trust and a bailment. In both cases property may be ‘handed’ over and the recipient takes the property subject to certain duties and responsibilities. However, there are a number of crucial differences between the two concepts, perhaps the most important being that a trustee does, but a bailee does not, obtain full legal ownership of the property. This means that while a trustee can pass good title to any third party (other than a bona fide purchaser for value of the legal estate) a bailee cannot. There are other differences: for example, bailment is the creation of the common law while the trust was developed by equity. Also, while any type of property can be made subject to a trust, only personalty can be bailed.

**Agency**

While there may be similarities between an agent and a trustee there is at least one important distinction. A trust creates proprietary rights whereas agency creates only personal rights. This will be important if it is sought to recover money or property. Under a trust there will be rights created against the property itself, while only personal claims against the agent can be made. This can be particularly important if the one against whom the claim is being made has become bankrupt. In cases of trust a claim can be made against the trust property whereas it is only possible to make a claim against an agent personally, which may have little chance of success if the debts of the agent greatly exceed his assets.

The office of trustee and agent are similar in that both have to be performed personally and often an agent, like a trustee, is in a fiduciary position.
**Administration of estates**

At first sight there would seem to be a similarity between the position of those administering the estate of a deceased person and trustees. The persons administering the estate of a deceased are called *personal representatives* which includes both *executors* and *administrators*. An executor is appointed by a testator in his will. If there is no executor, perhaps because the deceased died *intestate*, the court will appoint the personal representatives, who are called administrators.

Both trustees and personal representatives hold property, not for themselves but for other people, and both are under a fiduciary duty. These factors point towards similarity between the two offices.

The apparent similarity between trustees and personal representatives is partly due to the fact that in many cases a deceased will appoint the same persons to be both his executors and his trustees. In this type of situation it is often rather difficult to determine when the changeover from personal representative to trustee takes place. The generally accepted view is that once all the assets have been gathered in and the debts paid the residue will be held *qua* trustees. This means, for example, that from that date the powers contained in the Trustee Act 1925 to appoint new trustees can be used. However, it seems that the office of personal representative does not totally disappear once the residue has been ascertained but rather it fades into the background. The appointees remain liable for any breaches of duty committed while acting as personal representatives.

Also the apparent similarity of the two offices is indicated by the Trustee Act 1925 s 68(17), which states that ‘trustee’ includes ‘personal representative’ where the context permits.

There are differences, however, between personal representatives and trustees. The main objectives of personal representatives are to gather in the assets of the deceased, to pay off debts and to distribute whatever remains to those entitled under the will (or the intestacy rules if there is no will). In other words, the personal representative aims to deal with the property and to pass it on as quickly as possible. The role of a trustee is in many cases a longer-term one. He may well be expected to hold and administer the trust property for many years. For example, if the property is to be held on trust for Arthur for life, remainderer to Ben, the trustee would expect to be involved with the trust until Arthur dies and even then the responsibility will continue unless and until Ben calls for the trust property to be transferred to him.

Another important difference lies in the power to dispose of *personal property*. One of several personal representatives can pass title to personalty but all trustees must join in if the sale is to be effective.

As mentioned above, it is not uncommon to appoint the same persons as personal representatives and trustees and it may be important to determine in which capacity property is held, and at what point the property is no longer held *qua* personal representatives but is held *qua* trustees. If a transfer is purported to be made by trustees, the purchaser must assure himself that the property has been vested by the personal representatives in the trustees, otherwise he will not receive good title. If the property is personalty, the courts appear to be prepared to find an implied assent (transfer from personal representative to trustee) by reference to conduct. This can sometimes work to the disadvantage of one acquiring property.

In *Attenborough & Son v Solomon* [1911–13] All ER Rep 155, Moses Solomon appointed his two sons, A A Solomon and J D Solomon, to be his executors and trustees. He directed that the residue of his property should be held on specified trusts. All the
debts and expenses were paid within a year of the death. Some silver plate, which formed part of the residuary estate, remained in the possession of A A Solomon. Some 14 years after the death of the testator A A Solomon pledged the plate with Attenborough & Son for £65 and used the money to pay off a personal debt. The House of Lords held that Attenborough & Son had no title to the plate and must return it. The House inferred from the fact that the general administration had been completed, and that no attempt had been made to do any act under their powers as executors since that time, that the executors had assented to the vesting of the property in themselves as trustees. As trustees must act together to deal effectively with personalty, the title to the plate remained with the trustees.

However, if the property is land then the provisions of the Administration of Estates Act 1925 s 36(4) states that any assent to the vesting of the legal estate in land must be in writing, signed by the personal representative and must name the person in whose favour it is made. This means that even if the same people are appointed to act as personal representatives and trustees the legal estate will not vest in them unless they have signed a written statement naming themselves as those in whom the legal estate is to vest: Re King’s Will Trusts [1964] 1 All ER 833.

There is also a very important difference between the rights of beneficiaries under a trust and beneficiaries under a will. A beneficiary under a trust has an interest in property, an equitable interest, but a beneficiary under a will has no such right while the estate is being administered. On death the property of the deceased passes to his personal representatives who hold the property subject to the obligations imposed upon them by their office. They do not hold as trustees on trust for those named in the will.

In the case of Commissioner of Stamp Duties (Queensland) v Livingston [1964] 3 All ER 692, the Privy Council decided that while the estate was being administered a residuary beneficiary had no legally recognised right to any particular piece of property that formed part of the deceased’s estate. The main reason given for this decision was that to create a trust there must be certainty of the property within the trust and that the residuary estate was a constantly fluctuating body of property. The property comprising the residue was liable to changes as more property was gathered in and property was transferred out or sold to raise money to pay debts. The court did state that beneficiaries did have a chose in action, a right to compel the due administration of the estate, and this provides an indirect way for beneficiaries under a will to ensure that any property is properly dealt with, including its transfer to those entitled to it.

It is probable that once the residue has been ascertained the personal representatives do hold the property on trust for the residuary beneficiaries. The residue is ascertained once all debts and other liabilities have been provided for and when it is clear exactly which property will be available for the residuary beneficiaries. At this stage it is possible to say, with certainty, what property is within the residue and so within the trust.

The case of Commissioner of Stamp Duties (Queensland) v Livingston (1964) concerned the position of a residuary beneficiary but it is generally agreed that the same principles also apply to the case of specific beneficiaries under a will.

**Conditions**

If Arthur receives a legacy under a will ‘to pay Ben £200’ it is necessary to decide whether a trust has been created or if Arthur takes a conditional gift.

It is a matter of construction whether a trust or a conditional gift has been created. As usual with equity, the words used are not necessarily conclusive. For example, in
DISTINCTION BETWEEN A TRUST AND OTHER CONCEPTS

Re Frame [1939] 2 All ER 865, Simonds J decided that a trust had been created despite the fact that the testator gave property to Mrs Taylor, his housekeeper, ‘on condition that she adopt my daughter Alma Edwards and also gives my daughters Jessie Edwards and May Alice Edwards the sum of £5 each’. Simonds J said:

The question is what those words mean . . . As I listened to that argument it impressed itself more and more on me that, after all, this was not a condition at all, for in my view, on the true construction of this clause, the word ‘condition’ is not used in its strict legal sense. It is a gift to Mrs Taylor on condition, in the sense of on the terms or on the trust that she does certain things, and that, I think, becomes clearer when it is realised that the condition relates not only to the adoption of one daughter, but to the payment of certain sums to other daughters. A devise, or bequest, on condition that the devisee or legatee makes certain payments does not import a condition in the strict sense of the word, but a trust, so that, though the devisee or legatee dies before the testator and the gift does not take effect, yet payments must be made; for it is a trust, and no trust fails for want of a trustee.

In the example above, if a conditional gift has been imposed, Arthur has the choice either to take the gift subject to an obligation to pay £200 to Ben or to refuse the gift. In the latter case Arthur will not receive anything, but neither will Ben as his £200 can only flow from Arthur's gift, which he has declined. Even if Arthur accepts the gift, Ben will have no interest in property.

If the will imposes a trust then Arthur will take the property as a trustee and Ben, as the beneficiary, obtains an equitable interest under the trust that he can enforce in the usual ways. If there is a surplus after Arthur has paid Ben his £200, it is a question of construction if Arthur is entitled to keep it or if he holds it on a resulting trust for the deceased's estate. If Arthur refuses to act as trustee, the trust will not be allowed to fail for lack of a trustee, and in the last resort the court will ensure that a trustee is appointed.

Powers

It is often necessary to distinguish between trusts and powers. We are not discussing here the powers a trustee may have to administer and manage the trust property, which will be dealt with in Chapter 14. The discussion rather relates to the situation when the owner of property gives the power to another to decide on the distribution or destination of that property. In other words, the powers we are addressing are powers of appointment.

Since 1925 most powers of appointment can exist only in equity: that is, they must be contained within a trust or settlement.

If property is left by will the testator may direct that Arthur is to decide who is to take the testator's land, Greenacre. The testator may direct that Arthur is to select one of his (the testator's) three children as the recipient of the land. It is very important to be able to decide if the testator has given Arthur a power of appointment or if a trust has been created.

The key point is that trusts are imperative while powers are discretionary. If Arthur has been given a power to appoint he is under no obligation to exercise the power and to make a decision as to which child shall receive the property. If there is a trust, however, there is no such discretion; the trust must be performed and Arthur is under an obligation to ensure that the property is allocated, and if Arthur, the trustee, fails to perform his duty, in the last resort the court will step in and decide how the property shall be distributed, and the wishes and intentions of the testator will be borne in mind. In the
context of a family trust this may involve equal division between the members of the class if this is thought to reflect the settlor's intention. In other cases the court may decide that equal division would be the last thing that the settlor would want and so equal distribution would not be appropriate (see e.g. McPhail v Doulton [1970] 2 All ER 228).

Many, if not most, trusts are fixed trusts: that is to say that the settlor stipulates or fixes the extent of the interests of the beneficiaries. For example, the settlor may transfer property to trustees to invest and to distribute the income produced equally between the settlor's three children. The trustees have no discretion; the settlor has mapped out exactly the interests of the three children. This type of trust causes no confusion with powers of appointment.

However, the settlor may transfer property to trustees on trust to invest and to distribute the income generated between the settlor's three children 'as the trustee thinks fit'. This is a discretionary trust as it imposes obligations to distribute on the trustee; the precise way in which the beneficiaries are to take is left to the discretion of the trustee.

There are two types of discretionary trusts. First, there is the exhaustive discretionary trust where the trustee is under an obligation to distribute all the specified trust property (perhaps all the income generated by the trust) and the discretion extends only to whom the property shall be given. Second, there are non-exhaustive discretionary trusts where the trustee need not distribute all the specified trust property. There may well be confusion if the transferor has left decisions regarding allocation of property to others as to whether a discretionary trust or a power of appointment has been created. There is an obvious possibility of confusion between a power and a non-exhaustive discretionary trust.

There is more room for confusion when it is appreciated that powers of appointment exist within trusts and it may be that it is the trustee who is given the ability to decide on the destination of property. His being a trustee does not mean that his responsibility with regard to the property is a trust rather than a power. The issue is, is he under an obligation to distribute the property (a trust), or is the allocation of property by him permissive (a power)? If the trustee is given a power it will be deemed a fiduciary power and the trustee is under the duty to consider from time to time whether or not to exercise the power, and must consider whether any particular appointment is appropriate. If he should fail to undertake this periodic consideration the assistance of the courts may be sought to direct the trustee to act correctly. Also, the objects of the power may ask the court to intervene if the trustee exercises the power in a capricious manner. This imposes a greater burden on a trustee-donee than in the case of a power given to a non-trustee (a personal power) who, as has been seen, need not do anything at all. The holder of a personal power need never think about the power and whether he should exercise it. The donee of a personal power is able to exercise the power in a capricious manner without the courts being able to intervene.

One of the main problems with powers and discretionary trusts is the degree of certainty with which the objects or beneficiaries must be described. The issue of certainty will be discussed at pages 93 and 129–33.

There are three types of powers of appointment. A general power exists where there is no restriction as to whom the property may be appointed. It is even possible for the property to be appointed to the person exercising the power. A special power describes the situation where the property can be appointed only among specified people or among a specified group or class of people. A hybrid power exists where the property may be appointed to anyone except specified people or a specified class of people.
DISTINCTION BETWEEN A TRUST AND OTHER CONCEPTS

There is a difference in terminology between powers and trusts. Under a trust, the settlor transfers the property to trustees who will hold for the benefit of beneficiaries. Under a power of appointment the power is given by the donor of the power to the donee who has the power to appoint the property to the objects of the power. In many cases the objects of powers of appointment are individuals but it is possible to create powers in favour of purposes. It will be seen in Chapter 8 that the law of trusts generally does not permit trusts to be set up for non-charitable purposes but powers in favour of purposes are allowed. Creating a power of appointment among a range of purposes may be an attractive alternative to one who wishes to benefit purposes but wishes to ‘delegate’ the decisions as to the precise purpose to benefit and the extent of any benefit. The problem in creating a power is that there is no possibility of the objects seeking the aid of the court if appointments are not made.

In some Commonwealth jurisdictions the courts have the ability to classify an attempt to create a purpose trust – which will generally be invalid – as a power and so to give some effect to the intentions of the transferor. The English courts have consistently refused to take this approach, saying that if as a matter of construction a trust is intended there is no way that the intention can be reclassified as an intention to create a power.

If the trustee does not exercise his discretion and distribute the property then, as seen above, the beneficiaries can seek the help of the court and in the last resort the court will order the manner in which the property is to be distributed. In the case of a power of appointment, if the donee simply does nothing the objects of the power have no redress. If the power is never exercised the property will either revert to the donor (or his estate if he is dead) or will pass to those named by the donor as being entitled in default of appointment. The only time that the objects of the power can expect the help of the courts is if the donee makes an appointment outside the terms of the power.

Both the beneficiaries under a discretionary trust and the objects of a power of appointment have no guarantee that they will receive any benefit but there is a difference between their respective positions. Under a power the equitable ownership of the property is in those entitled in default of appointment whose interest is liable to defeasance if and when the power is exercised. An object of a power of appointment has no interest at all until the power is exercised in his favour. The precise nature of the interest of a beneficiary under a discretionary trust was considered in *Gartside v IRC* [1968] 1 All ER 121. The House of Lords stated that the beneficiaries under a non-exhaustive discretionary trust were in competition with each other and had individual rights. Anything given to a particular beneficiary was his and his alone. This also appears to be the position in the case of an exhaustive discretionary trust. All a beneficiary has is the right to be considered and the right to seek the assistance of the court in the event of the trustees’ maladministration of the trust. A beneficiary may also apply to the court if the trustees refuse to exercise their discretion or exercise it improperly. It is very difficult to see where the equitable interest in the trust’s property is, pending the trustees exercising their discretion and passing it to one of the beneficiaries. What is clear is that no single beneficiary has an equitable interest pending allocation to him, nor do the beneficiaries collectively own the beneficial interest. Perhaps it is simply in suspense pending the trustees exercising their discretion. (See also page 124.)

Whether a trust or a power of appointment has been created is a matter of construction for the courts. As stated above the key characteristic of a trust is its mandatory nature. Thus, the conclusive indication of an intention to create an exhaustive discretionary trust is that the beneficiaries are to benefit in any event. A trust involves the clear intention that the property will be distributed among the beneficiaries and the only
uncertainty is to which of the beneficiaries will it be given. The absence of this mandatory element necessarily means that a trust has not been created. One indication of an intention to create a power rather than a trust is the presence of an express gift over in default of appointment. The argument is that the transferor (to use a neutral word) cannot intend that the property must be distributed to the beneficiaries in any event (i.e. a trust) since if this were his intention there would be no possibility of the property not being distributed and so there could be no property remaining over which the gift over in default could operate. In other words the existence in the transferor’s mind of the possibility that property may not be distributed (evidenced by the transferor’s desire to determine the destination of such property by means of a gift over in default) can only indicate that a power and not a trust was intended. A gift over in default is needed only if it is envisaged that the property may not be distributed, for example, in the context of a power of appointment, the exercise of which is always optional not compulsory. It must be stressed, however, that the absence of a gift over in default of appointment does not mean that there is a trust but only that as a matter of construction there may be a trust. But the presence of a gift over does mean that there cannot be a trust.

**Burrough v Philcox (1840) 5 My & Cr 72**

The settlor, S, gave his surviving child power to distribute S’s estate among S’s nephews and nieces ‘either all to one of them, or to as many of them as my surviving child shall think proper’. The child died without making the choice. In accordance with general principles the power itself could not, of course, be exercised since the discretion lay with the child, who was dead. The court concluded that the words of the settlor indicated an intention that the class, i.e. the nephews and nieces, should as a whole benefit in any event and so the court in effect implied a trust for equal distribution in default of appointment. In other words, it was as if the settlor had made a gift over to them equally in default of the power to select being exercised.

In this case, Lord Cottenham found that a trust and a power both existed. He decided that property was initially subject to a power of appointment but that when the power was not exercised the intention was that the property should be distributed and that the class as a whole should benefit in any event. In other words, the court found a trust for equal division in default of the power being exercised. In the case, the testator gave a life interest in property contained in a trust fund to his two children with remainders to their issue. The testator stated that if each of the children should die without leaving lawful issue then the survivor of the two children should have the power to dispose of the property by will among the testator’s nephews and nieces, or their children ‘as my surviving child shall think proper’. There was no gift over in default of appointment. The testator’s two children did both die without leaving lawful issue. Lord Cottenham said, after reviewing a number of cases, that the courts would carry out the general intention in favour of a class where there has been a failure to exercise a power of appointment and to select individuals from within that class.

Lord Cottenham said:

. . . when there appears a general intention in favour of the class and a particular intention in favour of particular individuals of the class, to be selected by another person, and the particular intention fails from the selection not being made, the court will carry into effect the general intention.

Lord Cottenham said that the intention will be implemented by fastening a trust on to the property. In this particular case, Lord Cottenham felt that equal division would reflect the intention of the testator. This was, of course, a family trust.
In *Re Weeke’s Settlement* [1897] 1 Ch 289, the court found that a power had been created in a case where there was no express gift over in default. Mrs Slade gave her husband a life interest in some property and went on to state ‘and I give him the power to dispose of all such property by will amongst our children’. No appointment was made by the husband. If a trust had been imposed on the husband the children would have been entitled to take, but as a power had been created, the property resulted back to the estate of Mrs Slade. Romer J said:

If in this case the testatrix really intended to give a life interest to her husband and a mere *power* to appoint if he chose, and intended if he did not think fit to appoint that the property should go on default of appointment according to the settlement, why should she be bound to say anything more than she has said in this will?

Romer J then asked if there was any authority which prevented him from concluding that a power was intended:

The authorities do not shew, in my opinion, that there is a hard and fast rule that a gift to A for life with a power to A to appoint among a class and nothing more must, if there is no gift over in the will, be held a gift by implication to the class in default of the power being exercised. In my opinion the cases shew . . . that you must find in the will an indication that the testatrix did intend the class or some of the class to take – intended that the power be regarded in the nature of a trust – only a power of selection being given, as for example a gift to A for life with gift over to such of a class as A shall appoint.

Having failed to find an intention that the class should benefit in any event, Romer J held that a power had been created. See also pages 121–22.

### Taxation of trusts

Many trusts are created (or created in a particular form) to try to avoid or reduce tax for the settlor, the beneficiaries or both. Recent tax changes may well have reduced the attractiveness of trusts as a tax saving vehicle.

In a tax context 2010 was unusual in that there were two budgets. The first, in March, was that of the Labour Government, the second, in June, was the Coalition Government’s ‘emergency budget’. The three taxes that are of main concern are income tax, capital gains tax and inheritance tax (although stamp duty and VAT are sometimes relevant). All figures used for tax rates, personal allowances etc. are, wherever available, those for tax year 2011/12. It is beyond the scope of this book to deal with these taxes other than in outline.

#### Income tax

Income tax is levied on income. The law is contained in the Income and Corporation Taxes Act 1988, as amended by subsequent Finance Acts. For individuals, in 2011/12 the basic rate of income tax is 20 per cent. The higher rate, charged on taxable income between £35,000 and £150,000 is 40 per cent. Any taxable income above £150,000 is taxed at 50 per cent. For 2011/12 the personal allowance for individuals is £7,475 – there are higher personal allowances for some categories of taxpayers, including those aged 65 years or over and blind taxpayers.
Taxing trusts

The income generated by trust property is liable to income tax and the income is, in general, treated at this stage as belonging to the trustees and not to the beneficiaries. (The exceptions to this are where there is a bare trust in which case the beneficiary is directly liable to tax – *Baker v Archer-Shee* [1927] AC 844 – and where the income accrues directly to the beneficiary – *Williams v Singer* [1921] 1 AC 65.)

The income is not treated as a part of the trustees’ personal income, they are taxed separately from their own income and the tax charged does not relate at all to the personal circumstances or income of the trustees. They are not entitled to a personal allowance to set against the income. Personal allowances are available only to ‘individuals’ and trustees are not classified as individuals. Also, the higher rates of income tax (currently 40 and 50 per cent) are payable only by individuals and so the trustees are not liable to it but they are liable to the ‘trust rate’.

Levying tax on the trustees has at least one advantage to HMRC in that if the income under a trust is to be accumulated (and so turned to capital) it will never be distributed to the beneficiaries as income. If the initial charge was on the beneficiaries, rather than on the trustees, this income would escape income tax.

The rate of tax applicable to trust income depends on the nature of the income and the type of trust. For interest in possession trusts, where the beneficiary has the right to receive the income, income which is not savings income (for example profit from a trade) is taxed at 20 per cent. If the income is dividend income the rate will be the ordinary dividend rate of 10 per cent (although some types of dividend income is taxable at 32.5 per cent). For other savings income the rate is 20 per cent.

If the trust is a discretionary trust or if the trustees have the power to accumulate the income the trustees are liable to ‘the rate applicable to trusts’. For 2011/12 this rate is 50 per cent. Dividend income is taxable at the special dividend rate applicable to trusts of 42.5 per cent. However, ‘the rate applicable to trusts’ is not payable on the first £1,000 of income. This band is liable to tax at the same rates as interest in possession trusts (see above).

Beneficiaries are liable to income tax on any income distributed to them or to which they are entitled. A beneficiary entitled under a discretionary trust is only liable to tax on income actually paid to him. All trust income paid over to beneficiaries by trustees will have been taxed in the hands of the trustees and is grossed up at the relevant rate to take account of tax paid by the trustees. (Grossing up involves a calculation. One must compute the sum which would, after deducting tax at the relevant rate, leave the amount actually received by the beneficiary. It is that grossed up sum that the beneficiary must declare as income.) For example, if a beneficiary receives £80 rental income under a fixed trust (taxed in the trustees’ hands at 20 per cent) he must show an income of £100 in his income tax return. This is because a gross sum of £100 after the deduction of income tax at the relevant rate (here 20 per cent) will leave £80. Whether any tax is payable on the trust income by the beneficiary depends entirely on his tax position. If, like most people, his marginal rate of tax (the rate payable on any additional income) is the basic rate there will be no more tax to pay. The tax credit will exactly match his liability to tax. If his marginal rate of tax is 40 per cent (the higher rate) then he will have an additional tax liability amounting to the difference between his tax credit and liability at the higher rate. At the moment this would amount to an extra charge of 20 per cent. If the marginal rate of the beneficiary is the lower rate, then a tax rebate may be claimed which will equal the amount of credit minus the rate that should have been paid. If the beneficiary should
not have paid any income tax on this income at all then he will be entitled to reclaim £20 (the amount equal to the tax credit) from HMRC. Examples of beneficiaries who are not liable to pay income tax are individuals whose income is below the level of the personal allowance and charities which are generally exempt from liability to income tax by statute. If the income is from dividends, the beneficiary cannot reclaim any tax credit whatever his income tax position.

It is possible to exploit the trust concept to save tax.

**Example**

Ivor Lott, a higher rate (40 per cent) taxpayer, takes money from his taxed income to make a series of gifts to his aunt, Mona Lott. The gifts come from his net income, so for each £2,000 which he gives to his aunt he has to earn £3,333, which, after bearing tax at 40 per cent, will produce the £2,000. He may decide to transfer a block of assets to trustees to hold on trust for his aunt. Ivor calculates the assets will produce £2,000 p.a. net after bearing Mona’s, lower, rate of tax. (The transfer may, of course, have inheritance and capital gains tax implications.) The net effect will be that Mona continues to receive an increase in spending power of £2,000 (less any tax liability she may have) but Ivor sacrifices less of his income.

The alienation of income to a lower rate taxpayer is a very simple way to reduce the income tax payable, but as would be expected the opportunities to exploit it are restricted by statute. For example, the alienation of income through a trust will not reduce tax if the settlor or spouse has some interest in the trust property. A very simple example of this would be if, under the trust created by Ivor, he or his spouse was entitled to the remainder after Mona has died.

### Capital gains tax


Capital gains tax is charged annually on the chargeable gains flowing from the disposal of capital assets. A disposal includes a sale. Also, if the owner of property gives an asset away a capital gains tax liability will attach to the profit which could have been made had the property been sold for its market value. This deemed sale for market value takes place whenever there is a disposal which is not a bargain at arm’s length. A disposal to a connected person is always treated as not being a bargain at arm’s length and so the market value rule always applies to such a disposal. Among those connected to a disposer are his spouse and her relatives and the spouses of her relatives. Relatives include siblings, direct ancestors (parents, grandparents), lineal descendants (children, grandchildren, etc.) but not lateral relatives (aunts, uncles, nieces, nephews, etc.). Other connected people are the trustees of settlements created by the disposer.

The gain is calculated by deducting any allowable expenditure from the consideration received (or deemed to be received in the case of a gift). The most important item of deductible expenditure is the cost incurred in acquiring the asset, usually the purchase price. If the allowable expenditure exceeds the consideration received (or deemed to be received) a loss will result which can be set against a capital gain on another disposal and so reduce the tax on that other disposal.

There are a number of important exemptions from capital gains tax including disposals of motor cars, chattels for less than £6,000, tangible movable wasting assets (an asset
is a wasting asset if it has a predicted useful life of 50 years or less). Perhaps the most valuable exemption covers the gain made on the disposal of an individual’s only or main residence.

Capital gains tax is only levied on lifetime disposals. On death all assets vest in the deceased’s personal representatives at the market value at the time of death. Any gain accumulated during the lifetime of the owner is ignored for the purposes of this tax and so is free of capital gains tax.

From 23 June 2010 capital gains made by individuals are taxed at either 18 per cent for basic rate income tax payers or 28 per cent for higher or additional rate income tax payers.

There is a ‘concession’ aimed inter alia at business owners who sell all or part of their business. Any gains up to a lifetime limit of £5m will be taxed at 10 per cent. This relief is popularly known as ‘entrepreneurs’ relief’.

Capital gains tax is an annual tax and at the end of each tax year the taxpayer must calculate all his gains for the year and take away any losses made and to the extent that the annual total exceeds the annual exemption of £10,100 tax will be due.

**Taxing settlements**

Capital gains tax has a number of special provisions governing ‘settlements’. A settlement includes all trusts except those where property is held by trustees merely as nominees, or for a person who would be absolutely entitled were he not a minor or a person under some other disability, or for persons who are jointly entitled. The phrase ‘jointly entitled’ applies to both joint tenants and tenants in common. Thus, the definition of settlement excludes trusts where the trust may be thought of as a mere technical device. In such cases the trust property is regarded as belonging to the beneficiaries for capital gains tax purposes and so any disposal by the trustees will bring with it the same tax liability as if the beneficiary had himself disposed of the property.

If a settlement is created it will give rise to disposal of the settled property to the trustee. As the trustees and the settlor are connected people the disposal will be treated as having been made at market value.

Once the settlement has been set up capital gains tax may be payable if the trustees make actual disposals of trust property. For example, if part of the trust property is sold capital gains tax may become due. For 2011/12 the 28 per cent rate (above) applies to capital gains of trustees from 23 June 2010 and the 2011/12 annual exemption for the trustees of most trusts is £5,050.

Tax may also become payable in the event of a deemed disposal of trust assets. The legislation states that on the happening of certain events the trustees are deemed to dispose of the trust assets.

One example of a deemed disposal is when a beneficiary becomes absolutely entitled to trust property. For example, if property is settled on Arthur, contingent upon his attaining the age of 30, he will become absolutely entitled when he is 30. At this point the property will cease to be settled property, the trustees will be deemed to dispose of the property at market value and any gain shown will be taxable. The trustees are also deemed to reacquire the property immediately for the same market value. If, however, the event giving rise to a beneficiary becoming absolutely entitled is a death, then although there will be the same deemed disposal and reacquisition at market value, there will be no capital gains tax liability. This reflects the general position that capital gains tax is not payable on death.
If a life tenant dies but the settlement continues there will be a deemed disposal and reacquisition at market value but no tax will be payable. Again this is an example of the general rule that capital gains tax is not payable on death. The effect of this deemed disposal and reacquisition is to give a tax-free uplift to the trust property. This, in effect, wipes out any accrued gain.

If a beneficiary disposes of his interest under a settlement there is no liability to capital gains tax unless he acquired the interest for money or money's worth.

Inheritance tax

Taxes on transfers of capital, particularly on gifts, are a feature of many legal systems. In most systems the tax is primarily aimed at taxing property transferred on the death of its owner. The United Kingdom has inheritance tax.

Inheritance tax is a relatively new tax, having been introduced in 1986. It is based on estate duty and capital transfer tax. Estate duty was introduced in 1894 and was replaced by capital transfer tax in 1974 and then by inheritance tax in 1986. Inheritance tax is governed by the Inheritance Tax Act 1984 as amended.

Inheritance tax was devised to be a tax primarily payable on death and any threat to inter vivos transfers was virtually removed. The tax was imposed on ‘transfers of value’ which were not exempted from the tax by the legislation. In general terms a transfer of value is a disposition which has the effect of reducing the value of the transferor’s estate. A gift and a transfer at an undervalue will be transfers of value but a sale at the market price will not. Under inheritance tax most inter vivos transfers made by individuals are Potentially Exempt Transfers (PETS) and will not be taxed unless the donor dies within seven years. If the donor dies more than three years but less than seven years from the date of the PET, the inheritance tax bill may be reduced by taper relief. This relief operates by reducing the rate of tax that would otherwise be charged. The reduction is:

- transfers more than three years but not more than four years before death: 20 per cent reduction;
- transfers more than four years but not more than five years before death: 40 per cent reduction;
- transfers more than five years but not more than six years before death: 60 per cent reduction;
- transfers more than six years but not more than seven years before death: 80 per cent reduction.

The only important example of an inter vivos transfer which is not a PET, and which may be immediately liable to tax, is a transfer into a discretionary trust. In addition, there is a wide range of exemptions from the tax, including transfers to spouses, charities and political parties and transfers which are made with no gratuitous intent.

For inheritance tax the tax threshold for 2011/12 is £325,000, and tax is only payable once the threshold is exceeded. Under inheritance tax it is only necessary to include chargeable transfers of value made in the previous seven years in order to see if the threshold has been exceeded. Inheritance tax has one rate for lifetime transfers (20 per cent) and one rate for death transfers (40 per cent).

The inheritance tax rules mean that it is possible to ‘shift’ large amounts of capital which otherwise would be liable to tax provided at all times the ‘seven-year total’ does not exceed the threshold.
The wide range of exemptions coupled with the possibility of making PETs means that it is feasible for a well-advised and forward-thinking individual to arrange the disposition of his property so that little if any inheritance tax is paid. The main planning strategies involve early *inter vivos* transfers, to take advantage of lower lifetime rates, PETs and the seven-year cumulation period.

On death all chargeable transfers made within the previous seven years, together with the value of any PETs made within the previous seven years, are added to the value of the deceased’s property. This valuation is made on the basis of market value immediately prior to death, thus including a valuation for jointly owned property. Also included in the valuation is any property transferred *inter vivos* in which the transferee reserved a benefit operative within the seven years leading up to the death. Tax is payable at 40 per cent to the extent that the value of the property held on death exceeds the tax threshold.

The inheritance tax legislation contains a number of exemptions under which transfers are not liable for inheritance tax. Perhaps the most important example is the inter-spousal transfer exemption under which *inter vivos* transfers and transfers on death from one spouse to the other are not liable to tax. The exemption also applies to transfers between civil partners. On the death of a widow/widower or the survivor of a civil partnership any inheritance tax-free allowance not used on the death of the first spouse/civil partner will increase the tax-free amount on the second death. The tax-free allowance has not been increased but for married couples/people in a civil partnership the impact of the change on the second death may be important, particularly if no inheritance tax planning has been undertaken before the first death. The maximum tax-free amount available on the second death is twice the threshold at the date of the second death.

A further example may help to understand how inheritance tax works.

**Example**

On his death the property which a deceased owns and leaves by will is valued at £147,000. He leaves £59,000 to his wife. This is covered by an exemption and is not liable to tax and is left out of account when calculating liability. The value of chargeable transfers made in the seven years prior to his death is £247,000. What liability is there to inheritance tax at the 40 per cent death rate? As already discussed the £59,000 left to his wife is not relevant, being covered within an exemption. The remaining £88,000 is added to the £247,000 of chargeable transfers made within seven years of his death and is treated as the ‘top slice’ of the total (£335,000). Tax is payable on that part of the £88,000 that exceeds the tax threshold (£325,000). In this case tax will be payable on £10,000 at 40 per cent (death rate).

As the entire tax-free amount is used on the first death there will be no increase in the tax-free amount on the second death.

**Taxing settlements**

Inheritance tax has special and rather complex rules covering settlements and basically the legislation identifies three types of settlements:

- first, settlements with an interest in possession;
- second, settlements without an interest in possession (discretionary trusts); and
- third, accumulation and maintenance trusts.
The Finance Act 2006 made a number of very important changes to the impact of inheritance tax on trusts. The most important changes are to interest in possession trusts and to accumulation and maintenance trusts.

The broad effect of the changes was to drag many interest in possession trusts and accumulation and maintenance trusts into the inheritance tax charges regime that previously only affected discretionary trusts.

These provisions impact on trusts set up after 22 March 2006. The general effect is that the only lifetime gifts after 22 March 2006 which will not fall into the discretionary trust inheritance tax regime will be outright gifts to individuals or gifts to trusts for the disabled.

Interest in possession settlements

A settlement is an interest in possession settlement if there are beneficiaries who have an immediate entitlement to income produced by the trust property. It is now accepted that if there is a power to accumulate income this prevents there being an interest in possession settlement as there can be no entitlement to income: Pearson v IRC [1980] 2 All ER 479. The beneficiaries who are entitled to the income were regarded as the owners of the capital of the trust fund for inheritance tax purposes and the remainders were deemed to own nothing. The Finance Act 2006 has made important changes to the inheritance tax treatment of these trusts.

Interest in possession trusts created after 22 March 2006

Lifetime transfers into new or existing interest in possession trusts will potentially suffer an immediate inheritance tax entry charge at 20 per cent if the value exceeds the transferor's available inheritance tax nil rate band. This will be followed by periodic and exit charges.

Certain new interest in possession trusts will fall outside the new inheritance tax regime. For example if a trust is set up under a will and the interest in possession trust arises immediately on the death of the testator and the beneficiary is the surviving spouse or civil partner, the transfer by the deceased will be exempt from inheritance tax.

Interest in possession trusts existing at 22 March 2006

There are transitional rules for trusts in existence on 22 March 2006. Such trusts are in the main outside the new inheritance tax regime. The pre-22 March 2006 rules will continue to apply until the interest in possession trust comes to an end. If at that point property remains in the trust the discretionary trust regime will apply.

Non-interest in possession trusts

In the non-interest in possession type of settlement, the discretionary trust is the most important type. Unlike the case of the interest in possession trust, with a discretionary trust it is the trust itself that is regarded as taxable. Tax will be charged on the creation of the trust, on every tenth anniversary of its creation and when property passes out of the discretionary trust.

The creation of a discretionary trust will not be a PET and will normally be a chargeable transfer. In order to calculate what, if any, inheritance tax is payable it is necessary to calculate the settlor's seven-year total and tax is levied according to whether or not the transfer is above the tax threshold.
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On every tenth anniversary of the creation of the trust a periodic or automatic charge to tax will arise. The charge is levied on the relevant property, i.e. the property within the settlement immediately before the anniversary. The method of calculating the rate of tax payable is complex but once found the rate is used to find the amount of tax which would be due on the hypothetical transfer of the relevant property. The tax payable is 30 per cent of the tax payable on the hypothetical transfer of the relevant property. (As the highest rate that can be charged on the hypothetical transfer is 20 per cent, the most tax that can be charged is 30 per cent of 20 per cent, i.e. 6 per cent.)

When capital leaves the discretionary trust inheritance tax will be payable – the exit charge – and the tax will be levied on the reduction in the value of the trust fund. This would occur if capital was distributed to one of the beneficiaries. Again, the tax calculations are rather complicated but in essence the property leaving the trust is taxed at the appropriate fraction of the rate charged at the last ten-year anniversary. The appropriate fraction is the number of completed three-month periods since the last ten-year anniversary divided by 40 (the number of three-month periods in ten years). So if £10,000 of property is taken out of a trust eleven months after the last ten-year anniversary and the rate of tax charged at that anniversary was 6 per cent the exit charge tax will be £10,000 × 6 per cent × 3/40.

Accumulation and maintenance trusts

It is very common for a parent to wish to provide for his child through a trust but it is often considered unwise to give the child an absolute interest. It is, however, desirable that any income generated by the trust should be available to support and maintain the child. The answer is often the creation of an accumulation and maintenance trust, which is commonly set up for minors. Under such a trust there will be no one with an interest in possession. Under such a trust the beneficiaries will become entitled to the property or an interest in it on attaining a specified age and in the meantime the income generated by the trust will be accumulated to the extent that it is not needed to maintain the beneficiaries.

Accumulation and maintenance trusts created after 21 March 2006

For trusts created on or after 22 March 2006, the regime for discretionary trusts will apply for lifetime transfers. If the value transferred is greater than the available nil rate band there will be an ‘entry’ charge of 20 per cent on the value of transferred assets. There will also be a ‘periodic’ charge on the value of the assets every ten years from the commencement of the trust at up to 6 per cent. Additionally, there will be an exit charge on the value of assets leaving the trust at up to 6 per cent.

However, these new rules will be modified in some cases. For example, where there is a trust set up for a child under the will of at least one parent, provided that entitlement to the trust assets is outright at 18 there will be no periodic or exit charges. This is sometimes called a ‘Trust for bereaved minors’.

Where a trust is set up under the will of at least one parent, and the beneficiary will become entitled to the trust assets outright by age 25, no inheritance tax charges will apply while the beneficiary is under age 18. Restricted inheritance tax charges will, however, apply on the beneficiary becoming entitled to the trust assets between the ages of 18 and 25. In this situation the maximum rate of inheritance tax on acquiring the assets at age 25 would be 4.2 per cent. These trusts are called ‘Trusts for those age 18–25’.
Accumulation and maintenance trusts that were in existence on 22 March 2006

There are transitional provisions for accumulation and maintenance trusts existing at 22 March 2006. The previous (more favourable) inheritance tax treatment continues to apply if the terms of the trust provide (or are varied by 6 April 2008 so as to provide) that the beneficiary will become entitled to the trust assets outright by age 18. There will be inheritance tax periodic and exit charges from 6 April 2008 if the trust terms are not varied by then to give beneficiaries absolute entitlement by age 18 at the latest.

Summary

This chapter deals with the main stages in the growth of equity and the development of the trusts concept. The origins of equity lie in a body of rules created by the Court of Chancery, initially presided over by the Lord Chancellor. The origins of the rules of trusts and equity lay in overcoming shortcomings of the common law. Initially equity was flexible – resulting in uncertainty and unpredictability. This uncertainty led, in the late seventeenth and eighteenth centuries, to a body of precedent used in deciding cases, while the discretionary nature of equity was preserved.

Cases of conflict between equity and the common law were addressed by (inter alia) the Judicature Acts 1873–75.

As trust law developed it was recognised that beneficiaries have (at least very nearly) a proprietary interest, giving them the power to enforce the trust and rights against trust property.

The courts have the jurisdiction to supervise the administration of trusts.

Although many trusts are private (in that they exist to benefit an individual or a group of individuals), charitable trusts exist to benefit the public (or a section of it).

There are several types of trusts: express, statutory, resulting and constructive trusts.

Although many trusts are fixed (in that the extent of the beneficiaries’ interests are expressly set out), some trusts are discretionary trusts under which the trustees exercise their discretion as to the extent particular beneficiaries (as opposed to other beneficiaries) are to benefit.

The trust concept is a powerful one and (as will be seen in Chapter 3) may be used for a wide variety of purposes, including some purposes which some argue amount to exploitation of the concept. For example Barclays Bank v Quistclose Investments Ltd (1968) has been seen by some as providing an ‘unfair’ advantage to some creditors and thus is an application of the trust that some say is unjustifiable.

A definition of a trust (as opposed to description) is elusive, but the key elements of express private trusts are: a settlor who provides the trust property; trustees who hold the trust property subject to a range of duties and powers; and beneficiaries for whose benefit the trust exists and for whom the trustees hold and administer the trust property.

Tax avoidance or reduction is a reason for the creation of many trusts (or the form that the trust takes). The main taxes that are relevant are income tax, capital gains tax and inheritance tax.

Further reading

General

R Bartlett, ‘When is a “trust” not a trust?: the National Health Service’ [1996] Conv 186
CHAPTER 1 GROWTH OF EQUITY AND THE EVOLUTION OF THE TRUST

H G Hanbury, ‘The field of modern equity’ (1929) 45 LQR 196
D Hayton, ‘Developing the law of trusts for the twenty-first century’ (1990) 106 LQR 87

Quistclose trusts

P Millett, ‘The Quistclose trust: who can enforce it?’ (1985) 101 LQR 269

The Commercial context


Visit www.mylawchamber.co.uk/edwards to access study support resources including interactive multiple choice questions, practice exam questions with guidance, annotated weblinks, glossary, glossary flashcards, animated diagrams with audio commentary, legal newsfeed and legal updates all linked to the Pearson eText version of Trusts and Equity which you can search, highlight and personalise with your own notes and bookmarks.

Use Case Navigator to read in full some of the key cases referenced in this chapter with commentary and questions:
Re Denley [1969] 1 Ch 373
McPhail v Doulton [1971] AC 424
Twinsectra v Yardley [2002] 2 AC 164