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## Trusts introduced

### 1. Introduction

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

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

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

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

These generalisations reveal their origin in 1930s-Depression America (eg in the reference to capitalism's 'sickness'), but they illustrate well enough that, whatever its underlying moral base, the trust is by no means insulated from its social and political environment or from political controversy. The majority of those who consciously use the trust in a family context have been the minority of individuals and families who own capital to any significant extent. Moreover, the phrase 'professional managers of capital . . . beyond the control of the owner for consumption' suggests a significantly different role for trustees than is implicit in the phrase 'a confidence reposed in some other' or in other lawyers' descriptions of a trust (one of which is cited in the next section).

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

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

Consequently, how far the principal subject of our study, the trust concept, can be said still to be in a process of development is a recurring theme in this book. At this stage, just one aspect of this need be introduced. We have just referred to 'the trust concept' but this singular notion may itself be misleading. If, with Maitland, we want to understand the process of development we need to consider whether in fact the 'trust concept' is but a collective term for describing a family tree of different trust ideas at various stages of development. Some branches will have grown to full maturity whereas others as yet have scarcely sprouted, and a process of incremental development, usually gentle but at times

more dramatic, is still occurring. We should therefore be careful when meeting different types of trust not to assume that what is a central characteristic of one type of trust is a necessary element in all other types. Indeed we need to consider whether it is preferable to talk not of the law of trusts in the singular but of laws of trusts in the plural.

## 2. The nature of a trust in English law

One of the major traditional practitioners' texts on trusts law, *Lewin on Trusts*, gives the following description of a trust (18th edn, 2008) p 4:

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

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

- (1) In most cases, a trust arises out of the conscious act or declaration of an individual or group of individuals. To this individual or group no single name is consistently applied: one finds 'founder', 'settlor', 'creator' and 'donor' (or their plurals, as the case may be). Where the trust is created by a will, 'testator' or 'testatrix' – being the words for describing the maker of a will, whether or not it contains a trust – acts as a substitute. A founder of a trust may be a trustee and/or a beneficiary under it (subject to point (3) below). Where a trust arises out of the conscious act or declaration of a 'founder' (as will be seen later, he or she need not actually use the word 'trust'), it is called an 'express trust'.
- (2) Where there is no conscious act or declaration which creates the trust, it will owe its existence to legal rules (statutory and judge-made) which in certain defined situations impose trusts on individuals (so that they thereby become 'trustees') in respect of property owned by them or under their control. In such cases there is no founder of the trust, and the trust can be said to be an 'imputed' trust. 'Imputed' is not a recognised legal term in this context, but we will use it as a synonym for 'non-express'. As will

- be explained later, there are more specific (though somewhat confusing) sub-classifications: 'statutory', 'implied', 'resulting' and 'constructive' trusts.
- (3) A trust can have any number of beneficiaries or founders. The same applies to trustees, subject to practical considerations and to legal rules which insist in some cases that the number of trustees must not exceed four (Trustee Act 1925, s 34(1)). The same person (private individual or corporate body) may appear in any two or three of these roles, except that the law abhors the nonsense that a person should be sole trustee of property for himself or herself.
  - (4) The trust property may be any type of estate or interest recognised in property law, ranging from ownership of a car or a piece of land to 'intangible' property, such as a copyright.
  - (5) Although the Lewin definition refers to the property being 'held' by the trustee, 'or under his control', for practical purposes a trustee generally has legal title to the trust property. Where the trust property is an equitable proprietary interest – it may indeed be an interest under another trust – the trustee's title is equitable only.
  - (6) The 'consequential benefits and advantages' which accrue to beneficiaries may take the form of benefits in kind (eg occupation of land held on trust) or cash (eg income from shares). There is no rule that the entitlements of individual beneficiaries should be fixed in advance or that they should all receive benefit simultaneously; indeed, the allocation of benefits may be left to the trustee(s) (under a so-called 'discretionary trust') or to some third party, who may even have the power to exclude entirely beneficiaries listed or described in the trust deed. Furthermore it may be stipulated that interests arise only if a specified contingency is satisfied, and a trustee may have the duty or power to withhold all allocation of benefit within a specified period, ie to 'accumulate' income.
  - (7) In referring cryptically to 'some purpose which the law will recognise and enforce' the Lewin definition is speaking mainly of charitable trusts. Generally, a trust must have one or more persons as beneficiaries or potential beneficiaries, but if its terms require the trustee to administer the trust property for one or more purposes which fall within an artificial legal definition of 'charitable purposes', the trust may be valid even though it is expressed in terms of purposes rather than beneficiaries. There are some other narrowly defined situations where the failure to define beneficiaries is not fatal to a trust.

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

### 3. The trust's versatility

What aspects of the trust form give it the versatility so admired by Maitland, so that it has come to be employed for a wide variety of purposes over a long

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

#### 4. Manipulating facets of ownership through trusts

##### (a) The trust's 'tricks'

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

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

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

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

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

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

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

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

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

**Comment** The chief advantage of this arrangement as against a simple transfer of the shares from Wisegirl to Whizz-kid is that the latter may hope to conceal his ‘beneficial ownership’ of the shares from the company. He may want to do this if (for instance) he is a financial entrepreneur who is thinking of attempting a take-over. Note, however, that ss 793 and 820 of the Companies Act 2006 give UK companies the right to ask any registered nominee shareholder to disclose the beneficial owner of shares. It has been estimated that for most UK registered public companies at least 80% of their share register will comprise nominee names. It is thought that the rights under these sections are now used mainly by managements of companies which regard themselves as potential targets for a take-over bid (see Davies (ed) *Gower and Davies’ Principles of Modern Company Law* (8th edn, 2008) paras 26–19; 28–49 to 28–51).

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

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

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

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

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

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

The trustees shall stand possessed of the Trust Fund and the income thereof UPON TRUST for all or such one or more exclusively of the others or other of the members of the Specified Class if more than one in such shares and either absolutely or at such age or time or respective ages or times upon and with such limitations, conditions and restrictions and such trusts and powers (including discretionary trusts and powers over income and capital exercisable by any person or persons other than the Settlor or any Spouse of the

Settlor whether similar to the discretionary trusts and powers herein contained or otherwise) and with such provisions (including provisions for maintenance and advancement and the accumulation of income for any period or periods authorised by law and provisions for investment and management of any nature whatsoever and provisions for the appointment of separate trustees of any appointed fund) and generally in such manner as the Trustees (being not less than two in number or being a corporate trustee) shall in their absolute discretion from time to time by any deed or deeds revocable or irrevocable appoint.

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

- (i) The trustees can allocate the benefit of the trust according to the *current* needs of the various beneficiaries. The comparative rigidity of Stern’s will trust in example 3 could lead to anomalies; for example, if one of his sons becomes a millionaire pop star by the age of 25 while the other is unemployed, there is no provision in the will for giving all or substantially all of the trust fund to the latter. Furthermore, so long as Lucre is still alive, he can exercise *de facto* influence over his trustees (who may be wholly ‘tame’) to respect his views in this regard. (NB: For a salutary warning of the perils of behaving as a ‘tame trustee’ see *Turner v Turner* [1983] 2 All ER 745 and generally Chapter 11.)
- (ii) If any of Lucre’s beneficiaries go bankrupt, or are desperately trying to raise money to pay for the improvidence sometimes associated with the heirs of the wealthy, they have no ascertainable interest under the trust which their creditors can get hold of or which they themselves can sell or mortgage. To this extent, the trust remains immune from their creditors and acts as a ‘caretaker’ mechanism to protect them from their own improvidence or ill-luck.
- (iii) According to the law, at the time of this trust’s fictitious establishment in 1964, the trust had notable tax advantages. In particular, estate duty would not have been payable in respect of the creation of the trust, being an *inter vivos* disposition, provided Lucre lived for seven more years; and on the subsequent death of Lucre’s mother or wife or indeed any of the beneficiaries, the existence of the trust would not have increased the estate duty payable on the deceased’s estate because the deceased beneficiary would

have had no fixed interest in the trust fund, but merely an expectation of benefit. (By contrast, the value of Stern's house would have been subject to estate duty twice, in his estate on his death, and in his housekeeper's estate on her death.) Taxation of transfers of capital has changed since 1964, and the discretionary trust is no longer such an outright tax-saver (see Chapter 8), but it represents a classic case of tax avoidance through the use of trusts and its importance in this regard over many years has had a significant impact on the law of trusts.

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

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

- (i) The *bond or debenture trust*, whereby a single company solicits loans at fixed interest from the public, arranging for a trustee (usually a corporate body) to act as a nominal lender of the total amount subscribed, a conduit-pipe for interest and principal payments from the company to the individual investor and a watchdog for the investors' interests. It would in theory be possible for the borrower to issue bonds or debenture stock direct to the lenders/investors. This would involve the disadvantage of the borrower dealing direct with hundreds, perhaps thousands, of the lenders/investors. Arguably this would be wholly impracticable in the case of a secured debenture issue since each lender would acquire a security interest in the assets of the borrower. The interposition of a trustee as an intermediary

avoids these difficulties and provides the advantages referred to previously (see eg Duffet (1992) 1 JITCP 23–30; and generally Hayton et al (2002) 17(1) JIBFL 23).

- (ii) The *unit trust*, whereby under close statutory regulation a corporate ‘custodian trustee’ holds a fund gathered from the public in return for the issue of ‘units’ of the fund, and a corporate managing trustee invests this fund in whatever stock market securities seem best at any given time. Dividends and capital gains earned from the investment accrue for the benefit of current unit-holders (see Fan Sin *The Legal Nature of the Unit Trust* (1998)).
- (iii) The *private pension fund*, whereby money paid in on behalf of a company’s employees by the company and, in most cases, by the employees themselves is invested by a small group of trustees (who may include one or more representatives from the employer’s and the employees’ respective ‘sides’) in order to provide pensions for the employees on their retirement (see Chapter 13).

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

**Example 8** (tricks 4 and 6) About three months after a coal-tip disaster at Aberfan, South Wales on 21 October 1966, in which 144 people, including 116 children, died, the massive fund collected by public appeals (it ultimately reached about £1,750,000) was transferred in the form of cash and investments to 14 trustees. Under the trust deed, it was to be held and applied by them in accordance with the directions of a management committee (which initially comprised six of the trustees and nine other representatives of the local community) on the following trusts: