VARIATIONS OF TRUSTS

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Despite having attracted a good degree of suspicion and paranoia as to their uses as a tax avoidance vehicle, it should be apparent from their long history of use that trusts have a much wider and more useful function as a method of preserving and managing wealth. This latter role, if not always the former, means that it is often necessary for trusts to perform their function over many years, often up to, and sometimes beyond, the applicable perpetuity period. Unfortunately, even the most prescient of settlors is unlikely to be able to predict his beneficiaries' situations and needs in 20, 50 or 80 years time, or indeed the tax treatment of trusts from year to year.

Fiduciary nature of powers

The answer to this dilemma is of course to create trusts with a significant degree of flexibility and to trust, to a greater or lesser extent, those in whom powers are reposed to exercise them in a sensible and beneficial manner. Naturally there is a conflict between the control which a settlor retains over the trust fund and the flexibility which is granted to his chosen appointors. Most such powers are, however, fiduciary in nature. The essential basis of a fiduciary duty is one of loyalty to the beneficiary:

> "*The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. The core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.*" (*Bristol and West Building*

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Society v Mothew [1998] 1 Ch 18 per Millett LJ).

In most situations where a fiduciary obligation exists, any dispositive power will be exercised in a manner entirely consistent with the fiduciary obligation. Indeed, it is not difficult to avoid the more obvious restrictions on an appointor's exercise of his powers – the need to act in good faith, to avoid conflicts of interest, and to avoid the use of powers for a corrupt purpose. The difficulty which tends to arise relates to the circumstance where it is sought to alter the trusts of a settlement by use of a dispositive power which must be exercised for the benefit of a beneficiary or beneficiaries – often this will be to avoid the more excessive results of a change in the taxation of trusts so that the objection is not to the beneficial arrangements *per se* but rather to the consequences which they will result in.

It will often, if not always, be entirely correct to alter the trusts in these circumstances – the trustees are under an obligation to their beneficiaries, not the Exchequer. In order for such alteration to be effective, however, a certain degree of care will be required in relation to how the trustees reach their decision. In particular, the manner in which decisions are reached should be documented to avoid the appearance that they may have been incorrectly reached. The primary requirement in this respect will be for the trustees to give an honest and appropriate consideration to all of the relevant facts and circumstances which are in existence at the time the power is exercisable. Naturally this will require that they appreciate which are the relevant facts and which are the irrelevant facts, and that the latter should be ignored. The trustees-should act independently. While it is entirely proper that they are fully advised, any decision must be their own. They should not act under the dictation or instructions of another.

Related to this is the fact that the trustees should adopt an open policy at all times. The must not fetter their discretion by the adoption of inflexible policies. Equally they should not take an overly premature view of matters nor should they bind themselves by undertakings. There should not be an excessive execution of the power – that is to say that it should not be exercised for purposes or persons who are not proper objects of the power. Equally there should not be a fraud on a power. While this may seem self evident, it is to be noted that a fraud on a power does not require conduct amounting to fraud in the common law sense, but rather requires the exercise of a power for a purpose or with an intention which is beyond the scope of, or not justified by the terms of the power (see *Vatcher v Paull* [1915] AC 352). Accordingly, there can be a fraud on a power even where there is an honest belief that it is being exercised for the benefit of a beneficiary. The effect of these restrictions is that in some cases, although trustees or appointors may technically have power to do so something, they cannot exercise that power as to do so would breach the fiduciary duty. While this is not a problem in most cases – it ensures the beneficiary is protected – in some cases, it

can have the practical effect that a settlement is less flexible than was – initially apparent, with the result that certain avenues to meeting the implications of a change in the tax treatment or the end of an accumulation period may be shut – or at the very least require a very careful consideration. In most cases, however, the trustees may properly be able to reach a decision in a way which does not breach the fiduciary duties. What is required is to appreciate what the issues are, what can be properly be done, and whether that can be justified without having regard to those factors which cannot be taken into account.

What is important is that the decision which is reached can be properly justified, and often this will require a great deal further thought than initially appeared to be the case.

Powers contained in the trust instrument

More often, however, the difficulty in attempting to effect changes to a settlement is not fiduciary limitations on existing powers but rather with the settlor (or draftsman) who has not given sufficient thought to the flexibility (if any) to be built into his settlement. The difficulties in these circumstances generally lie in trying to make changes to a settlement in the most effective and cost efficient manner possible.

Naturally, settlements differ according to their circumstances and it would be impossible to deal with all of the issues which arise.

The first consideration will very often be powers which are contained within the trust instrument. Most modern trusts contain significant special powers of appointment which are very broadly worded. Nevertheless, even the most apparently wide power will have limitations – and it will always be necessary to consider what such limitations are.

- How is the power to be exercised?
- In what ways can the power be exercised?
- Who is the power reposed in?
- Are there any express restrictions on the exercise of the power?
- Are any consents necessary for the exercise of the power?
- For whose benefit must the power be exercised?

It is often a useful exercise to recite the power in question in any instrument purporting to exercise it. Any of these questions might be overlooked with potentially fatal consequences and reciting the power makes that less likely.

These questions are often matters of construction. If there is any doubt on this question consideration should be given to obtaining independent verification of a particular construction. In this respect it is noted that section 48 Administration of Justice Act 1985 provides for the High Court to make an order without a hearing authorising trustees to act on the advice of a person who has a 10 year High Court qualification in circumstances where a question on construction has arisen.

Benefit

Most dispositive powers have to be exercised for the benefit of a particular beneficiary. It is clear, however, that it is not necessary to benefit a person absolutely in order to benefit them (see *Pilkington v IRC* [1964] AC 612). Indeed, benefit to a given person might be achieved by creating trusts of which non objects are beneficiaries *(Re Hampden Settlement Trusts* [2001] 1 WTLR 195).

Statutory power of advancement

Often, the only dispositive power which is contained in a settlement – certainly older settlements and basic will trusts – is the statutory power of advancement contained in section 32 Trustee Act 1925:

(l) Trustees may at any time or times pay or apply any capital money subject to a trust, for the advancement or benefit, in such manner as they may in their absolute discretion think fit, of any person entitled to the capital of the trust property or of any share thereof, whether absolutely or contingently on his attaining any specified age or on the occurrence of any other event, or subject to a gift over on his death under any specified age or on the occurrence of any other event, and whether in possession or in remainder or reversion, and such payment or application may be made notwithstanding that the interest if such person is liable to be defeated by the exercise of a power of appointment or revocation, or to be diminished by the increase of the class to which he belongs: Provided that:

(a) the money so paid or applied for the advancement or benefit of any person shall not exceed altogether in amount one-half of the presumptive or vested share or interest of that person in the trust property; and

(b) if that person is or becomes absolutely and indefeasibly entitled to a share in the trust property the money so paid or applied shall be brought into account as part of such share; and

(c) no such payment or application shall be made so as to prejudice any person entitled to a prior life or other interest, whether vested or contingent, in the money paid or applied unless such person is in existence and of full age and consents in writing to such payment or application.

The power enables the payment or application of capital (which need not be in money form) for the *benefit* of a beneficiary. Benefit is used in its wider sense and so enables the creation of a settlement (*Pilkington v IRC* [1964] AC 612).

The beneficiary must be (i) entitled to the capital of the trust property and (ii) and person with a *prior life* or *other interest* must be of full age, in existence and consent to the advancement. This means that it is necessary to give full consideration to any intermediate interests.

Although this power is available in most circumstances, the major drawback is that unless the settlement states otherwise, it is restricted to half of the presumptive or vested share of the capital of the trust fund.

Narrower/wider powers

Care should be taken in drafting instruments exercising dispositive powers to either create or avoid creating a new settlement (see *Roome v Edwards* [1981] STC 96 and *Bond v Pickford* [1983] STC 517).

Perpetuities and accumulations

The exercise of a dispositive power will be read back into the settlement from which that power derives, with the result that the rule against perpetuities and the rule against excessive accumulations will apply by reference to the date of the creation of the settlement.

Possible ways of avoiding these difficulties include changing the governing law of the settlement or appointing trusts which enable accumulation under section 31 Trustee Ac 1925.

Variations by beneficiaries

If all of the beneficiaries of a settlement are of full age and agree to do so they can bring a settlement to an end in such circumstances as they see fit – or alternatively they can alter the terms of the settlement. This is generally referred to as the rule in *Saunders v Vautier*. It does, however, raise questions as to whether and to what extent each beneficiary becomes a settlor of the settlement. It is to be noted that *all* of the beneficiaries and potential beneficiaries must be of full age and agree to the variation for it to affect the entire settlement. This will preclude such an exercise where there is a power to add beneficiaries. A given interest in a settlement can be altered, however, if all of the beneficiaries entitled to that particular interest agree to such alteration. Further, where a beneficiary has a vested interest in, for example, income, he can assign it on new trusts, although he will be the settlor of those new trusts. This may enable for example the rule against excessive accumulations to be circumvented, although the new settlement will be subject to the settlor provisions and gift with reservation of benefit provisions as regards the assigning beneficiary.

Variation by the court

The most obvious means in which a Court can a vary a settlement is under the Variation of Trusts Act 1958 Section 1 of that Act provides as follows:

(1) Where property, whether real or personal, is held on trusts arising, whether before or after the passing of this Act, under any will, settlement or other disposition, the court may if it thinks fit by order approve on behalf of

(a) any person having, directly or indirectly, an interest, whether vested or contingent, under the trusts who by reason of infancy or other incapacity is incapable of assenting, or

(b) any person (whether ascertained or not) who may become entitled, directly or indirectly, to an interest under the trusts as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who would be of that description, or a member of that class, as the case may be, if the said date had fallen or the said event had happened at the date of the application to the court, or

(c) any person unborn, or

(d) any person in respect of any discretionary interest of his under protective trusts where the interest of the principal beneficiary has not failed or determined,

any arrangement (by whomsoever proposed, and whether or not there is any other person beneficially interested who is capable of assenting thereto) varying or revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts:

Provided that except by virtue of paragraph (d) of this subsection the court shall not approve an arrangement on behalf of any person unless the carrying out thereof would be for the benefit of that person.

(2) In the foregoing subsection "protective trusts" means the trusts specified in paragraphs (i) and (ii) of subsection (1) of section thirty-three of the Trustee Act 1925, or any like trusts, "the principal beneficiary" has the same meaning as in the said subsection (1) and "discretionary interest" means an interest arising under the trust specified in paragraph (ii) of the said subsection (1) or any like trust.

(3) … the jurisdiction conferred by subsection (1) of this section shall be exercisable by the High Court, except that the question whether the carrying out of any arrangement would be for the benefit of a person falling within paragraph (a) of the said subsection (1) shall be determined by order of the authority having jurisdiction under Part VII of the Mental Health Act 1983, if that person is a patient within the meaning of the said Part VII.

…

(5) Nothing in the foregoing provisions of this section shall apply to trusts affecting property settled by Act of Parliament.

It can be seen that the Act enables the Court to consent on behalf of those who would not otherwise be able to give their consent to a variation under the rule in *Saunders v Vautier*. A variation of trust under the Variation of Trusts Act 1958 can be used to restart the clock for the purposes of perpetuities and accumulations (see *Re Holts Settlement* [1969] 1 Ch 100). The obvious drawback of a variation under the Variation of Trusts Act 1958 is the potential costs involved. In some circumstances it may be possible to use section 57 Trustee Act 1925 to authorise

the use of the power over the entire capital of the trust fund. Although section 57 is in general restricted to 'management or administration' of property, such an application has been allowed on the basis that Court of Appeal in *Inglewood v IRC* [1983] 1 WLR 366 took the view that a power of advancement is similar to an administrative power.