

TRUSTS ESSAY NOTES

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NATURE, HISTORY AND PURPOSE OF TRUSTS

- ❖ While the functions of the trust may be said to be diverse and varied, in truth, the trust is basically a device that allows the wealthy to minimise tax and to avoid creditors. Discuss. (2012)
- ❖ The Trust has many functions. Its flexibility enables it to be used for wealth creation and for more noble purposes. Discuss. (2013)
- ❖ The use of the trust in commercial settings is just as important as its use in personal settings. Discuss. (2014 Pt B)

OUTLINE: The Trust has many functions. Its flexibility enables it to be hold for various (commercial and non-commercial) purposes. However, it also raises concerns, as in some cases it may be used for duplicitous (≈fraudulent) purposes.

- Personal vs commercial use
 - When the trust originated at the end of the Middle Ages, it was initially conceived as a means of transferring wealth within the family, and the trust remains our characteristic device for organizing intergenerational wealth transmission when the transferor has substantial assets or complex family affairs (Langbein) → the trust was a **gift; a gratuitous transfer**
 - However today commercial trusts have become extremely prevalent and are in fact arguably *more important* than personal trusts (Langbein's argument)

I. INTRODUCTION TO THE TRUST

What is a trust?

- A device at law used to separate the management and beneficial enjoyment of property
- Express trusts are a form of wealth management

History

- Express trusts emerged from medieval 'uses' of land and have been recognised and enforced in common law systems for over 700 years.
- Today they are no longer limited to land; any form of property can be held on trust.

Reasons for trusts?

- Historically, the trust arrangement was enforced because of what the Chancellor himself thought was right. His conscience said it was unconscionable for the trustee to retain the property for himself in the circumstances. Through time a body of rules emerged through 'treating like cases alike' → **trusts were declared where it would be 'unconscionable' or 'inequitable' not to do so**
- Today, a trust will exist because it was the settlor's intention to create a trust

→ **Although unconscionability and inequity used to be the reason for the rules, those reasons have faded through time. Today a body of rules has emerged, it is no longer a question of unconscionability.**

Basic structure of a trust

SETTLOR → TRUSTEE → BENEFICIARY
Subject-matter 'Object'

→ transfer of the legal title of property (common law)

→ what equity recognizes, i.e. that the person is a beneficiary under the trust (equity)

- The settlor is the absolute owner of property at the outset
- The trustee is the person who is entrusted with the property to hold it on behalf of the beneficiary
- It is essential that the trust has **property**, or that the trust assets have a **subject-matter**
 - Every trust must have a subject matter, namely assets or property. This is because every time you see a trust, it means that the trustee has an obligation in relation to property or to its assets.
 - Ex: the trustee has an obligation to hold the settlor's land. There is always some duty in relation to land.
- A beneficiary can be a natural person or a legal person, or even an abstract purpose – 'objects'
 - Without knowing what the 'objects' are you cannot have a trust. You would never know to whom the trustee owes duties, in which case he might as well be the owner of the property.

Settlors

- Once a trust is properly set up, the settlor drops out of the picture
 - The settlor never retains a role in relation to the ongoing life of the trust in that capacity

Reserving a power

- In some cases the settlor can reserve the power to either
 1. Revoke the trust
 2. Vary the trust
 3. Call himself an appointor (ie appoint new trustees or beneficiaries)
- It would therefore seem in those cases that the settlor doesn't drop out of the picture, but in fact he does. What he has done is made himself a 'done' of the trust (i.e. someone who has powers under the trust). This is not in his capacity as settlor.
- HOWEVER, this rarely occurs as there are tax consequences for doing this
 - S 102 *Income Tax Assessment Act 1936* (Cth)
 - Tax legislation that says that the settlor may be taxed on the assets when he reserves himself the power to revoke, vary or call himself an appointor. The reason being that technically he stays the owner of the property because he has the power to revoke the trust
 - Thus in practice, settlors rarely use this power

Designating themselves as 'appointor'

- The appointor may be given power to replace the trustee and/or to add or remove people from the class of eligible beneficiaries
- This is a device to allow the settlor to retain a measure of continued power over the assets held on trust.

Beneficiaries

- Beneficiaries are said to be the true owners in substance of the assets. Consequently:
 - Beneficiaries have personal rights against the trustee
 - Ex: T takes the money and uses it on a cruise. B has a personal right against the trustee to force the trustee to take out \$100,000 from his own pocket and replenish the trust fund.
 - The beneficiary has proprietary rights in the trust asset
 - Ex: if T goes bankrupt, normally all property owned by T becomes subject to a statutory insolvency scheme and he must pay back creditors. However, trust property is **ring-fenced** and is protected. Thus, the beneficiaries' interest is protected from the trustee's insolvency.
 - If T gives the trust property to another person C, B can sue C to recover the assets.

Saunders v Vautier rule:

- A beneficiary of **full age, sound mind and who has an absolute interest in the trust asset**, is entitled to force the trustee to give him the trust property
 - Even though the trust deed may say he cannot get the money until you are 45 years old, if he fulfils those conditions, he can force the trustee at 18 to give him the trust property
 - **This is a strong example of beneficiaries being the true owners**

Trusteeship: onerous office

- A trustee is subject to onerous duties and to a high standard which includes:
 - Trustee duties – those found in the trust deed, i.e. manage the trust fund, preserve it, investment duties
 - Fiduciary duties – a duty to be loyal to the beneficiary, not to put himself in a position of conflict of interest
- No one can be forced to be a trustee
 - If T is not happy with the duties imposed on him, he can either disclaim or relinquish trusteeship

'A trust will not fail for want of a Trustee'

- If all the trustees resign or die, the trust does not cease to exist
- Courts have a general jurisdiction to supervise trusts
 - This means that in cases where all trustees resign or die, the beneficiaries can go to court. The court will exercise its jurisdiction to supervise trusts, make an order or supervise the finding of new trustees.

Possible permutations of trusts

- The settlor declares himself a trustee for the benefit of a beneficiary – trust by settlement
 - S → TEE → BEN
- The settlor declares himself a trustee – this is creating a trust by self-declaration
 - S (TEE) → BEN
- The settlor creates a trust for himself
 - SOR → TEE → BEN (SOR)
- The settlor appoints a trustee for many beneficiaries
 - SOR → TEE → BEN1 & BEN2
- The beneficiaries may include the trustee or settlor

- SOR → TEE → BEN 1 & BEN 2 (TEE/SOR)
- There can be more than one trustee
 - SOR → TEE1 & TEE2 → BEN

No trust can exist in the following situation –

- There is a sole trustee for the same person
 - Ex: A holds a trust for A – A → A
 - Reason: You are the absolute owner therefore there is no trust, because you have no obligations to benefit for anyone else

History of the trust

Common law vs equity

- Equity developed in the Court of Chancery in England
- Equity and common law judges were originally set in different locations
- *Earl of Oxford's Case* (1615)
 - **Issue:** What happened if there was a clash in common law and equity rules?
 - **Held:** Equitable rules prevail where there is an inconsistency
- *Judicature Acts* 1873 – 75
 - All judges are vested the power to apply both common law and equity
 - Ex: individuals no longer need to go to a common law court for a common law remedy, then to a Chancery Court for an equitable solution
 - **Question:** Having fused both, ought we not fuse the substance of the law as well?
 - There seems to be a trend towards both being fused. However, judges still do refer to rules being equitable rules and common law rules, there isn't yet substantive fusion

The development of trusts

- The trust grew out of the fusion between common law and equity
- Trusts grew out of 'equity's exclusive jurisdiction'
 - This means that it is something that came out purely of the Chancery Court
 - It had nothing ever to do with the common law courts
 - This can be contrasted with equity's 'concurrent jurisdiction' which would be for example: in contract you go to a common law court and seek damages but if you don't get them, then go to the Court of Chancery instead.

Crusaders

- Before, women were not allowed to own title to property
- This was a concern to crusaders who were concerned if they died at sea
- A crusader transferred his legal title to a person 'T' for the use of his family.
 - T refused to hand back the title
 - The crusader went to a common law court. The judge asked him to show the title. The title was in T's name, therefore the land belonged to T.
 - T took the matter to Chancery. The Chancellor said it is unconscionable for T to retain the land.
 - At that time a land owner was called 'Feoffor'. T was the 'Feoffee to use'. The family was the 'cestui qui use'.

F W Maitland

- 'The trust is the greatest and most distinctive achievement performed by English men in the field of Jurisprudence'

Different types of trusts

2 types of trusts exist:

- ❖ **Express trusts** – created by a positive and proper manifestation of intention by a settlor to create a trust
 - You always need a settlor to create an express trust
 - 2 types:
 - **For purposes.** Generally you need purposes for express trusts, but there are 2 exceptions:
 - Private
 - Charitable
 - **For persons**
 - Fixed – each beneficiary has an ascertainable part of the trust fund, ex: the beneficiary has 100%. This is a fixed ascertainable portion of the trust fund. Ex 2: 1/3 each between 3 beneficiaries. The trustee still has discretion wrt investment, but he has no discretion wrt distribution.
 - Discretionary – the trustees have discretion as to distribution. The trustee may have discretion as to how much each is to get, or as to whether some people will get anything at all. In a discretionary trust, B1 cannot terminate the trust as in a fixed trust (under the *Saunders v Vautier*) rule because he

does not know his part in the trust. All that we know is that B1, B2 and B3 have all together absolute ownership. Therefore, all 3 together can exercise their *Saunders v Vautier* right, but each cannot do it alone whereas in a fixed trust one beneficiary can claim his part and drop out alone.

❖ **Trusts arising by operation of law** – trusts arising in other circumstances which the law imposes

- A settlor is not always necessary
- 2 types:
 - **Resulting**
 - **Constructive**

Note there are also **statutory trusts**

- These arise by way of statute; ex: *Aboriginal Lands Act 1970*
- We do not look at these in the course

Peter Jaffey, 'Explaining the trust'

→ Jaffey seeks to explain the existence of express trusts through the **obligational and proprietary theories**.

What is a trust

- By placing property on trust a SETTLOR (S) arranges for control of the property to be separated from the right to benefit from it. The TRUSTEE (T) has legal title, which confers control of the property, and the beneficiaries have an equitable interest, which is a right to an actual or possible benefit from the property in the way specified in the terms of the trust
- The separation of control and benefit represented by the **separation of legal title and equitable interest** allows for the benefit to be allocated in many different ways that an owner of property could not achieve by a simple transfer
- However, there is a longstanding controversy over the nature of the trust between two theories, the **proprietary** and **obligational** theories
 - The controversy is about whether the equitable interest of a beneficiary is a **property right in trust property**, or merely a **personal right** against the trustee with respect to the trust property

Obligational theory

- Persistent right – this is a subset of the obligational theory.
 - Based on the idea of a right against a right B has a right against the third party
 - Pb: the theory does not explain why B has a right against X

Theory: The obligational theory holds that the trust takes the form of a personal right of the beneficiary to the trustee's performance with respect to trust property owned by the trustee, and the contractual theory provides a basis or justification for the trust, understood in this way.

- Core aspects:
 - The beneficiary has no property right in the trust property (the trustee is the owner of the trust property)
 - B only has personal rights against T
 - The rationale is found in the trustee's agreement for trusteeship (contract-like)

Jaffey's critique:

- The obligational theory fails to explain what is normally understood as the proprietary aspect of the trust, namely the legal position of the beneficiary vis à vis third parties, including the trustee's creditors and recipients of unauthorized transfers of trust property
 - **INSOLVENCY:** If the trustee is bankrupt, the trust property is not available to satisfy the claims of his creditors, but is wholly reserved for distribution to the beneficiaries in accordance with the terms of the trust, by the original trustee or by a new trustee. The trust property is not treated as the trustee's own property
 - **THIRD PARTY RECIPIENTS:** Where there is an unauthorized transfer of trust property to a 3rd party, the recipient is subject to a claim by the beneficiary arising from the receipt, and the beneficiary has a proprietary claim to recover the trust property, the so-called equitable proprietary claim, which prevails over any claims of the recipient's creditors in a bankruptcy.