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Farewell, Trusty Old Law

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Published in:
Edinburgh Law Review

DOI:
[10.3366/elr.2022.0766](https://doi.org/10.3366/elr.2022.0766)

Publication date:
2022

Document Version
Peer reviewed version

[Link to publication in Discovery Research Portal](#)

Citation for published version (APA):
Evans, Y. (2022). Farewell, Trusty Old Law: New Trusts Bill on the Horizon. *Edinburgh Law Review*, 26(2), 257-262. <https://doi.org/10.3366/elr.2022.0766>

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Farewell, Trusty Old Law: New Trusts Bill on the Horizon

A. INTRODUCTION

At long last, the Scottish Government has indicated that it has begun detailed work towards presenting a Trusts Bill in the Scottish Parliament.¹ The key piece of Scots trusts legislation, the Trusts (Scotland) Act 1921, passed its centenary in August 2021. It is therefore welcome news that the Scottish Law Commission's extensive work in this area, and particularly their proposed Trusts (Scotland) Bill, updated in 2018, will be considered for implementation. This article will consider how the trusts landscape has shifted over the last century, identifying some ways in which trust law is out of kilter with modern practice. It will then analyse some aspects of the proposed legislation which seeks to consolidate and enhance trust law for the benefit of the Scottish economy and people.

B. THE CHANGING USES OF TRUSTS SINCE 1921

Trusts are now used in a wider range of private, charitable and commercial purposes than ever could have been envisaged by the drafters of the 1921 Act. Trust law is flavoured by its neighbouring fields of succession, family, tax, charity, insolvency, financial services, and commercial law, all of which have seen major updates. Many of the motives and incentives for using trusts in these various arenas have expanded substantially.²

The protection of assets held for children or incapable or vulnerable beneficiaries is a major reason to use trusts. In Scotland, a teenager aged sixteen or seventeen inherits outright unless there is a will containing trust provisions.³ Trusts are also used to hold assets for incapable beneficiaries as an alternative (or in addition) to guardianship.⁴

¹ Letter from A Regan MSP, Minister for Community Safety, to Lady Paton, Chair of the Scottish Law Commission dated 27 October 2021, available at https://www.scotlawcom.gov.uk/index.php/download_file/view/2278/1666/.

² There is some interesting analysis by K Leary and H Greevy, *Exploring the Use of Trusts*, HMRC Research Report 452 (2018), available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754714/Exploring_the_Use_of_Trusts_research_report.pdf.

³ See A Barr et al, *Drafting Wills in Scotland*, 2nd edn (2009) para 6.56.

⁴ K Phillips and E Gilpin, "Protecting the assets of the incapable" (2011) 20 SLT News 143-145

Laws relating to women's property rights, as well as increasing rates of divorce and cohabitation over the twentieth century, have shaped modern trusts practice. The Married Women's Property Acts in 1880 and 1881 helped some women, but women's property rights were curtailed well into the twentieth century, and the law of primogeniture in Scotland subsisted in relation to heritable property on intestacy until 1964.⁵ Trusts could get around some of the limitations. Liferent trusts can also be an appropriate safeguard where someone has children from a previous relationship and wishes to protect the ultimate succession rights of their own issue, whilst ensuring their surviving spouse or partner can live comfortably for the remainder of their life.

Trusts may be used for preservation of family wealth. Property held in trust is not owned by the individual so it cannot be regarded as matrimonial property.⁶ However, if one of the parties is a beneficiary of a trust, that could be viewed as part of the resources of the parties, since "resources" means "present and foreseeable resources".⁷ There remains a conceptual difficulty because the trustees of a discretionary trust have no obligation to pay anything to any particular beneficiary. In *M v M*,⁸ the husband had set up a trust for his children, but by the time the divorce occurred, he had very few other assets, so the court ordered a transfer of some of the trust funds to his wife. This is a rare example of financial provision trumping trust law, but perhaps we should expect more attempts to access trust funds in future divorce cases.⁹

Tax is a pertinent reason to use trusts in succession planning. For example, a nil rate band discretionary trust might be included in a will to preserve the "nil rate band", the amount of property an individual can leave before any inheritance tax would be due on their estate (currently £325,000).¹⁰ The Labour Government changed the law in 2007 so that spouses and civil partners can automatically transfer their nil rate bands to each other,

⁵ Succession (Scotland) Act 1964

⁶ Family Law (Scotland) Act 1985 s 10; J Kessler and W Grant, *Drafting Trusts and Will Trusts in Scotland: A Modern Approach*, 2nd edn (2018) paras 4.8-4.9.

⁷ Family Law (Scotland) Act 1985 s 8, 27; Kessler & Grant, *Drafting Trusts* para 4.10.

⁸ *M v M* [2011] CSOH 33.

⁹ The Supreme Court in *Prest v Petrodel Resources Limited and others* [2013] UKSC 34 sanctions piercing the corporate veil in cases where a company is used to attempt to defeat financial provision claims, and there is a suggestion at para 99 that this may be applicable to an (English) trust, although of course beneficial interest is a key difference between the jurisdictions.

¹⁰ Inheritance Tax Act 1984 s 8.

without the need for such a trust, but they might still be used where the beneficiary is not a spouse.¹¹

The reputation of trusts has been tainted by their attempted use in tax avoidance schemes. The Supreme Court decision in *RFC 2012 plc* is a notorious example.¹² An employees' remuneration trust (and 108 sub-trusts) was used to avoid income tax and national insurance contributions. Notably, the trusts involved were not Scottish trusts, and tax avoidance schemes do not often emanate from Scotland.¹³ However, the concerns about the use of trusts in the UK, and the international trend towards tax transparency, has led to ever-increasing compliance burdens on trustees of Scottish trusts.¹⁴ Trustees also have obligations in relation to reporting of land ownership in Scotland.¹⁵

Updates to trust law in the last twenty years have been driven by reform of the regulation of charities. The Charities and Trustee Investment (Scotland) Act 2005 widened the investment powers of trustees in all types of trust. It is notable that the one area where the use of trusts is in decline in Scotland is in the charitable sector, due to the introduction of Scottish Charitable Incorporated Organisations (SCIOs) in the 2005 Act.¹⁶

Beyond the domain of private client and charity law, trusts have become commonplace in commercial and financial transactions. As Lord Drummond Young noted in the Scottish Law Commission's 2014 *Report on Trust Law*,¹⁷ and has reiterated since, the most important and valuable use of trusts is to support pensions, life policies and other

¹¹ Inheritance Tax Act 1984 s 8A.

¹² *RFC 2012 Plc (In Liquidation) (formerly Rangers Football Club Plc) v Advocate General for Scotland* [2017] UKSC 45.

¹³ *Aberdeen Asset Management Plc v Revenue and Customs Commissioners* [2013] CSIH 84 is a rare example.

¹⁴ The Money Laundering and Terrorist Financing (Amendment) Regulations 2022 is the latest in a set of regulations implementing the EU Fifth Money Laundering Directive (5AMLD). It is notable that the concept of "beneficial owner" is used, which is not compatible with Scottish interpretation of trust law. See I Macdonald and A Pearson, "TRS: more trusts, more information, more access" (2021) JLSS (Feb) 42.

¹⁵ The Land Reform (Scotland) Act 2016 (Register of Persons Holding a Controlled Interest in Land) (Scotland) Regulations 2021.

¹⁶ SCIOs offer a simple way to hold assets, and members enjoy limited personal liability compared to regular trustees. In 2021, the Scottish Charity Regulator and Foundation Scotland established a project to revitalise "sleepy trusts" and encourage the merger or winding up of small charitable trusts, to make efficient use of funds held for charitable purposes. See OSCR, *Revitalising Trusts for Public Benefit*, available at <https://www.oscr.org.uk/news/revitalising-trusts-for-public-benefit>.

¹⁷ Scottish Law Commission, *Report on Trust Law* (SLC No 239, 2014). The full list of publications in the Trusts project is available at <https://www.scotlawcom.gov.uk/law-reform/law-reform-projects/completed-projects/trusts/>.

financial products. This is the aspect of trust law which affects most ordinary people in Scotland, and indeed supports our financial services industry. At the time of the Report in 2014, the total value of property held in trusts in Scotland was conservatively estimated at £500 billion, a figure that has “almost certainly increased since then”.¹⁸ This emphasises the need to modernise trust law.

C. DUSTY OLD LAW: FIXING PROBLEM AREAS

The trust legislation we have is not easily accessible. The Trusts (Scotland) Act 1921 sets out the definition of a trust, the requirements for its creation, the powers and duties of trustees, and some important limitations on trusts. It was certainly a helpful statement at its time, consolidating the Trusts (Scotland) Act 1867 and some minor statutory provisions which existed alongside (frequently inconsistent) trusts decisions from the eighteenth and nineteenth centuries.¹⁹ But it must now be read in conjunction with the Trusts (Scotland) Act 1961, the Law Reform (Miscellaneous Provisions) Act 1990 and the Charities and Trustee Investment (Scotland) Act 2005, as well as relevant taxation legislation. This is not ideal for lawyers, but is worse for lay trustees seeking to understand and implement their duties. In certain circumstances, if those duties are breached, trustees may find themselves personally liable.²⁰

With all the developments in trust practice discussed previously, Scottish practitioners drafting trusts invariably include provisions which deviate from the default statutory rules. Trust deeds are lengthy and complex documents, to counter the gaps and deficiencies in the powers and protections. By the start of the twenty-first century, it was clear that the default rules were no longer fit for purpose. The Scottish Law Commission has undertaken a large-scale review of trust law and practice, culminating in the publication their aforementioned *Report on Trust Law* in August 2014 and a draft Trusts (Scotland) Bill, revised in 2018.²¹ The Scottish Law Commission consulted the profession and looked to other jurisdictions for inspiration, with a view to Scots law being an attractive and competitive forum for trust business. The resulting recommendations are wide-ranging and some of them are quite a

¹⁸ P Nicholson, “Trusts: needing a new engine” (2019) JLSS (December).

¹⁹ W A Wilson and A G M Duncan, *Trusts, Trustees and Executors*, 2nd edn (1995) ch 1.

²⁰ Wilson & Duncan para 28.01.

²¹ SLC, *Report on Trust Law*.

radical departure from the current rules. The Trusts (Scotland) Bill would amend twenty-four Acts and would repeal fourteen Acts in full or in part.²²

The ability to remove and replace trustees without recourse to the courts would be sensible.²³ Default rules on attendance and quoracy in decision-making would be clearer, and this would certainly be more appropriate for remote meetings.²⁴ The rules on delegation of powers to agents, and appointment of nominees, would be clarified, and would be in line with common trust provisions in practice.²⁵

Clarifying the liability of trustees for breach of trust and to third parties would be beneficial since the current law is unclear and relies on inconsistent old authorities. The draft provision would prevent the exclusion of liability in a trust deed where professional trustees are acting but would allow exclusion of liability for lay trustees, provided that they had exercised their fiduciary duties with the requisite level of care.²⁶ Immunity and indemnity clauses would continue to be effective in excluding liability for negligence, but not for gross negligence.²⁷ This strikes a fair balance of protection of beneficiaries whilst keeping the most onerous obligations away from lay trustees.

New default rules relating to provision of information to beneficiaries would be an interesting development, reflecting modern approaches to data and confidentiality.²⁸ Where the duty to provide information has been expressly restricted in the trust deed, that limitation would be subject to review by the court.²⁹ This is a subtle shift towards greater transparency, and aligns with some of the trends noted above.

Another point of interest is the proposal that beneficiaries aged sixteen and seventeen would be incapable of agreeing to the termination of a trust, although their views should be considered.³⁰ This relates back to the point made earlier that trusts are regularly used to prevent such young individuals from inheriting assets outright. “Accumulation and Maintenance” trusts for beneficiaries under the age of twenty-five were quite common until their potential tax advantages were swept aside by the Finance Act 2006. The options for

²² Trusts (Scotland) Bill Schedules 1, 2.

²³ SLC, *Report on Trust Law*, Recommendations 1-11.

²⁴ *Ibid*, Recommendations 13, 14.

²⁵ *Ibid*, Recommendations 19-21.

²⁶ Draft Bill s 27.

²⁷ SLC, *Report on Trust Law*, Recommendations 47-51; Draft Bill s 27.

²⁸ Draft Bill s 25.

²⁹ Draft Bill s 26.

³⁰ SLC, *Report on Trust Law*, Recommendation 82; Draft Bill, ss 54(5)(a), 58, Schedule 1, para 2.

holding assets in trusts for young beneficiaries are now less suited to Scots law in practice, as the “trust for a bereaved minor” and “18-25 trust” in tax legislation are predicated on the English age of majority of eighteen years, and not the lower age of legal capacity in Scotland.³¹ There is an uneasy interaction here between succession, trusts, tax law, and the age of legal capacity, which will not be cured by amending trust law alone.

The powers of the court would also be revised and extended. One of the more extreme proposals is to grant a new power to the court to alter trust purposes in a private trust (not a commercial or public trust) where a material change of circumstances has occurred, and where a trust has been in existence for at least twenty-five years (or a lesser duration specified in the trust deed). The proposed definition is wide:

“change in circumstances” includes (without prejudice to the generality of the expression) a change in— (a) the nature or amount of the trust property, (b) the personal or financial circumstances of— (i) a member of the truster’s family, or (ii) any other person intended to be benefited by the trust, or (c) the tax regime.³²

This wide set of factors could invite creative applications to the court for variation of trusts. The consideration of changing personal or financial circumstances of family members is potentially helpful in dealing with some of the family law issues discussed previously. The court is reminded to have regard to the truster’s intentions, but is not constrained by them, which is a pragmatic way to set up this potentially wide discretion.³³ Moreover, a truster would not be able to exclude or limit the court’s power in the trust deed.³⁴

The possibility of changing the trust purposes when the tax regime changes is also valuable. As has been noted in several points above, taxation is an important driver of the use of trusts and they must be drafted carefully to secure specific advantages, or more crucially to avoid disadvantages under tax law. The powers over inheritance tax and capital gains tax are reserved to Westminster, as is the base of income tax, so the taxation of trusts is uniform across the United Kingdom. Yet, Scottish trust law is fundamentally different from English trust law. The devolution of capital taxes would be challenging and could create new

³¹ Age of Legal Capacity (Scotland) Act 1991; Kessler & Grant, *Drafting Trusts* paras 16.8-16.12.

³² SLC, *Report on Trust Law*, Recommendations 95, 98, 99; Draft Bill, ss 60(12), 71.

³³ SLC, *Report on Trust Law* para 18.48.

³⁴ Draft Bill, s 60(11)

problems.³⁵ Meanwhile, it is undoubtedly useful to be able to amend a Scottish trust in the event of substantial changes in UK tax treatment of trusts.

D. TRUSTS BILL

Reform is overdue and vital. The Scottish Law Commission's Trusts (Scotland) Bill has much to commend it. It consolidates the current piecemeal array of legislation, but more importantly it addresses some of the worst mismatches between the current law and reality by setting sensible, understandable default rules. It clarifies areas of law which are not certain and removes aspects which are no longer relevant. The extended powers of the court mean that trusts could potentially be more flexible and tailored to the changing needs of beneficiaries, whilst maintaining judicial oversight of trust variation. Implementation of this provision might even enhance the useful lifespan of the next Trusts (Scotland) Act, as it would mean that Scottish private trusts would be more adaptable to the needs of future trustees and beneficiaries.

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³⁵ S Eden, "Scotland Act 2016: further tax powers come north" (2016) 20 Edin LR 376 at 378.