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Variation of trusts and trust busting

Synopsis: How to change the terms of a trust, rectify a mistake in a trust deed or terminate a trust.

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General considerations

The terms of a trust can incorporate provisions permitting the trust to be altered. Often this will be possible by way of deed and could cover an alteration of administrative provisions or even provide for beneficiaries to be added, removed or their beneficial interests varied. These powers would usually be vested in the trustees but could be vested in others, e.g. the settlor.

If the trust does not specifically provide for amendment, then if the beneficiaries are all of full age and sound mind, and if they are all ascertained and there is no possibility of further beneficiaries, they can direct the trustees to hand the trust property to them absolutely or they can agree with the trustees to vary the terms of the trust (please see Saunders -v- Vautier (1841). However, while beneficiaries can re-arrange the trust terms, they cannot control the exercise of the trustees' discretions if they decide to allow the trust to continue (please see Morley v Moore, 1936).

Other than that, the only way to change the terms of a trust (e.g. if there are minor beneficiaries who cannot give their consent in the way described above) is to apply to the Court for a variation under Section 57 Trustee Act 1925 or the Variation of Trusts Act 1958. This is considered in more detail below, but in practice this route would rarely be taken.

The Trusts of Land and Appointment of Trustees Act 1996 incorporates a number of provisions to allow the beneficiaries of a trust under which all the beneficiaries are ascertained and between them absolutely entitled to the property (this will include a trust with a life tenant and adult remaindermen who will become absolutely entitled on the death of the life tenant) in some circumstances to direct trustees to comply with their wishes. This has effectively put, to some extent, the principle of Saunders -v- Vautier on a statutory footing.

The method of breaking up a trust is usually by a deed of partition, whereby the trust fund is divided between the beneficiaries. Where the beneficiaries are entitled to different interests (e.g. life tenancy, reversionary interest etc) it would be necessary for the actuarial values of their interests to be calculated. Of course, it would generally be possible for beneficiaries to agree to divide up the fund in whatever proportions they wish (although there may be tax consequences).

A trust can also be brought to an end or an interest of a beneficiary terminated if a beneficiary sells, gives away, releases or otherwise disclaims their interest. This could be to another trust beneficiary or to an outsider, e.g. an entitlement under a trust could be sold to an outsider in order to raise capital. Obviously only interests that are vested, whether a right to income or a right to capital (even if only

reversionary), can be disposed of in such a way. Discretionary interests by their nature do not have any value.

Another possible method of termination of a trust is by the trustees making an advancement of capital out of the trust to the beneficiaries. Where the trust is silent on powers to advance, for trusts created before 1 October 2014 only up to a half of the trust capital can be advanced to beneficiaries under section 32 Trustee Act 1925. This limit does not apply for trusts created on or after 1 October 2014 following an amendment to section 32 by the Inheritance and Trustees' Powers Act 2014. However, there would normally be a wider express power of advancement which could allow all of the trust fund to be distributed to the beneficiaries. This would effectively bring the trust to an end.

Most settlements will also include provisions for the trustees to have powers to appoint trust benefits on further trusts for the beneficiaries. When this happens, the original trust will effectively terminate and be replaced by the new trust.

Although in theory a trust could be expressed to be revocable by the settlor (which revocation would have the effect of its termination), such a trust would be of no effect for tax or probate purposes and so in practice revocable trusts are rarely if ever found in the UK.

Rectification of a mistake in the trust document

It is a well-known fact that once a deed of settlement has been executed it cannot simply be amended subsequently. Certainly, changes will not be allowed simply because the settlor changes their mind.

However, where it is clear that a mistake has been made and there is evidence to support this, a claim for rectification can be made to the Court. The decisions outlined below illustrate the principles.

Cromwell -v- Copley [2004] All ER (D) 339

In this case the settlor claimed rectification of a declaration of trust made in 1996. The declaration created a discretionary trust for the benefit of a wide class of beneficiaries. The settlor sought an order that his wife should be included within the class of beneficiaries on the grounds that the omission of his wife in the declaration of trust resulted from a drafting error on the part of his solicitors. The defendant was appointed to represent all trust beneficiaries who did not oppose the claim. There was also apparently plenty of evidence, namely the instructions given by the claimant to his solicitors. The Court declared that the declaration of trust should be rectified.

It is well established that voluntary settlements can be rectified or set aside as a result of ignorance or mistake. In this case there was strong evidence of fact as well as a legal basis for the claim to be allowed.

While the facts and the decision in this case are straightforward, they serve to remind us that the utmost care should be exercised when executing documents

such as trusts. Ideally, since the trust document is by definition expressed in legal terms, it is advisable that a plain English explanation of the settlor's intentions and the trust provisions is made out and kept for future reference.

Where no evidence of intention can be produced and, especially where any claim for rectification is opposed by another party, for example a beneficiary of the trust or a trustee, rectification may not be possible.

Andrews v Andrews and another [2014]

In this case the Court ordered rectification of a trust deed on the grounds of mistake, it having come to light that the settlors did not appreciate, when they signed the trust document, that it did not reflect their original instructions.

While the aim of the settlors, in setting up the trust, had always been for all their grandchildren to be able to benefit from the property and any income that it generated, the final draft conferred a fixed life interest on their then only grandchild ('Zoe') with future grandchildren being unable to benefit until that grandchild died.

The settlors argued that, although the solicitor's covering letter mentions Zoe's 'absolute entitlement to income' under the trust deed, the fact that this meant that the settlors would lose the ability to benefit anyone other than Zoe during her lifetime was neither discussed with the settlors before the decision to draft the deed in this way was made, or explained to them before they signed the trust deed.

Holding that "there was indeed a mistake as to the legal effect of the trust deed of settlement into which [the settlors] entered on 1st November 2010", the Court ordered the deed to be rectified so that an overriding power of appointment was inserted to enable other grandchildren to benefit before the death of the first grandchild.

An interesting facet to this case is that the instructions for the trust were taken by the clients' financial adviser and passed to the solicitor for drafting. To this end, the case highlights how easily information can become 'lost in translation' and reiterates the importance of ensuring that the client fully understands – and appreciates all the implications of – a trust document before signing.

Lawie v Lawie & others [2013] WTLR 85

This case illustrates the importance of correct completion of "standard" trust "forms" which may include inserting appropriate details in boxes provided on the form.

While the use of "standard" trust forms makes things easier for advisers and clients alike, completion of the said "trust forms" sometimes is not as diligent as it should be. Boxes which should be completed or ticked may be left uncompleted or not ticked. There may be a wrong word added by mistake. Does it matter? Can words be just added or changed later on? Can a mistake or a typo be simply "amended"

and initialled? The case mentioned above is a perfect illustration of what can happen in such circumstances.

In 2005 Mr and Mrs Lawie, with advice from a financial planner, decided to invest £100,000 into a Legal & General Portfolio Bond which was to be held in a flexible trust for their children and grandchildren. They wanted flexibility of being able to change beneficiaries. Their two grandchildren were named as the default beneficiaries. Under this type of flexible trust, the named beneficiaries would normally be entitled to the trust income outright and to the trust fund in default of another appointment in favour of discretionary beneficiaries. That would be the norm; however, under this particular "trust form", in order to retain the flexibility, "part 3" of the form had to be completed by inclusion of the details of the discretionary beneficiaries.

Unfortunately, the adviser who completed the form on behalf the Lawies (who signed the form, clearly without a proper check or understanding) failed to complete the said "part 3". The result was that the two named grandchildren were absolutely entitled despite the trust being called "flexible trust".

Mr Lawie and the executors of Mrs Lawie (as she had died by then) made an application to the Court to rectify their trust deed by an inclusion of the names of the discretionary beneficiaries in "part 3". The applicants were able to confirm to the Court their original intentions which were corroborated by the report from the adviser.

Initially, Mr Lawie also claimed that he had intended to include his own name in "part 3", but this was not corroborated and this part of the application was dropped. The application was opposed by one of the grandchildren, whose interest under the trust was at risk of being diluted or even lost completely, however, he did not put forward a case for his objection. In this case the Court was satisfied that a mistake occurred in preparing the trust deed and granted rectification.

The crucial point to remember about deeds is that once a deed has been signed and dated, it has a full legal effect and it is treated as accurately setting out the parties' intentions. This is necessary to ensure legal certainty of transactions. If there is a genuine mistake in the document, the Court may allow rectification, but the process is by no means straightforward.

As can be seen from the above, rectifying a faulty trust is not straightforward. The remedy is at the Court's discretion. The Court will take account of all the evidence before it, whether in support of or in opposition to the application for rectification and there can be no certainty of the outcome. Not to mention the costs involved. All of which, needless to say, can be avoided by ensuring that each and every trust form is correctly completed, after careful discussion of the trust provisions between the adviser and the client.

It should be noted that a mistake in the trust document is an entirely different matter to a mistake made by the trustees when exercising their powers under the trust.

Variations by the Court

If the beneficiaries of a trust are not *sui juris* or not all ascertained and it is desired to vary a trust, it is necessary that an application be made to the Court for a variation of the trusts. It is important to make a distinction for this purpose between two classes of variation by the Court...

(i) a variation concerned with the *management or administration* of the trusts, and

(ii) a variation of the *beneficial interest* arising under the trusts.

The Court has always had an inherent jurisdiction to sanction a departure from the terms of a trust, but it is now clearly established that this applies only to the management or administration of the trust. It does not apply to any rearrangement of the rights of the beneficiaries to the beneficial interests.

(a) Section 57 Trustee Act 1925

The Court's inherent jurisdiction to vary a trust has been largely superseded by section 57 of the Trustee Act 1925. The basis of this section is *expediency*. It provides in effect that the Court may empower trustees (but not Settled Land Act trustees) in the management or administration of the trust property to perform any act which is not authorised by the trust instrument if, in the opinion of the Court, it is expedient.

The ambit of the section was considered by the Court of Appeal in *Re Downshire's Settled Estates, Re Chapman's Settlement Trustees* and *Re Blackwell's Settlement Trusts (1953)*. According to Lord Evershed and Romer L J in their joint judgement, "the object of section 57 is to secure that trust property should be managed as advantageously as possible in the interests of the beneficiaries, and with that object in view, to authorise specific dealings or types of dealings with the property which the Court might have felt itself unable to sanction under the inherent jurisdiction, either because no actual "emergency" had arisen or because of inability to show that the position which called for intervention was one which the creator of the trust could not reasonably have foreseen; but it was no part of the legislative aim to disturb the rule that the Court will not rewrite a trust."

Moreover, the Court must be satisfied that the proposed transaction is for the benefit of the whole trust and not simply for a beneficiary.

Section 57 does not, therefore, confer on the Court any general jurisdiction to vary beneficial interests. It is limited to the managerial supervision and control of trust property by the trustees and cannot be stretched further than that.

However, subject to this important limitation, it is an overriding provision to be read into every trust and it has been used for various purposes, for example, to authorise the partitioning of land where the necessary consent could not be obtained, the sale of a reversionary interest which the trustees had no power to sell until it fell into possession, or to blend two charitable funds into one. Indeed, the

section has also been used to extend trustees' investment powers although an application for this purpose if needed prior to the Trustee Act 2000 coming into force, would have preferably been made under the Variation of Trusts Act 1958. (Please see below).

With regard to investment powers, in a series of cases decided shortly after the Trustee Investments Act 1961 came into force, the Courts indicated that special reasons had to be given before they would exercise their jurisdiction (either under the Variation of Trusts Act 1958 or under the Trustee Act 1925) so as to give powers wider than those conferred by the 1961 Act. In the *Mason -v- Farbrother* [1983] All ER 1078inflation since 1961 and the fact that the trust was a pension fund were treated as special reasons justifying the use of section 57 to substitute for a narrow power of investments a new wide power of investment. Megarry V-C has since held in *Trustees of British Museum -v A.G.* [1984] 1All ER 337 that there is now no need to prove special reasons: each case should be treated on its own merits. In considering what extended powers of investment should be conferred the Court should consider the object of the trust (e.g. if capital appreciation were sought to enable capital purchases), the size of the trust fund (more latitude for larger funds), the width and efficacy of provisions for advice and control, while the wider the proposed powers the more should consideration be given to restricting them to a specific fraction of the fund.

In *Anker-Petersen -v- Anker-Petersen* [1991] 16 LS Gaz R32 involving a trust fund of over £4 million the Court authorised under section 57 many transactions, so enabling the trustees to take full advantage of the services of a discretionary portfolio manager authorised under the Financial Services Act 1986.

First, the trustees were given power to invest in assets of any kind anywhere as if they were beneficial owners, subject to obtaining advice from an Investment Adviser being any person reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters to advise them on investment matters, and having regard to the need for diversification, the suitability of investments, the desirability of diminishing the risk of loss and need to strike a balance between income yield and capital appreciation.

Second, the trustees were given power to hold investments in the name of nominees.

Third, the trustees were given a general power to borrow money.

Fourth, the trustees were empowered to employ an Investment Adviser to act as discretionary portfolio manager (thereby delegating their crucial investment role), subject to laying down policy guidelines for the manager and using reasonable endeavours to ensure that the guidelines were observed and subject to the trustees being liable for any failure to take reasonable care in selecting a manager, fixing or enforcing the terms on which he was employed, or remedying any breaches of those terms or otherwise in supervising the manager, but not otherwise being liable for the acts or defaults of the manager.

While a variation of investment powers will rarely be needed today (because of the wide powers conferred by Trustee Act 2000), these decisions may still be relevant where the trustees' investment power has been restricted.

(b) Variation of Trusts Acts 1958

Where not all the beneficiaries are sui juris and ascertained and the proposed variation is outside the scope of Section 57 Trustee Act 1925, the only way to vary the trust provisions is to apply to Court under the Variation of Trusts Act 1958.

The Court has power, under the 1958 Act, to vary the beneficial interests under the trust (as well as the management or administration of the trust) and may also consent to a variation on behalf of minor/unascertained beneficiaries (although such consent will only be given if the Court is satisfied that the variation is for the benefit of those beneficiaries). It should be remembered that consent of all the beneficiaries who are sui juris must be obtained before the Court will consider the application.

Many applications have been made under the Variation of Trusts Act 1958 to extend the trustees' investment powers as well as to vary the beneficial trusts.

However, until 1984, only in one reported case have "special circumstances" justifying an extension been found. This is *Re University of London Charitable Trusts (Ch282)*, a case relating to charitable trusts. Wilberforce J held (inter alia) that he was entitled to extend the range of investments beyond that permitted by the Act of 1961 because, if he did not, the benefits of a proposed combined investment pool which would arise from the saving of administrative expenses, convenience of administration and the practicability of dividing the combined pool into parts would be frustrated.

As stated above, with the Trustee Act 2000 granting a wide investment power to trustees there should rarely now be a need for similar applications.

Cases in which the Court may approve an arrangement enlarging the powers of the trustees are not, of course, confined to those involving investment. Thus, in one case approval was given to the retention of remuneration by director-trustees; and in another, involving the trusts of a Will where the testator had died before 1926, approval was given to an arrangement which gave the trustees the power of advancement contained in section 32 of the Trustee Act 1925.

Currrently, where no alteration of beneficial interests is sought so that it is only wider administrative powers that are sought, it is more convenient to use section 57 of the Trustee Act 1925 as emphasised in *Anker-Petersen -v- Anker-Petersen*.

The advantages of section 57 are that the trustees are normally the applicants (unlike the position under the 1958 Act), it is not essential to obtain the consent of every sui juris beneficiary, the Court is not required to be given consent on behalf of every category of beneficiary separately but considers their interests collectively in income on the one hand and in capital on the other, so that section 57

applications are cheaper and more straightforward, especially because they are taken in chambers while 1958 Act applications are taken in open Court.

It should be borne in mind that any application to the Court to vary any provision of a trust will in any event represent an expensive alternative and frequently the costs involved in such an application will outweigh the benefits that can be achieved.

The 1958 Act has also been used to extend the statutory power to advance capital contained in section 32 Trustee Act 1925. In *CD (a minor) -v- O. [2004] EWHC 1036 (Ch) the Court agreed to vary a trust so as to extend the statutory power in section 32 Trustee Act 1925.

This case concerned a life policy trust. Following the death of the life assured the proceeds of two life policies were held on trust for three minor children in equal shares absolutely. The trustees treated the trust fund as if there were three separate funds for each beneficiary although the funds were not actually divided. The application was made on behalf of one of the beneficiaries. The income from her fund was applied to pay her school bills but was insufficient.

The question was therefore to what extent the trust capital (from the beneficiary's fund) could be used for that purpose. The trustees had no express wide power to advance capital, instead they were subject to the statutory provisions in section 32 Trustee Act 1925. This allows the trustees to apply not more than one half of the trust capital for the advancement of the beneficiary absolutely entitled. The trustees had already advanced part of the capital to pay the beneficiary's school fees. The application was made to the Court to, in effect, allow the trustees to use the whole of the capital of that beneficiary's fund, should it be necessary, for that purpose.

The Variation of Trusts Act 1958 applies where "property...is held on trusts... arising...under any will, settlement or other disposition". The Court held that it had jurisdiction in relation to the trust in question. It should be remembered that the Court will only approve a variation of a trust if it is satisfied that it is for the benefit of the relevant beneficiary. In the present case, based on the available evidence the Court was satisfied that the proposed variation was for the beneficiary's benefit and accordingly allowed the extension of the statutory power to advance to the whole of the beneficiary's fund, rather than just one half.

This case illustrates the restrictions that apply when one relies on statutory provisions as well as the need to carefully draft trust clauses. Unsurprisingly perhaps, statutory powers tend to err on the side of caution. The power of advancement is one example (although this has now been extended under the Inheritance and Trustees Powers Act 2014 Another is the statutory power of maintenance (section 31 Trustee Act 1925).

In each case it should of course be up to the settlor to decide what powers should their trustees have. These should be set out in the trust document - which will serve as a sort of "rule-book" for the trustees.

It is generally preferable if wide express powers are granted in the trust document rather than relying on the now somewhat outdated statutes. And it must be remembered that once the trust is created there are very limited ways in which it can be varied, especially where there are minor beneficiaries. Whilst on the facts the case of CD v O seemed relatively straightforward, it still had to involve an application to the Court with the related Court and legal fees. And should a similar issue arise in connection with the one or both remaining beneficiaries of the trust in question, a further application would have to be made - remember that in each case the Court must consider the relevant beneficiary affected by the proposed variation and must be satisfied that any proposed variation is for the benefit of that beneficiary.

All this trouble would have been avoided if the trust contained a wide express power to advance, instead of relying on section 32.

More recently, in Wright v Gater [2011] EWCH 2881(Ch), the Court was faced with an application under the 1958 Act to vary the terms of the statutory trust imposed on intestacy where the minor beneficiary's mother was opposed to his significant inheritance vesting at 18 and considered that creating a trust contingent upon attaining 30 would much more in her child's interest. Norris J made several useful points about the criteria to be applied when considering such an application...

- Previous decisions were all instructive but ultimately were driven by their own particular circumstances.
- While "benefit" is generally financial in nature it does not have to be. However, when assessing non-financial aspects, a judge has to be careful not simply to apply personal preferences and perceptions. One step towards making the assessment of non-financial benefit objective is to ask whether a prudent adult, motivated by intelligent self-interest, and after sustained consideration of the proposed trusts and powers and the circumstances in which they may fall to be implemented, would be likely to accept the proposal.
- Postponement of vesting can be of benefit and may be justified on the facts of a particular case; "perhaps because of the proven personal characteristics of the beneficiary; or perhaps because the size of the fund, the circumstance in life of the beneficiary, the family context in which the existing trusts will be implemented or some similar feature (the list is not exhaustive) gives rise to risks which any reasonable person would regard as real, and to which the proposed variation provides a sufficient and proportionate response." But, in this case he could not find that postponing the vesting age until 30 was of benefit, indeed it would come "dangerously close to (if not cross) the line between variation and resettlement". Nothing would remain of the statutory trust. Further there was nothing in the life and circumstances of the child to indicate that there were real risks if vesting was not postponed until 30.

On this basis, the Judge agreed to a compromise whereby the child would be entitled to income at 18, to 10% of the actual capital at 21 and to the remainder at age 25.

International aspects

An application to the Jersey Courts to vary the trusts' terms and the proper of law of the trust (in the matter of the representation of N and N, 1999 JLR 86) - reminded us of the importance of the law of trusts as well as the principle of the rule in Saunders v Vautier.

In the case in question a non-resident accumulation of maintenance trust was set up in Jersey for the benefit to the settlors' six children. The trust assets comprised shares in some 49 companies of an estimated gross value of £450 million and comprised investment properties in the UK, Israel and other locations.

The trust was set up before 1991 primarily for UK capital gains tax (CGT) purposes. The settlors were excluded from benefiting from the trust and a letter of wishes from the settlors indicated that the family fortune should remain intact for the benefit of the family for many years to come. The letter of wishes also gave the impression that the settlors thought they had created a discretionary trust.

Following changes to capital gains taxation introduced in the Finance Act 1998, tax advice was obtained and the opinions of several senior Counsel were that the property of the trust should be transferred under one of the trust powers to a new and separate settlement which was distinct from the existing one. Application for a variation of the trust was made to Court under Article 43 Trusts (Jersey) Law 1984.

The provisions for trust variation in Jersey are similar to their equivalent in England in that a Court can approve an arrangement to vary the trust on behalf of a minor or indirect beneficiary, i.e. a beneficiary who cannot give consent themself. Agreement of all the adult and ascertained beneficiaries is of course required in any event before any variation can take place. The Court had to consider whether the variation was for the benefit of the beneficiaries and in this particular case the decision was to approve the proposed variation.

The interesting part of the case was that one of the beneficiaries under the trust on whose behalf the Court was giving consent was in fact a 19-year-old beneficiary temporarily resident in Israel. At that age he was no longer a minor either in Israel or in the UK. However, he was still a minor in Jersey. This is an interesting point to bear in mind when a choice of law is available when a trust is being drafted.

Readers will be aware that under the Recognition of Trusts Act, a person domiciled in the UK can choose a trust to be governed by any valid trust law. Of course, in most cases it would be sensible to choose the law which is the law of the domicile of the settlor or the trustees. Where it is intended that the trust should be non-resident, often the law of the trustees' jurisdiction would be chosen. It should clearly be recommended that the settlor is aware of any special points or peculiarities of the local law before a commitment is made. It may also make sense

to include a provision in the trust for the proper law and forum for the trust administration to be changed by the trustees in certain circumstances.

It will be seen from the above that the basic principle for variation of trusts in Jersey is similar to that in England, namely that the agreement of all the sui juris beneficiaries is required. This stems from the rule in Saunders –v- Vautier [1841] EWHC ChJ82 although, interestingly, that particular case only established that a beneficiary who has an absolute indefeasible interest in the legacy is not bound to wait until the expiration of this period but may require payment at the moment he is competent to give a valid discharge. It was only in Wharton –v- Masterman [1895] AC 186 that this principle was confirmed as the rule in Saunders –v- Vautier. Moreover, it was only then when the rule was extended to apply to collective situations, that is, cases where two or more beneficiaries are between them absolutely entitled or between them absolutely entitled in succession.

This principle was confirmed in Re Nelson [1928] Ch 920n where four beneficiaries were between them absolutely entitled and the Court held that they could come to Court and say to the trustees "hand over the fund to us". Effectively you would treat the people put together just as though they formed one person for whose benefit the trustees were directed to apply the whole of a particular fund.

It should be noted that although the principle seems to be based on common sense, it is not followed in all jurisdictions. For example, while the American Courts initially followed it, in 1889 the Massachusetts case of Clafin –v- Clafin ZONE 454 changed the practice completely and emphatically rejected the rule. Contrary to the English approach, it was held that the testator's (or settlor's) right to dispose of his property as he thought fit should prevail over the beneficiaries' freedom of alienation. Admittedly, there are some provisions in US trust legislation for a trust to be broken by adult beneficiaries in some circumstances, but this is far more limited than the English law equivalent.

It has been said that the greatest legacy of the Saunders –v- Vautier has been the ability it gives to the beneficiaries to terminate or re-write trusts to lessen the impact of taxes. It should be added that any variation has to be done with the consent of the trustees – if the trustees do not consent, then all that the beneficiaries can ask for is for the trust to be terminated. However, as the above Jersey case shows, the principle can prove to be extremely useful.

The quoted case also illustrates the importance of all parties connected with a trust (especially the settlor) understanding the trust provisions and its purpose. Even where, as in the case quoted, considerable expertise was used in setting up a trust, the settlors were under a misunderstanding as to the nature of the trust they had created. As it happened, the Court approved the variation of the trust but this should not be relied on. Furthermore, the choice of law may have some unexpected consequences.