

AF1/J02 Trusts.

Part 2 Legal issues

The way in which trusts operate is governed by different Acts of Parliament and case law. These are more likely to be tested in J02 and but AF1 candidates should be aware of them. It should be remembered that these exams are set for financial advisers rather than solicitors or barristers so a general understanding of the principles is all that is required.

The milestones for this part are to understand:

- The three certainties of a trust.
- The differences between a trust and a contract
- The different legal terms for how trusts can be set up.
- The rules on registering a trust
- The rules on Perpetuities and Accumulations
- How a trust can be changed

The three certainties of a trust

For a court to recognise a trust as valid, it must satisfy what is termed the three certainties. These have been established by case law through the years with the leading case being Knight v Knight 1840.

Certainty of words or intention.

In other words, did the settlor intend to create a trust or was the transfer an absolute gift? This will normally be verified by the trust deed, the will or the actions of the settlor

Certainty of subject or property

It must be quite clear what property is to be held on trust. It must also be clear what interest each beneficiary has in the property.

Certainty of objects or beneficiaries

The trust must identify who can benefit. This can either be done by naming them or by having a formula that enables them to be identified. A wording that used “my family” to identify beneficiaries would be too vague.

The difference between a trust and a contract

This is one of those “stock” questions that examiners seem to include on a regular basis.

With a trust:

- No offer or acceptance is required.
- No consideration is needed.
- A beneficiary does not need to be aware of the trust
- Minors can be a party or beneficiary
- Beneficiaries can enforce legal rights to the trust

With a contract

- Offer and acceptance are required
- Consideration is required
- Both parties must be aware of the contract
- Each party must be 18 or over
- Only the parties to the contract have legal or equitable rights under the contract.

Legal terms used in setting up trusts

There are some legal and technical terms that you should be familiar with.

Express Trusts

Express here derives from “expression” and doesn’t mean the trust was put together in record time. It simply means that it is set up by a deed although it could also be made by an express oral declaration

Implied Trust

Conversely the actions of the different parties imply that they wish to set up a trust.

Presumptive Trust

This occurs where one person purchases property in the name of another so there is a presumption that the buyer is holding it in trust for the other.

The presumption does not apply when property is purchased for a spouse, child or for someone who the purchaser acts as guardian.

Constructive Trusts

This is one imposed by law on an individual to hold property for another person regardless of the intentions of those involved. Trustees are not formally appointed but are constructive trustees. An example would be where a trustee has allowed someone who is not a beneficiary to become entitled to the trust property. This is a breach of trust and the property would form part of a constructive trust. The recipient must hold this property for the beneficiaries. Any growth or profit on the asset will also belong to the trustees

Successive Trusts

Here property is held for successive interests. The trust needs to specify that each interest takes effect at the conclusion of the earlier one and the final interest is the ultimate trust.

Resulting Trusts

An example would be when a trust is made on a life policy for the beneficiary of the settlor's spouse but no one is named. If the spouse dies and the settlor does not remarry then the trust fails and will fall back into the settlor's estate on their death.

Trust Registration

Most trusts must now be registered with HMRC through its **Trusts Registration Service (TRS)**. This is in addition to registering for self-assessment. The rules were extended on October 8 2020 as part of the UK implementation of the Fifth Money Laundering Directive/

Trusts that must be registered

- All UK express trusts
- Non-UK express trusts that:
 - Acquire land or property in the UK after 6 October 2020
 - Have at least one UK resident trustee and enter a new business relationship with a UK relevant person

Trusts that are exempt

- Statutory trusts such as a trust created by intestacy
- Trusts created by a court order
- UK registered pension trusts
- UK charitable trusts
- Trusts holding insurance policy benefits provided that these are paid out within two years of death
- Pilot Trusts for future use set up before 6 October 2020 which hold no more than £100

- Will trusts created on death that only receive assets from the estate and are wound up in two years of death
- Will trusts that only receive death benefits from a life insurance policy and are wound up within two years of death.
- Trusts for vulnerable beneficiaries or bereaved minors
- Personal Injury Trusts

A key difference between the pre October 2020 rules and the current ones is the treatment of an Investment Bond in Trust. These did not need to be registered under the old rules until there was a Chargeable Event. They must now be registered when they are set up.

Bare trusts must also be registered.

How and when to register

One trustee is usually nominated as the “principal acting trustee”

The details that are required are:

- The name of the trust
- The date when it was established
- Where the trust is registered.
- The names of the settlor, trustees and protector (if any) together with their date of birth, and National Insurance number
- The name, date of birth and NINO of all individual beneficiaries. If they are unspecified, the description used in the trust
- Details of the assets in the trust

For trusts set up on or after 6 April 2021 must be registered by 90 days of being created or liable for tax or 1 September 2022 whichever is the latest.

For “non taxable “trusts, such as an Investment Bond in trust which now come under the new rules must register by 90 days of being created or liable for tax or 1 September 2022 whichever is the latest.

Perpetuities and Accumulations

The rules on perpetuities relate to how long a trust can exist. The rules on accumulations relate to how long a trust can accumulate income without paying it out to a beneficiary.

Perpetuities

Under the Common Law rule a gift that depends on the fulfilment of conditions will be void at outset if it cannot vest within the perpetuity period. For example, a trust “for my children for life, thereafter to their children for life “and so on would be invalid. A maximum period was set as being the life of a specified person (who need not be a party to the trust) plus 21 years. If no life was nominated those who are relevant to whether it will vest will determine the perpetuity period.

The **Perpetuities and Accumulations Act 1964** modified the Common law rules. It states that the ultimate interest under a trust must vest within one of the following periods, either one of which can be chosen by the trust:

- A fixed period of 80 years from the date the trust was created.
- The lifetime of a specified person alive when the trust was created plus 21 years

The **Perpetuities and Accumulation Act 2009** introduced a single period of 125 years and this applies to all trusts created after April 6 2010

Accumulations

Under the **Law of Property Act 1925**, income may not be accumulated for longer than one of four periods:

- life of the settlor
- 21 years from the death of the testator or settlor
- the minority or minorities of any persons living at the death of the testator or settlor
- the minority or minorities of any persons entitled under the settlement.

Two further periods were added by the Perpetuities and Accumulations Act 1964:

- the period of 21 years from the date of making the disposition.
- the minority or minorities of any person in being at that date.

The 2009 Act gave trustees the right to accumulate income for the whole of the trust period but a charitable trust can now only accumulate for a maximum of 21 years.

Changing a Trust

Once a trust has been set up it cannot be changed by any of the three parties unless the trust wording allows them to do this; it is irrevocable.

It is possible to change the beneficiaries using a power of appointment or discretionary trust but only within the prescribed classes.

There are some exceptions to the rule about varying or changing a trust.

- Using the **Trustee Act 1925, s57**. A court can give trustees power to do something outside their given powers if it is expedient for the trust as a whole. It cannot be used to vary the beneficial interests of the trust.
- Using the **Matrimonial Causes Act 1973** to vary any trusts of any marriage settlement made for the benefit of the parties or their children.
- Using the **Variation of Trusts Act 1958**. This gives a court discretion to vary trusts and beneficial interests. It cannot be used to take away the interest of an adult beneficiary.
The Court can only vary the rights of
 - Beneficiaries that are incapable of assenting due to infancy or capacity
 - Contingent beneficiaries
 - Unborn beneficiaries
 - Beneficiaries with a discretionary interest under a protective trust

Finally, the beneficiaries can ask the trustees to wind up the trust and distribute the assets under the **Saunders v Vautier** rule. This allows a trust to be ended if all beneficiaries are over 18, there is no possibility of other beneficiaries and all agree.

That concludes this part so you should now understand:

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- The rules on registering a trust
- The rules on Perpetuities and Accumulations
- How a trust can be changed

Further reading

<https://www.gov.uk/guidance/register-a-trust-as-a-trustee>

<https://www.azets.co.uk/news-insights/articles/new-hmrc-trust-registration-service-trs/>