



# REVIEW OF TRUST LAW IN NEW ZEALAND: INTRODUCTORY ISSUES PAPER



LAW·COMMISSION  
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The Law Commission is an independent, publicly funded, central advisory body established by statute to undertake the systematic review, reform and development of the law of New Zealand. Its purpose is to help achieve law that is just, principled, and accessible, and that reflects the heritage and aspirations of the peoples of New Zealand.

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## FOREWORD

A full review of the Trustee Act 1956 is long overdue. It needs modernisation. Some provisions need clarification and anomalies should be removed. The Law Commission published a report on *Some Problems in the Law of Trusts* in 2002 and this resulted in the Trustee Amendment Bill 2007. However, it became clear from submissions to Select Committee that there are problems and issues with trusts that were not traversed by the Commission in its 2002 report. The current review is a consequence of a call for a further, more comprehensive consideration of trusts, trust law and the Trustee Act 1956.

A full-scale review of the law of trusts is a major undertaking and will take time. The Law Commission has therefore decided to publish a series of Issues Papers on different aspects of the review. This first Issues Paper is essentially a background paper covering a brief history and development of trusts, what are their core features, the New Zealand Trustee Act 1956, and comparative overseas legislation, and particular problems to which the Law Commission has been alerted.

Issues Paper 1 will be followed shortly by a second Issues Paper that we aim to publish in December 2010, considering the uses of family trusts in New Zealand, and potential concerns about some of these. Issues Paper 2 should be of interest for the many New Zealanders who have trusts or are involved in trusts in any way. Issues Paper 3 on variation of trusts and the law against perpetuities will be published early in 2011.



*Geoffrey Palmer*

President of the Law Commission

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Members of the reference group are:

- Kerry Ayers of Helmore Ayers
- Andrew Butler of Russell McVeagh
- Chris Kelly of The New Zealand Guardian Trust Company
- Greg Kelly of Greg Kelly Law
- Jessica Palmer, Senior Lecturer of University of Otago
- Bill Patterson of Patterson Hopkins
- Professor Nicola Peart of University of Otago

The commissioner responsible for this reference is George Tanner, QC. Sir Geoffrey Palmer, President of the Law Commission has also been involved in the first part of this review.

The researchers and writers of this Issues Paper were Janet November, Senior Legal and Policy Adviser, Marion Clifford, Legal and Policy Adviser and Susan Hall, Senior Legal and Policy Adviser.

# Call for submissions

Submissions or comments (formal or informal) on this Issues Paper should be sent to Marion Clifford, Legal and Policy Adviser, by **28 February 2011**.

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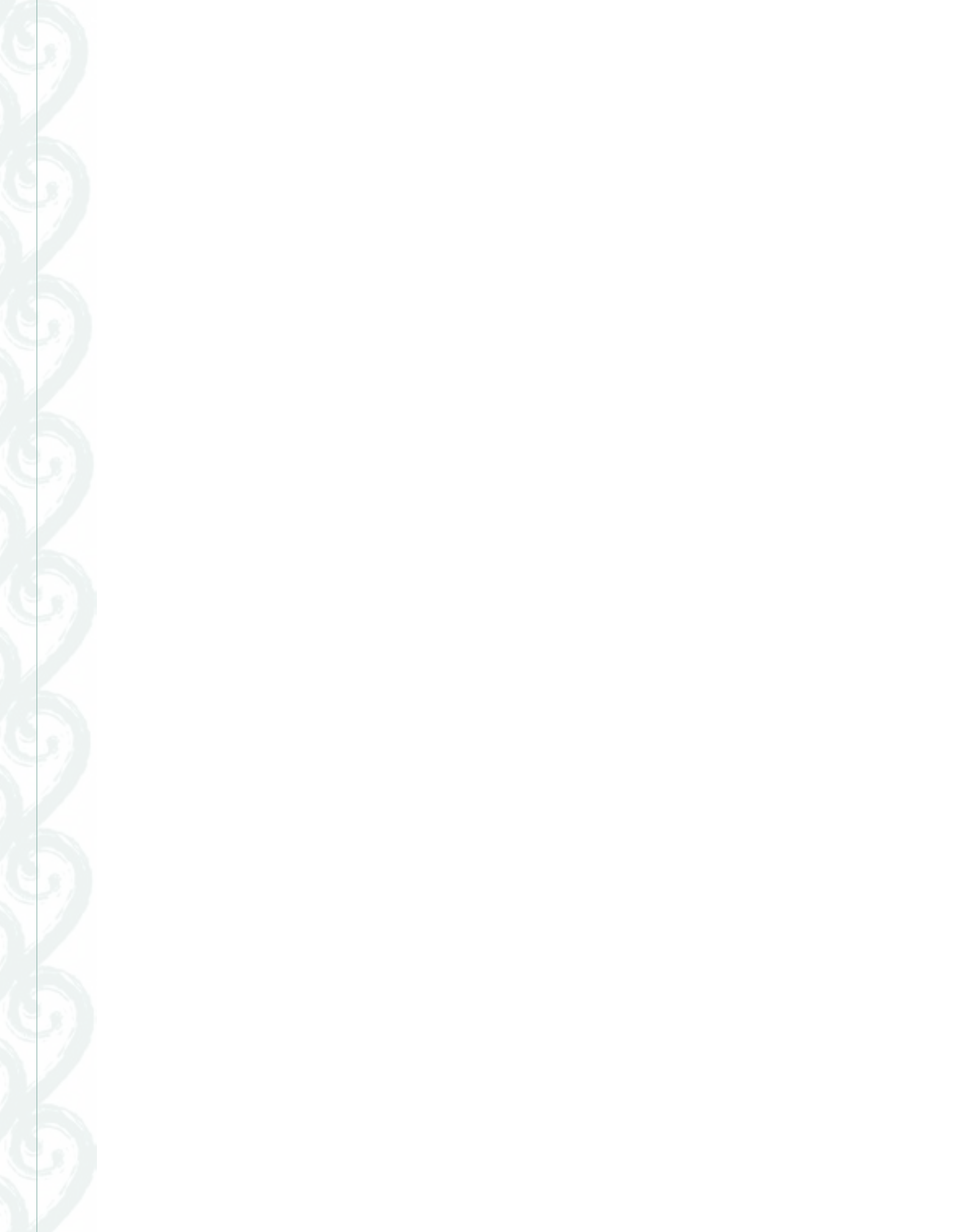
**or by email to [trusts@lawcom.govt.nz](mailto:trusts@lawcom.govt.nz)**

The Law Commission asks for any submissions or comments on this introductory Issues Paper on the review of the Law of Trusts. The submission can be set out in any format but it is helpful to specify the number of the question you are discussing.

There are some questions in chapters 3 and 4 of the paper that pinpoint the queries on which comments would be most valued. Submitters are invited to focus on any of these questions, particularly in areas that especially concern them, or about which they have particular views. It is certainly not expected that each submitter will answer every question.

Alternatively, submitters may like to make a comment about the trusts review that is not in response to a question in the paper and this is also welcomed







# Review of Trust Law in New Zealand

## Introductory Issues Paper

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# Chapter 1

## Introduction to the project

### TRUSTS LEGISLATION

- 1.1 In New Zealand, trusts law is contained in both case law and statute. Many of the rules surrounding the creation and use of trusts stem from ancient principles of equity and English cases that have existed for scores, and in some cases, hundreds, of years. In some instances, New Zealand courts have taken these rules and given them their own domestic flavour. In other cases, the rules and principles have changed little from their origins.
- 1.2 Other aspects of trusts law are contained in legislation. The main statute is the Trustee Act 1956. Its provisions relate mainly to the administration of trusts and their oversight by the courts. The Act re-enacts provisions of the 1908 Trustee Act which itself was a consolidation of earlier provisions that were scattered among a number of New Zealand statutes. The structure and wording of the Trustee Act 1956 are based closely on England's 1925 Trustee Act. The Act has not been reviewed as a whole since its enactment more than 50 years ago.
- 1.3 The Perpetuities Act 1964 is also relevant to trusts. It sets out a number of technical rules relating to the “rule against perpetuities”, that is, the rule determining the date within which the interests in a trust must vest.<sup>1</sup>
- 1.4 The Charitable Trusts Act 1957 exempts trusts that have an altruistic nature from various rules of law that are inconvenient or inappropriate for such organisations.<sup>2</sup> It provides for the trustees of certain trusts to incorporate as a board, with the associated benefits of perpetual succession and separate legal personality. Other provisions further facilitate the administration of charitable trusts, including by allowing the variation of these trusts.

1 The rule against perpetuities (or against the remoteness of vesting) has existed in the common law since the 17th century: see *The Duke of Norfolk's case* (1682) 3 Ch Ca 1, 22 ER 930, affirmed by the House of Lords (1685) 3 Ch Cas 54, 22 ER 963. The purpose of the rule is to promote freedom of alienation of property and the enjoyment of property by the living, prevent continuous entailment of estates and the tying up of property by the “dead hand” and also to reduce uncertainty of title.

2 A Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at 302.

- 1.5 The Trustee Companies Act 1967 and a number of other Acts that each establish “trustee companies” are also relevant.<sup>3</sup> Trustee companies act as the trustees of private trusts and also carry on business as trustees for holders of debt securities, statutory supervisors as regards participatory securities, trustees of unit trusts and superannuation schemes, and statutory supervisors for retirement villages.
- 1.6 Other legislative provisions have an impact on trusts. A number of Acts contain rules that enable the courts or some person to disregard a trust for certain purposes and access its assets. And, finally, some Acts establish specific rules for particular types of trusts: the Superannuation Schemes Act 1989 makes provision for superannuation, or pension, trusts; the Unit Trusts Act 1960 deals with unit trusts, established to hold and invest assets on behalf of a pool of investors for mutual gain; sections of the Securities Act 1978 relate to trustees of debt securities; and the Electricity Act 1992 places some requirements on the trustees of energy trusts.

THE LAW  
COMMISSION’S  
REVIEW OF  
THE LAW OF  
TRUSTS

- 1.7 The Law Commission’s task is to review some of these pieces of legislation. We propose to do this in three stages:
  - Stage one of the review will consider the Trustee Act 1956 and the Perpetuities Act 1964, with a review of trusts law generally;
  - Stage two will consider the Charitable Trusts Act 1957;
  - Stage three will consider the trustee companies legislation.
- 1.8 We will consult on various aspects of the review by way of a series of short Issues Papers. This is the first Issues Paper on stage one of the review. Stage one aims to include Issues Papers on:<sup>4</sup>
  - The history and nature of trusts, recent developments in the structure of trusts and the scope and framework of a revised Trustee Act (this paper);
  - Problems with the use of trusts, including issues relating to relationship property, creditor protection, qualification for Government assistance and sham trusts (December 2010);
  - The Perpetuities Act 1964 and the variation and resettlement of trusts (first quarter of 2011);
  - Trustees’ duties and liabilities, and beneficiaries’ rights, including indemnity provisions and exemption clauses, and proposals to improve trustee accountability (second quarter of 2011);
  - The office of trustee and trust administration, including discussion of trustee corporations, the capital and income distinction and court supervision of trusts (fourth quarter of 2011);
  - Trustees’ powers, including delegation, investment and insurance (fourth quarter of 2011);
  - Any remaining issues, including trading trusts, non-charitable purpose trusts, the Hague Trusts Convention, registration of trusts and obligations for trust advisors (fourth quarter of 2011).

3 Trustees Executors Limited Act 2002, Guardian, Trust, and Executors Company Act 1883, AMP Perpetual Trustee Company Act 1988, New Zealand Insurance Company Trust Act 1916, PGF Trust Limited Act 1989, New Zealand Permanent Trustees Limited Act 1991 and New Zealand Guardian Trust Company Act 1982.

4 The timeframes given for the publication of future Issues Papers are indicative only and may be subject to change. Please check the Law Commission’s website for details.

2002 LAW  
COMMISSION  
REPORT AND  
THE TRUSTEE  
AMENDMENT  
BILL 2007

- 1.9 The Commission will then release a final report on stage one which will include draft legislation. Work on stages two and three of the review will follow.

- 1.10 In his keynote address to the 2001 New Zealand Law Society Trusts Conference, Justice Blanchard described the Trustee Act 1956 as badly in need of rewriting. He referred to “large slabs of undigested text on obscure topics” and to a failure to state concepts “in the crisp, clear way which would be regarded as essential in a commercial context”. In 2002, while acknowledging the need for a complete overhaul of the Act, the Law Commission conducted a more limited review of some of its aspects. The review culminated with the report *Some Problems in the Law of Trusts*.<sup>5</sup> In that report, the Commission made recommendations relating to a short but diverse list of matters.<sup>6</sup>

- 1.11 The Commission’s report resulted in the Trustee Amendment Bill 2007, which was introduced into Parliament on 21 September 2007 and referred to the Justice and Electoral Committee. The Committee reported the Bill back to the House on 9 July 2008 recommending, by a majority, that it be enacted with changes. The Committee also stated that the Bill did not go far enough, that many issues outside the scope of the Bill had been raised, and that the Government should conduct a comprehensive review of the law of trusts as soon as practicable. The Government subsequently referred a review of the entire Act to the Law Commission. Although the Bill remains before Parliament, it is unlikely that it will proceed any further.

- 1.12 This review will revisit the matters dealt with in the 2007 Bill. It has the benefit of the submissions received by the Select Committee.

USE OF TRUSTS  
IN NEW ZEALAND

- 1.13 There is no definitive record of trusts in New Zealand, so it is impossible to be certain of their number. However, indications are that the number of trusts per head of population here may be considerably greater than that of England,<sup>7</sup>

5 Law Commission *Some Problems in the Law of Trusts* (NZLC R79, Wellington, 2002). See also New Zealand Law Commission *Some Problems in the Law of Trusts* (NZLC PP48, Wellington, 2002).

6 These were trustees’ powers of delegation, remuneration, powers to insure, exculpating trustees, protectors, trading trusts, powers of appointment, trustees’ duties to release of information and conflict of laws.

7 In the United Kingdom, 204,000 trusts were known to the Inland Revenue in 2005–2006: see < [www.hmrc.gov.uk/stats/trusts/table13-1.pdf](http://www.hmrc.gov.uk/stats/trusts/table13-1.pdf) >, referred to in Ministry of Justice “Impact Assessment of the rule against perpetuities and excessive accumulations” (24 March 2009) < [www.justice.gov.uk](http://www.justice.gov.uk) >. The United Kingdom HM Revenue & Customs must be notified about a trust if it will receive income or make chargeable capital gains (United Kingdom HM Revenue and Customs “Notifying HMRC about a new trust” < [www.hmrc.gov.uk](http://www.hmrc.gov.uk) >). As is the case in New Zealand, this figure only gives part of the picture: it gives no indication of the number of non-income earning trusts. It may also be the case that many trusts settled by United Kingdom citizens are based, and pay tax in, off shore jurisdictions such as Guernsey, Jersey and the Isle of Man. These would not feature in the United Kingdom figures. Based on the number of those filing a return with the Inland Revenue, however, there would be approximately one income-earning trust for every 294 United Kingdom citizens.



Australia<sup>8</sup> and Canada.<sup>9</sup> We can be sure that there are at least 237,500, since this was the number of tax returns filed by trusts with the Inland Revenue department (IRD) for the 2007–2008 tax year.<sup>10</sup> This number increased from 145,900 in the 2000–2001 tax year. Based on the 2008 figure, the most cautious assessment is that there is one trust for every 18 people in New Zealand. Trustees are required to file a tax return if the trust earns income during the financial year. However, they are not required to alert IRD (or any other agency) to their existence if they are not income earning.<sup>11</sup> Some commentators have estimated that the number of trusts may range up to 400,000.<sup>12</sup>

- 1.14 We have the impression that the number of trusts has grown steadily over at least the last 20 to 30 years and that New Zealanders have a predilection for trusts beyond that experienced in similar countries.<sup>13</sup>

### Use of different types of trusts

- 1.15 The discretionary trust is the most common type trust.<sup>14</sup> Fixed trusts are used less frequently. Family trusts have continued to grow in popularity. Family trusts of this type are used by a wide cross-section of the community, including the very wealthy to those of more modest means, because they are perceived as providing asset protection benefits, succession planning and flexibility.<sup>15</sup>

8 In Australia, an annual tax return must be lodged for a trust, regardless of the amount of income derived, even if it derives nil income or incurs a loss for tax purposes. In the 2007–2008 income year, 660,324 trusts filed returns. This equates to around one trust for every 34 Australians (Australian Tax Office *Taxation Statistics 2007-08* at 71 < ato.gov.au > ).

9 For the 2009–2010 fiscal year, the Canada Revenue Agency processed around 229,000 resident trust returns and 2,200 non-resident returns (email from Melinda Wood, Inland Revenue to Susan Hall, Law Commission regarding trust information from the Canada Revenue Agency (28 July 2010)). In Canada, trustees must file a tax return where income from the trust property is subject to tax (Canada Revenue Agency “T3 Trust Guide” < www.cra-arc.gc.ca > ). This equates to approximately one income-earning trust for every 148 Canadians.

10 Inland Revenue “Returns Filed 2001 to 2008” < www.ird.govt.nz > .

11 This is the case unless a New Zealand resident settlor settles a trust with a foreign resident trustee, or if a foreign trust is established with a New Zealand resident trustee (Tax Administration Act 1994, ss 59 and 59B).

12 See, for example, Anthony Grant and Nicola Peart “The case for the spouse or partner” (paper presented to the NZLS Trusts Conference, June 2009), citing Maria Kazmierow “When not to trust” *NZ Lawyer* (27 April 2007) at 14 and “Please sir, can we have some more?” *Sunday Star Times* 24 August 2008, Business Section D1.

13 The trusts culture in New Zealand has been described to us as “viral”, or influenced by a “me too” syndrome: that is to say that many people are motivated to establish a trust just because someone they know has one. Even writing in 1972, R C Pope said: “There is even the element of the status symbol – every successful man should have a trust.” (R C Pope *The Practice and Pitfalls of Trusts and Wills* (New Zealand Society of Accountants, Wellington, 1972) at 7).

14 Discretionary trusts and fixed trusts are discussed in detail in chapter 3.

15 Step Journal website, “Jurisdiction Summaries – New Zealand”, < www.stepjournal.org > .

- 1.16 Some trust advisers have actively sought to encourage people to have family trusts. One publication promoting and advising on the use of trusts and their benefits is in its 6th edition and has reportedly sold over 100,000 copies.<sup>16</sup> A search of the internet will reveal numerous advertisements for trusts seminars run by trusts professionals and lawyers for the purposes of attracting clients.
- 1.17 It continues to be common for wills to establish testamentary trusts. These are usually in a relatively simple form, with an individual's residuary estate left to a discretionary trust. Prior to the abolition of estate duty in the early 1990s, it was common for wealthy individuals to leave a life interest in the family home and investment assets to a surviving spouse, with the residuary estate passing to final beneficiaries. These trusts are now less common.<sup>17</sup>
- 1.18 Trusts are commonly used for commercial purposes in New Zealand. Unit trusts are used as vehicles for collective investment schemes. Trading trusts are being used increasingly as their flexibility and tax advantages make them attractive for small to medium-sized businesses. They are also used for cross-border activity as they provide tax advantages over corporate vehicles.<sup>18</sup> Changes to income tax rates from 1 October 2010 mean that trading trusts are likely to provide less of an advantage. Business trusts, where the trust holds shares in a company are commonly used as a simpler and less expensive alternative to true trading trusts. The trust vehicle is also used to allow debt investors to hold securities together in debenture trusts. There is a substantial foreign trust industry with settlors residing outside New Zealand settling trusts here with New Zealand resident trustees.

## THIS ISSUES PAPER

- 1.19 While the Commission's review primarily involves consideration of the technical aspects of the relevant law, it has become apparent that we cannot adequately review the law of trusts without identifying and understanding the history, nature and definition of trusts. We have started to construct a picture of the trust landscape by talking to practitioners and government agencies that encounter trusts. However, it is very difficult to develop a comprehensive view of that landscape, particularly since there is no definitive record of the number of trusts in New Zealand and because trusts are private vehicles. Also, the Trustee Act 1956 is largely a default Act. It does not define what a trust is or contain a template trust deed. In consequence, the Act provides very little indication of what actual trust structures and instruments are like.
- 1.20 Chapter 2 of this Issues Paper considers the history of trusts and developments in trust structures in New Zealand and worldwide. Chapter 3 explores the nature of the "trust" generally and how it may be defined. Chapter 4 looks at trusts legislation in New Zealand and overseas, and explores different approaches that may be taken to new trusts legislation in New Zealand.
- 1.21 Questions follow the discussions. The Law Commission appreciates responses to any or all of these questions.

16 See Martin Hawes *Family Trusts: A New Zealand Guide* (6th ed, Longacre Press, 2008). See < [www.martinhawes.com/](http://www.martinhawes.com/) > . See also, Jonathan Cron *Family Trusts in New Zealand* (Penguin Group NZ, 2010).

17 Step Journal website, above n 15.

18 Ibid.



# Chapter 2

## History and development of the trust

**INTRODUCTION** 2.1 Examining the history of the trust helps give a clearer understanding of its nature and purpose. This background chapter provides a brief early history of the trust in England, a summary of its 20th century evolution in New Zealand and describes briefly some worldwide developments. History shows that the trust has had remarkably similar purposes since its early days when it developed from the “use” although its nature has evolved over time, and its structures and, to some extent, its nature are still evolving.

### Possible early origins of the use/trust

- 2.2 The origin of the “use” in England is the subject of academic debate.<sup>19</sup> It may have been modelled on the Roman “fideicommissum” (whereby a legacy could be transmitted to a beneficiary via a person who would be trusted to honour his moral obligation). This was apparently used by priests to evade imperial restrictions on inheritances to clergy. Alternatively the use could be derived from 5th century Salic law (the law of a Germanic tribe, the Salian Franks) whereby property was transferred to a “salamannus” for specific purposes, to be carried out during the life or after the death of the person conveying it.<sup>20</sup> But the use was a much more complex concept involving separation of legal and beneficial estates and creation of life interests and others. So it seems doubtful that either of these hypothesised sources for the use can be supported on the evidence.<sup>21</sup>
- 2.3 The Islamic “waqf” has been suggested by Monica Gaudiosi as a model for the use/trust. It has a number of similarities with the charitable trust, in particular in relation to the 1264 Statutes of Merton College, Oxford.<sup>22</sup> Around that time

19 See MM Gaudiosi “The Influence of the Islamic Law of *Waqf* on the Development of the Trust in England – the Case of Merton College” [1988] U Pa LRev 1231, at 1240.

20 See OW Holmes “Early English Equity” (1885) 1 LQR 162, at 163–164.

21 The possible Roman origin is not accepted by Maitland: see FW Maitland *Equity – a Course of Lectures* (1909) revised by J Brunyate (1936, Cambridge University Press) at 32, [Maitland *Equity*].

22 Gaudiosi, above n 19, at 1232–1240 and 1244–1256.

## Early history until 1535: reasons for the development of the use

there was some cultural contact between England and the Middle East: during pilgrimages to the Holy Land in the 11th and 12th centuries and the Crusades from about 1095–1291. It may be significant that use type arrangements began to become more popular in the 13th century in England. However, it is feasible that the use was an English invention that did not owe its origins to any of the above sources.

- 2.4 As Megarry and Wade put it: “The ancestor of the trust is the use, which has substantially the same character.”<sup>23</sup> The “use” (derived from the Latin *ad opus* meaning “on his behalf”<sup>24</sup>) appears to have begun as a temporary arrangement, for Crusaders, for example, leaving their property to be held by a trusted friend or relative “to the use of” (for the benefit of) their wives and dependants while they were at war. Thus in 1224, a jury found a man had entrusted custody of his land to his brother before starting for the Holy Land.<sup>25</sup>
- 2.5 In about 1225, the Franciscan friars came to England. Although their order prevented them owning property, there was no objection to land being conveyed to a certain city corporation as “feoffee to the use” (trustee) of the friars.<sup>26</sup> The common law courts recognised the transfer of ownership to the feoffee. However, they refused to enforce the obligations of the feoffees to the *cestui que use* (beneficiary).
- 2.6 In the 13th century, the use became an increasingly popular means of avoiding harsh feudal dues on landowners (such as taxation on land when it was inherited by the heir) and “mortmain”.<sup>27</sup> Such dues could not be levied where land was in the possession of the *cestui que use*. Maitland notes that the feudal system had become a system of capricious burdens on land from which it was natural that men should attempt to free themselves.<sup>28</sup> In addition the use avoided the severe laws of forfeiture of land for crimes.

23 RE Megarry & HWE Wade *The Law of Real Property* (4th ed Stevens, 1975) [Megarry & Wade] at 152. There is a brief history of uses and trusts in this volume, at 151–172.

24 FW Maitland “The Origin of Uses” (1894) 8 Harv L Rev 127, at 127–129.

25 Ibid, and see WS Holdsworth *History of English Law* (Methuen & Co Ltd, London 1903) vol IV, at 415, referring to Bracton’s Notebook no 999.

26 F Maitland “The Origin of Uses”, above n 24, at 130; WS Holdsworth’s *History of English Law* (Methuen & Co Ltd, London, 1903) vol 1, at 239. See F Pollock & F Maitland *The History of English Law* (vol 2, 2nd ed revised by SFC Milsom, Cambridge University Press, 1968) at 231, and 237–238. The feoffee to uses was the person who held the freehold estate in land for the benefit of other persons. A feoffment was the solemn ceremony for conveying freehold land; the feoffor delivered possession of the land to the feoffee by symbol (such as a clod of earth) or appropriate words.

27 WS Holdsworth *History of English Law* (Methuen & Co Ltd, London, 1903) vol IV, at 443. Land owners developed a practice of bequeathing land to the Church in perpetuity as a way of avoiding feudal dues. Mortmain statutes were passed to prevent this practice by providing that no land could be granted to religious bodies without assent or licence from the Crown. “Mortmain” literally means “dead hand”, referring to the fact that a person long since dead dictated land use in perpetuity.

28 Maitland *Equity*, above n 21, at 29.

- 2.7 But there were abuses of the use. Claims of creditors could be evaded by transferring property to a use, purchasers could be defrauded when they were not aware they were dealing with land held by use. The Chancellor's Court of Chancery stepped in to protect the *cestui que use* (where the use was disregarded by the feoffee), and purchasers (where they were unaware of a use).<sup>29</sup>
- 2.8 Uses of a more permanent nature became common by the middle of the 14th century. Feudal estates in land descended to the heir and no-one else. At this time and until 1540 it was not possible to devise (gift) land by will and many authorities associate this fact with the growth of the use, as it enabled land owners in effect to settle land for future generations,<sup>30</sup> and to protect family members other than the heir. The lords and gentry found they could exercise a power of ownership that survived their death because their land became devisable by giving the directions to their feoffees (trustees). According to Holdsworth and Maitland, the testamentary power to in effect devise land by uses was one of the chief causes of the popularity of uses.<sup>31</sup>

### *The concept of legal and equitable ownership*

- 2.9 The first record of a decree in favour of a *cestui que use* (beneficiary) was in 1446. It was said that by 1499 the greater part of the land of England was held in use.<sup>32</sup> From the end of 14th century, the jurisdiction of Chancery over uses grew, mostly in relation to land and usually where they were established by wills<sup>33</sup> as a way of managing landed estates for the future.
- 2.10 It became established that the *cestui que use* had an equitable interest in the property and a right to compel the feoffees (later trustees) to carry out certain duties.<sup>34</sup> Megarry and Wade note that "uses became enforceable in Chancery only, and the great cleavage between legal and equitable interests was made."<sup>35</sup> The concept of relativity of ownership was introduced. The feoffee had legal ownership and absolute rights, but had a duty to exercise them for the benefit of the *cestui que use*. The *cestui que use* had equitable ownership of a chose in action: a right to compel feoffees to act as directed.

### *Benefits and detriments of the use system*

- 2.11 The advantages of the use to the settlor lords<sup>36</sup> and gentry were many and included enabling the avoidance of onerous feudal liabilities and of inheritance duties (the settlors owned nothing subject to the rules of succession when they

29 The Chancery Court developed from the role of the Chancellor, keeper of the King's conscience, as arbiter of disputes where matters of good faith and trust were involved, giving equitable relief.

30 WS Holdsworth *An Historical Introduction to Land Law* (Clarendon Press, Oxford, 1927) at 149.

31 Ibid, at 149; Maitland *Equity*, above n 21, at 25–26.

32 Megarry & Wade, above n 23, citing YB 15 Hen 7 Mich pl 1 (1499) per Frowicke CJ.

33 Holdsworth *History of English Law* vol IV, above n 27, at 420.

34 *Delamere v Barnard* (1657) 1 Plowd. 346, 352, cited in Megarry & Wade, *The Law of Real Property*, above n 23, at 153. Duties were to permit the *cestui que use* to take the profits of the land, to dispose of the land in accordance with his instructions, and to take all necessary proceedings to protect or recover the land.

35 Megarry & Wade, above n 23, at 153.

36 The settlor lord, who transferred the legal estate to the feoffees, was known as the feoffor at this time.

died) or of forfeiture of their land in their absence, or the evasion of a surviving wife's right to dower.<sup>37</sup> In most cases the settlors became the *cestui que use* and remained in possession of their estates as apparent owners, but escaped the liabilities of ownership.

- 2.12 However, the system continued to generate abuses, defeating the rights of creditors and purchasers. From 1377 to 1501, legislation to protect creditors was passed. Parliament also attempted to remedy the plight of those purchasers who later discovered the legal estate was held to a use. A purchaser who obtained the estate for value in good faith, without notice, was protected from suit.

### The Statute of Uses 1535

- 2.13 The Crown was most affected by the evasion of feudal dues and inevitably took action against the development of uses. Henry VIII determined to increase the royal revenue. In Maitland's words:<sup>38</sup> "The Statute of Uses was forced upon an extremely unwilling parliament by an extremely strong-willed king", (the legislators being the feudal lords), in 1535.

- 2.14 The preamble to the Statute of Uses<sup>39</sup> (the Statute) listed the problems with uses, focussing on the public interest, and creditor, beneficiary and purchaser vulnerability to fraud, as well as the King's loss of revenue:<sup>40</sup>

They [uses] being of an untrue crafte invention to put the King and his subjects from that which they ought to have of righte by the good true common law of the land.

- 2.15 The Preamble states that the *cestui que use* was at the mercy of the fraudulent bailiff or feoffee; there were losses to the King and Lords by way of feudal dues, (inheritance duties, curtesy and dower<sup>41</sup>); and no-one was secure in their purchase. The use was said to be "but the shadow of the thynge and not the thynge indeed". Appendix III noted that "[the use] causes the law to be double and several from apparent ownership" ... "which is a grett disseytt".<sup>42</sup>

- 2.16 The aim of the 1535 Statute was to give legal power to the *cestui que use* so that a purchaser would obtain legal title from him, and the Crown would obtain feudal dues (alienation fines, inheritance tax and other lost revenue).<sup>43</sup> The means employed by the Statute was to "execute" all uses in freehold land, meaning that the legal estate was vested immediately in the *cestui que use*.<sup>44</sup> Holdsworth states:

37 A widow was entitled to a life interest in one third of her husband's freehold estate while she remained unmarried (dower), so long as their common issue might have inherited it. Curtesy was the life estate a husband obtained from his deceased wife so long as their common issue might have inherited it.

38 Maitland *Equity*, above n 21, at 34.

39 Statute of Uses 1535 (27 Hen VIII c 10).

40 Holdsworth *History of English Law* vol IV, above n 27, at 454, citing "Replication of a Serjeant to the Doctor and Student" (Hargave Law Tracts, at 323–331).

41 See n 37.

42 Appendix III to the Statute of Uses, paras 32, 35 cited in Holdsworth *History of English Law* vol IV, above n 27, at 454–456.

43 Holdsworth *History of English Law* vol IV, above n 27, at 446.

44 Megarry & Wade *The Law of Real Property*, above n 23, at 156.



The first clause of the Statute provides that when any person or persons were or should be seised [possessed] of any land ... to the use of any other person or persons or ... body politic ... then these other persons or bodies politic should be seised for the like estates which they had in use;

- 2.17 So if an estate in land was given to A and his heirs to the use of (for the benefit of) B and his heirs, and B remained in possession of the land, the legal estate was taken by the Statute from A and vested in B. This, in effect, abolished most uses as in most cases the *cestui que use* (B in the above example) was in possession of the land.
- 2.18 The statute had no application where feoffees were in possession of land with active duties to perform;<sup>45</sup> or where a corporation held the legal estate. Significantly, where a settlor attempted to create a “use upon a use” (for example “to A and his heirs to the use of B and his heirs to the use of C and his heirs”), the Statute immediately gave the legal estate to B and ignored the second use.<sup>46</sup> This formula gave no interest at all to C at this time. But the formula of a “use upon a use” became important later as will be seen below.<sup>47</sup>

### *Effect of the Statute of Uses*

- 2.19 Immediately following the enactment of the 1535 Statute, the King acquired more revenue, and, for about a century, separate legal and equitable ownership disappeared.<sup>48</sup> The Statute was not popular with the landed gentry because they lost revenue to the Crown (although the highest lords would have received their feudal dues from the lesser gentry) and their power to devise and settle their lands.<sup>49</sup>
- 2.20 After the dissolution of the monasteries, the King’s revenues greatly increased and he restored a large measure of power to devise by the Wills Act 1540, reserving some rights of payment to the Crown. This eventually increased the power of testators to devise land as they were now in effect devising legal, not merely equitable estates, and a man could convey a legal estate to himself and his wife using the Statute (which was not possible at common law).

45 Maitland *Equity*, above n 21, at 38. For example, land might have been conveyed by S to A as feoffee to the use that he sell the land and divide the proceeds amongst S’s children. The Statute did not apply to this “active trust”.

46 Ibid; Megarry & Wade, above n 23, at 159–160. *Tyrrel’s Case* 1557 2 Dy. 155a confirmed that a “use upon a use” was void: Holdsworth *History of English Law* vol IV, above n 27, at 472.

47 A scheme for registration of conveyances was also devised at this time by providing for public rolls of alienations – a public register in effect, which would have greatly simplified land law at an early stage – but it was against the interests of landowners and conveyancers, and in time it failed. Holdsworth *History of English Law* vol IV, above n 27, at 460.

48 Ibid, at 467.

49 Holdsworth *An Historical Introduction to Land Law*, above n 30, at 157.

- 2.21 The skilled conveyancers “soon began to make a servant of the Statute”.<sup>50</sup> The evasion of feudal dues was reduced, but loopholes were discovered. The old common law cumbersome and time consuming means of conveying of land (requiring entry on the land by the parties) became obsolete as legal estates were transferred by the “execution” of uses by virtue of the Statute.<sup>51</sup>
- 2.22 The Statute had far reaching consequences that revolutionised property law. The development of the use, despite the Statute of Uses 1535, inspired Holdsworth to describe the statute, paradoxically, as “perhaps the most important of all the statutes dealing with the law of real property”.<sup>52</sup>

### The use is reincarnated as the trust

- 2.23 About a century after the Statute, when feudal dues were finally abolished,<sup>53</sup> the Chancery courts began to enforce a “use upon a use” where the justice of the case required it, and brought uses back to life – reincarnated as “trusts”. The reports of the mid-17th century are unclear and the precise origin of the change is unknown but by 1700 the trust was well established.<sup>54</sup> The wording of a transfer in trust, adopted from the mid-17th century, was “to A and his heirs unto and to the use of B and his heirs in trust for C and his heirs”. This was an artificial form of words necessary to avoid the Statute. Until the Statute was repealed in 1925 in England, B obtained the legal estate as trustee (by execution of the use) and C obtained the equitable estate. So trusts could be created with the essential nature of uses before 1535, and equitable interests entered a second phase of development.
- 2.24 The trust was a more flexible and complex device than its ancestor, the use: it could, for example, be attached to any interest in property, not merely a fee simple. It could be adapted to the needs of the times. Megarry and Wade consider that the development “mocked the reason and spirit of the statute if indeed it did not militate against the plainest principles of interpretation”.<sup>55</sup> However, the trust was a masterly invention and was not without its benefits.
- 2.25 Legal powers of appointment could be created by a conveyance to “the use of A and his heirs upon trust for B for life and thereafter to such uses as B should appoint.” Widows could become life tenants and other, more vulnerable, family members could be protected. Most importantly, legal executory interests (that is future interests) could be created, and elaborate settlements became common, for example, “to the use of A and his heirs upon trust for B for life, but if B inherits Whiteacre upon trust for C for life” – a “shifting use”; or “to the use of A and heirs upon trust for B if he marries – a “springing use”.

50 Megarry & Wade *The Law of Real Property*, above n 23, at 163, citing J Williams *Principles of the Law of Real Property* (23rd ed by TC Williams, 1920) at 189.

51 Megarry & Wade *The Law of Real Property*, above n 23, at 160-163.

52 Holdsworth *An Historical Introduction to Land Law*, above n 30, at 151.

53 See the Tenures Abolition Act 1660. The Crown had no pecuniary interests in uses once feudal dues were abolished.

54 See for example, *Grubb v Gwilliam* (1676) Lord Nottingham’s Chancery Cases 73 SS 347.

55 Megarry & Wade *The Law of Real Property*, above n 23, at 169, citing W Hayes *An Introduction to Conveyancing* (5th ed, 1840) at 54.

## Development of the trust in the 17th to 19th centuries

- 2.26 The 17th century was the era of the great development of future estates and equitable interests, contingent remainders (future estates or interests left to persons on certain conditions), shifting and springing uses, and other executory devices. Former restrictions imposed by the common law courts – barring entails,<sup>56</sup> restricting contingent remainders, limiting the time span of settlements – were relaxed by Lord Nottingham (Lord Chancellor, known as the “Father of Equity”), and his successors. Holdsworth says that the conveyancers and the courts manipulated the incidents of these new trust estates in such a way that they became interests of a different character from the mediaeval uses before the Statute, mainly in order to meet the need of settlors to ensure the continuity in the family of their landed estates.<sup>57</sup>
- 2.27 Thus “A” possessing property in fee simple could convey to trustees to the use of himself and heirs until marriage, then to the use of himself for life, remainder to his eldest and successive eldest sons. The landowners evaded the enrolment (registration) of conveyances system by settling estates in this fashion, enabling the primogenitur succession of the large estates, but with provision for other family members. Claims for widows and younger children were often met by rentcharges (periodic payments) or annuities on the property. Whilst the wealthy landed gentry thrived, most people were not property owners and there were public disadvantages, including large powers of disposition for the wealthy, secrecy and expensive dealings in land, stagnation and accumulation of property in the hands of a few. However, attempts to tie up land for several succeeding generations led to the creation of a rule against perpetuities.<sup>58</sup>
- 2.28 On the other hand, there were a number of public benefits. The large estate holders, securely in occupation for generations, imparted an element of stability in their localities, administered local government, acted as magistrates and provided employment. Trusts enabled unincorporated groups, such as parishes, to own property in equity, and uses for charitable purposes developed from the reign of Elizabeth I.<sup>59</sup> Uses (trusts) were set up for the maintenance of schools, for funding preachers, repairing highways and churches, maintaining the poor, building bridges, and supporting maimed soldiers.<sup>60</sup> “Charity” was widely defined in the Act of 1601 (43 Eliz c 4). In the Charitable Uses Act (9 George II c 36) the common law adopted the equitable conception of charities. Thus trusts “eked out the deficiencies of municipal government in the 18th and 19th centuries, creating bodies of trustees to carry out lighting, paving, drainage and so on.” The mediaeval forms survived, transformed, and in turn transformed the state.<sup>61</sup> Trusts also enabled the nonconformist churches to enjoy property.

56 Entails were estates left to successive heirs as life tenants, rather than in fee simple.

57 WS Holdsworth *History of English Law* (Methuen & Co Ltd, London, 1903) vol VII, at 135.

58 Ibid, at 205–206. The rule against perpetuities limits the length of a trust by prescribing the time within which an interest must vest. In New Zealand this is either within 80 years or the lifetime of a relevant person plus 21 years.

59 Holdsworth *History of English Law* vol IV, above n 27, at 393, and 398–399. See *Porter’s case* 1592 1 Co Rep 26a.

60 Ibid, at 476, and 479–480.

61 Holdsworth notes that to a very large extent England was governed by the large landowners at this time, see Holdsworth *An Historical Introduction to Land Law*, above n 30, at 304.



- 2.29 The courts looked favourably on charitable trusts.<sup>62</sup> Trusts deeds defined their powers, but, as Holdsworth put it, “the written deeds stymied continued development”. It became difficult to alter purposes for which trusts were created without losing all right to trust property.<sup>63</sup> Holdsworth considered the charitable trust a remarkable achievement nonetheless:<sup>64</sup>

The trust has in fact preserved, in a shape suited to modern legal and political ideas, the mediaeval power to create groups; and these groups, because autonomous and yet subject to the law, have had a share in imparting a sound political instinct to the greater part of the nation.

- 2.30 At the end of the 17th century, there were legislative modifications relating to the trust, such as statutes enabling the court to convey trust property when trustees could not do so (because they were overseas, infants, or mentally disabled).<sup>65</sup> Powers of appointment<sup>66</sup> as a means of creating rights also added greatly to the flexibility and more discretionary nature of trusts. Trusts were influential on family law and gradually on commercial law with the increasing importance of stocks and shares.<sup>67</sup> Trustees’ duties were established – essentially to deal with the property in the terms of the trust and to invest money with care, and somewhat conservatively. It was still an age of the landed gentry with their vast estates but the 18th century saw the start of the industrial revolution, which was to change the economy of the nation and the source of wealth of the rich.
- 2.31 The mid-17th century until 1914 was largely the period of the “settled land trust”, which aimed to provide residences and income for successive generations of the large landed families. Settled land trusts were known as “strict settlements”.<sup>68</sup> Land was kept in the family by resettlement of the trusts. However, in the late 18th century, the Settled Land Act 1882 was passed to remedy some of the mischiefs of the strict settlement and provide, in particular, for greater alienability of land.<sup>69</sup> The “trust for sale” became more common,<sup>70</sup> whereby trustees held the land for the purposes of selling it and holding the proceeds for the benefit of beneficiaries. Property in things other than land (in stocks and shares and “gilt-edged” investments), was increasingly becoming part of trust property, and the trust was taking its modern form in the 18th and 19th centuries.

62 See *Emman College Cambridge v Evans* (1625-6) 1 Ch Rep 21.

63 Holdsworth *History of English Law* vol IV, above n 27, at 479–480. See *General Assembly of Free Church of Scotland v Lord Overton* [1904] AC 515. Charitable trusts will be considered in a later part of this review.

64 Holdsworth, *History of English Law* vol IV, above n 27, at 479–480.

65 Holdsworth *History of English Law* vol VII, above n 57, at 148–149.

66 A power of appointment gives the donee of the power a discretion (sometimes circumscribed) to distribute property for the benefit of others.

67 WS Holdsworth *History of English Law*, (Methuen & Co Ltd, London, 1903) vol V, at 304–307.

68 Holdsworth *An Historical Introduction to Land Law*, above n 30, at 164.

69 Megarry & Wade, *The Law of Real Property*, above n 23, chapter 6. The Act gave life tenants wide powers of dealing with the land, free of the trusts of the settlement, to prevent the stagnation and the decline of agriculture that was occurring.

70 See Megarry & Wade, above n 23, chapter 6, especially at 285–288 and 293; and D Waters “The Trust in a Changed and Yet Changing World” [2008] *Journal of International Trust and Corporate Planning* (JTCP) 205 at 220–225 for more detail.

- 2.32 By the 19th century, the Statute of Uses had been far superseded. In 1879 Maitland called it “that marvellous monument of legislative futility ... through which not mere coaches and four, but whole judicial processions with javelinment and trumpeters have passed and re-passed in triumph ... It is not a mere Statute of Uselessness but a Statute of Abuses.”<sup>71</sup> Holdsworth would not agree – for him the Statute encouraged the development of uses and trusts, taxing the creativity of conveyancers and the courts of Equity. Conveyancers then – as now – were men of ingenuity and invention. Finally, in 1925 the Statute was repealed in England.
- 2.33 In the 19th century, the first legal texts on Trusts were written. Definitions of a trust and the elements of various types of trust and precedent rulings were elicited from the cases and collected together as the “law of trusts”.<sup>72</sup> Lord Langdale MR in 1840 declared that the “three certainties” were necessary prerequisites for a trust: certainty of words, certainty of subject matter and certainty of objects or persons to be benefited.<sup>73</sup> It was the 19th century judges who, according to Professor Parkinson, ordered “the law of trusts into a discrete area of law with a coherent body of doctrine”.<sup>74</sup> Towards the end of this century the first Trustee Acts were enacted (as discussed in chapter 4). The first Trustee Act for New Zealand was in 1883. By 1909, Maitland was classifying trusts into express and implied trusts (trusts by set up by parties), and resulting and constructive trusts (trusts imposed by law).<sup>75</sup>

### Late 19th and early 20th century

- 2.34 The 19th and early 20th centuries also saw increasing numbers of trusts of investment portfolios and of discretionary trusts.<sup>76</sup> According to Professor Parkinson, the “classical model” of the trust broke down in the 20th century. In 1975 Professor Langbein called the modern trust “a management regime for a portfolio of financial assets”.<sup>77</sup> While this may be the case in the United States, in New Zealand it seems that the most common trust asset is the settlor’s home and other common assets include investment properties.<sup>78</sup>
- 2.35 After the second World War, families became more mobile, more nuclear and more fragmented by divorce. The strict land settlement trusts of the wealthy in England had by then generally given way to the property management trust for sale.<sup>79</sup> Further, because of high taxation, the wealthy would go “off-shore” to

71 Megarry & Wade, above n 23, at 171 citing Maitland *Collected Papers* vol.i, at 191.

72 See Thomas Lewin *A Practical Treatise on the Law of Trusts and Trustees*, (A Maxwell, London, 1837).

73 *Knight v Knight* (1840) 3 Beav 148, at 173.

74 Patrick Parkinson, “Chaos in the Law of Trusts” (1991) 13 Syd LR 227, at 228.

75 Maitland *Equity*, above n 21, at 53–54.

76 Waters “The Trust in a Changed and Yet Changing World”, above n 70, at 224–225.

77 John H Langbein “The Contractarian Basis of the Law of Trusts” [1995] 105 Yale LJ 625, at 629.

78 P Briggs “Family Trusts – Ownership, Size and their Impact on Measure of Wealth and Home Ownership” Reserve Bank of New Zealand Discussion Paper DP 2006/06, Wellington July 2006, cited in C Kelly “Supervision of Trustees: Enforcement or Problem Solving”, thesis submitted for LL.M Victoria University of Wellington, 2009, 1. Briggs found that 137,800 economic units each had a family trust or trusts. Kelly notes that the figures need to be treated with care; they are based on the 2001 Census.

79 D Waters “The Trust in a Changed and Yet Changing World”, above n 70, at 226.

“tax havens” and jurisdictions that offered estate planning advantages not available in their home countries.<sup>80</sup> In addition, the trust was increasingly used for commercial purposes in the “mainland” common law jurisdictions (such as England, the United States, Canada, Australia and New Zealand) as discussed briefly below at paragraphs 2.67-2.72.

- 2.36 During the 20th century, the flexibility of the trust allowed it to continue to respond to changing economic and social conditions and to government policies, particularly taxation policies. The discretionary family trust became more and more popular, sometimes combined with a business trust (see brief discussion below). As noted, trust structures also began to be used more commercially – by banks, for superannuation schemes, and for investments (such as unit trusts). The constructive trust also entered a new phase when it was imposed by courts in cases of breakdowns of de facto relationships to allow a fair distribution of assets.<sup>81</sup>

### Increasing popularity of the family trust

- 2.37 According to Patterson, the modern history of New Zealand trusts started in about the 1950s.<sup>82</sup> Although some wealthy families had trusts earlier, the main incentive to create family trusts at this time was probably high rates of death duty. Taxing a deceased’s estate has a long history as has been seen.<sup>83</sup> However, wealth transfer taxes were not introduced in Australia and New Zealand until the second half of the 19th century; in New Zealand a tax on estates was first introduced in 1866,<sup>84</sup> the first major direct tax to be imposed.<sup>85</sup> Estate duty revenue increased until 1949, and thereafter it fell. Professor McKay considered that two factors might have accounted for this drop: a decline in political commitment to the tax and the growth of estate planning (using trusts).<sup>86</sup>
- 2.38 Neither estate nor gift duty are charged on distributions from a trust, so both forms of tax have long provided an incentive for people to gradually transfer their property to a trust for distribution to others. Furthermore, the incentive to settle a trust was spreading as inflation was eroding the value of estate and gift duty exemptions so that the burden of these taxes fell increasingly on small and

80 Ibid, at 227. “Off-shore” trust jurisdictions include the Channel Islands, Isle of Mann, Cayman Islands, Bermuda and the Cook Islands.

81 See for example *Lankow v Rose* [1995] 1 NZLR 277.

82 W M Patterson “When is a Trust a Trust?” (paper presented at the Legal Research Foundation Seminar “A Modern Law of Trusts”, Auckland, 28 August 2009).

83 See also RA Green and L McKay “The Estate and Gift Duties Amendment Act 1979: the Demise of Wealth Transfer Taxation” (1980) 10 VUWLR 227 at 229 citing Louis Eisenstein “The Rise and Decline of the Estate Tax” (1956) 11 Tax Law Rev 223: “Death Duties are ancient taxes. They were known to the Egyptians as well as the Romans and Greeks”.

84 Stamp Act 1866: see L McKay “Historical Aspects of the Estate Tax (1978) 8 NZUL Rev 1 at 1–2, and at 3–4, for the basis of the duties. See David G Duff “The Abolition of Wealth Transfer Taxes: Lessons from Canada, Australia and New Zealand [2005] Pittsburgh Tax Review 71, regarding the duties in Canada and Australia.

85 Previously government revenue relied almost entirely on customs and excise duties: Duff, above n 84, at 86.

86 McKay, above n 84, at 21–24. “Estate planning has an obvious relevance to the impact of the estate tax: indeed its principal, often exclusive, purpose is to limit and reduce that impact by reducing the value of the dutiable estate ...” (at 24).

medium sized estates.<sup>87</sup> The estate duty exemption was only \$25,000 in 1979, although it was increased in stages to \$250,000 by 1982. This encouraged a wider section of society to transfer assets to a trust to avoid crippling estate duties.

- 2.39 In the 1950s marginal rates of taxation were starting to have a serious impact on family businesses, particularly in the farming sector. In 1957, the top rate of taxation was 60 % on income exceeding \$7,200 per annum, and the top rate of estate duty was 40 % on estates over \$200,000.<sup>88</sup> Before its abolition in 1993, estate duty was being charged at 40 % on the value of an estate over \$450,000.<sup>89</sup> Although estate duty was abolished, the trusts set up when it was in force remained.
- 2.40 The provisions of the Estate and Gift Duties Act 1955 had meant that it was inadvisable for a settlor to be a beneficiary or exert too much control over, a trust. Trust assets could be treated as assets in the estate of the settlor (and thereby subject to estate duty) if there was an indication of settlor control or benefit. A response to this was the “mirror trust”. The property of spouses or partners was generally divided so that 50 % of it was gifted respectively to each trust, or the trust formed a partnership to own all the property. Mirror trusts allowed spouses to settle almost identical trusts and become beneficiaries of each other’s trust without estate duty applying to their own trust. After the abolition of estate duty, settlors were free to adopt more flexible trust structures, such as parallel trusts where the settlor spouse can be a beneficiary of their own trust as well as of each other’s. Other beneficiaries could include children of a previous relationship. An advantage is that it simplifies the division of property if there is a marriage breakdown.
- 2.41 The one constraint on the use of trusts for estate planning purposes was gift duty. However, in 1940,<sup>90</sup> the Court of Appeal held that an interest free loan made by one person to another, repayable on demand, was not a gift of the principal money lent as the ability to demand repayment amounted to consideration. Such a loan was not therefore liable to gift duty. The usual practice was to sell assets to the trust at market value and to take in exchange an interest free, unsecured debt, repayable on demand. This made transferring property to a trust easier. In *Re Marshall*,<sup>91</sup> the Court of Appeal held that where interest on a debt becomes payable if demanded, but the right to call for payment is not exercised, there is no gift of the interest foregone. Such an arrangement enabled term loans to be made where there was provision

87 See Duff, above n 84, at 117.

88 See Patterson, above n 82.

89 Estate duty was abolished in respect of deaths occurring after 17 December 1992: Estate Duty Abolition Act 1993. Parts 1–3 of the Estate and Gift Duties Act 1968, relating to estate duty, were repealed by the Estate Duty Repeal Act 1999.

90 *Commissioner of Stamp Duties v Card* [1940] NZLR 637 (CA).

91 *Re Marshall (Deceased) Commissioner of Inland Revenue v Public Trustee* [1965] NZLR 851.



for interest, payable on demand. The settlor would forgive a proportion of the debt each year, up to the threshold above which gift duty became payable, at no cost. The legislature has never intervened to prohibit these practices.<sup>92</sup>

- 2.42 There were other reasons for the increased use of family trusts in later 20th century New Zealand, including avoiding the superannuation surcharge on income over a certain amount from 1985 to 1998; and applying for the residential care subsidy and Working for Families tax credits for persons with limited assets and income. These will be discussed in detail in Issues Paper 2 (due late 2010).

### Trusts for commercial purposes

- 2.43 As noted above, trust structures have become increasingly popular for commercial purposes. A recent example is the “energy trust”. After the Energy Companies Act 1992, all municipal electricity departments and power boards were required to be incorporated under the Companies Act 1955. Communities could decide how the shares in the new companies were to be held and many opted for a local energy trust. The trusts are not regulated by a specific statutory regime although the Electricity Act 1992 imposes certain auditing and accountability standards on energy trusts, and Energy Trusts NZ (an umbrella organisation for these trusts) has issued guidelines that, for example, permit access by beneficiaries to information held by the trusts. The rule against perpetuities applies to energy trusts (unless they are set up as charities), and this has been perceived as problematic, as has the issue of variation.<sup>93</sup> There has been a substantial amount of litigation concerning energy trusts.<sup>94</sup>
- 2.44 A similar development was the community trust for regional trust banks, regulated in part by legislation. The Trustee Savings Bank Act 1948 provided that savings banks (like the Taranaki Savings Bank – TSB) were to be incorporated and their property deemed to be vested in the bank. In 1988 these banks were restructured, establishing trusts to acquire shares in the capital of their companies. The Community Trust Act 1999 now provides that their share capital is to be held on trust for purposes beneficial to the community (see section 12, which deems these purposes as charitable). Trusts structures are also used for superannuation schemes regulated currently by the Superannuation Scheme Act 1989.

92 On 1 November 2010, the Government signalled its intention to repeal gift duty. See Hon Peter Dunne “Gift duty to be abolished” (press release, 1 November 2010). Such a move will make it considerably easier, and quicker, to transfer property to a trust, since the transfer will be able to be made as a one-off disposition, without incurring any tax. It is possible that this could further increase trust use. See C MacLennan “Gifting to trusts will increase if threshold is repealed” LawNews (23 July 2010).

93 Consultation by the Law Commission with David Bigio of Shortland Chambers and Ian Ward of the Auckland Energy Trust Board on 27 May 2010.

94 See for example *Collinge v Kyd* [2005] 1 NZLR 847 regarding conflict of interest and *Manukau City Council v Lawson* [2001] 1 NZLR 599 regarding interpretation of complex trust deeds.

- 2.45 An example of an investment trust structure is unit trusts. Unit trusts have been in statutory form since the Unit Trusts Act 1960. The structure allows investment in commercial assets to be managed by one entity while being owned by another, under a system whereby the investments into assets owned by the unit trust can be traded for money through the allocation of units.<sup>95</sup>

### Foreign trusts

- 2.46 Taxation rules have led to a substantial foreign trust industry in New Zealand.<sup>96</sup> The genesis of New Zealand as an offshore trust jurisdiction was the tax and trusts regime introduced in 1988.<sup>97</sup> In short, the regime permits settlors residing outside New Zealand to settle trusts with New Zealand resident trustees without exposing the trustees, trust assets or their (non-resident) beneficiaries to tax in New Zealand.<sup>98</sup> The rule, which is uncommon in similar countries, combined with our settled political and legal system, makes New Zealand an attractive haven for offshore trusts.

### RECENT INTERNATIONAL DEVELOPMENTS IN TRUST STRUCTURES

- 2.47 A publication in 1984 listed five main “modern functional uses for the trust device”: estate planning, charitable gifts, pension (superannuation) trusts, business trusts (including unit trust funds) and trusts for the creation and enforcement of security interests.<sup>99</sup> The traditional (estate settlement) trust that developed in England originally, and was exported to the United States and the Commonwealth countries, has been adopted and modified in a number of other jurisdictions, including off-shore islands and in civil law countries (as noted in chapter 3, see paragraphs 3.43–3.45).
- 2.48 Trust legislation introduced in the offshore islands was often rather different from the mainland trust legislation, and has enabled the growth of new trust structures, in particular giving larger powers of settlor control and asset protection.<sup>100</sup>
- 2.49 Recent developments that might give rise to issues for this review include:
- Trust structures that are more akin to agencies;
  - Trusts including protectors, appointers, and advisory trustees;
  - Non-charitable purpose trusts and enforcers;
  - Use of trust structures for commerce, and for superannuation (pension) funds;
  - Protective trusts.

<sup>95</sup> Thanks to Kerry Ayers for this explanation.

<sup>96</sup> See J Prebble “The New Zealand Offshore Trust Regime” (2009) International Financial Centre Review 134, available at < papers.ssrn.com/ > .

<sup>97</sup> Income Tax Act 2007, s HC26. See also K Ayers “The New Zealand Offshore Trusts Regime” (2008) 14 *Trusts and Trustees* 574. These rules were introduced by the Income Tax (Amendment) Act (No 5) 1988.

<sup>98</sup> This applies provided the trust income is not sourced in New Zealand.

<sup>99</sup> See A Dyer and H van Loon “Report on Trusts and Analogous Institutions”, Hague Conference on Private International Law (edited by the Permanent Bureau of the Conference, The Hague, Netherlands, 1984) at 40–65. They also mention resulting and constructive trusts, and bank account trusts.

<sup>100</sup> See Waters “The Trust in a Changed and Yet Changing World”, above n 70, at 226–227.

## Trust structures more akin to agencies

- 2.50 In most text books on trusts, a trust is distinguished from an agency. So, for example a leading New Zealand text notes that:<sup>101</sup>

The trustee is not the agent of the settlor or the beneficiaries and is not subject to their control – except of course in the sense that the trustee may be restrained from committing a breach of trust, or may be required to make good a breach already committed.

- 2.51 Another leading textbook has noted that although both roles are subject to fiduciary duties, there are significant differences.<sup>102</sup> For example, agents do not need to have property vested in them. A trustee is directed by the trust instrument in making decisions; not by a settlor as “principal”.<sup>103</sup> The situation is complicated by the fact that a settlor may be a beneficiary and a trustee. Settlers have been beneficiaries since the days of the use but the settlor as a trustee (or as both trustee and beneficiary) seems to be a relatively recent phenomenon. This can lead to some blurring of the distinction between trusts and agencies.<sup>104</sup>
- 2.52 Settlers, understandably, may want a certain amount of control. They may not wish younger generations to know that they are possible beneficiaries of considerable assets, and they may therefore wish to withhold information from beneficiaries. Settlers now commonly write a non-binding “letter of wishes” to assist their trustees.<sup>105</sup> They may also want to influence management as well as distribution decisions. This is particularly the case where a settlor resides in one country and the trustees in another.
- 2.53 Some settlors reserve a number of powers to themselves, or the instrument may grant powers that permit the settlor or others to have control over the trustees.<sup>106</sup> In particular, in New Zealand, “most modern trust deeds contain a power to remove trustees, and usually to appoint new ones”.<sup>107</sup>
- 2.54 Trust deeds in off-shore jurisdictions often incorporate wide powers for settlors. The Bahamas and the Cayman Islands, for example, allow a clear settlor control element; their legislation lists powers to consent or direct in a range of administration matters as well as in the discretionary distribution of the trust fund income or capital.<sup>108</sup> This allows settlors, or grantees of the settlor,

101 N, C and G Kelly *Garrow and Kelly Law of Trusts and Trustees* (6th ed, LexisNexis Wellington, 2005) at [1.6.2] [*Garrow & Kelly Law of Trusts & Trustees*].

102 A Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at 53–55.

103 D Waters “Settlor Control – What Kind of Problem is it?” (2009) 15 *Trusts & Trustees* 12.

104 Until 1993, while estate duty was part of the New Zealand taxation system, trust assets could to be treated as assets in the estate of the settlor (and thereby subject to estate duty) if there was an indication of settlor control. See [2.40] above.

105 *Schmidt v Rosewood Trusts* [2003] 2 AC at 715 (PC), *Foreman v Kingston* [2004] 1 NZLR 841 (HC), *Breakspear v Ackland* [2008] EWHC 220 (Ch). Wish letters are apparently a common feature of modern discretionary settlements: see DM Fox “Disclosure of a Settlor’s Wish Letter in a Discretionary Trust” [2008] CLJ 252.

106 D Waters “Settlor Control”, above n 103, at 12.

107 *Garrow and Kelly Law of Trusts and Trustees*, above n 101, at [17.7.2].

108 Waters “Settlor Control”, above n 103, at 13, referring to *Trusts Law* (2001 Revision) Cayman Islands, s 14(1), and *Trustee Act* 1998 (Bahamas), s 81(1).



to consent or direct trustees in their exercise of most of their powers. As Professor Waters puts it: the legislation represents “a perception of the trust as being in this manner a more settlor-responsive property management device”.<sup>109</sup>

- 2.55 The Hague Trusts Convention, article 2, provides that “The reservation by the settlor of certain rights and powers ... [is] not necessarily inconsistent with the existence of a trust”. Waters points out that, in mainland trusts,<sup>110</sup> wide powers (to direct distribution and a range of administrative acts by a trustee) are found mostly in pension (superannuation) trusts, which are a product of a contract of employment.<sup>111</sup>
- 2.56 New Zealand’s trust legislation enables a certain amount of settlor control through such appointments as an advisory trustee, a managing trustee and a custodian trustee.<sup>112</sup> Geoffrey Cone has said that, historically, this is because British families who invested in New Zealand trusts did not want to cede complete control to local trustees.<sup>113</sup> This is similar to the rationale for the development of the “protector” role in the “off-shore” trusts.

### Protectors, appointers, advisory trustees

#### *Protectors and appointers*

- 2.57 A third party having some powers (such as powers of appointment) is not a new phenomenon in a trust, but the extent to which it is now occurring is recent<sup>114</sup> and a “protector” seems to have a wider and rather different role than third parties had in the past. Writing in 1996, Professor Waters described the protector as an individual or group (who might, for example, be a group of adult beneficiaries) granted power in the trust deed to direct the trustees, or to refuse consent to trustees, in their exercise of one or more of their administrative powers, or to appoint, or consent to the appointment and deletion of trust beneficiaries. Waters has said:<sup>115</sup>

The protector in the later 1980s appeared to be little more than a watchdog of the trustee on behalf of the settlor, ... and his task was to ensure that the trustee of [an off-shore] trust, so many miles away from the settlor and vested with the settlor’s property, was actually and efficiently discharging the various trustee duties.

- 2.58 Protectors apparently began to appear in offshore trusts routinely to give settlors “the long arm of control” or at least influence over trustees, and some assurance that their trust was being properly administered. Essentially such protectors had

109 Ibid, at 14–15, and Waters “The Trust in a Changed and Yet Changing World”, above n 100, at 240.

110 Mainland trusts include those of England, the United States, Canada, Australia and New Zealand, as distinct from the off-shore island trusts, such as those of Bermuda, Jersey and the Cook Islands.

111 Waters “Settlor Control”, above n 103, at 14.

112 See Trustee Act 1956, ss 49 and 50.

113 G Cone “Common Law Trusts by Persons based in Civil Law Jurisdictions: Does New Zealand offer a Solution?” (2010) 16 *Trusts & Trustees* 177 at 182.

114 D Waters “The Protector: New Wine in Old Bottles?” in AJ Oakley ed *Trusts in Contemporary Trust Law* (Clarendon Press Oxford 1996) 63, at 71 and 74–75.

115 Ibid, at 63.

power to dismiss and appoint trustees. In this role they are sometimes called “appointers”.<sup>116</sup> The role of the protector later broadened to include a power to direct trustees concerning investments and distributions. Waters says:<sup>117</sup>

In the last five years it is no exaggeration to say that at one time or another the protector has been employed to exercise every administrative and dispositive power associated with the common law concept of express trusts.

2.59 Some recent cases have considered that a protector having powers under a trust deed is a fiduciary.<sup>118</sup> In Waters’ view there are three central issues for a draftsman to consider:

- whether the courts have control over protectors as they have over trustees,
- what standards (fiduciary or others) are expected of protectors, and
- the liability of the trustees if they are being directed to do something by the protector that they know is in breach of the power, or the trust deed, or not in the best interests of the beneficiaries.<sup>119</sup>

2.60 Protectors started to appear more frequently in New Zealand trust deeds in the late 20th century, with varying powers.<sup>120</sup> The Law Commission in its report in 2002<sup>121</sup> recommended a new section in the Trustee Act defining a protector (as a person who, by virtue of the trust deed, may give trustees directions that the trustees are obliged to follow or whose consent to the exercise of trustee power is necessary), and enabling trustees to apply to court for directions in any case where the trustee knew, or ought to have known, that following the protector’s directions would conflict with the trust or any rule of law. We will reconsider this proposal in a later Issues Paper, looking at, amongst other things, the issues raised by Professor Waters above: the control of the court and the standard expected of a protector – whether or not it should be a fiduciary role.

### *Advisory trustees*

2.61 The authors of *Garrow and Kelly Law of Trusts and Trustees* find the growing popularity of the “protector” in New Zealand strange when section 49 of the Trustee Act 1956 permits the appointment of advisory trustees. They point out that section 49(3)(c) provides that “where any advice is ... given by the advisory trustee, the responsible trustee may follow the same ... and shall not be liable

116 Appointers are discussed by J Glover “Discretionary Trusts, Fiduciary Duties and the Family Law Act: has the Family Court acted beyond Power?” (2000) 14 Aust Family Law Jnl 184 at 190–192.

117 Waters “The Protector: New Wine in Old Bottles?”, above n 114, at 64.

118 See *Steele v Paz Ltd* [1993-1995] Manx LR 426 and *Re Osiris Trustees* (2000) 2 ITEL 404. However, one of the judges in *Steele v Paz* was of the opinion (obiter) that it was possible to confer mere powers on a protector as a personal privilege, that is, not trust or fiduciary powers. See Waters, “The Protector; New Wine in Old Bottles”, above n 114, at 114–118. Note that Professor Hayton states that a protector must be a fiduciary and any attempt to give a protector purely personal powers would be repugnant to the trust. See D Hayton “The Irreducible Core Content of Trusteeship”, in AJ Oakley (ed) *Trusts in Contemporary Trust Law* (Clarendon Press, Oxford, 1996) 47, at 54.

119 Hayton “The Irreducible Core Content of Trusteeship”, above n 118, at 65 and 77. See too, D Waters “Protectors and Enforcers: Drafting the Trust Instrument” (2000) 8 Journal of International Trust and Corporate Planning (JTCP) 237 at 248.

120 *Garrow and Kelly Law of Trusts and Trustees*, above n 101, at [11.8.2].

121 Law Commission *Some Problems in the Law of Trusts* NZLC R 79 (2002, Wellington) at [24].

for anything done ...” As these authors note, this is surely a powerful incentive – with a statutory basis – for the responsible trustee to act on any advice given by the advisory trustee.<sup>122</sup> The advisory trustee may be consulted on any matter relating to the trusts. The Law Commission in its report in 2002 noted that:<sup>123</sup>

The difference between an advisory trustee and a protector ... is that a trustee may elect to consult an advisory trustee but is obliged to act on the direction of a protector.

- 2.62 This is a significant difference. The Law Commission thought that it was wrong in principle that a trustee should “not be liable for anything done or omitted by him [sic] by reason of his following” the advice or direction of an advisory trustee (section 49(3)(c)). The Commission recommended amending the section to provide that if the trustee knows or ought to know that any advice or direction from the advisory trustee conflicts with the trust or any rule of law or exposes the trustee to any liability, that trustee must apply to the court for directions in the matter.

### Enforcers and the non-charitable purpose trust

- 2.63 Professor Waters describes the “enforcer”, in 2000, as the “new kid on the block”. At that time the enforcer was to be found only in the offshore trust jurisdictions as a result of the advent of the non-charitable purpose trust.<sup>124</sup> These are trusts for the benefit mainly of some philanthropic or business purpose, but not for the benefit of persons. This means they do not follow the “beneficiary” principle,<sup>125</sup> which for centuries was assumed necessary for the accountability and enforcement of a trust. As a result, an enforcer is considered vital in these trusts, for monitoring trustees and remedying fraud and fault.<sup>126</sup> Although some Canadian Law Reform Commissions have recommended adopting (or expanding) the non-charitable purpose trust, this was in the expectation they would be used for benefiting the public, not private businesses.<sup>127</sup>
- 2.64 Professor Hayton, writing in 1999, said that non-charitable purpose trusts are largely void except in some offshore jurisdictions (Bermuda, the Cook Islands, Jersey, the Cayman Islands and the Isle of Man), where an enforcer is appointed.<sup>128</sup> In some cases they are used as “special purpose vehicles” – SPVs – for purposes of mortgage funding, securitising bank loans and other corporate

122 *Garrow and Kelly Law of Trusts and Trustees*, above n 101 at [11.8.7].

123 Law Commission, above n 121, at [24].

124 See Waters “Protectors and Enforcers”, above n 119, at 258.

125 *Ibid*, referring to *Morice v Bishop of Durham* (1804) 9 Ves 399, and *Re Denley’s Trust Deed* [1969] 1 Ch 373, and the requirement for a trust to have a beneficiary.

126 Waters “Protectors and Enforcers”, above n 119, at 270.

127 See British Columbia Law Reform Commission *Report on Non-Charitable Purpose Trusts* (R 128, Vancouver, 1992) at 39–41, and Manitoba Law Reform Commission *Non-charitable Purpose Trusts* R 77 (Winnipeg, 1992). The examples in these reports of possible non-charitable purpose trusts are for public or similar purposes, not for private business purposes, although their recommendations would open the possibility of the latter. British Columbia allows a limited non-charitable purpose trust to be construed as a power to appoint the income or capital and to last 21 years only: *Perpetuity Act* RSBC 1979 c 321, s 21.

128 David Hayton “The Uses of Trusts in the Commercial Context” in *Modern International Developments in Trust Law* ed D Hayton, (Kluwer Law International, 1999) chapter 8, at 146 and 158–159. See for example, Cayman Islands, *Trusts Law* (2001 Revision), s 14.

financing transactions.<sup>129</sup> In Bermuda, the Trusts (Special Provisions) Amendment Act 1989 requires the purposes to be specific, reasonable, possible and not immoral or contrary to public policy or law. The trust deed must provide for the appointment of an enforcer (to ensure the terms of the trust are adhered to), and for the disposition of surplus assets of the trust upon its termination.<sup>130</sup> According to a Bermuda practitioner in 1991, they were used for philanthropic purposes, for holding shares for companies, corporate financing (for the purchase and construction of aircraft and ships), holding voting stock, and owning shares in a private trustee company.<sup>131</sup> They can last for up to 100 years in Bermuda.

- 2.65 The Canadian Law Reform Commissions suggest some solutions to the lack of certainty issue that might also assist where a purpose becomes obsolete or impracticable, such as the court having recourse to the *cy-pres* doctrine (finding a purpose as near to the original as possible).<sup>132</sup>
- 2.66 The Cayman Islands enacted the Special Trusts (Alternative Regime) Law 1997 which can create what Professor Hayton has called “the most sophisticated trust vehicle in the world”, known as “STAR trusts”.<sup>133</sup> They can be purpose trusts or “people” trusts or a mixture of both. But in all cases only an appointed enforcer has standing to enforce the trust, or rights against the trustee or the trust property. So in a “people” STAR trust, unless a beneficiary is appointed as enforcer, the so-called trust may not fit the traditional trust concept. No fiduciary duties are owed to the “beneficiaries” but the enforcer is deemed to have a fiduciary duty to act responsibly with a view to proper execution of the trust.<sup>134</sup> They can be perpetual trusts. One of the trustees must be a licensed trust corporation.

### Trusts structures in a commercial context

- 2.67 Professor Hayton has listed the uses of trusts in a commercial context to include investment trusts such as unit trusts, corporate custodian trusts (holding securities), debenture trusts (the trust as a collective security device for bondholders), subordination trusts (involving transactions where one creditor is subordinated to another), securitisation trusts (whereby a complex group of assets is held by a trustee, often via a SPV to be available as security to investors), retention fund trusts (used in the building construction industry), clients account trusts, and bills of lading trusts.<sup>135</sup>
- 2.68 These commercial trusts offer the protection of asset segregation and fiduciary obligations owed directly to beneficiaries. They can provide the equitable remedies of performance, restitution and tracing of assets.<sup>136</sup> However some of the rules applying to traditional (estate settlement) trusts are not appropriate to commercial trusts. The rule against perpetuities (which limits the length of a

129 Ibid, at 158.

130 See A Anderson “Bermuda Purpose Trusts A New Feature of Offshore Trust Planning” (1991–1992) 2 The Offshore Tax Planning Review (OTPR) 3.

131 Ibid, at 4–7, and see Trusts (Special Provisions) Amendment Act 1989, s 13 (Bermuda).

132 See Manitoba Law Reform Commission, above n 127, at 29–34.

133 D Hayton “Star Trusts” (1998) 8 The Offshore Tax Review (OTR) 43 at 43.

134 Ibid, at 45, and see Special Trusts (Alternative Regime) Law 1997, s 8(2).

135 David Hayton “The Uses of Trusts in the Commercial Context”, above n 128, at 163–168.

136 Waters “The Trust in a Changed and Yet Changing World”, above n 100, at 230–231.



trust by prescribing the time in which interests must vest) seems out of place in a commercial setting, such as in an energy trust. It does not apply to superannuation trusts in New Zealand. The rule in *Saunders v Vautier*<sup>137</sup> (under which adult beneficiaries entitled to the trust property can bring the trust to an end) has been held by the Canadian Supreme Court not to apply to pension trusts.<sup>138</sup> With respect to access to information, beneficiaries in commercial trusts are more like shareholders and should be entitled to trust accounting and information, not reliant on a court's discretion in any way.<sup>139</sup>

- 2.69 Trustees of commercial trusts may well be professionals. Section 50 of the Trustee Act (NZ) allows the appointment of corporations as custodian trustees, which enables assets to be managed by managing trustees who direct investments, leaving title to the assets in the name of the custodian trustee.
- 2.70 The modern trading trust might fall into the commercial trust category. The authors of a leading New Zealand textbook describe a trading trust as “a trust under which property, held by a trustee, is used to actively carry out a business ... A company is often used as a trustee in an attempt to limit the liability of the individuals involved in carrying on the business ... [O]ne serious problem is that the trustee company will often have little private wealth of its own. Its main asset will often be an indemnity against the trust assets themselves.”<sup>140</sup> According to Justice Heath the trading trust emerged in Australia in the late 1970s as an alternative to the use of a private company for the operation of a family business. Heath J states that “The term ‘trading trust’ was coined to identify a business operated by an assetless company, in the capacity as a trustee for named beneficiaries.”<sup>141</sup> Heath J says the appointment of an assetless corporate trustee is inconsistent with the interests of the beneficiaries. Professor Ford has called the trading trust “a commercial monstrosity”<sup>142</sup> because an assetless company is used as a “front” to trade, and there are no provisions requiring disclosure of the fact that assets are held on trust with the potential to undermine the utility of the company.
- 2.71 Trading trusts were considered by the Law Commission in its report in 2002.<sup>143</sup> The Commission recommended, amongst other things, that there should be imposed on the trustee company directors the same obligations to beneficiaries to which they would be subject if they had been trustees personally, and that, to assist creditors, the trustees’ entitlement to indemnity out of the assets of the trust should not be excluded. Because they clearly raise issues, trading trusts will be fully discussed in a later paper as part of this review.

137 *Saunders v Vautier* Cr & Ph 240, [1835-42] All ER Rep 58, 4 Beav 115.

138 See *Buschau v Rogers Communications Inc* (2006) 269 DLR (4th) 1 at [89]–[100] (SCC), and Waters “The Trust in a Changed and Yet Changing World”, above n 70, at 235–236. Waters quotes Lord Browne-Wilkinson in “Equity and its Relevance to Superannuation Schemes Today” (1992) 6 Trust Law International 119, at 125–126 suggesting a number of modifications for superannuation trusts.

139 See *Schmidt v Rosewood Trusts* [2003] 2 AC 709 at 715 (PC).

140 A Butler (ed) *Equity and Trusts in New Zealand*, above n 102, at [16.1].

141 *OPC Managed Rehab Ltd (in liq) v Ikiua and ors* HC Auckland, CIV 2007-404-6810, 24 July 2009, Heath J at [96]–[97]. See too, *Newmarket Trustees Ltd v CIR* HC Auckland, CIV-2009-404-8108, 14 April 2010.

142 See HAJ Ford “Trading Trusts and Creditors’ Rights” (1981) 13 Melb U LR 1 at 1.

143 Law Commission, above n 121, at [27]–[29].

- 2.72 Trading trusts need to be distinguished from “business trusts”, used principally as a means of succession planning (often in conjunction with family trusts) where the trust holds the shares in a company which owns the business assets.

### Protective trusts

- 2.73 Protective trusts give beneficiaries an interest for life, or a lesser period, which would not be lost in the event of bankruptcy. For this reason they are known as “spendthrift trusts” in the United States. They are not a new phenomenon but in recent times asset protection trusts have been established in some off-shore jurisdictions that are in effect self-settled spendthrift trusts, created in order to protect the settlor’s assets from the claims of creditors. For example, the Cook Islands International Trusts Act 1984 established protective trusts that allow a settlor to be a beneficiary.<sup>144</sup> Professor Sterk has said that the statute made the Cook Islands a favourite *situs* for settlors seeking to avoid creditor claims, particularly as the prohibition on fraudulent transfers under mainland trust jurisdictions<sup>145</sup> is absent, and the Cook Islands law “now virtually precludes creditors from attacking a transfer into a Cook Islands international trust as a fraudulent conveyance”.<sup>146</sup>
- 2.74 American courts have apparently taken a dim view of these trusts as a means to avoid creditors, child support and a fair division of matrimonial property on divorce.<sup>147</sup> But there have been arguments in favour of their recognition in the United States.<sup>148</sup> The New Zealand Trustee Act provides for protective trusts in section 42. The section is based upon section 33 of the English Trustee Act 1925. Neither section precludes the settlor being a protected beneficiary, but section 42(3) preserves the pre-existing law as to the validity of such trusts, so that if such a settlor beneficiary becomes bankrupt, the income will go to his or her creditors.<sup>149</sup> We have been told that protective trusts do not raise any issues in New Zealand.

### CONCLUSIONS ON THE HISTORY OF THE TRUST

- 2.75 Certain themes run through the history of the trust. From earliest times its purposes have been to settle land and assets for future generations of a family, to reduce onerous taxation and to avoid creditors.<sup>150</sup> From earliest times too, the trust has demonstrated that it is indeed an “institute of great elasticity and generality” as Maitland described it.<sup>151</sup>

144 See Cook Islands International Trusts Act 1984, s 13.

145 See The Statute of Elizabeth 13 Eliz (1570) (Eng), *Regal Castings v Lightbody* [2009] 2 NZLR 433 and the Property Law Act 2007, s 346, regarding the invalidity of transfers made with intent to delay, hinder or defraud creditors.

146 SE Sterk “Asset Protection Trusts: Trust Law’s Race to the Bottom?” [2000] 85 Cornell L Rev 1035 at 1048–1049.

147 See RC Ausness “The Offshore Asset Protection Trusts: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?” (2007) 45 Duq L Rev 147, at 182–183.

148 Ibid, at 187–189, with suggestions as to the approach to implementation.

149 DJ Hayton *Underhill and Hayton Law of Trusts and Trustees* (14th ed, Butterworths, London, 1987) at 158.

150 Holdsworth *History of English Law* vol IV, above n 27, at 408.

151 Maitland *Equity*, above n 21, at 23. He continued “This perhaps forms the most distinctive achievement of English lawyers”.

- 2.76 In the age of large landed estates, the wealthy used trusts mostly to settle their land. This could benefit members of the family in need of protection and financial assistance and protect family assets from a spendthrift. The trust – particularly the charitable trust – also brought significant public benefits.
- 2.77 In the 19th and 20th centuries, the flexibility of the trust concept enabled its adaption to largely financial assets, to trust companies, to trusts for pension funds, to varieties of family trust, often to avoid increasingly heavy taxation, particularly of the wealthy. Many leading trust cases are largely concerned with whether or not taxation (estate duty, or stamp duty, for example), is due, or can be avoided by reason of a trust. During the 20th century, trusts were increasingly used by middle income New Zealanders partly in response to changing social circumstances such as increases in divorce and corresponding increases in a need to provide for second or third families, and partly in response to government policies which encouraged asset protection. Recent developments, especially in the off-shore jurisdictions, tend to give more control of trusts to settlors.
- 2.78 The only substantial challenge to trusts was in the 16th century and the Statute of Uses 1535 was the outcome.<sup>152</sup> It is certainly arguable that similar reasons for the passage of the Statute could be made out now: losses to *bona fide* creditors, losses to the Crown by way of taxation avoided (with an increased burden on citizens who do not resort to trusts), and losses to separated spouses.
- 2.79 But the trust does have benefits, which include estate planning, protection of assets, especially to enable their preservation and use for the benefit of the vulnerable (children, the disabled or the elderly), for charitable purposes and as a flexible structure for businesses.
- 2.80 Questions that will be considered in later Issues Papers are whether the perceived abuses are real problems and should be addressed, and if so, how, and whether the flexibility of the trust should be permitted to continue or be reined in by legislative constraints.
- 2.81 It is first necessary to consider the nature of a trust in this enquiry: what is or what is not included in this concept in the twenty-first century? What are its core characteristics that distinguish it from other legal forms, to which trust law should apply?

<sup>152</sup> In the 1820s and 1830s, there was a systematic revision of New York property statutes that was in part a codification effort to enhance the transferability of land, particularly of future interests. The New York revision limited the number of trusts and restricted their boundaries. See GS Alexander “The Dead Hand and the Law of Trusts in the Nineteenth Century” (1985) 37 *StanLRev* 1189, at 1210–1218.



# Chapter 3

## Nature and definition of a trust

INTRODUCTION 3.1 This chapter examines the nature of a trust with a view to finding a working definition, at least for the purposes of this review, and possibly for the purposes of incorporation into new legislation. Recent developments in trust structures (discussed in chapter 2) and issues of when is a trust not a trust (but is a power of appointment or an agency, for example, or even a “sham”) as well as the issue of whether or not New Zealand should ratify the Hague Convention on trusts, mean that it is important to have some consensus on what are the core characteristics of a trust. The first part of the chapter looks at distinctions between trusts and other legal devices, the second part at two core characteristics of a “traditional” trust<sup>153</sup> and the third part considers options for defining a trust.

NATURE OF A TRUST 3.2 Because of its flexibility and the adaption of the trust structure to varying social and economic conditions throughout history, it is difficult to define a trust. An analysis of its nature and consideration of other legal constructs that are similar to trusts but not trusts (although the boundaries sometimes have become blurred), should assist in the search for a definition.

### Trusts distinguished from a contract

3.3 Professor John Burrows has noted that “A contract must be distinguished from a trust.”<sup>154</sup> Most textbooks on trusts do so. Professor Burrows continues:

In a trust, one person (the trustee) holds property on behalf of another (the beneficiary) and is bound to deal with it for the benefit of that other. While the trustee is the legal owner of the property, the beneficiary is said to have the beneficial, or equitable, ownership of it.

... Unlike a contract a trust does not depend on agreement [between settlor and beneficiary] and requires no consideration to establish it... The parties to a contract

153 D Waters “The Trust in a Changed and Yet Changing World” (2008) 15 *Journal of International Trust and Corporate Planning* (JTCP) 205, at 225. The “traditional trust” is the term used, particularly in Commonwealth jurisdictions, to refer to the land settlement trust and its successor, the trust for sale (the portfolio investment trust).

154 R Blainpain (ed) *International Encyclopedia of Laws*, New Zealand edition on “Contracts” by S Todd, J Burrows and J Finn (Kluwer International 2008) chapter 7 at 24–24.

can cancel it by agreement, but a settlor cannot revoke a ... trust unless the trust document reserves a power of revocation.

He explains that if A and B make a contract for the benefit of C, C has no right to enforce it unless the Contracts (Privity) Act 1982 applies, whereas a trust in favour of C creates a right of enforcement by C.

*Debate about the proprietary or contractual nature of a trust*<sup>155</sup>

- 3.4 For centuries there have been different views about whether a trust is essentially an agreement or is attached to property. In 1759, Lord Mansfield in *Burgess v Wheate*<sup>156</sup> said that:

An use or trust heretofore was (while it was an use) to be merely by an agreement, by which the trustee and all claiming from him in privity were personally liable to the cestui que trust and all claiming under him in like privity. But now the trust in this court is the same as the land and the trustee is considered merely as an instrument of the conveyance ... As the trust is the land in this court, so the declaration of trust is the disposition of the land".

- 3.5 At this time, the trust was therefore considered to be more than an agreement binding the trustees morally.<sup>157</sup> It was attached to the property.
- 3.6 The concept of the proprietary (or property) nature of a trust probably reached its high watermark with Lord Mansfield's pronouncement. Thomas Lewin in his textbook in 1837 described the trust as "a confidence reposed in some other" annexed to an estate (in land).<sup>158</sup> The idea of the trust being "the same as the land" had faded by the late 19th century, particularly during an era when trust assets expanded to include stocks, shares, bank accounts and other types of property.
- 3.7 There has been much recent debate as to whether a trust is by its nature essentially a contract or obligation,<sup>159</sup> or a property relationship. The American Restatement concept of a trust stresses the property and fiduciary basis:<sup>160</sup>

155 See Jessica Palmer "Controlling Trustees through Beneficiaries Rights" (paper given at the Law Foundation Trusts Conference in Auckland, August 2009) for a useful analysis of the debate, looking at the evidence for both sides, and concluding that a trust is a unique combination of the proprietary and obligations based models.

156 *Burgess v Wheate* (1759) 1 W Bl 162.

157 It was previously said that "the use was a confidence or trust which bound the conscience of the feoffees or anyone who took their estate in the land from or through them". (WS Holdsworth, *History of English Law* (Methuen & Co Ltd, London, 1903) vol VII, at 144–45).

158 Thomas Lewin said the trust was "a confidence reposed in some other, not issuing out of the land, but as a thing collateral, annexed in privity to the estate of the land, and to the person touching the land, for which *cestui que trust* has no remedy but by subpoena in Chancery". T Lewin *A Practical Treatise on the Law of Trusts and Trustees* (A Maxwell, London, 1837) cited by Patrick Parkinson "Reconceptualising the Express Trust" [2002] CLJ 657 at 658.

159 See for example, Charles Rickett "The Classification of Trusts" (1989–1990) 18 NZULR 305, Parkinson "Reconceptualising the Express Trust", above n 158; JH Langbein "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625).

160 The American Law Institute *Restatement of the Law of Trusts* (Third) (2003) vol 1, para 2 at 17. The Restatement is an authoritative summary of American trust law put together by leading academics and trust practitioners.

A trust, as the term is used in this Restatement, when not qualified by the word “resulting” or “constructive”, is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds the title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.

- 3.8 However, Professor Langbein in the United States has emphasised the “deal” between the settlor and the trustees, and the parties’ consensus over the terms of the trust deed. In his view these are the “bedrock elements of contractarian principle that informs the norms of trust law”.<sup>161</sup> The trust for Langbein embodies a contract about how property is to be deployed.<sup>162</sup> The debate is relevant to current views about “sham trusts”, which will be discussed in Issues Paper 2.<sup>163</sup>

- 3.9 A definition given at the start of *Underhill and Hayton Law of Trusts and Trustees*,<sup>164</sup> unites the obligation and property bases of a trust:

A trust is an equitable obligation, binding a person (called a trustee) to deal with property (called trust property) owned by him as a separate fund, distinct from his own private property, for the benefit of persons (called beneficiaries or, in old cases, cestui que trust), of whom he himself may be one, and any one of whom may enforce the obligation.

### *The magic of the trust*

- 3.10 For Kent Schenkel the “magic of the trust lies in its proprietary characteristics”. The trust can modify the legal interests of parties outside the trust relationship. With its flexibility, and what Schenkel suggests is the “fiction of the title split” (into legal and equitable parts), the trust can convert the rights of third parties (such as creditors or spouses) to “no rights” – something that a contract does not do.<sup>165</sup> So, for example, a creditor’s right to be paid from assets that apparently belong to a debtor – and which the debtor enjoys (like a home) – may be transformed into “no rights” by the magic of a trust because the assets are in trust and no longer belong to the debtor.
- 3.11 Schenkel maintains that trusts allow beneficiaries (and presumably settlors) to externalise the costs of property ownership and it is the stranger to the trust (the creditor or estranged spouse perhaps) who bears the cost. Schenkel suggests

<sup>161</sup> J H Langbein “The Contractarian Basis of the Law of Trusts” (1995) 105 Yale LJ 625 at 671.

<sup>162</sup> Compare P Parkinson “Reconceptualising the Express Trust” [2002] CLJ 657. For Professor Parkinson a definition of the trust in terms of obligation and enforcement offers a way to understand the irreducible core of the trust concept.

<sup>163</sup> See J Palmer, above n 155, noting that under the proprietary view it is the intention of the settlor alone that is relevant to determining whether a trust is a sham, whereas under the “deal” view the trustee’s intention is also relevant. See J Palmer “Dealing with the Emerging Popularity of Sham Trusts” [2007] NZ Law Rev 81.

<sup>164</sup> David J Hayton, Paul Matthews and Charles Mitchell *Underhill and Hayton Law of Trusts and Trustees* (17th edition, 2007, LexisNexis, London) at [1.1]. [*Underhill & Hayton Law of Trusts & Trustees*] The Indian Trusts Act 1882, s 3, defines a “trust” as “an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.”

<sup>165</sup> Kent D Schenkel “Trust Law and the Title-Split: A Beneficial Perspective” [2009] 78 UMKC Law Review 181 at 183.

that “as trusts gain in popularity it seems reasonable to predict that those externalized costs will become an increasingly difficult burden for the community to bear.” He suggests we ask whether trusts should be allowed to thwart important legal obligations (payment of debts, relationship property shares and taxes) leaving others to bear the costs.<sup>166</sup> Issues Paper 2 will look at this concern in depth.

- 3.12 It is clear that trusts are much more flexible and “magic” than contracts. In 1956 Dr Austin Scott in the USA wrote that:<sup>167</sup>

The purposes for which trusts can be created are as unlimited as the imagination of lawyers. There are no technical rules restricting the creation of trusts. The trust can be and has been applied as a device for accomplishing many different purposes.

... A trust can be created for any purpose which is not illegal, which is not against public policy. The duties of the trustee are such as the creator of the trust may impose; the interests of the beneficiaries are such as he may choose to confer upon them.

- 3.13 The minimal regulation of trusts and their lack of public transparency means they have remained extremely flexible. The question is – as Schenkel suggests – should this continue or is the public paying too high a price?

#### *The “traditional” trust and the commercial trust*

- 3.14 The debate about the essential nature of a trust seems more relevant to the “traditional” (estate settlement) private trust than to the commercial trust.<sup>168</sup> A commercial trust is clearly based on a contract, often for investment or other business purposes or security for lenders. Such a trust would include unit trusts or similar investments, solicitor’s trust accounts, the New Zealand energy trusts (see chapter 2) and superannuation (pension) trusts.<sup>169</sup> Usually assets are held for third parties (beneficiaries) who are either investors, shareholders or otherwise contributing to those assets, and are not donees but have rights associated with contracts. However, the commercial trust itself is still more than a contract, and shares at least the essential characteristics of a more traditional trust.

#### *Trusts distinguished from agencies*

- 3.15 As noted in chapter 2, a trust is different from an agency, although as was also noted, there has been some recent blurring of the distinction. A trustee is not the agent of the settlor or the beneficiaries, but is directed by the trust instrument. See paragraphs 2.50–2.56.

<sup>166</sup> Ibid, at 212–213.

<sup>167</sup> AW Scott *The Law of Trusts* (2nd ed, Little Brown & Co, Boston, 1956) at 1.

<sup>168</sup> D Waters “The Trust in a Changed and Yet Changing World”, above n 153.

<sup>169</sup> Ibid, at 228. Note that Professor Hayton considers that pension trusts are a “drastically different species of trust from the traditional trust”: see D Hayton “Pension Trusts and Traditional Trusts: Drastically Different Species of Trusts” [2005] 69 Conv 229, in particular with regard to beneficiaries’ claims to disclosure of information.

## Trusts distinguished from powers of appointment

- 3.16 A power of appointment is a legal device (often within a trust deed or will) whereby a property owner gives to the donee of the power a discretion to decide who may be the beneficial recipients of the property (whether of an income or of a capital nature).<sup>170</sup> A power may be general, permitting distribution to anyone including the donee of the power, or special – in favour of specified persons.
- 3.17 A central element of a trust is the obligation (to beneficiaries) whereas a power imports a discretion.<sup>171</sup> If a trustee (T) holds property on trust for A for life, then to B absolutely, this is a trust, but if T has the power to appoint income to B's children, T has a discretion whether or not to exercise this power to benefit B's children.
- 3.18 However the mandatory/discretionary distinction is often difficult to apply in practice. In particular, the cases have had problems distinguishing between “discretionary trusts” and powers of appointment.<sup>172</sup> In *McPhail v Doulton* for example, Goff J, at first instance, and a majority of the Court of Appeal held the relevant provision in the trust deed created a power of appointment, whereas the House of Lords held the provision created a discretionary trust.<sup>173</sup> Some commentators have said that there is no longer any analytical distinction between the two.<sup>174</sup>
- 3.19 In *McPhail v Doulton* Lord Wilberforce discussed the delicate shading of differences between trusts and powers:<sup>175</sup>
- A layman and, I suspect, also a logician would find it hard to understand what difference there is... A trustee ... given a power or a trust is still a trustee and he would surely consider in either case that he has a fiduciary duty...
- 3.20 To further complicate things, the donee of a power may or may not be also a trustee. If a trustee, the donee will have fiduciary obligations.

170 *Underhill & Hayton Law of Trusts & Trustees*, above n 164, at [1.66].

171 *Ibid*, at [1.67].

172 Discretionary trusts have been around since the 19th century but taxation considerations have made them popular since the last quarter of the 20th century. See D Waters “The Protector: New Wine in Old Bottles?” in AJ Oakley (ed) *Trusts in Contemporary Trust Law* (Clarendon Press, Oxford, 1996) 63 at 73.

173 *McPhail v Doulton* [1967] 1 WLR 1457; [1969] 2 Ch 388; [1971] AC 424.

174 For example JW Harris “Trusts, Powers and Duty” (1971) 87 LQR 31 and others cited in NP Gravells “Discretionary Trusts and Powers of Appointment: Progressive Assimilation” 5 Canterbury L Rev 67 at 71, footnote 18. Nigel Gravells has called a discretionary trust “a trust/power combination” (at 69). Likewise John Glover has said that “trusts and powers are blended in a legal relation of great elasticity known as the ‘discretionary trust’ but this is not a term of art known to Anglo-Australian law and has no single meaning”. (J Glover “Resettlements: Revenue Consequences of Varying Discretionary Trusts” (2005) 79 ALJ 620 at 620).

175 *McPhail v Doulton* [1971] AC 424, at 448–449. This case also decided that a similar test for certainty of objects should apply to “trust powers” (discretionary trusts) as to powers of appointment. All that was necessary was that it could be said with certainty whether any given individual is or is not a member of the class. But a more comprehensive enquiry was called for with trusts. This test has been followed in New Zealand and Australia. See *Re Beckhessinger* [1993] 2 NZLR 362 Tipping J (HC), and Peter Creighton “Certainty of Objects of Trusts and Powers: The Impact of *McPhail v Doulton* in Australia” [2001] 22 Syd LR 93.



- 3.21 Some examples based on those in *Underhill and Hayton Law of Trusts* may help clarify the distinctions:<sup>176</sup>
- (a) If the donee (P) is not a trustee and person Y leaves the contents of her house to P, trusting P will ensure her friends receive some nice pieces of jewellery, this is a general power of appointment.
  - (b) If the donee is a trustee (T), and the trust instrument indicates that T holds assets on trust to distribute to one or more of A, B, C, or D, but must actually exercise the power, this is a discretionary trust. The instrument makes distribution mandatory, but T has a discretion as to who benefits and to what extent.
  - (c) The trust deed may give T a power to distribute trust assets amongst a group of children (A, B and C) in T's absolute discretion, but in default of the distribution of all the assets, X is to be the beneficiary at final vesting. This is a trust for X but the deed contains powers of appointment.
- 3.22 There are significant differences in consequences between powers and trusts. The classification as either a trust or a power is important as it affects the duties and rights of the parties involved. The objects of a bare power of appointment cannot ask a court to enforce the power, whereas a court can intervene in a discretionary trust.<sup>177</sup> As noted in (b), a trustee of a discretionary trust has a duty to select which beneficiaries shall actually benefit, and to distribute to those selected beneficiaries, whereas a donee of a bare power of appointment generally has no such duty.<sup>178</sup> Cases since *McPhail v Doulton* have attempted to clarify the distinction.<sup>179</sup>

176 *Underhill & Hayton Law of Trusts & Trustees*, above n 164, at 1.71. Authority for the discretionary trust situation in (b) is cited as *Re Baden's Deed Trusts (no 2)* [1973] Ch 9 at 26 per Stamp LJ, *Re Hay's Settlement Trusts* [1981] 3 All ER 786 at 793 per Megarry VC and *Schmidt v Rosewood Trusts Ltd* [2003] 2 AC 709 at [37] and [40] per Lord Walker. Example (c) is often referred to as a discretionary trust in New Zealand.

177 See *Re Hay's Settlement Trusts* [1982] 1 WLR 202; [1981] 3 All ER 786. This was a case of an "intermediate power" to benefit anyone except a limited class of persons, rather than a general or special power. Megarry VC distinguished between donees of a power who are not trustees and have no fiduciary duties and those who are; the latter are subject to the control of the court to some degree: at 210 and 213–214. Objects of a power do have some rights, such as the right to hold the donee to account for not exercising the power honestly and in good faith, according to its terms. Rights of beneficiaries generally will be discussed in a later Issues Paper.

178 A general intention to benefit a class generally indicates a trust was intended: *Burroughs v Philcox* (1840) 5 My & Cr 72; *In re Leek Decd* [1967] 1 Ch 1061. But see *In re Leek* at 1073–1074 for the various forms of language that may be used and how they should be interpreted. At first instance Buckley J held the provisions in question to constitute a discretionary power; although the result was affirmed on appeal, it was held to be a discretionary trust.

179 *Re Hay's Settlement Trusts*, above n 177. See also *Re Manisty's Settlement* [1973] 3 WLR 341; [1974] Ch 17 discussed by IJ Hardingham in "Re Manisty's Settlement: the Continuing Saga of Certainty of Object of Discretionary Trusts" (1975) 49 ALJ 7; and *Metttoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587; [1991] 2 All ER 513, which Gravells suggests must inevitably complete the assimilation of discretionary trusts and powers of appointment, (Gravells, above n 174, at 82).

- 3.23 Whether or not there is a trust is a matter of the interpretation of the trust deed or the will as the New Zealand case of *Re Singh (dec'd)* shows.<sup>180</sup> In many modern trust deeds, although there may be a number of discretionary beneficiaries, we understand that generally there is a group who are final beneficiaries (similarly to example (c) above). There may have been discretionary distributions of income and assets throughout the period of the trust (pursuant to powers of appointment), but at final vesting when the trust comes to an end, there will be those beneficiaries who are entitled to the residue (if any) of the assets. If the deed includes ascertained final beneficiaries, this means the deed creates a trust, albeit the trustees may be given a number of discretionary powers of appointment exercisable from time to time until termination.

Q1 Some academics are of the view that discretionary trusts and powers have been more or less assimilated, and trust deeds with significant powers of appointment seem to be common. Despite these factors, where the deed provides for final beneficiaries, with a vested interest in the capital residue at termination, is a trust always created?

Q2 Does the law of trusts apply to powers of appointment within a trust merely because the person who has the power is also a trustee?

## CORE CHARACTERISTICS OF A TRUST

- 3.24 In the Law Commission's view, a trust is essentially different from a contract though features of a contract may be involved. It is different from a power of appointment though it often includes powers of appointment. It is not an entity as such in the way a company is an entity (or legal person) although it can be treated as an entity for tax purposes. A trust is, as Professor Peart has said, a fiduciary relationship, between trustees and beneficiaries.<sup>181</sup>
- 3.25 In the traditional trust relationship, the settlor transfers property to trustees who administer the assets for the benefit of specific persons (the beneficiaries). The three certainties are necessary prerequisites: certainty of intention to establish a trust, certainty that the trust assets are unambiguously defined, and certainty that the beneficiaries are capable of being ascertained, "with locus standi to enforce the trust against the trustees and make the trustees account for their stewardship of the trust property".<sup>182</sup> This last certainty is known as the "beneficiary principle". Title is said to be split between the trustees, who hold the legal estate, and the beneficiaries, who hold the equitable estate or interest and in many cases use and enjoy the property throughout the period of the trust.

180 *Re Singh (dec'd)* [1995] 2 NZLR 487. The deceased left property on trust with a life interest to his wife and capital and income to be held for 20 years, with so much of his income and capital being applied to his six children as the majority of them directed the trustees. But a final clause expressed the wish "without however creating a binding trust in that regard" that his residuary estate should pass to one particular son, X. The majority of the children decided on equal division but the trustee refused to act on the direction arguing that the final clause created a trust for X. The High Court held there was no trust in favour of X.

181 See Nicola Peart "Can your Trust be Trusted" (2009) 12 Otago L R 59 at 60.

182 D Hayton "When is a Trust not a Trust?" [1992] 1 Journal of International Planning 3 at 5.

- 3.26 Before discussing options for a definition of a trust it is necessary to consider two of these characteristics that have been considered core to the trust relationship: the separation of the legal and equitable estates, and the fiduciary relationship between trustees and beneficiaries. The question is, should these characteristics be part of any definition?

### The separation of the legal and equitable estates

- 3.27 The authors of *Underhill and Hayton Law of Trusts* note that history is responsible for the terminology of a trustee owning a legal interest in property and the beneficiaries owning equitable interests.<sup>183</sup> In many texts and cases this concept of a trust is perpetuated.<sup>184</sup> However, there has been a longstanding debate as to what estate or interest a beneficiary actually possesses.<sup>185</sup>
- 3.28 In a fixed trust the beneficiaries have fixed, usually vested, interests in the trust assets and there seems to be agreement<sup>186</sup> that whilst the trustees hold the legal estate in the assets, the beneficiaries have a proprietary interest in the assets of the trust to which they are entitled. More problematic is the nature of a discretionary beneficiary's interest in a discretionary trust.
- 3.29 The interest of such a beneficiary has been much discussed in recent cases. In *Hunt v Muollo*<sup>187</sup> the New Zealand Court of Appeal said that "it is generally regarded as settled law that a discretionary beneficiary's interest in a normal discretionary trust is no more than a mere expectancy". High Court decisions have followed this.<sup>188</sup> The Court of Appeal in *Hunt v Muollo* relied on cases such as *Commissioner of Stamp Duties v Livingstone* and *Gartside v IRC*<sup>189</sup> per Lord Reid. The Law Lords in *Gartside* all held that the beneficiaries in the

183 *Underhill & Hayton Law of Trusts & Trustees*, above n 164, at 4.

184 Patrick Parkinson "Reconceptualising the Express Trust", above n 158, at 659 referring to recent cases such as *Twinsectra Ltd v Yardley* [2002] 2 WLR 802 at 825.

185 DWM Waters "The Nature of the Trust Beneficiary's Interest" (1967) 45 Can BR 219 concerning the early 20th century debate as to whether this interest is *in rem* or *in personam*, involving both testamentary and *inter vivos* trusts. This ranges from Maitland's view that the right of a trust beneficiary is to compel the proper administration of the trust (an interest *in personam*), to the view of Austin Scott who said that the beneficiary is an equitable owner of the trust property. Both views have been followed by leading tax cases. See *Sudeley v AG* [1897] AC 1 (beneficiary's "interest" in an unascertained estate held to be a personal right of action, followed in *inter vivos* trust cases); compare *Baker v Archer Shee* [1927] AC 844 (fixed trust for one beneficiary who was held to have a proprietary interest), and others, including *Stannus v Commissioner of Stamp Duties* [1947] NZLR 1 (beneficiary's interest held to be a chose in action, distinguishing *Baker v Archer Shee*).

186 Scott's view seems to have prevailed, at least for fixed trusts: see n 185.

187 *Hunt v Muollo* [2003] 2 NZLR 322 at 325–326.

188 For example, *Foreman v Kingston* [2004] 1 NZLR 841 (HC), at [48]; *Jamieson-Bell v Hankins & DVM Trust* HC Wanganui CIV 2008-483-294 (11 December 2008) Associate Judge Gendall, at [29]; *R&I Bank of Western Australia v Anchorage Investments Pty Ltd* (1992) 10 WAR 59. Note, however, the "bundle of rights" theory that has developed in some New Zealand cases, for example, *Harrison v Harrison* [2009] NZFLR 687 at [10], where a number of rights in a trust might be considered to be "relationship property" for purposes of the Property Relationship Act 1976. See *Walker v Walker* [2007] NZFLR 772 (CA). This theory will be discussed in detail in Issues Paper 2.

189 *Commissioner of Stamp Duties v Livingstone* [1965] AC 694 at 712 (PC); *Gartside v IRC* [1968] AC 553, at 607 per Lord Reid (HL). His Lordship was referring to an "interest in expectancy" as distinct from an interest in possession. But compare *Leedale v Lewis* [1982] 3 All ER 808 where a small class of beneficiaries in a discretionary trust of capital and income were held to have an "interest in settled property" for the purpose of capital gains tax.

discretionary trust did not have an “interest” for the purposes of estate duty. However, Lord Wilberforce was of the view that their interest was more than a “mere spes”.<sup>190</sup>

- 3.30 The taxation cases rely to some extent on the interpretation of particular tax provisions and it is hard to glean general principles outside the context of particular cases. There would seem to be agreement at least that a discretionary beneficiary lacks a proprietary interest in any particular trust asset,<sup>191</sup> but has an interest in the proper administration of the trust.<sup>192</sup> This could mean that, as Professor Parkinson has said, in a discretionary trust there is generally no separation of the legal and equitable estate,<sup>193</sup> at least until such time as beneficiaries’ entitlements are ascertained (as they are in a fixed trust).<sup>194</sup> It could be said that the discretionary beneficiaries have rights enforceable in equity but this is not the same as saying they have an equitable estate or interest.
- 3.31 In a discretionary trust, where there are specified final beneficiaries, these beneficiaries would have vested equitable interests, although they may ultimately be defeated by distributions to the discretionary beneficiaries throughout the trust period.

Q3 Is it possible to define the interest of beneficiaries in a trust generally; or does this depend on the trust deed in question and the factual and statutory context?

Q4 Is the title split (into legal and equitable estates or interests) a helpful concept that should be part of a definition of a trust in New Zealand?

### The trustees’ fiduciary relationship

- 3.32 The core characteristic of a trust according to many authorities (Professors Peart, Hayton and Waters, and the American Restatement, for example) is that it creates a fiduciary relationship, with respect to property, between trustees and beneficiaries.<sup>195</sup> Lord Justice Millett has given a description of a fiduciary:<sup>196</sup>

190 *Gartside v IRC*, above n 189, at 618. They would have a right to be considered as potential recipients of a benefit and to have this right protected by a court of Equity. A “spes” in this context is a mere hope of benefiting from the trust assets.

191 *R&I Bank of Western Australia v Anchorage Investments Pty Ltd* (1992) 10 WAR 59.

192 *Queensland Trustees Ltd v Commissioner of Stamp Duties* (1952) 88 CLR 54 and *Commissioner of Stamp Duties (Qld) v Livingstone* [1965] AC 694 (PC); *Gartside v IRC* [1968] AC 553 (HL); *Nation v Nation* [2005] 3 NZLR 46 (CA) – a discretionary interest in a trust is not property for the purposes of the Property Relationships Act 1976; *Johns v Johns* [2004] 3 NZLR202 (CA).

193 Patrick Parkinson “Reconceptualising the Express Trust”, above n 158, at 660–663.

194 *Commissioner of Stamp Duties v Livingstone* [1965] AC 694, at 712 (PC). The Privy Council said that “Equity in fact calls into existence and protects equitable rights and interests in property only where their recognition has been found to be required in order to give effect to its doctrines.” See also *Stannus v Commissioner of Stamp Duties* [1947] NZLR 1. Rights of the beneficiaries in *Livingstone* and *Stannus* were considered to be a chose in action (a right to have the trust properly performed) until distribution.

195 *Underhill & Hayton Law of Trusts & Trustees*, above n 164, at [1.97]; D Waters “Settlor Control – what kind of problem?” (2009) 15 *Trusts & Trustees* 12 at 12; N Peart, above n 181.

196 *Bristol and West Building Society v Mothew* [1998] 1 Ch 1; [1996] 4 All ER 698 (CA) at 711.



A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty ... [which] 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 ...

- 3.33 Fiduciary duties are imposed to prevent persons acting in representative capacities with limited access to assets (such as trustees) from misusing their positions for their own advantage and that of third parties.<sup>197</sup> Not every breach of duty by a fiduciary is a breach of fiduciary duty.<sup>198</sup>
- 3.34 In terms of what are peculiarly fiduciary duties, two are widely recognised: first, the principle that prohibits a fiduciary from acting in a situation in which there is a conflict between the duty he owes to his principal and his personal interests, and secondly, the principle that prohibits a fiduciary from receiving any unauthorised profit as a result of the fiduciary position.<sup>199</sup>
- 3.35 More generally, trustees have a duty to act honestly and in good faith, and deal with the trust property with integrity for the beneficiaries.<sup>200</sup> As Millett LJ has said:<sup>201</sup>

The duty of the trustees to perform the trusts honestly and in good faith for the benefit of beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient.

#### TOWARDS A DEFINITION OF A TRUST

- 3.36 As Professor Waters has pointed out, the core concept of a trust may well vary as new eras and evolving economies use the trust idea in different ways.<sup>202</sup> But for the present day, a contextual definition could be helpful in order to determine when a trust is not a trust, that is, it is a power of appointment or an agency, for example, or it is a “sham trust”.

#### A suggested definition

- 197 See P Finn *Fiduciary Obligations* (Law Book Co Ltd, Sydney, 1977) at 8; J Glover “Discretionary Trusts, Fiduciary Duties and the Family Law Act: has the Family Court Acted Beyond Power?” (2000) 14 AJFL 184 at 188. R Flannigan “The Boundaries of Fiduciary Accountability” [2004] NZ Law Rev 215; M Conaglen *Fiduciary Loyalty, Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, Oxford and Portland, Oregon, 2010).
- 198 Conaglen, above n 197, at 16–17, citing *Bristol and West Building Society v Mothew*, above n 196. At 23 and 25–26. For the recent New Zealand approach, relying on English authority: see *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 at 680 (CA) and *Armitage v Paynter Construction Ltd* [1999] 2 NZLR 534, at 543–544 (CA). See too, Flannigan’s discussion distinguishing fiduciary and nominate duties, above n 197, at 225–227.
- 199 Conaglen, above n 197, at 39. He considers that the concept of loyalty operates to increase the likelihood of a fiduciary’s faithful adherence to duty, at 61. See too, Hayton “The Irreducible Core Content of Trusteeship”, above n 195. In A Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at 476, the authors list four core duties, which include the two referred to here, and the duty to avoid divided loyalties, and to report to a beneficiary the fact that a fiduciary duty has been breached.
- 200 Conaglen, above n 197, at 40.
- 201 *Armitage v Nurse & ors* [1997] 2 All ER 705 at 713, per Millett LJ (CA).
- 202 D Waters “The Trust in a Changed and Yet Changing World”, above n 153, at 211–212.



3.37 It could be concluded from the above discussion that the defining features of a trust comprise:

- an equitable obligation or obligations;
- binding trustees to deal with property (the trust assets);
- to which the trustees hold the legal title;
- but hold it separately from the trustees' own property;
- for the benefit of beneficiaries, (who may include settlors and trustees)
  - who include a beneficiary or beneficiaries who hold equitable interests, *or*
  - who have rights in equity (that is, there is no "title split" as such in the definition),
  - and to whom the trustees owe fiduciary (and other fundamental) duties;
- or for the benefit of a charitable object.

3.38 A trust may be set up by a settlor or settlors, (an *inter vivos* trust) or will-maker (a testamentary trust). It is the intention of the settlor that determines almost every clause of the trust deed's distributive provisions.<sup>203</sup> There must be the "three certainties" discussed at paragraph 3.25 above. An extended definition might include these matters.

3.39 The above definition covers charitable trusts but it assumes that otherwise trusts have beneficiaries. The issue of whether or not to include non-charitable purpose trusts (see discussion in chapter 2) will be discussed in a later Issues Paper.

### American Restatement and textbook definitions

3.40 Alternatively, less detailed definitions already in existence could be used. This might be the American restatement definition, that is:<sup>204</sup>

A trust, as the term is used in this Restatement, when not qualified by the word "resulting" or "constructive", is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds the title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.

3.41 Or, a definition like that in Professor Hayton's textbook could be used:<sup>205</sup>

A trust is an equitable obligation, binding a person (called a trustee) to deal with property (called trust property) owned by him as a separate fund, distinct from his own private property, for the benefit of persons (called beneficiaries or, in old cases, cestui que trust), of whom he himself may be one, and any one of whom may enforce the obligation.

3.42 Both of these are fairly basic definitions. The Restatement covers charitable trusts, specifies the fiduciary relationship and notes that the "person who holds title to the property" has duties to deal with it for the benefit of persons or

<sup>203</sup> Ibid, at 223.

<sup>204</sup> The American Law Institute *Restatement of the Law of Trusts* (Third) (2003) vol 1, para 2 at 17.

<sup>205</sup> *Underhill & Hayton Law of Trusts & Trustees*, above n 164, at [1.1].

charity. Hayton's definition emphasises the separation of the trust fund from the trustee's private funds. Neither refer to any requirement for the beneficiaries to hold an equitable estate or interest.

### The Hague Trusts Convention definition

- 3.43 Alternatively, it may be useful to have a legislative definition of core characteristics that covers all types of trust, including, for example, testamentary and *inter vivos*; family settlement, superannuation and commercial; public (such as charitable) trusts; and equity and non-equity jurisdiction trusts. It will not necessarily apply to trusts arising through operation of law (resulting and constructive trusts). The increasing use of trusts in a growing number of jurisdictions has resulted in an international convention on trusts, which includes such a wide definition (see below).
- 3.44 In the 1970s increasingly high taxation began to drive the wealthy off shore from mainland trust jurisdictions (such as England and the United States) to "tax havens" such as the Channel Islands and Caribbean islands, where these small jurisdictions offered advantageous estate planning opportunities. Trust legislation has been introduced in the off-shore jurisdictions that is often rather different from the mainland trust legislation.<sup>206</sup>
- 3.45 Furthermore, trust-like structures have developed outside the equity jurisdictions, (those that have inherited English law and equity) in the civil law jurisdictions of Scotland, Europe, and many other parts of the world (which do not recognise equity law).
- 3.46 In France the "*fiducie*" has a clear contractual character and its use is restricted to institutional and corporate activities; it is not to be used for private property succession planning.<sup>207</sup> There is apparently a similar policy in place in Central and South America, Japan and the People's Republic of China. In Italy, on the other hand, Italian residents can settle trusts in both wills and *inter vivos* estate planning so long as they do not violate Italian succession law, spousal property rights, creditors' rights or other laws reflecting Italian public policy.<sup>208</sup> These developments mean that it is not always clear when a "trust" has been created. An arrangement called a "trust" may not conform with the generally accepted core characteristics of a trust.<sup>209</sup> It seems that the People's Republic of China "practically equates the positions of trustee and agent."<sup>210</sup> Another civil law development is the "foundation", originally created for charitable purposes, now used for private purposes, which has a separate legal personality like a company.<sup>211</sup> It has now expanded to some common law jurisdictions such as the Bahamas (in 2004).

206 Waters "The Trust in a Changed and Yet Changing World", above n 153, at 226–227.

207 Ibid, at 206.

208 Ibid, at 207.

209 This of course begs the questions of what these core characteristics might be and in whose view.

210 Waters "The Trust in a Changed and Yet Changing World", above n 153, at 207.

211 Ibid, at 242–24.

- 3.47 Where settlors are in one country and their trust set up in another, conflict of law issues are likely to arise.<sup>212</sup> As a result of these developments, in 1980, the 14th Hague Conference decided to prepare a convention on the international recognition and validity of trusts,<sup>213</sup> and in 1985, this convention was completed. The definition of a trust incorporated at Article 2 of the Hague Convention on the Law Applicable to Trusts and Their Recognition provides:

For the purposes of this Convention, the term “trust” refers to the legal relationships created – inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

A trust has the following characteristics –

- (a) the assets constitute a separate fund and are not a part of the trustee’s own estate;
  - (b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
  - (c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.
- 3.48 The definition “embraces a wider understanding of the trust idea” and “has the potential to include ... the property management concepts, based on good faith, of a number of non-common law jurisdictions around the world.”<sup>214</sup>
- 3.49 It is a basic definition and much wider than that for the American Restatement or given in Professor Hayton’s textbook, which have essentially been designed for the equitable trust, originally the family estate settlement type trust, what Professor Waters would term the “traditional trust”.<sup>215</sup> Professor Lupoi has said that the Hague Convention definition creates the “shapeless trust”.<sup>216</sup> Unlike the equitable trust, assets are placed “under the control of a trustee”, not vested in the trustee (although “title stands in the trustee’s name”); the trustee is “accountable” but to whom? There is no reference to the fiduciary relationship and the “beneficiary principle” (a non-charitable trust must have a beneficiary) does not apply.
- 3.50 For the purposes of considering the Hague Convention definition, it should be noted that ratification would affect the applicable law, as Article 6 provides that a trust shall be governed by the law chosen by the settlor, although if no applicable law has been chosen, the trust will be governed by the law “with which it is most closely connected” (Article 7). If a New Zealand settlor chooses the appropriate foreign law to govern the trust, he or she could establish a non-charitable purpose trust or even a Cayman Islands STAR trust (see discussion in chapter 2) not presently permitted under New Zealand law.

212 See for example RC Ausness “The Off-shore Asset Protection Trust: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?” (2007) 45 Duq L Rev 147 at 162–172.

213 See A Dyer and H van Loon *Report on Trusts and Analogous Institutions* (Hague Conference on Private International law 1984), at 2.

214 Waters “The Trust in a Changed and Yet Changing World”, above n 153, at 226.

215 Ibid, at 225.

216 Maurizio Lupoi “The Shapeless Trust” (1995) 1 Trusts and Trustees and International Asset Management 15, at 16–17.

- 3.51 The Convention only applies to trusts created voluntarily and evidenced in writing. New Zealand has not ratified the Hague Trusts Convention. States that have ratified it include Australia, some Canadian provinces, Hong Kong, Italy, the Netherlands, Luxembourg and the United Kingdom (on behalf of Great Britain, Bermuda, the Isle of Man and other off-shore territories), Jersey, and Guernsey.
- 3.52 The issue of New Zealand ratifying the Convention was discussed in the Law Commission's 2002 report.<sup>217</sup> The Preliminary Paper noted that increasing globalisation and increasing resort by New Zealanders to off-shore trusts make it important that uncertainties be removed as to which law governs the operation of any particular trust.<sup>218</sup> The advantages and disadvantages of ratification will be discussed fully in a later Issues Paper.
- 3.53 In the Hague Convention definition, unsurprisingly, there is no reference to beneficiaries obtaining an equitable estate or interest. Arguably this is a characteristic of an equity jurisdiction trust, as discussed above. In the non-equity jurisdictions, trustees hold the assets of the trust as a separate "patrimony" from their personal assets, for the benefit of beneficiaries or possibly some specified purpose, but those beneficiaries do not have an equitable estate or interest in the trust assets – there is no concept of concurrent dual ownership (the "title split").<sup>219</sup> Acceptance of the Hague Convention definition for a New Zealand trust would open the door wide to differences in the traditional core concepts of a trust and a number of overseas developments in trust structures.

### The options and questions

- 3.54 Possible options for the basis of a definition of a trust are:
- (a) A definition based on the listed core characteristics in paragraph 3.37 above, which is more detailed and comprehensive than the Restatement or most textbook definitions; it could include a reference to the three certainties and possibly to the "title split";
  - (b) The American Restatement definition, or a current textbook definition;
  - (c) The Hague Convention definition in Article 2, which is a wide definition that can include a number of the civil law "trusts" but does not refer to trustees' fiduciary obligations and accountability to beneficiaries, and could include a non-charitable purpose trust.

Q5 Are you in favour of a legislative definition of a trust in a new New Zealand Trusts or Trustee Act?

Q6 If so, which of the options do you prefer – or do you have an alternative suggestion?

Q7 If not, what would be a useful working definition for this review?

<sup>217</sup> Law Commission *Some Problems in the Law of Trusts* (2002) NZLC R 79 at [41].

<sup>218</sup> Law Commission *Some Problems in the Law of Trusts* (2002) NZLC PP 48 at [34].

<sup>219</sup> See Scottish Law Commission *Discussion Paper on the Nature and the Constitution of Trusts* DP 133 2006, part 2, and LA Wright "Trusts and the Civil Law – A Comparative Study" (1967) 6 W Ontario L Rev 114.

# Chapter 4

## Trusts legislation

**INTRODUCTION** 4.1 This chapter focuses on the role that trusts legislation can and should play in the law of trusts. By “trusts legislation” we mean statutes that generally address the administration of trusts, the role and powers of trustees and the powers of the court, but may also include provisions fundamental to the nature and requirements of trusts. In New Zealand, the Trustee Act 1956 is the statute that fulfils this role. Legislation dealing with related but less core matters, such as the Trustee Companies Act 1967, Trustee Companies Management Act 1975, Perpetuities Act 1964, Charitable Trusts Act 1957 and Charities Act 2005 will be addressed in later Issues Papers and at later stages of the project.<sup>220</sup>

4.2 Most of the law of trusts is found in case law, but some is in trusts legislation. The future of the Trustee Act 1956 is an integral part of the Law Commission’s review of trusts. However, the Act is largely a default Act, as trust deeds may exclude many of its provisions. We ask whether any revised trusts statute should retain the same mold as the current Trustee Act 1956, or whether legislation that is wider in scope and has more requirements for trusts and trustees should be considered, and perhaps introduced as a Trusts Act rather than a Trustee Act.

4.3 This chapter examines the role that legislation has played in trusts law historically and looks at international approaches to trusts legislation with a view to searching for better models. The Trustee Act 1956 is considered in this context. We then explore the need for reform and discuss issues regarding the approach that a trusts statute may take, before examining particular sections and issues in the Trustee Act 1956 that have been identified as being in need of reform.

**BACKGROUND** 4.4 In jurisdictions similar to New Zealand trustee legislation is generally considered to be facilitative – an adjunct to the trust instrument and common law rules. Legislation in trusts law has aimed at facilitating the efficient administration of trusts.<sup>221</sup> Generally, provisions of trusts legislation that confer powers on trustees do not override the terms of a trust instrument, and statutory powers may be expressly excluded by the trust instrument.<sup>222</sup> Thus, the legislation assists where

220 This review will only affect the Public Trust Act 2001 and Māori Trustee Act 1953 to the extent that they are impacted on by the general law of trusts.

221 Irish Law Reform Commission *Consultation Paper on Trust Law: General Proposals* (Dublin, 2005) at 11.

222 British Columbia Law Institute, Committee on the Modernization of the Trustee Act *A Modern Trustee Act for British Columbia* (BCLI Report No. 33, 2004) at 2.



flaws or omissions in the deed cannot otherwise be resolved. This has generally been considered to be appropriate. This type of trust legislation can, therefore, be described as having largely “default” provisions.

- 4.5 Many Commonwealth trusts statutes, including New Zealand’s Trustee Act 1956, have followed this approach as a result of having their genesis in 19th century English Trustee Acts. This has led to a marked similarity in the Trustee Acts of a number of countries. As we will see when examining approaches to trusts legislation in different countries below, few countries have broken this mold of trusts legislation.
- 4.6 Trusts legislation is generally limited in scope to the administration of trusts, rather than having provisions setting out the details of the trust relationships and the roles of settlor, trustee and beneficiary.<sup>223</sup> The fundamental aspects of what a trust is, how it is established and how it operates are left to case law, with a high level of flexibility in the requirements that may be set out in trust instruments.

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#### INTERNATIONAL APPROACHES The English Trustee Acts and their adoption in other countries

- 4.7 The primary trusts legislation in England and Wales is the Trustee Act 1925. This was the latest iteration of numerous Trustee Acts and other trusts statutes introduced in the 19th century.
- 4.8 The earliest statutory trustee law in England was limited to narrow provisions to solve particular problems that arose and could not be remedied by the courts, such as the need to transfer the title to property to a new trustee when an original trustee was replaced.<sup>224</sup> Trusts legislation was consolidated in 1825 and again in 1850, but these produced piecemeal provisions, and were not formulated as general principles.<sup>225</sup> From the middle of the 19th century, pressure from trust practice forced the legislature to become more proactive on the law of trust administration.<sup>226</sup> Chantal Stebbings has stated that “largely due to a programme of steady legislative reform”, the trusts system “creaked and splintered, but did not collapse”.<sup>227</sup> Legislative reforms eventually led to a fairly comprehensive and accessible code of trust administration law with the Trustee Act 1893.<sup>228</sup>
- 4.9 Donovan Waters has described the English Parliament as having two purposes when it enacted the Trustee Acts in the 19th century. First, they aimed to clarify the manner of appointment and discharge of trustees and their administrative

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223 Ibid.

224 W Cornish, S Anderson, R Cocks, M Lobban, P Polden and K Smith *The Oxford History of the Laws of England Volume XII: 1820 – 1914: Private Law* (Oxford University Press, Oxford, 2010) at 270.

225 Ibid, at 271.

226 Chantal Stebbings *The Private Trustee in Victorian England* (Cambridge University Press, Cambridge, 2002) at 18.

227 Ibid, at 195.

228 Ibid.

powers. This allowed the continued administration of trusts with minimal court assistance, even where trustees were not given adequate administrative powers in a trust deed.<sup>229</sup>

- 4.10 A second purpose was to give the courts clear statutory authority to act where a trust has broken down. For instance, the courts were able to appoint and remove trustees, vest property in others when trustees were unable to act and authorise distributions of trust property among known beneficiaries.<sup>230</sup>
- 4.11 The Trustee Act 1893 (UK) was described as a statute to codify the law relating to trustees so far as it existed at the time.<sup>231</sup> However, it was not a complete codification of the law of trusts. It did enact some new law but only as a corollary and natural effect of codifying the old law. It did not attempt to codify the principles of trusts law that had been evolved by the decisions of the courts of Equity.<sup>232</sup> The 1893 Act repealed most of the preceding Acts. It primarily dealt with investments of trust property, powers and duties of trustees and the powers of the court. The Act was of immense assistance to lay trustees, who were able to more easily find the law that applied to them than they had been able to previously, an outcome which it might be possible to achieve through the current review.<sup>233</sup>
- 4.12 Much of the content of the Trustee Act 1925 is very similar to the Trustee Act 1893. The 1925 Act was included as part of a suite of property law statutes that were introduced at this time. For the most part it consolidated the trusts legislation that was already in force.<sup>234</sup> The 1925 Act includes provisions on the powers of trustees, the appointment of trustees and the court's powers.
- 4.13 Separate statutes have introduced additions to the statutory law of trusts through the latter half of the 20th century, addressing variation of trusts,<sup>235</sup> trustee investments,<sup>236</sup> and delegation of trustees' powers.<sup>237</sup> Following an English Law Commission report particularly addressing trustees' investment powers, the Trustee Act 2000 was enacted.<sup>238</sup> This provided a wider statutory power of investment that gives trustees the powers that they would have if they were the absolute owners of the property. This Act also created a statutory duty of care for trustees (although this can be excluded by the trust deed), widens the power of trustees to delegate and allows for the appointment of nominees and custodians.

229 Donovan Waters *Law of Trusts in Canada* (2 ed, Carswell Company, Toronto, 1984) at 905; British Columbia Law Institute, above n 222, at 2.

230 Waters, above n 229, at 905.

231 A Gudall and J Greig *The Law of Trusts and Trustees* (2 ed, Jordan and Sons, London, 1898) at xxxiii.

232 Ibid.

233 Stebbings, above n 226, at 19.

234 Email from Stuart Anderson to Janet November regarding the history of the English Trustee Acts (17 September 2010).

235 Variation of Trusts Act 1958 (UK).

236 Trustee Investments Act 1961(UK).

237 Trustee Delegation Act 1999 (UK).

238 The (English) Law Commission and the Scottish Law Commission *Trustees' Powers and Duties* (Law Com No 260, Scot Law Com NO 172, 1999).

- 4.14 The English trusts legislation generally contains default provisions that can be overridden by the terms of a trust instrument. The scope of the legislation is limited to powers of trustees and the courts, processes for appointing and discharging trustees, and protecting trustees from liability, the role of agents, nominees and custodians, and remuneration. These are administrative provisions rather than legislation that is directed at the core of the trust concept and trust relationships.

### *Ireland*

- 4.15 Like New Zealand, several other Commonwealth jurisdictions adopted statutes that closely reflected the English Trustee Acts. The principal trusts statute in force in Ireland is still the Trustee Act 1893 (UK). As it still applies to Ireland, the 1893 Act has been amended only in relatively minor respects since the foundation of the Irish State.<sup>239</sup> Two later Irish statutes have made relatively minor amendments to the 1893 Act.<sup>240</sup>
- 4.16 The Irish Law Reform Commission is currently reviewing Ireland's trusts legislation. In 2008 it made recommendations and presented a draft Bill for a modern legislative code concerning the duties, responsibilities and powers of trustees. The Irish Commission considers that there is need for complete reform of parts of the 1893 Act, while some provisions remain relevant but would benefit from modernisation of the language.<sup>241</sup> The succinct draft Bill contains modernised versions of existing provisions, reformed or expanded versions of some provisions and some entirely new provisions.<sup>242</sup> The draft Bill contains default provisions in that many of the obligations and arrangements put in place by the Bill can be altered by a contrary intention in a trust instrument. A provision on the fiduciary duty of a trustee to "perform the trust honestly and in good faith for the benefit of the beneficiaries" cannot be excluded by a trust instrument.<sup>243</sup> It is generally limited in scope to the same matters already covered by trusts legislation.

### *Scotland*

- 4.17 Trust law has developed somewhat differently in Scotland. The Trusts (Scotland) Acts 1921 and 1961 set up the framework of trustee's powers, provided for the appointment and removal of trustees, established powers of investment and allowed for the variation of a trust's purposes. The Scottish Law Commission has been engaged in a comprehensive review of trust law over the past decade, which has included a discussion paper on the nature and constitution of trusts.<sup>244</sup> This included proposals for statutory rules regarding the creation of a trust, and consideration of whether trusts where the settlor is also the sole trustee are

239 Irish Law Reform Commission *Trust Law: General Proposals* (Dublin, 2008) at 1.

240 The Trustee Act 1931 (Ireland) provided for the appointment of new trustees and the Trustee (Authorised Investments) Act 1958 (Ireland) amended the provisions relating to the investment of trust funds.

241 Irish Law Reform Commission, above n 239, at 1.

242 *Ibid*, at 1–2.

243 *Ibid*, cl 12 of draft Bill.

244 Scottish Law Commission *Discussion Paper on the Nature and Constitution of Trusts* (Edinburgh, 2006).

valid and whether there should be a public register of trusts.<sup>245</sup> This indicates that Scottish trusts legislation may be given wider scope than those under the English Trustee Act model.<sup>246</sup>

### Australia

- 4.18 The states and territories of Australia are each responsible for their own trust legislation. These Australian statutes are characterised by their age and similarity to the 1925 English Trustee Act and its predecessors. New South Wales and the Australian Capital Territory enacted Trustee Acts in 1925; South Australia followed in 1936; Victoria in 1958; and Western Australia in 1961. The newest, the Queensland Trustee Act 1971, is nearly 40 years old, while the Tasmanian Trustee Act was enacted in 1898. The subject matter of these Acts closely aligns with what is covered in the English legislation.

### United States' Uniform Trust Code and Restatement of the Law of Trusts

- 4.19 In the United States, trusts are a matter of state law and vary from state to state. However, the National Conference of Commissioners on Uniform State Laws produced a Uniform Trust Code in 2000. The Code was last amended in 2005.<sup>247</sup> As of this year, 22 states have adopted the Uniform Trust Code in full or in part.<sup>248</sup>
- 4.20 The Uniform Trust Code (the Code) was developed because of the increased use of trusts, both in family estate planning and in commercial transactions and the consequent realisation that trust law in many states was not sufficient to address all of the questions involving trusts that arose. The Code was intended to provide precise laws that would give sufficient guidance for administration of trusts. The Code codifies the common law of trusts, but also makes some changes to the extant law.<sup>249</sup>
- 4.21 The Code is generally a default statute, but does have several mandatory provisions that apply to every trust.<sup>250</sup> It contains some “optional” provisions that the National Conference of Commissioners on Uniform State Laws suggests states may want to modify or exclude to tailor the Code to their own jurisdiction.<sup>251</sup>
- 4.22 The Code addresses such topics as the requirements for creating, modifying and terminating trusts, rights of creditors, revocation and modification of trusts, rules for trustees, the remuneration, appointment, and removal of trustees,

245 Ibid, at 50–51.

246 However, it seems that this suggestion is not going to proceed (Meeting of Scottish Law Commission and Janet November, Law Commission, 12 July 2010).

247 STEP Journal website “Jurisdiction Summaries – United States” < [www.stepjournal.org](http://www.stepjournal.org) > .

248 These states are Alabama, Arizona, Arkansas, Florida, Kansas, Maine, Missouri, Michigan, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia and Wyoming; plus the District of Columbia (The National Conference of Commissioners on Uniform State Laws < [UTCproject.org](http://UTCproject.org) > .

249 David M English “The Uniform Trust Code 2005” (paper presented at American Law Institute – American Bar Association Conference on representing estate and trust beneficiaries, July 2005) at 2–3.

250 See paragraph [4.53] for a list of some of these mandatory provisions.

251 English, above n 249, at 3.



the duties and powers of trustees, the liability of trustees and rights of beneficiaries, and the application of the Code to existing trusts. The Code did not make sweeping changes from the case law but did make some.

- 4.23 The Third Restatement of the Law of Trusts also provides guidance on the law of trusts in the United States. The Restatements are written and approved by the American Law Institute. The Restatements collect and summarise the common law and where cases conflict, they strive to delineate the better rule and also fill in the gaps in the law. The intention is that courts of different states will rely on the Restatement and develop uniform rules. The Code was drafted in close coordination with the revision of the Restatement. State courts were free to depart from the Restatement, but if the Code is adopted by a State it provides mandatory rules that can be relied on and are easily accessible.<sup>252</sup>

### Reforms in Canada

- 4.24 The Canadian provinces have each enacted Trustee Acts. These were originally based on the 1893 English Trustee Act. Some provinces have adopted sections from the Trustee Act 1925 consolidation in England. There is some variation between provinces. This reflects the time of adoption of English law and the extent of recent reforms. Many of the more recent reforms have been based on the American uniform trust law proposals and the American Restatement of Trusts. For instance, the investment sections of most Canadian jurisdictions are now based on the US-developed modern portfolio theory.<sup>253</sup>
- 4.25 Quebec's situation is somewhat different to the other Canadian provinces. As a civil law jurisdiction, Quebec does not have the common law heritage and has no common law trust concept. The trust, or "*fiducie*", was introduced through the Quebec Civil Code in 1994. The Code contains provisions addressing the nature of a trust, kinds of trust and their duration, the administration of a trust, changes to trusts and termination of trusts.<sup>254</sup> By necessity because of the lack of core trust principles in other law, this legislation is comprehensive and addresses the fundamentals of the trust relationships.
- 4.26 The Trustee Acts of Canadian provinces and territories have been updated fairly regularly in comparison with most other Commonwealth jurisdictions. Most of their current Acts were enacted no earlier than the late 1980s.<sup>255</sup> However, there is concern that the Canadian Trustee Acts are outdated and problematic, leading to impetus for reform of trustee law in Canada.<sup>256</sup>

252 Ibid, at 7.

253 STEP Journal website, above n 247. Modern portfolio theory is a theory of investment which attempts to maximise returns for a given level of risk. A key way that this can be achieved is to spread risks across different assets by constructing a diversified portfolio.

254 Civil Code of Quebec S Q 1991 c 64, § 1260–1298.

255 Alberta Trustee Act RS A 2000 c T-8; British Columbia Trustee Act RS BC 1996 c 464; Manitoba Trustee Act CCS M 2008 c T-160; New Brunswick Trustees Act RS NB 1973 c T-15; Newfoundland and Labrador Trustee Act RS NL 1970 c T-10; North West Territories Trustee Act RS NWT 1988 c T-8; Nova Scotia Trustee Act RS NX 1989 c 479; Nunavut Trustee Act RSNWT Nu 1988 c T-8; Ontario Trustee Act RS O 1990 c 23; Prince Edward Island Trustee Act RS PEI 1988 c T-8; Saskatchewan Trustee Act S S 2009 c T-23.01; Yukon Trustee Act RS Y 2002 c 223.

256 Russell J Getz "Uniform Law Act: Progress Report" (paper presented at Uniform Law Conference of Canada, Civil Law Section, Ottawa, August 2009) at 2.



- 4.27 Manitoba and Saskatchewan have both introduced new Trustee Acts in the last two years. These Acts were basically modernisations of the existing Trustee Acts and have a relatively limited scope.
- 4.28 The British Columbia Law Institute's Committee on the Modernization of the Trustee Act produced a report and draft Bill in 2004. They recommended a modern Act that retained a similar scope and nature to their current Act. The Bill was drafted as default legislation so that, like other Canadian and Commonwealth Trustee Acts, it would be a supplement to the general law of trusts and trust instruments. The Committee considered producing a Bill that codified trust law, similarly to the United States Uniform Trust Code. However, they did not consider that codification was necessary or that it could be undertaken in a reasonable timeframe.<sup>257</sup> The Bill did involve some reform of the existing rules of general trust law. The Committee found that in some aspects of the law, the case law no longer corresponded with the reality of trust practice and the statutory law needed to be altered to reflect the reality. For instance, the draft Bill alters the traditional rule that trustees must act unanimously and empowers them to act by majority unless the trust instrument provides otherwise. The Committee included in the Bill some concepts that previously only existed in case law, such as the trustee's duty of integrity and standard of care.<sup>258</sup> Both of these would be default provisions.<sup>259</sup> The Bill also consolidates other separate trust statutes, such as the Trust and Settlement Variation Act 1996, under the umbrella of the Trustee Act.<sup>260</sup>
- 4.29 Concerns about a lack of consistency in Canadian trust law as well as the need to update most provinces' Trustee Acts led to a proposal at the Annual Meeting of the Uniform Law Conference of Canada in 2008. A project is now underway to produce a Uniform Trustee Act for Canadian provinces with a working group developing drafting instructions. It was proposed that the uniform Act would be capable of national enactment and without provisions specific to an individual province. It will be in accordance with modern trust usage and needs. The uniform statute is to be based on the British Columbia Law Institute's draft Bill.<sup>261</sup> At the 2009 Annual Meeting of the Uniform Law Conference of Canada the working group presented several important policy issues that had arisen during consideration of the uniform Trustee Act. These included the ability of trustees to act by majority, variation and termination of trusts and non-charitable purpose trusts.<sup>262</sup>

### India: A comprehensive Trusts Act

- 4.30 The Indian Trusts Act 1882 is a significantly different type of legislation to the English Trustee Acts. This Act has a much wider scope and codifies many of the basic principles of trusts law. It is not a default Act. The Act covers the definition of a trust, a trustee, a beneficiary, and the author of a trust, who can

<sup>257</sup> British Columbia Law Institute, above n 222, at 10.

<sup>258</sup> *Ibid*, at 10–11.

<sup>259</sup> *Ibid*, clauses 4 and 6 of Draft Bill.

<sup>260</sup> *Ibid*, at 11.

<sup>261</sup> Getz, above n 256, at 2.

<sup>262</sup> *Ibid*, at 3–7.

also be a trustee or beneficiary. It delineates how a trust is established, as well as trustees' duties, trustees' liabilities, rights and powers of trustees, and the appointment of trustees. It has provisions for revoking a trust, and defining when constructive trusts and obligations in the nature of a trust are in place. All trusts of immovable property must be registered. The Indian Act contains numerous examples to illustrate its provisions and, despite its age, is written in easily comprehensible language.

### Jersey and Guernsey

- 4.31 Jersey and Guernsey have relatively modern and accessible trusts statutes. The Trusts (Jersey) Law 1984 and the Trusts (Guernsey) Law 2007 are similar. These statutes provide a legal framework for the establishment of trusts, for the guidance of trustees and for the protection of beneficiaries.<sup>263</sup>

### NEW ZEALAND'S TRUSTEE ACT 1956

- 4.32 New Zealand's first Trustee Act was passed in 1883. There followed several amendment Acts from 1891 until 1907 and in 1908 a consolidated Trustee Act was passed. This was a comprehensive statute of 113 sections covering powers of the Supreme Court (the first 65 sections), relief of trustees, appointment of new trustees, miscellaneous powers, duties and liabilities of trustees and delegation of such powers. In 1956, the current Trustee Act was passed. It was based on the English Trustee Act 1925 "to give the benefit of the United Kingdom cases and text books",<sup>264</sup> but modified to suit New Zealand circumstances.
- 4.33 The only substantial amendments to the Act since its introduction have been the power of the court to vary a trust in sections 60 and 60A in 1960 and the substitution of a new Part II of the Act in 1988 relating to trustees' investment powers.
- 4.34 The 1956 Act is organised in 6 Parts.
- (a) Part 1 contains the usual preliminary provisions.
  - (b) Part 2 lists the powers and duties of trustees in relation to investment of the trust fund. These provisions were added in 1988.
  - (c) Part 3 sets out the general powers and indemnities of trustees. Part 3 contains the lengthiest provisions, detailing, in an exhaustive manner, trustees' powers to deal with and insure the trust property and to carry on business as a trustee. This Part also provides for delegation powers and the employment of agents, and the powers of maintenance and advancement and with protective trusts. Finally, it sets out a number of specific instances when a trustee is indemnified by the trust fund.
  - (d) Part 4 contains administrative provisions setting out the procedure for appointing new and discharging existing trustees. It also contains provisions relating to corporations as trustees and the appointment of advisory and custodian trustees.
  - (e) Part 5 deals with court oversight of trusts, including provisions relating to the appointment of new trustees, the variation of trusts and vesting of trust property.

<sup>263</sup> STEP Journal website, above n 247.

<sup>264</sup> J G Hamilton "The Trustee Act 1956" [1957] NZLJ 7.

- (f) Part 6 contains a number of miscellaneous administrative provisions, with most relating to charging and costs related to trusts.

## NEED FOR REFORM

### Problems with the Trustee Act 1956

- 4.35 Other than the variation powers introduced in 1960 and the new investment powers for trustees introduced in 1988, the Act has been neglected.
- 4.36 As a result of its history and this neglect, the Act contains some of the most lengthy and technical provisions on our statute book. Section 14, detailing trustees' powers to sell, exchange, lease, and generally deal with property stretches to five and a half pages. Similarly, section 40, which addresses the power to apply income for maintenance, education, advancement or benefit, and to accumulate surplus income during a minority, is three and a half pages in length.
- 4.37 Whereas the text of the Act has been left untouched, deed drafting techniques have continued to evolve, to the extent that the Act appears to be increasingly irrelevant to modern day legal practice. Practitioners have taken a variety of approaches with trust deeds. In some instances, they have done away with the complex and detailed language of the Act in favour of more modern and understandable formulations. For example, instead of the detail contained in section 14 of the Act, some trust deeds contain a more general clause along the lines that:
- the trustee has the power to buy and sell (by public auction, private agreement or otherwise), let, lease, mortgage, subdivide, repair, erect improvements on *or otherwise deal* with any property contained in the Trust Fund as the Trustees think fit.
- 4.38 In others, however, it appears that some lawyers have felt constrained to adhere to the Act's language. Thus, for the avoidance of doubt, some deeds will set out the entire detail of the section 14 powers. Lengthy and impenetrable trust deeds have at times resulted. The original purpose of the 19th century English Trustee Acts, to clarify the powers of trustees and the courts so that these do not need to be detailed in every individual deed, which has been carried through to the Trustee Act 1956, clearly continues to be relevant. Yet, the inaccessible form of much of the Act means that many deeds do not rely on the Act, but detail the powers at length.
- 4.39 In addition to concerns about the Act's usability and outdated language, we are aware that in many aspects modern trust practice does not correlate with the default law expressed in the Act. This means that the Act is not proving as useful in guiding and directing trust law and practice as it otherwise could be.
- 4.40 Furthermore, there are a number of specific provisions of the Act that are in need of attention. These are discussed below.

### Context of reform of the Trustee Act 1956

- 4.41 As discussed in chapter 2, there have been marked changes in the use of trusts in New Zealand in recent decades. The growth in the number of trusts has inevitably led to trust law issues coming before the courts more frequently and necessitated more people grappling with trust law. With family trusts in

particular becoming more common, more non-experts are playing roles within trusts and should be aware of their rights and obligations. We need to consider whether the Act takes the most appropriate approach with respect to the regulation and administration of trusts and trustees.

- 4.42 As can be seen from the international context, there have been developments in trusts legislation in several jurisdictions in the past 10 years. Law reform projects in Ireland, Scotland and British Columbia, and by the Uniform Law Conference of Canada have all proposed the rewriting of their primary trusts statutes by modernising the language of some current provisions, adjusting the law of others and including some entirely new provisions into statute law. The more circumspect approach in England was to retain the 1925 Trustee Act but add the Trustee Act 2000, which included updated provisions on investment and delegation of trustees' powers and new provisions on the trustee's duty of care. The United States' Uniform Trust Code represents a more ambitious reform of trust law as it involved the codification of wider principles of trust law than generally feature in trusts legislation.

#### APPROACH TO NEW LEGISLATION: SOME ISSUES

- 4.43 In considering the form of any new legislation to replace the Trustee Act 1956, there are several issues about the approach or style of legislation.
- 4.44 In reviewing the Trustee Act 1956, one of the objectives is to modernise and clarify the existing provisions where this is needed. It will be important to consider whether more extensive changes should be made. It is clear that trusts legislation is necessary. The Trustee Act 1956 continues to provide essential administrative powers where these are not supplied by the trust instrument or there is no trust instrument at all. However, it is not essential that New Zealand's trusts legislation retains its current structure and scope. It is certainly worth examining whether trusts law in New Zealand could be improved through changes to:
- its status as default legislation;
  - the scope of the legislation;
  - the degree to which it codifies existing trust principles; and
  - its focus on the intended audience – who will use the Act.

#### Default versus mandatory rules in trusts legislation

- 4.45 Many provisions of the 1956 Act are “default provisions”: that is, they apply subject to any contrary intention expressed in the trust instrument. Where those provisions are concerned, it is possible for the trust deed to “contract out” of the Act. To this end, section 2(4) states:<sup>265</sup>

The powers conferred by or under this Act on a trustee who is not a corporation are in addition to the powers given by any other Act and by the instrument, if any; creating the trust; but the powers conferred on the trustee by this Act, unless otherwise stated, apply if and so far only as a contrary intention is not expressed in the instrument, if any, creating the trust, and have effect subject to the terms of that instrument.

<sup>265</sup> Section 2(5) contains an equivalent provision catering for the scenario where the trustee is a corporation.

- 4.46 Section 2(4) does not apply to all the provisions in the Act, but to “[t]he powers conferred on the trustee by this Act”. From time to time, the courts have had to decide whether a particular provision confers such a power, and can thus be modified or excluded by the trust deed. In some cases, for instance in relation to the power to apply income for maintenance, education, advancement or benefit and to accumulate surplus income during a minority under section 40, it has been considered to be fairly clear that section 2(4) applied.<sup>266</sup> In other cases, whether a provision confers a power on trustees under the Act may be the subject of greater debate. For example, in *Donovan v Lynskey*,<sup>267</sup> notwithstanding that section 45 of the Act, relating to the retirement of trustees, does itself not confer such a power, the High Court determined that it could be modified by a contrary intention indicated in the trust deed, because of its relationship with section 43 of the Act (trustees’ power to appoint new trustees).<sup>268</sup> The words “contrary intention” are taken to mean that the particular application of a provision “would be inconsistent with the purport of the instrument”.<sup>269</sup>
- 4.47 Some other provisions in the Act, which clearly do not confer powers, state expressly that they apply notwithstanding anything to the contrary in the trust instrument. Examples are sections 34 (Protection against liability in respect of rents and covenants) and 35 (Protection against creditors by means of advertisements). On the terms of the Act, it appears that other provisions cannot be amended or excluded by the trust instrument. A trust instrument, it is assumed, cannot limit the court’s ability to oversee trusts, for example.
- 4.48 It is not uncommon for trusts to include clauses exempting trustees from liability for breaches of trust. It seems clear that trustees have certain basic obligations and that any attempt to exclude those obligations may be of no effect. However, the scope and effect of such exculpatory clauses is not settled. There may be benefit in clarifying in statute which obligations can and cannot be excluded by an exculpatory clause as there is probably a point at which a trustee’s obligations to the beneficiaries can be reduced to the extent that a trust cannot be said to exist.
- 4.49 The Law Commission suggests that the general approach of having a default statute with some mandatory provisions should be retained in a new Act. The premises that the legislation should operate to enlarge, rather than restrict, powers in the trust instrument, and that settlor autonomy, as expressed in the trust instrument, should be maintained, remain valid. We suggest, however, that it would be desirable for a new Act to put beyond doubt which provisions of the Act are subject to a section 2(4) type proviso.

266 *Cameron v Commissioner of Inland Revenue* [1964] NZLR 936.

267 *Donovan v Lynskey* HC Blenheim CIV-2006-406-293, 26 June 2009 at [51], [63] and [69].

268 An earlier English decision had determined that the 1925 Act equivalent (s 69(2)) related only to the “powers” in Part II of that Act: see *Re Turner’s Will Trusts* [1937] Ch 15. The English equivalents of ss 43 and 45 equivalents, however, fall within Part III. See now David J Hayton, Paul Matthews & Charles Mitchell *Underhill and Hayton Law of Trusts and Trustees* (17th edition, 2007, LexisNexis, London) at [72.8]–[72.10] which describes a more nuanced approach to those equivalent English provisions, citing the decisions in *Adam & Company International Trustees Limited v Theodore Goddard* [2000] WTLR 349 at [7] and *London Regional Transport Pension Fund Trust Ltd v Hatt* [1993] Pens LR 227 at 260–262.

269 See *Re Havill (deceased)* [1968] NZLR 1116 at 1126 and *Re Nichols* HC Dunedin, M104/96, 18 March 1999 and 23 June 2000.



- 4.50 The United States Uniform Trust Code provides an example of a statute that includes mandatory rules that cannot be overridden by trust deed. Like our Act, the Code contains both default and mandatory rules. But its mandatory rules cover considerably more ground than the existing New Zealand legislation. Prior to the Code, neither the Restatement of the Law of Trusts, treatise writers, nor state legislatures had attempted to describe the principles of trust law that are not subject to the settlor's control in the trust instrument.<sup>270</sup> Section 105 of the Uniform Trust Code clearly sets out which are the mandatory provisions in a single section. These include:<sup>271</sup>
- the requirements for creating a trust;
  - the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries;
  - the requirement that a trust and its terms be for the benefit of its beneficiaries, and that the trust have a purpose that is lawful, not contrary to public policy, and possible to achieve;
  - the duty to notify qualified beneficiaries of an irrevocable trust, who have attained 25 years of age, of the existence of the trust, of the identity of the trustee, and of their right to request trustee's reports.
- 4.51 Professor Langbein has analysed the mandatory provisions in the United States Uniform Trust Code as those that *defeat a settlor's intent* by limiting the settlor's power to prescribe how a trustee must invest trust property and how the beneficiaries are to order their lives or use the property they receive, and those that *implement the settlor's intent*.<sup>272</sup> Of the former, Langbein places significance on the requirement that a trust be administered for the benefit of the beneficiaries. He considers that this has weighty implications for trustees' investment decisions, given the recognition of modern portfolio theory as the basis of trust investment law and the objective and measurable standard of what is beneficial, which flows from that.<sup>273</sup> The mandatory rules in the Code are predominantly aimed at clarifying and channelling the settlor's intent.<sup>274</sup>
- 4.52 The Code's use of mandatory provisions helps to ensure that there are several important consistencies among all trusts in the jurisdictions in which Code legislation has been adopted. In this way, mandatory provisions can help to clarify what legally makes a trust a trust in a particular jurisdiction. They can also delineate the standards that trustees must adhere to and set administrative requirements for all trusts. At the same time, mandatory provisions potentially result in a loss of flexibility in the trust form.

270 English, above n 249, at 13.

271 National Conference of Commissioners on Uniform State Laws *Uniform Trust Code* (National Conference of Commissioners on Uniform State Laws, Chicago, 2005) § 105.

272 John H Langbein "Mandatory Rules in the Law of Trusts" (2004) 98 Northwestern University L R 1105 at 1105.

273 *Ibid*, at 1122.

274 *Ibid*.

## Codification and scope

- 4.53 There are a few notable omissions in the Trustee Act 1956. It says nothing about what a trust is.<sup>275</sup> It does not contain rules about how a valid trust may be established, how initial trustees are to be appointed, or who they may be. It says nothing of settlors or beneficiaries. It is called the “Trustee Act”, yet contains only one statement about the standard expected of trustees (in addition to the investment powers in Part 2 of the Act).
- 4.54 As we have seen, New Zealand’s Act is not unusual in this regard. Internationally, few trusts statutes deal with these matters. Most are modelled on the English Act, which has a fairly narrow scope and in only a handful of cases have amendments been made to fill any of these gaps.<sup>276</sup>
- 4.55 There are some exceptions. The Indian Trusts Act 1882 contains a chapter on the creation of trusts, which sets out requirements about their lawful purpose, when they must be in writing and spells out the three “certainties” required to establish a trust. It also states who may create trusts, be a beneficiary and a trustee, and trustees’ duties.<sup>277</sup> The wording of these provisions is brief and to the point. Certainly in New Zealand, there would be (in some cases considerable) case law expanding on the statements contained in those provisions. However, those elements of the Indian Act make more accessible and informative reading than our own Act, especially to the lay person.
- 4.56 The United States’ Uniform Trust Code refers to itself as a “codification”, but it also acknowledges that “although comprehensive, [it] does not legislate on every issue. Its provisions are supplemented by the common law of trusts and principles of equity.”<sup>278</sup> The Third Restatement of the Law of Trusts, with which the Code was “drafted in close coordination”,<sup>279</sup> is a more thorough collation of United States trust law. The Restatement extends to three volumes. Yet, the Restatement does not purport to be legislation. The Code and Restatement took a number of years to draft, by two large groups of eminent legal minds. Clearly, the Commission does not have such a comprehensive codification enterprise in mind in this review. However, we want to explore the extent to which well-established common law trust rules can be captured in a new statute.
- 4.57 One area for codification might be the one discussed in chapter 3, that is, the definition of a trust. Another area we intend to explore relates to the standards required of trustees. This will be discussed in a later Issues Paper.
- 4.58 The scope of the legislation makes a difference to its name. While currently named the Trustee Act, the legislation addresses more than just the role of trustees. With the suggestion that new legislation include provisions about the

275 See chapter 3 for further discussion.

276 The introductory commentary to the 1893 English Trustee Act mentions that a Bill to codify both the statute law and case law relating to trusts and trustees was introduced into the English Parliament some years prior to that Act, but that this failed to pass (Gudall and Greig, above n 231, at xxxiii).

277 See Indian Trusts Act 1882, Chapter II.

278 *Uniform Trust Code*, above n 271, Prefatory Note.

279 *Ibid.*

fundamental nature of a trust as well as trustees duties and powers, beneficiaries' rights, variation of trusts, court power and other matters, it may be more appropriate for the new legislation to be a Trusts Act.

### Intended audience

- 4.59 There are differing perspectives regarding who the intended audience of the Act should be. The Act could be devised as an understandable guide to lay trustees. If this is the case, the Act should be accessible and reader-friendly, with much of the technical language simplified. The trusts legislation of Ireland, India, Jersey and Guernsey could be useful models for presenting statutory trusts law in a simple, elegant and easily comprehensible manner.<sup>280</sup>
- 4.60 However, the opposing argument is that because trusts law is complex and the statute only details some of the law in this area, it should be necessary for lay trustees to obtain legal advice in order to discharge their duties and functions. In line with this view, the Act should retain its technical language and not over-simplify a difficult area of the law. We are keen to hear views on the approach that the statute should take.

### SPECIFIC PROVISIONS TO BE REVIEWED

- 4.61 The Trustee Amendment Bill 2007<sup>281</sup> proposed several changes to specific provisions of the Trustee Act 1956 based on the Law Commission's recommendations in the 2002 report *Some Problems in the Law of Trusts*. The Bill was considered at Select Committee and recommendations made based on submitter comments. This review of trusts follows from the Select Committee's call for the Government "to conduct a comprehensive review of the law relating to trusts as soon as possible". The Bill has not progressed further. Yet several of the proposed amendments in that Bill remain pertinent and will be considered as a part of the current review. Other sections did not fall under the Trustee Amendment Bill but have been drawn to our attention.
- 4.62 The following sections of the Trustee Act 1956, some of which were addressed in the Bill and some of which were not but require attention, will be addressed in this review:
- Section 24 – this section empowers a trustee to insure trust property to its full insurable value or, with the consent of the life tenant or the court, for its replacement value. It also empowers the trustee to insure against a risk or liability against which it would be prudent to insure if the trustee were acting personally. There are issues with the necessity for consent, apportionment of insurance between capital and income and who bears the cost of insurance indemnifying a trustee.
  - Section 29 – This section deals with the appointment of agents to perform trustee functions. Clarification is needed on which powers are delegable.
  - Section 41 – This section allows a trustee to apply trust capital for the maintenance, education, advancement or benefit of a capital beneficiary, subject to restrictive limits on how much money can be applied for this

280 The Indian Trusts Act 1882 can be viewed at < [www.netlawman.co.in/acts](http://www.netlawman.co.in/acts) > . The Trusts (Jersey) Law 1984 is available at < [www.jerseylaw.je/Law](http://www.jerseylaw.je/Law) > and the Trusts (Guernsey) Law can be found at < [www.guernseylegalresources.gg/ccm/legal-resources/laws](http://www.guernseylegalresources.gg/ccm/legal-resources/laws) > .

281 Trustee Amendment Bill 2007 144-2.

purpose without needing an application to the court.<sup>282</sup> How well this provision reflects current economic realities will need to be considered.

- Section 42 – This section provides for protective trusts, a variety of discretionary trust for the purpose of protecting property from dissipation by an extravagant beneficiary.<sup>283</sup> It is not clear whether this mechanism is appropriate.<sup>284</sup>
- Section 49 – This section allows a trustee to apply to the court for directions if he or she intends to follow the advice of an advisory trustee but considers the advice conflicts with the trust or with any law or exposes the trustee to liability. There are questions about whether it should be mandatory for a trustee to do this and regarding the role of protectors.<sup>285</sup>
- Section 73 – This section allows the court to relieve a trustee from liability for breach of trust if the trustee has acted honestly and reasonably and ought fairly to be excused. Our review will consider to what extent trustees should be personally liable for breaches of trust and the extent to which exculpatory clauses in trust instruments should be able to have effect.
- Proposed new section 87A – The Trustee Amendment Bill 2002 proposed this section which required trustees to notify beneficiaries having a vested interest in trust property of the beneficiary's right to call for a transfer to the beneficiary or to all beneficiaries. The review will look generally at whether greater clarity is needed regarding trustee's obligations to beneficiaries as well as at this proposal.

4.63 We are interested in hearing people's views about whether there are other specific provisions that are in need of reform.

## CONCLUSION

4.64 In Commonwealth countries trusts legislation has generally been aimed at the efficient administration of trusts and, in particular, at trustees. It has traditionally been default legislation, capable of being overridden by trust deeds. New Zealand's Trustee Act 1956, based on the English Trustee Act 1925 and its 19th century predecessors, is of this mold. Some jurisdictions have recently introduced new trusts legislation or are considering doing so. The reforms have mostly retained a similar scope to the English Acts, but have included some innovations that modernise trusts legislation. The United States' Uniform Trust Code, with its mandatory provisions, and India's Trusts Act 1882, with its wide scope, are statutes that take a different approach.

4.65 Reform of the Trustee Act is needed to remedy several problems, including its impenetrability in places and its outdated language, and to make it more applicable to and useful in the modern trusts environment. There are several options that could be taken with a new Act:

- Option one – an Act that covers the same ground as the present Trustee Act but modernises it, leaving it to the common law to define the fundamental elements of trust law;
- Option two – an Act that includes more of the core principles of trust law and that is wider in scope than the current Act (similar to the United States and India's legislation);

282 The total paid under section 41 must be no more than \$7,500 or half of the beneficiary's total entitlement (whichever is greater).

283 A Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at 62.

284 See paragraphs [2.73]–[2.74].

285 See paragraphs [2.61]–[2.62].

- Option three – an Act that is a mixture of mandatory and default provisions, delineating each clearly;
- Option four – an Act that is a combination of options two and three by including more core principles of trust law and having more mandatory provisions.

4.66 We must also decide whom the legislation should target: the general public who use trusts or expert trust advisors.

## QUESTIONS

4.67 The Commission is interested in your responses to the following questions.

Q8 Which provisions of the Act are out of touch with modern drafting practices? Are there any particular limitations or omissions in the existing provisions that you would like to see remedied?

Q9 Do you think that the Act should continue to contain a combination of default and mandatory rules? If so, which should be mandatory?

Q10 Do you think that the Act should codify well-understood and well-established common law rules, for the purpose of clarifying the law and making it more accessible?

Q11 Which of the above options in paragraph 4.65 do you prefer?

Q12 What would be your wishlist for a new Act?

Q13 Do you agree with the provisions of the Act we identify as being in need of reform?

Q14 Are there any other provisions of the Act that you would like to see amended or reformed? In what way would you want to see these changed?



# Appendices



# Appendix A

## Questions

Q1 Some academics are of the view that discretionary trusts and powers have been more or less assimilated, and trust deeds with significant powers of appointment seem to be common. Despite these factors, where the deed provides for final beneficiaries, with a vested interest in the capital residue at termination, is a trust always created?

Q2 Does the law of trusts apply to powers of appointment within a trust merely because the person who has the power is also a trustee?

Q3 Is it possible to define the interest of beneficiaries in a trust generally; or does this depend on the trust deed in question and the factual and statutory context?

Q4 Is the title split (into legal and equitable estates or interests) a helpful concept that should be part of a definition of a trust in New Zealand?

Q5 Are you in favour of a legislative definition of a trust in a new New Zealand Trusts or Trustee Act?

Q6 If so, which of the options do you prefer – or do you have an alternative suggestion?

Q7 If not, what would be a useful working definition for this review?

Q8 Which provisions of the Act are out of touch with modern drafting practices? Are there any particular limitations or omissions in the existing provisions that you would like to see remedied?

Q9 Do you think that the Act should continue to contain a combination of default and mandatory rules? If so, which should be mandatory?

Q10 Do you think that the Act should codify well-understood and well-established common law rules, for the purpose of clarifying the law and making it more accessible?

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Q14 Are there any other provisions of the Act that you would like to see amended or reformed? In what way would you want to see these changed?

# Appendix B

## Consultation List

The Law Commission has consulted with the following during the review of the law of trusts:

- Auckland Energy Trust Board
- Ayres Legal
- David Bigio
- John Brown
- Chapman Tripp
- English Law Commission
- Glaistor Ennor Solicitors
- Anthony Grant and Richard Green
- Inland Revenue
- KPMG
- Legal Services Agency
- Ministry of Economic Development
- Ministry of Justice
- Ministry of Social Development
- Anthony Molloy QC
- New Zealand Trustee Services
- Office of the Official Assignee
- Price Waterhouse Coopers
- Reserve Bank of New Zealand
- Scottish Law Commission
- Taylor Grant Tesiram
- The Treasury

We are grateful for their contribution.





