



Scottish Law Commission
promoting law reform

| (DISCUSSION

133)

Discussion Paper on the Nature and the Constitution of Trusts

discussion
paper



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Discussion Paper on the Nature and the Constitution of Trusts

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The Commission would be grateful if comments on this Discussion Paper were submitted by 31 January 2007. Comments may be made (please see notes below) on all or any of the matters raised in the paper. All correspondence should be addressed to:

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NOTES

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¹ Amended by the Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (SI 1999/1820).

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Part 1 Introduction

The Trust Law Review

1.1 This discussion paper deals with two topics, the nature and the constitution of trusts in Scots law. It is the second discussion paper to be published in Phase 2 of our review of trust law, following the publication of our paper on the variation and termination of trusts in December 2005.¹ In Phase 1, which concentrated on trustees and their powers and duties, papers were published on breach of trust, on the allocation and apportionment of receipts and outgoings between various classes of beneficiary, and on trustees and trust administration.² It is our intention to publish several more discussion papers under Phase 2. These will include papers on restraints on accumulation of income and on long-term private trusts, liability of trustees to third parties, and the ways in which beneficiaries may enforce their rights against the trustees and any third parties who have obtained property which is subject to the trust. However, in the course of planning Phase 2, we realised that our review had proceeded on the basis that the concept of a trust in Scots law was not controversial and that it was not necessary to ask fundamental questions in relation to the juridical nature or constitution of the trust. We are now convinced that this is not the case. Elementary matters such as when a trust is formed or the juridical nature of the beneficiary's rights have not been settled by recent judicial authority. Indeed, it may be many years before a suitable case arises in which these issues can be debated. In these circumstances, we feel that there is merit in taking the opportunity to raise some of these questions in a discussion paper. As a result, this discussion paper is more theoretical than the others hitherto published. But we feel that clarifying the juridical nature of a trust will help us to proceed in a more principled way when in later discussion papers we grapple with such difficult issues as the contractual and delictual liability of trustees to third parties.

Advisory Group

1.2 We continue to be assisted by an Advisory Group consisting of both academics and practitioners. The members of this group are listed in Appendix A. Members of the group attended our seminar on the legal personality of trusts and commented on earlier drafts of this discussion paper. We are very grateful to them for their input and constructive comments at these earlier stages.

Background to the Project

1.3 On 1 March 2005 we hosted a seminar to stimulate discussion about the concept of legal personality for trusts. The feasibility of creating a rule which would recognise a trust as an artificial legal entity with its own juristic personality, separate from that of the trustees, was considered. Unlike the present law, in terms of ownership, the trust itself - rather than

¹ Discussion Paper No 129 on *Variation and Termination of Trusts*.

² Discussion Paper No 123 on *Breach of Trust*, Discussion Paper No 124 on *Apportionment of Trust Receipts and Outgoings*, both published in September 2003, and Discussion Paper No 126 on *Trustees and Trust Administration*, published in December 2004.

the trustees - would be the owner of the trust property. Accordingly, title to heritable property for example, would be registered in the name of the trust and not the trustees.

1.4 The seminar was attended by some 24 participants consisting of a mix of both academics and practitioners. It was particularly useful in producing a clear answer - conferring legal or juristic personality on trusts would not, in the opinion of a significant majority, be a useful or desirable reform. The participants felt that the operational disadvantages of conferring legal personality on trusts far outweighed any presentational advantages. In contrast, there was a great deal of support for the dual patrimony theory as advanced previously by Professor Gretton and Professor Reid.³ In light of this response we felt the development of the dual patrimony theory was the most appropriate method of providing a principled, theoretical basis for the rules of trust law and most specifically those rules relating to the nature and constitution of a trust.

Outline of this Discussion Paper

1.5 The current law on the nature and the constitution of trusts - the two main areas covered in this discussion paper - is unclear and uncertain. The proposals which we put forward are, to a fairly large extent, fundamentally designed to clarify and modernise the law rather than alter the substantive effect of the existing rules. The proposals in this discussion paper would herald largely conceptual and theoretical changes as opposed to any significant alterations in current trust law practice.

1.6 In Part 2 we outline the present law in relation to the nature of a standard trust, identifying fiduciary ownership by the trustees for the benefit of a third party as the essential element. A standard trust is an express *inter vivos* trust involving a tripartite relationship among the truster, the trustee and the beneficiary: it is paradigmatic of a trust in Scots law. The formation of a trust and the corresponding rights and duties of the trustees and beneficiaries are discussed prior to an analysis and development of the dual patrimony theory. When a person becomes a trustee, he acquires a trust patrimony in addition to his own pre-existing private patrimony. The trust patrimony consists of the trust fund, which is owned⁴ by himself as trustee, and any obligations he has incurred in the proper administration of the trust. Meanwhile, his private patrimony consists of the aggregate of his own private legal rights and liabilities. Although the two patrimonies, *viz* the private patrimony and the trust patrimony, are owned by the same person, the trustee's private patrimony is treated as a separate legal entity from the trustee's trust patrimony. Most significantly, the dual patrimony theory provides a succinct explanation as to why the trust fund is immune from the claims of the trustee's personal creditors but not from trust creditors. We express the provisional view that the dual patrimony theory on the nature of a trust should be placed on a statutory footing in order to replace the current theoretical incoherence which exists, particularly in relation to the liability of trustees to third parties, and to mirror current developments in European trust law.⁵ Finally, we invite comment as to whether we are correct in our view that no further consideration should be given to the

³ See paras 2.16-2.28 below.

⁴ In this paper we use the language of "owning" and "ownership" in a broad sense so that a person "owns" - as opposed to "holds" - incorporeal property such as funds and debts: in doing so, we are not of course foreclosing any debate on the theoretical nature of the right of ownership in Scots private law.

⁵ See paras 2.16-2.28 below.

concept of recognising a trust as an entity with legal or juristic personality separate from that of the trustees.⁶

1.7 In Part 3 we consider the current law in relation to the constitution of express trusts, encompassing standard *inter vivos*, *mortis causa* and truster-as-trustee trusts within our discussion. Remarkably, the present law provides no definitive answer to the question - when is a trust created? The tendency has been to follow what we have described as the conventional analysis. This states that a trust is only formed when a declaration of trust has been communicated to the trustee(s) and the ownership of the property constituting the trust fund has been transferred to the trustee(s). But this analysis does not work in relation to *mortis causa* trusts where in the majority of cases the trustee/executor never becomes owner of the heritable property of the deceased's estate. As a result of this and other flaws we posit an alternative analysis. Here a trust is created as soon as the declaration of trust is communicated to the trustee(s) and at least one of the trustees accepts office. On both analyses, the property which constitutes the trust fund is only safe from the claims of the truster's personal creditors when it has been transferred to the trustee(s) and is no longer part of the truster's private patrimony, ie it has moved from the truster's private patrimony to the trustee's trust patrimony. In Part 4 we invite comment as to whether we are correct to abandon the conventional analysis in favour of this alternative analysis and suggest possible statutory options.⁷ In addition, we consider whether a requirement of writing for the creation of a standard *inter vivos* trust should be introduced.⁸ We discuss whether registration should become a mandatory requirement for trusts. We also ask whether, in order to be effective, a standard *inter vivos* trust should be registered in the Books of Council and Session or in a new register of trusts.⁹ We propose that no change in the law is necessary in relation to the existing rules on the constitution of *mortis causa* trusts.¹⁰ In Part 4, we also explore the specific difficulties raised by truster-as-trustee trusts. These arise when a person declares himself to be sole trustee of his own property. We feel that the major problem with this type of trust stems from the fact that they are typically latent.¹¹ Accordingly we propose that in certain limited circumstances there should be an exception to the rule that where there is a latent trust of moveable property, the trust fund remains immune to claims of both the truster and trustee's personal creditors.¹² Since the decision of *Heritable Reversionary Co Ltd v Millar*,¹³ a latent trust of land can also affect third parties and in particular, can defeat the personal creditors of the person registered as owner thereby breaching the publicity principle. In Part 4 we also seek views as to whether this rule should be abolished in respect of latent trusts of heritable property and if so, whether this should be restricted to truster-as-trustee trusts only and applicable in specifically defined circumstances.¹⁴

⁶ See paras 2.39-2.46 below.

⁷ See paras 4.1-4.5 below.

⁸ See paras 4.6-4.8 below.

⁹ See paras 4.12-4.13 below.

¹⁰ See paras 4.14-4.15 below.

¹¹ See paras 4.16-4.21 below.

¹² See paras 4.24-4.28 below.

¹³ (1892) 19 R (HL) 43.

¹⁴ See paras 4.29-4.42 below.

Legislative Competence

1.8 The proposals in this discussion paper relate to the nature and constitution of trusts which are not reserved matters under the Scotland Act 1998. They therefore lie within the legislative competence of the Scottish Parliament.

1.9 In our view our proposals, if enacted, would not give rise to any breach of the European Convention on Human Rights or of European law.

Part 2 The Nature of a Trust in Scots Law

Introduction

2.1 In Scots law the essential element of a trust is the concept of fiduciary ownership. Fiduciary ownership arises when the owner of property is under a duty to use it for the benefit of another and not for himself. In the law of trusts, the fiduciary owner is the trustee: the beneficiary is the person for whose benefit the trustee must use the property. The trust itself is simply the source of the obligations between truster, trustee and beneficiary. Like a contract or a will, a trust is a legal device, an institutional fact,¹ which is constitutive of rights and duties between persons. A contract or a will or a trust are institutional facts since they only exist as a contract or a will or a trust because there are legal or institutional, rules which are constitutive of such devices and provide that certain legal consequences follow when they are validly constituted. Without the legal rules, such devices would have no existence. They are institutional as opposed to natural facts.² Accordingly, a trust is simply the legal mechanism which creates the rights and duties among truster, trustee and beneficiary.

2.2 For the purpose of this Part of the discussion paper, we shall primarily be concerned with express *inter vivos* trusts. This is where A, the truster, sets up a trust which is to be effective during A's lifetime, in which B, the trustee, owns and administers the property which constitutes the trust fund for the benefit of the beneficiary, C. In particular, it will be noticed that in this kind of trust the truster and trustee(s) are different persons. These express *inter vivos* trusts are paradigmatic of trusts in Scots law. We shall call them standard trusts.³ *Mortis causa* trusts have testamentary effect and consequently special rules apply to their creation: these will be discussed in detail in Part 3.⁴ Scots law also recognises that an owner of property can declare that he owns it as sole trustee on behalf of another person. This is known as a truster-as-trustee trust. This type of trust raises particular difficulties which are also explored in detail in Part 3.⁵

The Formation of a Trust

2.3 In order to analyse the nature of a trust, it is necessary to give a short account of the formation of a trust.⁶ Initially a standard trust involves a tripartite relationship among the truster, the trustee and the beneficiary. The truster is the person who wishes to set up the trust. To do so, he makes a declaration of trust. Where the declaration of trust is made in writing, it is known as the trust deed. In the declaration of trust, the truster stipulates the purpose(s) of the trust: he will also nominate the trustees and the beneficiaries. It will also

¹ See generally D N MacCormick "Law as Institutional Fact" (1974) 90 LQR 102.

² Of course certain natural acts must be performed before the institutional fact can be created: for example, a testator must sign the writing which is to constitute the will.

³ This terminology is common in the academic literature: see for example K G C Reid "Constitution of Trust" 1986 SLT (News) 177; K J M Young "Intimation - The Equivalent Delivery of What?" 1996 SLT (News) 373.

⁴ Paras 3.23-3.28 below.

⁵ Paras 3.18.-3.22 below.

⁶ A full discussion of issues arising in relation to the creation of express trusts is discussed in Part 3.

identify the property that is to constitute the trust fund⁷ and the nature and extent of the trustees' powers to administer the trust property.⁸ Once the trustees have accepted office, the truster transfers⁹ the ownership of the property which is to constitute the trust fund to the trustees. When the property has been transferred, it is no longer vulnerable to the claims of the truster's personal creditors. At this stage, the trust has been constituted¹⁰ and as a general rule is irrevocable by the truster.¹¹

2.4 After the trust has been constituted, since he has transferred the ownership of the trust fund to the trustees and has empowered them to administer it, *prima facie* the truster has no right to engage in the affairs of the trust. If he wishes to retain some control, he can appoint himself a trustee.¹² However, if the purpose of the trust fails or the purpose of the trust does not exhaust the trust fund, the property will revert back to the truster in the sense that it will be held by the trustees in favour of the truster or his representatives.¹³ But as a general rule, once a trust has been constituted, it involves a bilateral relationship between the trustees and the beneficiaries: the truster falls out of the picture although the purpose of the trust is to give effect to his intentions as evidenced in the declaration of trust.

The Rights and Duties of Trustees and Beneficiaries

2.5 When a trust is constituted, it creates rights and duties between the respective parties, namely the trustees and beneficiaries. The trustees become the owners of the property which constitutes the trust fund. However, a trustee is under the fundamental obligation *only* to use the trust fund in order to fulfil the purposes of the trust. Even though he is the owner of the trust fund, the trustee is *obliged* to administer it honestly and in good faith for the purposes set out in the trust deed. At every stage of the administration of the trust, the trustee must always put the beneficiaries' interests before his own. This is the concept of fiduciary ownership. The beneficiary has a corresponding right to compel the trustee to administer the trust funds in accordance with the provisions of the declaration of trust. This is a personal right. It is axiomatic that in Scots law the beneficiaries do not have a real right or a quasi-real right in the trust property. They have no proprietary interest in the trust fund.¹⁴

⁷ In practice, often this is a nominal sum merely sufficient to amount to trust property: the substantive property is transferred into the trust at the same time or later.

⁸ Where the declaration does not expressly stipulate the trustees' powers, certain powers will be implied by the Trusts (Scotland) Act 1921.

⁹ Traditionally, the truster was said to "deliver" the trust fund to the trustees.

¹⁰ As we shall see, it has been argued that *as between trustee and truster*, obligations arise as soon as the declaration of trust has been communicated by the truster to the trustee and the trustee has accepted office: but until the truster has divested the property that is to constitute the trust fund it is still vulnerable to the claims of his personal creditors. For full discussion, see paras 3.1-3.9 below.

¹¹ *Cameron's Trustees v Cameron* 1907 SC 407. On revocability, see paras 3.42-3.50 below.

¹² Alternatively he could appoint himself as a person whom the trustees must consult before making their decisions or he could reserve certain powers, for example to appoint new trustees.

¹³ See for example *Edmond v Lord Provost of Aberdeen* (1898) 1 F 154. It is said that in these circumstances, the trustees hold the trust fund on a resulting trust for the truster: W A Wilson and A G M Duncan, *Trusts, Trustees and Executors*, (Edinburgh, 2nd edn 1995), hereinafter cited as "*Wilson and Duncan*", paras 6-40 ff. But there is force in the argument that a resulting trust is not a separate kind of trust but a term implied by law into all private trusts that in the event of a failure of the trust purposes while the trust fund still subsists the truster becomes the beneficiary of the trust: see G L Gretton "Constructive Trusts" (1997) 1 Edin LR 281 at 309-310.

¹⁴ *IR v Clark's Trs* 1939 SC 11; *Parker v Lord Advocate* 1960 SC (HL) 29. The view of Lord Watson in *Heritable Reversionary Co Ltd v Millar* (1892) 19 R (HL) 43 at 46-47 that the trustee, "though possessed of the legal title, and being the apparent owner, is in reality a bare trustee; and that the other [the beneficiary] to whom the whole beneficial interest belongs, is the true owner" has been abandoned. In *Sharp v Thomson* 1995 SC 455, the Lord President (Hope) opined at 475 that "...it is not part of the law of Scotland that there exist in the trustee and

2.6 In so far as the trust creates rights and duties between the trustee and beneficiaries, a trust is similar to a contract which creates rights and duties between the parties to the agreement. Like a contract, a standard trust is a manifestation of consent on the part of the truster and trustee which generates rights in the beneficiaries and obligations on the trustee. If a trustee breaches his trust obligations, he commits a wrong for which the beneficiary is entitled to seek reparation (in the widest sense). The declaration of trust by the truster, the acceptance of office by the trustee, the transfer to the trustees of the ownership of the trust fund are juristic acts on the part of truster and trustee which are constitutive of a trust.¹⁵ Once constituted, like a contract or promise, a trust becomes the *source* of legal rights and obligations between particular persons: in the case of a standard trust these parties are, of course, the trustees and beneficiaries.

2.7 As the fiduciary owners of the trust fund, trustees are under the fundamental obligation to administer the property in such a way as to achieve the purposes set out in the declaration of trust. In so doing, the trustees must always put the interests of the beneficiaries before their own. This obligation has three important manifestations:-

- (i) The trustee is in breach of trust if he acts in a way which is contrary to the provisions of the declaration of trust. This can be described as an *ultra vires* breach of trust. This would arise if for example the trustee pays out trust assets to persons who are not beneficiaries or purports to exercise a power that he does not have under the trust deed (or statute) or which has been excluded by the trust deed. This is a wrong where liability is strict. The trustee is personally liable for any losses sustained as a consequence of the breach. Moreover, because he owes a fiduciary duty to the beneficiary, the trustee must disgorge any personal gains he has made from his unauthorised conduct.
- (ii) The trustee must not be *auctor in rem suam*. This means that the trustee must exercise his powers in the way that best furthers the interests of the beneficiary rather than himself. To this end, the trustee cannot profit from his position as trustee; must avoid any conflict with the interests of the beneficiaries; and must not engage in self-dealing with the trust fund.¹⁶ Again this is a wrong where liability is strict. Not only is the trustee personally liable for any losses incurred by the trust fund but must also disgorge any personal gains he has made from the breach.

beneficiary concurrent rights of ownership in the property which is subject to the trust." This is because the Scots law of property is unititular ie two separate rights of ownership cannot exist in the same thing at the same time. It is submitted that in so far as it has not already been discredited, the theory expressed in *Heritable Reversionary Co Ltd v Millar* that the beneficiary under a trust is the beneficial owner of the trust fund should be eradicated from contemporary Scots law. This is in spite of views expressed in the House of Lords in *Sharp v Thomson* 1997 SC (HL) 66 that a person who has delivered a conveyance of heritable property to a purchaser and has accepted payment of the price no longer has a "beneficial interest" in the property. Nevertheless, until the purchaser registers the title such property remains part of the seller's private patrimony and is vulnerable to the claims of the seller's personal creditors and trustee in bankruptcy: see *Burnett's Trustee v Grainger* 2004 SC (HL) 19.

¹⁵ In Part 3 we argue that the transfer of the trust fund is not necessary to constitute a trust in the sense of creating rights and obligations between the truster and trustee - and indirectly the beneficiaries. But the truster's divestiture of the ownership of the trust fund is necessary before the property will be free from the claims of the personal creditors of the truster.

¹⁶ The provisions of the trust deed may of course permit the trustees to contract with each other as individuals on market terms.

- (iii) The trustee can be personally liable to account for any losses sustained by the trust fund as a consequence of his failure to act as a reasonably prudent trustee ie delictual liability for negligence.¹⁷

2.8 Since the trustee is the owner of the property which makes up the trust fund, he can transfer a good title to a third party. But if the transfer is not authorised by the declaration of trust (or statute), the trustee will be liable for breach of trust as outlined in the previous paragraph. However, because the beneficiary has no proprietary interest in the trust fund, he cannot vindicate the property from the third party.

2.9 Whether other remedies are available depends on the nature of the transfer and whether or not the transferee acted in good faith.¹⁸ Where the third party is a bona fide transferee for value, not only is his title secure but the beneficiary has no remedy against him. Because he was in good faith, he has committed no wrong: as he gave value, he has not been enriched. Moreover, section 2(1) of the Trusts (Scotland) Act 1961 expressly provides that where there has been an ultra vires breach of trust, neither the transaction or the transferee's title can be impugned if the trustee was purporting to exercise his powers in respect of trust property under section 4 of the Trusts (Scotland) Act 1961: these include sale, lease and the grant of security over trust property. However, as the property was sold etc in the course of the administration of the trust, as a consequence of real subrogation the value received by the trustee for the property becomes part of the trust fund.

2.10 Where the transfer was for value but the third party knew that it was in breach of trust, he is in bad faith and has committed a wrong. At common law, the third party's title was voidable and could be reduced by the beneficiary (or another trustee). However, the third party may now have the protection of section 2(1) of the Trusts (Scotland) Act 1961 which does not expressly stipulate that the transferee for value has to be in good faith. But even if his title is secure, it can be argued that the mala fide third party should remain liable for his wrong and could for example be forced to disgorge any profits that he made from the subsequent resale of the property. Once again, the value received by the trustee would automatically become part of the trust fund.

2.11 Where the transfer was not for value, the donee's title can be reduced whether the transferee was in bad faith or not.¹⁹ If the right of reduction is lost, the beneficiary may have a claim for recompense under the law of unjustified enrichment or a claim for reparation in delict if the transferee was in bad faith. Section 2(1) of the Trusts (Scotland) Act 1961 does not apply as the transaction is gratuitous and section 4 of the Trusts (Scotland) Act 1961 does not give a trustee the power to donate trust property.

2.12 It will be seen that although the beneficiary has no proprietary interest in the trust property, the law on reparation for wrongs and reversal of unjustified enrichment may provide a beneficiary with a remedy against a third party transferee of trust property. This is in addition to a claim against the trustee for breach of trust. These remedies arise from the breach of personal obligations owed by the third party to the beneficiary. The beneficiary does not have any real right in the trust property. While the beneficiary may have title to sue to have a wrongful transfer of trust property reduced, the property must be re-conveyed to

¹⁷ It is for this reason that the trust deed will often contain a term exempting trustees from liability in negligence.

¹⁸ See generally, J M Thomson "Unravelling Trust Law: Remedies for Breach of Trust" 2003 JR 129.

¹⁹ 18 *The Laws of Scotland (Stair Memorial Encyclopaedia)*, para 691.

the trustees so that the administration of the trust can continue and the trust purposes can be fulfilled. This is also the reason why, unlike an owner's right to vindicate her property, the beneficiary's right to seek recovery of trust property is defeated by a bona fide²⁰ transferee for value. As we have seen,²¹ since the transferee was in good faith he has committed no wrong: since he has given value, he has not been enriched. Therefore no liability arises under the law of delict or unjustified enrichment. Put another way, the law of *obligations* cannot provide a remedy for the beneficiary against a bona fide transferee for value. Nor can the law of trusts, since it is the trustee who is the owner of the trust fund and the beneficiary has only a personal right against the trustee to fulfil the trust purposes. But on the other hand, under the law of trusts the value the trustee received from the bona fide transferee automatically becomes part of the trust fund and consequently the subject matter of the obligations which the trustee owes to the beneficiaries.

2.13 We have emphasised that the beneficiary does not have a real right in the property which constitutes the trust fund. The beneficiary has only a personal right against the trustee to fulfil the purposes of the trust. But it is trite law that the trust fund is not available to a trustee's ordinary personal creditors.²² Consequently, the beneficiary's personal right against the trustee appears to be different from the unsecured rights of the trustee's personal creditors over which it seems to prevail. As Gretton has observed:²³

"It is a curious phenomenon. The general principle of insolvency law is that the unsecured creditors ...are subject to third party real rights but prevail over third party personal rights ... Since the right of a beneficiary in a trust is a personal right one would expect that it would be subject to the claims of the [trustee's] unsecured creditors. But it is not. Though a personal right, it is an enhanced personal right. So enhanced, indeed, that some people have felt a temptation to call it a real right, but that view, quite properly, has not prevailed. The right of a trust beneficiary is, in our law, not a real right which in some ways is like a personal right, but a personal right which in some ways is like a real right ... It is this quality that takes the trust wholly out of the law of obligations."²⁴

2.14 In an earlier essay,²⁵ the same writer stated:

"The rights of beneficiaries do not behave like ordinary personal rights, but at the same time they do not behave like real rights either. Functionally, they are something in-between. But if the law is to aspire to coherence, matters cannot be left thus. Conceptual analysis is needed."

2.15 Conceptual analysis has led Gretton²⁶ and Reid²⁷ to the view that the defining feature of the law of trust rests in the concept of patrimony. It is to that concept that we now turn.

²⁰ The transfer may not have to be in good faith if s 2(1) of the Trusts (Scotland) Act 1961 applies.

²¹ Para 2.9 above.

²² *Heritable Reversionary Co Ltd v Millar* (1892) 19 R (HL) 43. In the case of sequestration, the rule is now statutory: Bankruptcy (Scotland) Act 1985, s 33(1).

²³ G L Gretton "Constructive Trusts" (1997) 1 *Edinburgh Law Review* 281 at 287.

²⁴ Though as we have seen in paras 2.9-2.12 above, because a beneficiary has no real right in the property that constitutes the trust fund, she may have to seek remedies against third parties in the law of obligations.

²⁵ G L Gretton "Trust and Patrimony" in MacQueen (ed) *Scots Law into the 21st Century: Essays in Honour of W A Wilson*, (1996, Edinburgh) 182 at 184.

²⁶ *Ibid*; G L Gretton "Trusts without Equity" (2000) 49 *ICLQ* 599.

²⁷ K G C Reid "Patrimony Not Equity: the trust in Scotland" (2000) 8 *European Review of Private Law* 427.

The Dual Patrimony Theory

2.16 A private²⁸ patrimony is the aggregate of a person's legal rights and liabilities.²⁹ It includes the property that a person owns, for example his house (corporeal heritable property) or his books, jewellery and car (corporeal moveable property). Also included is incorporeal moveable property such as money (unless in the form of coinage when it is, of course, corporeal), shares and other investments. The rights that a person has to the performance of a contract, to the payment of a debt, to reparation for harm wrongfully caused, to a legacy under a will or to a benefit under a trust, all form part of his private patrimony. But in assessing the net value of a person's patrimony account must be taken of the obligations which he has incurred: for example, the loan he has taken out to purchase the house, money owed on credit cards and other debts or reparation to be paid to a person whose property he has damaged as a result of his negligent driving. Obligations as well as rights form part of a person's patrimony. As a consequence, a private patrimony is usually in a state of constant flux as the person engages in economic activity. While new property will be acquired and enter the patrimony, existing assets will leave if ownership is transferred to a third party: new rights will be acquired but new obligations will also be incurred.³⁰

2.17 On his insolvency, *prima facie* all the property in a person's private patrimony is vulnerable to the claims of his personal creditors. However, some creditors may have taken steps to obtain subordinate real rights in some of the debtor's property. Thus, for example, it is common when a person has obtained a loan in order to purchase a house that he grants the lender a standard security over the property. In the event of the debtor's insolvency, the lender is entitled to realise the security, by selling the house if necessary: and only after the loan has been paid is the balance available to meet the claims of the debtor's unsecured personal creditors.

2.18 When a person becomes a trustee he acquires a second patrimony: he now has his private patrimony as before and a trust patrimony.³¹ The trust patrimony consists of the trust fund which is owned by the trustee and any obligations he has incurred in the proper administration of the trust. If as will usually be the case there are two or more trustees, the trust patrimony is owned by them jointly. Although owned by the same person the trustee's private patrimony is a separate legal entity from the trustee's trust patrimony. As Reid observes:³²

"The two patrimonies are distinct in law, and should also be distinct in practice, by proper labelling and accounting. The assets of one patrimony cannot normally be transferred to the other. And if an asset is sold from one patrimony, the proceeds of the sale are paid into the same patrimony, each patrimony thus operating its own real subrogation."

²⁸ It is also known as a general patrimony.

²⁹ The concept of patrimony is, of course, similar to the concept of a person's "estate": this is familiar to Scots lawyers from the law of succession. Another parallel concept was a wife's *peculium* which was moveable property which she was allowed to hold independently of her husband and which did not therefore fall under her husband's *ius mariti*. Another parallel concept was the slave's *peculium* under classical Roman law.

³⁰ Sometimes this may occur at the same time. In a case of unjustified enrichment, for example, A may acquire the ownership of property while at the same time incurring an obligation to make restitution or pay recompense in respect of it.

³¹ K G C Reid "Patrimony Not Equity: the trust in Scotland" (2000) 8 *European Review of Private Law* 427.

³² *Ibid* at 432.

2.19 This theory can be used to explain why when trust property is transferred in breach of trust any value received by the trustee for it automatically becomes part of the trust fund.³³ When the trust property is transferred, the trustee is deemed to receive any proceeds into his trust - as opposed to private - patrimony. This is also the case in respect of any profits that a trustee makes in breach of the principle that he must not act as *auctor in rem suam*.³⁴ Accordingly if the dual patrimony theory is accepted, it would no longer be necessary to argue³⁵ that in such situations the trustee is holding the profits or proceeds on a constructive trust for the beneficiaries of the original trust.

2.20 The dual patrimony theory also explains why the trust fund is not vulnerable to the claims of the trustee's personal creditors.³⁶ As Reid has argued:³⁷

"A trustee may incur liabilities either in a private capacity or in the capacity as trustee, and a creditor is thus a private creditor or a trust creditor. The difference is crucial... a creditor is, in principle, restricted to a single patrimony. A private creditor must claim from the private patrimony and a trust creditor from the trust patrimony. If that patrimony is empty, he must go without, for the other patrimony is not available. In this principle lies the most convincing explanation of a beneficiary's protection against [the trustee's private] insolvency. The reason why a beneficiary prevails against the private creditors of the trustee is, quite simply, that each has a claim in respect of a different patrimony."

2.21 Thus the reason why the beneficiary's right prevails over the claims of the trustee's personal creditors is not because it is a quasi-real right or because the beneficiary and not the trustee is the "true" owner of the trust fund. It is simply because the claims of the trustee's personal creditors are restricted to the property in the trustee's private patrimony.

2.22 Conversely, it also follows from the dual patrimony theory that the beneficiary's right against the trustee to compel him to fulfil the trust purposes is restricted to the trust patrimony. Where obligations have been incurred in the trust patrimony,³⁸ the claims of the trust creditors have to be satisfied before the trust purposes can be fulfilled. If having paid the trust creditors, the trust fund is exhausted, the beneficiaries will receive nothing.³⁹ Put another way, the personal right of the beneficiary to compel the trustee to fulfil the trust is postponed to the personal rights of all the other creditors in the trust patrimony. And if the trust fund is used up satisfying the trust creditors, the beneficiaries are *not* entitled to go against the trustee's private patrimony to obtain what they were due under the trust. However, if the shortfall is the result of the trustee's breach of trust,⁴⁰ then the property in the trustee's private patrimony is vulnerable to the beneficiaries' claims for an account and damages, though the beneficiaries rank as ordinary creditors *pari passu* with other creditors of the trustee's private patrimony.

³³ Para 2.9 above.

³⁴ Para 2.7 above.

³⁵ *Black v Brown* 1982 SLT (Sh Ct) 50; see generally *Wilson and Duncan*, paras 6-63ff.

³⁶ Para 2.13 above.

³⁷ "Patrimony Not Equity: the trust in Scotland" (2000) 8 *European Review of Private Law* 427 at 432.

³⁸ By the trustee in the course of the administration of the trust or, in the case of a *mortis causa* trust, by the trustor before he died. Unless a trustee makes it clear that he is only contracting in his capacity as trustee, his private patrimony can be liable to the claims of the trust creditors: but the trustee will then be indemnified from the trust patrimony if the obligation was properly incurred in the course of the administration of the trust.

³⁹ This rarely happens in a standard *inter vivos* trust. But it may arise in a *mortis causa* trust where the whole estate can be used up in paying the deceased trustor's debts.

⁴⁰ For discussion see para 2.7 above.

2.23 Where, as is usual, there is more than one trustee, under the dual patrimony theory the trust patrimony is owned jointly between the trustees. If a trustee resigns, the trust patrimony is owned by the remaining trustees: there is no need for any formal transfer process.⁴¹ Similarly, if a trustee dies, the trust patrimony accrues to the remaining trustees and does not fall to the executor of the deceased's private patrimony. If all the trustees die or resign, the trust patrimony continues and the court can appoint new trustees who will then become the owners of the trust fund.

2.24 The dual patrimony theory also gives us important insights into a type of trust which has proved problematic in Scots law. This is the truster-as-trustee trust. Here A, the owner of property, makes a declaration that he is holding the property as *sole* trustee for the benefit of a beneficiary, B. As we shall see,⁴² as a general rule such a trust is not constituted until (a) a declaration of trust is made in writing and subscribed by A,⁴³ and (b) B is informed that a trust has been set up in her favour. What is happening when such a trust is being created is, of course, that A is transferring the property which is to constitute the trust fund from his private patrimony into the trust patrimony. The problem is that a third party who is a personal creditor of A will not normally appreciate that such a transfer has been made and may continue to undertake obligations with A in the belief that the property remains in A's private patrimony. The potential for abuse is obvious. The need, if any, for reform is discussed in detail in Part 4.

2.25 There is little doubt that the dual patrimony theory provides a convincing and satisfying explanation of the nature of a trust in Scots law. As Gretton has concluded:⁴⁴

"...With the explanation of trust as patrimony everything falls into place. The rights of the beneficiaries are personal rights. They are personal rights against the trustee, enforceable against the special [ie the trust] patrimony...Conversely, personal rights enforceable against the trustee in his personal capacity are not (in general) enforceable against the special patrimony. *There is thus no need to seek to classify the right of beneficiaries as being in some way privileged as quasi-real or as in some way 'trumping' the rights of the creditors of a trustee in his personal capacity.* There is no need to resort to duality of ownership. Instead of duality of ownership, there is duality of patrimony. As for the fact that a trust estate is a 'fund' the constituent items of which may change without changing the identity of the fund, this is of the essence of the idea of a patrimony. It is also essential to the trust concept..."

2.26 We agree. However, there appears to be no direct judicial authority that the dual patrimony theory should be used to explain the nature of a trust in Scots law.⁴⁵ And it may be many years before the courts have an opportunity to consider the issue. In these circumstances, it is our provisional view that the dual patrimony theory should be put into statutory form.⁴⁶ It would then be clear that the principle underpins the trust in Scots law. This would bring a greater degree of coherence to the existing rules of trust law. It should

⁴¹ The rule is now statutory: Trusts (Scotland) Act 1921, s 20.

⁴² Paras 3.18-3.22 below.

⁴³ Requirements of Writing (Scotland) Act 1995, s 1(2)(a)(iii).

⁴⁴ G L Gretton "Trusts Without Equity" (2000) 49 ICLQ 599 at 612. (Gretton's italics).

⁴⁵ Indeed, what little judicial authority there was on the nature of a trust in Scots law favoured concurrent rights of ownership of the trust fund between the beneficiary and trustee: *Heritable Reversionary Co Ltd v Miller* (1892) 19R (HL) 43. This has now been judicially criticised but no alternative theory has been expressly articulated: see *Sharp v Thomson* 1995 SC 455 *per* the Lord President (Hope) at 475 and discussion at note 12 above.

⁴⁶ Quebec has legislated for the trust by the use of the concept of separate patrimony: Civil Code, art 1260. Under the Quebec legislation, however, the trustees are not the owners of the trust assets: Civil Code, art 1261. Nobody appears to own them!

also ensure that any future judicial or legislative developments should, in the first place at least, be consistent with the dual patrimony theory with the result that the law would evolve in a more rational way than in the past.

2.27 A statutory statement of the dual patrimony theory would be consonant with developments in the law of trusts at the European level. For example, Article 6(1) of the Luxembourg Law of 27 July 2003 *Relating to the Trust and to Fiduciary Contracts* provides:⁴⁷

"The fiduciary estate ["patrimoine fiduciaire" in the original] is segregated from the personal estate ["patrimoine personnel" in the original] of the fiduciary as well as from any other fiduciary estate. The assets which make up such fiduciary estate can only be attached by those creditors whose rights have arisen in connection with the fiduciary estate. They do not form part of the personal estate of the fiduciary in case of the fiduciary's liquidation or bankruptcy or in any other situation of the fiduciary generally affecting the rights of its personal creditors."

There is also a proposal to introduce a statutory trust, la fiducie, into French law.⁴⁸ However, we think that the Luxembourg provision is too detailed for our purposes. Instead our provisional view is for a short, simple statement of principle. For example, the Co-ordinating Group on Trust Law⁴⁹ agreed on the following provision in their Trust Law Draft:

"The trust fund is a special patrimony distinct from the personal patrimony of the trustee and any other patrimonies owned or managed by the trustee".

2.28 Accordingly we ask:-

1. **Do you agree with our provisional view that the dual patrimony theory on the nature of a trust in Scots law should be placed on a statutory footing?**

The Reification of Trusts: Trusts as a Legal Category

2.29 As we have seen,⁵⁰ a trust is a legal device, an institutionalised fact, which creates rights and obligations among two parties namely A, the trustee, who is the owner of the property in the trust patrimony and who is under a fiduciary obligation to administer that property for the benefit of the second party, B, the beneficiary. This is done in accordance with the trust purposes expressed by C, the truster, in the declaration of trust and which A agreed to fulfil when he accepted the office of trustee. On this analysis, after the trust has been constituted and A has become the owner of the trust patrimony, in theory at least, we should only be concerned with B's right to compel A to fulfil the trust purposes and A's fiduciary obligation to do so.

⁴⁷ *Trust et Fiducie: La Convention de la Haye et la Nouvelle Législation Luxembourgeoise* (Montchrestien, Paris 2005), 131 (translation by Arendt & Medernach, avocats à Cour and Elvinger, Hoss & Prussen, avocats à la Cour).

⁴⁸ Proposition de Loi Instituant Fiducie No 178 (Senate 8th February 2005). Article 2062 states "...Le transfert s'opère dans un patrimoine d'affectation, appelé patrimoine fiduciaire, distinct du patrimoine personnel du fiduciaire et de tout autre patrimoine fiduciaire, le fiduciaire devenant titulaire ou propriétaire fiduciaire des droits transférés".

⁴⁹ This body is part of the Study Group on a European Civil Code. It is composed of professors and judges from all the EU countries.

⁵⁰ Para 2.1 above.

2.30 Because of the nature of the trustee's obligations and in particular because he is obliged to administer the trust patrimony which he owns for the benefit of another, the trust is often seen as a distinct type of legal entity. This arises as a consequence of a trust being an institutionalised fact which is the source of the beneficiary's rights and the trustee's fiduciary obligations.⁵¹ Thus for example, we talk of the trust fund or the trust assets. In doing so we are reifying the trust, or more correctly, treating the trust as a specific legal concept with its own distinctive principles and rules. In our view the law of trusts cannot be reduced to the law of property or the law of voluntary obligations. It is because C has created a 'trust' in favour of B and because A has agreed to act as a 'trustee' that the various rights and obligations of the respective parties can be explained and understood. We have argued above that a crucial feature about the nature of a trust is that a trustee owns both a private and a trust patrimony. This distinction would be meaningless unless there were a concept of trust. However although the language of trust property and the like is quite appropriate, there is no implication that a trust is a separate legal or juristic person with its own legal personality. Reification is not the same as personification. For under the current law a trust cannot own any property because it has no legal personality and therefore no passive capacity to do so. As we have emphasised,⁵² the property is owned by the trustees albeit that it is held in a patrimony - the trust patrimony - which is separate from the trustees' private patrimonies: it is because it is held in the trust patrimony - as opposed to their private patrimonies - that the trust fund is safe from the claims of a trustee's personal creditors.

2.31 To give another example: it is settled law that a trustee can contract expressly as a trustee in which case his liability for non-performance or breach of contract is restricted to the trust - as opposed to his private - patrimony.⁵³ It might be said that in these circumstances the trustee is contracting in a representative capacity. But representative of whom? One possible answer is "the trust". Yet this cannot be correct. It does not follow from treating a trust as a separate legal category which creates the relationship of trustee and beneficiary that a trust must also be a legal person. On the contrary, under the existing law it has no legal or juristic personality and therefore no active capacity and so cannot be bound by a contract. Accordingly, where trustees contract expressly as trustees, they and not the trust are the persons who undertake the contractual obligations. While the trustees are jointly and severally liable to the trust creditor if the contract is breached, it will only be to the extent of the trust patrimony.

2.32 Yet at the same time there might be a tendency to give the trust an existence as a legal person over and above its function as an institutional fact which creates legal rights and obligations between the trustee and the beneficiary. Why is there this desire to transfer the legal rights and duties of trustees beyond that of the concept of trust to that of an entity with legal personality? Why do we do this in respect of the trust and not for example other institutional facts or categories such as a contract or a will where the language of legal personality seems out of place?

⁵¹ It would be possible to state all the rules about the obligations of trustees and the rights and powers of beneficiaries without using the language of 'trust' but doing so would not only complicate the exposition of the law but also fail to bring out what is distinctive about these rules. For an account of the organising function of legal concepts such as 'contract' or 'trust' see MacCormick, (1974) 90 LQR at 106-107.

⁵² Paras 2.5-2.15 above.

⁵³ *Gordon v Campbell* (1842) 1 Bell's App 428; *Muir v City of Glasgow Bank* (1879) 6 R (HL) 21 *per* Cairns LC at 22. See generally, R G Anderson "Contractual liability of Trustees to Third Parties" 2003 JR 45.

2.33 These questions do not admit of easy answers. Parties to a contract obtain rights and undertake duties as a consequence of the obligor's consent. But a beneficiary also obtains rights as a consequence of manifestations of consent namely the truster's in the declaration of trust and the trustee's when she accepts office. It will be argued⁵⁴ that the transfer of the ownership of the trust fund from the truster's private patrimony into the trustee's trust patrimony is not constitutive of these rights; but it is recognised that that property remains vulnerable to the claims of the truster's personal creditors unless and until such a transfer takes place. Where a truster becomes insolvent before the trust fund is transferred, the trustee and beneficiaries would rank as ordinary personal creditors of the truster.

2.34 But, of course, once the ownership of the property that constitutes the trust fund has been transferred from the truster's private patrimony into the trustee's trust patrimony, not only is it no longer vulnerable to the claims of the *truster's* personal creditors⁵⁵ but it is also immune from the claims of the *trustee's* personal creditors. This is easily explicable by, and is, indeed, an inevitable consequence of, the dual patrimony theory. But we can readily see why there is a temptation to explain it on the basis that "the trust" owns the trust fund which is only managed by the trustees.

2.35 It may also be difficult to accommodate the concept of fiduciary ownership which is the hallmark of being a trustee. This is the idea that property can be *owned* by persons, trustees, who must use it solely for the benefit of others and, indeed, put the interests of others before their own. Further, contrary to the normal rules of ownership by more than one person, where, as is usually the case, there is more than one trustee, the trust fund is owned jointly by the trustees.⁵⁶ This means that each trustee does not have a separate *pro indiviso* share of the property: instead, there is one, single title which is owned jointly by the trustees. Put another way, the property belongs to the persons who are from time to time trustees. So if for example a trustee dies, the title remains with the surviving trustees. If a sole trustee dies, the trust fund remains part of the deceased's trust patrimony and the court can appoint new trustees. To that extent "the trust" appears to exist without trustees.⁵⁷

2.36 It is clear that the law currently recognises that a trustee's ownership of the trust fund differs in important respects from the concept of ownership of property that is paradigmatic in Scots law. In these circumstances, there is again an understandable temptation to create a structure that appears better to represent the economic and social realities of how a trust operates in practice: namely, that it is "the trust" which *owns* the trust fund which is only *managed* by trustees. This is reinforced by the fact that trusts are treated as separate entities for most tax purposes. And in the context of the sequestration of a trust estate in respect of debts incurred by the trustees on behalf of "the trust", section 6(1)(a) of the Bankruptcy (Scotland) Act 1985 refers to "a trust in respect of debts incurred by *it*" (italics added).

⁵⁴ Para 3.6 below.

⁵⁵ Subject to the rules on gratuitous alienations and unfair preferences if the truster was insolvent at the time of the transfer.

⁵⁶ *Dalglish v Land Feuing Co Ltd* (1885) 13 R 223; *Banff Magistrates v Ruthin Castle Ltd* 1944 SC 36 per Lord Justice Clerk (Cooper) at 68. The only other example of joint property in Scots law is the assets of an unincorporated association which are owned jointly by the members of the association.

⁵⁷ In the case of a *mortis causa* trust the person appointed trustee or executor-nominate may predecease the truster/testator. While in these circumstances a residuary legatee is entitled to be confirmed as an executor-nominate, an executor-dative would have to be appointed in the absence of a residuary legatee.

2.37 These tendencies intensify when there are a large number of trustees and decisions are generally taken by a quorum. This is particularly evident in the case of public trusts which have been established for a long time. Some of these trusts have social and economic functions similar to those of charitable institutions which have been set up as companies limited by guarantee which, of course, have legal personality. Moreover the Charities and Trustee Investment (Scotland) Act 2005⁵⁸ introduces a new corporate entity for charities, the Scottish Charitable Incorporated Organisation (SCIO): a SCIO will have juristic personality. Finally, statutory trusts such as the National Trust for Scotland and the Scottish Hospital Endowments Research Trust are bodies corporate.⁵⁹

2.38 While it might be natural to personify the trust in this way, we have emphasised⁶⁰ throughout this discussion paper that under the current law it is the trustees who are the fiduciary owners of the trust fund. A trust is not an entity with separate legal personality: it is not a juristic person. A trust is rather an institutionalised fact, a legal device, used to create the obligations between the beneficiaries and the trustees. The difficulty is that many trustees are lay persons who accept office believing that any potential liability to third parties arising from their trusteeship will be borne by "the trust". This led us to consider whether or not the time was ripe for Scots law fully to embrace these reification tendencies and recognise that a trust should become an entity with legal or juristic personality separate from that of the trustees. For this purpose we held a seminar at the Commission.⁶¹

Should Trusts Have Legal or Juristic Personality?

2.39 Many interesting issues were raised at the seminar. The most important are summarised in the following paragraphs.

2.40 There was general agreement that the use of language which tended to personify a trust and implied an incorrect understanding of the legal analysis of a trust was not in itself a convincing argument for reform of the law. It did not follow that when a trust was being reified, it was being regarded as an entity with legal or juristic personality. If as a result of their administration, lay trustees incurred personal liability to third parties under the mistaken belief that "the trust" would be liable, the rules on liability could be changed: it was not necessary to give trusts legal personality. A distinction could be made between public and private trusts and a case might be made that the former should have juristic personality: but it was accepted that there already existed suitable routes for public trusts to obtain separate legal personality namely incorporation as a company limited by guarantee or as a SCIO, if the public trust was also charitable.

2.41 Trusts are used for a variety of purposes. The value of the current structure of the trust is its simplicity and therefore its adaptability for use in new economic and social environments. To introduce an extra juristic person, the trust, would complicate matters. The trust would have to exercise its active legal capacity through agents, presumably the trustees. Apart from issues of *vires*, the agency rules which would govern the relationships

⁵⁸ Sections 49-64. Implementation of the new corporate entity for charities is unlikely for at least another year.

⁵⁹ The National Trust for Scotland was incorporated by the National Trust for Scotland Order 1935: the Research Trust by para 2 of Sch 7 to the National Health Service (Scotland) Act 1978. Some statutory "trusts", for example NHS trusts, are not trusts in any meaningful sense, the misnomer being a result of political rather than legal considerations.

⁶⁰ Para 2.30 above.

⁶¹ Seminar on Legal Personality for Trusts held at the Scottish Law Commission on 1 March, 2005.

between the trust, the trustees and third parties would not be simple. It was accepted that even if a trust had separate juristic personality, trustees would continue to owe fiduciary obligations to the beneficiaries as well as the trust: difficult conflicts of interest could be envisaged.

2.42 At first sight an analogy might be thought to exist with partnership. In Scots law a partnership has its own legal personality which is separate from that of the persons who are partners. However, partnerships are profit-seeking enterprises and the partners intend to receive a share of any profits which the partnership makes. That is not the position of trustees who own the trust fund for the benefit of others ie the beneficiaries and not for themselves. Put another way, the persons who manage the partnership ie the partners are also the intended beneficiaries of the enterprise: the managers of a trust ie the trustees are not. Accordingly not only would the structure of a trust entity be more complex than a partnership but - almost inevitably - the room for conflicts of interest between the trust, trustees and beneficiaries would be greater.

2.43 It was thought important that a trust should continue to be regarded as a legal device which creates legal relationships - particularly fiduciary relationships - between truster, trustee and beneficiary. This would be inhibited if a trust became a separate juristic person: it would certainly complicate the law. Moreover, the concept of a legal institution where property was owned by one person on behalf of another was being developed at European⁶² and international levels. If Scotland went out on a limb in relation to the legal personality of the trust, we might cut ourselves off from future developments in trust law elsewhere.

2.44 In the end there were three main reasons why juristic personality for trusts might be considered desirable: procedural convenience, dissatisfaction with the rules regarding the rights and duties of beneficiaries and trustees and considerations of the ownership of the property in the trust. The first reason would not in itself provide sufficient justification for reform. In relation to the second, there appeared to be general satisfaction with the nature of the obligations of a trustee to a beneficiary: any changes thought desirable could be achieved without giving the trust separate legal personality. Thirdly, in Scots law issues relating to trust property could be dealt with by the dual patrimony theory, treating the entrusted property as a pool or fund in the trustee's trust - as opposed to - private patrimony.

2.45 In these circumstances, we have taken the view that there is little, if any, support for the view that a trust should be an entity with legal personality separate from that of the beneficiaries and the trustees. Problems, for example those arising in trust conveyancing, which might be alleviated if trusts were to become juristic persons will still have to be addressed but particular, specific solutions should be found. The seminar confirmed that principled solutions could be obtained by utilising and if necessary further developing the dual patrimony theory.

⁶² See for example the 1986 Hague Convention on the Recognition of Trusts and the work of the Co-ordinating Group on Trust Law referred to in para 2.27 above.

2.46 Nevertheless we ask the following:-

2. **Are we right in our preliminary view that we should give no further consideration on whether under Scots law a trust should be an entity with legal or juristic personality separate from that of the beneficiaries and trustees?**

Part 3 The Constitution of Trusts

Introduction

3.1 As we have seen,¹ a standard trust initially involves a tripartite relationship among the truster, the trustee(s) and the beneficiary. It is generally accepted that two juristic acts are necessary in order to create a standard trust. First, the truster must make a declaration of trust ie he declares that he is setting up a trust. When the declaration is made in writing, this is known as the trust deed. In the declaration, the truster will set out the purposes of the trust. In particular he will nominate the beneficiaries, the trustees and the property that is to constitute the trust fund. It is also common to stipulate the nature and extent of the trustees' powers to administer the trust fund.

3.2 Second, the ownership of the property that is to constitute the trust fund must be transferred² to the trustees:

"A trust is ... constituted when the owner of the property, who becomes the truster, transfers the legal ownership of the property to trustees to hold it for defined purposes on behalf of the beneficiaries .. The constitution of the trust is completed by delivery."³

3.3 It would therefore appear that the truster has to be divested of the property that is to constitute the trust fund. In the words of Bell, "the trust estate cannot be considered as fully created, until the right is so vested in the trustee as to denude the maker of the trust ...".⁴ According to the analysis adopted in this discussion paper, we would say that the trust property must have moved from the private patrimony of the truster into the trustees' trust patrimony.

3.4 In this and the following Part, we shall describe the theory that a trust is only created when there is a declaration of trust *and* the transfer of ownership of the trust property to the trustees as the conventional analysis.⁵ However, the conventional analysis is problematic. If it were correct, beneficiaries would only obtain a vested right to compel trustees to fulfil the trust purposes when the trustees had become the *owners* of the trust property. For example, A makes a written declaration of trust under which T is to hold land for the benefit of B. A communicates the declaration of trust to T by delivering the deed to T. T accepts the office of trustee. A conveys the title of the land to T. But it is only when T registers his title that he becomes owner of the property. On the conventional analysis, it is only when the title is registered that a trust would be constituted and B would have a vested right to compel T to fulfil the trust purposes. Accordingly, if T delayed or refused to register his title, B would

¹ Above paras 2.2.

² Traditionally the phrase used was "delivery" of the trust property to the trustees: see, for instance, *Wilson and Duncan*, chapter 3. However, some kinds of property cannot be delivered, for example land. Moreover, the ownership of certain kinds of property, for example land and shares, is transferred by registration. We have therefore taken the view that it is more appropriate to use the term "transfer" rather than "delivery" of property.

³ 24 *Stair Memorial Encyclopaedia*, para 12. See also *Wilson and Duncan*, paras 3-01 ff.

⁴ *Commentaries* (7th ed., 1870) 34.

⁵ In this context the conventional analysis is only concerned with the *constitution* of trusts: it has nothing to do with the theories discussed in Part 2 which are concerned with the *nature* of a trust in Scots law.

have no right under the law of trusts to force him to do so as it is only on registration of the title that a trust would be created and B obtain his rights as a beneficiary. This would also mean that if B dies after the conveyance has been delivered to T but before T has registered his title to the property, B's legatees or heirs on intestacy have no rights in respect of the trust. This is because at the time of B's death, the trust has not been created as T has not become owner of the trust fund and consequently no rights under the trust could form part of B's private patrimony.⁶

3.5 At first this might appear simply to be an unfortunate consequence of the rules on the constitution of trusts. There is little, if any, judicial authority on the constitution of an express *inter vivos* trust ie a trust which is to come into effect during the life of the truster. But in the context of *mortis causa* trusts ie a trust which is only to come into effect on the death of the truster, the result contradicts current Scots law. For it is well established that⁷ a beneficiary under a testamentary deed - probably the most common kind of express trust - has a vested right to her legacy⁸ on the date of the testator's death. It will be weeks or even months later before the executor/trustee obtains confirmation whereby the ownership of the property in the estate can be conveyed to him.⁹ Accordingly, a *mortis causa* trust must come into existence before the ownership of the property constituting the trust fund is transferred to the executor/trustee.

3.6 In an important article,¹⁰ Reid has argued that in Scots law divestiture of the trust property from the truster's private patrimony to the trustee's trust patrimony is not an essential requirement for the constitution of a trust, although the trust property will remain vulnerable to the claims of the truster's creditors for as long as it remains part of the truster's private patrimony. Instead, Reid maintains that the trust is created by the declaration of the trust: and that once the declaration of trust is communicated to the trustees, they can call on the truster to denude in their favour.¹¹ The point is that when the ownership of trust property is transferred to trustees, it is protected from the truster's personal creditors simply because it is no longer part of the truster's private patrimony. While this may be a common reason for setting up a trust, it does not follow that the transfer of the ownership of the trust property to the trustees should be an essential requirement for the constitution of a trust.

3.7 If a trust is created when the declaration of trust is communicated to the trustee, then the truster is under an obligation to transfer the property to the trustee. The truster's obligation to transfer the property is itself a trust asset. For example A makes a written declaration under which T is to hold land for the benefit of B. The declaration is delivered to

⁶ To avoid this result it might be argued that when the conveyance is delivered to T, T becomes the owner of the personal right to have the title to the property registered in his name. In other words, the property which constitutes the trust fund is not the land but the incorporeal moveable right to have the title to the land registered in T's name. If so, as soon as the ownership of the right has been transferred by delivery of the conveyance to T, a trust is constituted and B would have a vested right and could compel T to register.

⁷ Except where vesting is suspended for some reason.

⁸ Ie the right to demand payment of the legacy from the executor or *mortis causa* trustee has become part of the beneficiary's private patrimony: if the beneficiary dies before the legacy has been paid, the right will pass to the beneficiary's legatees or heirs on intestacy.

⁹ Even then where the estate consists of heritable property, ownership does not pass to the executor when confirmation is granted but when he makes up title by registration. In practice, few executors make up title to heritable property.

¹⁰ K G C Reid "Constitution of Trust" 1986 SLT (News) 177.

¹¹ Once the declaration has been communicated and the trust thereby constituted, the trustees are under an obligation to fulfil the purposes of the trust and the beneficiaries have therefore the right to demand that the trustees call upon the truster to transfer the ownership of the trust property to them ie to the trustees.

T who accepts office as trustee. On Reid's analysis¹² a trust is now created. T has the right to demand that A transfers the land to him: this is because A's obligation to do so is an asset of the trust. But because a trust has been constituted, B also has the right to compel T to fulfil the trust purposes. So if as in the example above, A has delivered the conveyance of the land to T but T refuses to register the title, B can compel T to do so. And, of course, because a trust has been created as soon as the declaration of trust has been communicated to T and T has accepted office, B has a vested right under the trust *before* the land is conveyed to T and T has been registered as owner.¹³

3.8 If it is accepted that a trust is constituted when the truster communicates the declaration of trust to the trustees, the question arises whether or not the truster can change his mind and revoke the trust before the ownership of the property which is to constitute the trust fund is transferred to the trustees. On the conventional analysis, the truster is free to do so as no trust is created until ownership passes to the trustee: once ownership has passed the trust is formed and is generally irrevocable.¹⁴ However, if communication of the declaration of trust to a trustee creates the trust, it appears to follow that the trustee should be able to call upon the truster to divest the ownership of the property which is to constitute the trust fund: this is because the truster's obligation to do so is in itself a trust asset. If this is correct, the truster cannot change his mind after the declaration of trust has been made and communicated to a trustee.¹⁵

3.9 On the other hand, where the truster has set up a *mortis causa* trust in his will or other testamentary deed, it is a fundamental principle of Scots law that the truster *can* always change his mind even if he has communicated the declaration of trust to his executor/trustee (or even to a legatee or beneficiary).¹⁶ For when a trust is intended to have testamentary effect ie only to come into effect when the truster dies, it is the death of the truster alone that gives legal effect to the declaration of trust: and it is only when the declaration of trust is triggered in this way that a *mortis causa* trust is constituted. This means that until he dies, the truster can change his mind and use the property which was intended to be the trust fund as he pleases.¹⁷ It should also be noticed that the *mortis causa* trust comes into effect as soon as the truster dies: the declaration of trust in the will or testamentary deed does not have actually to be communicated to the executor/trustee before the trust is effective. Put another way, in a *mortis causa* trust, the truster's death is the equivalent of communication of the declaration of trust in an *inter vivos* trust.

¹² Above note 10.

¹³ This analysis avoids the artificiality of arguing that the property which constitutes the trust fund is T's personal right to register the title to the land after the conveyance has been delivered to him as discussed in footnote 6 above. As the truster's obligation to transfer the trust property is a trust asset, there is no need to argue that the property that is to later constitute the trust fund is anything other than the land itself.

¹⁴ See for example *Milligan v Ross* 1994 SCLR 430.

¹⁵ Unless the trust has been set up for administrative purposes only: see para 3.49 below.

¹⁶ In the vast majority of cases, the truster does not inform his executor let alone his legatees or beneficiaries of the contents of his will or trust deed.

¹⁷ The truster, A, - or more likely A's estate - may incur liability if A had promised B that he would set up a *mortis causa* trust for the benefit of B or would leave B a legacy. As this promise will usually be a gratuitous unilateral obligation, it will not be constituted unless it is made in writing and subscribed by the promisor: Requirements of Writing (Scotland) Act 1995, s 1(2)(a)(ii). If with his knowledge A allows B to act or refrain from acting in reliance of the promise so that B would suffer a detriment if the promise was withdrawn, then B may be able to use ss 1(3) and (4) of the 1995 Act to establish that the unilateral obligation is valid even though it has not been constituted in writing. See further para 3.53 below.

3.10 These are important and difficult issues. The problem is that they have not been directly addressed by the courts. In most of the cases, rather than having to determine when a trust has been created vis-a-vis truster and trustee or beneficiary, the courts have been concerned with whether or not the truster has been divested of the assets which are to constitute the trust fund so that the property is no longer vulnerable to the truster's personal creditors or the Revenue.¹⁸ Moreover, the discussion has often taken place in the context of cases where the truster has declared himself to be the sole trustee of his own property viz truster-as-trustee trusts,¹⁹ which as we shall see²⁰ raise particular difficulties. In short, the current law is uncertain and underdeveloped. In these circumstances, any discussion of the creation of trusts can only be based on a tentative - and, almost inevitably, at times controversial - view of what the law currently is.

The Declaration of Trust

3.11 Scots law makes an important distinction between trusts that are to take effect during the lifetime of the truster (*inter vivos* trusts) and those which are only to take effect when the truster dies (*mortis causa* trusts).

(a) *Inter Vivos* Trusts

3.12 Before a trust can arise the truster must have the intention to create a trust. This intention is found in the declaration of trust. It is well settled that no special form of words is necessary in order to create a trust: in particular, there is no need to use the word "trust".²¹

3.13 Thus for example, if A conveys property to B "for behoof of" or "for the benefit" of C, this amounts to the declaration of a trust by A whereby B is to be the trustee who has the property in trust for the beneficiary, C.²² Whether a statement amounts to a declaration of trust is ultimately a question of construction of the language used by the alleged truster.²³

3.14 In relation to the formalities involved in the creation of an *inter vivos* trust, a distinction is made between a standard trust and a truster-as-trustee trust. In the case of a standard trust it will be remembered that the truster and trustee are separate persons: a truster-as-trustee trust is where the truster appoints himself as the sole trustee of his own property.

3.15 **Standard Trusts** Section 1(1) of the Requirements of Writing (Scotland) Act 1995 (the 1995 Act) provides that, "Subject to subsection (2) below and any other enactment, writing shall not be required for the constitution of a contract, unilateral obligation or trust". It is perhaps unfortunate that the 1995 Act does not provide a definition of "trust". However, the 1995 Act is concerned with when a requirement of writing is necessary in order to constitute a valid juristic act. In this context, we consider that "trust" must mean "declaration of trust". Consequently, the effect of section 1(1) is that a *declaration of trust* does not have

¹⁸ See for example, *Allan's Trs v Lord Advocate* 1971 SC (HL) 45; *Clark's Trs v Inland Revenue* 1972 SLT 190; *Gibson v Hunter Home Design Ltd* 1975 SC 23 per Lord Cameron at 31.

¹⁹ *Ibid.* See also *Clark Taylor Ltd v Quality Site Development (Edinburgh) Ltd* 1981 SC 111; *Tay Valley Joinery Ltd v CF Financial Services Ltd* 1987 SLT 207; *Balfour Beatty v Britannia Life Ltd* 1997 SLT 10.

²⁰ Paras 3.18-3.22 below.

²¹ *Gillespie v City of Glasgow Bank* (1879) 6 R (HL) 104 per Lord Cairns LC at 107.

²² *Gilpin v Martin* (1869) 7 M 807; *Michie's Exrs v Michie* (1905) 7 F 509.

²³ *Wilson v Lindsay* (1885) 5 R 539 per the Lord President (Inglis) at 541; *MacPherson v Macpherson's CB* (1894) 21 R 386 per Lord MacLaren at 387. See generally *Wilson and Duncan*, paras 2-04ff.

to be *constituted* in writing. In practice, however, a declaration of trust will usually take the form of a written document, the trust deed. Where the trust fund consists of land, the declaration of trust is sometimes found in the deed conveying the title of the property to the trustee.

3.16 A deed has no legal effect until it is delivered - or otherwise communicated - to the grantee.²⁴ In the case of a trust deed, the grantee will be the trustee. Until the trust deed is delivered to the trustee, the trust is not created and the truster is free to change his mind and decide not to set up the trust. In the same way, it is thought that where the declaration of trust is made orally, it will not be effective until the truster's statement is communicated to the trustee: until that is done, no trust is created and once again the truster is free to change his mind and decide not to set up the trust. Thus although writing is not required for the constitution of a declaration of trust, a declaration of trust is not effective until it has been communicated to the trustee. And even when there is a written trust deed, the declaration of trust is not effective until the deed has been delivered - or otherwise communicated - to the trustee.

3.17 There is little doubt that the 1995 Act proceeds on the basis of the conventional view that a trust is not created until (a) there has been a declaration of trust which has been communicated to a trustee; *and* (b) the ownership of the property which is to constitute the trust fund has been transferred to the trustees. This is evident from the Scottish Law Commission's *Report on Requirements of Writing*²⁵ on which the 1995 Act is based. Because the Commission thought that a standard trust did not arise until the trust fund was transferred to the trustees, our predecessors took the view that a truster could change his mind at any time before that was done. Accordingly, they did not think that a truster needed the protection of a requirement of writing in respect of the declaration of trust: for if he was later to regret a declaration of trust which he had made impulsively, the truster could simply decline to transfer the trust fund to the trustee(s) and the trust would not arise.

3.18 But if it is the law that a trust is created as soon as a declaration of trust has been communicated to the trustee, then the truster may be obliged to transfer the ownership of the property which is to constitute the trust fund to the trustee(s). In these circumstances, our predecessors' rationale for not requiring the declaration of trust to be in writing is removed.²⁶

3.19 **Truster-as-Trustee Trusts** There is an exception to the general rule that a declaration of trust does not have to be constituted in writing. Section 1(2)(a)(iii) of the 1995 Act provides that writing is required for the constitution of "a trust whereby a person declares himself to be sole trustee of his own property or any property which he may acquire". This deals with the following situation. A owns property. A declares that he owns that property as sole²⁷ trustee for the benefit of a third party. For the declaration of trust to be validly constituted, it must be in writing subscribed by the truster, A. In their *Report on*

²⁴ See generally W W McBryde, *The Law of Contract in Scotland*, (2 edn 2001), chapter 7.

²⁵ Scot Law Com No 112 especially at para 2.37.

²⁶ See Part 4.

²⁷ The requirement of writing does not apply where the truster appoints himself and another person as trustees: this would be treated as a standard trust. But we can envisage situations where a trust involving two trustees could be problematic. For example a house is owned in common by H and W. They declare that they are holding the house on trust for their children. If each is holding his or her own one half *pro indiviso* share for the children, it would appear that each would be treated as sole trustee of the property and writing would be required: if both were to be trustees of each one half *pro indiviso* share, then no writing is required as the truster is no longer the sole trustee of the property constituting the trust fund.

Requirements of Writing,²⁸ the Scottish Law Commission took the view²⁹ that writing was necessary in this situation as a protection against impulsive gestures by the trustor which he might later regret.³⁰ However, it is thought that the mischief of trustor-as-trustee trusts is not so much impulsive gestures of the trustor but the potential effect of such trusts on the interests of the trustor's personal creditors.³¹

3.20 Nevertheless, section 1(2)(a)(iii) is subject to sections 1(3) and (4) of the 1995 Act. These sections provide:

"(3) Where ...a trust mentioned in subsection (2)(a) above is not constituted in a written document...but ...a beneficiary under the trust ('the first person') has acted or refrained from acting in reliance on... the trust with the knowledge and acquiescence of...the trustor ('the second person') -

the second person shall not be entitled to withdraw from...the trust; and

the trust shall not be regarded as invalid on the ground that it is not so constituted, if the condition set out in subsection (4) below is satisfied.

(4) the condition referred to in subsection (3) above is that the position of the first person - (a) as a result of acting or refraining from acting as mentioned in that subsection has been affected to a material extent; and

(b) as a result of such a withdrawal as is mentioned in that subsection would be adversely affected to a material extent."

3.21 Consider the following example. A owns a house. He makes an oral declaration to his girlfriend, B, that he is holding the house in trust for her. A is the trustor and has declared that he is holding the property as sole trustee for the benefit of B. The declaration of trust is not constituted because it is not in writing: section 1(2)(a)(iii) of the 1995 Act. However, *if with the knowledge of the trustor*, A, the beneficiary, B, acts or refrains from acting in reliance on the trust then A cannot withdraw from the trust and the trust will not be regarded as invalid for lack of writing provided (a) that B has been materially affected by her acts or omissions and (b) that A's withdrawal would adversely affect her to a material extent: sections 1(3) and (4) of the 1995 Act. This would occur if, for instance, *with A's knowledge*, B gave up the lease of her flat in reliance of A's statement that he was holding his house in trust for her.³²

3.22 It will be clear that before sections 1(3) and (4) operate, the trustor must have communicated his - initially ineffective - declaration of trust to the beneficiary. But even where the declaration is in writing and therefore satisfies section 1(2)(a)(iii), communication of the declaration of trust to a beneficiary is vitally important. For it is well settled that a trustor-as-trustee trust is not created merely by a valid declaration of trust.³³ As the trustor is also the sole trustee, communication of the declaration of trust to the trustee is not regarded

²⁸ Scot Law Com No 112.

²⁹ *Ibid* at para 2.37, Rec 5.

³⁰ It is for this reason that writing is also necessary for the constitution of gratuitous unilateral obligations: section 1(2)(a)(ii) of the 1995 Act.

³¹ This issue is discussed at paras 4.16-4.21 below.

³² For an example of sections 1(3) and (4) operating to prevent a trustor-as-trustee trust failing because of the lack of a requirement of writing see *McHugh v McHugh* 2001 Fam LR 30 at 36.

³³ *Allan's Trs v Lord Advocate* 1971 SC (HL) 45.

as sufficient to make the declaration - and consequently the trust - effective. Instead, it is now settled that in a truster-as-trustee trust, the declaration of trust has to be communicated to a beneficiary under the trust.³⁴ This demonstrates that the truster has gone beyond the stage of deliberation to that of actual intention. Only then will the trust be created. This is necessary for the protection of the truster's personal creditors. As Lord Reid explained in *Allan's Trustees v Lord Advocate*³⁵ if it were otherwise, "it would be easy to execute such a declaration, keep it in reserve, use it in case of bankruptcy to defeat the claims of creditors, but, if all went well and the trustee desired to regain control of the fund, simply suppress the declaration of trust."

3.23 Therefore in order to create a truster-as-trustee trust, the declaration of trust has to be constituted in writing. Although this was originally perceived as a formal requirement which would protect an impulsive truster who came to regret an oral declaration of trust, it also provides some - admittedly small - degree of protection for the truster's personal creditors. Particularly for the latter reason, it is thought that the requirement of writing to constitute a declaration of a truster-as-trustee trust should continue. Moreover, the rule that a declaration of truster-as-trustee trust is not effective until communicated to a beneficiary appears also to be essential in order to protect the personal creditors of the truster.

(b) Mortis Causa Trusts

3.24 A *mortis causa* trust is a trust which the truster intends to take effect only on his death. It is a conditional³⁶ trust as it does not come into effect until a condition is purified ie the truster dies. Traditionally this was known as a trust disposition and settlement. In the deed the truster appoints trustees and states the purposes of the trust, for example that his surviving spouse is to have a liferent of the estate and the fee is to be paid to his children on her death. Because it is not effective until the truster dies, a trust disposition and settlement has been described as "really a will that has on-going purposes".³⁷ Where a person has made a will but has made no express provision for a trust disposition and settlement, on his death his estate will be administered by an executor who will distribute it to the beneficiaries in accordance with the terms of the will. The executor owes the beneficiaries a fiduciary obligation to fulfil the testator's purposes as expressed in the will. Put another way, an executor is in effect a trustee vis-a-vis the beneficiaries under the will.³⁸ An executor's position is analogous with that of a trustee appointed under a trust disposition and settlement: and the beneficiaries under such a trust are in a similar position as the beneficiaries under a will. Accordingly, for the present discussion, a *mortis causa* trust includes the trust relationship which exists between an executor and the beneficiaries under a will as well as a trust disposition and settlement *stricto sensu*.

3.25 Section 1(2)(c) of the Requirements of Writing (Scotland) Act 1995 provides that writing is required for "the making of any will, testamentary trust disposition and settlement or

³⁴ *Ibid.* Intimation to an agent of the beneficiary will also be sufficient. It is thought that registration of the declaration of trust in the Books of Council and Session or sheriff court books would be the equivalent of intimation to the beneficiary.

³⁵ 1971 SC (HL) 45 at 54.

³⁶ It is thought that there may be other kinds of conditional trust. For example, A may appoint an attorney with a power in the event of A no longer being capable of running his own affairs, to transfer assets to trustees to hold for A in liferent and his children in fee.

³⁷ K McK Norrie and E M Scobbie, *Trusts*, Edinburgh 1991, (hereinafter cited as "*Norrie and Scobbie*"), p 17.

³⁸ By statute trustee has been defined to include an executor nominate: Trusts (Scotland) Act 1921, s 2. An executor dative has the same powers as a trustee: Succession (Scotland) Act 1964, s 20.

codicil". Because it has testamentary effect, it is thought that the formalities for the declaration of a trust disposition and settlement should continue to be the same as those required for a will and therefore the requirement of writing should continue for the declaration of a *mortis causa* trust.

3.26 It should also be noticed that the provisions of sections 1(3) and (4) of the 1995 Act³⁹ do *not* apply to section 1(2)(c). This means that if A makes an oral declaration of a *mortis causa* trust, it remains invalid for lack of writing even if A has allowed B, a beneficiary under the purported trust, to act to his detriment in reliance of the declaration.

3.27 But even if the declaration of a *mortis causa* trust has been made in writing, because it is a testamentary deed it has no legal effect before the truster dies. Only the death of the truster activates the declaration and creates the trust. Consequently, it does not matter if the truster has communicated the declaration to the trustees or even informed the beneficiaries; *provided that the trust is only to have effect when he dies*, the truster is entitled to change his mind at any time before his death. Conversely, because the declaration of trust is activated as soon as the truster dies, on his death a trust is created even although he had not communicated the declaration of trust to his trustees or beneficiaries while he was alive. In short, it is the death of the truster which activates the declaration and creates the *mortis causa* trust.

3.28 Whether a testator intended to create a *mortis causa* trust is ultimately a matter of construction of the language used by him in the testamentary deed.⁴⁰

(c) Trusts of Heritable Property

3.29 Section 1(2)(b) of the Requirements of Writing (Scotland) Act 1995 (the 1995 Act) provides that writing is required for "the creation, transfer, variation or extinction of a real right in land otherwise than by the operation of a court decree, enactment or rule of law". As we have seen,⁴¹ when a truster makes a declaration of a standard *inter vivos* trust, no writing is required and arguably a trust is created when the declaration is communicated to the trustee. In our view, writing is not required for the declaration of such a trust merely because the property which is to constitute the trust fund includes land. A declaration of trust in respect of such property does not create, transfer, vary or extinguish a real right in land and consequently section 1(2)(b) of the 1995 Act does not apply.⁴² However, when the ownership of land which is to constitute the trust fund is transferred from the truster to the trustee, section 1(2)(b) does apply and the conveyance has, of course, to be in writing. On the conventional analysis, when a trust is not created until the ownership of the trust fund has been transferred from the truster to the trustee, there will have to have been a written conveyance in respect of any land included in the trust fund before the trust is constituted.

³⁹ Discussed paras 3.19-3.20 above.

⁴⁰ See for example, *Macpherson v Macpherson's CB* (1894) 21 R 386 (bequest to A for the benefit of A and B, held to be intended to create a trust for the benefit of both A and B, with A as trustee); *Wilson and Duncan* paras 2-04 ff. A request to an executor or a beneficiary that the deceased's estate should be used by them in a particular way may create a precatory trust: *Walker's Exr v Walker* 1953 SLT (Notes) 59. The request is more likely to be construed as creating a trust for that purpose if it is directed to an executor as opposed to a legatee: *Garden's Exr v More* 1913 SC 285 *per* the Lord President (Dunedin) at 288. On precatory trusts, see *Wilson and Duncan*, paras 2-13 ff.

⁴¹ Paras 3.14-3.15.

⁴² Similarly, a contract for the sale of land does not require writing by virtue of s 1(2)(b): instead, s 1(2)(a)(i) of the 1995 Act expressly provides that writing is required for "a contract or unilateral obligation for the creation, transfer, variation or extinction of a real right in land".

This in turn led to the common practice of including the declaration of the *inter vivos* standard trust in the same deed which conveys the land to the trustee. It is therefore not surprising that it is often maintained that writing is a requirement for the constitution of an *inter vivos* standard trust of heritable property.⁴³ Nevertheless, in our view, technically writing is not required for the declaration of an *inter vivos* standard trust even if land is included in the trust fund.

The Legal Effect of a Declaration of Trust

3.30 At this point it might be useful to explore in a little more detail the legal effect of a declaration of trust. For the purpose of the discussion, we are concerned with the declaration of a standard trust. It has been argued that on the alternative analysis a trust is created when the declaration of trust is communicated to the trustee. As soon as this is done, the truster cannot change his mind. The trustee can compel the truster to transfer the property from his private patrimony into the trustee's trust patrimony so that the trustee can begin to administer the trust. It is thought that the obligation on the truster to transfer the trust fund to the trustee is a *sui generis* obligation arising from the law of trusts as opposed to the law of contract or promise.⁴⁴ Put another way, as soon as the trust is created, the truster comes under an obligation to transfer the trust fund to the trustee. This obligation can be seen as an asset of the trust: it is an obligation which is part of the trustee's trust patrimony and which the trustee has the right to enforce. It could perhaps be argued that the trustee's personal right itself constitutes trust property but the difficulty remains on how that personal right was "conveyed" to the trustee as it was not part of the truster's private patrimony. The answer has to be that the truster's obligation and the trustee's corresponding right are created by the law of trusts and automatically become trust assets.

3.31 We have taken the view that the declaration of trust becomes effective when it is communicated to the trustee. We appreciate, of course, that the trustee is entitled to refuse to accept office. If the trustee refused to accept office, the question arises whether the trust would still nevertheless have been constituted. If it is the communication of the declaration to the trustee that triggers the truster's obligation, then in the event of the trustee's refusal to serve, it could be argued that the truster cannot change his mind. In these circumstances, if a beneficiary knew about the declaration, she would have the right to seek the appointment of alternative trustees. On the other hand, there might be sound reasons why the trustees did not accept office, for example if the objectives of the intended trust could be obtained in a simpler or less expensive way. In this case it would seem strange that a truster should be lumbered with an expensive and cumbersome trust merely because a beneficiary knew of the declaration.

3.32 This raises a further issue. Would it be enough for the constitution of a standard trust if the truster communicated the declaration of a standard trust to a beneficiary rather than a trustee? As we have seen⁴⁵ communication to a beneficiary is necessary and sufficient for the constitution of a truster-as-trustee trust provided the requirement of writing is satisfied. But in the case of a standard trust, the truster's communications with the beneficiary are

⁴³ See for example, *Wilson and Duncan*, para 2-55.

⁴⁴ It is therefore not affected by any requirements of writing in respect of contracts or gratuitous unilateral obligations ie promises.

⁴⁵ Para 3.21 above.

more likely to take the form of telling the beneficiary that he is going to set up the trust rather than a declaration that a standard trust is being constituted.⁴⁶

3.33 The current law does not provide any clear answers to these questions. Even on the alternative analysis, it seems that the question when a trust arises is problematic. In our view a simple and coherent rule would be that a standard trust is formed when the declaration of trust is communicated to a trustee and the trustee accepts that office.

3.34 After the trust has been formed, if the truster should change her mind and refuse to transfer the ownership of the property that is to constitute the trust fund, the trustee could obtain a decree *ad factum praestandum* to compel her to do so. The beneficiaries, moreover, would have the right to force the trustee to do so since the trustee is under a fundamental obligation to fulfil the trust purposes. If the truster becomes insolvent before she has transferred the trust fund, the trustee - and therefore indirectly the beneficiaries - would rank among the truster's unsecured personal creditors.

3.35 Finally, while some at least of these propositions appear to follow logically from the premises on which the alternative analysis is based, it should be re-emphasised that there is no direct judicial authority that these conclusions accurately represent the current law.

The Transfer of the Ownership of the Property which is to Constitute the Trust Fund

3.36 Under the conventional analysis, a trust is only created when (a) the truster has made a valid declaration of trust; and (b) the truster has transferred the ownership of the property which is to constitute the trust fund to the trustees. On the alternative analysis, a trust arises when a valid declaration of trust has been communicated to a trustee and the trustee has accepted that office. But at this point the trustees have only a personal right to call upon the truster to convey the property. Until the property is transferred from the truster's private patrimony to the trustees' trust patrimony, it remains vulnerable to the claims of the truster's personal creditors. We have suggested⁴⁷ that these would include the trustees and the beneficiaries under the trust. Once the ownership of the property has been conveyed into the trustees' trust patrimony, it is no longer vulnerable to the claims of the truster's personal creditors as it is no longer part of the truster's private patrimony:⁴⁸ nor is it liable to the claims of the trustees' personal creditors as it is part of the trustees' trust - as opposed to private - patrimony.⁴⁹

3.37 What juristic act is necessary in order to transfer the ownership of the trust fund from the truster to the trustee will depend on the nature of the property. This is a matter for the law of property. Thus for example the ownership of corporeal moveable property will be transferred when the truster gives the trustees possession of the property: the ownership of land will be transferred when the trustees' title to the property is registered in the Land Register. The ownership of incorporeal moveable property, for example debts due to be paid to the truster, will be transferred when the truster, the obligee, assigns the obligation to

⁴⁶ There may be liability for breach of a unilateral obligation if the truster promises to set up a standard trust under which the promisee is to be a beneficiary. For full discussion see paras 3.51-3.52 below.

⁴⁷ Para 3.33 above.

⁴⁸ See for example *Lord Advocate v Galloway* (1884) 11 R 541; *Inland Revenue v Wilson* 1928 SC (HL) 42. This is, of course, subject to the rules on gratuitous alienation and unfair preferences if the truster is insolvent at the time the property is transferred.

⁴⁹ *Heritable Reversionary Co Ltd v Millar* (1892) 19 R (HL) 43; Bankruptcy (Scotland) Act 1985, s 33(1)(b).

the trustees and the trustees intimate the assignation to the obligor. A truster can also assign his right to future property (*acquirenda*) to the trustees and this right will be part of the trust fund though, of course, the trustees must intimate the assignation to the obligor as and when an obligation arises and becomes enforceable.⁵⁰ (But there is, of course, no need for the trustees to intimate the *declaration of trust* to these debtors in order for the trust to be created).⁵¹

3.38 There are few difficulties where the trust is an *inter vivos* standard trust. Whether the truster has divested himself of the ownership of the property which is to constitute the trust fund is essentially a question which is governed by the ordinary rules of property law. While primarily concerned with whether the trust property has been transferred out of the truster's private patrimony, it is important to remember that there may be rights entering the truster's patrimony which are directly relevant to the trust. For example, A makes a declaration that B is to hold A's house in trust for A. A transfers the ownership of the house to B who registers his title to the property in the Land Register. On both the conventional and alternative analysis there is a trust where B is the trustee and A the beneficiary. But as A is the sole beneficiary, under the law of trusts he has the right to have the trust brought to an end and call upon B to denude the trust fund in his favour.⁵² This right enters A's private patrimony at the same time that the trust is created.⁵³ Accordingly, this right is vulnerable to A's personal creditors who can demand that B transfers the property from his trust patrimony back to A's private patrimony.

3.39 The case of an *inter vivos* truster-as-trustee trust is different. At the time of the declaration of the trust, the person who is to be the trustee already owns the property but in the capacity of truster. Put another way, when the trust is declared, the property which is to constitute the trust fund is part of the truster's private patrimony. The truster does not want legally to divest himself of the property: he wishes to continue to own the property *but in the capacity of a trustee*. In other words, he must transfer the property from his private patrimony into his trust patrimony. As we have seen,⁵⁴ a declaration of a truster-as-trustee trust must be in writing and is not effective until it has been communicated to a beneficiary. It is also the case that the trust fund will not be treated as having been transferred from the truster's private patrimony into his trust patrimony until the truster has intimated to a beneficiary that this has been done. Until this happens, the property will be vulnerable to the claims of the truster's personal creditors. That said, it will be obvious that when the declaration of trust is communicated to a beneficiary,⁵⁵ often this will also amount to intimation that the property which is to constitute the trust fund is no longer being held in the truster's private patrimony but has been transferred to his trust patrimony.⁵⁶ As in the case of

⁵⁰ *Boyd's Trs v Boyd* (1877) 4 R 1082; *Middleton's Trs v Middleton* 1909 SC 67; *Clark Taylor & Co Ltd v Quality Site Development (Edinburgh) Ltd* 1981 SLT 308; *Tay Valley Joinery Ltd v CF Financial Services Ltd* 1987 SLT 207; cf *Kerr's Trs v Inland Revenue* 1974 SLT 193; *Export Credits Guarantee Dept v Turner* 1981 SLT 286. For full discussion see K G C Reid "Constitution of Trust" 1987 SLT (News) 177 at 180; K G C Reid "Trusts and Liquidators" 1988 SLT (News) 305; *Wilson and Duncan*, chapter 4.

⁵¹ *Tay Valley Joinery Ltd v CF Financial Services Ltd* 1987 SLT 207.

⁵² *Miller's Trs v Miller* (1890) 18 R 301; *Yuill's Trs v Thomson* (1902) 4 F 815. See generally Scottish Law Commission *Discussion Paper on Variation and Termination of Trusts* (Discussion Paper No 129).

⁵³ On both analyses: either at the time the trustee becomes the owner of the trust fund (conventional) or at the time the declaration of the trust is communicated to the trustee (alternative). In the latter case, should the truster change his mind, this right operates to cancel the truster's obligation to transfer the ownership of the property to the trustee.

⁵⁴ Paras 3.18-3.22 above.

⁵⁵ Thereby activating the declaration.

⁵⁶ *Allan's Trs v Lord Advocate* 1971 SC (HL) 45.

a standard trust,⁵⁷ at the time the property is transferred from the truster's private patrimony to his trust patrimony, he may obtain a personal right in respect of the trust fund.⁵⁸ If so, that right will enter the truster's private patrimony and will, of course, be vulnerable to the claims of the truster's personal creditors.

3.40 In the case of *mortis causa* trusts, we have seen⁵⁹ that the declaration of trust is not effective to create a trust until the truster dies. Accordingly, at any time before his death, a truster can change his mind and use the property which was intended to be the trust fund in any way he likes. Moreover, the ownership of the property intended to constitute the trust fund remains in the truster's private patrimony until he dies and even then is available to pay any debts which the truster owed at the date of his death. In other words, during his lifetime the truster will not have transferred the property to the trust patrimony of the persons who are to act as his *mortis causa* trustees.

3.41 Of course, it is open to a person to create a standard *inter vivos* trust under which the interests of the beneficiaries are not to be paid until the truster dies. For example, A makes a declaration of trust under which the ownership of his house is to be transferred to trustees who are to allow him to live in the house until he dies - a *liferent*. On his death, the house is to be sold and the proceeds - the fee - paid to his children, B and C. The rights of B and C under the trust are to vest⁶⁰ in them as soon as the trust is created. The declaration of trust is communicated to the trustees and A conveys the ownership of the house to them. The trustees record their title in the Land Register. Under the law of trusts, in the absence of the agreement of the other beneficiaries, B and C, A has no right to call upon the trustees to denude the property in his favour even though the fee is not to be paid to B and C until A's *liferent* has come to an end. This is because it is an *inter vivos* trust under which B and C have a present gift of their interest under the trust although payment is postponed until A's death. Because their interests have vested ie have entered their private patrimonies, B and C could if they wished assign their interests under the trust to a third party during A's lifetime. If either B or C predeceased A, their interests under the trust would be part of their estates and would be distributed to their legatees or heirs on intestacy.

3.42 If A had no children at the time the trust was created, he would be the sole beneficiary under the trust. Under the law of trusts, as the sole beneficiary A has the right to have the trust brought to an end and the trustees denude the trust fund in his favour. This right enters the truster's private patrimony as soon as the trust is created. It is therefore vulnerable to the claims of the truster's personal creditors.

⁵⁷ Para 3.37 above.

⁵⁸ For example, the truster as trustee may hold the trust property, for example a house, in *liferent* for himself and for his children in fee. The truster's rights as a *liferenter* will form part of his private patrimony and are therefore vulnerable to the claims of his personal creditors.

⁵⁹ Paras 3.23-3.27 above.

⁶⁰ Provided it is clear that the truster intended to give the beneficiaries a present gift of a beneficial interest, it does not matter that it is contingent and vesting is postponed to the date of the truster's death: *Robertson v Robertson's Trs* (1892) 19 R 849; *Murray v Murray's Trs* (1895) 22 R 927. The test is whether the beneficiary has a *ius quaesitum* as opposed to a *spes successionis*: *Bertram's Trs v Bertram* 1909 SC 1238; *Lawson's Tr v Lawson* 1938 SC 632; *Bulkeley-Gavin's Trs v Bulkeley-Gavin's Trs* 1971 SC 209. There is no difficulty where the interest has vested as in the example in the text because clearly the beneficiary will then have a *ius crediti*.

Revocation of Trusts

3.43 It is generally accepted that in some circumstances a trust can be revoked by the trustor.⁶¹ However, the idea that a trustor can retain the right to revoke a trust is problematic. The whole purpose of a trust is that the ownership of the property which is to constitute the trust fund is transferred from the private patrimony of the trustor into the trust patrimony of the trustees. Because the trustor has divested himself of the trust fund, that property is no longer vulnerable to the claims of the trustor's personal creditors and does not form part of the trustor's estate when he dies. Yet these aims can only be achieved if the trust is irrevocable. For if the trustor has a right to revoke the trust, that right will be part of his private patrimony and is vulnerable to the claims of his personal creditors who would be able to compel him to revoke the trust⁶² and on his death the right to revoke the trust would still form part of his estate. It is therefore not surprising that when the authorities are examined, the scope of revocation is much more restrictive than might at first appear.

(a) *Mortis Causa* Trusts

3.44 Because it is a testamentary deed, a declaration of a *mortis causa* trust does not have any legal effect until the trustor's death. Consequently a *mortis causa* trust is only *created* when the trustor dies. In these circumstances it is inaccurate to talk of a testamentary trust being revocable by the trustor at any time before his death.⁶³ While a *mortis causa* trust cannot be revoked by the trustor as it does not come into existence until the trustor dies, a trustor may give up his right to revoke the will or testamentary deed which contains the declaration of trust. This can happen when the grantor has entered into a contractual⁶⁴ obligation not to revoke the testamentary deed which contains the trust disposition and settlement.⁶⁵ An example of when this can arise is a mutual will.⁶⁶ But in the absence of some contractual constraint, a trustor can always revoke a testamentary deed. Even if a testamentary deed contains a clause that states that the deed is to be irrevocable, the grantor is still free to revoke it: as part of a revocable deed, the declaration of irrevocability is itself revocable.⁶⁷

3.45 As we have seen,⁶⁸ it may be difficult to determine whether the trustor has set up an *inter vivos* trust whose beneficiaries have at least a *ius quaesitum* in respect of their interests under the trust: or whether it is a *mortis causa* trust in which the beneficiaries have only a

⁶¹ See for example, *Norrie and Scobbie*, pp 190ff: *Wilson and Duncan*, chapter 11.

⁶² See for example, *Lawson's Tr v Lawson* 1938 SC 632.

⁶³ "In the absence of some contractual restraint, a testamentary trust is revocable until it takes effect on the grantor's death", *Wilson and Duncan*, para 11-01: "in accordance with the general rule that trusts can be revoked before they take effect, a trust disposition and settlement will be revocable before the death of the testator", *Norrie and Scobbie* at 191.

⁶⁴ This could also be a unilateral obligation.

⁶⁵ The contract will usually be onerous: *Paterson v Paterson* (1893) 20 R 484. There is no reason however why the grantor should not enter into a gratuitous obligation not to alter the settlement: see, for example, *Hutchison v Graham's Exx* [2006] CSOH 15. But a gratuitous unilateral obligation can only be constituted in writing subscribed by the grantor: Requirements of Writing (Scotland) Act 1995, s 1(2)(a)(ii) which is subject to ss 1(3) and (4) of the Act. These provisions have been discussed at paras 3.19-3.20 above.

⁶⁶ It is because the parties may have entered into a contractual obligation not to change the provisions of the will after one of them has died that the use of mutual wills should be discouraged.

⁶⁷ J Chalmers *Trusts: cases and materials* (Edinburgh 2002), paras 13.01-13-04.

⁶⁸ Para 3.40 above.

spes successionis. This depends on the granter's intention which is ultimately a matter of construction of the language of the deed.⁶⁹

(b) *Inter Vivos* Trusts

3.46 In the case of *inter vivos* standard trusts, on the conventional analysis a trust is not created until the truster has been divested of the property that is to constitute the trust fund. Yet it is sometimes stated that a trust is revocable until the ownership of the trust fund has been transferred to the trustee.⁷⁰ The point is, of course, that on the conventional analysis the trust does not exist until the truster is divested of the property that is to constitute the trust fund. In short, as the trust has not been created, it is misleading to say that in these circumstances the truster can revoke the trust as there is no trust to revoke!

3.47 On the alternative analysis viz that an *inter vivos* standard trust is created when the declaration of trust is communicated to the trustee, prima facie the truster cannot revoke the trust even although the ownership of the property which is to constitute the trust fund has not been transferred to the trustee(s). Indeed, the most important consequence of this analysis is precisely that the truster *cannot* change his mind once the declaration of trust has been communicated to the trustee and that the trustee - and beneficiaries - are entitled to demand that the truster transfers the ownership of the trust fund. Of course, although the trust exists as between truster and trustee, the trust fund remains vulnerable to the claims of the truster's personal creditors until the truster has divested himself of his property ie until the ownership of the property which is to constitute the trust fund is transferred from the truster's private patrimony to the trustees' trust patrimony.

3.48 On either analysis, there appears to be no reason why a truster should not expressly reserve the right to revoke a trust after it has been set up. For example, a truster could expressly stipulate in a declaration of trust in favour of his children that he retains the right to revoke the trust if his children behaved badly or, if the trust fund was farm land, in the event of the beneficiaries not continuing to farm the property. Public policy considerations aside, the point is that this right to revoke would be part of the truster's private patrimony and would be vulnerable to the claims of his personal creditors.

3.49 Where A, the truster, is the only beneficiary under the trust, he has the right to demand that the trustee(s) denude the trust fund in his favour. This might be thought to be a situation where a truster has an implied right to revoke a trust after the ownership of the trust fund has been transferred to trustees.⁷¹ However, it is thought that the better analysis is that A's right to demand that the trustees denude is done in A's capacity as *sole beneficiary*⁷² not in his capacity as *truster*. It is therefore not an example of revocation which can only be done by a truster in his capacity as such. As we have explained,⁷³ this right to demand that the

⁶⁹ *Wilson and Duncan*, paras 11-10 to 11-25. While a declaration of irrevocability cannot be conclusive and would not prevail where the truster has made it clear that his directions are only to have testamentary effect, "there is no case in which an *inter vivos* divestiture has been found revocable in spite of a declaration of irrevocability contained in the deed"; *ibid* at para 11-16.

⁷⁰ For example, "A trust will remain revocable until such time as property in the trust estate has passed from the truster to the trustees": *Norrie and Scobbie*, p 192.

⁷¹ Or on the alternative analysis after the declaration of trust has been communicated to the trustee(s). Once the ownership of the trust fund has been transferred, the point made in the text is true on both analyses.

⁷² *Miller's Trs v Miller* (1890) 18 R 301.

⁷³ Para 3.37 above.

trustee(s) denude in his favour enters A's private patrimony as soon as the trust is created. It is therefore vulnerable to A's personal creditors and, on his death, forms part of his estate.

3.50 A truster is treated as the sole beneficiary where the trust has been set up for administrative purposes only, for example because the truster wished his funds to be administered by financial experts or he had little confidence that he would look after his own property.⁷⁴ But a trust is also treated as for administrative purposes only where no beneficiaries exists or none has obtained title to enforce the trust: accordingly, the truster is regarded as the sole beneficiary and can demand that the trustees denude in his favour and therefore bring the trust to an end. Thus for example if A sets up a trust for the benefit of his future wife and children, until he marries or has children, A can demand that the trustees transfer the ownership of the trust fund to him thus bringing the trust to an end.⁷⁵ In determining the existence of other beneficiaries, it is enough that they have a *jus quaesitum* in respect of their interest under the trust: it is not necessary that the beneficiary's interest should have vested.⁷⁶

3.51 It is submitted that in the situation where the truster is the sole beneficiary or is to be treated as the sole beneficiary, it is not strictly accurate to describe a duly constituted trust as revocable since the truster's right to demand that the trustees denude in his favour arises from his capacity as sole beneficiary rather than truster.

A Promise to Create a Standard Trust

3.52 We have been considering the question when a declaration of a standard trust becomes effective. This must be distinguished from the situation where T *promises* B that he will set up a standard trust in which B will be the beneficiary. If T fails to do so, can B seek specific implement of T's unilateral obligation to set up the trust or damages for breach of that obligation? If the unilateral obligation is not gratuitous, there is no need for a requirement of writing: section 1(1) of the 1995 Act. A unilateral obligation is not gratuitous if the promisor has to receive a benefit from the promisee before the promise is prestable. This would arise if for example T made the promise in return for B looking after T's children or nursing T's mother through a terminal illness. In these circumstances, there appears to be no reason why B cannot sue for breach of T's promise if T refuses to set up the trust after B has purified the condition by looking after the children or nursing T's mother. The source of T's obligation is, of course, the promise and not a declaration of trust.

3.53 If, however, the unilateral obligation is gratuitous, section 1(2)(a)(ii) of the 1995 Act provides that writing is required for the constitution of "a gratuitous unilateral obligation except an obligation undertaken in the course of business". A gratuitous promise arises when the promisor does not have to receive a benefit from the promisee before the promise is prestable but for the requirement of writing. The paradigmatic example is when T promises to set up a trust for B as a gift. And so, if for example T made an oral promise to B

⁷⁴ *Byre's Trs v Gemmell* (1895) 23 R 332 . "A trust for the administration of the granter's affairs in his lifetime, including the payment of his debts, does not divest the granter. Notwithstanding the execution of such a deed, he retains the radical beneficial interest in his estate. He may revoke the deed at pleasure, or may even without noticing the trust make an effectual destination of his property to heirs or legatees": *ibid per* Lord McLaren at 337. See also for example *Bertram's Trs v Bertram* 1909 SC 1238.

⁷⁵ *Bulkeley-Gavin's Trs v Bulkeley-Gavin's Trs* 1971 SC 209. However, even if no children were in existence, such a trust could not be revoked if it was contained in an ante-nuptial marriage contract.

⁷⁶ For discussion, see paras 3.40-3.41 above.

that he would set up a standard trust under which the trustees would pay for B's education, *prima facie* B has no legal redress if T changes his mind and fails to do so. Unless and until B's promise is in writing subscribed by him, a unilateral obligation to set up the trust is not constituted and B is free to change his mind. Section 1(2)(a)(ii) is however subject to sections 1(3) and (4) of the 1995 Act.⁷⁷ These sections provide that if *with the knowledge of T*, B acted in reliance on T's promise and would be adversely affected if the promise was withdrawn, the unilateral obligation will be valid in spite of the lack of formalities. This would occur if, for example, *with the knowledge of T*, B entered into the lease of a student flat in the expectation that the rent would be paid from the income he would receive from the trust. Once again, the source of T's obligation to set up the trust arises from his promise to do so which has become valid and enforceable and not a declaration of trust.

A Promise to Create a *Mortis Causa* Trust

3.54 The constitution of a *mortis causa* trust must also be distinguished from the situation where, for example, A promises that he will make a will leaving a legacy to B. If the promise was made gratuitously, it is a gratuitous unilateral obligation and is not constituted unless in writing and subscribed by A: section 1(2)(a)(ii) of the 1995 Act. But this provision *is* subject to sections 1(3) and (4) of the 1995 Act. So for example the promise may be enforceable in the absence of writing if *with the knowledge of A*, B had acted to his detriment in reliance of A's promise that A would leave him a substantial legacy. If the requirements of writing can be satisfied,⁷⁸ B may be able to obtain reduction of A's will or damages from A's estate for the loss of the legacy. If the promise was not gratuitous, there can be liability for breach of a unilateral obligation even when it has not been made in writing: for example, if A promised to leave B a substantial legacy if B would nurse A through a terminal illness.

⁷⁷ Discussed in detail in the context of trustee-as-trustee trusts, paras 3.19-3.20 above.

⁷⁸ Or ss 1(3) and (4) are applicable.

Part 4 Issues for reform

A Rule for the Creation of a Standard Trust?

4.1 It is a remarkable feature of the Scots law of trusts that there appears to be no definitive answer to the apparently simple question when is a trust created? The conventional analysis is that a trust is only formed when (i) a declaration of trust has been communicated to the trustee(s) and (ii) the ownership of the property which is to constitute the trust fund has been transferred to trustees. This analysis regards the transfer of property from the truster's private patrimony to the trustees' trust patrimony as the key constituent element in the creation of the trust. Thus for example McLaren¹ defines a trust in the following way:

"A trust may properly be defined as an interest *created by the transfer of property* to a trustee, in order that he may carry out the truster's directions respecting its management and disposal. This definition includes the two essentials of a trust, viz., *the conveyance or transfer of the legal estate to a trustee*, and the constitution of a trust purpose."(Italics added).

4.2 Trusts are seen as inherently an aspect or development of the law of property. In particular, little, if any, weight is given to the rights of persons who would be beneficiaries under the trust. If a trust is not created until the trustee becomes the owner of the trust fund, there appears to be nothing that a potential beneficiary can do if the "trustee" refuses to become the owner of the property, for example by registering his title to heritable property in the Land Register. For until that is done, on the conventional analysis, no trust has been created and the potential beneficiary has therefore no right to compel the "trustee" to fulfil the trust purposes. Moreover, as Reid² has demonstrated, the conventional analysis is simply wrong in respect of *mortis causa* trusts where in the vast majority of cases the beneficiaries' rights vest as soon as the truster dies rather than the time when, if ever, the trustee or executor becomes owner of the truster's estate.

4.3 For these reasons an alternative analysis has been developed.³ This recognises that the law of trusts is not simply an aspect of the law of property. Here a trust is created as soon as the declaration of trust is communicated to the trustee and the trustee accepts office. Once this is done both the trustee and the beneficiaries have the right to call upon the truster to transfer the ownership of the trust fund to the trustee(s) and the beneficiaries have the right to compel the trustee(s) to fulfil the trust purposes, for example by registering their title to trust heritable property in the Land Register. These rights arise from the law of trusts, not the law of contract or promise. They regulate the relationship among the truster, trustee(s) and beneficiaries *inter se*. However they are only personal rights. If for example, the truster became insolvent before he had divested the ownership of the property which

¹ McLaren at para 1508. "A trust is a tripartite relationship, involving a truster, trustees and beneficiaries, *which involves the passing of property*"; *Norrie and Scobbie* , p 1 (italics added).

² K G C Reid, "Constitution of Trusts" 1986 SLT (News) 177.

³ K G C Reid, "Constitution of Trusts" 1986 SLT (News) 177; K J M Young "Intimation - The Equivalent Delivery of What?" 1996 SLT (News) 373.

was to constitute the trust fund, the trustee has no real right in that property and simply ranks with the truster's other unsecured, personal creditors.

4.4 On the alternative analysis, the transfer of the ownership of the trust assets is not a constitutive element in the creation of the trust. The reason why the trust fund in a duly constituted trust is usually⁴ safe from the claims of the truster's personal creditors is because the property is no longer part of the truster's private patrimony: it is not because it was conveyed to trustees as opposed to any other third party. There is therefore no necessary connection between the truster's divestiture of the ownership of the trust fund and the constitution of the trust. We are therefore primarily concerned with the relationship between the truster and the trustee(s).⁵ In the case of *inter vivos* trusts, there are some similarities with the rules on formation of contract. First the declaration of the trust is of no legal effect until it has been communicated to the persons who are to be the trustees: like an offer or acceptance,⁶ a declaration of trust is a thing writ in water until it has been *communicated* to the addressee ie the potential trustee(s). Secondly, the person to whom the declaration of trust is made must voluntarily accept the office: in the same way as a promisee can refuse a promisor's largesse, no one can be compelled to be a trustee against his will. But once the declaration has been communicated to the trustee and he has accepted office, a trust is thereby created and the truster is obliged to transfer the ownership of the trust fund to the trustee for the benefit of the beneficiaries. And it is the law of trusts which generates the truster's *obligations* not the law of contract (including promise) or the law of property.

4.5 At present we are inclined to accept the alternative analysis of the creation of a standard *inter vivos* and *mortis causa* trust. We think that it better reflects the existing law, particularly in the context of *mortis causa* trusts. We do not see why in a standard trust a truster should be allowed to change his mind after he has communicated the declaration of trust to the trustee and the trustee has accepted office. Although it will often be a gratuitous act on the truster's part, communication of the declaration shows that he has moved from deliberation to settled intention. Nevertheless, the current law is evidently uncertain and whatever analysis is finally adopted we think that it would be useful if the rules were put in statutory form. Accordingly we seek views on whether or not we are right to abandon the traditional analysis and ask the following:-

3. **Should there be a statutory rule under which a standard *inter vivos* trust is created when a declaration of trust is communicated to the potential trustee(s) and the trustee, or at least one of the trustees, accepts office?**
4. **If not, what statutory rule should be adopted for the creation of a standard *inter vivos* trust?**
5. **If a rule on the basis of that set out in (3) was adopted, should there be a statutory statement that the property which is to constitute the trust fund remains vulnerable to the claims of the truster's personal creditors until the ownership of that property has been transferred from the truster's private patrimony into the trust patrimony of the trustee(s)?**

⁴ But not if the truster is the sole beneficiary: see para 3.37 above.

⁵ And, albeit indirectly, the beneficiaries who once the trust is formed have the right to call upon the trustees to implement the trust purposes.

⁶ An exception is, of course, the postal acceptance rule.

A Requirement of Writing for the Creation of a Standard Trust?

4.6 As we have seen,⁷ for the creation of a standard *inter vivos* trust a declaration of trust does not have to be in writing. This is because it was thought that a trust was not created until the ownership of the property which was to constitute the trust fund was transferred to the trustee(s). This meant that a truster was free to change his mind in the period after the declaration of trust and the conveyance of the ownership of the property. In these circumstances, the Scottish Law Commission did not think that an impulsive truster required the additional protection that the declaration of trust should be in writing.⁸ But if the rule in proposal (3) was accepted, then a truster would be obliged to transfer the property that was going to constitute the trust fund as soon as the declaration of trust was communicated to the trustee(s) and a trustee accepted office. In other words, the truster would no longer be able to change his mind up until the ownership of the trust fund was transferred. Accordingly, the Commission's reason for not insisting on a requirement of writing would no longer apply.

4.7 Moreover, although writing is not technically necessary for the constitution of a valid declaration of trust, it has long been considered good practice to have the declaration in writing. This is because the terms of the trust - including the powers of the trustees - will be much easier to establish. It was also because of the - technically, mistaken - view that where the trust fund contained heritable property the declaration of trust - as opposed to the conveyance of the heritage - had also to be in writing.⁹

4.8 In these circumstances, our provisional view is that a declaration of a standard *inter vivos* trust should be constituted in writing in accordance with section 2 of the Requirements of Writing (Scotland) Act 1995. Accordingly we ask:-

6. Should a declaration of a standard *inter vivos* trust have to be in writing subscribed by the truster in order for the trust to be validly constituted?

4.9 If it was agreed that there should be a requirement of writing for the valid constitution of the declaration of a standard *inter vivos* trust, the question then arises whether this should be subject to sections 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995.

4.10 As we have seen,¹⁰ these provisions apply in relation to truster-as-trustee trusts where writing is required for the constitution of the declaration of trust.¹¹ Consequently, where the declaration is not in writing, it may nevertheless be valid if *with the knowledge of the truster* a beneficiary has acted (or refrained from acting) to her detriment in reliance on the existence of the trust. But it should be remembered that in truster-as-trustee trusts, even if the declaration of trust is in writing, intimation to a beneficiary¹² is necessary in order to make the declaration effective and thereby create the trust.¹³ And in a truster-as-trustee trust intimation to the beneficiary is also taken to be the equivalent in a standard trust of the transfer by the truster of the trust fund to the trustee(s). It is by intimation to the beneficiary

⁷ Para 3.14 above.

⁸ *Report on Requirements of Writing* (Scot Law Com No 112) para 2.37.

⁹ For discussion see para 3.28 above.

¹⁰ Paras 3.19-3.20 above.

¹¹ Requirements of Writing (Scotland) Act 1995, s 1(2)(a)(iii).

¹² As a third party.

¹³ For discussion see paras 3.21-3.22 above.

that the property constituting the trust fund leaves the truster's private patrimony and enters his trust patrimony and is no longer vulnerable to the truster's personal creditors.

4.11 In other words, in truster-as-trustee trusts, the beneficiary will often have a key role in the constitution of the trust and will know about the truster's intentions. In the case of a standard trust, however, it is communication of the declaration of trust to the *trustee* which we have argued should create the trust when the trustee accepts the office. In the usual case,¹⁴ the beneficiary will play no part in the constitution of a standard *inter vivos* trust. In these circumstances, it is our provisional view that sections 1(3) and (4) should not apply to the requirement that a declaration of a standard trust should be in writing. This is, of course, the current position with wills and testamentary trust dispositions and settlements.¹⁵ We therefore ask:-

- 7. If there is to be a requirement of writing for a standard *inter vivos* trust, should it be subject to sections 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995?**

Should Trusts have to be Registered?

4.12 One of the reasons that we have provisionally rejected the idea that a trust should have separate legal or juristic personality¹⁶ is the relative simplicity of the trust as a legal concept and its consequent utility in a wide range of contexts. We think that this would be undermined if the steps necessary to constitute a standard trust became too formalised. While it is our provisional view that there should be a requirement of writing for a declaration of trust, it is enough that the truster declares that he is setting up a trust and stipulates the trustee(s) and the trust purposes, in particular who the beneficiaries are. This writing could be informal or be in the conveyance of heritable property which is to constitute the trust fund. On the other hand, as in the case of wills, the declaration of trust ie the trust deed will often be drawn up by a lawyer. Where this is so, the trust deed may be registered in the Books of Council and Session.

4.13 While we see the advantages of registration of trust deeds, we are reluctant to add a further formality - and expense - to the constitution of a valid trust by insisting that a trust is only to be effective on registration in the Books of Council and Session or indeed in a new register of trusts. We have also borne in mind that many trusts are - and were intended to be - fairly short lived. Nevertheless we ask:-

- 8. Should it be a requirement for a standard *inter vivos* trust to be effective that a trust deed should be registered in the Books of Council and Session or a new register of trusts?**

¹⁴ Where a truster informs a beneficiary that he will set up a standard trust for his benefit and does not do so, the beneficiary may be able to sue for breach of a unilateral obligation to do so provided the requirement of writing is satisfied: Requirements of Writing (Scotland) Act 1995, s 1(2)(a)(ii): this provision is subject to ss 1(3) and (4). If successful, the beneficiary could obtain specific implement of the promise. If the truster had told the beneficiary that he had set up a trust for his benefit, this is arguably a truster-as-trustee trust and ss 1(3) and (4) apply.

¹⁵ Requirements of Writing (Scotland) Act 1995, s 1(2)(c) which is not subject to ss 1(3) and (4) of the Act.

¹⁶ Paras 2.39-2.46 above.

Mortis Causa Trusts

4.14 As we have seen,¹⁷ by section 1(2)(c) of the Requirements of Writing (Scotland) Act 1995 there is already a requirement of writing in respect of a declaration of a *mortis causa* trust: this is because it is a testamentary deed. Section 1(2)(c) is not subject to sections 1(3) and (4) of the 1995 Act so that invalidity from lack of formalities cannot be cured even although the truster has allowed the beneficiary to act to her detriment in reliance on the existence of the trust.¹⁸ However, the declaration is only effective when the truster dies. Accordingly, even when the declaration has been made in writing, at any time before he dies the truster is free to change his mind and not go ahead with the trust. It does not matter that he has communicated the declaration to trustees or intimated to beneficiaries that they are to benefit under the trust. When the truster dies the declaration becomes effective and a trust is created immediately without the need for the declaration to have been communicated to the trustees or the executor. It should also be noticed that where confirmation has been obtained by an executor there will be a public record of the existence of the trust.

4.15 It is our preliminary view that these rules are satisfactory and are not in need of any major reform. However, we think that it would be useful if they were put in statutory form. Accordingly we ask the following:-

9. Do you agree that the existing rules on the constitution of *mortis causa* trusts are satisfactory? If not, what rules should be changed?

10. Do you agree that the rules on the constitution of *mortis causa* trusts should be put into statutory form?

Truster-as-Trustee Trusts

4.16 As we have seen,¹⁹ a truster-as-trustee trust is now recognised as a valid *inter vivos* trust in Scots law. However the rules on how it is created remain uncertain and contentious,²⁰ particularly when the trust is being set up as a form of security for the beneficiary.²¹ What is clear is that by section 1(2)(a)(iii) of the Requirements of Writing (Scotland) Act 1995, a declaration of a truster-as-trustee trust must be constituted in writing; this is subject to sections 1(3) and (4) of the 1995 Act. But before the trust is created the declaration of trust must be intimated to the beneficiary.²² This is the equivalent of communication of the declaration of trust to the trustee(s) in the case of a standard trust. In other words, a truster-as-trustee trust is created by intimation of the declaration to the beneficiary in the same way as communication of the declaration of trust to the trustee(s) creates a standard trust when the trustee(s) accepts office.

¹⁷ Paras 3.23-3.27 above.

¹⁸ If the truster had *promised* the beneficiary that he would have a legacy under a will or be a beneficiary under a *mortis causa* trust, there may be liability for breach of a unilateral obligation. But there is generally a requirement of writing for the constitution of such promises: s 1(2)(a)(ii). This provision is subject to ss 1(3) and (4) of the 1995 Act.

¹⁹ Paras 3.18-3.22 above.

²⁰ See for example, *Wilson and Duncan*, paras 2-25 to 2-29 and 3-30 to 3-55.

²¹ *Wilson and Duncan*, chapter 4.

²² Or a third party who represents the beneficiary: *Allan's Trs v Lord Advocate* 1971 SC (HL) 45; *Clark's Trs v Inland Revenue* 1972 SLT 189; cf *Kerr's Trs v Inland Revenue* 1974 SLT193.

4.17 But although a standard trust is created when the declaration of trust has been communicated to the trustee, the property which is to constitute the trust fund remains vulnerable to the truster's personal creditors until the truster has divested himself of the ownership of the property. This occurs when the ownership of the property that is to make up the trust is transferred to the trustee ie when the ownership of the property leaves the truster's private patrimony and enters the trustee's trust patrimony. In the case of a truster-as-trustee trust, however, there is no transfer of the ownership of the trust fund as the trustee is already the owner of the property at the time the trust is created. What the truster is seeking to do is to change the *status* in which he owns the property ie from his private capacity to his capacity as a trustee. Put another way, he wishes to transfer the ownership of the property from his private patrimony to his trust patrimony. How is this to be done? It has long been recognised that it is not enough for the truster simply to state in the declaration of trust that the property constitutes the trust fund: if it were so, he could easily defraud his personal creditors. Lord Reid explains:²³

"I reject the argument for the appellants that mere proved intention to make a trust coupled with the execution of a declaration of trust can suffice. If that were so it would be easy to execute such a declaration, keep it in reserve, use it in case of bankruptcy to defeat the claims of creditors, but if all went well and the trustee desired to regain control of the fund simply suppress the declaration of trust."

4.18 But at the same time it was recognised that the ownership of the property could not be transferred from the owner as truster to the owner as trustee: thus the search for an "equivalent of delivery" ie the equivalent of the transfer of the ownership of the trust fund to the trustee in the case of a standard trust. It is now settled that this occurs when the truster tells the beneficiary what property constitutes the trust fund. And in practice, intimation of the property which constitutes the trust fund to the beneficiary will often²⁴ take place at the same time as intimation to her of the declaration of trust. Thus Lord President Emslie:²⁵

"The person in question [the truster] can, for example, execute a deed or declaration of trust over defined trust subjects in favour of his intended beneficiary and proof of a validly created trust will be complete when he has done something which can be regarded as equivalent to the delivery of the subjects of the trust which would be required to constitute a valid trust with a third party as trustee. Intimation to the beneficiary of the execution of the deed or declaration of trust and of its terms, would clearly suffice for this purpose. In each case, however, it will be a matter of circumstances whether the truster has done enough to establish the necessary constructive delivery of the trust subjects to himself as trustee of an irrevocable trust."

4.19 Thus a truster-as-trustee trust is created as soon as a written declaration of trust is communicated to a beneficiary who is also told what property constitutes the trust fund. There is no need for any further publicity. This means that not only can a truster-as-trustee trust be set up without the knowledge of anyone other than the truster and beneficiary but also without any indication to a third party that the property which constitutes the trust fund has been moved from the truster's private patrimony to his trust patrimony and is therefore no longer available to his personal creditors.

²³ *Allan's Trs v Lord Advocate* 1971 SC (HL) 45 at 54.

²⁴ The exception is where the trust fund is to include property which the truster might own in the future ie *acquirenda*.

²⁵ *Clark Taylor & Co Ltd v Quality Site Development (Edinburgh) Ltd* 1981 SC 111 at 115.

4.20 In these circumstances, the question arises whether the requirement of writing and the need for intimation to a beneficiary of both the declaration of trust and the property which is to constitute the trust fund are sufficient safeguards to prevent potential abuse. The issue is most likely to arise when the truster cannot fulfil the obligations which he owes to his personal creditors. If the truster-as-trustee trust was only constituted when the truster was insolvent, it would, of course, be challengeable as a gratuitous alienation or unfair preference under the law on bankruptcy.²⁶ But if this is not the case, the truster-as-trustee trust is valid and good against the truster's personal creditors even though they are unaware of the existence of the trust. From this perspective, we can see that the difficulty stems from the general principle that a trust can be valid under Scots law even although it is latent.

4.21 We shall consider the problems raised by latent trusts - including latent truster-as-trustee trusts - later in this Part and shall suggest possible solutions.²⁷ Here we raise a more fundamental point. It is whether, because of their potential for abuse, we should continue to recognise a truster-as-trustee trust at all.²⁸ At first sight it is difficult to see why a person should not be able to declare that he is holding his own property in trust for the benefit of another person. But in certain circumstances this could undermine the rights of the truster's creditors. For example, a seller, A, can declare that he is holding the asset which is the subject of the sale on trust for the buyer, B, thus protecting B from the seller's insolvency. The only purpose of such a trust is to give B a preference over A's general creditors and there is some authority that such a trust is unenforceable for this reason.²⁹ On the other hand, there are other authorities which appear to accept that truster-as-trustee trusts have a legitimate role to play in commerce in providing a vehicle under which a creditor of the truster can obtain security over the truster's property, particularly *acquirenda*,³⁰ any abuse of the truster-as-trustee trust in order to avoid the claims of personal creditors when the truster is insolvent being a matter which should be regulated by the law on gratuitous alienations and unfair preferences. In the current context, we take the view that the major difficulty that arises from this type of trust is that often it is latent because intimation to the beneficiary that the trust fund has moved from the trustee's private to his trust patrimony is a *private* juristic act. Accordingly, we see some force in the argument that truster-as-trustee trusts should only be valid if they have been registered in a public register such as the Books of Council and Session (or where the trust fund is heritable property, the property is registered in the Land Register as being owned by the truster in the capacity of trustee).³¹ In these circumstances we ask the following:-

11. (a) Should truster-as-trustee trusts no longer be valid? or

(b) Should truster-as-trustee trusts continue in their current form? or

(c) Should truster-as-trustee trusts be valid only if registered in a public register?

²⁶ Bankruptcy (Scotland) Act 1985, s 34; Insolvency Act 1986, s 242. (gratuitous alienations). Bankruptcy (Scotland) Act 1985, s 36; Insolvency Act 1986, s 243 (unfair preferences).

²⁷ Paras 4.22-4.42 below.

²⁸ Truster-as-trustee trusts are not recognised under the law of South Africa. "It is not possible for a trust to be created of assets of which the founder is to remain *sole owner*": *Honoré's South African Law of Trusts* (5th edn, 2002) 6 (italics added).

²⁹ *Clark Taylor & Co Ltd v Quality Site Development* 1981 SC 111 at 116

³⁰ *Tay Valley v CF Financial Services* 1987 SLT 207. This development has had a long and sometimes controversial history. See generally *Wilson and Duncan*, chapter 4 for review of the case law and literature.

³¹ Discussed at paras 4.29 – 4.42 below.

Latent Trusts

4.22 The essence of a trust is that the owner of the trust fund, the trustee, holds the property for the benefit of another, the beneficiary. The property is held by the trustee as part of his trust patrimony. As we have seen,³² in a standard *inter vivos* trust when the truster transfers the ownership of the property which is to constitute the trust fund into the trust patrimony of the trustee, the trust fund is free from the claims of the truster's personal creditors.³³ Conversely, because the trust fund is part of the trustee's trust patrimony, it is not vulnerable to the claims of the trustee's personal creditors. It is for this reason that the beneficiary's rights under the trust are protected.

4.23 There are no difficulties if when he completes title to the trust fund, it is made clear that the trustee owns the property in a fiduciary capacity. This can be done when registration is constitutive of the ownership of the property, for example in relation to real rights in land³⁴ or intellectual property such as patents,³⁵ design rights³⁶ and trademarks.³⁷ However, there is *no obligation* on the trustee to do so in order to create a valid trust with the result that it may not be clear from the register that the trustee owns the property in a fiduciary capacity. While latent, the trust is valid and good against the trustee's personal creditors even though relying upon the Registers, they believed that the trustee owned the property in a private capacity. And there are cases where a trustee is prohibited from registering his title other than in his private capacity. For example, it is not possible for a trustee to register the ownership of stocks and shares of a company registered in England in his name as trustee:³⁸ he can only do so in his private capacity. Many companies registered in Scotland adopt articles that state that, except where required by law, no person is to be recognised as holding any share upon trust³⁹ ie the company is precluded from registering trustees as owners of the shares in their capacity as trustees.

(a) Latent Trusts of Moveable Property

4.24 It must always be remembered that as a general principle the ownership of moveable property is transferred to the trustee without the need for registration.⁴⁰ The ownership of investments is transferred by assignation and intimation; cash by delivery to the trustee; and corporeal moveables by transfer of possession to the trustee. These are *private* juristic acts which in the case of a standard *inter vivos* trust are effective to divest the truster and invest the trustee with the ownership of the trust fund. Unless the law on gratuitous alienations and unfair preferences applies, the truster's ordinary creditors have no claims on the trust fund once the truster has divested the property: as is, of course, the case when he transfers property out of his private patrimony in other ways such as for example by a gift.⁴¹ To avert or minimise such risks, it is open to the truster's personal obligee to obtain a security over

³² Para 3.35 above.

³³ Subject to the rules on gratuitous alienations and unfair preferences.

³⁴ Title to which is registered in the Land Register.

³⁵ Patents Act 1977, ss 32 and 33.

³⁶ Registered Designs Act, s 19. However, unregistered design rights are allowed under Part III of the Copyright, Designs and Patents Act 1988.

³⁷ Trademarks Act 1994, s 25.

³⁸ Companies Act 1985, s 360.

³⁹ Form of Articles contained in the Companies (Tables A to F) Regulations (SI 1985 No 805), Table A, reg 5.

⁴⁰ Registration is, of course, required for the transfer of the ownership of ships and incorporeal moveable property such as patents, company shares and bonds. In many respects, latent trusts of registered moveable property raise the same issues as latent trusts of heritable property. See paras 4.29–4.42 below.

⁴¹ Or drinking as opposed to laying down lots of champagne!

his property - or another form of security such as a cautionary obligation - before the trust fund has been divested.

4.25 Conversely, while the ownership of the trust fund is transferred into the trustee's trust patrimony, there is no obligation on the trustee to publicise that this is the case by, for example, having a bank account expressly in his name as trustee. Indeed, in the case of corporeal moveable property this would be difficult unless, for example, the property was jewellery and could be kept in a deposit box. Accordingly, there is a risk that a person may enter into a private obligation with the trustee in the belief that the moveable property which constitutes the trust fund is part of the trustee's private patrimony. If the trustee fails to perform this obligation, his personal creditors' claims remain restricted to the trustee's private patrimony even although the trust was latent because the trust fund was made up of moveable property. This result is inevitable once it has become accepted⁴² that the rights of a beneficiary under a trust must prevail over the claims of a trustee's personal creditors.⁴³

4.26 It will therefore be clear that the personal creditors of a trustee can be at risk because they are unaware that property is being held in his trust as opposed to private patrimony. This seems to be inevitable unless we introduce a system under which all trusts have to be registered, including the property which makes up the trust fund. For the reasons discussed above,⁴⁴ our provisional view is that registration should not be necessary for the constitution of a standard *inter vivos* trust. We do not think that the risk to a trustee's personal creditors of a latent standard trust of moveable property is sufficient to change our provisional view. The whole concept of a standard trust is that in these circumstances the rights of the beneficiary should always prevail. And this should be so, whether or not the ownership of the moveable property can - or must - be registered⁴⁵ since these registers are not used by potential creditors in the same way as the Land Register. We do not see any reason why a potential personal obligee of the trustee should not be expected to take steps to satisfy himself of the trustee's creditworthiness including the extent of his private patrimony. If the trustee is untruthful to him we do not see why the beneficiary should be the victim of the fraud rather than the personal creditor who had the opportunity to arrange other forms of security, for example a standard security over land in the trustee's private patrimony or a cautionary obligation in the event of the trustee's default.

4.27 Should the position be different if the trust is a truster-as-trustee trust of moveable property? Three situations should be distinguished. First, there are the personal obligees of the truster before the truster-as-trustee trust is formed. The property that is to constitute the trust fund remains liable to their claims until it is removed from the trustee's private to his trust patrimony by intimation to the beneficiary that he is doing so. We cannot distinguish their case from the personal creditors of a truster at the time he creates an *inter vivos* standard trust and transfers the ownership of the trust fund to the trustee. In both cases, the creditors run the risk that the truster will divest his property. They can attempt to minimise the risk by obtaining securities over the property and are protected by the law against gratuitous alienations and unfair preferences. Second, there are persons who enter into obligations with the truster-trustee after the trust has been set up and the property has

⁴² On the history, see G L Gretton "Trusts" in *A History of Private Law in Scotland* (Reid & Zimmerman eds., 2000) Vol 1 at 500.

⁴³ *Heritable Reversionary Co Ltd v Millar* (1893) 19 R (HL) 43; now enshrined in statute in the case of a trustee's personal sequestration in the Bankruptcy (Scotland) Act 1985, s 33(1)(b).

⁴⁴ Paras 4.12-4.13 above.

⁴⁵ Para 4.24 above, note 39.

entered the trust patrimony of the truster. Again we cannot distinguish this case from the personal creditors of a trustee of a standard *inter vivos* trust. In both cases, there is a risk of a latent trust in respect of the moveable property owned by the trustee and account should be taken of such a risk before the obligation is undertaken: appropriate steps might be, for example, to take a standard security over land in the trustee's private patrimony. The third category are persons who had entered into obligations before the trust was formed and undertake new obligations with the truster after the trust has been formed, unaware that the property has been transferred from the truster's private patrimony to his trust patrimony. This is unlikely to happen in a standard *inter vivos* trust after the trust fund has been transferred out of the truster's private patrimony into the trust patrimony of the trustee.⁴⁶ In the truster-as-trustee trust, an existing creditor will be unaware of any change in the status of the truster's property when deciding whether or not to undertake further obligations with him ie he will not know that a new risk assessment is necessary. It could be argued that any new obligations undertaken by the obligee in these circumstances should not be affected by the existence of the trust, unless and until the truster has informed the creditor that the property has been removed from his private to his trust patrimony. But this would have the odd result that the trust fund could be subject to the claims of the truster's personal creditors in respect of obligations incurred *after* the trust was formed while it would not be vulnerable in respect of unsecured personal obligations incurred by the truster before he set up the trust.⁴⁷

4.28 Accordingly we seek views on the following:-

12. Where there is a latent trust of moveable property, the trust fund should continue to remain immune from the claims of both the truster's and trustee's *personal* creditors. But there should be an exception to this rule in respect of a truster-as-trustee trust of moveable property, when the creditor of the truster/trustee:

(a) had been a creditor of the truster before the trust was formed;

(b) had entered into a personal obligation with the truster/trustee after the trust was formed, and

(c) had not been told by the truster/trustee that the property had been transferred from his private to his trust patrimony.

(b) Latent Trusts of Heritable Property - Trustee with a Recorded Title

4.29 The position may be different where the trust fund includes heritable property. The leading decision is *Heritable Reversionary Co Ltd v Millar*.⁴⁸ The facts of the case were as follows. MacKay was a manager of the Heritable Reversionary Company. In 1882, he purchased heritable property and recorded the disposition granted to him in the Register of Sasines. He had in fact purchased the property on behalf of the Company which had provided him with the purchase price. In 1886, MacKay executed a written declaration of

⁴⁶ One can, of course, envisage exceptional situations where confusion could arise, for example if the truster reserved a liferent over or had the use of furniture which he had formerly owned.

⁴⁷ Subject of course to the law on gratuitous alienations and unfair preferences.

⁴⁸ (1892) 19 R (HL) 43.

trust in which he stated that he owned the property on behalf of the company. No deed of conveyance in favour of himself as trustee for the Heritable Reversionary Company was ever recorded in the Sasines Register. Accordingly, anyone relying on the Register would not know that MacKay was anything other than the owner of the property as there was nothing on the face of the Register to suggest that he held it in trust for the Heritable Reversionary Company. In 1890 MacKay was sequestrated. The question was whether the land was part of "the property of the debtor"⁴⁹ so that it vested in MacKay's trustee in bankruptcy.

4.30 The Inner House⁵⁰ held that it was, albeit there was a latent trust in the Company's favour. The Lord President (Inglis) observed:⁵¹

"...there is a principle in the law of Scotland which affirms that where a party has a legal title in writing, whether he be disponent or assignee, and that title has been perfected by sasine in the one case and intimation of the assignation in the other, the title is not defeasible by reference to any latent equities".

4.31 This decision was reversed by the House of Lords. Clearly influenced by English law, their Lordships took the view that MacKay, "though possessed of the legal title, and being the apparent owner, is in reality a bare trustee: and that the other [the Company], to whom the whole beneficial interest belongs, is the true owner".⁵² Since the beneficiary was the "true" owner, it followed that as a "bare" trustee MacKay had no beneficial interest in the land: therefore it did not form part of his property and did not fall to his trustee in bankruptcy.

4.32 In the twentieth century, the theoretical basis of the decision of the House of Lords has become the subject of sustained criticism. It is now accepted, if it ever was really doubted, that in Scots law it is the trustee and not the beneficiary who is the owner of the trust fund.⁵³ In *Sharp v Thomson*,⁵⁴ for example, the Lord President (Hope) said:

"...the preponderance of authority is to the effect that the property, in the normal sense, is vested in the trustee... In my opinion it is not part of the Law of Scotland that there exist in the trustee and the beneficiary concurrent rights of ownership in the property which is subject to the trust. The argument that there can be a separation of interests of ownership according to what was described as the reality of the situation is contrary to principle".

4.33 But the principle laid down in *Heritable Reversionary Co Ltd* that the trust fund should not be vulnerable to the claims of the trustor's personal creditors is regarded as axiomatic in the law of trusts and in so far as sequestration is concerned is enshrined in statute.⁵⁵ Indeed, the whole purpose of a trust would be severely undermined if that were not the case. But this principle is now underpinned by the theory that the trust fund while owned by the trustee is held by him as part of his trust as opposed to private patrimony.

⁴⁹ Bankruptcy (Scotland) Act 1856, s 102.

⁵⁰ (1890) 18 R 1166.

⁵¹ *Ibid* at 1181.

⁵² (1892) 19 R (HL) 43 *per* Lord Watson at 46-47.

⁵³ Paras 2.5-2.15 above.

⁵⁴ 1995 SC 455 at 475. In *Burnett's Trustee v Grainger* 2004 SC (HL) 19 the unitary nature of ownership in the Scots law of property was accepted by the House of Lords.

⁵⁵ Bankruptcy (Scotland) Act 1985, s 33(1)(b).

4.34 On the other hand, *Heritable Reversionary Co Ltd* has been criticised on the ground that the House of Lords failed to take account of the fundamental principle of Scottish land law that in issues relating to real rights in land persons are entitled to transact on the faith of the Registers. This is also known as the publicity principle. In Scots law as a general rule a real right in land can only be obtained by registering title in the Land Register.⁵⁶ This means that a person who has relied on the Register should not be met by the existence of any rights in the land which do not appear in the Register. The recognition by the House of Lords in *Heritable Reversionary Co Ltd* that a latent trust of land can defeat the creditors of the person registered as owner breaches the publicity principle.⁵⁷ While this is also true in the case of an *inter vivos* standard trust if the trustee does not register his title expressly as trustee, in *Heritable Reversionary Co Ltd* the trust created by MacKay was a truster-as-trustee trust.⁵⁸ In such trusts the transfer of the ownership of the property from the trustee's private to his trust patrimony is done merely by intimation to the beneficiary, a *private* juristic act.⁵⁹ In such circumstances there is no indication from the Register that the owner's *status* has changed and that he now owns the land as a trustee for the benefit of a beneficiary under a latent trust.

4.35 There appear to us to be at least four major problems arising from this aspect of the case:-⁶⁰

- (i) The fact that the property being held in the owner's trust patrimony does not have to appear in the Register. This makes it relatively easy for an owner of heritage to defraud his personal creditors. Take this example. A is a businessman who owns the family home. He executes a written declaration of trust of the house in favour of his wife. If he intimates the declaration to her, he will have created a valid truster-as-trustee trust. A keeps the declaration of trust in his safe. If his business goes well, the declaration of trust need never be produced: the only risk A runs is if his wife calls upon him to denude the property in her favour! If his business runs into difficulties and he is inhibited or sequestered, the declaration of trust can be produced and the family home will be safe. As the trust has been created by *private* juristic acts, the creditors cannot know that the house is being held by their debtor, A, in his trust as opposed to private patrimony. Because there is no obligation to register the owner's status, the latent trust is open to abuse.
- (ii) The rule means that to protect trust property against creditors, registration is not necessary. The incentive to register disappears. Take this example. Company X conveys property to company Y. In the disposition there is a declaration that prior to registration the property is to be held in trust by company X for company Y. If company Y chooses not to register the disposition, this is an almost risk-free decision. Company Y's rights under the trust would not be affected by Company

⁵⁶ Formerly the deed of grant was recorded in the Register of Sasines.

⁵⁷ This absurdity was brought out by Lord Hoffmann in *Burnett's Trustee v Grainger* 2004 SC (HL) 19 at 22. See also G L Gretton, "Ownership and Insolvency: *Burnett's Trustee v Grainger*" 2004 Edinburgh Law Review 389; D M Skene "Whose Estate Is It Anyway? The Debtor's Estate on Sequestration" 2005 JR 311.

⁵⁸ See also *Hinkelbein v Craig* (1905) 13 SLT 84.

⁵⁹ The declaration of trust must, of course, be constituted in writing and also intimated to the beneficiary: for discussion, see paras 3.18-3.22 above.

⁶⁰ Similar problems arise in the case of registered moveable property such as ships, patents, company shares and bonds: see para 4.24, note 40.

X's insolvency. Moreover there could be important incentives not to register. Company Y will have no registration dues to pay. There is, of course, the risk that company X may dispoise the property again to a third party: but in the context of inter-group transfers, this risk is tiny. With no incentive to register, the utility of the registers is impaired.

- (iii) The rule creates difficulties for trustees in sequestration, liquidators and receivers. A is the owner of heritable property. He is holding the property in his trust patrimony for the benefit of B. The trust is latent. A cannot pay his personal creditors. He becomes bankrupt. A's trustee in sequestration can acquire title to all the property in A's *private* patrimony but is not entitled to any property in A's *trust* patrimony. If by mistake A's trustee in bankruptcy uses his act and warrant to obtain title to the heritage which forms A's trust as opposed to private patrimony, such title is void. The trustee cannot then transfer a good title to a bona fide transferee for value.⁶¹ A remains the owner and can recover the property from a third party for the benefit of the beneficiaries under the original trust. Thus even when the bona fide transferee has registered a title in the Land Register, it will be subject to rectification. Thus if the use of latent trusts became common, a trustee in sequestration, liquidator or receiver could not be sure whether or not heritable property was affected by a latent trust which would remove it from the sequestration, liquidation or receivership. The fact that there has not been an unregistered conveyance cannot be proven. In turn, purchasers cannot be sure that the trustee in sequestration, liquidator or receiver has title to sell.
- (iv) The registers should give as much information as is reasonably possible. It is seriously misleading to creditors if land is presented as owned by X when it is merely held in trust by X for Y. It is, however, common for many trustees, for example executors, trustees in sequestration or trustees under a trust deed on behalf of creditors, to hold land on an unregistered conveyance while the registered title is with another. But in these cases, the trust is short-lived. Those interested may be alerted to the trust in other ways, for example by an entry in the Register of Adjudications and Inhibitions. But that is not the case where there has been a voluntarily unregistered deed of trust.

4.36 On the other hand, the difficulties raised by the rule in *Heritable Reversionary Co Ltd v Millar*⁶² must be kept in perspective. As Lord McLaren said in his dissenting judgment in the Inner House:⁶³

"Creditors on guard do not give credit to a bankrupt in reliance on any supposed presumption that property standing in his name is his private property. Unless they are going to advance money on heritable security they know nothing of his title deeds, and trust only to his personal credit."

⁶¹ The bona fide transferee does not have the benefit of s 2(1) of the Trusts (Scotland) Act 1961 as unlike the usual situation A's trustee in bankruptcy does *not* have any title to the property which he purported to sell.

⁶² (1891) 18 R 1166; (1892) 19 R (HL) 43.

⁶³ (1891) 18 R 1166 at 1174.

4.37 We have taken the view that in deciding whether or not to undertake a personal obligation with another, the onus rests on the potential creditor to determine what property belongs to the debtor's private as opposed to trust patrimony.⁶⁴ If the creditor takes a standard security over the debtor's land when it was part of the debtor's private patrimony, the standard security will take priority over any subsequent declaration of trust. If he has not done so and the debtor subsequently creates a trustee-as-trustee trust in respect of the land, the creditor may have the protection of the law on gratuitous alienations and unfair preferences. But as we have pointed out above,⁶⁵ a creditor in this position may merit special protection if he continues to undertake personal obligations with the trust as he does not know that the property has been transferred from his private into his trust patrimony as the change in the trustee's status has *ex hypothesi* not been recorded in the Land Register.

4.38 Moreover where a trustee sells land to a bona fide transferee for value, the transferee will obtain a good title which is not liable to reduction by the beneficiary: instead, the beneficiary's remedy lies against the trustee in respect of the price he received when he sold the property. The third party transferee could also rely on section 2(1) of the Trusts (Scotland) Act 1961 under which neither the transaction nor her title can be impugned if the trustee was purporting to exercise the powers in sections 4(a)-(ee) of the Trusts (Scotland) Act 1921 when the property was conveyed to her. But while the third party's *title* to the property cannot be impugned, if she was in bad faith at the time of the transaction, for example if she knew about the trust, there may be liability to the beneficiary under the law of delict or unjustified enrichment.⁶⁶ However, section 2(1) of the 1961 Act cannot provide a solution where title is purportedly taken from trustees in sequestration, liquidators or receivers: but in these cases, it is the Keeper's policy to register the acquirer's title in the Land Register without exclusion of indemnity.⁶⁷

4.39 It can be argued that the problem arising from latent trusts of heritable property is in fact restricted to personal creditors of the trustee who have sought to rely on the property registers for the purpose of diligence and insolvency. If this is so, it would be possible to devise a targeted and relatively simple solution. The law could be changed so that for *the purpose of the law of diligence and insolvency* heritable property would not be treated as part of a trust fund unless it had been registered in the Land Register in terms which disclose the existence of a trust. It would apply to the diligence processes relating to land namely inhibition and adjudication (and when introduced, the diligence of land attachment recommended in our *Report on Diligence*).⁶⁸ The insolvency processes would include sequestration and all the various forms of corporate insolvency namely liquidation, receivership, administration, and company voluntary arrangements.

4.40 The result would be that a latent trust of heritable property would not defeat diligence by the trustee's ordinary personal creditors. The failure to register the land as trust property would, of course, amount to a breach of trust and the trustee would be liable to the beneficiary. Accordingly, on a trustee's insolvency, the beneficiary under the trust would rank alongside the trustee's personal ordinary creditors. But once registered as trust

⁶⁴ For discussion, see paras 4.24-4.28 above.

⁶⁵ Para 4.27 above.

⁶⁶ For full discussion, see paras 2.8-2.12 above; J M Thomson, "Unravelling Trust Law: Remedies for Breach of Trust" 2003 JR 129.

⁶⁷ *Registration of Title Practice Book* para 5.37.

⁶⁸ Scot Law Com No 183.

property, like the rest of the trust fund, land would also become immune from claims by the trustee's ordinary personal creditors. For all other purposes, an unregistered trust of heritable property would remain an effective trust.

4.41 On the other hand, it might be thought that even this relatively narrow change represents too great an inroad into the fundamental principle of the law of trusts that any property which forms part of the trustee's trust patrimony is not vulnerable to the claims of the trustee's personal creditors. Any inroad into this principle is done at the potential expense of the beneficiary. The point is, however, that until it is registered as trust property, for this purpose the land would not form part of the trustee's trust patrimony and therefore technically there would be no breach of the principle that property in his trust patrimony is not available to the trustee's personal creditors. As suggested above, the beneficiary would have a remedy against the trustee for breach of trust in failing to register the heritage as trust property: and the beneficiary would rank along with the trustee's ordinary personal creditors.

4.42 It appears that the recognition of latent trusts in respect of heritable property remains controversial. At present the law favours the interests of the beneficiary as against those of the trustee's personal creditors. More importantly perhaps, it runs counter to the principle of publicity and transparency of the registers. In these circumstances we ask the following questions:-

- 13. Should the rule laid down in *Heritable Reversionary Co Ltd v Millar* in respect of the recognition of latent trusts of heritable property be abolished?**
- 14. Should there be a rule that until it has been registered in the Land Register as trust property, heritable property should not become part of the trustee's trust patrimony for the purposes of any diligence affecting land, or for sequestration, liquidation, receivership, administration or voluntary winding up arrangements?**
- 15. Should the changes in Proposal 14 be restricted to truster-as-trustee trusts?**
- 16. Should the changes in Proposal 14 only apply in the case of a person who was the truster's personal creditor before the truster-as-trustee trust was established and continued to undertake personal obligations with the trustee after the truster-as-trustee trust was created?**

Part 5 List of Proposals and Questions

1. Do you agree with our provisional view that the dual patrimony theory on the nature of a trust in Scots law should be placed on a statutory footing?

(Paragraph 2.28)
2. Are we right in our preliminary view that we should give no further consideration on whether under Scots law a trust should be an entity with legal or juristic personality separate from that of the beneficiaries and trustees?

(Paragraph 2.46)
3. Should there be a statutory rule under which a standard *inter vivos* trust is created when a declaration of trust is communicated to the potential trustee(s) and the trustee, or at least one of the trustees, accepts office?

(Paragraph 4.5)
4. If not, what statutory rule should be adopted for the creation of a standard *inter vivos* trust?

(Paragraph 4.5)
5. If a rule on the basis of that set out in (3) was adopted, should there be a statutory statement that the property which is to constitute the trust fund remains vulnerable to the claims of the truster's personal creditors until the ownership of that property has been transferred from the truster's private patrimony into the trust patrimony of the trustee(s)?

(Paragraph 4.5)
6. Should a declaration of a standard *inter vivos* trust have to be in writing subscribed by the truster in order for the trust to be validly constituted?

(Paragraph 4.8)
7. If there is to be a requirement of writing for a standard *inter vivos* trust, should it be subject to sections 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995?

(Paragraph 4.11)

8. Should it be a requirement for a standard *inter vivos* trust to be effective that a trust deed should be registered in the Books of Council and Session or a new register of trusts?
- (Paragraph 4.13)
9. Do you agree that the existing rules on the constitution of *mortis causa* trusts are satisfactory? If not, what rules should be changed?
- (Paragraph 4.15)
10. Do you agree that the rules on the constitution of *mortis causa* trusts should be put into statutory form?
- (Paragraph 4.15)
11. (a) Should truster-as-trustee trusts no longer be valid? or
(b) Should truster-as-trustee trusts continue in their current form? or
(c) Should truster-as-trustee trusts be valid only if registered in a public register?
- (Paragraph 4.21)
12. Where there is a latent trust of moveable property, the trust fund should continue to remain immune from the claims of both the truster's and trustee's *personal* creditors. But there should be an exception to this rule in respect of a truster-as-trustee trust of moveable property, when the creditor of the truster/trustee:
- (a) had been a creditor of the truster before the trust was formed;
(b) had entered into a personal obligation with the truster/trustee after the trust was formed; and
(c) had not been told by the truster/trustee that the property had been transferred from his private to his trust patrimony.
- (Paragraph 4.28)
13. Should the rule laid down in *Heritable Reversionary Co Ltd v Millar* in respect of the recognition of latent trusts of heritable property be abolished?
- (Paragraph 4.42)
14. Should there be a rule that until it has been registered in the Land Register as trust property, heritable property should not become part of the trustee's trust patrimony for the purposes of any diligence affecting land, or for sequestration, liquidation, receivership, administration or voluntary winding up arrangements?
- (Paragraph 4.42)

15. Should the changes in Proposal 14 be restricted to trustor-as-trustee trusts?

(Paragraph 4.42)

16. Should the changes in Proposal 14 only apply in the case of a person who was the trustor's personal creditor before the trustor-as-trustee trust was established and continued to undertake personal obligations with the trustee after the trustor-as-trustee trust was created?

(Paragraph 4.42)

Appendix A Advisory Group on Trust Law

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